

PRINCE ALBERT MUNICIPALITY

BUDGET RELATED POLICY **BORROWINGS POLICY**

DOCUMENT AND VERSION CONTROL

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Summary:

This document describes the Borrowings Policy that will be applicable with effect from **1 July 2015**.

Copies of this document can be viewed at the offices of the Municipality, all the public libraries in the municipality and the municipal website.

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1. Application and Scope

- a) The primary goal of 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.
- b) 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.
- c) 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.
- d) Prudence: Borrowings shall be made with care, skill, prudence and diligence. The standard of prudence to be used shall be the “prudent person” standard and shall be applied in the context of managing overall debt. All loans must be in the name of Prince Albert Municipality.

2. Objectives of this Policy

- a) To establish a borrowing framework policy for the Municipality and to set out the guidelines for the borrowing of funds with the goals to;
 - Manage interest rates and credit risk exposure.
 - Maintain debt within specified limits and ensure adequate provision for the repayment of debt.
 - To ensure compliance with all Legislation and Council policy governing borrowing of funds.

3. Legal framework

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

4. Considerations

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.

4.1 Factors to be considered when borrowing:

- the type and extent of benefits to be obtained from the borrowing;
- the length of time the benefits will be received;
- the beneficiaries of the acquisition or development;
- the impact of interest and redemption payments on both current and forecasted property tax income;
- the current and future capacity of the property tax base to pay for borrowings and the rate of growth of the property tax base;
- likely movements in interest rates for variable rate borrowings;
- other current and projected sources of funds;
- competing demands for funds;
- timing of money market interest rate movements and the long term rates on the interest rate curve;
- The Municipality will, in general, seek to minimise 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.

4.2 Potential lenders include:

- The Development Bank of Southern Africa
- Registered Banks in Southern Africa

5. Refinancing Debt

- a) Section 46 of the Municipal Finance Management Act provides that the Prince Albert Municipality may refinance existing long term debt, if such refinancing is in accordance with the prescribed framework.
- b) 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.
- c) Cognisance must be taken of any early repayment penalty clauses in the initial loan agreement, as part of the financial feasibility assessment.
- d) No loans will be prematurely redeemed unless there is a financial benefit to the Municipality.

6. Debt Repayment Period

- a) 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 between ten to twenty years, closely matching the underlying asset lives serviced by the loans.
- b) 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 optimize the most favourable and cost effective benefit to the Municipality.

7. Security

- a) The Municipal Finance Management Act provides that 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.

- b) Currently one DBSA loan requires cession of the rental revenue the Bank.

8. Overdraft

- a) Prince Albert Municipality has a Bank overdraft facility. The facility must be paid off by the end of the financial year and has to be renewed each financial year after a careful analysis and assessment of the municipality's expected cash flows.
- b) The municipality will not have debit and credit balances with different institutions and different accounts since the cost of an overdraft facility is more than the interest earned on an investment.
- c) A council resolution signed by the Mayor of the municipality is required for an overdraft facility or the renewal thereof.

9. Short Term Debt

- a) 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.
- b) The Municipality must pay off short term debt within the same financial year and may not renew or refinance its short term debt.
- c) The Municipality may, in terms of the Municipal Finance Management Act, incur short term debt only if the Chief Financial Officer has made a prior written finding that the

debt is either within prudential limits on short term debt as previously approved by the Municipality, or is necessary due to an emergency that could not reasonably have been foreseen and cannot await Council approval.

10. Disclosure

- a) Any official involved in the securing of loans by 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.
- b) 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.

11. Guarantees

- a) 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.
- b) The guarantee must be authorized 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.

12. Approval of Loans by the Municipality

- a) 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.
- b) 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.

- c) 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 must be submitted to Council at least 21 days prior to the meeting to discuss the proposed loan, together with particulars of-
 - the essential repayment terms, including the anticipated debt repayment schedule; and the anticipated total cost in connection with such debt over the repayment period.

13. Provision for Redemption of Loans

- a) Prince Albert Municipality may borrow from Institutions and 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. These sinking funds may also be invested directly with the Lender's Bank.
- b) 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.
- c) The municipality can also use guaranteed endowment policies to facilitate the payment on maturity date.

14. Non-Repayment or Non-Servicing of Loan

- a) Prince Albert Municipality must honour all its loan obligations timeously.
- b) Failure to effect prompt payment will adversely affect the raising of future loans at favourable costs of borrowing.
- c) 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.

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

15. Prohibited Borrowing Practices

- a) In the past some Municipalities have borrowed funds with the sole purpose of investing them to earn a return. The motive was clearly speculative. The cost of debt is almost always more expensive than the return that the Municipality can derive by investing in permitted investments.
- b) Consequently, as a principle, Prince Albert Municipality does not borrow for investment purposes, but depending on the shape of the interest yield curve may borrow in advance of its capital cash flow needs in a given financial year to take advantage of an inverse interest yield curve.
- c) Foreign Borrowing is permitted in terms of section 47 of the Municipal Finance Management Act, whereby 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.

16. Internal Control

- a) In terms of section 79 of the Act, the Accounting Officer has delegated to the Director: Finance (CFO), the authority to manage the borrowings of Council effectively and economically in terms of the prescribed borrowings framework.
- b) All borrowings must be made in the name of the Prince Albert Municipality.
- c) The internal control procedures involve Internal Audit and Performance Management, and the Auditor General reviewing and testing the systems of the Finance Department on a regular basis.
- d) In order to prevent losses arising from fraud, misrepresentations, error, conflict of interest or imprudent action, a system of internal controls governs the administration and management of the portfolio.

- e) Controls deemed most important include:-
- Control of collusion, separation of duties.
 - Custodial safekeeping of loan agreements and contracts.
 - Clear delegation of duties.
 - Checking and verification by senior officials of all transactions.
 - Documentation of transactions and repayments.
 - Code of ethics and standards.
 - Procedure manuals.
 - Electronic Funds Transfer limits and a detailed procedure manual for the system.

17. Due Care and Investment Ethics

In dealing with financial institutions, the following ethical principles must be observed:

- The Chief Financial Officer is responsible for the management of borrowings, and he has to steer clear of outside interference, regardless of whether such interference comes from individual councillors, agents or any institution.
- Under no circumstances may he be susceptible to coercive measures of any description.
- No member of staff may accept any gift other than something which is so small that it cannot possibly be seen as anything but a sign of goodwill, regardless of whether such gift influences him in his work or is intended to do so.
- The Chief Financial Officer must act according to his own discretion and should report any serious cases, such as for instance offers of a personal commission or payment in kind, etc. to his council. Discretion should be the order of the day and excessive gifts and hospitality (gifts and hospitality with a value of more than R350) should be refused and avoided.

- The Chief Financial Officer and all staff in his/her directorate shall not accede to any influence by or interference from Councilors, bank agents, institutions or any other outsiders.
- Interest rates and repayment terms quoted by one institution must not be disclosed to another institution.
- The business ethics of any controlling body of which the relevant financial institution is a member must be observed by such institution or body at all times.

18. National Treasury Reporting and Monitoring Requirements

- a) The Municipality quarterly submits the Borrowings Monitoring return to National Treasury and the Provincial Treasury. It is mainly coordinated by the Financial Administration Division. One such return, prepared on a quarterly basis, requires the Municipality to itemize all its external borrowings for the quarter ended.
- b) Regular reporting mechanisms are in place in order to assess the borrowings portfolio and to ensure compliance with policy objectives, guidelines and applicable laws.

19. Annual Review of Policy

- a) This policy on borrowings will be reviewed annually or earlier if so required by legislation. Any changes to the policy must be adopted by council and be consistent with the Act and any National Treasury regulations.
- b) The effective date of this policy will be 1 July 2015 and shall be reviewed on an annual basis to ensure that it is in line with the municipality's strategic objectives and with legislation.