



# Structured Finance



## City of Johannesburg

### HIGHLIGHTS

- Rand 1bn (US\$153mn equivalent) 12-year bond issue by the City of Johannesburg (South Africa)
- Partial credit guarantee for 40% of principal shared equally by IFC and the Development Bank of Southern Africa (DBSA)
- Achieved a national scale rating of double-A minus, three notches above the City's stand-alone rating
- First structured and longest maturity municipal bond in South Africa

### THE COMPANY

The City of Johannesburg (COJ or the City), South Africa's largest city with a population of 3.2 million, is located in the Gauteng province, the mining heartland of South Africa. It is the country's main business center, contributing more than 16% of the national GDP.

The City's economy is dominated by four sectors, namely financial and business services, wholesale and retail trade, community and social services, and manufacturing. It provides 12% of national employment – but the city has a high unemployment rate, currently standing at 33%.

The City provides the full range of municipal services, ranging from power transmission to waste management. City revenues come primarily from power, water and sewerage tariffs, property taxes, and business taxes. The City operates a balanced budget and this is anticipated to continue.

### FINANCING OBJECTIVES

The City's objectives were fourfold: (i) extend the maturity of its debt to better match its long-term assets, (ii) finance long-term infrastructure projects, (iii) refinance existing high-cost bank debt, and (iv) diversify its funding sources. The latter was a prime objective since the banks have had a near monopoly on debt funding of municipalities.

This bond issue was an essential part of the City's financial diversification strategy since it allowed them to tap the institutional investor market. Although the City sought funding beyond 10 years, they faced a constraint in that they could not issue beyond 6 or 7 years at an acceptable price without external credit enhancement. Consequently, they used a partial credit guarantee in order to raise the credit rating, allowing for an extension of the bond maturity.

### THE STRUCTURE

The Rand 1bn, 11.90% coupon bond matures in 2016 and amortizes over the last 3 years in six semiannual payments. The transaction incorporates a sinking fund for principal payments, which will be funded on a monthly basis starting seven months prior to any principal payment date.

IFC assisted in structuring the transaction and provided credit enhancement in the form of a partial credit guarantee. The guarantee was sized at 40% of the principal outstanding and was shared equally with DBSA on a several but not joint basis.

The guarantee can be used to repay up to the full amount of principal and interest falling due and payable to bondholders on any given payment date (subject to guarantee limits) if there are insufficient funds for a particular period. The guarantee may also be called upon if the bonds have been accelerated. In addition, the guarantors can accelerate their obligations under the guarantee in certain circumstances.



## OUTCOME

The bonds were rated AA-.zaf by FitchRatings, a three-notch upgrade from COJ's stand-alone rating of A-.zaf. The issue was oversubscribed 2.3 times with approximately Rand 2.3bn bids received in an initial credit spread range of between 150 basis points to 200 basis points over the benchmark government bond.

The oversubscription allowed for spread tightening to 164 basis points above the benchmark and it was subscribed by 13 investors. The issue was a significant success since it allowed the City to meet its financing objectives. It was the first structured municipal bond in South Africa and the longest-dated municipal bond. The transaction priced tighter than expected, reflecting a strong endorsement by the market of the credit-enhanced structure. As a comparator, the City's inaugural 6-year bond (rated A-.zaf), issued in April 2004, was placed at 235 basis points above the government benchmark; 71 basis points higher than the IFC credit-enhanced bond.

The transaction was IFC's first partial credit guarantee in South Africa and has laid the groundwork for future involvement in the country's capital markets and the municipal sector.

## TERMS AND CONDITIONS

<b>Amount</b>	ZAR 1bn (approximately US\$153mn)
<b>Currency</b>	South African Rand
<b>Issue Date</b>	June 23, 2004
<b>Maturity</b>	12 years
<b>Series</b>	1 Series
<b>Interest Payment</b>	11.90%, payable semiannually
<b>Principal Payment</b>	Six equal semiannual payments over the last 3 years
<b>Rating</b>	AA-.zaf by FitchRatings
<b>Enhancement</b>	Principal and interest for an amount up to 40% of principal outstanding, shared by IFC and DBSA on a several but not joint basis