REPUBLIC OF KENYA

THE COUNTY GOVERNMENT OF KISUMU

COUNTY TREASURY

COUNTY DEBT MANAGEMENT STRATEGY PAPER 2022-2024

FEBRUARY 2022

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FOREWORD

The Public Finance Management Act 2012 Section 123 (1) provides that 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, clearly showing its actual liabilities in respect of loans and its plan for dealing with those liabilities.

The Medium Term Debt Strategy Paper is prepared annually on a three year rolling basis and guides the County Governments' public debt management and borrowing to ensure sustainability for each fiscal year and the over the Medium term.

This Strategy paper provides guidance to the County Government of Kisumu on the amount and type of borrowing to undertake over the medium term. It also evaluates the costs and risks of various debt management strategies and provides recommendations on optimal strategy for implementation since it will have an impact on future borrowings.

The strategy further outlines priorities that will assist in financial risk reduction. It is for this reason that the County Government of Kisumu recognizes the need for prudence in debt management to avoid unwarranted financial risks that emanate from poor debt management strategies. The County is employing significant efforts and resources to ensure improvement in the debt management as well as enhancing capacity of assessing risks.

The County debt will only realize sustainability if a prudent debt management and borrowing policy is adopted. This is particularly important to a credit – rated county such as Kisumu.

Considering the current level of outstanding pending bills and statutory obligations arising from the County Government, the MTDMS 2022-2024 will reinforce measures geared towards reduction of the county's obligations. Debts that have already materialized need to be paid, in line with the PFM Act, (2012) and the declarations in the County Fiscal Strategy Paper (CFSP – 2022/2023). The County will continue to maintain effective linkages with the National Treasury for effective debt management and provision of technical advice on this important element of fiscal management in the County.

GEORGE OMONDI OKONG'O
CECM-FINANCE AND ECONOMIC PLANNING

ACKNOWLEGEMENT

The preparation of 2022 Medium Term Debt Strategy ensures sustained accountability and transparency in management of public debt. Review of the previous medium-term debt strategy is as previously indicated, and the review will be done annually in accordance with PFM Act 2012.

The Debt Management Strategy Paper (DMSP) provides guidance on the amount and type of borrowing to undertake over the medium term. It evaluates the costs and risks of various Debt Management Strategies and provides recommendations on meeting its obligation geared towards clearing of debs.

As required by the PFMA the MTDMS will be formally tabled to the County Assembly on or before 28th February 2022. The 2022 MTDMS will be submitted to the Commission on Revenue Allocation (CRA) and the Intergovernmental Budget and Economic Council as per PFM Act 2012.

Let me take this opportunity to acknowledge the C.E.C.M – Finance & Economic Planning for his overall leadership role in steering preparation of this important document. With same morale I acknowledge all the Debt Management Strategy Paper preparation committee members in finance for their contribution in preparation of the medium-term debt strategy.

WILSON ABIERO
AG. CHIEF OFFICER FINANCE

ABBREVIATIONS AND ACRONYMS

BPS	Budget Policy Statement
CFSP	County Fiscal Strategy Paper
DMS	Debt Management Strategy
FY	Financial Year
GDP	Gross Domestic Product
MTDMS	Medium Term Debt Management Strategy
MTEF	Medium Term Expenditure Framework
PFM	Public Finance Management
ES	Equitable Share
OSR	Own Source Revenue
AIE	Authority to Incur Expenditure
VBMS	Vote Book Management System
PPP	Public – Private Partnership
BOT	Build Operate & Transfer
NSSF	National Social Security Fund
KRA	Kenya Revenue Authority
LAPFUND	Local Authority Provident Fund
LAPTRUST	Local Authority Pensions Trust

EXECUTIVE SUMMARY

The medium Term Debt Management Strategy (MTDMS) is published every year and guides County Government borrowing in the medium term while providing a path for sustainable level of debt over the same period. The MTDMS act as a guide for public debt & borrowing practices for the County Government, including the issuance process and management of the debt portfolio. It also emphasizes the need to adhere to the laws and regulations governing public debt management.

This Debt Management strategy has been prepared in accordance with Section 123 of the Public Finance Management Act (2012) and it covers the period FY 2022-2023 –FY 2023-2024 over which optimal debt portfolio is to be achieved.

The accumulation of the County Government of Kisumu expenditure arrears (pending bills) is one of the most common problems in public financial management. The Government debts are financial obligations incurred by any level of the public sector for which remain unpaid when due. However, the county has experienced debts arising from payment arrear (pending bills).

There is need to ensure effective management of pending bills by aligning procurement plans to cash flow projections, adequate budgetary provision, and to payment of pending bills on a First – In- First – Out basis.

Section 140 (1) of the PFM Act, authorizes the County Executive Committee Member for Finance, to raise loans to implement Government programs, only if the loan and the terms and conditions for the loan are set out in writing and are in accordance with—

a) Article 212 of the Constitution; - A county government may borrow only— (i) if the national government guarantees the loan; and (ii) with the approval of the county government's assembly
b) Section 58 of the PFM Act; Mandates the cabinet Secretary (National Treasury) to guarantee loans for county governments or any other borrower on behalf of the national government with approval by Parliament.
c) Section 142 of PFM Act; the County Assembly may authorize short term borrowing by county government entities for cash management purposes only. However, such borrowing shall not exceed five per cent of the most recent audited revenues of the county. The borrowing should be repaid within a year from the date on which it was borrowed.

d) The fiscal responsibility principles and the financial objectives of the county government set out in its most recent County Fiscal Strategy Paper; and
e) The debt management strategy of the county government over the medium term.

Pursuant to PFM regulations 177(2) a county government may from time to time borrow within and outside Kenya such sums of money in such amount and on such terms and conditions as to interest, repayment, disbursement or otherwise as the County Executive Committee Member may think fit, in any of the following ways—

(a) By issuing County Treasury bonds;

(b) By bank overdraft facility from the Central Bank of Kenya; and

(c) By any other loan or credit evidenced by instruments in writing

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 of 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 liabilities, potential liabilities with respect to loans and its measures to be undertaken to settle 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 and Economic Planning shall publish and publicize the statement and submit a copy to the Commission on Revenue Allocation (CRA) and Intergovernmental Budget and Economic Council (IBEC). On being requested to do so by the County Assembly, the County Treasury shall prepare and submit to the County Assembly a report on any matter relating to its responsibilities within fourteen days of the request.

I. INTRODUCTION

Overview of debt management

Debt management refers to having a robust plan to ensure debt owed to various creditors are settled expeditiously, within the shortest period possible, and at minimal cost. It entails prudent management of cash flows, through enhancement of revenue streams, prevention of revenue leakages, prudent cost/ expenditure management, whilst also ensuring "value for money" on all projects undertaken and goods/ services procured.

Debt management also entails amicable negotiations with creditors, with a view of extending repayment periods and thereby "easing strain" on cash flow on the debtor.

The primary aim of debt management is to raise the required amount of funding at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk, but it can also be critical to macro-financial stability and to financial sector development. A Debt Management Strategy (DMS) is a plan for the evolution of the public debt portfolio that operationalizes the debt management objectives given the constraints, and specifically the government's preferences about cost-risk trade-offs.

A DMS should thus have a strong focus on managing the risk exposure embedded in the debt portfolio, and notably the potential variations in the cost of debt servicing. A DMS is a guiding component of public debt management, which involves also tactical decisions, and coordination with other public-sector policies.

Debt managers are responsible for ensuring that financing constraints do not lead to sharp reversals in fiscal policy or spikes in interest costs. Thus, sound debt management contributes to reduced macro-financial risks, complementing prudent fiscal management and monetary policy implementation. Debt management contributes also to market and institutional development.

The principal objective of County Debt Management Strategy Paper is ensuring the County government's financing needs and payment obligations are met at the lowest possible cost consistent with a prudent degree of risk. The secondary objective is to facilitate County Government access to financial markets. The County Government will strive to maintain a balanced budget to avoid incurring unnecessary debts. This document lays out plans for debt management for the next three years.

The composition of the County's debt portfolio as at 7th February 2022 is shown below

Table 1: Total County Pending bills portfolio

Description	**(DMSP 2022) Kshs**	**% of Total debt**	**(DMSP 2021) Kshs.**	**% of Total Debt**
Recurrent (Suppliers)	427,116,604.36	8%	951,454,079.00	17%
Development (Contractors)	1,295,093,489.22	24.3%	956,287,376.00	36%
NSSF	386,948,860.00	7.3%	288,000,000	11%
Unremitted retention	70,426,518.00	1.3%	70,426,518.00	3%
Gratuity	630,092,577.00	11.8%	365,000,000.00	14%
Medallion	8,000,000.00	0.2%	5,400,000.00	0.9%
LAPFUND	420,143,310.16	7.9%	206,794,398.00	8%
Legal fees and Court Decrees	790,000,000.00	14.8	246,859,533.00	9%
LAPTRUST	98,791,853.12	1.9	-	-
KRA unremitted taxes	-	-	31,239,288.00	1.1%
National Housing Corporation	1,200,000,000.00	22.5	-	
Total	**5,326,613,211.86**		**2,621,461,212.00**	

The County's debt portfolio stands at Kshs **5,326,613,211.86**. This is an increase of Kshs 2,705,151,999.86 from the amount of Kshs 2,621,461,212 reported in the 2020-2021 Debt Management Strategy Paper. The increase was because of:

a) The LAPTRUST, LAPFUND and NSSF are inclusive of the principal amount and Penalties
b) The debt owed to the National Housing Corporation was not captured in the previous DMSP 2021
c) The increase in Gratuity & Medallion was as a result of the report submitted by the committee that was appointed to verify them.
d) Some of the legal fees and court decrees were not capture in the previous DMSP 2021

These are some of the factors that have led to accumulation of debts;

- Unmet local revenue projections - over the years the county has fallen short of its budgeted revenue projections. This is witnessed in the local revenue where the collection realized has been less half of the projection. Given that the budget is shared on the basis of projection and AIE holders begin committing on that basis, it follows that with collection below the target commitment translates to pending bills.

- Non- implementation of Debt Management policy paper –failure to implement mitigation measures in previous DMSP 2021 on steps/ways to reduce to public debt portfolio has led to continuous accumulation of these debts.

The County Government, in its CFSP, has outlined measures being implemented to ensure fiscal responsibility is upheld to effectively manage the debts. These include:

Maintaining balanced budgets

The County's projected total revenue for 2021/2022 is Ksh**. 12.14 billion** with an equal total expenditure.

Allocation of funds to settle pending bills in development expenditure

In the FY 2021/2022 approved budget, Ksh. 648,749,190 was allocated to partially settle the outstanding development pending bills.

The County Government of Kisumu has so far paid an amount of Ksh.418 million in the current financial year, with additional payments envisaged within the financial year. The CFSP 2022-2023 indicates the County Government's decision to include all pending bills in the budget estimate for the FY 2022/2023.

County debt financing only used for development

No major external borrowing is envisaged in the FY2022/2023 by the County Government as at this time. However, the Intergovernmental Budget & Economic Council (IBEC) has granted approval for County governments to borrow in order to finance development expenditure, as and when the need arises. With improved Credit Rating and several project proposals coming out of Public – Private Partnerships (PPPs), the County may seek to borrow from the financial markets for project financing, in line with procedure in the PFM Act.

Sustainable debt

The county's debt shall be maintained at a sustainable level not exceeding fifteen percent (15%) of the County Government's total revenue as approved by the County Assembly. Short term borrowing shall be restricted to management of cash flows and shall not exceed five percent (5%) of the most recent audited County Government revenue.

The options available to the County to manage the debt, not exclusively but on continuations or all at the same time.

- Borrowing from commercial banks;
- Maximizing collection of local revenue;
- External borrowing/Grants from donors;
- Borrowing from the money and capital markets;
- Engaging with partners to finance Public Private Partnership projects;
- Disposing off idle/boarded assets, proceeds from which to be utilized to offset debts.

The risks the County envisaged due to debt accumulation include:

- The creditors may charge interest on pending bills thereby escalating the eventual cost of goods and services.
- Legal risk, as delayed payments enhances the risks of litigation.
- Risk of non-completion or delay of development projects leading to reduced level of value for money for the citizenry.
- Reputation risk could lead to service providers/ contractors avoiding taking up contracts awarded by the County. Furthermore, costs of such projects could escalate after factoring in the prospect of delayed payments when bidding for tenders.

With a huge and unmanageable debt portfolio, the County's risk rating may be unfavorable leading to inability to attract funding from suitable development partners and/ or financial institutions.

Debt Management Strategies

Strategies to deal with the existing debt

The current debt portfolio shows that all the debts are already overdue as most are owed to suppliers, contractors and statutory institutions. Strategies to deal with the existing debt portfolio include:

a. Enhancing Revenue Collection

One of the reasons why pending bills are increasing is due to the County's failure to meet its annual local revenue targets. The County has already embarked on enhancing local revenue collection in order to liquidate debts and to improve liquidity by scaling up automation of local revenue collection.

b. Debt rescheduling or renegotiation

County may seek to reschedule amounts owed to statutory institutions (KRA, NSSF, Lapfund, Laptrust etc) with a view of getting better or favorable terms .i.e. an enhanced or longer repayment period. This will go a long way in easing pressure on cash flows and thereby free the cash resources to service delivery.

c. Enforcing prioritization of Recurrent pending bills and budgetary allocation for payment of development pending bills.

The department should prioritize payment recurrent pending bills as first charge in their respective budgets before procuring any new items. In addition, adequate budgetary allocation should be made for payment of development pending bills.

d. Debt/assets trade offs

This strategy may be applied in instances where the County owes various statutory institutions such as NHIF, NSSF, NHC and utility firms such as Kenya Power and Lighting Company, while at the same time, these institutions also owe the County in terms of outstanding rates, rent etc. The County may enter into negotiations with such institutions or creditors with a view to trade off debts with the County.

e. Debt write offs

The County may enter into negotiations with the National Government (e.g debt owed the National Housing Corporation) with a view to writing off long outstanding debts that it guaranteed in order to clean the balance sheet and improve credit worthiness.

f. Improving cash flow management

Good cash flow management will ensure that liquidity is available to meet payments obligations as they fall due e.g issuance of strict AIE to the departments.

g. Realistic budgetary estimates and targets

One of the most effective ways of addressing persistent pending bills problem is to ensure implementation of realistic budgets based on reasonable and realizable forecasts. Internally generated revenue forecasts and targets should be realistic and achievable.

h. Strengthening internal control systems

Strengthening systems of controls will ensure that the County does not initiate expenditure or procurement without ensuring availability of funds and cash to support the expenditure. IFMIS will continue to be used as an expenditure control tool by using the Vote Book Management System.

Debt Management Strategy Paper will be reviewed annually. Current strategy shall be reviewed to accommodate changing debt status to the current economic trends in internal, external and remote environment in which the county continues to operate.

Other strategies

Developing a procedure manual and other regulatory framework that will define payment terms, reporting requirements, controls at budget authorization, commitment and payment stages and sanctions associated with any breach of those provisions.

II.BACKGROUND TO MEDIUM TERM DEBT MANAGEMENT STRATEGY

History of County Government of Kisumu debts

One of the major causes of pending bills accumulation is the County's challenge in meeting revenue targets coupled with an increasing wage bill. The pressure on need to spend increases day by day while the resource envelope is limited. An example is the revenue performance of FY 2020/2021 where the county realized 78% of the projected local revenue of Ksh.1,579,168,106, (The County Government of Kisumu Reports and Financial Statements for the FY ended 30th June 2021)

Table 3: Consolidated report on budget efficiency

Revenue Streams	Budget FY2020/2021	Actuals FY2020/2021	Surplus/Deficit	Efficiency %
Locally collected Revenue				
Main Revenue Streams				
Land Rates	231,869,266.00	131,977,762.00	(99,891,504.00)	56.9
Rents	46,622,714.00	24,766,887.00	(21,855,827.00)	53.1
Boda-boda self-regulating fees	32,100,000.00	50,050.00	(32,049,950.00)	0.2
Trade License Fees	159,800,000.00	180,419,311.00	20,619,311.00	112.9
Bus Park Fees	168,216,655.00	95,587,240.00	(72,629,415.00)	56.8
Parking Fees	131,530,846.00	92,938,030.00	(38,592,816.00)	70.7
Market Fees	131,726,647.00	60,168,713.00	(71,557,934.00)	45.7
Building Plans	33,090,911.00	21,598,678.00	(11,492,233.00)	65.3
Sign Board promotion etc	87,740,000	106,350,456	18,610,456.00	121.2
Sundry revenue & Other sources	58,961,667	27,220,961.00	(31,740,706.00	46.2
Over Payment of Bulk Revenues	-	-	-	0
Public Health and Others	13,210,000.00	2,153,300.00	(11,056,700.00)	16.3
Sub-total	**1,094,864,706.00**	**743,231,388.00**	**(351,633,318.00)**	
Revenue from Departments				
Health	342,400,000.00	382,586,814.00	40,186,814.00	111.7
Agriculture, Livestock and Fisheries	16,050,000.00	5,619,006.00	(10,430,994.00)	35

Tourism, Trade and Heritage	1,872,500.00	992,800.00	(879,700.00)	53
Water	10,700,000.00	-	(10,700,000.00)	0
Lands, Housing and Physical Planning	3,210,000.00	75,149,925.00	71,939,925.00	2341.1
Education, Youth, Culture and Sports	8,560,000.00	4,444,560.00	(4,115,440.00)	51.9
Industrialization / Cooperatives	74,900.00	-	(74,900.00)	0
Liquor Licenses	32,100,000.00	15,375,955.00	(16,724,045.00)	47.9
Green Energy	4,815,000.00	-	(4,815,000.00)	0
Energy & Mining	2,461,000.00	-	(2,461,000.00)	0
Roads, Transport and Public Works	59,920,000.00	1,025,100.00	(58,894,900.00)	1.7
Environment	2,140,000.00	1,124,120.00	(1,015,880.00)	52.5
Governance & Administration	0	1,477,530.00	1,477,530.00	
Payroll Revenue	0	13,454,100.00	13,454,100.00	
Sub-Total	**484,303,400.00**	**501,249,920.00**	**16,946,510.00**	**103.5%**
GRAND TOTAL	**1,579,168,106.00**	**1,244,481,298.00**	**(334,686,808)**	**78.8%**

Source: Financial statements 2020/2021

Economic Effect of Debts on the County.

1. High interest rates.

The high interest rates charged on commercial loans and overdrafts has an adverse impact on liquidity and ultimately affects service deliveries, as such funds must be channeled to offset these debts.

2. Increased cost of service provision

Suppliers of goods and services tend to charge more on their supplies to mitigate against the risk of delayed payments. Their prices are therefore adjusted upwards.

3. Loss of bargaining power and forfeiture of discounts

When goods and services are not paid for promptly, the County tends to lose "bargaining power" and forfeit the discounts which could have been earned.

4. Reduced or interrupted public service delivery

Non- payment of critical suppliers may lead to withholding of critical supplies to the County Government which will lead to interruption of service delivery to the citizens.

III. DEBT MANAGEMENT OBJECTIVES AND SCOPE

Debt management has significant repercussions on future spending levels, both in the mid- term period and long - term. Debt management objectives determine the long term aims of debt management and should cover all County government liabilities including contingent liabilities.

Objective as per PFM Act, 2012

- The principal objective of the County government debt management is to meet its financing requirements at the least cost possible with a prudent degree of minimal risk.
- The secondary objective is to enable the government to deal with the existing debt portfolio to release resources to service delivery.

The 2022 MTDS will guide the County Government operations in FY2022/2023 - FY2024/2025. The strategy seeks to balance cost and risk of public debt while considering the financing needs of the county and to develop initiatives for new funding sources.

IV.COST AND RISK CHARACTERISTICS OF COUNTY GOVERNMENT DEBT PORTFOLIO AS AT 7TH FEBRUARY 2022

The risks associated with the various categories of debt illustrated in the table below: -

Table 4: Risks associated with Debt

Debt category	Nature of risk	Level of risk	Step taken to mitigate against the risk identified
Court Awards Ksh. 790,000,000	Legal and financial risks resulting in penalties and accrued interest. Taxing of outstanding legal fees resulting in higher fees. Instituting legal proceedings against the County government.	High	- Negotiation with various law firms and decree holders for an extended repayment period. - Budgetary allocations to cater for settlement of the awards and fees.
Medallion Kshs. 8,000,000	Reputation risk in failure to reward employees. Legal risk through instituting legal proceedings to claim the debt.	High	- Amount owed has been factored in the budget for the FY 2021/2022. Payment will expunge the debt and clear the attendant risks.
Gratuity Kshs.630,092,577	Reputation risk for failure to meet the obligations to the employees. Legal risk. Financial risk	High	- Measures have been instituted to remit monthly gratuity to County Pension Fund. - Increment in the Personnel Emolument allocations towards settling it.
Contractors and Suppliers of goods and services Kshs 1,722,210,100.58	Legal risk through court proceedings to recover owed sums. Reputation risk. Financial risk in the event interest clause in the contracts are triggered.	High	- Recurrent pending bills amount to Kshs.427 million are currently being processed in departments as first charge. - A balance of Kshs.230 million in the pending bills vote will be used to settle development pending bills. The residual balances to be

			given priority in subsequent budgetary allocations.
Statutory deductions (NSSF & LAPFUND & LAPTRUST) Kshs.905,884,023.28	Compliance Risk. Reputational Risk Financial Risk from resultant penalties from non-compliance.	High	- Negotiating with these institutions with a view of staggering payments. - Includes verification and reconciliation and finally a viable repayment plan. - Possibility of asset swap also under consideration.
Unremitted Retention Funds Ksh.70,426,518.00	Reputation Risk Financial Risk. Compliance Risk Legal Risk	High	- Payment of retention funds as and when they fall due. - Adequate provision for retention funds.
National Housing Corporation Kshs. 1,200,000,000.00	Reputation risk. Legal Risk Financial Risk.	High	- Includes verification and reconciliation and finally a viable repayment plan. - Equity in development of housing estate. - Loan from commercial bank to repay outstanding debt .

N/B: The debts owed NSSF, LAPTRUST, LAPFUND and NHC are still contested no verification has been done to determine the actual outstanding debt.

Table 5: General debt risk analysis table

Debt category	Nature of risk	Level of risk	Mitigation action taken so far
Employee pension Schemes	Compliance risk	Highly critical	Ensure compliance with the laws and legislation.
Other Employee Benefits	Reputation risk.	High	Increase tangible benefits to employees.
Court Awards/ Fees	Legal risks Financial risk	High	Ensure strict compliance with court rulings and decrees. Prompt payment of legal fees.

Other Suppliers and Service Providers	Reputation risks Legal Risk	High	Adhere to customer service charter.
Contractors	Legal risks	Highly critical	Timely payment to contractors through the Vote book management system.

V. BASELINE MACROECONOMIC ASSUMPTIONS AND KEY RISKS

A. Baseline Macroeconomic Assumptions

The medium-term economic framework used in this document is derived from the County fiscal *framework in the 2021 County Fiscal Strategy Paper* whose targets are anchored on the priorities of the Third Medium Term Plan of the Vision 2030 and the Sustainable Development Goals as emphasized in the Governor's ten-point Manifesto and enshrined in the Constitution of Kenya 2010.

The key objectives of the County Government of Kisumu's medium-term agenda include:

(i) Revitalize agriculture for food security and agribusiness;
(ii) Ensure a healthy population living in a clean environment;
(iii) Build modern physical infrastructure;
(iv) Promote skills development and innovation;
(v) Conserve the environment while opening the Kisumu lakefront for business;
(vi) Provide decent housing in inclusive towns, semi-urban centres and villages;
(vii) Promote sports, culture and the arts;
(viii) Promote industrialization and a vibrant service sector, supported by sustainable energy sources and information and communication technologies;
(ix) Promote tourism driven by culture and heritage as well as new products and,
(x) Deepen the structures of devolved governance and strengthen revenue generation and accountability in use of public funds.

The baseline National Government assumptions likely to be mirrored in the Counties are as tabulated in the 2022 BPS and summarized below:

Table 6: GDP Indices

	Unit	18/19	19/20	20/21	21/22	22/23	23/24
Real GDP	Per cent	5.9	3.0	6.3	6.3	5.7	6.0
Consumer Price Index (av.)	Per cent	5.1	5.1	5.8	5.0	5.0	5.0
Revenue	Per cent of GDP	18.3	17.1	16.8	18.5	18.5	18.4
Expenditure	Per cent of GDP	26.2	25.9	22.8	21.9	21.8	21.8
Overall Fiscal Balance (excl grants)	Per cent of GDP	-7.9	-8.0	-4.2	-3.5	-3.3	-5.1
Gross reserves in months of imports		6.4	6.3	6.4	6.4	6.4	6.4

Source: National Treasury, 2022 Budget Policy Statement

1. **Growth Outlook**

a) **Global Growth Outlook**

The global economic recovery continues to strengthen, largely supported by gradual reopening of economies, relaxation of Covid-19 restriction particularly in the major economies, ongoing roll out of vaccines and strong policies measures. Nevertheless, the outlook for global growth remains highly uncertain due to the resurgence of infections, reintroduction of containment measures, and the uneven pace of vaccinations across the globe. As such global growth is projected to grow at 5.9% in 2021, moderation to 4.9% in 2022 from the contraction of 3.1% in 2020.

b) **Domestic Growth Outlook**

Like the rest of the world, the domestic economy was not spared from the adverse impact of the pandemic and estimated to have contracted to 0.3% in 2020. The economy is expected to rebound to 6.0% in 2022, attributed to pick up of activities after the reopening of the economy. In terms of fiscal years, the economy is projected to expand by 5.9% in FY 2021/2022 and 6.1% in FY

2022/2023. This outlook will be reinforced by the prevailing stable macroeconomic environment and the ongoing implementation of the strategic priorities of the Government under the "Big Four" Agenda and Economic Recovery Strategy.

2. FY 2021/2022 -2023/2024 Debt Outlook

i. National Debt Outlook

Kenya's debt position remains sustainable, but the risk of debt distress has increased to high level due to the COVID -19 crisis weakening exports and real GDP growth and delaying fiscal consolidation. Kenya's total public debt has more than doubled to kshs.7.6 trillion at the end of September, 2021 compared to Kshs. 3.1trillion in January 2016. During this period, the amount of external debt also rose from Kshs. 1.654 trillion in January 2016 to Kshs. 3.7 trillion. Kenya's domestic debt also rose from Kshs. 1.5 trillion in January 2016 to Kshs. 3.6 trillion as at September 2021.

With lower domestic revenue mobilization and elevated budget expenditures before the unwinding of COVID -19 related fiscal stimulus measures., the budget deficit is expected to remain broad and add to Kenya stock of public debt.

ii. County Debt Outlook.

Kisumu County Government has debt arising from expenditure arrears. The Government has been operating on a cash basis, income balancing expenditure within the available fiscal space. Despite this, there has been periodic delays in disbursement of equitable share from the National Government negatively affecting service delivery through accumulation of expenditure arrears (pending bills).

Since the year 2020, the County Government of Kisumu has participated in the Credit Rating initiative conducted by Global Credit Rating on behalf of the National Treasury, World Bank & Commission of Revenue Allocation. This rigorous exercise looks at various aspects of the County Government of Kisumu's operations including, but not limited to financial management, revenue enhancement, human resource management etc. There has been support from development partners i.e World Bank & Commission on Revenue Allocation to strengthen the aforementioned areas. The expected results from the credit rating initiative is access to finance through the capital markets for public infrastructure development and service delivery. The County will also be able to seek attractive sources of funding away from the traditional ones i.e Equitable share & Own Source Revenue, thereby freeing resources to settle long outstanding debt/improving the County's financial position thereby significantly reducing debt.

Table 7: Revenue and Expenditure Analysis, 2019/2020– 2023/2024 (Kenya shillings Millions)

Category	Actual FY2019/2020	Actual FY2020/2021	Projection FY2021/2022	Estimates FY2022/2023	Estimates FY2023/2024
Gross Revenue	**8,733.5**	**10,176.2**	**12,146.1**	**12,340.8**	**12,275.5**
Gross Expenditure	8,351.7	**9,768.3**	**12,146.1**	**12,340.8**	**12,275.5**
Surplus/Deficit	381.8	407.9	-	-	-

Sources: 1) Kisumu County CFSP 2022
2) Kisumu County Financial Statement FY 2020/2021
3) Kisumu County final approved budget FY 2020/2021 & FY 2021/2022

B. Risks to the Baseline Macroeconomic Assumptions in the 2022 MTDS

- Global economic growth is expected to recover to 5.5 % in FY 2021/2022 from a contraction in FY 2020/2021 of 3.5% due to effects of the Covid-19 pandemic. The projected global economic growth reflect optimism in the fight against the Covid-19
- The National Treasury is expected to sustain the efforts towards minimizing the delays in disbursement of equitable share transfers and other factors which might lead to escalation of demand for short-term finance by the counties.
- The macro-economic framework underpinning the FY 2021/2022-2023/2024 MTDS is consistent with projections included in the 2021 County Fiscal Policy Strategy Paper. The fiscal strategy paper aims at providing a general fiscal direction to support economic activities taking into consideration debt harmony in the next three years with improved forecast of the national economy.
- The macroeconomic framework underpinning the strategy will remain stable during the medium-term period. Forecasted GDP growth rates and variables such as inflation rates, interest rates amongst others are expected to remain stable to minimize the cost of debt.

- Delay in disbursements by the National government due to economic challenges may force the creditors to charge interest on pending bills and the suppliers increase their prices.
- There is a high risk of litigation
- Risk of non-completion of development projects leading to no value for money
- Risk of the County Government's reputation due to unsettled debts (socio-political risk).

The economic outlook under the MTEF anticipates prudent debt management**.** This will be achieved through avoidance of any delay in defraying the invoices and a schedule for clearing the debts depending on age (FIFO method.)

VI. POTENTIAL SOURCES OF FINANCING

Since the inception of devolution, County governments have had two principal sources of financing. These are National Government Revenue (Equitable Share (ES) and Conditional grants) from National Government and locally collected revenue also known as Own Source Revenue (OSR).

In the first term of devolution, between the FY 2013/2014 and FY 2016 /2017, the mix between the two principal sources of financing in Kisumu County was an average of 81% and 19% respectively. In the second term between FY 2017/2018 and FY 2021/2022 the mix has been an average of 87% and 13% respectively. This is indicative of a trend in which the ES is growing while the OSR for Kisumu County largely remains constant or is growing at a very slow pace.

While the Resource Envelope has grown marginally over time, the demand on the three expenditure categories of Personnel Emoluments (PE), Capital Expenditure and Operation & Maintenance Expenditure (O&M) has been higher than the resource envelope. This has put a strain on the limited resources and prompts the need to resort to other alternative sources of financing.

The potential sources of financing are in two broad categories of External Sources and Internal Sources.

1) INTERNAL SOURCES

i. Debt Swap

The County Government owns estates whose rent is collected by the National Housing Corporation due to a debt arrangement dating back many years. The County Government may apply for a conditional allocation from National Government to be paid directly to the NHC to offset the outstanding debt. This will release the Assets constituting the estates to be a full source of OSR.

ii. Enhancement Measures

The County Government is to shift to a digital revenue collection platform to curb revenue leakages. The key pillars of automation is to introduce pay-bills for the health facilities and other departmental revenue streams and integrate the County Revenue Management System with the revenue collections banks and National Government institutions like National Transport & Safety Authority (NTSA), Business Registration Services (BRS), Integrated Financial Management & Information System (IFMIS), Edams, World Bank E-Citizen. The County Government has also proposed changes in the governance of revenue collection by proposing establishment of a Semi-autonomous Revenue Board.

iii. Upgrading of new Towns

The upgrading of new towns will attract funding which will spur local investment thus have a demand pull on various economic activities. The emergence of economic activities will generate OSR.

iv. Valuation Roll

The updated valuation roll expects an additional 30,000 new rate payers which when enforced will earn additional own source revenue to the County. The expected annual yield of the new valuation is estimated at KSh 2 billion. While implementation of this Valuation Roll has been temporarily stopped by the High Court, the County Government is making progress towards unlocking the judicial.

v. Modernization of the Markets

The modernization and construction of various markets within the County (eg. Uhuru Business Park, Kibuye, Otonglo, Kombewa, Awasi, Lela & Katito) will greatly enhance the ability of the County to tap more revenue through automation and biometric registration of traders.

vi. Contribution in Lieu of Rates

In the defunct Local Authorities, Government Buildings were required by law to pay an amount for the space occupied in the local authorities. This was an annual source of revenue prescribed by the ministry in charge of Local Government. It is supported by the Valuation for Rating Act, Cap 266 and Rating Act, Cap 267 both of which are alive and applicable.

vii. Disposal of idle / boarded Assets

Boarded/unused assets lying idle will be disposed of according to the *Public Procurement and Disposal of Assets Act, 2015* and the proceeds applied to supplement the resource envelope.

2) EXTERNAL SOURCES

a. Borrowing from commercial banks

This has not been applied in Kisumu County except in overdraft arrangement for payment of staff salaries in the FY 2020/2021. However, the County can pursue borrowing from commercial banks or Central Bank of Kenya. Borrowing from the CBK attracts low interest rate but requires the National Treasury to guarantee.

b. External borrowing / grants

External financing is usually at concessional rates and for longer periods compared to commercial banks. The County may float international bonds or borrow from foreign banks. This is subject to volatility of the international money market and specifically fluctuation of the exchange rate since the bonds are denominated in foreign currency. The County should embark on aggressive collaboration with international organizations to get grants to finance programs of huge capital outlay like water, health and infrastructure development. Being a Credit – rated County, the County

Government of Kisumu will exploit opportunities in local and international markets to raise funds for project financing.

c. Borrowing from the money and capital market

The County may borrow from the money and capital market through issuance of County bonds. Borrowing from the capital and money markets is however subject to very strict conditions by the Capital Markets Authority.

d. Public Private Partnership

The County may engage in public- private partnerships and joint ventures to finance projects. The process is lengthy and rigorous and requires expert advice and approvals from the National Treasury which has a directorate to handle PPPs and BOTs. There are several project proposals that arose from the Kisumu International Investments Conference held in December 2021. These proposals will be concretized as PPPs with private sector partners, to implemented through various vehicles, mainly the Lakefront Development Corporation.

VII. COST AND RISKS ANALYSIS OF ALTERNATIVE DEBT MANAGEMENT STRATEGIES

From the analysis of the potential financing strategies, borrowing from the commercial banks is a viable option in the medium term. However due to the volatility of the interest rates, the County will need to negotiate with banks for fixed interest rates for the duration of the loan**.** The borrowing should be capped at 10% of total revenues realized in the previous year subject to approval by the County Assembly in accordance with Section 141(2) of the PFM Act 2012.

The County Government should seek guidance from National Debt Management Office as stipulated in Section 65 of the PFM Act, 2012 to enable it to execute its mandate efficiently.

While implementing the potential finance strategies, preference should be given to those favorable in terms of cost-benefit analysis. Cost and risk of implementation of the strategies are tabulated bellow:

Table 8: Cost-benefit Analysis of Strategies

	Approach	Risk	Cost
1	Debt swap	Lack of support from National Treasury	Minimal
2	Enhancement measures	Non responsiveness from National Government entities	Minimal
3	Upgrading of new towns	Delay in getting conditional grants for upgrading of the towns	High
4	Valuation roll	Prolonged litigation	Minimal
5	Modernization of markets	Low funding	Minimal
6	Contribution in lieu of rates	Delayed legislation	High
7	Disposal of idle assets	Proceeds may be negligible	Minimal
8	Borrowing from commercial banks	Capped interest rates	Minimal
9	External borrowings / grants	Tight attendant conditionality	Minimal
10	Borrowing from the money and capital market	Non approval/guarantee by National Government	High
11	Public private partnership	Ring fenced repayment projected revenue may not be met by the County	Minimal

VIII. DEBT SUSTAINABILITY

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 sustainable level as approved by the 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 importance of managing debt prudently to avoid unwarranted debt burden and reduce risk of macroeconomic instability. Significant efforts have been made to improve the institutional debt management as well as capacity to assess risks.

From Table 1, the total outstanding expenditure arrears stands at Kshs 5.32 billion as at 8th February 2022.The total budgeted revenues for FY 2021/2022 is Kshs 12.15 billion. This implies that expenditure arrears stand at approximately 43.7% of total revenues. These debts are owed to suppliers of goods and services, contractors, staff, statutory institutions and court awards. The County does not presently have any loans or long term borrowing from commercial banks.

The County intends to embrace strong fiscal responsibility measures such as paying recurrent bills as first charge in the current budget FY 2021-2022 and a sizeable portion towards payment of development pending bills

From the analysis above if compared with National Government whose debt to income ratio stands at 51.2% according to its MTDS Paper 2021 the County's debts remain sustainable over the medium term as there are no long-term borrowings incurring interests and payable in the near future.

IX.IMPLEMENTING THE DMS 2022

The County Treasury shall adopt modalities in dealing with its debt in the medium term. This will involve strategies such as enhanced budget allocation to pending bills, debt servicing, prioritization of debts and debt rescheduling. These are considered in the matrix below

Table 9: Expenditure arrears Repayment Plan for FY 2022/2023 - 2023/2024

Category	Actual debt Kshs	Phase I plan 2022/2023 Kshs	%age	Phase II plan 2023/2024 Kshs	%age
Personnel Deductions	905,884,023.28	200,000,000.00	22%	705,884,023.28	78%

Suppliers of goods and services	1,722,210,093.58	1,057,210,093.58	61.4%	665,000,000.00	38.6%
Court awards/legal fees	790,000,000.00	100,000,000.00	12.6%	690,000,000.00	87.4
Gratuity & Medallion	638,092,577.00	50,000,000.00	7.8%	588,092,577.00	92.2%
Unremitted Retention	70,426,518.00	70,426,518.00	100%		
National Housing Corporation	1.200,000,000.00	600,000,000.00	50%	600,000,000.00	50%
TOTAL	**5,326,613,211.86**	**2,077,636,611.58**	**39%**	**3,248,976,600.28**	**61%**

Other action plans that will be implemented include:

1. Verification of arrears - Once data on the outstanding debts has been collected; the data will be verified to ensure that such payments are genuine transactions to avoid payment of fraudulent claims. This activity is to be undertaken by the internal audit directorate, an independent interdepartmental committee of the County and where necessary the Kenya National Audit Office and private audit firms, depending on the legal and institutional arrangements and capacity available.

2. Improving cash and debt management - Reliable cash projections should ensure that liquidity is available to meet payment obligations as they arise. For effective cash management, the County Treasury is adopting "Programme Based Budgeting through adoption of vote book management system.

3. Preparation of a realistic budget- A major remedy in addressing the recurring debt problem is preparation of a realistic annual budget. This is dependent on robust assumptions and forecasts in the fiscal framework on which the budget is based. Estimates of Internal revenues should be realistic. The County is to formulate realistic revenue targets and ensure the actual collection in a FY is enhanced.

The County should consider new strategies in dealing with the debt burden. The following proposals include:

1. Enhance revenue collection**:** The simplest measure of debt redemption is to enhance revenue collection and get the required revenue to pay the debts. The County will strive to enhance revenue collection as a measure to acquire additional revenue that will be channeled towards debt settlement.
2. Creation of a Sinking fund**:** A sinking fund is a fund created by the government and gradually accumulated every year by setting aside a part of current public revenue in such a way that it would be sufficient to pay off the funded debt at the time of maturity..
3. Vote Book Management System: The County should consider adopting the vote book management system to ensure budget implementation and monitoring. The VBMS will ensure the County only commit the LSO/LPO vis-a vis the actual available resources/fund.

X. CONCLUSION

Public debt management forms an integral part of macroeconomic environment in any economy. It has implications on public expenditure and also has a direct bearing on macroeconomic stability.

The 2022 - 2025 Debt Management Strategy objectives are; to ensure the county government's financing needs and payment obligations are met at the lowest cost over the medium term, with a prudent degree of risk, to ensure the equitable sharing of benefits and burdens of public debt between the current and future generation

The 2022 -2025 Debt Management Strategy is a forward-looking framework that describes the sustainability of the county debt in the medium-term. The County Government of Kisumu is currently faced with expenditure arrears arising from delays in disbursement of funds from the National Treasury and unmet revenue targets during the financial years.

The County Government of Kisumu will endeavor to implement sound policies and structural reforms to strengthen its credit rating to enhance access to a wider array of resources of financing at lower cost and risk while maintaining overall debt within sustainable level.

In the final analysis, debt control will require discipline among officers of the County Government of Kisumu, especially in budget implementation across departments and a strong commitment to pay up current pending bills.