MOODY'S INVESTORS SERVICE

CREDIT OPINION
6 April 2017

Update

Rate this Research

RATINGS

Johannesburg, City of

Domicile	Johannesburg, South Africa
Long Term Rating	Baa2 , 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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Johannesburg, City of

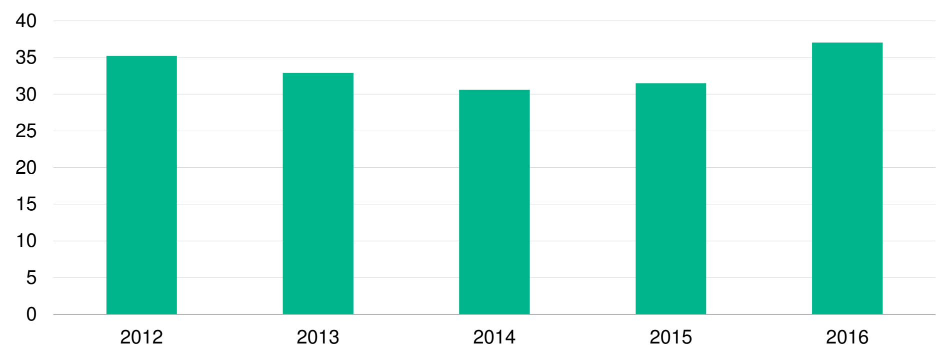
Update Following Initiation of Rating Review

Summary Rating Rationale

The City of Johannesburg's global scale ratings of Baa2/P-2 and national scale ratings of Aa1.za/P-1.za primarily reflect the city's status as South Africa's business capital and main financial and economic centre, which allows it access to a broad tax base. The ratings also incorporate the city's improving liquidity level despite the substantial increase in capital expenditure programme. We expect that Johannesburg's debt-to-revenue ratio to moderately increase, despite the city's high capital expenditure plan in the medium term.

Moderate debt levels despite high capital investment plan

Exhibit 1
Net Direct and Indirect Debt/Operating Revenue (%)



Source: Moody's Investors Service

National Peer Comparison

We rate Johannesburg at the high end of the range of South African municipalities, whose ratings span from Aaa.za to Baa2.za. Johannesburg's relative position reflects debt and debt service levels that are higher than the median of rated metropolitan municipalities in the country.

Credit Strengths

» Strong revenue growth supported by broad tax base

» Improving liquidity position

» Sophisticated financial management

» Large and diversified economic base

Credit Challenges

» Increasing debt stock, but debt ratio to remain in line with other rated peers

» High capital expenditure plan

Rating Outlook

» The rating under review for downgrade on City of Johannesburg mirrors the rating action taken on the ratings of its support provider, the Government of South Africa (Baa2/ RUR).

Factors that Could Lead to an Upgrade

» An upgrade of City of Johannesburg's global scale ratings will require an upgrade of the sovereign rating.

» The national scale ratings of the city would experience an upward rating pressure independent from the sovereign impact, in the event of a significant improvement in the city's liquidity position while maintaining moderate debt levels.

Factors that Could Lead to a Downgrade

» A weakening of the South African sovereign credit profile could lead to downward adjustments in the rating of the City of Johannesburg.

» Additionally, financial difficulties resulting in cash flow tensions or growing debt levels could lead to downward rating actions independent of sovereign rating movements.

Key Indicators

Exhibit 2

Key Indicators

Johannesburg, City of

	2011	2012	2013	2014	2015
Net direct and indirect debt/Operating revenue (%)	38.8	35.2	32.9	30.6	30.2
Interest Payments/Operating Revenue (%)	7.1	5.6	5.1	4.0	4.2
Gross Operating Balance/Operating Revenue (%)	5.6	7.7	11.6	10.9	7.0
Cash Financing Surplus (Requirement)/Total Revenue (%)	-7.6	-1.7	-5.8	-3.4	-5.9
Intergovernmental Transfer/Operating Revenue (%)	18.2	17.3	15.0	14.0	14.9
Real GDP (% change) [1]	3.7	2.7	2.6	2.1	-
GDP per capita as % of National Average	143.5	130.1	141.1	143.6	-
[1] GDP at Provincial level					

[1] GDP at Provincial level

Source: Moody's Investors Service

Recent Developments

On 4 April 2017, Moody's placed the long-term global scale ratings of 10 South African regional and local governments (RLGs) on review for downgrade, including Johannesburg's Baa2 global scale issuer rating. The decision reflects the close operational and financial linkages between the national government and municipalities and follows the potential weakening of the South African government's credit profile, in particular in the country's institutional, economic and fiscal strength, as captured by Moody's recent decision to place South Africa's Baa2 government bond ratings on review for downgrade.

Johannesburg's national scale ratings of Aa1.za/P-1.za were not affected by the action.

Detailed Rating Considerations

Johannesburg's Baa2/Aa1.za ratings combines (1) the entity's baseline credit assessment (BCA) of baa2, and (2) a moderate likelihood of extraordinary support coming from the national government in the event that the entity faces acute liquidity stress.

Baseline Credit Assessment

STRONG REVENUE GROWTH SUPPORTED BY BROAD TAX BASE

Johannesburg is the largest South African city in terms of budget size, with total revenue of ZAR42 billion ($3.2 billion) in fiscal year (FY) 2015. The city consistently maintained strong operating balance, which stood at 7% in FY 2015, following significantly improved margins in the prior years. Despite economic challenges and low GDP growth recorded in recent years, the city managed to record a robust operating revenue growth of 10% on average over the five-year (2011-2015) period.

The city's strong revenue growth was driven largely by service charges, which grew on average by 15% in the past five years, with electricity sales contributing the most. As a result of substantial increase in capital investment, the city recorded cash financing deficit of 6% in 2015. The deficit was financed largely through borrowing and own resources, this did not have any significant impact on the city's debt level. Going forward, the city will likely continue recording a financing deficit in line with its high capital investment plan. Discretionary own source revenues are growing moderately and amounted to 85% of operating revenue in FY 2015, reflecting a high revenue flexibility, underpinned by a very large and steadily growing tax base.

The improvement in the city's financial position over the past three years was largely influenced by city's strong cash flows and prudent expenditure management, which led to a reduction in borrowing need as well as improvement in revenue collection rate. In 2012 the city announced its ZAR100 billion capital expenditure plan for the next 10 years spending to deal with infrastructure service requirements, which may exert fiscal pressure in the medium term. Despite the city's large capital expenditure plan, funding sources remain relatively diversified. The city will continue to finance a larger part of its capital expenditure plan through internally generated funds, leading to a moderate growth in debt level in the medium term.

IMPROVING LIQUIDITY POSITION

Fiscal discipline and strong revenue growth led to an improvement in the city's liquidity position, supported by consistently strong revenue collection rate of 92%. The city continue to maintain strong cash position despite spending 30% of own cash to finance capital investments. In 2015 FYE the city recorded cash and cash equivalent of ZAR4.9 billion (2014 ZAR5.3 billion) this enabled the city to maintain its improving liquidity ratio of 1x despite investing a larger part of its capital expenditure from own funds.

SOPHISTICATED FINANCIAL MANAGEMENT

Sound financial management and budget planning support Moody's view that increasing spending on capital expenditure investment will not result in a significant deterioration of the city's overall financial performances. Investment policies are generally adequate to reduce investment risk to low level. In the past three years the current administration succeeded in improving the city's liquidity position and reduce debt exposure, despite substantial increase in capital investment. In 2015 the city received unqualified audit opinion for three years in a row, signalling an ongoing improvement in financial management and reporting.

LARGEST ECONOMIC BASE IN THE COUNTRY

Johannesburg is South Africa's largest city, with over four million inhabitants, and retains its status as the country's business capital. The city is home to most of the corporate headquarters and the largest listed companies in the country. The Gauteng province, in which Johannesburg is situated, contributes more than a third of the country's GDP and has a GDP per capita that is 50% higher than the national average.

The city's strong GDP growth is largely supported by its diverse economic sectors like - finance and business services, community services, manufacturing and trade - collectively account for more than 82% of economic activity within the city. Johannesburg has well-developed infrastructure which enables the city to continue expanding its economic base. Nonetheless, the maintenance of existing infrastructure may present a challenge for the city, if the capital expenditure plans are not realised, which may increase service delivery backlogs and intensify the city's spending pressures.

INCREASING DEBT STOCK, BUT DEBT RATIO TO REMAIN IN LINE WITH OTHER RATED PEERS

Johannesburg's net debt stock increased to ZAR12 billion in the fiscal year ended (FYE) 30 June 2015 which is equivalent to 30% of its annual operating revenues, from ZAR10.2 billion in 2014. Despite the city's new borrowing of ZAR3.3 billion in FYE 2015, the net debt to revenue ratio marginally increased in 2015. The city's debt stock consists of 49% bonds and 51% bank loans and other sources of funding, with an average debt maturity of eight years. The city's net debt stock should reach ZAR16.5 billion in 2018 from ZAR12 billion in 2015. Despite high anticipated increases in debt stock, the city should maintain a moderate debt to revenue ratio of 33% in 2018 from 30% in 2015.

HIGH CAPITAL EXPENDITURE PLAN

During the year under review the city increased spending on capital infrastructure to 10.2 billion from ZAR7.3 billion the previous year representing a substantial increase of 40%. Cash investment from own sources contributed 30% to total capital expenditure in 2015. Strong cash position helped the city to fund a larger part of its capital expenditure from own funds minimising the city's exposure to high debt burden.

Going forward, the city plan to spend about ZAR29 billion on capex during the 2016-18 period, which will be funded largely from own resources (34%), borrowing (33%) and capital transfers from national government (30%) while contributions and donations will make up the remaining 3%. The projected capital investment will focus on a combination of infrastructure requirements such as electricity, water related services, and economic development infrastructure such as social housing, roads and the public transport system. Despite substantial increase in capital expenditure in the past five years, Johannesburg still faces a huge infrastructure backlogs following a rapid urbanisation experienced mostly by larger cities in the past two decades.

Extraordinary Support Considerations

The moderate likelihood of extraordinary support from the national government reflects our assessment of the national government's policy stance, at the jurisdictional level, on promoting greater accountability and financial sustainability for South African municipalities. The reputation risk for the central government is modest given the predominance of bank loans instead of bonds. Although the new legal framework regulates the recovery of municipalities experiencing financial difficulties, it does not suggest timely extraordinary bail-out actions to avoid defaults on debt obligations. However, the government has some interest in addressing major financial problems that could be experienced by the metropolitan municipalities given their relative importance countrywide.

Output of the Baseline Credit Assessment Scorecard

In the case of Johannesburg, the BCA matrix generates an estimated BCA of baa3, close to the BCA of baa2 assigned by the rating committee. The matrix-generated BCA of baa3 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 Baa2, as reflected in the sovereign bond rating (Baa2 negative). The idiosyncratic risk scorecard and BCA matrix, which generate estimated BCAs from a set of qualitative and quantitative credit metrics, are tools used by the rating committee in assessing regional and local government credit quality.

The credit metrics captured by these tools provide a good statistical gauge of standalone credit strength, and higher ratings are generally likely among issuers with the highest scorecard estimated BCAs. Nevertheless, the scorecard-estimated BCAs do not substitute for rating committee judgments regarding individual BCAs, and the scorecard is not a matrix for automatically assigning or changing these assessments. Scorecard results have limitations in that they are backward-looking, using historical data, while the assessments are forward-looking opinions of credit strength. Concomitantly, the limited number of variables included in these tools cannot fully capture the breadth and depth of our credit analysis.

Rating Methodology and Scorecard Factors

Exhibit 3

Johannesburg, City of						
Rating Factors						
Baseline Credit Assessment	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Scorecard						
Factor 1: Economic Fundamentals						
Economic strength	1	[illegible]	70%	1	20%	0.20
Economic volatility	1		[illegible]			
Factor 2: Institutional Framework						
Legislative background	5		50%	[illegible]	[illegible]	[illegible]
Financial flexibility	5		50%			
Factor 3: Financial Performance and Debt Profile						
Gross operating balance / operating revenues (%)	3	[illegible]	12.5%	2.75	30%	0.53
Interest payments / operating revenues (%)	[illegible]	4.19	[illegible]			
Liquidity	5		25%			
Net direct and indirect debt / operating revenues (%)	1	[illegible]	[illegible]			
Short-term direct debt / total direct debt (%)	1	10.00	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						[illegible]
Systemic Risk Assessment						Baa2
Suggested BCA						baa3

Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
JOHANNESBURG, CITY OF	
Outlook	Rating(s) Under Review
Issuer Rating -Dom Curr	Baa2[1]
NSR Issuer Rating	Aa1.za
Senior Unsecured -Dom Curr	Baa2[1]
NSR Senior Unsecured	Aa1.za
ST Issuer Rating -Dom Curr	P-2[1]
NSR ST Issuer Rating	P-1.za

[1] Placed under review for possible downgrade on April 4 2017
Source: Moody's Investors Service

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