Policy

Borrowing

Responsible Manager (Title)	Manager Finance & Supply		
Adopted by Council	15 December 2020		Minute Number 6c.20.187
File Reference Number	ECM_2188363_v1_Borrowing Policy December 2020	Version 7.0	Review Due Jul-21
Document(s) this policy Supersedes	V6.0 – 23/07/2019 – 6c.19.026		
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

- 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.' EY's report stated that the proposed $21M increase in Council's assessed sustainable debt level is explained by Council's improved financial performance over the period since EY's debt review in 2015, including increased revenues and Council efficiency improvements (e.g. operating cost reductions and reduced interest costs).

EY's updated 2016 Debt Review report supports an additional $5M in General Fund borrowings to address the backlog based on analysis of the General Fund sustainable debt level by EY (utilising consistent methodology to that employed on a consolidated basis) which suggests the General Fund on a standalone basis has additional debt capacity of up to approximately $40M (for 2015/16 and 2016/17). However EY highlighted a number of financial considerations in relation to Council's capacity to increase borrowing going forward, including:

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.

g. 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 (Aa3), 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.

h. Forecast sustainable debt level analysis is subject to the risk of Council achieving its financial forecasts.

i. 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 that 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 $131,000,000.

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.

Clarence Valley Council

Debt review update

9th March 2021

Building a better working world

Disclaimer

Ernst & Young Ernst ("we" or "EY") was engaged on the instructions of Clarence Valley Council's ("CVC", "you" or the "Council")" to review the Council's debt position and how it has changed since our report dated August 2016 (the "2016 Report"), together with consideration of the Council's sustainable debt capacity in relation to the Council on a consolidated basis and Clarence Coast Holiday Parks ("CCHP") on a standalone basis, in accordance with the engagement agreement dated 16 November 2020

The results of EY's work, including the assumptions and qualifications made in preparing the report, are set out in EY's report dated [17] December 2020 (the "Report"). The Report should be read in its entirety including the transmittal letter, the applicable scope of the work and any limitations. A reference to the Report includes any part of the Report. No further work has been undertaken by EY since the date of the Report to update it.

EY has prepared the Report for the benefit of Council and has considered only the interests of Council. EY has not been engaged to act, and has not acted, as advisor to any other party. Accordingly, EY makes no representations as to the appropriateness, accuracy or completeness of the Report for any other party's purposes.

No reliance may be placed upon the Report or any of its contents by any recipient of the Report for any purpose and any party receiving a copy of the Report must make and rely on their own enquiries in relation to the issues to which the Report relates, the contents of the Report and all matters arising from or relating to or in any way connected with the Report or its contents.

EY disclaims all responsibility to any other party for any loss or liability that the other party may suffer or incur arising from or relating to or in any way connected with the contents of the Report, the provision of the Report to the other party or the reliance upon the Report by the other party.

No claim or demand or any actions or proceedings may be brought against EY arising from or connected with the contents of the Report or the provision of the Report to any party. EY will be released and forever discharged from any such claims, demands, actions or proceedings.

This Report and its contents may not be quoted, referred to or shown to any other parties except as provided in the Engagement Agreement The material contained in the Report, including the EY logo, is copyright and copyright in the Report itself vests in EY. The Report, including the EY logo, cannot be altered without prior written permission from EY.

EY's liability is limited by a scheme approved under Professional Standards Legislation.

Executive summary

Introduction

Introduction

- As per our Engagement Agreement dated 16 November 2020, EY has been engaged to review the sustainable debt funding capacity of Clarence Valley Council ("CVC", "you" or the "Council") and Clarence Coast Holiday Parks ("CCHP"), and consider the risks of either of these entities independently debt funding proposed capital expenditure totalling $24m.

Background

- EY were previously engaged in August 2016 to undertake a review of CVC's debt position and assessment of Council's capacity to increase borrowings. Our findings (amongst others) detailed a forecast sustainable debt level (as at Jun '17) of $131m providing debt funding headroom of $8m to its forecast sustainable debt level.
- In the time since the August 2016 report was completed, CVC has reduced its debt position through amortisation repayments to $104m, whilst improving its earnings through cumulative rate increases of approximately 25% over the last three years combined with $6m annual savings through a cost reduction program.
- In 2020, we understand that CVC is seeking to borrow approximately $24m to fund the refurbishment and redesign of CCHP under the Draft Strategic Plan 2020-2030. Importantly, CCHP operates as a separate business activity of the Council, with the objective that CCHP remains financially independent.
- CVC is now seeking EY to conduct a review of its debt position and how it has changed since the 2016 report, together with consideration of the proposed $24m capital expenditure and its impact on the sustainable debt capacity of:
  - the Council on a consolidated basis; and
  - CCHP on a standalone basis.

Scope of work

- To undertake this debt review and assessment of the Council's and CCHP's funding capacity (as outlined in the introduction above) we have reviewed:
  - CVC's debt position and how it has changed since the 2016 Report
  - Budget, strategy, long-term financial plan and up-coming borrowing needs
  - Capacity in the General Fund to increase borrowings
  - Capacity in CCHP to borrow on a standalone basis
  - Sustainable debt level changes (if any)

Key findings

Council has sufficient additional capacity to borrow $24m, however CCHP will exceed its sustainable debt range

CVC debt capacity

- Due predominantly to improved financial performance, Council's sustainable debt level has increased by $67m to $197m as at 30-Jun-21, (from the $130m debt level as at 30-Jun-16).
- Council's current debt level of $104.1m sees it compliant with the 'Conservative risk' debt range calculated under the same methodology as the 2016 Report (at which time Council was compliant with the 'Moderate risk' debt range).
- Council therefore has additional borrowing headroom of $92.9m which is greater than the proposed additional borrowing amount of $24m to fund the refurbishment and redesign of CCHP. We further note Council never exceeds the 'Conservative risk' debt range under its forecast figures, indicating it could undertake further borrowings if required (above the proposed additional $24m) while remaining below its sustainable debt level.

CCHP debt capacity

- We assess CCHP's sustainable debt level at $10.9m based on Moody's credit rating methodology for Consumer Service businesses at a target 'Baa' level.
- CCHP's current debt level of nil indicates there is additional borrowing headroom of $10.9m, which is less than the proposed additional borrowing amount of $24m.
- Applying Moody's credit rating methodology, the forecast desktop credit profile for CCHP with the additional borrowing of $24m is a 'B1' rating, which translates (by Moody's) to rated as 'speculative and high credit risk'.
- Forecast debt amounts for CCHP with the additional borrowing of $24m remain above a sustainable level throughout the forecast period, equivalent to a 'high risk' debt range and reflecting an increased probability of loan default. We note bank debt would likely be unavailable particularly given the absence of material assets as collateral combined with long-term leveraged profile for a consumer services business, and alternative sources of debt that could lend this amount would do so at much higher (and uneconomic) pricing levels.

Conclusion

- Whilst CVC is forecast to have more than sufficient headroom to borrow an additional $24m and maintain a sustainable level of debt, we view the same additional borrowing amount for CCHP as representative of a 'high risk' debt amount.
- Should Council elect to continue viewing CCHP as financially independent, it may wish to consider whether the proposed capital expenditure amount of $24m is appropriate in view of the extended repayment profile, high level of debt leverage for a business of its kind, and risk of independently raising the debt amount, again noting that Council has sufficient headroom for the additional borrowing.

	2016 sustainable debt level	2021F sustainable debt level	Additional sustainable debt capacity	$24m additional borrowing within a sustainable debt level
CVC	$131m	$197m	$92.9m	✓
CCHP	n/a	$10.9m	$10.9m	✗

Policy

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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.

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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:

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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 $92.2~~1~~M 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 throught a cost reduction program.~~improved financial performance over the period since EY's debt review in 2015, including increased revenues and Council efficiency improvements (e.g. operating cost reductions and reduced interest costs).~~

EY's updated 2021~~16~~ Debt Review report supports an additional $24~~5~~M in ~~General Fund~~ borrowings on a consolidated basis to fund infrastructure upgrades to the Clarence Coast Holiday Parks. ~~address the backlog~~ B~~b~~ased on analysis of the General Fund sustainable debt level by EY (utilising consistent methodology to that employed on a consolidated basis) ~~which~~ 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.~~suggests the General Fund on a standalone basis has additional debt capacity of up to approximately $40M (for 2015/16 and 2016/17)~~.

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 ~~However EY highlighted a number of financial considerations~~ in relation to Council's capacity to increase borrowing going forward, includ~~ing~~e:

- 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).
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- 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.