MERAFONG CITY LOCAL MUNICIPALITY

BP7
BORROWING POLICY
FINANCIAL YEAR 2022/2023

BP7
Borrowing Policy

Policy: Tariff Policy – Trade Services	**Effective Date: 01 July 2022**
Approved:	**Review Date: 31 March 2022**

1. PURPOSE

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

Process to be followed when debt is incurred.

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), has the meaning so assigned, and:

"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 of Merafong Local 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 –
(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.

"Delegatee" – means an official / person delegated to perform tasks on behalf of nother 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 year ending 30 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 a 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 a 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.

3. THE OBJECTIVES OF THE POLICY ARE AS FOLLOWS:

(a) To comply with the legislative requirements;

(b) Manage interest rate and credit risk exposure;

(c) 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 borrowing of funds.

4. APPROVAL AND EFFECTIVE DATE

The policy will be effective as from 1 July 2020.

5. POLICY AMENDMENT

The Accounting Officer must–
(a) at least annually review the implementation of this Policy; and
(b) when the AO considers it 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.

6. RELATIONSHIP WITH OTHER POLICIES

This policy needs to be read in conjunction with other relevant adopted policies of the municipality, including the following:
(a) Delegation of Powers;
(b) Accounting Policy;
(c) Cash Management and Investment Policy
(d) Long Term Financial Plan Policy;
(e) Budget Implementation and Monitoring Policy;

7. SCOPE OF THE POLICY

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.

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.

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.

Officials are required to adhere to:
a) written procedures and these guidelines
b) exercise due diligence
c) prepare all reports timeously
d) ensure strict compliance with all Legislation and Council policy

8. CONSIDERATIONS

The Municipality from time to time, will use certain of its surplus funds to fund it 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.

8.1 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.

8.2 Potential lenders include:

The Development Bank of Southern Africa
Banks registered in terms of the Banks Act, 1990 (Act No 94 of 1990)

9. DEBT REPAYMENT PERIOD

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.

10. SECURITY

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.

10.1 A municipality may by resolution of its council provide security for:

10.1.1 Any of its debt obligations; and
10.1.2 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 other person for the purpose of achieving the objective of local government in terms of section 152 of the Constitution.

10.2 A municipality may in terms of section 9.1 above provide any appropriate security, including by:
10.2.1 Giving a lien on, or pledging, mortgaging, ceding or otherwise hypothecating, an asset or right, or giving any other form of collateral;
10.2.2 Undertaking to effect payment directly from money or sources that may become available and to authorize 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;
10.2.3 Undertaking to deposit funds with the lender, investor or third party as security;

10.2.4 Agreeing to specific payment mechanisms or procedures to ensure exclusive or dedicated payments to lenders or investors, including revenue intercepts, payments into dedicated accounts or other payment mechanisms or procedures'

10.2.5 Ceding as security any category of revenue or rights to future revenue;

10.2.6 Undertaking to have disputes resolved through mediation, arbitration or other dispute resolution mechanisms;

10.2.7 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;

10.2.8 Undertaking to make provision in its budget for the payment of its financial obligations, including capital and interest;

10.2.9 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

10.2.10 Agreeing to such other arrangements as the municipality may consider necessary and prudent.

10.3 A council resolution authorizing the provision of security:

10.3.1 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

10.3.2 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.

10.4 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, my, 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.

10.5 A determination in terms of section 9.3 above 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.

11. OVERDRAFT

The municipality may establish an overdraft facility with the bank when necessary to bridge shortfalls within a financial year during which the debt is incurred.

The overdraft facility must be approved by Council.
The overdraft facility must be settled by 30 June.
All the requirements applicable to Short Term Debt in terms of Clause 12 also applies *mutatis mutandis*, to an overdraft.

12. 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 Municipality must pay off short term debt within the same financial year and may not renew or refinance its short term debt. 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 Municipality, or is necessary due to an emergency that could not reasonably have been foreseen and cannot await Council approval.

The Merafong Municipality is in the fortunate position that due to its sound financial position it is not necessary to raise any short term loans.

13. LONG TERM DEBT

The municipality may incur long-term debt for purposes of financing its long-term strategic objectives, and outlined in the Constitution of the Republic of South Africa, Act 108 of 1996, and Chapter 74 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; and
- Encourage the involvement of community organisations in the maters of local government.

A municipality may incur long-term debt of:

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

A municipality may incur long-term debt only if the Accounting Officer of the municipality, 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 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, the 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, and
    - 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, and 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 life property, plant or equipment for which the money was originally borrowed;
- The net present value of the projected future payments (including principal and interest payments) after refinancing is less than the net present value of projected future payments before refinancing; and
- 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 capital budget.

The municipality may also incur long term debt in the form of a Finance lease (instalment sale agreement) for the financing of plant and equipment, such as various vehicles and equipment.

14. DISCLOSURE

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. 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.

15. 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 must be submitted to Council at least 21 days prior to the meeting to discuss the proposed loan, together with particulars of –

i. the essential repayment terms, including the anticipated debt repayment schedule; and
ii. the anticipated total cost in connection with such debt over the repayment period.

16. PROVISION FOR REDEMPTION OF LOANS

Merafong 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. 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. Use can also be made of guaranteed endowment policies to facilitate the payment on maturity date.

17. NON-REPAYMENT OR NON-SERVICING OF LOAN

Merafong Municipality must honor all its loan obligations timeously. Failure to effect prompt payment will adversely affect the raising of future loans at favorable costs of borrowing. In addition to the timeous payment of the loans, the Municipality must adhere to the covenants stipulated in the loan agreements.

18. PROHIBITED BORROWING PRACTICES

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. Consequently, as a principle, Merafong 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. 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.

19. INTERNAL CONTROL

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. 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.

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.
Electronic Funds Transfer limits and a detailed procedure manual for the system.

20. NATIONAL TREASURY REPORTING AND MONITORING REQUIREMENTS

The Municipality submits numerous returns to National Treasury. It is mainly coordinated by the Finance Department. One such report deals with the Municipality's external interest paid each month. Another return, prepared on a quarterly basis, requires the Municipality to itemise all its external borrowings for the quarter ended.

21. OTHER REPORTING AND MONITORING REQUIREMENTS

Regular reporting mechanisms are in place in order to access the borrowings portfolio and to ensure compliance with policy objectives, guidelines and applicable laws.

Quarterly activities:
National Treasury MSCOA Borrowings return

General:-
Report actual borrowings (in compliance with Section 71 of the Municipal Finance Management Act) to the mayor and Provincial Treasury

Annually:-
Preparation of Annual MTERF Budget
Preparation of Annual Cash Flow Forecast in Table A5 & A7
Preparation of Annual Financial Statements
Confirmation of Lender balances at financial year end obtaining written certification of loan balances at year end
Completion of credit rating questionnaire
Regular reviews by Auditor General

22. APPROVAL

22.1 Once Council approves the loan, the AO 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;

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

- 22.2.1 Loan number;
- 22.2.2 Type of loan;
- 22.2.3 Financial institution;
- 22.2.4 Date issued;
- 22.2.5 Purpose of loan;
- 22.2.6 Loan period;
- 22.2.7 Interest rate;
- 22.2.8 Installments (capital and interest);
- 22.2.9 Due dates (quarterly / half-yearly / yearly);
- 22.2.10 Security (if any);
- 22.2.11 Final redemption date;
- 22.2.12 Opening balance at the beginning of the financial year;
- 22.2.13 Amounts received during the financial year;
- 22.2.14 Capital amounts redeemed during the financial year; and

22.2.15 Closing balance at the end of the financial year.

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

23. DOCUMENTS TO BE KEPT ON RECORD

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

23.1.1 Loan agreements;
23.1.2 Any applicable security agreements;
23.1.3 Copy of annual loans register;
23.1.4 Signed copies of monthly reconciliations;
23.1.5 Copies of all repayments made;
23.1.6 Copies of amortization schedules;
23.1.7 Copies of quarterly National Treasury returns.

24. POLICY REVIEW

The CFO will for the purposes of ensuring that this policy is aligned to the legislation, consider if and when necessary to amend the policy. In the event of the policy not being amended during the budget process, the approved policy will remain applicable.