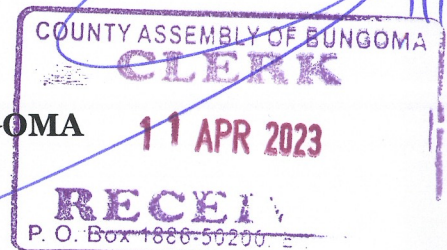


Tabled by Hon.
Jack Wambui
on 11/04/2023
at 2:30 p.m.
Notice of motion issued
to be circulated to Hon.
Members.

COUNTY GOVERNMENT OF BUNGOMA



COUNTY ASSEMBLY OF BUNGOMA

THIRD ASSEMBLY – SECOND SESSION

BUDGET AND APPROPRIATIONS COMMITTEE REPORT

ON

**THE COUNTY MEDIUM TERM DEBT MANAGEMENT STRATEGY PAPER
FOR FY 2023/24 – FY 2025/26**

APRIL, 2023

The Office of the Clerk

County Assembly Buildings

Bungoma - Kenya

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CHAPTER ONE

1.0 Preamble

Mr. Speaker Sir, it is my pleasure to present the report on the Medium Term Debt Management Strategy Paper for the period of three years 2023/24 to 2025/26 which was tabled on 28th February, 2023 at 2.30 pm and committed to Budget and Appropriations Committee for consideration.

1.1 The Mandate of the committee

Mr. Speaker Sir, Budget and Appropriations Committee is established under Standing Order 210 of the County Assembly of Bungoma and is mandated to:

- a) Discuss and review the estimates and make recommendation to the County Assembly;
- b) Examine the County Fiscal Strategy Paper presented to the County Assembly;
- c) Examine the County Debt Management Strategy Paper presented to the County Assembly;
- d) Examine Bills related to the County Budget, including Appropriations Bills; and
- e) Evaluate tax estimates, economic and budgetary policies and programmes with direct budget outlays.

1.2 Committee Membership

Mr. Speaker Sir, the Committee on Budget and Appropriation as currently constituted comprises the following Members:-

1. Hon. Jack Wambulwa, MCA	Chairperson
2. Hon. Charles Nangulu, MCA	Vice chairperson
3. Hon. Anthony Lusenaka, MCA	Member
4. Hon. Joan Kirong, MCA	Member
5. Hon. Meshack Simiyu, MCA	Member
6. Hon. Sudi Busolo, MCA	Member
7. Hon. Ali Machani , MCA	Member
8. Hon. Milliah Masungo, MCA	Member
9. Hon. Grace Sundukwa, MCA	Member
10. Hon. Polycap Wandabusi, MCA	Member
11. Hon. Caleb Wanjala, MCA	Member

1.4 Acknowledgment

Mr. Speaker Sir, the Committee would like to pay special compliment to the following:

The Committee appreciates the Offices of the Speaker and that of the Clerk of the County Assembly for making this undertaking a success through facilitation and other Logistics offered during report writing. The Committee would also like to register its appreciation to the members of staff who worked with us for their untiring commitment to ensure the success of the committee report.

Mr. Speaker Sir,

It is therefore my pleasant duty and privilege, on behalf of the Budget and Appropriations Committee, to table this report and recommend it to the Assembly for consideration.

Signed:  Date.....4/4/2023.....

Hon. Jack Wambulwa, MCA
Chairperson, Budget and Appropriations Committee

CHAPTER TWO

2.0 GUIDING PRINCIPLES IN THE EXAMINATION OF THE DEBT MANAGEMENT STRATEGY

2.1 Legal Framework

Mr. Speaker Sir, the Debt Management strategy paper has been developed in accordance with Section 123 of the Public Finance Management Act, 2012 which provides as follows:

“(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.

Further, Article 212 of the Constitution of Kenya provides for borrowing powers by Counties on guarantee by the National Government.”

Regulation 182(2) (d) of the Public Finance Management (County Governments) Regulations 2015 requires the preparation of the County Medium Term Debt Strategy to be consistent with the County Fiscal Strategy Paper.

Further **Section 140(1) (c) (d) of the Public Finance Management Act 2012** provides that

(1) A County Executive Committee member for finance may, on behalf of the county government, 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;

(b) Sections 58 and 142 of this Act;

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

(d) The Debt Management Strategy Paper of the county government over the medium term.

(2) A loan may be raised either within Kenya or outside Kenya.

Article 212 provides that “A county government may borrow only—

a) If the national government guarantees the loan; and

(b) With the approval of the county government’s assembly

Section 142 of **Public Finance Management Act 2012** states that:

1) The County Assembly may authorize short term borrowing by county government entities for cash management purposes only.

(2) Any borrowing under subsection (1) may not exceed five percent of the most recent audited revenues of the entity.

(3) A county government entity that has any such borrowing shall ensure that the money borrowed is repaid within a year from the date on which it was borrowed.

Mr. Speaker Sir, it is worth noting that the linkage between the County Fiscal Strategy Paper (CFSP) and Medium Term Debt Management Strategy Paper (MTDMSP) cannot be overlooked and this explains why the two documents are tabled on the same day.

It should be understood that approving the Medium Term Debt Management Strategy Paper does not in itself authorize the County Government to borrow but it only gives a framework and an additional strategy which the County Government can pursue to fund deficit in its budget.

The National Government is guarantor for all debts accrued by the County Governments therefore County government can borrow only if and when the National Government approves. These powers are vested in the Cabinet Secretary for Finance who guarantees the loans by County Governments and this is approved by Parliament.

However, the County loans will be guaranteed by the National Government only if the following Fiscal Responsibility Principles are adhered to:

1. Over the medium term a minimum of thirty percent of the County Government shall be allocated to the development expenditure.
2. The County Government expenditures on wages and benefits for its public officers shall not exceed 35% of the County Government total revenue.
3. Over the medium term the County Government's borrowing shall be used only for the purposes of financing development expenditure and not for recurrent expenditure.
4. The County debt shall be sustained at 20% of the most recently audited revenues and the cost of debt shall not exceed 15%.
5. A reasonable degree of predictability with respect to the level of tax rates and tax bases shall be maintained taking into account any tax reforms that may be made in the future.
6. The fiscal risk shall be managed prudently.

2.2 Procedure for borrowing by the County Government

Mr. Speaker Sir, pursuant to Section 58 PFMA, the following procedure will apply when County Government wants to borrow especially long term borrowing:

- a) The County Executive Committee Member for Finance shall submit the borrowing proposal to the County Executive Committee for approval of the borrowing including its terms and conditions;
- b) 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 of the borrowing, including its broad terms and conditions;
- c) After obtaining the approval of the County Assembly, the County Executive Committee 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;
- d) The Cabinet Secretary, after receiving the request from the county government, shall seek the recommendations of the Inter-governmental Budget and Economic Council;
- e) The Cabinet Secretary to the National Treasury, after receiving recommendations of the Inter-governmental Budget and Economic Council, shall seek the recommendations of the Attorney-General;
- f) The Cabinet Secretary may, upon taking into account the recommendations of the Intergovernmental Budget and Economic Council and the Attorney-General, approve or reject the request;
- g) The Cabinet Secretary shall reject a request for loan guarantee with reasons and communicate the same to the concerned County Executive Committee Member for Finance.
- h) Upon approval of a loan guarantee request, the cabinet secretary shall submit a sessional paper to parliament with recommendations seeking its approval;

- i) The Cabinet Secretary shall communicate the decision of Parliament on the draft loan guarantee to the respective County Executive Committee Member for Finance; and
- j) Upon approval by the parliament the Cabinet Secretary shall issue a loan guarantee.
- k) After receiving the communication of the decision of the Parliament on the draft loan guarantee, the County Executive Committee Member shall report to the County Assembly of the decision.

CHAPTER THREE

3.0 SCRUTINY OF THE MEDIUM TERM DEBT MANAGEMENT STRATEGY PAPER FOR FY 2023/24 TO FY 2025/26

3.1 Introduction

Mr. Speaker Sir, the Medium Term Debt Strategy paper provides directions and benchmarks for managing the county's debt portfolio. It will guide the County Government to ensure that debt levels stay affordable and sustainable, that any borrowing is for a good purpose and that the costs and risks of borrowing are minimized.

The County Government has not done any borrowing to date. With this strategy in place, and with National Government guarantees, the county is expected to initiate borrowing externally and domestically to finance the budget deficit. 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, irrespective of the source.

The County MTEF budget for FY 2023/24 and the medium term projections shows an enlarging financing gap and with the County administration focussing in completing flagship projects there justification for this paper and county borrowing. The proposed MTEF ceiling stood at Kshs. 40.2 billion for both recurrent and development. In reference to the approved CFSP the County Government of Bungoma can finance 68.3% of the total recurrent requirements and only 28.7% of total development requirement.

This paper has also highlighted the magnitude outstanding financial obligations resulting from the pending bills across the department totalling to Kshs. 1.05 billion affecting the debt carrying capacity of the County.

3.2 Scope and Objectives

Mr. Speaker Sir, the debt management strategy covers three years with provisions for annual review. The main objectives of the Medium Term Debt Management Strategy Paper are as follows:

- a) To meet the County Governments financing requirements at the least cost with a prudent degree of risk
- b) To guide county government debt management operations in the FY 2023/24 to FY 2025/26.
- c) To balance cost and risk of county debt while taking into account the County Government financing needs by incorporating initiatives to seek new funding sources, support the County Government development priorities and achieve debt sustainability.
- d) To diversify the governments funding sources and their investment portfolio.
- e) To advance measures to maintain and develop an efficient domestic debt market.

3.3 Potential Financing Sources

Mr. Speaker Sir, the potential sources of loans for Bungoma County Government will fall under two categories:

3.3.1 Domestic sources of loans

Potential sources of domestic funding will consist of borrowing from local financial and non-financial institutions.

3.3.2 External sources of loans

The main sources of funding for external sources will include loans and grants from bilateral and multilateral organizations which can be either on commercial or concessional terms.

3.4 Strategies for management on Debt in the Medium Term

The County Debt Management Strategy presents three main strategies that County Government of Bungoma will explore in the next three years in debt management. These strategies include: -

Strategy 1: External Financing (Semi and concessional) and some domestic bond financing.

Mr. Speaker Sir, external debt refers to the loans raised through foreign lenders, such as foreign commercial banks, foreign government and international financial institutions. In the case of external debt all payments must be in currency in which the debt was issued.

This strategy evaluates the cost and risk aspects of a continuation of current borrowing practices for Bungoma County which will form a benchmark for examining different approaches. This strategy is based on current practice of external and domestic borrowing and therefore does not best address the priority issues of foreign exchange risk, liquidity and repayment risk, creditor concentration risk and refinancing risk.

Mr. Speaker Sir, the following are the risks associated with this strategy:

- a) **Affects economic growth:** Economic growth occurs when governments and companies incur capital expenditures that boost production and increase output and income levels. If large amounts of external debt need to be repaid, then there is less money left for investment purposes. It hampers future economic growth.
- b) **Long gestation period:** Gestation period is the interim period between the initial investment in a project and the time the project becomes productive. When external debt is used to fund infrastructure projects, it takes a few years for the project to start giving a return on the investment. However, the debt will need to be repaid, along with interest, within a provided time of receiving the loan. Thus, government will face the pressure of repaying the loan even before the project starts yielding a stable return.
- c) **Unexpected devaluation of domestic currency:** If the currency of the borrowing country depreciates with respect to that of the lending country, then the real value of interest will rise.
- d) **The Vicious Cycle of Debt:** The most crucial disadvantage of external debt is that it often leads to a vicious cycle of debt. The debt cycle refers to the cycle of

continuous borrowing, accumulating payment burden, and eventual default. When a government's expenditure exceeds how much it earns in a year, it faces a fiscal deficit. In order to finance the adverse gap, the government borrows money from another country. In the next year, with the additional expense of interest payment and loan repayment, the government might face a deficit again and be forced to take another external loan. In subsequent years, there might be a situation where it borrows money in order to repay its previous loans.

Strategy 2: Negotiated domestic borrowing and utilization of securities market

Mr. Speaker Sir, domestic borrowing involves the borrowing in the local markets. It is done through the issuance of securities like treasury bills, which are short term debt instruments with tenure ranging from 91 to 364 days and treasury bonds with a maturity period of more than a year.

The risks associated with this strategy are as listed;

- a) Domestic borrowing could lead to pressure on institutional investors and banks to absorb "too much" government debt and this may have a negative effect on financial stability.
- b) Expanding the market for domestic government bonds may have the risk that the public sector may crowd out private issuers.
- c) Finally, there are political economy reasons that may make domestic debt more difficult to restructure. In fact, a few highly indebted countries which were able to use debt relief initiatives to address their external debt problems are still burdened with high levels of domestic debt.

Strategy 3: External financing and some domestic bond financing

Mr. Speaker Sir, this is where the County combines both external and domestic financing in order to take advantage of the medium to high risk mainly due to the foreign exchange factor and low to medium cost in relation to County revenues. With

gradual development of the domestic market this would provide a more balance composition of the public debt with less external debt and more domestic debt.

Bungoma County intends to use the third option which allows the county to source funding from both External and Internal sources of funding but with emphasis on domestic borrowing in order to minimize the risks associated with external borrowing.

3.5 Baseline projections and best practices in debt management

Mr. Speaker Sir, the county fiscal policy is a primary tool to improve income distribution through both its revenue and spending policies. Fiscal policy is designed to support macroeconomic stability, correct market failures and provide public goods or services.

To ensure prudent debt management, the county will pursue with improvements the following measures:

- a) Improving estimation of funding ceilings based on realistic assessments of revenue raising capacity, budget support and development assistance, and where appropriate prudent borrowing;
- b) More careful assessing and managing of appropriate levels of public debt and cash reserves required to create fiscal space to respond to shocks and unforeseen events;
- c) Improving budget allocation across sectors by better analysis, prioritization and discussions to better align funding allocations to departmental/agency corporate plans based on the County Strategic Development Framework (CSDF) and overall available funding;
- d) Improving quality of expenditure by ensuring commitments are properly cost and funded, restricting ad hoc funding additions during the year, improved financial management and reporting, linked to reporting on progress against sectoral plan indicators.

- e) Establishment of Debt Unit: The County should establish a Debt Management Unit which will be in charge of debt audit, managing debtors and creditors' information.
- f) Payment of creditors: The Bungoma 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 run.
- g) Monthly savings: The departments should spend prudently 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.
- h) Stakeholders' Involvement: Some activities such as 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.

Mr. Speaker Sir, monetary policy is a preserve of the Central Bank of Kenya. However, the monetary decisions of the CBK affect the debt portfolio of counties. The roles of monetary policy include

- a) ensuring sound financial institutions
- b) maintaining adequate foreign reserves
- c) protecting external balance
- d) supporting price stability
- e) Facilitating growth of the domestic economy.
- f) The capping of interest rates

There are several downside risks to the baseline macroeconomic outlook. These include the risk of not securing the mandatory National Government guarantees for borrowing; remittances and revenue not increasing as robustly as expected; the county not being able to control the wage bill. These risks are likely to dampen growth prospects, and lead to a rise in domestic and/or external borrowing needs.

3.6 RISK SCENARIO TESTING

There are many inherent risks in any debt portfolio. The County Government of Bungoma should employ measures to mitigate these risks and to minimize the impact of various exogenous shocks on the debt portfolio. These risks include;

Creditor Concentration Risk: This refers to risks associated with most of the debt portfolio being held by one or two creditors. Those who hold a large proportion of debt could have a vested interest in the course of a county's affairs and could potentially have an undue influence in policy development hence the investor base should be diversified and expanded.

Credit Risk of on-lent and guaranteed loans: When the level of outstanding on-lent loans from County Government of Bungoma is high, there is an implicit exposure to default and non-payment of obligations even when the loans are guaranteed. Deeper analysis and oversight required on this transaction.

Operational Risk: This arise from a small staff size and limited capacity. The difficulty in developing and retaining skilled staff in the Debt Management office is a risk for Treasury and the County Government of Bungoma in general. It can also mean inadequacies or failures in internal controls, or in systems and services; reputation risk; legal risk; security breaches; or natural disasters that affect business activity.

Strategic Risk: Strategic risk is the risk that decisions made about management of the debt portfolio have a high opportunity cost. If the County Government of Bungoma decides not to borrow, then it could miss out on grant funding. If decisions to borrow for particular projects do not match expectations, then this money could have been better spent elsewhere on more beneficial projects. Money spent on servicing debt might be better spent on providing essential services.

Financial Risk: In this case, County Government of Bungoma's portfolio management is so poor that it creates a source of instability for the private sector, less money is available for servicing the county's basic needs which could undermine development. A build-up of debt arrears might negatively influence investor confidence, weakening private sector activity, leading to a withdrawal of investment in the county, a decline in growth prospects and a further increase in debt to revenue ratios. This is an extreme risk.

Market Risk: Refers to the risks associated with changes in market prices, such as interest rates, exchange rates, commodity prices, on the cost of the government's debt servicing.

Rollover Risk: The risk that debt will have to be rolled over at an unusually high cost or, in extreme cases, cannot be rolled over at all. To the extent that rollover risk is limited to the risk that debt might have to be rolled over at higher interest rates, including changes in credit spreads, it may be considered a type of market risk.

Liquidity Risk: This refers to a situation where the volume of liquid assets can diminish quickly in the face of unanticipated cash flow obligations and/or a possible difficulty in raising cash through borrowing in a short period of time.

Credit Risk: The risk of non-performance by borrowers on loans or other financial assets or by a counterparty on financial contracts.

Settlement Risk: Refers to the potential loss that the government, as a counterparty, could suffer as a result of failure to settle, for whatever reason other than default, by another counterparty.

Operational Risk: This includes a range of different types of risks, including transaction errors in the various stages of executing and recording transactions;

CHAPTER FOUR

4.0 COMMITTEE'S OBSERVATIONS AND RECOMMENDATIONS:

4.1 Committee Observations

Mr. Speaker Sir, the committee after analyzing the Debt Management Strategy Paper made the following observations;

1. The Medium Term Debt Management Strategy Paper is a robust framework for prudent debt management that will provide a systematic approach to decision making on the appropriate composition of debt finance taking into account both cost and risk.
2. The Medium Term Debt Management Strategy Paper for FY 2023/24 – FY 2025/26 provides a framework and an additional strategy which the County Government can pursue to fund its budget deficits.
3. The County Government of Bungoma's decision to borrow is vested in the County Assembly of Bungoma as the 1st approver. If the County Assembly is of the opinion that the county government's borrowing carries substantial financial risk, may attract high cost of servicing and is a threat to the County's budgeting and service delivery, then the Assembly can deny approval for the borrowing.
4. The Committee notes that the county pending bills is indicated as Kshs. 544,539,799 for recurrent expenditure and Kshs. 509,386,003 for development expenditure totaling to Kshs. 1,053,925,802.
5. The County Government of Bungoma has not adhered to most of the Fiscal responsibility principles reducing the ability of the County to borrow.

4.2 Committee's Recommendations

Mr. Speaker, after keen scrutiny of the Bungoma County Medium Term Debt Management strategy paper the committee recommends as follows;

1. **THAT**, the County Government of Bungoma adopts Strategy 3; **External financing and some domestic bond financing, which will allow the county to source for funding from both External and Internal sources of funding**

but with emphasis on Domestic borrowing in order to minimize the risks associated with external borrowing.

2. **THAT**, as per the 1st Supplementary Budget, the total pending bill across all department was Kshs. 3,502,264,363 and only Kshs 875,564,091 that is 25% was provided for leaving out an outstanding the pending bill of Kshs. 2,626,700,272 that is contrary to Kshs, 1,053,925,802 indicated in the Debt Management Strategy Paper. The county treasury should be consistent on the total amount of pending bills for easy planning and budgeting because pending bills should be given first charge and once all the pending bills are cleared, the credit worthiness of the county with improve.
3. **THAT**, the County government should purpose to adhere to the fiscal responsibility principles and all the provisions of the law guiding borrowing and general debt management.
4. **THAT**, the County Executive Committee Member for Finance should fast tracker the establishment of debt management unit to be in charge of debt audit, manage debtors and creditors' information

4.3 Conclusion

Mr. Speaker Sir, the approval of this Medium Term Debt Management Strategy Paper for the period FY 2023/24 -2025/26 by this Honorable House will provide the much needed framework for the County Government of Bungoma to pursue for additional funds to finance its budget deficits especially on developments.

5.0 ANNEXTURE

The draft Bungoma County Medium Term Debt Management Strategy Paper for FY
2023/24 –FY 2025/26

Adoption schedule

Name

Title

Sign

1. Hon. Jack Wambulwa

Chairperson

2. Hon. Charles Nangulu

Vice Chairperson

3. Hon. Milliah Masungo

Member

4. Hon. Antony Lusenaka

Member

5. Hon. Meshack Simiyu

Member

6. Hon. Joan Kirong

Member

7. Hon. Sudi Busolo

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8. Hon. Ali Machani

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9. Hon. Grace Sundukwa

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Member