



REPUBLIC OF KENYA
COUNTY GOVERNMENT OF NYERI

COUNTY TREASURY

**MEDIUM TERM DEBT MANAGEMENT
STRATEGY PAPER**

2017/18-2019/20

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Foreword

The 2017/2018-2019/2020 Medium Term Debt Management Strategy is prepared in accordance with section 123 of the Public Finance Management (PFM) Act 2012 and is consistent with county government development policies and strategies. The main objective of MTDMS is to ensure that the county government financial needs and payment obligations are met at the lowest possible cost in the market, which is consistent with a prudent degree of risk, while ensuring that the overall level of public debt is sustainable.

The sustainability of debt is a key fiscal responsibility principle and this, among other issues, will be dealt with in this document. Through a resolution of the Nyeri County Assembly as required under the PFM Act section 107 (2) (e) and section 107 (4) that deal with sustainability of debt, an annual borrowing limit has been set for any future requirements.

The County Treasury shall ensure that the medium-term debt management strategy is aligned to the broad strategic priorities and policy goals set out in the County Fiscal Strategy Paper. The Policy goals and strategic priorities are geared towards poverty reduction through provision of an enabling environment to all the residents of Nyeri.

The county government inherited a huge debt from the four defunct local authorities i.e. Nyeri County Council, Nyeri Municipal Council, Karatina Municipal Council and Othaya Town Council. The inherited debt will continue to increase the county debt burden and to ensure sustainability the MTDMS has proposed measures to be undertaken to reduce the debts to a manageable level.

Considering the current level of debt, both inherited and county pending bills, the 2017/2018-2019/2020 MTDMS largely proposes strategies on how to reduce the current debts level and how to manage future debts if they will ever occur. The county will endeavor to ensure that both the burden of and benefit from public borrowing is shared equitably between the current and future generation as stipulated under Article 201 of the Constitution.

Further, the county government will form a debt management committee, within the County Treasury, and build its capacity in terms of staffing and training to ensure that it is in a position to handle all matters relating to borrowing and servicing of debt. Effective linkages will be established with the National Treasury to facilitate the management of the inherited debts, future borrowing and provision of technical advice.



Dr. Charles Githua Githinji, PhD

Ag, C.E.C.M - FINANCE AND ECONOMIC PLANNING

Acknowledgement

The 2017/2018-2019/2020 MTDMS is intended to ensure accountability and transparency in management of the county public debt. The review and preparation of the medium term debt management strategy is done annually in accordance with section 123 of the PFM Act, 2012. A public debt is a charge on the County Revenue Fund, though an Act of the County Assembly may provide for charging all or part of the public debt to other established public funds.

In the year 2014, the county government, in conjunction with the Transition Authority compiled a report on the Assets and liabilities inherited from defunct local authorities and verification process has been concluded but are yet to be officially handed over to County Government. According to the BPS, 2017, the transfer is expected to be concluded by March 31st, 2017.

To enhance debt management in the county, the County Treasury will endeavor to establish a debt management committee that will be mandated to prepare the debt management strategy and to give comprehensive, accurate and timely information. The establishment of the committee will lay the ground for future borrowing to finance the budget and servicing of outstanding debt. Despite the establishment of the committee the overall control and accountability remains with the C.E.C.M - Finance and Economic Planning.

The MTDMS will formally be submitted to the Commission on Revenue Allocation (CRA) and the Intergovernmental Budget and Economic Council as per PFM Act 2012. In addition, MTDM strategy will be published and made available at the county website, www.nyeri.go.ke, to ensure wide circulation as envisaged under the PFM Act, 2012.

Let me take this opportunity to acknowledge the C.E.C.M – Finance and Economic Planning for his overall leadership, Chief Officer Finance and Accounting for the support during the preparation of MTDMS, the entire

staff of the department of Finance and Economic Planning and specifically the following; Gibson Mwangi, Chris Gathogo and Lucy Kirigo for spending substantial amount of time putting together this MTDMS and ensure it was produced on time while maintaining the expected standards.



Francis Maranga Kirira
C.O. - ECONOMIC PLANNING

Abbreviations and Acronyms

BPS	Budget Policy Statement
CBROP	County Budget Review and Outlook Paper
CFSP	County Fiscal Strategy Paper
CRA	Commission on Revenue Allocation
Kshs.	Kenya Shilling
LAPFUND	Local Authority Provident Fund
LAPTRUST	Local Authority Pension Trust
LGLA	Local Government Loans Authority
MTDS	Medium Term Debt Management Strategy
NSSF	National Social Security Fund
PFM	Public Finance Management
TA	Transition Authority
MTDMS	Medium Term Debt Management Strategy
CECM	County Executive Committee Member
IGRTC	Intergovernmental Relations Technical Committee
NHIF	National Hospital Insurance Fund
VAT	Value Addition Tax
PAYE	Pay As You Earn
NHC	National Housing Corporation

LEGAL BASIS FOR PUBLICATION OF MEDIUM TERM DEBT MANAGEMENT STRATEGY PAPER

The debt management strategy is published in accordance with section 123 of the Public Financial Management (PFM) 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.

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.

Executive Summary

The 2017/2018-2019/20 Medium Term Debt Strategy Paper has been prepared in accordance with PFM Act, 2012. The preparation of the strategy is in line with fiscal responsibility principles and is interlinked with other budget documents such as departmental reports, county budget review and outlook paper, annual financial statements and county fiscal strategy paper.

The county government inherited approximately Kshs 592,807,561.54 from defunct local authorities i.e. Nyeri County Council, Nyeri Municipal council, Karatina Municipal council and Othaya Town Council; and Kshs 28,464,516.32 from Devolved ministries/departments. In dealing with inherited debts, the county treasury through the help of the Transition Authority has been verifying liabilities inherited from these former local authorities.

The inherited debt together with pending bills arising from county government ministries has caused a sharp rise in debt since the county government assumed power. As at 30th June, 2016 the county debt was Kshs. 690,016,852.54 comprising of inherited debt of Kshs. 592,807,561 and pending bills from county government departments amounting to Kshs 97,209,291.

To reduce the county debt to manageable levels sufficient funds, as budgetary reserves, will be allocated in the budget to cater for debt repayment especially the pending bills from the last financial year. The County Treasury requires Kshs. 97,209,291.00 million to settle pending bills during the financial year 2016/17, however only Kshs. 58,613,429 have been allocated as per the approved budget for FY 2016-2017. In dealing with the other substantial liability inherited, once they are handed over, the county government will negotiate with creditors to spread the

debt burden for a few year since the fiscal space may not accommodate all the payments in one year.

To reduce future pending bills from the departments, all county entities will be required to reprioritize their projects and programs and align their expenditure to availability of funds and cash flow forecast. In addition, procurement in the fourth quarter of the year should be discouraged to avoid huge pending bills. The pending bills will be cleared as a first charge in the approved budget, to avoid accumulation, as provided for under section 41(2) of the Public Finance Management (County Governments) Regulations, 2015.

The County Treasury will create and strengthen a debt management committee to handle matters relating to borrowing and management of county debt. The County Treasury will also continue to work closely with the National Treasury to enhance the capacity building of staff and also offer technical expertise in issues relating to borrowing and repayment of debts especially those inherited from the defunct local authorities.

1 INTRODUCTION

1.1 Background

The debt management strategy is prepared in accordance with section 123 of PFM Act, 2012 which requires the County Treasury to 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 and its plans for dealing with those liabilities. The statement should, among other information, contain:

- (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.

There are other section of PFM Act that guides the management of county debt, this include PFM Act sections 107, 140,141,142,143 and 144. Other documents that guide the preparation of debt management strategy are county fiscal strategy paper (CFSP) and county budget review and outlook paper (CBROP).

In this MTDMS more emphasis has been put in ensuring the sustainability of the current debt and establishment of necessary structures to facilitate future borrowing. The County Fiscal Strategy Paper, 2017 does not envisage any borrowing to finance the budget and therefore the MTDM strategy will be geared toward servicing of existing debt. With the current level of debt the county government may not be able to accommodate additional borrowing to finance it expenditure therefore over the medium term the government will put more emphasis on servicing of existing debts

namely those inherited from the defunct local authorities and the pending bills.

The County Treasury will form a debt management committee to verify all liabilities inherited from the defunct local authorities once the handing over is conclude by the National Treasury, and the pending bills. The main goal of this exercise will be to establish the debt position of County Government of Nyeri and ascertain the borrowing power available.

The debt management committee will be expected to undertake the following;

- a) Compile list of all creditors both statutory and sundry.
- b) Establish whether the claims are genuine or not.
- c) Establish whether all procedures were followed in incurring the debts.
- d) Establish whether all supporting documents are available.
- e) Prioritize the debt.

The establishment of the committee is the first step in ensuring that the county government is in a position to handle its current debt and is ready to undertake future borrowing to finance the budget within the legal framework.

1.2 Objective of debt management

The following are the main objectives of debt management in the county;

- a) To ensure the financial needs and payment obligations of county government are met at the lowest possible cost in the market and is consistent with a prudent degree of risk.
- b) To ensure that the overall level of public debt is sustainable and debt shall never exceed twenty (20%) percent of the county governments total

revenue at any one time as stipulated in the Public Finance Management (County Government) Regulations section 25 (1)(d).

c) To ensure that both the burden of and benefit from public borrowing is shared equitably between the current and future generation as stipulated under Article 201 of the constitution.

1.3 Scope of Medium Term Debt Management Strategy

The Medium Term Debt Management Strategy (MTDMS) covers actual and potential liability i.e. it covers all loans and other debt, whether inherited or created by the county government, that require payment of principal with or without interest by the county government to the creditor at a date or dates in future. The MTDMS is prepared for financial year 2017/18 but also makes projection for year 2018/19 and 2019/20.

2 REVIEW OF NYERI COUNTY PUBLIC DEBTS

2.1 Stock of debt

The total stock of debt as at 30th June 2016 stood at Kshs. 690,016,852.54. This comprises of both inherited debt, though unverified, of Kshs. 592,807,561.54 and county government pending bills amounting to Kshs. 97,209,291. This was a great improvement when compared to the pending bills of Kshs 336,040,453.52 in the financial year 2014/2015. However the county debt is projected to be approximately 600 million by 30th June, 2017 if the contingent liability materialize and putting into consideration interest charged on outstanding pension contribution.

2.2 Source of loans/debts made to the county government

The source of debt to the county government will be categorized into two namely;

1. Pending bills arising from works done and not paid during the financial year 2015/2016.
2. Inherited debt from defunct local authorities

2.2.1 Pending bills from the County Departments.

The county government accumulated huge pending bills from departments during the financial year ending 30th June, 2016 amounting to Kshs. 97,209,291. This was attributed to late disbursement of the last tranche of equitable share from the national treasury and therefore the county exchequer was received on 30th June, 2016. Further, failure by the county government to achieve its local revenue target by a total of Kshs. 372,445,565 could have led a huge deficit if contracts signed during the financial year 2015/2016 were executed during the year.

The summary of pending bills for the county by departments, as reported, is shown in the table below;

Department	Recurrent	Development	Total
Office of the Governor	2,839,218	0	2,839,218
Office of the county Secretary	1,305,150	0	1,305,150
Finance and Economic Planning	1,559,805	0	1,559,805
Lands and Infrastructure	2,102,252	48,807,888.89	50,910,141
Health and Sanitation	18,178,086.71	757,228.00	18,935,315
Special Programmes	3,244,770	189,310.00	3,434,080
Public Administration Information and Communication	2,330,837.70	0	2,330,838
Agriculture livestock and fisheries	1,949,084.37	1,350,102.43	3,299,187
Trade Culture cooperatives and industrial Development	2,166,493	969,900.00	3,136,393
Education and ICT	551,096	2,189,305.00	2,740,401
Water, Irrigation and Natural Resources	1,244,879.65	4,349,694.33	5,594,574
County Public Service Board	1,092,190	0	1,092,190
Energy	32,000	0	32,000
Total	38,595,862	58,613,429	97,209,291

Source: County Treasury, 2016

While pending bills are considered as those payment vouchers which had reached the treasury and not settled, there were other contracts which had been signed but not executed by the end of the financial year, 2015/2016, which can easily lead to accumulation of debts if not considered in the supplementary budget for the financial year 2016/2017

2.2.2 Inherited debt from defunct local authorities

According to the BPS, 2017, Preparation of the draft Legal Notice to enable the transfer of assets and liabilities has been done by the Intergovernmental Relations Technical Committee (IGRTC), which succeeded the defunct Transition Authority (TA). The IGRTC will coordinate the actual auditing of the assets and liabilities. As part of the institutional arrangement to facilitate this transfer process, multi-agency committees are to be set up in the counties, and the Auditor-General will audit the final outcome.

The transfer is expected to be concluded by March 31st, 2017. Among assets and liabilities of the defunct Local Authorities to be covered in this process are:

- i) Pending bills
- ii) Tax arrears; and
- iii) Statutory deductions relating to the National Hospital Insurance Fund (NHIF), National Social Security Fund (NSSF), Pension Funds, VAT and PAYE.

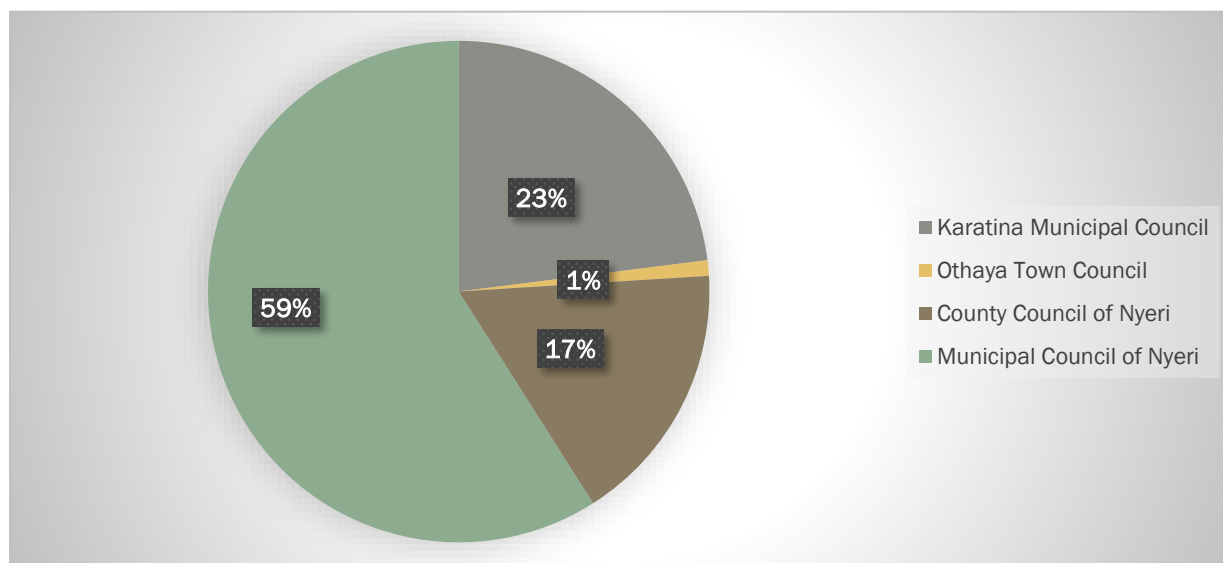
The inherited debt as reported by all defunct local authorities is shown in the table below;

Defunct Local Authority	Outstanding Debt as at 30th June 2013
Karatina Municipal Council	137,505,036.75
Othaya Town Council	5,262,092.09
County Council of Nyeri	100,917,404.70
Municipal council of Nyeri	349,123,028.00
TOTAL	592,807,561.54

Source: Nyeri County Assets and liability report, 2014

Most of the debt were inherited from defunct municipal council of Nyeri with 59% of the total debt inherited, followed by Municipal council of Karatina with 23%. County council of Nyeri had 17% while Othaya Town Council had the least debt inherited with only 1% of the total debt.

2.2.3 Outstanding Debt as at 30th June 2013



Source: Nyeri County Assets and liability report 2014

A detailed analysis on specific debts are shown below per defunct local authority;

(a) Defunct Municipal Council of Nyeri

Item	Debt as at 31st December 2014
Loan from LGLA	320,319,642
Unpaid emoluments	3,544,357
Creditors	25,259,029
TOTAL	349,123,028

(b) Defunct Town Council of Othaya

Item	Debt as at 31st December 2014
LAPTRUST	2,582,956
LAPFUND	267,250.09
Creditors	2,411,886
TOTAL	5,262,092.09

(c) **Defunct Municipal Council of Karatina**

Item	Debt as at 31st December 2014
Loan from LGLA	38,931,070.20
Loan from NHC	258,929
Unpaid emoluments	7,401,096
LAPTRUST	15,488,531.56
LAPFUND	3,533,102.20
Creditors	71,892,307.79
TOTAL	137,505,036.75

(d) **Defunct County Council of Nyeri**

Item	Debt as at 31st December 2014
Unpaid emoluments	17,573,065
NSSF	26,927,359
LAPTRUST	3,558,619
LAPFUND	34,510,344.70
Creditors	18,348,017
TOTAL	100,917,404.70

2.3 Assumptions underlying the debt management strategy

The county government will continue to pursue the fiscal responsibility principles and policies outlined in the County Fiscal Strategy Paper. This will help the government to reorient expenditure to priority programmes in roads and infrastructure, water, health, education and agriculture and avoid accumulation of pending bills in the county.

Over the medium term, the aim of the county government is to continue maintaining a balanced budget where total revenue will always equal to total expenditure i.e. the MTDM strategy does not envisage borrowing to finance the budget and over the medium term the focus will be on ensuring the sustainability of current debt. As provided under the PFM Act (County Government) Regulations, 2015, section 177 (2)(b), the county shall consider an overdraft from Central Bank of Kenya in event of cash flow problems.

Revenue growth is expected to be maintained as earlier projected in the budget review and outlook paper (CBROP) i.e. at 10% in each subsequent financial year. This will ensure that sufficient resources are allocated toward debt servicing and ensure that the current levels of debt falls below 10% of the total budget by year 2018/19.

2.4 Sustainability of debt

The sustainability of debt is guided by PFM Act section 107 (2)(e) and section 107 (4). According to section 107 (2)(e) the county debt shall be maintained at a sustainable level as approved by county assembly. Section 107 (4) further states that every county government shall ensure that its level of debt at any particular time does not exceed a percentage of its annual revenue specified in respect of each financial year by resolution of the county assembly. For the case of Nyeri County Government the percentage has been set at five percent but should never exceed twenty per cent.

The county government recognizes the need to manage debt prudently to avoid unwarranted debt burden. At the County Treasury the debt management committee will be mandated to ensure that there is prudent debt management and that the debt level is sustainable. The County Treasury acknowledges the need to maintain debt at sustainable levels and is closely monitoring spending by departments and other spending units and is working with all entities to cut on possible pending bills.

The National Treasury measures debt sustainability based on various parameters, borrowing from those parameters the debt sustainability in the county will be measured based on only two parameters namely;

- a.** Debt to revenue ratio
- b.** Debt service to revenue ratio

Indicator	2016/17	2017/18	2018/19
debt to revenue ratio	10.7%	14.8%	11.9%
debt service to revenue ratio	2.0%	2.0%	2.0%

In year 2016/17 the Kenyan government had a debt to revenue ratio of 187.6 and debt service to revenue ratio of 24.7 which according to World Bank threshold is sustainable. Therefore benchmarking with the national government the county debt can be considered as sustainable.

The current debt is about 20% of the annual revenue, the County Assembly of Nyeri has set the debt to revenue ratio at 5 percent and thus the burden is considered high in the medium term and thus the level is considered unsustainable due to the requirement that at least 30 per cent of the county budget must be allocated development.

3 STRATEGIES OF DEALING WITH DEBT

3.1 Debt servicing

The inherited debts must be paid, once the handing over has been concluded, and this necessitates setting aside sufficient funds in the 2017/18 budget to repay part of them if not all as it will be negotiated with the statutory institutions and other creditors. As indicated earlier the total stock of debt as at 30th June, 2016 was Kshs. 0.7 billion. To reduce this debt to manageable levels a minimum of Kshs 100 million will be set aside in the budget for debt repayment, however, the actual ceiling will be firmed up in County Fiscal Strategy Paper, 2017 after considering all sectors requirement vis a vis the funds available .

3.2 Debt Restructuring

Apart from debt servicing, the county government is exploring the possibility of debt restructuring as one method of dealing with huge debts

particularly for bank loans and pension funds inherited from the defunct local authorities once the handing over is concluded. This will spread the debt burden over a period of time since the existing debt cannot be cleared within a year due to budgetary constraints. Restructuring will also help the county to avoid payment of penalties and interest that have accrued and costly legal battles.

3.3 Prioritization of programmes

The pending bills arising from all departments will have to be cleared as a first charge in the succeeding budget beginning with 2016/17 supplementary budget to avoid further accumulation of debts as provided for under section 41(2) of the PFM (County Government) Regulations, 2015. Departments will also be required to prioritize projects/programmes in cognizance of resource constraints. The County Treasury shall prepare a report on cash flow projections in early April, 2017 so as to advise on commitments to avoid pending bills by the end of the financial year as per section 44(5) of the PFM (County Government) Regulations, 2015. This might compromise implementation of some of the critical projects/programmes as well as service delivery but it is a necessary measure in ensuring that the county does not accumulate debts in succeeding years.

4 IMPLEMENTING THE 2017/18-2019/20 MTDMS

Upon the approval of the this strategy the Department of Finance and Economic Planning will develop a program for pending bills repayment based on priorities and cash flow forecast.

The debt management committee, which, will be based at the County Treasury will review all pending bills from the departments and make recommendation for payment or otherwise as it deem fit as a new financial year starts. This will ensures that all pending bills approved are settled as a first charge in the budget. The County Assembly has set the ceiling for borrowing at 5 percent of the county revenue and the County Treasury shall provide a budgetary allocation for payment of pending bills. This will not only guide the sustainability of debt but will also lay the ground for future borrowing to finance the budget.

Negotiation with various parties' owed substantial amounts of money will be fast tracked once the handing over of assets and liabilities is concluded. The government will strive to ensure that the negotiations are concluded by the end of June 2017 so that implementation of the agreement(s) can start at the beginning of year 2017/18. Timely conclusion of these agreements will facilitate their inclusion in 2017/18 debt repayment program.

The County Treasury will create and strengthen the proposed debt management committee in terms of staffing, training and provision of working tools and equipment to ensure that the office is in a position to give comprehensive, accurate and timely information on debt. In addition, effective linkages will be established with the National Treasury to facilitate training on debt management techniques and offer guidance and support on future borrowing. The national government is expected to guarantee borrowing by county governments and therefore the National Treasury

plays a critical role in ensuring the success of debt management in the county.

5 CONCLUSION

The 2017/2018-2019/2020 Medium Term Debt Management Strategy is a forward looking framework that describe the sustainability of the county debt in the medium Term. Even though the current debt level is high it is sustainable, however it is important that the county government continue to implement prudent debt management practice and policies to avoid unmanageable debt levels. The high debt levels calls for sufficient allocation of funds in the 2017/2018 budget and consecutive budgets in order to improve the debt position and avoid unnecessary cost such as interest and penalties especially from the statutory bodies.

The current stock of debt is in excess of 0.7 billion, however, in the 2016/2017 approved budget estimates, the government have provided a total of Kshs. 58.6 million towards payment of pending bills. This clearly illustrates that the county government may not be able to settle all the debts in year 2017/18 and some will have to be schedule to the subsequent years in the medium term.

Since this MTDMS envisages no borrowing to finance the budget more emphasis has been put on management of current debt. Henceforth, all county departments and other entities are expected to be more conscious while spending and ensure that projects and programmes implementation is in line with the approved budget and availability of fund at the County Treasury. Procurement processes should be concluded before the end of third quarter to avoid pending bills in subsequent years. Further it is expected that the National Treasury will be releasing the exchequer as per the agreed cash flow schedules.