

Borrowing and Loans Policy 2024

POL011



Policy No:	POL011
Policy Title:	Borrowing and Loans Policy
Section Responsible:	Finance
Minute No/Ref:	22/132
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1. INTENT

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 several 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.

2. SCOPE

This policy applies to all funds within Council's consolidated reporting entity.

3. OBJECTIVE

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 industry financial benchmarks.

4. POLICY STATEMENT

Council will only use borrowing as a source of funds for works where all 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, water 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;

- The Long Term Financial Plan resourcing the Community Strategic Plan
- The relevant Asset Management Plan or Integrated Water Cycle Management Plan informing the Community Strategic Plan
- Achieving the benchmark Operating Result Ratio
- Achieving the benchmark Asset Renewal Ratio
- Debt service ratios

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

5. PROVISIONS

5.1 DEBT

5.1.1 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.

5.1.2 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 industry benchmarks.

5.1.3 What are Appropriate Sources and Terms of Debt?

The Office of Local Government sets controls for borrowings which may change at any time and Council needs to remain 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 quarterly or 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.

5.2 HOW WILL A PROJECT BE APPROVED FOR FUNDING?

Assessment of a project will incorporate the following mandatory analysis:

- **Council Priorities**
The project outcome must support an objective of Council's Strategic Priorities.
- **Community Expectations**
The project outcome must align to an action adopted under the Community Strategic Plan and Council's Delivery Program.
- **Asset Management**
The expenditure is 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 at or above the industry Asset Renewal Ratio benchmark?
- **Financial Management**
The operating and capital cost of a project must be accurately assessed and included in 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.

- **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.

5.3 LOANS

5.3.1 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.

5.3.2 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.

5.3.3 Loan Terms

In considering loan terms Council will be guided by:

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

5.3.4 Acceptance of Loans

Acceptance of the successful quote will be authorised by the General Manager subject to the borrowing amount being previously approved by Council and adherence to the requirements of the 'Loan Borrowing Policy'.

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.

6. DEFINITIONS

- **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:**

$$\frac{\text{Operating Revenue excluding Capital Grants \& Contributions less Operating Expenses}}{\text{Operating Revenue excluding Capital Grants \& Contributions}}$$

This ratio measures Council's achievement of containing operating expenditure within operating revenue. The industry benchmark is greater than 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. Industry benchmarks require a ratio of one 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 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%.

7. 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.

8. RELATED LEGISLATION

- NSW Local Government Act 1993 - particularly Part 12, Chapter 15 and section 410(3) and 410(4) for internal loans.
- NSW Local Government (General) Regulations 2021

9. RELATED POLICIES AND DOCUMENTS

- Ministerial Borrowing Order (Code of Accounting Practice & Financial Reporting)
- NSW Office of Local Government circulars
- NSW Minister of Local Government orders
- Office of Local Government 'Capital Expenditure Guidelines', December 2010

10. VARIATION

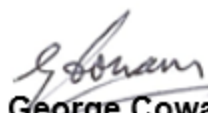
Council reserves the right to review, vary or revoke this policy in accordance with legislation and regulation changes, where applicable. Council may also make changes to this policy and the relevant procedures from time-to-time to improve the effectiveness of its operation.

11. PREVIOUS VERSIONS

Reference to a superseded policy number and/or name is also considered a reference to the new policy number. This policy was previously named:

- CS230 Borrowing/Loans Policy

POLICY HISTORY

Responsible Officer	Finance Manager
Approved by	General Manager
Approval Date	14/03/024
GM Signature <i>(Authorised staff to insert signature)</i>	 George Cowan
Next Review	31 May 2028

Version Number	Endorsed by ELT	Endorsed by Council	Date signed by GM
1 Adopted	-	17/01/2017	17/01/2017
2 Reviewed	3/02/2020	17/03/2020	27/04/2020
3 Reviewed	8/03/2022	17/05/2022	23/05/2022
4 Reviewed	14/03/2024	-	15/03/2024

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