Borrowings And Asset Financing

Policy Type: Council Policy Policy Owner: Manager Financial Services	Policy No. CP- 024 Last Review Date: 17 May 2016

Policy Objectives

To affirm that the preferred policy position of the City of Melville is to remain debt free, and should that not be practicable, 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.

Policy Scope

This Policy relates to forms of financing which create a liability for future repayment. It does not include those financing methods shown in Excluded Borrowings below, or the funding of asset purchases via ongoing operational funding mechanisms such as Rates, fees and charges and grants.

Definitions

External Borrowings – includes raising and obtaining, in any way money, credit and other financial accommodations from sources external to the City.

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.

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 City; and
- (c) Structured property finance, including sale and lease back and asset swaps for longer dated funding associated with potential developments of City owned real property.

Excluded Borrowings – includes money, credit or other financial accommodation obtained in the ordinary course of the City performing its function such as -
- (a) An operating lease for plant and motor vehicle, office furniture/equipment or information technology assets ;
- (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.

Gross Debt – all debts owing by the City including self supporting loans.

Self Supporting Loans – Loans taken out by City the repayments of which are made by a third party e.g. club, organisation or ratepayers through a Special Area Rate/Service Charge.

Net Debt - gross debt less cash assets.

Economic Life - The estimated period during which an asset is expected to be economically usable by one or more users, with normal repairs and maintenance. It should therefore be noted that the economic life of an asset may be considerably less than the physical life of that asset. This may be due to the fit for use life being less than the physical life of the asset. 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 swimming pool is an example of a specific use asset.

Policy Statement

Whilst the preferred policy position of the City of Melville (City) is to remain Debt Free (except for Self Supporting loans), the City 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.

Operating Expenditure

The City 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.

Recurrent Capital Expenditure

The City 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.

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.

Should the City decide to borrow funds, the term of the borrowing shall generally not be greater than half of the Economic Life of the asset being acquired or constructed. This is to enable the City to use the remaining economic half life 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 City will **not** generally borrow funds (other than by way of Excluded Borrowings) to acquire an asset that has an economic life of less than five (5) years.

Borrowing Ratios

Prior to undertaking any borrowing the City shall assess its capacity to pay, to ensure that the community is not burdened with unnecessary risk. The City shall then reassess its capacity to pay on an annual basis and publish the results of that assessment in its annual report.

When assessing the borrowing ratios, consideration will be given to the economic earnings potential of the asset being acquired or constructed.

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

- Debt Service Cover Ratio 3 as per WA Treasury Corp Borrowing Guidelines.
- Net Debt (Gross Debt less cash assets) to Operating Revenue Ratio 50% as per WA Treasury Corp Borrowing Guidelines.

In order to reflect the City's contingent liability risk as guarantor for Self Supporting Loans as well as partial guarantor for the loan borrowings undertaken by the Southern Metropolitan Regional Council (SMRC), the permissible borrowing limit of the City will be reduced by the amount of the outstanding value of self supporting loans and the City's percentage share, as stipulated in the SMRC participants agreement, of the SMRC's loan.

Circumstances for Which Long Term Borrowing/Financing Will Be Considered

The City 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 the City's asset base or replaces an existing asset with one that is significantly larger and has an Economic Life of greater than 5 years; or
- All alternative options for undertaking the project without borrowing, have been investigated and proven less advantageous to the City; 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 CP-010 ; 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 or constructing the asset today.

As a general rule the benefits received (cost savings or income earned) from undertaking the borrowing should be greater, over the life of the borrowing, than the costs of borrowing.

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, such funds should be used prior to seeking external funds. It should be noted that the Local Government Act 1995 places restrictions on the use of funds held in Reserve accounts i.e. Municipal Fund equity, as follows:-

> 6.11. Reserve accounts
>
> (1) Subject to subsection (5), where a local government wishes to set aside money for use for a purpose in a future financial year, it is to establish and maintain a reserve account for each such purpose.
>
> (2) Subject to subsection (3), before a local government –
> (a) changes* the purpose of a reserve account; or
> (b) uses* the money in a reserve account for another purpose,
> it must give one month's local public notice of the proposed change of purpose or proposed use. * Absolute Majority Decision Required.
>
> (3) A local government is not required to give local public notice under subsection (2) –
> (a) where the change of purpose or of proposed use of money has been disclosed in the annual budget of the local government for that financial year

Where use of such funds is made, notional internal journal entries shall be made reflecting the value of forgone investment earnings and principal repayments 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.

Statutory Limitations

Any borrowings will be conducted in accordance with relevant statutory requirements as contained in the *Local Government Act 1995* and the *Local Government (Financial Management) Regulations 1996*.

Other Limitations

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

Local government loan application guidelines published by the Western Australian Treasury Corporation (WATC) from time to time will also limit the amount of borrowings that can be undertaken.

Determining the Appropriate Lending Institution

Unless borrowing from the WATC 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.

Security for Borrowings

In accordance with section 6.21 of the *Local Government Act 1995*, the only security that will be offered in return for the borrowings, shall be the general funds of the City.

Interest Rate Parameters

Should any borrowings be undertaken, the City will consider the following factors when deciding an appropriate period for which interest rates will be fixed:-

- 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.

Structure of Borrowings

The City will obtain 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 and 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.

References that may be applicable to this Policy

Legislative Requirements:

Procedure, Process Maps, Work Instructions:

Other Plans, Frameworks, Documents Applicable to Policy:

Delegated Authority No:

ORIGIN/AUTHORITY		ITEM NO.
Ordinary Meeting of Council	15/05/07	C07/2001

REVIEWS

Ordinary Meeting of Council	15/12/09	C09/5097
Ordinary Meeting of Council	15/11/2011	C11/5199
Ordinary Meeting of Council	10/12/2013	C13/5341
Ordinary Meeting of Council	17/05/2016	C16/5484