LOANS POLICY

POLICY, PROCESSES & PROCEDURES

RECOMMENDED

THAT the **Loans Policy** and the contents thereof be tabled at the Mayoral Committee for recommendation for approval by Council.

Version	Version 3.2021		
Date	March 2021		
Document Name	**Loans Policy and Procedures**		
Reviewed By	______________________ **INTERNAL AUDITOR**	**Date**:	______________________
Supported By	______________________ **ACTING CHIEF FINANCIAL OFFICER**	**Date**:	______________________
Signature	______________________ **ACTING MUNICIPAL MANAGER**	**Date**:	______________________
Adopted by the Mayoral Committee	______________________ **CHAIRPERSON**	**Date**:	______________________
Approved by the Council	Approved: A1532 1st Review: A1631 2nd Review A1927 ______________________ **RESOLUTION**	**Date**:	08 June 2016 31 May 2017 29 March 2019 ______________________
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Contents

1. Policy

1.1 Overview

Sedibeng District Municipality has developed its loans policy to include activities at all departments at which municipality business is conducted. This in recognising its:

i. community orientation; and
ii. the need for good governance.

The loans policy is a transparent and codified internal control system aimed at promoting its core District Objectives to ensure that the limited resources at the disposal of Sedibeng District Municipality will be focused towards serving the various stakeholders in the pursuit of their interactions with Sedibeng District Municipality and where necessary bolstered by applying the correct financial lending instrument. This whilst being both efficient and congruent to approved budgets and broader financial policies of Sedibeng District Municipality and minimizing the temptation of misuse of municipality funds.

The policy is applicable to all Sedibeng District Municipality staff that are entrusted with financial management in any form on behalf of the municipality. It seeks to institutes the necessary control measures to facilitate the daily activity of the municipality by providing:

i. A guideline for all stakeholders as to the what is required for the formulation of borrowings;
ii. An internal dynamic document detailing the processes required for the efficient discharge of duties relative to financial controls necessary to ensure the efficient administration of the Sedibeng District Municipality budgets and budget shortfalls.
iii. A guideline for business units in the usage of borrowings.

1.2 Purpose

To, establish a borrowing framework policy for the Sedibeng District Municipality, and set out the objectives, policies, statutory requirements and guidelines for the borrowing of funds.

1.3 Objectives

i. Manage interest rates and credit risk exposure

ii. Maintain debt within specified limits and ensure adequate provision for the repayment of debt

a. To ensure compliance with all Legislation governing the borrowing of funds

iii. To ensure that the funds are obtained at the lowest possible interest rates and at minimum risk, within the parameters of authorised borrowings

1.4 Business Process Framework

1.4.1 Legislative Framework

The Municipal Finance Management Act (MFMA) 56 of 2003, the Municipal Systems Act (MSA) 32 of 2000, and all other applicable legislation, policies and circulars make reference.

1.4.2 Accounting Framework

The responsibility of capital projects and infrastructure development lies with the Accounting Officer and Chief Financial Officer, or delegated official, who has to ensure that reasonable controls exist to support the implementation of policies. In delegating this function to subordinates, it does not alleviate the responsibility of the Chief Financial Officer. The Accounting Officer has to ensure all policies and procedures are communicated to and implemented by the responsible individual(s).

1.5 Recommendations

a. This policy, processes and procedures document supersedes all previously issued Debt Management policy;

b. This policy, processes and procedures document be recognised as identifying, characterizing and addressing the various stages of the debt management transaction cycle;

c. This policy, processes and procedures document be recognised as denoting all internal control mechanisms relevant to the efficient and effective discharge of debt management;

d. This policy document is adopted by the Executive Management and the broader Council of Sedibeng District Municipality as the framework for Debt Management

2. Processes

Definitions

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*
Cost of Borrowings	*The borrowings should be structured to obtain the lowest possible interest rate, on the most advantageous terms and conditions, taking cognizance of borrowing risk constraints, infrastructure needs and the borrowing limits determined by Legislation*
Prudence	*Borrowings shall be made with care, skill, prudence and diligence. The standard of prudence to be used shall be the "prudent person" standard and shall be applied in the context of managing overall debt. Officials are required to adhere to:* • *written procedures and these guidelines* • *exercise due diligence* • *prepare all reports timeously and ensure strict compliance with legislation*
Ownership	*All loans must be in the Name of Sedibeng District Municipality*

2.1 Types of Loans

2.1.1 Vanilla Loans

"Vanilla" loans are straightforward and uncomplicated. The loan amount, interest rate and repayment period offered by the Financial Institution are fixed. The calculation of the installment payable on an annuity basis is simple and straightforward. Normally with a “vanilla” 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 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) must be taken out. An IRS agreement will need to be signed with the party agreeing to accept the variable rate and 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 legal requirement of the Municipality, that of annually producing a balanced budget. Debt servicing comprises some xx% of the annual operating budget hence the need for certainty of annual debt payments

There are from time to time various options offered from Financial Institutions which need to be treated on their merits and which invariably result in slightly lower interest rates being offered. Recent examples include the pledging of a specific income stream, the use of Council owned property as a form of security, etc.

2.1.2 Structured Finance Loans

In its simplest form, a structured finance loan is one where the Lender, who is a tax payer, uses certain tax ”claims” and effectively passes a portion of this benefit onto the Municipality by way of a reduced interest rate

The advantage of this type of financing is that the benefits are utilised, giving the borrower a lower interest rate on the loan. The disadvantage is that any amendments in South African tax laws or the underlying assumptions in the financial model determining the structure of the loan will result in changes in the overall interest rate

It must be appreciated that before entering into any structured finance contract the Municipality, being a Statutory body, will carefully scrutinise all aspects of the structured finance loan agreement including seeking legal advice both from the Head: Legal and, where necessary, from Senior Legal Counsel to ensure that the Municipality is not participating in a structure which the South African Revenue Service may deem to be one which leads to tax evasion.

The Municipality should always adopt a prudent and carefully evaluated approach before entering into structured finance loan agreements

2.1.3 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 semiannual 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

2.2.3.1 Advantages of a Municipal Bond issue are:

1	*A Municipal Bond issue may match the life of the asset being financed. This allows for pay-as-you-use, whereby the ratepayer pays for the use of the asset over the life of the asset*
2	*A Municipal Bond issue can take advantage of conditions in the interest rate market. The best example being when short-term rates are higher than long term rates – an inverted yield curve. If all preparations have been taken to enter the market quickly, then a Bond issue with a medium to long term duration could take advantage of short term volatility in the market*
3	*If a Municipality establishes a position in the market, it can realize certain benefits. It gives the Issuer a benchmark for further issues. If there are several large maturities that are listed / quoted, it may be possible that a small add-on issue could be put into the market at a lower cost than a new issue*
4	*A Municipal Bond issue is an alternative to Bank loans or structured loans. Also, because of the involvement of such parties as Financial Advisors and Underwriters, there should be better understanding and knowledge about interest rates and investor capacity for lending*

2.2.3.2 Disadvantages of a Municipal Bond issue are:

1	The regulatory requirements which must be complied with prior to an issue will take more time to accomplish than the concluding of a Bank loan
2	The cost of an issue will be more expensive than a Bank loan
3	There will be more parties to a Bond issue and therefore organizing and implementing such an issue will require greater administration
4	Because of the public offer nature of a Bond issue, there will be a greater need for continuing information disclosure, and the accuracy of this information will be important in order not to mislead the Investors
5	There will be a number of Investors rather than one Lender, payment of interest and principal will need to be made to many Lenders, requiring greater administration

2.2.3.3 Duty of care to be Exercised for Issuing Municipal Bonds

Liquidity	*Due to the lack of liquidity in Municipal Bonds, it will be necessary for the Bond issue to be in excess of an amount bigger than 10 million rand. An issue of this magnitude will attract interest from the larger Institutional Investors and would be sufficient to create the necessary liquidity for Municipal bonds. It would not be necessary to place the full amount of such an issue at one time so long as the market was assured the full amount of the issue would be placed within a reasonable time frame*
Timing	*The timing of the issue will be of paramount importance, and, for example, a volatile money market environment shrouded with uncertainty will not be an opportune time to offer a public issue of Municipal Bonds*
Financial Advisor	*The Financial Advisor will be the professional interface between the Municipality and the financial markets, including the Investors and Underwriters. The Financial Advisor will assist in the preparation of the prospectus*
Pricing	*Depending on the Financial Position and credit rating of the Municipality the price of the Bonds to be offered could be benchmarked*

2.1.4 Use of Internal Funds

The Municipality from time to time, should use certain of its surplus funds to fund its Capital programme. The utilisation of surplus funds will enable 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.

3. Procedures

3.1 Factors to be considered when borrowing:

1	*The type and extent of benefits to be obtained from the borrowing*
2	*The length of time the benefits will be received*
3	*The beneficiaries of the acquisition or development*
4	*The impact of interest and redemption payments on both current and forecasted property tax income*
5	*The current and future capacity of the property tax base to pay for borrowings and the rate of growth of the property tax base*
6	*Likely movements in interest rates for variable rate borrowings*
7	*Other current and projected sources of funds*
8	*Competing demands for funds*
9	*Timing of money market interest rate movements and the long term rates on the interest rate curve*

SDM will, in general, seek to minimise its dependence on borrowings in order to minimise future revenue committed to debt servicing and redemption charges

SDM may only borrow funds, in terms of the Municipal Finance Management Act, for the purpose of acquiring assets, improving facilities or infrastructure to provide service delivery.

Sedibeng District 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.

3.2 Refinancing Debt

Section 46 of the Municipal Finance Management Act provides that Sedibeng District Municipality may refinance existing long term debt *[if any],* if such refinancing is in accordance with the prescribed framework. The Municipality may borrow money for the purpose of refinancing existing long term debt, provided the existing long term debt was lawfully incurred and the refinancing will not extend the term of the debt beyond the useful life of the infrastructure, property, plant or equipment for which the money was originally borrowed.

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

No loans will be prematurely redeemed unless there is a financial benefit to the Municipality

3.3 Debt Repayment Period

Whilst the period for which loan debt may be received will vary from time to time according to the needs of the various Lenders, presently the typical debt repayment period for loans is between ten to twenty years, closely matching the underlying asset lives serviced by the loans

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

3.4 Security

The Municipal Finance Management Act provides that the Municipality may provide security for any of its debt obligations, including the giving of a lien, pledging, mortgaging or ceding an asset, or giving any other form of collateral.

It may cede as security any category of revenue or rights of future revenue. Some Lenders may require the Municipality to agree to restrictions on debt that the Municipality may incur in future until the secured debt is settled

3.5 Short Term Debt

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.

The Municipality must pay off short term debt within the same financial year and may not renew or refinance its short term debt. Provisions of **MFMA** section 70,74 and 101 – see reporting to Treasury below – apply.

The Municipality may, in terms of the Municipal Finance Management Act, incur short term debt only if the Chief Financial Officer has made a prior written finding that the debt is either within prudential limits on short term debt as previously approved by Municipality, or is necessary due to an emergency that could not reasonably have been foreseen and cannot await Council approval

3.6 Disclosure

Any Official involved in the securing of loans 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. Whilst this is a standard and acceptable business practice, it is also in compliance with section 49 of the Municipal Finance Management Act

3.7 Guarantees

The Municipal Finance Management Act 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.

3.8 Approval of Loans by the Municipality

Section 46 of the Municipal Finance Management Act 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

A copy of the information statement must be submitted to Council at least 21 days prior to the meeting to discuss the proposed loan, 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*

3.9 Provision for the redemption of loans

The Municipality may borrow from Institutions and 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.

These sinking funds may also be invested directly with the Lender's Bank. 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.

Use can also be made of guaranteed endowment policies to facilitate the payment on maturity date.

3.10 Non-Repayment or Non-Servicing of Loan

Sedibeng District 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

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
In addition to the timeous payment of the loans, the Municipality must adhere to the covenants stipulated in the loan agreements and the under mentioned are some examples of typical covenant requirements:

1	*Furnish audited annual financial statements timeously*
2	*Long term credit rating not to decline below A+*
3	*Reporting of material changes in financial position of the Municipality*
4	*Material changes in the functions, power and duties of the Municipality*

3.11 Prohibited Borrowing Practices

In the past some Municipalities have borrowed funds with the sole purpose of investing them to earn a return. The motive was clearly speculative. The cost of debt is almost always more expensive than the return that the Municipality can derive by investing in permitted investments.

Consequently, as a principle, Sedibeng District Municipality should not borrow for investment purposes, but depending on the shape of the interest yield curve may borrow in advance of its capital cash flow needs in a given financial year to take advantage of an inverse interest yield curve

Foreign Borrowing is permitted in terms of section 47 of the Municipal Finance Management Act, whereby 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

3.12 Internal Control

The internal control procedures involve Internal Audit and Performance Management, and the Auditor General reviewing and testing the systems of the Finance Department on a regular basis.

In order to prevent losses arising from fraud, misrepresentations, error, conflict of interest or imprudent action, a system of internal controls governs the administration and management of the portfolio

Controls deemed most important include following-

i. Control of collusion, separation of duties.
ii. Custodial safekeeping of loan agreements and contracts.
iii. Clear delegation of duties.
iv. Checking and verification by senior officials of all transactions.
v. Documentation of transactions and repayments.
vi. Code of ethics and standards.
vii. Procedure manuals.
viii. Electronic Funds Transfer limits and a detailed procedure manual for the system

3.13 National Treasury Reporting and Monitoring Requirements

The Municipality submits numerous returns to National Treasury. It is mainly coordinated by the Accounting Division. One such report deals with the Municipality’s external interest paid each month.

Sections 70 and 101 of the **MFMA** holds that where the municipality holds more than one account, and the consolidated balance shows an overall deficit position / net overdrawn, for a period of 3 months, then the Accounting Officer must inform National Treasury within 14 days after the 3 month period. The return (Form F) needs to stipulate the amount by which the account/s are overdrawn, the reason for the overdrawn account/s and the proposed remedial steps to rectify the situation.

Reporting obligations - Overdraft				
Action	Information to Report	To whom	How	MFMA Section
Net overdraft for a period exceeding 3 months	• Amount overdrawn • Reasons for the overdraft • Corrective measures to be implemented to rectify	• Full Council • National Treasury • Provincial Treasury	Formatted (Form F) Report to indicated authorities	70 74 101

Another return, prepared on a quarterly basis, requires the Municipality to itemise all its external borrowings for the quarter ended.

3.14 Other Reporting and Monitoring Requirements

Regular reporting mechanisms should be put in place in order to access the borrowings portfolio and to ensure compliance with policy objectives, guidelines and applicable laws. We tabulate some reporting mechanisms as being:

3.14.1 Monthly Activities:-

i. Reconciliation of bank accounts
ii. Payment requisition verification and authorization
iii. South African Reserve Bank returns (Stock Loans)
iv. Comparison of actual payment to budget
v. Update records for draws
vi. Maintain schedule of payment dates and amounts.
vii. National Treasury Cash Flow return

viii. Analysis of Ratios
ix. Loan repayments are made by Electronic Fund Transfer (EFT)
x. Scrutiny of loan agreements to ensure compliance with loan covenants

3.14.2 Quarterly Activities:-

i. National Treasury Borrowings return
ii. Restructure Grant input
iii. Summary Debt Schedule for Exco report

3.14.3 Annually:-

i. Preparation of Annual Budget
ii. Preparation of Annual Cash Flow Forecast
iii. Preparation of Annual Approximates/Estimates
iv. Preparation of Annual Financial Statements
v. Confirmation of Lender balances at financial year end obtaining written certification of loan balances at year end
vi. Completion of credit rating questionnaire
vii. Regular reviews by Internal Audit and Performance Management and Auditor General

3.14.4 General:-

i. Payment to Bond holders only after receipt of original stock certificates
ii. Report actual borrowings (in compliance with Section 71 of the Municipal Finance Management Act) to the mayor and Provincial Treasury

3.15 Amendment and Review of the Policy

The Loans Policy shall be reviewed annually and/or at the discretion of the CFO due to changing circumstances as a result of the legislation or otherwise.

Appendix One:

LOCAL GOVERNMENT MUNICIPAL FINANCE MANAGEMENT ACT *No.56 OF 2003*

CHAPTER 6: DEBT

Section of the MFMA	Power/ Duty Conferred	Applicable Conditions
45(1)	Deciding whether to incur short term debt	1. In terms of section 160(2) of the Constitution the Council may not delegate the raising of loans 2. A decision to raise a loan must be taken by the Council with a supporting vote of a majority of its members in terms of section 160(3)(b) of the Constitution 3. In terms of section 30(5) of the Local Government: Municipal Structures Act 1998 (Act No 117 of 1998) the Council may only after it received and considered the report and recommendations of the Executive Mayor regarding a loan, approve the raising of a loan
46(1)	Deciding whether to incur long term debt	4. In terms of section 160(2) of the Constitution the Council may not delegate the raising of loans 5. A decision to raise a loan must be taken by the Council with a supporting vote of a majority of its members in terms of section 160(3)(b) of the Constitution 6. In terms of section 30(5) of the Local Government: Municipal Structures Act 1998 (Act No 117 of 1998) the Council may only after it received and considered the report and recommendations of the Executive

		Mayor regarding a loan, approve the raising of a loan

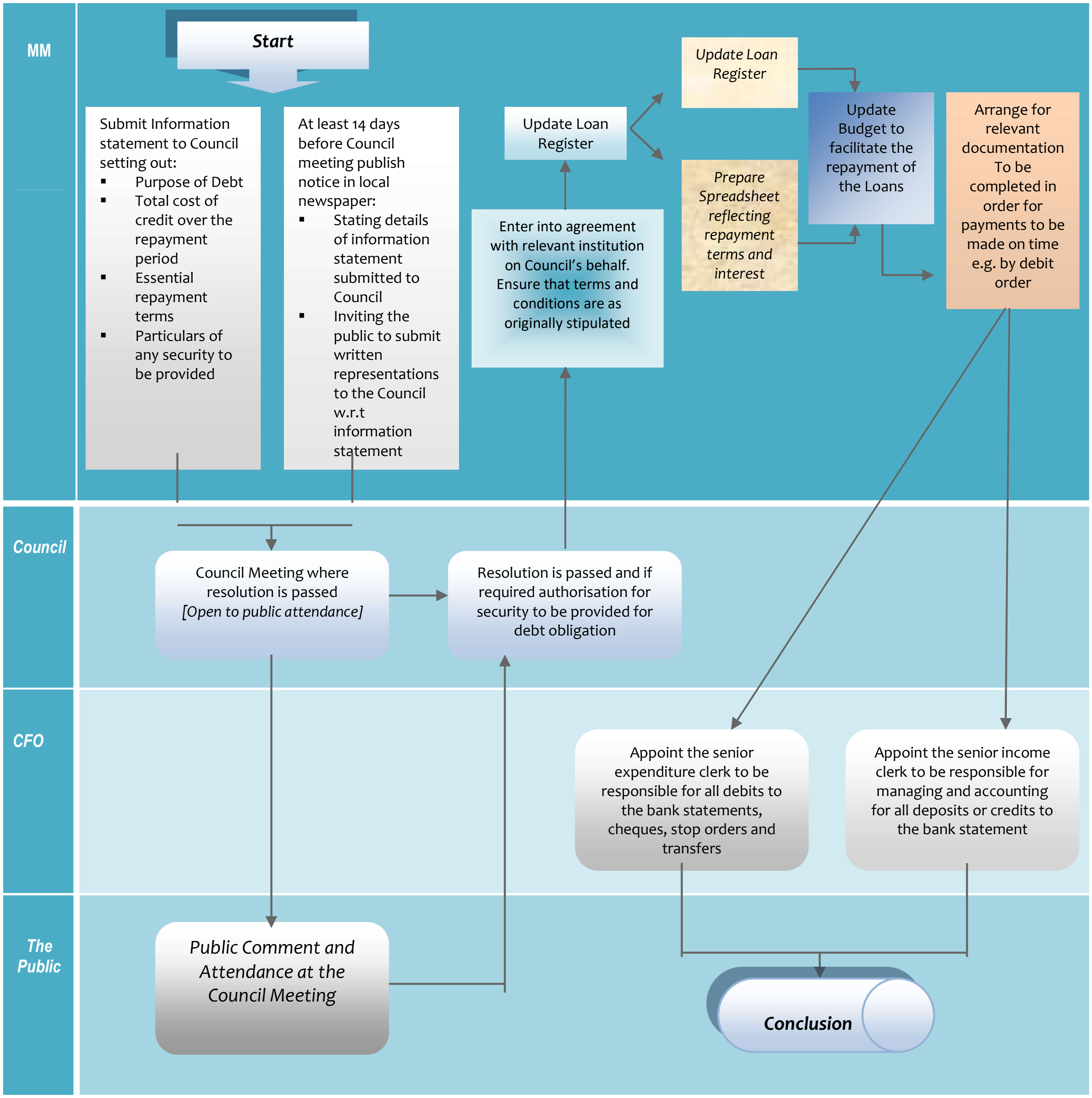
Section of the MFMA	Power/ Duty Conferred
48(1)	Deciding whether to provide security for any of the Municipality's debt obligations, debt obligations of a municipal entity under its sole control and contractual obligations of the Municipality undertaken in connection with capital expenditure by other persons on property, plant or equipment to be used by the Municipality or such other person
48(2)	Deciding the form/nature of security to be provided for any of the Municipality's debt obligations, debt obligations of a municipal entity under its sole control and contractual obligations of the Municipality undertaken in connection with capital expenditure by other persons on property, plant or equipment to be used by the Municipality or such other person
48(3)(a)	Deciding whether an asset or right that has been hypothecated in any manner as security is necessary for providing the minimum level of basic municipal services
48(3)(b)	Deciding, if an asset or right that has been hypothecated in any manner as security is necessary for providing the minimum level of basic municipal services, the manner in which the availability of the asset or right will be protected

❖ The municipality must pay off any short-term debt within the financial year in which it was incurred, and may not renew or refinance short-term debt, whether its own debt or that of any municipal entity, where such renewal or refinancing will have the effect of extending the short-term debt into a new financial year

- Section 46 [5] of the Municipal Finance Management Act, 2003 further stipulates that a Municipality may borrow money for the purpose of re-financing existing long-term debt, provided that-
  - The existing long-term debt was lawfully incurred;
  - The re-financing 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;
  - The net present value of projected future payments (including principal and interest payments) after re-financing is less than the net present value of projected future payments before re-financing

Appendix Two:

Loans Procedures Flow Chart:



[*Source: SALGA –Local Government Financial Best Practice Manual]*