

CREDIT OPINION

30 July 2021

Update

 Rate this Research

RATINGS

Johannesburg, City of

Domicile	Johannesburg, South Africa
Long Term Rating	Ba3 , Possible Downgrade
Type	LT Issuer Rating - Dom Curr
Outlook	Rating(s) Under Review

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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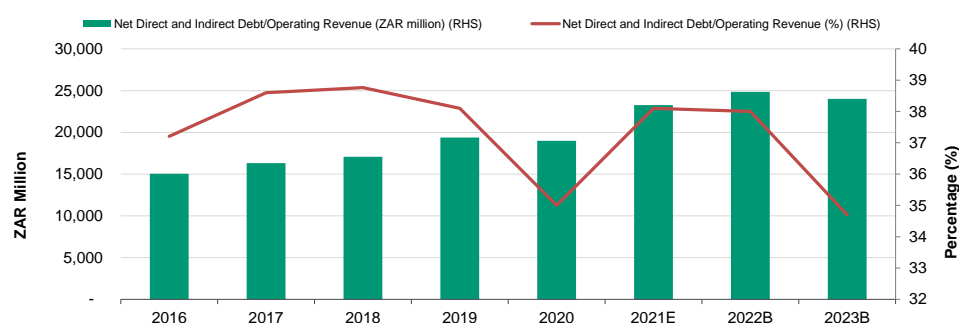
City of Johannesburg (South Africa)

Update following the downgrade

The credit profile of the [City of Johannesburg](#) (Ba3 rating on review) 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 credit profile also incorporates the city's manageable debt levels, and improving operating performance, although likely to be under pressure in the coming years. The placement of the rating on review reflect the uncertainty surrounding the city's ability to withstand the deterioration in the operating environment driven by the structural economic weaknesses as well as the ongoing disruption caused by the coronavirus pandemic, which is likely to constrain the city's financial performance through lower revenue collection.

Exhibit 1

Johannesburg's debt stock is growing, but remains manageable



Fiscal year ending 30 June.

E: Issuer estimates

B: Issuer budget

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

Credit strengths

- » Strong operating performance which will be challenged by the impact of the pandemic
- » Gradually improving liquidity position
- » Sophisticated financial management
- » Large and diversified economic base

Credit challenges

- » Increasing debt stock, although the debt ratio should remain relatively stable
- » High capital spending plan

Rating outlook

The placement of the rating on review for downgrade reflects downside risks related to the city's difficult operating environment and performance because revenue could fall short of previous expectations while cash buffers diminish. The review period will allow us to assess the prospects for the city's operating balance, cash position, financing needs, as well as its ability to secure additional financing over the next three years. We will also assess the city's likely policy response and contingency planning in case of more pronounced revenue shortfalls than currently expected or constrained access to funding.

Factors that could lead to an upgrade

Given the fact that the rating has been placed on review for downgrade, an upgrade is currently unlikely. However, we could confirm the rating if the city is likely to face only limited revenue shortfall and retain its current cash balances, and if it is able to rely on secure and comprehensive funding.

Factors that could lead to a downgrade

The city's rating could be downgraded if we see increasing risks that financing may not be forthcoming; and liquidity buffers depleted to levels not consistent with the current rating. Additionally, the rating would be strained if the Ba2 sovereign rating were to be downgraded.

Key indicators

Exhibit 2

City of Johannesburg

	2016	2017	2018	2019	2020	2021 E	2022 B	2023 B
City of Johannesburg								
Net direct and indirect debt/Operating revenue (%)	37.2	38.6	38.8	38.1	35.0	38.1	38.0	34.7
Interest Payments/Operating Revenue (%)	4.7	5.7	5.7	4.9	4.7	5.0	4.9	4.8
Gross Operating Balance/Operating Revenue (%)	7.5	2.2	5.4	10.4	5.1	7.0	7.2	8.1
Cash Financing Surplus (Requirement)/Total Revenue (%)	-6.0	-6.8	-1.1	2.0	0.7	-2.7	-2.7	1.4
Intergovernmental Transfer/Operating Revenue (%)	14.6	15.5	16.0	15.5	15.8	17.0	16.3	15.5
GDP Growth (% change) [1]	1.4	1.1	1.1	-	-	-	-	-
GDP per capita as % of National Average	142.3	135.6	135.6	-	-	-	-	-
[1] GDP at Provincial level								

[1] GDP at the provincial level.

2021 E: Estimates, 2022-2023 B: Budget.

Fiscal year ending 30 June.

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

Detailed credit considerations

On 16 July 2021, we downgraded the City of Johannesburg's long-term global scale issuer and debt ratings to Ba3/A1.za (from Ba2/Aa1.za) to reflect the structurally very weak growth in the country which we expect to strain the municipalities operations in the coming years given their reliance on own-source revenue. As the country continues to face economic challenges, exacerbated by strict lockdown measures, we expect the municipal sector to experience operating pressures in the next two years, which will put pressure on operating balances.

The credit profile of the City of Johannesburg, as expressed in its Ba3 rating combines the city's Baseline Credit Assessment (BCA) of ba3 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.moody's.com for the most updated credit rating action information and rating history.

Baseline Credit Assessment

Strong operating performance which will be challenged by the impact of the pandemic

Johannesburg is South Africa's largest city in terms of budget size, with total revenue of ZAR58.4 billion, according to the city's 2020 financial statements for the fiscal year ended 30 June 2020 (fiscal 2020). The City of Johannesburg's total revenue grew by only 5.7% in fiscal 2020 compared to 14.4% recorded in 2019. The decline in service demand was driven by the economic lock-down implemented by the government to reduce the coronavirus impact. Despite the difficult environment, the city managed to contain expenditure growth, which increased by 7.8%, in 2020 compared with 9.6% in 2019. The expenditure growth was mainly driven by salary costs, which grew by 18% in 2020 to ZAR14.8 billion from ZAR12.6 billion in 2019. Although salary costs recorded a higher increase as a percentage of expenditure, they still contribute 25.8% of operating expenditure in 2020 down from 26.1% recorded in 2019. Bulk purchases grew by 7% to 17.7 billion in 2020 from ZAR16.5 billion in 2019.

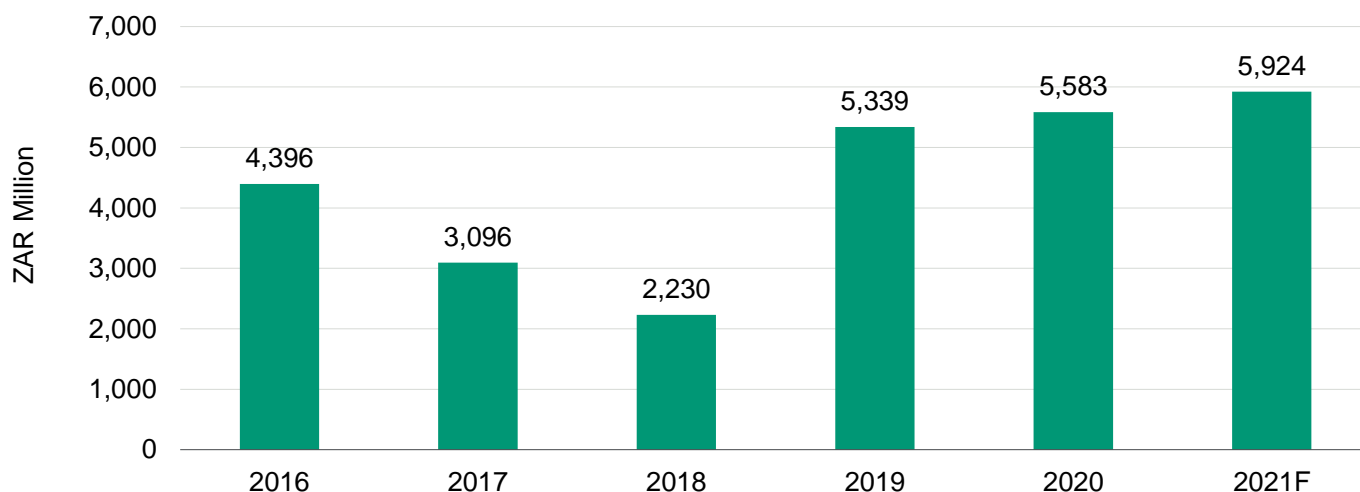
The impact of declining service demand resulted in the city's recording a low gross operating balance to operating revenue of 5.1% in fiscal 2020 compared to 10.4% recorded in fiscal 2019. According to the medium-term budget, the city's operating performance is likely to gradually improve, although at a lower rate compared with the previous three years. We believe that the challenging operating environment and the possibility of increasing consumer pressure will challenge the city's plan to increase its gross operating balance to operating revenue ratio to an average of 7.4% in fiscal 2021-23.

Gradually improving liquidity position

The city's aggressive credit control measures contributed to the city's gradual improvement its closing cash balance over the past three years. However, its liquidity position remains weaker compared with its peers rate at the high end of the rating scale. The city's quick ratio declined to 0.45x in fiscal 2020 from 0.46x in fiscal 2019. Although the city's cash balance is gradually improving, in the medium term budget, the city expects to post a cash financing deficit of ZAR1.7 billion in 2021 and ZAR1.8 billion in 2022, which will likely be covered through borrowing or from reserves. As we expect some deterioration in the operating and liquidity metrics for municipalities in the next 12-18 months, we expect financial institutions and other public sector lenders to further tighten their credit control processes. We will monitor whether this could affect the city's ability to access external funding in near to medium term.

Exhibit 3

City of Johannesburg's 2020 cash position slightly improved despite the impact of the pandemic



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

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 2020 for the eighth 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 has helped it achieve sound financial management and budget planning. Due to the deteriorating operating environment and the likely operating pressure the city will face, it will have to manage larger deficits in the coming years to be covered through borrowing or from reserves.

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 of 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% 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 should remain relatively stable

As of the second quarter of fiscal 2021, the City of Johannesburg accounted for about 35% of the total municipal debt in South Africa. The city recorded net direct and indirect debt/operating revenue of 35% in fiscal 2020, slightly lower than 38% in fiscal 2019. The city has also redeemed its ZAR850 million bond that was due in March 2021 funded from the sinking fund. As of 31 March 2021, the city continued to manage its sinking fund investments of ZAR2.5 billion 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 borrowing plan of ZAR8.7 billion for the period (2021-23), the likely improvement in operating revenue will offset the city's growing debt ratio. We expect the city's debt to remain below 40% of operating revenue in 2023. That said, there are significant downside risks to these projections given the uncertainty that the pandemic creates on revenue collection.

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 (fiscal 2021-23), Johannesburg expects to spend ZAR24.3 billion on capital infrastructure. The city's capital infrastructure remains relatively diversified. The city will fund up to 36% of its total infrastructure investment from borrowing, while its own funds and government grants will contribute 27% and 37%, respectively. Significant reliance on borrowing could be challenging in the event of a further deterioration in the operating environment, which may lead to lenders to tighten the borrowing requirements.

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 demography-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 pandemic as a social risk under our ESG framework, given the impact of public health and safety on 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 June 2021.

Rating methodology and scorecard factors

The City of Johannesburg's assigned BCA of ba3 is in line with 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 4

Johannesburg, City of Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				1	20%	0.20
Economic Strength [1]	1	135.58%	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				3.25	30%	0.98
Operating Margin [2]	3	6.67%	12.5%			
Interest Burden [3]	5	4.88%	12.5%			
Liquidity	5		25%			
Debt Burden [4]	3	35.03%	25%			
Debt Structure [5]	1	8.78%	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						3.88 (4)
Systemic Risk Assessment						Ba2
Suggested BCA						ba3

[1] Local GDP per capita as a percentage of national GDP per capita.

[2] Gross operating balance/operating revenue.

[3] Interest payments/operating revenue.

[4] Net direct and indirect debt/operating revenue.

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

Source: Moody's Investors Service, Fiscal year 2020

Ratings

Exhibit 5

Category	Moody's Rating
JOHANNESBURG, CITY OF	
Outlook	Rating(s) Under Review
Issuer Rating -Dom Curr	Ba3 ¹
NSR Issuer Rating	A1.za ¹
Senior Unsecured -Dom Curr	Ba3 ¹
NSR Senior Unsecured	A1.za ¹
ST Issuer Rating -Dom Curr	NP
NSR ST Issuer Rating	P-1.za ¹

[1] Placed under review for possible downgrade on 16 July 2021.

Source: Moody's Investors Service

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