

REPUBLIC OF KENYA

COUNTY GOVERNMENT OF SIAYA



FINANCE AND ECONOMIC PLANNING



COUNTY DEBT MANAGEMENT STRATEGY PAPER

MEDIUM TERM PERIOD

2024/25-2026/27

FEBRUARY 2024

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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
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 for borrowing and sustainable management of public debt by both national and county governments. All borrowing by national government Ministries, Departments and Agencies (MDAs) and county governments must therefore be guaranteed by the National Treasury. Whereas the framework for borrowing by national government MDAs exists and is operational, that for borrowing by county governments has not been operationalized and no county government has been able to borrow to date. Public debt in this strategy therefore refers to pending bills incurred/likely to be incurred by the county government in the course of budget execution.

The total verified pending bills at the beginning of FY 2023/2024 was Kshs.741,559,698 out of which Kshs.367,733,536 had been paid by end of February 2024 leaving a balance of Kshs.373,826,162 which the county government commits to pay in the year under implementation. Going forward, the county government intends to eliminate accumulation of pending bills fiscal discipline in budget execution. This paper provides strategies for managing pending bills in the medium term to reduce/eliminate pending bills. Preparation of the Medium-Term Debt Management Strategy (MTDS) is provided for under section 123 of the PFMA.



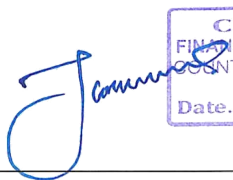
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ACKNOWLEDGEMENT

This is the first Medium Term Debt Management Strategy to be prepared and tabled in the county assembly for the 2023-2027 plan period in line with the provisions of section 123 of the PFMA 2012. Notably, preparation of this document was premised on a robust stakeholder engagement and the entire county leadership playing a leading role. I therefore wish to recognize the following leaders for their tireless contributions in preparation of this document.

To begin with, 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.

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Section One

Public Debt Management

1.0 Introduction

Section 123 of the Public Finance Management Act (PFMA) 2012 requires that on or before the 28th of 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 regarding 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 Objective for Public Debt Management

In the context of the County government, the County Debt Management Strategy (CDMS) is a framework that guides in the reduction and/or elimination of pending bills. The main objective of this strategy 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

1.2 Scope of the Strategy

This County Debt Management Strategy is for the medium term 2024/25-2026/27 and aims at providing policy direction that will facilitate County Government access to financial markets as well as support future development of a comprehensive debt policy over the medium term.

Section Two

County Public Debt

2.0 Introduction

The County Public debt portfolio should comprise all financial obligations, attendant to loans raised and security issued and pending bills incurred by the County. The debt policy guides the County in determining, establishing and upholding legal and institutional framework that are in place to guide borrowing and addresses both external and domestic debt management within the County. The County Government in its operations will accumulate pending bills which accrue due to roll-overs occasioned by late procurement process during financial years, erratic exchequer releases affecting the projected cash flow and continuous non-realization of local revenue target.

County Public Debt Portfolio

The County Government of Siaya has outstanding pending bills amounting to Kshs.373,826,162.03 as at 25th February 2024. The pending bills comprise balances owed to contractors and suppliers of goods and services as shown in table 1 below:

Table 1: Summary of accumulated pending bills as at 25th February, 2024

Description	Outstanding Pending Bills as at 25th February 2023	Outstanding Pending Bills as at 25th February 2024
Recurrent	289,763,490.44	238,891,499.78
Development	210,846,432.29	134,934,662.25
Salary By-products	-	-
Total	500,609,922.73	373,826,162.03

Source: County Treasury

Section Three

Borrowing Framework

3.0 Overview

The power to borrow by the County Government is provided for under article 212 of the CoK 2010 and section 140 of the PFM act, 2012. Section 140 of PFMA, 2012 provides the circumstances and the policy framework under which the County Executive Committee Member (CECM) for Finance may, on behalf of the county government, raise a loan for that government's purposes within or outside Kenya. The loan and terms and conditions for the loan must be set out in writing and must be in accordance with:

1. Article 212 of the Constitution;
2. Sections 58 and 142 of this Act;
3. The fiscal responsibility principles and the financial objectives of the county government set out in its most recent County Fiscal Strategy Paper;
4. Debt Management Strategy (DMS) of the county government over the medium term.

Section Four

County Debt Management Strategy

4.0 Overview

The CDMS aims at: maintaining 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.

4.1 Sustainable Debt Level

To minimize pending bills the county government will employ the following strategies;

- 1 Formation of standing pending bills committee for Verification of outstanding claims.
- 2 Providing budgetary allocation within departments for payment of verified pending bills.
- 3 Reduce interest and penalties charged due to non-remittance of statutory and other payment obligations
- 4 Strict Adherence to budgeted programmes and projects during implementation. to avert expenditure outside the budget.
- 5 Timely procurement of goods and services to reduce pending bills

Upon operationalization of the borrowing framework for county governments, the county government of Siaya will employ the following strategies to ensure that debt levels are sustainable and affordable.

- 6 Pursue grant funding for budget support-Where grants are unavailable, or where a loan element of grant funding for priority development projects is mandatory, limited concessional borrowing may be sought from multi or bilateral donors or development partners;
- 7 Concessional debt terms and conditions must be appropriate for the project being financed;
- 8 Projected debt servicing cost, not allowing for grace periods, must be less than 8 per cent of forecast domestically sourced revenues.
- 9 Debt servicing shall be sequenced to avoid large peaks in repayment expenses at certain times of year.

4.2 Legal and Fiscal Responsibility guidelines

The County Government must ensure that any new borrowing follows legal and fiscal responsibility guidelines for a fit for purpose; from an allowable source; and with acceptable terms and conditions. New borrowing must be recommended by a County Debt Management Advisory Unit (CDMAU) 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:

4.2.1 Fit for Purpose.

In order to ensure borrowing is fit for purpose, the following types of projects will be prioritized:

- a) Investing in the productive capacity of Siaya County;
- b) Funding priority core infrastructure and development initiatives;
- c) Specific purposes (projects) identified as a high priority in the county CIDP, CADP and CFSP 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 Kenya Vision 2030 and the County Integrated Development Plan (CIDP 2023-2027).

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. Finally, the County shall not borrow to fund shortfalls in recurrent expenditure and any form of losses incurred by the County.

4.2.2 Borrowing 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 AfDB 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.

The County Government of Siaya is in discussions with AFREXIM Bank to evaluate and fund Project Preparation Facility (PPF) targeting flagship projects, however the PPF for successful projects will be recovered from the strategic investor.

4.2.3 Borrowing 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 County Debt Management Unit (CDMU). The following factors will be examined while checking for favorable terms:

1. Debts with a large grant component and fulfils the fit purpose should be given preference as they have concessional elements ingredients.
2. The volume and cost of debt must not have a negative impact on debt sustainability and affordability.
3. 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.
4. The term of the loan (tenor) 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.
5. 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.

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

Section Five

Implementation Framework

5.0 Overview

This section seeks to introduce and consolidate fiscal, legal, institutional and operational measures that ensure that the objectives of the Strategy are met. These measures are needed to strengthen debt management and operationalize borrowing framework as well as increase transparency and accountability.

5.1 Fiscal measures

The County Government must continue its commitment to balanced budget in line with the CFSP.

5.2 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.

5.3 Institutional framework

(i) Process for recommending borrowing proposals to County Executive

There is need to be clear on 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:

- 1 Debt is sustainable and affordable;
- 2 Debt is below the thresholds established;
- 3 Debt is from an acceptable source;
- 4 Debt is for a good purpose and the project is a high priority in the CIDP;
- 5 Debt is not for funding recurrent expenditure;
- 6 Project has a positive Net Present Value or helps achieve Vision 2030 and the MDGs;
- 7 The cost of any contingent liabilities and obligations such as tied procurement are factored into the cost and risk of debt;
- 8 Cash flows from projects can be identified that will be used for repaying the loan;
- 9 Loan terms and conditions are acceptable and achieve the best cost and risk outcome;
- 10 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.

5.4 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 the 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.

5.5 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. The assumptions are

as follows:

- 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 2023/24- 2025/26 MTDMS is consistent with projections included in the County Fiscal Strategy Paper for FY 2023/24. 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:
 - a) The County Government will be allocated fund as provided for in law;
 - b) The National Government will guarantee all county government loans;
 - c) The County Government will adhere to the strategies contained in this document.

Appropriate enabling debt management framework exist (adequate legal framework; effective institutional arrangements and comprehensive and efficient debt recording).