

Loan Borrowing Policy

(A3841434)

1. Policy statement

Council has identified loan funding as an important funding source for its Capital Works program, but has adopted a conservative position in relation to long-term borrowing and will resort to loan funds only when it is financially prudent to do so.

2. Reason for Policy

The purpose of this Policy is to outline Council's position in relation to the undertaking of loan borrowings, including the methods and criteria that will be applied in the evaluation of whether to utilise this source of funding.

3. Scope

This policy will apply to Council and all Council officers.

4. Authorisation

This Policy is managed by the **Financial and Corporate Planning** Department, and is approved by Frankston City's Mayor and Council's Chief Executive Officer (CEO):



Mayor, Frankston City



CEO, Frankston City Council

in accordance with Frankston City Council resolution at its Ordinary Council meeting of 23 September 2019.

5. Revision date

This Policy will be reviewed and presented to Council no later than 2023 or earlier as deemed necessary by Council, and therefore once within each subsequent Council term.

6. Principles

Council has through resolution of the Long Term Financial Plan endorsed the below principles in relation to the application of loan funds:

- 1) That Council approves the principle of loan funding as a viable and equitable mechanism of:
 - a. Funding new/significantly upgraded major assets that provide a broad community benefit
 - b. Funding capital projects that provide a financial return above annual loan funding costs
 - c. Funding of one-off extraordinary operating items in excess of \$1.00 million

- 2) That Council caps loan borrowings at no more than 60 per cent (total indebtedness/rate revenue) to ensure that Council is within prudential limits and has the capacity to consider further borrowings if the need arises for unexpected events.

Council will not undertake any borrowings for recurrent expenditure or asset renewal works.

Where Council elects to undertake borrowings to fund infrastructure deemed by Council to be of broad community benefit, the rate of financial return will not be relevant in these instances. The financial assessment required in these instances (beyond other requirements of this Policy) will be the forward financial modelling of the impact of the proposed borrowings on Council's long-term financial position and the determination of the funding mechanism to meet annual loan repayment requirements.

Where borrowings are sought to be undertaken on the basis of net financial return to Council, this Policy establishes the evaluation methodology and criteria that must be satisfied prior to Council endorsing the use of loan borrowings for these projects.

This Policy further establishes a Policy framework to deal with the following issues:

- Minimum Borrowing thresholds
- Prudential Borrowing limits
- Evaluation of competing loan projects
- Cost factors to be included as part of any assessment process

6.1 Minimum Loan Thresholds

For efficiency purposes, the establishment of a loan facility should not be undertaken for minor capital works. Loan funds should ideally be restricted to hallmark projects that are unable to be financially achieved unless loan funds are accessed. For consideration of loan funds on a capital project based on funding new/significantly upgraded major assets that provide a broad community benefit, a minimum loan threshold of \$3 million should be met prior to loan funding becoming a consideration.

Funding of one-off extraordinary operating items, a minimum loan threshold of \$1.00 million is established.

6.2 Prudential Loan Limits

The Office of Local government has previously established three prudential guidelines in respect of considering applications from Councils to undertake borrowings. They are:

- Debt Servicing (Interest repayments) as a percentage of total revenue should not exceed 5 per cent
- Total Indebtedness as a percentage of rate revenue should not exceed 60 per cent (with this latter prudential limit – where ratios exceed 60 per cent, Councils are required to demonstrate long-term strategies to reduce indebtedness prior to undertaking further borrowings)
- Working capital ratio (current assets/current liabilities) to remain in excess of 1.1

A maximum ceiling restricting Total Indebtedness to no more than 60% of Annual Rate Revenue is established under this Policy on the proviso that Council is able to evidence that it will continue to meet both of the other prudential guidelines.

6.3 Consideration of Loan Projects

In order to undertake loan borrowings, the *Local Government Act (1989)* requires that Council include any proposed borrowings in a formally adopted and advertised Council Budget or Revised Budget.

Council must further seek and receive approval to undertake loan borrowings through an annual application process conducted via the office of Local Government and the Department of Treasury.

Unless exceptional circumstances are deemed to exist via resolution of council, proposals to undertake loan borrowing will only be considered as part of the annual budget process. Where exceptional circumstances are deemed to exist, Council will seek loan approval from the Department of Treasury and if successful will undertake a formal Revised Budget process to incorporate a proposal for loan borrowings.

6.4 Length of Loan Periods

The length of a proposed loan must not exceed the expected life of the asset being acquired by the use of loan funds. Council will retain the option to refinance loans following the completion of the initial loan term.

6.5 Loan Repayment Structures

Council will retain the option to access loans on either the basis of principal and interest repayments or an interest only basis.

6.6 Evaluation of Loan Projects

Loan projects will be evaluated in accordance with Council's proposed capital program through the annual budget process. All projects will be considered from a social, environmental and economic perspective.

Where projects being assessed are deemed to provide new/significantly upgraded major assets that provide a broad community benefit, these projects will typically not involve a financial rate of return assessment. The community benefit for these projects will be assessed by Council in comparison to that of other projects within the capital works program.

In the event of loan borrowings being sought to fund projects on the basis of net financial return to Council, the following criteria must be satisfied.

- 1) The future cash inflows and outflows must:
 - a. Be able to be reliably and accurately measured
 - b. Possess a high probability of actually occurring

- 2) Proposed projects will be further evaluated using the internal rate of return methodology.
- 3) Through the application of this methodology, proposed projects must provide a rate of return in excess of the prevailing loan interest rate.

7. Roles and responsibilities

Responsibility for this Policy rests with the Chief Executive Officer and Council staff involved with the management of this policy.

Monitoring and reporting of loan borrowings rests with the Financial and Corporate Planning Department to ensure that the balances are accurately recorded, and that the transfer of funds in the finance system is in accordance with Section 6.

A report on the current and non-current balances of Council's loan borrowings will be included in the Quarterly Financial Report and Annual Report. A detailed report of loan borrowing is included in the Quarterly Financial Report.

8. Policy non-compliance

Non-compliance with this Policy has the potential to risk the long term financial sustainability of Council. The potential risk of borrowing for recurrent expenditure or asset renewal works can lead to an unsustainable financial position.

9. Related documents

Long Term Financial Plan
Local Government Act 1989

10. Implementation of the Policy

To be implemented immediately following the Council resolution to adopt this policy.

11. Definitions

Not Applicable