

ISSUER IN-DEPTH

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Cape Town, City of

Green Bond Assessment

Summary



Summary Opinion

A GB1 (Excellent) grade is assigned to the senior unsecured amortizing green notes to be issued by [Cape Town](#) (Baa3 negative), the second largest city in [South Africa](#) (Baa3 negative), on or about July 17. The GB1 grade is supported by the use of proceeds dedicated to refinancing and, to a lesser degree, financing water, sanitation and transportation projects to mitigate and adapt to climate change. Key considerations in our assessment include:

- » The city's effective organization and formalized approach to identifying, qualifying and selecting environmentally beneficial projects.
- » Green note proceeds allocated to projects to mitigate and adapt to climate change through investments in water, sanitation and transportation projects, in accordance with the city's green bond framework and other accepted standards.
- » Summaries that outline the details of each projects, including rand amounts and, where possible, the environmental benefits of each project.
- » A system to track proceeds and funds invested by the city in cash and cash equivalents until allocated.
- » The city's adoption of comprehensive disclosure commitments that extend for the life of the notes.

Factor	Factor Weights	Score	Weighted Score
Organization	15%	1	0.15
Use of Proceeds	40%	1	0.40
Disclosure on the Use of Proceeds	10%	1	0.10
Management of Proceeds	15%	1	0.15
Ongoing Reporting and Disclosure	20%	1	0.20
Weighted Score			1.00

The transaction's weighted score, using the green bond scorecard, is 1.0. This, in turn, corresponds to a GB1 grade.

Transaction Summary

The City of Cape Town is planning to issue senior unsecured amortizing green notes with a tenor of 10 years, on or about 17 July 2017, in the amount of up to 1 billion rand (\$77 million), pursuant to the municipality's updated R7 billion Domestic Medium Term Note Programme (DMTN). The notes are expected to be listed on the Johannesburg Stock Exchange (JSE).

Strengths and Weaknesses

Strengths	Weaknesses
Well-defined organizational structure and decision making process for considering, evaluating and selecting eligible projects	
100% of the proceeds allocated to qualifying environmental projects	
Project-level summaries that highlight how proceeds will be spent and the anticipated environmental benefits	
System to track remaining proceeds invested by the city in accordance with its cash management policy	
Comprehensive annual disclosures that extend through the life of the notes	

Organization



Cape Town has adopted a Green Bond Framework that details how it plans to use green bonds to finance green projects. The framework also details how projects will be identified, qualified and selected, along with the reporting and disclosure practices and cash management policies. Issuance of green bonds is a citywide initiative advocated by the mayor and responds to investor appetite for green and sustainable investment opportunities.

The city's July green bond issuance process involved coordination with multiple city government departments and functions. The initiative was primarily led by the city's Environmental Management Department, a unit under the Transport and Urban Development Authority Directorate, which helps implement the city's environmental strategy policy. These groups worked in conjunction with the city's Green Economy, Environment and Climate Change Working Group to ensure Cape Town's long-term environmental sustainability. They also coordinated closely with the city's finance directorate.

The various parties evaluated the capital program with a view towards identifying significant projects that not only fit the climate-change adaptation and mitigation strategies, but aligned with the taxonomy established by the Climate Bonds Initiative (CBI). Projects were screened, formally documented and evaluated on the basis of climate change vulnerability assessments.

To this end, the city has obtained pre-issuance assurance from CBI that the framework and identified programs, projects and assets qualify for certification under the CBI taxonomy. Post-issuance assurance will be sought within three months after the registration of the notes in order to ensure compliance with certification requirements. The transaction will also be accompanied by pre- and post-issuance assurances by KPMG.

Any reallocation of proceeds will be done after ensuring that the program, project or asset are in compliance with the requirements of the relevant Climate Bonds Certification Criteria. To ensure continued compliance and maintain the certification of the notes, the proceeds will be allocated in accordance with the Climate Bonds Standard version 2.1.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Factor 1: Organization (15%)	Yes	No
Environmental governance and organization structure appear to be effective	•	
Policies and procedures enable rigorous review and decision making process	•	
Qualified and experienced personnel and/or reliance on qualified third parties	•	
Explicit and comprehensive criteria for investment selection, including measurable impact results	•	
External evaluations for decision making in line with project characteristics	•	
Factor Score	1	

Use of Proceeds



Cape Town's green note proceeds will be allocated to projects to mitigate and adapt to climate change through investments in water, sanitation and transportation projects. The city selected the projects in accordance with its established green bond framework. Projects also accord with the taxonomies established by the Green Bond Principles as well as the Climate Bonds Initiative.

The proceeds will be used to finance and refinance nine projects largely intended to adapt to, but also mitigate, climate change through investments in water and sanitation projects as well as transportation. These programs are intended to save water through reduced usage – especially critical given Cape Town's drought-induced water crisis – leakage and wastage, upgrading of sewage pipes and infrastructure to avoid storm-related damage, protection against future flooding, rehabilitation and restoration of Sir Lowry's Pass River, upgrading of various seawalls and the launch of a pilot project to introduce electric buses with the aim of reducing CO₂ emissions (see Exhibit 1 and highlight box).

Exhibit 1

Cape Town green bond projects largely dedicated to water

Project	Type	Category	Actual/Budgeted Amounts, Fiscal 2014-17 (Rand, millions)	Future Budgeted Amounts, Fiscal 2018-19 (Rand, millions)
Upgrade of Reservoirs Citywide	Adaptation	Water	9	-
Pressure Management: Zone Metering and Valves	Adaptation	Water	33	22
Treated Effluent: Reuse and Infrastructure Upgrades	Adaptation	Water	65	20
Meter Replacement Program	Adaptation	Water	639	505
Replacement and Upgrade of Sewer Pump Station	Adaptation and Mitigation	Water	6	-
Sir Lowry's Pass River Upgrade Scheme	Adaptation	Water	10	140
Coastal Structures Rehabilitation	Adaptation	Water	19	-
Replacement and Upgrade of Sewer and Water Supply Network Citywide	Adaptation	Water	198	-
IRT Vehicle Acquisition (Electric Vehicles)	Mitigation	Transportation	-	131
Totals			977	819

Source: City of Cape Town

Actual project expenditures through 31 May 2017 to be refinanced total R916 million (\$71 million). The full-year fiscal 2016-17 budget for the green projects was revised to an amount of R220 million and approved on 31 May 2017. Under this budget, total project expenditures through the end of fiscal 2016-17 will total R977 million. Future budgeted project expenditures total R410 million for fiscal 2017-18 and R408 million for fiscal 2018-19.

Green note proceeds will be used to finance and refinance nine projects

- » Upgrade of Reservoirs Citywide: The city replaced the roofs on the Neptune and Brakkloof reservoirs. The projects qualify as adaptation projects given that the city will save water through the prevention of contamination of potable water and through reduced evaporation.
- » Pressure Management: Zone Metering and Valves: Proceeds will be used to advance a project under the city's water conservation and water demand management strategy. This project will improve the city's ability to calculate the water balance and identify areas where the greatest water leakages are being experienced that need to be prioritized for intervention, for example through pipe replacements. The project will help the city save water through lower water pressure (as less water is released through the tap), fewer pipe bursts and the ability to identify leakages more quickly.
- » Treated Effluent: Reuse and Infrastructure Upgrades: Proceeds will be used for a project to use treated effluent for purposes that don't require potable water, providing an alternative source of water for non-potable purposes and thus prolonging the need for new and more costly potable water sources. The city will use the treated effluent from the waste water treatment plants for distribution to industry, park, recreation and public open space and school fields. The city saves potable water that would usually be used for irrigation or industrial processes through the use of treated effluent.
- » Meter Replacement Program: The city will use proceeds for meter replacement, leaking infrastructure upgrades and the installation of water management devices. These projects will increase the city's control and management of its water resources and will seek to address water leaks on private property in low-income communities.
- » Replacement and Upgrade of Sewer Pump Station: This project involved the upgrade and refurbishment of the Lourens River Pump Station, situated in Strand. This includes the upgrading of the civil components of the pump stations as well as the upgrading and replacement of mechanical and electrical equipment. The project's mitigation aspect involves the reduction of greenhouse gas emissions as less energy will be consumed, while the adaptation aspect involves the reduction of contaminated water potentially entering natural water bodies.
- » Sir Lowry's Pass River Upgrade Scheme: The city will seek to return the river to a more natural state, a project that will protect surrounding areas against future flooding that is expected due to projections of more intense rainfall in Cape Town. Restoring the river to its natural state will also enable the resumption of natural ecological services provided by the river system, rendering the system more resilient to future shocks and stresses.
- » Coastal Structures Rehabilitation: This project involved the upgrading of various sea walls in the city to prevent flooding of the adjacent businesses, residential properties and beach roads.
- » Replacement and Upgrade of Sewer and Water Supply Network Citywide: The city replaced and upgraded large portions of its sewer reticulation pipe network. These upgrades and replacements will help to prevent contaminated water from entering natural water bodies and lead to fewer pipe bursts and water leakages.
- » IRT Vehicle Acquisition (Electric Vehicles): Proceeds will be used to fund an electric bus pilot project as part of Transport for Cape Town's (TCT) greening program. TCT is exploring a range of alternative bus technologies and alternative fuel options for its MyCiTi bus fleet. The pilot electric bus project will be comprised of 10 electric buses and additional goods and services that are required to maintain the buses at a high quality and operational level of service. The transportation sector in Cape Town accounts for 65% of the total energy consumed and 34% of total CO₂ emissions produced.

Factor 2: Use of Proceeds	Yes	No
>95% - 100% of proceeds allocated to eligible project categories that are determined based on the issuer's adopted policies and the categories established under the Green Bond Principles that will be further informed by one or more robust and widely recognized green bond frameworks or taxonomies that qualify eligible projects, including any applicable regulatory guidelines.	●	
Factor Score	1	

Disclosure on the Use of Proceeds



Each project is identified with a summary that describes the project, including the location, and amounts budgeted, operational life span of the project, and the expected adaptation or mitigation benefits. Wherever possible, particularly with respect to mitigation-oriented projects, specific metrics have been identified and will be measured and disclosed. Otherwise, reporting will focus more on the progress of the projects. Reporting will be provided at the time of issuance and periodically thereafter, but at least annually, over the life of the notes up to 10 years.

The city's planned disclosure approach is consistent with its overall commitment pursuant to its Climate Change Policy to use appropriate tracking tools in order to fully assess carbon effects and climate resilience at various levels to assess progress relative to its broader climate policy.

Factor 3: Disclosure on the Use of Proceeds	Yes	No
Description of green projects, including portfolio level descriptions, actual or intended	•	
Adequacy of funding and/or strategies to complete projects	•	
Quantitative and/or qualitative descriptions for targeted environmental results	•	
Methods and criteria, both quantitative and qualitative, for calculating performance against targeted environmental results	•	
Issuer relies on external assurances: Second Party reviews, audits and/or third party certifications	•	
Factor Score	1	

Management of Proceeds



In addition to compliance with any locally applicable rules and regulations, Cape Town intends to track proceeds through its applications and products (SAP) enterprise resource planning (ERP) system. This system allows the municipality to extract reports that will for each project describe the budgeted amount, actual amount disbursed, funding source and breakdown of the work performed.

While the proceeds are largely earmarked to finance projects that have already been initiated by the city (such that the proceeds will be allocated to eligible projects as soon as possible after the notes are placed and transactions settled), any remaining balances will be invested internally by the city in cash and cash equivalents until all proceeds are allocated. This strategy is pursuant to the city's formally adopted cash management and investment policy. Under this policy, the city has outlined the following classes of securities as permitted investments:

- » Securities issued by the national government
- » Listed corporate bonds with a short-term investment grade rating of A1 or better from a nationally or internationally recognized credit rating agency
- » Deposits with banks registered in terms of the Banks Act, 1990
- » Deposits with the public investment commissioners as contemplated by the Public Investment Commissioners Act, 1984
- » Deposits with the Corporation for Public Deposits as contemplated by the Corporation for Public Deposits Act, 1984
- » Bankers acceptance certificates or negotiable certificates of deposit of banks registered under terms of the Banks Act, 1990

- » Guaranteed endowment policies with the intention of establishing a sinking fund
- » Repurchase agreements with banks registered in terms of the Banks Act, 1990
- » Municipal bonds issued by a municipality
- » Any other investment type that the minister of finance may identify by regulation in terms of section 168 of the Banks Act, in consultation with the Financial Services Board

In addition to an independent assurance to be provided by KPMG that will look at where the funds are post-issuance, the tracking of bond proceeds will also be audited by the auditor general, the independent auditor for all public entities in South Africa, as part of the ongoing audit of the city's books and records.

Factor 4: Management of Proceeds	Yes	No
Bond proceeds are segregated and separately tracked on an accounting basis or via a method by which proceeds are earmarked	•	
Application of proceeds is tracked by environmental category and project type	•	
Robust process for reconciling planned investments against actual allocations	•	
Clear eligibility rules for investment of cash balances	•	
Audit by external organization or independent internal audit unit	•	
Factor Score	1	

Ongoing Reporting and Disclosure



In addition to quarterly internal management reporting and some interim reports that may be posted on the city's website, annual disclosures in line with the city's financial reporting requirements will be provided while the notes are outstanding, for a period up to 10 years. Such reporting, which will also be posted on the city's website, will provide updated project details, including amount of funds allocated and unallocated funds as of the reporting date, along with a description of the projects' environmental benefits and associated quantitative measurements to the extent available. Other city reports that highlight the status of environmental projects may contain additional detail related to the notes, but these reports are not part of management's ongoing reporting commitment.

Factor 5: Ongoing Reporting and Disclosure	Yes	No
Reporting and disclosure post issuance provides/to be provided detailed and timely status updates on projects	•	
Ongoing annual reporting is expected over the life of the bond	•	
Disclosures provide granular detail on the nature of the investments and their expected environmental impacts	•	
Reporting provides/to be provided a quantitative and/or qualitative assessment of the environmental impacts actually realized to-date	•	
Reporting includes/to include quantitative and/or qualitative explanation of how the realized environmental impacts compare to projections at the time the bonds were sold	•	
Factor Score	1	

About the City of Cape Town

The City of Cape Town is the second largest city in South Africa, based on total revenue, and one of South Africa's eight metropolitan municipalities. Cape Town is home to over 4 million people and delivers services to approximately 1.3 million households, accounting for 64% of the population in the Western Cape. The city's key strategic focus is to promote the development and promotion of solid infrastructure-led economic growth through the creation of a solid platform of urban infrastructure and supporting services.

In 2001, Cape Town became the first city in Africa to approve and adopt a comprehensive citywide environmental policy in the form of the Integrated Metropolitan Environmental Policy (IMEP). Today the City of Cape Town is aligned with international, national and

local organizations and various climate- and sustainability-related conventions across the world focused on seeking and implementing climate solutions.

Moody's Green Bond Assessment (GBA)

Moody's GBA represents a forward-looking, transaction-oriented opinion on the relative effectiveness of the issuer's approach to manage, administer and allocate assets to, and report on, environmental projects financed by proceeds from green bond offerings. GBAs are expressed using a five-point relative scale, ranging from GB1 (Excellent) to GB5 (Poor). A GBA does not constitute a credit rating.

Moody's Related Research

Methodology:

- » [Green Bonds Assessment \(GBA\)](#), March 30, 2016

Credit Opinion

- » [Cape Town, City of: Update Following Sovereign Action](#), June 14, 2017

Sector In-Depth:

- » [Green Bonds - Global: France's Sovereign Offering Propels Strong First-Quarter 2017 Issuance](#), April 20, 2017
- » [Environmental Risks: Shift in US Climate Policy Would Not Stall Global Efforts to Reduce Carbon Emissions](#), February 16, 2017
- » [Green Bonds - Global: Record Year for Green Bonds Likely to Be Eclipsed Again in 2017](#), January 18, 2017
- » [Environmental Risks - Sovereigns: How Moody's Assesses the Physical Effects of Climate Change on Sovereign Issuers](#), November 7, 2016
- » [Regional and Local Governments - EMEA: Sub-sovereign green bond issuance has growth potential](#), September 21, 2016
- » [Environmental Risks: Risks and Opportunities: What the Paris Agreement Means for Capital Markets](#), July 20, 2016
- » [Cross Sector - Global: Moody's Approach to Assessing the Credit Impacts of Environmental Risks](#), November 30, 2015
- » [Environmental Risks: Heat Map Shows Wide Variations in Credit Impact Across Sectors](#), November 30, 2015
- » [Environmental, Social and Governance \(ESG\) Risks - Global: Moody's Approach to Assessing ESG Risks in Ratings and Research](#), September 8, 2015

Sector Comment:

- » [US - Utilities and Public Power: US Executive Order on Clean Power Plan Will Slow, But Not Halt, Transition Away From Coal](#), March 31, 2017
- » [Green Bonds - Global: Green Bond Principles \(GBP\) Are Updated and Expanded](#), August 31, 2016

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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