MOODY'S RATINGS



CREDIT OPINION
3 July 2024

Update

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**RATINGS**

**Cape Town, City of**

| | |
|---|---|
| Domicile | Cape Town, South Africa |
| Long Term Rating | Ba3 |
| Type | LT Issuer Rating - Dom Curr |
| Outlook | Positive |

*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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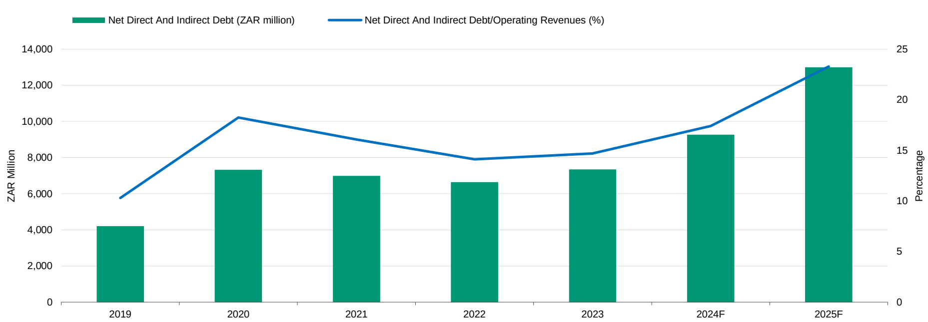
# City of Cape Town (South Africa)

## Update following outlook change to positive from stable and affirmation of ratings

## Summary

The credit profile of the City of Cape Town (Ba3 positive) reflects its consistently strong and improving operating and financial performances and a sound liquidity position. The city's moderate debt burden, which it can comfortably service, is expected to gradually increase in the medium term. We note a track record of improved management policies and practices, which should help the city to maintain sound financial metrics, despite constraints imposed by increasing pressure to spend on infrastructure to address social and environmental risks amid the country's structurally weak economic environment. The city itself enjoys a broad and diversified economic base.

Exhibit 1
**Debt level is expected to rise in the medium term**




Fiscal year ending 30 June.
F=Moody's Forecast
*Source:Moody's Ratings, City of Cape Town*

## Credit strengths

» Robust financial performance, strengthening over the next 12-18 months

» Strong debt management practices and sturdy liquidity

» Large and diversified economic base

## Credit challenges

» Rising debt, albeit likely to remain affordable

» Growing pressure to increase capital spending for social and environmental risks

## Rating outlook

The positive outlook reflects Moody's view that Cape Town's financial performance could further strengthen over the next 12-18 months, surpassing baseline forecasts. The city's progress on improving revenue collection should contribute to consolidate its financial performance and mitigate the reliance on debt for its substantial investment program.

## Factors that could lead to an upgrade

We could consider an upgrade of Cape Town ratings in case of continued strengthening of operating and financial performances without an excessive debt accumulation.

## Factors that could lead to a downgrade

We would consider a downgrade of the ratings if the city experiences significant deterioration in operating performance and liquidity. We would also consider a rating downgrade if the sovereign ratings were downgraded.

## Key indicators

Exhibit 2

**City of Cape Town**

| City of Cape Town | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 B | 2025 B |
|---|---|---|---|---|---|---|---|
| Net Direct And Indirect Debt/Operating Revenues (%) | 10.3 | 18.2 | 16.1 | 14.1 | 14.7 | 17.4 | 23.3 |
| Debt Service/Total Revenues (%) | 2.6 | 2.8 | 2.6 | 2.3 | 4.1 | 4.6 | 6.6 |
| Interest Expenses/Operating Revenues (%) | 1.8 | 2.0 | 1.9 | 1.6 | 1.5 | 1.7 | 2.2 |
| Operating Margin (Primary Operating Balance / Operating Revenue) | 19.5 | 8.8 | 8.8 | 10.7 | 11.2 | 11.9 | 13.3 |
| Liquidity ratio (cash and cash equivalents/operating revenue) | 21.3 | 29.4 | 25.4 | 23.4 | 25.0 | 24.8 | 25.1 |
| Capital expenses/total expenses (%) - IS | 13.0 | 12.9 | 13.3 | 10.6 | 12.1 | 13.9 | 14.3 |
| Cash Financing Surplus / Requirement (CF) as of total revenues (%) | 7.1 | 0.6 | -2.3 | 1.1 | -1.8 | -1.7 | 0.3 |

Fiscal year ending 30 June.
F=Moody's Forecast
*Source: Moody's Ratings, City of Cape Town*

## Detailed credit considerations

On 28 June 2024, we changed the outlook of the City of Cape Town to positive from stable, and affirmed the Ba3 long-term issuer and senior unsecured debt ratings, the (P)Ba3 senior unsecured MTN program rating, the Aa3.za National Scale issuer, senior unsecured debt and senior unsecured MTN program ratings (NSR). The Not Prime (NP) short term issuer rating and the P-1.za national scale short term issuer ratings have been affirmed. At the same time, the Baseline Credit Assessment (BCA) of ba3 has also been affirmed.

The Ba3 rating also incorporates a low likelihood of extraordinary support from the Government of South Africa (Ba2, stable) in the event that the City of Cape Town faced severe liquidity stress.

## Baseline credit assessment

**Robust financial performance, strengthening over the next 12-18 months**

The city's operating margin improved to 11.2% in fiscal year 2023, up from 10.7% in previous fiscal year. The improvement indicates robust collection rate of 97% in fiscal 2023, as well as contained operating expenditures. Property taxes and service charges were the primary drivers of the city's operating revenue, amounting to more than 70% of this revenue in fiscal 2023. The city's high revenue collection capacity has ensured that the city maintained overall robust operating performance during the past 5 fiscal years. The city's proactive approach to tackle revenue collection challenges and control expenditure growth demonstrates its strong governance and effective budget management. Recent initiatives, such as the cross utilization of prepaid electricity payments from residential property taxes, are expected to further diminish the risks of nonpayment or late payment, which are persistent challenges for South African municipalities.

We expect the city to maintain solid operating surpluses in the next 12-18 months resulting from high collection rates amid a sluggish economic growth.

**Strong financial and debt management practices and sturdy liquidity**

We note that a track record of strong and improved financial management policies and practices should help the city to maintain sound financial metrics despite upcoming infrastructure spending over the medium term. 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 2023. Additionally, the projected recovery of the cash financing to a surplus of 0.3% in 2025, from a minimal requirement of 1.8% in 2023, indicates prudent budgetary practices.

The city's liquidity will remain stable at an average of 25% of operating revenues in the next two years; the city has sufficient liquidity to cover debt obligations.

**Large and diversified economic base**

Cape Town is the economic hub and the capital city of the Western Cape Province. 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. Cape Town performs relatively well when compared to the Western Cape and national unemployment rates, with the fiscal 2023 unemployment rate being 22.5% (which is still high and indicative of an economy where access to economic opportunities remains constrained). In addition to financial services, port activities and tourism contribute significantly 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.

**Rising debt, albeit likely to remain affordable**

Our baseline forecasts project the city's debt burden to rise from 14.7% of operating revenues in 2023 to a still manageable 23.3% in 2025. Advancements in revenue collection could further limit the need for debt financing. The city's medium-term capital spending plans indicate additional long-term borrowing, but it is not planned to exceed a moderate level over the coming decade. The city has good access to funding with a more diverse pool of funders than other South African municipalities. Cape Town's cash and cash equivalents balances cover 170% of its net debt and indirect debt. Its strong liquidity will help to keep its debt burden moderate despite a sizeable capital expenditure plan, amounting to ZAR49 billion over the next five years, which will be invested in infrastructure projects, primarily in water and sanitation, urban mobility, and electricity access.

With the city's commitment to infrastructure-led growth we expect that a larger share of the city's revenues will be allocated to servicing debt in the coming years. Debt service as a percentage of total revenues is also projected to increase from 4.1% in 2023 to 6.6% in 2025. The interest expense as a percentage of operating revenues will increase from 1.5% in 2023 to a projected 2.2% in 2025. The city's operating efficiency is expected to continue improving, which will prevent deterioration of current debt affordability.

**Growing pressure to increase capital spending for social and environmental risks**

The city finances its capital spending program using a mix of debt, grants, and its own source of revenue. Long-term capital investment projects, involving planned spending of approximately ZAR120 billion, are partly debt-funded. These projects primarily focus on water and wastewater management and energy-related initiatives. The energy projects aim to end load-shedding through the use of alternative energy sources, independent power producers (IPPs), and purchasing surplus energy from all producers, including commercial, industrial, and residential. Attention is also given to enhancing the city's safety and security with products like CCTV and drones.

The city successfully alleviated the water crisis in 2018 using a combination of demand reduction and water augmentation projects. The goal is to transform the city from a water-sensitive area to one with a diversified and sustainable water supply. The city's capital expenditure plan, including an additional ZAR7.3 billion in new borrowing for the budget year 2024/25, underscores its commitment to infrastructure-led growth.

The city's exposure to water management risks are a key driver of our environmental risk assessment. Moreover, rising electricity shortages as well as historically poorly maintained infrastructure – which, among inequality and labour market constraints, are key drivers of social risks – also place all South African municipalities under growing capital spending pressure.

### 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

### Cape Town, City of's ESG credit impact score is CIS-4

Exhibit 3
**ESG credit impact score**

CIS-4


ESG considerations have a discernible impact on the current rating, which is lower than it would have been if ESG risks did not exist. The negative impact of ESG considerations on the rating is higher than for an issuer scored CIS-3.

*Source: Moody's Ratings*

City of Cape Town's ESG Credit Impact Score (**CIS-4**) reflects highly negative exposure to environmental and social risks that are largely driven by water stress and weak labor and income, and neutral-to-low governance risks.

Exhibit 4
**ESG issuer profile scores**


*Source: Moody's Ratings*

### Environmental

The City of Cape Town's exposure to environmental risk (**E-4**) mainly relates to physical climate risk (4) and water management (4). The city's main exposures relate to water shortages. Droughts are the most frequent environmental constraint that directly affect 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 is 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

Exposure to social risk (**S-4**) mirrors high labor & income risks (4) as well as high exposure to health and safety risks (4), limited access to basic services (4) and housing shortages (4). The city 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.

### Governance

City of Cape Town's governance risk (**G-2**) reflects high data transparency, with all financial statements, along with medium-term budgets, published publicly on the city's and National Treasury's websites. We view improved management policies and practices, which should help the city to maintain sound financial metrics despite significant partly debt funded capital investments.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

## Rating methodology and scorecard factors

The assigned BCA of ba3 is in line with the BCA scorecard-indicated outcome.

The principal methodology used is the Regional and Local Governments rating methodology, published 28 May 2024.

Exhibit 5

**Cape Town, City of**

**Regional & Local Governments**

| Baseline Credit Assessment – Scorecard | Score | Value | Sub-factor Weighting | Sub-factor Score | Factor Weighting | Total |
|---|---|---|---|---|---|---|
| **Factor 1: Economy** | | | | | **25%** | **2.49** |
| Regional Income [1] | 11.60 | 19059.84 | 15% | 1.74 | | |
| Economic Growth | 12.00 | ba | 5% | 0.60 | | |
| Economic Diversification | 3.00 | aa | 5% | 0.15 | | |
| **Factor 2: Institutional Framework and Governance** | | | | | **30%** | **3.15** |
| Institutional Framework | 15.00 | b | 15% | 2.25 | | |
| Governance | 6.00 | a | 15% | 0.90 | | |
| **Factor 3: Financial Performance** | | | | | **20%** | **1.08** |
| Operating Margin [2] | 7.04 | 11.22% | 10% | 0.70 | | |
| Liquidity Ratio [3] | 1.51 | 24.98% | 5% | 0.08 | | |
| Ease of Access to Funding | 6.00 | a | 5% | 0.30 | | |
| **Factor 4: Leverage** | | | | | **25%** | **0.65** |
| Debt Burden [4] | 1.24 | 14.70% | 15% | 0.19 | | |
| Interest Burden [5] | 4.61 | 1.54% | 10% | 0.46 | | |
| **Preliminary BCA Scorecard-Indicated Outcome (SIO)** | | | | | | **(7.37) a3** |
| **Idiosyncratic Notching** | | | | | | **0.0** |
| **Preliminary BCA SIO After Idiosyncratic Notching** | | | | | | **(7.37) a3** |
| **Sovereign Rating Threshold** | | | | | | **Ba2** |
| **Operating Environment Notching** | | | | | | **-1.0** |
| **BCA Scorecard-Indicated Outcome** | | | | | | **(13.00) ba3** |
| **Assigned BCA** | | | | | | **ba3** |

[1] Regional GDP per capita in terms of purchasing power parity (PPP) terms, in international dollars
[2] Primary Operating Balance / Operating Revenue
[3] Cash and Cash Equivalents / Operating Revenue
[4] Net Direct and Indirect Debt / Operating Revenue
[5] Interest Payments/ Operating Revenue
*Source: Moody's Ratings; Fiscal 2023.*

## Ratings

Exhibit 6

| Category | Moody's Rating |
|---|---|
| **CAPE TOWN, CITY OF** | |
| Outlook | Positive |
| Baseline Credit Assessment | ba3 |
| 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 Ratings*

REPORT NUMBER 1410384

CLIENT SERVICES

| | |
|---|---|
| Americas | 1-212-553-1653 |
| Asia Pacific | 852-3551-3077 |
| Japan | 81-3-5408-4100 |
| EMEA | 44-20-7772-5454 |