

**LEKWA TEEMANE
LOCAL MUNICIPALITY
“NW 396”**



BORROWING MANAGEMENT POLICY

**ADOPTED BY COUNCIL
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CONTENTS:

1. Background
2. Definitions
3. Objectives
4. Responsibilities and Accountabilities
5. Security & Guarantees
6. Borrowing Mechanisms & Other Considerations
7. Borrowing Repayments
8. Refinancing of Debt
9. Risk Management
10. Borrowing Ratios and Limitations on Borrowing
11. Prudence & Ethics
12. Reporting
13. Policy Review
14. Municipal Debt Disclosure Regulations
15. Annexure "A" Borrowing Procedure Manual

1. Background

- Long- and short-term debts are necessary to fund the prime mechanisms by which a Council can fulfil its constitutional mandates for:
 - Delivery of sustainable services,
 - Social and economic development,
 - Promoting safe and health environments and,
 - Providing the basic needs to the community.
- The borrowing policy deals with the municipal rules required to ensure the enforcement of appropriate stewardship of Council's borrowings.
- The compilation of borrowing registers as prescribed by the Accounting Standards Board to ensure the appropriate financial treatment for borrowings.

2. Definitions

"Council" will mean Lekwa-Teemane Local Council.

"borrower" will be the Lekwa-Teemane Local Municipality.

"lender" is a registered financial institution and recognized by law as a lawful lender of money that a Council is entering into with a borrowing contract.

"policy" is a borrowing management policy of the Lekwa-Teemane Local Municipality.

"debt" means:

(a). A monetary liability or obligation created by a financing agreement, note, debenture or overdraft, or by the issuance of municipal debt instruments

or

(b) A contingent liability such as guaranteeing a monetary liability or obligation.

“long-term debt” means debt repayable over a period exceeding one year.

“short-term debt” means debt repayable over a period not exceeding one year.

“financing agreement” includes any loan agreement, lease, instalment, purchase contract or a hire purchase arrangement under which a Council undertakes to repay a long-term debt over a period.

“Constitution” is the Constitution of the Republic of South Africa.

3. Objectives

3.1. Statutory objectives

All external borrowings of the Lekwa-Teemane Local Municipality must comply with the relevant municipal financial management legislation below.

- The Constitution of the Republic of South Africa, 1996
- Municipal Structures Act, No. 117 of 1998
- Municipal Systems Act, No 32 of 2000
- Annual Division of Revenue Act
- Municipal Finance Management Act, No 56 of 2003
- Any standards specified by the Accounting Standards Board.

This policy will be updated annually or whenever legislative or accounting standard amendments significantly change the requirements pertaining to borrowing in general and the administration thereof.

This policy does not overrule the requirement to comply with other policies. The Chief Financial Officer will provide guidance or adjust this policy where an apparent conflict exists between this policy and other policies, legislation or regulations.

3.2. Operational Objectives

Council should be structuring external long-term borrowing to optimise flexibility and to ensure a spread of debt maturity in accordance with this policy.

Borrowing costs, risks and exposure to adverse interest rate movements associated with external borrowing should be minimised and contribute towards prudent management of borrowings to improve Council's creditworthiness.

Any borrowing that Council intends to undertake must be provided for in the approved and adopted budget.

Long-term borrowing incurred should be for the financing of service delivery enhancing infrastructure only.

4. Responsibilities and Accountabilities

The responsibilities of Council, the Municipal Manager, the Chief Financial Officer and Senior Managers are in terms of the Municipal Finance Management Act No 56 of 2003 mutatis mutandis applicable onto this policy.

The following table outlines specific responsibilities for borrowing activities, including delegated authorities and any respective limitations.

Activity	Delegated Authority	Limit
Approving and changing policy	The Council	Unlimited
Borrowing new debt	The Council	Unlimited (subject to legislative and other regulatory limitations)
Approval for charging assets as security over borrowing (Policy currently exclude this and should this be a requirement in future the policy will have to be reviewed)	The Council	Subject to the policy amendment

Overall day-to day borrowing management	Accounting Officer (delegated by Council) Chief Financial Officer (delegated by Council)	Subject to policy
Re-financing existing debts	Accounting Officer (delegated by Council) Chief Financial Officer (delegated by Council)	Subject to policy
Authorising lists of signatories	Accounting Officer	Unlimited
Annual review of policy	Chief Financial Officer	Not applicable
Ensuring compliance with policy	Chief Financial Officer	Not applicable

To prevent unauthorised transactions or difficulties in executing transactions due to an insufficient number of signatories, the following procedures should be adhered to:

- All delegated authorities and signatories must be reviewed annually to ensure that they are still appropriate and current.
- A comprehensive letter must annually be sent to all counterparties reflecting details of all the relevant current delegated authorities.
- Whenever a person with any delegated authority in respect of municipal borrowing leaves Council, Council should immediately revise the relevant current delegated authorities and advise all relevant counterparties in writing of such changes to prevent any irregularities.

5. Security & Guarantees

With regard to the provision of Section 48 & 50 of Municipal Finance Management Act No 56 of 2003, Council does not provide any security or issue any guarantee to obtain a borrowing. Whenever any securities or guarantee will be needed in future, Council may review the policy in this regard.

6. Borrowing Mechanisms & Other Considerations

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.

Factors to be considered when evaluating borrowing mechanisms for the raising of short or long-term loans incurred in terms of sections 45 and 46 of the Municipal Finance Management Act No 56 of 2003:

- Available terms from banks and capital markets.
- Council's overall debt maturity profile, to ensure concentration of debt is avoided at reissue/rollover time.
- Prevailing interest rates and margins relative to term for bank borrowing and funding from the capital markets.
- The outlook for future interest rate movements.
- Ensuring that the implied finance terms within the specific debt (e.g. project finance) are at least as favourable as municipalities could achieve in their own right.
- The impact of the proposed borrowing on municipalities.
- Legal documentation and financial covenants.
- The term of a loan must not be longer than the economic life of the capital assets it funds (as defined by Council resolution) and in any event no more than [20] years.
- All loans must be in the name of the Lekwa-Teemane Local Municipality

7. Borrowing Repayments

One of the following three payment methods may be used

- (i) Direct electronic payment
- (ii) Debit order payment
- (iii) Cheque payment

8. Refinancing of Debt

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

9. Risk Management

Borrowing procedures which have to be adhered to is attached as ANNEXURE "A"

The following Municipal risk areas have been identified:

9.1. Interest rate risk;

- Using of financial products such as interest rate risk management contracts to manage Council's risks must be avoided, unless such plans is discussed with National Treasury. The following two interest rate risk management tools or

strategies may be implemented when entering into a borrowing contract with a prospective lender.

- Fixed interest rate – it is advisable to go for this option when the interest rates are at the relatively lower levels and with no possibility of going further down over the repayment period, in terms of economic speculations.
- Interest rate hedging – this option is ideal when interest rates are relatively high. Council should use hedging contracts only to protect actual borrowings; no speculative activities should be undertaken. In addition, hedging contracts should only take place with counter-parties who have a long-term credit rating of 'A-' or better.

9.2. Liquidity risks;

- Council must maintain a level of liquidity sufficient to meet both planned and unforeseen cash requirements.

9.3. Operating risks;

- Council must manage its borrowings so that the impact of settlement default will not adversely affect its operations.
- Operating procedures are specified in ANNEXURE "A".

10. Borrowing Ratios and Limitations on Borrowing

Mandatory limits on the amount of borrowings and the proportion of income used for interest payments are reflected below.

10.1. Borrowings Ratios

- **Short term debt as a percentage of total revenue**

The ratio determines the amount of income required to cover short-term debt. The norm is 16% and in practise it is perceived that the situation is unsound if the requirement exceeds 16.6%.

The formula used to calculate the ratio is:

$$\frac{[(\text{Bank overdraft} + \text{STPLTL} + \text{call bonds} + \text{creditors}) / \text{total revenue}]}{100}$$

Municipality can improve the ratio by paying their creditors timeously.

- **Capital cost as percentage of income**

Capital cost is expressed as a percentage of total revenue to indicate which portion of income is required to service loan charges. The norm is 15% and if this ratio exceeds 20% the municipality may be over borrowed.

The formula used to calculate the ratio is:

$$(\text{Total capital cost} / \text{total revenue}) 100$$

- **Total long-term debt as percentage of total revenue**

Long-term debt is expressed as a percentage of total revenue and compared to the absolute limited of 40%.

The formula used to calculate the ratio is:

$$(\text{Total long-term liabilities} / \text{total revenue}) 10$$

10.2. Limitations on Borrowing

- Council limits short-term borrowing to bridge operating cash shortfalls in anticipation of specific grants to be received, or long-term debt to be issued within that fiscal year
- 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, Lekwa-Teemane Local 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

- Council determines that a loan for funding of the operational budget is prohibited.
- Council limits long-term borrowing to funding of capital expenditure on property, plant and equipment.
- In terms of section 47 of the Municipal Finance Management Act, the Lekwa-Teemane Local Municipality may only incur debt 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
- Council determines that future maturity dates of borrowings to be at least four months apart.
- Council determines the maximum limit for the portion of total borrowing in any one year not to exceed 20% of its yearly operating expenditure.

11. Prudency & Ethics :

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

12. Reporting

Municipal Treasury officials should prepare monthly reports on borrowing operations.

Quarterly reports on borrowing operations and proposed borrowing strategies must be submitted to council committees with oversight for municipal borrowing activities. At a minimum, these reports should address the following topics:

- Current funding facilities and liquidity
- Actual and forecast debt (current year) based on all outstanding debt
- Budgeted and year to date actual debt servicing costs
- Funding and Interest Rate Risks
- Debt-maturity profiles and expected timing of debt raising
- Hedging: this report would cover hedging contracts taken up since the last report and hedging and derivative contracts in place at the time of the report.

13. Policy Review

This policy will be reviewed on an annual basis. The Chief Financial Officer should prepare an annual review report (following the preparation of annual financial statements) that is presented to the relevant council committee; the report will include:

- Recommendation as to changes, deletions and additions to the policy
- Overview of the borrowing function in achieving the stated borrowing objectives

- Summary of breaches of policy and one-off approvals outside policy to highlight areas of policy tension
- Comments and recommendations from the Council's external auditors on the borrowing function, particularly internal controls, accounting treatment and reporting

In addition, Council must undertake an annual audit of the borrowing management systems and procedures.

Borrowing policy reviews should be completed and presented to Councils within [five] months of the financial year-end. Council should subsequently receive the reports, approve policy changes and/or reject recommendations for policy changes.

14. Municipal Debt Disclosure Regulations

The following information must be contained in a disclosure statement when entering into a borrowing agreement

- (1) The disclosure statement must set out the following information concerning the Council:
 - (a) the name of the Council and details of its establishment under the Local Government: Municipal Structures Act, 1998, (Act No. 117 of 1998);
 - (b) where the Council is located;
 - (c) the exact wording of the council resolution approving the debt in terms of section 45(2) or 45 (3) of the Act;
 - (d) the exact wording of the information statement required in terms of section 46(3) of the Act;
 - (e) any restrictions or limits imposed on borrowing which arise by virtue of any agreement, resolution, or otherwise.

- (2) The disclosure statement must set out the following information pertaining to the municipal debt securities:
- (a) the issue date;
 - (b) the purposes for which funds raised will be used;
 - (c) the total principal amount of securities issued, and if the current issue is part of a larger authorisation by the municipal council, the amount of the total authorisation and of any previous debt issued within that authorisation;
 - (d) the aggregate amount of interest payable in respect thereof over the repayment period, as calculated at the issue date;
 - (e) the applicable interest rate, or the basis for determination thereof, if not determined, and the method for the calculation thereof in summary form, and the date from which interest will accrue;
 - (f) the due dates for payment of any amounts payable;
 - (g) the final maturity date;
 - (h) any legal restrictions under which the municipal debt securities will be offered, sold, transferred or delivered;
 - (i) the status of the municipal debt securities or the subordination thereof, in relation to the other debts of the Council or municipal entity;
 - (j) the subscription or cancellation rights of any lender, underwriter, or investor;
 - (k) whether the municipal debt securities will be listed on an exchange and details thereof;
 - (l) debt amortisation terms;
 - (m) procedures relating to the method of issue and/or allocation;
 - (n) clearing and settlement procedures;

- (o) a summary of the most important rights of lenders and investors;
 - (p) any penalty or early redemption premium payable by the Council;
 - (q) the minimum denominations in which the municipal debt securities may be taken up by any person;
 - (r) the details of any security to be provided in terms of section 48 of the Act, and where the relevant documentation shall be available for inspection, subject to the provisions of regulation 7;
 - (s) whether any asset or right in respect of which security is provided has been determined by a council resolution in terms of section 48 (3) of the Act to be necessary for the provision of the minimum level of basic municipal services, and if so, the manner in which the availability of the asset or right for the provision of that minimum level of basic services will be protected;
 - (t) such other key terms and salient features of the debt transaction as may be necessary to enable a potential lender or investor who was not party to the original transaction to understand the essence of the transaction;
- (3) The disclosure statement must set out the full names, and the relevant qualifications and experience of –
- (a) the Mayor or Executive Mayor;
 - (b) the Chief Financial Officer;
 - (c) the Municipal Manager;
 - (d) the person that will be administering the debt and repayment, if not the chief financial officer; and
- (4) The disclosure statement must set out the following information pertaining to the financial situation and financial management of the Council or municipal entity:

- (a) details of its existing debt obligations including the identity of creditors, the capital outstanding, the applicable interest rate(s); the repayment schedules and security provided;
 - (b) the revenue of the Council in respect of the preceding three years, or if it has not, at the time, been established for a period of three years, then since establishment, with reference to the –
 - (i) allocations received under the annual Division of Revenue Act;
 - (ii) revenue from service fees, property rates, and other charges;
 - (iii) revenue from other sources;
 - (iv) the amounts collected within 30, 60, 90 and 120 days of due date, from the sources referred to in paragraph (ii);
 - (c) details of any default pertaining to outstanding or repaid debt, during the immediately preceding three years or if it has not, at the time, been established for a period of three years, then since establishment;
 - (d) the reserves of the Council;
 - (e) the Council's policies and practices in respect of the collection of unpaid service fees, property rates, and other charges;
 - (f) a summary of the applicable investment policies;
 - (g) the nature and amounts of insurance policies which relate to the debt and to the risk factors contemplated in sub-regulation 7 (f).
- (5) The disclosure statement must set out summary information reflecting the extent of social delivery and stability within the Council, including, where applicable –

- (a) the number of houses constructed with the assistance of the Government Housing Subsidy Scheme, now the Housing Act, 1997 (Act No. 107 of 1997);
 - (b) details of public private partnerships initiated, in progress or completed during the preceding three financial years, or if it has not, at the time, been established for a period of three years, then since establishment;
 - (c) municipal services provided;
 - (d) capital projects undertaken; and
 - (e) the existence or not of any consumer boycotts or any mobilisation around the non-payment of any services or loan obligations.
- (6) The disclosure statement must set out the following information pertaining to local economic indicators:
- (a) the average income levels of persons employed within the Council;
 - (b) the number of persons unemployed within the Municipal ;
 - (c) the ten employers employing the greatest number of persons within the Council;
 - (d) the ten major contributors to the municipal rate base;
 - (e) growth projections for the next five years; and
 - (f) the material risk factors which, in accordance with the Council or the municipal entity's assessment, will have a direct impact on its ability to meet repayment obligations.
- (7) Where debt is incurred for purposes related to a particular service and where the debt is to be repaid from revenues linked to the particular service, the disclosure statement must set out the following information:

- (a) whether a lender's or investor's rights of recovery against the Council or municipal entity is limited in any respect or limited to revenues linked to that particular service;
 - (b) any security or security mechanisms as contemplated in section 45 of the Act;
 - (c) operational statistics pertaining to any particular municipal service that is relevant to the debt transaction.
- (8) The disclosure statement must set out –
- (a) whether any credit rating has been applied from a rating agency and whether or not a rating was obtained, and if obtained, what rating, from which agency and when it was obtained;
 - (b) the names, contact persons, addresses, contact details and registration numbers of its legal and financial advisors and auditors;
 - (c) the addresses where relevant documentation is available for inspection by potential lenders, underwriters, investors, and other interested parties, subject to the provisions of regulation 7; and
 - (d) who is available to provide any further information and where and how the person can be contacted.

14.1. ANNEXURE "A" Borrowing Procedure Manual of the Lekwa-Teemane Local Municipality

STEPS, CONDITIONS AND CRITERIA FOR THE RAISING OF LOANS

(Terms of the Municipal Finance Management Act No 56 of 2003 & the Municipal Systems Act No 32 of 2000)

A. Calling for Tenders

1. Compiling the notice of tender.

2. Obtain input from the Specification Committee
3. Placement of notices in newspapers, Council's display area's and web site.
4. Compilation of tender documents in accordance with Council's Supply Chain Management Policy.
5. Provision of tender documents and organise compulsory information sessions.
6. Opening, summarisation, evaluation of tenders.
7. Allocation of tender by bid committee.

B. Approval of Debt - Publication – Section 46 (3) (a) (i)

21 Days prior to Council's meeting the Accounting Officer must make public an information statement setting out particulars as specified in ANNEXURE "A"

C. Approval of Debt - Invitation – Section 46 (3) (a) (ii)

Municipality invites the following parties to submit their written comments:

1. The local community.
2. National Treasury.
3. Provincial Treasury.

D. Approval of Debt – Inform Council – Section 46 (3) (a) (ii)

21 Days prior to Council's meeting, at which the approval of the debt is considered, the Accounting Officer must submit a copy of the information statement to the Municipal Council reflecting:

1. The repayment terms, including the debt repayment schedule
2. The total cost over the repayment period.
3. Obtain Council's resolution to create the debt.

E. Media

Any notification to the community must be done through the following media:

1. A local newspaper.
2. A newspaper determined by Council as a newspaper of record.
3. By means of radio broadcast covering the area of the municipality.
4. A copy of every notice must be published in the Provincial Gazette.
5. Notifications must be displayed at the Municipal offices.

Notifications must be in the official languages of Council – Setswana, English & Afrikaans.

F. Transparency

Municipal Manager must make available the draft contract to the Municipal Council.

The contract may not be withheld from public scrutiny.

The contract must be awarded to the successful tenderer.