FISH HOEK VALLEY
RATEPAYERS & RESIDENTS ASSOCIATION

(Incorporating Fish Hoek, Clovelly and Sun Valley)

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SUBJECT: OBJECTION TO THE CITY'S PROPOSED INTENTION TO INCUR LONG-TERM FOREIGN CURRENCY DEBT FOR WASTEWATER FACILITIES UPGRADES

DUE: 25 SEPTEMBER 2018

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1. **DISCUSSION**

In accordance with Section 46(3) of the Local Government: Municipal Finance Management Act (No 56 of 2003), whereby the City of Cape Town made public an information statement setting out particulars of a proposed long-term debt to be considered for approval by the Council of the City of Cape Town at its meeting on 25 October 2018. The City has been approached by a Development Finance Institution (DFI) to fund specific projects exclusively for the refurbishment and expansion of several waste water treatment plants in Cape Town. Notice was further given in accordance with Section 21A and Section 21 of the Local Government Municipal Systems Act, No. 32 of 2000, that we can submit comments in respect of the proposed long-term debt.[1]

Just because a sales person comes knocking, doesn't mean that one has to accept their offer. This is essentially an unsolicited bid, which used to be frowned upon by the City. In this case, the Development Finance Institute approached the City to take out long-term debt of €80m with the KfW Development Bank of Germany over 15 years at 8.25%. However, Section 47 of the Municipal Finance Management Act (MFMA) #56 of 2003 requires all financial transactions to be done in South African Rands not indexed or affected by fluctuations in the value of the Rand against any foreign currency. This loan's interest rate is calculated on a Euribor basis which is a daily reference rate that is then swapped into the Rand equivalent. By this definition, this loan seems to be in contravention of not being indexed or affected by fluctuations in the value of the Rand against any foreign currency.

The additional 50 basis points "margin" is not defined. This could be a profit margin leaving the rand exchange conversion undeclared and the mechanism for payment in constant Rand value as required in all Supply Chain Management Bid Adjudication Committee tender awards.

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[1] http://www.capetown.gov.za/City-Connect/Have-your-say/Issues-open-for-public-comment/comment-on-proposed-intention-to-incur-long-term-debt

It could be assumed that the additional 50 basis points to 8.75% is to cover the Rand / Euro fluctuation over the 15 year period. As Rand exchange derivatives cover six month periods only, premium payments will have to be made 29 times and thus, we think the cost will be greater than the 50 basis points mentioned. If the rand exchange coverage is rather covered by a future, then this is even more problematic as there is an unlimited downside associated with futures, meaning that the City could end up paying more than the original €80m.

As the 8.75% is stated as an "indicative" rate, we hope this means that the rate is fixed and is not a floating rate that can fluctuate over time.

We disagree with the City's media statement [2] that 8.75% is a "highly subsidised interest rate". Government retail bonds are paying this rate, depending upon duration. Has the City's credit rating dropped? Euro denominated debt has been in the low single units for years. South African use of Euro debt has had to pay an, *inter alia*, inflation differential risk premium. Still, previous City foreign debt has been in the 4% to 5% range. So, why is 8.75% now seen as attractive?

We also disagree with the statement that "the loan funding will…avoid excessively burdening ratepayers". Irrespective that none of the earmarked projects (Cape Flats, Bellville, Mitchells Plain, Borchard's Quarry, Hout Bay, Gordon's Bay and Zandvliet wastewater treatment plants) affect the Fish Hoek Valley directly, ratepayers must pay the redemption and interest charges. Paying higher interest of 8.75% will be an additional burden bordering on wasteful and fruitless expenditure. According to the City council's financial reports, Capetonians already owe the municipality R8.8bn, with arrears debt at R5.5bn. [3] As we are in the second recession within 10 years, this could lead to job losses and even weaker economic activity causing more hardships for citizens trying to pay their rates. "Many consumers cannot afford their payments to councils."

The City's current debt level might be at an acceptable rate to the City. However, continuing to take on additional debt may not be sustainable, especially over 15 years. It is the inability to service this sort of foreign currency debt obligation that is forcing many emerging markets, particularly in sub Saharan Africa, to seek International Monetary Fund (IMF) bailouts at present. Also, KfW is expecting the South African Government to provide a sovereign guarantee. [4]

2. RECOMMENDATIONS

Therefore, for the reasons set out in this report, we recommend that:

- Where debt external to the City needs to be incurred, South African instruments, such as retail bonds, be used;

- Wastewater treatment upgrades be properly explained prior to proposals for off-balance sheet financing, through a proper public participation process;

[2] http://resource.capetown.gov.za/documentcentre/Documents/Forms,%20notices,%20tariffs%20and%20lists/Information%20Statement-English.pdf

[3] https://www.iol.co.za/capeargus/news/city-of-cape-town-to-take-out-r14bn-loan-and-ratepayers-may-have-to-pay-it-back-16937058

[4] https://csp.treasury.gov.za/Resource%20_Centre/Conferences/Documents/DFI%20Day/KFW_Muni_Finance%20DFI%20Day%20Presentation.pdf)

- Public-private-partnerships in the development of wastewater treatment plants be explored;

- Stricter management of what goes into the wastewater system be applied - such as grease management from restaurants, industrial effluent and inappropriate solids from domestic users; and

- That the City put pressure on National Treasury to give Cape Town its fair and equitable share of the national revenue.

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