DEBT MANAGEMENT POLICY

POLICY, PROCESSES AND PROCEDURES

RECOMMENDED

THAT the **Debt Management Policy** and the contents thereof be tabled for approval at the Mayoral Committee.

Version	Version 2
Date	March 2014
Document Name	**Debt Management Policy and Procedures**
Reviewed By	
	______________________ **Date**: ______________________ **INTERNAL AUDITOR**
Supported By	
	______________________ **Date**: ______________________ **CHIEF FINANCIAL OFFICER**
Signature	______________________ **Date**: ______________________ **MUNICIPAL MANAGER**
Adopted by the Mayoral Committee	
	______________________ **Date**: ______________________ **CHAIRPERSON**
Approved by the Council	
	______________________ **Date**: ______________________ **RESOLUTION**
Effective date	**…………………………………**
Next	**…………………………………**
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Page Number

1. POLICY

1.1 Overview

Sedibeng District Municipality has developed its debt management or borrowing 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 debt management 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 both efficiently and congruent to approved budgets and broader financial policies of Sedibeng District Municipality, whilst minimizing the temptation of misuse of municipality funds.

The policy is applicable to all Sedibeng District Municipality staff charged with discharging municipality related activities. It seeks to institutes the necessary control measures to facilitate the daily activity of the municipality by providing:

i. A guideline for all stakeholders;
ii. An internal dynamic document detailing the processes required for the efficient discharge of duties to ensure the efficient administration of the Sedibeng District Municipality budgets

The policy is intended to provide a framework for Municipality's debt management and implement effective processes to sustain cash flow in a manner prescribed in the Municipal Finance Management Act, 2003 and National Treasury Regulations.

1.2 Purpose

The purpose of this policy is to establish guidelines for the issuance, use of or the budgeting of debt instruments within the Sedibeng District Municipality.

The policy is further intended to meet the requirements of the Municipal Finance Management Act, 2003 and to be consistent with any debt regulations issued by the South African National Treasury. This policy applicable to all forms of debt issued for the Municipality and any debt incurred by or for the Municipality must be made in conformity with this policy

1.3 Objectives

The policy objectives also specifically seek to:

i. Maintain or reduce the cost of capital attracted by borrowing;

ii. Maintain the following solvency ratios:

   a. Interest cost to total expenditure not to exceed …..%;

   b. ong term debt to internal funds and reserves not to exceed …..%

   c. Long term debt to fixed assets not to exceed …..%

iii. Maintain a credit rating of …….. as per Moody's Investors Rating;

iv. To achieve a Capital Budget in excess of of R   per annum

1.4 Legal and Accounting Framework Definitions

MFMA	Municipal Finance Management Act, 2003 as amended, Chapter 6 and Chapter 108 prescribes
Operating Budget	For the purpose of this policy only means the total amount of expenditures/ revenues budgeted for in a financial year by the Municipality exclusive of internal charges, capital expenditures , agency services, annual cost for debt interest and principle, conditional grants received for non-capital expenditures
Capital Expenditure	Means any payment by the Municipality for the procurement of assets with a value higher than R 30,000

Capital Transfer	Means the non-payable, unrequited payments to or through a Municipality for the purpose of financing capital expenditure
Debt	Means a monetary liability or obligation incurred by the Municipality by a finance agreement or through the issue of notes , bonds and debentures or other financial instrument, by attaining overdrafts or through other short-term and long-term borrowing, or a contingent liability such as that created by guaranteeing a monetary liability or obligation of another
Long-term Debt	Means debt repayable over a period of more than one-year
Short-term Debt	Means debt repayable over a period of less than one-year
Annual Debt Service Requirements	For the purpose of this policy means both the annual and principle repayments required to fund the debt instruments annual payments due
Debt Service Coverage Ratio	Is calculated for a specific user service revenue stream or function to determine that an adequate net income is available from that revenue stream to pay for the annual debt service requirements applicable to that particular revenue stream. [it is calculated by taking revenues less net ***expenditures (expenditures for that function less the annual debt service requirements)***]

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

2.1 Conditions for Debt Issuance

The nature of the municipal existence dictates that the municipal infrastructure exists over a long period of time, and that a general rule of thumb is that current ratepayers cannot pay for future ratepayers. This places strain on municipal service delivery and consequently the case is made for long term borrowing. Such borrowing then needs to be regulated through clear processes.

2.2 Short Term Debt Issuance

The issuance of all short-term debt by the Municipality must be clearly identified as such. Short-term debt may only be issued when necessary to bridge an expected cash flow shortfall during the financial year. This bridging financing may only be used in specific circumstances;

2.2.1 To operational shortfalls within the financial year in which the debt is incurred, but only in anticipation of specific and realistic income to be received within that financial year; or

2.2.2 To bridge capital needs within a financial year, when it is to be repaid from specific funds to be received from enforceable allocations or long-term debt commitments

2.2.3 No short-term debt may be incurred unless:

1	**The council has passed a resolution approving the debt agreement**
2	The Mayor has signed the resolution
3	The accounting officer has signed the agreement or any other document that creates debt

2.2.4 The Municipality must pay off all short-term debt incurred in a financial year before the end of the financial year. No short-term debt may extend beyond the financial year and no renewal that has the effect of extending the short-term debt beyond that financial year is allowed

2.2.5 No lender may extend short-term debt to the Municipality past the end of a given financial year

2.3 Long Term Debt Issuance

2.3.1 The Municipality may only incur long-term debt for the following purposes;

2.3.1.1 Making capital expenditure on property, plant and equipment *[PPE]* to be utilised for the purpose of achieving the objectives of Local Government as set out in the Constitution section 152, including costs referred to in subsection [4] and the costs of financing professional services, legal and other miscellaneous fees including costs of professional services related directly with the capital expenditure [MFMA section 46 (4)]; or

2.3.1.2 The re-financing of existing long-term debt provided the requirements in MFMA section 46 (5) are met

2.3.2 Long-term debt will not be issued to provide capital expenditures on agency functions for which the Municipality is performing for another organ of state unless the total funding of such debt is committed to in writing by the contracting organ of state.

2.3.3 S46 of the **MFMA** holds that no long-term debt may be issued unless;

1	**The council has passed a resolution approving the debt agreement**
2	The Mayor has signed the resolution
3	The accounting officer has signed the agreement or any

	other document that creates debt
4	Only if the Accounting officer has: • in accordance with the Municipal Systems Act, section 21A] made public at least 21 days prior to a council meeting to approve the debt an informational statement setting out particulars of the proposed debt including the amount, the purpose for which the debt is being incurred , and any security to be pledged or provided for the debt; and ▪ At least 21 days prior to the council meeting, invited the public, the National Treasury and Provincial Treasury to submit written comments or presentations to the council in respect to the proposed debt; and ▪ Has submitted a copy of the informational statement to the council at least 21 days prior to the meeting that council is asked to approve the debt. This statement must include particulars of the essential debt repayment terms, the debt repayment schedule and the anticipated total cost in connection with the debt over the total repayment period
5	The long-debt must be consistent with municipality's capital budget and other provisions of the Municipal Finance Management Act, including sections 17 and 19

2.3.4 Long Debt should be issued only when the economic /useful life of the asset to be created is at least five years and the repayment period for the debt must not exceed the relevant asset's economic useful life

2.3.5 In general the Municipality should strive to issue debt that is supported by specific revenue sources and avoid the pledging of rates and general revenues unless a substantial proportion of the population will receive benefit from the asset being financed

2.3.6 Forms of long term borrowings

2.3.6.1 Balance sheet loans (secured or unsecured) from registered South African banks or other financial institutions offering such facilities;

2.3.6.2 Project Finance from registered South African banks or other financial institutions offering such facilities;

2.3.6.3 Municipal Bonds through the Bond Exchange of South Africa;

2.3.6.4 Long term debt arrangements with National Government;

2.3.6.5 Long term debt arrangements between state owned enterprises of SA National Government and the municipality;

2.3.6.6 Long term debt arrangements with municipalities;

2.3.6.7 Long term debt arrangements between municipalities and municipal entities.

2.4 Conditions that apply to both short-term and long-term loans

1	**The Municipality may incur debt only if the debt is valued in Rand and not indexed or affected by fluctuations in the value of the Rand against foreign currency**
2	If security is to be provided by the Municipality, the Council must determine by resolution whether the asset or right provided as security is necessary for providing the minimum level of basic Municipal Services and how that availability of an asset or right for the provision of that minimum level of basic services will be protected
3	The issuance of debt should be evaluated so as not to constitute an unreasonable burden to residence and tax payers
4	The funding of capital projects should be timed in such a way to allow debt to be issued as infrequently as possible so as to take advantage of the economy of scale in issuing one larger rather than several smaller debt instruments
5	The Municipalities use of debt should strive to ensure that a meaningful proportion of citizens/community benefit from the proceeds of any debt issuance paid for from the general rates and

	revenues of the Municipality
6	Debt that is for the procurement of assets associated with a specific service or utility of the Municipality should strive to be self-supporting from the revenues generated from that particular activity
7	The Municipality should ensure that the payment for such debt comes from those users that received the benefits of that debt

2.5 Limitations on Debt Issuance

2.5.1 Sedibeng District Municipality believes that it is in the best interest of the Municipality's long-term financial health to place self-imposed limitations on the issuance of and the use of long-term debt instruments within the Municipality

2.5.2 While the use of long-term debt can assist the Municipality in leveraging its resources to provide a better service delivery to those that live in our community the issuing of debt can also have the potential of burdening future councils and residents of paying tomorrow for what they can use today.

2.5.3 The cost of capital projects should be paid for over its economic life but it must be ensured that the Municipality has the revenue capacity/capability to fund these costs before it issues a long-term debt

2.5.4 There are numerous mechanisms to place limits on how much debt the Municipality can issue. Speaking in broader terms, limitations may be placed on much is required for each financial year to make the annual debt repayments and by limiting the total amount of debt that the Municipality can owe at any one time. Within these two broad limitations specific Rand value and ratios limits can be set that will limit how much debt the Municipality can issue

2.6 Annual Debt Service Limitations

When we speak about debt limitations one of the most important areas to consider is the Municipality's ability to make its annual cash payment on that debt. This requires an analysis of two reporting areas.

2.6.1 First under ***GRAP*** accounting the Municipality must budget for the annual interest payments within its operating budget

2.6.2 Secondly the Municipality must have enough cash available to actually make the annual interest and annual payments required at the specified time

2.6.3 The Municipal Finance Management Act, 2003 requires that the Municipality maintains a balanced operating budget and a positive cash flow budget each year

2.6.4 Municipal revenue can broadly be divided between those revenues associated with a specific user service for which a specific user fee or tariff is charged (such as electricity), those revenues that the municipality collects that are not associated with a specific user service but are more general in nature and intended to fund municipal operations in general (such as rates, traffic fines, equitable share, etc.) and those other revenues that are received for agency functions and as conditional grants (such as water, clinics, MIG, etc)

2.6.5 SDM believes that it is important to separate these revenue sources from each other when looking at debt. Debt that is issued to fund a project or asset that is associated with a particular user related revenue stream such as electricity should be funded by the revenues from that function. In addition, any security required as a part of the debt issuance should be from the assets of that function.

2.6.6 For the purpose of this policy two classes of debt service are used. First is debt service for a specific user service revenue stream functions (such as electricity) and the second is debt that is not tied to a specific revenue stream but general to the entire municipality (since debt for agency functions is not allowed it is excluded from the list).

2.6.7 Debt service payments should be both predictable and manageable. For the purpose of providing this predictability and manageability to debt service payments the following limitations are established:

2.6.7.1 The total annual debt service requirements for the municipality's general operations will not exceed 10% of the total 'operating budget' revenues as defined in this policy in any financial year

2.6.7.2 The total annual debt service requirements for the municipality's general operations will not exceed 10% of the total 'operating budget' revenues as defined in this policy in any financial year

2.6.7.3 The total annual debt service requirements for any specific user service revenue stream function (such as electricity) will maintain a Debt Service Coverage Ratio of at least 110%.

2.6.7.4 Any debt that is proposed to be paid from a surcharge or any particular revenue source dedicated solely for the repayment of any such debt must be accompanied by a certified analysis indicating the proposed source, amount and duration of any such revenue source.

2.6.7.5 Any proposed municipal debt must be accompanied by an analysis that shows the effect that the new annual debt service requirements will have on both the overall budget (including cash flow) of the municipality and, if relevant, the specific revenue and expense stream of the function proposed to fund the debt

2.7 Limitations on the Amount of Total Outstanding Municipal Debt

In the same way that we limit the annual debt service requirements to operating budgets we also want to limit the total outstanding debt that the municipality incurs to some relevant measurement

To assist SDM to accomplish this, it is important to again divide long-term debt between 'general' debt (see above) and debt that is linked to a 'specific user service' revenue stream. The limits for total outstanding debt are:

2.7.1 For 'general' debt the total outstanding debt will not exceed:

[a] x% of the total value of assessed property in the municipality, and

[b] xxx Rand per capita of municipal population

2.7.2 For debt that is proposed to be funded from a specific user service revenue stream the total outstanding debt will not exceed:

[a] A reasonable percentage (x% to x%) of the specific revenue base (the annual revenue expected to be generated from the specific revenue stream less expected bad debt expense associated with that revenue stream).

2.8 Characteristics of Debt issuances

These policy guidelines relate to the characteristics of the debt that is being issued and include repayment provisions, maturity guidelines and debt servicing requirements

1	At a minimum, xx% of the debt issuance principle will be retired within seven years
2	The municipality will use only level or declining debt repayment schedules to reduce interest costs and avoid overly optimistic projections
3	The municipality will maintain an average maturity life of all

	loans at or below xx years
4	The maturity life of any particular bond issuance will not exceed the expected life of the assets acquired with its proceeds
5	Funds will be allocated into the municipality’s consolidated loans fund on a monthly basis for all debt service repayments to ensure that adequate cash is set aside for payment in the municipality’s consolidated loans fund to ensure payment of interest and principle each year. An amortization schedule will be developed for each separate debt issuance within the municipality. This schedule will detail the monthly cash transfer required for each particular debt instrument to ensure that adequate cash is available for the next scheduled interest and/or principle payment due for that particular debt instrument.

3. PROCEDURES

3.1 *Administrative Conditions on which Municipal Debt may be incurred*

3.1.1 To obtain council's approval for a long-term loan the Municipal Manager or his delegate must submit:

a) A quotation from at least three financial institutions stating the loan period (payback-period), comparable interest rates and administrative costs

b) A long-term operating budget reflecting the effect of capital costs on service charges

c) Statements from the financial institutions that the proposed instruments are in line with national legislation

3.1.2 To obtain council's approval for a bank-overdraft, call bond or short-term loan the Municipal Manager or his delegate must submit:

a) A cash flow statement indicating the anticipated shortfalls and anticipated further income streams that will repay the short-term debt

b) Monthly cash flow reports indicating progress toward the repayment of the bank overdraft, call bond or short-term loan

3.2 Approval

3.2.1 If the council approves the loan, the Municipal Manager or Municipal Treasurer should enter into an agreement with the recommended financial institution on council's behalf. The Municipal Treasurer must ensure that the terms and conditions are as originally agreed before committing the council

3.2.2 The loans register must then be updated and a spreadsheet drawn up reflecting at least the following relevant information:

a) Type of Loan

b) Financial Institution

c) Purpose of loan

d) Loan period

e) Interest rate

f) Installments (capital and interest)

g) Due dates

h) Security

3.3 Other Conditions – applicable to both short term and long term borrowing

3.3.1 Section 47 of the **MFMA** holds that the debt has to be Rand based and "not indexed to or affected by fluctuations in value of the Rand against any foreign Exchange";

3.3.2 Section 48 of the **MFMA** holds that the municipality may provide backing security;

3.3.3 Section 49 of the **MFMA** holds that any delegated municipal official involved in the borrowing of money on behalf of the municipality when representing the municipality with the prospective financier, needs to disclose all information material to the decision making process for the potential financier, and any written submissions in this regard binds the author and municipality;

3.3.4 National treasury needs to be informed of borrowings in the following prescribed format:

Details	**MFMA section**
An information statement containing particulars of the proposed borrowing/debt instrument	46(3)(a)(i)
Pertinent Information in the information sheet: • Amount of debt to be raised • Purpose of the borrowing • Interest rates applicable • Inception and end date	46(3)(b)(i) and (ii)

• Detailed payment schedule for the lifespan of the borrowing and depicting dates, capital amount and interest repayments • Estimated cost of capital over the period • Type of financial instrument • Security pledged or proposed • Source of loan funds	
A schedule of consultation undertaken: • Dates as to when information sheet made public • Details of public consultative process – meetings, advertisements, etc.	46(3)(a)(i) and (ii)
A copy of the approved budget with supporting documentation, highlighting the asset to be funded by the proposed borrowing and the revenue which will flow there from. Also how it is consistent with the IDP.	46(6) 17(2) 19
For refinancing of long term debt, the following additional information: • Description of assets for which the original loan was used • The useful remaining life of the asset • The net present rate of the asset inclusive of the discount rate used and any assumptions in the calculations • The net present value of projected future payments before refinancing, inclusive of the discount rate and assumptions used • The net present value of projected future payments after refinancing inclusive of the discount rate and any assumptions	46(5)
The source of funding designated for the	

repayment – denoting the revenue stream being existing or new	19(1)(d)
A schedule detailing all long term borrowings depicting principal and interest payments for the life of all loand and any associated investments	
Copy of the relevant council resolution approving the debt instrument, once passed	

3.4 Extent of Borrowing

3.4.1 The municipality's long term finance strategy will determine the affordability model for all loans and will tie in with the Medium term Income and Expenditure Framework (MTREF);

3.4.2 The economic and environmental factors of the day will determine the assumptions for the forecast model;

3.4.3 Such forecast model will depict the allowable extent of borrowing;

3.4.4 The amount of borrowing will follow an approval process akin to the MTREF process.

3.5 Amendment and Review of the policy

The Debt Management 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