



REPUBLIC OF KENYA
THE NATIONAL TREASURY AND PLANNING

Telegraphic Address: 22921
FINANCE-NAIROBI
Fax No.: 315779
Telephone: 2252299

THE NATIONAL TREASURY
P.O. Box 30007 - 00100
NAIROBI
KENYA

When replying please quote
Ref No. DMD 4/268

09 February 2021

Treasury circular No 1/2021

TO: ALL CABINET SECRETARIES
ALL PRINCIPAL SECRETARIES
ALL GOVERNORS
ALL COUNTY EXECUTIVE COMMITTEE MEMBER FOR
FINANCE
CLERKS OF ALL COUNTY ASSEMBLIES

GUIDELINES ON BORROWING BY COUNTY GOVERNMENTS

I. PURPOSE

1. These guidelines are issued as per the requirements of the Constitution of Kenya Article 212 on County Borrowing, Article 213 on Loans Guarantee by the National Government; and Article 214 which defines public debt. The National Government is guided by the provisions in the Public Finance Management (PFM) Act, 2012 Sections 49 to 65 and Sections 140 to 143 and the relevant regulations which require that a county government may borrow only if the National Government guarantees the loan and with the approval of the county assembly, and that all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the National Government constitutes public debt

2. The purpose of this circular is to provide guidance for County Governments as they seek to tap into the debt and loans market to finance their budgets. In particular, this circular is a guide to counties on:
 - i. County Government Medium Term Debt Strategy requirements;
 - ii. Raising loans, debt securities, and grants;
 - iii. Request for National Government guarantees by County Governments;
 - iv. Ensuring sustainability of County Government debt; and
 - v. Capacity building, monitoring and reporting of debt operations of county government.

II. BACKGROUND

3. The Government of Kenya, through the National Treasury, has been implementing the National Government budget including transfers to the 47 county governments through raising tax and non-tax revenues, borrowings and grants. The PFM Act Section 49, gives the Cabinet Secretary responsible for Finance authority to borrow on behalf of the National Government.
4. In determining the level of debt, the National Treasury is guided by the fiscal responsibility principles set out in the Constitution, the PFMA, 2012 and other fiscal objectives as set out in the most recent Budget Policy Statement and the Medium Term Debt Strategy (MTDS) of the National Government. The MTDS published every year by the National Treasury is a policy document that guides the Government's public debt management and borrowing to ensure its sustainability. The strategy guides the government in pursuing the desired structure of the public debt portfolio which reflects its choice on cost and risk trade-offs. The strategy is approved by Parliament every fiscal year.
5. All borrowing by the National Government and guaranteed County Governments debts constitute public debt, and in accordance with Article 214 of the Constitution (Public Debt means "all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the National Government"). In accordance with the Constitution, borrowings by County Governments must be guaranteed by the National Government.

6. The authority to borrow by a County Government rests with the Cabinet Secretary responsible for Finance as stipulated in Section 58 of the PFMA, 2012. County Governments are therefore required to channel their request for borrowing through the Cabinet Secretary for approval process. This forms the basis of issuance of this circular.
7. County Governments planning to raise debt shall be required to strictly adhere to the fiscal responsibility principles as set out in the PFM Act 2012, the procedures for provision for County borrowing guarantees, and County Government Medium Term Debt Strategy.
8. The Government of Kenya through the National Treasury is committed to improving the developmental impact of County Government expenditures through sustainable revenue sharing and support to County borrowings.
9. The Government of Kenya through the National Treasury is committed to improving the implementation of County Government Budget through sustainable sources of financing.

III. AUTHORITY TO RAISE DEBT BY COUNTY GOVERNMENTS

10. As provided under Section 140 of the PFM Act 2012, a County Executive Committee member for finance may, on behalf of the County Government, raise a loan for that County Government's purposes, only if the terms and conditions for the loan are set out in writing and are in accordance with: -
 - i. Article 212 of the Constitution;
 - ii. Sections 58 and 142 of the Public Finance Management Act 2012 ;
 - iii. Regulations to the PFM Act 2012;
 - iv. The fiscal responsibility principles and the financial objectives of the County Government set out in its most recent County Fiscal Strategy Paper; and
 - v. The debt management strategy of the County Government over the medium term.
11. The National Treasury in processing request for borrowing, shall ensure that County Governments strictly adhere to the requirements of section 140 of the PFM Act 2012.

IV. RAISING LOANS AND DEBT SECURITIES

12. The National Treasury acknowledges and supports that County Governments may raise loans, issue securities, whether for money that it has borrowed or for any other purpose only in accordance with the PFM Act 2012 and its regulations.
13. The Constitution and the PFM Act gives County Government powers to 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 for finance may think fit, in any of the following manners: —
 - i. By issuing county Treasury bonds; and
 - ii. By loan or credit evidenced by instruments in writing.
14. In particular, the auction of domestic government securities shall take into account the following factors:
 - i. Pricing of the domestic government securities;
 - ii. Refinancing risk of the domestic government securities;
 - iii. The domestic market stability when taking up County Government securities; and
 - iv. The borrowing programme which is consistent with the County Medium Term Debt Strategy and County Fiscal Strategy Paper.

V. NATIONAL GOVERNMENT GUARANTEES TO COUNTIES

15. In accordance with the PFM Act 2012, counties are allowed to borrow only with a National Government guarantee. In guaranteeing and borrowing money, the National Government shall ensure that its financing needs and payment obligations are met at the lowest possible cost in the market which is consistent with a prudent degree of risk, while ensuring that the overall level of public debt is sustainable.
16. The application for the guarantee shall be submitted to the National Treasury with a draft loan agreement.
17. The Cabinet Secretary shall participate in the negotiations on the contracting of a guaranteed loan by advising the borrower on the best financial terms available, and shall sign on behalf of the National

Government all agreements on the issuance of a government guarantees or guarantee letters.

18. Any proposals for amendments to the loan agreement for which a guarantee is already issued shall be done with prior approval of the Cabinet Secretary.
19. Where necessary, the Cabinet Secretary may request additional information on National Government guaranteed loans from the County Governments.

Criteria for issuing guarantees to County Governments

20. A County Governments for which a guarantee is requested, shall meet the following requirement: -
 - i. Demonstrate that the project could not be financed on reasonable terms and conditions without a government loan;
 - ii. The County has adopted a unified approach in Project Cycle Management that includes the preparation, appraisal and management of public investment projects that is consistent with the standards applied by the National Government.
 - iii. Conditions precedent for the implementation of the project have been met including:
 - a. Land acquisition, compensation and resettlement of persons affected and stakeholder management
 - b. Detail designs have been completed and relevant approvals obtained where applicable
 - c. Necessary regulatory approvals have been granted
 - d. Detailed resource requirement including sources of funding and personnel to operationalize the project have been planned for: and
 - e. Project details have been captured in the pipeline of Public Investment Management Information System.
 - iv. Provide the projected cash flow clearly setting out the projected disbursement schedule and repayment plan;
 - v. Contribute a substantial portion of project funds from their own resources and in any case not less than fifteen (15) percent; and
 - vi. Demonstrate that the proposed feasible project(s) have been approved by the County Government as required by county legislation.

21. The Cabinet Secretary shall not guarantee a loan unless:

- i. The loan is for a capital project;
- ii. The County Government has the ability to repay the loan, pay any interest or other amount payable in respect of it;
- iii. The financial position of the County Government over the medium term is deemed to be satisfactory;
- iv. The terms under the guarantee comply with the fiscal responsibility principles and financial objectives of the National Government and those of the County Government;
- v. The County Government has not surpassed the borrowing limits set out in the PFM Act regulations of 2015 section 179 (1) (2), and if it exceeds that limit, the draft guarantee document has been approved by resolution of both Houses of Parliament;
- vi. There is equity between the National Government's interests and the County Government's interests so as to ensure fairness; and
- vii. The County Government complies with any conditions imposed by the Cabinet Secretary in accordance with the regulation.

22. The Cabinet Secretary shall take into account the recommendation of the Intergovernmental Budget and Economic Council (IBEC) in respect of any guarantee to a County Government.

23. A County Government that defaults on a loan shall be put on an agreed financial recovery programme by the National Treasury.

24. The Cabinet Secretary to the National Treasury, upon recommendation of Guarantee, shall submit the request to the Cabinet and thereafter to the Parliament for approval of the draft loan guarantee document.

25. Borrowers under government guaranteed loans shall provide to the Cabinet Secretary, on a quarterly basis, information on the disbursements and repayments of funds under the loan.

Procedure for submission of Loan guarantee request

26. A County Government requesting for a guarantee on a loan shall adhere to the following procedures;

- a) Before seeking the National Government guarantee, the County Executive Committee member for finance shall submit the borrowing

- proposal to the County Executive Committee for approval of the borrowing, including its terms and conditions;
- b) After approval by the County Executive Committee, the County Executive Committee member for finance shall submit the signed loan agreement and a sessional paper to the County Assembly for approval of the borrowing, including its broad terms and conditions;
 - c) After obtaining the approval of the County Assembly, the County Executive Committee member for finance shall submit the final draft loan financing agreement and the approval of the County Assembly to the Cabinet Secretary requesting for the guarantee of the final loan financing agreement;
 - d) The Cabinet Secretary to the National Treasury after receiving the request from the County Government, shall seek the recommendations of the IBEC in fulfillment of the requirements of section 58(2)(i) of the PFMA, 2012;
 - e) The Cabinet Secretary to the National Treasury after receiving recommendations of IBEC shall then seek the recommendations of the Attorney General;
 - f) The Cabinet Secretary to the National Treasury upon taking into account the recommendations of the IBEC, the Cabinet and the Attorney General may recommend for approval or rejection of the request;
 - g) Upon rejection of a loan guarantee request, the Cabinet Secretary shall give reasons and communicate the same to the concerned County executive member for finance;
 - h) Upon approval of a loan guarantee request, the Cabinet Secretary to the National Treasury shall submit a sessional paper to Parliament with recommendations seeking its approval;
 - i) The Cabinet Secretary to the National Treasury shall communicate the decision of Parliament on the draft loan guarantee to the respective County Executive Committee Member for finance; and
 - j) Upon approval by Parliament the Cabinet secretary to the National Treasury shall issue a loan guarantee.

Procedure for submission of County Treasury Bonds guarantee request

27.A County Government requesting for guarantee on a County Treasury Bonds shall adhere to the following procedures;

(a) The County Executive Committee Member for finance shall develop and submit the cash plan, indicating the borrowing requirements to the County Executive Committee for approval of the borrowing including its terms and conditions;

(b) After approval by the County Executive Committee, the County Executive Committee Member shall submit the cash plan, referred to above, to the County Assembly for approval of the borrowing including its terms and conditions;

(c) Upon approval by the County Assembly, the County Executive Committee Member shall submit the final cash plan and the approval of the County Assembly to the Cabinet Secretary requesting for the guarantee of the Treasury Bond and its inclusion in the issuance calendar;

(d) The Cabinet Secretary to the National Treasury, after receiving the request from the County Government, shall seek the recommendations of the IBEC in fulfillment of the requirements of section 58(2)(i) of the Act;

(e) The Cabinet Secretary to the National Treasury may, upon taking into account the recommendations of the IBEC and the Attorney General, recommend for approval or rejection of the request;

(f) The Cabinet Secretary shall reject a request for loan guarantee with reasons and communicate the same to the concerned County Executive Member;

(g) Upon approval of a loan guarantee request, the Cabinet Secretary to the National Treasury shall submit the request to Parliament with recommendations seeking its approval;

(h) The Cabinet Secretary to the National Treasury shall communicate the decision of Parliament on the draft loan guarantee to the respective County Executive Committee Member for finance;

(i) Upon approval by Parliament, the Cabinet Secretary shall include such authorized Treasury Bonds in the overall national issuance calendar;

(j) Once the issuance calendar is known, when the National Governments advertises its bond issuance for a specific month it shall also incorporate those to be issued on behalf of County Governments;

(k) on the issuance day, the County whose bond is being issued, shall be represented in the auction committee meeting by the County Executive Committee Member or their representative; and

(l) after the National Treasury and the County Government sign an on-lending agreement, the National Treasury shall transfer the proceeds of the Treasury Bond to the Revenue Fund of that County Government and such on-lending transactions shall attract a fee to be determined by the National Treasury.

Defaults on debt guaranteed by National Government

Section 94 of the PFM Act 2012 shall guide determination of a state of default on a loan by a County Government. The following factors, singly or in combination, may further indicate a County Government is in serious material breach or persistent material breach under a loan or debt security: -

- i. Has failed to make any loan payments as and when due;
- ii. Has defaulted on financial obligations for financial reasons; and
- iii. Has had an operating deficit in excess of a percentage of revenue in the most recent financial year for which financial information is available as prescribed in regulations.

Recovery of money paid by National Government under a guarantee in case of default

28. The costs, interests and principal payments made by the National Government on behalf of the county concerning loans to the County Government shall, together with the principal amount, be reimbursed to the National Government by the County Government.

29. Money paid by the Cabinet Secretary on a guarantee, including any expenses incurred by the Cabinet Secretary in respect of the guarantee, shall be a debt due to the National Government from the borrower whose loan was guaranteed; and recoverable through withholding transfer of money in terms of Article 225 of the Constitution if the borrower receives

appropriations from the County's share of transferable revenues. The money received or recovered in respect of money paid under a guarantee shall be paid into the Consolidated Fund.

30. Where Cabinet considers that the debt is more likely to be recovered if the borrower is allowed to pay the debt over a period of time, the Cabinet Secretary may enter into an agreement with the borrower to pay the debt over that period and at such intervals, and subject to such terms and conditions, as may be specified in the agreement.

VI. COUNTY GOVERNMENT MEDIUM TERM DEBT STRATEGY

31. Borrowing by County Governments shall be guided by the County Medium Term Debt Management Strategy and shall set out the framework for the management of County public debt.

32. The medium term debt management strategy shall be formulated annually on a three year rolling basis and reviewed annually. The strategy shall be prepared by the County Treasury and shared with Public Debt Management Office (PDMO) before execution by the County Treasury.

33. The Strategy shall be approved by the County Executive Committee.

34. The County Medium Term Debt Strategy shall be prepared taking into account—

- (a) The borrowing needs of the County Government;
- (b) Fiscal responsibility principles set out in Section 107 of the PFM Act and Regulation 25 of the PFM Act;
- (c) Prevailing macro-economic conditions;
- (d) Prevailing conditions of the financial markets;

35. The County Medium Term Debt Strategy shall include measures for minimizing borrowing costs with a prudent degree of risks.

36. The County Medium Term Debt Management Strategy shall be implemented through the annual County Government borrowing programme for each fiscal year.

- 37.A County Government annual borrowing programme shall include issuance of County Government securities, external guaranteed loans and disbursements for the fiscal year and show indicative dates of such issuance and disbursements.

VII. ENSURING SUSTAINABILITY OF COUNTY GOVERNMENT DEBT

- 38.The National Government from time to time shall monitor the sustainability indicators of counties to ensure the overall Government debt remains at sustainable levels.
- 39.The fiscal framework in the County Fiscal Strategy Paper shall contain an analysis and explanation of deficit and debt policy, including an analysis of county debt sustainability.

VIII. CAPACITY BUILDING, MONITORING AND REPORTING OF DEBT OPERATIONS OF COUNTY GOVERNMENT

- 40.The National Treasury will prepare a training program for purposes of building capacity in updating County debt recording and settlement activities.
- 41.The Public Debt Management Office (PDMO) will assist a County Government at its request in its debt management and borrowing including preparation of the County Medium Term Debt Strategy.
- 42.The National Government through the National Treasury, will monitor County Government debt operations; maintain a debt database including reports on performance of County Government guarantees.
- 43.The National Treasury shall require County Governments as additional condition for issuance of a guarantee, to maintain a reliable debt data base for all loans taken by the County Governments and their entities.
- 44.A County Treasury shall submit to the National Treasury a report on county public debt as prescribed in the PFM Act regulations

The purpose of this circular is to provide you with the guidelines as required by law and request you to bring the contents of this circular to all relevant entities under your agency.



HON. AMB. UKUR YATANI, EGH
CABINET SECRETARY/NATIONAL TREASURY

Copy to: Head of the Public Service
Attorney General
Governor, Central Bank of Kenya
Intergovernmental Budget and Economic Council
Commission for Revenue Allocation
Controller of Budget
Chairman – Council of Governors
Speaker, Senate
Speaker, National Assembly