CITY OF CAPE TOWN
ISIXEKO SASEKAPA
STAD KAAPSTAD

CITY OF CAPE TOWN

BORROWING POLICY
(POLICY NUMBER 11831)

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BORROWING POLICY

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1. DEFINITIONS

In this Policy, unless the context indicates otherwise -

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

''authorised official'' means an employee of the City 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;

"City" means the City of Cape Town, a municipality established by the City of Cape Town Establishment Notice No. 479 of 22 September 2000, issued in terms of the Local Government: Municipal Structures Act, 1998, or any structure or employee of the City acting in terms of delegated authority;

"council" means the Municipal Council of the City;

"COID" means the Compensation for Occupational Injuries and Diseases;

"CFO" means the Chief Financial Officer of the City;

"disclosure statement" means a statement issued or to be issued by the Municipality which intends to incur debt by issuing municipal debt instruments;

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

"juristic person" means a body of persons, a corporation, a partnership, or other legal entity that is recognized by law as the subject of rights and duties;

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

"loan covenant" means a condition in an agreement relating to a loan or bond issue that requires the borrower to fulfil certain conditions or which forbids the borrower from undertaking certain actions, or which possibly restricts certain activities to circumstances when other conditions are met. Violation of a covenant may result in a default on the loan being declared, penalties being applied, or the loan being recalled;

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

"Muncipality" means the City of Cape Town;

"municipal debt" means:

a) a monetary liability or obligation on a City 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;

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

"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

"QBMR" means Quarterly Borrowing Monitoring Return.

2. PROBLEM STATEMENT

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

2.2 Given that a large portion of municipal infrastructure has a long-term economic life and the general principle that current ratepayers should not pay for an asset in the short term that is to be used by future ratepayers during the life of the asset, there is a strong economic argument to finance this 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 economic life of assets should always be equal to or longer than the tenure of the debt finance.

2.3 It would be appropriate for the City to adopt a borrowing policy which shall be consistent with the Act and its regulations.

3. DESIRED OUTCOME

3.1 This Policy, in line with sections 19, 46 and 47 of the Act, sets out the procedures to be followed in sourcing funding from external financial service providers.

3.2 The objectives of the policy are to:

a) enable the City to exercise their obligation to ensure sufficient cash resources to implement capital programme in the most effective manner;
b) ensure compliance with the relevant legal and statutory requirements relating to municipal borrowing;
c) govern the taking up of short-term and long-term debt according to the legislative framework;
d) manage interest rate and credit risk exposure;

e) maintain debt within specified limits and ensure adequate provision for the repayment of debt; and
f) to maintain financial sustainability.

4. STRATEGIC INTENT

The intention of the policy is to:
a) Ensure a transparent and corruption-free government;
b) Establish an efficient and productive administration that prioritises delivery;
c) Ensure financial prudence, with clean audits by the Auditor-General.

5. POLICY PARAMETERS

5.1 The process for obtaining external loan funding for the City and its municipal entities falls exclusively within the functional area of the Treasury Directorate of Finance.

5.2 All borrowings made by the City must be in accordance with this policy and with any regulations promulgated by national government.

6. ROLE PLAYERS AND STAKEHOLDERS

6.1 The CFO must, in consultation with the Budget and Treasury Directorates, assess the City's financial requirements and determine the amount of funds that need to be raised from external service providers, particularly to fund the capital programme. The assessment must be made in conjunction with the Medium Term Revenue and Expenditure Framework (MTREF) and the capital budget which is approved by Council.

6.2 The Treasury Directorate is responsible for the implementation of this policy.

7. REGULATORY CONTEXT

The legislative framework governing borrowing is informed by the following legislation:
a) Local Government Municipal Finance Management Act, (Act 56 of 2003); and
b) Municipal Regulations on Debt Disclosure, Regulation R492, published under Government Gazette 29966, 15 June 2007.

8. OPTIONS FOR RAISING OF EXTERNAL DEBT

8.1 There are four possible methods of raising external debt have been identified, namely:
a) Raising of project specific loans through financial services providers;
b) Raising of a non-project specific loan value for a particular financial year; and
c) Raising of bonds on the bond market;

d) Appointment of a financial services provider as sole financier to the Council for a period of not exceeding three (3) financial years.

8.2 A combination of all four methods of raising external debt could be utilised over a period of time.

9. ASSESSMENT OF FUNDING REQUIREMENTS

9.1 Funding requirements for capital projects/assets, together with an assessment of the funding sources, must -

a) be determined annually;
b) take into account a multi-year period; and
c) be done in order to determine the adequacy of available funding sources.

9.2 Council must take into account how funding decisions affect the operating budget for the multi-year period, which will include the long term impact on tariffs.

10. FINANCIAL RESOURCES

A full analysis of all cash reserves is required prior to borrowing to ensure the most cost effective method of financing.

11. RAISING OF EXTERNAL DEBT FOR FUTURE FINANCING OF CAPITAL EXPENDITURE

Budgeted Financial Plan

11.1 On an annual basis, the CFO must assess the City's financial requirements and determine the amount of funds that needs to be raised from external service providers.

11.2 Consideration must be taken of the limitations per the capital and operating budgets and the expected impact that any external debt raised may have on the budget.

11.3 The City's standard budgeting process must be followed when assessing the funding requirements of the City and the need for long term funding from external sources.

11.4 The impact of the financial plan on the capital and operating budget must be considered and included in the budget.

12. COMPLIANCE WITH FINANCIAL SERVICE PROVIDER REQUIREMENTS

12.1 Financial Ratios

a) Where it has been decided that funding will be sourced externally, the financial service provider may, when considering an application for external debt from the City, take certain ratios into consideration.

b) The CFO must determine the applicable ratios for long term funding and suggested performance levels.

c) The ratios should be monitored to ensure that the City is able to meet its requirements to access external debt from financial services providers of its choice.

d) Where these performance levels, relating to the financial ratios, are not attained, corrective action should be taken to prevent non adherence to the loan covenants.

12.2 Credit rating

a) The CFO is responsible for securing and maintaining an appropriate credit rating from a recognised, reputable credit rating organisation.

b) Supply Chain Management procedures must be followed in evaluating and appointing an appropriate credit rating agency.

13. RATIOS USED TO DETERMINE THE CITY'S ABILITY TO BORROW

To ensure a financially sustainable City, the following ratios are used as guidelines to determine the City's ability to borrow -

a) total debt to revenue (excluding grants);
b) debt service coverage ratio;
c) debt to net Cash Ratio;
d) financing cost ratio;
e) cash flow interest cover ratio; and
f) cash available from operations before external interest paid.

14. COMPULSORY DISCLOSURES WHEN INCURRING MUNICIPAL DEBT

14.1 When entering into discussions with a prospective lender with a view to incur municipal debt, the City must indicate in writing to the prospective lender whether it intends to incur short-term or long-term debt.

14.2 In the case of short-term debt it must be disclosed whether the debt is to finance -

a) shortfalls within a financial year during which the debt is incurred in expectation of specific and realistic anticipated revenue to be received within that financial year; or
b) capital needs within a financial year, to be repaid from specific funds to be received from enforceable allocation or long-term debt commitments.

14.3 In the case of long-term debt, whether the purpose of the debt is for -

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.

15. COMPLIANCE WITH MUNICIPAL REGULATIONS ON DEBT DISCLOSURE

Regulation 6 of the Municipal Regulations on Debt Disclosure, 2007, states that whilst the City is party to a municipal debt instrument it has to have a credit rating in place which must be reviewed annually by an independent credit rating institution until it has been redeemed.

16. BORROWING PROCESS

The Borrowing process will be effected in terms of Section 6 of the Act.

17. SUBMISSION OF DOCUMENTS

When entering into 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 Integrated Development Plan; and
d) repayment schedules pertaining to existing short-term or long-term debt.

18. NOTIFICATION TO NATIONAL TREASURY

18.1 The MFMA requires a City or municipal entity to invite the National Treasury (hereafter referred to as “NT”), the relevant provincial treasury and the public to submit written comments or representations to the council / board of directors in respect to the raising of any proposed debt through borrowing or any other instrument (refer sections 46 & 108).

18.2 To expedite this process and to enable the NT and relevant provincial treasury to provide informed comments, the City / municipal entity is requested to supply the following information and include the signed certification (see annexure A), along with the invitation for comment. Failure to provide this information may delay the process.

18.3 The table below sets out the information to be provided with respect to a long-term debt proposal:

	Details	MFMA
1	A copy of the information statement required by section 46(3), containing particulars of the proposed borrowing (debt instrument).	46(3)(a)(i)
2	If not already incorporated in the information statement, please ensure the following information is provided separately (note QBMR = Quarterly Borrowing Monitoring Return to National Treasury): a) Amount of debt to be raised through borrowing or other means; b) Purposes for which the borrowing (debt) is to be incurred; c) Interest rate(s) applicable (state whether fixed or variable etc.); d) Planned start and end date (term of instrument); e) Detailed repayment schedule for the duration of the borrowing (debt) (showing dates and all payments of principal and interest, etc.); f) Total estimated cost of the borrowing (debt) over the repayment period; g) Type of instrument (select from QBMR); h) Security to be provided (select from QBMR) and provide details; and i) Source of loan funds (select from QBMR).	46(3)(b)(i) and (ii)
3	A schedule of consultation undertaken, including: a) Date(s) when the information was made public b) Details of meetings, media adverts and other methods used to consult on the proposed long-term borrowing (debt)	46(3)(a)(i),(ii)
4	a) 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. b) It must be demonstrated that the proposed borrowing (debt) is consistent with the IDP, the capital budget and the revenue shown accordingly.	46(6) 17(2) 19
5	If the borrowing (debt) is for the purpose of refinancing existing long-term borrowing (debt), the following information should be provided: a) A description of the asset(s) for which the original loan was required; b) The remaining useful life of the asset(s); c) The net present value of the asset(s), including the discount rate used and any assumptions in the calculations; d) The net present value of projected future payments <u>before</u> refinancing, including the discount rate and assumptions used; and e) The net present value of projected future payments <u>after</u> refinancing, including the discount rate and assumptions used.	46(5)
6	The source of funding that will be used to repay the loan as well as the revenue stream(s) must be specified, irrespective of whether it is an existing or new revenue stream.	19(1)(d)
7	A schedule of all long-term borrowing (debt) obligations should be compiled in the format of the QBMR, showing principal and interest payments for the life of all loans and any associated investments set up as sinking funds etc.	NA

	Details	MFMA
8	In the case of a municipal entity, details of any guarantee or other forms of security to be issued by the parent municipality respect of the entity's proposed borrowing (debt) should be provided.	50
9	A copy of the council/board of directors' resolution approving the borrowing (debt) instrument should be forwarded once approved.	NA

The information detailed above together with the certification (referred to in Annexure A), should be forwarded the National Treasury and the relevant Provincial Treasury.

19. INTEREST RATE RISK

Interest rates are to be fixed at an optimal rate unless it can be shown that a variable rate can provide better cost efficiency.

20. MONITORING, EVALUATION AND REVIEW

The policy will be monitored by the Treasury officials annually and may be amended.

ANNEXURE A

Certification of long-term borrowing (debt)

Name of Municipality / entity: ________________________________

Proposed borrowing (debt) :R________________________________

We hereby certify that the proposed long-term borrowing (debt), as specified in the attached *information statement* and supplementary pages complies with sections 17(2), 19, 46 and 108 of the MFMA and will be used for the purposes of capital expenditure on property, plant or equipment:

a) For the purpose of achieving the objects of local government as set out in section 152 of the Constitution;
b) Capital expenditure is appropriated in an approved multi-year capital budget;
c) Repayments for the duration of the loan are affordable and will be appropriated in future budgets; and
d) If the loan is required to refinance existing long-term borrowing (debt), that the original borrowing (debt) was lawfully incurred and the refinancing does not extend the term of the borrowing (debt) beyond the life of the asset for which the money was originally borrowed.

A copy of the council/board of director's resolution approving the loan will be forwarded to the National Treasury and the relevant Provincial Treasury within 7 days of approval.

Signatures:

______________________________	______________________________
Accounting Officer	***Mayor/Chairperson of the Board***
Name:	Name:
Date:	Date:

ANNEXURE B

Financial Ratio Formulas

Total Debt to Revenue
= Total Debt / [Total Revenue – Unspent conditional grants – Capital Government grants and subsidies]

Debt service cost ratio
= [Cash generated from operations – Unspent conditional grants – Capital government grants and subsidies] / [Finance cost + Loans repaid + Increase/ (Decrease) in sinking fund deposits]

Debt to net cash ratio
= Total debt / [Cash generated from operations – Unspent conditional grants – Capital government grants and subsidies]

Financing cost ratio
= [Interest on external Borrowings + Capital paid on external debt]/ Total Revenue

Cash Flow Interest Cover Ratio
= [Cash flow from operations+ interest paid] / Interest paid

Cash available from operations before external interest paid
= [Cash generated from operations plus investment income plus changes in working capital] / External interest paid