REPUBLIC OF KENYA

COUNTY GOVERNMENT OF MAKUENI

COUNTY TREASURY

County Debt Management Strategy Paper

FY 2018/2019 – 2020/21 MEDIUM TERM EXPENDITURE FRAMEWORK

FOREWORD

Public Debt Management is the process of establishing and executing a strategy for managing the government's debt. This is done in order to raise the required amount of funding to meet any arising budget deficit necessary to realize the objectives set by government.

The Makueni County Debt Management Strategy provides a framework that will guide the County Government to ensure that; debt levels stay affordable and sustainable, any new borrowing is for a good purpose and that the costs and risks of borrowing are minimized.

The purpose of the 2018 Medium Term Debt Strategy is to guide County Government borrowing in the medium term while providing a path for sustainable level of debt over the same period. It evaluates both costs and risks of various debt management strategies and recommends an optimal debt management strategy for implementation in the future.

The County Government of Makueni has no plans of incurring debt in the financial year 2018/2019. The County's Budget will be balanced with the resource envelope available hence there will be no anticipated need for deficit financing. However, due to the implementation of the Vision 2025, the Medium Term Debt Management Strategy will highlight strategies to be explored in seeking funding for the enormous financial needs from either internal or external sources. This will help to deliver the programmes in the Vision.

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COUNTY EXECUTIVE COMMITTEE MEMBER - FINANCE & SOCIO ECONOMIC PLANNING

ACKNOWLEDGEMENT

This is the first Medium Term Debt Management Strategy (MTDS) prepared by the County Government under the requirement of the PFM Act 2012. The document sets out the debt management strategy for the Government of Makueni County.

The Makueni Debt Management strategy for FY 2018/19 is informed by a fiscal policy supportive of the macro-economic stability and growth. As at now, the County Government's public debt is nil.

I would like to acknowledge the overall guidance provided by ECM Finance Mrs. Mary K. Kimanzi throughout the preparation period of this debt management strategy. The Budget, Revenue & Planning team spent a significant amount of time to put together the report. In this regard, I'm grateful for their technical input and commitment to the success of the process. Thank you all for the excellent support and work.

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EXECUTIVE SUMMARY

The 2018 Makueni County Government Debt Management Strategy Paper is the first to be developed by the County Treasury. This is in line with section 123 of the Public Finance Management 2012 Act.

This document lays out plans for Makueni County debt management for the next three years. It targets three different ways to help the county achieve its objectives. Firstly, it sets out the analysis required for a debt strategy and to determine annual borrowing limits, secondly it puts in place a borrowing framework that is intended to be incorporated into Fiscal Responsibility Legislation and lastly, clarifies the responsibilities of the Debt Management Unit (DMU) of the docket of finance and Planning.

The strategy is structured in four sections with each section highlighting a specific segment of the paper.
Section one provides the general objectives, goals and principles of debt management and defines debt and debt management. The chapter also highlights the legal framework for MTDS.

Section two discusses the key assumptions in preparing the strategy paper and also puts a focus on debt management & sustainability strategies. The chapter also outlines the institutional and operational framework for debt management.

Section three discusses macroeconomic framework underpinning the 2018 Medium Term Debt Management Strategy. The chapter has also analyzed Potential financing sources for the County Government.

Section four provides the conclusions, summary and recommendations for the County Government.

1.0 GENERAL OBJECTIVES OF DEBT MANAGEMENT IN MAKUENI COUNTY

1.0 Introduction

Makueni County Government has a long term development blue print aimed at transforming the county socio economically by year 2025. The development blue print christened vision 2025 aims at achieving accelerated and inclusive economic growth and development; improved access to quality water and health services, access to quality education, increased job creation, increased household incomes and sustainable food security.

The strategic interventions contained in the vision are crucial for setting a background for economic development and also provide a conducive environment for the growth of all sectors.

To successfully realize the dream, the county has to have a robust resource mobilization strategy to secure funds towards these strategies.

The Government will therefore seek funding through debt in the medium term, to fund key flagship projects in the Vision for socio economic transformation of the county.

1.1 Public Debt Management & its Objectives

Public Debt; is defined by Constitution Art.214.(2) as all financial obligations relating to loans raised or guaranteed and securities issued or guaranteed by the national government.

Public Debt Management -is the process of establishing and executing a strategy for **managing** the government's **debt** in order to; raise the required amount of funding, achieve its risk and cost objectives, and to meet any other **objectives set by** government.

Deficit is the financing gap created when projected expenditure exceeds available revenues. To finance this gap government's resort to borrowing and debt is created.

Public debt management objectives are; to ensure that the county government's financing needs and payment obligations are met at the lowest possible cost over the medium to long term, with a prudent degree of risk, while ensuring the equitable sharing of benefits and burdens of public debt between the current and future generation.

Government debt or borrowing includes the contracting or guaranteeing of domestic and/or external (foreign) debt through loans and any other type of borrowing.

External debt is defined as debts owed to creditors domiciled outside the economy while domestic debt is defined as debt owed to creditors domiciled within the economy

1.2 Purpose of a debt strategy paper.

A debt strategy guides the government on **how, where, when and what** to borrow in order to finance the budget deficit

As per PFM Act Section 123, counties are required to prepare and submit a debt management strategy over the medium term to the County Assembly on or before 28th February in each year. This is in regard to its actual and potential liabilities in respect of loans and its plans of dealing with those liabilities.

The County Debt Management Strategy Paper sets out the framework for the management of county public debt. The strategy is formulated annually on a three year rolling basis and will be revised when market conditions change.

1.3 Scope & Objective of a County Debt Management Strategy Paper

This Debt Management Strategy Paper is a framework that the County government intends to use over the medium-term to meet its debt financing requirements to ensure delivery of Vision 2025. The strategy is on a three year rolling basis with an aim to ensure that debt levels stay affordable and sustainable.

Main objective of a County Debt Management Strategy Paper;

i. Identifies the optimal way to meet the government financing requirements at the least cost with a prudent degree of risk, determine the appropriate trade-off between cost and risk and satisfy the financing requirement.
ii. Considers a range of alternative debt management strategies
iii. Assesses the performance of the strategies on the basis of
    a. Cost and risk
    b. Achievement of other objectives as set out by the county
iv. Identifies preferred strategy

This Debt Strategy covers both domestic and external debts of the county government or its agencies as may be authorized by the county assembly.

The 2018 Debt Management Strategy will guide County Government debt management operations in the Medium Term FY 2018/19- 2020/2021. The Strategy seeks to balance cost and risk of county debt while taking into account the county government financing needs. In addition, the strategy incorporates initiatives to seek new funding sources, support the County Government priorities for socio economic transformation and achieve debt sustainability.

The Debt Management Strategy will provide appropriate guidelines and direction to assist in making sound debt management decisions, while further demonstrating strong financial management practices for our county citizens, outside investors and credit agencies.

1.4 Legal framework for debt management & developing the MTDS for the county government;

1.4.1 Responsibilities of County Treasury in matters of debt

Pursuant to PFM ACT Section 107 (2) The County Treasury is mandated to manage its public finances in accordance with the principles of fiscal responsibility and ensure that it does not exceed the limits stated in the regulations. In managing the county government's public finances, the County Treasury shall ensure; over the medium term, the government's borrowings shall be used only for the purpose of financing development expenditure and not for recurrent expenditure; and the county debt shall be maintained at a sustainable level as approved by county assembly;

Pursuant to PFM regulation 25; the county public debt shall never exceed twenty (20%) percent of the county governments total revenue at any one time.

1.4.2 Authority for borrowing by county governments.

According to Section 140. (1) of the PFM Act, the County Executive Committee member for finance, on behalf of the county government, may raise a loan for that Government's purposes, only if the loan and the terms and conditions for the loan are set out in writing and are in accordance with—

a) Article 212 of the Constitution;- A county government may borrow only— (i) if the national government guarantees the loan; and (ii) with the approval of the county government's assembly

b) Section 58; Mandates the cabinet Secretary (National Treasury) to guarantee loans for county governments or any other borrower on behalf of the national government with approval by Parliament.

c) Section 142 of PFM Act; the County Assembly may authorize short term borrowing by county government entities for cash management purposes only. However such borrowing shall not exceed five percent of the most recent audited revenues of the county. The borrowing should be repaid within a year from the date on which it was borrowed.

d) The fiscal responsibility principles and the financial objectives of the county government set out in its most recent County Fiscal Strategy Paper; and

e) The debt management strategy of the county government over the medium term.

Pursuant to PFM regulations 177(2) a county government may from time to time borrow within and outside Kenya such sums of money in such amount and on such terms and conditions as to interest, repayment, disbursement or otherwise as the County Executive Committee Member may think fit, in any of the following manners—

(a) By issuing County Treasury bonds;
(b) By bank overdraft facility from the Central Bank of Kenya; and
(c) By any other loan or credit evidenced by instruments in writing.

However, any borrowing under paragraph (2) (a) and (c) of PFM regulation 177 shall require a national government guarantee pursuant to section 58 of the PFM Act.

At any time, the annual debt service cost of a county government shall not exceed fifteen (15%) percent of the most recent audited revenue of that county government, as approved by county assembly (PFM Act regulation 179 (2)).

1.4.3 Legal framework for preparing a MTDS

The PFM Act section 123 mandates the county to develop a medium-term debt management strategy paper; Sec 123 states - **(1)** "On or before the 28th February in each year, the County Treasury shall submit to county assembly a statement setting out the debt management strategy of the county government over the medium term with respect to its actual liability and potential liability in respect of loans and guarantees and its plans for dealing with those liabilities.

(2) The County Treasury shall include the following information in the statement-

- The total stock of debt as at the date of the statement
- The sources of loans made to the county government
- The principal risks associated with those loans
- The assumptions underlying the debt management strategy; and
- An analysis of the sustainability of the amount of debt, both actual and potential

(3) As soon as practicable after the statement has been submitted to the county assembly under this section, the County Executive Committee member for Finance

shall publish and publicize the statement and submit a copy to the Commission on Revenue Allocation and the Intergovernmental Budget and Economic Council.

2.0 MACROECOMIC ASSUMPTIONS OF THE MTDMS.

2.1 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 assumption is:

i. The macroeconomic framework underpinning the strategy will remain stable during the medium term period. Forecasted GDP growth rates and variables such as inflation rates, interest rates amongst others are expected to remain stable to minimize the cost of debt.
ii. The macro-economic framework underpinning the 2018/2019-2020/2021 MTDS is consistent with projections included in the 2018 County Fiscal Policy Strategy Paper. The fiscal strategy paper aims 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.
iii. The political, social and economic environment is expected to remain favorable during the implementation of the strategy.
iv. As per the constitution, the national government is expected to guarantee county government loans
v. The National Treasury is expected to sustain the efforts towards minimizing the delays in disbursement of equitable share transfers and other factors which might lead to escalation of demand for short-term finance by the counties.

2.2 Analysis of Debt Sustainability

The County Government of Makueni does not have debts. The expenditure per year has always balanced off with the revenues. However in the medium term the county will seek funding for the flagship projects identified in the Vision 2025 that will be geared towards stimulating growth in the other sectors of the county Government.

2.2.1 Debt Management Strategies

This section outlines debt management strategies envisaged should the County Government of Makueni contract a debt in future.
In the event, the county seeks debt to finance its operations, the following shall be adhered to;

i. Debt shall be sustained at affordable levels.

To realize this, the county will ensure;

a) It pursues grant funding and budget support
b) Where grants are unavailable, or where a loan element of grant funding for priority development projects is mandatory, limited concessional borrowing will be sought
c) Borrowing will be limited to concessional loans from multi- or bilateral donors or development partners

ii. Any new borrowing shall follow fiscal responsibility guidelines for a fit purpose; from an allowable source and with acceptable terms and conditions.

Any borrowing sought by the County will be for;

a. Investing in the productive sectors of Makueni County;
b. Funding priority core infrastructure and development initiatives as identified in Vision 2025;
c. Specific purpose projects identified as a high priority in the county Vision 2025; Preference shall be given to projects that have the chance to stimulate growth and development of all other sectors.

No borrowing will be done to fund shortfalls in recurrent expenditure.

iii. Introduce and consolidate fiscal, legal, institutional and operational measures that ensure that the above objectives are met.

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.

2.3 Institutional and Operational Framework

2.3.1 County Debt Management Unit

There shall be a County Debt Management Unit (CDMU) under the County Treasury of Makueni county government. The Debt management Unit will provide secretariat services to the County Debt Management Advisory Committee (DMAC).

The functions and responsibilities of the County Debt Management Unit will include:

i. Making debt payments on time and for the correct amount,

ii. Keeping timely, comprehensive and accurate records of outstanding government debt, guarantees, contingent liabilities and new borrowing in a single debt database;
iii. Publishing, in a timely manner, monthly (and quarterly) reports showing the status of outstanding debt, debt payments, and projected debt payment obligations;
iv. Preparing, reviewing and updating the Debt Strategy;
v. Preparing an annual borrowing plan
vi. Assessing 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;
vii. Submitting all debt reports and debt management strategy to DMAC for consideration and recommendation.

2.3.2 County Debt Management Advisory Committee

The County shall establish a County Debt Management Advisory Committee (DMAC).This Committee will be chaired by the Chief Officer in charge of finance with membership of technical officers from County Treasury & representatives from the three pillars of the Vision 2025 i.e (Economic Pillar (Department of Transport & Infrastructure), Social Pillar (Department of water) & political pillar (Department of Devolution & Public service). The Debt Management Advisory Committee will evaluate borrowing proposals and make recommendations to the CECM for finance as to whether borrowing should or should not proceed.

The County Debt Management Advisory Committee will assess the volume and risk characteristics of debt to ensure that:

i. Debt is sustainable and affordable;
ii. Debt is below the thresholds established;
iii. Debt is from an acceptable source;
iv. Debt is for a good purpose and the funded project is a high priority in the CIDP 2018-2022 & Vision 2025;
v. Debt is not for funding recurrent expenditure;
vi. The project to be funded has a positive Net Present Value or helps achieve Vision 2025 and the SDGs;
vii. The cost of any contingent liabilities and obligations such as tied procurement are factored into the cost and risk of debt;
viii. Loan terms and conditions are acceptable and achieve the best cost and risk outcome
ix. Borrowing aligns with the CFSP.

2.3.3 Process for approving loan Proposals by the County Government

Pursuant to Section 184 of PFM regulations the County Executive Committee member for finance shall submit the borrowing proposal which will include its terms and conditions to the County Executive Committee for approval of the borrowing;
After approval by the County Executive Committee, the County Executive Committee member for finance shall submit the signed loan agreement and a sessional paper to the County Assembly for approval.
After obtaining the approval of the County Assembly, the County Executive Committed member for finance shall submit 'the final draft loan financing agreement and the 'approval of the County Assembly to the Cabinet Secretary requesting for the guarantee of the final loan financing agreement;

The County Debt Management Advisory Committee will be responsible for recommending and ranking acceptable proposals to be submitted by the County Executive Committee Member for Finance to the County Executive Committee for considerations and approval. The approved proposals will then be submitted and incorporated as part of the budget approval and appropriation process after signing by the CEC member for finance. Borrowing will not be legal unless it has been signed off by CEC member for finance.
The operating framework for the debt management unit will consist of:

a) **Debt recording**: The CDMU shall maintain accurate and up-to-date records of all debt and investments, which can then be reported. CDMU will also keep records on liabilities of county entities.

b) **Debt reporting**: CDMU shall 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 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 also 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 in the DMU, and a review of progress and performance against the Debt Strategy. Reports shall be published in a timely manner, so that stakeholders have access to up-to-date information

c) **Debt Strategy**: Every year the CDMU shall 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 the county broader fiscal and government's development strategies that of borrowing fits within the debt/sustainability/affordability thresholds defined in legislation or any other official documents and with achieving macroeconomic objectives.

d) **Borrowing Plan**: the CDMU shall prepare a borrowing plan.

e) **Debt Sustainability Analysis**: CDMU shall prepare a debt sustainability analysis.

f) **Integration with Cash Management**: The CDMU shall 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 and when they fall due.

g) **Compliance**: Where staffing levels permit, the CDMU 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 County Treasury toward greater integration of the cash management task.

h) **Capacity Building**: Capacity building shall continue at all levels and the CDMU will update its capacity development plan annually.

3.0 MACROECONOMIC ENVIRONMENT AND POTENTIAL SOURCES FOR FUNDING.

3.1 National debt outlook

Kenya's debt ratios compared with internationally recognized threshold continues to show that our debt level remains sustainable (Table 3.1). Both the present value of public sector debt to GDP ratio and present value of public sector debt to revenue ratio are well within internationally recognized thresholds.

Table3.1: Public Debt Indicators

Indicator (Threshold)	**2016**	**2017**	**2019**	**2021**	**2026**
PV of public sector debt to GDP ratio (74)	48.7	49.0	48.6	43.2	35.6
PV of public sector debt-to-revenue ratio (300)	247.2	235.7	226.6	201.4	161.4
Debt service-to-revenue and grants ratio (30)	32.0	34.8	29.6	26.5	23.7

Source; National BPS.

3.2 County debt outlook

The County has no debt. However any new debt to be sought will be in line with the strategies outlined in this Debt strategy Paper.

3. 3 Potential financing sources

The potential sources of Loans for Makueni County Government falls under two categories;

a) Domestic sources of loans

This will consist of borrowing from Financial (Banks, pension funds, insurance companies) and non-financial institutions (domestic instruments E.g. T-bills, T-bonds).

b) External sources of loans

The main sources will include Loans and grants from multilateral, bilateral organizations.

4.0 CONCLUSION

The 2018/19 – 2020/21 County Debt Management Strategy Paper is a robust framework for prudent debt management. It provides a systematic approach to decision making on the appropriate composition of external and domestic borrowing to finance the budget in the medium term, taking into account both cost and risk. The paper observes that the County Government of Makueni is yet to contract a debt within the interpretation of Section 122 and 123 of the PFMA, 2012. In this regard, it proceeds to make proposals on strategies to be adopted in future.

The institutional framework envisaged will ensure that both the executive and the assembly play their roles within the provisions of Section 9 (1) and (2) of the County Governments Act, 2012 for the benefit of the public. The strategies proposed will ensure low cost funding with high returns, thereby promoting socio-economic well-being of the citizens. This is expected to contribute to economic growth both at the county and national level and ensure delivery of Vision 2025 for enhanced socio economic transformation.

Implementation of the strategies is the responsibility of the CEC Members led by the CEC Member for Finance and Economic Planning while the Assembly will provide the oversight role in line with the law.