



# **Borrowings and Asset Financing (debt) Policy**

<b>Date policy was adopted by Council:</b>	25 February 2009
<b>Resolution number:</b>	061/09
<b>Previous Policy review date:</b>	August 2013
<b>Next Policy review date:</b>	March 2016
<b>Reference number:</b>	C095493

## **1. OBJECTIVES**

Whilst the preferred position of the Queanbeyan City Council is to remain debt free, should that not be practicable, this Policy aims to set out the circumstances in which the Council may consider Borrowings or Other Financial Accommodation to fund the acquisition, renewal or construction of specified assets and to provide guidance as to the appropriate terms of any such borrowing.

This Policy provides for responsible financial management on the loan funding of infrastructure capital projects by ensuring the level of Council indebtedness is within acceptable limits to Council, its ratepayers and interested external parties. This Policy is in accordance with Section 8 of the Local Government Finance standard 2005 as amended.

However, as a general principle, Council recognises that loan borrowings for capital works are an important funding source for Local Government and that 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. Whilst recognising the importance of loan borrowings, Council shouldn't place undue reliance upon loans as a source of income.

Council will restrict all borrowings to expenditure on identified capital projects that are considered by Council to be of the highest priority, and which cannot be funded from revenue, as identified by the adopted budget. In no circumstances should Council borrow funds for recurrent expenditure.

The basis for determination of the utilisation of loan funds will be as follows:

- (a). Where a capital project for a service that is funded by utility or user charges e.g. water, sewer, waste, is determined to be funded by way of loans, the user charge should reflect the cost of providing the service including the loan servicing.
- (b). Other specific capital projects, not funded by user charges, should only be considered for loan funding where the project is considered by Council to be beneficial to the majority of ratepayers, and
- (c). The term of any loan should not exceed the expected life of the asset being funded.

## **2. PRINCIPLES**

Borrowing will be considered as an appropriate funding source in the following circumstances:

- (a). In the context of the strategic objectives of Council.
- (b). In the context of long term financial forecasts and objectives.
- (c). As an alternative funding source for asset additions.
- (d). As a method of spreading the cost of long life (intergenerational) assets, and
- (e). As a mechanism to fund temporary cash shortfalls.

Council has responsibility for approximately \$671m of non-current assets. The use of borrowings is an important funding source and is a useful mechanism for allocating the costs of asset replacement or creation over a time frame that reflects when residents will benefit from the assets.

Short term borrowings can be a useful mechanism to meet short term cash needs. Short term borrowing may be used to sustain the cash flows of Council having regard to anticipated receipts and expenditures and the annual cash flow budget. For this purpose, Council may operate an overdraft on its bank account and/or a cash advance facility from a financial institution. However this mechanism is rarely used by Council.

Council's management of borrowing will focus on the net debt situation and consequently sound cash management practises will dictate that Council will not borrow at higher interest rates when

significant funds are invested at lower interest rates. When surplus funds exist, Council will consider applying these against planned borrowings subject to consideration of maintaining adequate funds for day-to-day management and emergency situations.

Management shall not speculate on interest rate movements.

As a guide, borrowing levels are to be within the parameters of a debt servicing ratio (rates) of less than 10% and subject to meeting repayment obligations.

All borrowings will be subject to Council approval on the recommendation of the Director of Corporate Services. The nature of any borrowings (short or long term) and the interest rate (fixed or variable) will take into account the purpose of the borrowings and seek to minimise interest rate exposure. All borrowings will be considered in line with Council's Forward Financial Estimates. As a guide, however, the following borrowing terms shall be applied:

<b>Borrowings Amount</b>	<b>Term</b>
Less than \$500,000	1-5 years
\$500,000-\$1,000,000	10 years
Greater than \$1,000,000	15 years

To ensure Council continues to receive competitive rates for borrowing, quotations from not less than three (3) financial institutions will be sought on borrowings greater than \$1,000,000.

### **3. GOVERNING LEGISLATION**

#### **3.1 Part 12 Loans *Local Government Act 1993***

- 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.

#### **3.2 Local Government (General) Regulation 2005**

- Section 229      Loans 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.
- Section 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 (from Section 624)**

Council may borrow at any time for any purpose allowed under the *Local Government Act 1993*. Prior to 2007/2008, Ministerial approval was required for any proposed borrowings. This is no longer necessary if borrowings are part of the Management Plan; however the Minister may impose limitations or restrictions on borrowings.

Council is required to complete the Department of Local Government's "requested borrowing" return detailing the projects to be funded by any borrowings.

If borrowings are not in the Management Plan, Council must resolve to borrow funds and submit "requested borrowing" to the Department of Local Government.

A council shall not:

- (a). Borrow at an interest rate in excess of the indicative interest rate as calculated by the New south Wales Treasury Corporation.
- (b). Borrow for a period of less than thirty (30) days nor for a period in excess of the estimated life of the asset for which the borrowing is made.
- (c). Borrow from any source outside the Commonwealth of Australia nor in any currency other than Australian currency.
- (d). Pay a placement fee exceeding 0.25% of the total amount being borrowed, or
- (e). Pay a documentation fee, or any other fee associated with a borrowing, exceeding 0.1% of the total amount being borrowed.

### **3.4 Authority to Authorise Loans and Borrowings**

The authority to authorise loans and/or Council funding requirements is vested with Council by virtue of the *Local Government Act*. No officer of Council is authorised to undertake the establishment of a new loan facility without the authorisation of Council obtained following the conduct of an ordinary or special meeting of Council to discuss the proposed borrowing.

**4. DEFINITIONS**

The following items which are used in the financial/prudential ratios and policy are defined below.

<b>ITEM</b>	<b>DEFINITION</b>
Current Assets	Total current assets disclosed in the Statement of Financial Position.
Current Liabilities	Total current liabilities disclosed in the Statement of Financial Position.
Debt Servicing Costs	Interest and charges on loans, overdrafts, financial leases and interest on payments for capital items purchased on vendors' terms.
Economic Life	The estimated period during which the asset is expected to be economically usable by one or more users, with normal repairs and maintenance. Includes the concept of fit for use e.g. a building may suit a particular use, but when that use is no longer required it may not be suitable for another use. A recreation or aquatic centre is an example of a specific use. It should be noted that the economic life of an asset may be considerably less than the physical life of that asset.
Excluded Borrowings	Includes money, credit or other financial accommodation obtained in the ordinary course of the Council performing its function such as: (a) An operating lease for plant and motor vehicle assets and office or information technology; (b) A credit or purchase card facility; (c) A short-term bank loan/overdraft required to balance daily cash flow requirements or as a result of a set-off arrangement; or (d) A hire purchase agreement.
External Borrowings	Includes raising and obtaining, in any way, money, credit and other financial accommodations from sources external to the Council.
Internal Borrowings	Means the use of internal funds set aside for projects or future liabilities that are not expected to be expended or crystallised in the current financial year, to temporarily fund projects not previously budgeted, as an alternative to external borrowing.

ITEM	DEFINITION
Net Debt	Total (gross) debt less cash assets.
Other Financial Accommodation	Includes: (a) Finance leases primarily to raise amounts to buy, or to finance the purchase of, property the subject of the leases; (b) Guarantees, letters of credit and any other form of undertaking, provided by a financial institution or other person to meet the liabilities or obligations of the Council; and (c) Structured property finance, including sale and lease back and asset swaps for longer dated funding associated with potential developments of Council-owned real property.
Rate and Charge Revenue	Includes: (a) All rates declared under Sections 494 and 495 of the <i>Local Government Act 1993</i> ; (b) All annual charges declared under Sections 496, 496A, 501 or 502 of the Act; and (c) All accrued interest charged under Section 566 of the Act.
Self Supporting Loans	Loans taken out by Council, the repayments of which are made by a third party, e.g. club, organisation or ratepayers through a Special Areas Rate/Service Charge.
Total (Gross)Debt	Include all loans/borrowings, overdrafts, financial leases and the outstanding amount owing for capital items purchased on vendors' terms.
Total Liabilities	Include all financial and non-financial liabilities (both current and non-current) as shown in the Balance Sheet/Statement of Financial Position.
Total Realisable Assets	Includes all assets which can be sold within a reasonable period of time, but excludes infrastructure assets such as drainage, roads, parks and gardens, land and buildings on Crown Land, etc.
Total Revenue	Total Operating Revenues plus any financing transactions including proceeds from loans, asset sales and transfers from reserves/accumulated surplus.

## 5. POLICY STATEMENT

Whilst the preferred position of Council is to remain Debt Free (except for Self Supporting Loans), Council recognises that in order to ensure intergenerational equity in funding the acquisition, renewal or construction of assets, it may need to resort to the prudent use of loan borrowings, debt instruments or allow finance or capital raising methodologies from time to time.

In considering the need for new loans, the following criteria will be analysed:

- (a). Loans will only be used as a last resort to finance expenditure.
- (b). Any proposed borrowing amounts must be contained in the Management Plan, unless the need for borrowings becomes a matter of urgency.
- (c). Current and estimated future revenues.
- (d). Strategic planning for the future of Council covering short, medium and long term.
- (e). Intergenerational equity considerations in terms of the ratepayers who benefit from the expenditure and therefore on a user pay basis, who should pay for the costs associated with such expenditure.
- (f). Current and future funding needs for both operating and capital expenditures.
- (g). Ensure, where possible, that the structure of the borrowing is appropriate for the nature of the assets being funded, and
- (h). Any other strategic imperative that is linked to revenue and expenditure capacities.

The following principles are to be applied when considering undertaking borrowings or other asset financing.

### 5.1 Operating Expenditure

Council will **not** borrow money (other than by way of Excluded Borrowings) to fund operating expenditure. This type of expenditure should be funded through operating revenue streams such as rates, fees and charges or operating grants.

### 5.2 Recurrent Capital Expenditure

Council will **not** borrow money or obtain debt finance (other than by way of Excluded Borrowings) to fund the acquisition, replacement or renewal of assets that is expected to occur on an annual or similar basis at approximately the same level each year, i.e. recurrent capital works. Examples of this type of expenditure are road resurfacing, plant replacement, information technology and office equipment acquisitions and replacement. This type of expenditure shall be funded through operating revenue streams such as rates and fees and charges.

### 5.3 Borrowing Term

The term of the Borrowing or Other Financial Accommodation shall be set having due regard to the economic life of the asset being acquired or constructed.

Council aims to use the economic life of the asset to set sufficient funds aside in a sinking or reserve fund in order to renew or replace that asset, should that be required, at the end of its economic life.

Council will **not** generally borrow funds to acquire an asset that has an economic life of less than ten (10) years.

#### 5.4 Borrowing Ratios

Prior to undertaking any borrowing, Council shall assess its capacity to pay, to ensure that the community is not burdened with unnecessary risk. Council shall then reassess its capacity to pay on an annual basis as part of its budgeting process. When assessing the borrowing ratios, consideration will be given to the economic earnings potential of the asset being acquired or constructed.

Area	Financial Indicator
Liquidity	Unrestricted Current Assets to Current Liabilities
Debt Exposure	Total Liabilities to Total Realisable Assets
Debt Management	Total Debt as a % of Revenue
Debt Management	Debt Servicing Costs as a % of Total Revenue

##### ***Liquidity: Unrestricted Current Assets to Current Liabilities***

This indicator reflects on Council's short-term liquidity position, i.e. its ability to repay current commitments from cash or near cash assets. If Council has a ration of 1:1 and below or with a deteriorating trend, it may be financially at risk of not being able to meet creditors' commitments.

##### ***Debt Exposure: Total Liabilities to Total Realisable Assets***

This indicator reflects the ability of Council to acquit existing liabilities with the proceeds from the disposal of its realisable assets. Ideally, total liabilities should be significantly less than 100% of total realisable assets.

##### ***Debt Management: Total Debt as a % of Revenue***

The *Local Government Act 1993* requires that all loans are secured against the revenue stream of Council. A Council with total debt in excess of its total revenue would be unable to meet all debt commitments from revenue should they be required to be repaid at the one time.

##### ***Debt Management: Debts servicing costs as a % of Total Revenue***

This indicator reflects the proportion of total revenue that is used to service debt (interest on outstanding debt and any loan administration charges) and which cannot be used directly for service delivery.

#### 5.5 Circumstances for Which Long Term Borrowing/Financing will be considered

Council will give favourable consideration to borrowing money for the acquisition or construction of an asset where:

- The asset to be acquired is a new addition to Council's asset base or replaces an existing asset with one that is significantly upgraded and has an economic life of greater than 10 years; or
- All alternative options for undertaking the project without borrowing have been investigated and proven less advantageous to Council; or
- The income stream from the assets to be acquired or constructed exceeds the cost of borrowing over the life of that asset; or
- Repayments will be met by a third party, e.g. self-supporting loans and the financial stability of that party meets Council's criteria; or
- The index of the cost of acquisition or construction is increasing at a rate that exceeds the cost of borrowing i.e. to "save" for the acquisition or construction will result in the actual cost being greater than the cost of borrowing the money and acquiring it today.

As a general rule, the benefits received from undertaking the borrowing should be greater, over the life of the borrowing, than the costs of borrowing.

## **5.6 Internal Borrowings**

### ***Externally Restricted Funds***

Internal loans from externally restricted funds do not need to be included in the Department of Local Government's "requested borrowing" return. Internal loans from externally restricted funds must have Ministerial approval before the internal loan can be drawn. Section 410(3) states:

*"Money that is not yet required for the purpose for which it was received may be lent (by way of internal loan) for use by the Council for any other purpose if, and only if, its use for that other purpose is approved by the Minister."*

### ***Internally Restricted Funds***

The use of internally restricted funds is not considered to be an internal loan by the Department of Local Government.

Where the cost of using external funds acquired through borrowing is greater than the forgone investment earnings on funds that are surplus to current requirements, e.g. carried forward works, such funds should be used prior to seeking external funds. It should be noted that the *Local Government Act* places restrictions on the use of funds held in Reserve accounts, i.e. Domestic Waste.

Where use of such funds is made notional, internal journal entries shall be made reflecting the value of forgone investment earnings as a cost to the program for which the funds were borrowed and crediting the relevant investment earnings budget account for the fund/reserve account from which the funds were "borrowed".

Under no circumstances shall funds be "borrowed" from the Trust Fund or Trust Accounts.

## **5.7 Statutory Limitations**

Any borrowings will be conducted in accordance with relevant statutory requirements as contained in the *Local Government Act 1993* and the *Local Government (General) Regulations 2005*.

### **5.8 Other Limitations**

Borrowings shall be undertaken in Australia and be in Australian dollars so as to ensure the council is not exposed to foreign currency risks.

Local Government Loan Application Guidelines published by the Minister for Local Government, the Department of Local Government and the Department of Commerce from time to time.

### **5.9 Determining the Appropriate Lending Institution**

Where practicable, three written quotations shall be obtained or a loan tender called in order to determine the appropriate lending institution for any loan borrowings. Determination of the appropriate institution will be based on the interest rate and loan costs offered, the terms and conditions of the loan and the financial stability of the lender.

### **5.10 Security for Borrowings**

In accordance with Section 623 of the *Local Government Act 1993*, the only security that will be offered in return for the borrowings shall be the general funds of Council.

### **5.11 Interest Rate Parameters**

Should any borrowings be undertaken, Council will obtain independent advice in regards to determining the period for which the interest rate should be fixed. The factors that will be taken into account when deciding an appropriate fixed term period shall include:

1. The level of the interest rate when compared to the long term average official interest rate;
2. Recent movements in the official interest rate, and
3. The term of the loan.

### **5.12 Structure of Borrowings**

Council will obtain independent advice in regards to determining the most appropriate structure of any borrowings with regard to:

1. Fixed or floating rate,
2. CPI – Linked rate, or
3. Interest Capitalised, Interest Only or Principal and Interest.

Where possible, the nature of cash flows related to the funded asset will be used as a guide to the most appropriate borrowings structure. For example, interest capitalised may be appropriate for capital expenditure related to a land release with full principal repayment from land sales.

**6. OVERDRAFT**

Council has an overdraft facility established with the Westpac Bank.

The overdraft facility is only used for short term unavoidable and essential cash flow purposes.

Financial operations staff will generally avoid the use of the overdraft facility via careful cash management practices that ensure sufficient funds are available to fund daily expenditure requirement.

The use of an overdraft facility will normally occur when the cost of surplus funds held in interest bearing deposits, for which the transfer to cash will incur a significant penalty is largely not cost effective.

If council remains in overdraft for more than seven (7) days, the General Manager is to be advised. If this extends beyond fourteen (14) days, the Mayor is to be notified.

At no time is the overdraft facility to be used as an ongoing debt facility or to fund anything except short-term cash flow.

APPENDIX 1

As debt decisions have a long term impact on Council's ongoing financial position consideration of the level of debt and its impact needs to be assessed as follows. A prudent assessment of capacity to service debt and progress thresholds over time is as follows:

**STAGED ASSESSMENT FRAMEWORK**

**Liquidity: *Current Assets to Current Liabilities***

Current Assets to Current Liabilities	Improve to:	Period for Achievement
0.6:1	Proposed New Borrowing Rejected	
>0.6:1, to 1.1:1	> 1.1:1	5 Years

**Debt Exposure: *Total Liabilities to total Realisable Assets***

Total Liabilities to Total Realisable Assets	Target	Period for Achievement
150%	Proposed New Borrowing Rejected	
100%, < 150%	100%	5 Years
80%, < 100%	80%	5 Years
50%, < 80%	Review Debt Strategy	Not applicable

**Debt Management: *Total Debt as a % of Revenue***

Total Debt as a % of Revenue	Target	Period for Achievement
> 100%	Proposed New Borrowing Rejected	
85%, < 100%	85%	5 Years
66%, < 85%	66%	5 Years
66%, < 50%	50%	5 Years
40%, < 50%	Review Debt Strategy	Not applicable

**Debt Management: *Debts Servicing Costs as a % of Total Revenue***

Debts Servicing Costs as % of Total Revenue	Reduce to:	Period for Achievement
10%	Proposed New Borrowing Rejected	
5%, < 10%	5%	5 Years

It should be noted that proposed borrowings will be assessed against Council's overall operating and financial position.

**In Summary**

Council will **not** borrow funds when such borrowing would result in any of the following financial ratios being exceeded:

1. Current Assets to Current Liabilities <60%,
2. Total Liabilities to total Realisable Assets >150%,
3. Total Debt as a percentage of revenue >100%, and
4. Debt Service Ratio >10%.

POLICY:-	
<b>Policy No:</b>	
<b>Policy Title:</b>	Borrowings and Asset Financing (Debt)
<b>Date Policy was adopted by Council:</b>	25 February 2009
<b>Resolution Number:</b>	061/09
<b>Previous Policy Review Date:</b>	August 2013
<b>Next Policy Review Date:</b>	March 2016
PROCEDURES/GUIDELINES:-	
<b>Date Procedure/Guideline (if any) was developed:</b>	Nil
RECORDS:-	
<b>Container Reference in TRIM: Policy</b>	SF080616
<b>Container Reference in TRIM: Procedure</b>	Nil
<b>Other locations of Policy:</b>	Intranet (linked to TRIM Container)
<b>Other locations of Procedures/Guidelines:</b>	Nil
DELEGATION (if any):-	
RESPONSIBILITY:-	
<b>Draft Policy developed by:</b>	General Manager
<b>Committees (if any) consulted in the development of the Draft Policy:</b>	Nil
<b>Responsibility for Implementation:</b>	Group Manager – Corporate Strategy and Finance
<b>Responsibility for Review of Policy:</b>	Group Manager – Corporate Strategy and Finance

INTEGRATED PLANNING FRAMEWORK:	
<b>Community Strategic Plan:</b>	Strategic Priority No.
<b>Delivery Program Title:</b>	
<b>Operational Plan:</b>	Program No. N/A

<b>Senior Authorising Officer</b>	<b>Position</b> General Manager	<b>Signature/Date</b>  10 March 2009
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ACTION	COUNCIL MEETING DATE	RESOLUTION NUMBER	REPORT ITEM NUMBER
<b>NEW/RECONFIRMED/AMENDED</b>			
New	25 February 2009	061/09	Item 16

DATE REVIEWED	REVIEWER POSITION	REVIEWER NAME
August 2013	Group Manager – Corporate Strategy and Finance	Kerry McMurray