Final May 2023

ABAQULUSI

MUNICIPALITY

MUNISIPALITEIT

# Borrowing Policy

# 2023/2024

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**ABBREVIATIONS**

| | |
|---|---|
| ALM | AbaQulusi Local Municipality |
| AO | Accounting Officer |
| ASB | Accounting Standards Board |
| CFO | Chief Financial Officer |
| CRR | Capital Replacement Reserve |
| GRAP | Generally Recognised Accounting Practise |
| IDP | Integrated Development Plan |
| MFMA | Municipal Finance Management Act |
| MSA | Municipal Systems Act |
| VAT | Value Added Tax |
| SDBIP | Service Delivery and Budget Implementation Plan |

**PURPOSE OF THIS DOCUMENT**

This policy sets out the principles for determining the following: -

- The Municipality's borrowing requirements
- The process to be followed when debt is incurred

**DEFINITIONS**

In this policy, unless the context otherwise indicates, a word or expression to which a meaning has been assigned in the Local Government Municipal Finance Management Act, 2003 (Act No 56 of 2003), has the meaning so assigned, and:

***"Accounting officer"***
means the Municipal Manager, as indicated in section 60 of the Local Government: Municipal Finance Management Act, 2003, Act No 56 of 2003;

***"Act"***
as referred to in this policy means the Local Government: Municipal Finance Management Act, 2003, Act No. 56 of 2003;

**"*Chief Financial Officer*"** means
An officer of the Municipality, designated in terms of section 80(2) (a) of the Act by the Municipal Manager to be administratively in charge of the financial affairs of the municipality;

"***Council" or "Municipality"*** means
the Municipal Council of AbaQulusi Municipality as referred to in Section 18 of the Municipal Structures Act;

"**Creditor*"*** in relation to the municipality, means
Any person or service provider to whom money is owing by the Municipality;

**"*Debt*"** means

a) a monetary liability of obligation created by a financing agreement, note, debenture, bond, overdraft or the issuance of municipal securities; or
b) a contingent liability such as that created by guaranteeing a monetary liability or obligation of another

**"*Delegate*"** means

An official/person delegated to perform tasks on behalf of another person

"***Financial Statement***" means statements consisting of at least

a) a balance sheet (statement of financial position);
b) an income statement (statement of financial performance);
c) a cash-flow statement;
d) any other statements that may be prescribed; and
e) any notes to these statements

***"Financial Year"*** means

A period of twelve months ending on the 30th of June

***"Financing Agreement"*** means

Any long-term agreement, lease, installment purchase contract or hire purchase agreement under which the Municipality undertakes to pay the capital cost of property, plant or equipment over a period of time

***"Lender"*** in relation to the Municipality means

A person or service provider who provides debt finance to a municipality

***"Long Term Debt"*** means

Debt which is repayable over a period exceeding 12 months

***"Municipal Debt Instrument"*** means

Any note, bond, debenture, or other evidence of indebtedness issued by the Municipality, including virtual or electronic evidence of indebtedness intended to be used in raising debt

***"Security"*** means

A lien, pledge, mortgage, cession or other form of collateral intended to secure the interest of a creditor

***"Short Term Debt"*** means

A debt which is repayable over a period not exceeding 12 months

In this document unless the context otherwise indicates, words and expressions denoting the singular shall include the plural and vice versa, words and expressions denoting the male sex shall include the female sex and vice versa and reference to a natural person shall include a legal person and vice versa.

**BACKGROUND**

The Local Government Municipal Finance Management Act No 56 0f 2003 (hereafter MFMA) Section 18 requires that an annual budget may only be funded from:

- realistically anticipated revenues to be collected
- cash backed accumulated funds from previous years' surpluses not committed for other purposes
- borrowed funds, but only for capital projects

Section 19 of the MFMA also requires spending on a capital project may only be commenced once the funding sources have been considered, are available and have not been committed for other purposes. Furthermore, Chapter 6 of the MFMA guides on the requirements of obtaining Short Term and Long-Term Debt. Conditions to comply with when applying for Debt Security, Disclosures and Municipal Guarantees.

The Local Government Municipal Finance Management Act No 56 of 2003, Municipal Budget and Reporting Regulations, 2009 Section 8 requires that each Municipality should have a Borrowing Policy.

**OBJECTIVES**

The objectives of the policy relating to funding and reserves are as follows:

a) To comply with the legislative requirements;
b) To manage interest rate and credit risk exposure;
c) To maintain debt within specified limits and ensure adequate provision for the repayment of debt;
d) To ensure compliance with all Legislation and Council policy governing the borrowing of funds

**INTRODUCTION AND BACKGROUND**

The Municipality may only incur debt in terms of the Municipal Finance Management Act, 56 of 2003

A Municipality may incur short-term and long-term debt only if:

- The debt is denominated in Rand and is not indexed to, or affected by, fluctuations in the value of the Rand against any foreign currency
- A council resolution is taken authorising the provision of security if security is to be provided by the Municipality
- The following rations for Liability Management is favourable:

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

    *Purpose/Use of the Ratio*
    The Ratio indicates the cost required to service the borrowing. It assesses the borrowing or payment obligation expressed as a percentage of Total Operating Expenditure

    *Formula*
    Capital Cost (Interest Paid and Redemption)/Total Operating Expenditure x 100

    *Norm*
    The norm is between 6% and 8%

    *Interpretation of Results*
    Operating below the Norm could indicate that the Municipality has the capacity to take on additional financing from borrowing to invest in infrastructure projects or it could relate to cash flow problems where it is unable to access borrowed funds or the funding decisions of the municipality impacts on these levels. On the other hand, exceeding the Norm could pose a risk to the Municipality should changes or fluctuation in financing costs arise. When assessing this ratio, the cash flow requirements of the Municipality should be considered

  - Debt (Total Borrowings)/Total Operating Revenue

    *Purpose/Use of the Ratio*
    The Ratio indicates the extent of Total Borrowings in relation to Total Operating Revenue. It indicates short- and long-term debt financing relative to operating revenue of the municipality. The purpose of the Ratio is to provide assurance that sufficient revenue will be generated to repay Liabilities. Alternatively stated, the Ratio indicates the affordability of the Total Borrowings

    *Formula*
    Debt (Short Term Borrowing + Bank Overdraft + Short Term Lease + Long Term Borrowing + Long Term Lease)/Total Operating Revenue – Operational Conditional Grant

    *Norm*
    The norm is between 45%

*Interpretation of Results*
If the result of the Ratio analysis indicates less than 45% then the Municipality still has capacity to increase funding from borrowings, however, this should be considered within the cash flow requirements of the Municipality

**SHORT TERM DEBT**

The Municipality may incur short-term debt only when necessary to bridge:

- Shortfalls within a financial year during which the debt is incurred, in expectation of specific and realistically anticipated income to be received within that financial year
- Capital needs within a financial year, to be repaid from specific funds to be received from enforceable allocations or long-term debt commitments

A Municipality may incur short-term debt only if:

- A resolution of the municipal council, signed by the Mayor, has approved the debt agreement; and
- The Accounting Officer has signed the agreement or other document which creates or acknowledges the debt

A Municipal Council may

- Approve a short-term transaction individually; or
- Approve an agreement with a lender for short-term credit facility to be accessed as and when required, including a line of credit or bank overdraft facility provided that the credit limit must be specified in the resolution of the council. The terms of the agreement including the credit limit may be changed only by a resolution of council. If council approves a credit facility that is limited to emergency use, the Accounting Officer must notify the council in writing as soon as practical of the amount, duration and cost of any debt incurred in terms of such a credit facility as well as options for repaying such debt

The Municipality must pay off short-term debt within the financial year and may not renew or refinance short-term debt where such renewal or refinancing will have the effect of extending the short-term debt into a new financial year

No lender may willfully extend credit to the Municipality for the purpose of renewing or refinancing short-term debt that must be paid off

If a lender willfully extends credit to a Municipality in contravention of this policy, the Municipality is not bound to repay the loan or interest on the loan. However, this does not apply if the lender relied in good faith on written representations of the Municipality as to the purpose of the borrowing or did not know and had no reason to believe that the borrowing was for the purpose of renewing or refinancing short-term debt

**LONG TERM DEBT**

The Municipality may incur long-term debt for the purpose of capital expenditure on property, plant and equipment for the purpose of achieving its long-term strategic objectives as outlined in the Constitution of the Republic of South Africa, Act 108 of 1996 and Chapter & on Local Government:

- to provide democratic and accountable government for local communities
- ensure the provision of services to communities in a sustainable manner
- promote social and economic development
- promote a safe and healthy environment
- encourage the involvement of communities and community organisations in the matters of local government

A Municipality may incur long-term debt only if

- A resolution of the municipal council, signed by the Mayor, has approved the debt agreement; and
- The Accounting Officer has signed the agreement or other document which creates or acknowledges the debt

The Municipality may incur long-term debt only if the Accounting Officer has in accordance with Section 21A of the Municipal Systems Act:

- At least twenty one (21) days prior to the meeting the council at which approval for the debt is to be considered, made public an information statement setting out particulars of the proposed debt, including the amount of the proposed debt, the purpose for which the debt is to be incurred and particulars of any security to be provided; and
- Invited the public, National Treasury and the relevant Provincial Treasury to submit written comments or representations to the council in respect of the proposed debt; and
- Has submitted a copy of the information statement to the municipal council at least twenty-one (21) days prior to the meeting of the council, together with particulars of the essential repayment terms, including the anticipated debt repayment schedule as well as the anticipated total cost in connection with such debt over the repayment period

Capital expenditure may include:

- Financing costs including capitalised interest for a reasonable initial period. Costs associated with security arrangements in accordance with Section 48 of the Act, discounts and fees in connection with the financing, fees for legal, financial, advisory, trustee, credit rating and other services directly connected to the financing and costs connected to the sale or placement of debt as well as costs for printing and publication directly connected to the financing

Costs of professional services directly related to the capital expenditure and such other costs as may be prescribed

A Municipality may borrow money for the purpose of refinancing existing long-term debt provided that:

- The existing long-term debt was lawfully incurred

- The refinancing does not extend the term of the debt beyond the useful like of the property, plant or equipment for which the money was originally borrowed
- The net present value of projected future payments (including principal and interest payments) after refinancing is less than the net present value of projected future payments before refinancing
- The discount rate used in projecting net present value and any assumptions in connection with the calculations must be reasonable and in accordance with criteria set out in a framework that may be prescribed
- A Municipality's long-term debt must be consistent with its approved capital budget
- The Municipality may also incur long-term debt in the form of a Finance lease (instalment sale agreement) for the purchase of various vehicles and equipment

**RELATIONSHIP WITH OTHER POLICIES**

This policy is read in conjunction with the following relevant adopted policies of the municipality including:

- Accounting Policy
- Delegation of Power
- Cash Management and Investment Policy
- Long Term Financial Plan Policy
- Budget Implementation and Monitoring Policy

**SECURITY**

The Municipality may be resolution of its council provide security for

- Any of its debt obligations
- Contractual obligations of the Municipality undertaken in connection with capital expenditure by the persons on property, plant or equipment to be used by the Municipality or such person for the purpose of achieving the objectives of local government in terms of Section 152 of the Constitution

A Municipality may provide any appropriate security, including by:

- Giving a lien on, or pledging, mortgaging, ceding or otherwise hypothecating, an asset or right, or giving any other form of collateral
- Undertaking to effect payment directly from money or sources that may become available and to authorise the lender or investor direct access to such sources to ensure payment of the secured debt or the performance of the secured obligations, but this form of security may not affect compliance with Section 8(2) of the MFMA
- Undertaking to deposit funds with the lender, investor or third party as security
- Agreeing to specific payment mechanisms or procedures to ensure exclusive or dedicated payment to lenders or investors, including revenue intercepts, payments into dedicated accounts or other payment mechanisms or procedures
- Ceding as security any category of revenue or rights to future revenue
- Undertaking to have disputes resolved through mediation, arbitration or other dispute resolution mechanisms
- Undertaking to retain revenues or specific municipal tariffs or other charges, fees or funds at a particular level or at a level sufficient to meets its financial obligations

- Undertaking to make provision in its budgets for the payments of its financial obligations, including capital and interest
- Agreeing to restrictions on debt that the municipality may incur in future until the secured debt is settled or the secured obligations are met
- Agreeing to such other arrangements as the Municipality may consider necessary and prudent

A council resolution authorizing the provision of security

- Must determine whether the asset or right with respect to which the security is provided is necessary for providing the minimum level of basic municipal services
- Must indicate the manner in which the availability of the asset or right for the provision of that minimum level of basic municipal services will be protected

If the resolution has determined that the asset or right is necessary for providing the minimum level of basic municipal services, neither the party to whom the municipal security is provided, nor any successor or assignee of such party, may in the event of a default by the municipality deal with the asset or right in a manner that would prelude or impede the continuation of that minimum level of basic municipal services

A determination that an asset or right is not necessary for providing the minimum level of basic municipal services is binding on the Municipality until the secured debt has been paid in full or the secured obligations have been performed in full as the case may be

**DISCLOSURE**

Any person involved in the borrowing of money by the Municipality must when interacting with a prospective lender or when preparing documentation for consideration by a prospective investor:

- Disclose all information in that person’s possession or within that person’s knowledge that may be material to the decision of that prospective lender or investor
- Take reasonable care to ensure the accuracy of any information disclosed

Information to be provided should include:

- Audited financial statements for the preceding three (3) financial years with audited outcomes
- Approved annual budget
- The Municipal IDP
- Repayment schedules pertaining to existing short-term and long-term debt

A lender or investor may rely on written representations of the municipality signed by the Accounting Officer, if the lender or investor did not know and had no reason to believe that those representations were false or misleading

**MUNICIPAL GUARANTEES**

- The Municipality may not issue any guarantee for any commitment or debt of any organ of state or person except if the guarantee is within limits specified in the Municipality's approved budget
- Neither the National or Provincial government may guarantee the debt of a Municipality except to the extent that Chapter 8 of the Public Finance Management Act provides for such guarantees

**APPROVAL**

Once Council approves the loan, the Accounting Officer has to enter into an agreement with the recommended financial institution on behalf of Council. The Chief Financial Officer must ensure that the terms and conditions are as originally agreed before the Council is committed:

- All Municipal loan commitments must be recorded in a Loans Register reflecting at a minimum the
    - Loan number
    - Type of loan
    - Financial institution
    - Date issued
    - Purpose of loan
    - Loan period
    - Interest rate
    - Instalments (capital and interest)
    - Due dates (quarterly/half-yearly/yearly)
    - Security (if any)
    - Final redemption date
    - Opening balance at the beginning of the financial year
    - Amounts received during the financial year
    - Capital amounts redeemed during the financial year
    - Closing balance at the end of the financial year

- Sufficient provision must be made in the budget to depreciate assets linked to the loan

**DOCUMENTS TO BE KEPT ON RECORD**

The following loan documentation and certificates at a minimum must be safeguarded at all times:

- Loan agreements
- Any applicable security agreements
- Copy of annual loans register
- Signed copies of monthly reconciliations
- Copies of all repayments made
- Copies of amortisation schedules
- Copies of quarterly National Treasury returns

## POLICY AMENDMENT

The Accounting Officer must at least annually review the implementation of this policy and when considered necessary submit proposals for the amendment of this policy to the Council.

The review of this policy and any amendment should be made with due consideration and in conjunction with the annual review of the budget related policies as prescribed in the Municipal Budget and Reporting Regulations 2008

## APPROVAL AND EFFECTIVE DATE

The policy will be effective from 1 July 2023