

FINANCIAL MANAGEMENT – LOAN BORROWINGS

Purpose

This Policy provides direction to management in relation to the decision-making framework surrounding the use of borrowings to finance activities. The objectives of this policy are to:

- Determine the circumstances borrowing should and should not be used;
- Minimise the costs of borrowings;
- Ensure, where possible, the structure of the borrowing is appropriate for the nature of the assets being funded;
- Consider intergenerational funding equity as part of determining the most appropriate way to fund major assets;
- Establish the process for monitoring the level of borrowing capacity; and
- To ensure decisions in relation to the use of borrowings are made within a long-term financial context with reference to the Shire's strategic plans.

Policy

Introduction

This Policy underpins the Shire's decision-making in the funding of the Shire's activities in the context of cash flow, budgeting, borrowings and investments. It is an important financial management tool in the funding of the Shire's expenditure. As such, this policy links closely to the Shire's Long Term Financial Plan and Corporate Business Plan in the context of:

- Strategic planning for the future of the Shire, covering short, medium and long term spending requirements;
- Current and estimated future revenues and the ability to increase the revenue stream through either rates, user charges, additional grant funds or entrepreneurial activities;
- Inter-generational equity; and
- Current and future funding needs for both operating and capital expenditures.

Intergenerational Equity

Intergenerational Equity means the concept of fairness or justice between generations

The Shire will seek to achieve intergenerational equity through the funding mix for assets with a very long useful life. The use of borrowings greatly assists to achieve this alignment of better matching the cost of paying for an asset with the consumption/benefit of the asset.

Types of Expenditure to be Funded by Loan Borrowings

Long-term borrowings will generally be considered for the following purposes:

1. Commercial activities, providing the proposed activity results in a positive cash inflow, positive net present value or the operation can meet the loan repayment obligations at no net cost to the Shire (e.g. Mount Barker Regional Saleyards);
2. Community assets that:

- provide intergenerational benefit; and
 - have an economic life of over 5 years; and
 - if a disposal of the asset is planned, all associated borrowings are extinguished from the proceeds; and
 - the construction or acquisition is planned within the current Long Term Financial Plan and Corporate Business Plan and support the goals as outlined in the current Strategic Community Plan; and
 - the term of the borrowing does not exceed the economic life of the funded asset.
3. Self-Supporting loans (refer separate Council Policy – Self Supporting Loans); or
 4. Refinancing existing borrowings; or
 5. Projects that intensify the capital base for the purpose of reducing future operating costs.

Types of Expenditures not to be Funded by Long Term Borrowings

The Shire will not use borrowings to fund asset renewal which occurs on a frequent, regular or recurrent basis, such as:

- Road resurfacing;
- Plant and equipment changeover;
- ICT network renewal; or
- Office equipment.

To ensure that the Shire does not become reliant on borrowings as a mechanism to fund operations, the Shire shall not use borrowings to fund operating activities except for:

- Overdraft;
- Credit Cards; or
- Operating Leases.

Link to Strategic Planning

Borrowings shall be considered as a mechanism to assist in achieving the strategic objectives of the Shire and the decision to borrow is made in the context of its implication on the long-term financial sustainability of the Shire. The financial implications of current and proposed borrowings shall be included in the Corporate Business Plan and Long-Term Financial Plan.

Borrowing Capacity Limitations

The level of borrowings shall be maintained within defined limits to ensure long-term financial sustainability. The Shire shall ensure that the amount of borrowings does not exceed the limits, so that debt servicing costs can be met on an ongoing basis.

The following ratio benchmarks will be used when considering borrowing capacity limitations:

1. **Total Debt Ratio (TDR)** - is a measure of leverage and indicates the extent to which the total debt of a local government can be serviced by operating activities.

The Shire should maintain a TDR of 50% or less (base on WA Treasury Corporation guidelines). The ratio is calculated by:

$$= \frac{\text{Debt}}{\text{Operating Income}}$$

Operating Revenue

2. **Debt Service Cover Ratio (DSCR)** - is a measurement of debt serviceability and an indicator of the Shire's ability to generate sufficient cash flow to cover debt repayments.

The Shire should maintain a DSCR greater than or equal to 2.0 (based on Department guidelines). The ratio is calculated by:

$$= \frac{\text{Adjusted Operating Surplus}}{\text{Debt Service Costs}}$$

or

$$= \frac{\text{Op. Revenue} - (\text{Op. Expenditure} - \text{Depreciation} - \text{Interest})}{\text{Debt Service Costs}}$$

Consideration of Future Borrowings

The following applies to all new loan borrowings:

- a) Future Borrowings will only proceed if the proposed borrowings will not result in a breach of the borrowing capacity limitations as set in this policy;
- b) The decision on the type of borrowing, the term and interest rate arrangements shall take into account the purpose of the borrowing, the nature of the assets being funded, intergenerational equity and the cost of debt at the time of the borrowing, giving due regard to minimising exposure to interest rate movements; and
- c) Council approval is required for all new borrowings, predominately through the annual budget adoption process.

Document Control			
Document Responsibilities			
Owner	Chief Executive Officer	Business Unit	Corporate & Community Services
Reviewer	Executive Manager	Approval	Council
Document Compliance			
Legislation	S6.20 & s6.21 Local Government Act 1995		
Other	Self-Supporting Loans Policy		
Document Management			
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1	23 January 2007	Adopted	
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