SWELLENDAM MUNICIPALITY

BORROWING POLICY

APPROVED BY COUNCIL ON 27 MAY 2021

IMPLEMENTATION DATE 1 JULY 2021

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1. DEFINITIONS

In this policy, unless the context indicates otherwise -

1.1 "**Authorised official**" means an employee of the Municipality responsible for carrying out any duty or function, or exercising any power in terms of this policy and includes employees delegated to carry out or exercise such duties, functions or powers;

1.2 "**Council**" means the Municipal Council of the Municipality;

1.3 "**Financing agreement**" means any loan agreement, lease, installment, purchase arrangement under which the Municipality undertakes to repay a long-term debt over a period of time;

1.4 "**Lender**" means a juristic person who provides debt finance to the Municipality;

1.5 "**Long term debt**" means debt repayable by the Municipality over a period exceeding one (1) year;

1.6 **"MFMA"** means Municipal Finance Management Act No.56, 2003.

1.7 **"Municipality"** means the Swellendam Municipality**;**

1.8 "**Municipal debt**" means:

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

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

1.9 "**Security**" means any mechanism intended to secure the interest of a lender or investor and includes any of the mechanisms mentioned;

1.10 "**Short term debt**" means debt that is repayable over a period not exceeding one (1) year;

1.11 "**Sinking fund**" means a fund established where provision is made to accumulate sufficient funds to repay the capital on a municipal bond issue at the end of the loan period as a lump sum which is termed a 'bullet' payment; and

2. PURPOSE

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

3. OBJECTIVES OF THE POLICY

3.1 Swellendam Municipality's aimed at gaining the lowest interest rate on any external borrowings, short-term as well as long-term, but still the credit exposure risk in mind. The effectiveness of this policy is to ensure that the cash management program makes provision for the repayment of interest and redemption on the external borrowings.

3.2 It is the responsibility of the council as a trustee of the community's revenue to ensure that the best repayment interest rates on external borrowings are obtained through a fair and transparent tender process and to ensure compliance with all legislation and Council policies governing borrowings of funds.

4. SCOPE

4.1 The primary goal in the borrowing of funds is to ensure that the funds are obtained at the lowest possible interest rates at minimum risk, within the parameters of authorised borrowings.

4.2 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.

4.3 Cost of Borrowings

The borrowings should be structured to obtain the lowest interest rate, on the most advantageous terms and conditions, taking cognisance of borrowing risk constraints, infrastructure needs and the borrowing limits determined by

Legislation.

4.4 Prudence

Borrowings shall be made with care, skill, prudence and diligence.

5. PRINCIPLES

5.1 The guiding principles in Chapter 6, sections 45 to 51, of the MFMA in terms of short-term and long-term debt must be adhered to facilitate the administration of the council's borrowings.

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

5.3 MFMA Circular 71 stipulates the following guidelines regarding borrowing:

5.3.1 **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%

5.3.2 **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%

6. DELEGATIONS OF AUTHORITY

6.1 The relevant legislation in terms of which borrowing decisions are governed is the Local Government Municipal Finance Management Act, No 56 of 2003.

6.2 Local Government Municipal Regulations and Debt Disclosure, Regulation 492, published under Government Gazette 29966, 15 June 2007.

6.3 Council is the only body that can approve external borrowing as a budget item. The Bid Adjudication committee appoints the tender to the successful bidder and thereafter Council will delegate to the Municipal Manager of the municipality to enter into a contract with the successful bidder and the signing thereof.

7. NOMINEE ACCOUNT

7.1 All monies disbursements as a result of the borrowing must be placed into the primary bank account of the municipality and this account must be reported to the National and Provincial Treasury and the Auditor general in terms of section 9 (a) and (b) of the MFMA.

8. REGISTERED FINANCIAL INSTITUTIONS

8.1 When borrowing needs to be done it should be required from the borrowing institutions to state whether they have registered in terms of the bank act of 1990 and/or any other applicable legislation.

9. GENERAL BORROWING PRACTICE

9.1 GENERAL

9.1.1 Borrowings shall be done at an institution offering the most favorable repayment interest rates on the amount to be borrowed over a specific period.

9.1.2 Institutions shall be advised that in submitting their tenders they must offer their best interest rates for the repayment of the interest and redemption on the borrowings. Council has the right to take on a loan in full or just part thereof.

9.1.3 After submission of the tender, no discussion or negotiation will be entered into until such time the tender is awarded to the successful bidder.

9.1.4 Certificates of balances on the outstanding amounts on the loans must be acquired and the end of the financial year.

9.2 TYPES OF LOANS AND FINANCING

9.2.1 Annuity loans

Annuity loans are straightforward and uncomplicated. The loan amount, interest rate and repayment period offered by the Financial Institution are fixed. The calculation of the installment payable on an annuity/fixed redemption basis is simple and straightforward. Normally with an annuity loan, the installment of the loan will be repaid in equal six monthly installments over the term of the loan. The capital portion of the installment will increase over the duration of the loan, and conversely, the interest amount 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.

9.2.2 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).

9.2.3 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. Bondholders 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 the maturity date. The coupon, maturity, principal value and market value are intrinsic features of 0a Bond. The most critical variable factor in determining Bond rates is the expected long-term trend in inflation, 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.

9.2.4 Use of Internal Funds

The Municipality from time to time will use certain of its surplus funds to fund its Capital Program. 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 and should be within limits to reduce the impact on fixed cost coverage.

9.3 OTHER CONSIDERATIONS

9.3.1 The Municipality has by the judicious use of surplus funds and external long-term debt implemented its Integrated Development Plan, which has facilitated the much-needed service delivery program.

Factors to be considered when borrowing:

(a) The type and extent of benefits to be obtained from the borrowing;
(b) The length of time the benefits will be received;
(c) The beneficiaries of the acquisition or development;
(d) The impact of interest and redemption payments on both current and forecasted property tax and services revenue;
(e) The current and future capacity of the property tax base and rendering of services to pay for borrowings and the rate of growth of the property tax base and services;
(f) Likely movements in interest rates for variable rate borrowings;
(g) Other current and projected sources of funds;
(h) Competing demands for funds; and
(i) Timing of money market interest rate movements and the long-term rates on the interest rate curve.

9.3.2 The Municipality will, in general, seek to limit its dependence on borrowings 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.

9.3.3 Swellendam Municipality may incur long-term debt only for the purpose of Capital expenditure on infrastructure, 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.

9.3.4 The use of external loans should be limited to financing infrastructure where a return can be realised from tariffs to service the debt, with long-term benefits to the community as a whole, where indirect revenue streams are subject to financial affordability.

9.3.5 The current gearing for external loans should not exceed the 40% mark (total outstanding debt ÷ total operating revenue less conditional grants). However, if investment in infrastructure is needed to stimulate economic development with clear benefits for the community as a whole over the short and medium-term, then the gearing ratio may exceed the 40% mark provided that interest and redemption to service external loans shall not exceed 20% of total operating expenditure or subject to financial affordability.

9.4 CONTROL AND MONITORING BORROWINGS

9.4.1 A proper record must be kept and maintained of all the borrowings made, indicating at least the Institution, Borrowing amount, Interest rate, Start date, Closing date, Redemption amount, Interest amount and the purpose of the borrowing.

9.4.2 Repayment schedules received from the borrowing institutions must be checked to verify the correctness of the repayments. Repayment of Interest and redemption must be done in time to avoid penalty interest.

10. REFINANCING DEBT

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

10.2 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.

11. DEBT REPAYMENT PERIOD

11.1 Whilst the period for which loan debt may be received will vary from time to time according to the needs of the various Lenders, presently the typical debt repayment period for loans is fifteen years, though not closely matching the underlying asset lives serviced by the loans.

11.2 Cognisance is taken of the useful lives of the underlying assets to be financed by the debt, and 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.

12. SECURITY

12.1 In terms of section 48 of the Municipal Finance Management Act, 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 the future until the secured debt is settled.

13. SHORT TERM DEBT

13.1 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.

13.2 The municipal council may approve an individual transaction or a credit facility for a line of credit or overdraft facility.

13.3 The Municipality must pay off the short-term debt within the same financial year and may not renew or refinance its short-term debt if it will have the effect of extending the short-term debt into a new financial year.

14. DISCLOSURE

14.1 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. GUARANTEES

15.1 The Municipal Finance Management Act provides that the Municipality may not guarantee any debt of any entity unless the entity is a Municipal entity under its sole ownership control. The debt must be reflected in the approved business plan of the entity. The guarantee must be authorised by the Municipality. This must be done in the same manner and subject to the same conditions applicable to any other borrowings. Neither the National nor Provincial Government may guarantee the debt of any Municipality.

16. APPROVAL OF LOANS BY THE MUNICIPALITY

16.1 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 before 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.

16.2 A copy of the information statement submitted to Council at least 21 days before the meeting to approve the loan agreement must contain particulars of –

(a) the essential repayment terms, including the anticipated debt repayment schedule; and
(b) the anticipated total cost in connection with such debt over the

repayment period.

17. PROVISION FOR REDEMPTION OF LOANS

17.1 Swellendam 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.

18. NON-REPAYMENT OR NON-SERVICING OF LOAN

18.1 Swellendam Municipality must honour all its loan obligations timeously. Failure to effect prompt payment will adversely affect the raising of future loans at favourable costs of borrowing.

18.2 Failure to pay any loan installment, even by one day, and even if only through an administrative oversight, will have severe repercussions, and may jeopardise the Municipality's credit rating.

18.3 In addition to the timeous payment of the loans, the Municipality must adhere to the covenants stipulated in the loan agreements.

18.4 Any failure by the Municipality to make payments on its loan needs to be reported to the Accounting Officer and the Executive Mayor.

19. PROHIBITED BORROWING PRACTICES

19.1 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.

19.2 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 commissions, rewards or costs, that will be paid in respect of the debt.

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

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

19.5 Swellendam Municipality shall not borrow for investment purposes, with the sole purpose of investing to earn a return.

19.6 A Municipality may only incur debt if the debt is dominated in Rand and is not indexed to, or affected by, fluctuations in the value of the Rand against any foreign currency.

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

20. SUBMISSION OF DOCUMENTS

20.1 When entering into a 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; and
(d) repayment schedules pertaining to existing short-term or long-term debt.

21. NOTIFICATION TO NATIONAL TREASURY

21.1 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;
- particulars of any security to be provided.

(b) If not already incorporated in the information statement, the following information is provided separately, MFMA (46)(3)(b)(i) and (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);
- the detailed repayment schedule for the duration of the borrowing (debt) (showing dates and all payments of principal and interest etc.);
- final maturity date;
- the total estimated cost of the borrowing (debt)
- over the repayment period;
- type of instrument;
- debt amortization terms;
- security to be provided and provide details;
- source of loan funds.

(c) A schedule of consultation undertaken, including, MFMA 46(3)(a)(i) and (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);

(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, MFMA 46(6), 17(2), 19

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

- 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.

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

22. REPORTING

22.1 In terms of section 71 of the MFMA, the Municipality must report on all loans at least once a month to the Mayor and Provincial Treasury.

22.2 The Accounting Officer must within 10 working days after the end of each quarter furnish the Mayor, National and Provincial Treasury with a report setting out the detail of each debt portfolio.

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

23. SHORT TITLE

23.1 This policy shall be called the Borrowing Policy of the Swellendam Local Municipality.