

Policy

Borrowing

Responsible Manager (Title)	Manager Finance & Supply		
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Community Plan Linkage	5 Leadership		
	5.2 We will have an effective and efficient organisation		
	5.2.1 Operates in a financially responsible and sustainable manner		

1 Purpose

To ensure Council has a structured and disciplined approach to borrowing of funds for the purpose of funding new infrastructure and renewal of existing infrastructure as outlined in Council's long-term financial plan.

2 Definitions

Minister	Refers to the NSW Minister for Local Government.
Borrowing(s)	Includes conventional loans, deferred payment arrangements, finance leases and any other forms of raising new capital funds. From 1 July 2019 as per Australian Accounting Standard AASB 16 Leases, operating leases will be recognised as borrowings.
Debt Service Ratio	This is an indicator of the extent to which council's operating revenue is committed to servicing both interest and the repayment of principal on existing borrowings.
Debt Service Cover Ratio	This is an indicator that assesses the impact of principal and interest repayments on borrowings on the discretionary revenue of council.
Finance Lease	Leases of property, plant and equipment where Council, as lessee, has substantially all the risks and rewards of ownership.
Operating Lease	Leases in which a significant portion of the risks and rewards of ownership are not transferred to Council as lessee.

3 Background/legislative requirements

3.1 Local Government Act 1993 – Part 12 – Loans

- *Section 621* - When and for what may a council borrow?

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

- *Section 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.

- *Section 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 any equal footing, despite any other Act.

- *Section 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.

- *Part 3 Delegation of functions, Section 377* - General power of the council to delegate

A council may not delegate to the general manager or any other person or body (not including another employee of the council) the borrowing of money.

3.2 Local Government (General) Regulation 2005

- *Clause 229* – Loan to council to be charged 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.

- *Clause 230* – General Manager to notify borrowings to Director-General

1. Within seven (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 (as per Section 624 of the Local Government Act 1993)

The Ministers Borrowing Order states that a council shall not borrow from any source outside the Commonwealth of Australia nor in any currency other than Australian currency.

4 Policy statement

Council recognises that borrowings for capital works are an important funding source for Local Government and the full cost of infrastructure should not be borne entirely by present-day ratepayers, but be contributed to by future ratepayers who will also benefit. This principle is known as inter-generational equity.

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

Council will ensure the cost of borrowings is sustainable in terms of Council's ability to meet future repayments within budgetary constraints.

5 Issues

The report "Revenue Framework for Local Government" by the Independent Pricing and Regulatory Tribunal states that the financial position of a council is considered to be healthy when financial liabilities, including debt, are at levels where council's activities and the cost of servicing the debt can be met comfortably from its existing annual operating revenue. Ideally, council should be a modest debtor with loans comprising a minority of the total capital invested in its infrastructure and other assets. The report goes on to say that as a general guideline, councils should have a combination of debt and revenue funding for capital purposes and that additional debt may be justifiable if a council is committed to reducing operating expenses or is willing and able to progressively increase its revenue over time.

Clarence Valley Council's various Asset Management Plans indicate that there is a significant shortfall between what Council is currently spending on maintaining and renewing its asset base and what is required. Whilst maintenance is funded through operating revenue, capital expenditure is funded by a combination of grants, loans, cash reserves in addition to an allocation of operating revenue.

To address the significant shortfall between what Council is currently spending on maintaining and renewing its asset base and what is required, Council engaged consultants Ernst & Young in February 2015 to complete a review of Council's current debt management practices to identify potential savings from improved debt management. The review was a 2 stage process.

Firstly the review conducted an evaluation of Council's current debt portfolio and financing strategy. The key findings of this stage of the review process were:

- a. A revised borrowing philosophy be implemented, focussing on a sustainable target debt level which incorporates a transition to interest only ("I/O") debt.
- b. Refinancing where possible immediately after the review to take advantage of favourable market conditions which will drive interest savings.

The next stage of the review involved market testing of the above findings, and evaluation of responses. The key findings of this stage of the review process were:

Partial transition to new borrowing philosophy being a combination of I/O on both fixed and floating rate basis for new debt may provide the following key benefits

- o Asset / liability matching

- Surplus cash
- Flexibility
- Access to other debt sources and structures
- Operational efficiency

Partial refinance of existing debt may achieve interest savings

The review found that Council's current debt levels are high as suggested by the credit metrics/ Key Financial Indicators (KFIs) and market feedback from banks and it was recommended that Council's total debt over the long term to be managed within a sustainable target debt range as determined through revised KFI's used by the Office of Local Government and Moody's credit rating agency.

At the 18 October 2016 Ordinary Council meeting (Item 15.112/16) in response to a report from Ernst and Young (EY) titled 2016 Debt Review Update, Council resolved 'That Council update its Loan Borrowing Policy to reflect the increased Sustainable Debt Level of \$131M.'

At the 27 April 2021 Ordinary Council meeting (Item ??) Council considered an updated review of Council's current debt position by Ernst & Young (titled Debt Review Update 9 March 2021) and resolved 'That Council update its Loan Borrowing Policy to reflect the increased Sustainable Debt Level of \$197M.'

EY's 2021 report stated that the proposed \$92.2M increase in Council's assessed sustainable debt level is explained by Council's reduced debt position through amortisation repayments to \$104M (as at 30 June 2020), whilst improving its earnings through cumulative rate increases of approximately 25% over the last 3 years combined with \$6M annual savings through a cost reduction program.

EY's updated 2021 Debt Review report supports an additional \$24M in borrowings on a consolidated basis to fund infrastructure upgrades to the Clarence Coast Holiday Parks. Based on analysis of the General Fund sustainable debt level by EY (utilising consistent methodology to that employed on a consolidated basis) is at \$101M (as at 30 June 2021), representing an increase of \$35M from the level of 2015/16 and 2016/17. With existing debt of \$15.3M, this suggests the General Fund has additional debt capacity of up to \$86.1M on a standalone basis.

Applying Moody's credit rating methodology EY assess the credit profile of Council to be Aa2 which translates to rated as 'high quality and very low credit risk'. This rating is one notch above the assessment from the 2016 EY Report (Aa3) and is 2 notches below the Commonwealth of Australia and the State of NSW (both triple A rated).

Key principles for Council to keep focus on in relation to Council's capacity to increase borrowing going forward, include:

- Council's sustainable debt levels should be assessed on a regular basis given Council's sustainable debt levels may fluctuate over time due to the interrelationship between financial performance (i.e. revenues, operating result, efficiency) and the ability to service debt obligations (i.e. interest and principal payments).
- Increased sustainable debt levels may be achieved via operational and financing efficiencies and increased revenues over time.
- Debt levels above the sustainable debt range may be justified in the short term to support essential capital works given Council's strong credit profile (Aa2), however it

is suggested that where this is the case a clear plan be implemented to reduce debt levels back to within the target range benchmark.

- Forecast sustainable debt level analysis is subject to the risk of Council achieving its financial forecasts.
- Whilst the General Fund has additional debt capacity on a standalone basis, it is prudent to consider this in the context of Council's consolidated sustainable debt level.

The KFI Council has adopted in its current Financial Planning Policy to measure debt management performance is the Debt Service Ratio (DSR). The DSR measures how much Council is spending servicing debt as a percentage of operating revenue. Up until 30 June 2013 this was the NSW Office of Local Government (OLG) accepted KFI, and the OLG accepted benchmarks for the DSR were as follows:

Less than 10% - satisfactory

Between 10% and 20% - fair

Over 20% - could be of concern

Council has adopted the following DSR benchmarks per the Financial Planning Policy at the 26 June 2018 Ordinary Council Meeting.

General Fund	Less than 12%
Water Fund	Less than or equal to 50%
Sewer Fund	Less than or equal to 50%

Applicable from the 2013/14 financial year the OLG introduced the Debt Service Cover Ratio (DSCR). The DSCR measures the operating results before capital excluding interest and depreciation divided by debt servicing costs. The OLG benchmark for the DSCR is greater than 2, regardless of the fund. Council's Financial Planning Policy has been revised to reflect this new OLG debt management performance KFI.

6 Procedures

- 6.1 All borrowings will be subject to Council approval and should be in accordance with the Revenue Policy within the adopted Operational Plan.
- 6.2 Council will not borrow money to fund operating expenditure. This type of expenditure should be funded through operating revenue.
- 6.3 Before borrowing, a complete analysis of all funding options as outlined in Council's Long Term Financial Plan is required, including a forward program of capital works identified as part of Council's long term management of its infrastructure assets, to determine borrowing requirements.
- 6.4 Where a capital project for a service that is funded by user charges (e.g. Water, Sewer, Domestic Waste) is determined to be funded by way of borrowings, the user charge should reflect the cost of providing the service (including any borrowing repayments).

- 6.5 Other specific capital projects, not funded by user charges, should only be considered for borrowings when all alternate funding sources have been exhausted.
- 6.6 Borrowings for infrastructure that provides a revenue stream to Council will take priority over borrowing for other assets.
- 6.7 The term of any borrowings should not exceed the expected economic life of the asset being funded.
- 6.8 Prior to undertaking any borrowings, Council shall assess its capacity to repay the borrowings by factoring the associated debt service costs into the long term financial plan.
- 6.9 Funds raised for a specific purpose as the result of levying a special rate or charge, are not to be re-allocated to other areas without justification in terms of service provision and compliance with internal loan requirements, which require Council to obtain approval from the Minister of Local Government.
- 6.10 The nature of any borrowings (short or long term) and the interest rate (fixed, variable or a combination of fixed and variable), if applicable, will take into account the purpose of the borrowings and seek to minimise interest rate exposure.
- 6.11 Council's goal for the General Fund Debt Service Ratio is to achieve a financial indicator of less than 12% and for the Water and Sewer Fund an upper limit of 50% for each Fund.
- 6.12 Council maintains a portfolio approach towards debt management and targets a long term sustainable debt range of \$197,000,000.
- 6.13 Council transitions its loan portfolio from principal and interest repayment loans to interest only loans over time.

7 Overdraft Facilities

Council has an overdraft facility with the Commonwealth Bank. The overdraft facility is to be utilised for short term, unavoidable and essential cash flow requirements only. Use of the overdraft facility is to be minimised by employing careful cash management practices that ensure sufficient cash at bank to satisfy daily expenditure requirements.

8 Determination of appropriate lending institution

- 8.1 Once a borrowing has been approved by Council, an "Expression of Interest" (EOI) process will be conducted whereby appropriate lending institutions (Authorised Deposit Taking Institutions for loan borrowings) will be invited to submit written quotations on Council's borrowing requirements.
- 8.2 Written quotations for loan borrowings must include the:
 - Interest rate and whether the rate is fixed, variable, or a combination of fixed and variable
 - Term of the loan
 - Repayment intervals (monthly, quarterly, etc.)

- Interest only repayment instalment amount
 - Any applicable fees.
- 8.3 A minimum of three (3) written quotations will be obtained for Council's approved loan borrowing from Authorised Deposit Taking Institutions.
- 8.4 Appropriate and acceptable documentation must be provided to Council by any prospective lender during the EOI process.
- 8.5 The calculation process for any loan break costs must be clearly set out in the loan documentation.
- 8.6 The General Manager has authority to accept loan offers, subject to the loan borrowing amount being previously approved by Council and the requirements of the "Borrowing Policy" being adhered to.