



LEKWA LOCAL
MUNICIPALITY

BUDGET RELATED POLICY
BORROWING POLICY 2024/2025

LEKWA LOCAL MUNICIPALITY BORROWING POLICY

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DEFINITIONS

“Accounting Officer” – means a person appointment in terms of section 82(l)(a) or (b) of the Municipal Structures Act.

“allocation” means:

(i) a municipality's share of the local government's equitable share referred to in section 214(l)(a) of the Constitution;

(ii) an allocation of money to a municipality in terms of section 214(1)(c) of the Constitution;

(iii) an allocation of money to a municipality in terms of a provincial budget; or

(iv) any other allocation of money to a municipality by any other or another municipality, otherwise than in compliance with a commercial or other business transaction.

“Act” – means the Local Government: Municipal Finance Management Act, 2003 (Act 56 of 2003);

“Chief Financial Officer” – means an officer of the Municipality, designated by the Municipal Manager to be administratively in charge of the financial affairs of the municipality;

“Council” or “Municipality” – means the Municipal Council of Lekwa Local Municipality as referred to in Section 18 of the Municipal Structures Act;

“Creditor” – in relation to a municipality, means any person or service provider to whom money is owed by the Municipality;

“Debt” – means – (a) a monetary liability of obligation created by a financing agreement, note, debenture, bond, overdraft, or the issuance of municipal securities; or (b) a contingent liability such as that created by guaranteeing a monetary liability or obligation of another.

“Delegate” – means an official / person delegated to perform tasks on behalf of another person;

“Financial Statement” – means statements consisting of at least –

(a) a statement of financial position;

(b) a statement of financial performance;

(c) a statement of changes in net assets;

(d) any other statements that may be prescribed; and

(e) any notes to these statements.

“Financial year” – means a year commencing on 1 July and ending on 30 June of the following year;

“Financing Agreement” means any long-term agreement, lease, instalment purchase contract or hire purchase agreement under which the Municipality undertakes to pay the capital cost of property, plant, or equipment over a period of time;

“Lender” – in relation to a municipality means a person or service provider who provides debt finance to a municipality;

“Long Term Debt” – means debt which is repayable over a period exceeding 12 months;

“Municipal debt instrument” – means any note, bond, debenture, or other evidence of indebtedness issued by a municipality, including virtual or electronic evidence of indebtedness intended to be used in raising debt;

“Security” – means a lien, pledge, mortgage, cession, or other form of collateral intended to secure the interest of a creditor;

“Short Term Debt” – means a debt which is repayable over a period not exceeding 12 months.

In this document unless the context otherwise indicates, words and expressions denoting the singular shall include the plural and vice versa, words and expressions denoting the male sex shall include the female sex and vice versa and reference to a natural person shall include a legal person and vice versa

PURPOSE OF THIS DOCUMENT

This policy sets out the principles for determining the following:

1. The Municipality's borrowing requirements.
2. Process to be followed when debt is incurred.

BACKGROUND

In terms of the Municipal Finance Management Act, Act 56 of 2003, chapter 4 on municipal budgets, subsection (18), states that: An annual budget may only be funded from;

- a) Realistically anticipated revenues to be collected;
- b) Cash-backed accumulated funds from previous years' surpluses not committed for other purposes; and
- c) Borrowed funds, but only for capital projects.

Section 19 of the MFMA also requires spending on a capital project may only commence once the funding sources have been considered, are available and have not been committed for other purposes. Furthermore, Chapter 6 of the MFMA 6 guides on the requirements of obtaining Short Term and Long-Term Debt, Conditions to comply with when applying for Debt, Security, Disclosures and Municipal Guarantees.

OBJECTIVE

The objective of this policy is to ensure municipality;

- (a) comply with the legislative requirements;
- (b) Manage interest rate and credit risk exposure;
- (c) Maintain debt within specified limits and ensure adequate provision for the repayment of debt; and
- (d) To ensure compliance with all Legislation and Council policy governing borrowing of funds.

INTRODUCTION

The Municipality may only incur debt in terms of the Municipal Finance Management Act, Act 56 of 2003.

5.2 The following ratios for Liability Management is favourable:

• **Capital Cost (Interest Paid and Redemption) as a % of Total Operating Expenditure Purpose/ Use of the Ratio**

The Ratio indicates the cost required to service the borrowing. It assesses the borrowing or payment obligation expressed as a percentage of Total Operating Expenditure.

Formula Capital Cost = (Interest Paid and Redemption) / Total Operating Expenditure x 100

If cost of capital is higher than the expected return of the project, the project will not be profitable. In the instance of the municipality the asset (investment) useful life should be relatively longer than the loan term.

Norm

The norm is between 6% to 8%

Interpretation of Results

Operating below the Norm could indicate that the Municipality has the capacity to take on additional financing from borrowing to invest in infrastructure projects or it could relate to cash flow problems where it is unable to access borrowed funds or the funding decisions of the municipality impacts of these levels. On the other hand, exceeding the Norm could pose a risk to the Municipality should changes or fluctuations in financing costs arise. When assessing this ratio, the cash flow requirements of the Municipality should also be considered.

• Debt (Total Borrowings) / Total Operating Revenue

Purpose / Use of the Ratio

The Ratio indicates the extent of Total Borrowings in relation to Total Operating Revenue. It indicates short- and long-term debt financing relative to operating revenue of the municipality. The purpose of the Ratio is to provide assurance that sufficient Revenue will be generated to repay Liabilities. Alternatively stated, the Ratio indicates the affordability of the Total Borrowings.

Formula Debt = (Short Term Borrowing + Bank Overdraft + Short Term Lease + Long Term Borrowing + Long Term Lease) / Total Operating Revenue - Conditional Grants

Norm

The norm is 45%

Interpretation of Results

If the result of the Ratio analysis indicates less than 45% then the Municipality still has capacity to increase funding from borrowings, however, this should be considered within the cash flow requirements of the Municipality.

TYPE OF DEBT

6.1 Short Term Debt

1. 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 realistically 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.

2. A municipality may incur short-term debt only if:

- A resolution of the municipal council, signed by the executive mayor, has approved the debt agreement; and
- The Accounting Officer has signed the agreement or other document which creates or acknowledges the debt.

3. For the purpose of subsection 2 (a), a municipal Council may:

- Approve a short-term transaction individually; or
- 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:
 - (a) the credit limit must be specified in the resolution of the council
 - (b) the terms of the agreement, including the credit limit, may be changed only by a resolution of the council; and
 - (c) if the council approves a credit facility that is limited to emergency use, the AO 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.

4. The Municipality:

- a) Must pay off short-term debt within the financial year; and
- b) May not renew or refinance short-term debt, where such renewal or refinancing will have the effect of extending the short-term debt into a new financial year.

5. (a) No lender may wilfully extend credit to a municipality for the purpose of renewing or refinancing short-term debt that must be paid off in terms of section 4 (a)

(b) If a lender wilfully extends credit to a municipality in contravention of this policy, the municipality is not bound to repay the loan or interest on the loan.

6. Section 5 (b) above 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.

6.2 Long-term loan

1. The Municipality may incur long-term debt only in accordance with and subject to any provisions of chapter 6 of the MFMA, including section 19 of the MFMA, and only for the purpose of

- a) capital expenditure on property, plant and equipment for the purpose of achieving its long-term strategic objectives, as outlined in section 152 Constitution, including costs in subsection 4 below or
- b) re-financing existing long-term debt subject to subsection 5 below

2. 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 AO has signed the agreement or other document which creates or acknowledges the debt.

3. A municipality may incur long-term debt only if the AO of the municipality:

- a. Has, in accordance with section 21A of the Municipal Systems Act:
 - 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
 - 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; and
- 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:
 - the essential repayment terms, including the anticipated debt repayment schedule; and
 - the anticipated total cost in connection with such debt over the repayment period.

4. Capital expenditure contemplated in subsection (1) (a) may include-

- a. Financing costs, including:
 - capitalised interest for a reasonable initial period;
 - costs associated with security arrangements in accordance with section 48 of the Act;
 - discounts and fees in connection with the financing
 - fees for legal, financial, advisory, trustee, credit rating and other services directly connected to the financing; and
 - 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.

5. 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, 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. A municipality's long-term debt must be consistent with its approved capital budget

7. SECURITY

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

7.1.1 Any of its debt obligations; and

7.1.2 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.

7.2 A municipality may in terms of section 9.1 above provide any appropriate security, including by:

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

7.2.2 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;

7.2.3 Undertaking to deposit funds with the lender, investor or third party as security;

7.2.4 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;

7.2.5 Ceding as security any category of revenue or rights to future revenue;

7.2.6 Undertaking to have disputes resolved through mediation, arbitration or other dispute resolution mechanisms;

7.2.7 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;

7.2.8 Undertaking to make provision in its budgets for the payment of its financial obligations, including capital and interest;

7.2.9 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

7.2.10 Agreeing to such other arrangements as the municipality may consider necessary and prudent.

7.3 A council resolution authorising the provision of security:

7.3.1 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

7.3.2 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.

7.4 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.

7.5 A determination in terms of section 7.3 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.

8. DISCLOSURE

8.1 Any person involved in the borrowing of money by the municipality must, when interacting with a prospective lender or when preparing documentation for consideration by a 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 any information disclosed.

8.2 Information to be provided should include:

- 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.
- e. 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.

9. MUNICIPAL GUARANTEES

9.1 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.
- b. Neither the national nor a provincial government may guarantee the debt of a municipality except to the extent that chapter 8 of the Public Finance Management Act provides for such guarantees.

10. CONDITIONS TO APPLY FOR BOTH SHORT-TERM & LONG-TERM DEBT

5.1 A municipality may incur short-term and long-term debt only if:

5.1.1 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;

5.1.2 A council resolution is taken authorising the provision of security if security is to be provided by the municipality;

11. APPROVALS

Once Council approves the loan, the Accounting Officer has to enter into an agreement with the recommended financial institution on behalf of Council. The Chief Financial Officer must ensure that the terms and conditions are as originally agreed before the Council is committed.

12. DOCUMENTS TO BE KEPT

The following loan documentation and certificates, at a minimum, must be safeguarded at all times:

- a. Loan agreements;
- b. Any applicable security agreements;
- c. Copy of annual loans register;
- d. Signed copies of monthly reconciliations;
- e. Copies of all repayments made;
- f. Copies of amortization schedules;
- g. Copies of quarterly National Treasury return

In addition, the municipality is to keep a loan register reflecting the below but not limited to:

- a. Loan number;
- b. Type of loan;
- c. Financial institution;
- d. Date issued;
- e. Purpose of loan;
- f. Loan period;
- g. Interest rate;
- h. Instalments (capital and interest);
- i. Due dates (quarterly / half-yearly / yearly);
- j. Security (if any);
- k. Final redemption date;
- l. Opening balance at the beginning of the financial year;
- m. Amounts received during the financial year;
- n. Capital amounts redeemed during the financial year; and
- o. Closing balance at the end of the financial year

13. RELATIONSHIP WITH OTHER POLICIES

This policy shall be read in conjunction with other relevant adopted policies of the municipality, including the following;

- a. The Budget Implementation Policy
- b. Cash management policy
- c. Cash Management and Investment Policy
- d. Long Term Financial Plan Policy