Republic of Kenya

COUNTY GOVERNMENT OF VIHIGA

Medium Term
Debt Management Strategy

2019/20 – 2020/21

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Table of Contents

FOREWORD

The Medium-Term Debt Management Strategy (MTDS) is one of the important deliverables of the County Treasury as provided for under the PFMA. It provides the guidance to the Counties on the amount, type of borrowing to undertake over the medium term. It evaluates the costs and risks of various scenarios and recommends an optimal strategy for implementation.

The National Treasury has developed guidelines for country domestic and external borrowing to guide engagement between the GOK and development partners, counties and National Government to ensure proper coordination not only in the area of loans but also grants and on other forms of aid.

Vihiga County Government through its Fiscal Strategy Paper 2019 does not anticipate to borrow in the Medium Term. We are affected by contingency, creditors and statutory liabilities. (pending bills).

Vihiga County Government will ensure that the servicing and management of the County Government's financing requirements and payment obligations are met on a timely basis, and at the lowest possible cost over the medium to long run. consistent with a prudent degree of risk.

HON. ALRED INDECHE
CEC MEMBER FOR FINANCE
COUNTY GOVERNMENT OF VIHIGA
FEBRUARY 2019

ACKNOWLEDGEMENT

The MTDS sets out the debt management strategy of the County over the medium term with respect to actual and potential debts liabilities for both loans and other payables.

As required by the PFMA the MTDS will be formally tabled to County Assembly, submitted to the Intergovernmental Relations office and will be published and publicized.

To ensure circulation of the MTDS, it will be available in the County website. www.Vihiga.go.ke.

Let me take this opportunity to acknowledge the staff of the County Treasury who were involved in the preparation of the 2019 MTDS.

The Office of the Governor and the Executive committee for guidance.

LIVINGSTONE L. IMBAYI:CHIEF OFFICER

CHIEF OFFICER FINANCE AND ECONOMIC PLANNING

COUNTY GOVERNMENT OF VIHIGA

FEBRUARY 2019

Legal Basis for the Publication of the Debt Management Strategy

The Debt Management Strategy is published in accordance with Section 123 of the Public Finance Management Act, 2012. The law states that:

(1) On or before the 28th 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 liability and potential liability in respect of loans and its plans for dealing with those liabilities.

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

(a) the total stock of debt as at the date of the statement;

(b) the sources of loans made to the county government;

(c) the principal risks associated with those loans;

(d) the assumptions underlying the debt management strategy; and

(e) 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 publicise the statement and submit a copy to the Commission on Revenue Allocation and the Intergovernmental Budget and Economic Council.

LIST OF ABBREVIATIONS

ADB	African Development Bank
ADF	African Development Fund
ATM	Average Time to Maturity
BoP	Balance of Payments
BPS	Budget Policy Statement
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CPI	Consumer Price Index
CPIA	Country Policy and Institutional Assessment
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
DGIPE	Department of Government Investment and Public Enterprises
DMD	Debt Management Department
DSA	Debt Sustainability Analysis
DX	Domestic currency denominated debt
EAC	East African Community
ECF	Extended Credit Facility
EEC	European Economic Community
EIB	European Investment Bank
EMBI	Emerging Markets Bond Index
ERD	External Resources Department
FX	Foreign currency denominated debt
FY	Financial Year
GDP	Gross Domestic Product
IDA	International Development Association
IFB	Infrastructure Bond
IFC	International Finance Corporation
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
ISB	International Sovereign Bond
Ksh	Kenya Shilling
LIC	Low Income Country

MEFMI	Macroeconomic and Financial Management Institute of Eastern and Southern Africa
MTDS	Medium Term Debt Strategy
NPV	Net Present Value
NSE	Nairobi Securities Exchange
NT	National Treasury
PFM	Public Financial Management
PPP	Public Private Partnerships
PV	Present Value
SDR	Special Drawing Rights
SGR	Standard Gauge Railway
US	United States
USD	United States Dollars

EXECUTIVE SUMMARY

The accumulation of government expenditure arrears is one of the most common problems in public financial management (PFM). Government debts are financial obligations incurred by any level of the public sector for which payments have not been made by the due date. Payments may be overdue based on a particular legal obligation (such as payment of social security benefits, or salaries), a specific contractual commitment (such as payment for construction of a road), or a continuing service arrangement (such as payment for electricity supply).

Debt remains one of the major economic policy issues facing County Governments.

I. OUTLINE OF THE 2019 MTDS

Objective of Debt Management in Vihiga County Government

Recent Developments

1.Section III provides an overview of the recent economic developments in both the domestic and external front.

Characteristics of County's Public Debt

2.Section IV describes the salient features of Vihiga County Government outstanding publicly guaranteed debt. It provides guidance on how to deal with the cost and risk considerations of the debt portfolio.

***2014 MTDS:* Key assumptions**

3.Section V ooutlines the fiscal framework that is supportive of growth over the medium-term, while continuing to provide adequate resources to facilitate development of the County governments while at the same time ensuring that the public debt is sustainable. It also highlights the future financing and pricing assumptions.

Outcomes of Analysis of Strategies

4.Section VI gives the performance of the five alternative strategies in terms of their relative cost and risk..

Debt Sustainability

5.Section VII provides the debt sustainability thresholds for the County

Implementing the *2019 MTDS*

6. Section VIII outlines the commitment of Government in implementing the *2019 MTDS*. It also provides the engagements the Government intends to undertake.

Conclusion

7. Section IX concludes.

II. OBJECTIVE OF DEBT MANAGEMENT IN VIHIGA COUNTY GOVERNMENT

Public debt management is more than making debt payments. There are two overall objectives

Ensure that the servicing and management of the County Government's financing requirements and payment obligations are met on a timely basis, and at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk;

Support the development of a domestic debt market.

The secondary objective is to enable the government to deal with the existing debt portfolio in order to release resources to service delivery. The 2019 MTDS will guide the County Government operations in 2019/2020 and 2020/2021. The strategy seeks to balance cost and risk of public debt while taking into account the financing needs of the County and to develop initiatives for new funding sources.

III. RECENT DEVELOPMENTS

a) Development in the Domestic Debt Market

Interest rates

The BPS 2019 shows that Interest rates remained stable and low in the period 2013-2017 except June – December 2015 when world currencies were under pressure. During the period, the policy rate (Central Bank Rate) was adjusted appropriately to anchor inflation expectations. The rate is currently (January 2017) at 10.0 percent since August 2016. The interbank rate has remained low at 7.7 percent in December 2017 from 5.9 percent in December 2016 due to ample liquidity in the money market, while the 91-day Treasury bill rate declined to 8.0 percent from 8.4 percent over the same period. The 182 day and the 364-day Treasury bills averaged 10.6 percent and 11.1 percent in December 2017 from 10.5 percent and 11.0 percent in December 2016, respectively.

Inflation According to the BPS 2019 Inflation rate has been low, stable and within the Government target range of 5+/-2.5 percent in the period 2013 to 2017 as a result of prudent monetary and fiscal policies. Inflation averaged 6.7 percent in the period (2013-2017) compared with 7.4 percent in the period (2002-2007), 10.6 percent in the period (2008-2012) Inflation during the period 2008 to 2012 was highly volatile following a steep depreciation of the Kenya shilling exchange rate and policy responses. However, inflation increased to above target in the first half of 2017 due to drought that affected food prices. Inflationary pressures started to ease in the second half of 2017 as the weather situation improved and earlier measures taken by the Government to address the food shortages took effect. These measures included: allowing duty free imports of major food items (maize, wheat, sugar, and milk) and introducing a temporary subsidy on maize meal prices. As a result, overall month on month inflation was 4.5 percent in

December 2017 from 6.4 percent in December 2016, and was within the Government's target range.

b) External Financing

THE KENYA SHILLING EXCHANGE RATE

The Kenya Shilling exchange rate as per BPS 2019 remained broadly stable against major international currencies. As at December 2017, the shilling exchange rate against the Dollar was at Ksh 103.1 from Ksh 102.1 in December 2016. Against the Euro and the Sterling pound, the Shilling weakened to Ksh 122.0 and Ksh 138.2 in December 2017 from Ksh 107.7 and Ksh 127.7 in December 2016, respectively**.**

The Kenya Shilling exchange rate as compared to most sub-Saharan

African currencies, has continued to display relatively less volatility. This stability reflected resilient receipts from tea and horticulture despite lower export volumes due to adverse weather conditions in the first quarter of 2017. Additionally, receipts from tourism, coffee exports and Diaspora remittances remained strong.

IV. CHARACTERISTICS OF COUNTY PUBLIC DEB

STOCK OF DEBTS TABLE I: SUMMARY OF OUTSTANDING DEBTS AS AT 30TH JUNE 2018 IN KSHS

Type	Outstanding As at 30th June 2018
Recurrent Pending Bills	163,279,968
Development Pending Bills	1,626,301,430
Staff Payables	91,711,589
Current Loans	-
Total	**1,881,292,987**

Table 1(a): External and Domestic Debt, End June 2018

	Ksh	Percent of GDP	Share of total debt (%)	Weighted average interest rate (%)
Domestic debt (gross)	1,881,292,987			
External debt o/w Guarantees	0			
Total debt	**1,881,292,987**			

Source: County Treasurer

Table 1(c): Projected External and Domestic Debt, June 2018

	Ksh	Percent of GDP	Share of total debt (%)	Weighted average interest rate (%)
Domestic debt (net)	0			
External debt o/w Guarantees	0			
Total debt	**0**			

a) Sources of Loans made to the County Government

i. Domestic Sources of Loan

The total debt portfolio stood at Kshs. 1,881,292,987 as at 30TH Jane 2018. The stock of debts is mainly composed of unpaid statutory deductions, unpaid supplies and utilities.

In addition, the County inherited debts are yet to be verified and approved. Though the details available are scanty, the debts were loans taken from development partners for the development of infrastructure by the former Luanda Town Council, Vihiga Municipal Council and Vihiga County Council. The debts remained in the books of the former Councils until the 2013 when the County Government took over.

Sources of loans

The County inherited loans and other liabilities from the defunct local Authority Councils. The current liabilities are arising due to pending bills.

Table 2: Domestic Debt Stock, Ksh Million

Instrument	June 2019		December 2019		Change
	Amount	%	Amount	%	
Total Stock of Domestic Debt (A+B)	**0**	***0***	**0**	*0*	**0**
A. Government Securities (1-2)	**0**	*0*	**0**	*0*	**0**
1.Treasury Bills	**0**	*0*	**0**	*0*	**0**
Banking Institutions					
Others	0	*0*	0	*0*	0
2.Treasury Bonds	**0**	*0*	**0**	*0*	**0**
Banking Institutions	0	*0*	0	*0*	
Others				*0*	0
3. Pre-1997 Government Debt	**0**	*0*	**0**	*0*	**0**
B. Others[1]					
Of which CBK Overdraft					

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Table 3: Domestic Debt by Holder, Ksh Million, End December 2019

Holder	June 2019		December 2019	
	Amount	**%**	**Amount**	**%**
Banks				
Central Bank	0	0	0	0
Commercial Banks	0	0	0	0
Non-Banks				
Non- Residents	0	0	0	0
Non-Bank Sources	0	0	0	0
Total	**0**	**0**	**0**	**0**

ii. External Sources of Loans

The County has not incurred any external debt since its inception for external sources like ADB/ADF, Japan, IMF, EEC/EIB, France, China, IDA.

Cost /risk characteristics of public debt

Due to the short-term nature of debts the County has it is faced with many risks in terms of high interest rates on loans and cost of litigations and Court awards undue pressure to pay these short-term creditors. This in effect has a bearing on our liquidity and ultimately affecting service delivery especially where the funds must be channeled to paying these debts.

Strategies to deal with the existing debt

The current debt portfolio shows that all the debts are already overdue as most are owed to suppliers, pension schemes and government agencies.

Strategies to deal with the existing debt portfolio include:

Strategy 1 – Debt rescheduling/renegotiation: The County will seek authenticate the inherited debts from the former local Authorities and where possible to reschedule the loans with a view to obtaining favorable terms and for a longer period. This will ease the pressure on the cash flows and thereby release the scarce resource to service delivery.

Strategy 2 - Debt Write offs: In order to clean our balance sheet and improve our creditworthiness, the County shall enter into negotiations with the GOK with a view to write off debts that were guaranteed by the central Government to the former Councils.

Strategy 3: Enhancing revenue collection: Further the County shall also explore ways of enhancing revenue collection in order to liquidate these debts to improve liquidity

Strategy 4. The County to establish pending bills committee to verify authenticity of all outstanding payments and formulate strategies to eliminate all arrears.

V. 2019 MTDS: KEY ASSUMPTIONS

Objectives and scope

In the 2019 MTDS, Vihiga County will continue pursuing broad objectives of funding the County Government Budget while maintaining a prudent level of risk taking account of costs. However, the County has no intention of borrowing within the 2019/20 – 2020/2021 and therefore it will continue maintaining a balanced budget. This will be finance by the County own revenues sources, the allocations from the equitable share and Conational grants and grants from development partners.

In case of cashflow challenges within the period the County government will explore internal strategy of borrowing from the National Treasury window to advance the County Governments funds and refund when their disbursements become due.

The County will also strengthen its own revenue source through automation, policies and legislations to enforce and explore new revenue streams

Macroeconomic Environment and Risks

The Macroeconomic framework underpinning the MTDS is consistent with the projections included in the 2019/20 County Fiscal Strategy (CFSP). It is hoped that fiscal policy will continue to support economic activity within the context of a sustainable public financing. From the year 2019/20 the County has reoriented expenditure towards priority programs such as Health, Education, Infrastructure ,Trade, Agriculture and Water under the Medium-Term Expenditure Framework(MTEF). This process will be strengthened with a revamped legislative framework to enable accommodation of critical programs that will accelerate socio-economic development.

The medium outlook for 2019/2020 -2020/2021 assumes a balanced budget with no deficits. In order to realize the budget objectives, the County needs to realize all the potential revenues both from the GOK and internally generated revenues to finance all our budget activities. Overall growth of the economy will depend on the pace of global economic growth, weather patterns and fuel prices will impact negatively on revenues of both the National and County Governments and hike expenditure demands.

Increased investment in infrastructure may necessitate the County Government to take in more debt to finance these additional expenditures.

Potential Financing Sources

The preferred source of financing remains our own revenues in view of the cost and risk of other sources of financing. National Treasury also has a window to advance the County Governments funds and refund when their disbursements become due.

VI. OUTCOMES OF ANALYSIS OF POTENTIAL FINANCING STRATEGIES

From the analysis of the potential financing strategies, borrowing from the commercial banks remains the only viable option in the medium term. However, our strategy is not to borrow from commercial banks within the MTEF.

Otherwise, borrowing should be capped at 15% of total revenues realized in the previous year subject to approval by the County Assembly in accordance with section 141(2) of the PFMA**.**

VII. DEBT SUSTAINABILITY

The County Government recognizes the importance of managing debt prudently to avoid unwarranted debt burden to the future generation and reduce risk of macroeconomic instability. Significant efforts have been made to improve the institutional debt management as well as capacity to assess risks. As a County we need to embraces strong fiscal responsibility measures such as paying in full all current statutory deductions as they fall due to avoid un necessary penalties and fines

Other Operational Strategies

Enhancing the credibility and realism of the budget-

One of the first steps in addressing a persistent arrears problem is to strengthen the realism of the annual budget. This will depend on robust assumptions and forecasts in the fiscal framework on which the budget is based. Internal revenues should be realistic and matched against expenditure. The County should set up realistic revenue targets and ensure the actual collection in a FY is enhanced.

b) Strengthening commitment controls - Commitment controls are part of the internal control system, which should prevent the County from initiating expenditure without available budget and cash. IFMIS and E-Procurement will be used to enforce commitment control to ensure that expenditure incurred in a financial year has been budgeted for.

c) Improving cash and debt management - Reliable cash forecasting should ensure that liquidity is available to meet payment obligations as they arise. For effective cash management, the County treasury needs to develop accurate and timely short-term estimates of cash inflows and outflows. Spending Sector's should be required to prepare financial plans both a schedule of commitments and likely cash outflows.

d) Verification of Arrears - Once data on the outstanding debts has been collected, the data should be verified to ensure that such payments are genuine claims to avoid payment of fraudulent claims. This activity can be undertaken by the internal audit function of the County, Office of the Auditor General or private audit firms, depending on the legal and institutional arrangements and capacity available.

e) Strengthening the legal and regulatory framework- The legal framework or related regulations should define payment terms (and when a payment is in arrears); reporting requirements; controls at the budget authorization, commitment, and payment stages; and the sanctions associated with any breach of those provisions. A clear credit policy should be put in place to enhance reporting, prioritization and timely payment of debt.

VIII. IMPLEMENTING THE 2019 MTDS

The Government has enacted legislation governing both external and internal borrowing under the PFMA with provisions that are in line with the requirements of the Constitution of Kenya, 2010 and best international practices. The total debt including contingencies stood at Kshs 1,881,292,987 as at 30th June 2018.

However most of the contingent liabilities are owed to the national government on account guaranteed loans to former local authorities.

The County will also establish a debt management office to strengthen the institutional arrangement for management of debts. Comprehensive, accurate and timely information on public debt is critical in managing of debts. Public debt information will be published more regularly to enhance transparency on debt management in accordance with other best practices in the world.

The County will also continuously engage the Debt Management Office (DMO) at the National Treasury in order to manage to improve on debt management and especially concerning the debts guaranteed by the National Treasury. Specifically, and in-order to clear already outstanding debts the County proposes the following implementation plan and way forward.

IX. CONCLUSION

The 2019 MTDS is a robust framework for prudent debt management. It provides a systematic approach to decision making on the appropriate financing of development projects. The 2019 MTDS has considered the current macroeconomic environment both at the local and external environment and other the related vulnerabilities. The recommended strategy is one that seeks to borrow from the National Treasury and enhancing our own local revenues.

The County will not borrow form commercial banks within the MTEF 2019/20 – 2020/2021. The County will finance its budget through its own revenues sources, the allocations from the equitable share and conditional grants from development partners.

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