

CREDIT OPINION

7 February 2019

Update

✓ Rate this Research

RATINGS

Ekurhuleni, City of

Domicile	South Africa
Long Term Rating	Baa3
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 Ekurhuleni (South Africa)

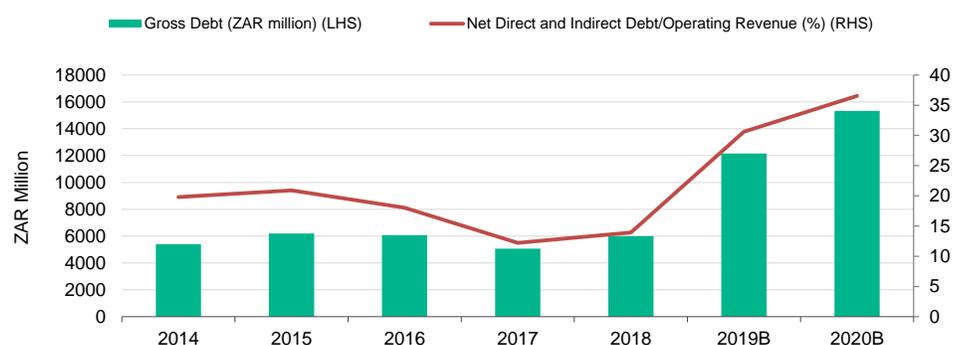
Update to credit analysis

Summary

The credit profile of the [City of Ekurhuleni](#) (Baa3/Aaa.za stable) reflects its stable financial performance, supported by a large and diverse economic base, and significant, predictable revenue from service charges and property taxes. The credit profile also reflects challenges associated with rising debt due to an increase in planned capital spending over the next three years. The city's consistently strong liquidity remains above the average of its rated peers in [South Africa](#) (Baa3 stable) and will mitigate its exposure to increasing capital requirements.

Exhibit 1

Ekurhuleni's debt will increase substantially but remain in line with rated domestic peers



B: Budget

Sources: City of Ekurhuleni, Moody's Investors Service

Credit strengths

- » Robust financial performance, reflecting strong revenue growth
- » Strong liquidity
- » Large economy with a strong industrial base
- » Conservative financial management

Credit challenges

- » High capital spending pressure for service delivery
- » Rising debt levels, though these will remain in line with rated South African peers

Rating outlook

The stable rating outlook reflects our expectation that the City of Ekurhuleni will sustain its comparatively strong financial performance and liquidity despite increased capital spending and debt over the next three years. Its track record of prudent budgetary management supports the outlook.

Factors that could lead to an upgrade

An upgrade to the city's Baa3 global scale rating would largely depend on the rating of its support provider, the [Government of South Africa](#) (Baa3 stable), being upgraded.

Factors that could lead to a downgrade

Although a downgrade is currently unlikely in view of the stable outlook, we would consider downgrading the city's rating if its operating performance deteriorated unexpectedly and its liquidity reduced substantially. We would also downgrade its global scale rating if South Africa's government bond rating is downgraded.

Key indicators

Exhibit 2

City of Ekurhuleni

Year ending 30 June 2018

Key Indicators						
Ekurhuleni, Metropolitan Municipality of						
	2013	2014	2015	2016	2017	2018
Net direct and indirect debt/Operating revenue (%)	20.6	19.8	20.9	18.0	12.2	13.9
Interest Payments/Operating Revenue (%)	2.5	2.5	2.3	3.3	3.0	2.9
Gross Operating Balance/Operating Revenue (%)	8.5	9.5	8.3	6.1	3.9	3.5
Cash Financing Surplus (Requirement)/Total Revenue (%)	5.2	4.9	3.9	1.9	-5.9	-9.6
Intergovernmental Transfer/Operating Revenue (%)	16.5	15.5	15.3	16.2	17.0	16.7
Real GDP (% change) [1]	2.6	2.1	1.3	1.4	-	-
GDP per capita as % of National Average	141.1	143.6	142.1	143.5	-	-
[1] GDP at provincial level.						

Source: City of Ekurhuleni, Moody's Investors Service

Detailed credit considerations

The credit profile of the City of Ekurhuleni, as expressed in a Baa3/Aaa.za rating, combines (1) a Baseline Credit Assessment (BCA) of baa3, and (2) a moderate likelihood of extraordinary national government support should the city face acute liquidity stress.

Baseline Credit Assessment

Robust financial performance reflects strong revenue growth

With total revenue of ZAR34.3 billion (\$2.7 billion) for fiscal year 2018, ended 30 June 2018, Ekurhuleni ranks third among the six South African metropolitan municipalities we rate in respect of total revenue after [City of Cape Town](#) (Baa3 negative) and [City of Johannesburg](#) (Baa3 negative).

The city's operating performance has generally been favourable. Its gross operating balance averaged 6% of operating revenue between fiscal 2014 and fiscal 2018, driven largely by service charges, property rates and fiscal transfers from the national government. We expect the gross operating balance to rise to 7% of operating revenue over the next three years.

Operating revenue growth is likely to remain strong at an average 9% over fiscal 2019-21, supporting a strong budgetary performance. Service charges and property rates accounted for 77% of operating revenue in fiscal 2018 and are expected to account for 75% in fiscal 2019.

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.

Discretionary own source revenue accounted for 82% of operating revenue in fiscal 2018. It is expected to increase to 83% in fiscal 2019, reflecting the city's strong capacity to generate own-source revenue.

Nondiscretionary items such as costs related to Ekurhuleni's approximately 15,000 employees and bulk purchases related to water and electricity are the main contributors to operating expenditure. They accounted for a high 67% in fiscal 2018 and are expected to account for 68% and 69% in fiscal 2019 and 2020, respectively, providing the city with very limited spending flexibility.

Strong liquidity

Consistently strong liquidity, which provides a significant measure of stability, supports Ekurhuleni's credit profile. Although cash and investments of ZAR4 billion as of 30 June 2018 were down 31% from a year earlier, mainly because the city financed ZAR3.1 billion of capital spending from its own funds, its liquidity ratio of 1.3x for fiscal 2018 was in line with the average for rated South African peers.

We expect liquidity to remain strong despite a planned increase in capital spending. The city expects cash and cash equivalents to begin to build in fiscal 2019, notwithstanding higher capital spending, helping to improve its liquidity ratio to an average 1.7x over the coming three financial years (starting July 2018).

Large economy, with a strong industrial base

Ekurhuleni's economic base is large and relatively dynamic, and driven by manufacturing. Wholesale and retail trade and finance and business services are also significant contributors, providing a level of diversification. Ekurhuleni's population of approximately 3.5 million accounts for 25% of the population of Gauteng province and 5.8% of the population of South Africa. The city accounts for around 8.1% of national economic output.

Ekurhuleni's well developed transport network has contributed to notable industrial growth. Oliver Tambo International Airport is the busiest in Africa and the city is building on this economic advantage. A local economic development plan has identified a number of projects, primarily around the airport precinct, to promote economic growth and job creation.

Typical of large municipalities in South Africa, migration to the area presents a challenge. Growing informal settlements are putting significant pressure on spending because of the need to provide basic services, including housing.

Conservative financial management

Ekurhuleni has traditionally displayed conservative financial management and good budgetary planning, and we expect it to continue to do so over the next three years. However, while it has strengthened revenue collection and managed spending prudently, its intention to reduce infrastructure backlogs through annual capital spending increases over the next three years will put pressure on its levels of indebtedness.

High capital expenditure pressure for service delivery

An increase in Ekurhuleni's population due to urbanisation and the city's mandate to provide basic services mean that local authorities remain under pressure to increase capital spending to meet demand for services and improve local residents' quality of life. The city plans to increase capital infrastructure spending to ZAR20 billion in fiscal 2019-21, a 43% rise from ZAR14 billion in fiscal 2016-18.

The bulk of this budget is earmarked for social housing and basic services. Borrowing will provide 52% of the funding, government transfers 35% and Ekurhuleni's own funds just 13%. As a result, the city's gross debt will increase to ZAR18 billion in fiscal 2021 from ZAR6 billion in fiscal 2018.

Rising debt levels, though these will remain in line with rated South African peers

Ekurhuleni's medium-term budget sees net direct and indirect debt increasing to 30.6% of operating revenue in fiscal 2019 from a low 13.9% in fiscal 2018, but its overall indebtedness will remain in line with rated South African peers. Plans to spend ZAR6.5 billion on capital infrastructure in fiscal 2019 compared with ZAR5.3 billion in fiscal 2018 is behind the projected debt increase.

Ekurhuleni's debt stock consists of amortising bonds (49%), bullet bonds (34%) and bank loans (17%), and has an average maturity of six years. Interest expenses for fiscal 2018 amounted to around ZAR921 million, or 2.9% of operating revenue, and are expected to increase to ZAR992 million in fiscal 2019 and ZAR1.2 billion in 2021. However, interest expense to operating revenue is expected fall to an average 2.8% over the next three years as operating revenue rises more rapidly.

Ekurhuleni's commitment to focusing on infrastructure investments will continue to require debt financing. As a result, debt levels will increase over the next three years, consisting of amortising and bullet bank loans. However, revenue growth and strong liquidity will mitigate the fiscal pressure from rising levels of debt.

Extraordinary support considerations

We view the City of Ekurhuleni as having a moderate likelihood of extraordinary support from the Government of South Africa. This reflects our assessment of the national government's policy stance, at the jurisdictional level, of promoting greater accountability and financial sustainability for South African municipalities. The reputational risk for the national government is modest given the predominance of bank loans as opposed to bonds.

Although the new legal framework regulates the recovery of municipalities experiencing financial difficulties, it does not suggest timely extraordinary bailout actions to avoid defaults on debt obligations. However, the government has an interest in addressing major financial problems that metropolitan municipalities could experience, given their relative importance countrywide.

Rating methodology and scorecard factors

The City of Ekurhuleni's assigned Baseline Credit Assessment (BCA) of baa3 is close to the BCA of ba1 generated by the scorecard. The matrix-generated BCA of ba1 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 Baa3, as reflected in the sovereign bond rating for South Africa (Baa3 Stable). For details of our ratings approach, please refer to [Rating Methodology: Regional and Local Governments](#), January 16, 2018.

Exhibit 3

Rating Factors						
Ekurhuleni, City of						
Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	1	140.87	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 (%)	5	3.99	12.5%	1.75	30%	0.53
Interest payments / operating revenues (%)	3	2.99	12.5%			
Liquidity	1		25%			
Net direct and indirect debt / operating revenues (%)	1	13.90	25%			
Short-term direct debt / total direct debt (%)	1	8.40	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						2.03(2)
Systemic Risk Assessment						Baa3
Suggested BCA						ba1

Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
EKURHULENI, CITY OF	
Outlook	Stable
Issuer Rating -Dom Curr	Baa3
NSR Issuer Rating	Aaa.za
Senior Unsecured -Dom Curr	Baa3
NSR Senior Unsecured	Aaa.za
ST Issuer Rating -Dom Curr	P-3
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

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