COUNTY GOVERNMENT OF VIHIGA

THE COUNTY TREASURY

Medium Term
Debt Management Strategy

2021/22 – 2022/23

February, 2021

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FOREWORD

The Medium-Term Debt Management Strategy (MTDS) proved the strategies the County government has put in place to handle and manage its debts. Section 140 of the PFM, Act 2012 authorizes a County Executive Committee Member for finance to borrow on behalf of the County Government only if the terms and conditions for the loan are set out in writing and are in accordance to Article 212 of the Constitution and Sections 58 and 142 of the PFM, Act 2012 among other conditions. 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.

Before a County Government borrows, there should be established the internal rate of growth in regard to the respective County GDP, sustainability and credit worthiness besides due diligence. The Commission on Revenue Allocation in collaboration with the World Bank Group (WBG) and other stakeholders, initiated the County Creditworthiness Initiative (CCI) for Kenya to provide technical assistance to County Governments in bridging the creditworthiness gap and access market finance for infrastructure and other development projects.

Vihiga County Government has not been accessed, the programme has just been rolled out and so far the initiative has seen the credit rating for three County Governments (Bungoma, Kisumu and Makueni). Therefore in 2021 Vihiga County does not anticipate to borrow in the Medium Term, it will maintain a balanced budget without any deficit. The only debts that affect the County are; by contingency, creditors and statutory liabilities. (Pending bills).

ALFRED INDECHE, CPA,
County Executive Committee Member for Finance
COUNTY GOVERNMENT OF VIHIGA

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.

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.

Let me take this opportunity to acknowledge the staff of the County Treasury who were involved in the preparation of the 2021 MTDS. The Office of the Governor and the Executive committee for guidance.

LIVINGSTONE L. IMBAYI (CPA),
Chief Officer, Finance and Economic Planning.
COUNTY GOVERNMENT OF VIHIGA

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 publicize 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 constructors), or a continuing service arrangement (such as payment for electricity supply).

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

OUTLINE OF THE 2021 MTDS

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

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.

Section V outlines 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.

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

Section VII provides the debt sustainability thresholds for the County.

Section VIII outlines the commitment of Government in implementing the 2021 MTDS. It also provides the engagements the Government intends to undertake.

Section IX concludes.

1. OBJECTIVE OF DEBT MANAGEMENT IN COUNTY GOVERNMENT OF VIHIGA

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 2021 MTDS will guide the County Government operations in 2021/2022 and 2022/2023. 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.

2. RECENT DEVELOPMENTS

(a) Development in the Domestic Debt Market

Interest Rates

Short-term interest rates remained fairly low and stable. The Central Bank Rate was retained at 7.00 percent on November 26, 2020 same as in April 2020 to signal lower lending rates in order to support credit access by borrowers especially the Small and Medium Enterprises, distressed by COVID-19 pandemic. The interbank rate declined to 5.1 percent in December 2020 from 6.0 percent in December 2019 in line with the easing of the monetary policy and adequate liquidity in the money market. The 91-day Treasury Bills rate was at 6.9 percent in December 2020 from 7.2 percent in December 2019. Over the same period, the 182-day Treasury Bills rate declined to 7.4 percent from 8.2 percent while the 364-day decreased to 8.3 percent from 9.8 percent.

Inflation

Year-on-year overall inflation remained low, stable and within the Government target range of 5+/-2.5 percent since end of December 2017 demonstrating prudent monetary policies. The inflation rate was 5.6 percent in December 2020 from 5.8 percent December 2019.

Figure 2: Inflation Rate, Percent

Source of Data: Kenya National Bureau of Statistics

This is reflecting muted demand pressures in the economy on account of prudent monetary policies. However, the contribution of fuel inflation to overall year-on-year inflation rose to 1.7 percent in December 2020 from 0.6 percent in December 2019 on account of increasing international fuel prices.

(b) External Financing

THE KENYA SHILLING EXCHANGE RATE

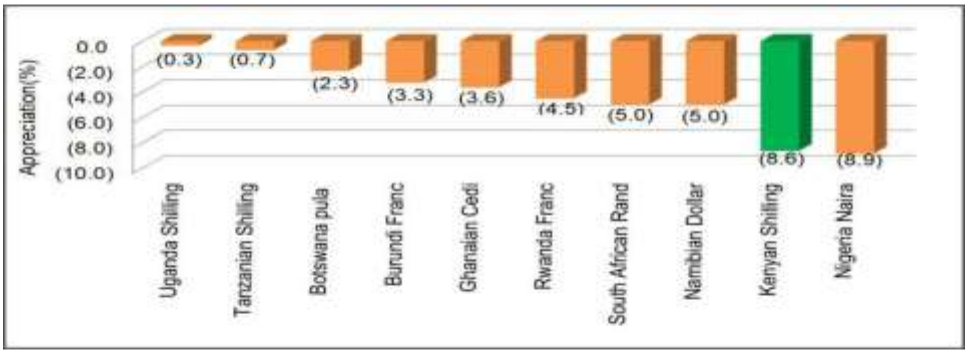
The foreign exchange market has largely remained stable but was partly affected by a significant strengthening of the US Dollar in the global markets and uncertainty with regard to the Covid-19 Pandemic. In this regard, the Kenya Shilling to the dollar exchanged at Kshs 109.8 in January 2021 compared to Kshs 101.1 in January 2020 as shown in **Figure 4** below

Figure 4: Kenya Shilling Exchange Rate

Source of Data: Central Bank of Kenya

Like most Sub-Saharan African currencies, the Kenya Shilling has remained relatively stable weakening by only 8.6 percent against the US Dollar in the year to January 2021 as shown in **Figure 5** below. This stability in the Kenya Shilling was supported by increased remittances and adequate foreign exchange reserves.

Figure 5: Performance of selected currencies against the US Dollar (January 2020 to January 2021)



Source of Data: Various National Central Banks

3. CHARACTERISTICS OF COUNTY PUBLIC DEBT

STOCK OF DEBTS TABLE I (A): SUMMARY OF OUTSTANDING DEBTS AS AT 30TH JUNE 2020 IN KSHS

Type	**Outstanding As at 30th June 2020**	**Outstanding As at 30th June 2019**
Pending Bills	1,204,809,162.66	2,341,157,919
Accounts Payable	191,257,121	218,265,000
Current Loans	0	0
Total		

Pending Bills

Pending bills consist of unpaid liabilities at the end of the financial year arising from contracted goods or services during the year or in past years. For our case we accumulated pending bills of historical and current in nature.

The County Government has a serious challenge as regards pending Bills. During the Financial year 2019/20, the County Government embarked on payment of pending bills as per the directives issued by the National Treasury. A total of Kshs. 756,732,467 for Historical Pending bills was paid. On the other hand, the county accumulated pending bills of Ksh. 427,070,452.81 during the Financial Year 2019/20. This was as a result of failure by the National treasury to release all the funds meant for Vihiga County for the Fiscal year 2019/20. The county total pending bills stood at Kshs. 1,204,809,162.66 as at 30th June, 2020 Compared to Kshs. 2,341,157,919 as at 30th June 2019

Accounts Payable

We have two categories of Accounts Payable namely; Retention & Deposits and Employee Deductions Payable.

Retention & Deposits, these are deposits and retention held on behalf of third parties have been recognized as accounts payable. This is in recognition of the government practice of retaining a portion of contracted services and works pending fulfillment of obligations by the contractor and to hold deposits on behalf of third parties.

Table 1(b) Accounts Payable categories

	2019/2020	**2018/2019**
	Kshs	**Kshs**
Retention & Deposits	114,683,779	128,429,250
Employee Deductions Payables	76,573,342	89,835,750
Total	**191,257,121**	**218,265,000**

Table 1(b): External and Domestic Debt, End June 2020

		Ksh	Percent of GDP	Share of total debt (%)	Weighted average interest rate (%)
Domestic debt (gross)		**1,396,110,267**			
External debt		0			
o/w Guarantees					
Total debt		**1,396,110,267**			

Source: County Treasury

Table 1(c): Projected External and Domestic Debt, June 2020

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

(c) Sources of Loans made to the County Government

(i) Domestic Sources of Loan

The total debt portfolio stood at Kshs. 1,396,110,267 as at 30th June 2020. The stock of debts is mainly composed of unpaid statutory deductions, unpaid supplies and utilities (Pending bills).

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

(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.

2021 MTDS: KEY ASSUMPTIONS

Objectives and scope

In the 2021 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 2021/22 – 2022/2023 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 2021 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 2021/2022 -2022/2023 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. Meanwhile the County is awaiting the County Creditworthiness Initiative (CCI) assessment.

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 unnecessary 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 2021 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. 1,396,110,267 as at 30th June 2020.

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 2021 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 2021 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 2021/22 – 2022/2023. The County will finance its budget through its own revenues sources, the allocations from the equitable share and Conditional grants from development partners.