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BORROWING POLICY

THEMBELIHLE LOCAL MUNICIPALITY BORROWING POLICY.

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1. DEFINITIONS

In this Policy, unless the context indicates otherwise-

“Acts” means the Local Government: Municipal Finance Management Act, 2003(Act No.56 of 2003);

“authorised official” means an employee responsible for carrying out any duty or function, or exercise any power in terms of his policy and includes employees delegated to carry out or exercise such duties, functions or powers;

“Town” means the town of Hopetown & Strydenburg in a municipality Established Notices No. 479 of 22 September 2000, issued in terms of the Local Government: Municipal Structure Act, 1998, or any structure or employee of the town acting in terms of delegated authority;

“council” means the Municipal Council of the Town;

“COID” means the Compensation for Occupational Injuries and Diseases;

“CFO” means Chief Financial Officer of the Town

“disclosure statement” means a statement issued or to be issued by the Municipality which intends to incur debt by issuing municipal debt instruments;

“financing agreement” means any loan agreement , lease , instalment, purchase arrangement under which the Town undertakes to repay a long-term debt over a period of time;

“juristic person” means a body of persons, a corporation, a partnership, or other legal entity that is recognized by law as a subject of rights and duties;

“lender” means a juristic person who provides debt finance to the town;

“loan covenant” means a condition in an agreement relating to a loan or bond issue that requires the borrower to fulfill certain conditions or which forbids the borrower from undertaking certain actions, or which possibly restricts certain activities to

circumstances when other conditions are met. Violation of a covenant may result in a default on the loan being declared, penalties being applied, or loan being recalled;
“long term debt” means debt repayable by the Town over a period exceeding one(1) year;

“Municipality” means the Town of Hopetown;

“municipal debt” means :

- a) a monetary liability or obligation on a Town
 - a financing agreement, note, debenture, bond or overdraft: and
 - the issuance of municipal debt instrument; an
- b) a contingent liability such as that created by guaranteeing a monetary liability or obligation of another.

“security” means any mechanism intended to secure the interest of a lender or investor and includes any of the mechanisms mentioned;

“short term debt” means debt that is repayable over a period not exceeding one(1) year;

“sinking fund” means a fund established where provision is made to accumulate sufficient funds to repay the capital on a municipal issue at the end of the loan period as a lump sum which is termed a ‘bullet’ payment and;

“QBMR” means Quarterly Borrowing Monitoring Return.

2. PROBLEM STATEMENT

- 2.1 Considering the large demand for municipal infrastructure, borrowing is an important element to obtain additional funding sources to fund the municipal capital programme over the medium term.
- 2.2 Given that a large portion of municipal infrastructure has a long-term economic life and the general principle that the current ratepayers should not pay for an asset in the short term that is to be used by future ratepayers during life of the asset, there is a strong economic argument of finance this capital expenditure through long-term borrowing in order to accelerate the pace of delivery and to mirror the repayment funds with the economic life of the asset. The economic life of assets should always be equal to or longer than the tenure of the debt finance.

- 2.3 It would be appropriate for the Town to adopt a borrowing policy which shall be consistent with the Act and its regulations.

3. **DESIRED OUTCOME**

- 3.1 This Policy, in line with sections 19, 46 and 47 of the Act, sets out the procedures to be followed in sourcing funding from external service providers.

- 3.2 The following objectives of the policy are to:

- a) enable the Town to exercise their obligation to ensure sufficient cash resources to implement capital programme in the most effective manner;
- b) ensure compliance with the relevant legal and statutory requirements relating to municipal borrowing;
- c) govern the taking up of short-term and long-term debt according to the legislative framework;
- d) manage interest rate and credit exposure;
- e) maintain debt specified limits and ensure adequate provision for the repayment of debt; and
- f) to maintain financial sustainability.

4. **STRATEGIC INTENT**

The intent of the policy is to:

- a) Ensure a transparent and corruption- free government;
- b) Establish an efficient and productive administration that priorities delivery;
- c) Ensure financial prudence, with clean audits by the Auditor-General

5. **POLICY PARAMETERS**

- 5.1 The process for obtaining external loan funding for the Town and its municipal entities falls exclusively within the functional area of the Treasury Directorate of Finance
- 5.2 All borrowing made by the Town must be in accordance with this policy and with any regulations promulgated by national government.

6. ROLE PLAYERS AND STAKEHOLDERS

6.1 The CFO must, in consultation with the Budget and Treasury Directors, assess the Town's financial requirement and determine the amount of funds that need to be raised from external service providers, particularly to fund the capital programme. The assessment must be made in conjunction with the Medium Term Revenue and Expenditure Framework (MTREF) and the capital budget which is approved by Council.

6.2 The Treasury Directorate is responsible for the implementation of this policy.

7. REGULATORY CONTEXT

The legislative framework governing borrowing is informed by the following legislations:

- a) Local Government Municipal Finance Management Act,(Act 56 of 2003(; and
- b) Municipal Regulations on debt Disclosure, regulation R492, published under Government Gazette 29966, 15 June 2007.

8. OPTIONS FOR RAISING OF EXTERNAL DEBT

8.1 There are four possible methods of raising external debt have been identified, namely:

- a) Raising of project specific loans through financial services providers;
- b) Raising of non-project specific loan value for a particular financial year; and
- c) Raising of bonds on the bond market;
- d) Appointment of a financial service provider as sole financier to the Council for a period of not exceeding three (3) financial years.

8.2 A combination of all four methods of raising external debt could be utilized over a period of time.

9. ASSESSMENT OF FUNDING REQUIREMENT

9.1 Funding requirements for capital projects/assets, together with an assessment of the funding sources, must-

- a) be determined annually;
- b) taken into account a multi-year period; and
- c) be done in order to determine the adequacy of available funding sources.

- 9.2 Council must take into account how funding decisions affect the operating budget for the multi-year period, which will include the long term on tariffs.

10. FINACIAL RESOURCES

A full analysis of all cash reserves is required prior to borrowing to ensure the most cost effective method of financing.

11. RAISING OF EXTERNAL DEBT FOR FUTURE FINANCING OF CAPITAL EXPENDITURE

Budget Financial Plan

- 11.1 On an annual basis, the CFO must assess the Town's financial requirements and determine the amount of funds that needs to be raised from external service providers.
- 11.2 Consideration must be taken of the limitations per capital and operating budgets and the expected impact that any external debt raised may have on the budget. 11.3 The Town's standard budgeting process must be followed when assessing the funding requirements of the Town and the need for long term funding from external sources.
- 11.4 The impact of the financial plan on the capital and operating budget must be considered and included in the budget.

12. COMPLIANCE WITH FINANCIAL SERVICE PROVIDER REQUIREMENTS

12.1 Financial Ratios

- a) Where it has been decided that funding will be sourced externally, the financial service provider may, when considering an application for external debt from the Town, take certain ratios into consideration.
- b) The CFO must determine the applicable ratios for long term funding and suggested performance levels.
- c) The rations should be monitored to ensure that the Town is able to meet its requirements to access external debt from financial service providers of its choice.

- d) Where these performance levels, relating to the financial ratios, are not attained, corrective action should be taken to prevent non adherence to the loan covenants.

12.2 Credit rating

- a) The CFO is responsible for securing and maintaining an appropriate credit rating from a recognized, reputable credit rating organization.
- b) Supply Chain Management procedures must be followed in evaluation and appointing an appropriate credit rating agency.

13. RATIOS USED TO DETERMINE THE TOWN'S ABILITY TO BORROW

To ensure a financially sustainable Town, the following ratios are used as guidelines to Determine the Town's ability to borrow-

- a) total debt to revenue(excluding grants)
- b) debt service coverage ration;
- c) debt to net Cash ration;
- d) financing cost ration;
- e) cash flow interest cover ration; and
- f) cash available from operations before external interest paid.

14. COMPULSORY DISCLOSURES WHEN INCURRING MUNICIPAL DEBT

14.1 When entering into discussions with a prospective lender with a view to incur municipal debt, the Town must indicate in writing to the prospective lender whether it intends to incur short-term or long-term debt.

14.2 In cases of short-term debt it must be disclosed whether the debt is to finance-

- a) shortfalls within a financial year during which the debt is incurred in expectation of specific and realistic anticipated revenue to be received within that financial year; or
- b) capital needs within a financial year, to be repaid from specific funds to be received from enforceable allocation or long-term debt commitments.

14.3 In the case of long-term debt, whether the purpose of the debt is for-

- a) capital expenditure on property, plant or equipment to be used to the purpose of achieving the objectives of local government, subject to section 46(4) of the Act; or
- b) refinancing of existing long-term debt, subject to section 46(5) of the Act.

15. COMPLIANCE WITH MUNICIPAL REGULATIONS ON DEBT DISCLOSURE

Regulation 6 of the Municipal Regulations on Debt Disclosure, 2007, states that whilst the Town is party to a municipal debt instrument it has to have a credit rating in place which must be reviewed annually by an independent credit rating institution until it has been redeemed.

16. BORROWING PROCESS

The Borrowing process will be affected in terms of section 6 of the Act.

17. SUBMISSION OF DOCUMENTS

When entering into discussion with a prospective lender with a view to incur short-term or long-term debt, the following information must be made available to the prospective lender-

- a) audited financial statements for the preceding three(3) financial years with audited outcomes;
- b) approval annual budget;
- c) the Integrated development Plan;
- d) repayment schedule pertaining to existing short-term or long-term debt.

18. NOTIFICATION TO NATIONAL TREASURY

18.1 The MFMA requires a Town or municipal entity to invite the National Treasury(hereafter referred to as “NT”), the relevant provincial treasury and the public to submit written comments or representations to the council/board of directors in respect to the raising of any proposed debt through borrowing or any other instrument (refer section sections 46&108).

18.2 To expedite this process and to enable the NT and relevant provincial treasury to provide informed comments. The town/municipal entity is requested to supply the following information and include the signed certification (see annexure), along with the invitation for comment. Failure to provide this information may delay the process.

18.3 The table below sets out the information to be provided with respect to a long-term debt propose:

Borrowing Policy approved by the Council on 30 May 2018

	Details	MFMA
1	A copy of the information statement required by section 46(3), containing particulars of the proposed borrowing (debt instrument).	46(3) (a)(i)
2	If not already incorporated in the information statement, please ensure the following information is provided separately (note QBMR=Quarterly Borrowing Monitoring return to National Treasury): a) Amount of debt to be raised through borrowing or other means; b) Purpose for which the borrowing (debt) is to be incurred; c) Interest rate(s) applicable (state whether fixed or variable etc.); d) Planned start and end date (term of instrument);	46(3)(b)(i) and (ii)
	e) Detailed repayment schedule for the duration of the borrowing (debt) (showing dates and all payments of principal and interest, etc.); f) Total estimated cost of the borrowing(debt) over the repayment period; g) Type of instrument(select from QBMR) ; h) Security to be provided (select from QBMR) and provide details; and i) Sources of loan funds (select from QBMR).	
3	A schedule of consultation undertaken, including: a) Date(s) when the information was made public b) Details of meetings, media adverts and other methods used to consult on the proposed long-term borrowing(debt)	46(3)(a)(i),(ii)
4	a) A copy of the approved budget, and relevant documentation supporting the budget, highlighting the asset(s) to be funded by the proposed borrowing(debt) and the revenue to be received b) It must be demonstrated that the proposed borrowing (debt) is consistent with the IDP, the capital budget and the revenue shown accordingly.	46(6) 17(2) 19
5	If the borrowing(debt) is for the purpose of refinancing existing long-term borrowing(debt), the following information should be provided: a) A description of the asset(s) for which the original loan was required; b) The remaining useful life of the asset(s); c) The net present value of the asset(s), including the discount rate used and any assumptions in the calculations; d) The net present value of projected future payments <u>before</u> refinancing , including the discount rate and assumptions used; and e) The net present value of projected future payments <u>after</u> refinancing, including the discount rate and assumptions used.	46(5)
6	The source of funding that will be used to repay the loan as well as the revenue stream(s) must be specified, irrespective of whether it is an existing or new revenue stream.	19(1)(d)
7	A schedule of all long-term borrowing(debt) obligations should be compiled on the format of the QBMR, showing principal investments set up as sinking funds etc.	N/A
8	In the case of a municipal entity, details of any guarantee or other forms of security to be issued by the parent municipality respect of the entity's proposed borrowing (debt) should be provided.	50
9	A copy of the council/board of directors 'resolution approving the borrowing (debt) instrument should be forwarded once approved.	NA

This information detailed above together with the certification (referred to in Annexure A), should be forwarded to the National Treasury and the relevant Provincial Treasury.

19. INTEREST RATE RISK

Interest rates are to be fixed at an optimal rate unless it can be shown that a variable rate can provide better cost efficiency.

20. MONITORING , EVALUATION AND REVIEW

The policy will be monitored by Treasury officials annually and may be amended.

ANNEXURE A

Certification of long-term borrowing (debt)

Name of Municipality/entity

Proposed borrowing (debt): R.....

We hereby certify that the proposed long-term borrowing (debt), as specified in the attached *Information statement* and supplementary pages complies with sections 17(2), 19, 46 and 108 of the MFMA and will be used for the purposes of capital expenditure on property, plant or equipment:

- a) For the purpose of achieving the objects of local government as set out in section 152 of the Constitution;
- b) Capital expenditure is appropriate in an approved multi-year capital budget;
- c) Repayments for the duration of the loan are affordable and will be appropriated in future budgets; and
- d) If the loan is required to refinance existing long-term borrowing (debt), that the original borrowing (debt) was lawfully incurred and the refinancing does not extend the term of the borrowing (debt) beyond the life of the asset for which the money was originally borrowed.

A copy of the council/board of director's resolution approving the loan will be forwarded to the National Treasury and the relevant Provincial Treasury within 7 days of approval.

Signatures:

.....
Accounting Officer
Name:
Date:

.....
Mayor/Chairperson of the Board
Name:
Date:

ANNEXURE B

Financial Ratio Formulas

Total debt to Revenue

= Total debt/ [total Revenue – Unspent conditional grants – Capital Government grants and subsidies]

Debt service cost ratio

= [Cash generated from operations – unspent conditional grants- capital government grants and subsidies]/ [Finance cost + Loan repaid + Increase/(Decrease) in sinking funds deposits]

Debt to net cash ratio

= Total debt/[Cash generated from operations-unspent conditional grants – Capital government grants and subsidies]

Financing cost ration

= [Interest on external Borrowings + Capital paid on external debt] / Total revenue

Cash Flow Interest Cover ratio

Borrowing Policy approved by the Council on 30 May 2018

= [Cash flow from operations + interest paid

Cash available from operations before external interest paid

=[Cash generated from operations plus investment income plus changes in working capital]/external interest paid.