LEKWA-TEEMANE LOCAL MUNICIPALITY

BOROWING POLICY

CONTENTS

DEFINITIONS

"act" means the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003).

"disclosure statements" means a statement issued or to be issued by:

a municipality which intends to incur debt by issuing municipal debt instruments; and

a person who intends to incur debt by issuing securities backed by municipal debt.

"financing agreement" means any loan agreement, lease, instalment, purchase arrangement under which a municipality undertakes to repay a long-term debt over a period of time.

"lender" means a person who provides debt finance to the municipality.

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

"municipal debt" means:

(a) a monetary liability or obligation on a municipality by
- a financing agreement, note, debenture, bond or overdraft; and
- the issuance of municipal debt instruments.

(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.

2. INTRODUCTION

Considering the large demand for municipal infrastructure, borrowing is an important element to obtain additional funding sources to fund the municipal capital programme over the medium term.

The purpose of the policy is to govern the taking up of short-term or long-term debt according to the legislative framework.

3. OBJECTIVES OF POLICY

The objectives of the policy are to:

3.1 Enable the municipality to exercise their obligation to ensure sufficient cash resources to implement their capital programme in the most cost-effective manner.

3.2 Ensure compliance with the relevant legal and statutory requirements relating to municipal borrowing.

3.3 Manage interest rate and credit risk exposure.

3.4 Maintain debt with specified limits and ensure adequate provision for the repayment of debt.

3.5 To maintain financial sustainability.

4. LEGISLATIVE REFFERENCES

The legislative framework governing borrowings are:

4.1 Local Government Municipal Finance Management Act, Act 56 of 2003; and

4.2 Local Government Municipal Regulations and Debt Disclosure, Regulation R492, published under Government Gazette 29966, 15 June 2007.

5. COMPULSORY DISCLOSURES WHEN INCURRING MUNICIPAL DEBT

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

5.2 In the case of short-term debt it must be disclosed whether the debt is to bridge:

(a) shortfalls within a financial year during which the debt is incurred, in expectation or specific and realistic anticipated revenue to be received with 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.

5.3 In the case of long-term debt, whether the purposes 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.

(b) refinancing of existing long-term debt, subject to section 46(5) of the act.

6.SHORT-TERM DEBT AND LONG-TERM DEBT

(1) Short-term Debt

(a) A short-term debt is a debt repayable by the Municipality over a period not exceeding 1 (one) year.

(b) The Municipality may incur short-term debt only in accordance with and subject to the provisions of section 45 of the MFMA and only when necessary to bridge:

(i) 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

(ii) capital needs within a financial year, to be repaid from specific funds to be received from enforceable allocations or long-term debt commitments

(2) Long-term Debt

(a) A long-term debt is a debt repayable by the Municipality over a period exceeding 1 (one) year.

(b) The Municipality may incur long-term debt only in accordance with and subject to the provisions of section 46 of the MFMA and only for the purpose of:

(i) capital expenditure on property, plant or equipment to be used for the purpose of achieving the objects of local government as set out in section 152 of the Constitution, including costs referred to in sub-paragraph (e) below; or

(ii) re-financing existing long-term debt subject to sub-paragraph

7. PROCESS

The process as required by the act is as follows:

Short-term debt

6.1 A municipality may incur short-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.

6.2 A short term debt transaction may be:

(a) approve individually; or

(b) approve an agreement with a lender for short-term credit facility to be accessed as and when required, including a line of credit or bank overdraft facility, provided that:

(i) the credit limit must be specified in the resolution of the council;

(ii) in terms of the agreement, including the credit limit, may be changed only by a resolution of the council; and

(iii) if the council approves a credit facility that is limited to emergency use, the accounting officer must notify the council in writing as soon as practical of the amount, duration and cost of any debt incurred in terms of such a credit facility, as well as options for repaying such debt.

6.3 A municipality:

(a) must pay off short-term debt within the financial year; and

(b) may not renew or refinance short-term debt, whether its own debt or that of any other entity, where such renewal or refinancing will have the effect of extending the short-term debt into a new financial year.

6.4 No lender may wilfully extent credit to the Municipality for the purpose of renewing

or refinancing short-term debt that must be paid off within the financial year. If a

lender wilfully extends credit to the Municipality in contravention with the

beforementioned, the Municipality is not bound to repay the loan or interest on the

loan.

6.5 If a lender willfully extends credit to a municipality in contravention of paragraph 6.4, the municipality is not bound to repay the loan or interest on the loan.

6.6 Subsection 6.5 does not apply if the lender:

(a) relied in good faith on written representations of the municipality as to the purpose of the borrowing; and

(b) did not know and had no reason to believe that the borrowing was for the purpose of renewing or refinancing short-term debt.

Long-term debt

6.7 A municipality may incur long-term debt only if:

(a) a resolution of the municipal council, signed by the executive mayor, has approved the debt agreement; and

(b) the accounting officer has signed the agreement or other document which creates or acknowledges the debt.

6.8 A municipality may incur long-term debt only if the accounting officer of the municipality:

(a) has, in accordance with section 21A of the Municipal Systems Act:

(i) 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 the amount of the proposed debt, the purposes for which the debt is to be incurred and particulars of any security to be provided; and

(ii) 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. The Municipality must provide the following information regarding the proposed long term debt, or any other information as may be determined from time to time by the National and/or Provincial Treasury, along with the abovementioned invitation for comment:

(b) 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:

(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.

6.9 Capital expenditure contemplated in 5.3(a) may include:

(a) financing costs, including:

(i) capitalized interest for a reasonable initial period;

(ii) costs associated with security arrangements in accordance with section 48 of the act;

(iii) discounts and fees in connection with the financing;

(iv) fees for legal, financial, advisory, trustee, credit rating and other services directly connected to the financing; and

(v) costs connected to the sale or placement of debt, and costs for printing and publication directly connected to the financing.

(b) costs of professional services directly related to the capital expenditure; and

(c) such other costs as may be prescribed.

6.10 A municipality may borrow money for the purpose of refinancing existing long-term debt, provided that:

(a) the existing long-term debt was lawfully incurred;

(b) the refinancing 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;

(c) the net present value of projected future payments (including principal and interest payments) after refinancing is less than the net present value of projected future payments before refinancing; and

(d) 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.

6.11 A municipality's long-term debt must be consistent with its capital budget referred to in section 17(2) of the act.

8. CONDITIONS APPLYING TO BOTH SHORT-TERM AND LONG-TERM DEBT

7.1 A 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) of the act has been complied with, if security is to be provided by the municipality.

9. SECURITIES

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

(a) any of its debt obligations; and

(b) any debt obligations of a municipal entity under its sole control; or

(b) 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 objectives of local government in terms of section 152 of the Constitution.

8.2 The Municipality may in terms of sub-paragraph (a) above provide any appropriate security, including by:

(i) giving a lien on, or pledging, mortgaging, ceding or otherwise hypothecating, an asset or right, or giving any other form of collateral;

(ii) 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) of the MFMA;

(iii) undertaking to deposit funds with the lender, investor or third party as security;

(iv) 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;

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

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

(vii) 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;

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

(ix) 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

(x) agreeing to such other arrangements as the Municipality may consider necessary and prudent.

(c) A Council resolution authorising the provision of security in terms of giving a lien on, or pledging, mortgaging, ceding or otherwise hypothecating, an asset or right, or giving any other form of collateral:

(i) 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

(ii) 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.

(d) 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.

(e) A determination in terms of sub-paragraph (c) 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.

10. DISCLOSURE

(a) In compliance with the provisions of section 49 of the MFMA the Municipality must, when interacting with a prospective lender or when preparing documentation for consideration by a prospective investor: -

(i) disclose all information in that person's possession or within that person's knowledge that may be material to the decision of that prospective lender or investor; and

(ii) take reasonable care to ensure the accuracy of any information disclosed.

(b) A 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.

(c) The Minister of Finance, acting with the concurrence of the Minister for Provincial and Local Government, has in terms of section 168 of the MFMA, made the Municipal Regulations on Debt Disclosure, published under GN R 492 in Government Gazette No. 29966 of 15 June 2007, which has been effective from 1 July 2007

(d) In terms of regulation 3 of the abovementioned regulations, the Municipality must when entering into discussions with a prospective lender, other creditor or underwriter with a view to incur municipal debt, otherwise than through municipal debt instruments, indicate in

writing to the prospective lender, other creditor or underwriter whether it intends to incur short-term or long-term debt, and:

(i) if it intends to incur short-term debt, whether the purpose of the debt is to bridge:

(aa) shortfalls within a financial year as contemplated in section 45(1)(a) of the MFMA; or

(bb) capital needs within a financial year as contemplated in section 45(1)(b) of the MFMA; or

(ii) if it intends to incur long-term debt, whether the purpose of the debt is for:

(aa) capital expenditure on property, plant or equipment as contemplated in section 46(1)(a) of the MFMA; or

(bb) re-financing existing long-term debt as contemplated in section 46(1)(b) of the MFMA.

(e) In terms of regulation 4 of the abovementioned regulations, the Municipality must when entering into discussions with a prospective lender, other creditor or underwriter with a view to incur short-term or long-term debt (otherwise than through municipal debt instruments), make available to the prospective lender, other creditor or underwriter certified copies of:

(i) its audited financial statements for the preceding 3 (three) financial years together with an indication whether the audit deadline referred to in section 126(1) and section 126(2) of the MFMA has been met;

(ii) its approved annual budget;

(iii) the Municipality's Integrated Development Plan; and

(iv) its repayment schedules pertaining to its existing short-term and long-term debt.

(f) In terms of regulation 15 of the abovementioned regulations, where debt incurred by the Municipality is to be repaid from revenues linked

to a particular municipal service, the Municipality must disclose the following information, irrespective of whether the debt was incurred by way of the issuing of municipal debt instruments or in any other way:

(i) whether the rights of recovery of a lender or investor against the Municipality is limited:

(aa) to revenues linked to that particular service; or

(bb) in any other respect;

(ii) particulars of any security provided by the Municipality; and

(iii) operational statistics pertaining to that particular municipal service and any other municipal service that is relevant to the debt transaction.

A disclosure in terms of the sub-regulation 15(1) must:

(i) be contained in the disclosure statement if the debt is incurred through the issuing of municipal debt instruments; or

(ii) be made by written notice to the lender if the debt is incurred in any other way.

(g) In terms of regulation 16 of the abovementioned regulations, the Municipality having incurred debt, irrespective of whether by way of the issuing of municipal debt instruments or otherwise, must provide written notification to lenders, investors and other holders of record of such debt instruments or debt, any designated fiduciaries representing any such lenders, investors or holders, any securities exchange on which the instruments are listed, and the National and Provincial Treasury, as soon as possible after becoming aware of:

(i) any event which is likely to affect the ability of the Municipality to meet its repayment or security obligations in respect of its debt;

any failure by the Municipality to meet its repayment obligations on the due date other than non-payment for technical reasons which is remedied within 72 hours;

(iii) any failure by the Municipality to meet:

(aa) any of its obligations pertaining to security provided by the Municipality; or

(bb) any other obligation constituting a default as defined for purposes of a debt transaction;

(iv) any new debt incurred by the Municipality;

(v) the provision of any additional security by the Municipality to an existing creditor; or

(vi) any mandatory intervention by the provincial executive in terms of Chapter 13 of the MFMA.

(h) In terms of regulation 17 of the abovementioned regulations, the Municipality must without derogating from any obligation to make documents available at places set out in a disclosure statement, keep readily available at its main office for inspection, on request of any interested person, copies of all documents relating to a debt transaction or documentation required to be disclosed or made available in terms of these regulations, including:

(i) any documentation referred to in regulation 4;

(ii) any guarantees, security arrangements or other credit enhancement arrangements;

(iii) all advertisements, notices, resolutions, information statements, disclosure statements;

(iv) annual updates of disclosure statements referred to in regulation 14; and

(v) any material event disclosures referred to in regulation 16.

10. GUARANTEES

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

(i) the guarantee must be within limits specified in the Municipality's approved budget;

(ii) the 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 the Municipality in terms of Chapter 6 of the MFMA;

(iii) the 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:

(aa) 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

(bb) 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

11. SUBMISSION OF DOCUMENTS

11.1 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 municipal integrated development plan;

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

12. NOTIFICATION TO NATIONAL TREASURY

12.1 The following information must be provided to National Treasury with respect to a long-term debt proposal:

(a) A copy of the information statement required by section 46(3)(a)(i), containing particulars of the proposed borrowing (debt) instrument:
- the name of the municipality;
- where the municipality is located;
- particulars of the proposed debt;
- amount of proposed debt;
- purposes for which the debt is to be incurred; and
- particulars of any security to be provided.

(b) If not already incorporated in the information 46(3)(b)(i) and (ii)statement, the following information is provided separately:
- amount of debt to be raised through borrowing or other means;
- issue date;
- 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);

Details MFMA 46(3)(b)(i) and (ii)

- detailed repayment schedule for the duration of the borrowing (debt) (showing dates and all payments of principal and interest etc.);
- final maturity date;
- total estimated cost of the borrowing (debt) over the repayment period; type of instrument;
- debt amortization terms;
- security to be provided and provide details; and
- source of loan funds.

A schedule of consultation undertaken, including: MFMA 46(3)(a)(i), (ii)

- date(s) when the information statement was made public; and
- details of meetings, media adverts and other methods used to consult on the proposed long-term borrowing (debt);

MFMA46(6) 17(2) 19 Requirements

(d) 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.

MFMA46(5) Requirements

(e) If the borrowing (debt) is for the purpose of refinancing existing long-term borrowing (debt), the following information must be provided:

- 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 payment before refinancing, including the discount rate and assumptions used; and
- the net present value of projected future payments after refinancing, including the discount rate and assumptions used.

MFMA46(5) Requirements

(f) A copy of the council/board of directors' resolution approving the borrowing (debt) instrument should be forwarded to National and relevant provincial Treasury once approved.

13. FINANCIAL AFFAIRS OF THE MUNICIPALITY

13.1 The following information concerning the financial situation and financial management of the municipality must be disclosed:

(a) schedule of all long-term debt obligations stating principal and interest payments for the life of all loans and any security provided to secure such debt;

(b) the amount of any short-term debt outstanding;

(c) the revenue of the municipality for the preceding three (3) financial years stated separately:

(i) government grants and public donations;

(ii) revenue from rates and service charges; and

(iii) other revenue sources

(d) what source of funding will be used to repay the loan;

(e) details of any default by the municipality on outstanding or repaid debt during the preceding three (3) years;

(f) the reserves of the municipality;

(g) a summary of financial policies and practices; and

14. INTEREST RATE RISK

14.1 As a general principle when interest rates are expected to decrease, it is advisable that a floating rate be negotiated in order to take advantage of the lower interest rates in future. If interest rates are expected to increase, it is advisable to obtain a fixed rate so that the benefits of the current low interest rate are maintained.

14.2 The interest risk must be limited in so far as possible. The policy directive is to negotiate fixed interest rates for all long-term borrowings. This will ensure stability of the repayments and reduce the risk for high rates and tariff increases as a result of interest rate hikes in the market.

14.3 Variable rates should be considered for short-term debt only.

15. LIMITATIONS

To ensure a financially viable municipality the following ratios are used to determine the municipal gearing ability to borrow:

- interest cost to total expenditure to not exceed 8%;
- long-term debt to revenue (excluding grants) not be exceed 50%;
- payment rate matures above 95%; and
- percentage of capital charges to operating expenditure less than 18%.

16. REVIEW

This policy will be reviewed annually to ensure that it complies with changes in applicable legislation and regulation.

17. SHORT TITLE

This policy shall be called the Borrowing Policy of the Lekwa Teemane Local Municipality