SOL PLAATJE MUNICIPALITY

Short and Long Term Borrowing Policy

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1. OBJECTIVES OF THE POLICY

To regulate the borrowing framework of Sol Plaatje Municipality to ensure optimum use is made of financial gearing.

2. INTRODUCTION

Given the large portion of municipal infrastructure has a long term economic life and a general principle is that the current ratepayers should not pay for the usage of future ratepayers, there is a strong economic argument to finance its capital expenditure through long-term borrowing in order to accelerate the pace of delivery and to mirror the repayment of funds with the economic life of the asset.

The devolution of service delivery responsibilities poses significant difficulties for the municipality coupled with insufficient financial resources and capacity related issues. As we all know, managing municipal services such as water systems, road networks, sewer reticulation and storm-water drains does not come cheap especially when you are projecting future funding requirements ahead and the factor in the cost of replacing large pieces of these systems.

Each year the municipality contributes significant resources to improve services and infrastructure for the community, thus incurring a financial risk. Increasing demand on these services calls for sound governance processes that enable the city to minimise the financial risks to the considering the types of financial risks associated with both its assets and liabilities.

Financial risk is an inherent part of service delivery and whilst it is impossible to operate in an environment devoid of risk, risks can be managed. These risks emanates from various sources in the process panning, funding and implementing various programmes.

3. BORROWING MANAGEMENT

The borrowing requirements of the municipality must be minimised in order to limit future revenue committed to debt servicing and redemption charges. It should be in the centre of the intent to borrow that funding must be obtained at the lowest possible rates of interest and at minimum risk. No speculative activity is permitted, in particular any borrowing for the purpose of investing funds in order to earn a return.

Where borrowing for specific CAPEX requirements, firstly they must be linked to the revenues of the underlying assets, secondly, the term of borrowing must not exceed the economic useful life of the underlying asset, and thirdly, the cost of funding must be taken into account in the setting of the relevant tariffs.

The economic life of the asset should always be equal to longer than the tenure of the of the debt finance.

4. RISKS ASSOCIATED WITH BORROWING

The following are the strategies that the municipality must consider to reduce, eliminate or mitigate risks associated with borrowing;

Liquidity risk must be minister by diversification of funding sources and ensuring an even spread of maturities across the borrowing horizon (laddered portfolio), in particular the pool of long debt where the intention is to renew or incur additional debt on maturity.

Where the risk concentration risks exists, in particular where large amounts of debt will be redeemed via a balloon payment on maturity or where it is a condition of the borrowing by the originating financial institution, the creation of the sinking fund for the future repayments of the debt should be considered. Use can also be made of guaranteed endowment policies to facilitate the payment on maturity date.

Alternative funding strategies must be considered based on the projected requirements including refinancing options particularly where a reduction in cost is possible.

Where the cost of using external funds acquired through borrowing is greater than the investment forgone earnings on municipal funds that are surplus to the current requirements, such funds must be used prior to seeking external funds.

a. LIQUIDITY RISK MANAGEMENT

Contingency funding/ reserve borrowing capacity in the form of committed but undrawn on demand credit facilities of at least R500 000.00. Facilities should be maintained with no less than four different institutions and renewed as required. A bank account may at no time be in overdraft by more than R100 000.00 in total.

A current ratio must never be below 1, and the cost coverage ratio not below 1 month.

b. RISK APPETITE

The amount of risk exposure or the potential adverse impact from an event that the municipality is willing to accept/retain or the level of risk the municipality is prepared to be exposed to before it decides action is necessary. Once the risk appetite threshold have been breached, risk management treatments and business control are implemented to bring the exposure level back within the accepted range.

RISK MEASURE	RISK TOLERANCE/APPETITE

Cost coverage ratio	30 days
Debt to revenue	50%
Debt coverage ratio	13:1

The municipality is fully committed to the principles of enterprise wide risk management which will be proactively, cost and business effectively implemented and actively managed.

The focus of the municipality risk management philosophy is to;

- Reduce the ratio of total cost of risk relative to an agreed base, such as revenue or total expenditure and to maintain the improvement over a sustained period
- Preserve and protect assets
- Promote the safety and health of employees through safe working procedures the environment as well as the wellbeing of stakeholders
- Improve the municipality's image relative to the stakeholders it serves through a reduction of incidents causing conditions which affect the service it renders
- Preserve and enhance the intellectual property of the broader enterprise and
- Optimise the earnings and potential of all potential of all operational activities

c. Interest Rate Risk

The municipality shall approve the strategy for managing the interest rate risk as tabled by the Finance Directorate subject to the strategy being in compliance with this policy. The Financial Services Directorate shall approve the use of fixed or floating interest rates having regard to the sensitivity and the term of the underlying assets or liability and the nature of the interest rate environment in compliance with this policy.

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 the 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.

In a municipal environment, however, it is advisable that interest rate risk be limited insofar as possible. This will ensure stability in terms of annual rates increases and reduce the potential of unfunded liabilities arising during the year without the ability to adjust the revenue of the municipality.

The policy directive is to negotiate fixed interest rates on all long term borrowings. Variable rates should be used for short term debt only.

5. FINANCIAL SERVICES DIRECTORATE

The directorate will be responsible for managing centralised treasury functions and acts as the municipality's central banker. This involves managing the primary bank account, borrowings, investments and financial risks management for the municipality. It will also be responsible for managing and coordinating financial planning and monitoring and the reporting on expenditure trends and activities as well as improving compliance to the legislative requirements.

The directorate is delegated to perform the following

1. Manage the fund raising activities including the structuring conduit loans
2. Manage the municipality's investments instruments
3. Manage the process for credit rating reviews and ensure that rating agency guidelines and recommendations are implemented by the municipality to sustain or improve the current rating.
4. Ensure a sound investor relations with external and internal stakeholders
5. Continually explore and implement funding and investment instruments and market approaches which will enhance balance sheet value for the city
6. Provide sound financial advice to all municipal business units and matters of capital investments and financial structuring and ,modelling

6. BORROWING MANAGEMENT POLICY

Whilst the policy position of Sol Plaatje Municipality is to remain debt free, the Council recognises that in order to ensure funding the acquisition, renewal or construction of assets, may need to resort to the prudent use of borrowings including loans, debt instruments and other finance or capital raising methods from time to time.

Municipalities are required by law to develop both a medium term integrated development plans (IDP) and annual operational plans (Service Delivery and Budget Implementation Plans (SDBIP)), in terms of Municipal Systems Act and Municipal Finance Management Act. These are comprehensive plans that align the municipality's activities around a clear medium term priorities and objectives.

In line with international practise, the municipality also subscribes to the development of the long term City Development Strategy (CDS) which is used to inform IDP and SDBIP's. Annual budget must be prepared in line with MFMA section 15 to 33. It is the responsibility of the Finance Directorate to develop and propose to management a revised funding strategy. In doing so, cognisance must be taken of the borrowing ratios;

Area	**Financial Indicator**

Liquidity	Current assets to current liabilities
Debt exposure	Total assets to total realisable assets
Debt Management	Total debt as % of revenue
Debt management	Debt servicing costs as % of total revenue

Liquidity:

This indicator reflects the municipality's short term liquidity position that is the ability to repay current commitments from cash and near cash assets. If the municipality's ratio is 1:1 and below, or with a deteriorating trend, it may be financially be at risk of not being able to meet creditor's commitments.

Debt exposure

This indicator reflects the ability of the municipality to acquit the existing liabilities with the proceeds from the disposal of its realizable assets. Ideally, total liabilities should be significantly less 100% of total realizable assets.

Debt Management

The municipality with a total debt in excess of its revenue will be unable to meet all debt commitments from revenue should they be required to be repaid at one time.

The debt servicing cots indicator reflects the proportion of total revenue that is used to service debt and which cannot be used directly for service delivery.

7. USE OF DERIVATIVE INSTRUMENTS AND HEDGING

A derivative instrument is a written financial contract whose value depends on the values of one or more underlying assets and indices.

The use of derivative instruments must be conservative and only for the purpose of eliminating or reducing the municipalities risk relating to foreign currency, interest rate and other relevant market risks.

The municipality may decide to have a list of permitted derivative instruments for the hedging strategies. If this is the case, it must be clearly communicated and all of the municipality's hedging strategies must be in line with this. No gold and precious metal derivative products or commodity and equity derivative contracts may be entered into. The municipality may enter into hedging contracts with approved counterparties.

The municipality must perform its own independent analysis on the most appropriate instruments to be used. The analysis must at least consider the following;

- Underlying economic conditions
- The derivative instrument payoff profile and
- Term of underlying

The municipality must keep an up to date register of all hedging instruments used by the municipality and this must include details on;

- Date of contract
- Amount of hedge
- Reason for the hedge including its intended benefit
- Performance of hedge and
- The municipality officials who approved the hedge

Hedging documents must be safeguard in secure place.

8. LEGISLATIVE FRAMEWORK

Chapter six of the Municipal Finance Management Act 56 of 2003 (MFMA) and the National Treasury Regulations on Debt Disclosure must be complied with.

The municipality may incur long term debt only if;

- MFMA Section 46 (2)

a) A resolution of council, signed by the Mayor has approved the debt agreement and
b) The accounting officer has signed the agreement or other document which crates or acknowledges debt

A municipality may incur long term debt only if the accounting officer of the municipality has,

a) in accordance with Section 21A of the Municipal Systems Act
    (i) At least 21 days prior to the meeting of the council at which approval for the debt is to be considered, make a public an information statement setting out 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, 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 to the municipal council at least 21 days prior to the meeting of the council together with the particulars of

i) The essential repayment terms including the anticipated debt repayment schedule and
ii) The anticipated total costs in connection with such debt over the debt repayment period

9. OTHER CONDITIONS

Conditions applying to both short term and long term debt

Section 47 of MFMA – A municipality may incur debt only if

a) The debt is denominated in Rand and is not indexed or affected by, by fluctuations in the value of the Rand against any foreign currency and

b) Section 48 (3) has been complied with, if security is to be provided by the municipality

Section 48 (Security)

c) A municipality may, by resolution of its Council provide security for
   i) Any of its debt obligations (if security is provided, there are additional conditions complied with)

Section 49 (Disclosure)

1) Any person involved in the borrowing of money by the municipality must when interacting with the prospective lender or when preparing documentation for consideration by the prospective investor
   a. 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
   b. Take reasonable care to ensure the accuracy of nay information disclosed

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.

In addition to the above MFMA requirements, the debt disclosure requirements must be complied with in respect of information to be provided.

The following information to be provided to National Treasury with respect to a long term debt proposal.

	DETAILS	**MFMA**
	A copy of the information statement required by section	46 (3) (a) (i)

	46 (3) containing particulars of the proposed borrowing (debt) instrument	
	If not already incorporated in the information statement, please ensure the following information is provided separately ((note the Quarterly Borrowing Monitoring Return) • Amount of de3bt to be raised through borrowing or other means • Purposes for which the borrowing (debt) is to be incurred • Interest rates applicable • 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 • Total estimated cost of the borrowing (debt) over the repayment period • Type of instrument • Security to be provided and provide details • Source of loan funds	46 (3) (b) (i) and (ii)
	A schedule of consultation undertaken including; Dates when the information statement was made public Details of meetings media adverts and other methods used to consult on the proposed long term borrowing (debt)	46 (3) (a) (i) (ii)
	A copy of the approved budget and relevant documentation supporting the budget highlighting the assets 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	46 (6) 17 (2) 19
	If the borrowing (debt) is for the purpose of refinancing existing long term borrowing (debt), the following information; • Description of the asset for which the original loan was required • The useful remaining life of the asset • The net present value of the asset including the discount rate used and any assumptions in the calculations • The net present value of the projected future payments before refinancing including the discount rate and assumptions used • The net present value of the projected future payments after refinancing including the discount rate and assumptions used	
	What source of funding will be used to repay the loan, specify revenue streams and whether this is existing revenue or new revenue	19 (1) (d)
	Schedule of all long term borrowing obligations in the	

	format of QMBR showing principle and interest payments for the life of all the loans and any associated investment set up and sinking funds	
	In the case of the municipal entity, details of any guarantee or other forms of security to be issued by the parent municipality in respect of the entity's proposed borrowing (debt)	50
	A copy of the council or board of directors resolution approving the borrowing (debt instrument) should be forwarded once approved	

10. FORM OF BORROWINGS

Long term borrowings will be taken up in the following forms:

- Balance Sheet loans (both secured and unsecured) from registered South African banks and/or other financial institutions offering balance sheet loans.

- Long term debt agreements between the RSA National Government and the municipality (where applicable).

- Long term debt agreements between State Owned Enterprises of the RSA National Government and the municipality (where applicable).

- Long term debt agreements between municipalities.

11. CONCLUSION

The provision of municipal and social infrastructure to the community should be fast tracked to ensure backlog eradication within the timeframes set by National Government, or as soon as possible thereafter. In order to achieve this, a myriad of funding methods including borrowings will be applied by the Sol PLaatje Local Municipality.