

BORROWING/LOANS

CS230



NARRANDERA SHIRE COUNCIL POLICY

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BORROWING / LOANS

Policy No:	CS230
Policy Title:	Borrowing/Loans
Section Responsible:	Corporate Services - Finance
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Objective

Loan borrowings provide an important source of funding for council works as an alternative to accumulated reserves where external grants or contributions are not available. The funds can be borrowed from both internal and external sources and there are a number of legislative requirements and financial principles that need to be considered when determining if and how funds are to be borrowed and repaid.

This policy is to provide a framework for determining when the use of borrowings (internal and external) is both appropriate and financially sustainable.

The objective of Council's Loan Borrowing Policy is to:

- Ensure that all borrowings (both internal and external) are in accordance with legislative requirements.
- Minimise the cost of borrowings.
- Ensure the total amount of loan borrowings is sustainable in terms of ability to meet future repayments, budgetary obligations and Fit For The Future improvement plan commitments and benchmarks.

Policy Statement

Council will only use borrowing as a source of funds for works where all of the following conditions are met:

- The expenditure is for capital works other than annual renewal requirements of existing assets.
- The loan term will not exceed the anticipated economic life of the asset.
- The loan repayments can be funded from a sustainable source without adversely affecting council's existing operational commitments or financial indicators.
- The priority for the work has been assessed in line with the Community Strategic Plan, Project Risk Evaluation Matrix and approved through Council's Project Management and Control process.

- A Capital Expenditure Review undertaken where required by legislation.

Council will restrict all borrowings to expenditure on identified capital projects that are considered by Council to be of the highest priority, and which are unable to be funded from revenue. Under no circumstances will Council borrow funds for recurrent expenditure.

Where a capital project for a service that is funded by user charges (e.g. waste or sewer) is determined to be funded by way of loans, the user charge should reflect the cost of providing the service (including any loan repayments).

Other specific capital projects, not funded by user charges, will only be considered for loan funding where the project is considered by Council to be beneficial to the majority of ratepayers.

In considering the impact of borrowing on council's budget council will be guided by;

- Council's Fit For The Future (FFTF) improvement plan
- The Long Term Financial Plan resourcing the Community Strategic Plan
- The relevant Asset Management Plan resourcing the Community Strategic Plan
- (FFTF) Operating result ratio
- (FFTF) Asset renewal ratio
- Debt service ratios

Council will consider internal loan sources before external sources. N.S.W. Treasury Corporation borrowing facilities will be considered along with private sector lenders.

Internal Loans

The use of internal loans will be guided by:

- Liquidity of the source fund.
- The source fund will be paid interest by the borrowing fund at a rate equivalent to the interest earned by council's investment portfolio in each year.
- Council will comply with the provisions of the Local Government Act and Regulation in relation to internal loans.
- Granting of Ministerial approval where required.

External Loans

When sourcing external loans, Council will assess Treasury Corporation facilities against commercial lenders where it will seek at least three written quotations and only use providers and funds allowed under the legislation and directions below.

Written quotations must include:

- Interest rate.
- Term of the loan.
- Repayment intervals (monthly, quarterly etc).
- Repayment instalment amount.

- Any applicable fees.

In considering loan terms Council will be guided by:

- The estimated economic life of the asset.
- The minimisation of interest rate exposure.
- Budgeting requirements.

Acceptance of the successful quote will be authorised by the Chief Executive Officer subject to the borrowing amount being previously approved by Council and the requirements of the 'Loan Borrowing Policy' being adhered to.

Council will ensure all procedures to plan for and obtain borrowings are compliant and accountable. Council will comply with all borrowing application and reporting requirements of the Office of Local Government.

Scope

The following provides some context for the above policy points.

When to use debt?

The use of debt is closely linked to the concept of intergenerational equity. Operating and asset renewal expenses should be paid by current residents and therefore current revenue. Expenditures that provide benefits over many years should be paid for by users that benefit from the works over its economic life. This cannot be achieved by accumulating current revenues for future expenditure, but is achieved by using current revenues to fund loan repayments over the life of the asset.

Debt is also appropriate where the expenditure results in a reduction of operating costs or an increase in operating revenues that cover the cost of borrowing. There may also be emergency situations where works are required urgently to avoid significant risks or escalations in remediation costs.

How will a project be approved for funding?

Assessment of a project will incorporate the following mandatory analysis:-

Council Priorities

Does the project outcome support an objective of Councils Strategic Priorities Action Plan.

Community Expectations

The project outcome must align to an action adopted under the Community Strategic Plan and Council's Delivery Program.

Asset Management

Is the expenditure programmed in the appropriate Asset Management Plan adopted by Council under the integrated planning and reporting provisions of the Local Government Act. Will the project contribute to Council maintaining its Asset Renewal Ratio as proposed in Council's FFTF improvement plan.

Financial Management

Have the operating and capital cost of a project been accurately assessed and entered into Council's Long Term Financial Plan to determine the financial impact of a project and the capacity for Council to maintain a positive Operating Result Ratio to meet commitments made in the FFTF improvement plan.

Risk Management

All projects shall be evaluated under the Project Risk Assessment Matrix and identified risks will be mitigated or managed as documented in the risk assessment.

When is debt affordable?

Debt is affordable where the works are self-funding either from reduced operating costs or an increase in revenues or the net result of both. Alternatively, debt is only affordable if the relevant fund has an operating surplus sufficient to cover the loan repayments. Operating revenues should be able to cover cash operating expenses as well as non-cash accruals for leave entitlements, depreciation and remediation, before committing to loan repayments, for the fund to be financially sustainable. The fund is required to maintain a positive Operating Result Ratio to achieve FFTF benchmarks.

What are appropriate sources and terms of debt?

The Office of Local Government will set controls for borrowings which may change at any time and Council needs to keep aware of these through the related legislation and references below. Council will not indulge in speculative debt arrangements and will adhere to standard table loans with set bi-annual instalments and rates fixed for at least four years. Repayment periods will not exceed the economic life of the works to ensure intergenerational equity, and will be in proportion to the size of the loan.

Definitions

Fit For The Future (FFTF) Improvement Plan:-

A Council Improvement Proposal submitted to the Office of Local Government as required under the Strengthening Local Government initiative. The proposal included current performance, the issues facing Council with planned improvement strategies and outcomes. Council committed to key strategies to improve performance against the sustainability benchmarks in the 2016-20 period, including the outcomes expected to be achieved.

Long Term Financial Plan:-

Council's Ten (10) year budget maintained in its resourcing strategy in accordance with Section 403 Local Government Act, 1993

Operating Result Ratio:-

Operating Revenue excluding Capital grants & Contributions less Operating Expenses
Operating Revenue excluding Capital grants & Contributions

This ratio measures Council's achievement of containing operating expenditure within operating revenue. The FFTF benchmark is greater or equal to break even average over three years).

Operating results are negatively impacted by increased depreciation and operating costs from new assets and any service the asset provides.

As existing assets pass the optimal refurbishment/replacement point degradation and ensuing maintenance costs increase substantially, this increases operating expenditure and negatively impacts the operating ratio.

Replacing/refurbishing an existing asset can improve the operating result by making the asset more effective (better fit for purpose) and more efficient by reducing operating and maintenance costs.

Asset Renewal Ratio:-

$$\frac{\text{Asset Renewals}}{\text{Depreciation, Amortisation \& Impairment Expense}}$$

This ratio measures Council's ability to renew assets at a rate equivalent to or greater than the consumption expense of Council's assets each year. FFTF benchmarks require a ratio of 1 or above.

Expenditure on new assets reduces the expenditure on replacement or refurbishment of existing assets.

New assets increase the depreciation expense but do not address the renewal backlog having a negative impact in the ratio. Refurbishments with earlier intervention strategies can prolong the life of an infrastructure asset and therefore reduce the depreciation rate and expense. This provides a positive result to the renewal ratio and operating ratio

Debt Service Ratio:-

From the IPART Fit For the Future Methodology

$$\frac{\text{Cost of Debt Service (interest expense + principal repayments)}}{\text{Total Continuing Operating Revenue (excluding capital grants \& contributions)}}$$

The Debt Service Ratio is a general indication of debt levels and not itself a measure of whether debt is affordable. A ratio of less than 10% is generally considered acceptable. IPART in its Fit for the Future evaluation permits up to 20%.

Roles and Responsibilities

All borrowings will be subject to Council Approval.

Council must identify the source of funds to service the loan before approving any loan borrowings and acknowledge the necessary adjustments to Council's budget.

Related Legislation/Guidelines/Narrandera Policies and Associated Procedures

Council borrowing is subject to the following legal controls;

- The NSW Local Government Act 1993 , particularly Part 12, Chapter 15 and section 410(3) and 410(4) for internal loans.
- The NSW Local Government (General) Regulations 2005
- The NSW Office of Local Government circulars
- The NSW Minister of Local Government orders
- Office of Local Government “Capital Expenditure Guidelines” December 2010
- The Ministerial Borrowing Order (Code of Accounting Practice & Financial Reporting)

Policy History

Endorsed by relevant Committees (name) and date

Adopted by Council 17 January 2017



Signed: Chief Executive Officer

Date: 25 January 2017