BORROWING

POLICY

2024/2025

FETAKGOMO TUBATSE LOCAL MUNICIPALITY

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1. DEFINITIONS

1.1 “**Act**” Means the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003).

1.2 “**Disclosure statements**” means a statement issued or to be issued by:

- a municipality which intends to incur debt by issuing municipal debt instructions; and
- A person who intends to incur debt by issuing securities backed by municipal debts.

1.1 “**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.

1.2 “**Lender**” means a person who provides debt finance to the municipality.

1.3 “**Long term debt**” means debt repayable by the municipality over a period exceeding one (1) year.

1.4 “**Municipal debt**” means:

a) A monetary liability or obligation on a municipality by:

- A financing agreement , note, debenture, bond or overdraft; and
- The assurance of municipal debt instruments.

b) A contingent liability such as that created by guaranteeing a monetary liability or obligation of another.

1.5 “**Security**” means any mechanism intended to secure the interest of a lender or investor and includes any of the mechanisms mentioned.

1.6 “Short **term debt**” means debt that is repayable over a period not exceeding one (1) year.

2. INTRODUCTION

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

The purpose of this policy is to establish a borrowing framework for the Municipality and set out the objectives, policies, statutory requirements and guidelines for the borrowing of funds.

3. OBJECTIVES OF POLICY

The objectives of the policy are to:

3.1 Enable the municipality to ensure sufficient cash resources for its capital program in a 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**

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. RISK MANAGEMENT

5.1 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.

6. **COMPULSORY DISCLOSURES WHEN INCURRING MUNICIPAL DEBT**

6.1 When entering into discussions with 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.

6.2 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 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.

6.3 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.

7. **BORROWING PROCESS**

The process as required by the Act is as follows:

<u>Short- term debt</u>

7.1 A municipality may incur short-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.

7.2 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.

7.3 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.

7.4 No lender may wilfully extend credit to a municipality in contravention of renewing or refinancing short-term debt that must be paid off in terms of subsection 6.3(a)

7.5 If a lender wilfully 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.

7.6 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

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

a) A resolution of the municipal council, signed by 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.

7.8 A municipal may incur long –term debt only if the accounting officer of the municipality:

a) Has, in accordance with section 21A of the Municipal System 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. Invite 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

b) Has submitted a copy of the information statement of the municipality 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.

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

a) Financing costs, including:
   I. Capitalised interest for a reasonable initial period.
   II. Costs associated with security arrangements in accordance with section 48 of the Act;
   III. Discount 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) Cost of professional service directly related to the capital expenditure; and
c) Such other cost may be prescribed.

7.10 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;
d) The discount rate used in projecting net present value referred to in paragraph 14 e, 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.

7.11 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

8.1 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 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

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

a) Any of its obligation; and
b) Contractual obligation of the municipality undertaken in connection with capital expenditure by the person of the 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.

9.2 Appropriate security is contemplated in section 48(2) of the Act.

9.3 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.

9.4 Other additional conditions to be complied with the contemplated in section 48(3) to (5) of the Act.

10. TYPES OF LOANS AND FINANCING

10.1 Annuity loans

- Annuity loans are straight forward and uncomplicated. The loan amount, interest rate and repayment period offered by the Financial Institution are fixed. The calculation of the instalment payable on an annuity/fixed redemption basis is simple and straight forward.
- Normally with an annuity loan, the instalment of the loan will be repaid in equal monthly instalments over the term of the loan. The capital portion of the instalment will increase over the duration of the loan, and conversely, the interest charged will decrease over the loan period.
- Where the interest rate offered by the Financial Institution is on a variable basis, an interest rate swap (IRS) should be taken out. An IRS agreement will need to be signed with the party agreeing to accept the variable rate and in turn, offer the fixed rate to the Municipality. An Interest Rate Swap Agreement must comply with the terms set out by the International Swap Dealers Association (ISDA).
- The fixing of debt repayments is an important consideration in meeting the financial requirements of the Municipality, that of annually producing a balanced budget. There are from time-to-time various options offered by Financial Institutions which need to be treated on their merits and which could invariably result in slightly lower interest rates being offered.

10.2 Bullet payment redemption

- In this instance, the total capital is usually repaid at the end of the term and interest on the total amount borrowed is paid annually or semi-annually.
- The interest rate can be fixed and the interest payable is known for the duration of the loan. Cash has to be set aside to repay the capital at the end of the term.
- The lender could require security in the form of an investment (sinking fund).

10.3 Bonds

- A Bond is an instrument used by Government and Parastatals such as Telkom, Eskom, Transnet, Corporates and Municipalities to raise loan capital on the open market.
- Bond holders have the right to interest, usually paid on a semi-annual basis, and the repayment of the capital amount reflected on the stock certificate held on maturity date.
- The coupon, maturity, principal value and market value are intrinsic features of a Bond. The most critical variable factor in determining Bond rates is the expected long-term trend in inflation, in order to provide a return that equals inflation plus a risk premium.
- The higher the risk attached to a borrower; the higher will be the risk premium investors will demand. During its tenure the Bond will trade on the Bond market at prevailing

- interest levels. The price of a Bond trading at any given time on the market is a function of prevailing interest rates. Bond prices move inversely to movements in interest rates.

10.4 **Use of Internal Funds**

- The Municipality from time to time, will use certain of its surplus funds to fund its 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.
- The use of internal funds impacts negatively on surplus cash for return of interest and should be within limits to reduce the impact on fixed cost coverage.

11. DISCLOSURE

11.1 Any person involved in the borrowing of money by a municipality must, when interacting with a prospective lender or when preparing documentation by a prospective investor

a) Disclose all information in that person 's possession or which that person's knowledge that may be material to the decision of that prospective lender or investor; and

b) Take reasonable care to ensure the accuracy of any information disclosed.

11.2 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.

12. **GUARANTEES**

12.1 A municipality may not issue any guarantee for any commitment or debt of any organ of state or person, except on the following condition:

a) The guarantee must be within limits specified in the municipality's approved budget.

12.2 Neither the national nor provincial government may guarantee the debt of a municipality expect to the extent that chapter 8 of the public finance Management Act provides for such guarantees

13. SUBMISSION OF DOCUMENTS

13.1 When entering into discussion with a prospective lender with a view to incur short-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

14. NOTIFICATION TO NATIONAL TREASURY

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

Details	**MFMA**
a) A copy of the information statement required by section 46(3), containing particulars of the proposed borrowing (Debt) instrument:	46(3)(a)(i)

- The name of the municipality;
- Where the municipality is located;
- Particulars of the proposed debts;

Details

- 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 statement, the following information is provided separately:	46(3)(b)(i), (ii)

- 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);
- 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 amortisation terms;
- Security to be provided and provide details; and
- Source of loan funds.

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

- Date(s) when the information statement was made public; and
- Details of meetings, media adverts and other long-term borrowing (debts);

d) A copy of the approved budget and relevant documentation supporting the budget, highlighting the assets(s) to be funded by the proposed borrowing (debt) and the revenue to be received.	46(6) 17(2) 19

It must be demonstrated that the proposed borrowing (debt) is consistent with the IDP, the capital budget and the revenue is shown accordingly.

Details	**MFMA**
e) If the borrowing (debt) is for the purpose of refinancing existing long-term borrowing (debt), the following information must be provided:	46(5)

- Description of the asset(s) for which the original loan was required;
- The useful remaining life of the assets(s)
- The net present value of the assets(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 payment after refinancing, including the discount rate and

assumptions used.

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

15. FINANCIAL AFFAIRS OF THE MUNICIPALITY

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

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

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 services charges; and
iii. Other revenue sources

a) What source of funding will be used to repay the loan;

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

c) The reserves of the municipality

d) A summary of financial policies and practices; and

e) The latest credit rating obtained.

16. INTEREST RATE RISK

16.1 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 rate 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.

16.2 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.

16.3 Variable rates should be considered for short-term only.

17. LIMITATION

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

- Long-term credit rating BBB;
- Interest cost to total expenditure to not exceed 8%;
- Long-term debt revenue (excluding grants) not be exceed 50%;
- Payment rate mature above 95%; and
- Percentage of capital charges to operating expenditure less than 18%.

18. **REVIEW**

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