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PARLIAMENT OF KENYA

THE NATIONAL ASSEMBLY

THIRTEENTH PARLIAMENT (SECOND SESSION)

PUBLIC DEBT AND PRIVATIZATION COMMITTEE

REPORT ON THE LOANS CONTRACTED BY THE NATIONAL GOVERNMENT BETWEEN MAY 2022 AND APRIL 2023

SEPTEMBER 2023

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CHAIRPERSON'S FOREWORD

Section 31(1) of the Public Finance Management Act mandates the Cabinet Secretary, National Treasury and Economic Planning, to submit to Parliament on a quarterly basis, a report of all loans made to the national government, national government entities and county governments. To this extent, the National Treasury submitted to the 13th Parliament, reports on all new loans contracted by the national government for the following periods: 1st May 2022 to 31st August 2022; 1st September to 31st December 2022; and 1st January 2023 to 30th April 2023.

Pursuant to Section 31(3) of the PFM Act, the quarterly reports should contain the following information: loan balances brought forward, carried down, drawings and amortizations on new loans obtained from outside Kenya or denominated in foreign currency. Specifically, the report should include the names of the parties to the loan; the amount of the loan and the currency in which it is expressed and in which it is repayable; the terms and conditions of the loan including interest and other charges payable and the terms of repayment; the amount of the loan advanced at the time the report is submitted; the purpose for which the loan was used and the perceived benefits of the loan; and such other information as the Cabinet Secretary may consider appropriate.

The committee observed that the reports contained information relevant for basic review of the nature of the individual loans contracted, such as, interest rate charged, maturity period, and repayment terms; but lacked critical details required to determine the overall impact of the loans contracted such as impact on the overall stock of public debt, loan balances brought forward, carried down, drawings and amortizations, among others.

Examination of the Quarterly Reports

Pursuant to Standing Order 207A(3)(i), the quarterly reports on loans were submitted to the Public Debt and Privatization Committee to review and make recommendations to the National Assembly. The committee has fulfilled this mandate and hereby submits this report to the House for consideration and adoption.

In reviewing the three quarterly reports, the Committee held productive deliberations with the National Treasury as well as the Controller of Budget and received their submissions which have been taken into account in the finalizing of this report.

Key Recommendations

Arising from these consultative engagements, the Committee has made the following recommendations:

1) Subsequent reports to be submitted by the National Treasury should ensure full compliance with Section 31 (1) & (3) of the PFM Act, 2012. In particular, the National Treasury should ensure that the reports indicate all loans made to the national government, national government entities, and county governments, as well as loan balances brought forward, carried down, drawings, and amortizations on new loans.
2) The quarterly reports, referred to under Sections 31(1) and 31(3) are part of the financial statements referred to under the Public Finance Management Act, 2012. As such, they

should follow the fiscal year calendar cycle, which is adhered to by other PFM documents. The two reports referred to under Section 31 of the PFM Act 2012 should therefore be guided by the following deadlines:

i. Quarter one (July - September) Report – The deadline for submission is 14 days after the end of the quarter;
ii. Quarter two (October - December) Report – The deadline for submission is 14 days after the end of the quarter;
iii. Quarter three (January - March) Report – The deadline for submission is 14 days after the end of the quarter; and
iv. Quarter Four (April - June) Report – The deadline for submission is 14 days after the end of the quarter.

3) In addition to the PFM Act 2012 provisions, the reports indicated above should also include information related to:
    i. Report on the use of Export Credit Agencies (ECA) and respective contingent liability exposure. This will include contracts signed, expected benefits to the country, and any guarantee offered should be subject to the approval of Parliament; and
    ii. Report on the use of the Central Bank overdraft facility.
4) Quarterly reporting on project/program loans should be guided by Program Based Budgeting principles (to indicate Implementing Agencies, Key Performance Indicators (KPIs), output targets, the activities) and the respective project valuation, appraisal, and assessment reports should be attached;
5) In order to facilitate oversight of debt and to promote transparency and accountability of loan contracts entered into, the National Treasury should attach the contracts signed against each submitted report and should not enter into any contract that does not adhere to principles of Public Finance as set under Article 201 of the Constitution;
6) As from the date of adoption of this report, the National Treasury should prioritize the sourcing and disbursement of concessional finance. Concessional finance contains a grant element, implying that larger borrowing can be sourced with minimum impact on debt sustainability by reducing the refinancing and interest rate risk;
7) A review of the sectors financed by loans borrowed during this period indicates that they targeted sectors with greater social returns but minimum financial returns. External borrowing should be driven by financing requirements for sectors or development projects that promote export-driven production in order to address forex exchange imbalances;
8) The National Treasury should address factors that affect timely and full disbursement of loan financing and submit a report to the National Assembly, within 60 days of the adoption of this report, indicating actions taken to increase the efficient disbursement of loan financing;
9) Not later than thirty (30) days after the end of each financial year, Ministries, State Departments, and Implementing Agencies (MDAs) responsible for the projects for which loans have been obtained, should submit a report to the National Assembly indicating measures taken to ensure timely and full disbursement of all the loans in their purview.

These reports should be considered by the Public Debt and Privatization Committee and a report should be submitted to the House within thirty (30) days;

10) Within ninety (90) days, the National Treasury should fully digitalize the loan approval and monitoring system to enhance reporting, transparency, and accountability. This should also include training of technical personnel and the establishment of a system that is accessible to other public finance management institutions such as the Central Bank of Kenya, the Office of the Controller of Budget, and the Office of the Auditor General;

11) As from FY 2024/25, at the end of the Sector Working Group engagement, the National Treasury should submit to the National Assembly a report containing the list of potential projects for which loan financing will be contracted, the potential creditors, and the respective loan terms. This report should also indicate timelines for project valuation, appraisal, and assessment; and,

12) Arising from 8.11 above, a final list of projects to be financed by borrowing should be submitted alongside the annual Medium Term Debt Management Strategy. The list should be reconcilable with the development budget and the fiscal deficit.

ACKNOWLEDGEMENTS

The Committee extends its gratitude to the Office of the Speaker and the Office of the Clerk of the National Assembly for the support extended in fulfilling its mandate of reviewing the reports of new loans contracted by the National Government for the period between May 2022 and April 2023. Sincere gratitude is also extended to the National Treasury and the Office of the Controller of Budget, for honouring our invitation and providing critical information.

Finally, the Committee would like to thank the Parliamentary Budget Office for the extensive technical assistance provided in the review of the submissions and for the finalization of this report.

It is therefore my pleasant undertaking, on behalf of the Public Debt and Privatization Committee, to table this report to this House and recommend it for adoption.

SIGNED

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HON. ABDI SHURIE, MP.
CHAIRPERSON, PUBLIC DEBT & PRIVATIZATION COMMITTEE

.......28/9/2023.......

DATE

PREFACE

Establishment and Mandate of the Committee

The powers of each House of Parliament to establish committees and to make Standing Orders for the orderly conduct of its proceedings are provided for under Article 124 of the Constitution of Kenya, 2010. For critical oversight over matters relating to public debt and debt guarantees, public-private partnerships, and privatization of national assets, standing order 207A establishes the Public Debt and Privatization Committee with specific mandates among which is to:

i. Oversight of public debt and guarantees, pursuant to Article 214 of the Constitution
ii. Examine matters relating to debt guarantees by the National government;
iii. Oversight Consolidated Fund Services excluding audited accounts;
iv. Examine reports on the status of the economy in respect of the public debt;
v. Oversight of public-private partnership programs by the national government in respect of the public debt; and
vi. Oversight privatization of national assets

This Committee is therefore mandated, among other functions, to examine the reports of all loans made to the national government, national government entities, and county governments subject to Article 211(2) of the Constitution and PFM ACT 2012, and submits recommendations as contained in this Report for the adoption of the House.

Membership of the Committee

The Public Debt and Privatization Committee as currently constituted, comprises of the following Members of Parliament: -

CHAIRPERSON
Hon. Abdi Shurie, M.P.
Balambala Constituency
Jubilee Party

VICE-CHAIRPERSON
Hon. (Dr.) Makali Mulu M.P
Kitui Central Constituency
Wiper Party

Hon. Junet Mohamed S.N. CBS. M.P
Suna East Constituency
ODM Party

Hon. Mohamed Abdikadir Hussein, M.P
Lagdera Constituency
ODM Party

Hon. Omboko Milemba M.P
Emuhaya Constituency
ANC Party

Hon. (CPA) Suleka H. Harun. M.P
Nominated
UDM Party

Hon. (Dr.) Irene Kasalu M.P
Kitui County
Wiper Party

Hon. Chege Njuguna M.P
Kandara Constituency
UDA Party

Hon. Kwenya Thuku Zachary, M.P
Kinangop Constituency
Jubilee Party

Hon. Abdi Ali Abdi, M.P
Ijara Constituency
NAP-K

1. Introduction

1.1. Between May 2022 and April 2023, nineteen (19) externally financed loans, amounting to Kshs. 213.24 billion, were signed between the national government and international creditors. This is broken down as follows: between May and August 2022, six (6) loans amounting to Kshs. 105.06 billion were signed; between September and December 2022, eight (8) loans valued at Kshs. 43.38 billion were signed; and in the January to April 2023 period, five (5) loans amounting to Kshs. 64.8 billion were signed.

1.2. During the review of the loan reports it was noted that only three (3) loans totaling Kshs. 24.2 billion, primarily commercial loans, had been partially disbursed indicating a disbursement rate of less than 11 percent. The disbursed commercial loans were primarily utilized for general budget support. Timely and full disbursement of loans is critical for both the capacity to repay loans (by generating financial or economic resources) and for enhancing project implementation to spur economic development.

1.3. Other loans contracted during the period included bilateral or multilateral loans intended for infrastructural projects, energy sector, education sector, and other projects with high social impact. Failure to disburse these loans on time implies that the intended project benefits may not be realized by the time the repayments begin. Furthermore, it denotes a lack of capacity to effectively exploit (semi) concessional/program loans offered by development partners. This will primarily affect financing for projects and/or initiatives designed to achieve social development objectives, support policy and institutional reforms of national and subnational governments.

1.4. Given the number undisbursed loans there is an increased likelihood of incurrence of commitment fees, among other charges. Notably, the repayment profile of the loans contracted during this period indicates that a substantial number of the loans will be due for repayment between 3 and 10 years.

Stock of Public Debt and FY 2022/23 Fiscal Deficit Financing

1.5. The total public debt stock as of the end of April 2023 amounted to Kshs. 9.634 trillion (approximately 66 percent of GDP). This comprised of Kshs. 5.09 trillion (53 percent) in external debt and Kshs. 4.54 trillion (47 percent) in domestic debt. The national debt has increased consistently over the years due to the incurrence of the fiscal deficit.

1.6. The FY 2022/23 fiscal deficit amounted to Kshs. 824 billion to be financed by Net Foreign Financing amounting to Kshs. 395.7 billion (47 percent) and Net Domestic Financing amounting to Kshs. 428.3 billion (53 percent). This deviates from the Medium Term Debt Management Strategy (MTDS) approved strategy of net domestic borrowing to net external borrowing of 68:32 respectively. It is projected that in FY 2023/24, the fiscal deficit will reduce to Kshs. 718.9 billion in line with the government fiscal consolidation plan.

1.7. The net foreign financing for FY 2022/23 included a Kshs. 110 billion International Sovereign Bond from global banks including Export Credit Agencies. This indicates the continued use of commercial debt in deficit financing. Indeed, in FY 2023/24, the National Government is expected to borrow a further Kshs. 270 billion as commercial

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Hon. Kirwa Abraham Kipsang, M.P
Mosop Constituency
UDA Party

Hon. (Dr.) Daniel Manduku, M.P
Nyaribari Masaba Constituency
ODM Party

Committee Secretariat

In the preparation of this report, the Committee was facilitated by the following staff:

Mr. Chacha Machage
Fiscal Analyst I/ Lead Clerk

Mr. Job Mugalavai
Fiscal Analyst III/ Clerk Assistant

Ms. Fridah Ngari
Media Relations Officer III

Mr. Eugene Luteshi
Audio Officer III

Ms. Yasmin Hassan
Assistant Serjeant-at-Arms

Ms. Florence Mbuthi
Protocol Officer III

Ms. Audrey Ogutu
Legal Counsel II

Parliamentary Budget Office

The Committee also received technical support from the following staff of the Parliamentary Budget Office:

Dr. Martin Masinde
Director, Parliamentary Budget Office (PBO)

Mr. Robert Nyaga
Deputy Director, Parliamentary Budget Office

Ms. Millicent Makina
Fiscal Analyst I

Ms Julie Mwithiga
Fiscal Analyst I

financing. This will increase the overall risk to the cost of public debt stock as a result of increased interest rate risk, exchange rate risk, and refinancing risk.

2. Loans contracted between May and August 2022

2.1. The May – August 2022 report indicated that a total of six (6) new loans were contracted between the government and bilateral, multilateral, and commercial creditors, between the period 1st May 2022 to 31st August 2022. These loans amount to Kshs. 105.06 billion and were intended to finance initiatives under the Agricultural sector and Economic Empowerment through the financing of Micro, Small, and Medium Enterprises (MSMEs). The creditor sources are as follows,

i. Multilateral loans - Kshs. 65.3 billion (62 percent);
ii. Commercial loans - Kshs. 39.18 billion (34 percent); and,
iii. Bilateral loans - Kshs. 3.62 billion (3 percent).

2.2. In the review of the report, the Committee observed the following:

i. Commercial financing from the Syndicated Short Term Multicurrency Facility worth Kshs. 36.2 billion, accounted for 34 percent of debt contracted, while concessional and program loans accounted for Kshs. 68.9 billion (66 percent);
ii. Of the six loans contracted, only the commercial loan had been partly disbursed (66 percent), by the time the report was submitted to Parliament.
iii. There was no information provided on loans made to national government entities and related contingent liability exposure. Notably, the Controller of Budget report had indicated that as of June 2022, there were Kshs. 218.8 billion non-performing loans charged against various government entities;
iv. Loan repayments will fall due from 2025, peaking in 2027 and 2047. This indicates an increase in refinancing requirements from 2027;
v. The loans contain certain financial terms that might hide the true cost of a loan. Such terms include: lending margins, commitment fees, front-end fees, maturity premiums, service fees, commitment charges; and,
vi. The information provided does not include specifics such as project outputs, activities, and implementation period (single or multiple-year projects).
vii. The World Bank's International Development Association (IDA) was the largest creditor; accounting for 52 percent of amounts borrowed during the quarter. The second largest creditor was the Eastern & Southern African Trade Development Bank (34 percent), followed by Africa Development Bank (10 percent) and the Khalifa Fund for Enterprise Development – UAE (3 percent).
viii. A review of the currency composition showed that the USD accounted for 62 percent of amounts borrowed with the Euro accounting for 38 percent.

2.3. During this period, the loans were contracted to finance the following projects:

a. East Africa Skills Transformation and Regional Integration Loan Project (Kshs. 12.67 billion – undisbursed)

2.4. This is a Kshs. 12.67 billion loan signed on 27th July 2022, financed by the World Bank's - International Development Association for the East Africa Skills Transformation and

Regional Integration Loan Project. The project aims to strengthen regional harmonization, dissemination, and use of core economic social statistics for Kenya, Rwanda, and Tanzania. It is a concessional loan with a 5-year grace period with interest charged at 1.25 percent p.a. including a service fee of 0.75 percent p.a. and commitment charge of 0.5 percent p.a. on the unwithdrawn financing balance. Despite these favorable borrowing terms, the loan had not been disbursed by the date of submission of the report and the status remains unknown. The report does not provide any project-specific information such as implementation timelines, agency in charge, outputs etc.

b. De-Risking, inclusion and value enhancement of pastoral economies in the Horn of Africa project (Kshs. 15.67 billion)

2.5. The loan to finance this project was signed on 29th June 2022 with the World Bank's - International Development Association. This was a concessional loan aimed at financing the de-risking, inclusion, and value enhancement of pastoral economies in the Horn of Africa project. The project aims to enhance pastoralists' access to financial services for drought risk mitigation by including them in the value chain and facilitating livestock trade in Africa. However, details of the implementing agency and other project-specific information were not provided including the distribution of the resources within the targeted area(s).

c. National Agricultural Value Chain Development Project (Kshs. 26.4 billion - undisbursed)

2.6. This loan was contracted on 10th June 2022, amounting to Kshs. 26.396 billion. It was provided by the World Bank's International Development Association and is therefore a concessional loan. The Euro-valued debt is targeted towards the National Agricultural Value Chain Development Project which is intended at increasing market participation and value addition for targeted farmers in select value chains in project areas. The explanation provided for the loan is general and lacks specificity on the program implementation, that is, the select value chains in project areas. Finally, given the late date of acquisition and non-disbursement by the time the report was tabled, it implies resources were not utilized on time and possibly, commitment fees have been incurred.

d. Syndicated Short-Term Multicurrency Facility (Kshs. 36.18 billion)

2.7. This is a commercial loan signed on 23rd August 2022, worth Kshs. 36.18 billion. It accounts for 34 percent of loans signed during the period. It is financed by the Eastern & Southern African Trade Development Bank, in both USD and Euro currencies. In general, the amounts are for financing the development budget including but not limited to trade development activities. As per the explanation, this implies general budgetary support and lacks critical financing specifications required to promote oversight over the use of the resources.

2.8. The loan which has a 3-year grace period lacks installment payments and will require a bullet payment on 30th September 2025. This is likely to cause refinancing pressures leading to liquidity shortages during the year of repayment if appropriate financial/cash planning is not put in place. In the interim period, interest payments will be payable at the rate of: Reference Rate (both USD & Euro are 6M Term Secured Overnight Reference Rate - SOFR, & 6M Euribor, respectively) plus margin per annum (USD - 4.45 percent and Euro - 4.3 percent). Interest on overdue amounts to be increased by 2 percent per annum above the applicable rate.

e. Micro, Small or Medium Enterprises Sector Program Support (Kshs. 3.62 billion – undisbursed)

2.9. This loan is contracted from the Khalifa Fund financed by Enterprise Development (UAE) amounting to Kshs. 3.62 billion. It is the smallest loan (3 percent of total loans) obtained during the quarter. It is a concessional loan with a 5-year grace period and interest payment of 1.5 percent per annum. Unlike other loans, this particular loan does not lead to the incurring of commitment fees. Nonetheless, it remains undisbursed. The SMEs Support program aims to: a) develop private sector initiatives, support entrepreneurship, alleviate poverty, and promote economic development, b) focus on improving SME sector in Kenya, contributing to economic development and job creation for women and youth, c) focus on sectors to be agreed with the Fund. No further information on implementation agency, regional distribution, implementation parameters, outcomes etc., was not provided.

f. Competitiveness & Economic Recovery Support Program (CESRP-II) - (Kshs. 10.52 billion)

2.10. The loan was signed on 22nd August 2022 and financed by the African Development Bank. It is targeted at General Budget Support for post-COVID-19 pandemic economic recovery through enhancing fiscal performance, strengthening industrial development and competitiveness, and promoting economic and social inclusion through support to SMEs. The information provided does not indicate how the resources are allocated and will be utilized. Budget support financing should be submitted in line with the Program Based Budgeting parameters by indicating the projects, Key Performance Indicators (KPIs), output targets, and activities in order to promote transparency and accountability.

2.11. It is worth noting that there is no specific interest rate indicated for this loan. The interest rate provided is a percentage rate per annum equal to a Floating Base Rate, Funding cost Margin, Lending Margin, and Maturity Premium of 10 basis points. This interest rate is based on pure variables that change/fluctuate based on financial status or economic impact on the Euro. Such loans are likely to promote uncertainty in debt servicing expenditure.

3. Loans contracted between September and December 2022

3.1. The National Treasury submitted the September to December loans report to Parliament on 22nd March 2023. It indicated that eight (8) new loans were contracted between the government and bilateral, multilateral, and commercial creditors, between September 2022 to December 2022 totaling Kshs. 43.38 billion. The sectoral distribution of the loans was as follows: Water (44 percent), Health (6 percent), agriculture (27 percent), and trade (8 percent), sectors.

3.2. Notably, the Kshs. 43.38 billion loan amount included loans contracted outside the quarter such as a loan contracted on 23rd February 2022 (ADB loan worth Kshs. 5.06 billion) and 2nd June 2022 (IFAD loan worth Kshs. 2.59 billion). It is estimated that concessional loans accounted for 68 percent (Kshs. 29.51 billion) of the loans borrowed, while semi-concessional to semi-commercial loans amounted to Kshs. 13.87 billion (32 percent of total borrowing). By the time the report was submitted to Parliament, only two of the eight loans contracted had been partially disbursed.

3.3. The World Bank's International Development Association (IDA) was the largest creditor, providing Kshs. 16.67 billion or 38 percent of the amounts borrowed during the period. Other important financiers included the Federal Government of the Republic of Germany (Kshs. 10.26 billion or 24 percent), Agence Francaise De Development (Kshs. 6.16 billion or 14 percent), and African Development Bank.

3.4. A review of the currency composition indicates that the Euro accounted for 88 percent of the amounts borrowed, while the African Development Bank's Unit of Account, XUA, accounted for 12 percent (however, repayment will be in Euro). While this may indicate diversification from the USD (which accounts for approximately 67 percent of total debt stock), it increases exposure to the Euro which has depreciated by 15 percent since mid-April 2022 (when it traded at Kshs. 125.3) and currently trading at Ksh.144.5 (First week of April 2023). The exchange rate remains a key factor for consideration in borrowing and debt servicing.

3.5. In reviewing the report, the Committee noted the following:

i. The submitted report lacked key information required to guide policymaking and oversight. Adherence to Section 31 of the PFM Act, 2012 should be guided by reporting under the Program Based Budgeting model and should indicate Implementing Agencies, Key Performance Indicators (KPIs), output targets, and activities among others.

ii. Details on domestic debt contracted over the period were not provided.

iii. A review of adherence to the PFM Act, 2012 indicated that the following information had not been provided:
   a) A statement of loan balances; carried down and drawings of new foreign, and loans to county governments
   b) A statement on loans made to national government entities and related contingent liability exposure. A report by the Controller of Budget indicated that as of June 2022, there were Kshs. 218.8 billion in non-performing loans charged against various government entities.

iv. Non-disbursement or partial disbursement of loans indicates a general inability to efficiently use concessional financing which is critical for projects with low repaying capacity (e.g. social/climate change projects) but high economic returns.

v. Non-disbursement of loans leads to the incurring of commitment fees and other non-disbursement costs.

vi. There was no information provided on project appraisal including evaluation of the sustainability of the projects and capacity to generate financial or economic returns to repay the loans when they are due.

vii. There was no follow-up report on the disbursement of loans contracted in the previous quarter making it difficult to determine whether the loans were eventually disbursed or not.

viii. There was no information provided on the use of Export Credit Agencies (ECA) indicating the possibility of contingent liability exposure.

3.6. **During this period, the loans were contracted to finance the following projects:**

a. Horn of Africa - Groundwater for resilience project (Kshs. 16.67 billion - undisbursed)

3.7. This is a Kshs. 16.7 billion loan contracted on 1st September 2022 from the World Bank's - International Development Association; for financing the Horn of Africa – Ground water for Resilience Project. The project seeks to increase sustainable access and management of groundwater in the Horn of Africa borderlands, targeting Ethiopia, Kenya and Somalia.

3.8. In Kenya, it focuses on aquifer systems with regional and transboundary implications in ASAL areas, drought affected communities and counties such as; Turkana, Marsabit, Mandera, Wajir and Garissa bordering Ethiopia and Somalia. It is a concessional loan with a 6-year repayment grace period and 1.25 percent per annum, a service fee of 0.75 percent per annum, and a commitment charge of 0.5 percent per annum on the unwithdrawn financing balance.

b. Turnkey Medical equipment and refurbishment package contract up - upgrading maternal and newborn care units at 20 sites (Kshs. 2.65 billion – undisbursed)

3.9. The loan was signed on 12th September 2022 with the Mizuho Bank Europe N.V. This is a semi-commercial loan with a grace period of 5 years and the interest rate is charged at the 6 month Euribor rate (3.34 percent - 3.36 percent) plus a margin of 1.8 percent per annum, the commitment charge rate is 0.6 percent per annum on the lender's available commitment on the available period, among other fees. This financing design aims to support an Export Credit Agency intended at upgrading maternal and newborn care units at 20 sites (not indicated). Key project specific details were not provided.

c. To build resilience for food and nutrition security in the Horn of Africa Program – Kshs. 5.06 billion (Partially disbursed – Kshs. 36.1 Million or 1 percent)

3.10. This loan was signed on 23rd February 2022 with the Africa Development Fund; amounting to Kshs. 5.056 billion. It is a semi-concessional loan to build resilience for food and nutrition security in the Horn of Africa (Djibouti, Kenya, Somalia and South Sudan). The program aims to increase sustainable productivity and agropastoral production systems; increase incomes from agropastoral value chains; and enhance the adaptive capacity of the people to prepare for and manage climate change risks and variation. While this is a cross-border project, project specificity is lacking. In addition, having been signed in February 2023, late reporting of the loan implies a lack of adherence to the PFM Act, poor reporting practices, and lack of adherence to fiscal planning in the acquisition of loans. Furthermore, the loan remains undisbursed implying that commitment fees were incurred.

d. Waste to water management at Lake Victoria South (Kshs. 2.46 billion – Undisbursed)

3.11. This is a commercial loan amounting to Kshs. 2.46 billion. It is a concessional loan provided by the Government of the Federal Republic of Germany to improve wastewater and water management in Kisii and Kericho. Whilst the concessional loan is characterized by a low-interest rate and a long grace period, the report does not provide specific projects to be undertaken.

e. Rural Kenya Financial Inclusion Facility - Kshs. 2.59 billion (Partially disbursed – Kshs. 38.34 Million or 1 percent)

3.12. This loan was signed on 2nd June 2022 and is financed by the International Fund for Agricultural Development (IFAD). It is valued at Kshs. 2.59 billion and aims to finance the Rural Kenya Financial Inclusion Facility Project. The project intends to increase rural financial inclusion and green investments by agriculture value chain stakeholders, promote equitable employment opportunities, production systems, and increase incomes. This is a concessional loan with a 9.5-year grace period and Euro repayment installments to begin in 2032 and 2042. Even though it was signed in June 2022, less than 1 percent of the loan had been disbursed – uses of these resources have not been provided and the expected impact on undisbursed balances has not been provided. This indicates an inefficient supply of financial resources and in an irregular manner to enable timely project implementation.

f. Food security and youth employment in western Kenya through local climate resilience project (Kshs. 4.25 billion – undisbursed)

3.13. This loan was signed on 15th December 2022 between the government of Kenya and the Government of the Federal Republic of Germany. It is worth Kshs. 4.25 billion and is intended to finance local climate resilience projects in western Kenya to address food security and youth employment. The project aims to finance performance-based grants to counties in western Kenya, to plan, implement, and monitor climate resilient investments with a focus on agriculture related activities as well as national level activities that strengthen climate change management by the national government. This is a concessional financed loan with a 6-year grace period. Despite the favorable financing terms, the loan had not been disbursed as at the time of submission of the report to Parliament indicating inefficient use of concessional financing to address climate change related matters. Furthermore, there is no project-specific information provided to facilitate a cost-benefit analysis of the loan.

g. Program for Promotion of Entrepreneurship and Employment (Centre for Entrepreneurship) – Kshs. 3.55 billion, undisbursed

3.14. This bilateral loan was signed on 22nd December 2022 between the GOK and the Government of the Federal Republic of Germany. Worth Kshs. 3.55 billion, the loan aims to finance the promotion of Entrepreneurship and Employment through the establishment of a center for entrepreneurship (including satellites) with its integrated voucher systems. Whilst the report does not provide further details, the program aims to improve the employability of young people through promoting market-based entrepreneurial models, promotion of services for entrepreneurial skills, and improvement of access to needs-based financial services. Despite having favorable concessional terms, this loan remains undisbursed.

h. Second Informal Settlements Improvements Project (KISIP-2) – Kshs. 6.16 billion - undisbursed

3.15. This loan, worth Kshs. 6.2 billion, is financed by the Agence Francaise de Development/ French Development Agency for the KISIP-2 project. Currently, the KISIP-2 is a County Government support program that received Kshs. 2.8 billion in FY 2022/23 and Kshs. 3.3 billion in FY 2023/24, and financed by the World Bank. The disbursement to counties is undertaken through the County Government Additional Allocations (CGAA) Act, 2022. Disbursement of this loan may require amendment of the CGAA Act 2022 or inclusion in the CGAA Bill 2023 to be disbursed in FY 2023/24.

3.16. The project aims to facilitate county governments in the following:

a) Planning for tenure regularization and social/economic inclusion;
b) Infrastructure upgrading focuses on investment in settlement level infrastructure, and, where necessary, extension of trunk infrastructure to settlements;
c) Institutionalizing slum upgrading through institutional and policy development at national and county levels; and,
d) Project Management and Capacity Building through technical assistance, training, workshops, and other capacity-building activities aimed at enhancing the ability of national, county, and community teams.

4. Loans contracted between January and April 2023

4.1. The report was tabled on 14th June 2023 and indicated that by the end of April 2023, five (5) new loans worth Kshs. 64.8 billion had been contracted between the government and one (1) bilateral, three (3) multilateral, and one (1) commercial creditors. The Kshs. 64.8 billion also included loans contracted outside the quarter. These are loans signed in May 2022 between the Government of Kenya and the African Development Bank. There is therefore a concern about the omission of public debt in quarterly reports that could distort the overall reporting of public debt.

4.2. The African Development Bank (ADB) was the largest creditor providing Kshs. 30.52 billion or 47 percent of the amounts borrowed during the period. Other important financiers included the syndicated Term Facility (Kshs. 27.57 billion or 43 percent) and the Federal Government of the Republic of Germany (Kshs. 6.71 billion or 10 percent).

4.3. A review of the currency composition indicates that the loans were signed under the African Development Bank unit of account – UA (47 percent – Kshs. 30.52 billion) followed by the EURO and the USD. Nevertheless, over 90 percent of the loans signed during this period will be repaid in Euro. All factors held constant, this could indicate increased exposure to currency variations (as the loans were contracted in UA but repaid in Euros), increased interest payments, and refinancing expenditures given that the exchange rate is Kshs. 153.66 per Euro compared to Kshs. 140.43 per dollar, as of June 29, 2023.

4.4. In the review of the report, the following is noted:

i. The report did not adhere fully to the reporting requirements under the PFM Act. That is, it did not provide information related to: statements of loan balances carried down; drawings and amortization of new foreign loans, or information on all loans made to the national government, national government entities, and county governments.

ii. There was no information in the submitted report indicating the disbursement rate per loan.

iii. The loan amounts accrued during this period will fall due from 2025 through 2051;

iv. There are certain financial terms that might hide the true cost of a loan. Such terms include: lending margins, commitment fees, front-end fees, maturity premium, service fees, and commitment charges among others.

v. The information provided is not specific, that is, it does not provide details such as projects, outputs, activities, and implementation period (single or multiple-year projects).

vi. Variation of the use of currencies is noted for certain loans. This is indicated by loan contracts that have different currencies during loan acquisition and repayment. This requires prudence to prevent the increase of debt servicing expenditures owing to exchange rate depreciation.

4.5. Specific details of the loans are as follows:

a. East Africa's centers of excellence for skills and tertiary education in biomedical sciences – Phase 1 (Additional Financing)

4.6. The loan, amounting to Kshs. 2.56 billion or UA 14 million, was signed on 5th April 2023 between the Government of Kenya and the African Development Fund (ADF). It is intended to contribute to the development of a relevant and highly skilled workforce in biomedical sciences to meet the East African Community (EAC) immediate labour market needs and support the implementation of the EAC's free labour market protocols.

4.7. The loan will be repaid in 30 equal semi-annual repayments of EUR 343.6 thousand from 1st September 2029 through 1st March 2054. The Interest rate of the loan is 1 percent per annum and the service charge is 0.75 percent per annum on disbursed loan balance. The commitment charge rate is 0.5 percent per annum on the undisbursed loan balance.

b. Olkaria I & IV Uprating Geothermal Project

4.8. The loan, valued at Kshs. 6.71 billion (EUR 45 Million), is intended to finance the upgrading of the geothermal power plant Olkaria I & IV. It was signed on 28th February 2023 between the Government of the Federal Republic of Germany as the lender and the Government of Kenya as the borrower. The loan will be repaid in twenty (20) instalments of EUR 2.14 million from 15th December 2027 through to 15th June 2037 and one (1) instalment of EUR 2.14 on 15th December 2037.

4.9. The interest rate of the loan is 6 months Euribor plus a margin of 0.25 percent per annum. The commitment charge rate is 0.25 percent per annum on undisbursed loan amounts. Further, there is a one-time lumpsum management fee of 0.50 percent of the loan amount.

c. Syndicated Term Loan Facility the parties to the loan

4.10. The loan was signed on 5th April 2023, valued at Kshs. 27.57 billion. This is broken down into USD 100 Million for facility B and EUR 93 million for facility C. It was signed between the Government of Kenya and Citibank, N.A. (London Branch); Rand Merchant Bank (a division of FirstRand Bank Limited - London Branch); the Standard Bank of South Africa Limited; and the Standard Chartered Bank.

4.11. The facility B loan will be repaid in six (6) equal monthly instalments of USD 16.67 million from 15th April 2025 through to 15th October 2027. Facility C will be repaid in 6 equal monthly instalments of EUR 15.5 million from 15th April 2025 through to 15th October 2027. The interest rate for both facilities is a margin of 5.4 percent per annum plus a term reference rate on the disbursed loan balance. The borrower is required to pay an up-front fee and agency fee in the amount and the times agreed in a fee letter.

4.12. Even though the report indicates that the loan is intended to fund the development project as well as any fees, costs, and expenses incurred in connection with the finance documents, a breakdown of the specific expenditures to be incurred is not provided, including their expected economic or financial impact.

d. Multinational Horn of Africa Isiolo - Mandera Corridor: EL WAK - Rhamu Road Upgrading Project – Kshs. 9.65 billion

4.13. The loan was signed on 9th May 2022 between the African Development Bank and the Government of Kenya. The loan was intended to improve road transport and trade along the Isiolo - Mandera corridor by reducing travel time and vehicle operational costs and to improve road traffic safety along the road.

4.14. The amount of the loan is UA 64.66 million or approximately Kshs. 9.65 billion. It will be repaid in 34 equal semi-annual installments of EUR 1.9 million from 15th May 2030 to 15 November 2046. The interest payable on the disbursed loan balance shall be a percentage rate per annum to the sum of: the Floating base rate; lending margin; funding cost margin; and maturity Premium twenty (basis) points per annum. The commitment charge rate is 0.25 percent per annum on the undisbursed loan balance. In addition, there is a front-end fee on the loan amount at a rate equal to 0.25 percent of the loan.

e. Multinational Horn of Africa Isiolo - Mandera Corridor: EL WAK - Rhamu Road Upgrading Project – Kshs. 18.31 billion

4.15. The loan was signed on 9th May 2022 between the African Development Fund and the government of Kenya and is worth UA 100 Million or approximately Kshs. 18.32 billion. It will be repaid in 50 equal semi-annual installments of EUR Kshs. 2.45 Million from 15th May 2027 to 15th November 2051. The interest rate of the loan is 1 percent per annum on the disbursed loan balance and a service charge of the loan is 0.75 percent per annum on the disbursed loan balance. The commitment charge rate is 0.5 percent per annum on the undisbursed loan balance.

4.16. The loan was intended for the improvement of transport and trade along the Isiolo - Mandera corridor by reducing travel time, vehicle operational costs, and road traffic safety.

5. Submissions by the National Treasury

In their submission, the Committee was informed that:

5.1. The report on new loans is aligned with the requirements of Section 31 of the Public Finance Management Act, 2012. Further information relating to project-level reporting such as performance indicators, output targets, and specific activities are contained under regular Monitoring and Evaluation Reports by the State Department for Economic Planning.

5.2. Project appraisals are generated by line ministries and submitted to the Cabinet for approval before sourcing for financing by the National Treasury. Furthermore, the statutory reporting under Section 31(3) of the PFM Act does not require the submission of project appraisal reports to Parliament. The reports may be supplied by implementing MDAs who own the reports.

5.3. No county government has contracted any loans since the enactment of the PFM Act, 2012. Furthermore, it was noted that any borrowing by county governments would require the guarantee of the National Government and therefore the approval of the National Assembly.

5.4. The non-performing loans relate to on-lent loans to National Government entities that are facing financial challenges and are unable to continue servicing their debts. On-lent loans are considered assets to the National Government and not liabilities as they are repaid back to the Government.

5.5. Every four months, the National Treasury submits a report on new loans to Parliament. However, further information may be obtained from the Quarterly Economic and Budget Review, Annual Debt Management Report, the Budget Review and Outlook Paper, and the Budget Policy Statement.

5.6. Disbursement of a loan is dependent on the fulfillment of set conditions by the implementing agencies

5.7. Export Credit Agencies (ECA) are private or quasi-governmental institutions that act as intermediaries between national governments and exporters to issue export financing. This can take the form of credits (financial support) or credit insurance and guarantees (pure cover) or both, depending on the mandate the ECA is given by the Government. ECAs examples include: ES-EXIM Bank, JBIC of Japan, EULER HERMES of Germany, EDC of Canada, and EXIM China. Examples of projects include the Standard Gauge Railway whose financier is the Exim Bank of China, the guarantee provider is *Sinosure* (ECA)) and the government is the borrower.

5.8. Charges on loans vary from lender to lender based on the lending policy. Most lenders charge various fees as part of the loan cost, in addition to interest charges and principal repayments such as lending margins, and charge fees as part of their lending policy.

Other lenders also charge one-off front-end fees while commitment fees are charged on the un-disbursed portion of the loans.

5.9. Commercial loans or budget support loans are disbursed in full after conditions precedent are met while other loans are disbursed over a given period based on project implementation.

5.10. The reporting cycle is not consistent with the fiscal year associated with other government documents due to the timing of the start of the reporting on new loans. In addition, the signing of loans can take place at any time within the fiscal year but the disbursement of the loans can only take place if the loan is included in the budget estimates.

6. Submissions by the Controller of Budget

During the engagement, the Committee was informed that;

6.1. Most loans signed during this period have a grace period which alleviates the pressure on servicing the loans in the short term. However, once this period elapses, the payments all fall due at the same time. This will put more pressure on loan servicing at that time as other older loans are also being serviced. Most of the loan payment start date is FY 2027/28, and this is also the year the country will be conducting the next general elections.

6.2. The loans signed during these periods need to have their functions clearly defined. There is ambiguity in the program being financed and consequently, monitoring, evaluating, and auditing the programs will be complex.

6.3. Some loans are signed on behalf of profitable semi-autonomous government agencies. The National Treasury should not enter into loan agreements on behalf of these entities but provide a guarantee to enable the agencies to access additional financing and reduce debt servicing expenditures as the entities themselves will be liable for debt servicing.

The Controller of Budget made the following recommendations:

6.4. Loans signed on behalf of other agencies that generate revenue should be guaranteed loans, and the National Treasury should ensure that these agencies pay off these loans.

6.5. The Public Debt Management Office should ensure that they have cash flow projections that will enhance the planning of new loan negotiations and payments of both existing and new loans signed.

6.6. Robust project planning with clear timelines and detailed cost estimates will reduce the risk of delays loan in disbursement. The Government should invest in project preparation facilities to ensure that projects are ready for financing before sourcing funding.

6.7. There is a need to consistently develop the capacity and expertise of the government's financial and technical teams to facilitate favorable loan negotiating by mapping specific projects to relevant financing types. For example, social projects should solely be financed through highly concessional loans, while commercial projects that generate income can be funded using commercial loans.

6.8. Enhancing transparency and governance through a transparent and accountable system is critical in building trust with lenders. Lender confidence directly impacts the perceived risk and subsequent cost of lending.

6.9. Regularly communicating and coordinating with lenders can help understand their requirements and concerns. This will foster a stronger relationship and facilitate smoother loan disbursements.

6.10. The national government should develop a comprehensive risk assessment and mitigation plan to reassure lenders about potential challenges and how they will be addressed.

6.11. The government should leverage technology through implementing digital solutions for financial transactions, monitoring, and reporting. This can streamline processes, reduce paperwork, and improve efficiency.

7. Committee Observations

In view of the above, the Committee observed the following:

7.1. The submitted reports lack project-specific information required to guide policymaking and oversight, which indicates low levels of transparency and accountability. In addition, adherence to Section 31 of the PFM Act, 2012 should have been guided by reporting under the Program Based Budgeting model and should indicate the implementing Agencies, Key Performance Indicators (KPIs), output targets, and activities, among other factors. If provided, this information will promote public finance decision-making capacity by the National Assembly.

7.2. As per the reports, only three (3) loans totaling Kshs. 24.2 billion, primarily commercial loans, had been partially disbursed thus indicating an estimated disbursement rate of 11 percent. This indicated that 89% of the loan resources, despite being signed for, remained under the accounts of the creditors by the time the reports were submitted to the National Assembly. It is noted that timely and full disbursement of loans is critical in not only enhancing project finance but also addressing the ongoing liquidity and foreign exchange imbalances.

7.3. Non-disbursement or partial disbursement of funds in the reports indicates a general inability to efficiently use concessional financing which is critical for projects with low repaying capacity (e.g., social/climate change projects) but contribute to economic development;

7.4. A number of projects (unknown as project-specific information is not provided not attached to the reports) would be affected due to non-disbursement or low disbursement of loans. This could affect the absorption rate of loans contracted alongside the increased probability of incurring commitment fees;

7.5. There was no follow-up report on the disbursement of loans nor any information on loans brought forward, carried down, and drawings from one quarter to another. This made it impossible to ascertain whether the loans contracted were eventually disbursed or not;

7.6. Submission of reports to Parliament did not follow the fiscal year reporting cycle (quarterly) adhered to by other reports under Kenya's Public Finance Management Framework. This misalignment distorted the tracking of reported loans and their disbursement. In addition, loan reporting should be linked to the financing of the fiscal deficit of a particular year, in line with that year's sector working groups financing requirements.

7.7. There is partial adherence to Section 31(1) of the PFM Act 2012, which mandates the Cabinet Secretary to submit to Parliament, every four months, a report of all loans made to the national government, national government entities, and county governments. This has not been adhered to as the reports submitted to Parliament only contain information on External loans and lack details on domestic loans and borrowing by government entities. Notably, the Controller of Budget Report indicated that as of June 2022, there were Kshs. 218.8 billion in non-performing loans charged against various government entities.

7.8. There is partial adherence to Section 31(3) of the PFM Act 2012. The reports do not provide information on the loan balances brought forward, carried down, drawings, and amortizations on new loans obtained from outside Kenya. As such, the Committee could not determine the disbursement rate and the overall impact of the new loans contracted on the overall stock of debt;

7.9. There was no information provided on project appraisal, evaluation of the sustainability of the projects, and the capacity to generate financial or economic returns to repay the loans;

7.10. There was no information provided on the use of the Central Bank overdraft facility or the use of Export Credit Agencies (ECA) indicating the possibility of contingent liability exposure; and,

7.11. In this regard, the committee noted that reforms relating to public debt management have lagged behind even as strides are made in other areas of public finance management such as through enhanced procedures for revenue collection and expenditure determination. Major gaps are still prevalent in the legal framework relating to reporting, transparency, and accountability in loan acquisition and efficient use of the same.

8. Committee Recommendations

In view of the above, the Committee recommends that:

8.1. Subsequent reports to be submitted by the National Treasury should ensure full compliance with Section 31 (1) & (3) of the PFM Act, 2012. In particular, the National Treasury should ensure that the reports indicate all loans made to the national government, national government entities, and county governments, as well as loan balances brought forward, carried down, drawings, and amortizations on new loans.

8.2. The quarterly reports, referred to under Sections 31(1) and 31(3) are part of the financial statements referred to under the Public Finance Management Act, 2012. As such, they should follow the fiscal year calendar cycle, which is adhered to by other PFM documents. The two reports referred to under Section 31 of the PFM Act 2012 should therefore be guided by the following deadlines:

v. Quarter one (July - September) Report – The deadline for submission is 14 days after the end of the quarter;

vi. Quarter two (October - December) Report – The deadline for submission is 14 days after the end of the quarter;

vii. Quarter three (January - March) Report – The deadline for submission is 14 days after the end of the quarter; and

viii. Quarter Four (April - June) Report – The deadline for submission is 14 days after the end of the quarter.

8.3. In addition to the PFM Act 2012 provisions, the reports indicated above should also include information related to:

iii. Report on the use of Export Credit Agencies (ECA) and respective contingent liability exposure. This will include contracts signed, expected benefits to the country, and any guarantee offered should be subject to the approval of Parliament; and

iv. Report on the use of the Central Bank overdraft facility.

8.4. Quarterly reporting on project/program loans should be guided by Program Based Budgeting principles (to indicate Implementing Agencies, Key Performance Indicators (KPIs), output targets, the activities) and the respective project valuation, appraisal, and assessment reports should be attached;

8.5. In order to facilitate oversight of debt and to promote transparency and accountability of loan contracts entered into, the National Treasury should attach the contracts signed against each submitted report and should not enter into any contract that does not adhere to principles of Public Finance as set under Article 201 of the Constitution;

8.6. As from the date of adoption of this report, the National Treasury should prioritize the sourcing and disbursement of concessional finance. Concessional finance contains a grant element, implying that larger borrowing can be sourced with minimum impact on debt sustainability by reducing the refinancing and interest rate risk;

8.7. A review of the sectors financed by loans borrowed during this period indicates that they targeted sectors with greater social returns but minimum financial returns. External borrowing should be driven by financing requirements for sectors or development projects that promote export-driven production in order to address forex exchange imbalances;

8.8. The National Treasury should address factors that affect timely and full disbursement of loan financing and submit a report to the National Assembly, within 60 days of the adoption of this report, indicating actions taken to increase the efficient disbursement of loan financing;

8.9. Not later than thirty (30) days after the end of each financial year, Ministries, State Departments, and Implementing Agencies (MDAs) responsible for the projects for which loans have been obtained, should submit a report to the National Assembly indicating measures taken to ensure timely and full disbursement of all the loans in their purview. These reports should be considered by the Public Debt and Privatization Committee and a report should be submitted to the House within thirty (30) days;

8.10. Within ninety (90) days, the National Treasury should fully digitalize the loan approval and monitoring system to enhance reporting, transparency, and accountability. This should also include training of technical personnel and the establishment of a system that is accessible to other public finance management institutions such as the Central Bank of Kenya, the Office of the Controller of Budget, and the Office of the Auditor General;

8.11. As from FY 2024/25, at the end of the Sector Working Group engagement, the National Treasury should submit to the National Assembly a report containing the list of potential projects for which loan financing will be contracted, the potential creditors, and the respective loan terms. This report should also indicate timelines for project valuation, appraisal, and assessment; and,

8.12. Arising from 8.11 above, a final list of projects to be financed through borrowing should be submitted, to the National Assembly, alongside the annual Medium Term Debt Management Strategy. The list should be reconcilable with the development budget and the fiscal deficit.

SIGNED

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HON. ABDI SHURIE, MP.
CHAIRPERSON, PUBLIC DEBT & PRIVATIZATION COMMITTEE

25/9/2023

DATE

THE NATIONAL ASSEMBLY

DATE: 28 SEP 2023

TABLED BY