

MOSSEL BAY MUNICIPALITY



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BORROWING, FUNDS AND RESERVES POLICY

Version 6 – 1 July 2019

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1. INTRODUCTION

The documented **Borrowing, Funds and Reserves Policy**, sets out the framework for the prudent use of Borrowing, Funds and Reserves available to the municipality.

This Policy should be read in conjunction with the approved **Liquidity Policy**. The Liquidity Policy sets out the prudent level of cash to be maintained by the Municipality as one of several factors to ensure long term financial sustainability. It is however of equal importance to protect, maintain and extend the infrastructure of the Municipality to ensure the continued provision of services at an acceptable standard.

This policy is implemented to provide guidance on the appropriation of capital funding resources on a sustainable basis in the longer term.

2. BACKGROUND AND APPROACH

With reference to the applicable legislation, refer to in the sections below. Legislation exists and prescribes the framework of a Borrowing as well as Funds and Reserves Policy and these factors will all be addressed in this Policy.

Although legislation provides guidance as to the broader framework to ensure financial management of resources in order for the Council to meet all of its obligations timeously, it is not prescriptive with regards to quantifying not only the prudent level of Borrowing, Funds and Reserves but more so the optimal level thereof.

Therefore, in this Policy cognisance has been taken of the legislative guidelines whilst more prescriptive guidelines are set for the optimal management and monitoring of resources to the Municipality's avail based on sound financial practices.

3. FUNDING POLICY

3.1. LEGISLATIVE FRAMEWORK

3.1.1. The Local Government Municipal Budget and Reporting Regulation, Regulation 393, published under Government Gazette 32141, 17 April 2009 stipulates:

“8(1) Each municipality must have a funding and reserves policy which must set out the assumptions and methodology for estimating -

- a) A projected billings, collections and all direct revenues;*
- b) the provision for revenue that will not be collected;*
- c) the funds the municipality can expect to receive from investments;*
- d) the dividends the municipality can expect to receive from municipal entities;*

- e) *the proceeds the municipality can expect to receive from transfer or disposal of assets;*
- f) *the municipality's borrowing requirements; and*
- g) *the funds to be set aside in reserves."*

3.1.2. In terms of Section 18 and 19 of the MFMA an annual budget may only be funded from:

3.1.2.1. *Cash backed accumulated funds from previous years' surpluses not committed for other purposes*

3.1.2.1.1. Transfers from the accumulated surplus to fund operating expenditure will only be allowed for specific once-off projects with no recurring operating expenditure resulting thereof.

3.1.2.2. *Borrowed funds, but only for capital projects*

3.1.2.2.1. Actual capital expenditure may only be incurred on a capital project if:

- The funding for the project has been appropriated in the Capital Budget, and
- The funding has been secured from the financial source that is not committed for another purpose.

3.1.2.3. *Realistically anticipated revenues to be collected*

3.1.2.3.1. Realistic anticipated revenue projections must take into account projected revenue for the current year based on actual collection levels in previous financial years.

3.2. OPERATING BUDGET

3.2.1. The Operating Budget should be cash funded.

3.2.2. The Operating Budget is funded from the following main sources of revenue:

- 3.2.2.1. Property Rates;
- 3.2.2.2. Service Charges;
- 3.2.2.3. Government Grants and Subsidies; and
- 3.2.2.4. Other revenue, fines, interest received etc.;

3.2.3. The following guiding principles apply when compiling the Operating Budget:

3.2.3.1. Growth parameters must be realistic taking into account the current economic conditions;

3.2.3.2. Tariff adjustments must be in line with the Rates and Tariff policies of The Municipality;

3.2.3.3. Revenue from Government Grants and Subsidies must be in line with allocations gazetted in the Division of Revenue Act and provincial gazettes. Transfers of a conditional nature must be appropriated only as prescribed and should not be used to fund any other Operating Budget items;

Revenue from public contributions, donations or any other grants may only be included in a budget (Adjustment or Original budget) if there is acceptable documentation that guarantees the funds;

3.2.3.4. Provision for revenue that will not be collected is made against the expenditure line item called Impairment Losses. The provision must be calculated in terms of GRAP 104.64 and is calculated based on the highest of:

3.2.3.4.1. The difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset; or

3.2.3.4.2. The actual collection levels for the previous financial year and the reasonably projected annual non-payment rate;

3.2.3.5. Interest received from actual Long-term and or Short-term Investments are based on the amount reasonably expected to be earned on cash amounts available during the year according to the expected interest rate trends.;

3.2.3.6. A detailed salary budget is compiled on an annual basis. All funded positions are budgeted for in total as well as new and/or funded vacant positions. As a guiding principle the salary budget should not constitute more than 35% of annual Operating Expenditure;

3.2.3.7. Depreciation charges are fully budgeted for according to the Capital Asset Register;

3.2.3.8. The annual cash flow requirement for the repayment of borrowings must fully be taken into consideration with the setting of tariffs;

- 3.2.3.9. Sufficient provision must be made for the maintenance of existing infrastructure based on affordable levels. The maintenance budgets are normally lower than the recommended levels, as a guiding principle repair and maintenance should constitute between 5% and 8% of total operating expenditure and should annually be increased incrementally until the required targets are achieved; and
- 3.2.3.10. Individual expenditure line items are to be revised each year when compiling the budget to ensure proper control over expenditure.

3.3. CAPITAL BUDGET

3.3.1. The capital budget provides funding for the municipality's capital programme based on the needs and objectives as identified by the community through the Integrated Development Plan and provides for the eradication of infrastructural backlogs, renewal and upgrading of existing infrastructure, new developments and enlargement of bulk infrastructure.

3.3.2. The capital budget is limited by the availability and access to the following main sources of funding:

- 3.3.2.1. Accumulated cash backed internal reserves such as the Capital Replacement Reserve;
- 3.3.2.2. External borrowings;
- 3.3.2.3. Government Grants and Subsidies; and
- 3.3.2.4. Public Donations and Contributions.

3.3.3. The following guiding principles apply when considering sources of funding for the capital budget:

3.3.3.1. Government Grants and Subsidies:

- 3.3.3.1.1. Only Government Gazetted allocations or transfers as reflected in the Division of Revenue Act or allocations as per Provincial Gazettes may be used to fund projects;
- 3.3.3.1.2. The conditions of the specific grant must be taken into consideration when allocated to a specific project.

3.3.3.2. Public Donations and Contributions:

- 3.3.3.2.1 In the case of public contributions, donations and/or other grants, such capital projects may only be included in the annual budget if the funding has been received by the municipality already or a signed contract or Memorandum of agreement is in place.

3.3.3.3. External Borrowing:

3.3.3.3.1. The borrowing requirements as contained in the **Borrowing Policy** section are used as a basis to determine the affordability of external loans over the Medium-Term Income and Expenditure Framework.

3.3.3.3.2. The ratios to be considered to take up additional borrowings are as follows, unless in contravention with any loan covenants:

3.3.3.3.2.1. Estimated long-term credit rating of Baa3 and higher. Only when a general down grading of institutions is performed by Moody's, the Accounting Officer on recommendation of the Chief Financial Officer may allow a lesser favourable grading that is still acceptable according to their management judgement. In the case of a general upgrading of institutions, the above-mentioned rating will be adjusted upwards in line with the above rating and the upgrade.;

3.3.3.3.2.2. Interest Paid to Total Expenditure not to exceed 5%;

3.3.3.3.2.3. Total Long-term Debt to Total Operating Revenue (excluding conditional grants and transfers) not to exceed 35%;

3.3.3.3.2.4. Cash from operating activities covers the annual loan repayments at least 1 time;

3.3.3.3.2.5. Percentages of total annual loan repayment (Capital and Interest) to total operating expenditure not more than 10%.

3.3.3.4. Cash backed Reserves

3.3.3.4.1. Allocations to capital projects from cash backed internal reserves will be based on the available funding for each ring-fenced reserve according to the conditions of each reserve as contained in the **Reserves Policy** section.

3.3.3.4.2. All capital projects have an effect on future operating budget therefore the following additional cost factors should be considered before approval:

3.3.3.4.2.1. Personnel cost relating to the staff at the new facilities once operational;

3.3.3.4.2.2. Contracted services, for example security, cleaning etc.;

3.3.3.4.2.3. General expenditure such as services cost, stationery, telephones, material etc.;

3.3.3.4.2.4. Other capital requirements to operate the facility such as vehicles, plant and equipment, furniture and office equipment etc.;

3.3.3.4.2.5. Costs to maintain the capital assets;

3.3.3.4.2.6. Interest and redemption in the case of borrowings;

3.3.3.4.2.7. Depreciation charges; and

3.3.3.4.2.8. Revenue generation as the additional expenses incurred may be offset by additional revenue generated to determine the real impact on tariffs or cast benefit.

4. RESERVES POLICY

4.1. LEGAL REQUIREMENTS

4.1.1. There are no legal requirements for the creation of reserves apart for the Housing Act, No. 107 of 1997 that requires the creation of the Housing Development Fund.

4.1.2. According to Generally Recognised Accounting Practices (GRAP) such reserves may only be created if such reserves are cash backed. Fund accounting is not allowed and any reserves must be legal reserves created by law or through a Council Resolution.

4.2. TYPES OF RESERVES

4.2.1. No non-cash funded reserve is allowed in Mossel Bay Municipality.

4.2.2. The following reserves are allowed in Mossel Bay Municipality:

- 4.2.2.1. Housing Development Fund;
- 4.2.2.2. Self-Insurance Fund; and
- 4.2.2.3. Capital Replacement Reserve (CRR)

4.2.3. Housing Development Fund

4.2.3.1. The Accounting Officer must create a Housing Development Fund in terms of the Housing Act, No 107 of 1997.

4.2.3.2. The Housing Development Fund must be cash backed. The proceeds of the Housing Development Fund are utilised for housing development in accordance with the National Housing Policy.

4.2.3.3. Any profit on the rental, sale or alienation of property financed previously from Government housing funds has to be transferred to the Housing Development Fund.

4.2.4. Capital Replacement Reserve (CRR)

4.2.4.1. The capital replacement reserve is a capital asset financing source that represents an alternative to other funding sources available, namely external loans, government grants and subsidies.

- 4.2.4.2. An amount equal to the actual depreciation charges, bulk service levies received, the VAT claimed on capital budget housing projects, revenue received from insurance claims linked to the replacement of capital assets as result of insurance claims and the proceeds on land sales must be contributed to the capital replacement reserve.
- 4.2.4.3. As at year end the Chief Financial Officer must determine whether the Municipality meets its **minimum liquidity criteria** as stipulated in the **liquidity policy**. Excess cash in addition to the prescribed level in terms of the liquidity policy is to be calculated and appropriated to the Capital Replacement Reserve.
- 4.2.4.4. The capital replacement reserve may only be utilised for purpose of financing capital assets, specifically for the replacement or renewal of existing capital assets and may not be used for the maintenance of any capital assets.
- 4.2.4.5. The amount available for financing of the next year capital program is determined as follow:
(Financial years has been included only for reference purposes)
Step 1 - Determine the excess cash:
Excess cash in CRR is determined by using the opening balance of previous year (1 July 2014) less the current year capital budget allocation (2014/2015) finance from the capital replacement reserve.
Step 2 - Determine the current year contributions to CRR:
The current year contributions are the budgeted depreciation charges, bulk service levies received, the VAT claimed on capital budget housing projects, insurance claims paid out relating to capital assets and the proceeds on land sales (2014/2015)
Step 3 – Determine the available amounts:
The available amount for the next budget (2015/2016) is 33.3% of the result as determined in Step 1 plus the result of Step 2. The exercise in terms of step 2 is repeated for the two outer years using the budgeted figures, whilst the rest of the surplus in Step 1 is divided equally between two outer years.
- The intension is never to deplete the capital replacement reserve over a MTREF period, but rather to sustain at least the current levels of own funding available for the financing of the capital program.
- 4.2.4.6. The municipality aims, but is not limited to use not less than 80% of the programmes or projects financed from the Capital Replacement Reserve towards the upgrading, replacement and refurbishment of existing assets and the rest towards the creation of new capital assets.

4.2.5 **Self-Insurance Reserve**

- 4.2.5.1 The purpose of the self-insurance reserve is to cover own damage relating to the policy of all risks, the municipal vehicle fleet and claims below the excess levels of the reinsurance policy of the Municipality. It is the intension of the Municipality to progressively grow the self-insured portfolio of the Municipality.
- 4.2.5.2 Over and above the net result of the operating account of all insurance related expenses (Premium of reinsurance plus the claims expenses less reinsurance refunds), an additional amount equal to 0.03 percent of the value as reflected on the face of the statement of financial position for all capital assets must be contributed to the self-insurance reserve.
- 4.2.5.3 The additional contribution and the net result of the operating account of insurance must be cash funded, therefore always creating the reserve to grow till the limit as set out below.
- 4.2.5.4 As at year end the Chief Financial Officer must determine whether the Municipality meets its **minimum liquidity criteria** as stipulated in the **liquidity policy**. Excess cash in addition to the prescribed level in terms of the liquidity policy is to be calculated and may be appropriated to the Self-Insurance Reserve.
- 4.2.5.5 The self-insurance reserve may only be utilised for financing activities that was caused by an unforeseen activity and which resulted in damage to the assets of the Municipality or a third party, other than by means of normal wear and tear.
- 4.2.5.6 The municipality aims, but is not limited, to progressively fund the self-insurance reserve to a level of 2% of the carrying value of capital assets as determined annually at the end of each financial year.

5 BORROWING POLICY

5.1 LEGISLATIVE REQUIREMENTS

The legislative framework governing borrowings, funds and reserves are:

5.1.5 The Municipality must comply with Chapter 6 of the MFMA. This chapter deals in sections 45 to 51 with short and long-term debt, the conditions, security, disclosure, municipal guarantees and National and Provincial guarantees.

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

5.1.7 Local Government Municipal Finance Management Act, Act 56 of 2003 (MFMA) must be complied with and MFMA Circular 71 stipulates the following guidelines regarding borrowing:

5.1.7.1 **Capital Cost (Interest Paid and Redemption) as a % of Total Operating Expenditure**

Formula:

Capital Cost (Interest Paid and Redemption) / Total Operating Expenditure
x100

Criteria: 6% - 8%

5.1.7.2 **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%

5.1.8 Local Government Municipal Budget and Reporting Regulation, Regulation 393, published under Government Gazette 32141, 17 April 2009.

5.1.9 Local Government Municipal Regulations and Debt Disclosure, Regulation R492, published under Government Gazette 29966, 15 June 2007.

5.2 ACCESSING NEW BORROWINGS

5.2.5 Municipal infrastructure has a long-term economic life and it is appropriate to fund assets of this nature with long term external borrowing. The economic life of capital assets should be equal to or longer than the tenure of the external borrowing.

5.2.6 The following needs to be taken into consideration when accessing external borrowing:

5.2.6.1 **Types of Debt and Financing sources**

The types of debt that may be incurred and the debt financing which may be incurred are as follows:

5.2.6.1.1 Short-term Debt

- 5.2.6.1.1.1 Bank overdraft;
- 5.2.6.1.1.2 Short Term Loans;
- 5.2.6.1.1.3 Marketable Bonds;
- 5.2.6.1.1.4 Non-Marketable Bonds; and
- 5.2.6.1.1.5 Other Securities

5.2.6.1.2 Long-term Debt

- 5.2.6.1.2.1 Long-Term Loans;
- 5.2.6.1.2.2 Instalment Credits;
- 5.2.6.1.2.3 Finance Leasing;
- 5.2.6.1.2.4 Marketable Bonds;
- 5.2.6.1.2.5 Non-Marketable Bonds;
- 5.2.6.1.2.6 Other Securities

5.2.6.1.3 Financing Sources

- 5.2.6.1.3.1 Public;
- 5.2.6.1.3.2 Banks;
- 5.2.6.1.3.3 Development Bank of South Africa;
- 5.2.6.1.3.4 Infrastructure Finance Corporation;
- 5.2.6.1.3.5 Public Investment Commissioners;
- 5.2.6.1.3.6 Insurance Companies;
- 5.2.6.1.3.7 Municipal Pension Funds;
- 5.2.6.1.3.8 Other Public Pension Funds;
- 5.2.6.1.3.9 Bond Trusts;
- 5.2.6.1.3.10 Internal Funds; and
- 5.2.6.1.3.11 Other Sources

5.2.6.2 **Types of long-term loan**

5.2.6.2.1 Annuity Loans enable the Municipality to provide for the redemption of loans on an amortising basis which is generally the most cost effective method of financing often referred to as vanilla funding;

5.2.6.2.2 Bullet Redemption Loans are attractive as interest on the loan is serviced with the capital redemption only taking place at the end of the tenure of the loan. However, this method is costlier as interest is paid on the full debt throughout the term as the Capital does not reduce. This type of loan also requires an annual contribution to a sinking fund, which in essence then mimics the traits of an annuity loan although at a higher cost. The use of such structure warrants a detailed motivation based on the benefits to the implementation of the capital project; and

5.2.6.2.3 Sculpted Repayment Loans offer a combination of the above two types, as loans are sculpted according to the potential cash flows to be generated from the capital project in future. For example, the following can be included in a sculpted loan:

5.2.6.2.3.1 A capital grace period in the first years of the development of the capital project;

5.2.6.2.3.2 An incremental annual increase in the repayment in relation to the projected growth in revenue from the project.

5.2.6.3 **Interest Rate Risk Management**

5.2.6.3.1 The impact of interest and capital redemption payments on both the current and forecasted property rates and service charges through tariffs taking into consideration the current and future capacity of the consumer to pay therefore;

5.2.6.3.2 Likely movement in interest rates for variable rate borrowings. There are benefits to be yielded from borrowing on a variable rate if rates are projected to decrease in future, however it is prudent for the municipality to enter into fixed interest rate loans to accurately budget for expenses incurred.

5.2.6.4 **Competitive Bidding**

5.2.6.4.1 The Accounting Officer should ensure that no deviations from the Supply Chain Management process are allowed with regards to the calling for interest rates during the calling for bids for any form of debt (short term or long term or finance lease or new borrowings), whether this is allowed in terms of the Council's Supply Chain Management policy or not.

5.2.6.4.2 For the purposes of price evaluating tenders in terms of costs, the expected interest debt over the full term of the proposed debt agreement must be calculated and used.

5.2.6.5 **Tenure of Borrowing**

5.2.6.5.1 The tenure of external borrowings should, where possible, match the economic useful life of the asset.

5.2.6.6 **Security & Guarantees**

5.2.6.6.1 Unless sufficient motivation is provided and other than for the provision of a sinking fund for the redemption of a bullet loan, the provision of any security against external borrowings, should be specifically motivated by the CFO for approval by Council.

5.2.6.6.2 The Municipality may not issue any guarantee for any commitment or debt of any organ of state or person, except on the following conditions:

5.2.6.6.2.1 The guarantee must be within limits specified in the municipality's approved budget;

5.2.6.6.2.2 The municipality may guarantee the debt of a municipal entity under its sole control only if the guarantee is authorised by the Council; and

5.2.6.6.2.3 The municipality may guarantee the debt of a municipal entity under its shared control or of any other person, but only with the approval of the National Treasury.

5.2.6.6.3 Neither the National nor Provincial Government may guarantee the debt of any Municipality.

5.2.6.7 **Loan Agreements**

5.2.6.7.1 The municipality is to maintain a loan agreement register detailing all the agreements entered into with each active loan agreement until date of maturity thereof;

5.2.6.7.2 Compliance with all loan agreements are to be monitored and reported on bi-annually to ensure that the municipality does not breach any agreement;

5.2.6.7.3 Should a default be triggered based on non-compliance with loan agreement, the accounting officer is to alert Council and send the related financial institution a written commitment to address the matter within a reasonable timeframe.

5.2.6.8 **Level of gearing**

5.2.6.8.1 The gearing of the Municipality is not only limited by the level of debt against the Total Operating Revenue (excluding conditional grants) but also limited by other operational factors as per section 3.3.3.3.2 including compliance with the stipulations of the approved **Liquidity Policy**.

5.2.6.8.2 Should the municipality not be in contravention with any stipulations in the **Liquidity Policy** or any other approved financial policy, then the municipality aims to maintain external gearing at levels not lower than 25% but not higher than 35%.

5.3 FORBIDDEN ACTIVITIES

- 5.3.5 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;
- 5.3.6 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 commission, rewards or costs, that will be paid in respect of the debt.
- 5.3.7 No debt may be made otherwise than in the name of the municipality.
- 5.3.8 Money cannot be borrowed for the purpose of investments.
- 5.3.9 No person, including officers and council members, may interfere or attempt to interfere in the management of fault attributed to the Accounting Officer or persons delegated by the Accounting Officer.
- 5.3.10 No debt may be made in any other currency than the Rand, and that is not linked, or is affected by any change in the value of the Rand against any foreign currency.
- 5.3.11 No debt shall be made for expenses not related to the functions and powers of the municipality.

5.4 PERFORMANCE, MONITORING AND DISCLOSURE OF INFORMATION

- 5.4.5 The Accounting Officer must within 10 working days after the end of each quarter furnish the Mayor with a report setting out the detail of each debt portfolio.
- 5.4.6 The above report must be part of the section 71 report and in the format provided by National Treasury for reporting and monitoring of debt.
- 5.4.7 The Accounting Officer must annually measure and report to the Council on the performance of its debt in terms of the gearing objectives of this policy.

- 5.4.8 Any person involved in the borrowing of funds by 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.

6 **CORPORATE GOVERNANCE (OVERSIGHT)**

- 6.1 Compliance with the various stipulations as documented in this Borrowing, Funds and Reserves Policy needs to be monitored by the Chief Financial Officer and reported on to the Accounting Officer on a monthly basis and to the Finance/Audit Committee on a quarterly basis.
- 6.2 Where compliance has been breached the Chief Financial Officer must present an action plan to correct the non-compliance. The Finance Committee must monitor the successful implementation of the corrective action plans and report progress to Council.

7 **TRANSITIONAL ARRANGEMENT**

- 7.1 Upon adoption of this policy by the Council, the Accounting Officer in conjunction with the Chief Financial Officer must determine the current performance levels of the municipality against this Policy and present a plan of action towards achieving and maintaining the stipulation as set out in this policy thereby utilising a more blended funding mix for capital infrastructure investment.
- 7.2 The Council must approve an appropriate timeframe within which the municipality must achieve the approved stipulations as set out in this Policy. The period between the date of the policy adoption by Council and the target date for compliance shall be known as the Transitional Period.
- 7.3 The Finance Committee must report progress during the approved Transitional Period to the Council.

8 **POLICY MANAGEMENT**

- 8.1 The Borrowing, Funds and Reserves Policy forms part of the municipality's overall financial objectives and therefore forms part of approved budget related policies. The policy must be reviewed at least annually during the budget revision and presented to Council for approval.
- 8.2 The Policy is effective from the date as determined by Council.

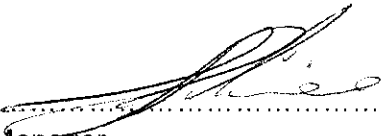
DOCUMENT AND VERSION CONTROL

Version: **Revision 6**

Date: **May 2019**

Summary: This document describes the Borrowing Funds and Reserves Policy that will be applicable to the Mossel Bay Municipality, with effect from

1 July 2019

Signature: 
Municipal Manager
(Accounting Officer)

Date: 31/05/2019

Signature: 
Executive Mayor

Date: 31/05/2019