COUNTY GOVERNMENT OF BUNGOMA

THE COUNTY TREASURY

MEDIUM TERM DEBT MANAGEMENT STRATEGY PAPER FOR

FY 2017/18 – FY 2019/20

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ALL INQUIRIES ABOUT THIS COUNNTY DEBT MANAGEMENT STRATEGY PAPER 2017/18 – 2019/20 SHOULD BE ADDRESSED TO: CHIEF OFFICER, FINANCE AND ECONOMIC PLANNING

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FOREWORD

In ongoing efforts by the County Government of Bungoma for prudent debt management and continuous improvement in service delivery, the County Treasury has prepared this Medium Term Debt Management Strategy (MTDS) to provide an overall guidance for the best management of debt in the medium term.

The County's debt management objective is to maintain debt within levels that are sustainable over time. This requires regular monitoring of debt levels against commonly accepted debt targets or thresholds established by national and multilateral institutions while also ensuring that any financing requirements are met at low cost with a minimum degree of risk in the medium term. This general objective and approach is also reflected in the county's policy documents and development plans.

The county will explore opportunities for new prudent borrowing with care. The focus will be on saving costs, driving growth, and addressing the urgent development needs as documented in the County Integrated Development Plan 2018 – 2022. In doing so, the county will remain mindful of the risks associated with holding significant levels of debt, and the need to ensure its sustainability.

Challenges will remain, the development of prudent debt management will require concerted efforts to constantly explore ways to mitigate the costs and risks in County Government's debt portfolio.

In conclusion, I would like to emphasise the county's commitment to promoting transparency and accountability in public financial management. The publication of this inaugural CMTDS (2017/18 – 2019/20 will be reviewed annually in line with fiscal and macro development, It will provide a critical tool for informed policy decisions by all stakeholders with the intention to improve the debt burden and other fiscal vulnerabilities and also the relations with external and domestic financiers including the National Government and development partners.

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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 ABBREVIATIONS AND ACRONYMS

ADB	:	African Development Bank
BCG	:	Bungoma County Government
BRICS	:	Brazil, Russia, India, China and South Africa
CBAs	:	Collective Bargaining Agreements
CBR	:	Central Bank Rate
CGoB	:	County Government of Bungoma
CIDP	:	County Integrated Development Plan
CMTD	:	County Medium Term Debt Management Strategy
CSDF	:	County Strategic Development Framework
CSDF	:	County Strategic Development Framework
DMS	:	Debt Management Strategy
ECDE	:	Early Childhood Education
EIB	:	European Investment Bank
EU	:	European Union
FDI	:	Foreign Direct Investments
FY	:	Financial Year
GDP	:	Growth Domestic Product
GFS	:	Government Finance Statistics
ICT	:	Information Communication Technology
IDA	:	International Development Association
IFAD	:	International Fund for Agricultural Development
MTBF	:	Medium Term Budget Framework
MTDMS	:	Medium Term Debt Management Strategy
MTEF	:	Medium Term Expenditure Framework
OPEC	:	Organization of the Petroleum Exporting Counties
PFMA	:	Public Finance Management Act
PPP	:	Public Private Partnerships
SACCOS	:	Savings and Credit Cooperative Societies
SDGs	:	Sustainable Development Goals
WB	:	World Bank

EXECUTIVE SUMMARY

This County Medium Term Debt Management Strategy (CMTDS) is the first formal strategy for management of debt. Prior to this, the county was required to maintain balanced budgets hence little or no debt was accumulated since 2013. 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.

The County MTEF budget estimates for FY 2017/18 and the medium term projections show an enlarging financing gap, thus justifying the need for this strategy. With a new county administration focusing on initiating significant flagship projects, this provides a considerable evaluation and revision of the debt sustainability thresholds and gives the county more scope for prudent borrowing going forward.

PFM County Government Regulations Sec. 179(1) states that public debts should not exceed 20% of the most recent and audited revenues

During this initial CMTDS period, practical options must be identified for the county to implement in order to keep its future financing requirements at prudent levels and a minimum degree of cost and risk as a high priority. However, as the preferred option, that county will continue to exhaust all possible financing requirements from the grant pool fund as available from our development partners. As feasible, there are numerous potential sources of debt financing so long as the provisions of the PFMA and its regulation are observed

The strategic advice for the County Executive Committee Member for Finance on advancement of this CMTDS, for consideration of any borrowings required to finance possible budget deficits (GFS definition) and to improve the performance of the debt portfolio will be provided by the Public Debt Management Unit to be established by the County Treasury.

Four strategies are analyzed to compute the most optimal strategy for the county.

Strategy 1: External financing (semi and concessional) and some domestic bond financing. The strategy combines both external and domestic sources of loanable funds.

Strategy 2: Negotiated domestic loans, overdrafts and utilization of securities market

Strategy 3: Concessional financing. The strategy focuses on external long term, low interest loans.

Strategy 4: Bilateral financing: Strategy 4 looks at an alternative approach to making use of the external market, by borrowing from "new" bilateral creditors carrying quasi- or semi concessional terms (almost 70% of international flows), in addition to multilaterals (at half of baseline proportions), and a small 8% share of domestic debt.

In anticipation of results, Strategy 3 should exhibit a lower cost profile given advantageous interest rate terms, but foreign exchange risk may be heightened. Strategy 4 may show a low-cost/higher risk profile as well. This strategy best addresses the priority issue of refinancing risk.

Of the four strategies, **strategy 2 is the preferred option for the County Government of Bungoma to implement in the medium term.** Although it provides a higher interest cost than the other strategies, it is minimal compared to the difference in risk level due to non - exposure of domestic borrowing to foreign exchange fluctuations. With gradual development of the domestic market, it would also provide a more balanced composition of public debt with less external debt and more domestic debt.

Outline of the 2017 Debt Management Strategy Paper

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.
- Chapter two gives the objectives, goals and principles of Debt Management in the county and outlines the basis on which the 2017 Debt Management Strategy is prepared.
- Chapter three discusses the macroeconomic environment, risks and potential sources.
- Chapter four provides emphasis on specific strategies the County Government intends to 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
- The last chapter gives the summary of the Bungoma County Debt Management strategy FY 2017/2018.

CHAPTER ONE: OVERVIEW OF DEBT MANAGEMENT

1. The County Medium Term Debt Management Strategy (CMTDS) is a high priority of the County Government of Bungoma, given the increasing gap between development resource requirements and the available allocation.

2. The county has recognized the need to have a formal and explicit CMTDS in place to ensure improved debt management as part of a stronger Medium Term Budget Framework (MTBF) to ensure county finances are placed on a more sustainable footing.

3. The MTDS provides directions and benchmarks for managing the county's debt portfolio. This will lead to the 'preferred debt composition', i.e. the preferred cost-risk trade-off, taking into account constraints posed by the economic and market environment.

4. 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.

5. 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.

6. 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.

7. 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.

8. Unsustainable levels of debt lead to adjustments in expenditure levels, with view of obtaining additional resources which 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.

9. Inability to repay debts can lead to a situation known as debt distress. A county is 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.

10. 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.

CHAPTER TWO: OBJECTIVES OF DEBT MANAGEMENT STRATEGY

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

12. The Debt Management Strategy will guide County Government debt management operations in the FY 2017/2018 and the medium term. 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 development priorities and achieve debt sustainability.

13. The Debt Management Strategy will provide appropriate guidelines and direction to assist in making sound debt management decisions, while demonstrating strong financial management practices for posterity.

2.1 Scope of the Medium Term Debt Management Strategy

14. This CMTDS covers the County Government of Bungoma (CGoB) debt portfolio which includes external debt, domestic debt, and contingent liabilities of on-lent debt and guaranteed debt with the public and other enterprises.

15. External debt is defined as debts denominated in currencies other than Kenyan shilling while domestic debt is defined as debt denominated in Kenyan shillings, even when the creditor is a foreign entity.

16. In line with international reporting requirements, CGoB will consider review in future for current reporting of domestic debt (as may be required) to include the outstanding liability for transfer value under the pension scheme for civil servants.

17. Although the focus of the CMTDS is on actual direct liabilities of the CGoB, contingent liabilities (whether explicit or implicit) may have an important bearing on the sustainability of debt and robustness of this strategy. Consequently, it is prudent to consider the potential risk that contingent exposures could materialise under specific scenarios and thus may need to be addressed in the future.

2.2 Goals for the Debt Management Strategy

18. The aim of the CMTDS shall be to support the government's strategy in implementing the FY2017/18 budget and over the medium term by ensuring that the government's financial requirement and payment obligations are met at the lowest cost with prudent degree of risk in line with PFM Act, 2012. In addition, the strategy will;

a) Underscore the County Government's commitment to developing and designing a strategy that is evidence based and feasible in ensuring that public debt levels remains sustainable and supports broad-based and inclusive growth.
b) Serve as a strategy of financing the fiscal deficit of the County Government over the medium term

2.3 Debt Management Strategy Financing Principles

19. 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 pegged on 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 transformative
d) Debt must be guaranteed
e) The debt must be for capital projects

CHAPTER THREE: MACROECONOMIC ENVIRONMENT, RISKS AND POTENTIAL SOURCES

20. The Kenyan Economy is estimated to have expanded by 5.8 per cent in 2016 compared to a revised growth of 5.7 per cent in 2015. Accommodation and food services recorded improved growth of 13.3 per cent in the year under review compared to a contraction of 1.3 per cent in 2015. The other sectors that registered significant improved performance in economic activities were in the information and communication; real estate; and transport and storage.

21. Persistent drought hampered growth in the fourth quarter of 2016 impacting negatively on agriculture and electricity supply. On the other hand, growth in construction; mining and quarrying; and financial and insurance activities decelerated in 2016. From the demand side, growth was buoyed by consumption in both the public and private sector.

22. Annual average inflation eased to 6.3 per cent in 2016 compared to an average of 6.6 per cent in 2015. This was mainly due to decline in prices of transportation; housing and utilities; and communication. The Shilling strengthened against the Pound Sterling, South African Rand, Ugandan Shilling, Tanzanian Shilling and the Rwandan Franc but weakened against the US Dollar, Euro, and the Yen in 2016.

3.1 Potential Financing Sources

23. The potential sources of Loans for Bungoma County Government falls under two categories:
    a) Domestic sources of Loans
    b) External sources of loans

3.1.1 Domestic Sources of funding

24. 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

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

CHAPTER FOUR: ANALYSIS OF FUNDING SOURCES

26. Infrastructure and reconstruction spending is a near-term priority, while in the medium term, the county will aim to gradually reduce the debt-to-revenue ratio. The county continues to be exposed to natural disasters e.g. fall army worms, landslides and lightning, as well as the priority development needs, which requires careful management of fiscal space.

27. In reference to the National Budget Statement 2017/18, as learnt over recent years, there is no scope for further fiscal expansion from large external loans due to the already large debt portfolio. Fiscal expansion beyond the capacity of domestic revenue must be funded by increases in budget support and external aid, issuance of domestic bonds that mobilizes excess domestic liquidity, with some prudent external borrowing for viable projects, on highly concessional terms.

28. Borrowing will be limited to financing of the budget gap for the various initiatives undertaken by county in efforts to diversify and stimulate the economy.

29. During the medium term, and subject to guarantee from the National Government, half of the financing requirements will be sourced from highly concessional external borrowing from World Bank (WB) for budget support (loan portion) also for the flagship infrastructure projects. The balance will be sourced domestically but through consultations with National Government. For the 2 outer years, similar financing methods will also be taken.

30. During this 3 year period of the CMTDS, the county does not project to undertake any external borrowing under commercial terms but only on concessional terms. On other financing options as explored in this CMTDS it includes 'existing' sources and also 'potential' sources that the county can consider to seek financing from.

Table 1 provides information on related potential Creditors and briefly includes some cost and risk indicators on the various types of financing.

Table 1: Creditors Cost and Risk Indicators

	Creditors			Cost indicators	Risk Indicators:
Multilateral					
	Concessional				
		IDA, ADB, IFAD, EI	Highly Concessional	Very low interest rates	Fixed Interest rates Long amortization profile Foreign currency, risk mitigated by the long amortization profile
	Potential	Japan	Highly Concessional	Very low interest rates	Fixed Interest rates Long amortization profile Foreign currency, risk mitigated by the long amortization profile
Bilateral					
	Potential				
		China	Semi-concessional	low interest rates	Foreign currency indicators Fixed interest rates
		Rep. of Korea	Focusing on rural development and ICT		Depending on the source of financing
		India	Focusing on agricultural projects		Depending on the source of financing
		Indonesia	Focusing on social transformation		Depending on the source of financing
		Africa Dev Bank	Focusing on infrastructure development		Foreign currency indicators Fixed interest rates
Theme Funds					
	Potential:				
		Climate Change Funds	Grants/Loans		depending on the source of financing
Domestic					
	Bonds	Domestic		Market - will reflect market development	Depends on tenors achieved, may be some refixing, indexation creates other risk exposures
	Loans	Commercial loans		Respond to changes in interest rates	Interest fluctuations create risk exposures

31. Under non-traditional sources of financing, such as Climate Change 'theme funds', the WB manages 6 climate change funds, which could provide important amounts of financing for the county.

32. For consideration in future periods, some semi or concessional financing may also be available from other sources such as Brazil, Russia, India, Indonesia, China, South Africa (BRICS), and from the European Union (EU) and the Organization of the Petroleum Exporting Counties (OPEC).

CHAPTER FIVE: STRATEGIES FOR MANAGEMENT OF DEBT IN THE MEDIUM TERM

33. The County Debt Management Strategy presents four main strategies that CGoB 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

a) To evaluate the cost and risk aspects of a continuation of current borrowing practices for Bungoma County, and to use these factors to set a benchmark for examining different approaches.

b) In conclusion, this strategy is based on current practice of external and domestic borrowing, that it does not best address the priority issues of foreign exchange risk, liquidity and repayment risk, creditor concentration risk and refinancing risk.

c) Under the cost and risk analysis over the 3 year period, this strategy in comparison to 2, 3 and 4, provides medium to high risk mainly due to the foreign exchange factor and low to medium cost in relation to County revenues.

Strategy 2: Negotiated domestic borrowing and utilization of securities market

a) To examine the cost and risk aspects of taking steps to further develop the domestic debt market, Strategy 2 highlighted an overall balance of new borrowing that tapped the domestic market for 95% of financing requirements, and the external debt market for 5%. A domestic yield curve was established following the existing rate structure in Kenya for the 5-6 year debt stock, and extended to cover the issuance span from 1 to 10 year maturities.

b) Bond issuance was posited to be concentrated by almost 60% (of domestic flows) in 5-6 year bonds—deepening the existing market, while building to an average 30% concentration in 10-year bonds—establishing a longer term maturity in the market; and by an average 7% at the 1-year maturity. A priority, one would anticipate greater costs for this strategy vis-à-vis baseline, given the higher level of domestic interest rates versus international concessional ones; but exchange rate risk would be diminished by the higher share of domestic-currency denominated debt.

c) In conclusion, this strategy best addresses the priority issue of foreign exchange risk and liquidity and repayment risk with rollover of domestic securities on maturity.

d) Under the cost and risk analysis over the 3 year period, this strategy in comparison to 1, 3 and 4, provides low risk mainly due to the foreign exchange factor of external borrowing and high cost in relation to county revenues due to the interest rate factor and shorter maturity compared to external borrowing.

Strategy 3: Concessional financing

a) Strategies 3 and 4, in contrast to Strategy 2, examine the tradeoffs in expanding external borrowing, in Strategy 3 by boosting the proportion of gross external borrowing over the 2017-2024 period to 83% from 50% in the baseline, here concentrated in concessional multilateral borrowing. Domestic debt issuance is diminished to 17% of total financing requirements.

b) In conclusion, this strategy best addresses the priority issue of refinancing risk. Under the cost and risk analysis over the 3 year period, this strategy in comparison to 1, 2 and 4, provides medium risk mainly due to the foreign exchange factor and lowest cost in relation to county revenues due to the interest rate factor available from multilateral sources offering highly concessional terms.

Strategy 4: Bilateral financing

a) Strategy 4 looks at an alternative approach to making use of the external market, by borrowing from "new" bilateral creditors carrying quasi-or semi concessional terms (almost 70% of international flows), in addition to multilaterals (at half of baseline proportions), and a small 8% share of domestic debt. In anticipation of results, Strategy 3 should exhibit a lower cost profile given advantageous interest rate terms, but foreign exchange risk may be heightened. Strategy 4 may show a low-cost/higher risk profile as well.

b) In conclusion, this strategy best addresses the priority issue of creditor concentration risk.

c) Under the cost and risk analysis over the 3 year period, this strategy in comparison to 1, 2 and 3, provides highest risk mainly due to the foreign exchange factor and less concessional terms (from terms offered by multilateral sources).

d) To determine the cost-risk profile of the baseline macroeconomic scenario-borrowing strategy combination, a set of standard market shock tests are applied to the strategy in order to assess the different vulnerabilities to exchange and interest rate fluctuations.

e) Given the analysis of the four strategies based on the lowest cost and risk between the four strategies, Strategy 3 best addresses that requirement. However, on the priority requirement to minimize the significant level of foreign exchange risk as result of the high proportion of external debt at 91% (compared to 9% of domestic debt), under this strategy CGoB will continue to be vulnerable to this risk in the medium term. Further, with progressing of the county economy, access to highly concessional borrowing from multilateral sources will also become limited.

f) To consider the strategy that best addresses the high risk of foreign exchange and comparison of difference between cost and risk of the four strategies. Strategy 2 is the preferred option for CGoB to implement in the medium term. Although it provides a higher interest cost than the other strategies that it is minimal compared to the difference in risk level due to no exposure of domestic borrowing to foreign exchange. With gradual development of the domestic market that it would also provide a more balanced composition of public debt with less external debt and more domestic debt.

CHAPTER SIX: BASELINE PROJECTIONS AND BEST PRACTICES IN DEBT MANAGEMENT

6.1 Fiscal Policy

34. **The county fiscal policy** is its primary tool to improve income distribution through both its revenue and spending policies. Fiscal policy are designed to support macroeconomic stability, correct market failures and provide public goods with particular emphasis on inclusiveness, in particular elderly welfare, special needs of vulnerable groups and the disabled, access to free and improved health care, and free basic primary education and subsidized post-secondary education.

35. **The county recurrent budget** shows the significant contribution of budget support relative to local revenue. The share of staff costs compared to operating expenditure continues to account for over 62.3%. The balances brought forward for each FY will contribute to county cash balances.

36. To ensure prudent debt management, the county will pursue with improvements the following measures (with support of specific policies):

   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.

g) Monthly savings: 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.

h) Stakeholders' Involvement: Some activities such 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.

6.2 Monetary

37. 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 (with support of specific policies):

a) ensuring sound financial institutions (encourage strong and viable banking);

b) maintaining adequate foreign reserves

c) protecting external balance (balance of payments and currency convertibility);

d) supporting price stability (low inflation);

e) facilitating growth of the domestic economy.

38. The capping of interest rates to a maximum of 4.0 per cent above the Central Bank Rate (CBR) resulted in a significant decline in interest rates and a decline in credit to the private sector. However, the low interest rates presents an opportunity for the county to seek out low interest domestic loans for development expenditure.

6.3 Key Challenges for Bungoma County:

39. 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 tourism not increasing as robustly as expected; the county not being able to control the wage bill (due to CBAs for health workers and ECDE teachers) combined with a tax reform not resulting in the expected revenue increases. These risks are likely to dampen growth prospects, put downward pressure on the exchange rate, and lead to a rise in domestic and/or external borrowing needs.

40. Continuation of financial difficulties in the main origin countries of remittances from Kenyans abroad and main sources of tourists (USA and the EU) would negatively affect the expected national economic growth rate with negative consequences to the county (since county allocations are based on performance of the national economy). Furthermore, any delays in implementing revenue reforms and reducing the wage bill (currently at 43%) could exert further pressure to resort to additional borrowing over the medium term.

6.4 Other Longer Term Structural Adjustments

41. The County Strategic Development Framework (CSDF), which encompasses nine priority areas, continues to guide the overall strategic reform of the county. Table – shows the projects/initiatives contained in the CSDF for the medium term.

Table 2: County Strategic Development Framework initiatives

Sector	Project/Initiative
Agriculture	Develop the Chwele Agribusiness zone
Roads and Transport	Upgrade 250 km of major county roads to bitumen standards through Public Private Partnerships
Education	Invest in provision of quality pre-school and vocational education
Sports	Renovation and modernization of Masinde Muliro Stadium
Water	Invest in safe drinking water, promote rain-water harvesting and Develop gravity fed water systems
Health	Constructing a county Referral Hospital,, staffing and equipping at-least one dispensary per ward
Industry	Development of cottage and manufacturing industries
Trade	Develop modern truck shops on the Webuye Malaba Road
Tourism	Use partnership model to attract Tourism Investments in Bungoma County

42. In support of addressing the expected debt overhang and the requirement for fiscal consolidation and structural reform in the medium term, the CSDF covers the following related areas beyond the CMTDS.

43. **Structural Policy:** Structural reforms to facilitate the functioning of credit markets especially Savings and Credit Cooperative Societies (SACCOS) need to be implemented and with renewed vigour. The county intends to gradually improve revenue collection and management to support her growth agenda. The promotion of foreign direct investments (FDI) should focus on business enabling structural reforms, while the use of tax incentives should be minimized and well targeted.

44. The county is committed to further strengthening the **Public Private sector Partnership (PPP)** to increase competition which helps improve quality and lower prices for customers. Promoting FDI should focus on business enabling structural reforms, and there is the need to strike the right balance between promoting FDI projects and protecting revenue base.

45. **Improving county operations to a more efficient, effective and affordable** public service needed to deliver on policies and required results while ensuring fiscal stability is a major requirement for the medium term.

46. Major reforms are under way and these relate to economic and social policy analysis, integrated development planning and budgeting, staff performance and management, improved governance and transparency as well as other technical areas.

47. The development of county domestic debt market, presents an alternative financing option for the county. This involves development of legal and institutional arrangements to obtain financial and non-financial resources to support the county development programmes from individual and corporates operating within the county.

48. The county recognizes that the medium-term prospects depend on the continued implementation of its wider program of structural reforms as well as retaining a focus on the CMTDS within the wider strengthening of the MTBF to ensure that county finances are on a sustainable path. This will also provide policy space to allow better response to future shocks.

CHAPTER SEVEN: RISK SCENARIO TESTING

7.1 Inherent Risks in the Debt Portfolio

49. There are several inherent risks in the debt portfolio. The CGoB has in recent years, noted the priority need to employ various measures to mitigate these risks and to minimize the impact of various exogenous shocks on the portfolio. The CGoB will continue to identify and mitigate risks to the implementation of the debt management strategy. Prudent debt management practices will be pursued over the medium-term with a view of satisfying the mandate as outlined in the CMTDS.

7.2 Risk Scenario Testing

50. Stress testing involves deciding on realistic problems (downside risks) that the county might face, and looking at how they are likely to affect the county's future economy. CGoB recognizes that stress testing is an important part of a debt sustainability analysis, where the effect of downside risks on the ability of a county to continue to make debt repayments is examined.

7.3 Analysis of Cost and Risk Indicators

51. Looking forward over the next 3 years, cautious monitoring of the county treasury's debt sustainability level is required and especially on any ease for future external borrowing. This is to ensure improvement in our current level of economic activity and prudent public debt management, in order to mitigate the vulnerability to shocks.

7.3.1 Exchange Rate Risk

52. Foreign exchange rate risk relates to vulnerability of the debt portfolio and its impact on the CGoB's debt servicing cost due to a depreciation of the Kenya Shillings (Kshs) against the currencies in which the external debt is denominated.

53. Foreign exchange movements will change both the amount of debt servicing and the value of debt outstanding, and therefore the related debt ratios. The annual external debt servicing obligations will be initiated in FY 2017/18.

7.3.2 Refinancing Risk

54. Rollover risk is the risk that a maturing debt cannot be replaced or refined, or that the replacement debt will be more expensive.

7.3.3 Interest Rate Risk

55. Interest rate risk is the risk associated with interest rate changes in the debt portfolio.

56. The weighted average interest rate of both external and domestic debt will be estimated at the end of every FY for analysis to inform decision making organs.

7.3.4 Liquidity and Repayment Risk

57. Servicing debt is a primary concern for debt management and to ensure that the total expenditure including debt service costs does not exceed revenue collected. This risk can be expressed as the cost of debt repayments compared with funds available.

58. This is a real risk for CGoB especially from FY 2017/18 with the initiation of external debt servicing costs. In comparison of these costs to both revenue and expenditure it may create inability to meet all the repayments as due.

7.3.5 Creditor Concentration Risk

59. Creditor concentration risk 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 country's affairs and could potentially have an undue influence in policy development.

60. In order to diversify the investor base, the County Treasury will work closely with the National Treasury as may be required to explore the scope and options of instruments to offer the domestic market.

7.3.6 Credit Risk of on-lent and guaranteed loans

61. When the level of outstanding on-lent loans from CGoB is high, there is an implicit exposure to default and non-payment of obligations by the borrowing entities even when the loans are guaranteed. Introducing more analysis and oversight of these transactions will reduce the overall risks embedded in the CGoB's debt portfolio.

7.4 Other Risks in Managing the Portfolio

7.4.1 Operational Risk:

62. The operational risks 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 CGoB in general.

63. In order to address this risk, Debt Management Unit Staff should undergo capacity development through external trainings organized by the National Treasury and donors such as the IMF-WB on respective areas of debt management.

7.4.2 Strategic Risk

64. Strategic risk is the risk that decisions made about management of the debt portfolio have a high opportunity cost.

65. If the CGoB decides not to borrow, then it could miss out on grant funding (if grant funding for these projects is not available from other sources). If decisions to borrow for particular projects do not match expectations, then this money could have been better spent elsewhere on other, more beneficial projects. Money spent on servicing debt might be better spent on providing essential services.

66. Alternatively, it is better to pay down debt (which saves the CGoB future interest payments and increases borrowing opportunities in the future) rather than spending funds unwisely.

67. In view of this risk, the county treasury as part of the annual budget preparation needs better review and coordination to best determine for any financing that the CGoB may require and to analyse the related costs and risks for those options.

7.4.3 Financial Risk

68. Financial risk is the risk that the CGoB's portfolio management is so poor that it creates a source of instability for the private sector. The risk for Bungoma is that a poorly managed debt portfolio will mean that less money is available for servicing the county's basic needs which could undermine development and progress towards the CIDP, Vision 2030, SDGs and other interlinked plans.

69. A burgeoning debt portfolio or 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.

CHAPTER EIGHT: SUMMARY AND CONCLUSION

70. The 2017 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.

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

72. 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.

73. The recommended strategy is one that seeks the issuance of medium to long term domestic debt, and contracting of external concessional debt.

74. As required under the Public Finance Management Act 2012, the Strategy is in line with the county policy objectives. Going forward, the County Government will implement measures aimed at enhancing the transparency and accountability in public debt management.