SA municipalities face operational and financial challenges

Though notable progress has been made with respect to the roll-out of basic services and infrastructural developments across the municipal sector in recent years, resulting in generally stable credit rating outlooks across the entire sector, various operational and financial challenges will continue to persist into the future.

This is according to Marc Joffe, head analyst for the municipal sector at Global Credit Ratings (GCR), who says these challenges have been exacerbated by increasing population levels and urbanisation, specifically with regards to the metropolitan areas and secondary cities, which has resulted in on-going demand for basic services and increasing pressure being placed on existing ageing assets.

"These challenges have been aggravated of late by on-going concerns facing South Africa, particularly surrounding economic policies, a rise in the number and intensity of annual wage negotiations and a sustained high unemployment rate," he says.

Flexibility was impacted

As a result of the recent downgrade of South Africa's sovereign debt rating, the financial flexibility of government was impacted which is likely to lead to potential ramifications for the municipal sector, given that a notable portion of local government funding is sourced from national and provincial government transfers.

"The challenging economic environment, compounded by above inflationary tariff increases being implemented across a number of municipal services (such as electricity), as well as rising costs across a number of non-municipal related services, has placed increasing pressure on consumer affordability. As such, a continued rise in consumer debtors and potential non-recovery thereof poses a significant threat to the financial position of a number of municipalities."

He also notes a generally sharp deterioration in key liquidity ratios for the industry in recent years, indicating significant cash flow strain, particularly with regards to the smaller municipalities. "As a result stringent cash flow management and the possible delay or reprioritisation of certain capital projects may be required in the short term to shore up cash balances and improve liquidity metrics.

Borrowing expected to decline

"The continuous upward trend in the borrowing profile of municipalities in recent years, driven by on-going demand for infrastructure relating to service delivery, is expected to decline as municipalities reassess the strength of their balance sheets in light of the challenging economic environment," says Joffe.

The impact of further downgrade(s) of South Africa's credit rating would also likely adversely impact on the credit profile of municipalities (given its close link to government), in turn, driving higher borrowing costs.

Following the termination of the regional electricity distributors policy in December 2010, municipalities are assured that electricity supply will remain their responsibility. "Cognisance is, however, taken of the cost pressures associated with the distribution of this service and high tariff increases being applied. Furthermore, the high number of vacancies and/or instability at a senior management level poses a risk to the financial and operational management of a municipality," concludes Joffe.