

City of Johannesburg Metropolitan Municipality

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
City of Johannesburg	Long Term issuer	National	A _(ZA)	Negative Outlook
Metropolitan Municipality	Short Term issuer	National	A1 _(ZA)	

Analytical entity

City of Johannesburg Metropolitan Municipality (CoJ or the metro) is one of the 3 category A municipalities in the Gauteng province of South Africa. It covers around 1,645km² of the province's 9,918km² domain, housing the largest population and being the centre of South Africa's economy. The metro consists of seven regions, of which a few of the main areas are Midrand, Sandton, Roodepoort, Soweto, Alexandra, Inner City (central Johannesburg) and Orange Farm.

Credit profile summary

Strengths

- Regarded as the economic hub of South Africa, being the home to many large national and international companies across a diverse range of economic activity
- Well-diversified internally generated revenue base with low reliance on grant funding
- Continues to demonstrate some access to debt funding

Weaknesses

- High reliance on tariffs to drive income growth whilst facing significant expenditure pressure
- High gearing with moderately weak credit protection metrics
- Lower debtors collection has led to reduced cash flows for capital investment and service delivery
- Deteriorating infrastructure is hampering service delivery and exacerbating the already huge capex backlog, which cannot be adequately addressed under current financial conditions
- Elevated levels of Unauthorised Irregular Fruitless and Wasteful Expenditure, albeit this is being addressed

Rating summary

The Negative Outlook on City of Johannesburg Metropolitan Municipality's (CoJ or, the Metro) rating continues to reflect its weak financial position, characterised by high debt and decreasing cash reserves. This has resulted in lower levels of capex and service delivery, with the Metro's infrastructure evidencing increasing backlogs. Nevertheless, supporting the rating, CoJ remains the economic centre of South Africa, with diverse sources of income.

Outlook statement

The Negative Outlook reflects GCR's view that CoJ's financial position remains weak, constrained by low debtors collection levels, high debt and limited liquidity. While the initiatives to improve operating performance are noted,

effecting the improvements may prove challenging amidst still weak household incomes and deteriorating infrastructure. In the absence of demonstrated improvements, the operating performance may worsen.

Rating triggers

CoJ's rating could be further downgraded if its operating performance does not meaningfully improve. Factors in this regard include: 1) weak collection rates below 90% that impedes the liquidity position; 2) declining spend on capex and maintenance; 3) ballooning creditors payments; and 4) further weaknesses in governance controls or political instability.

In the shorter term, a return to a Stable Outlook depends on the metro's ability to stabilize its operating performance and liquidity reserves. This could be derived through improved income growth and collections thereby driving stronger cash flows that allow for higher maintenance and capex spend. The Metro must also demonstrate progress in implementing financial improvements and capital projects.

Risk score summary

Rating components & factors	Risk Score
Operating environment	13.75
Country and sector risk score*	14.00
Adjustments	(0.25)
Business profile	2.00
Local and Regional Government Profile	3.00
Operating Performance	(0.50)
Management & governance	(0.50)
Financial profile	(3.00)
Leverage & capital structure	(1.50)
Liquidity	(1.50)
Comparative profile	0.00
Government Support	0.00
Peer analysis	0.00
Total risk score	12.75

*The country risk score serves as a proxy for sector risk.

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2024
 GCR Rating Scales Symbols and Definitions, May 2023
 Criteria for Rating Local and Regional Governments, May 2024
 GCR's Country Risk Score report, August 2024

Ratings history

City of Johannesburg Metropolitan Municipality

Rating scale	Review	Rating class	Rating	Outlook/Watch	Date
Long Term Issuer	Initial	National	AA _(ZA)	Stable Outlook	October 2018
Short Term Issuer		National	A1+ _(ZA)		
Long Term Issuer	Last	National	A+ _(ZA)	Stable Outlook	July 2023
Short Term Issuer		National	A1 _(ZA)		

Operating environment

Country risk

The South African country risk score of '7.00', partially reflects the strong GDP per capita underpin, which we expect to range well above the rest of Africa average at between USD6,500 to USD6,850 in the next 18 to 24 months. A well-diversified economy, institutional strength, independence of the Central Bank to continue to steer monetary policy towards managing inflation, and currency stability are also positively considered. Governance considerations continue to reflect rigour, especially with respect to the independent voice of civic society and the rule of law, although the country risk assessment could be negatively impacted by failure to sustain cohesion of a coalition government or to maintain socioeconomic stability beyond the electoral season.

As with most regional territories, South Africa has become increasingly vulnerable to natural phenomena, especially highly destructive weather patterns, which have increased the extensive infrastructural burden on the fiscus. In addition, various levels of government are behind on targets to supply indigent members of the population with basic amenities. This means a sizeable component of government revenues will go towards more economic inclusion, but this could curtail our country risk assessment unless it is balanced by policy that also builds productivity enhancing infrastructure and further stimulates foreign direct investment. Overall, the fiscal position continues to be strained by high government debt, projected at 70.0% to 85.0% of GDP through to 2026. Including explicit debt guarantees and implied support for critical state owned entities, the ratios are considerably higher, indicating risk of continued pressure on the fiscus. In view of these considerations, and our expectations that real GDP growth will continue to track below 2.0% against an unemployment backdrop of 30.0% to 40.0%, we expect the Gini coefficient and multi-dimensional poverty indices to remain weak in the medium term despite the high social spend.

Details on the country risk score are outlined in GCR's Country Risk Score report, available at <https://gcratings.com/risk-scores/>

Sector risk

GCR considers the South African municipal sector to demonstrate a strong institutional and legislative framework. The quality of financial reporting is robust in that municipalities are required to publish quarterly financial performance reports, as well as very detailed annual financial statements. There are also several oversight bodies, most notably the Auditor General, who audits the financial statements annually and provides detailed opinions as to compliance with the necessary financial and operational regulations.

However, the South African municipal sector is experiencing a number of financial and political challenges. Rates and service tariffs have been rising faster than inflation and are expected to see even sharper increases in 2024 and 2025 as Eskom and the water boards implement high tariff increases. As such, residents have increasingly struggled to meet monthly payments to municipalities, resulting in weak debtors' collection rates. Financial institutions have also become much more reluctant to lend to municipalities, given their deteriorating financial position. These problems have been

exacerbated by political instability within many municipalities, negatively impacting the various councils' ability to address short term challenges, as well as implement long term planning for financial sustainability.

As per GCR's criteria, the operating environment score is double the country risk score, whereafter some adjustments may be made. Given the current challenges in the South African municipal sector, a small negative adjustment has been made, which could be increased if the problems and instability persists.

Details on the Sector risk score are outlined in GCR's Sector Risk Score report, available at <https://gcratings.com/risk-scores/>

Business profile

Local and regional government profile

CoJ is the economic hub of South Africa, contributing c.15% to the country's GDP. The metro is also considered to be an economic gateway to the African continent, being the headquarters for many multinational companies' African operations. It boasts a well-developed road and highway network that serves as a portal to national and international routes. Further, CoJ benefits from its diverse economy, which continues to anchor its economic stability. Underpinned by a broad services sector, the metro provides economic and social opportunities to both South African citizens and migrants. The 2022 national census indicated a much lower population in COJ of around 4.8 million residents, around a 20% reduction from the mid-term estimate in excess of 6 million. The accuracy of the census figure has been questioned and the Metro continues to budget on the basis of a population of 6 million, increasing at around 2% p.a.

Some 85% of the metro's income is internally generated revenue (IGR), of which electricity and water sales and income from property taxes are the key contributors. As a result, the Metro is only reliant on grants for around 15% of its income. In line with the national trend, CoJ's GDP growth has been slowing for much of the past decade and has not been adequate to meet the demands of the increasing population amidst a high unemployment rate of around 40% within the metro. 52.5% of the population is estimated to live below the poverty line (compared to c.62.6% nationally), which burdens CoJ with additional social grant responsibilities for its residents, against more constrained income levels. Nevertheless, the census indicates a clear increase in access to service by residents over the past 10 years. The percentage of formal dwellings, flush toilets, and access to piped water and electricity for lighting have all increased, and remain above the national averages.

Operating performance

CoJ continued to experience operating challenges through fiscal 2023 and 2024, ending 30 June. Both electricity and water income are under severe pressure. During fiscal 2023, electricity units sold decreased by 12%, impacted by the high level of loadshedding, as well as the continued transition of residents and businesses to alternative power sources. As the tariff increase was below the growth in bulk expenditure, the electricity margin decreased to a review period low of 12%, compared to historical levels of around 25%. A much steeper 14% tariff increase was implemented for fiscal 2024, which combined with lower levels of load shedding in 2H 2024, saw preliminary electricity income rise by around 18%. However, high electricity losses of around 30% over the past three years continue to place strain on this critical source of income. Consumers moving off the grid remains a major medium term concern for electricity income, but CoJ is looking to restructure tariffs to reflect capacity charges, whilst there are also initiatives to improve monitoring of usage to reduce losses.

Similarly, income from water distribution is under strain, with the gross margin deteriorating from 20% to 12% over the review period. This could partly be attributed to a high level of non-revenue water (NRW), reaching 33% in fiscal 2023 and 36% for fiscal 2024. Water income in fiscal 2024 was bolstered by a steeper 9.3% tariff increase, but this may be offset by the impact of water outages, with the cost of water tankers adding to the expense base. To remedy its NRW,

Joburg Water is focussing on a few high impact projects, such as repairing leaks at its reservoirs. This will cost over ZAR500 million, but the savings from the project translate into a payback period of less than 4 years. There are also several upgrade projects, most notably Soweto, which should reduce losses and improve the monitoring of water usage and billing.

Providing some support to income, property rates are expected to have risen by 16% in fiscal 2024, as the new valuation roll has been introduced and CoJ has also been more proactive in pursuing cases where the rates are in dispute.

Grant income remains under pressure. The equitable share grant, intended to cover the cost of services to indigent residents has continued to increase, but is slightly below inflation. Along with the growing number of indigents in the Metro, this is placing further strain on income and infrastructure. Capital grants remain below historical levels due to the reduction of the budget at the national level.

Exhibit 1: Income progression (ZARmillion)							
	FY2020	FY2021	FY2022	FY2023	FY2024*	%Δ FY2024	5yr CAGR
Rates	13 446	13 660	13 721	14 337	16 676	16,3	5,5
Electricity	15 412	15 569	17 095	16 228	19 156	18,0	5,6
Water	6 964	7 282	7 871	8 502	9 986	17,5	9,4
General service	7 106	8 050	8 326	8 536	9 812	14,9	8,4
Grants & subsidies	11 183	12 604	8 189	9 393	8 334	(11,3)	(7,1)
Other income	2 753	3 347	6 375	6 733	6 452	(4,2)	23,7
Total income	56 864	60 511	61 577	63 729	70 417	10,5	5,5

Source: AFS * Unaudited preliminary accounts

Expenditure has generally increased in line with income, although a ZAR1 billion operating deficit was reported in fiscal 2023, driven by 8% growth in staff costs and bulk costs rising ahead of distribution income. Staff costs rose by 9% in fiscal 2024, but bulk costs decreased somewhat in initial accounts. Although the staff cost to total cost ratio remains below 30%, it has been edging up over the review period, placing pressure on available resources. CoJ has indicated that it plans to reduce the growth in staff costs and is budgeting for a 4.8% increase in overall costs in financial 2025. Nevertheless, there remains significant pressure on expenditure and GCR expects the average surplus to fall below historical levels over the medium term.

Exhibit 2: Expenditure progression (ZARmillion)							
	FY2020	FY2021	FY2022	FY2023	FY2024*	%Δ FY2024	5yr CAGR
Salaries and wages	14 527	15 437	16 271	17 787	19 246	8,2	7,3
Electricity	11 640	12 260	14 023	14 216	13 640	(4,1)	4,0
Water	6 041	6 090	6 639	7 439	5 988	(19,5)	(0,2)
Grants & donations	289	38	138	104	84	(18,6)	(26,5)
Depreciation	3 366	3 859	3 916	4 049	4 867	20,2	9,7
Contracted Services	41	50	0	0	7 408	n.a	267,5
Repairs & maintenance.	2 478	2 775	0	0	0	n.a	(100,0)
Other expenses	6 858	8 019	12 256	12 414	9 241	(25,6)	7,7
Bad debts	7 014	6 667	5 657	7 220	7 213	(0,1)	0,7
Net interest	2 524	2 607	2 621	2 725	2 397	(12,0)	(1,3)
Total expenditure	54 777	57 801	61 522	65 952	70 083	6,3	6,4

Source: AFS * Unaudited preliminary accounts

This impact of the weak financial performance has been most evidenced through an erosion in municipal infrastructure and services, with water and electricity outages becoming more common and key transport infrastructure being affected. CoJ has achieved over 90% of its capital budget over most of the last 10 years (aside from the COVID disruptions), although this is considered against a general decline in the actual level of spend from around ZAR8 billion in 2016 and 2017 to below ZAR6 billion in 2023. Repairs and maintenance spend has remained low at around 5% of total spend (below the National Treasury's guidance of 8%), insufficient to maintain existing infrastructure. Although CoJ has developed plans to address these issues, progress has been hampered by financial constraints.

CoJ has indicated that capex will increase to around ZAR6.6 billion in fiscal 2024, being 96% of the budget, whilst R7.4 billion in 2024/25 and R7.9 billion thereafter. Of this around half is targeted towards Electricity, Water and Human Settlements, with roads and transport also receiving large allocations. However, this falls well short of the ZAR220 billion infrastructure backlog estimated by the city. To address problems more proactively and ensure the necessary capacity, from both the public and private sectors is available to implement projects and better maintain existing infrastructure, the city has implemented an Infrastructure Asset Management (IAM) improvement programme.

Exhibit 3: Operating Surplus analysis (ZARmillion)					
	FY2020	FY2021	FY2022	FY2023	FY2024*
Income	56 864	60 511	61 899	64 012	70 417
Expenditure	(52 253)	(55 195)	(58 901)	(63 227)	(67 686)
Op. surplus	4 611	5 316	2 998	786	2 731
Interest	(1 840)	(1 960)	(1 907)	(1 820)	(1 608)
Net surplus	2 772	3 356	1 091	(1 034)	1 123

Source: AFS * Unaudited preliminary accounts

Debtors collections remain a major challenge, with impairments to total debtors increasing further to 82.1% in fiscal 2023 (fiscal 2022: 81%), although there are some signs of improvement. The collections ratio has averaged around 87%/88% over the 2022-2024 period, which is below the 90% collection rate the Metro is targeting. Fiscal 2024 collections fell to around 86% due to weaker collections in 1H 2024, but the collection level increased in the six months to June 2024 as interventions came into effect. This included better management of large rates/electricity users and more stringent enforcement of disconnections. Going forward, the Metro will implement enhanced stakeholder engagement, especially for large residential and commercial customers. CoJ also aims to reduce the number of estimations and billing errors. The target is to improve collections to over 90% in the short term and over 95% over the next 18 months, although the current budget is based on a collection level of 88%.

Exhibit 4: Cashflow (ZAR'm)					
	FY2018	FY2019	FY2020	FY2021	FY2022
Cash flow from operations	4 894.7	8 548.4	5 739.4	6 048.8	4 066.3
Net capital expenditure	(6 497.6)	(7 397.1)	(5 309.3)	(6 782.5)	(6 620.7)
Investment activity	959.5	(9.4)	0.9	574.4	(269.0)
Retained cash	(643.4)	1,142.0	431.0	(159.3)	(2 823.4)

Source: AFS * Unaudited preliminary accounts

Management and governance

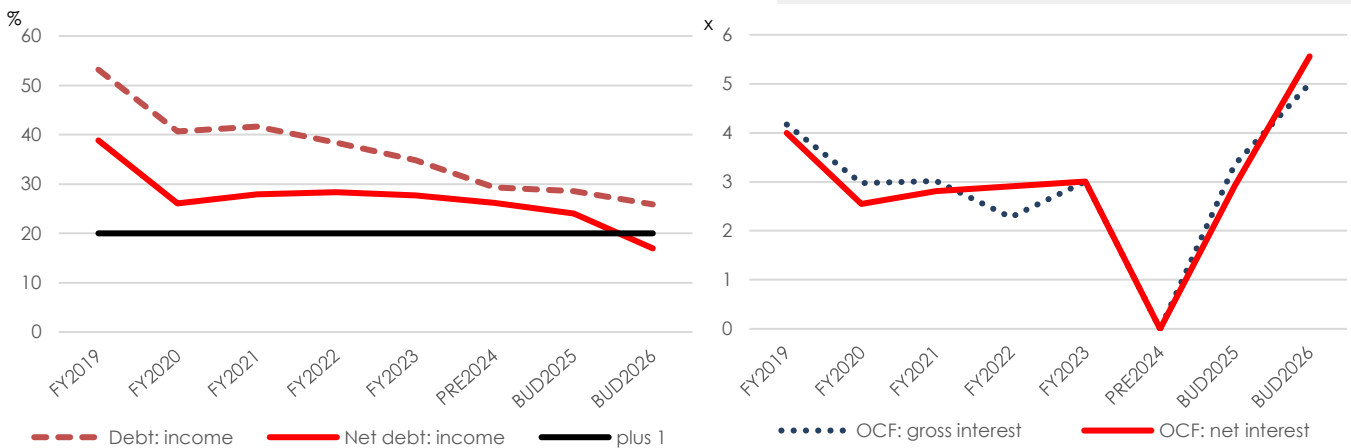
CoJ has received unqualified audit reports for the last 10 years, albeit that some municipal entities have deteriorated from previous Clean Audits. The majority of the findings relate to non-compliance with the Municipal Finance Management Act (MFMA) on procurement and tender management, leading to an increase in unauthorised, irregular, fruitless and wasteful expenditure (UIFWE) to a cumulative ZAR21.9 billion at fiscal 2023 (fiscal 2022: restated to ZAR17.6 billion). To reduce its UIFWE, the Metro is working to regularise historical expenditure through the council and condone current expenditure timeously. Around ZAR7 billion has already been condoned and the Metro is targeting a reduction in total cumulative UIFWE to ZAR7.9 billion by mid-2025. Reporting of potential matters has also been improved to address current concerns. CoJ is also making some progress in addressing the Auditor General's findings with significant input from National Treasury. While around 75% of findings were remedied in fiscal 2024 substantial issues remain in the delivery of services such as water, electricity, and refuse removal. In this regard, CoJ currently estimates that it has a ZAR220 billion infrastructure backlog, which could further hamper its development and service delivery if not addressed.

GCR also remains concerned about ongoing political instability within the council, albeit noting relative stability within the executive management team.

Leverage and capital structure

CoJ's gross debt decreased slightly to ZAR19.3 billion in fiscal 2024 from ZAR22.3 billion in fiscal 2023 (fiscal 2022: ZAR23.8 billion), as no new facilities were raised during the year, whilst amortisation and redemption payments amounted to ZAR2.6 billion. Although reducing debt is generally positive, the decrease reflects the low appetite of funders to provide further facilities to the South African municipal sector, as well as political disagreements within the council. Post year end, CoJ did receive a ZAR2.5 billion loan from Agence Française de Développement (AFD), including which debt would have been largely unchanged. Looking ahead, CoJ, plans to raise around ZAR2.5 billion p.a., of which around half is to replace amortising debt and half for new projects.

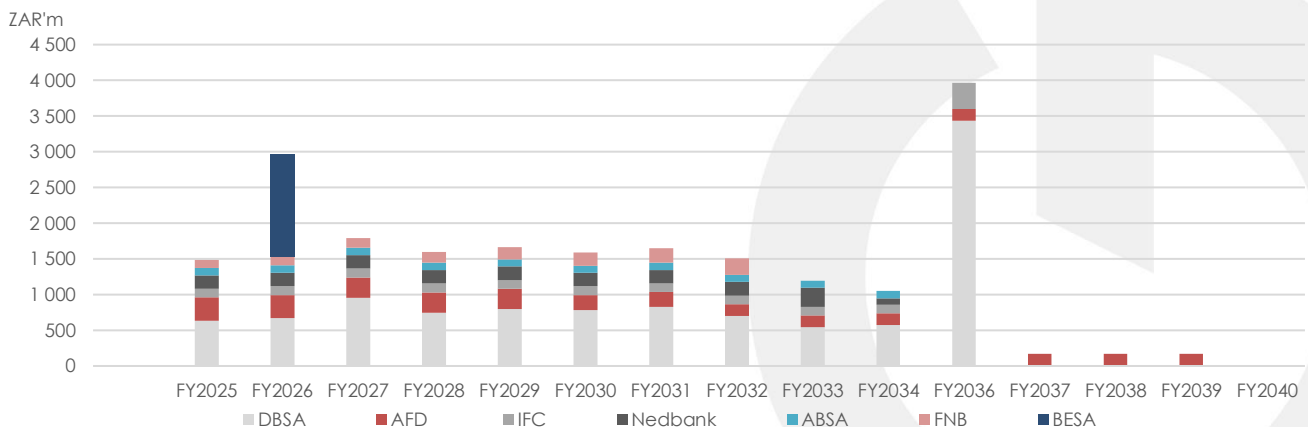
Exhibit 5: Leverage progression **Exhibit 6: Interest Coverage**



Source: AFS * Unaudited preliminary accounts

Given the decrease in debt, gearing metrics improved in financial 2024 and are likely to remain around current levels over the medium term. Thus, Net debt to income declined to 24% in fiscal 2024, but following the new loan is likely to return to around 28% in financial 2025. Excluding capital grants, CoJ calculated their net debt to income ratio at around 35%, which is well below the covenant level of 55%. Gross interest cover continues to trend around the 3x level, which we expect to be maintained going forward. Although a decreasing interest rate environment suggests some improvement in the metric, CoJ is less sensitive to interest rates as a large portion of its interest rates are fixed, whilst it may also face higher spreads in an effort to attract private sector funding.

Exhibit 7: Debt Maturity Profile by Lender



Source: CoJ

GCR remains concerned about the high debt concentration to DBSA, which accounted for around 51% of debt at fiscal 2024. However, the AFD loan did demonstrate some access to funding from international development agencies,

which could become a more prominent source of funding, while engagements with local commercial banks have indicated a renewed appetite to fund specific projects. The Metro repaid its ZAR1.5 billion maturing bond during fiscal 2024, utilising cash in the sinking fund, and is in the process of renewing its DMTN programme, with a view to future issuances. There is only a single ZAR1.5bn bond left that will mature in financial 2026.

Maturities are well spaced, stretching to 16 years, with most issuances being amortising debt. Of concern, however, is the shorter tenor of new debt facilities, with most amortising over a ten-year period, compared to periods of 15 to 25 years previous.

Liquidity

Concerns over CoJ's liquidity position have heightened as cash holdings fell to a review period low of ZAR2.2 billion in fiscal 2024, equating to just 5.5 days cash on hand. This was somewhat compensated for with the receipt of the ZAR2.5 billion loan post fiscal 2024 year-end, but days cash on hand are expected to remain below 30 days through fiscal 2025. Positively, CoJ was able to fund all capex internally in fiscal 2024 in the absence of the new loan. While GCR considers debt redemptions to be moderate in the short to medium term, ongoing access to internal liquidity and funding is required to improve CoJ's capex and service delivery responsibilities. Accordingly, attaining a collection rate above 90% is critical to supporting a recovery in the liquidity profile.

Comparative profile

Peer analysis

No peer adjustments have been factored into the ratings.

Group support

Group support is not applicable to the ratings.

Rating adjustment factors

Structural adjustments

No Rating Adjustment Factors have been factored into the ratings.

Instrument ratings

No adjustments for instrument ratings are applicable.

Glossary

Asset	A resource with economic value that a company owns or controls with the expectation that it will provide future benefit.
Capital	The sum of money that is invested to generate proceeds.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Issuer	The party indebted or the person making repayments for its borrowings.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.

Long Term Rating	See GCR Rating Scales, Symbols and Definitions.
Maturity	The length of time between the issue of a bond or other security and the date on which it becomes payable in full.
Portfolio	A collection of investments held by an individual investor or financial institution. They may include stocks, bonds, futures contracts, options, real estate investments or any item that the holder believes will retain its value.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Short Term Rating	See GCR Rating Scales, Symbols and Definitions.

Salient Points of Accorded Ratings

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- Audited Annual Financial Statements to June 2023 (Plus four years of comparative audited numbers);
- Draft unaudited financial statements to June 2024
- Auditor General report to June 2023;
- Draft Integrated Development Plan 2024/2025;
- Annual report to June 2023;
- Budget for 2024 and 2025;
- Full details of funding facilities
- Other relevant market information.

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