

# OVERSTRAND MUNICIPALITY



## BORROWING POLICY

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1 July 2023*

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## **1 PURPOSE**

To establish a borrowing framework policy for the Municipality and set out the objectives, policies, statutory requirements and guidelines for the borrowing of funds.

## **2 OBJECTIVES OF POLICY**

The objectives of this Policy are to:

- a manage interest rate and credit risk exposure;
- b maintain debt within specified limits and ensure adequate provision for the repayment of debt;
- c to ensure compliance with all Legislation and Council policy governing borrowing of funds.

## **3 SCOPE OF THE POLICY**

The primary goal in the borrowing of funds is to ensure that the funds are obtained at the lowest possible interest rates at minimum risk, within the parameters of authorized borrowings.

### **3.1 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.

### **3.2 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.

### **3.3 Prudence**

Borrowings shall be made with care, skill, prudence and diligence.

## **4 LEGISLATIVE FRAMEWORK AND DELEGATION OF AUTHORITY**

The relevant Legislation in terms of which borrowing decisions are governed is the Local Government Municipal Finance Management Act, No 56 of 2003.

The Municipal Regulations on Debt Disclosure has been promulgated (Government Gazette no. 29966, 15 June 2007) and has been effective from 01 July 2007 for a municipality or municipal entity.

## 5 TYPES OF LOANS AND FINANCING

### 5.1 Annuity loans

Annuity loans are straight forward and uncomplicated. The loan amount, interest rate and repayment period offered by the Financial Institution are fixed. Normally with an annuity loan, the instalment of the loan will be repaid in equal six monthly instalments over the term of the loan. The capital portion of the instalment will increase over the duration of the loan, and conversely, the interest amount charged will decrease over the loan period. Where the interest rate offered by the Financial Institution is on a variable basis, an interest rate swap (IRS) option should be included in the agreement. An IRS agreement will need to be signed with the party agreeing to accept the variable rate and in turn, offer the fixed rate to the Municipality. An Interest Rate Swap Agreement must comply with the terms set out by the International Swap Dealers Association (ISDA). The fixing of debt repayments is an important consideration in meeting the financial requirements of the Municipality, that of annually producing a balanced budget. There are from time to time various options offered by Financial Institutions which need to be treated on their merits and which could invariably result in slightly lower interest rates being offered.

### 5.2 Bullet payment redemption

In this instance, the total capital is usually repaid at the end of the term and interest on the total amount borrowed is paid annually or semi-annually. The interest rate can be fixed and the interest payable is known for the duration of the loan. Cash has to be set aside to repay the capital at the end of the term.

The lender could require security in the form of an investment (sinking fund).

### 5.3 Bonds

A Bond is an instrument used by Government and Parastatals such as Telkom, Eskom, Transnet, Corporates and Municipalities to raise loan capital on the open market. Bond holders have the right to interest, usually paid on a semi-annual basis, and the repayment of the capital amount reflected on the stock certificate held on maturity date. The coupon, maturity, principal value and market value are intrinsic features of a Bond. The most critical variable factor in determining Bond rates is the expected long term trend in inflation, in order to provide a return that equals inflation plus a risk premium. The higher the risk attached to a borrower, the higher will be the risk premium investors will demand. During its tenure the Bond will trade on the Bond market at prevailing interest levels. The price of a Bond trading at any given time on the market is a function of prevailing interest rates. Bond prices move inversely to movements in interest rates.

#### 5.4 Use of Internal Funds

The Municipality from time to time, will use certain of its surplus funds to fund its Capital programme. The utilisation of surplus funds enables the Municipality to reduce its reliance on external debt financing, thereby allowing it to borrow only funds from external sources when favourable market conditions prevail. The use of internal funds impacts negatively on surplus cash for return of interest and should be within limits to reduce the impact on the Current Ratio, ideally to be at a minimum ratio of 1.5 : 1, and the Cost Coverage, ideally not be less than 2 months.

### 6 OTHER CONSIDERATIONS

The Municipality has by the judicious use of surplus funds and external long term debt implemented its Integrated Development Plan, which has facilitated the much needed service delivery program.

#### Factors to be considered when borrowing:

- (a) the type and extent of benefits to be obtained from the borrowing;
- (b) the length of time the benefits will be received;
- (c) the beneficiaries of the acquisition or development;
- (d) the impact of interest and redemption payments on both current and forecasted property tax and services revenue;
- (e) the current and future capacity of the property tax base and rendering of services to pay for borrowings and the rate of growth of the property tax base and services;
- (f) likely movements in interest rates for variable rate borrowings;
- (g) other current and projected sources of funds;
- (h) competing demands for funds;
- (i) timing of money market interest rate movements and the long term rates on the interest rate curve.

The Municipality will, in general, seek to limit its dependence on borrowings in order to minimise future revenue committed to debt servicing and redemption charges. The Municipality may only borrow funds, in terms of the Municipal Finance Management Act, for the purpose of acquiring assets, improving facilities or infrastructure to provide service delivery.

Overstrand Municipality may incur long term debt only for the purpose of Capital expenditure on infrastructure, 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.

The use of external loans should be limited to financing infrastructure where a return can be realised from tariffs to service the debt, or major infrastructure exceeding R10 million for a single project, with long term benefits to the community as a whole, where indirect revenue streams are evident.

The gearing for external loans (total outstanding debt to operating revenue, including recurrent operational grants) was fixed at a ceiling of 60% as at 30 June 2012. To reduce the reliance on external long term borrowing this percentage must reduce till a level of 45% or less is attained by 30 June 2022.

## **7 REFINANCING DEBT**

Section 46 of the Municipal Finance Management Act provides that the Overstrand Municipality may refinance existing long term debt, if such refinancing is in accordance with the framework as prescribed by the Municipal Finance Management Act, as follows:

- The Municipality may borrow money for the purpose of refinancing existing long term debt, provided the existing long term debt was lawfully incurred and the refinancing will not extend the term of the debt beyond the useful life of the infrastructure, property, plant or equipment for which the money was originally borrowed.

Cognisance must be taken of any early repayment penalty clauses in the initial loan agreement, as part of the financial feasibility assessment. No loans will be prematurely redeemed unless there is a financial benefit to the Municipality.

## **8 DEBT REPAYMENT PERIOD**

Whilst the period for which loan debt may be received will vary from time to time according to the needs of the various Lenders, presently the typical debt repayment period for loans is fifteen years, though not closely matching the underlying asset lives serviced by the loans.

Cognisance is taken of the useful lives of the underlying assets to be financed by the debt, and, moreover, careful consideration is taken of the interest rates on the interest yield curve. Should it be established that it is cost effective to borrow the funds on a shorter duration (as opposed to the life of the asset) as indicated by the interest yield curve, the loan will be negotiated to optimise the most favourable and cost effective benefit to the Municipality.

## **9 SECURITY**

In terms of the Municipal Finance Management Act the Municipality may provide security for any of its debt obligations, including the giving of a lien, pledging, mortgaging or ceding an asset, or giving any other form of collateral. It may cede as security any category of revenue or rights of future revenue. Some Lenders may require the Municipality to agree to restrictions on debt that the Municipality may incur in future until the secured debt is settled.

**10 SHORT TERM DEBT**

The Municipal Finance Management Act provides that 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 realistic anticipated income to be received within that financial year; or capital needs within a financial year, to be repaid from specific funds to be received from enforceable allocations or long term debt commitments.

The municipal council may approve an individual transaction or a credit facility for a line of credit or overdraft facility.

The Municipality must pay off short term debt within the same financial year and may not renew or refinance its short term debt if it will have the effect of extending the short term debt into a new financial year.

**11 DISCLOSURE**

The Municipality must, when interacting with a prospective Lender or when preparing documentation for consideration by a prospective Investor, disclose all relevant information that may be requested or that may be material to the decision of the prospective Lender or Investor. Reasonable care must be taken to ensure the accuracy of any information disclosed. Whilst this is a standard and acceptable business practice, it is also in compliance with section 49 of the Municipal Finance Management Act.

**12 GUARANTEES**

The Municipal Finance Management Act provides that the Municipality may not guarantee any debt of any entity unless the entity is a Municipal entity under its sole ownership control. The debt must be reflected in the approved business plan of the entity. The guarantee must be authorised by the Municipality. This must be done in the same manner and subject to the same conditions applicable to any other borrowings. Neither the National nor Provincial Government may guarantee the debt of any Municipality.

**13 APPROVAL OF LOANS BY THE MUNICIPALITY**

Section 46 of the Municipal Finance Management Act stipulates that the Municipality may incur long-term debt only if a resolution of the Council, signed by the mayor, has approved the debt agreement and the Accounting Officer has signed the agreement or other document which acknowledges the debt. At least 21 days prior to the meeting of the Council at which approval for the debt is to be considered, the Municipality must make public an information statement setting out particulars of the proposed debt, including the amount of the proposed debt, the purposes for which

the debt is to be incurred and particulars of any security to be provided. The Public, the National Treasury and Provincial Treasury must be invited to submit written comments or representations to the council in respect of the proposed debt.

A copy of the information statement submitted to Council at least 21 days prior to the meeting to approve the loan agreement must contain particulars of -

- (a) the essential repayment terms, including the anticipated debt repayment schedule; and
- (b) the anticipated total cost in connection with such debt over the repayment period.

#### **14 PROVISION FOR REDEMPTION OF LOANS**

Overstrand Municipality may borrow from Institutions and set up sinking funds to facilitate loan repayments, when the repayment is to be met by a bullet payment on the maturity date of the loan. These sinking funds may also be invested directly with the Lender's Bank. 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.

#### **15 NON-REPAYMENT OR NON-SERVICING OF LOAN**

Overstrand Municipality must honour all its loan obligations timeously. Failure to effect prompt payment will adversely affect the raising of future loans at favourable costs of borrowing.

Failure to pay any loan instalment, even by one day, and even if only through administrative oversight, will have severe repercussions, and may jeopardise the Municipality's credit rating.

In addition to the timeous payment of the loans, the Municipality must adhere to the covenants stipulated in the loan agreements.

#### **16 PROHIBITED BORROWING PRACTICES**

Overstrand Municipality shall not borrow for investment purposes, with the sole purpose of investing to earn a return. The cost of debt is almost always more expensive than the return that the Municipality can derive by investing in permitted investments.

#### **17 FOREIGN BORROWINGS**

Foreign Borrowing is permitted in terms of section 47 of the Municipal Finance Management Act, whereby the debt must be denominated in Rand and is not indexed to, or affected by, fluctuations in the value of the Rand against any foreign currency.

#### **18 NATIONAL TREASURY AND OTHER REPORTING AND MONITORING REQUIREMENTS**

The Municipality submits returns to National Treasury quarterly and annually, as well as



submissions to Council. It is mainly coordinated by the Financial Services Department.

## 19 IMPLEMENTATION AND REVIEW PROCESS

This policy shall be implemented on **1 July 2023** and shall be reviewed on an annual basis to ensure that it is in line with the municipality's strategic objectives and with legislation.

<b>POLICY SECTION:</b>	SENIOR MANAGER: FINANCIAL SERVICES
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