

MUNICIPAL BORROWING

BULLETIN

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BACKGROUND

The Municipal Borrowing Bulletin is a quarterly publication targeted at all role players involved in the long-term municipal borrowing market. It intends to contribute to a better understanding of the movements and trends in municipal borrowing through sharing data, offering analysis, highlighting trends and discussing topical issues. This information is shared with stakeholders and the public to promote prudent and responsible use of municipal borrowing as an effective and efficient infrastructure financing tool, and transparency and accountability.

This report covers information up to 30 September 2016, which corresponds to the first quarter of 2016/17 municipal financial year. Sources of data used in this Bulletin include data submitted by municipalities to National Treasury as required by Sections 71

and 74 of the Municipal Finance Management Act of 2003; data obtained from lenders; information published by the South African Reserve Bank (SARB); and data from the Johannesburg Stock Exchange (JSE) sourced from STRATE.

KEY HIGHLIGHTS

- Municipalities started a new financial year on 1 July 2016 and local elections took place in August. New administrations could not change much in terms of adopted budgets, integrated development plans, and other strategic positions because the financial year had already started.
- Total long term debt outstanding as reported by municipalities has decreased by 1.5 percent when compared against the previous year and now stands at R60 billion for all municipalities.

- According to municipal budgets for the financial year, municipalities plan to borrow R12.4 billion in 2016/17. It should be noted however that the change in political leadership in the 3 metros (City of Tshwane, City of Johannesburg and Nelson Mandela Bay) is likely to affect the performance of the metros' budgets hence borrowing outcomes may not match the budget plans.
- Non-reporting by one major commercial bank means that we are using old data for that lender in this quarter's Bulletin.
- Municipal borrowing data is continuously improving. The difference between the demand side data (which indicates R60 billion total debt outstanding) and supply side data is R2.3 billion which could be attributed to misreporting.
- Budgeted borrowing as a percentage of total budgeted capital expenditure amounts to 18 percent for the current financial year, an increase by just 1 percent when compared to the previous financial year.



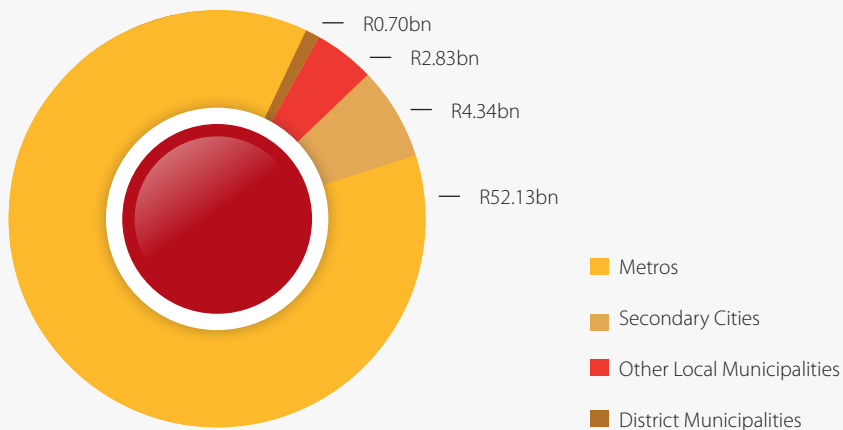
national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

DATA AND ANALYSIS

1. Total debt outstanding as reported by municipalities

Figure 1: Long term municipal debt outstanding as at 30 September 2016



Source: National Treasury

Municipalities budgeted to take out new borrowing amounting to R12.4 billion in the 2016/17 financial year. This is an increase of 2.9 percent when compared to their adjusted budgets for borrowing for the previous year, which amounted to R11.7 billion. Of the total budgeted borrowing, metros' share is equal to 87 percent, 7 percent for secondary cities and the remaining portion is for the other locals and district municipalities.

Actual new borrowing in the first quarter of the current financial year is R947.3 million or 7.9 percent of the budgeted borrowing for the fiscal year. It should be noted that municipalities tend to borrow a large share of their budgeted borrowings between the third and fourth quarters, sometimes as a result of poor planning of projects or delayed procurement processes.

Total debt as at the end of the first quarter of 2016/17 amounts to R60 billion, a decrease by 1.5 percent when compared to the last quarter of 2015/16.

Table 1: Outstanding long term debt as at 30 September 2016

Long term debt outstanding (30 June 2016)									
		Total debt Q4 2016/17 R'000	Share of total debt	Budgeted revenue 2016/17* R'000	Debt to revenue ratio	Population**	Debt per capita R	GVA*** R'000	Debt as % of GVA
Metros	BUF	485 238	1%	5 907 039	8%	755 200	643	62 122 732	0,8%
	NMA	1 387 063	2%	9 535 857	15%	1 152 115	1 204	94 565 655	1,5%
	MAN	719 925	1%	6 641 627	11%	747 431	963	58 872 541	1,2%
	EKU	5 396 726	9%	32 378 969	17%	3 178 470	1 698	266 048 559	2,0%
	JHB	17 880 605	30%	46 175 187	39%	4 434 827	4 032	549 810 995	3,3%
	TSH	10 776 154	18%	30 209 869	36%	2 921 488	3 689	313 014 335	3,4%
	ETH	8 946 688	15%	31 267 560	29%	3 442 361	2 599	339 978 590	2,6%
	CPT	6 537 609	11%	34 520 879	19%	3 740 026	1 748	349 948 095	1,9%
	Total Metros	52 130 008	87%	196 636 987	27%	20 371 918	2 559	2 034 361 501	2,6%
Local mun.		7 171 965	12%	107 676 448	7%	31 398 642	251	3 110 900 920	0,3%
District mun.		697 487	1%	19 218 926	4%				
Total all municipalities		59 999 460		323 532 361	19%		1 159	5 145 262 421	1,2%

* excluding capital transfers

** per Census 2011

*** Gross value added per municipality in 2015 as reported by IHS Global Insight

Data source: Q1 2016/17 Quarterly Borrowing Monitoring Report from municipalities to National Treasury, 2016/17 budgets and STATSSA

Table 1 above shows the breakdown of long term debt across municipalities. The metropolitan municipalities remain the largest borrowers and have issued a total of R52.1 billion of long term debt. The share of long term debt for City of Johannesburg amounts to 30 percent of aggregate long term debt for all municipalities, which equates to a debt to revenue ratio of 39 percent. City of Johannesburg correspondingly shows the highest long term debt per capita. The second largest borrower is City of Tshwane at 18 percent, closely followed by eThekweni (15 percent) and Cape Town (11 percent). City of Tshwane is the largest borrower when considering debt as a share of economic activity. The total long term debt for local municipalities i.e. secondary cities, smaller cities and rural towns, stands at R7.2 billion, which is roughly 12 percent of the total long term debt. The total debt to revenue ratio of the local municipalities is 7 percent, substantially lower than the metro average at 27 percent. The district municipalities have only R697.5 million as long term debt, or 1 percent of total municipal debt.

Table 2: Capital expenditure, new borrowing and outstanding debt

Capital expenditure, new borrowing and outstanding debt										
R'000	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2016/17
	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Actual	Full-year forecast	Q1 Actual
Capital expenditure	39 577	39 625	30 945	33 239	41 679	47 932	53 241	54 682	69 425	8 813
New Borrowing	9 463	8 226	6 401	6 211	6 490	7 583	9 357	9 222	12 353	947
New borrowing as a % of CAPEX	24%	21%	21%	19%	16%	16%	18%	17%	18%	11%
Outstanding debt	32 366	35 388	43 190	45 640	48 078	51 431	53 493	60 903	67 119	59 999

Data source: National Treasury

Total capital expenditure (capex) for the 2016/17 financial year is budgeted at R69.4 billion for all municipalities and they plan to fund R12.4 billion or 18 percent of total capex from new borrowing. This increases the share of capital expenditure funded from borrowing by just one percentage point from the previous financial year and matches the average over the last years. The reliance on borrowing varies greatly across municipalities.

2. Growth in long term debt as reported by lenders

Figure 2: Growth in long term municipal borrowing

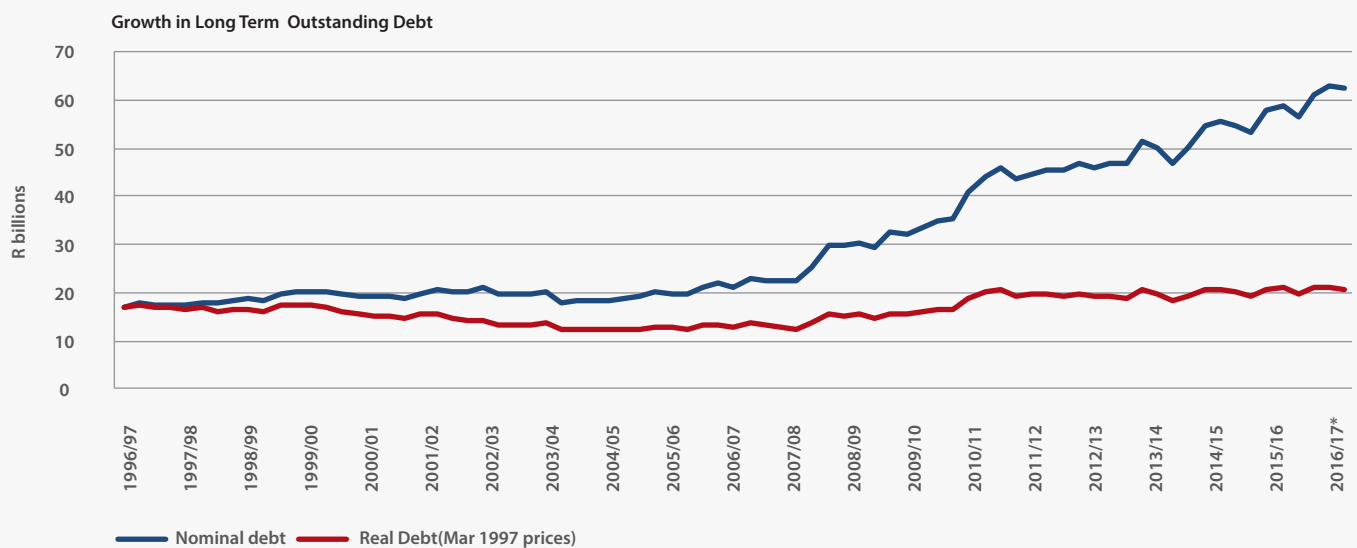
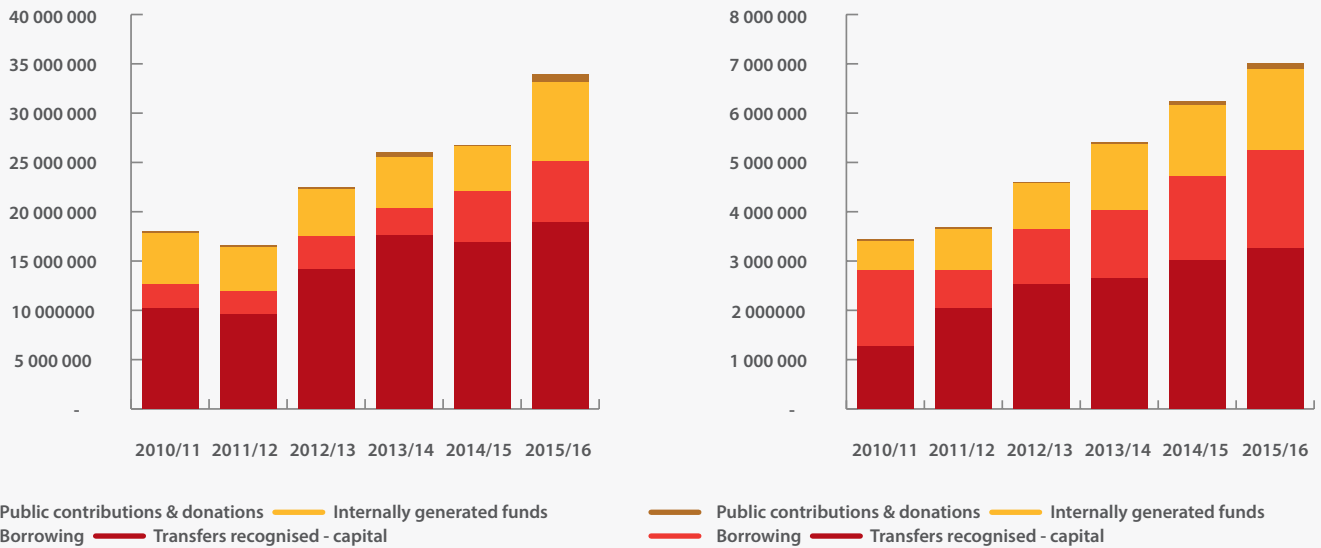


Figure 2 shows the trend in long-term municipal borrowing since 1996/97 financial year. The blue line indicates nominal debt, starting from R17 billion and reaching R62.3 billion in quarter one of 2016/17. Growth in nominal terms was slow until 2007/08 and then took off. Since 2014/15, outstanding municipal debt has remained over R50 billion. Lenders report total debt to be R62.3 billion for quarter 1 while municipalities report it to be R60 billion. The discrepancy between the two figures has been reduced significantly and timely and accurate reporting by all partners is encouraged to allow the report to publish a single figure in the future.

The red line shows the trend in total debt in real terms, i.e. adjusted for inflation. One can see that total real debt dropped between 2000/01 and 2005/06, and grew again until 2010/11 when the debt level stabilised with seasonal fluctuations.

Figure 3: Composition of capital funding over time

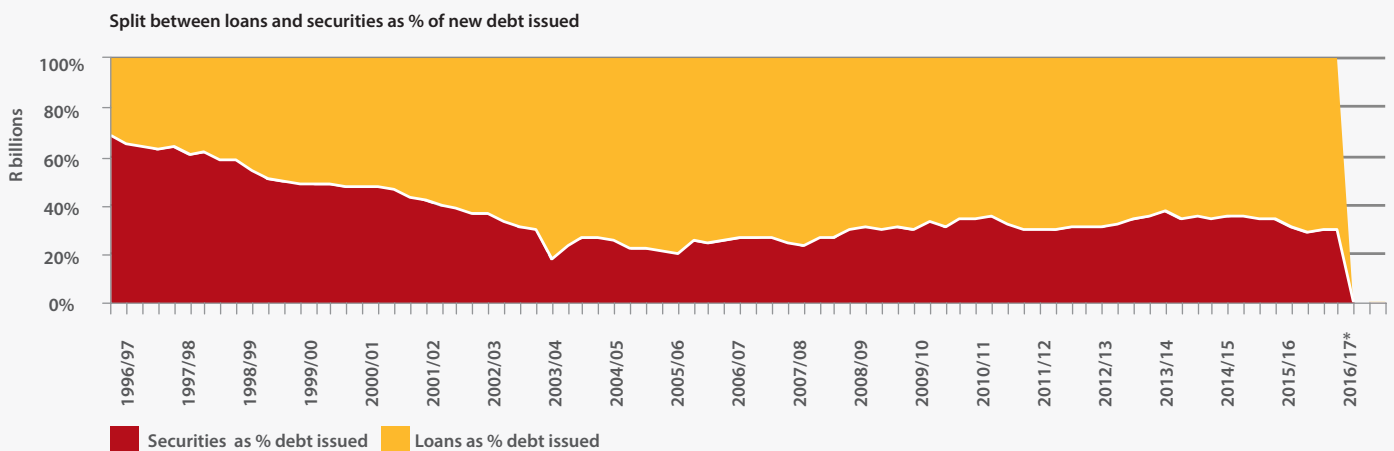


Source: National Treasury

Figure 3 shows the composition of the capital budget for metros and secondary cities, up to 2015/16. One can see that for metros and secondary cities, the largest share of capital expenditure is funded from transfers (grants). According to a study done for National Treasury/ Palmer Development Group, metros would need to invest R43 billion (2014 prices) annually in infrastructure to reduce backlogs and grow the economy. Their capital budget for 2016/17 is R37.4 billion, 8 percent higher than last year's budget but still short of the estimated need. Metros have increased their contribution of own revenues and borrowing since 2011/12, with borrowing having increased with an annual average growth rate of 27 percent compared to 13 percent for capital grants. Secondary cities have also increased their own revenue and borrowing contribution to capital expenditure. The average annual growth rate for borrowing for the secondary cities is 27 percent and 19 percent for capital grants.

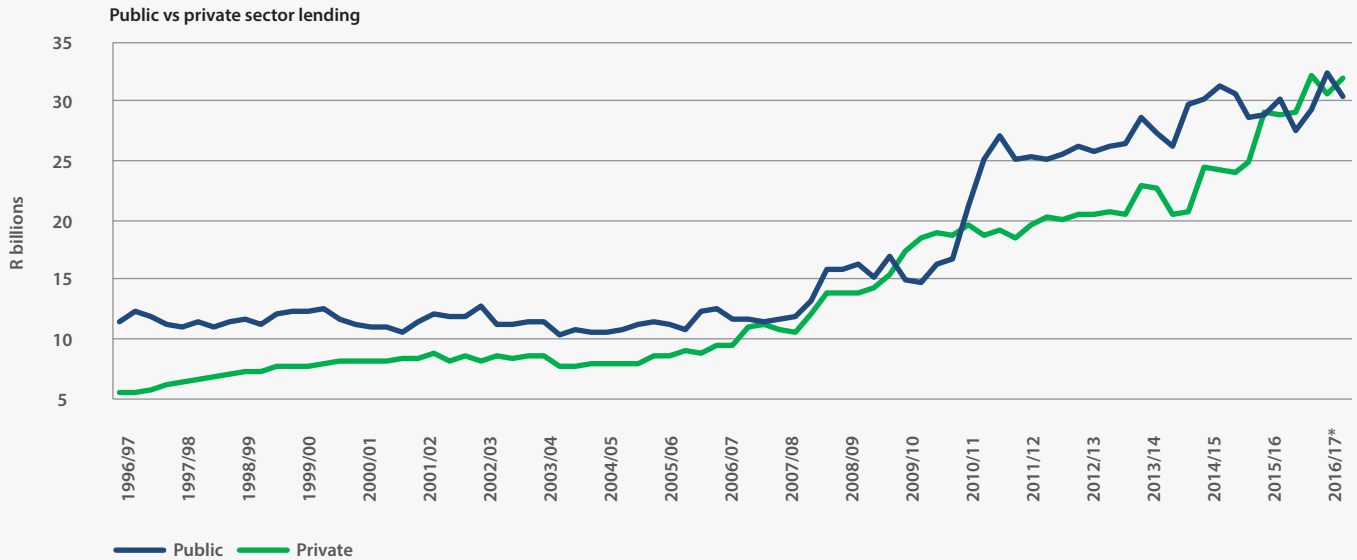
Figure 4 shows the distribution of municipal debt obligations between loans and securities. Since 2000/01 municipalities have favoured loans over securities and this trend is emphasised in recent quarters. City of Johannesburg, City of Cape Town, City of Tshwane and Ekurhuleni remain the only municipal bond issuers in South Africa. No new securities have been issued in the first quarter of 2016/17. Of the R62,3 billion outstanding debt reported by lenders, 30 percent is held in municipal bonds and the remaining 70 percent in long term loans. Figure 5 below shows the split between loans and securities over time and demonstrates relatively stable proportions over the past ten years.

Figure 4: Split between debt instruments issued by municipalities over time



3. Holders of municipal loans and bonds

Figure 5: Public and private sector lending to municipalities

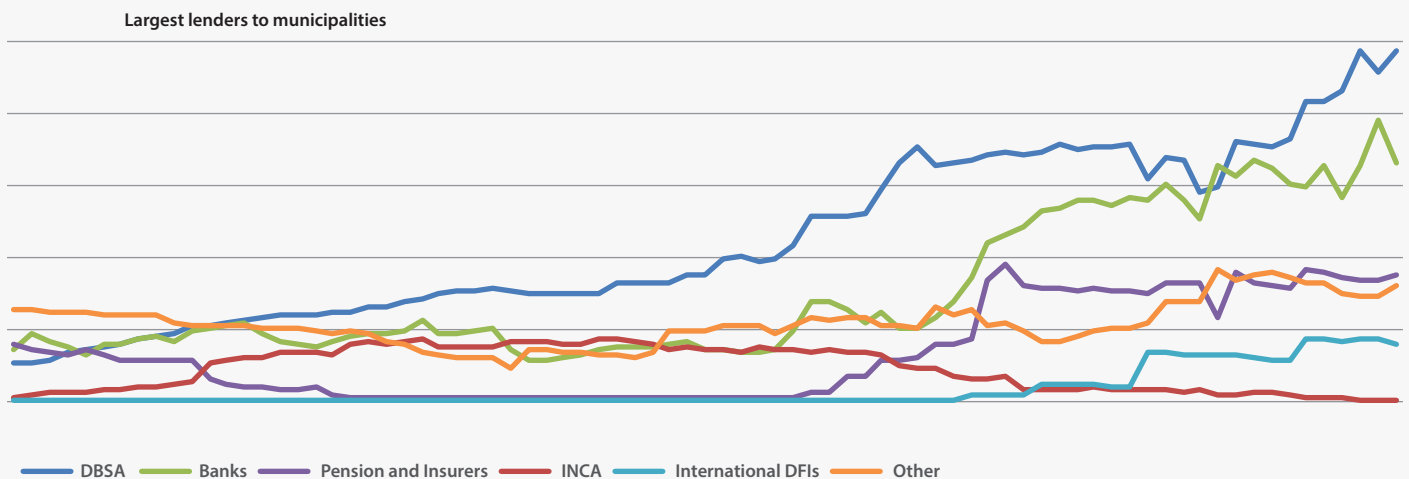


*Q1 2016/17

Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Figure 5 shows the distribution of municipal debt obligations between public and private investors. During the final municipal quarter of 2015/16, the private sector had briefly overtaken the public sector, holding 51 percent of municipal debt, but in the first quarter of 2016/17 public lenders again hold 51 percent or R31.9 billion of the R62.3 billion total debt book.

Figure 6: Largest lenders to municipalities



*Q1 2016/17

Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Figure 6 above shows the different types of lenders who are currently involved in the municipal debt market. As it stands, the Development Bank of Southern Africa (DBSA) is the largest lender followed closely by the banks, pension & insurers, other, international development finance institutions and INCA.

Terms of borrowing

Table 3 compares the longest and shortest terms of new long term debt instruments by categories of municipalities for the period 2010/11 – 2015/16 based on information submitted by municipalities to National Treasury. Except for 2012/13, the longest term for metropolitan municipalities' long term debts is constant at 20 years. The longest term for local municipalities varies between 15 year and 25 years. By contrast, the longest term for district municipalities varies 5 year and 15 years.

The shortest term of long term debts for metropolitan municipalities varies between 2 and 5 years for the period 2010/11 – 2012/13, then becomes constant at 10 years for the period 2013/14 – 2015/16. Long term debts with maturities of less than 10 years are generally issued by municipalities to finance non-infrastructure assets such as vehicles and office equipment.

Table 3: Tenor of new long term debts originated in years

Financial year	Metros		Locals		Districts	
	Longest tenor	Shortest tenor	Longest tenor	Shortest tenor	Longest tenor	Shortest tenor
2010/11	20	5	20	4		
2011/12	20	2	25	5		
2012/13	16	9	20	3	10	3
2013/14	20	10	15	3	5	3
2014/15	20	10	15	2	5	3
2015/16	20	10	20	1	15	1

Sources: National Treasury and Bloomberg

An important question of intergenerational equity always emerges when talking about maturities or terms of debt instruments to finance infrastructure. The intergenerational equity implies that the financial burden with regard to financing infrastructure or assets must be distributed across current and future generations of beneficiaries instead of falling solely on the taxpayers of a given fiscal period. One possible implication of financing infrastructure whose life span is longer than the term of a long debt instrument is that a municipality will have to set very high tariffs and rates for consumers and residents until the debt is redeemed. In this situation the likelihood that consumers or residents of services related to that infrastructure once the debt is redeemed will contribute in proportion of benefits they enjoy for these services is very small.

In the current context where bank loans dominate municipal debt market in South Africa, it is difficult to realise the perfect intergenerational equity. However, municipalities are encouraged to structure long term debts in a way that significantly the gap between terms and life spans of infrastructure assets to be financed.

DISCUSSION



1. Perspectives of urban infrastructure investment

A well-functioning and properly maintained urban infrastructure network is important for provision of services such as water, electricity, roads, sanitation, and waste collection to households and businesses. To meet increasing demand for these services, municipalities continue to invest in building new infrastructure and extending the capacity of existing infrastructure. Given limited resources, municipalities should make strategic choices regarding infrastructure investments that promote financial sustainability, social inclusion, and economic productivity.

Regarding financial viability, it is important to note that for every facility built there are costs that a municipality will incur to operate and maintain for the life of that facility. It is necessary for a municipality to evaluate whether its decision to invest in a particular facility will negatively affect its ability to achieve, in the long run, its objective of provision of services. As a result, a municipality wanting to invest in a facility (infrastructure) should consider the following two elements. First, the municipality should choose the appropriate infrastructure such that its operating and maintenance costs are affordable in terms of projected revenues. Second, it should choose the method of financing the facility that is affordable in terms of its current and realistically anticipated future revenues.

As put forward in the Local Government White Paper, the National Development Plan 2030, and innumerable economic studies, municipalities are our drivers of social development, of which social inclusion is an integral part. Social inclusion entails the transformation of existing spatial patterns, particularly in urban areas, that were promoted by colonial and apartheid policies. Post-apartheid, these conditions have been aggravated by ongoing patterns of urbanisation in South Africa that result in more poor households, in particular black South Africans, living in settlements that are far from economic opportunities and sometimes with limited access to basic services. Well-located housing, and accessible public transport, and infrastructure are key elements to achieve social inclusion.

Although South African municipalities do not have full control over housing and public transport, they can shape the urban form through infrastructure and land management arrangements. In other words, municipalities are drivers of spatial transformation in South Africa. Choices that they make, in particular with regard to the location infrastructure development, affect social mobility and access to economic opportunities for previously marginalised communities.

Municipalities are also critical centres of economic activity. Adequate, timely and efficient delivery of infrastructure and sound land use planning can attract investment, allowing urban centres to realise their potential to drive economic growth and improve productivity. Municipalities can maximise their financial envelope through strategic financial planning that does not only rely on fiscal transfers and own revenue sources to finance infrastructure investment, but successfully mobilises private sector investment.