# 16.8 Borrowing Policy

## COUNCIL POLICY

### PURPOSE

Borrowing funds is a legitimate and responsible financial management tool when used to finance major projects, as it spreads the payments for such assets across the generations or rate payers who benefit. The purpose of this Borrowing Policy is to:

- Establish objectives and principles that outline when it is appropriate for Council to undertake borrowings within a sound financial management framework;
- Ensure Council keeps within the relevant prudential requirements provided by State Government; and
- Set out the manner in which Council may establish and manage a debt portfolio.

### SCOPE

This policy applies to all interest bearing funding arrangements entered into by Council. It does not include lease liabilities.

Short term, non-interest bearing, debt such as creditors and corporate credit card programs are excluded from this policy.

### DEFINITIONS

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|---|---|
| Act | *Local Government Act 1989* |
| Borrowing/Loan | A contract entered into with the promise to repay a principal amount plus any applicable interest |
| LGPRF | Local Government Performance Reporting Framework |
| SRP | Strategic Resource Plan |

### REFERENCES

*Local Government Act 1989*

Local Government (Planning and Reporting) Regulations 2014

Local Government Performance Reporting Framework

## GUIDELINES/POLICY DETAILS

**Legislative Framework**

The *Local Government Act 1989* (the Act) provides Councils the power to borrow. Section 144(1) of the Act states 'Subject to the principles of sound financial management, a Council may borrow money to enable the Council to perform the functions and exercise the power conferred on the Council under this Act or any other Act.'

Sections 145 to 150 of the Act further specify the circumstances in which the power to borrow may be exercised, securities to be used for local government borrowings, and how the borrowings should be disclosed, etc. Council must approve all borrowings and Section 98(1)(c) stipulates that Council not delegate the power to borrow money.

The Victorian Government established the Local Government Performance Reporting Framework (LGPRF) in 2014. It outlines the measures Council must report in its performance report, which forms part of Council's Annual Report. Certain indicators must also be included in Council's Annual Budget and Strategic Resource Plan (SRP). This framework includes financial performance of a Council, and specific to this policy, includes measures in relation to Council's obligations (to determine whether debt and other long term obligations are appropriate to the size and nature of Council's activities).

**Policy Objectives**

- To provide an alternative financing option for:
    - Capital works projects that are of strategic significance (that could not otherwise be financed from ongoing income sources and provide benefit across generations); or to
    - Meet Council's obligations in relation to future defined benefit superannuation calls, if required;
- To ensure the total amount of loan borrowings is sustainable in terms of ability to meet future repayments, budgetary constraints and prudential ratios;
- Manage any new borrowings in the context of optimising cash flow; and
- Develop and maintain a borrowing structure that achieves a balance between predictability and flexibility and aims to minimise borrowing costs.

**Borrowing Principles**

The following principles have been set to ensure Council has a structured and disciplined approach to borrowing of funds that fit with a longer term financially sustainable framework.

- Borrowings are only to be used to finance items described in the policy objectives and must be supported by a robust business case;
- Borrowings must be tied to a specifically identified project and not be drawn down until the commencement of the project;
- Council will not borrow to fund operating expenditure (other than large defined benefit superannuation calls);

- All borrowings will be considered as part of Council's long term financial planning using sound financial management principles (and fall within the borrowing ratios outlined in this policy); and
- The nature of any borrowings (short or long term) and the interest rate (fixed or variable) will take into account the purpose of the loan and seek to balance interest rate exposure with refinancing flexibility.

Council's position on borrowings is supported by the following resolution from 25 June 2014

*That Council:*

a. *Resolves that, apart from debt approved in budgets before this resolution was adopted, Council does not agree to any further increase in debt, unless supported by a robust and feasible business plan with a demonstrated significant economic, environmental and/or social benefit.*
b. *Instructs that the Chief Executive is to ensure that no contract or other proposal is considered where it is dependent on Council borrowing more funds, unless in exceptional circumstances including, but not limited to, liquidity issues, special charge schemes or natural disasters.*
c. *Directs that this instruction is to continue until such time as this resolution is expressly rescinded by a subsequent resolution.*

**Borrowings Ratios & Limits**

Borrowings should not be undertaken if the effect of such borrowings is projected to result in borrowing ratios greater than Council's maximum levels indicated in the table below. Council may resolve to exceed these targets in order to meet specific funding requirements, e.g. refinancing, major projects, etc.

In addition, the LGPRF borrowing ratios will be projected in Council's Strategic Resource Plan and Annual Budget and reported in Council's Annual Performance Statement.

| LGPRF Measure | Council's Maximum Ratio | Recommended Targets |
|---|---|---|
| **Loans and Borrowings Repayment Ratio**<br><br>Interest and principal repayments on interest bearing loans and borrowings / rate revenue | 5% | LGPRF 0% to 5%* |
| **Loans and Borrowings Ratio^**<br><br>Interest bearing loans and borrowings / rate revenue | 20%^ | LGPRF 20% to 60% * |
| **Indebtedness Ratio**<br><br>Non-current liabilities / Own Source Revenue | 40% | LGPRF 10% to 40%*<br><br>VAGO <60%<br>(low to medium risk) |

*Local Government Victoria no longer provide indicative targets in their guidance. These target bands were last published in the 2016/17 Indicator Workbook.

^Council will accept a maximum Loans and Borrowings Ratio of 30%, only where the additional loans and borrowing are utilised to fund any unplanned expenditure such as natural disaster or Defined Benefit Superannuation calls. Council will then implement a plan to bring the ratio down to the lower limit (20%) as soon as practicable.

**Borrowing Arrangements**

When entering into borrowing arrangements, Council will seek to minimise interest costs over the long term without introducing undue volatility in annual interest costs. Council's borrowings will be appropriately structured to constrain risk and will be consistent with the following parameters:

- Council will consider the appropriateness of the various types of debt products available (including savings offset arrangements);
- The term of a loan will typically be 10 years, but no greater than the expected useful life of the asset being funded by the loan;
- Council intends to maintain a repayment schedule consistent with "principal and interest" repayment calculations. In the case of interest only borrowings, this will require an investment reserve to be established to hold funds equivalent to principal repayments;
- Loan repayments will be made in a regular schedule, such as quarterly, bi-annually or otherwise determined at the time of entering the loan agreement. Consideration should be given to efficiency of payment while minimising interest costs.
- Where a budgeted loan is delayed for any reason, the initial loan amount will be reduced by an amount equal to any budgeted principle repayments during that same budget year.

## RELATED DOCUMENTS

Nil

## FILE MANAGEMENT

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| Policy owner | Finance | Division | Corporate Services |
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