

## CREDIT OPINION

3 December 2020

### Update

 Rate this Research

#### RATINGS

##### Johannesburg, City of

Domicile	Johannesburg, 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.

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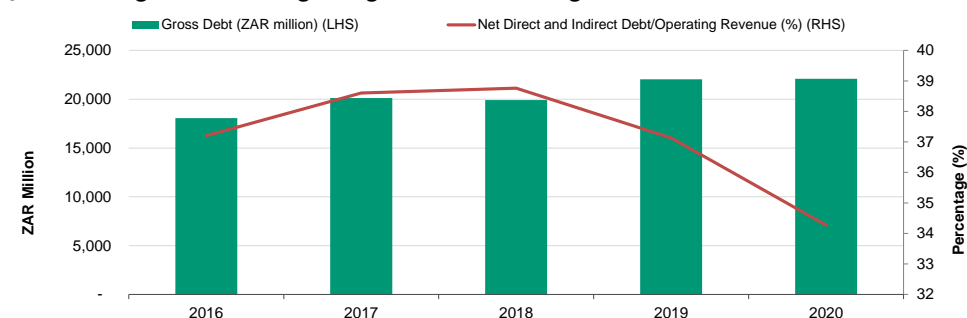
## City of Johannesburg (South Africa)

### Update following rating downgrade to Ba2

The credit profile of the [City of Johannesburg](#) (Ba2 negative) reflects the city's status as [South Africa's](#) (Ba2 negative) business capital and main financial and economic centre, which allows it to access a broad tax base. The city's credit profile also reflects the challenges associated with its high infrastructure backlog and rapid population growth, which strain its capital infrastructure plans. Nonetheless, the credit profile incorporates the city's moderate debt levels, and improving liquidity and operating performance. The negative outlook reflects the weakening of the credit profile of its support provider, the Government of South Africa. The coronavirus pandemic and the associated deterioration in the global and national economic outlooks have constrained the city's financial performance through lower revenue collection as a result of higher unemployment.

Exhibit 1

#### Johannesburg's debt stock is growing, but remains manageable



Fiscal year ending 30 June.

Sources: Moody's Investors Service and City of Johannesburg's financials

### Credit strengths

- » Strong operating performance, although affected by the coronavirus impact
- » Improving liquidity
- » Sophisticated financial management
- » Large and diversified economic base

### Credit challenges

- » Increasing debt stock but to remain manageable
- » High capital spending plan

## Rating outlook

Johannesburg's negative rating outlook reflects the weakening of the credit profile of the city's support provider, the Government of South Africa, taking into account the strong operational and financial links between the two.

## Factors that could lead to an upgrade

Given the negative outlook, an upgrade is unlikely at this time. The outlook could be changed to stable if the outlook on the sovereign rating changes to stable from negative.

## Factors that could lead to a downgrade

The rating could be downgraded in the event of a downgrade of the Ba2 sovereign rating. Additionally, the city's rating could be downgraded if its liquidity and financial performance deteriorate.

## Key indicators

Exhibit 2

### City of Johannesburg

	2016	2017	2018	2019	2020 [1]
<b>City of Johannesburg</b>					
Net direct and indirect debt/Operating revenue (%)	37.2	38.6	38.8	37.1	34.3
Interest Payments/Operating Revenue (%)	4.7	5.7	5.7	4.8	4.1
Gross Operating Balance/Operating Revenue (%)	7.5	2.2	5.4	13.0	9.4
Cash Financing Surplus (Requirement)/Total Revenue (%)	-6.0	-6.8	-1.1	2.1	0.6
Intergovernmental Transfer/Operating Revenue (%)	14.6	15.5	16.0	15.1	14.9
GDP Growth (% change) [2]	1.4	1.1	1.1	-	-
GDP per capita as % of National Average	142.3	135.6	135.8	-	-
[1] 2020 AFS unaudited					
[2] GDP at Provincial level					

Fiscal year ending 30 June.

Sources: Moody's Investors Service and City of Johannesburg's financials

## Detailed credit considerations

On 25 November 2020, we downgraded the City of Johannesburg's global scale long-term and short-term issuer and debt ratings to Ba2/NP from Ba1/NP, reflecting the challenges stemming 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 factors that keep 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 at Aa1.za/P-1.za.

The credit profile of the City of Johannesburg, as expressed in its Ba2/NP negative global scale ratings, combines the city's Baseline Credit Assessment (BCA) of ba2 and a low likelihood of extraordinary support from the national government if the city faces acute liquidity stress.

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.moodys.com](http://www.moodys.com) for the most updated credit rating action information and rating history.

### Baseline Credit Assessment

#### Strong operating performance, although affected by the coronavirus impact

Johannesburg is South Africa's largest city in terms of budget size, with total revenue of ZAR58.1 billion, according to the city's 2020 unaudited financial statements for the fiscal year ended 30 June 2020. The City of Johannesburg's operating performance declined in fiscal 2020 as a result of higher-than-expected operating expenditure. Operating expenditure increased by 7%, while operating revenue grew by 5%. As a result, the city's gross operating balance/operating revenue decreased to 9% in fiscal 2020 from 13% in fiscal 2019. We forecast that the city's Gross Operating Balance (GOB)/operating revenue to slightly improve in 2021.

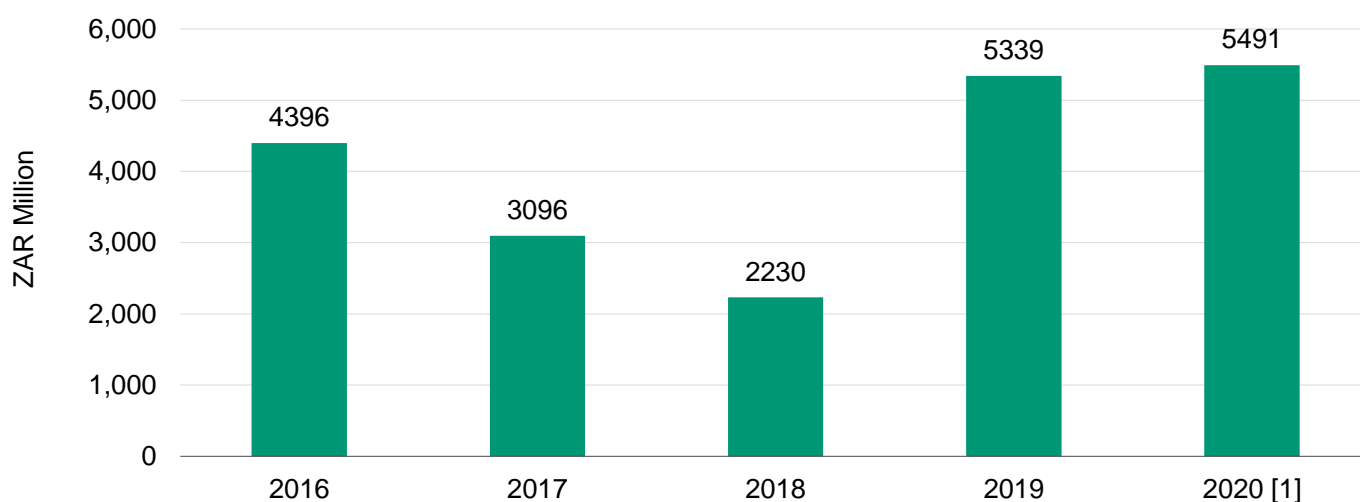
Discretionary own-source revenue contributed 83% of operating revenue in fiscal 2020, reflecting the city's high revenue flexibility, and its large and steadily growing tax base. On the spending side, rigid cost items, such as bulk purchases and salary costs, represented a high 67% of operating expenditure in fiscal 2020, limiting the city's ability to reduce its operating expenditure.

#### Improving liquidity position

The city's decision to delay some capital expenditure and aggressive credit control measures contributed to the city slightly improved closing cash balance. However, its liquidity position remains moderate compared with that of its peers. The city's quick ratio declined to 0.34x in fiscal 2020 from 0.37x in fiscal 2019. We expect the city's liquidity position to improve in fiscal 2021.

Exhibit 3

#### City of Johannesburg's 2020 cash position slightly improved despite coronavirus impact



2020 AFS: unaudited

Source: City of Johannesburg & Moody's calculations

#### Sophisticated financial management

The City of Johannesburg's strong administration has implemented a number of strategies aimed at strengthening its financial management and reporting. The city achieved an unqualified audit opinion in fiscal 2019 for the seventh year in a row, indicating a continued improvement in its financial management. The city's status as the country's business capital and its very large revenue base helped it achieve sound financial management and budget planning. These initiatives support our view that an increase in capital spending will not cause the city's overall financial performance to deteriorate.

#### Large and diversified economic base

Johannesburg is South Africa's largest city and the country's business capital. The city is home to most of the corporate headquarters in the country. Gauteng Province, where Johannesburg is located, contributes more than one-third to the country's GDP and has a GDP per

capita that is higher than the national average. Johannesburg has the largest metropolitan economy in the country, contributing about 15% of South Africa's GDP.

Johannesburg is South Africa's most populous city by a significant margin, being home to an estimated 5.3 million people in 2018, 9.0% of South Africa's population. Projections show that Johannesburg's population could increase to around 5.43 million by 2021, presenting potentially significant challenges and opportunities. In terms of population change dynamics in South African cities, Johannesburg's population growth has been the highest (96.4%) since 1996 among all South African metros. High unemployment and the infrastructure backlog pose challenges for the city's growing population. Over the past three years, the city's administration has implemented a number of strategies, such as inner city regeneration, "operation Buya Mthetho" (bring back the law) and Diphetogo (changes), which attracted a number of businesses to help revive the city's economy, in particular within the inner city precinct. As of fiscal 2019, the city had released 154 inner city properties to private investors, with a signed lease value amounting to ZAR1.7 billion. The city expects these properties to generate investment of about ZAR32 billion on completion, create over 11,000 jobs and provide 6,500 affordable houses. The city's central location, among other factors, underpins the dominance of trade and finance in its economy.

Diversified economic sectors support Johannesburg's large economic base. Johannesburg's economy is dominated by the services sector, which is responsible for 76% of the city's economic output. The finance sector is the largest, accounting for 28% of the city's economy, while community services contribute 24% and other sectors collectively account for 48% of economic activity. The city's infrastructure is also well developed, which allows it to continue to expand its economic base. However, maintaining the existing infrastructure may prove to be a challenge if Johannesburg does not realise its capital spending plans. A failure to execute capital infrastructure spending against a backdrop of high unemployment and rapid population growth will intensify the service delivery backlog and exert further spending pressure on the city.

#### **Increasing debt stock, although the debt ratio will remain relatively stable**

The City of Johannesburg accounted for about 34% of the total municipal debt in South Africa, and its outstanding bonds accounted for 37% of total municipal bonds as of the second quarter of fiscal 2018. The city recorded net direct and indirect debt/operating revenue of 34% in fiscal 2020, a slightly lower than 37% in fiscal 2019. The city's next bond redemption of ZAR850 million is due in March 2021. The city also manages a sinking fund for non-amortising debt, which helps ensure it has sufficient funds for maturities. Although Johannesburg's debt stock is projected to increase over the next three years, in line with the city's planned borrowing of ZAR8.7 billion for the period, the expected improvement in operating revenue will offset the city's growing debt ratio. We expect the city's debt levels to remain below 40% of operating revenue in 2023.

#### **High capital spending plan**

The infrastructure backlog and rapid population growth continue to exert pressure on the city to increase capital investments. Over the next three fiscal years, 2021-23, Johannesburg has reduced its capital expenditure plan to ZAR19 billion from earlier projections of ZAR22.6 billion due to uncertainties related to the coronavirus impact. Funding for the city's planned capital investments will be relatively diversified. The City of Johannesburg will fund up to 35% of its total infrastructure investment with borrowings, while its own funds and government grants will contribute 32% and 33%, respectively.

The projected capital investments will focus on key infrastructure requirements such as electricity; water-related services; and economic development infrastructure, including social housing, roads and the public transportation system. Although its capital investments have increased substantially over the past five years, the city still faces significant challenges from its historical infrastructure backlog and rapid population growth over the past two decades.

#### **Extraordinary support considerations**

The City of Johannesburg has a low likelihood of receiving 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 Johannesburg

We take account of the impact of ESG factors when assessing sub-sovereign issuers' economic and financial strength. In the case of the City of Johannesburg, the materiality of ESG factors to its credit profile is as follows:

Environmental considerations are material to the City of Johannesburg's credit profile. Similar to the rest of South Africa, its main exposures relate to water shortages. 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.

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 pressures. Demographic pressures are likely to continue to grow 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 its 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 the local governments in the country, creating risks of social unrest. We also view the coronavirus pandemic as a social risk under our ESG framework, given the impact for public health and safety in the City of Johannesburg.

Governance considerations are material to the City of Johannesburg's credit profile. The city's strong administration has managed to implement prudent financial practices over the years, which have led to the city attaining an unqualified audit opinion over the past five years. Similar to those of all local governments in South Africa, Johannesburg's financial undertakings are guided by the Municipal Finance Management Act and by the national government, through the treasury, which plays an oversight role. Data transparency is very 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 ESG Risks](#), published in January 2019.

### Rating methodology and scorecard factors

The assigned BCA of ba2 is the same as the BCA of ba2 generated by the scorecard. The matrix-generated BCA of ba2 reflects an Idiosyncratic Risk score of 3 (presented below) on a scale of 1-9, 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 for South Africa.

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

Exhibit 4

**City of Johannesburg**  
 Regional and Local Governments

**Johannesburg, City of**

Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
<b>Factor 1: Economic Fundamentals</b>						
Economic strength	1	135.77	70%	1	20%	0.20
Economic volatility	1		30%			
<b>Factor 2: Institutional Framework</b>						
Legislative background	5		50%	6	20%	1.20
Financial flexibility	7		50%			
<b>Factor 3: Financial Performance and Debt Profile</b>						
Gross operating balance / operating revenues (%)	1	12.34	12.5%	2.5	30%	0.75
Interest payments / operating revenues (%)	5	4.50	12.5%			
Liquidity	5		25%			
Net direct and indirect debt / operating revenues (%)	1	34.30	25%			
Short-term direct debt / total direct debt (%)	1	8.80	25%			
<b>Factor 4: Governance and Management - MAX</b>						
Risk controls and financial management	1			1	30%	0.30
Investment and debt management	1					
Transparency and disclosure	1					
<b>Idiosyncratic Risk Assessment</b>						<b>2.45(2)</b>
<b>Systemic Risk Assessment</b>						<b>Ba2</b>
<b>Suggested BCA</b>						<b>ba2</b>

Fiscal 2019.

Source: Moody's Investors Service

## Ratings

Exhibit 5

Category	Moody's Rating
JOHANNESBURG, CITY OF	
Outlook	Negative
Issuer Rating -Dom Curr	Ba2
NSR Issuer Rating	Aa1.za
Senior Unsecured -Dom Curr	Ba2
NSR Senior Unsecured	Aa1.za
ST Issuer Rating -Dom Curr	NP
NSR ST Issuer Rating	P-1.za

Source: Moody's Investors Service

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