

CREDIT ANALYSIS

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This Credit Analysis provides an in-depth discussion of credit rating(s) for Johannesburg, City of and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on [Moody's website](#).

Ekurhuleni, Metropolitan Municipality of

South Africa

Ratings

Ekurhuleni, Metropolitan Municipality of

Category	Moody's Rating
Outlook	Negative
Long-term: Issuer and Debt Ratings (South African National Scale)	Aa2.za
Short-term: Issuer Rating	P-1.za

Summary Rating Rationale

Ekurhuleni Metropolitan Municipality's Aa2.za/Prime-1.za national scale issuer and debt ratings are underpinned by its relatively large economic base, its moderate – albeit gradually growing debt levels (including municipally owned entities), and its traditionally conservative approach to financial management. However, the ratings also consider the fiscal challenges associated with relatively low, but gradually improving, revenue collection rates and the city's high expenditure requirements, and their potential impact on the city's financial performance and liquidity position in the medium term.

National Peer Comparison

Ekurhuleni is rated at the high end of the six metropolitan municipalities rated by Moody's in South Africa, whose ratings span from Aa2.za to A1.za. Ekurhuleni's relative position reflects debt and debt service levels that are lower than the median of the metropolitan municipalities. Furthermore, the city's liquidity profile remains in line with the median of its peers.

Rating Outlook

The negative rating outlook mirrors the outlook on South Africa's government bond rating.

What Could Change the Rating – Up

An upgrade is regarded as unlikely given the negative rating outlook. A stabilisation of Ekurhuleni's rating outlook would require a stabilisation of the sovereign rating outlook.

What Could Change the Rating – Down

A downgrade of South Africa's sovereign rating would likely lead to a downgrade of Ekurhuleni's rating. The city's ratings would also come under pressure in the event of fiscal slippage, leading to a weakening of its financial position and/or increase in debt levels.

Key Rating Considerations

Financial Position and Performance

Strengthening financial performance

Based on total revenue of ZAR17.3 billion (US\$2 billion) for the fiscal year ending (FYE) June 2011, Ekurhuleni ranks third among the six metropolitan municipalities rated by Moody's in South Africa. Following lower revenue growth recorded in 2008-09 due to the economic downturn, total revenue rebounded (+23%) in 2010-11.

Restored revenue growth combined with continued fiscal discipline have boosted gross operating margins to 5.9% in FYE2011, from 0.2% in FYE2010. Going forward, we expect that continued focus on revenue collections and tight control over expenditure dynamics will allow Ekurhuleni to consolidate positive financial results, which will help to restore a comfortable liquidity position and to sustain a moderate increase in debt levels.

Discretionary revenues to operating revenues constitutes 90%, indicating the city's relatively high revenue autonomy. At the opposite, non-discretionary expenditure, such as employee costs for its approximately 15,000 staff and bulk purchases represent a large and growing proportion (60%) of total expenditure. With regard to core public services, electricity distribution losses are reported at 11% and compares well with that of the other metropolitan municipalities. As regards service operations, water distribution losses were high at 30% in 2011 notwithstanding the adequate operating margins. The city has begun to focus on streamlining the water service operations with specific efficiency targets to be achieved by 2017. Repairs and maintenance expenditure remain stable at a moderate 7% of total expenses.

Ekurhuleni's liquidity profile picked up considerably to 0.9x in FY2011, up from a five-year low 0.6x in FYE2010 (*see figure 1 below*). Whilst we note the reversal in the cash reduction trend observed in the past four years, Ekurhuleni's cash position remains far from the peaks recorded pre-crisis. The city expects the cash reserves to improve in the medium-term, supported by the company's historical policy strategy to keep expenditure within revenue-generating capacity levels.

FIGURE 1
Liquidity Ratios^[1]

	2007	2008	2009	2010	2011
Ekurhuleni	2.2	1.7	0.9	0.6	0.9
Johannesburg	0.7	0.7	0.5	0.4	0.5
Cape Town	1.0	1.2	1.2	1.3	1.3
Nelson Mandela	1.6	1.4	0.9	0.9	0.8
Tshwane	1.0	0.9	0.8	0.7	0.7

Note 1: Net off 50% of Balance sheet Debtors (Source: Moody's)

On the capital side of the budget, the city estimates ZAR2.2 billion capital expenditure for FYE2012, slightly above the two preceding years. Going forward, the city projects a total of ZAR8.1 billion in capital expenditure in 2013 - 2015. The funding mix for this capex program will comprise primarily capital grants (59%) and own-funds (12%); new borrowings will cover the difference.

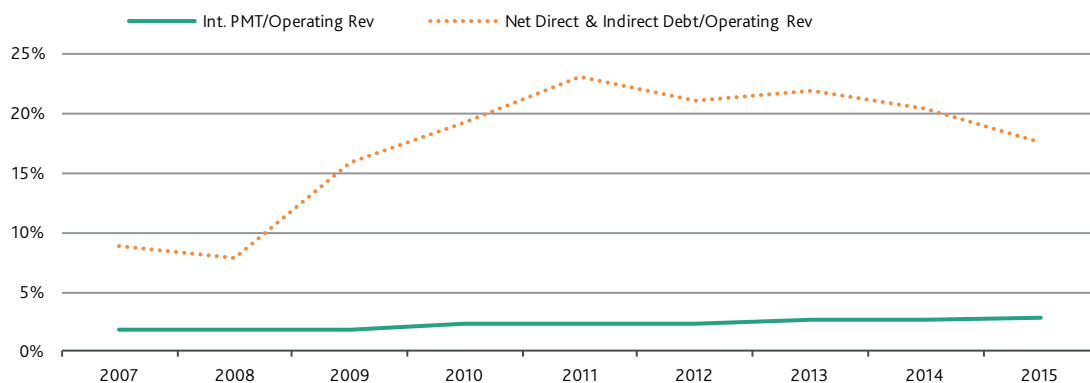
Debt Profile

Moderate, albeit growing, debt levels

Ekurhuleni's net direct debt is estimated to amount to ZAR4.6 billion as at 30 June 2012, equivalent to a moderate 21% of forecast operating revenue, a slight decrease from 23% in FY2011. This debt stock comprises both direct municipal debt of ZAR4.5 billion and the first drawdown of ZAR50 million in guaranteed debt incurred by its waste water treatment company (ERWAT).

Ekurhuleni's direct debt stock comprises 54% bonds and 46% amortising bank loans, with an average debt maturity of seven years. Sinking fund deposits and/or long-term cash investments established for the redemption of its bullet maturities are estimated at ZAR434 million for FYE2012 and are expected to continue increasing. Ekurhuleni's first bond (EMM01) issued under the DMTN programme of ZAR4 billion is due in 2020. Interest expenses will amount to approximately ZAR461 million or 2.4% of operating revenue for FYE2012 and this ratio is expected to remain flat in the medium term (see figure 2 below).

FIGURE 2
Debt Trend



Source: Moody's elaboration from official figures: 2012 pre-close; 2013-15 budget

The city's commitment to focusing on infrastructure investments will continue to require debt financing. Municipal bonds issued under the existing DMTN programme of ZAR4 billion are expected to finance approximately 29% of budgeted capital expenditure for 2013-15. In addition to municipal bond issuances, drawdowns by ERWAT will add ZAR550m guaranteed debt. Nonetheless, Moody's view the city's prospective indebtedness as manageable against increased budget volumes.

Governance and Management Factors

Conservative financial management

Ekurhuleni has traditionally displayed conservative financial management and budgetary planning. The city consistently provides annual financial statements, including balance sheets, income statements and cash flow statements, which are always independently audited by the Auditor General and has received unqualified opinion for three years in succession to FYE2011.

Among the major future challenges for the municipal administration, we note that the city will need to build on recent improvements in revenue collection and prudently manage its financial leverage, including indirect debt exposure from its municipal entities.

Economic Fundamentals

Large and diversified economic base

Ekurhuleni displays a large and relatively dynamic economic base, which contributes approximately 7% to the country's GDP. The local economy is driven by manufacturing in the secondary sector, with a focus towards the production of structural steel and fabricated metal products. Transport networks are well developed and have contributed to notable industrial growth in the area over the years. The metropolitan municipality is home to the Oliver Tambo International Airport, the busiest airport in Africa. Ekurhuleni also has the largest industrial concentration in South Africa and is often referred to as the "workshop of Africa." Nonetheless, contribution by wholesale & retail trade as well as finance & business services to the local economy is significant and provides further diversification.

The municipality has a population of 2.8 million, accounting for 28% of the Gauteng province's and 5.6% of South Africa's total population. Despite its location within Gauteng, which is the leading economic province of the country, the local economy has grown at a slightly slower rate than the national economy. The city's economy was significantly impacted by the 2009 economic recession, with a local GDP slump of just above 3% recorded in that year mainly due to its export-linked manufacturing base. Economic contraction weighed on the city's finances through lower-than-average revenue collection rates.

Typical of large municipalities in South Africa, migration into the area is a key challenge. In 2009, it was estimated that Ekurhuleni had more than 100 informal settlements in the area, the largest of all metropolitan municipalities in the country, which exerts significant expenditure pressure for service provisions and on housing.

Operating Environment

The operating environment in which Ekurhuleni operates is characterised by moderate-to-low GDP per capita, relatively low GDP volatility and a moderate ranking on the World Bank's Government Effectiveness Index. These characteristics suggest low systemic risk. The sovereign rating is currently A3, with negative outlook.

South Africa's economy is currently recovering from the mild recession experienced in 2009, having posted real GDP growth of 2.8% in 2010, which is well below pre-crisis levels. The recently published Medium-Term Budget Policy Statement (MTBPS) revised GDP growth forecasts downwards to 3.1%-3.5% in 2011 and 2012. This is expected to have an impact on the country's ability to deal with socio-economic challenges. Notwithstanding the country's political transformation and socio-economic progress, South Africa has a multitude of challenges, including high levels of poverty, soaring unemployment and under-employment, wide income disparities and poor general education attainment. If inadequately addressed, these challenges could threaten the long-term economic and political stability of the country.

Institutional Framework

The institutional framework, which encompasses the arrangements determining intergovernmental relations and jurisdictional powers and responsibilities, features moderate financial predictability and stability. The municipal system in South Africa comprises eight metropolitan municipalities (category A), 226 local municipalities (category B) and 47 district municipalities (category C). The administration system and associated policies are generally consistent and oriented towards enhancing accountability at the local levels; municipal oversight regarding budget approval and monitoring is performed by provincial governments, assisted by the National Treasury.

Spending responsibilities and revenue structures of South African municipalities are difficult to alter due to a consolidated legal framework. The high degree of revenue autonomy enjoyed by metros and large local municipalities – with transfers from the national government accounting for 5-20% of total revenue – compensates for the rigidity of their expenditure profile as a result of their statutory responsibilities (which are chiefly related to the delivery of basic services and municipal infrastructure). Conversely, district and small to medium-sized municipalities - whose primary role is to facilitate, fund and execute infrastructure development in the local municipalities within their jurisdiction – demonstrate moderate-to-high fiscal dependence on government grants. Municipal budgets are sensitive to economic cycles due to the nature of their own revenue sources, which include primarily property taxes and service charges for electricity, water, refuse and sewage. Municipalities are responsible for the collection of local taxes and charges and enjoy the discretion to set tax rates and tariffs. This allows for a moderate degree of revenue flexibility, particularly for metros and large municipalities.

The combination of fiscal transfers and own-source revenues at most metros and local municipalities has proved insufficient to provide the comprehensive range of services required. However, despite these pressures, municipal debt levels have generally remained low to moderate.

Application of Joint-Default Analysis

As a reflection of the application of Moody's joint-default analysis methodology for regional and local governments, the City of Ekurhuleni's national scale issuer rating of Aa2.za is composed of two principal inputs: a baseline credit assessment (BCA) of 7 (on a scale of 1 to 21, in which 1 represents the lowest credit risk), a moderate likelihood that the Government of South Africa (rated A3, negative outlook) would act to prevent a default by the City of Ekurhuleni and a moderate level of default dependence between the Government of South Africa and the City of Ekurhuleni.

The moderate likelihood of extraordinary support reflects, at the jurisdictional level, Moody's assessment of the national government's policy stance of promoting greater accountability and financial sustainability for South African municipalities. Reputation risk for the central government is

deemed modest, mainly in view of the large 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, Moody's recognizes some interest of the government in addressing major financial problems that could be experienced by the metropolitan municipalities, in view of their relative importance countrywide.

About Moody's Sub-Sovereign Ratings

National and Global Scale Ratings

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".za" for South Africa. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Implementation Guidance published in March 2011 entitled "[Mapping Moody's National Scale Ratings to Global Scale Ratings](#)."

The Moody's Global Scale rating for issuers and issues allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Annual Statistics

Ekurhuleni, Metropolitan Municipality of

Year ended 30 June (R million)	2007 Realised	2008 Realised	2009 Realised	2010 Realised	2011 Realised	2012 Pre-close
BALANCE SHEET						
Funds and reserves	8,143.1	38,752.6	43,322.7	42,445.0	41,867.0	41,732.0
Long-term liabilities	1,127.8	1,054.2	1,945.6	2,446.9	3,882.2	4,383.4
Consumer deposits	294.4	337.9	373.2	420.4	490.8	517.2
Long-term provisions and other liabilities	210.4	222.9	1,781.6	1,758.6	1,889.1	2,028.3
Deferred income	-	-	-	-	0.5	-
Non-current liabilities	1,632.7	1,615.0	4,100.3	4,625.9	6,262.6	6,928.9
Creditors and provisions	1,686.0	1,918.2	2,423.9	2,860.7	2,868.1	3,214.4
Short-term debt	54.6	73.6	131.3	434.2	194.1	182.4
Current liabilities	1,740.6	1,991.8	2,555.2	3,294.9	3,062.2	3,396.7
Total liabilities	11,516.4	42,359.4	49,978.2	50,365.8	51,191.8	52,057.6
Fixed assets	5,932.5	37,933.6	46,706.5	47,209.3	46,986.9	46,324.5
Investments	339.5	248.1	279.2	88.0	230.9	413.1
Other non-current assets	630.2	169.1	213.0	203.0	203.4	160.2
Non-current assets	6,902.1	38,350.8	47,198.7	47,500.3	47,421.2	46,897.8
Inventory	82.3	129.7	177.1	160.0	157.5	144.8
Accounts receivable	1,617.4	1,171.3	1,168.8	1,485.1	1,780.6	2,047.7
Bank and short-term investments	2,881.4	2,452.4	1,131.4	950.4	1,456.1	2,569.2
Other	33.1	255.2	302.2	270.0	376.5	398.1
Current assets	4,614.3	4,008.6	2,779.5	2,865.5	3,770.6	5,159.8
Total assets	11,516.4	42,359.4	49,978.2	50,365.8	51,191.8	52,057.6

Ekurhuleni, Metropolitan Municipality of

Year ended 30 June (R million)	2007 Realised	2008 Realised	2009 Realised	2010 Realised	2011 Realised	2012 Pre-close
INCOME STATEMENT						
Revenue						
Property rates	1,688.0	1,741.9	1,886.6	2,201.4	2,478.1	2,716.9
Grants and subsidies	1,918.5	2,062.2	2,477.0	2,886.0	3,407.5	3,289.8
Electricity	3,118.3	3,291.7	4,054.2	5,583.8	7,372.5	9,289.8
Water	1,328.8	1,140.6	1,180.9	1,457.6	1,771.2	1,941.4
Other	819.1	947.9	970.4	1,033.5	1,381.6	1,577.9
Other income	1,016.1	1,138.3	995.2	838.6	871.3	2,132.9
Total revenue	9,888.8	10,322.5	11,564.3	14,000.9	17,282.2	20,948.6
Expenditure						
Employee & councillor costs	2,568.7	2,781.8	3,506.9	4,157.2	4,565.2	4,094.2
Bad debts charges	1,233.7	1,328.6	1,453.6	1,425.2	1,445.3	1,587.1
Bulk purchases	3,034.6	3,298.1	4,122.0	4,951.2	6,182.6	7,791.4
Depreciation	397.0	402.7	2,134.4	2,112.3	2,146.2	2,124.7
Interest paid	182.1	180.1	196.7	327.0	400.0	461.5
Other expenses	1,185.1	1,499.2	1,478.7	1,563.6	1,933.3	4,357.8
Repairs & maintenance	588.5	789.2	1,059.9	1,010.7	1,167.6	-
Total expenditure	9,189.6	10,279.6	13,952.1	15,547.1	17,840.3	20,416.7
Surplus/ (deficit)	699.2	42.9	(2,387.8)	(1,546.2)	(558.1)	531.9

Ekurhuleni, Metropolitan Municipality of						
Year ended 30 June (R million)	2007 Realised	2008 Realised	2009 Realised	2010 Realised	2011 Realised	2012 Pre-close
CASH FLOW STATEMENT						
Cash generated by operations	574.6	399.5	237.8	1,019.5	1,325.9	3,201.7
Investment income	592.7	797.3	198.7	366.2	338.6	268.7
External interest paid	(182.1)	(180.1)	(181.8)	(327.0)	(400.0)	(488.2)
Cash available from operations	985.2	1,016.7	254.7	1,058.7	1,264.5	2,982.2
Proceeds on sale of fixed assets	242.1	6.5	6.1	66.3	85.0	-
Other	94.6	(7.7)	60.9	(185.8)	12.9	(182.2)
Cash retained from operations	1,321.9	1,015.5	321.7	939.1	1,362.4	2,800.0
Fixed assets and investments	(1,033.2)	(1,464.3)	(2,559.4)	(1,975.1)	(1,961.4)	(2,159.5)
Net cash flow operating & Investing Activities	288.7	(448.8)	(2,237.7)	(1,036.0)	(599.0)	640.5
Financing activities						
Loans increase / (decrease)	(126.7)	(79.3)	949.0	607.3	1,176.7	624.6
Cash contributions	-	-	-	-	-	-
Consumer deposits increase / (decrease)	32.1	-	35.3	56.5	70.8	30.2
Cash resources (increase) / decrease	(194.1)	528.1	1,253.4	372.2	(648.5)	(1,295.4)
Net cash from financing activities	(288.7)	448.8	2,237.7	1,036.0	599.0	(640.5)

Key Ratios And Indicators

	2007 Realized	2008 Realized	2009 Realized	2010 Realized	2011 Realized
ECONOMIC STRUCTURE AND PERFORMANCE					
Population ('000s)	2699.4	2699.4	2699.4	2800.0	2800.0
GDP per capita as a % of national average (%)	168.0	156.8	158.7	150.6	-
Unemployment rate (%)	22.3	22.9	23.9	25.3	25.3
FINANCIAL PERFORMANCE					
Total revenue growth rate [1] (%)	14.0	4.0	12.0	21.0	23.0
Total expense growth rate [2] (%)	21.0	15.0	27.0	7.0	15.0
Total expenses per capita (EUR)	3640.5	4202.0	5326.8	5709.5	6305.5
Primary operating balance/operating revenues (%)	12.9	3.5	-4.8	2.6	8.3
Gross operating balance/operating revenues (%)	11.1	1.7	-6.6	0.2	5.9
Net operating balance/operating revenues (%)	9.8	0.9	-8.0	0.2	4.3
Cash Financing deficit (surplus)/total revenue (%)	4.0	-5.6	-22.5	-8.4	-3.9
Intergovernmental transfers/operating revenue (%)	19.4	17.8	18.0	17.4	16.8
Tax revenues/operating revenue (%)	17.0	17.0	17.0	16.0	15.0
Transfers (op. related)/operating expenses (%)	19.4	17.8	18.0	17.4	16.8
Capital expenses/total expenses (%)	11.0	13.0	18.0	13.0	11.0
Net operating balance/capital expenses (%)	94.0	6.0	-35.0	1.0	37.0
Self-financing ratio (%)	1.3	0.3	-0.1	0.3	0.9
Gross new borrowings/capital expenses (%)	0.1	-	43.0	31.0	74.0
DEBT PROFILE					
Total direct and indirect debt growth rate (%)	-12.0	-5.0	84.0	39.0	41.0
Net direct and indirect debt growth rate (%)	-19.0	-10.0	124.0	47.0	49.0
Net direct and indirect debt per capita (EUR)	323.2	290.8	652.1	955.8	1375.8
Short-term direct debt [11]/direct debt (%)	11.3	21.0	6.3	15.1	4.8
Foreign currency direct debt (after swaps)/direct debt	0.0	0.0	0.0	0.0	0.0
Net direct and indirect debt/operating revenue (%)	8.8	7.8	15.9	19.2	23.1
Net direct and indirect debt/total revenue (%)	8.8	7.6	15.2	18.4	22.3
Net direct debt /operating revenue (%)	8.8	7.8	15.9	19.2	23.1
Net direct debt/total revenue (%)	9.0	8.0	15.0	18.0	22.0
Net direct debt / gross operating balance (years)	0.8	4.5	-	110.4	3.9
Interest expense growth rate (%)	-3.0	-1.0	9.0	66.0	22.0
Interest payments/operating revenue (%)	1.8	1.8	1.8	2.4	2.4
Debt service growth rate (%)	-18.0	-16.0	39.0	-9.0	102.0
Debt service/operating revenue (%)	3.1	2.6	3.2	2.4	4.0
Debt service/total revenue (%)	3.1	2.5	3.1	2.3	3.8
Debt repayment/gross operating balance (%)	1.0	1.0	1.0	-	2.0

Moody's Related Research

Credit Opinions:

- » [Government of South Africa, May 2012](#)
- » [City of Tshwane, June 2012](#)
- » [City of Cape Town, March 2012](#)

Analysis:

- » [City of Johannesburg, March 2012 \(140763\)](#)

Sector Comment:

- » [South African Municipalities: Lower Electricity Tariff Hike Eases Liquidity Pressures, March 2012 \(140792\)](#)

Statistical Handbook:

- » [Non-U.S. Regional and Local Governments, June 2012 \(141944\)](#)

Rating Methodologies:

- » [Regional and Local Governments Outside the US, May 2008 \(107844\)](#)
- » [The Application of Joint-Default Analysis to Regional and Local Governments, December 2008 \(99025\)](#)
- » [Mapping Moody's National Scale Ratings to Global Scale Ratings, March 2011 \(126632\)](#)

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