



Reference: PTR 16/1/25/1

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The Municipal Manager

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For attention: Mr M MEMANI

WESTERN CAPE PROVINCIAL TREASURY COMMENT ON THE LONG-TERM BORROWING PROPOSAL FOR THE BITOU MUNICIPALITY

Provincial Treasury (PT) has considered the long-term borrowing proposals of Bitou Municipality and herewith provides comments based on compliance with the legislative requirements in terms of the Local Government: Municipal Finance Management Act (Act No. 56 of 2003) (MFMA) as well as raising concerns on the affordability of the proposed long-term borrowing proposal. It is expected that the Provincial Treasury comments are tabled in the Municipal Council.

Compliance Assessment

1. The Municipality made public an information statement setting out particulars of the proposed external financing of its capital programme.
2. PT notes that the Municipality has submitted the required information as per MFMA Circulars 26, 42 and 115.
3. The Municipality has set its objectives in accordance with section 152 of the Constitution of South Africa (Act No. 108 of 1996) and ensured full compliance with the MFMA and Municipal Supply Chain Management Regulations.
4. Table 1 indicates the relevant sections in relation to the National Treasury Circulars which provide the necessary legislative guidelines and information required to make the needed comments as stated in section 46(3)(a) of the MFMA.

Table 1 Compliance with MFMA in relation to MFMA Treasury Circular 26,42 & 115 as issued by National & Provincial Treasury

| MFMA/ Circulars | Treasury | Details | Compliance Yes/No |
|--|------------------------|---|----------------------|
| S46(3)(a)(i) and (ii) | | The information statement and media advertisements were made public on the Facebook page as well as in libraries, on notice boards of the Municipality and the Municipal Website 22 December 2023. | Yes |
| S46(3)(b)(i) and (ii) | | The loan funds will be sourced from financial institutions accredited in terms of the Banks Act. | Yes |
| S46(6), S17(2), S19 | | The long-term loan is consistent with its Capital budget as referred to in section 17(2) of the MFMA. The total loan amount is for R38.84 million. | Yes |
| S46(5) | | This section is not applicable, because the borrowing (debt) purpose is not for refinancing existing long-term borrowing (debt). | N/A |
| S19(1)(d) | | The sources of the funding have been considered, are available and have not been committed for other purposes. | Yes |
| MFMA Treasury No.26/2005 | National Circular | A schedule of all long-term borrowing (debt) obligations in the format of the QBMR showing principal and interest payments for the life of all loans and any associated investments set up as sinking funds etc. | Yes |
| MFMA Treasury No. 42/2010 | Provincial Circular | The Long-Term Debt Certification to be dated and signed by the Municipal Manager (Accounting Officer) and the Executive Mayor/Chairperson of the Board. | Yes |
| S 18 of MFMA, Reg 22 of MBRR & MFMA National Treasury Circular 115 | | The Annual Budget may only be funded by realistically anticipated revenues to be collected, cash-backed accumulated funds from previous years' surpluses not committed for other purposes, and borrowed funds, but only for capital budget referred to in section 17(2) of the MFMA. An adjustments budget of a municipality must be appropriately funded. | Yes |

Affordability Assessment

5. The affordability assessment that follows is based on the Audited 2020/21 and Unaudited 2021/22 Annual Financial Statements (AFS); the In-year monitoring (IYM) operating and capital expenditure reports for the 2022/23 financial year as at 30 November 2022; Cash Flow Actual performance for the 2022/23 financial year as at 30 November 2022; as well as the Integrated Development Plan (IDP) 2022/23.
6. The purpose of the external loan is to raise R38.84 million with a financial institution over a period of 10-years to provide the necessary infrastructure to improve Council's service delivery to the community. The infrastructure appears to be a mix of some revenue-generating infrastructure and several social infrastructure projects. The interest rates applicable for the respective loans are both set at 12.50 per cent which are in line with the current market trends for borrowing. The finance charges would contribute R30.27 million to the total cost of the external loan.

7. The repayments will be made semi-annually with the first instalment to be paid on 31 December 2023 and last payment due on 31 December 2032
8. In considering the affordability of the proposed loans, a selected number of financial ratios (based on the Audited AFS of 2020/21 and Unaudited 2021/22) were considered and are depicted in Table 2 below.

Table 2: Ratio analysis

| Ratio | National Treasury Norm or acceptable range | Comment | 2020/21 (Audited) | 2021/22 (Audited) | M05 November 2022 (In-year monitoring) |
|--|--|--------------------------|-------------------|-------------------|--|
| Current Ratio | 1.5:1 to 2 | Below NT norm | 1.04:1 | 1.05:1 | 1.84:1 |
| Debtors' collection period | 30 days | Negatively above NT norm | 33 days | 33 days | 62 days |
| Capital Cost (Interest paid and redemption to total operating expenditure) | 6% - 8% | Below NT norm | 4.5% | 4.2% | 0.15% |
| Total Liabilities to Total Assets | <50% | Within NT norm | 24.5% | 22.4% | 17.72% |
| Cash and cash equivalents to Current liabilities | 1:1 | Below NT norm | 0.5:1 | 0.3: 1 | 0.69 |
| Debt (Total Borrowings) to Total Operating Revenue | 45% | Within NT norm | 15.6% | 12.4% | 27.18 |

9. The current ratio has increased from 1.04:1 in 2020/21 to 1.05 in the 2021/22 financial year and is below the NT's acceptable norm. The ratio indicates that the Municipality may not have sufficient cash and cash equivalents to meet its short-term obligations.
10. The net debtors collection remains constant at 33 days in 2020/21 and 2021/22. However, the ratio is not within the acceptable NT norm of 30 days. To increase cash flow from outstanding debt and align the debtor collection duration in with NT's norms, the Municipality should strengthen its present credit management and debtor collection policies and processes.
11. The interest paid and redemption to total operating expenditure ratio has decreased slightly from 4.5 per cent in 2020/21 to 4.2 per cent in 2021/22 and remains favourably below the NT norm of 6-8 per cent.
12. The total liabilities to total assets ratio decreased from 24.5 per cent in 2020/21 to 22.4 per cent in 2021/22 and remains within the NT norm. This ratio result indicates that the Municipality has sufficient assets to cover its liabilities when they are due.
13. The cash and cash equivalents to current liabilities ratio decreased to 0.5:1 in 2020/21 to 0.3:1 in 2021/22 financial year. The ratio is below the NT norm of 1:1, indicating that the Municipality holds insufficient liquid cash resources to cover its current liabilities. This ratio has remained below the norm for the period under review.
14. The debt to total operating revenue ratio improved from 15.6 per cent in 2020/21 to 12.4 per cent in the 2021/22 financial year and remains within the NT norm of 45 per cent, implying that the

Municipality has capacity to increase its borrowings. The municipality budgeted to borrow R38.84 million in the current financial year 2022/23. The ratio will increase to 39.44 per cent from 27 per cent including the current long-term borrowing proposal. In addition, should the Municipality decide to take on additional funding, all other cashflow projections need to be considered for affordability purposes and closely manage the drawdowns to remain within the debt to revenue ratio norm.

15. In addition to the financial ratios calculated from the 2020/21 audited and 2021/22 audited AFS, further analyses based on the 2022/23 IYM have been performed.
- a) The operating revenue amounted to R316.92 million or 38.5 per cent of the adjusted budget of R822.69 million while the actual operating expenditure is at R278.55 million or 34.00 per cent against the adjusted budget of R818.77 million as at 30 November 2022.
 - b) The Municipality's total debtors as at 30 November 2022 amounted to R296.62 million indicating an increase of R1.64 million from the R294.97 million reported in October 2022 and a year-on-year increase of 8 per cent when compared to the R273.98 million reported in November 2021.
 - c) In November 2022, the liquidity ratio increased to 0.69 times from 0.61 times compared to October 2022. The ratio is still below the National Treasury recommended norm of 1.1, indicating that the Municipality may not meet its short-term obligations and could struggle to settle its short-term obligations immediately.
 - d) In November 2022, the cost coverage ratio increases to 1.13 times from 0.61 times compared to October 2022, indicating the Municipality may have the ability to meet at least its monthly fixed operating commitments from cash and short-term investments without collecting any additional revenue.
 - e) The Municipality's collection rate exhibits a decreasing trend. The collection rate has decreased by 7 per cent from the collection rate of 87 per cent reported at the end of the first quarter to 80 per cent as reported at the end of the second quarter. This is a significant deterioration from the budgeted position of the municipality and raises questions about the ability of the municipality to afford its budgeted expenditure and borrowing.

Conclusion

16. After assessing the proposed long-term borrowing, Provincial Treasury draws the Municipality's attention to the following:
- a) The Municipality appears to have a weak financial position which may have a negative effect on the ability to service the loan.
 - b) Cash pressures may materialise if the collection rate continues to deteriorate and does not stabilise.
 - c) The weak liquidity position of the municipality raises the risk-profile of the municipality and is likely to result in a higher cost of borrowing.
 - d) The Municipality intends to take up an external loan during a period when interest rates are increasing, and the cost of borrowing is likely to increase further. This increased cost of borrowing may adversely affect the Municipality's ability to service the loan, and may require higher tariffs in future to cover the cost of the borrowings.

- e) Although the Municipality has capacity to take on additional borrowing in terms of its debt to operating revenue ratio, this loan should be considered within the broader context of the cash flow requirements and affordability parameters of the Municipality.
- f) The Municipality's work to improve its liquidity position and financial sustainability is noted and the Municipality is advised to continue with implementing aggressive and stringent credit control and debt collection measures.
- g) All factors considered, the WCPT advises the municipality to reconsider this loan. The Municipality is advised to prioritise stabilising its liquidity position and to structure a borrowing proposal that takes account of the weakened financial position of the municipality, as well as commitments already made.
- h) It is noted that the loan amount is in line with the adopted budget of the municipality and its capital funding mix. However, the loan amount could be reduced by adjusting the municipality's capital budget to delay loan-funded projects that have not yet begun implementation.
- i) PT therefore advises the municipality to consider PT's comments/ recommendations and reduce the amount of borrowing taken up in 2022/23.
- j) This letter should be presented to Council for review.

Kind regards,

MR S KENYON
CHIEF DIRECTOR: LOCAL GOVERNMENT PUBLIC FINANCE
WESTERN CAPE PROVINCIAL TREASURY