MUNICIPAL BORROWING POLICY FRAMEWORK

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National Treasury
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MUNICIPAL BORROWING POLICY FRAMEWORK

- The original policy framework - developed in 1998/1999
- Intended to strengthen the capital market and help creditworthy municipalities to access capital
- Policy served as a guide for legislation- MFMA (chapter 6 and 13)

The core principles underpinning the policy framework include:

- Creditworthy municipalities should ***borrow prudently*** to finance capital investment and fulfil their constitutional responsibilities
- Municipal access to private capital, ***based on investors' evaluation of municipal creditworthiness***, is a *key to efficient local government* and fiscal discipline
- Municipalities should ***borrow in the context of long-term financial strategies***, which reflect clear priorities and the useful life of assets
- Neither national nor provincial government will ***underwrite or guarantee*** municipal borrowing

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NATIONAL TREASURY 3

UPDATED MUNICIPAL BORROWING POLICY FRAMEWORK

- Despite successful implementation; there are still some limitations:
  - Borrowing is not as long term as initially intended (it does not relate to the useful life of assets)
  - Secondary market has developed but not vibrant as anticipated
  - The role of DFIs in municipal infrastructure financing was not clearly defined (to avoid crowding out private sector)
- To address these challenges, National Treasury has updated the borrowing policy framework

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NATIONAL TREASURY 4

PROPOSED AMENDMENTS

Financing mechanisms allowed to leverage borrowing	The updates clarify alternative infrastructure financing instruments: • Project finance • Revenue bonds • Land based instruments e.g. Tax increment financing, development charges • Pooled Financing Mechanisms • Public-Private Partnerships (PPP)
Strategies to Support liquid secondary market	Public and private sectors are encouraged to support a liquid secondary market through: • Encouraging all lenders, including commercial institutions and DFIs, to ***originate new borrowing in the form of bonds*** to increase stock of bonds in the market • Encouraging municipalities to borrow for ***longer tenures*** (beyond 20 years) that matches life circle of assets • ***Securitising existing loans*** held by public or private financial institutions
Clarifies the role of DFIs	• The role of Development Finance Institutions (DFIs) was not clearly articulated in the original policy, • Update encourages DFIs to **pursue developmental goals** (outlined in the policy) as an effort to **minimise DFI lending in direct competition** with private sector lenders and not crowd out the market

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PROPOSED AMENDMENTS - ROLE OF DFIs IN DIFFERENT TYPES OF MUNICIPALITIES

For Metros clear and measurable development outcomes may include:

- Extending the weighted average maturity of a municipality's borrowing ***beyond*** 20 years
- Substantially increasing the ***volume of municipal bonds*** listed on the JSE
- Establishing or supporting market-makers in municipal securities, to ensure liquidity
- Enabling or ***accelerating*** otherwise unaffordable ***investment in spatially transformative development***
- Supporting the development of long term financial ***strategies*** aligned with long term physical and engineering planning

For ICMs clear and measurable development outcomes may include:

- Making long term credit available with a weighted average maturity of ***at least*** 20 years
- Establishing or supporting ***pooled borrowing mechanisms*** which limit each municipality's risk to its own capital investment needs
- Supporting the development of long term financial ***plans*** aligned with long term physical and engineering planning

For poor or rural municipalities clear and measurable development outcomes may include:

- Sustainable use of borrowing to fund appropriately scaled infrastructure investments
- Sustainable financing for basic infrastructure and services
- Supporting the development of long term financial plans aligned with long term physical and engineering planning

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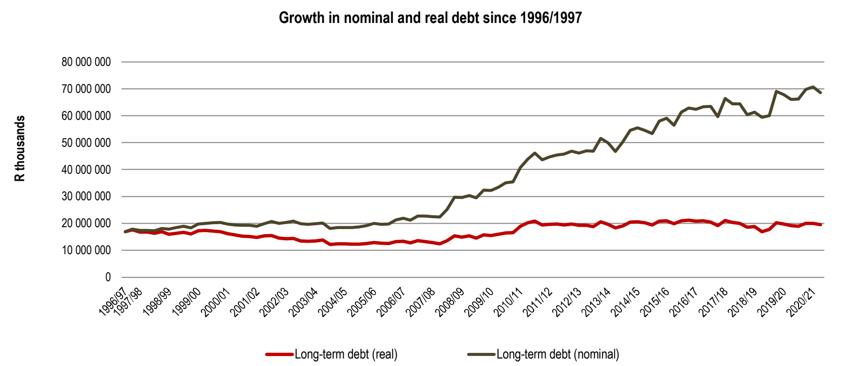
Growth in long term municipal borrowing



*Incl QII
Data sources: Banks, DBSA, INCA, DFIs, STRATE, SARB

Although municipal long term debt (nominal) has grown more than threefold over the years from R16.9 billion in March 1996/97 to R70.4 billion at the end of Q4 FY2020/21, real growth has been stagnant

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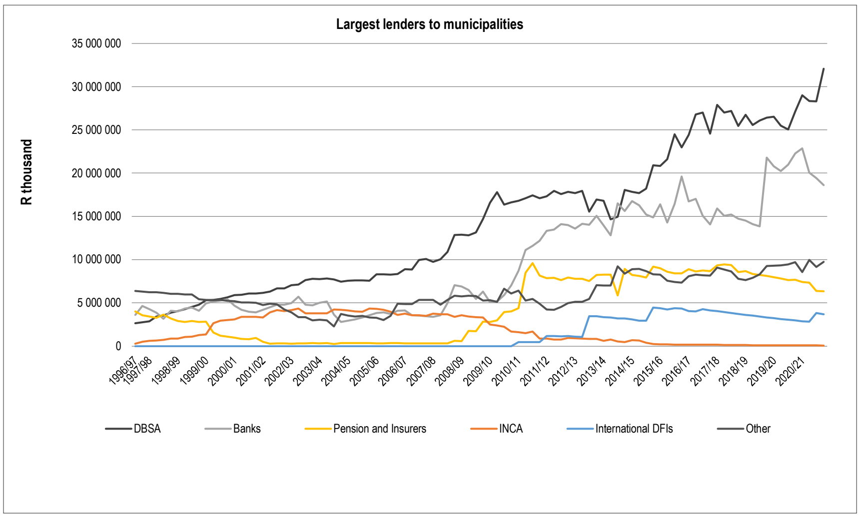
MUNICIPAL LENDERS



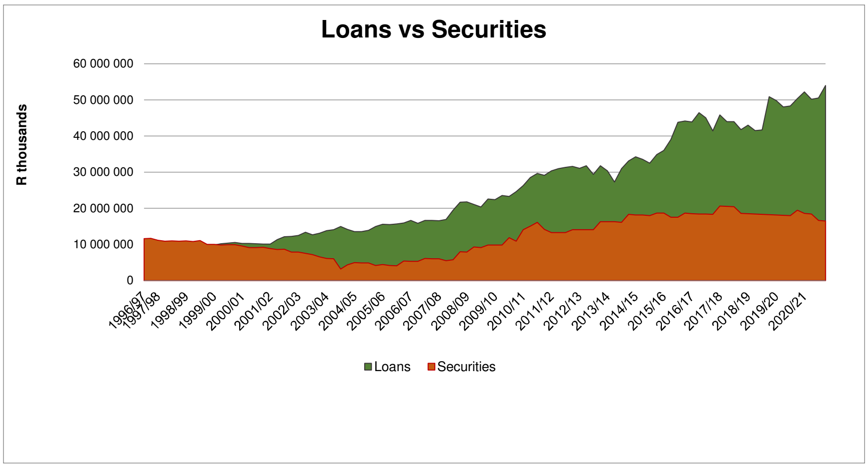
MUNICIPAL LENDERS

- Municipal debt investor base comprises of both private sector and public sector investor
- Currently the **majority of lending to municipalities is from public sector** financiers
- As at the end of FY2020/21, **public sector lenders are owed R37.2 billion** compared to R33.2 billion that is due to private sector lenders
- Public sector municipal lenders comprise of mainly the DBSA, Agence Française de Développement (AFD) and KFW, which are all development finance institutions
- Commercial banks, pension funds and insurers make up the main private sector lenders.
- Compared to about R5.6 billion 21 years ago, the DBSA has significant grown its investment in municipal long-term debt obligations to about R32 billion at the end of the 2020/21 financial year.
- The **DBSA is currently the single largest lender to municipalities** and accounts for almost 40 percent of total long-term lending to municipalities
- The **DBSA is also responsible for more than 80 percent of public sector lending** to municipalities and almost 80 percent of their lending is to metros which are more creditworthy and exercise better fiscal discipline than the rest of the other municipalities.

MUNICIPAL LENDERS continued…..

- Commercial banks are the second largest group of lenders to municipalities
- **Municipalities owe commercial banks a total of R18.6 billion**, which equates to about 26 percent of total outstanding long-term municipal borrowings.
- This group of investors is responsible for about 56 percent of municipal borrowings held by private sector financiers and about 85 percent of their lending to municipalities has been in the form of loans while the remaining 15 percent is held in municipal bonds.
- Commercial banks have preference for **long-term financing ranging between 5 – 10 years**, with semi-annual annuity repayments as a result of increased liquidity requirements on banks at the wake of the 2008 global financial crisis. Hence their preference for loans over municipal bonds.
- Pension funds and insurers make up the institutional investor community. These usually have longer term mandates, hence their appetite for appropriately priced and creditworthy municipal bonds.
- This **investor community is today owed R66.3 billion** municipalities from just R1 billion 21 years ago and their investment in municipal long-term debt obligations is exclusively held in municipal bonds
- INCA which historically engaged in lending to municipalities, has stopped doing so since FY 2008/09 and its outstanding borrowing to municipalities is still in the process of being paid off
- The international DFI community which entered the municipal debt market during FY 2010/11 almost coincided with the withdrawal of INCA, perhaps filling up the void that INCA had left in the municipal debt market.
- Municipal debt held by these DFIs has increased since their arrival during the 2010/11 financial year and now stand at R3.6 billion.

MUNICIPAL DEBT INSTRUMENTS



Loans continue to form the larger share of municipalities' long term borrowing. Only four out of eight metros are issuing bonds

MUNICIPAL DEBT INSTRUMENTS

- Municipalities mainly borrow in the form of loans and securities
- Municipal long-term borrowing **is dominated by loans** and this has been the case for the past 21 years
- Municipal debt held in loans has grown faster than debt held in bonds, from R10.4 billion in FY 1999/00 to just shy of R54 billion at the end of the 2020/21 financial year.
- Municipal bonds only grew from R9.8 billion to just R16.4 billion over the same period
- **Loans account for about 77 percent** of total outstanding municipal long-term debt while municipal bonds account for the remaining 23 per cent
- **Loans are preferred by most municipalities** because they are easier and cheaper to arrange ~~and~~ by financiers with shorter term mandates such as commercial banks because they can be paid back faster since they usually have shorter maturities
- The **maturities of these loans range between 5-20 years**, with the majority ranging between 5 – 15 years. Very few have maturities of 20 years. These loans are not appropriate for financing municipal infrastructure as the repayment periods thereof usually fail to match the long useful lives of most municipal infrastructure

LG DEBT BY DIFFERENT TYPES OF MUNICIPALITIES

Table 2: Outstanding long term debt as at 30 June 2021

Municipal Category	Municipality	Total debt Q4 2020/21 R'000	Share of total debt	Actual Revenue 2020/21 R'000	Debt to revenue ratio
A	BUF	233 185	0,3%	7 590 865	3%
	NMA	1 130 446	2%	12 102 045	9%
	MAN	743 366	1%	6 844 945	11%
	EKU	9 600 922	14%	37 417 870	26%
	JHB	23 665 301	33%	66 045 762	36%
	TSH	10 307 881	15%	34 834 607	30%
	ETH	9 015 666	13%	38 951 056	23%
	CPT	7 076 063	10%	42 527 468	17%
	Total Metros	**61 772 830**	**87%**	**246 314 618**	**25%**
B	**B1 (19)**	5 873 150	8%	68 207 632	9%
	Other Municipalities	2 777 554	4%	84 821 585	3%
C	**Districts**	484 238	1%	21 477 544	2%
	Total all municipalities	**70 907 772**		**420 821 379**	**17%**

*excluding capital transfers

Source: National Treasury Database

MUNICIPALITIES ENGAGED IN BORROWING

- About **87 percent (R61.7 billion)** of municipal borrowing is undertaken by the metros
- The **secondary cities account for about 8 percent** (R5.9 billion) municipal borrowing
- **Four per cent** (R2.8 billion) of municipal borrowing belongs to the rest of the local municipalities while only 1 percent (R484 million) belongs to district municipalities
- The metros are highly geared than the rest of the other municipalities with an aggregate debt to revenue ratio of 25
- The secondary cities have an aggregated debt to revenue ratio of 9 percent while the rest of other locals have an aggregated debt to revenue ratio 3 per cent

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2030 NDP

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