CAPE WINELANDS DISTRICT
MUNICIPALITY • MUNISIPALITEIT • UMASIPALA

BORROWING POLICY

Approved by Council: 27 May 2021
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1. DEFINITIONS

"Act" means the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003);

"Council" means the Municipal Council of the Municipality;

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

"lender" means a juristic person who provides debt finance to the Municipality;

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

"Municipality" means the Cape Winelands District Municipality;

"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.

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

"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;

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

Any word or expression used in this policy shall that is not defined above, unless the context clearly requires a different interpretation, bear the same meaning attached to it in the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) or the Disclosure Regulations, as the case may be; provided that if there is any conflict between a definition contained in the MFMA and a definition contained in the Disclosure Regulations, then the definition contained in the MFMA shall prevail.

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 The Municipality aimed at gaining the lowest interest rate on any external borrowings, short-term as well as long-term, but still having the credit exposure risk in mind. The effectiveness of this policy is to ensure that the cash management program make provision for the repayment of interest and redemption on the external borrowings. The policy will set out specific limits in which debt needs to be maintained to ensure adequate provision for the repayment of debt to ensure financial sustainability.

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

4. SCOPE

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 authorized borrowings.

4.1 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.

4.2 Cost Borrowings

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

4.3 Prudence

Borrowings shall be made with care, skill, prudence and diligence. To this end, officials of the Municipality are required to:

(a) adhere to this policy, and other procedures and guidelines;

(b) exercise due diligence;

(c) prepare all reports in a timely fashion; and

(d) ensure strict compliance with all Legislation and Council policy.

5. REGULATORY CONTEXT

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

5.2 The Municipal Regulations on Debt Disclosure has been promulgated (Government Gazette no. 29966, 15 June 2007) and has been effective from 01 July 2007 for a municipality or municipal entity.

5.3 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.

6. TYPES OF LOANS AND FINANCING

6.1 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 six 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 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) may 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.

6.2 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).

6.3 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.

6.4 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 the limits.

7. SOURCES OF BORROWINGS

7.1 Subject to any particular determination of the Council of the Municipality, the Municipality may enter into financing agreements with:

a) registered South African Banks;

b) the Development Bank of Southern Africa;

7.2 Unless the Council of the Municipality specifically determines otherwise, the Municipality shall not incur any debt by the issuance of any municipal debt instruments.

8. BORROWING FACTORS

8.1 The Municipality shall take into account the following factors when deciding whether to incur debt:

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 financed by the debt;

d) the impact of interest and redemption payments on both current and forecasted revenue available;

e) other current and projected sources of funds;

f) likely movements in interest rates for variable rate borrowings;

g) competing demands for funds;

h) timing of money market interest rate movements and the long term rates on the interest rate curve; and

i) the expected impact that any external debt raised may have on the operational budget.

8.2 The Municipality will, in general, seek to limit its dependence on borrowings in order to minimise future revenue committed to debt servicing and redemption charges. The Municipality may only borrow funds, in terms of the MFMA, for the purpose of acquiring assets, improving facilities or infrastructure to provide service delivery.

8.3 The 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.

8.4 The current gearing for external loans should not exceed the 50% mark total outstanding debt to Revenue. Revenue is limited to the RSC Levy Replacement Grant, Equitable Share, Interest from External Investments and Roads admin fee.

9. PROHIBITED BORROWING PRACTICES

9.1 The Municipality shall not borrow for investment purposes, with the sole purpose of investing to earn a return. The cost of debt is almost always more expensive than the return that the Municipality can derive by investing in permitted investments.

9.2 Foreign Borrowing is permitted in terms of Section 47 of the MFMA, whereby the debt must be denominated in Rand and is not indexed to, or affected by, fluctuations in the value of the Rand against any foreign currency.

10. DEBT REPAYMENT

10.1 Whilst the period for which loan debt may be received will vary from time to time according to the needs of the various Lenders.

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

10.3 No loans will be repaid before due date unless there is a financial benefit to the Municipality.

10.4 The Municipality shall therefore assess the nature and extent of any benefits of early repayment before it makes any such early repayment.

10.5 Cognisance must be taken of any early repayment penalty clauses in the initial loan agreement, as part of the assessment.

10.6 The Municipality may 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.

10.7 Such sinking funds may be invested directly with the Lender's Bank.

10.8 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.

11. NON-REPAYMENT OR NON-SERVICING OF LOAN

11.1 The 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.

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

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

12. CONTROL AND MONITORING OF BORROWINGS

12.1 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.

12.2 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.

13. APPROVAL OF LOANS BY THE MUNICIPALITY

13.1 Section 46 of the MFMA 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 prior to 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.

13.2 A copy of the information statement submitted to Council at least 21 days prior to 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.

14. SECURITY

14.1 In Section 48 of the MFMA provides that the Municipality may provide security for any of its debt obligations in any of the forms referred to in Section 48(2).

14.2 Such security shall be given only pursuant to a resolution of the Council, which resolution must comply with the provisions of Section 48(3), (4) and (5) of the MFMA.

15. SHORT TERM DEBT

15.1 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.

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

15.3 The Municipality must pay off 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.

16. GUARANTEES

16.1 The MFMA Section 50 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.

17. REPORTING

17.1 The Financial Officer shall in terms of Section 71 of the MFMA report to National and Provincial Treasury on the state of the borrowings. This reporting must be done on a monthly and quarterly basis.

18. DISCLOSURE

18.1 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 to the prospective Lender or Investor. Whilst this is a standard and acceptable business practice, it is also in compliance with Section 49 of the MFMA.

18.2 In the case of long-term debt it must be disclosed whether the debt is to finance -

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; or

b) refinancing of existing long-term debt, subject to section 46(5) of the Act.