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FITCH UPGRADES CITY OF JOHANNESBURG TO 'AA-(ZAF)'; OUTLOOK STABLE

Fitch Ratings-London/Johannesburg-31 July 2008: Fitch Ratings has today upgraded the South African City of Johannesburg Metropolitan Municipality's (CoJ) National Long-term rating to 'AA-(AA minus)(zaf)' from 'A+ (zaf)' and National Short-term rating to 'F1+(zaf)' from 'F1(zaf)'. The rating Outlook remains Stable. The action affects ZAR8.2bn financial debt outstanding at end-June 2008, as well as future direct borrowing.

The upgrade reflects CoJ's strengthening operating performance, driven by a growing tax base and subsidies from the national government. It also reflects higher provisions for asset depreciation, which help to self-finance its investments, now approaching ZAR5bn, up from ZAR1bn in FY04. The rating also considers the municipality's long-term challenges, such as income inequality and low labour participation, which tend to limit tax generation while requiring subsidies.

The ratings could be upgraded further if easing macroeconomic tensions help to alleviate rising cost pressures on the municipality's operating performance, and if the sale of its ZAR2bn net debtor-book is completed successfully, providing the municipality with corresponding liquidity. Conversely, the ratings might come under downward pressure if borrowing overshoots projections, leading to declining debt and debt-service coverage ratios, and if real GDP growth weakens, constraining tax revenue growth.

CoJ's operating performance continues to be strong, underpinned by tax and fee collection rates of about 95%. Adjusted for depreciation provisions, the operating margin averaged about 15% per year of operating revenue during FY05-FY08, up from 6% in FY03. Operating balance should stabilise at the same level during FY09-FY11 as slowing economic activity could limit the municipality's ability to pass on increasing costs of water, electricity and other services to residents.

Although investments are gradually approaching ZAR5bn, growing capital subsidies from the central government to fund infrastructure spending related to the 2010 FIFA World Cup and a rising operating surplus should limit CoJ's borrowing requirements to about ZAR1bn on average over the next three fiscal (FY09-FY11) years.

CoJ's financial debt should increase to about ZAR10bn by FY2011, while remaining rather stable relative to the budget size and continue to account for less than 50% of consolidated operating revenue. The city is also committed to keeping interest expenses below 7% of operating expenditure. However, bullet bond issues in recent years have raised the average life of its debt to close to 10 years. Although CoJ is building up reserves in the sinking funds and escrow accounts (ZAR2bn) to repay debt at maturity, and its debt/current balance is only five years, the rising average life of its debt exposes the city to a potential decline in its debt coverage ratio should its operating margin decline.

The rise of commodity prices and frequent power cuts could negatively affect the local economy while putting upward pressure on the municipality's operating costs, such as personnel and bulk purchases. However, local economic growth should hover around 3% per year over the medium term, benefiting from public works related to both the 2010 World Cup and to overcome infrastructure backlog. Estimated income per capita of about ZAR60,000 is approximately 40% above the national average and should help to underpin an average operating revenue growth of close to 10%. Tax and fee rates linked to inflation and the continual expansion of the tax base should help to maintain a good match between revenue and spending.

CoJ's long-term challenges remain. Self-determination on major revenue and expenditure continues to be weak and remains under the national government's control. Nevertheless, the 2007 Municipal Fiscal Power Act has introduced some elements of revenue-raising potential, such as the 2% business levy for inner city regeneration. Income inequality and the still high percentage of population infected with HIV remain the main burden on future economic growth, with their demand for higher social and health costs over the medium term. A potential burden stems also from pension and potential unfunded liabilities, which the city seeks to control by implementing self-insurance policies.

CoJ has a population of about 3.5 million, representing 7% of the national total. It is the financial hub of South Africa, accounting for about 16% of GDP and around 15% of employment, and houses most of the headquarters of companies operating in the country

An updated credit report will soon be available on Fitch's subscription website, www.fitchreaserch.com

Contact: Raffaele Carnevale, Milan, Tel: +39 02 879087 216; Federico Alfonsi, +39 02 879087 246; Tertius Smith, Johannesburg, +27 11 380 0913

Media Relations: Peter Fitzpatrick, London, Tel: + 44 (0)20 7417 4364.

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