Council Policy 3.2.12 – Draft Borrowings

Objectives: Progressive

Outcome: 4.1 - A resilient, efficient and effective organisation.

Strategy: 4.1.1 - Provide efficient, effective, innovative, professional management of Shire operations to deliver the best outcome for the community within allocated resources.

Purpose

This Policy underpins the Shire's decision-making in the funding of the Shire's activities in the context of cash flow, budgeting, borrowings and investments. It is an important financial management tool in the funding of the Shire's expenditure. As such, this policy links closely to the Shire's overall Long Term Financial Plan (LTFP) in the context of:

1. Strategic planning for the future of the Shire, covering short, medium and long term spending issues;
2. Current and estimated future revenues and the ability to increase the revenue stream through either taxation, user charges, additional grant funds or entrepreneurial activities;
3. Inter-generational equity; and
4. Current and future funding needs for both operating and capital expenditures.

Definitions

"Self-Supporting Loans" loans taken out by Shire the repayments of which are made by a third party e.g. local club and organisation or ratepayers through a specified area rate or service charge.

"Economic Life" the estimated period over which an asset is expected to be economically usable by one or more users, with normal repairs and maintenance.

"Intergenerational Equity" the concept of fairness or justice between generations.

Policy

This Policy provides direction to management in relation to the decision-making framework surrounding a decision to use borrowings to finance activities. The objectives of this policy are to:

1. Ensure the appropriate level of funds are available at the appropriate time to support its strategic objectives;
2. Be financially responsible and prudent in financial matters ensuring all risks are considered in the decision-making process;
3. Minimises the costs of borrowings;

4. Ensures, where possible, the structure of the borrowing is appropriate for the nature of the assets being funded;

5. Consider intergenerational issues as part of determining the most appropriate way to fund activities;

6. Ensure the Shire's funding activities are in accordance with its legislative responsibilities;

7. Establish the process for monitoring the level of borrowings and to ensure decisions in relation to the use of borrowings are made within a long-term financial context.

Link to the Forward Financial Plan

Borrowings shall be considered as a mechanism to assist in achieving the strategic objectives of the Shire and the decision to borrow is made within the context of its implication on the long-term financial sustainability of the Shire.

The financial implications of the borrowings shall be included in the current LTFP.

Inter-Generational Equity

The Shire will seek to achieve intergenerational equity in its use of borrowings as a means of funding long lived assets to achieve an alignment of the cost of funding the asset(s) and the consumption of the benefit.

Types of Expenditures to be Funded by Long Term Borrowings

Long-term borrowings will generally be considered for the following purposes:

1. Commercial activities, providing the activity results in a positive cash inflow or positive net present value;

2. Community assets that:

   a) provide intergenerational benefit; and
   b) have an economic life of over 5 years; and
   c) if a disposal of the asset is planned, all associated borrowings are extinguished from the proceeds; and
   d) the construction or acquisition is planned within the current LTFP, corporate business plan and support the goals as outlined in the current Strategic Community Plan; and
   e) the term of the borrowing does not exceed the economic life of the funded asset.

3. Self-Supporting loans, providing adequate security is obtained to ensure, in the case of default, any outstanding liability is fully recovered; or

4. Refinancing existing borrowings; or

5. Natural disaster management; or

6. Projects that intensify the capital base for the purpose of reducing future operating costs.

Types of Expenditures not to be Funded by Long Term Borrowings

The Shire will not use borrowings to fund asset renewal which occurs on a frequent, regular or recurrent basis, such as:

1. Road resurfacing;
2. Plant and equipment changeover;
3. IT network renewal; or
4. Office equipment.

To ensure that the Shire does not become reliant on borrowings as a mechanism to fund operations, the Shire shall not use borrowings to fund operating activities except for:

1. Overdraft;
2. Credit Cards; or
3. Operating Leases.

Interest Only Loans

Interest only loans will only be considered to fund commercial activities that are planned to return positive future cash inflows.

Consideration of Future Borrowings

Prior to any long-term borrowing being considered:

1. A cost/benefit analysis of the proposed borrowing shall be undertaken for presentation to the Council for consideration; and

2. The analysis shall:

   a. consider all alternative funding options; and
   b. contain a projection of the financial impact of the borrowings on:

      i. the levels of the ratio indicators set out in the policy; and
      ii. the overall financial circumstances of the Shire as set out in the current LTFP.

Future Borrowings will only proceed if:

1. The additional borrowings will not result in a breach of the borrowing level limitations as set in this policy; and

2. The Council considers the conclusion of the cost/benefit analysis is that the borrowings are necessary to achieve the benefits as outlined in the analysis and the cost of borrowings is exceeded by the benefits; including consideration of the movement of construction acquisition costs of the project over the life compared to the interest rate over the same period.

Limitation on the Level of Borrowings

The level of borrowings shall be maintained within defined limits to ensure long-term financial sustainability. The Shire shall ensure that the amount of borrowings does not exceed the limits, so that debt servicing costs can be met on an ongoing basis.

Two indicators are identified as set out below:

Ratio	Value	Limitation	Level
Debt Servicing Ratio	Percentage	Below	6%
Borrowing Ratio	Percentage	Below	50%

Indicator Calculation:

<table>
<tr><th>Ratio Name</th><th>Calculation</th><th>Definitions</th><th>Rationale</th></tr>
<tr><td rowspan="2">Borrowings Ratio</td><td>NUMERATOR
The amount of loan principal outstanding</td><td>The aggregate of all principal outstanding on previous borrowings measured at the end of the period under review. Includes self-supporting loans.
Self-supporting loans are loans taken out in the name of the local government with the proceeds passed to external parties on the proviso the external party agrees to refund all future outflows associated with the borrowing.</td><td rowspan="2">An indicator of the level of principal on past borrowings owed by the Shire to external entities expressed as a percentage of the amount of general funds available to the Shire.
Self-supporting loans are included in the ratio as the local government has primary responsibility to repay the borrowing in the event the external party defaults on their agreement.
The use of general funds as the denominator provides an indication of the level of outstanding borrowings relevant to the Shire’s capacity to generate discretionary revenue to repay those future commitments.</td></tr>
<tr><td>DENOMINATOR
General Funds</td><td>As per Section 6.21(4) of the Act, general funds are:
• General Rates; and
• Government grants which were not given to the local government for a specific purpose; and
• any sources prescribed (none to date)

Note: General rates do not include revenue from specified area rates or service charges.</td></tr>
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Ratio Name	Calculation	Definitions	Rationale
Debt Servicing	**NUMERATOR** Principal and interest paid (adjusted)	The aggregate of all loan principal and interest for the period under review. (Exclude any early repayment of the principal on past borrowing.)	An indicator of the level of general annual obligation of principal and interest resulting from past borrowings owed by the Shire to external parties. Self-supporting loans are included in the ratio as the Shire has the primary responsibility to repay the borrowing in the event the external party defaults on their agreement. One off, early or balloon repayments of principal are excluded from the numerator to provide an option for early repayment of the principal without having an adverse impact on the ratio limitation. An increasing ratio over time suggests an increasing proportion of discretionary funds is being applied to the repayment of past borrowings and the associated interest.
	DENOMINATOR Adjusted General Funds	Adjusted general funds being: • General Rates; and • Government grants which were not given to the local government for a specific purpose; and • interest and principal for the period relating to loans established on the basis that they would be repaid using revenue sourced from a specified area rate or service charge or on a self-supporting basis; and • any sources prescribed (none to date). The use of an adjusted general funds as the denominator provides an indication of the level of the annual commitment to repay past borrowings relevant to the local government's discretionary revenue plus revenue sources specifically for repaying annual principal and interest to match those included in the ratio numerator.	

Monitoring of Borrowing Level Limitations

Borrowing ratios are to be reported in the annual budget and LTFP with the current level compared to the limitations as set by this policy. To assist with the task of monitoring the ratios, the following gradient is to be applied:

Ratio	Lower Risk	Medium Risk	Higher Risk
Debt Servicing Ratio	**0.0% to 2.9%**	**3.0% to 4.9%**	**5.0% to 6.0%**
Borrowing Ratio	**0.0% to 19.9%**	**20.0% to 34.9%.**	**35.0% to 50.0%**

Risk Minimisation

All treasury activities are to be undertaken in a manner that seeks to manage the risk to the Shire, in particular:

1. The decision on the type of borrowing, the term and interest rate arrangements shall take into account the purpose of the borrowing, the nature of the assets being funded, intergenerational equity and the cost of debt at the time of the borrowing, giving due regard to minimising exposure to interest rate movements; and

2. Council approval is required for all new borrowings.

Legislative Provisions

The legislative requirements relating to borrowings are summarised below:

Part six, division five of the *Local Government Act 1995* – Section 6.20 - provides that a Shire has the power to borrow. Section 6.21 – states the restrictions on borrowings.

The Shire may borrow money as part of adopting the annual budget in accordance with 6.2 of the *Local Government Act 1995.* Should the Shire propose to exercise the power to borrow and it has not been included in the annual budget, the Shire must follow the procedure as detailed in Sections 6.20 (2) of the *Local Government Act 1995*.

References

Name of Policy	3.2.12 Draft Borrowings
Previous Policy	CSP39 – Draft Borrowings (E15/5096)
Date of Adoption and Resolution Number	Adopted CGAM082/05/08 26/05/2008 Ordinary Council Meeting Adopted OCM179/12/17 18/12/2017 Ordinary Council Meeting
Review dates and Resolution Numbers	Reviewed OCM187/09/15 29/09/2015 Ordinary Council Meeting Proposed Policy 11/07/2017
Next review date	
Related documents	**Acts/Regulations** *Local Government Act 1995* **Plans/Strategies** Strategic Community Plan 2017 - 2027 **Policies** Nil **References** Nil **Delegations** Nil **Work Procedures** Nil

Note: changes to references may be made without the need to take the Policy to Council for review.

