

REPORT TO: COUNCIL

1. ITEM NUMBER **MC 33/05/22**

2. SUBJECT

CREDIT RATING OPINION OF THE CITY OF CAPE TOWN

ONDERWERP

OPINIE OOR KREDIETGRADERING VAN DIE STAD KAAPSTAD

ISIHLOKO

**ULUVO OLUNGOKUMISELWA KWINQANABA ELITHILE NGOKWAMATYALA
KWESIXEKO SASEKAPA**

LSUG4064

3. DELEGATED AUTHORITY

In terms of delegation

This report is for NOTING BY

Committee name :

The Executive Mayor together with the Mayoral Committee (MAYCO)

Council

4. DISCUSSION

Moody's Investors Service published their latest credit opinion for the City of Cape Town on 14 April 2022 (Annexure A). It has reaffirmed the existing long- and short-term national and global scale rating of Aa3.za/P-1.za and Ba3/NP, and changed the outlook from negative to stable. This update follows after the City received its 17th consecutive unqualified audit report and after the change in outlook of the sovereign (the Republic of South Africa) from negative to stable.

No Report is for noting only and has no risk implications.

POPIA Compliance Yes It is confirmed that this report has been checked and considered for POPIA compliance.

5 RECOMMENDATIONS

It is recommended that the report on the outcome of the credit opinion issued by Moody's Investors Service on the City of Cape Town, be noted.

AANBEVELING

Daar word aanbeveel dat daar kennis geneem word van die verslag oor die uitslag van die kredietopinie oor die Stad Kaapstad, uitgereik deur Moody's Investors Service.

ISINDULULO

Kundululwe ukuba makuqwalaselwe ingxelo engesiphumo soluvo lokubekwa kwinqanaba elithile ngokwamatyala kweSixeko saseKapa olukhutshwe ngabakwa-Moody's Investors Service.

ANNEXURES

ANNEXURE A: Moody's Credit Rating Opinion dated 14 April 2022

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NAME

COMMENT:

DATE

SIGNATURE

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MAYORAL COMMITTEE MEMBER

NAME

COMMENT:

DATE

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- REPORT COMPLIANT WITH THE PROVISIONS OF COUNCIL'S DELEGATIONS, POLICIES, BY-LAWS AND ALL LEGISLATION RELATING TO THE MATTER UNDER CONSIDERATION.
- NON-COMPLIANT

NAME

COMMENT:

DATE

For information.

SIGNATURE

Joan-Mari Holt Digitally signed by Joan-Mari Holt
Date: 2022.04.25 15:39:00 +02'00'

CREDIT OPINION

14 April 2022

Update

Send Your Feedback

RATINGS

Cape Town, City of

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

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)

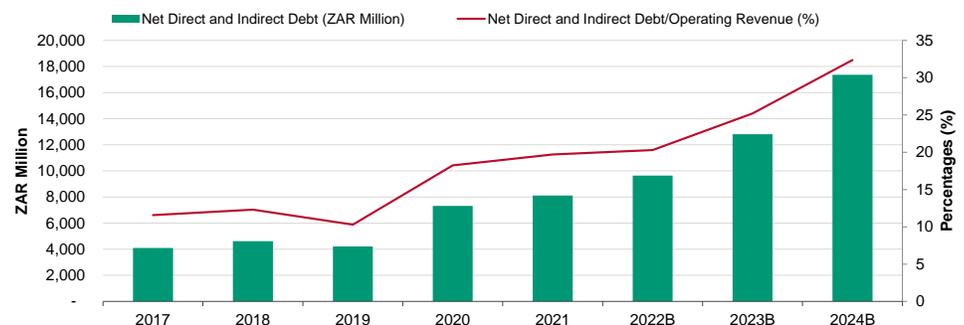
Update Following Sovereign Rating Action

Summary

The credit profile of the [City of Cape Town](#) (Ba3/NP stable) reflects its moderate 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 stable). Although we expect debt to rise gradually over the medium term, it will remain lower than most of its peers, we rate, 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.

B: Issuer budget

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

Credit strengths

- » Robust financial performance,
- » Strong financial and debt management practices
- » Large and diversified economic base
- » Robust 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 outlook is stable, mirroring the drivers of the stable outlook for South Africa (Ba2 stable). Moody's expects the resilient operating environment, in the context of recent shocks, to lead to moderate revenue collections for the RLG sector, resulting in moderate operating performances during the medium term.

Factors that could lead to an upgrade

A rating upgrade is unlikely, considering the stable outlook assigned to the City. Moody's will consider changing the ratings if the city displays robust operating performance and liquidity resilience to the operating environment structural challenges.

Factors that could lead to a downgrade

Moody's will consider a further downgrade of the ratings if the city experiences significant deterioration in operating performance and liquidity. A ratings downgrade will also be considered in case of a Sovereign downgrade.

Key indicators

Exhibit 2

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	10.3	18.2	19.7	20.3	25.2	32.4
Interest Payments/Operating Revenue (%)	2.1	2.1	1.8	2.0	2.0	1.7	2.5	2.8
Gross Operating Balance/Operating Revenue (%)	15.0	15.5	17.7	6.8	1.2	4.7	5.9	5.8
Cash Financing Surplus (Requirement)/Total Revenue (%)	0.9	3.3	7.1	0.6	-2.0	-5.4	-3.8	-7.7
Intergovernmental Transfer/Operating Revenue (%)	16.5	17.1	17.4	12.4	14.0	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.

B: Issuer budget

Source: Moody's Investors Service

Detailed credit considerations

On 7 April 2022, Moody's affirmed the City of Cape Town's long-term global scale (LT GSR) and long-term national scale (LT NSR) issuer and debt ratings of Ba3/Aa3.za, to reflect the city's resilient operating performance and liquidity. 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 1.2% of operating revenues, for the fiscal year ended 30 June 2021. Moody's expects

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 to maintain moderate operating balances in the medium term, with forecasts indicating an average GOB/operating revenue of 5.5% during fiscal 2022-24.

The city has high revenue-generating capacity, with its own-source revenue contributing 86% 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 75% 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, 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 2021. However, operating environment structural challenges will add some pressure to the city's overall performance in the next three fiscal years, although the city continues to follow prudent financial management policies.

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 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 cash ratio (Cash And Cash Equivalents) / (Current Liabilities + Current/ Short-Term Debt) of 1x 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 cash ratio of 0.6x, between fiscal 2022-2024.

Rising debt

Net Direct and Indirect Debt (NDID) remained very low at 19.7% of operating revenues, for the fiscal year ended 2021. 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 increase to 32.3% 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 bonds 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). Cape Town's debt is set to increase to fund its increasing capital spending. As per the 2021/2022 budget, 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 2% 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

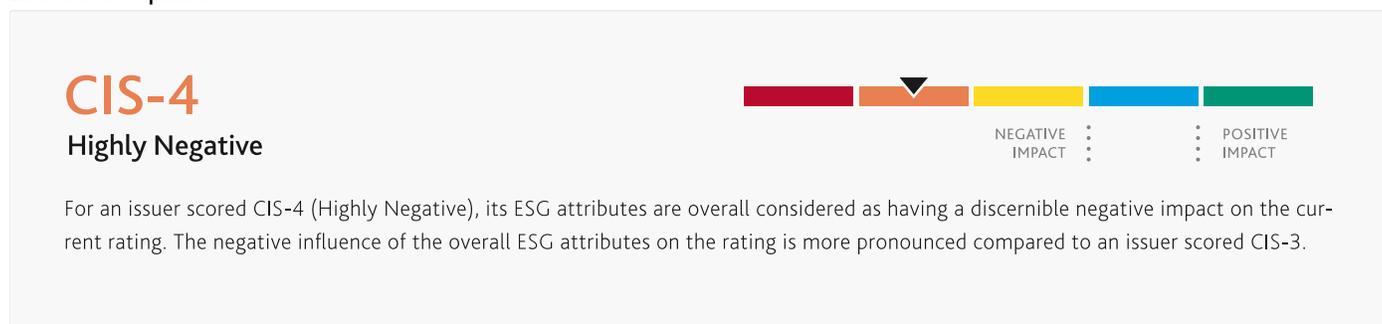
The City of Cape Town has a low likelihood of extraordinary support from the national government, reflecting, at the jurisdictional level, the national government's policy stance of promoting greater accountability for South African municipalities. This assessment is in line with the national government's 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

CAPE TOWN, CITY OF's ESG Credit Impact Score is Highly Negative CIS-4

Exhibit 3

ESG Credit Impact Score



Source: Moody's Investors Service

City of Cape Town's ESG Credit Impact Score is highly negative (**CIS-4**), reflecting a 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 Investors Service

Environmental

City of Cape Town's highly negative exposure to environmental risk, reflected in its **E-4** issuer profile score, mainly relates to physical climate risk and water management. 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 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 is highly negative (**S-4** issuer profile score), mirroring the high labor & income risk and as well as high exposure to health and safety risks. 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. 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

We assess the City of Cape Town's governance issuer profile score as neutral to low (**G-2** issuer profile score). Data transparency is high, with all financial statements, along with medium-term budgets, published publicly on the city's and National Treasury's websites.

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 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 5

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				3	30%	0.90
Operating Margin [2]	1	5.13%	12.5%			
Interest Burden [3]	3	1.97%	12.5%			
Liquidity	5		25%			
Debt Burden [4]	1	19.69%	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						4.08 (4)
Systemic Risk Assessment						Ba2
Scorecard-Indicated BCA Outcome						ba3
Assigned 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 6

Category	Moody's Rating
CAPE TOWN, CITY OF	
Outlook	Stable
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 Investors Service

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