FM 10 – Assets Financing and Borrowings

1 Objectives

The purpose of this policy is to affirm that the preferred position of Council is to remain debt free (except for self supporting loans). However, should this not be practicable, then to:

- establish the framework within which Council may consider Borrowings or Other Financial Accommodation(s) to fund the acquisition, renewal or construction of specified assets;
- provide guidance as to the appropriate terms of any borrowings funded assets thus identified; and
- ensure that an organisation wide and inclusive approach is taken to the capitalisation of physical assets (e.g. facilities) in the district that are to be borrowings funded.

2 Scope

This Policy relates to forms of financing which create a liability for future repayment and not for recurrent capital works i.e. road resurfacing. It does not include those financing methods shown in Excluded Borrowings below, or the funding of asset purchases via ongoing operational funding mechanisms such as rates, fees and charges and grants.

3 Definitions

The following definitions are relevant to this Policy:

3.1 Act

means the *Local Government Act 1995*.

3.2 Asset

means a (physical) facility or component of a facility which has value, enables a service to be provided and has an economic life of greater than 12 months.

3.3 Council

means the Council of the Shire of Bridgetown-Greenbushes.

3.4 Economic Life

The estimated period during which an asset is expected to be economically usable by the Shire, with normal repairs and maintenance. It is worth noting that the economic life of an asset may be considerably less than the physical life of that asset, as the 'fit for use life' of an asset may be less than the physical life of that asset 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 by the local government. Stock yards are an example of a specific use asset.

3.5 External Borrowings

includes raising and obtaining, in any way money, credit and other financial accommodations from sources external to the Shire.

3.6 Excluded Borrowings

includes money, credit or other financial accommodations obtained in the ordinary course of the Shire performing its function such as –

(a) An operating lease for fleet vehicles, office furniture/equipment or information technology assets;
(b) A credit or purchase card facility;
(c) An overdraft required to balance daily cash flow requirements;
(d) A hire-purchase agreement.

3.7 Gross Debt

means all debts owing by the Shire including self supporting loans.

3.8 Internal Borrowings

means the use of internal Municipal 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.

3.9 Liability

means a debt or financial obligation for which the Shire is responsible.

3.10 Long Term Financial Plan

means a minimum ten year rolling financial plan incorporated into the Shire's Corporate Business Plan that activates Strategic Community Plan priorities.

3.11 Net Debt

gross debt less cash assets.

3.12 Self Supporting Loans

are Shire loans taken out, the repayments of which are made by a third party i.e. Shire Community/Sporting Groups.

3.13 Shire

means Shire of Bridgetown-Greenbushes.

3.14 Strategic Community Plan

means the Strategic Community Plan adopted by the Council.

4 Policy

Whilst the preferred policy position of the Shire of Bridgetown-Greenbushes (Shire) is to remain debt free (except for Self Supporting loans), the Shire recognises that in order to ensure intergenerational equity in funding the acquisition, renewal or construction of some assets, it may need to resort to the prudent use of loan borrowings, debt instruments or other finance or capital raising methodologies from time to time. The following principles are to be applied when considering undertaking borrowings or other asset financing.

4.1 Matters to be considered by Council

The following matters need to be considered by Council when assessing borrowing of funds:

1 The Shire's Long Term Financial Plan and forecast debt financing capacity – across the proposed life of any loan or portfolio of loans.

2 Regulated borrowing limits as determined by WA Treasury Corporation.
3 Debt Service Coverage Ratio (calculated as per Local Government Operational Guidelines – Number 18 Financial Ratios) meets that required by both the Department of Local Government, Sport and Cultural Industries Standard and WA Treasury Corporation.
4 Standard is NOT met if ratio is less than 2X (two times).
5 Basic Standard if ratio is between two (2X) and five times (5X).
6 Advanced Standard if greater than five (5).
7 Note: Currently this indicator is used by WA Treasury Corporation when considering loan applications from the Shire.
8 The current financial position of the Shire.
9 New Capital Works program priorities and funding requirements.
10 Compliance with legislative requirements associated with borrowing of monies under Sections 6.11, 6.20 and 6.21 of the Local Government Act 1995.

4.2 Guidelines

Operating Expenditure - The Shire will not borrow money (other than by way of Excluded Borrowings) to fund operating expenditure. This type of expenditure shall be funded through operating revenue streams such as rates, fees and charges or operating grants.

Recurrent Capital Expenditure - The Shire 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 e.g. 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. The Shire's Landfill business unit is an exception to this, as it has the capacity to finance borrowings for plant replacement (for example) out of its rates and fees and charges.

4.3 Limitations

4.3.1 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.

Should the Shire decide to borrow funds, the term of the borrowing shall generally not be greater than half of the Economic Life of the asset being acquired or constructed. This is to enable the Shire to use the remaining economic half life to set sufficient funds aside in a reserve (sinking) fund in order to renew or replace that asset, should that be required, at the end of its Economic Life.

4.3.2 Borrowing Ratios –

Prior to undertaking any borrowing the Shire shall assess its capacity to pay, to ensure that the community is not burdened with unnecessary risk.

When assessing the borrowing ratios, consideration will be given to the economic earnings potential of the asset being acquired or constructed.

The Shire will not borrow funds when such borrowing would result in the following financial ratios being exceeded:

- Debt Service Cover Ratio being greater than 3X (three times, WA Treasury Corp Guideline is 3X); and
- Net Debt (Gross Debt less cash assets) to Operating Revenue Ratio 45% (WA Treasury Corp Guideline is 50%).

In order to reflect the Shire's contingent liability risk as guarantor for Self Supporting Loans the permissible borrowing limit of the Shire will be reduced by the amount of 50% of the outstanding value of self supporting loans.

The Shire will not generally borrow funds (other than by way of Excluded Borrowings) to acquire an asset that has an economic life of less than five (5) years.

4.3.3 Statutory Limitations –

Any borrowings will be conducted in accordance with relevant statutory requirements as contained in the Act and the *Local Government (Financial Management) Regulations 1996*.

Other Limitations - Borrowings shall be undertaken in Australia and be in Australian dollars.

Local government loan application guidelines published by the WA Treasury Corporation from time to time will also limit the amount of borrowings that can be undertaken.

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.

4.3.4 Interest Rate Parameters –

Should any borrowings be undertaken, the Shire will consider the following factors when deciding an appropriate period for which interest rates will be fixed:-

- the level of the interest rate when compared to the long term average official interest rate;
- recent movements in the official interest rate; and
- the term of the loan.

4.3.5 Structure of Borrowings –

The Shire will obtain advice to determine the most appropriate structure of any borrowings with regard to:

- Fixed or Floating rate
- CPI – Linked rate
- 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.

4.4 Assessment

The Shire 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 the Shire's asset base or replaces an existing asset with one which affords the Shire substantially better service 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 the Shire; or
- the income stream from the asset 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 the criteria as set out in the Self Supporting Loans Policy F.18; 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 or constructing the asset today.

As a general rule the benefits received (cost savings or income earned) from undertaking the borrowing should be greater, over the life of the borrowing, than the costs of borrowing.

4.5 Internal Borrowings

Where the cost of using external funds acquired through borrowing is greater than the forgone investment earnings on Municipal funds (held in Reserve accounts) that are surplus to current requirements, such funds should be used prior to seeking external funds. It should be noted that the Act places restrictions on the use of funds held in Reserve accounts i.e. Municipal Fund equity, as follows:-

6.11. Reserve accounts

1 *Subject to subsection (5), where a local government wishes to set aside money for use for a purpose in a future financial year, it is to establish and maintain a reserve account for each such purpose. (2) (3)*

2 *Subject to subsection (3), before a local government – (a) changes* the purpose of a reserve account; or (b) uses* the money in a reserve account for another purpose, it must give one month's local public notice of the proposed change of purpose or proposed use. * Absolute Majority Decision Required.*

3 *A local government is not required to give local public notice under subsection (2) –*

  (a) where the change of purpose or of proposed use of money has been disclosed in the annual budget of the local government for that financial year.

Where the use of such Reserve account funds is made 'notionally available' as internal borrowings, journal entries shall be made reflecting the value of forgone investment earnings as a cost to the programme 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 Employee Leave or Bus Reserve accounts, Trust Fund or Trust accounts.

4.6 Roles and Responsibilities

Executive Manager Corporate Services:

Review and appraise each (external/internal) loan proposal, and make a recommendation (approve/not approve) for presentation to the Audit Advisory Committee.

Audit Committee:

Appraise the Executive Manager Corporate Services' recommendation (approve/not approve) for presentation to Council.

Council:

Review recommendation and make final determination by absolute majority to approve or not approve the (external/internal) loan proposal.

5 Applicable Legislation and Documents

Act	*Local Government Act 1995* s.2.7(2)(b) – The council is to determine the local government's policies s.6.11 – Reserve accounts s.6.20 – Power to borrow s.6.21 – Restrictions on borrowing
Regulation	*Local Government (Financial Management) Regulations 1996* r.18 – When local public notice not required for change of use of money in reserve account r.20 - When local public notice not required for exercise of power to borrow r.21 - When local public notice not required for change of use of borrowed money
Local Law	N/A
Shire Policies	CM 3 – Asset Management FM 9 – Self-Supporting Loans to Shire Community-Sporting Groups
Related Documents	Strategic community Plan Corporate Business Plan Long Term financial Plan
Related Procedure	N/A

6 Administration

Original Adoption Date	26 September 2013
Last Reviewed	30 June 2022
Scheduled Reviewed Date	27 April 2023