CITY OF UMHLATHUZE

BORROWING POLICY

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1. DEFINITIONS

"Act" means the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003);
"authorised official" means an employee of the City responsible for carrying out any duty or function, or exercising any power in terms of this policy and includes employees delegated to carry out or exercise such duties, functions or powers;

"CFO" means the Chief Financial Officer of the City;

"council" means the Municipal Council of the City;

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

"*lender*" means a juristic person who provides debt finance to the municipality;

"long term debt" means debt repayable by the City over a period exceeding one (1) year;

" ***"MFMA"*** Local Government: Municipal Finance Management Act, No 56 of 2003;

"Municipality" means the City of uMhlathuze;

municipal debt" means:

a) a monetary liability or obligation on a City by -
   i) a financing agreement, note, debenture, bond or overdraft; and
   ii) the issuance of municipal debt instruments (a municipal debt instrument is defined as any note, bond, debenture or other evidence of indebtedness issued by a municipality or municipal entity, including dematerialized or electronic evidence of indebtedness intended to be used in trade); and

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 bond 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. INTRODUCTION

The documented **Borrowing Policy** sets out the framework for the prudent use of borrowing available to the municipality. Considering the large demand for municipal infrastructure, borrowing is an essential element to obtain additional funding sources to fund the municipal capital programme over the medium term.

It is required that the Municipality comply with the guidelines of Chapter 6 of the MFMA with regards to Debt Disclosure as detailed in Sections 46, 47, 48 and 49. External borrowings may only be incurred for approved capital programmes and may under no circumstances be allocated to fund the Operating Budget.

Municipal infrastructure has a long-term economic life and it is appropriate to fund assets of this nature with long term external borrowing. The economic life of assets should be equal to or longer than the tenure of the external borrowing.

3. POLICY OBJECTIVE

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 financial service providers.

3.2 The objectives of the policy are to:

a) enable the City 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 risk exposure;

e) maintain debt within specified limits and ensure adequate provision for the repayment of debt;

f) to maintain financial sustainability.

g) given that the municipality is a permanent going concern, the first priority be given to funding capital expenditure through the zero interest rate funding in the Capital Replacement Reserves to the maximum extent to which the CRR Policy allows.

4. ROLE PLAYERS AND STAKEHOLDERS

The CFO must assess the City's financial requirements 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), together with the Long Term Capital Expenditure Framework Plan

5. STATUTORY

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

a) Local Government: Municipal Finance Management Act, No 56 of 2003;

6. OPTIONS FOR RAISING OF EXTERNAL DEBT

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

a) Raising of project specific loans through financial services providers but for capital assets that will be required as per the approved Council MTREF;
b) Raising of a non-project specific loan value for a particular financial year; and
c) Raising of bonds on the bond market;
d) Raising of bonds on free hold property belonging to the municipality.
e) Appointment of a financial services provider as sole financier to the Council for a period of not exceeding three (3) financial years.
f) A combination of all five methods of raising external debt could be utilized over a period of time.

7. ASSESSMENT OF FUNDING REQUIREMENTS

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

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

d) be limited to the extent to which the ratios in Annexure A allow (refer Clause 9.1 below)

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

Budgeted Financial Plan

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

9. COMPLIANCE WITH FINANCIAL SERVICE PROVIDER REQUIREMENTS

9.1 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 City, take certain ratios into consideration.

b) The CFO must determine the applicable ratios for long term funding and suggested performance levels.

c) The ratios should be monitored to ensure that the City is able to meet its requirements to access external debt from financial services 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.

9.2.1 Credit rating

a) The CFO is responsible for securing and maintaining an appropriate credit rating from a recognised, reputable credit rating organisation.

b) Supply Chain Management procedures must be followed in evaluating and appointing an appropriate credit rating agency.

c) Obtaining a credit rating is only an absolute imperative when the municipality is in the process of incurring debt that will be classified as a *municipal debt instrument.*

10. RATIOS USED TO DETERMINE THE CITY'S ABILITY TO BORROW

To ensure a financially sustainable City, the following ratios are used as guidelines and affordability limits/parameters to determine the City's ability to borrow -

a) total debt to revenue (excluding grants) – Not to exceed 45%;

b) total debt to Net Assets – Not to exceed 30%

c) debt service coverage ratio;

d) debt to net Cash Ratio;

e) financing cost ratio;

f) cash flow interest cover ratio; and

g) cash available from operations before external interest paid.

11. COMPULSORY DISCLOSURES WHEN INCURRING MUNICIPAL DEBT

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

11.2 In the case 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.

11.3 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 for 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.

12. COMPLIANCE WITH MUNICIPAL REGULATIONS ON DEBT DISCLOSURE

Regulation 6 of the Municipal Regulations on Debt Disclosure, 2007, states that whilst the City 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.

13. BORROWING PROCESS

The Borrowing process will be effected in terms of Chapter 6 of the Municipal Finance Management Act, No. 56 of 2003.

14. 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) approved annual budget;

c) the Integrated Development Plan; and

d) repayment schedules pertaining to existing short-term or long-term debt.

15. NOTIFICATION TO NATIONAL TREASURY

15.1 The MFMA requires a City 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 sections 46 & 108).

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

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

Information to be provided with respect to a long-term debt proposal

	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 NT, see over page for further information): • amount of debt to be raised through borrowing or other means • purposes for which the borrowing (debt) is to be incurred • interest rate(s) applicable (state whether fixed or variable etc) • planned start and end date (term of instrument) • detailed repayment schedule for the duration of the borrowing (debt) (showing dates and all payments of principal and interest, etc) • total estimated cost of the borrowing (debt) over the repayment period • type of instrument (select from QBMR) • security to be provided (select from QBMR) and provide details • source of loan funds (select from QBMR)	46(3)(b)(i) and (ii)
3	A schedule of consultation undertaken, including: • date(s) when the *information statement* was made public • 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 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. It must be demonstrated that the proposed borrowing (debt) is consistent with the IDP, the capital budget and the revenue is 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: • description of the asset(s) for which the original loan was required • the useful remaining life of the asset(s) • the net present value of the asset(s), including the discount rate used and any assumptions in the calculations • the net present value of projected future payments <u>before</u> refinancing, including the discount rate and assumptions used. • the net present value of projected future payments <u>after</u> refinancing, including the discount rate and assumptions used.	46(5)
6	What source of funding will be used to repay the loan? Please specify the revenue stream(s) and whether this is existing revenue, or new revenue.	19(1)(d)

7	Schedule of <u>all</u> long-term borrowing (debt) obligations in the format of the QBMR showing principal and interest payments for the life of <u>all loans</u> and any associated investments set up as sinking funds etc.	
8	In the case of a municipal entity, details of any guarantee or other forms of security to be issued by the parent municipality(s) in respect to the entity's proposed borrowing (debt).	50
9	Please note: a copy of the council/board of directors' resolution approving the borrowing (debt) instrument should be forwarded once approved.	
10	Please specify the projects to be funded by the loan.	
11	A copy of the latest credit rating.	

16. 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.

17. MONITORING, EVALUATION AND REVIEW

The policy will be reviewed by the Financial Services Department annually with other budget related polices.

Financial Ratio Formulas

Total Debt to Revenue
= Total Debt / [Total Revenue – Unspent conditional grants – Capital Government grants and subsidies]

Total Debt to Total Net Assets

= Total Debt / Total Net Assets

Debt service cost ratio
= [Cash generated from operations – Unspent conditional grants – Capital government grants and subsidies] / [Finance cost + Loans repaid + Increase/ (Decrease) in sinking fund deposits]

Debt to net cash ratio
= Total debt / [Cash generated from operations – Unspent conditional grants – Capital government grants and subsidies]

Financing cost ratio
= [Interest on external Borrowings + Capital paid on external debt]/ Total Revenue

Cash Flow Interest Cover Ratio
= [Cash flow from operations+ interest paid] / 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