

CREDIT OPINION

26 November 2021

Update

 Rate this Research

RATINGS

Cape Town, City of

Domicile	Cape Town, South Africa
Long Term Rating	Ba3
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

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

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

City of Cape Town (South Africa)

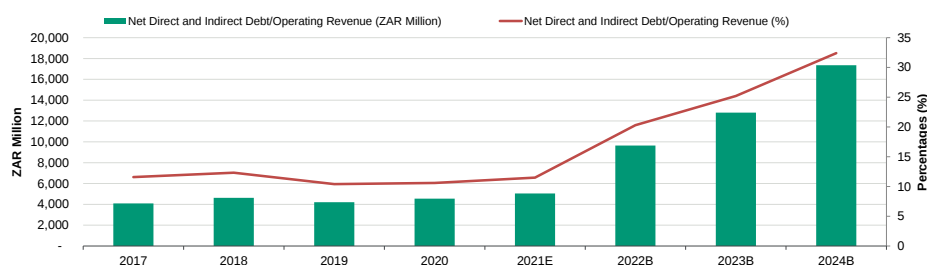
Update following rating confirmation

Summary

The credit profile of the [City of Cape Town](#) (Ba3/NP negative) reflects its strong but declining financial performance, supported by prudent financial management, as well as its large and diversified economic base. The city has consistently reported robust operating surpluses, with stronger liquidity than that of its peers, that we rate, in [South Africa](#) (Ba2 negative). Although we expect debt to rise gradually over the medium term, it will remain lower than most of its peers in the country (see Exhibit 1). The city's credit profile is constrained by capital spending pressure, related to infrastructure backlogs and population growth. It is also constrained by the structurally weak economic environment; worsened by the ongoing coronavirus restrictions; which is expected to moderate the city's operating performance.

Exhibit 1

Debt level is expected to rise in the medium term, but remain lower than most of its rated South African peers



Fiscal year ending 30 June.

E: Issuer estimates

B: Issuer budget

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

Credit strengths

- » Robust financial performance, albeit challenged by the low economic growth environment
- » Strong financial and debt management practices
- » Large and diversified economic base
- » Robust but moderating liquidity

Credit challenges

- » Rising debt levels; but likely to remain lower than most of its rated South African peers

» Growing pressure to increase capital spending

Rating outlook

The rating outlook is negative, mirroring the drivers of the negative outlook for South Africa (Ba2 negative). Ongoing weak economic growth, notwithstanding a rebound from the pandemic-related contraction in 2020, continues to weigh on revenue collection. The financial pressure is exacerbated by needs to vastly expand investment, in particular, in water and electricity infrastructure.

Factors that could lead to an upgrade

A ratings upgrade is unlikely, considering the assigned negative outlook. Moody's will consider stabilizing the outlook if the issuer displays robust operating performance and liquidity resilience to the expected macroeconomic pressure, in a way that is consistent with its current ratings.

Factors that could lead to a downgrade

Moody's will consider a further downgrade of the ratings if the city experiences deteriorations in operating performance and liquidity; such that its credit profile is no longer in line with the current rating levels. A ratings downgrade will also be considered if the macroeconomic environment deteriorates such that we see a Sovereign downgrade.

Key indicators

City of Cape Town

City of Cape Town	2017	2018	2019	2020	2021 E	2022 B	2023 B	2024 B
Net direct and indirect debt/Operating revenue (%)	11.6	12.3	10.4	10.6	11.5	20.3	25.2	32.4
Interest Payments/Operating Revenue (%)	2.1	2.1	1.8	1.9	1.9	1.7	2.5	2.8
Gross Operating Balance/Operating Revenue (%)	15.0	15.5	17.7	12.5	7.4	4.7	5.9	5.8
Cash Financing Surplus (Requirement)/Total Revenue (%)	0.9	3.3	7.1	0.5	-1.9	-5.4	-3.8	-7.7
Intergovernmental Transfer/Operating Revenue (%)	16.5	17.1	17.4	17.8	19.5	11.9	11.4	10.0
Real GDP (% change) [1]	1.2	0.8	-	-	-	-	-	-
GDP per capita as % of National Average	118.1	118.1	-	-	-	-	-	-
[1] GDP at provincial level.								

[1] GDP at the provincial level.

Fiscal year ending 30 June.

E: Issuer estimates

B: Issuer budget

Source: Moody's Investors Service

Detailed credit considerations

On 19 November 2021, Moody's confirmed the City of Cape Town's long-term global scale issuer and debt ratings of Ba3/Aa3.za to reflect the city's resilient operating performance and liquidity, in the challenging operating environment. Though the operating balance is forecast to moderate in the medium term, due to rising operating expenditure pressures, the resilience in the city's cash position is expected to remain. The low debt level, together with the city's liquidity reserves places the city in a favourable position to raise funding.

The credit profile as expressed in its Ba3 rating, combines a Baseline Credit Assessment (BCA) of ba3 and a low likelihood of extraordinary support from the national government; in the event that the city faces acute liquidity stress.

Baseline Credit Assessment

Robust financial performance, albeit challenged by the low economic growth environment

Though Cape Town's operating performance has been affected by the prevailing weakness in the economic environment, the city achieved a positive estimate gross operating balance (GOB) of 7% of operating revenues, for the fiscal year ended 30 June 2021. Whilst Moody's expects the city to maintain positive operating balances in the medium term, the continued fragility in the operating environment is expected to moderate the GOB. Forecasts indicate an average GOB of 5% over fiscal 2022-24.

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.

The city has high revenue-generating capacity, with its own-source revenue contributing 81% of its operating revenue according to the fiscal 2021 estimates. Property taxes and service charges were the primary drivers of the city's operating revenue, amounting to an estimate of 68% of operating revenue in fiscal 2021. Own-source revenue will likely contribute the same proportion, on average, over the medium term.

Regarding expenditure, fixed-cost items — such as bulk purchases and salary costs — accounted for 58% of total expenditure in fiscal 2021 estimates, which limits the city's expenditure flexibility. Moody's does not expect changes in the operating expenditure structure over the next three fiscal 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 2020. However, pandemic-related challenges will significantly weaken the city's overall performance in the next three fiscal years, although the city continues to follow prudent financial management policies. Due to the deteriorating operating environment and the likely operating pressure the city will face, it will have to manage spending pressure which will lead to an increase in debt levels in the next three years.

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 which is the second-wealthiest province in South Africa after Gauteng, as reflected in the higher-than-average levels of income per capita. With more than four million inhabitants, Cape Town accounted for 68% of the total provincial population in 2018. Cape Town is also 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 the national economic output is significant. The Western Cape province also had the lowest official unemployment rate of 22.5% in 2020, compared with that of other provinces. In addition to financial services, port activities and tourism contribute significantly to the 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.

Robust but moderating liquidity

The city has continued to demonstrate robust liquidity, with its cash position covering its most immediate obligations at an estimated current ratio (current assets/current liabilities) of 2x for fiscal 2021. Though resilience in the liquidity position is expected over the medium term, growing capital spending needs are expected to moderate liquidity, resulting in a forecasted average current ratio of 1.8x between fiscal 2022-2024.

Rising debt

According to fiscal 2021 estimates, the city did not issue any new debt. Net Direct and Indirect Debt (NDID) therefore remained very low at 11.5% of operating revenues. However, according to the medium term budget, capital spending needs will lead to a substantial increase in the city's debt levels. The NDID is forecast to ramp up to 32.4% of operating revenues in fiscal 2024.

Cape Town's debt stock comprises of domestic bonds (70%) and bank loans (30%) – 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 ZAR3.1 billion in fiscal 2021 (this amount is netted off our debt ratios in fiscal 2021). As previously mentioned, Cape Town's debt is set to increase to fund its increasing capital spending. The city plans to borrow ZAR2.5 billion in fiscal 2022; a further ZAR4.5 billion in fiscal 2023; and ZAR7 billion in 2024. As a result, the city's net direct debt will increase to ZAR17.2 billion by fiscal 2024.

Growing pressure to increase capital spending

The city uses a combination of debt, grants and own source funding in order to finance its capital spending programme. Although the city managed to alleviate the water crisis in 2018— through various methods of demand reduction and water augmentation projects — it still plans to invest further in its water infrastructure to avoid another crisis. Rising electricity shortages as well as historically poorly maintained infrastructure also places all South African municipalities under growing capital spending pressure.

The rising need for capital spending was reflected in the estimated cash financing requirement of 1.9% of total revenues for fiscal 2021. This was covered through the use of own cash. The cash financing requirement is expected to increase over the medium term, averaging 5.63% of total revenue during fiscal 2022-2024. This shall be financed through increased borrowing, own funds and capital grants.

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 (ESG) risks inform our credit analysis of the City of Cape Town

We take into account the impact of ESG 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 those of 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 of implementing and maintaining diverse water sources will be borne by the city. A recent three-year drought 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 demographic 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 16 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 high, with all financial statements, along with medium-term budgets, published publicly on the city's 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 Environmental, Social and Governance Risks](#), published in June 2021.

Rating methodology and scorecard factors

The City of Cape Town's assigned BCA of ba3 is in line with the BCA of ba3 generated by the scorecard. The scorecard-indicated BCA of ba3 reflects an Idiosyncratic Risk score of 4 (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 by the sovereign bond rating for South Africa.

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

Exhibit 3

Cape Town, City of Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				2.40	20%	0.48
Economic Strength [1]	3	118.09%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				6	20%	1.20
Legislative Background	5		50%			
Financial Flexibility	7		50%			
Factor 3: Financial Position				2.75	30%	0.83
Operating Margin [2]	1	10.35%	12.5%			
Interest Burden [3]	3	1.87%	12.5%			
Liquidity	5		25%			
Debt Burden [4]	1	11.46%	25%			
Debt Structure [5]	3	19.29%	25%			
Factor 4: Governance and Management				5	30%	1.50
Risk Controls and Financial Management	1					
Investment and Debt Management	5					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						4.01 (4)
Systemic Risk Assessment						Ba2
Suggested BCA						ba3

[1] Local GDP per capita as % of national GDP per capita

[2] Gross operating balance/operating revenues

[3] Interest payments/operating revenues

[4] Net direct and indirect debt/operating revenues

[5] Short-term direct debt/total direct debt

Source: Moody's Investors Service; Fiscal 2021.

Ratings

Exhibit 4

Category	Moody's Rating
CAPE TOWN, CITY OF	
Outlook	Negative
Issuer Rating -Dom Curr	Ba3
NSR Issuer Rating	Aa3.za
Senior Unsecured -Dom Curr	Ba3
NSR Senior Unsecured	Aa3.za
ST Issuer Rating -Dom Curr	NP
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

© 2021 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 CREDIT RATINGS AFFILIATES ARE THEIR 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 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 APPLICABLE MOODY'S RATING SYMBOLS AND DEFINITIONS PUBLICATION FOR INFORMATION ON THE TYPES OF CONTRACTUAL FINANCIAL OBLIGATIONS ADDRESSED BY MOODY'S 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 \$5,000,000. 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 61 003 399 657 AFSL 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 JPY550,000,000.

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

REPORT NUMBER

1301244