

Ashfield Municipal Council

BORROWINGS & ASSET FINANCING (DEBT) POLICY

Adopted by Council April 2008

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1. PRELIMINARY

Policy Type

Business Function

Financial Management

Process Owner: Manager Administration and Finance

Effective Date: April 2008

Date to be reviewed April 2012

POLICY NO:

BORROWINGS & ASSET FINANCING (DEBT) POLICY

2. POLICY OBJECTIVES

Whilst the preferred policy position of Council is to remain debt free, should that not be practicable, this policy aims to set out the circumstances in which the Council may consider Borrowings or Other Financial Accommodation to fund the acquisition, renewal or construction of specified assets and to provide guidance as to the appropriate terms of any such borrowing.

3. GOVERNING LEGISLATION

3.1 Part 12 Loans Local Government Act 1993

621 When and for what may a council borrow?

A council may borrow at any time for any purpose allowed under this Act.

622 What form may a council borrowing take?

A council may borrow by way of overdraft or loan or by any other means approved by the Minister.

623 Security for borrowings

(1) A council may give security for any borrowing in such manner as may be prescribed by the regulations.

(2) All such securities rank on an equal footing, despite any other Act.

624 Are there any restrictions on a council borrowing?

The Minister may, from time to time, impose limitations or restrictions on borrowings by a particular council or councils generally despite the other provisions of this Part.

3.2 Local Government (General) Regulation 2005

229 Loans to council to be charge on the council's income

The repayment of money borrowed by a council (whether by way of overdraft or otherwise), and the payment of any interest on that money, is a charge on the income of the council.

230 General Manager to notify borrowings to Director-General

(1) Within 7 days after a council borrows money under a loan contract, the general manager must notify the Director-General of the borrowing.

(2) This clause extends to further advances made to a council under an existing loan contract, but does not apply to a borrowing by a council by way of overdraft.

3.3 Ministers Borrowing Order (From S624)

A council shall not:

1. Borrow at an interest rate in excess of the indicative interest rate as calculated by the New South Wales Treasury Corporation;
2. Borrow for a period of less than thirty (30) days nor for a period in excess of the estimated life of the asset for which the borrowing is made;
3. Borrow from any source outside the Commonwealth of Australia nor in any currency other than Australian currency;
4. Pay a placement fee exceeding 0.25% of the total amount being borrowed; or
5. Pay a documentation fee, or any other fee associated with a borrowing, exceeding 0.1% of the total amount being borrowed.

3. DEFINITIONS

The following items which are used in the financial/prudential ratios and policy are defined below.

| ITEM | DEFINITION |
|----------------------|---|
| Current Assets | Total current assets disclosed in the Statement of Financial Position. |
| Current Liabilities | Total current liabilities disclosed in the Statement of Financial Position. |
| Debt Servicing Costs | Interest and charges on loans, overdrafts, financial leases and interest on payments for capital items purchased on vendors' terms. |
| Economic Life | The estimated period during which the asset is expected to be economically usable by one or more users, with normal repairs and maintenance. Includes the concept of fit for use e.g. A building may suit a particular use but when that use is no longer required it may not be suitable for another use. A recreation or aquatic centre is an example of a specific use. It should be noted that the economic life of an asset may be considerably less than the physical life of that asset. |
| Excluded Borrowings | Includes money, credit or other financial accommodation obtained in the ordinary course of The Council performing its function such as - (a) An operating lease for plant and motor vehicle assets and office or information technology; (b) A credit or purchase card facility; (c) A short-term bank loan/overdraft required to balance daily cash flow requirements or as a result of a set-off arrangement; (d) A hire-purchase agreement. |
| External Borrowings | Includes raising and obtaining, in any way money, credit and other financial accommodations from sources external to the Council. |
| Internal Borrowings | Means the use of internal Municipal funds set aside for projects or future liabilities that are not expected to be expended or crystallised in the current financial year, to temporarily fund projects not previously budgeted, as an alternative to external borrowing. |

| | |
|-------------------------------|--|
| Net Debt | Total (gross) debt less cash assets |
| Other Financial Accommodation | Includes (a) Finance leases primarily to raise amounts to buy, or to finance the purchase of, property the subject of the leases and (b) Guarantees, letters of credit and any other form of undertaking, provided by a financial institution or other person to meet the liabilities or obligations of the Council; (c) Structured property finance, including sale and lease back and asset swaps for longer dated funding associated with potential developments of Council owned real property. |
| Rate and Charge Revenue | Includes: <ul style="list-style-type: none"> • all rates declared under sections 494 and 495 of the Local Government Act 1993 (the Act); • all annual charges declared under sections 496, 496A, 501 or 502 of the Act; and • all accrued interest charged under section 566 of the Act. |
| Self Supporting Loans | Loans taken out by Council the repayments of which are made by a third party e.g. club, organisation or ratepayers through a Special Area Rate/Service Charge. |
| Total (Gross) Debt | Include all loans/borrowings, overdrafts, financial leases and the outstanding amount owing for capital items purchased on vendors' terms. |
| Total Liabilities | Include all financial and non-financial liabilities (both current and non-current) as shown in the Balance Sheet/Statement of Financial Position. |
| Total Realisable Assets | Includes all assets which can be sold within a reasonable period of time but excludes infrastructure assets such as drainage, roads, parks and gardens, land and buildings on Crown Land etc. |
| Total Revenue | Total Operating Revenue plus any financing transactions including proceeds from loans, asset sales and transfers from reserves/accumulated surplus. |

4. POLICY STATEMENT

Whilst the preferred policy position of the Ashfield Council (Council) is to remain Debt Free (except for Self Supporting loans), the Council recognises that in order to ensure intergenerational equity in funding the acquisition, renewal or construction of assets, it may need to resort to the prudent use of loan borrowings, debt instruments or other finance or capital raising methodologies from time to time.

The following principles are to be applied when considering undertaking borrowings or other asset financing.

4.1 Operating Expenditure

The Council will **not** borrow money (other than by way of Excluded Borrowings) to fund operating expenditure. This type of expenditure should be funded through operating revenue streams such as rates, fees and charges or operating grants.

4.2 Recurrent Capital Expenditure

The Council will **not** borrow money or obtain debt finance (other than by way of Excluded Borrowings) to fund the acquisition, replacement or renewal of assets that is expected to occur on an annual or similar basis at approximately the same level each year i.e. recurrent capital works. Examples of this type of expenditure are road resurfacing, plant replacement, information technology and office equipment acquisitions and replacement. This type of expenditure shall be funded through operating revenue streams such as rates and fees and charges.

4.3 Borrowing Term

The term of the Borrowing or Other Financial Accommodation shall be set having due regard to the Economic Life of the asset being acquired or constructed.

Council aims to use the Economic life of the asset to set sufficient funds aside in a sinking or reserve fund in order to renew or replace that asset, should that be required, at the end of its Economic Life.

The Council will **not** generally borrow funds to acquire an asset that has an economic life of less than ten (10) years.

4.4 Borrowing Ratios

Prior to undertaking any borrowing the Council shall assess its capacity to pay, to ensure that the community is not burdened with unnecessary risk. The Council shall then reassess its capacity to pay on an annual basis as part of its budgeting process. When assessing the borrowing ratios, consideration will be given to the economic earnings potential of the asset being acquired or constructed.

| Area | Financial Indicator |
|-----------------|--|
| Liquidity | Current Assets to Current Liabilities |
| Debt Exposure | Total Liabilities to Total Realisable Assets |
| Debt Management | Total Debt as a % of Revenue |
| Debt Management | Debt Servicing Costs as a % of Total Revenue |

Liquidity: Current Assets to Current Liabilities

This indicator reflects on Council's short-term liquidity position, that is, its ability to repay current commitments from cash or near cash assets. If Council has a ratio of 1:1 and below or with a deteriorating trend it may be **financially at risk of not being able to meet creditors' commitments**.

Debt Exposure: Total Liabilities to Total Realisable Assets

This indicator reflects the ability of Council to acquit existing liabilities with the proceeds from the disposal of its realisable assets. Ideally, total liabilities should be significantly less than 100% of total realisable assets.

Debt Management: Total Debt as a % of Revenue

The Local Government Act 1993 requires that all loans are secured against the revenue stream of Council. A Council with total debt in excess of its total revenue would be unable to meet all debt commitments from revenue should they be required to be repaid at the one time.

Debt Management: Debts Servicing Costs as a % of Total Revenue

This indicator reflects the proportion of total revenue that is used to service debt (interest on outstanding debt and any loan administration charges) and which cannot be used directly for service delivery.

4.5 Circumstances for Which Long Term Borrowing/Financing Will Be Considered

The Council will give favourable consideration to borrowing money for the acquisition or construction of an asset where:-

- ◆ The asset to be acquired is a new addition to Council's asset base or replaces an existing asset with one that is significantly upgraded and has an Economic Life of greater than 10 years; or
- ◆ All alternative options for undertaking the project without borrowing have been investigated and proven less advantageous to the Council; or
- ◆ The income stream from the asset to be acquired or constructed exceeds the cost of borrowing over the life of that asset; or
- ◆ Repayments will be met by a third party e.g. self supporting loans and the financial stability of that party meets the criteria as set out in the Self Supporting Loans Policy 13-004 ; or
- ◆ The index of the cost of acquisition or construction is increasing at a rate that exceeds the cost of borrowing i.e. to "save" for the acquisition or construction will result in the actual cost being greater than the cost of borrowing the money and acquiring it today.

As a general rule the benefits received from undertaking the borrowing should be greater, over the life of the borrowing, than the costs of borrowing.

4.6 Internal Borrowings

Where the cost of using external funds acquired through borrowing, is greater than the forgone investment earnings on Municipal funds that are surplus to current requirements e.g. carried forward works, such funds should be used prior to seeking external funds. It should be noted that the Local Government Act places restrictions on the use of funds held in Reserve accounts i.e. Domestic Waste or ELE Reserve.

Where use of such funds is made notional internal journal entries shall be made reflecting the value of forgone investment earnings as a cost to the programme for which the funds were borrowed and crediting the relevant investment earnings budget account for the fund/reserve account from which the funds were "borrowed".

Under no circumstances shall funds be "borrowed" from the Trust Fund or Trust accounts.

4.7 Statutory Limitations

Any borrowings will be conducted in accordance with relevant statutory requirements as contained in the Local Government Act 1993 and the Local Government (General) Regulations 2005

4.8 Other Limitations

Borrowings shall be undertaken in Australia and be in Australian dollars so as to ensure the Council is not exposed to foreign currency risks.

Local government loan application guidelines published by the Minister for local Government, the Department of Local Government and the Department of Commerce from time to time.

4.9 Determining the Appropriate Lending Institution

Where practicable three written quotations shall be obtained or a loan tender called in order to determine the appropriate lending institution for any loan borrowings. Determination of the appropriate institution will be based on the interest rate and loan costs offered, the terms and conditions of the loan and the financial stability of the lender.

4.10 Security for Borrowings

In accordance with section 623 of the Local Government Act 1993, the only security that will be offered in return for the borrowings shall be the general funds of the Council.

4.11 Interest Rate Parameters

Should any borrowings be undertaken, the Council will obtain independent advice in regards to determining the period for which the interest rate should be fixed. The factors that will be taken into account when deciding an appropriate fixed term period shall include:-

- ◆ the level of the interest rate when compared to the long term average official interest rate;
- ◆ recent movements in the official interest rate;
- ◆ the term of the loan.

4.12 Structure of Borrowings

The Council will obtain independent advice in regards to determining the most appropriate structure of any borrowings with regard to;

- ◆ Fixed or Floating rate
- ◆ CPI – Linked rate
- ◆ Interest Capitalised, Interest Only or Principal & Interest.

Where possible, the nature of cash flows related to the funded asset will be used as a guide to the most appropriate borrowings structure. For example, interest capitalised may be appropriate for capital expenditure related to a land release, with full principal repayment from land sales.

APPENDIX 1

As debt decisions have a long term impact on councils ongoing financial position consideration of the level of debt and its impact needs to be assessed as follows. A prudent assessment of capacity to service debt and progress thresholds over time is as follows:

STAGED ASSESSMENT FRAMEWORK

Liquidity: *Current Assets to Current Liabilities*

| Current Assets to Current Liabilities | Improve to: | Period for Achievement |
|---------------------------------------|----------------------------------|------------------------|
| ... 0.6:1 | Proposed New Borrowing Rejected. | |
| >0.6:1, ... 1.1:1 | > 1.1:1 | 5 Years |

Debt Exposure: *Total Liabilities to Total Realisable Assets*

| Total Liabilities to Total Realisable Assets | Target | Period for Achievement |
|--|----------------------------------|------------------------|
| — 150% | Proposed New Borrowing Rejected. | |
| — 100%, < 150% | 100% | 5 Years |
| — 80%, < 100% | 80% | 5 Years |
| — 50%, < 80% | Review Debt Strategy | Not applicable |

Debt Management: *Total Debt as a % of Revenue*

| Total Debt as a % of Revenue | Target | Period for Achievement |
|------------------------------|----------------------------------|------------------------|
| > 100% | Proposed New Borrowing Rejected. | |
| — 85%, < 100% | 85% | 5 Years |
| — 66%, < 85% | 66% | 5 Years |
| — 66%, < 50% | 50% | 5 Years |
| — 40%, < 50% | Review Debt Strategy | Not applicable |

Debt Management: *Debts Servicing Costs as a % of Total Revenue*

| Debts Servicing Costs as % of Total Revenue | Reduce to: | Period for Achievement |
|---|----------------------------------|------------------------|
| — 10% | Proposed New Borrowing Rejected. | |
| — 5%, < 10% | 5% | 5 Years |

It should be noted that proposed borrowings will be assessed against Council's overall operating and financial position.

In Summary

The Council will **not** borrow funds when such borrowing would result in any of the following financial ratios being exceeded:

- Current Assets to Current Liabilities <60%
- Total Liabilities to Total Realisable Assets >150%
- Total Debt as a percentage of revenue >100%
- Debt Service Ratio >10%

Other References Applicable to this Policy Self Supporting Loan Policy

Delegated Authority No:

Procedure No:

**Adopted by Ordinary Meeting of the Council held / 04 / 08
This policy is scheduled for review in April 2012**