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IN THIS ISSUE

The borrowing powers of universities

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The borrowing powers of universities

In recent years, South African universities have increasingly been borrowing large sums of money to fund their major infrastructure projects or working capital requirements. In this article, the source of public higher educational institutions' (referred to as universities) borrowing powers is discussed.

Generally, universities are funded through a combination of the state's budget allocations to universities, student fees and other sources such as donations and services rendered to third parties for fees. The other sources are sometimes known as third-stream income.

As creatures of statute, universities derive their powers, rights and obligations from the Higher Education Act 101 of 1997 (Act) read with their respective Institutional Statutes. Unlike statutes, policies and practices adopted by universities are internal governance instruments that do not enjoy the force of law.

Section 40 of the Act contains the principal funding instruments and sources applicable to universities, including their borrowing powers, capacity and authority. The Act empowers universities to *inter alia* raise money and to raise money by means of loans and overdrafts.

The loan proceeds can be used for any lawful purpose, including refinancing existing debt, even though the Act is silent on this.[1] So empowered, universities can, once they have obtained a university council resolution authorising the terms and conditions of the loan (council resolution), enter into loan agreements or overdraft agreements.[2] Councils are required to apply their collective minds to the acceptability or otherwise of the loan's terms and conditions. In certain instances, discussed below, the prior approval of the Minister of Higher Education and Training (Minister) is required to enter into a loan agreement or an overdraft agreement. Section 40(2)(a) states that, subject to section 40(2)(b) (the ministerial approval section discussed below), a university may enter into a loan agreement or an overdraft agreement.

[1] In contrast, section 71(b) of the Public Finance Management Act 1 of 1999 (PFMA) empowers the Minister of Finance, for purposes of section 66(2), to borrow money to refinance maturing debt or a loan paid before its redemption date. The PFMA does not apply to universities.

[2] Section 40(2)(a) of the Act. This section is complicated by the words 'not taking into account any vacancy that may exist', the meaning of which is unclear.

The borrowing powers of universities

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A formula contained in section 40(2)(b) determines whether or not the Minister must approve of the borrowing by approving the council resolution. The Minister is required to approve the council resolution if the sum of the borrowing authorised by the council resolution plus the borrowing previously approved but not yet taken up, plus the university's short-term and long-term debt at that date exceeds (i) such amount as the Minister has determined for such university; or (ii) in the absence of such determination, 5% of the average annual income of the university during the two years immediately preceding the date of the council resolution. The terms *"annual income"*, *"short-term debt"* and *"long-term debt"* are not defined in the Act and ought to be given their ordinary, standard meaning. It appears that, as the Minister has not made any determination(s), for the purposes of (i) above, the 5% threshold applies to all universities wishing to borrow money. However, lenders should establish, on a deal-by-deal basis, whether the Minister has made a determination for purposes of (i) above in respect of the relevant university to which that lender intends to lend to. Ministerial approval of the council resolution is mandatory under the Act if the new borrowing would trigger the 5% threshold. It is in the interests of both the lenders and universities as borrowers to determine whether the 5% threshold would be triggered such that ministerial approval is required. A failure by a university to issue a council resolution or to obtain the ministerial approval will render the loan or overdraft transaction void. Accordingly, retrospective approval by the council and the Minister will not cure a void loan or overdraft.

The Act takes a rather formalistic approach to the council resolution and the ministerial approval in that it does not deal with the substance of the council approval in respect of the loan or overdraft, or the substance of the ministerial approval in respect of the council's approval. The substance of the approval is left to the discretion and determination of the council and the Minister respectively.[3]

A strict interpretation of these statutory conditions is that universities may not sign the loan agreement or overdraft agreement until the council has passed the council resolution and the ministerial approval has been obtained because the relevant sections (40(2)(a) and (b)) are inter-conditional and signature of the agreement is equivalent to entering into the agreement. A liberal interpretation of these statutory conditions that universities sometimes apply is as follows. Once the council has passed the council resolution, even though the ministerial approval may not have yet been obtained, the university's

[3] The position in the Act is unlike the position in sections 44 and 45 of the Companies Act 71 of 2008 where the board of a company must consider whether the terms of the proposed financial assistance (as defined) are fair and reasonable to the company.

The borrowing powers of universities

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authorised signatory(ies) sign the loan agreement or overdraft agreement on the basis that the council resolution authorised the university to enter into the loan agreement or overdraft agreement, but the council then does not draw down from the loan facility until such time as the Minister issues his/her ministerial approval. This approach is sometimes justified by universities arguing that obtaining the ministerial approval may take many months during which lenders may increase the pricing on the loan and the project that the loan is to fund will stall. The process to request, and the issuance of, the ministerial approval is not regulated by the Act, and is largely determined by the practice in this area.

The Act is silent on the power, capacity and authority of universities to encumber their assets and property as security for their loan repayment obligations. It is submitted that as universities are constituted as juristic persons in terms of section 20(4) of the Act, they have the power, capacity and authority to encumber their assets and property in the ordinary course of their businesses as security, as juristic persons typically are able to do. Universities power, capacity and authority to grant persons real rights in their immovable property is, however, restricted by section 20(5), which requires the concurrence of the Minister for the real right to be valid. A bond registered over a university's immovable property as security for its loan repayment obligations is an example of a (limited) real right that requires the Minister's concurrence in order to be valid.[4] The use of common law forms of security such as the pledge of movable property and the pledge and cession *in securitatem debiti* of incorporeal rights to secure universities' loan repayment obligations may be easier to use as ministerial concurrence is not required.

Lenders funding university projects or working capital requirements ought to stipulate that councils passing their council resolutions, and the Minister issuing his/her ministerial approval, must be conditions precedent to the lenders lending obligations. If, however, it is likely that obtaining the ministerial approval will take many months or only occur after financial close of the loan transactions, lenders could require that the Minister issuing his/her ministerial approval must be a condition precedent to the first draw down or a condition subsequent to the loan transactions.

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[4] Dendy 'Mortgage and Pledge' LAWSA vol 29 3 ed (2020) para 326.

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