COUNTY GOVERNMENT OF VIHIGA

THE COUNTY TREASURY

Medium Term
Debt Management Strategy

2023/24 – 2025/26

FEBRUARY, 2023

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FOREWORD

The Medium-Term Management Strategy (MTDS) provides 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, it should establish 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 assessed. Therefore, in FY 2023/24 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).

DR. BOSTON JAIRUS AMAYI

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 term and in the 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 2023/24 MTDS and The Office of the Governor and the Executive committee for its guidance and approval. I also wish to express my gratitude to the County Assembly for providing the policy direction that guided the preparation and subsequent approval of the document.

Finally, it is my sincere belief that with good planning, focused budgeting and timely implementation of set priorities, the aspiration of prosperity and improved livelihood of Vihiga residents will be attained.

CPA JAMES ATEMBA

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
BPS	Budget Policy Statement
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CCI	County Creditworthiness Initiative
CPA	Certified Public Accountant
DMO	Debt Management Office
EEC	European Economic Community
EIB	European Investment Bank
FY	Financial Year
GDP	Gross Domestic Product
GoK	Government of Kenya
IDA	International Development Association
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
Kshs.	Kenya Shilling
MTEF	Medium Term Expenditure Framework
MTDS	Medium Term Debt Strategy
PFM	Public Financial Management
US	United States
USD	United States Dollars
WBG	World Bank Group

EXECUTIVE SUMMARY

The accumulation of government expenditure areas 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.

Chapter one describes the main objectives of Debt Management.

Chapter two provides an overview of the recent economic developments in both the domestic and external front.

Chapter three 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.

Chapter four 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 Government while at the same time ensuring that the public debt is sustainable. It also highlights the future financing and pricing assumptions. The chapter also gives an in-depth understanding of strategies to be applied while assessing them in terms of their relative cost and risk. Lastly the chapter provides the debt sustainability thresholds for the County and outlines the engagements the County Government will undertake while implementing the 2023 MTDS.

Chapter five then provides the conclusion.

CHAPTER ONE

OBJECTIVE OF DEBT MANAGEMENT IN COUNTY GOVERNMENT OF VIHIGA

Public debt management is more than making debt payments. The major overall objectives are:

i. 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;
ii. Support the development of a domestic debt market; and
iii. To enable the government to deal with the existing debt portfolio in order to release resources to service delivery.

The 2023 MTDS will guide the County Government operations in the MTEF period 2023/2024-2025/2026. 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.

CHAPTER TWO

RECENT DEVELOPMENTS

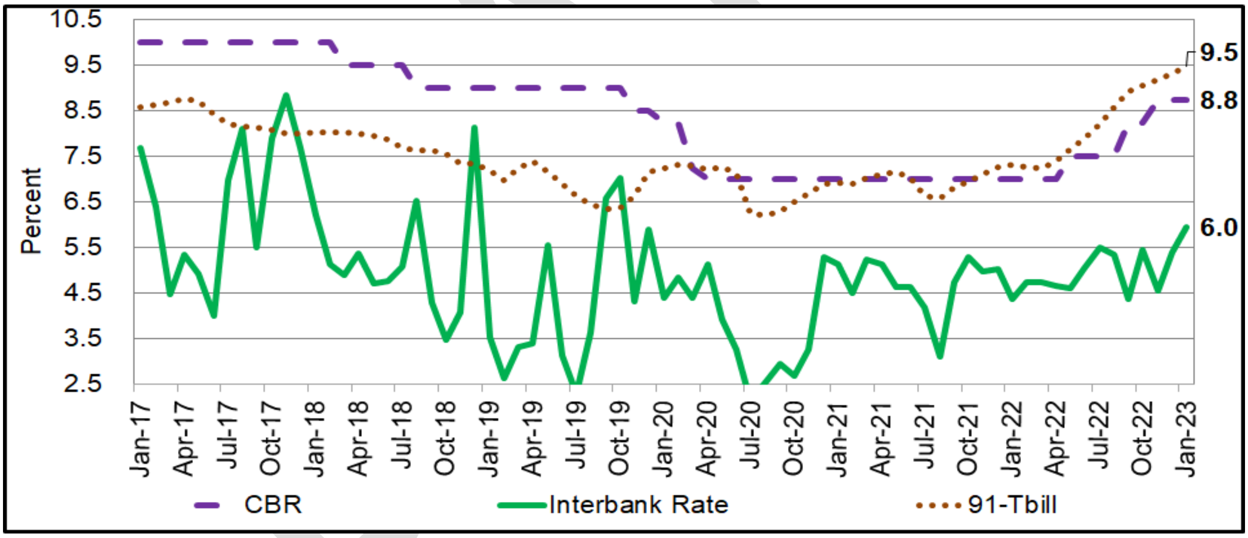
(a) DEVELOPMENT IN THE DOMESTIC DEBT MARKET

Interest Rates

Monetary policy stance remains tight to anchor inflation expectations due to the sustained inflationary pressures, elevated global risks and their potential impact on the domestic economy. In this regard, the Central Bank Rate was raised from 8.25 percent to 8.75 percent in November 2022 and retained at the same rateon30th January 2023, as shown in the **Figure 1 below.**

The interbank rate increased to 6.0 percent in January 2023 compared to 4.4percent in January 2022 while the 91-day Treasury Bills rate also increased to 9.5percentcomparedto7.3percentover the same period due to tight liquidity conditions.

Figure 1: Short Term Interest Rates, Percent



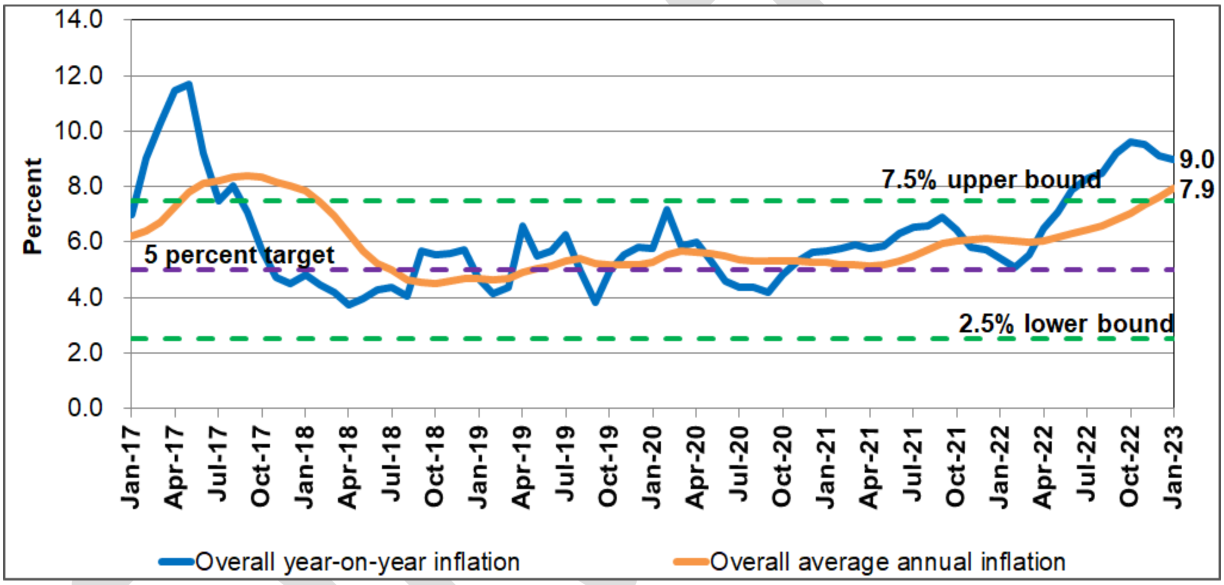
Source of Data: Central Bank of Kenya

Commercial banks' lending rates remained relatively stable in November2022 supported by the prevailing monetary policy stance during the period. The average lending rate was at 12.6 percent in November 2022 from 12.2 percent in November 2021 while the average deposit rate increased to 7.1 percent from 6.4percent over the same period. Consequently, the average interest rate spread declined to 5.5percent inNovember2022 from5.7 percent in November2021.

Inflation Rate

The year-on-year inflation rate eased for the third consecutive month in January 2023 but was still above the 7.5 percent upper bound target. Inflation rate eased to 9.0 percent in January 2023 from 9.1 percent in December 2022 and 9.5percent in November 2022 due to a decline in food prices as a result of favourable rains and lower global commodity prices particularly for edible oils and wheat with the easing of international supply chain disruptions as shown in **Figure 2** below. However, this inflation rate was higher than the 5.4 percent recorded in January 2022. Overall annual average inflation increased to 7.9 percent in January 2023 compared to the 6.1 percent recorded in January 2022.

Figure 2: Inflation Rate, Percent



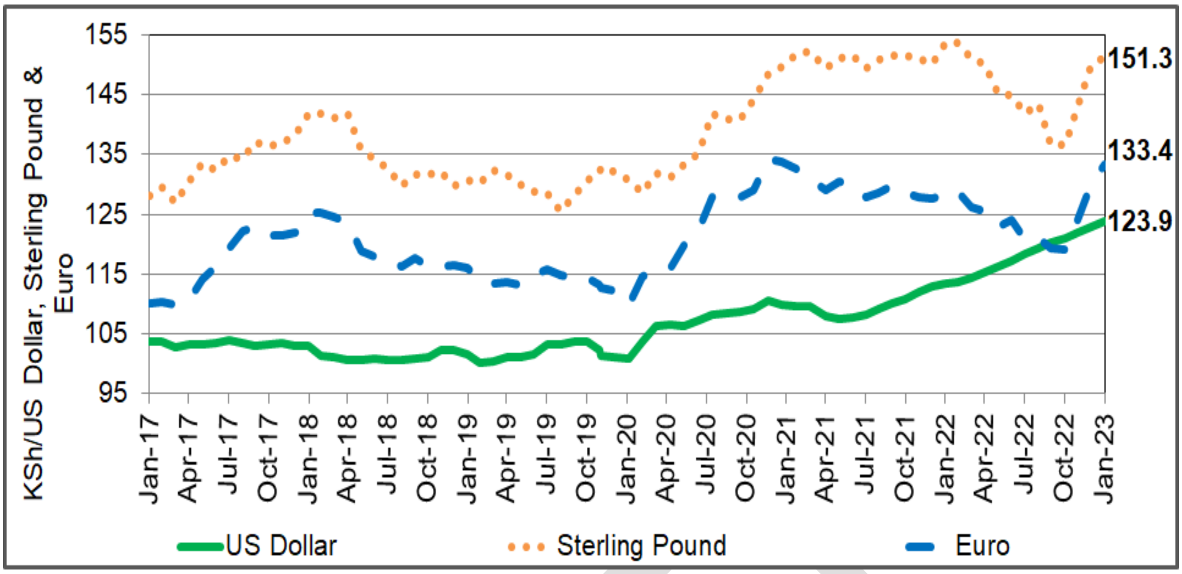
Source of data: Kenya National Bureau of Statistics

(b) EXTERNAL FINANCING

The Kenya Shilling Exchange Rate

The foreign exchange market has largely remained stable despite the tight global financial conditions attributed to strengthening US Dollar and uncertainties regarding the ongoing Russian-Ukraine conflict. Due to the strong dollar, the exchange rate to the Kenya shilling like all world currencies has weakened to exchange at Kshs. 123.9 in January 2023 compared to Kshs. 113.4 in January 2022 as shown in **Figure 3** below. Against the Euro, the Kenya shilling also weakened to Kshs. 133.4from Kshs. 128.4 over the same period. The Kenyan Shilling strengthened against the Sterling Pound exchange at Kshs.151.3 in January 2023 compared Kshs.153.6 in January 2022.

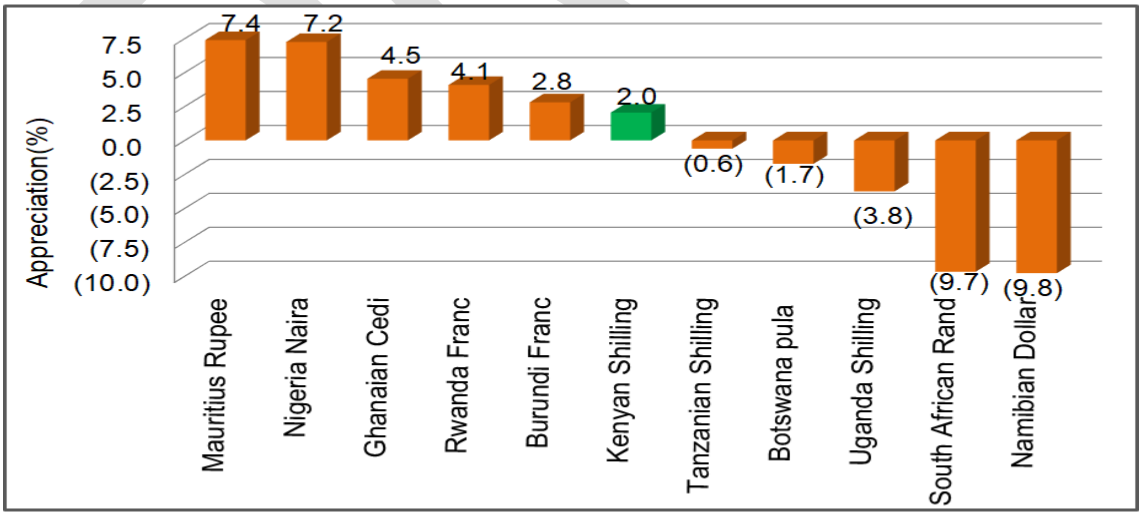
Figure 3: Kenya Shilling Exchange Rate



Source of Data: Central Bank of Kenya

In comparison to Sub-Saharan Africa currencies, the depreciation of the Kenya Shilling exchange rate has remained relatively low at 9.3 percent against the US Dollar in January 2023 as shown in **Figure 4** below. The depreciation rate of the Kenya Shilling was lower than that of Botswana pula, South African Rand, Namibian Dollar and Malawi Kwacha. The stability in the Kenya Shilling was supported by increased remittances, adequate foreign exchange reserves and improved exports receipts.

Figure 4: Performance of selected currencies against the US Dollar (January 2022 to January 2023)



Source of Data: National Central Banks

CHAPTER THREE

CHARACTERISTICS OF COUNTY PUBLIC DEBT

Table 1 (a): Stock of debts summary of outstanding debts as at 30th June 2022 in Kshs.

Type	Outstanding As at 30thJune 2022 (Kshs.)	Outstanding As at 30thJune 2021 (Kshs.)
Pending Bills	1,254,980,505	663,442,448.31
Accounts Payable	92,079,695	226,569,839.23
Total	**1,347,060,200**	**890,012,287.54**

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.

On the other hand, the county accumulated pending bills of Kshs.1,254,980,505 during the Financial Year 2021/22. This was as a result of failure by the National treasury to release all the funds meant for Vihiga County for the Fiscal year 2021/22. The county total pending bills stood at Kshs.1,254,980,505as at 30th June, 2022 Compared to Kshs.663,442,448.31 as at 30th June 2021.

Accounts Payable

We have two categories of Accounts Payable namely:

i. Retention & Deposits
ii. Employee Deductions Payable.

Retention & Deposits, these are deposits and retention held on behalf of third parties that have been recognized as accounts payable.

This is in recognition of the government practice of retaining a portion of contracted services and works pending fulfilment of obligations by the contractor and to hold deposits on behalf of third parties.

Table 1(b): Accounts Payable categories FY 2020/2021

Type	**2020/2021 (Kshs.)**
Retention & Deposits	145,073,447.00
Employee Deductions Payables + Deposits	81,496,392.23
Total	**226,569,839.23**

Source: County Treasury

Table 1(c): Accounts Payable categories FY 2021/2022

Type	**2021/2022 (Kshs.)**
Retention	92,079,695
Employee Deductions Payables+ Deposits	6,867,981
Total	**98,947,675**

Source: County Treasury

In the FY 2021/2022 total retention stood at Kshs.92, 079,695 while employee deductions payables and deposits stood at Kshs.6, 867,981. The Accounts Payables for FY 2021/2022 stood at Kshs.98,947,675 compared to the previous FY 2020/2021 which was Kshs.226,569,839.

Table 1(d): External and Domestic Debt, End June 2022

Type	**Kshs.**	**Percent of GDP (%)**	**Share Total Debt (%)**	**Weighted average interest rate (%)**
Domestic debt (gross)	1,347,060,200			
External debt				
O/W Guarantees				
Total debt	**1,347,060,200**			

Source: County Treasury

Table 1(e): Projected External and Domestic Debt, June 2023

Type	**Kshs.**	**Percent of GDP (%)**	**Share of total debt (%)**	**Weighted average interest rate (%)**
Domestic debt(net)	0			

External debt	0			
O/W Guarantees	0			
Total debt	**0**			

Source: County Treasury

Sources of loans made to the County Government

Domestic Sources of Loans

The total debt portfolio stood at Kshs.1,347,060,200as at 30th June 2022. The stock of debts is mainly composed of unpaid statutory deductions, unpaid supplies and utilities (Pending bills).

In addition, the County inherited debts that 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.

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 etc.

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, cost of litigations and court awards leading to undue pressure to pay these short-term creditors. This in effect has a bearing on our liquidity and ultimately affects service delivery especially where the funds must be channelled to pay these debts.

CHAPTER FOUR

FISCAL FRAMEWORK OF 2023 MTDS

Objectives and scope

In the 2023 MTDS, Vihiga County will continue pursuing broad objectives of funding the County Government Budget while maintaining a prudent level of risk and taking account of costs.

However, the County has no intention of borrowing within the MTEF period 2023/24 – 2025/2026 and, therefore, will continue maintaining a balanced budget. This will be financed by County own revenues sources, the allocations from the equitable share, National Government conditional grants and grants from Development Partners.

In case of cash flow challenges within the period the County Government will explore an 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 2023 County Fiscal Strategy (CFSP). It is hoped that fiscal policy will continue to support economic activity within the context of a sustainable public financing.

The medium outlook for 2023/24 – 2025/2026 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 own 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, all which have an impact on revenues of both the National and County Governments, with an overall resultant effect on 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.

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. Meanwhile the County is awaiting the County Creditworthiness Initiative (CCI) assessment.

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

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.

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.

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.

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 debt management committee, 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.

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.

IMPLEMENTATION OF THE 2023 MTDS

The National 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.1,347,060,200as at 30th June 2022.

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.

CHAPTER FIVE

CONCLUSION

The 2023 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 2023 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 2023/24 – 2025/2026. The County will finance its budget through its own revenues' sources, the allocations from the equitable share and Conditional grants from development partners.