

CREDIT OPINION

1 December 2020

Update

 Rate this Research

RATINGS

Cape Town, City of

Domicile	Cape Town, South Africa
Long Term Rating	Ba2
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.

Contacts

Sebastien Hay +34.91.768.8222
Senior Vice President/Manager
sebastien.hay@moody's.com

Daniel Mazibuko +27.11.217.5481
Associate Lead Analyst
daniel.mazibuko@moody's.com

Cape Town, City of

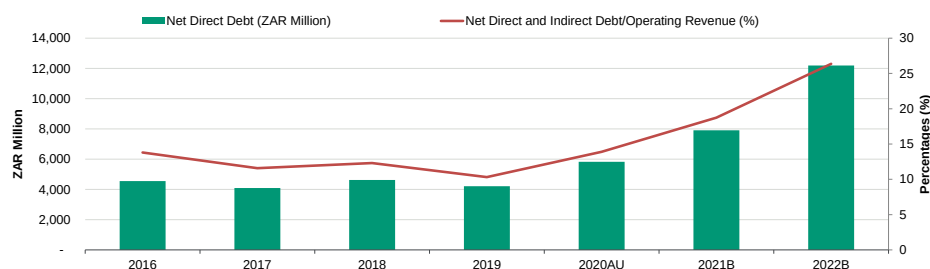
Update following rating downgrade to Ba2

Summary

The [City of Cape Town's](#) (Ba2/NP negative) credit profile reflects its strong financial performance, which is supported by prudent financial management; a large and diversified economic base; and predictable revenue sources from property taxes and service charges. The city has consistently reported an operating surplus, stronger liquidity than its peers in [South Africa](#) (Ba2 negative) and low debt, although we expect debt to rise gradually over the next three years. The city's credit profile is constrained by the capital spending pressure arising from infrastructure backlogs and population growth. It is also constrained by the impact of the coronavirus pandemic, which has hurt operating performance and weakened liquidity, although it remains stronger than that of its peers in the country that we rate. The low economic growth will constrain the city's financial performance in the form of lower revenue collection resulting from higher unemployment.

Exhibit 1

Debt will increase over the next three years, but remain lower than that of its peers



Fiscal year ending 30 June.

Sources: City of Cape Town's financials and Moody's Investors Service

Credit strengths

- » Favourable financial performance, characterised by annual operating surpluses
- » Strong financial and debt management practices
- » Large and diversified economic base

Credit challenges

- » Rising debt level, although it will remain lower than that of South Africa's other metros
- » Increasing capital spending pressure to improve water infrastructure to mitigate the impact of drought

Rating outlook

The negative rating outlook reflects the weakening credit profile of the city's support provider, the South African government, taking into account their strong operational and financial links.

Factors that could lead to an upgrade

Given the negative outlook, an upgrade is currently unlikely. The city's rating outlook could be changed to stable if the outlook on the South African government's rating were to change from negative to stable.

Factors that could lead to a downgrade

The city's rating could be downgraded if the Ba2 sovereign rating is downgraded. Additionally, it could be downgraded if its liquidity and financial performance were to deteriorate.

Key indicators

Exhibit 2

City of Cape Town

	2016	2017	2018	2019	2020 [1]
Net direct and indirect debt/Operating revenue (%)	13.8	11.6	12.3	10.3	11.4
Interest Payments/Operating Revenue (%)	2.3	2.1	2.1	1.8	1.9
Gross Operating Balance/Operating Revenue (%)	13.0	15.0	15.5	17.5	12.5
Cash Financing Surplus (Requirement)/Total Revenue (%)	0.5	0.9	3.3	7.1	0.5
Intergovernmental Transfer/Operating Revenue (%)	17.1	16.5	17.1	17.2	17.8
Real GDP (% change) [2]	1.1	1.2	0.8	-	-
GDP per capita as % of National Average	121.7	118.1	118.1	-	-
[1] 2020 based on October section 71 report					
[2] GDP at provincial level.					

Fiscal year ending 30 June.

Source: Moody's Investors Service

Detailed credit considerations

On 25 November 2020, we downgraded the City of Cape Town's global scale ratings to Ba2/NP from Ba1/NP and maintained the negative outlook. The downgrade of the city's ratings reflects the challenges emanating from the weakening of the sovereign credit profile. We view the centralised nature of the regional and local government (RLG) sector in South Africa and the close financial links between the national government and the RLGs as the factor that keeps the city's ratings at par with the sovereign bond rating. At the same time, we affirmed the long-term and short-term national scale issuer and debt ratings of Aaa.za/P-1.za.

The credit profile of the City of Cape Town, as expressed in its Ba1 rating, combines a Baseline Credit Assessment (BCA) of ba1 and a low likelihood of extraordinary support from the national government in the event that the city faces acute liquidity stress.

Baseline Credit Assessment

Favourable financial performance, characterised by annual operating surpluses

The City of Cape Town's operating performance was significantly hurt by the pandemic, according to the October 2020 section 71 report. However, the city has been recording very strong operating performance over the years, it still recorded a positive gross operating balance of 12.5% in fiscal 2020, compared with 17.5% in fiscal 2019. We expect the city to continue to post a strong operating balance compared with other metros in the country that we rate despite challenges related to the pandemic. For fiscal 2020, the city recorded total revenue of ZAR43.8 billion (\$3.2 billion), the second highest among the South African cities after [Johannesburg](#) (Ba2 negative). However, we expect the city's financial performance over the next three years to decline because of the pandemic, with an average gross operating balance of 5.7% over fiscal 2020-22. The city has strong revenue-generating capacity, with its own-source revenue contributing 82%

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

of its operating revenue in fiscal 2020. Own-source revenue will likely contribute the same proportion, on average, over the three years starting fiscal 2020. Property taxes and service charges will remain the primary contributors to the city's operating revenue, averaging 73% of operating revenue in the next three fiscal years (fiscal 2020-22).

The city has broad operating and capital spending responsibilities, most of which are related to essential and expensive services. This reduces the city's overall spending flexibility, especially related to the water crisis. Fixed items such as bulk purchases and employee costs accounted for 63% of the city's operating expenditure in fiscal 2020, limiting expenditure flexibility. We do not expect changes to the operating expenditure structure over the next three years.

Strong financial and debt management practices

The administration regularly monitors its budget execution and cash flow, and is committed to reinforcing internal controls. As in previous fiscal years, the city received an unqualified audit report for fiscal 2019. However, challenges related to the pandemic will significantly reduce the city's overall performance in the next three years, although it follows prudent financial, debt and liquidity management policies.

Large and diversified economic base

Cape Town is the second-largest city in South Africa in terms of budget size after Johannesburg. It is the capital city of the Western Cape Province and the second-wealthiest province in South Africa after Gauteng, as reflected in the higher-than-average levels of income per capita. With around four million inhabitants, Cape Town makes up roughly 64% of the total provincial population and is the main hub of the Western Cape Province's economic activity. The local economy is relatively diversified, with manufacturing and various business activities in the tertiary sector (including finance, insurance, tourism and retail) contributing significantly to regional GDP. Cape Town drives the provincial economy, contributing around 70%. As a result, its contribution to national economic output is significant. In addition to financial services, port activities and tourism contribute meaningfully to local output. Situated on one of the world's busiest trade routes, the port of Cape Town is one of the largest deep water harbours in Africa. Commercial services is the largest economic sector in terms of investments, employment and the diversification of services.

Debt level rising, but will remain lower than that of South Africa's other metropolitan municipalities

According to the October 2020 section 71 report, the city issued new debt of ZAR1.1 billion. As a result, its net direct debt increased to 11.4% of operating revenue from 10.3% in fiscal 2019. Cape Town's debt stock comprises domestic bonds (77%) and bank loans (23%), all denominated in the domestic currency and at fixed rates. The bulk of the city's debt is financed through bonds, which are secured via sinking fund investments, estimated at ZAR2.5 billion in fiscal 2020 (this amount is netted off our debt ratios in fiscal 2020). Cape Town's debt is set to increase to fund its increasing capital spending. The city plans to borrow ZAR2.5 billion in fiscal 2021 and a further ZAR5 billion in fiscal 2022. If the city fully implements its capital spending plans, its net direct debt will increase to ZAR14.7 billion by fiscal 2022, with net direct and indirect debt as a percentage of operating revenue rising to 26%. The increase in borrowing will also result in an increase in interest payments as a percentage of operating revenue to 2.7% in fiscal 2022 from 1.8% in fiscal 2019. However, the city's projected debt will still be in line with that of South Africa's other rated metropolitan municipalities.

The city's consistently strong liquidity will help ease the pressure from rising debt. Cape Town has consistently maintained strong cash flow, which supports its robust liquidity profile (a liquidity ratio of 2.2x as of year-end fiscal 2019). Cape Town's liquidity is likely to remain strong despite the city's intention to fund a large part of its capital spending in the next three years from own funds.

Increasing capital spending pressure to improve water infrastructure to mitigate the impact of water shortage

Challenges associated with the water crisis have prompted the city to increase borrowing to fund capital spending. In fiscal 2018, the city launched its first green bond in a ZAR1 billion issuance to finance water, sanitation and transport projects. The city plans to spend around ZAR29 billion on capital infrastructure over fiscal 2020-22.

Although the city managed to alleviate the water crisis — through various methods of demand reduction and water augmentation projects — it still plans to invest further in its water infrastructure to try to avoid another crisis. The city has outlined and budgeted for a number of projects aimed at diversifying water sources to be implemented over the next 10 years. Of the total capital spending budget for fiscal 2020-22, 34% in fiscal 2020, 42% in fiscal 2021 and 43% in fiscal 2022 is earmarked for water-related infrastructure. Although the city's debt is likely to increase over the next three years as a result of the increase in capital spending, it will remain lower than that of its South African peers that we rate.

Extraordinary support considerations

The City of Cape Town has a low likelihood of extraordinary support from the national government, reflecting, at the jurisdictional level, the national government's policy stance of promoting greater accountability for South African municipalities. This assessment is in line with the national government's stance to encourage municipalities to be self-sustainable. Although the legal framework regulates the recovery of municipalities experiencing financial difficulties, it does not suggest timely extraordinary bailout actions to avoid defaults on debt obligations.

ESG considerations

How environmental, social and governance risks inform our credit analysis of the City of Cape Town

We take account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of the City of Cape Town, the materiality of ESG factors to its credit profile is as follows:

Environmental considerations are material to Cape Town's credit profile. Similar to the rest of South Africa, the city's main exposures relate to water shortage. Drought is the most frequent environmental constraint that directly affects the city's revenue. This challenge is managed through partnerships between the central government's department of water and the city. However, some of the financial burden for implementing and maintaining diverse water sources will be borne by the city. A three-year drought recently caused Cape Town's dam system levels to deteriorate significantly, and the city has, in response, launched a new strategy to build an integrated water management system that will result in more diverse water sources.

Social considerations are material to the city's credit profile. Although the economy is large and relatively richer than the national average, the city faces growing demography-related spending pressure. Demographic pressure is likely to continue to rise as a result of high levels of urbanisation and population growth, and it will become increasingly difficult for the city to meet the required capital infrastructure spending. The city also has a high unemployment rate, which directly affects the ability of the city's residents to pay for services, and increases the number of households that are entirely dependent on the city for basic services. In addition, South Africa has one of the highest inequality rates in the world, and this also filters through to local governments, giving rise to risks of social unrest. We also view the pandemic as a social risk under our ESG framework, given the impact on public health and safety in the City of Cape Town.

Governance considerations are material to Cape Town's credit profile. The city's strong administration has implemented prudent financial practices over the years, which has led to the city attaining an unqualified audit opinion over the past 15 years. Similar to those of all local governments in South Africa, Cape Town's financial undertakings are guided by the Municipal Finance Management Act and the national government, although the treasury plays an oversight role. Data transparency is very high, with all financial statements, along with medium-term budgets, published publicly on the city and national treasury's websites.

Further details are provided in the "Detailed credit considerations" section above. Our approach to ESG is explained in our cross-sector methodology [General Principles for Assessing ESG Risks](#).

Rating methodology and scorecard factors

The assigned BCA of ba2 is similar to the BCA of ba2 generated by the scorecard. The matrix-generated BCA of ba1 reflects an Idiosyncratic Risk score of 2 (presented below) on a scale of 1 to 9, where 1 represents the strongest relative credit quality and 9 the weakest; and a Systemic Risk score of Ba2, as reflected in the sovereign bond rating of South Africa.

For details about our rating methodologies, please refer to our [Regional and Local Governments](#) rating methodology, published on 16 January 2018.

Exhibit 3

City of Cape Town**Regional and Local Governments**

Cape Town, City of						
Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	3	118.10	70%	2.4	20%	0.48
Economic volatility	1		30%			
Factor 2: Institutional Framework						
Legislative background	5		50%	6	20%	1.20
Financial flexibility	7		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenues (%)	1	14.36	12.5%	1.25	30%	0.38
Interest payments / operating revenues (%)	3	1.90	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	11.40	25%			
Short-term direct debt / total direct debt (%)	1	6.10	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						2.36(2)
Systemic Risk Assessment						Ba2
Suggested BCA						ba2

Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
CAPE TOWN, CITY OF	
Outlook	Negative
Issuer Rating -Dom Curr	Ba2
NSR Issuer Rating	Aaa.za
Senior Unsecured -Dom Curr	Ba2
NSR Senior Unsecured	Aaa.za
ST Issuer Rating -Dom Curr	NP
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

© 2020 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND/OR ITS CREDIT RATINGS AFFILIATES ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MATERIALS, PRODUCTS, SERVICES AND INFORMATION PUBLISHED BY MOODY'S (COLLECTIVELY, "PUBLICATIONS") MAY INCLUDE SUCH CURRENT OPINIONS. MOODY'S INVESTORS SERVICE DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT OR IMPAIRMENT. SEE MOODY'S RATING SYMBOLS AND DEFINITIONS PUBLICATION FOR INFORMATION ON THE TYPES OF CONTRACTUAL FINANCIAL OBLIGATIONS ADDRESSED BY MOODY'S INVESTORS SERVICE CREDIT RATINGS. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS, NON-CREDIT ASSESSMENTS ("ASSESSMENTS"), AND OTHER OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. AND/OR ITS AFFILIATES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS DO NOT COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS, ASSESSMENTS AND OTHER OPINIONS AND PUBLISHES ITS PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS, AND PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS OR PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

MOODY'S CREDIT RATINGS, ASSESSMENTS, OTHER OPINIONS AND PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing its Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY CREDIT RATING, ASSESSMENT, OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any credit rating, agreed to pay to Moody's Investors Service, Inc. for credit ratings opinions and services rendered by it fees ranging from \$1,000 to approximately \$2,700,000. MCO and Moody's Investors Service also maintain policies and procedures to address the independence of Moody's Investors Service credit ratings and credit rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold credit ratings from Moody's Investors Service and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any credit rating, agreed to pay to MJKK or MSFJ (as applicable) for credit ratings opinions and services rendered by it fees ranging from JPY125,000 to approximately JPY250,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER

1253956