

**COUNTY GOVERNMENT OF SIAYA**



**DEPARTMENT OF FINANCE AND ECONOMIC PLANNING**

**DEBT MANAGEMENT STRATEGY PAPER**

**MEDIUM TERM PERIOD**

**2022/23-2024/25**

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## **ABBREVIATIONS**

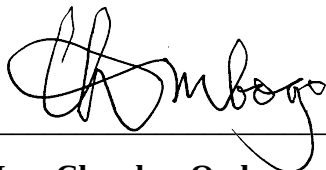
|       |                                                  |
|-------|--------------------------------------------------|
| CoK   | Constitution of Kenya                            |
| PFMA  | Public Finance Management Act                    |
| PDMO  | Public Debt Management Office                    |
| MTDS  | Medium-Term Debt Management Strategy             |
| DLA   | Defunct Local Authorities                        |
| CRA   | Commission on Revenue Allocation                 |
| IBEC  | Intergovernmental Budget and Economic Council    |
| GDP   | Gross Domestic Product                           |
| MOU   | Memorandum of Understanding                      |
| CIDP  | County Integrated Development Plan               |
| ADP   | African Development Bank                         |
| IMF   | International Monetary Fund                      |
| CDMU  | County Debt Management Unit                      |
| DMAC  | Debt Management Advisory Committee               |
| DMU   | Debt Management Unit                             |
| DMAC  | Debt Management Advisory Committee               |
| CALC  | County Asset and Liabilities Committee           |
| IGRTC | Inter- governmental Relation Technical Committee |

## **FOREWORD**

The Constitution of Kenya (CoK) 2010 and the Public Finance Management Act (PFMA) 2012, provide the requisite framework to ensure counties continue with prudent debt management. The PFMA has provision for the National Treasury to establish a Public Debt Management Office (PDMO) that will assist in analysis and processing of debt information and borrowing on behalf of counties.

Preparation of the Medium-Term Debt Management Strategy (MTDS) is provided for under section 123 of the PFMA. The document provides guidance to the county government on the amount and type of borrowing to undertake over the medium term.

This Paper elaborates county debt management strategies for the period, 2022/23-2024/25 and takes note of inherited debts of the Defunct Local Authorities (DLAs) amounting to Kshs 325,911,147 and pending bills of Kshs 146,020,022. In addition, the paper also puts in place mechanisms for county debt management framework, which if realized, will provide for prudent debt management. The institutional framework envisaged will ensure that both the executive and the assembly play their respective roles within the ambits of Section 9 (1) and (2) of the County Governments Act, 2012.



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## ACKNOWLEDGEMENT

This is the last Medium Term Debt Management Strategy to be prepared and tabled in the county assembly during the 2018-2022 planning period in line with the provisions of section 123 of the PFMA 2012. The document provides the general framework for incurring and management of public debt as it sets out strategies aimed at ensuring that government's financing needs and payment obligations are met at the lowest possible cost consistent with a prudent degree of risk.

Preparation of this document was predicated on robust stakeholder engagement with the entire county leadership playing a leading role. I wish to therefore express my gratitude to the following leaders and officers for their steadfastness during the preparation of this document.

First and foremost, my gratitude goes to the County Executive Committee led by H.E. the Governor for providing leadership, vision, and resources required for preparation of this document. Secondly, all the stakeholders who provided input during the preparation of this document are highly appreciated. Finally, my gratitude goes to the secretariat for working tirelessly to ensure timely collection and collation of information incidental to the preparation of this paper.



**Hezbon K. Mariwa**

**Chief Officer-Finance and Economic Planning**

## **1.0 Introduction**

This MTDMS sets out the county plan of action on debt management for the period 2022/2023 to 2024/2025. It operationalizes the government's debt management objectives of ensuring government's financing needs and payment obligations are met at the lowest possible cost consistent with a prudent degree of risk. The document has a strong focus on managing the risk exposure embedded in the debt portfolio specifically, potential variations in the cost of debt servicing and its impact on the budget. In particular, the document identifies how costs and risks vary with the composition of debt.

## **1.1 Legal Framework**

### **1.1.1 Basis for Preparation of the Debt Management Strategy Paper**

Section 123 of the Public finance management act (PFMA) 2012 requires that on or before the 28<sup>th</sup> February in each year, the County Treasury shall submit to the County Assembly a statement setting out the debt management strategy of the county government over the medium term with regard to its actual and potential liabilities in respect of loans and its plans for dealing with those liabilities. After submission to the assembly, the County Executive Committee Member (CECM) for finance is required to publish and publicize the statement and submit a copy to the Commission on Revenue Allocation (CRA) and the Intergovernmental Budget and Economic Council (IBEC).

### **1.1.2 Framework for Borrowing by County Governments**

Article 212, of the CoK 2010 gives county governments a window of opportunity to borrow and to ensure that all borrowed funds are guaranteed by the national government and approved by the county assembly. The constitutional provision on borrowing is operationalized by section 58 (1-4) of the PFMA, 2012 which stipulates the conditions against which the cabinet secretary responsible for the national treasury may guarantee a loan to county governments. Borrowing by county governments should be guided by the fiscal responsibility principles provided for under section 107 (1-5) of the PFMA, 2012 that inter alia requires county governments to exercise prudence in appropriation of public funds to various functions.

Section 140 (1-2) of the PFMA bestows the powers to borrow on behalf of the county government to the CECM for finance. However, before raising the loan the CECM must satisfy

him/herself that the terms and conditions for the loan are set out in writing and are in accordance with: article 212 of the CoK 2010; sections 58 and 142 of the PFMA 2012; The fiscal responsibility principles and the financial objectives of the county government set out in its most recent County Fiscal Strategy Paper and the debt management strategy of the County Government over the medium term.

Section 141 (1-9) sets the obligations and restrictions with respect to borrowing by county governments while section 142 (1-3) sets out conditions for short-term borrowing by county government entities. Authority to execute loan documents at the county level is provided for under section 143 (1-2) while section 144 (1-20) sets out conditions under which county governments may issue securities against borrowed funds.

## **1.2 Objectives of the Strategy**

The main objective of this document is to ensure that the financing needs and payment obligations of the county government are met at the lowest possible cost over the medium to long term and are consistent with a prudent degree of risk.

The strategy aims at providing a general policy direction that will facilitate access to financial markets as well as supporting future development of a well-functioning vibrant debt policy. The underlying intention is to update the strategy regularly, presenting it on an annual basis with the budget estimate documents. Specifically, the Strategy aims at covering financing needs and payment obligations, while minimizing medium to long-term costs and limiting risk in the public debt portfolio to provide an optimal and sustainable composition of public debt.

In summary, the strategy seeks to balance cost and risk of public debt and take account of demand constraints. It also seeks to institutionalize the production of a debt strategy publication as provided for in the PFMA, 2012.

## **2.0 Analysis of Existing Debt**

The debt portfolio of the county government comprises debts inherited from defunct local authorities (DLAs) and pending bills incurred during the period 2019/20-2021/22. The county government inherited debts of the (DLAs) which when analyzed by the County Assets and Liabilities Committee (CALC), amounted to an estimated Ksh 325,911,147. These debts

together with those incurred by national government entities that were devolved will be discharged once the Inter-governmental Relations Technical Committee (IGRTC) grants authority based on the CALC report.

During the period, 2018/19 to 2020/2021, the county government incurred cumulative pending bills amounting to Kshs. 609,121,535 out of which Kshs. 463,101,512 have been paid leaving an outstanding balance of Ksh. 146,020,022.78, out of these Ksh. 105,092,567 was classified as ineligible by the office of the auditor general.

### **3.0 Maintenance of Debt at Sustainable and Affordable Levels**

The components of the MTDMS are to: maintain debt at sustainable and affordable levels; ensure that new borrowing follows fiscal responsibility guidelines for a fit purpose and are from an allowable source and with acceptable terms and conditions; introduce and consolidate fiscal, legal, institutional and operational measures that ensure that the above objectives are met. To ensure that the above components are adhered to the county government will employ the following strategies:

- 1 Pursue grant funding and budget support;
- 2 Where grants are unavailable, or where a loan element of grant funding for priority development projects is mandatory, limited concessional borrowing may be sought;
- 3 Borrowing must be limited to concessional loans from multi- or bilateral donors or development partners,
- 4 The criteria for considering concessional financing shall be a grant element.
- 5 Concessional debt terms and conditions must be appropriate for the project being financed
- 6 Currency exposure should be diversified, but consideration will also be taken of potential volatility of the international currencies
- 7 Projected debt servicing cost, not allowing for grace periods, must be less than 8 per cent of forecast domestic sourced revenues, assuming no growth in revenue;
- 8 Debt servicing shall be sequenced to avoid large peaks in repayment expenses at certain times of year.
- 9 As part of the budget process, an annual borrowing limit will be set such that debt levels will not exceed the minimum set thresholds

10 As a general rule, and to maintain any debt to be incurred at its affordable and sustainable levels or below, the cumulative new issuance should not exceed the cumulative principal repayments to be made once interest to incur debts are floated;

11 Debt levels must be lower than any thresholds stipulated in the Public Finance Management Act 2012 and any other land legislation governing matters debt;

12 Debt levels used in monitoring and analysis will be total public debt;

13 Any additional fiscal surplus arising from buoyant county revenues will be used to retire domestic debt.

14 Ensure that any new borrowing follows legal and fiscal responsibility guidelines for a fit purpose; from an allowable source; and with acceptable terms and conditions.

15 New borrowing must be recommended by a County Debt Management Advisory Unit and approved through the proper legal channels. It must comply with the conditions contained within the MOU signed by the county and the entity issuing the debt. New borrowing must be:

16 For a fit purpose.

*(i) Borrowing must be for the following types of projects*

17 Investing in the productive capacity of Siaya County;

18 Funding priority core infrastructure and development initiatives;

19 Specific purposes (projects) identified as a high priority in the county CIDP or specific sector plans;

Preference shall be given to projects with high rates of return or projects such as investing in hospitals or schools that generate a high ‘social rate of return’ and those that can help the county reach the Millennium Development Goals and the Kenya Vision 2030. Investment projects cash flows need to be clearly identified as sufficient to make debt repayments and the cost of any contingent liabilities and obligations such as tied procurement must be factored into the cost and risk of debt. When lending for revenue generating enterprises, the rate of return must be sufficient to make debt servicing payments and contribute to the future capital requirements of the county.

*(ii) Borrowing must not be used for:*

Funding shortfalls in recurrent expenditure.

Funding any form of losses incurred by the county.

From an acceptable source.

Acceptable and unacceptable funding sources shall be prescribed in the yet to be proposed county debt management bill. For the duration of this Debt Management Strategy (three years), borrowing after the transition period shall be restricted to concessional sources of finance from multilateral or bilateral donors. Such financing generally comes with greater scrutiny and oversight, making sure that funding is used for the purposes it was provided and decreasing reputational risk.

Concessional lending is available through multilateral agencies like the ADB and World Bank and bilateral donors. Loan amounts will depend on the specific projects to be funded and donors' funding allocations to the county. The denomination of the loan currency will also influence the acceptability of the source. Acceptability of source will also depend on the individual characteristics of the loan, limitations, terms and conditions on the loan. Lending from bilateral partners is linked to specific projects and terms and conditions depend on the project.

Unacceptable funding sources:

It is proposed that borrowing from the commercial lenders will be explicitly prohibited. Servicing loans from commercial lenders is expensive and prohibited by IMF programs.

Private sources are prohibited

Borrowing from private sources such as commercial banks is prohibited for the following reasons:

Cost – interest rates are high;

Interest rate risk – with variable interest rates, costs can increase

Rollover risk – loans tend to be short-term;

Requires assets to be offered as collateral;

Lack of transparency.

With favorable terms and conditions.

The terms and conditions associated with any debt proposals must be examined carefully. Loans will be subject to a cost risk analysis by the CDMU

The following factors will be examined:

Grant/ concessional element: Preference should be given to debt with a large grant component. However, the project still needs to be for a fit purpose.

Debt sustainability and affordability: The volume and cost of debt must not have a negative impact on debt sustainability and affordability. All economic indicators must be below the thresholds when subjected to stress tests and using conservative estimates of economic variables.

Hidden costs, such as fees (transaction, commitment, agency or underwriting), requirements for the county Government to fund maintenance or project management expenses must be included in the analysis.

Currency and exchange rate risk: Despite offering very low interest rates, concessional loans still carry foreign exchange risk. The benefit of very low or even zero interest rates could be negated by depreciation. Stress tests used in the above analysis must assess the impact on affordability and sustainability of foreign exchange movements.

Interest rate: Debt with a lower interest rate will have a lower cost. Fixed interest rates have a lower risk than variable interest rates where the future cost of debt is not known.

Tenor: The term of the loan should be more closely aligned to the cash flows of the project. The advantages of very long-term loans (such as the impact of inflation on the value of the loan) and very low repayment amounts can be outweighed by accumulating large amounts of debt over many generations. Very long-term loans may encourage fiscal irresponsibility, because if the project fails, it is future generations that must bear the cost. By using up the borrowing envelope now, it might restrict the ability of future generations to borrow, and they will be servicing debt for projects that were completed before they were born and for which they receive no tangible benefit.

Grace period: Debt sustainability analysis must extend beyond grace periods. The length of the grace period should be assessed in terms of factors such as the revenue stream from the project, its duration, inter-generational equity and the time value of money.

Conditions: Preference should be given to debt with positive characteristics such as project administration or management and advisory services. Negative characteristics such as tied procurement, the requirement to use particular companies or nationalities for project implementation, future expense commitments (such as auditing expenses or maintaining equipment) need to be factored into assessments of the cost of debt.

Concentration risk: If the volume of the loan is large, it may contribute to concentration risk. If an institution or bilateral partner has a large concentration of debt it could use this as a means of exerting undue political influence or bargaining for favors (for example tax concessions, access to resources). The behavior of the lender needs to be assessed.

Legal risk: Borrowing proposals must be examined for potential legal risks. They must not contravene any land legislation

## **4.0 Implementation framework**

This section seeks to introduce and consolidate fiscal, legal, institutional and operational measures that ensure that the objectives of the Strategy are met. Fiscal, legal, institutional and operational measures are needed to strengthen debt management and establish a borrowing framework. These measures also need to increase transparency and accountability so as to restore credit worthiness through rebuilding reputation. The PFMA 2012 provides an effective borrowing framework.

### **4.1.1 Fiscal measures**

The County Government must continue its commitment to balanced recurrent budgets and debt should not be used for recurrent spending.

Annual borrowing limits will be set as part of the budget process to keep debt at sustainable and affordable levels, based on conservative forecasts of macro-economic factors, and in line with the County Fiscal Strategy Paper.

### **4.1.2 Legal measures**

Essential aspects of debt management contain these elements:

- 1 Definition of debt to include loans, borrowings, guarantees and on-lending;
- 2 Clear authorization by county assembly to approve borrowings and loan guarantees on behalf of the county government;
- 3 A requirement that all borrowing proposals (including guarantees) are reviewed by a Debt Management Advisory Committee (DMAC) and recommendations submitted to the CECM for finance before borrowing and loan guarantees can be approved on behalf of the government;
- 4 Decisions surrounding borrowing made as part of the budget process so that projects can be compared on merit, and appropriations are made for borrowed funds;
- 5 Clear authorization from the CECM for Finance to the debt management entities to undertake borrowing and debt-related transactions and to manage loan guarantees
- 6 Clear debt management objectives, including that the cost of the debt is minimized from a medium/long-term perspective, the risks in the debt portfolio are kept at acceptable levels, and that development of the domestic debt market is promoted;

7 A requirement to review and update the Debt Strategy annually which will serve as an operational strategy and will provide a framework for how the county government will achieve its debt management objectives; and

8 As part of the annual update of the Debt Strategy, mandatory reporting on progress since the last review, covering an evaluation of outcomes against stated objectives.

#### **4.1.3 Institutional framework**

##### *(i) Process for recommending borrowing proposals to County Executive*

There is needed to be clear delegation of responsibilities for recommending and approving debt, where debt includes loans, borrowings, and guarantees and on lending by the county government. In this regard, DMAC will recommend and rank acceptable proposals. It is therefore, proposed that:

Proposals that have been recommended by the DMAC can then be submitted and incorporated as part of the budget approval and appropriation process.

The CECM for finance has sole authority to approve loans. Therefore, borrowing will not be legal unless it has been signed off by CEC Member for finance.

##### *(ii) Functions and responsibilities of the Debt Management Unit*

The functions and responsibilities of the DMU will include:

- 1 Make debt payments on time and for the correct amount;
- 2 Keep timely, comprehensive and accurate records of outstanding government debt, guarantees, contingent liabilities and new borrowing in a single debt database;
- 3 Publish, in a timely manner, monthly (and quarterly) reports showing the status of outstanding debt, debt payments, and projected debt payment obligations;
- 4 Prepare, review and update the Debt Strategy;
- 5 If required, prepare an annual borrowing plan;
- 6 Prepare and publish auction calendars for issuance of domestic securities (Treasury Bills and Treasury Bonds);
- 7 Assess the risks in issuing any guarantees, and prepare reports on the method used for each assessment and the results thereof for the attention of the CEC Member for Finance;

DMAC will assess the volume and risk characteristics of debt to ensure that:

- 8 Debt is sustainable and affordable;
- 9 Debt is below the thresholds established;

- 10 Debt is from an acceptable source;
- 11 Debt is for a good purpose and the project is a high priority in the CIDP;
- 12 Debt is not for funding recurrent expenditure;
- 13 Project has a positive Net Present Value or helps achieve Vision 2030 and the MDGs;
- 14 The cost of any contingent liabilities and obligations such as tied procurement are factored into the cost and risk of debt;
- 15 Cash flows from project can be identified that will be able to be used for repaying the loan.
- 16 Loan terms and conditions are acceptable and achieve the best cost and risk outcome.
- 17 Borrowing aligns with the CFSP

*(iii) Debt Management Advisory Committee*

The Debt Management Advisory Committee will evaluate borrowing proposals. The Debt Management Advisory Committee will be chaired by the chief officer in charge of finance with membership from Planning, Infrastructure and water dockets. The county treasury will act as secretariat for the Committee. The Committee will make recommendations to the CECM for finance as to whether borrowing should or should not proceed.

#### **4.1.4 Operational framework**

Operating framework will consist of:

*Debt recording:* The DMU will maintain accurate and up-to-date records of all debt (including guarantees, on- lending and contingent liabilities) and investments, which can then be reported. DMU also needs to keep records on liabilities of county entities.

*Debt reporting:* DMU will publish monthly reports on the status of County's total debt including loans, guarantees, contingent liabilities and payment arrears. The report will include details of new borrowing and issuance of Government guarantees, as well as debt repayments, rescheduling, write-offs, and retirements.

Quarterly debt bulletins indicating debt levels and cost, debt sustainability and affordability and actual and projected debt service costs over the medium term will be published on county's websites. An Annual Report will be produced showing changes in the debt status over the year, details of any new borrowing and debt repayments, key events in the management of debt and

the DMU, and a review of progress and performance against the Debt Strategy. Reports will be published in a timely manner, so that stakeholders have access to up-to-date information.

*Debt Strategy:* Every year the DMU will review, update the debt management strategy and present to the county assembly. The Debt Strategy will provide a framework for ensuring debt financing decisions are consistent with County government's broader fiscal and development strategies and that the level of borrowing fits within the debt sustainability/affordability thresholds defined in legislation or any other official documents and with achieving macroeconomic objectives.

*Borrowing Plan:* When required, DMU will prepare a borrowing plan.

*Debt Sustainability Analysis:* DMU will prepare a debt sustainability analysis.

*Integration with Cash Management:* The DMU will continue to work with county treasury to integrate cash and debt management. Cash management ensures that County government has sufficient funds to meet its obligations as at when they fall due. Use of cash management tools depends on reliable cash forecasting. For example, Treasury Bills can be issued to fund forecast cash shortfalls, with maturity timed to coincide with periods of forecast cash surplus. Similarly, excess cash can be invested in term deposits or similar instruments to earn the county government reasonable rates of return, with term deposits maturing at times of forecast cash shortfall.

*Compliance;* Where staffing levels permit, the DMU will move toward an office organization with separation of back, middle and front office duties so that work can be monitored and verified. DMU will also work with Treasury toward greater integration of the cash management task.

*Capacity Building:* Capacity building will continue at all levels and the DMU will update its capacity development plan annually.

*Business Continuity and Disaster Recovery:* Business continuity will be strengthened by documenting procedures for all key processes. A register will be kept of key spreadsheets and documents, and these will be backed up regularly.

## **5.0 Key Assumptions**

This section describes the medium-term strategy assumptions considered during preparation and those that are to affect the realization of the proposed management strategies.

- 1 The macroeconomic framework underpinning the strategy will remain stable during the medium-term period. Forecasted GDP growth rates will be realized and variables such as inflation rates, interest rates amongst others will remain stable to minimize the cost of debt.
- 2 The macroeconomic framework underpinning the 2022/2023- 2024/2025 MTDMS is consistent with projections included in the County Fiscal Strategy Paper for FY 2022/23. The fiscal strategy paper objects at providing a general fiscal direction to support economic activities taking into consideration debt harmony in the next three years with improved forecast of the national economy.
- 3 The political, social and economic environment will remain favorable during the implementation of the strategy.
- 4 As per the constitution:
- 5 The county government will be allocated fund as provided for in law;
- 6 The national government will guarantee all county government loans;
- 7 The County Government of will adhere to the strategies contained in this document
- 8 Appropriate enabling debt management framework exist (adequate legal framework; effective institutional arrangements and comprehensive and efficient debt recording).

## **6.0 Conclusion**

This Paper has enunciated county debt management strategies for the period, 2022/2023 – 2024/2025. The Paper takes note of inherited debts of the DLAs, pending bills and leasing of equipment. In addition, the Paper also puts in place mechanisms for county debt management framework, which if realized, will provide for professional debt management. The institutional framework envisaged will ensure that both the executive and the assembly play their roles within the ambits of Section 9 (1) and (2) of the County Governments Act, 2012. The strategies proposed will ensure low-cost funding with high returns, thereby promoting socio-economic well-being of the citizens.