Harry Gwala District Municipality

# HGDM-P010 BORROWING POLICY 2016-17 (DRAFT)

## CONTENTS

## 1. INTRODUCTION AND BACKGROUND

The Municipality may only incur debt in terms of the Municipal finance management act, Act No 56 of 2003. The Municipality may incur two types of debt, namely short-term and long term debt.

**Short Term Debt**

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

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

The Municipality:

a) Must pay off short term debt within a financial year
b) May not renew or refinance its short-term debt.

**Long Term Debt**

The Municipality may incur long-term debt for purposes of financing its long-term strategic objectives, as outlined in the Constitution of the Republic of South Africa, Act No 108 of 1996, and Chapter 7 on Local Government, to:

a) Provide democratic and accountable government for local communities.
b) Ensure the provision of services to communities in a sustainable manner.
c) Promote social and economic development.
d) Promote a safe and healthy environment
e) Encourage the involvement of communities and community organizations in the matters of local government.

The municipality may incur long-term debt only if
(a) a resolution of the municipal council, signed by the mayor, has approved the debt agreement; and
(b) The accounting officer has signed the agreement or other document which creates or acknowledges the debt.

## 2. 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) and / or other related legislation/regulations has the same meaning as in that Act.

**Accounting Officer -** Means the Municipal manager and vice versa.

**Act -** Means the Local government: Municipal Finance Management Act, 2003 (Act No 56 of 2003).

**Chief Financial Officer -** Means an officer of the Municipality, designated by the Municipal Manager to be administratively in charge of the financial affairs of the Municipality

**Council or Municipality -** Means the Municipal Council or Sisonke District Municipality as referred to in Section 18 of the Municipal Structures Act.

**Creditor -** In relation to a Municipality, means any person or service provider to whom money is owing by the Municipality.

**Debt -** means monetary liability of obligation created by a short term or long term debt.

**Delegate -** Means an official/person delegated to perform tasks on behalf of another person.

**Financial Statement -** Means statements consisting of at least

i. A statement of financial position
ii. An statement of financial performance
iii. A cash-flow statement
iv. Any other statements that may be prescribed
v. Any notes to these statements.

**Financial Year -** Means a year starting 01 July and ending 30 June

**Financing Agreement -** Means any long-term agreement, lease, instalment 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 -** 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.

**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.

## 3. SCOPE AND APPLICATION

This policy governs the taking up of new loans, as well as the maintenance and redemption of existing loans. It specifically applies to:

a) Conditions under which Municipal debt maybe incurred.
b) Security.
c) Approvals.
d) Internal Controls.

e) Reporting and monitoring Procedures.
f) Financial Viability.

## 4. CONDITIONS UNDER WHICH MUNICIPAL DEBT MAYBE INCURRED

**Statutory Conditions**

The Municipality may incur debt, only if:

(a) 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; and
(b) Section 48 (3) has been complied with, if security is to be provided by the municipality.

The Municipality may incur debt, provided that:

a) The debt is approved by resolution of Council, signed by the Mayor, and the Accounting officer has signed the agreement or other document, which creates or acknowledges the debt (Section 46 (2) of the Act).

b) The Accounting Officer has, at least 21 days prior to the meeting of the Council at which the resolution is to be considered, published a notice in a newspaper of general circulation.

1. Stating particulars of the draft resolution, including the amount of the loan, the purpose of the loan to be incurred and the particulars of any security to be provided (Section 46(3)(a)(i) of the Act).

2. Inviting the public to submit written representations to the Council in respect of the draft resolution (section 46(3)(a)(ii) of the Act.

c) The Accounting Officer has, prior to the adoption of the resolution, submitted an information statement to the Council setting out the purpose for which the debt is to be incurred, the anticipated total cost of credit over the repayment period, the essential repayment terms and particulars of any securities to be provided (Section 46(3)(b) of the Act).

d) The relevant resolution was adopted at a meeting of the Council, which was open to the Public.

e) Where Security is to be provided, the provisions of Section 6 below have been compiled with (Section 47(b) of the Act.

**Administrative Conditions**

a) To obtain Council's approval short-term loan, the Accounting Officer or his/her delegate must submit:

1. A cash flow statement indicating the anticipated shortfalls and anticipated further income streams that will repay the short-term debt.

2. Monthly cash-flow reports indicating progress towards the repayment of the short-term loan.

b) To obtain Council's approval for a long term loan, the Accounting Officer or his/her delegate must submit:

1. The Bid committee's recommendation after having obtained and evaluated quotations from at least three financial institutions stating the loan period (repayment period), comparable interest rates and administrative costs.

2. An operating budget reflecting the effect of the anticipated depreciation of the envisaged asset to be financed and / or capital costs on service charges.

3. Statements from the financial institutions that the proposed instruments are in line with national legislation.

## 5. OBJECTIVES

The objectives of this policy are to:

a) Ensure compliance with the relevant legal and statutory requirements relating to Municipal borrowing.

b) Record the circumstances under which the Municipality may incur debt.

c) Describe the conditions that must be adhered to by the Accounting Officer or his/her delegate when a loan application is submitted to Council for approval.

d) Set out the internal control measures applicable to the maintenance and redemption of loans.

e) Ensure timeous reporting on the loans register as required by the act and in accordance with Generally Recognised Accounting Practice.

f) Record the key performance indicators to ensure access to the money markets.

## 6. SECURITY

1. The Municipality may, by a resolution of the Council, authorise security to be provided for any of its debt obligations.
    *(a)* any of its debt obligations;
    (c) any debt obligations of a municipal entity under its sole control; or
    (d) contractual obligations of the municipality undertaken in connection with capital expenditure by other persons on property, plant or equipment to be used by the municipality or such other person for the purpose of achieving the objects of local government in terms of section 152 of the Constitution.
2. A municipality may in terms of subsection (1) provide any appropriate security, including by:
    (a) giving a lien on, or pledging, mortgaging, ceding or otherwise hypothecating, an asset or right, or giving any other form of collateral;
    (b) 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);
    (c) undertaking to deposit funds with the lender, investor or third party as security;
    (d) 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;

(e) ceding as security any category of revenue or rights to future revenue;

(f) undertaking to have disputes resolved through mediation, arbitration or other dispute resolution mechanisms;

(g) undertaking to retain revenues or specific municipal tariffs or other charges, fees or funds at a particular level or at a level sufficient to meet its financial obligations;

(h) undertaking to make provision in its budgets for the payment of its financial obligations, including capital and interest;

(i) agreeing to restrictions on debt that the municipality may incur in future until the secured debt is settled or the secured obligations are met; and

(j) Agreeing to such other arrangements as the municipality may consider necessary and prudent.

3. A council resolution authorising the provision of security in terms of subsection (2) (a)
   (a) 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; and
   (b) If so, 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.

4. 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 preclude or impede the continuation of that minimum level of basic municipal services.
5. A determination in terms of subsection (3) 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.
6. Without contravening the above, the municipality when incurring debt may:

   a. Undertake to maintain revenues or specific charges, fees, tariffs or funds at a particular level or at a level sufficient to meet its obligations arising from that debt.
   b. Undertake to effect payment directly from monies or sources that may become available and authorise direct access to such sources to ensure payment of those obligations;
   c. Undertake to make provision in its budget for the payment of those obligations, including capital and interest;
   d. Undertake to deposit funds with the lender or a third party as security for the debt;

e. Agree to specific payment mechanisms or procedures to ensure exclusive or dedicated payment to lenders, including payments into special purpose fund/accounts or other payment mechanisms / procedures;

f. Cede as security any category of revenue or rights to future revenue specified in the financing agreement or information statement contemplated;
g. Undertake to have disputes resolved through mediation, arbitration or other dispute resolution mechanisms;
h. Agree to restrictions on debt, which the Municipality may want to incur in future;
i. Agree to such other arrangements, as the Municipality may consider necessary and prudent.

7. A Council resolution authorizing the giving of security as referred to in Security (a):
   a) Must determine whether the asset or right with respect to which the security is given, is necessary for providing a minimum essential municipal service.
   b) If so, must indicate the manner in which the availability of the asset or right for the provision of that service will be protected.

8. If the resolution has determined that the asset or right is necessary for providing a minimum essential, the lender to whom the Municipal security is given, may not, in the event of a default by the Municipality, deal with the asset or right in the manner that would preclude or impede the continuation of the minimum essential municipal service. The 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

9. A determination in terms of Security (c) that an asset or right is not necessary for providing a minimum essential municipal service is binding on the Municipality until the secured debt has been paid in full.

In terms of Section 50 of the Municipality Finance Management Act;

The municipality may not issue any guarantee for any commitment or debt of any organ of state or person, except on the following conditions:

(a) The guarantee must be within limits specified in the municipality's approved budget;
(b) a municipality may guarantee the debt of a municipal entity under its sole control only if the guarantee is authorised by the council in the same manner and subject to the same conditions applicable to a municipality in terms of this Chapter if it incurs debt;
(c) a municipality may guarantee the debt of a municipal entity under its shared control or of any other person, but only with the approval of the National Treasury, and then only if:
   i) the municipality creates, and maintains for the duration of the guarantee, a cash-backed reserve equal to its total potential financial exposure as a result of such guarantee; or

ii) The municipality purchases and maintains in effect for the duration of the guarantee, a policy of insurance issued by a registered insurer, which covers the full amount of the municipality's potential financial exposure as a result of such guarantee.

## 7. BORROWING APPROVAL

The municipality may borrow money for the purpose of re-financing existing long-term debt, provided that:

I. the existing long-term debt was lawfully incurred;

II. the re-financing does not extend the term of the debt beyond the useful life of the property, plant or equipment for which the money was originally borrowed;

III. the net present value of projected future payments (including principal and interest payments) after re-financing is less than the net present value of projected future payments before re-financing; and

IV. the discount rate used in projecting net present value referred to in paragraph (c), 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) 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.

b) All municipal loan commitments must be recorded in a Loans Register reflecting at a minimum the:

I. Loan number
II. Type of loan
III. Financial institution
IV. Date issued
V. Purpose of the loan
VI. Loan period
VII. Interest rate
VIII. Instalments (capital and interest)
IX. Due dates (quarterly/ half yearly / yearly)
X. Security
XI. Final redemption date
XII. Opening balance at the beginning of the financial year
XIII. Amounts received during the financial year
XIV. Capital amounts redeemed during the financial year
XV. Closing balance at the end of the financial year.

c) Sufficient provision must be made in the budget to depreciate assets linked to the loan.

## 8. INTERNAL CONTROL OVER BORROWINGS

**Draw down claims on loans**

Regular claims must be prepared, signed and submitted for processing to the financing institution providing the loan facility. The following supporting documents must be attached to each drawdown claim:

a) Signed copy of certified statement, signed to be an authorized representative of the municipality.

b) Signed copy of Application for loan draw-down, signed by an authorized representative of the Municipality.

c) Expenditure summary listing the expenditure being claimed.

**Repayment made on loans**

Loans are paid at the end of each quarter, being September, December, March and June. Payments are made in terms of the amortization schedules or notices from the financing institution for the respective loans due for repayments. The following supporting documents must be attached to each loan repayment.

a) Signed copy of cheque requisition

b) Copy of amortization schedule or notice from financing institution detailing the capital and interest amounts due and payable.

**Reconciliation's between General Ledger / Loans Register and Financing Institutions**

The following reconciliation are performed between the Loans register, statements/ Amortization schedules of financing institutions and the General Ledger and are examined by a senior official under the direction of the Chief Financial Officer:

a) Loans register to general ledger on a monthly basis.

b) Capital redemption per the General ledger to the redemptions schedule on a monthly basis.

c) Interest paid per the general ledger to the interest schedule on a monthly basis.

**Documentation kept on record**

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

a) Loan agreements
b) Any applicable security agreements
c) Copy of annual loans register
d) Signed copies of monthly reconciliations
e) Copies of all repayments made
f) Copies of amortization schedules
g) Copies of quarterly National Treasury returns.

## 9. REPORTING AND MONITORING PROCEDURES

Regular reporting mechanisms shall be put in place in order to assess the overall standing of the Municipality's borrowings and to ensure that the current borrowings comply with policy objectives, guidelines, applicable legislation and regulations.

As a minimum, the following reports shall be prepared:

**For Internal Treasury Management**

a) A monthly schedule of loans detailing each loan.
b) A monthly reconciliation of all interest / capital repaid and capital received.

**For the Mayor and Council**

A monthly report, within 10 working days of each month, on the borrowing portfolio to the Mayor and thereafter to the Finance Portfolio Committee for information, detailing:

a) Date issued.
b) Interest rate.
c) Loan number.
d) Reference number.
e) Redemption date.
f) Institution funding source.
g) Opening balance at the beginning of the financial year.
h) Amounts received during the financial year.
i) Capital amounts redeemed during the financial year.
j) Closing balance at the end of the financial year.

**For External Parties**

a) A schedule of the Municipality's borrowings must be published as part of the annual financial statements.

b) Any information to be submitted to the financing institutions and or security provider / guarantors as and when required.

## 10. FINANCIAL VIABILITY

a) The Accounting Officer or his / her delegate must ensure that the Municipality is financially viable and will be able to access the capital market. A report in this regard must be submitted to council after the completion of the financial statements at the end of every financial year.

b) The Chief Financial Officer must complete a financial analysis of at least the following ratios and the achievement of the following targets / norms must be included in the report:

i. **Percentage of Total Debt to Assets**

A = B/C x 100; where
A = Percentage debt in relation to assets,
B = (Long term Liabilities + Current Portion of Long term liabilities)
C= Total assets
Target = Less than 10%

ii. **Percentage of Debt to Revenue**

A = B/C x 100; where
A = Percentage debt in relation to Revenue,
B = (Long term Liabilities + Current Portion of Long-term liabilities)
C= (Total income for the year – Operating Government Grants)
Target = Less than 45% of Revenue

iii. **Percentage of capital Charges to Operating Expenditure**

A = B/C x 100; where
A = Percentage capital charges in relation to
Operating expenditure
B = Capital charges
C= Operating expenditure
Target = Less than 18%

**iv. Percentage of Interest Paid to Operating Expenditure**

A = B/C x 100; where
A = Percentage Interest paid in relation to Operating Expenditure
B = Interest paid
C= Operating expenditure
Target = Less than 5%

**v. Percentage of Total Debt to Equity**

A = B/C x 100; where
A = Percentage debt in relation to Equity
B = (Long-term Liabilities + Current Portion of long term Liabilities)
C= Funds and Reserves
Target = Less than 15%

**vi. Gearing**

A = B/C x 100; where
A = Ratio of Equity in relation to Long term Debt
B = Funds and Reserves
C= (Long-term Liabilities + Current Portion of Long Term Liabilities)
Target = Less than 25%

**vii. Current Ratio**

A = B/C x 100; where
A = Ratio of Current Assets in relation to Current Liabilities
B = Curent Assets
C = Curent Liabilities
Norm = better than 2:1

**viii. Liquid Ratio**

A = B/C x 100; where
A = Ratio of Cash Assets in relation to Current Liabilities
B = Cash Assets (e.g. Call deposits, Cash, Bank)
C = Current Liabilities
Norm = At least 1.5: 1

**ix. Percentage of Outstanding debtors to revenue**
A = B/C x 100; where
A = Percentage Outstanding debtors in relation to Revenue
B = (Consumer debtor + other debtors – Current Portion of long term receivables)
C = Total Income for the year
Target = less than 20%

**x. Percentage of Personnel Cost to Operating Income**

A = B/C x 100; where
A = Percentage of personnel cost in relation to Operating income
B =Personnel Cost
C = Operating Income
Norm = less than 30% of Operating income

c) The Accounting officer must indicate the steps to be taken in order to address deviations from the set targets and / or any other action required to ensure access to the capital market on a continuous basis.

## 11. REVIEW OF POLICY

In terms of section 17(1)(e) of the MFMA this policy must be reviewed on annual basis and the review policy tabled to Council for approval as part of the budget process.
The following should be taken into account for future amendments to this policy:

- Changes in financial strategy;
- Changes in no-financial strategic strategies; and
- Changes in legislation

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| **Policy section:** | Director: Budget and Reporting |
| **Current date:** | 30 March 2016 |
| **Previous review date:** | 22 May 2015 |

## 12. APPROVAL AND IMPLEMENTATION OF POLICY

This policy shall be implemented on 01 July once approved by council.

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|---|---|
| **Policy section:** | Director: Budget and Reporting |
| **Approval by council:** | |