MOODY'S
INVESTORS SERVICE

CREDIT OPINION
13 January 2017

Update

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RATINGS

Cape Town, City of

Domicile	Cape Town, South Africa
Long Term Rating	Baa2
Type	LT Issuer Rating - Dom Curr
Outlook	Negative

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Cape Town, City of

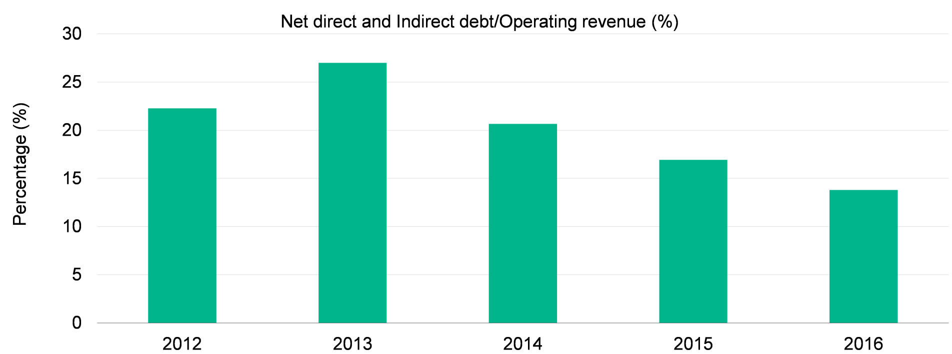
Updated credit opinion

Summary Rating Rationale

The City of Cape Town's Baa2/ P-2 Aaa.za/P-1.za global and national scale issuer and debt ratings reflect the city's consistently robust budgetary performance, strong liquidity position and low debt levels. The financial position is supported by the administration's prudent financial policies and its relatively large and diversified economic base. The rating is constrained by its sizable capital expenditure requirements, which will moderately increase the city's debt levels in the medium term.

Exhibit 1

City of Cape Town has low debt levels, albeit expected to moderately increase in the medium term



Source: Moody's Investors Service

National Peer Comparison

The City of Cape Town is rated at the high end of the range of South African municipalities rated by Moody's, whose ratings span from Aaa.za to Baa2.za. Cape Town's relative position reflects debt levels that are lower than the median of other metropolitan cities. Cape Town compares favourably with the other rated metros in South Africa in terms of budgetary performance and management, and consistently displays robust cash holdings.

Credit Strengths

» Strong financial position, including robust liquidity

» Prudent financial management

» Low debt relative to budget volumes

» Large and diversified economic base

Credit Challenges

» Sizeable capital expenditure programme, which will increase financial leverage

Rating Outlook

» The negative outlook on City of Cape Town's rating mirrors the rating action taken on the ratings of its support provider, the Government of South Africa (Baa2/ Negative).

Factors that Could Lead to an Upgrade

» An upgrade of Cape Town's global scale rating will likely require an upgrade of the sovereign rating.

Factors that Could Lead to a Downgrade

» A downgrade of the sovereign rating will likely lead to a downgrade of Cape Town's ratings.

» Furthermore, Cape Town's ratings would come under pressure in the event of deterioration in fiscal discipline, resulting in the weakening of its liquidity position and/or a substantial increase in its financial leverage.

Key Indicators

Exhibit 2

Cape Town, City of					
	2012	2013	2014	2015	2016
Net direct and indirect debt/Operating revenue (%)	22.5	27.0	20.7	16.9	13.8
Interest Payments/Operating Revenue (%)	3.2	3.0	3.1	2.7	2.6
Gross Operating Balance/Operating Revenue (%)	7.7	6.7	5.1	13.2	13.0
Cash Financing Surplus (Requirement)/Total Revenue (%)	4.2	-3.2	-7.1	4.7	0.5
Intergovernmental Transfer/Operating Revenue (%)	7.6	8.3	9.1	17.8	17.1
Real GDP (% change) [1]	2.8	2.5	2.0	-	-
GDP per capita as % of National Average	121.7	118.9	115.4	-	-
[1] GDP at provincial level.					

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Source: Moody's Investors Service

Detailed Rating Considerations

Cape Town's Baa2/Aaa.za rating combines (1) the entity's baseline credit assessment (BCA) of baa2, and (2) a moderate likelihood of extraordinary national government support if the City faced acute liquidity stress.

Baseline Credit Assessment

STRONG FINANCIAL POSITION, INCLUDING ROBUST LIQUIDITY

As at 30 June 2016 FY, City of Cape Town's total revenue of ZAR35.2 billion (US$2.7 billion) places it second as the largest cities in South Africa. The city continues to display strong revenue generation capabilities as it generated 82% of its operating revenues from own sources. Property taxes and service charges dominate its revenue structure and constituted 74% of operating revenue, helping the city to maintain its operating revenue growth rate of 12% on average over the past five years, an indication of a very strong revenue generating capacity. As a result of strong growth in key revenue drivers, such as service charges and property rates, the city maintained its strong operating balance of 13% in 2016 when compared to other metros in the country.

That said, City of Cape Town has broad operating- and capital related expenditure responsibilities, most of which are essential yet expensive services, which reduces its overall expenditure flexibility. On the operational expenditure side, fixed items such as bulk purchases and employee costs contributed 61% of operating expenditures in 2016 FY thus offer limited expenditure flexibility.

Strong cash flows enabled the city to finance its capital infrastructure without taking new debt in the past three years. Despite financing a larger part of its capital investment from own funds, the city maintained its strong liquidity ratio of 1.1x in 2016, which remains favourable relative to other rated metropolitan municipalities in the country. The city's strong cash flows are largely underpinned by its consistently high revenue collection rates of 93% in 2016.

PRUDENT FINANCIAL MANAGEMENT

The administration regularly monitors its budget execution and cash flows and is committed to reinforcing internal controls. As in previous financial years, the city received an unqualified audit report for the financial year ending 30 June 2016. The city also maintained a clean audit with respect to last year's financial performance. Notwithstanding the city's plan to maintain high capital expenditures, which will increase its financial leverage in the medium term, the city follows prudent financial, debt and liquidity management policies.

LOW DEBT RELATIVE TO BUDGET VOLUMES

The city did not issue any new debt in 2016; as a result, its net direct debt declined further to 14% of operating revenues from 17% in the previous year. Its robust cash flows enabled the city to post a marginal cash financing surplus of 0.5%. The city funded its entire capital expenditure for 2016 from transfers and own funds. Cape Town's debt stock is comprised of domestic bonds (63%) and bank loans (37%), all denominated in domestic currency and at fixed rates. The average maturity ratio is around 8.8 years and the bulk of the city's debt is financed through bonds, which are secured with sinking funds' investments, estimated at ZAR2 billion in FY2016 (this amount is netted off Moody's debt ratios in FY2016). Cape Town's interest payments, which absorbed a moderate 2.3% (2.7% in 2015) of operating revenues in FY2016, is expected to moderately decline in the medium term if the city continues with its conservative approach to borrowing and fund its capital infrastructure from transfers and own funds.

LARGE AND DIVERSIFIED ECONOMIC BASE

Cape Town is the second-largest city in South Africa in terms of budget size. It is the capital city of the Western Cape Province, the second wealthiest province in South Africa after Gauteng, as reflected by higher-than-average levels of income per capita. With around 3.7 million inhabitants, Cape Town makes up roughly 64% of the total provincial population and is the main driver of the Western Cape's economic activity. The local economy is relatively diversified, with manufacturing and various business activities in the tertiary sector, such as finance, insurance and retail, contributing significantly to the GDP of the region. Cape Town drives the provincial economy and consequently its contribution to national economic output is significant. In addition to financial services, port activities and tourism contribute meaningfully to the local output. Situated in one of the world's busiest trade routes, the Port of Cape Town is one of the largest deep-water harbours in Africa and also contributes to the local economy. Tourism is regarded as a major growth sector as far as investment, employment and the diversification of services are concerned.

SIZEABLE CAPITAL EXPENDITURE PROGRAMME WILL INCREASE FINANCIAL LEVERAGE

Going forward, the city plans to spend about ZAR17.9 billion on capital infrastructure from 2017-19 financial year. If the city implements the capital expenditure plan, its net direct and indirect debt levels should increase to a moderate 27% of operating revenues by 2019, from a low 14% in 2016. The planned capital expenditure program projected to remain relatively diversified. New borrowing and capital transfers from government will contribute 45% and 37%, respectively, while own funds and public contributions will constitute only 18%. Whilst Cape Town's debt exposure does not present a significant credit risk, Moody's will continue to monitor the extent to which the expansive medium term capital programme affects the city's ability to generate adequate cash flow surpluses.

Extraordinary Support Considerations

Moody's assigns a moderate likelihood of extraordinary support from the national government, reflecting, at the jurisdictional level, Moody's assessment of the national government's policy stance of promoting greater accountability and financial sustainability for South African municipalities. Reputation risk for the central government is deemed modest, mainly in view of the predominance of bank loans instead of bonds. Although the new legal framework regulates the recovery of municipalities experiencing financial difficulties, it does not suggest timely extraordinary bail out actions to avoid defaults on debt obligations. However, Moody's recognises some interest of the government in addressing major financial problems that could be experienced by the metropolitan municipalities, in view of their relative importance countrywide.

Output of the Baseline Credit Assessment Scorecard

In the case of Cape Town, the BCA matrix generates an estimated BCA of baa3, close to the BCA of baa2 assigned by the rating committee.

The matrix generated BCA of baa3 reflects (1) an idiosyncratic risk score of 2 (presented below) on a 1 to 9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and (2) a systemic risk score of Baa2, as reflected in the sovereign bond rating (Baa2 negative).

The idiosyncratic risk scorecard and BCA matrix, which generate estimated baseline credit assessments from a set of qualitative and quantitative credit metrics, are tools used by the rating committee in assessing regional and local government credit quality. The credit metrics captured by these tools provide a good statistical gauge of stand-alone credit strength and, in general, higher ratings can be expected among issuers with the highest scorecard estimated BCAs. Nevertheless, the scorecard estimated BCAs do not substitute for rating committee judgments regarding individual baseline credit assessments, nor is the scorecard a matrix for automatically assigning or changing these assessments. Scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Concomitantly, the limited number of variables included in these tools cannot fully capture the breadth and depth of our credit analysis.

Rating Methodology and Scorecard Factors

Exhibit 3

Cape Town, City of						
Rating Factors						
Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	1	131.03	70%	1	20%	0.20
Economic volatility	1		30%			
Factor 2: Institutional Framework						
Legislative background	5		50%	5	20%	1.00
Financial flexibility	5		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenues (%)	1	11.93	12.5%	1.25	30%	0.38
Interest payments / operating revenues (%)	3	2.50	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	13.80	25%			
Short-term direct debt / total direct debt (%)	1	7.20	25%			
Factor 4: Governance and Management - MAX						
Risk controls and financial management	1			1	30%	0.30
Investment and debt management	1					
Transparency and disclosure	1					
Idiosyncratic Risk Assessment						1.88(2)
Systemic Risk Assessment						Baa2
Suggested BCA						baa3

Ratings

Exhibit 4

Category	Moody's Rating
CAPE TOWN, CITY OF	
Outlook	Negative
Issuer Rating -Dom Curr	Baa2
NSR Issuer Rating	Aaa.za
Senior Unsecured -Dom Curr	Baa2
NSR Senior Unsecured	Aaa.za
ST Issuer Rating -Dom Curr	P-2
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

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