CENTLEC

Borrowings Policy

CENTLEC (SOC) LTD	
Subject: Borrowings Policy	Policy No: POL 003
Directorate: Finance	Board Item No:
Sub-Directorate: Accounting & Compliance	Date Approved: **31 May 2018**
Custodian: GM: Accounting & Compliance	Effective Date: **1 July 2019**
Last Date Of Review: 2018-2019	Reference:

TABLE OF CONTENT

DEFINITIONS:

Qualifying asset: means an asset that necessarily takes a substantial period of time (over a year) to get ready for its intended use or sale.

SECTION 1: OBJECTIVES

a) To facilitate the entity's long-term and short-term borrowing of funds both externally and internally at the best possible rate of interest obtainable; and
b) To ensure that all borrowings are in accordance with legislative requirements.

SECTION 2: LEGISLATIVE CONTEXT

Municipal Finance Management Act No 56 of 2003(hereafter MFMA) section 18 requires that an annual budget may only be funded from:

a) Realistically anticipated revenues to be collected;
b) Cash backed accumulated funds from previous year sumpluses not committed for other purposes; and
c) Borrowed funds, but only for capital projects.

Section 19 of the MFMA also requires spending on a apital project may only be commenced once the funding source have been considered, are available and have not been committed for other purposes.

Section 108 requires entity to borrow money, but only in accordance with-

a) The entity's multi-year business plan referred to in section 87(5)(d); and
b) The provision of Chapter 6 to the extent that those provisions can be applied to a municipal entity.

Futhermore, Chapter 6 of Municipal Finance Management Act 2003, Act 56 of 2003 guides on the requirements of obtaining short-term and long term debt, conditions to comply with when applying for Debt, Security, Disclosures and Municipal Guarantees.

This policy must therefore be read together with the provisions of this chapter when the entity intends to borrow money for short or long-term term needs.

SECTION 3: POLICY PRINCIPLES

3.1 Short-Term Borrowings

The entity shall incur short-term debt in strict compliance with the Municipal Finance Management Act and any Treasury Regulations and Guidelines regarding short-term borrowings.

Short-term borrowings shall be incurred only when necessary to for the following purposes:

a) 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

b) For capital needs within a financial year, to be repaid from specific funds to be received from enforceable allocations or long-term debt commitments.

A short-term debt shall be incurred only if:

a) The board of directors and the council of the parent municipality have passed a resolution, signed by the Mayor, approving the debt agreement; and
b) The Accounting Officer or his/her delegate has signed the agreement or other document which creates or acknowledges the debt.

In cases of short-term credit facility to be accessed as and when required, including bank overdraft and credit cards facilities, the board of directors shall approve debt agreement provided that:

a) the credit limit must be specified in the resolution of the board of directors;
b) the terms of the agreement, including the credit limit, may be changed only by a resolution of the board of directors; and
c) if the board approves a credit facility that is limited to emergency use, the Accounting Officer or his/her delegate must notify the board in writing as soon as practical of the amount, duration and cost of any debt incurred in terms of such a credit facility, as well as options for repaying such debt.

3.2 Long -Term Borrowings

The entity shall incur long-term debt in strict compliance with the Municipal Finance Management Act and any Treasury Regulations and Guidelines regarding long-term borrowings, and must be consistent with the entity's capital budget.

Long-term borrowings shall be incurred only when necessary for the purpose of:

capital expenditure on property, plant or equipment to be used for the purpose of achieving the service delivery objectives as set out in the Service Delivery Agreement entered into with the parent municipality, including finance costs as contemplated in section 46(4) of Municipal Finance Management Act 2006, Act 56 of 2003. For the purpose of this policy, capital expenditure include:

i. capitalised interest for a reasonable initial period;
ii. costs associated with security arrangement ;
iii. discounts and fees in connection with the financing;
iv. fees for legal, financial, advisory, trustee, credit rating and other services directly connected with financing;
v. cost connected to the sale or placement of debt, and cost for printing and publication directly connected with the financing;
vi. costs of professional service directly related to the capital expenditure ; and
vii. such other cost may be prescribed

a) re-financing existing long-term debt, provided that:
   i. the existing long-term debt was lawfully incurred;
   ii. 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;
   iii. 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; and
   iv. the discount rate used in projecting net present value and any assumptions in connection with the calculations, must be reasonable and in accordance with criteria set out in a framework that may be prescribed.

A long-term debt may be incurred only if:

a) The Accounting Officer of the parent municipality or his/her delegate has, at least 21 days prior to the meeting of the Council at which approval for the debt to be incurred by the entity is to be considered, made public an information statement setting out particulars of the proposed borrowing, 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; and

b) The Accounting Officer of the parent municipality or his/her delegate invited the public, the National Treasury and the Free State Provincial Treasury to submit written comments or representations to the council in respect of the proposed debt of entity; and

c) The Accounting Officer of the parent municipality or his/her delegate has submitted a copy of the information statement to the municipal council at least 21 days prior to the meeting of the council, together with particulars of the essential repayment terms, including the anticipated debt repayment schedule; and the anticipated total cost in connection with debt to be incurred by the entity over the repayment period.

SECTION 4: CONDITIONS APPLYING TO BOTH SHORT-TERM AND LONG- TERM EXTERNAL BORROWING

The entity will incur debt only subject to the following conditions:

a) 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;

b) Borrowings shall be applied for with institutions registered as banks in terms of the Banks Act, 1990 (Act No. 94 of 1990) or development finance institutions such as Development Bank of Southern Africa, Industrial Development Corporation, etc.

c) The following are to be carefully evaluated prior to borrowing commitment:

   i. the extent to which borrowing is an appropriate funding source for the expenditure in question;
   ii. whether alternative sources of funding are available;
   iii. prevailing economic conditions;
   iv. that proposed borrowings are disclosed in the Multi-Year Business Plan of the entity
   v. potential movements in interest rates and associated impacts on debt servicing costs;
   vi. inter-generational equity considerations; and

vii. current and future funding needs for both capital and operational expenditure.

d) All new borrowings, their extent and their purpose must been approved by the board of directors and the council of the parent municipality.

e) Any person involved in the borrowing of money by municipal entity must, when interacting with prospective lender or when preparing documentation for consideration by prospective lender:

(i) disclose all information in that person's possession or within that person's knowledge that may be material to the decision of that prospective lender or investor
(ii) take reasonable care to ensure the accuracy of any information disclosed

(f) A lender may rely on written representations of the entity signed by the accounting officer, if the lender or investor did not know and had no reason to believe that those representations were false or misleading.

SECTION 5: DEBT SECURITY

Where appropriate the entity may, by resolution of the board and that of the council of the parent municipality and subject to section 48(3) of Municipal Finance Act, provide security for:

a) any of its debt obligations; or
b) contractual obligations of the entity undertaken in connection with capital expenditure by other persons on property, plant or equipment to be used by the entity or such other person for the purpose of achieving the service delivery objectives as set out in the Service Delivery Agreement between the parent municipality and the entity.

SECTION 6: REPAYMENT OF BORROWINGS

6.1 Short-Term Debt

a) All short-term debt must be paid within the financial year in which it was raised. Short-term debt may not be renewed or refinanced where such renewal or refinancing will have the effect of extending the short-term debt into a new financial year.

6.2 Long-Term Debt

a) The repayment period of a long-term loan shall not exceed the useful life of the asset being created. ***For example***:- *A loan for the construction of a new power station with an expected life of 30 years shall not have a repayment period in excess of 30 years.*

b) Where surplus funds are available, any decision to repay borrowings ahead of schedule shall be made based on the facts available at that time. Any such decision must give due regard to the policy objective of minimizing the overall debt servicing costs.

SECTION 7: BORROWING COSTS / INTEREST

7.1 Initial Recognition and Measurement

7.1.1 Capitalising or expensing borrowing costs

a) Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset shall be capitalised to the cost of the asset. All other borrowing costs should be recognised as an expense in the period in which they are incurred.

b) Situations may arise where it is difficult to link the borrowing requirement of an entity directly to the nature of the expenditure to be funded. For example, an entity borrows funds for the construction of an office building and to incur maintenance on the buildings currently owned. In such a situation, the entity might be unable to distinguish whether the borrowings were incurred for capital or current expenditure.

c) Any borrowing cost incurred under such circumstances shall be recognised as an expense.

7.1.2 Borrowing costs on specific borrowings

a) When the entity borrows funds specifically to obtain a qualifying asset, and therefore there is a direct link between the asset and the borrowing costs that will be incurred, the borrowings costs amount to be capitalised is the actual borrowing costs incurred during the period, less any investment income on the temporary investment of those funds.

7.1.3 Borrowings costs on general borrowings

a) To determine the borrowing costs eligible for capitalisation where general borrowings were used to obtain a qualifying asset, a capitalisation rate shall be applied to the expenditure on that asset. The capitalisation rate should be a weighted average rate applied to those general borrowings of the entity that are outstanding during the period.

If the calculated borrowing costs exceed the actual borrowing costs incurred, the amount to be capitalized should be limited to the actual amount of borrowing costs incurred during the period.

7.2 Subsequent Measurement

7.2.1 Cessation of capitalisation of borrowing costs

a) Capitalisation of borrowing costs should cease when substantially all the activities necessary to get the asset ready for use or sale are complete. In situations where routine administrative work still continues or minor modifications are still outstanding, capitalisation of borrowing costs should still cease as these are not considered to be substantial activities necessary to get the asset ready for use or sale.

Where construction of a qualifying asset is done in parts, and each part can be used or sold separately, capitalisation of borrowing costs should cease on the completed parts while being continued on the other parts that are still being constructed.

7.2.2Suspending capitalisation of borrowing costs

a) When active development of a qualifying asset is interrupted for extensive periods, the entity should suspend the capitalisation of borrowing costs during such periods, however, capitalization shall continue during the extended period if, for example, strong winds or heavy rains delay construction / works, if strong winds or such heavy rains are **common** during the construction period in the geographical region involved.

SECTION 8: EXISTING BORROWINGS

a) Where applicable, any existing borrowings shall be redeemed over the period originally negotiated, except if the entity may negotiate new repayment schedules which shorten the term of the debt for various loans.

b) Where the provisions of this borrowing policy allow, loans which fall due for conversion shall be fully redeemed at the time specified for conversion. Loans which fall due for conversion, and are to be renegotiated, shall be renegotiated as if they are new loans under this borrowing policy.

SECTION 9: DEFERRED SETTLEMENT TERMS

a) There may be situations where an entity is allowed to settle payment for an asset beyond normal credit terms. In such a case, the difference between the cash price equivalent and the total payments shall be recognised as interest over the period.

b) Since that borrowing costs can only be capitalised to the cost of a qualifying asset. Therefore, for an asset acquired on deferred settlement terms, the finance cost to be paid over the period of the deferred settlement can only be capitalised to the cost of the related asset if the asset is a qualifying asset.

SECTION 10: MINIMIZING FINANCIAL CONSTRAINTS DUE TO BORROWING

a) No borrowings shall be undertaken if the effect thereof will result in annual interest and redemption payments exceeding 8 % of entity's total operating expenditure, unless specifically authorized otherwise by resolution of the council of the parent municipality.

SECTION 11: INTERCOMPANY LOANS

a) Intercompany transactions are commonly made between the entity and the parent municipality, which in the end are classified as intercompany loans, and therefore the following principles shall apply in respect of any transaction which culminates into intercompany loans:

(i) Measures shall be taken to ensure that as far as possible, intercompany loans are entered into in accordance with normal commercial terms (i.e terms that would apply should a similar transaction be entered into with unrelated party).

(ii) Fixed intercompany loans shall initially be recognised at fair value, plus directly attributable transaction costs for items that will not be measured at fair value subsequently.

(iii) Given that there is no active market for inter-company loans, fair value will usually need to be estimated by discounting the future loan repayments using a market rate of interest for similar loan transactions. The discount (i.e. difference between the loan amount and fair value) shall then be recorded as part of the parent's cost of investment in the subsidiary.

(iv) If the loan is repayable at the discretion of the parent municipality (i.e. it contains a demand feature), then Centlec (SOC) Ltd shall therefore record the full loan amount as a liability in its books.

(v) This policy should be read with Related Party Policy of Centlec (SOC) Ltd.

10.1 Intercompany Loans Forming Part of the Net Investment in Centlec (SOC) Ltd

a) The parent municipality may sometimes make loans to the entity [i.e Centlec (SOC) Ltd] for which settlement is neither planned nor likely in the foreseeable future and these loans shall be regarded as perpetual loans.

b) If the intercompany loan is perpetual (i.e. not repayable at all), or repayable only at the discretion of the Centlec (SOC) Ltd, this loan shall be recorded as a component of equity in the records of Centlec (SOC) Ltd and no discounting or amortization shall be required.

10.2 Fixed Term Intercompany Loans from the Parent Municipality to Centlec (SOC) Ltd

a) Fixed term inter-company loans shall be recognized initially at fair value, estimated by discounting the future loan repayments using a market rate of interest that the entity would pay to an unrelated lender for a loan with similar conditions (amount, term, security etc.)

b) The difference between the loan amount and the fair value (discount or premium) shall be recorded as:

(i) an investment in the parent's financial statements (as a component of the overall investment in Centlec (SOC) Ltd);
(ii) a component of equity in the entity's financial statements.

c) Subsequently, the loan shall be measured at amortized cost, using the effective interest rate method. This involves “unwinding” the discount such that, at repayment, the carrying value of the loan equals the amount to be repaid. The unwinding of the discount shall be recorded as interest income or expense.

d) Estimates of repayments shall be evaluated in future periods and revised if necessary; the effect of a change in estimate shall be:

(i) treated as an adjustment to the cost of investment by the parent/lender; and
(ii) treated as an additional contribution (or distribution) by the subsidiary/borrower.

e) Loans that are expected to be repaid in the near future shall be recorded at the loan amount by both parties.

SECTION 12: INTERNAL CONTROL OVER LOANS

a) The Accounting Officer or his/her delegate, with the assistance of the Chief Financial Officer is responsible for establishment of a registry of documentation and information pertaining to the entity's borrowings.

b) The loan register shall be in the format that complies with the requirements of generally recognized accounting practice (GRAP) and any other accounting requirements which may be prescribed by the National Treasury from time to time. Below loan / debt records shall remain in the loans register for safegauarded at all times for as long as it remains outstanding:
i) Loan agreements;
ii) Any applicable security agreements;
iii) Signed copies of monthly reconcilliations;
iv) Copies of all repayments made;
v) Copies of amortization schedules;
vi) Copies of quarterly National Treasury returns.

SECTION 13: RECORDING OF APPROVED BORROWINGS IN THE REGISTER

13.1 Once Council approved the loan, the Accounting Officer has to enter into an agreement with the recommended financial institution on behalf of Council. The Chief Financial Officer must ensure that the terms and conditions are as originally agreed before the Council is committed:

13.2 All entity loan commitments must be recorded in a Loan register reflecting at a minimum the:

13.2.1 Loan number;
13.2.2 Type of loan;

13.2.3 Financial institution;

13.2.4 Date issued;

13.2.5 Purpose of loan;

13.2.6 Interest rate;

13.2.7 Loan period;

13.2.8 Installments (capital and interest);

13.2.9 Due date;

13.2.10 Security (if any);

13.2.11 Final redemption;

13.2.12 Opening balance at the beginning of the financial year;

13.2.13 Amounts received during the financial year;

13.2.14 Capital amounts redeemed during the financial year; an

13.2.15 Closing balance at the end of the financial year.

13.3 Sufficient provisions must be made in the budget to depreciate assets linked to the loan.

SECTION 14: REPORTING AND DISCLOSURE REQUIREMENTS

a) Reporting and disclosures relating to borrowings and intercompany loans must be given in sufficient detail in the entity's financial statements to enable the effect of the loans on the financial statements to be understood and should include the following as a minimum:

(i) Held at cost or amortized;
(ii) Current and non-current portions;
(iii) Finance costs;
(iv) Repayments;
(v) Related party;
(vi) Conditions, etc.

b) Where there are significant uncertainties, such as the expected terms of a loan, the disclosures should refer to such uncertainties.

SECTION 15: REVIEW PROCESS

This policy and underlying strategies will be reviewed at least annually, or as necessary, to ensure its continued application and relevance.