



COUNTY GOVERNMENT OF NAKURU

COUNTY TREASURY

MEDIUM TERM DEBT MANAGEMENT STRATEGY PAPER

FEBRUARY 2015

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Foreword

This is the first medium term debt strategy (MTDS) to be prepared since the assumption of office by the county government. The county treasury was not able to prepare a medium term debt strategy for the financial year 2014/15 because by end of February 2014 when the strategy was expected to be tabled in county assembly the county government was still laying operational structures and being the first year of county government existence many tethering challenges hindered the preparation of MTDS.

The preparation of medium term debt strategy is in accordance with public finance management (PFM) Act 2012 and is consistent with county government policies and strategies. The main objective of MTDS is to ensure that the county government financing needs and payment obligations are met at the lowest possible cost in the market that 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 the 2015 MTDS will among other issues deal with sustainability of county debts. A bill that propose annual borrowing limit will be drafted and presented to county assembly for adoption, this is in line with PFM Act section 107 (2)(e) and section 107 (4) that deal with sustainability of debt. The county government inherited huge debt from the four defunct local authorities i.e. Nakuru County Council, Nakuru Municipal council, Naivasha municipal council and Molo Town Council. The inherited debt has increased the county debt burden and to ensure sustainability the MTDS has elaborated on measures to be undertaken to reduce the debts to a manageable level.

Considering the current level of debt both inherited and county debt the 2015 MTDS will largely deal with reducing the county debt level and developing strategies to deal with future debt. In addition the county government will continue to build capacity of debt management unit in term of staffing and training to ensure that it is in position to handle all matters relating to borrowing and servicing of debt. Effective linkages will be established with the national treasury to facilitate future borrowing and provision of technical advice.

FRANCIS MATHEA
C.E.C – FINANCE AND ECONOMIC PLANNING

Acknowledgement

The preparation of 2015 MTDS is the first step in ensuring accountability and transparency in management of public debt. Despite the many tethering problem faced by the county government during the first full year of operation the government has been able to formally present it first debt management strategy under PFM Act, 2012.

Henceforth the review of medium term debt strategy will be done annually in accordance with PFM Act 2012. The county government has made great stride in verifying liabilities inherited from defunct local authorities and verification process is expected to be concluded before preparing the 2016 debt strategy.

To enhance debt management in the county, the county treasury has established a debt management department that is mandated to prepare the debt strategy and to give comprehensive, accurate and timely information on debt. The establishment of the office lays the ground for future borrowing to finance budget and servicing of outstanding debt.

The 2015 MTDS 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 the debt strategy will be published and will be made available at the county website i.e. www.nakuru.go.ke to ensure wide circulation.

Let me take this opportunity to acknowledge the C.E.C – Finance for his overall leadership, Director Economic Planning for overseeing the preparation of MTDS, debt management committee members for their contribution, staff of debt management department for preparing the MTDS, transition authority coordinator for role played during transition period and interim debt management committee for verifying inherited debt.

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Abbreviations and Acronyms

PFM	Public Finance Management
MTDS	Medium Term Debt Strategy
CRA	Commission of Revenue Allocation
CBROP	County Budget Review and Outlook Paper
CFSP	County Fiscal Strategy Paper
TA	Transition Authority
NSSF	National Social Security Fund
LAP	Local Authority Pension
NAWASSCO	Nakuru Water and Sanitation Service Company
KBBR	Kenya Bank Base Rate
Ksh	Kenya Shilling

Legal basis for publication of medium term debt management strategy

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.

(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 publicise the statement and submit a copy to the Commission on Revenue Allocation and the Intergovernmental Budget and Economic Council.

Executive Summary

The 2015 medium term debt strategy 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 document such as sectors reports, county budget review and outlook paper, annual financial statements and county fiscal strategy paper.

The county government inherited approximately 1.2 billion from defunct local authorities i.e. Nakuru County Council, Nakuru Municipal council, Naivasha municipal council and Molo Town Council. In dealing with inherited debt the county treasury formed a debt management committee that has been verifying liabilities inherited from 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 31st December, 2014 the county debt was ksh1,510,431,498.29 this comprises of inherited debt of ksh 1.02 billion and pending bills from county government ministries amounting to kshs483.5million. Some of devolved ministries such as agriculture and health had outstanding debt which was passed to the respective ministries after devolution, this debts have been accounted for as ministry's debt.

In addition there is a contingent liability of 171 million inherited from defunct local authorities. This comprises of statutory debt of 82 million, utility bills of 22.8 million and suppliers credit of 66.2 million.

To reduce the county debt to manageable levels sufficient fund will be allocated in the budget to cater for debt repayment. The county treasury requires 600 million to settle debt during the financial year 2015/16 however 432 million have been allocated as per county fiscal strategy paper 2014 while 483 million will be paid as a first charge from the ministries budget at the beginning of the year. In dealing with the other substantial liability inherited, the county government will negotiate with creditors to spread the debt burden for a few year since the fiscal space may not accommodate all payment in one year.

To reduce future pending bills from ministries, all ministries will be required to reprioritize their programs and align their expenditure to cash flow forecast and availability of fund. In addition pending bills will be cleared as a first charge in the budget to avoid accumulation of bills.

The county treasury will continue to strengthen the debt management department in term of training and staffing to ensure that it is in position 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.

1.0 Introduction

1.1 Background

The debt management strategy is prepared in accordance with section 123 of PFM Act, 2012. As per the act the County Treasury is required 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 section 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).

Being the first MTDS for the county more emphasis has been put in ensuring the sustainability of the current debt and establishment of necessary structures to facilitate future borrowing. The 2014Fiscal strategy paper does not envisage any borrowing to finance the budget therefore the 2015 debt 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 verification of all liabilities from the defunct local authorities and servicing of existing debt.

One of the mandates of the Transition Authority (TA) is to develop an inventory of all government assets and liabilities in accordance with Section 7 (e) of the Transition to Devolved Government Act, 2012. However the TA has not published the list of liabilities inherited from

the defunct local authorities but the county treasury has formed a debt management committee to verify all liabilities inherited from the defunct local authorities. The main goal of the committee was to establish the debt position of Nakuru County Government as inherited from the four defunct Local Authorities namely former County Council of Nakuru, Municipal Council of Nakuru, Municipal Council of Naivasha and Town Council of Molo. The mandates of the committee was to;

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

The committee has so far being able to verify debt amounting to 1.02 billion from the four defunct local authorities. However the committee has been facing several challenges in verification since the defunct councils have not being keeping proper records and majority of the financial records that were in use were not properly handed over hence most document cannot be traced. The defunct councils provided a list of creditors but did not provide all creditors file as per the list provided which further makes the verification process move slowly.

The county treasury has already established a debt management office to handle matters relating to debt and borrowing. The establishment of the office will complement the work of debt management committee (DMC) and spearhead the process of liabilities verification. The establishment of the office is the first step in ensuring that the county government is in position to handle it current debt and is ready to undertake future borrowing to finance the budget.

1.2 Objective of debt management

The principal objective of debt management is to ensure that the financing 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. The second objective is ensuring that the overall level of public debt is sustainable. The third objective is ensuring 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 (MTDS) covers actual and potential liability i.e. it covers all loans and other debt that require payment of principal with or without interest by the county government to the creditor at a date or dates in future. The MTDS is prepared for financial year 2015/16 but also makes projection for year 2016/17 and 2017/18.

2.0 Review of Nakuru County public debts

2.1 Stock of debt

The total stock of debt as at 31st December 2014 stood at ksh1,510,431,498.29

This comprises of both inherited debt of ksh1,026,871,335.45 and county government debt of kshs483,560,162.84. This debt is projected to be approximately 1.8 billion by 30th June, 2015 if the contingent liability materialize and putting into consideration interest charged on outstanding pension contribution.

Inherited debt included as part of county debt is summarized in the following table

Description	Debt Outstanding as at 30 June 2014
STATUTORY DEBTS	230,175,894.61
SALARY ARREARS	4,528,805.00
PAYROLL DEDUCTIONS	10,823,164.00
SUPPLIERS AND CONTRACTORS	296,416,346.87
BANK LOAN	192,869,991.01
LEGAL FEE	292,057,133.96
Totals	1,026,871,335.45

Source: debt management committee report

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 from ministry
2. Inherited debt from defunct local authorities

2.2.1 Pending bills from ministry

The county government accumulated huge pending bills from ministries for the financial year ending 30th June, 2014. This was attributed to late disbursement of the last tranche of equitable share from the national treasury that was hardly used and a large portion was returned to the county revenue account held at central bank. In addition the county government was expecting to receive kshs 424 million as loans and grant from the national treasury but this amount was not disbursed despite being factored in the budget. In addition the national treasury withheld 1.3 billion for devolved staff in March 2014 whereas the county had not budgeted for this staff. This

created a liquidity problem in the last quarter of the last financial year thus leading to huge pending bills.

The summary of pending bills by ministries is illustrated in the following table.

Outstanding Pending Bills for the Period Ending 31st December 2014				
MINISTRY	RECURRENT	DEVELOPMENT	TOTAL	Percentage of Total Debt
ROADS,PUBLIC WORKS & TRANSPORT	16,326,672.00	88,802,370.85	105,129,042.85	21.7%
ICT& E-GOVERNMENT	2,917,300.00		2,917,300.00	0.6%
PUBLIC SERVICE BOARD	12,676,788.40	-	12,676,788.40	2.6%
ENVIRONMENT,NATURAL RESOURCES,WATER&ENERGY	3,797,469.00	4,599,487.00	8,396,956.00	1.7%
LAND, PHYSICAL PLANNING& HOUSING	5,811,871.30	6,780,568.30	12,592,439.60	2.6%
INDUSTRIALIZATION,TRADE& TOURISM	14,515,051.75		14,515,051.75	3.0%
EDUCATION,CULTURE,YOUTH &SOCIAL SERVICES	18,357,266.15	45,006,718.71	63,363,984.86	13.1%
AGRICULTURE,LIVESTOCK&FISHERIES	12,660,928.00	-	12,660,928.00	2.6%
FINANCE & ECONOMIC PLANNING	19,790,527.68	-	19,790,527.68	4.1%
PUBLIC SERVICE MANAGEMENT	121,331,040.97	5,003,059.36	126,334,100.33	26.1%
HEALTH	98,545,996.77		98,545,996.77	20.4%
EXECUTIVE	6,637,046.60		6,637,046.60	1.4%
TOTAL	333,367,958.62	150,192,204.22	483,560,162.84	

Source: ministry reports

The ministry of public service management had the highest recurrent debt. This was attributed to outstanding legal fee amounting to kshs 96.5 million. The county government has been involved in many legal cases leading to huge fee demanded by advocates representing the government. The total legal fee demanded so far in relation to the county government amount to kshs 155 million however for the last two financial year legal fee amounting to ksh 58 million has been paid leaving a balance of 96 million. Majority of this cases are ongoing and therefore the outstanding debt relating to legal cases are expected to be higher by closer of financial year.

Under the ministry of health 57.9 million of the debt belong to the county government whereas 40.5 million was debt incurred by various health facilities before devolution but this debt has been taken over by the ministry following devolution of these facilities. Following late disbursement of fund the ministry was not able to spend 54 million which was returned to county revenue account at the closure of year 2013/14 and this largely contributed to huge pending bills in this ministry.

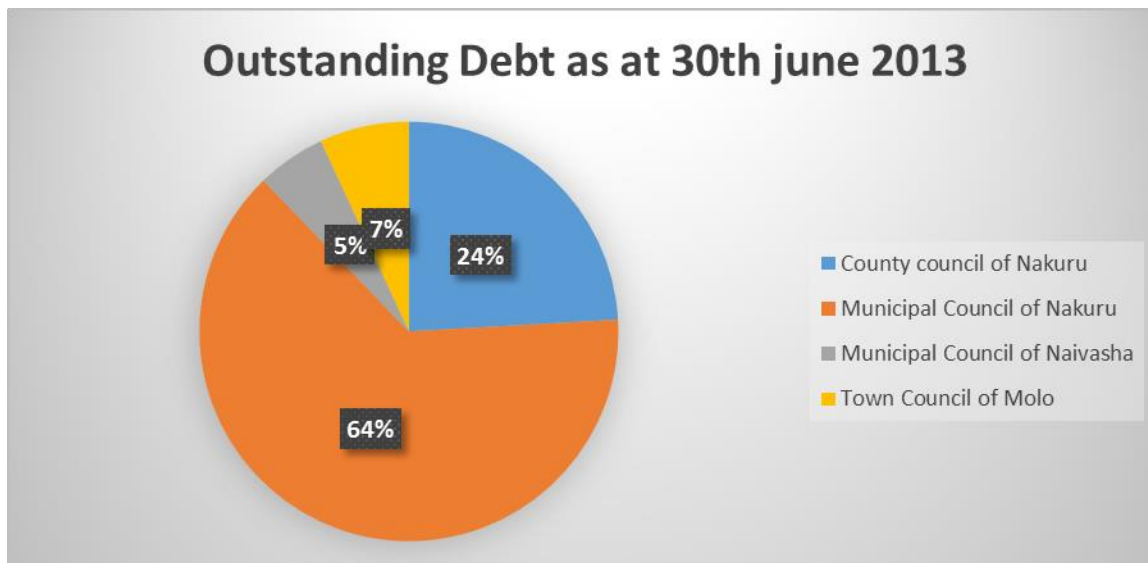
2.2.2 Inherited debt from defunct local authorities

The inherited debt as reported by all defunct local authorities is illustrated in the following table

Defunct Local Authority	Outstanding Debt as at 30th June 2013
County council of Nakuru	290,500,460.04
Municipal Council of Nakuru	767,221,772.15
Municipal Council of Naivasha	64,053,756.00
Town Council of Molo	83,127,642.60
TOTAL	1,204,903,630.79

Source: Asset and liability report 2013

Majority of the debt were inherited from defunct municipal council of Nakuru with 64% of the total debt inherited, followed by county council of Nakuru with 24%. Molo town council had 7% and Naivasha municipal council had the least debt inherited with only 5% of the total debt.



(a) DEFUNCT MUNICIPAL COUNCIL OF NAIVASHA

The outstanding debt as at 30th June 2013 included actuarial deficit amounting to kshs 64,053,756 owed to laptrust. However Staff arrears of kshs 27,388,234 and creditors of kshs 330,225 were latter included to the list of creditors. The actuarial deficit has been adjusted to kshs 23,423,504.00. In addition fee notes totaling to kshs12.3 million relating to various cases which are still ongoing have been issued. Court judgments amounting to kshs 71.4 million has

been awarded. Salary arrears amounting to kshs25,630,998.00 was cleared in financial year 2013/14. National Social Security Fund (NSSF) and Telkom Kenya have issued a debt note of kshs 17,070,427 and 1,226,675.22 respectively.

(b)MOLO TOWN COUNCIL

The council owed contractorskshs 13,615,274 as per creditors list provided. Reconciled amount owed to lapfund and laptrust as at 30thJune, 2013 is kshs 19,787,415 and 8,333,148.80 respectively. Other substantial liability include salary arrears of kshs12,287,700 arising from collective bargaining agreement of 2012 and 31,948,810 for reinstated forty member of staff by court. Other liability include suppliers credit of kshs 1,038,500 and legal fee of kshs 5,416,560.00. In addition to what was provided NSSF and Telkom Kenya have issued a debt note of kshs 17,381,085 and kshs 2,412,964.65 respectively. Salary arrears of kshs12, 287,700 and legal fee of kshs 1,000,000 have been cleared. However since amount owed to NSSF, LAP-FUND and LAP-TRUST attract penalties (interest) the reported debt as at 30th June, 2013 has since increased. Some of legal cases are still ongoing and therefore legal cost is expected to increase once these cases are concluded. Negotiations are ongoing to create a road map for paying the same.

(c)NAKURU MUNICIPAL COUNCIL

Beside the total debt reported on 30thJune, 2013 amounting to kshs 767,221,772.15, additional debt note amounting to kshs 46,403,781.61 has been received. As per creditors list provided legal fee amounted to kshs42,342,702 but fee notes issued so far amount to kshs162 million however 17 million has been paid leaving an outstanding legal fee of 145 million. Most cases are not yet concluded hence liability relating to legal cost continue to increase as additional fee note are received. Salary arrears of kshs 132,126,225 was cleared in financial year 2013/14. The council had a loan facility at family bank amounting to kshs 148, 211,204.21 as at 30th June which continues to attract interest and by September 2014 the loan had increased to kshs 201,779,923.47. In addition the debt owed to NSSF, LAP-FUND and LAP-TRUST continue to attract penalties and has since increased from the figure reported in June 2013.

(d)NAKURU COUNTY COUNCIL

The council owed employees' salary arrears arising from collective bargaining agreement (CBA) totaling to kshs 48,609,601.74 and pension contribution amounting to kshs 37.34 million. Suppliers and contractors credit amounted to kshs 203 million. Beside what was listed, fee note

amounting to kshs30,328,542.00 has so far been issued for various cases ongoing and legal fee amounting to kshs2 million has already been cleared leaving an outstanding legal fee of 28 million. Salary arrears amounting to kshs 44,200,917 was cleared in financial year 2013/14.

(e)Substantial liability inherited from defunct local authorities

i. Loan

The county government has a loan with the Family Bank of Kenya Nakuru Branch. This loan was inherited from defunct municipal council of Nakuru and comprised of overdraft facilities and long-term loans. The Credit facilities were restructured into a long term loan and overdraft facilities through consent letter Ref No. MLG 399-03/IV/174 and No. 399-03/IV/177 dated 8/3/2012 and 13/3/2012 respectively from the office of the Deputy Prime minister and ministry of Local Government. The loan facility restructuring was effected when the credit facility was liquidated to an outstanding balance of Kshs. 152,000,000 vide letter dated 24th April, 2012 from family bank.

NAME OF FACILITY	ACCOUNT NAME	ACCOUNT NUMBER	AMOUNT KSHS
OVERDRAFTS	GRF	018000024420	25M
OVERDRAFTS	SALARY A/C	018000001279	45M
LONG TERM LOAN	LOAN A/C	018SERL121010001	82M
TOTAL			152M

Source: Bank Statement

The terms of the loan was 60 months repayment period from the date of disbursement on a reducing balance and a monthly installment 2,578,129 per month. Family Bank granted the defunct Municipal Council of Nakuru the above facilities and the amounts were posted to the relevant accounts on 10th April 2012. The defunct Council had been servicing the overdraft and the loan up to 30th April, 2013. The status of the outstanding balances as at 30th June, 2013 and 2014 was as follows;

NAME OF FACILITY	ACCOUNT NAME	ACCOUNT NUMBER	OUTSTANDING LOAN BALANCE	
			30/6/2013	30/6/2014
OVERDRAFT	GRF	018000024420	30,059,934.65	40,938,755.59
OVERDRAFT	SALARY A/C	018000001279	42,107,740.22	56,997,756.42
LONG TERM LOAN	LOAN A/C	018SERL121010001	76,043,529.34	94,933,479.00
TOTAL			148,211,204.21	192,869,991.01

Source: Bank statement

Given the above scenario the defunct Council Credit facility increased from Kshs. 148,211,204.21 as at 30th June, 2013 to Kshs. 192,869,991.01 as at 30th June, 2014. The difference for the twelve months being Kshs. 44,658,786.80 which has been driven by the costly charges of servicing the overdraft and the loan through the interest and penalties attraction.

ii. Pension contribution

Nakuru county employees make contribution to either Lapfund or Laptrust.

Lap-fund

Outstanding contribution owed to Lapfund for the former defunct councils employees was kshs 46.69 million as at 30th June 2013. The defunct councils continued to operate until June 2013 when they ceased to exist and their operation taken over by county government. For the three month i.e. April, May and June the defunct council did not make pension contribution therefore causing pension debt to accumulate for three month. Outstanding pension contribution grew by 20 million for the three month from 1st April, 2013 to 30th June, 2013. From 1st July, 2013 the county government took over the payroll and have been submitting pension fund for all staff however since the debt outstanding as at 30th June, 2013 has not been cleared it continued to attract penalties and interest at a rate of 3% per month and for 12 months ending 30th June 2014 the outstanding balance had attracted interest charges amounting to 18.6 million bringing the total debt to 65.34 million. For the six month ending 31st December 2014 additional interest of 12.6 million was charged for the outstanding pension contribution.

Lap-trust

The amount owed to Laptrust was 39.41 million as at 30th June 2013 which comprised of kshs 31.08 million for defunct Municipal Council of Nakuru and 8.33 million for Molo town council.

In addition, actuarial deficit of kshs 122,140,784.00 was charged on the four defunct local authorities as illustrated in the following table

Defunct Local Authority	Acturial Deficit
County council of Nakuru	22,893,511.00
Municipal Council of Nakuru	71,954,343.00
Municipal Council of Naivasha	23,423,504.00
Town Council of Molo	3,869,426.00
TOTAL	122,140,784.00

Source: laptrust statement

Therefore the total debt owed to lap-trust as at 30th June, 2013 was kshs 171.2 million however due to penalties charged on outstanding contribution (interest charges at 1.25% compounded monthly) the outstanding balance has since increased.

iii. Utility bills

Municipal council of Nakuru owed Nakuru water and sanitation service co. ltd (NAWASSCO) Kshs 247,117,878.05 as at 30th June, 2013 for various water accounts held by the defunct local authority.

Telcomkenya is demanding kshs 22.7 million for outstanding telephone bills owed by the former defunct council as illustrated below.

Outstanding debt owed to Telkom Kenya LTD	
Defunct Local Authority	Outstanding Debt as at 30th june 2013
County council of Nakuru	1,444,487.65
Municipal Council of Nakuru	17,710,945.95
Municipal Council of Naivasha	1,226,675.52
Town Council of Molo	2,412,964.25
TOTAL	22,795,073.37

Source: Telkomkenya

The above debt is in the process of verification and has been included as a contingent liability that might become actual liability after reconciling the statements provided.

iv. Statutory deductions

National social security fund (NSSF) has demanded payment of 82 million owed by former defunct council as outstanding contribution of employees as illustrated in the following table.

Outstanding debt owed to NSSF	
Defunct Local Authority	Outstanding Debt as at 30th June 2013
County council of Nakuru	4,067,611.00
Municipal Council of Nakuru	43,539,380.00
Municipal Council of Naivasha	17,070,427.00
Town Council of Molo	17,381,085.00
TOTAL	82,058,503.00

Source: NSSF

The amount owed to NSSF has been included as contingent liability since reconciliation of the above debt is not yet complete but once verification is complete then necessary arrangement will be made to settle the debt if any.

v. 5. Legal fees

The county government inherited huge legal debt from defunct local authorities as summarized below.

Outstanding legal Debt from Defunct Local Authorities	
Defunct Local Authority	Outstanding Balance
County council of Nakuru	28,250,882.00
Municipal Council of Nakuru	145,007,920.56
Municipal Council of Naivasha	83,794,311.40
Town Council of Molo	35,004,020.00
TOTAL	292,057,133.96

Source: Legal Department

Under the defunct municipal council of Naivasha kshs 69,499,309.00 of outstanding legal fee relate to court judgment in favor of dismissed staffs that were later reinstated by court. In addition 40 staff dismissed in Molo town council following a strike were later reinstated by court without loss of salary or benefit giving rise to salary arrears amounting to kshs31,948,810.00. The total salary arrears arising out of court judgment from all defunct councils is kshs102,826,570.00. Other court judgments in favor of other parties is kshs 16 million, the balance is outstanding fee owed to various advocates for representing the defunct local authorities. However some of the cases started while the defunct authorities were still in existence are still ongoing and therefore legal fee may increase once the cases are concluded.

2.3 Principal risk associated with loans/Debt

The risk associated with various categories of debt is illustrated in the following table

DEBT CATEGORY	NATURE OF RISK	LEVEL OF RISK	STEP TAKEN TO MITIGATE AGAINST THE RISK IDENTIFIED
Bank loan Kshs 201,779,923.47	1.Changes in interest rate. 2.Auction of secured asset in case of default	low	The county government has already negotiated and agreed with bank to restructure the loan and make equal monthly installment of kshs 3,527,258.03 per month for a period of 60 month.
statutory fund kshs 230,175,894.61	1.penalties	low	Deliberation on debt settlement. The county treasury propose to clear contribution amounting to 89 million in 2015/16 being principal contribution, interest charges kshs 22 million and the balance (kshs 141,140,326.50) being penalties and actuarial deficit to be cleared in the next 5 years (kshs 2,352,338.78 monthly.
utility bills kshs247,117,878.05	1. instituting legal proceedings	low	Negotiation with service providers on a debt settlement proposal i.e. settle the debt in the next 5 year i.e. kshs4,118,631.30 monthly
Legal fee 292,057,133.96	instituting legal proceedings	high	Negotiating with advocates to settle the debt in five year i.e. 20% in each year and clearing outstanding salary arrears arising from court judgment amounting to

DEBT CATEGORY	NATURE OF RISK	LEVEL OF RISK	STEP TAKEN TO MITIGATE AGAINST THE RISK IDENTIFIED
			102 million in a year.
suppliers, payroll deductions and contractors kshs 60,121,632.82	instituting legal proceedings to claim their debt	high	Payment of various debts amounting to kshs60 million in 2015/16.

In case of bank loan the risk is low since an agreement with the bank to restructure the loan had already been agreed by both parties and the county will only be required to pay monthly installment. The interest rate charged on family bank loan is pegged on base lending rate set by central bank i.e. The loan attract an interest rate of 14.25% (KBBR Rate of 9.13 plus 5.12 margin). Therefore any changes in base lending rate will affect the interest rate. Currently there are no indication of increase in base lending rate but future changes in macroeconomic environment may necessitate increase in base lending rate thus affecting interest payment and the overall debt position. However over the medium term the rate is not expected to surpass 9.13.

The risk associated with pension fund is low since only two firms are involved i.e Lap-fund and Lap-trust and it is possible to reach an agreement with the two firm on a convenient debt settlement.

In case of utility bills the risk involved is low since the county government own 50% of NAWASSCO and therefore it is possible to reach an agreement with the company on how to settle the outstanding debt. However since the amount involved is substantial this negotiation will be fast tracked to ensure that debt repayment start in financial year 2015/16.

In case of legal fee and debt owed to suppliers and contractors the risk involved is high since it involves many parties and reaching an agreement with all parties is challenging however effort will be made to negotiate with creditors who are owed substantial amount while at the same time settling small debt to minimize the risk.

2.4 Assumptions underlying the debt management strategy

The county government will continue to pursue the fiscal responsibility principles and policies outlined in fiscal strategy paper and budget policy statement. This will help the government to reorient expenditure to priority programmes in infrastructure, health, education and agriculture and avoid accumulation of pending bills in ministries.

Over the medium term the county government will continue to maintain a balanced budget where total revenue equal total expenditure i.e. the preparation of MTDS does not envisage borrowing to finance the budget and over the medium term the focus will be on ensuring the sustainability of current debt.

Revenue growth is expected to be maintained as earlier projected in budget review and outlook paper (CBROP) i.e. at 16% in financial year 2015/16 and 10% in each of the years 2016/17 and 2017/18. 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 2017/18.

The base lending rate is not expected to surpass 9.13% otherwise any increase beyond this may subject the county to higher interest payment and consequently raise the cost of servicing the loan.

2.5 Sustainability of debt

The sustainability of debt is guided by PFM Act section 107 (2)(e) and section 107 (4). As per 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.

The county government recognizes the need to manage debt prudently to avoid unwarranted debt burden. At the county treasury the debt management office is 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 ministries and working with all government entities to cut on pending bills.

The national government measures sustainability based on various parameters, borrowing from those parameters the debt sustainability will be measured based on two parameters

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

Indicator	2015/16	2016/17	2017/18
debt to revenue ratio	18.0%	14.8%	11.9%
debt service to revenue ratio	2.0%	2.0%	2.0%

In year 2015/16 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, even though no any resolution has been passed yet on the annual limit of debt, the debt level is considered sustainable. However the county treasury will draft a bill to be presented to assembly setting the annual limit on debt.

3.0 Strategies of dealing with debt

3.1 Debt servicing

The inherited debts which have already been verified need to be paid and this necessitate setting aside sufficient fund in the 2015/16 budget to repay debt. As indicated earlier the total stock of debt as at 31st December 2014 was 1.5 billion, in addition there is contingent liability amounting to ksh171 million therefore the debt outstanding is estimated to be 1.8 billion by 30th June, 2015. To reduce this debt to manageable levels a minimum of kshs 432 million will be set aside in the budget for debt repayment however the actual ceiling will be firmed up in county fiscal strategy paper 2015 after considering all sectors requirement vis a vis the fund available . Repayment of debt will be prioritized as follows

- a. Bank loan
- b. Statutory deductions and pension contribution
- c. Legal fees and other creditors

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 loan and pension fund. This will spread the debt burden over a period of time since the existing debt cannot be cleared within a year due to budget constraint. Restructuring will also help the county to avoid payment of penalties and interest that have been occasioned during the last two years and costly legalbattles. So far the county government has agreed with Family Bank to restructure the loan facility.

The agreement was reached on 22nd September, 2014 when the loan balance was ksh 201,779,923.47 as illustrated in the following table

NAME OF FACILITY	ACCOUNT NAME	ACCOUNT NUMBER	OUTSTANDING LOAN BALANCE
			18/9/2014
OVERDRAFT	GRF	018000024420	42,789,647.76
OVERDRAFT	SALARY A/C	018000001279	59,574,655.24
LONG TERM LOAN	LOAN A/C	018SERL121010001	99,415,620.47
TOTAL			201,779,923.47

This indicates that the loan facility increased by kshs53,568,719.26 for fifteen month from 30th June 2013 to September 2014. This reflect an average increase of 3.5 million per month in term of penalties and interest.

Family bank has agreed to restructure the credit facility totaling kshs 150, 750,000. This figure was arrived at through liquidating the various credit facilities into a long-term loan as illustrated below

NAME OF FACILITY	ACCOUNT NAME	ACCOUNT NUMBER	OUTSTANDING BALANCE
OVERDRAFT	GRF	018000024420	372,978.63
OVERDRAFT	SALARY A/C	018000001279	61,988,124.35
LONG TERM LOAN	LOAN A/C	018SERL121010001	98,142,920.44
SUB-TOTAL			160,504,023.42
Interest waiver			10,504,023.42
TOTAL			150,000,000.00
Restructuring fee of 0.5%			750,000.00
GRAND TOTAL			150,750,000.00

The outstanding balance of General Fund Account (018000024420) is offset with fixed deposit of kshs 40 million held as collateral plus kshs 16 million interest earned, net of withholding tax of 15%.

The county on it part will have to make equal monthly installment of kshs 3,527,258.03 per month for a period of 60 month in order to clear the outstanding balance. The loan will attract an interest rate of 14.25% (KBBR Rate of 9.13 plus 5.12 margin) on a reducing balance. The major benefit of restructuring will be the interest waiver of 10.5 million and a convenient payment period that will not have adverse impact on cash flow. Besides the 40 million fixed deposit, the above credit facility was also secured by title deed for LR No. 451/615(IR No 124/80) thus there was a need to safeguard the county asset from possible auction for non-payment of debt.

The pension debt cannot be paid within one year due to the huge amount involved and the budget constraint. Plans are underway to make an agreement with both Lap-fund and Lap-trust on payment of debt owed. For all substantial liability an agreement will be made with creditors to

have those debt restructured to facilitate payment and spread the debt burden to the following years.

3.3 Prioritization of programmes

The pending bills arising from all ministries will have to be cleared as a first charge in the succeeding budget beginning with 2015/16 budget to avoid accumulation of bills. This will compromise implementation of some of the Sector's programmes as well as service delivery but is a necessary measure in ensuring that the county does not accumulate debt in succeeding years. This will also require all ministries to prioritize programmes taking cognizance of resource constraints.

3.4 Increased staffing in county attorney's office

The huge outstanding legal fee could easily be avoided if the county government employ competent lawyers rather than outsourcing the services to third parties. Currently the office is understaffed and cannot efficiently handle all legal cases. In addition a more vibrant office will win more court cases and lower the number of court awards against the county government. To reduce the number of disputes which end up in court, the legal department is expected to give advice on all legal matters to ministries and other government entities. To perform the above role efficiently more lawyers should be incorporated in the legal department as the cost of compensating them is much lower compared with legal fee currently been serviced by the county government.

4.0 Implementing the 2015 MTDS

Upon approval of budget the debt management office will develop a program for debt repayment based on priorities and cashflow forecast and forward the same to county treasury for implementation.

A pending bill committee which draw membership from all ministries will be formed and this committee will sit at the end of each financial year to review all pending bills from ministries and make recommendation for payment or otherwise as it deem fit. This will ensures that all pending bills approved are settled as a first charge in the budget.

A bill that propose annual borrowing limit will be drafted and presented to county assembly for adoption. 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 amount will be fast tracked to ensure that those negotiation are concluded by the end of June 2015 so that implementation of the agreement can start at the beginning of year 2015/16. Timely conclusion of this agreement will facilitate their inclusion in 2015/16 debt repayment program.

The county treasury will continue to strengthen the debt management office in term of staffing, training and provision of working tools and equipment to ensure that the office is in 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 government therefore the national treasury plays a critical role in ensuring the success of future borrowing by county government.

5.0 Conclusion

The 2015 medium term debt management strategy is a forward looking framework that describe the sustainability of the county debt in the long-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 unnecessary accumulation of debt. The high debt levels calls for sufficient allocation of fund in the 2015 budget and consecutive budgets in order to improve the debt position and avoid unnecessary cost such as interest and penalties.

The current stock of debt is in excess of 1.5 billion however the 2014 county fiscal strategy paper provide for 300 million toward debt repayment in the budget. This clearly illustrate that the county government may not be able to settle all the debt in year 2015/16 and some debts will have to be schedule to the following years.

Being the first MTDS for the county and where no borrowing is envisaged in financial year 2015/16 to finance the budget more emphasis has been put on management of current debt. Henceforth all ministries are expected to more conscious while spending and ensure that programme implementation is in line with the budget and availability of fund.

APPENDIX 1

DEBT STRATEGY MATRIX

STRATEGY	COURSE OF ACTION	TOTAL COST YEAR 2015/16														
1. Debt servicing	<p>Setting aside kshs 432 million in the budget toward debt repayment</p> <p>This repayment is analyzed as follows</p> <table border="1" data-bbox="378 554 938 919"> <thead> <tr> <th data-bbox="378 554 662 590">TYPE OF DEBT</th> <th data-bbox="662 554 938 590">ANNUAL REPAYMENT</th> </tr> </thead> <tbody> <tr> <td data-bbox="378 604 662 640">Bank loans</td> <td data-bbox="662 604 938 640">42,327,096.36</td> </tr> <tr> <td data-bbox="378 655 662 690">Statutory fund</td> <td data-bbox="662 655 938 690">139,455,012.43</td> </tr> <tr> <td data-bbox="378 705 662 741">NAWASSCO</td> <td data-bbox="662 705 938 741">49,423,575.60</td> </tr> <tr> <td data-bbox="378 756 662 791">LEGAL</td> <td data-bbox="662 756 938 791">140,672,682.79</td> </tr> <tr> <td data-bbox="378 806 662 842">SUPPLIERS</td> <td data-bbox="662 806 938 842">60,121,632.82</td> </tr> <tr> <td data-bbox="378 856 662 919">Total cost</td> <td data-bbox="662 856 938 919">432,000,000.00</td> </tr> </tbody> </table>	TYPE OF DEBT	ANNUAL REPAYMENT	Bank loans	42,327,096.36	Statutory fund	139,455,012.43	NAWASSCO	49,423,575.60	LEGAL	140,672,682.79	SUPPLIERS	60,121,632.82	Total cost	432,000,000.00	432 million
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2. debt restructuring	<p>a. The county government has already negotiated and agreed with bank to restructure the loan and make equal monthly installment of kshs 3,527,258.03 per month for a period of 60 month.</p> <p>b. The county treasury will clear outstanding pension contribution amounting to 89 million in 2015/16 being principal contribution, interest charged kshs 22 million and the balance (kshs 141,140,326.50) being penalties and actuarial deficit to be cleared in the next 5 years (kshs 2,352,338.78 monthly).</p> <p>c. Negotiation with NAWASSCO on a debt settlement proposal i.e. settle the debt in the next 5 year i.e. kshs 4,118,631.30 monthly</p> <p>d. Negotiating with advocates to settle the debt in five year i.e. 20% (37,846,112.79 annually)in each year and settling salary arrears arising out of court judgment amounting to kshs 102,826,570.00 in one year.</p>	<p>42,327,096.36</p> <p>139,455,012.43</p> <p>49,423,575.60</p> <p>140,672,682.79</p>														
3. Prioritization of programmes	<p>Pending bills arising from all ministries will have to be cleared as a first charge in the succeeding year budget beginning with 2015/16 budget. This will also require all ministries to prioritize programmes taking cognizance of resource constraints.</p>	483,560,162.84														

STRATEGY	COURSE OF ACTION	TOTAL COST YEAR 2015/16
4.Increased staffing in county attorney's office	recruitment of four lawyers	5,000,000