Borrowing Policy

2022/2023

No Amendment to the Policy

1. Purpose

1.1. The purpose of this policy is to establish a borrowing framework for the Municipality and to set out the objectives, policies, statutory requirements and guidelines for the borrowing of funds, in order to:

- Manage interest rate and credit risk exposure;
- Maintain debt within specified limits and ensure adequate provision for the repayment of debt;
- Ensure compliance with all Legislation and Council policy governing borrowing of funds.

1.2 This Policy should be implemented in conjunction with the approved Liquidity, Funding and Reserves Policy.

1.3 This policy is implemented to provide guidance on the appropriation of capital funding resources on a sustainable basis in the longer term.

1.4 Although legislation provides guidance as to the broader framework to ensure financial management of resources to ensure the Council meets all of its obligations timeously, it is not prescriptive with regards to quantifying not only the prudent level of Borrowing but more so the optimal level hereof.

1.5 Therefore in this Policy cognisance has been taken of the legislative guidelines whilst more prescriptive guidelines are set for the optimal management and monitoring of external funding sources to the Municipality's avail based on sound financial practices.

2. Legislative Framework

2.1 All borrowings made by the Municipality shall be subject to the requirements of the Local Government: Municipal Finance Act, 2003 (“the MFMA”) and the Municipal Regulations on Debt Disclosure (“the Disclosure Regulations”) made thereunder and published under GN R 492 in Government Gazette 29966 of 15 June 2007.

2.2 Further the MFMA Circular 71 stipulates the following guidelines regarding borrowing:

Capital Cost (Interest Paid and Redemption) as a % of Total Operating Expenditure

2.3 Capital Cost (Interest Paid and Redemption) / Total Operating Expenditure x100

Criteria: 6% - 8%

Debt (Total Borrowings) / Revenue

2.4 (Overdraft + Current Finance Lease Obligation + Non Finance Lease Obligation + Short Term Borrowings + Long Term Borrowings) / Total Operating Revenue

Criteria: Maximum 45%

3. Definitions

Any word or expression used in this policy shall, unless the context clearly requires a different interpretation, bear the same meaning attached to it in the MFMA or the Disclosure Regulations, as the case may be; provided that if there is any conflict between a definition contained in the MFMA and a definition contained in the Disclosure Regulations, then the definition contained in the MFMA shall prevail.

4. Types of Debt

4.1 This policy applies to the debt incurred by the Municipality through the issue of municipal debt instruments or in any other way.

4.2 Without derogating from the generality of the preceding subparagraph, this policy will apply:

4.2.1 To any debt, whether short -term or long term;

4.2.2 To any debt incurred pursuant to any financing agreement, which includes any of the following agreements under which the Municipality undertakes to repay a long-term debt over a period of time:

4.2.2.1Loan agreements;

4.2.2.2Leases;

4.2.3 Instalment purchase contracts;

4.2.4 Hire purchase arrangements;

4.2.5 To any debt created by the issuance of municipal debt instruments, including:

4.2.5.1 Any note;

4.2.5.2 Bond; or

4.2.5.3 Debenture; and

4.2.6 To any contingent liability such as that created by guaranteeing a monetary liability or obligation of another.

4.3 Types of loan financing

4.3.1 Annuity Loans enable the Municipality to provide for the redemption of loans on an amortising basis which is generally the most cost effective method of financing often referred to as vanilla funding;

4.3.2 Bullet Redemption Loans are attractive as interest on the loan is serviced with the capital redemption only taking place at the end of the tenure of the loan. However, this method is more costly as interest is paid on the full debt throughout the term as the Capital does not reduce. This type of loan also requires an annual contribution to a sinking fund, which in essence then mimics the traits of an annuity loan although at a higher cost. The use of such structure warrants a detailed motivation based on the benefits to the implementation of the capital project;

4.3.3 Sculpted Repayment Loans offer a combination of the above two types, as loans are sculpted according to the potential cash flows to be generated from the capital project in future. For example the following can be included in a sculpted loan:

4.3.3.1 A capital grace period in the first years of the development of the capital project;

4.3.3.2 An incremental annual increase in the repayment in relation to the projected growth in revenue from the project.

5. Principles Guiding Borrowing Practices

The following principle shall guide the borrowing practices of the Municipality, namely:

5.1 Risk Management: The need to manage interest rate risk, credit risk exposure and to maintain debt within specified limits is the foremost objective of the borrowing policy. To attain this objective, diversification is required to ensure that the Chief Financial Officer prudently manages interest rate and credit risk exposure;

5.2 Cost of Borrowings : The borrowings should be structured to obtain the lowest possible interest rate, on the most advantageous terms and conditions, taking cognisance of borrowing risk constraints, infrastructure needs and the borrowing limits determined by Legislation;

5.3 Prudence: Borrowings shall be made with care, skill, prudence and diligence. To this end, officials of the Municipality are required to:

5.3.1 adhere to this policy, and other procedures and guidelines;

5.3.2 exercise due diligence;

5.3.3 prepare all reports in a timely fashion;

5.3.4 ensure strict compliance with all Legislation and Council policy.

6. Factors to be taken into account when borrowing

6.1 The Municipality shall take into account the following factors when deciding whether to incur debt:

6.1.1 the type and extent of benefits to be obtained from the borrowing;

6.1.2 the length of time the benefits will be received;

6.1.3 beneficiaries of the acquisition or development financed by the debt;

6.1.4 the impact of interest and redemption payments on both current and forecast income;

6.1.5 the current and future capacity of the Municipality's revenue base to pay for borrowings;

6.1.6 other current and projected sources of funds;

6.1.7 likely movements in interest rates for variable rate borrowings;

6.1.8 competing demands for funds;

6.1.9 timing of money market interest rate movements and the long term rates on the interest rate curve.

6.1.10 The Borrowing and other financial ratios norms, standards and benchmarks applicable to comparable municipalities

6.2 The Municipality will, in general, seek to minimize its dependence on borrowings in order to limit future revenue committed to debt servicing and redemption charges.

7. Sources of Borrowings

7.1 Subject to any particular determination of the Council of the Municipality, the Municipality may enter into financing agreements with:

7.1.1 Registered South African Banks;

7.1.2 The Development Bank of Southern Africa;

7.1.3 Vendors or suppliers of goods acquired under leases, installment purchase contracts or hire purchase arrangements;

7.1.4 Any other institution approved by the Council from time to time.

7.2 Unless the Council of the Municipality specifically determines otherwise, the Municipality shall not incur any debt by the issuance of any municipal debt instruments.

8. Short-term Debt

8.1 The Municipality may incur short –term debt only in accordance with and in the circumstances contemplated in Section 45 of the MFMA.

8.2 In particular, the provisions of section 45 (1) of the MFMA must be noted, these requiring that the Municipality may incur short –term debt only when necessary to bridge:

8.2.1 Shortfalls within a financial year during which the debt is incurred, in expectation of specific and realistic anticipated income to be received within that financial year; or

8.2.2 Capital needs within a financial year, to be repaid from specific funds to be received from enforceable allocations or long-term debt commitments.

8.3 Furthermore, as required by section 45 (4) of the MFMA, the Municipality must pay off short term debt within the financial year.

9. Overdraft Facility

9.1 Overdraft facilities are regulated by Section 45(3) of the MFMA.

9.2 The current policy of the Council of the Municipality is that the Municipality shall not have an overdraft facility.

10. Long Term Debt

10.1 The Municipality may incur long-term debt only in accordance with and in the circumstances contemplated in Section 46 of the MFMA.

10.2 Long-term debt may be incurred only for the purposes contemplated in Section 46(1) of the MFMA, namely:

10.2.1 Capital expenditure on property, plant or equipment to be used for the purpose of achieving the objects of local government, as set out in Section 152 of the Constitution; or

10.2.2 Re-financing existing long term debt, subject to section 46(5).

11. Council approval

Sections 45(2) and 46(2) require that sort-term debt and long-term debt respectively may be incurred only if:

11.1 A resolution of the Council, signed by the Mayor, has approved the debt agreement;

11.2 The accounting officer has signed the agreement or other document which creates or acknowledges the debt.

12. Refinancing

12.1 Short-term debt may not be renewed or refinanced where that would have the effect of extending the short-term debt into a new financial year.

12.2 The Municipality may borrow in order to refinance long-term debt subject to the conditions contained in Section 46(5) of the MFMA.

13. Early repayment of loans

13.1 No loans will be repaid before due date unless there is a financial benefit to the Municipality.

13.2 The Municipality shall therefore assess the nature and extent of any benefits of early repayment before it makes any such early repayment.

13.3 Cognisance must be taken of any early repayment penalty clauses in the initial loan agreement, as part of the assessment.

14. Debt Repayment Period

14.1 As far as is practical, cognisance must be taken of the useful lives of the underlying assets to be financed by the debt for purposes of determining the duration of the debt.

14.2 Should it be established that it is cost effective to borrow the funds for a duration shorter than that of the life of the asset, the Municipality should endeavour to negotiate terms for the loan agreement on a shorter duration.

15. Provision for Redemption of Loans

15.1 The Municipality may set up sinking funds to facilitate loan repayments, especially when the repayment is to be met by a bullet payment on the maturity date of the loan.

15.2 Such sinking funds may be invested directly with the Lender's Bank.

15.3 The maturity date and accumulated value of such investment must coincide with the maturity date and amount of the intended loan that is to be repaid.

16. Non-Repayment or Non-Servicing of Loan

16.1 The Municipality must honour all its loan obligations.

16.2 Failure to effect prompt payment may jeopardise the Municipality's credit rating and adversely affect the ability of the Municipality to raise loans in the future at favourable interest rates.

16.3 In addition to ensuring the timely payment of the loans, the Municipality must adhere to the covenants stipulated in the loan agreements, including, in particular, the following where applicable:

16.3.1 furnishing audited annual financial statements;

16.3.2 maintaining long-term credit rating;

16.3.3 reporting of material changes in financial position of the Municipality.

17. Borrowing for Investment Prohibited

The Municipality shall not under any circumstances borrow funds for the purposes of investing them.

18. Interest Rate Risk Management

18.1 The impact of interest and capital redemption payments on both the current and forecasted property rates and service charges through tariffs taking into consideration the current and future capacity of the consumer to pay therefore;

18.2 Likely movement in interest rates for variable rate borrowings. There are benefits to be yielded from borrowing on a variable rate if rates are projected to decrease in future, however it is prudent for the municipality to enter into fixed interest rate loans to accurately budget for expenses incurred.

19. Loan Covenants

19.1 The municipality is to maintain a Loan Covenants Register detailing the covenants entered into with each active loan agreement until date of maturity thereof;

19.2 Compliance with all loan covenants are to be monitored and reported on semi-annually to ensure that the municipality does not breach any covenants;

19.3 Should a default be triggered based on non-compliance with loan covenants, the municipality is to alert Council and send the related Financial Institutions a written commitment to address the matter within a reasonable timeframe.

20. Level of gearing

20.1 Gearing is not only limited by the level of debt against the Total Operating Income (excluding conditional grants) but also limited by other operational factors including compliance with the stipulations of the approved Liquidity, Funding and Reserves Policy.

20.2 Should the municipality not be in contravention with any stipulations in the Liquidity Policy or any other approved financial policy, then it is recommended that the municipality maintain external gearing at levels not lower than 25% but not higher than 35%.

20.3 The ratios to be considered to take up additional borrowings are as follows, unless in contravention with any loan covenants:

20.3.1 Estimated long-term credit rating of BBB and higher;

20.3.2 Interest Paid to Total Expenditure not to exceed 5%;

20.3.3 Total Long-term Debt to Total Operating Revenue (excluding conditional grants and transfers) not to exceed 35%;

20.3.4 Operating Cash Surplus generated before loan repayments are made covers the Total Annual Repayment at least 1 time;

20.3.5 Percentages of Total Annual Repayment (Capital and Interest) to Operating Expenditure to be less than 10%.

21. Security

21.1 Section 48 of the MFMA provides that the Municipality may provide security for any of its debt obligations in any of the forms referred to in Section 48(2).

21.2 Such security shall be given only pursuant to a resolution of the Council, which resolution must comply with the provisions of Section 48(3), (4) and (5) of the MFMA.

21.3 Unless sufficient motivation is provided and other than for the provision of a sinking fund for the redemption of a bullet loan, the provision of any security against external borrowings, should be specifically motivated by the CFO for approval.

22. Disclosure

22.1 Section 49 of the MFMA requires that any person involved in the borrowing of money by a municipality must, when interfacing with a prospective lender or when preparing documentation for consideration by a prospective investor, disclose all relevant information in that persons possession or within that person’s knowledge that may be material to the decision of that lender or investor, and take reasonable care to ensure the accuracy of any information disclosed.

22.2 In addition the Disclosure Regulations establish detailed requirements for the disclosure of information to prospective lenders and investors. Regulations 2, 3, 4, 5, 15, 16 and 17 are of particular importance to the Municipality, given the nature of the borrowings which it intends to make.

23. Guarantees

The Municipality may issue guarantees only in accordance with the provisions of Section 50 of the MFMA.

24. Internal Control

The accounting officer shall ensure that mechanisms, procedures and systems are put in place to ensure that:

24.1 Duties are separated in order to prevent fraud, collusion and other misconduct;

24.2 loan agreements and contracts are kept in proper safe custody;

24.3 there is a clear delegation of duties relating to the borrowing process;

24.4 senior officials check and verify all transactions;

24.5 transactions and repayments are properly documented;

24.6 Code of ethics and standards is established and adhered to;

24.7 procedures relating to the borrowing process are established.

25. National Treasury Reporting and Monitoring Requirements

The Municipality shall promptly submit all returns and reports relating to borrowings as required by National Treasury, including reports on the Municipality's external interest paid each month, and the quarterly itemization of all of its external borrowings.

26. Other Reporting and Monitoring Requirements

26.1 The Municipality shall on a monthly basis perform the following control and reporting functions relevant to borrowings:

26.1.1 Reconciliation of bank accounts;

26.1.2 Payment requisition verification and authorization;

26.1.3 Completion of South African Reserve Bank returns;

26.1.4 Maintain schedule of payment dates and amounts;

26.1.5 Complete National Treasury Cash Flow returns;

26.1.6 Submission of particulars of borrowings as required by Section 71 of MFMA;

26.1.7 Perform analysis of ratios;

26.1.8 Scrutinise loan agreements to ensure compliance with loan covenants.

26.2 The Municipality shall on a quarterly basis perform the following control and reporting functions relevant to borrowings:

26.2.1 Submit National Treasury Borrowings return

26.2.2 Prepare debt schedules for reporting to the Executive Committee.

27. Corporate Governance (Oversight)

Compliance with the various stipulations as documented in this Borrowing Policy need to be monitored by the Chief Financial Officer and reported on to the Municipal Manager on a monthly basis and to the Executive Mayor on a quarterly basis.

Where compliance has been breached the Chief Financial Officer must present an action plan to correct the non-compliance. The Executive Mayor must monitor the successful implementation of the corrective action plans and report progress to Council.

28. Transitional Arrangement

Upon adoption of this policy by the Council, the Municipal Manager in conjunction with the Chief Financial Officer must determine the current performance levels of the municipality against this Policy and present a plan of action towards achieving and maintaining the stipulation as set out in this policy thereby utilising a more blended funding mix for capital infrastructure investment.

The Council must approve an appropriate timeframe within which the municipality must achieve the approved stipulations as set out in this Policy. The period between the date of the policy adoption by Council and the target date for compliance shall be known as the Transitional Period.

The Executive Mayor must report progress during the approved Transitional Period to the Council.

29. Policy Management

The Borrowing Policy forms part of the municipality overall financial objectives and therefore forms part of approved Budget Policies. The policy must be reviewed at least annually during the budget revision and presented to Council for approval.

30. Related Policies

This policy must be read in conjunction with the following other policies of the Municipality:

30.1 Budget Process Policy;

30.2 Cash Management and Investment Policy;

30.3 Virement Policy

30.4 Liquidity, Funds and Reserves Policy.

30.5 Long term financial planning policy

31. Municipal Manager to Implement Policy

The Municipal Manager, as accounting officer of the Municipality, shall be responsible for implementing this policy, provided that he or she may delegate in writing any of his or her powers under this policy to any senior finance official of the Municipality.

32. Commencement

This policy shall come into force on a date to be determined by Council of the Municipality.