



KISII COUNTY GOVERNMENT

COUNTY TREASURY

MEDIUM TERM

**DEBT MANAGEMENT STRATEGY
PAPER**

FEBRUARY 2015

Table of Contents

FOREWARD	iii
ACKNOWLEDGEMENT	iv
LEGAL BASIS FOR THE PUBLICATION OF THE DEBT MANAGEMENT STRATEGY	v
LIST OF ABBREVIATION	vi
EXECUTIVE SUMMARY	vii
CHAPTER ONE	1
1.0 OVERVIEW OF DEBT MANAGEMENT	1
1.1 Outline of the 2015 Debt Management Strategy Paper	2
CHAPTER TWO	3
2.0 OBJECTIVES OF DEBT MANAGEMENT STRATEGY	3
2.1 GOALS FOR THE DEBT MANAGEMENT STRATEGY	3
2.2 DEBT MANAGEMENT STRATEGY FINANCING PRINCIPLES	4
CHAPTER THREE	5
3.0 MACROECONOMIC ENVIRONMENT, RISKS AND POTENTIAL SOURCES	5
3. 1 POTENTIAL FINANCING SOURCES	6
3.1.1 Domestic Sources of funding	6
3.1.2 External sources of funding	6
CHAPTER FOUR	7
4.0 STRATEGIES OF ADDDRESSING DEBTS	7
4.1 Debt reduction strategies	7
CHAPTER FIVE	8
5.0 MANAGEMENT OF DEBTS IN FY 2015/2016	8
5.1 Best practices on debt management	8
5.1.1 Establishment of Debt office:	8
5.1.2 Payment of creditors:	8
5.1.3 Monthly savings:	8
5.1.4 Stakeholders' Involvement:	8
CHAPTER SIX.....	9
6.0 SUMMARY/CONCLUSION:.....	9

FOREWARD

The Public Finance Management Act 2012 section 123 (1), Provides that 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 clearly showing its actual liability in respect of loans and its plan for dealing with those liabilities.

The Debt Management Strategy Paper (DMSP) 2015 provides guidance to Kisii County Government (KCG) on the amount and type of borrowing to undertake over the medium term. It evaluates the costs and risks of various debt management strategies and provides recommendations on optimal strategy for implementation since it will have an impact on future borrowings.

The 2015 County Debt Management Strategy Paper outlines priorities that will assist in the financial risk reduction. It is for this reason that the Kisii County Government recognizes the need for prudence in debt management so as to avoid unwarranted financial risks that emanating from poor debt management strategies. The County is employing significant efforts and resources to ensure improvement in the debt management as well as enhancing capacity of assessing risks.

The Kisii County Government's debt will only realize sustainability if a prudent debt management and borrowing policy is adopted by the Government. However it is worth noting that there is no borrowing envisaged in the near future.

DR. KODHEK OMWANCHA MIGIRO
EXECUTIVE COMMITTEE MEMBER, FINANCE AND PLANNING

ACKNOWLEDGEMENT

This is the second Medium Term Debt Management Strategy (MTDS) by the County Government to be tabled in the County Assembly under the requirement of the PFM Act 2012.

The Medium Term Debt Management Strategy sets out the debt management strategy for the Kisii County Government.

It is worth noting that the preparation of DMSP is a relatively technical process because of inadequate and quality input data and thus determining an appropriate tool from which we can reliably determine an optimal borrowing strategy. To ensure wide circulation of the DMSP we shall upload the same into our website: *www.kisiicounty.co.ke*

Let me take this opportunity to acknowledge the overall guidance provided by ECM Finance Dr. Kodhek Omwancha throughout the preparation period of this debt management strategy. I sincerely acknowledge the staffs from Finance and Economic Planning, Strategy, Delivery and Project Management department who were involved in the preparation of the 2015 DMSP. Their dedication and immense contributions are appreciated. I specifically wish to very sincerely thank the core team under the guidance of Mr. Onchari Kenani and Mr. John Nyamiobo, comprising of the following: Mr. Daniel Njuguna, Johnes Chacha, Mr. Edward Mayogi, Mr. Elijah Kianga, Mr. P.N. Ondieng'a, Mr. P. Nyakeri, Mr. Alfred Keter, Mr. Chrispinus Ibalai, Mr. Julius Kitunda, Mr. Steve Siso and Joshua Simba and Naom Nyamache.

MR. WILFRED AUMA

CHIEF OFFICER, FINANCE AND ECONOMIC PLANNING

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 assumption 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 ABBREVIATION

ALGA	Association of Local Government Auditors
ALGAE	Association of Local Government Authority Employers
ALGAK	Association of Local Government Authorities of Kenya
CIDP	County Integrated Development Plan
DMSP	Debt Management Strategy Paper
FSP	Fiscal Strategy Paper
FY	Financial Year
GDP	Gross Domestic Product
IFMIS	Integrated Financial Management Information System
KCG	Kisii County Government
KENAO	Kenya National Auditor Office
KHS	Kenya Shillings
KRA	Kenya Revenue Authority
LAPFUND	Local Authorities Provident Fund
LAPTRUST	Local Authority Pension Trust Fund
LGLA	Local Government Loaning Agency
NHIF	National Housing Insurance Fund
PAYE	Pay As You Earn
PPP	Public Private Partnership
PFM	Public Finance Management
CT	County Treasury
ECM	Executive Committee Member
DMSP	Debt Management Strategy Paper

EXECUTIVE SUMMARY

The 2015 Kisii County Government Debt Management Strategy Paper is the second to be developed by the County Treasury. This is in line with section 123 of the Public Finance Management 2012 which stipulates that on or before the 28th. February of 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.

The strategy is structured in six chapters with each chapter highlighting a specific segment of the paper.

Chapter one provides an overview of the Debt Management Strategy Paper by defining debt and debt management. The chapter also highlights the impact of unsustainable debt in the County. The chapter further provides broad explanations on the burdens governments like the Kisii County Government are likely to shoulder if debt is not closely monitored, strategized and repaid.

Chapter two discusses the objectives, goals and principles of Debt Management and the need for the County Government to develop the same. The chapter also outlines the basis on which the 2015 Debt Management Strategy is prepared.

Chapter three discusses macroeconomic framework underpinning the 2015 Medium Term Debt Management Strategy as stipulated in the Fiscal Strategy Paper February 2015. Some of the macroeconomic indicators highlighted in this chapter include; GDP growth rate, inflation growth rate, interest rates and foreign exchange rate and remittances from the diaspora. The chapter has also analyzed Potential financing sources for the County Government.

Chapter four provides emphasis on debt reduction strategies the County Government will employ in dealing with debts in future.

Chapter five details the Debt reduction policies and strategies designed to assist the County in its effort to reduce debts in a fast and prudent manner. Some of the policies highlighted are; sticking to the budget, not borrowing to offset debts, cutting expenses, seeking reduced interest rates and setting goals and priorities. The chapter also details analysis of County Management of debts while analyzing the best debt management practices.

Chapter six provides the conclusions, summary and recommendations for the County Government.

CHAPTER ONE

1.0 OVERVIEW OF DEBT MANAGEMENT

1. Government debt or borrowing includes the contracting or guaranteeing of domestic and external (foreign) debt through loans, financial leasing, on-lending and any other type of borrowing, including concessional and non-concessional borrowing, whatever the source. External debt is defined as debts dominated in currencies other than Kenyan shilling while domestic debt is defined as debt dominated in Kenyan shillings, even when the creditor is a foreign entity.

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

3. Most economies in the world whether developed or developing resort to borrowing in order to address any financing needs. This is a useful source of financing however; it is worth noting that reliance on debt must be closely monitored and strategized.

4. Debt can be sustainable or unsustainable. By sustainable debt, it implies that the debt can be serviced without resorting to exceptional financing (such as debt relief) or a major future correction in the balance of income and expenditure while unsustainable debt simply means that debt inflows are exerting severe burdens on the economy in the future.

5. When Governments realize they are managing unsustainable levels of debt, they are forced to adjust expenditure levels. The additional resources are then directed towards the repayment of debt and associated interest payments. These reallocations negatively impact on the implementation of priority programmes, local investment, and poverty reduction initiatives.

6. In ability to repay debts can lead the County economy towards a situation known as debt distress. A county can be said to be in this situation when one or more of the following conditions hold:

(a) The sum of interest arrears is large relative to the outstanding stock of debt;

(b) A county receives debt relief in the form of rescheduling and or debt reduction from the creditors, and;

(c) The county receives substantial budget support from the national government through the conditional grants.

7. The cost of financing increases due to failure to repay debt obligations as well as making it increasingly difficult to obtain financing from development partners. This makes it necessary therefore for the County Government to undertake a review of its debt situation based on the present stock debt as well as future commitments and obligations.

1.1 Outline of the 2015 Debt Management Strategy Paper

8. This Debt Management Strategy paper consists of six chapters. Chapter one gives the general introduction of debt management and the general outline of the strategy.

9. Chapter two gives the objectives, goals and principles of Debt Management in the county and outlines the basis on which the 2015 Debt Management Strategy is prepared.

10. Chapter three discusses the macroeconomic environment, risks and potential sources.

11. Chapter four provides emphasis on specific strategies the County Government intends to employ in dealing with debts in future.

12. Chapter five details the Debt reduction policies and strategies designed to assist the County in its effort to reduce debts in a fast and prudent manner

13. The last chapter gives the summary of the Kisii County Debt Management strategy FY 2015/2016.

CHAPTER TWO

2.0 OBJECTIVES OF DEBT MANAGEMENT STRATEGY

15. The principal objective of the Kisii County Government debt management is to meet the County Government's financing requirements at the least cost with a prudent degree of risk.

16. In 2014, the County Treasury (CT) prepared a formal debt management strategy, the 2014 Debt Management Strategy Paper (DMSP), which outlined the County Government debt strategy for the period 2014/15 FY. The 2014 Debt Management Strategy Paper was the County Government's first formal and explicit strategy and was an important step towards enhancing transparency of the Kisii County Government's debt management decisions. The Debt Management Strategy Paper was presented to the County Assembly as part of the budget documents by the Executive Committee Member (ECM) for Finance. To institutionalize the production of the debt strategy, the publication of the Debt Management Strategy Paper has been provided for under Section 123 of the Public Finance Management Act 2012.

17. The 2015 Debt Management Strategy will guide County Government debt management operations in the FY 2015/2016. 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 to reduce poverty and achieve debt sustainability.

18. 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.

2.1 GOALS FOR THE DEBT MANAGEMENT STRATEGY

19. The Debt Management Strategy lays down the Government's debt financing plans for the next Financial Year 2015/16. The Debt Management Strategy provides a policy framework for undertaking liability management operations aimed at ensuring certain clear, objective standards are in place to enable the County Government protect its financial resources for purposes of meeting its long term capital needs.

The 2015/16 Debt Management Strategy will:

- Ensure transparency in decision process and identify all expenditures of principal, interest and annual costs, along with issues specific transaction costs;
- Address any potential conflict of interest issues;
- Provide requirements for new debts.

2.2 DEBT MANAGEMENT STRATEGY FINANCING PRINCIPLES

20. The debt management strategy will address the County government's financing requirements at the lowest cost and a prudent degree of risk by adhering to the following principles:

- (a) Financing must be taken up in a balanced to ensure debt sustainability over long term.
- (b) Prudence must be observed when contracting debt while taking into account the cost and risk implications.
- (c) Debt must be contracted to support expenditure in the identified County priority areas that are geared towards poverty reduction and promotion of overall County development.
- (d) Debt must be guaranteed.
- (e) The debt must be for capital projects

CHAPTER THREE

3.0 MACROECONOMIC ENVIRONMENT, RISKS AND POTENTIAL SOURCES

21. The macroeconomic framework underpinning the Medium Term Debt Management Strategy is consistent with projections in the 2015/16 Fiscal Strategy Paper (2015 FSP). In the medium term outlook for FY 2015/16, the GDP growth for the past six months averaged at 5.6 percent. However, the GDP dropped to 5.5 percent in the second quarter as compared to 6.3 percent registered in the previous year according to Trading Economics (January 2015).

22. Growth was mainly driven by finance and insurance activities, wholesale and retail trade and agriculture and forestry while the tourism sector shrank for the seventh consecutive quarter. The recent developments in infrastructure have created numerous jobs opportunities across the county and have sparked further economic growth in the county. The real estate's have largely benefitted from this as well and will continue to grow in the future.

23. The risk to the medium term outlook includes further weakening in global economic growth and unfavorable weather conditions. Lower growth will negatively affect the primary deficit through both lower revenue collection and increased outlays to protect the most vulnerable.

24. Overall, growth will depend on the pace of global growth, drought and international fuel prices that impact negatively on revenue and hike expenditure demands.

25. Short term interest rates have also eased in line with the drop in inflation. The Central Bank of Kenya has left the interest rate at 8.5 percent as the current monetary policy stance is considered to deliver the desired objective of price stability. Overall inflation declined in both September and October 2014 to within the prescribed range of the medium term target of 5 percent after some sporadic effects in the months of July and August. According to Central Bank monthly reports, inflation rate increased from 7.67 in July 2014 to 8.36 in August, but then indicated a downward trend all through to December 2014 with the rate being at 6.02.

26. Resilient foreign remittances from the diaspora contributed greatly to the economic growth; there was an increase in remittances in the first quarter of FY 2014/2015 as compared to the same period in the previous year as shown in figure 3 below. As a source of external funding at the National level, remittances impact the

economy of a nation from an individual level by augmenting the recipient's income which will in turn lead to reduced poverty levels, the remittances also increase the credit worthiness of a country to the international markets for financing and this can alleviate credit constraints and also act as a substitute for financial development. The large percentage of this remittances trickle down to Kisii County due to many Sons and daughters in the diaspora who have continued to maintain strong ties and bonds with family members. This is evident in increase in financial institutions in the county and rapid development especially in the real estate sector.

3.1 POTENTIAL FINANCING SOURCES

27. The potential sources of Loans for Kisii County Government falls under two categories:

- a) Domestic sources of Loans
- b) External sources of loans

3.1.1 Domestic Sources of funding

28. Potential sources of domestic funding to the County Government will consist of borrowing from Financial and non financial institutions.

3.1.2 External sources of funding

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

CHAPTER FOUR

4.0 STRATEGIES OF ADDRESSING DEBTS

30. The Kisii County Government needs to anchor its debt management strategy paper on the national government's debt management strategy paper which has not been concluded yet. It is therefore difficult to really determine the level of our indebtedness since most of the debts are inclined to the national government. Once the national government concludes theirs we will re-align ours accordingly.

4.1 Debt reduction strategies

35. The county will apply the following strategies in addressing its debts in the 2015/16 FY.

The Kisii County Government will prudently manage its public finance by adhering to the budget.

1. The Kisii County Government will strictly borrow for developmental oriented projects and not to offset the existing debts.
2. The culture of saving will be embraced by every sector in the County by doing away with the non priority activities in the budget. This savings will be used to offset the debt.
3. The debts which attract high interest rates will be offset first then followed by the rest.
4. The prioritization of projects will be done in line with the CIDP.

CHAPTER FIVE

5.0 MANAGEMENT OF DEBTS IN FY 2015/2016

5.1 Best practices on debt management

5.1.1 Establishment of Debt office:

37. The County should establish the Debt Management Department Office which will be in charge of debt audit, managing debtors and creditors' information.

5.1.2 Payment of creditors:

38. The Kisii County Government to pay its creditors promptly to maintain good cordial relationship with them and to reduce the risk of accruing interest which becomes a burden in the long.

5.1.3 Monthly savings:

39. The departments should save monthly by reducing unnecessary expenditure even those budgeted for and use the monies for debt payment and in economic development subject to approval by the county assembly.

5.1.4 Stakeholders' Involvement:

40. Some activities like cleaning the environment, tree planting to be undertaken through involvement of the community. This will be a strategy to minimize debts arising through wages and allowances.

CHAPTER SIX

6.0 SUMMARY/CONCLUSION:

41. The 2015 Debt Management Strategy (DMS) is a robust framework for prudent debt management. It provides a systematic approach to decision making on the appropriate composition of debt finance taking into account both cost and risk.

42. This is the second time the debt management strategy paper is being presented in accordance with the PFM Act 2012. As required under the Act, the strategy is in line with the Fiscal Strategy Paper (FSP) presented to the County Assembly. Going forward, the Government will implement measures aimed at enhancing transparency in County debt management. This initiative will be implemented and entrenched in legislation going forward.

43. There is need for active investor and market consultation to get up to date information on the market. This will help determine a priori the investor appetite for the various instruments before it is due.

44. There is need for constant monitoring and review of performance and progress made on the medium term debt strategy. County debt information will be published more regularly to enhance transparency on debt management in accordance with best international practices.

