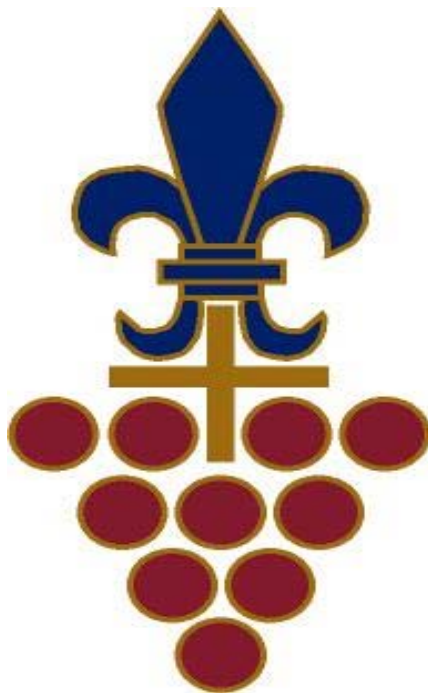


STELLENBOSCH MUNICIPALITY



**LONG-TERM FINANCIAL PLAN
2024-2025
EXECUTIVE SUMMARY**

STELLENBOSCH MUNICIPALITY

LTFM Outcomes of the Tabled Budget 2024/25



Prepared by
INCA Portfolio Managers
May 2024



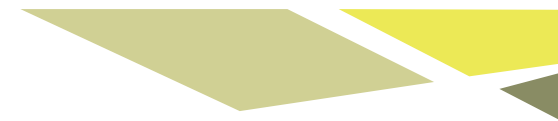
REPORT OVERVIEW – INTRODUCTION AND BACKGROUND

INCA Portfolio Managers has developed Long-Term Financial Plans (LTFP) for many municipalities in the Western Cape. Following a tender process, Stellenbosch LM appointed INCA Portfolio Managers to update their LTFP in March 2024. This condensed report aims to critique the Tabled budget and provide recommendations for council's approval.

The objective of a Long-Term Financial Plan is to recommend strategies and policies that will maximise the probability of the municipality's financial sustainability into the future. This is achieved by forecasting future cash flows and affordable capital expenditure based on the municipality's historic performance and the environment in which it operates.

The historic financial analysis was updated with the information captured in the municipality's audited financial statements of 30 June 2023. IPM's Long-Term Financial Model (latest and updated version) was populated and run with this latest information, and the outcome thereof is reflected in this report. In particular, the model was calibrated against the municipality's audited financial statements as well as the Tabled Budget for the 3 years from 2024/2025 to 2026/2027.

For this update, a review of the Asset Register, or all the documents normally considered when the full LTFP is compiled, (viz. IDP, Master Plans, etc.) was not undertaken.



EXECUTIVE SUMMARY

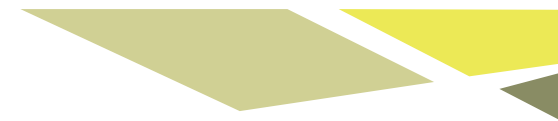
ANALYSIS OF THE TABLED BUDGET 2024/25-2026/27

Stellenbosch LM has budgeted for operating surpluses throughout the MTREF period. This is in line with the historic performance observed in recent years. As such, we are of the view that the Tabled Budget reflects a realistic and achievable Operating Budget. An MTREF Case was run whereby the Tabled Budget was run through the LTFM with no adjustments made to current assumptions. This is done to assess the viability of the Tabled Budget. As indicated in the table below, the MTREF Case presents a sustainable outcome that is characterised by strong financial performance, a healthy liquidity position and an affordable capital investment programme.

The municipality has budgeted for a significant acceleration of borrowing, with R200 million in loans expected to be undertaken in each year of the MTREF period. This is forecast to bring debt service levels above the recommended maximum limit of 7% for the majority of the planning period. While the municipality is forecast to hold sufficient liquidity to absorb these debt service charges, should other financial targets not be met, the municipality may come under pressure to service the additional debt.

A further issue identified in the MTREF Case is the lack of repairs and maintenance expenditure. Repairs and maintenance expenditure as a percentage of PPE and IP stood at just below 1% in FY2022/23. This is critically low and must be addressed. Further to this, the low levels of repairs and maintenance expenditure is a primary driver of the strong financial performance and liquidity position forecast in the MTREF Case. It is recommended that the municipality urgently addresses this issue by increasing repairs and maintenance expenditure. This is addressed in the Base Case. Another issue identified in the MTREF Case is the forecast growth in creditors. This is a predominant driver of the substantial cash balance forecast over the planning period. This has been addressed in the Base Case.

The Base Case presents a sustainable outcome that aims to address the issues identified in the MTREF Case. The Base Case outcome is characterised by an affordable capital investment programme, underpinned by a sustainable debt profile. Financial performance is forecast to be strong and improve over the planning period. This translates into the ability to generate cash from operations which underpins the healthy liquidity position. The Base Case assumptions are seen as realistic and achievable and are included to provide a holistic approach to achieving long-term sustainability.



BASE CASE ASSUMPTIONS

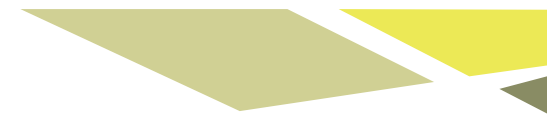
With the issues identified in the MTREF Case in mind, the following assumptions were made in arriving at the Base Case:

1. A collection rate of 97% was assumed throughout the planning period.
2. The model incorporated the increases in revenue and expenditure items as announced in the Tabled Budget.
3. Tariff increases were maintained as put forward in the Tabled Budget Document.
4. The Base Case operates on the premise that the current creditors accounts will be settled as and when they fall due.
5. The Tabled Capital Budget was unadjusted. Assumed growth in capital investment beyond the MTREF period is 4% p.a.
6. The borrowing programme was adjusted as follows:
 - FY2026/27: R175 million (from R200 million)

The annual borrowing under this scenario was adjusted to an average of **15-year** amortising loans at a fixed interest rate equal to 5% over forecast CPI in any given year. Assumed annual growth in borrowing beyond the MTREF period is 4%.

7. A loadshedding scenario was incorporated into the Base Case. Considering the impact of load shedding was factored into the budgeting process, the usual assumption of an average stage of load shedding for a defined period was not modelled. A 5% reduction of electricity sales is included to model the impact of the loss of customers who have moved to alternative power sources. Additionally, a 3% reduction of water sales pursuant to loadshedding, due to pumps not being able to fill reservoirs for example, is also included.
8. Repairs and maintenance expenditure was increased to 3.0% of PPE & IP over the planning period.
9. Electricity distribution losses were maintained at 4.2% over the planning period. Water distribution losses were reduced to 20.0% over 5 years.

A comparison between the MTREF Case and Base Case outcomes are listed on the Table below:

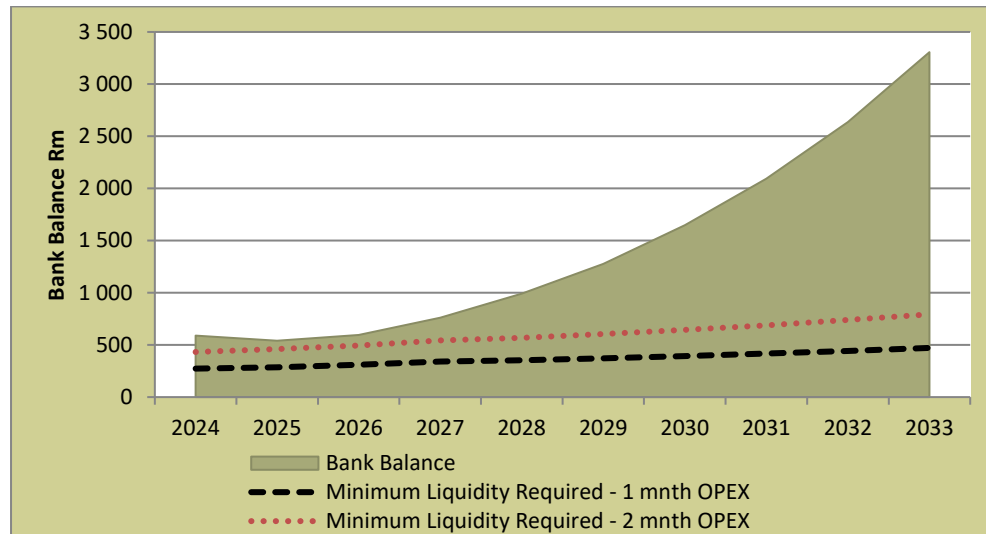


LONG-TERM FINANCIAL MODEL OUTCOMES

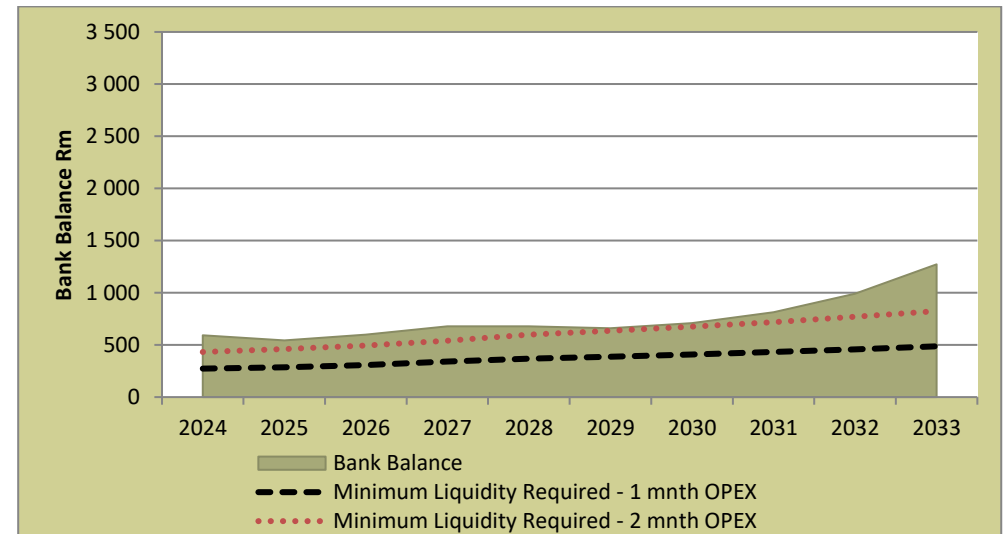
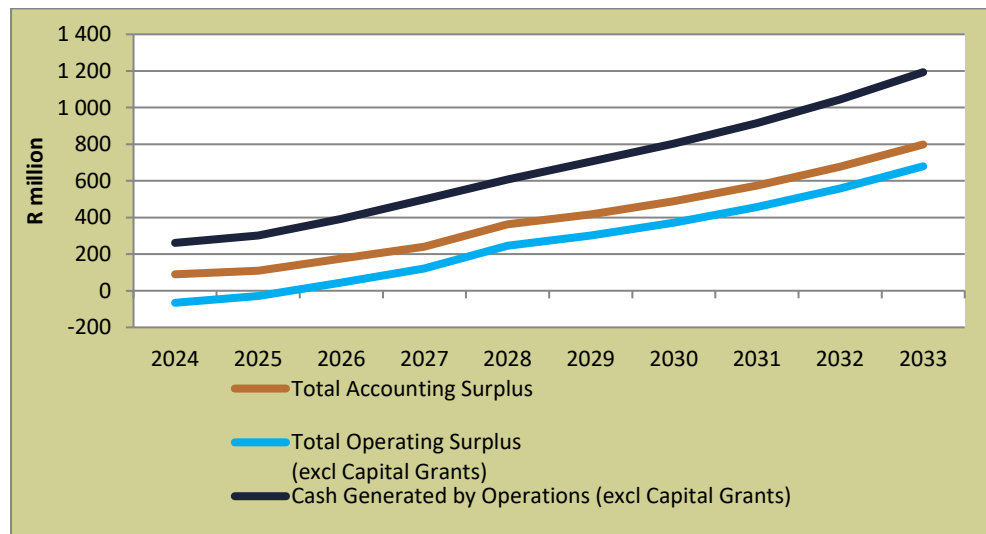
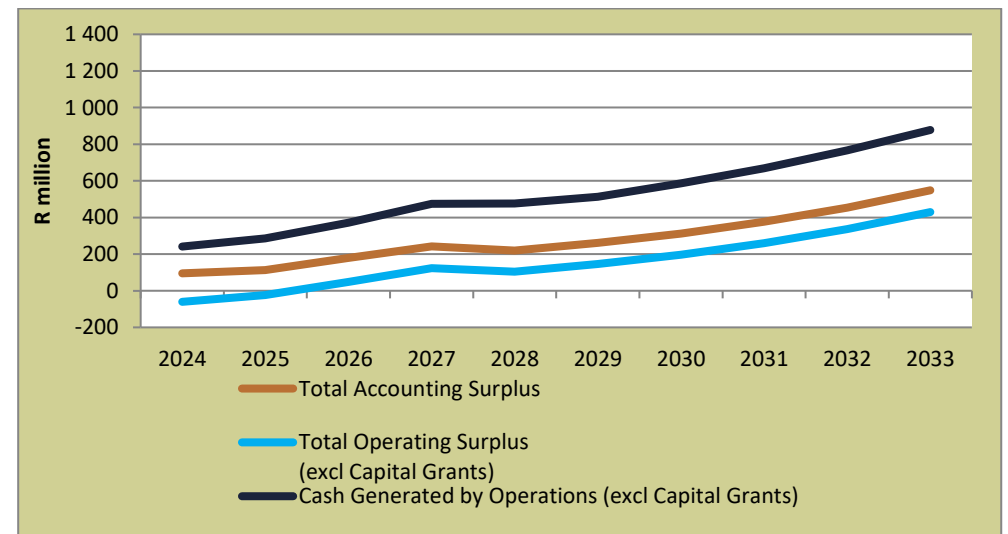
Based on these assumptions, key outcomes for the 10-year planning period are as follows:

Outcome	MTREF Case	Base Case
Average annual % increase in Revenue	9,5%	9,1%
Average annual % increase in Expenditure	9,1%	9,3%
Accounting Surplus accumulated during Planning. Period (Rm)	R 3 929	R 2 803
Operating Surplus accumulated during Planning. Period (Rm)	R 2 686	R 1 559
Cash generated by Operations during Planning. Period (Rm)	R 6 723	R 5 260
Average annual increase in Gross Consumer Debtors	11,6%	9,2%
Capital investment programme during Planning. Period (Rm)	R 5 973	R 5 973
External Loan Financing during Planning Period (Rm)	R 2 127	R 1 929
Cash and Cash Equivalents at the end of the Planning Period (Rm)	R 3 306	R 2 134
No of Months Cash Cover at the end of the Planning Period (Rm)	10,3	6,5
Liquidity Ratio at the end of the Planning Period	3 : 1	3.2 : 1
Gearing at the end of the Planning Period	22,6%	29,0%
Debt Service to Total Expense Ratio at the end of the Planning Period	7,6%	5,6%

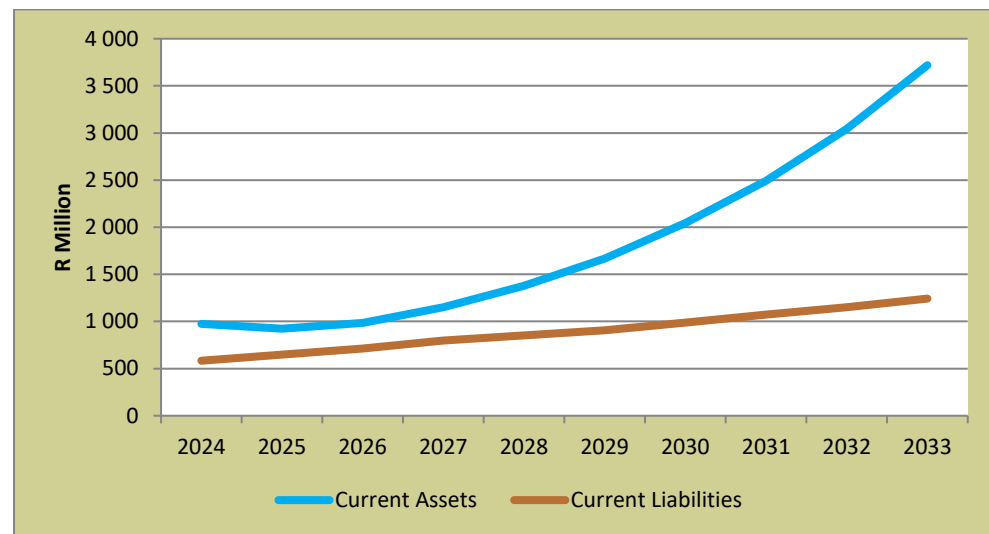
MTREF CASE SCENARIO



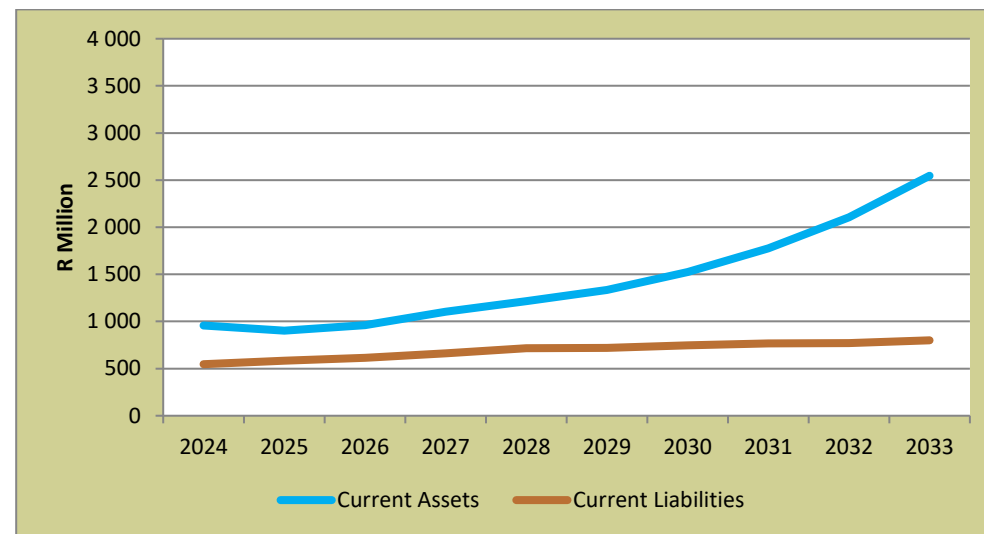
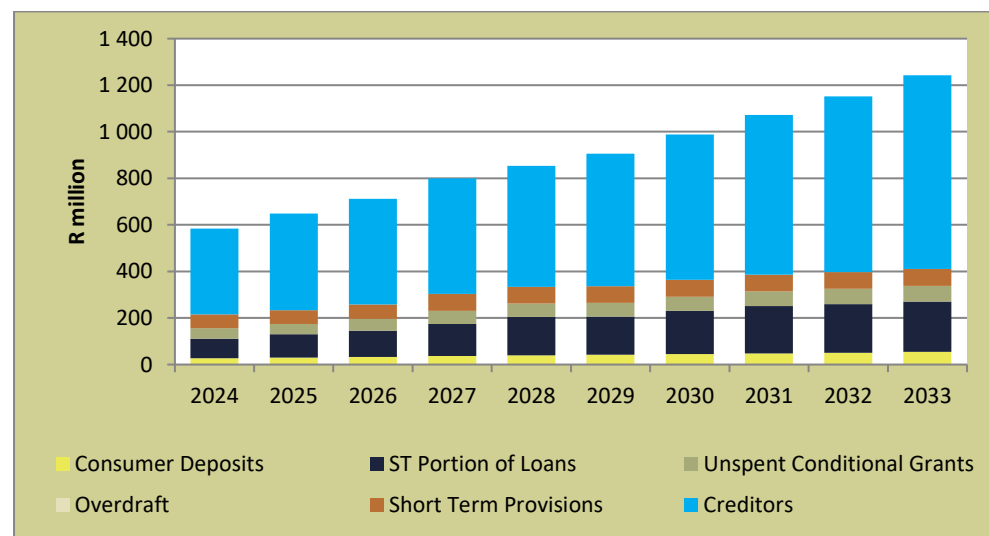
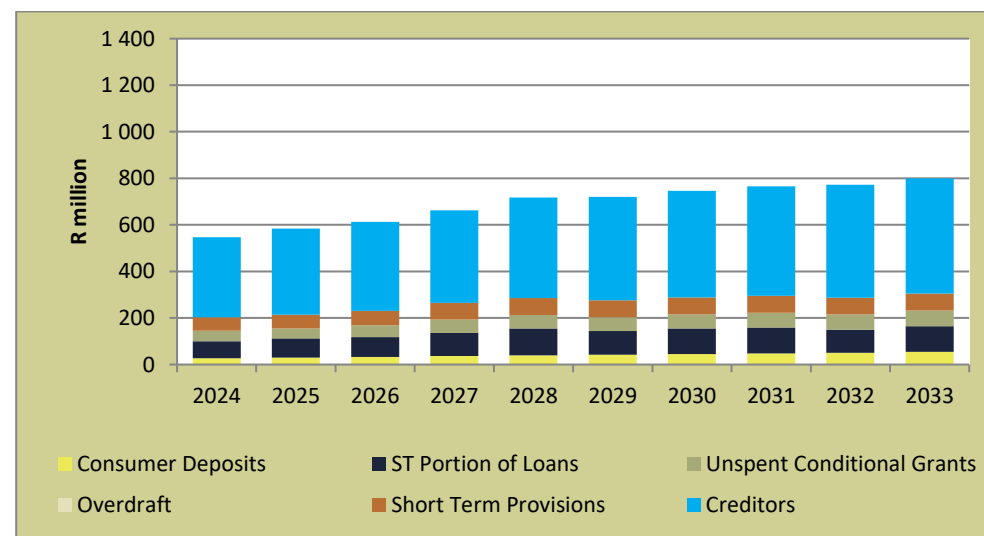
BASE CASE SCENARIO



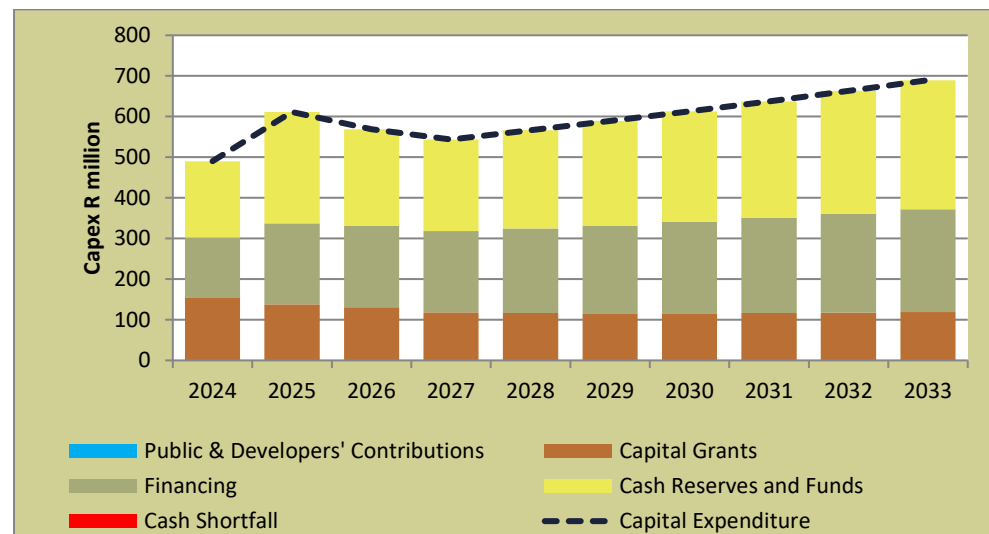
MTREF CASE SCENARIO



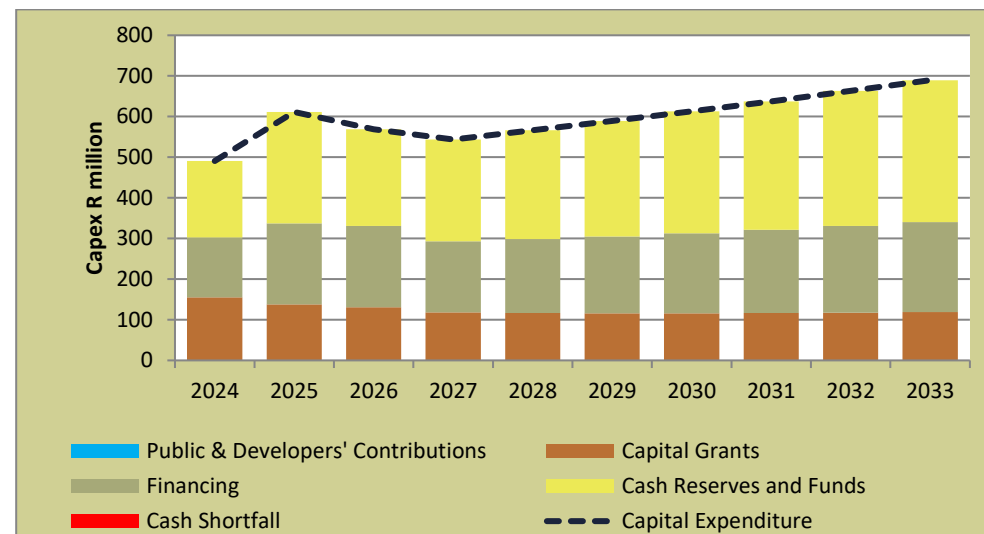
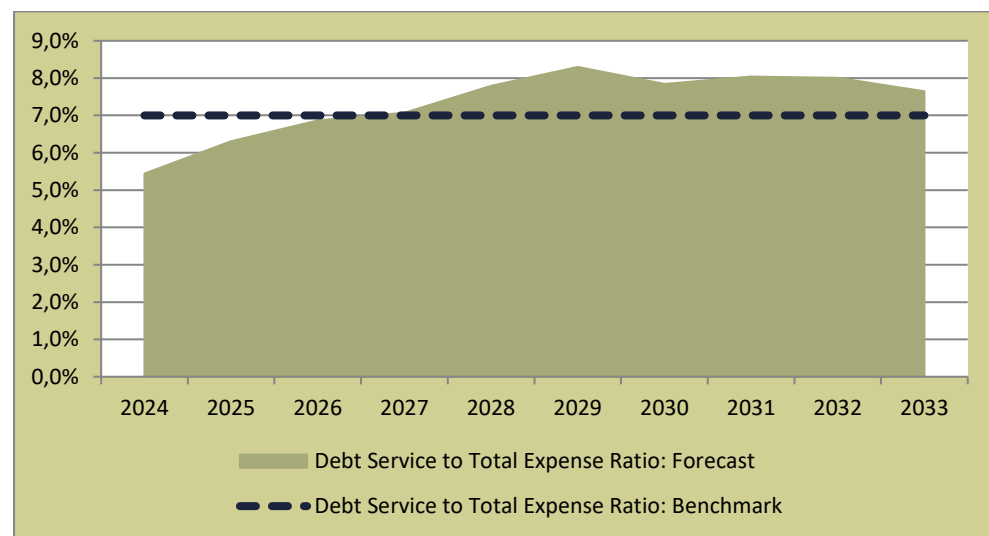
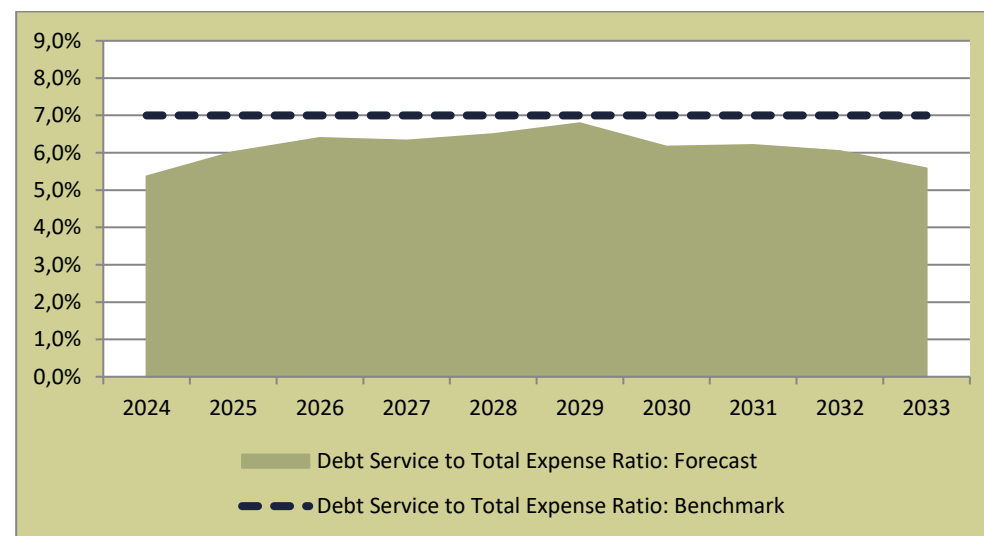
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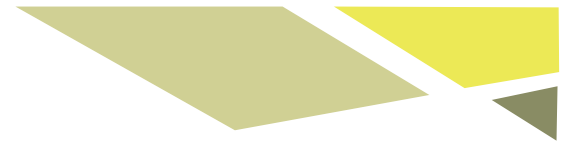


MTREF CASE SCENARIO



BASE CASE SCENARIO





RECOMMENDATIONS

Based on the results of the Long-Term Financial Model, ***it is recommended that*** Stellenbosch:

1. Maintain an optimised funding mix that strikes a balance between the utilisation of external borrowings and own cash as a supplement to capital grant funding. The municipality must be wary of not overleveraging the debt profile. It is further recommended that the loan tenor is extended to 15 years.
2. Maintain a balanced approach for the long-term capital investment programme which prioritises investments that contribute to economic growth and revenue generation and prioritise timeous investment in bulk infrastructure. Expenditure incurred to repair and maintain the municipality's asset base must be increased urgently. A ratio of 3% of PPE & IP must be targeted over the next 5 years, with further increases targeted thereafter.
3. Ensure timeous payment of creditors.
4. Formalise a capital investment prioritisation and tracking system to optimise management's capital investment decisions and mitigate the risk of underspending on capital projects.
5. The municipality must maintain its ability to post surpluses and to generate cash from operations through ensuring that actual expenditure remains within the budgeted limits. The municipality must further ensure that the revenue targets set in the Tabled Budget are met. Further to this, the low levels of electricity losses must be maintained and measures implemented to curtail water distribution losses.
6. Prevent a deterioration of the collection rate through the implementation of measures such as strict credit control, debt collection procedures etc. The Base Case collection rate of 97% must be maintained.
7. Institutionalise the utilisation of a sophisticated tariff model to ensure that tariffs reflect the true cost of delivering the service, on an organisation-wide approach (also taking into account property rates and organisational overheads).
8. Update the long-term financial plan annually with the most recent information to remain a relevant and valuable strategic tool that serves as input to the annual budgeting process. Institutionalisation of the long-term financial model to support strategic financial decision-making in the municipality will provide immense benefits to the municipality.
9. Finally, Stellenbosch's healthy financial position is a result of a sustained period of financial discipline and sound operational management. This must continue to be the norm. Continuing to build on the strength of the financial position will unlock further opportunities to invest in needed bulk infrastructure that aims to not only promote future growth and development, but ultimately improve the lives of its inhabitants.