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Municipal Borrowing – leveraging national transfers

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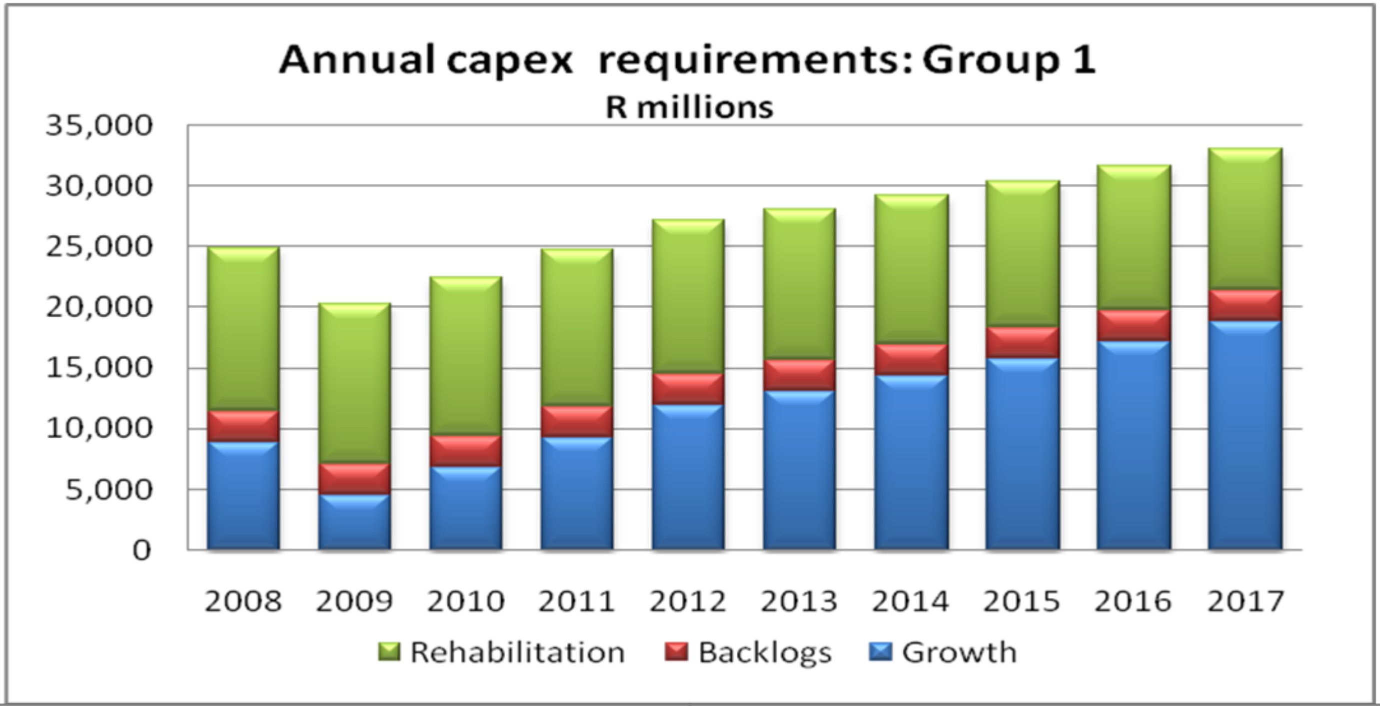
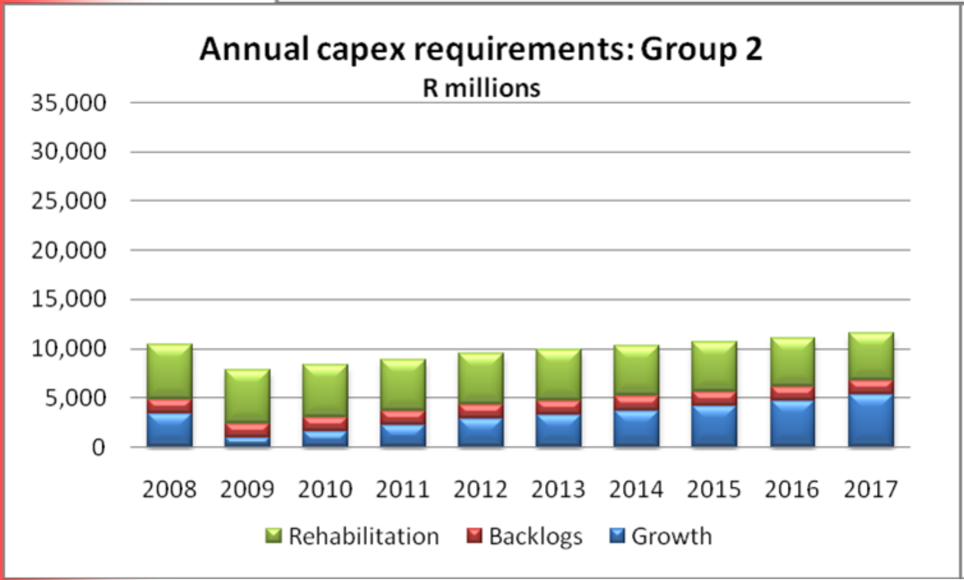
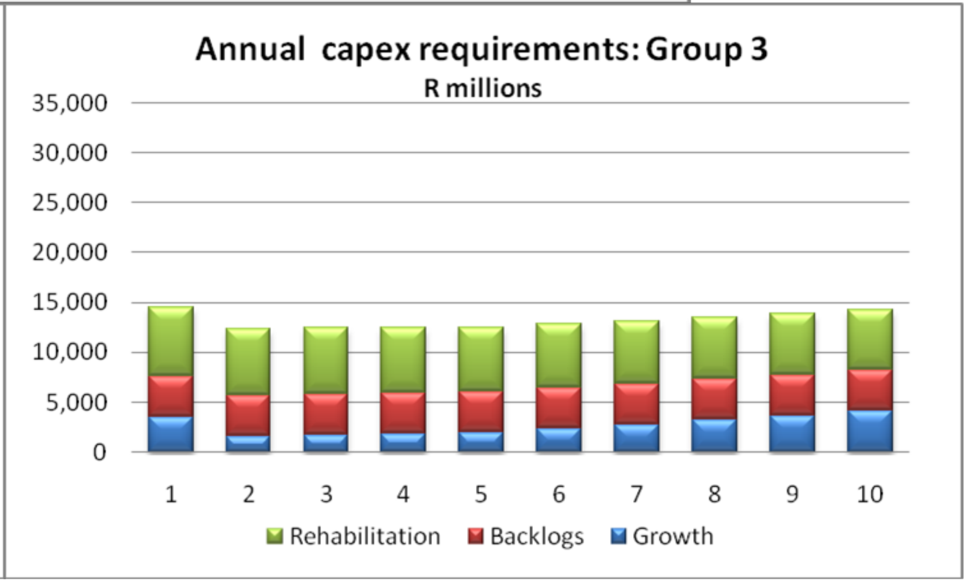
Need for additional capital spending

- <u>Service delivery backlogs</u>:
  - investments to give households access to basic services that municipalities are meant to provide, such as water and sanitation, electricity, solid waste disposal, roads, and other public services
- <u>Rehabilitation</u>:
  - Investments to upgrade, repair or replace infrastructure that has deteriorated beyond the point of routine maintenance
- <u>Growth</u>:
  - investments in infrastructure needed to support a growing population and a growing economy

Estimated Demand for Investment







Sources of Private Finance

- Long term loans
- Municipal bonds
- PPPs
- Development charges
- Project finance

- Is the leveraging of national transfers an option?

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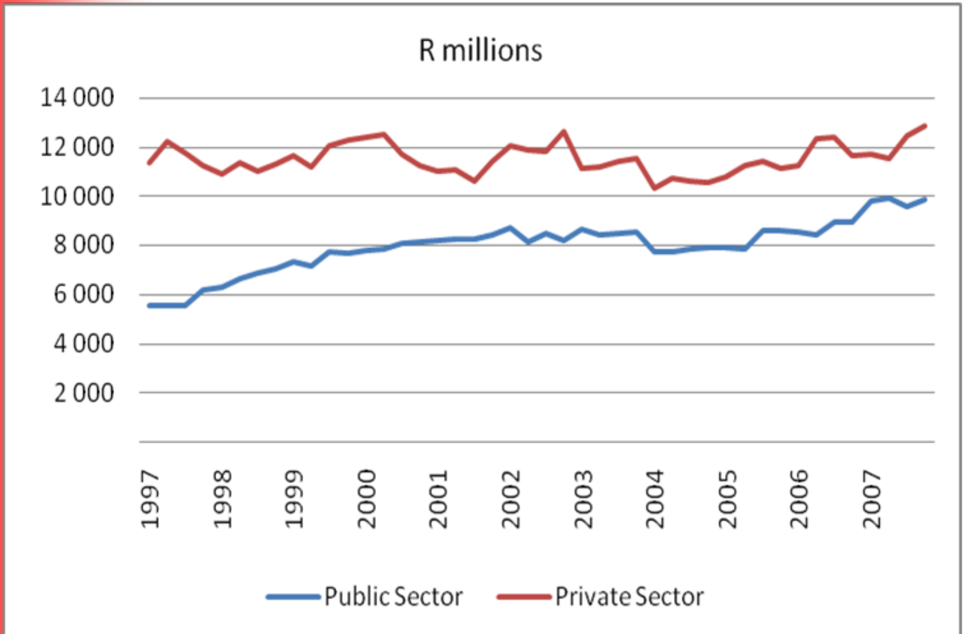
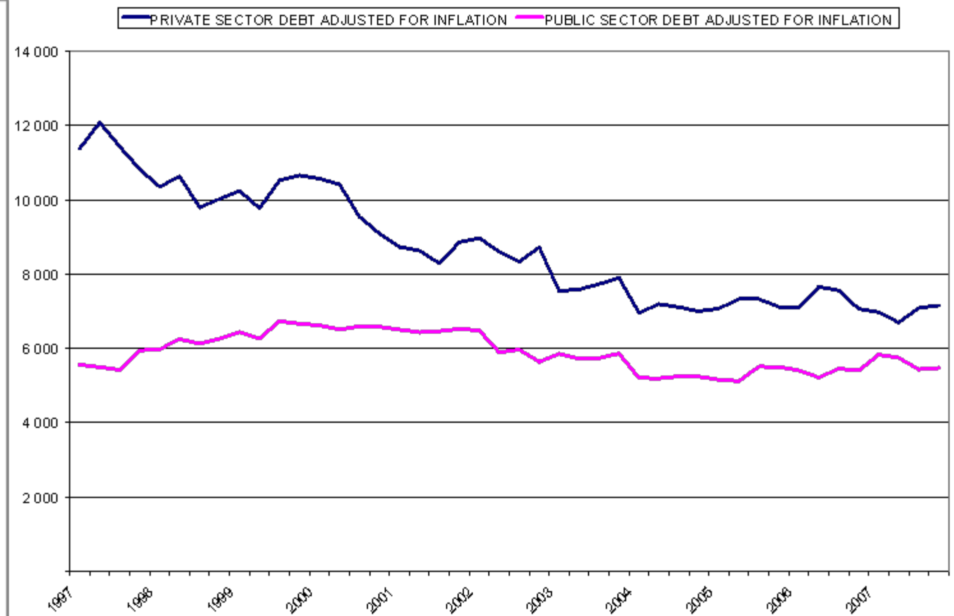
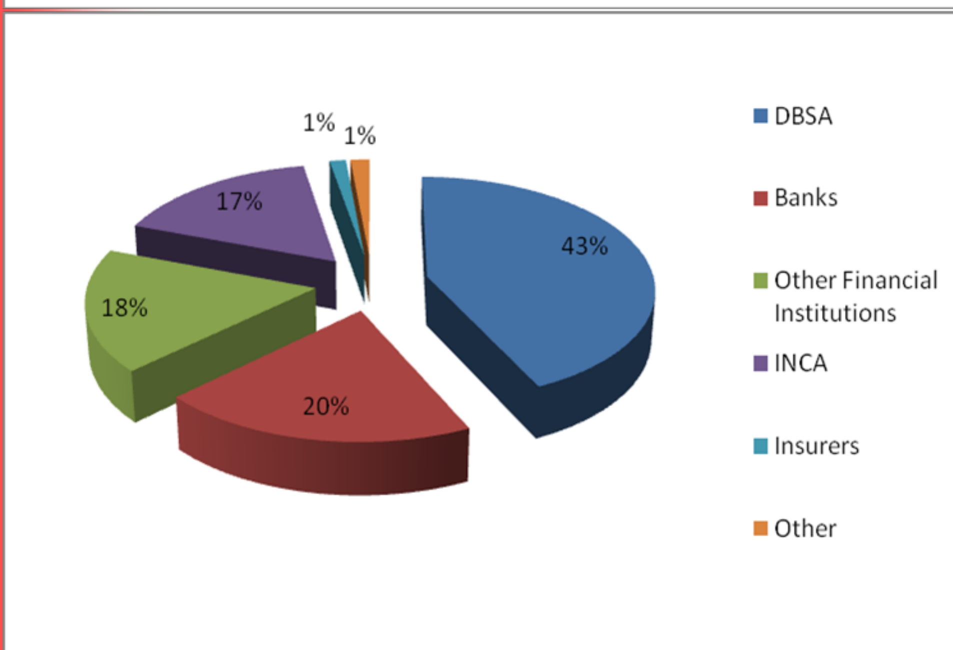
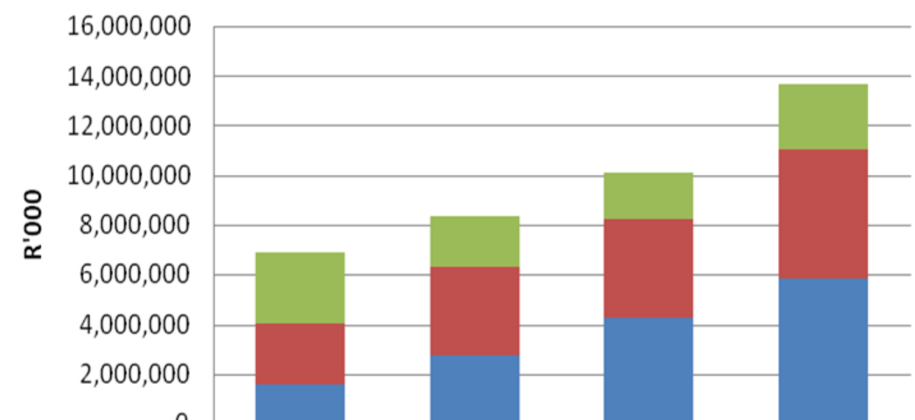
Overview of Municipal Borrowing









	2003/4	2004/5	2005/6	2006/7
Other	2,895,851	2,015,255	1,848,421	2,635,517
Grants	2,440,639	3,563,898	3,948,128	5,243,873
Loans	1,560,441	2,755,814	4,289,182	5,811,307

Why consider leveraging of transfers?

- Arguments put forward:
  - Smaller municipalities cannot access affordable loans based on their own revenues
  - Including a transfers as a revenue source that can be leveraged serves to strengthen municipalities' balance sheets for borrowing purposes
  - Leveraging transfers would reduce the cost of borrowing
  - The pace of municipal capital investment is slow – needs additional revenue sources to speed it up
  - The flow of transfers does not provide for lumpy infrastructure investments

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How would leveraging work?

- The transfers' revenue stream would be *pledged* or *ring-fenced* to repay borrowing
- There may be an escrow or 'lock-box' arrangement to transfer pledged funds into a dedicated subaccount to repay loan
- ***Intercept schemes* are not supported**
  - National government should never be liable for municipal debts
    - separate spheres therefore separate liabilities
    - need to manage moral hazard
  - No direct relationship between fiscus and municipal lender – minimise contingent liabilities
  - Ensure all municipal borrowing costs appear on-budget of municipalities
  - Simplify accounting procedures

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Current Policy Position

- Currently, there is no national policy position that permits the leveraging of national transfers
- This means:
  - a substantial amount of technical work needs to be done to investigate the desirability of leveraging national transfers
  - on the basis of this work, a policy framework would need to be developed and presented to Cabinet for approval
  - Only once such approval has been given and the necessary policy framework is in place could the leveraging of national transfers be permitted

- Given the long term implications for the fiscus this issue needs to be considered very carefully - and not rushed

Leveraging the Equitable Share

- While the ES is part of a municipality's overall 'own revenue' in terms of the Constitution, current policy does not support the pledging of ES revenue streams to leverage borrowing because:
  - ES intended to support municipal operational expenditures
  - ES designed to supplement funding of the operational cost of providing free basic services
  - Leveraging ES would limit future councils' decision-making with regard to the use of these funds

- The ES is nevertheless part of a municipality's own revenue and so must be taken into consideration when looking at the overall balance sheet of the municipality for borrowing purposes

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Leveraging MIG - advantages

- Municipal perspective
  - Facilitate bringing capital spending forward
  - Strengthen balance sheet of municipalities
  - Reduce the cost of borrowing
  - Ties the intergovernmental fiscal system into providing a minimum level of transfers
- Bank perspective
  - Provide a nationally ‘guaranteed’ revenue source to back loans – which lowers risk substantially
  - No operational risk related to other revenue source
  - Easier to manage loan
- National perspective
  - Leveraging national transfers can be a means to speed up investment

Leveraging MIG - disadvantages

- Municipal perspective
  - Limits future councils' decision-making over transfer revenue streams
  - Are the current investment decisions the right ones?
  - Does not provide any incentive to ensure proper operational management and sound revenue management
  - Undermines sound municipal credit ratings
    - based on quality of own revenue and finance management
- Banks' perspective
  - None
- National perspective
  - Simply another form of national borrowing – taking place outside of national government's asset management strategy
  - Using funds that are partly borrowed to leverage further borrowing
  - Will impact negatively on investors' evaluation of national government's credit rating – investors will see beyond the veil
  - Tie the intergovernmental fiscal system into a particular level of transfers to local government
  - Reduce flexibility in managing and directing resources

Are there alternatives?

- Have existing private financing options been fully exploited?
  - Current research suggests that many municipalities are under-borrowed
  - Does this imply that there is no real need to leverage transfers at this stage?
- Create a Joint Municipal Bond Facility that allows for risk pooling by lenders to smaller municipalities
- Require DBSA to take on more risk by linking borrowing to specific municipal 'own revenue' streams
  - instead of reducing risk by leveraging transfers
- Review approach to funding municipalities that do not have sufficient 'own revenues' to support borrowing
- Reform MIG in other ways to better support municipal infrastructure investment

Reforming MIG to better support municipal infrastructure investment

- Move MIG away from the 'project based' management system so that it becomes part of the overall funding stream for capital, which would serve to strengthen municipal balance sheets
  - along lines of MIG (Cities), but still not allow direct leveraging
- Develop a proper MTEF management system that will enable municipalities to access future conditional grant funding flows for specific 'lumpy' projects
  - i.e national government would borrow on behalf of these municipalities, and they would 'payback' through future transfers
- Allow for consolidating of MIG grants within Districts
- Develop a system of prioritising large municipal infrastructure projects along the lines of the hospital revitalisation grant, rather than using a formula approach to the distribution of MIG funds

Conclusion

Still a lot of thinking and research to be done on this matter

Thank You