RAY NKONYENI MUNICIPALITY

"The Game changer of South Coast Development"

BORROWING POLICY

2024/2025

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1. INTRODUCTION / PREAMBE

The documented borrowing policy sets out the framework for the prudent use of borrowing available to the municipality. It is however of equal importance to protect, maintain and extend the infrastructure of the municipality to ensure the continued provision of services at an acceptable standard. This policy is implemented to provide guidance on the appropriation of capital funding resources on a sustainable basis in the longer term.

2. BACKGROUND AND APROACH

With reference to the applicable legislation as referred to in the sections below –

Legislation exists and prescribes the framework for borrowing policy and these factors will all be addressed in this policy. Although legislation provides guidance as to the broader framework to ensure financial management of resources for Council to meet all its obligations timeously, it is not prescriptive with regards to quantifying not only the prudent level of borrowing but more so the optimal level thereof. Therefore, in this policy cognisance has been taken of the legislative guidelines whilst more prescriptive guidelines are set for the optimal management and monitoring of resources to the Municipality's avail based on sound financial practices. The primary objective of the policy ultimately is to clarify the assumptions and methodology followed in funding the municipal budget.

3. LEGISLATIVE REQUIREMENTS

The legislative framework governing borrowings, funds and reserves are:

a) The municipality must comply with Chapter 6 of the MFMA. This chapter deals in sections 45 to 51 with short and long-term debt, the conditions, security, disclosure, municipal guarantees, and National and Provincial guarantees.

b) Section 46 of the MFMA should be read in conjunction with Section 19 of the MFMA.

c) Local Government Municipal Finance Management Act 56 of 2003 (MFMA), must be complied with and MFMA Circular 71 stipulates the following guidelines regarding borrowing:

   - Capital Cost (Interest Paid and Redemption) as a % of Total Operating Expenditure Formula:
   Capital Cost (Interest Paid and Redemption) / Total Operating Expenditure x 100
   Criteria: 6% - 8%
   - *Debt (Total Borrowings) / Revenue Formula:*

   (Overdraft + Current Finance Lease Obligation + Non-Finance Lease Obligation + Short Term Borrowings + Long Term Borrowings) / Total Operating Revenue
   Criteria: Maximum 45%

d) Local Government Municipal Budget and Reporting Regulation, Regulation393, published under Government Gazette 32141, 17 April 2009.

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

4. ACCESSING NEW BORROWINGS

a) 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 capital assets should be equal to or longer than the tenure of the external borrowing.

The following needs to be taken into consideration when accessing external borrowing:

4.1 Types of Debt and Financing sources - The types of debt that may be incurred and the debt financing which may be incurred are as follows:

Short-term Debt

i. Bank overdraft;
ii. Short Term Loans; and
iii. Other Securities.

Long-term Debt

i. Long-Term Loans;
ii. Instalment Credits;
iii. Finance Leasing; and
iv. Other Securities.

Financing Sources

i. Public;
ii. Banks;
iii. Development Bank of South Africa;
iv. Infrastructure Finance Corporation;
v. Public Investment Commissioners;
vi. Insurance Companies;
vii. Internal Funds; and
viii. Other Sources.

4.2 Types of long-term loans

a) Annuity Loans enable the municipality to provide for the redemption of loans on an amortising basis which is generally the most cost-effective method of financing often referred to as vanilla funding;

b) Bullet Redemption Loans are attractive as interest on the loan is serviced with the capital redemption only taking place at the end of the tenure of the loan. However, this method is more expensive, as interest is paid on the full debt throughout the term as the capital amount does not reduce. This type of loan also requires an annual contribution to a sinking fund, which then mimics the traits of an annuity loan although at a higher cost. The use of such structure warrants a detailed motivation based on the benefits to the implementation of the capital project; and

c) Sculpted Repayment Loans offer a combination of the above two types, as loans are sculpted according to the potential cash flows to be generated from the capital project in future. For example, the following can be included in a sculpted loan:

   i. A capital grace period in the first years of the development of the capital project;
   ii. An incremental annual increase in the repayment in relation to the projected growth in revenue from the project.

4.3 Interest Rate Risk Management

a) The impact of interest and capital redemption payments on both the current and forecasted property rates and service charges through tariffs taking into consideration the current and future capacity of the consumer to pay, therefore.

b) Likely movement in interest rates for variable rate borrowings - There are benefits to be yielded from borrowing on a variable rate if rates are projected to decrease in future, however it is prudent for the municipality to enter fixed interest rate loans to accurately budget for expenses incurred.

4.4 Competitive Bidding

a) The Accounting Officer should ensure that no deviations from the Supply Chain Management process are allowed with regards to the calling for interest rates during the calling for bids for any form of debt (short term or long term or finance lease or new borrowings), whether this is allowed in terms of the Council's Supply Chain Management policy or not.

b) For the purposes of price evaluating tenders in terms of costs, the expected interest debt over the full term of the proposed debt agreement must be calculated and used.

4.5 Tenure of Borrowing

The tenure of external borrowings should, where possible, match the economic useful life of the asset.

4.6 Security & Guarantees

a) Unless sufficient motivation is provided and other than for the provision of a sinking fund for the redemption of a bullet loan, the provision of any security against external borrowings, should be specifically motivated by the CFO for approval by Council.

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

- The guarantee must be within limits specified in the municipality's approved budget.
- The municipality may guarantee the debt of a municipal entity under its sole control only if the guarantee is authorised by the Council; and
- 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.
- Neither the National nor Provincial Government may guarantee the debt of any Municipality.

4.7 Loan Agreements

a) The municipality is to maintain a loan agreement register detailing all the agreements entered into with each active loan agreement until date of maturity thereof;

b) Compliance with all loan agreements is to be monitored and reported on bi-annually to ensure that the municipality does not breach any agreement;

c) Should a default be triggered based on non-compliance with loan agreement, the accounting officer is to alert Council and send the related financial institution a written commitment to address the matter within a reasonable timeframe.

4.8 Level of gearing

4.8.1 The gearing of the municipality is not only limited by the level of debt against the Total Operating Revenue (excluding conditional grants) but also limited by other operational factors as previously stated, including compliance with the stipulations of the approved Liquidity Policy.

4.8.2 Should the municipality not be in contravention with any stipulations in the Liquidity Policy or any other approved financial policy, then the municipality aims to maintain external gearing at levels not lower than 25% but not higher than 35%.

5. FORBIDDEN ACTIVITIES

a) No Commission is payable to an officer or board member, or spouse to, business partner or immediate relative of an officer or board member by an institution, investors, or financiers, for any reference made by them.

b) Any commission, fee or other compensation paid to any person by an institution must be disclosed by means of a certificate to the municipality by the institution. Any quotation tender to the municipality given by an institution must be net of fees, commissions, or rewards, but also need to include commission, rewards, or costs, that will be paid in respect of the debt.

c) No debt may be made otherwise than in the name of the municipality.

d) Money cannot be borrowed for the purpose of investments.

e) No person, including officers and council members, may interfere or attempt to interfere in the management of fault attributed to the Accounting Officer or persons delegated by the Accounting Officer.

f) No debt may be made in any other currency than the Rand, and that is not linked, or is affected by any change in the value of the Rand against any foreign currency.

g) No debt shall be made for expenses not related to the functions and powers of the municipality.

6. PERFORMANCE, MONITORING AND DISCLOSER OF INFORMATION

a) The Accounting Officer must within 10 working days after the end of each quarter furnish the mayor with a report setting out the detail of each debt portfolio.

b) The above report must be part of the section 71 report and in the format provided by National Treasury for reporting and monitoring of debt.

c) The Accounting Officer must annually measure and report to the Council on the performance of its debt in terms of the gearing objectives of this policy.

d) Any person involved in the borrowing of funds by the municipality must, when interacting with a prospective lender or when preparing documentation for consideration by prospective investors 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.

7. CORPORATE GOVERNANCE (OVERSIGHT)

7.1. Compliance with the various stipulations as documented in this Borrowing, Funds and Reserve Policy needs to be monitored by the Chief Financial Officer and reported on to the Accounting. Officer monthly and to the Audit Committee on a quarterly basis.

7.2. Where compliance has been breached the Chief Financial Officer must present an action plan to correct the non-compliance. The Audit Committee must monitor the successful implementation of the corrective action plans and report progress to Council.

8. TRANSITIONAL ARRANGEMENT

a) Upon adoption of this policy by the Council, the Accounting Officer in conjunction with the Chief Financial Officer must determine the current performance levels of the municipality against this Policy and present a plan of action towards achieving and maintaining the stipulation as set out in this policy thereby utilising a more blended funding mix for capital infrastructure investment.

b) The Council must approve an appropriate timeframe within which the municipality must achieve the approved stipulations as set out in this Policy. The period between the date of the policy adoption by Council and the target date for compliance shall be known as the Transitional Period.

c) The Finance or Budget Steering Committee must report progress during the approved Transitional Period to the Council.

9. POLICY REVIEW

The chief financial officer shall be the custodian of the Policy and shall be responsible for the review of the policy, every year (1) as minimum. The approval of this policy shall lie with the Municipal Executive Committee.