SOUTH AFRICA 2012

JOHANNESBURG – BOND ISSUANCE AS PART OF AN ISSUANCE PROGRAM ON THE DOMESTIC MARKET

LONG TERM EXTERNAL RESOURCES

Local government

Johannesburg is one of the 6 *metropolitan municipalities (with* eThekwini (former Durban), Cape Town, Ekurhuleni (former East Rand), Nelson Mandela (Port Elizabeth), Tshwane (Pretoria))

3,3 million inhabitants

Bond issuance on the domestic market

Bond issues : only the city of Johannesburg uses this financing method

SPECIFICITIES OF LOANS

- Series of bond issues since 2004 : six bond issues for a global amount of ZAR 5,8 billion (USD 762 million)
- Since 2006 : bond issues launched as part of the « Johannesburg Domestic Medium Term Note Programme » which allows the city to issue until ZAR 6 billion by 2010, without additional documentation requirements
- 12 years in 2004
- Loans only intended to capital expenditures
- Loan term limited to the financed infrastructures' lifespan

INSTITUTIONAL AND REGULATORY FRAMEWORK

- The last territorial reorganizations led to the recentralization of decentralized institutions, and a series of governmental reforms and project seem to lean towards increasing centralization
- Between 1995 and 2000, the number of local governments have been divided fourfold
- 2000 : elimination by the state of municipalities , replaced by *district municipalities*, divided in *local municipalities*, and in *metropolitan municipalities* for the country's largest cities ; in metropolitan municipalities, a metropolitan council, implemented by the *Local Government Municipal Systems Act,* is elected through direct election and headed by a mayor
- South Africa has well-developed financial markets : the *Johannesburg Stock Exchange* (JSE) is an international financial market
- Strong constraints:
  - threshold : ZAR 500 M minimum
  - financial health : rating
  - transparency of the information: environment trust

INSTITUTIONAL AND REGULATORY FRAMEWORK

- En 2006, les 283 municipalités se répartissent en 6 *metropolitan municipalities (*Johannesburg, eThewini (ex Durban), Cape Town, Ekurhuleni (ex East Rand), Nelson Mandela (Port Elizabeth), Tshwane (Pretoria), 46 *district municipalities* et 231 *local municipalities.*
- In 2006, the 283 municipalities are distributed in 6 *metropolitan municipalities (*Johannesburg, eThekwini (ex Durban), Cape Town, Ekurhuleni (ex East Rand), Nelson Mandela (Port Elizabeth), Tshwane (Pretoria), 46 *district municipalities* et 231 *local municipalities*
- The nine Provinces, represent the largest territorial unit
- The *White Paper on Local Government* in 1998 puts municipalities at the center of local development, by granting them autonomy and placing social services and basic infrastructures such as water and electricity distribution, waste collection sewage systems, care centers and local railway lines under their jurisdiction
- On the other hand, the allocation of responsibilities between the three territorial levels (State, provinces and municipalities) is not determined by the legislation.

Loan

- Tradition of municipal borrowings in South Africa since the Apartheid: white municipalities borrowed from commercial banks, and for some of them, issued with implicit state guarantee; and as a consequence, limited regulatory and risk analysis mechanisms.
- New Constitution : no state guarantee on local governments' loans
- 2004 : entry into force of the *Municipal Financial Management Act* (MFMA)
  - Regulatory framework intended to respond to concerns due to municipal reforms and to reassure investors: the new administrative definition of municipalities, the end of state guarantee on non-sovereign loans and of the legal vacuum on local governments' financing terms had indeed created a climate of uncertainty; the increasing risks and transaction costs had led to the withdrawal of private investors
  - Clear rules providing strong incentives
  - Control of financing terms for local governments while providing incentives for them to improve financial management, transparency and skills
  - According to MFMA's terms, loans are only granted for capital expenditures and the loan term is limited to the financed infrastructures' lifespan.

USES

- Investments target primarily disadvantaged peripheral areas

RESOURCES

- Internal resources : the share of internal resources on total income is decreasing, primarily due to the institutional reforms of the Central State (see page 3)
- Domestic bond market

RESOURCES

- Own resources
  - Large cities benefit from income generated by economic activities : land taxes (for *metropolitan* and *local municipalities*), fluid sales (electricity mainly) and until recently, the Regional Service Council (RSC), a professional tax levied on the turnover and total payroll; the budget of metropolitan municipalities was relying for 90% on this income; for medium-sized or smaller municipalities, this ratio is far lower
  - The Constitutional Council has abolished the RSC in 2006. It generated 17% of the nine largest cities' total income while state transfers only generated 10%. Since transfers have not increased to compensate the income shortfall, the legislation not only led to the municipalities' loss of financial autonomy but also to a reduction in overall resources.
  - Other measures seem to indicate a decline in the responsibilities exercised by municipalities: electricity distribution, which generated significant financial surplus, particularly for large metropolitan municipalities, is transferred to regional distributors; the government is considering pooling investment amounts – from municipalities which have fell behind schedule in upgrading their infrastructure network – into a central fund.

- Transfers : The State has implemented two types of transfers to foster investment
  - *Equitable Share* (ES) is an equalization mechanism by which 50% of global transfers are facilitated
  - *The Municipal Infrastructure Grant* (MIG) is used to finance basic infrastructure particularly for the poorest municipalities and represents 35% of national transfers
  - There are three simultaneous restructuring and capacity building funds (*Municipal Systems Improvement Grant*, *Financial Management Grant*, *Local Government Restructuration Grant*), that represent only a small fraction of transfers
  - The government spends a increasing share of the State budget on transfers (3.3 % in 2002, 5.9 % in 2006 and 6.5 % in 2009), that sends a strong signal to municipalities and enables greater visibility for them to plan their investments

- Local governments also receive money from provinces : large municipalities are complaining about the unpredictability of transfers' amounts and of the disbursement schedule, as well as the lack of transparency in the process of fund allocation

MANAGEMENT

- Johannesburg, eThekwini, Cape Town, Buffalo City, Mangaung and Msunduzi have joined together to form the *South Africa City Network*, an initiative of the *Minister for Provincial and Local Government*, in partnership with the *South African Local Government Association* (SALGA)

CREDITWORTHINESS / CREDIT ANALYSIS / RISK

- In 2004, part of the bond issues have been guaranteed equally by SFI and DBSA, that allows to extend the issue's term (twelve years) and to improve the city's credit quality
- The city is rated AA by Fitch Ratings (2008) for long term loans and F1 for short term
- The city's self financing capacity (operational savings less depreciation), estimated at 14 % of current revenues in 2006, compared to 8 % in 2003: this change is due mainly to the improved mobilization of local taxation, which is boosted by the city's GDP growth at a rate of more than 6% annually.
- The city implemented a Sinking Fund drawing on dedicated resources that guarantees the payment of interests upon maturity.

DISADVANTAGES, ISSUES RAISED

- The legal framework is conducive to the use of debt, but in practice borrowing and absorption capacities of small and medium-sized municipalities remain low and hinder market development
- Local governments also receive money from provinces : it leads to jurisdictional conflicts in sensitive areas such as housing, basic health services and public transportation

- The first bond issues have been well received in the professional sector as a precursory event introducing a new era. In this respect, expectations were not met, since municipal bond issues remained an exception
- The private sector still dominates. Even in larger municipalities, credit institutions still provide the most attractive terms (rate, maturity, grace period) on financial products
- The debt market has not yet reached its full development potential

Sources : T.Paulais (2012)