REPUBLIC OF KENYA

HARAMBEE

NATIONAL ASSEMBLY

ELEVENTH PARLIAMENT – FIFTH SESSION

DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE

REPORT ON THE CONSIDERATION OF THE SESSIONAL PAPER NO.3 OF 2017 ON THE GOVERNMENT GUARANTEE OF USD 750 MILLION (EQUIVALENT TO KES 77.48 BILLION) IN SUPPORT OF THE RESTRUCTURING OF KENYA AIRWAYS

DIRECTORATE OF COMMITTEE SERVICES
CLERKS CHAMBERS
PARLIAMENT BUILDINGS
NAIROBI

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ABBREVIATIONS

NPV	-	Net present Value
GDP	-	Growth Domestic Product
KQ	-	Kenya Airways
GoK	-	Government of Kenya
PFMA	-	Public Finance Management Act

CHAIRPERSON'S FOREWORD

On Wednesday 7th June 2017 the Leader of the Majority Party tabled Sessional Paper No 3 of 2017 on the Government Guarantee of USD 750 million (equivalent to KES 77 48 billion) in support of restructuring of Kenya Airways He further gave a Notice of Motion that the House approves the guarantee Thereafter, the Sessional Paper was committed to the Departmental Committee on Finance, Planning & Trade for consideration and report to the House, Pursuant to Section 58 of the Public Finance Management Act of 2012

The Committee met with the Cabinet Secretary for the National Treasury and a team from Kenya Airways for a briefing session on two occasions to apprise the Committee on the contents of the Sessional Paper From these meetings, the Committee observed that the Kenya Airways PLC was a viable business entity that could be turned around and that there were positive signs that decisions made in the last eighteen months regarding restructuring of the airline had begun to bear fruits

The Committee also observed that Kenya Airways found itself in financial problems due to bad managerial decisions that were made on commercial and financial matters especially during the fleet expansion programme dabbed "project Mawingu". To return to profitability, the national carrier had engaged the services of a consultant who has since developed a restructuring model that would require Government guaranteeing Remedial USD 750 million The Committee noted that though heavily indebted, the national carrier's brand beneficial to the country hence the need for financial intervention by the Government The Committee therefore recommends that the National Assembly approves the requested guarantee to help the airline turn around its fortunes to profitability

The Committee appreciates the assistance provided by the Office of the Speaker and the Clerk of the National Assembly that enabled it to discharge its mandate during the consideration of this Sessional Paper I further wish to express my appreciation to the Members of the Committee who dedicated their time to participate in the activities of the Committee and preparation of this Report It is therefore my pleasant duty and privilege, on behalf of the Departmental Committee on Finance, Planning & Trade, to table its Report on the consideration of Sessional Paper No 3 of 2017 for consideration and adoption by the House in accordance with the provisions of Section 58 of the Public Finance Management Act, 2012

EXECUTIVE SUMMARY

This report contains the Committee's proceedings on the consideration of Sessional Paper No.3 of 2017 on the Government guarantee of USD 750 million (equivalent to KES 77.48 billion) in support of restructuring of Kenya Airways The Committee met officials from the National Treasury and the Kenya Airways (KQ) on 10^{th} and 13^{th} June 2017 The Committee observed the following from the deliberations on the Sessional Paper:

1 That KQ was heavily indebted a point where it may not be able to meet its financial obligations,

2 That KQ found itself in the current financial problems due to bad commercial decisions that were made by the management

3 That in the last eighteen months, the airline had been developed turn around strategies, some of which had already been implemented especially in the change of management and sale of non- core assets

4 That KQ was a viable business entity that could be profitable in the next three to five years if restructured

5 That the carrier required the government to guarantee its loans to a tune of KES 77 48 billion

6 That after restructuring, the government share- holding would be between 43% and 48%, retaining its status as the majority shareholder Currently, the Government has 29.8% share- holding

7 That other shareholders like KLM were willing to inject cash in kind such as IT systems training and provision of parking space It is estimated that KLM's shareholding after restructuring would be between 8% and 9% as compared to its current shareholding of 26%

8 That as drafted, the Sessional Paper complies with the PFMA requirement for the Government to guarantee KQ the USD 750 million

1.1 MANDATE OF THE COMMITTEE

The Committee on Finance, Planning & Trade is one of the Departmental Committees of the National Assembly established under Standing Order 216 and mandated

(a) to investigate, inquire into, and report on all matters relating to the mandate, management, activities, administration, operations and estimates of the assigned ministries and departments,

(b) to study the programme and policy objectives of ministries and departments and the effectiveness of the implementation,

(c) to study and review all legislation referred to it,

(d) to study, assess and analyse the relative success of the ministries and departments as measured by the results obtained as compared with their stated objectives,

(e) to investigate and inquire into all matters relating to the assigned ministries and departments as they may deem necessary and as may be referred to them by the House;

(f) to vet and report on all appointments where the Constitution or any law requires the National Assembly to approve, except those under Standing Order 204 (*Committee on Appointments*), and

(g) make reports and recommendations to the House as often as possible, including recommendation of proposed legislation

The Committee is mandated to consider subject matters relating to public finance, monetary policies, public debt, financial institutions, investment and divestiture policies, pricing policies, banking, insurance, population, revenue policies, planning, national development, trade, tourism promotion and management, commerce and industry (growth of the industries in Kenya especially the small businesses)

1.2 COMMITTEE MEMBERSHIP

Chairman	The Hon Benjamin Langat, MP
Vice Chairman	The Hon Nelson Gaichuhie, MP
	The Hon. Dr Oburu Oginga, MP
	The Hon Jimmy Nuru Angwenyi, MP
	The Hon Eng Shadrack Manga, MP
	The Hon Ahmed Shakeel Shabbir Ahmed, MP
	The Hon Alfred W Sambu, MP
	The Hon Sammy Koech, MP
	The Hon Sammy Mwaita, MP
	The Hon Tiras N Ngahu, MP
	The Hon. Abdul Rahim Dawood, MP
	The Hon. Abdullswamad Sheriff, MP
	The Hon Anyanga Andrew Toboso, MP
	The Hon Daniel E Nanok, MP
	The Hon Dennis Waweru, MP
	The Hon Hezron Awiti Bolo, MP
	The Hon Joash Olum, MP
	The Hon Jones M Mlolwa, MP
	The Hon. Joseph Limo, MP
	The Hon Kirwa Stephen Bitok, MP
	The Hon Lati Lelelit, MP
	The Hon. Mary Emase, MP
	The Hon Ogendo Rose Nyamunga, MP
	The Hon Patrick Makau King'ola, MP
	The Hon Ronald Tonui, MP
	The Hon Sakaja Johnson, MP
	The Hon Sakwa John Bunyasi, MP
	The Hon Sumra Irshadali, MP

1.3 COMMITTEE SECRETARIAT

First Clerk Assistant	-	Evans Oanda
Third Clerk Assistant	-	Nicodemus Maluki
Third Clerk Assistant	-	Fredrick Otieno
Legal Counsel II	-	Emma Esendi
Research Officer III	-	Sharon Rotino

1.4 RECOMMENDATION

Pursuant to Section 58(1) of the Public Finance Management Act, 2012, the Committee recommends that

a) The National Assembly approves Sessional Paper No 3 of 2017 on Government guarantee of USD 750 Million (equivalent of KES 77 48 billion) in support of restructuring of Kenya Airways

b) The National Treasury should report to the National Assembly semiannually on the performance of Kenya Airways PLC with a clear status of the airline's loan portfolio

2.0 BACKGROUND INFORMATION

2.1 Presentation of the Sessional Paper

The Sessional Paper No. 3 of 2017 was developed and presented to the National Assembly by the Cabinet Secretary for the National Treasury. It was tabled in the House by the Leader of the Majority Party on 7th June 2017 and thereafter committed to the Departmental Committee on Finance, Planning & Trade for consideration pursuant to Section 58 of the Public Finance Management Act of 2012.

2.2 Legal provisions

The requirements to be met whenever a government guarantees an entity are provided for in Section 58(1) of the Public Finance Management Act of 2012. The said section provides as follows:

> **58. Power of the Cabinet Secretary to guarantee loans**
>
> (1) Subject to subsection (2), the Cabinet Secretary may guarantee a loan of a county government or any other borrower on behalf of the national government and that loan shall be approved by Parliament.
>
> (2) The Cabinet Secretary shall not guarantee a loan under subsection (1) unless—
>
> (a) the loan is for a capital project;
>
> (b) the borrower is capable of repaying the loan, and paying any interest or other amount payable in respect of it;
>
> (c) in the case of a private borrower; there is sufficient security for the loan;
>
> (d) the financial position of the borrower over the medium term is likely to be satisfactory;
>
> (e) the terms of the guarantee comply with the fiscal responsibility principles and financial objectives of the national government;
>
> (f) where Parliament has passed a resolution setting a limit for the purposes of this section—
>
> (i) the amount guaranteed does not exceed that limit; or
>
> (ii) if it exceeds that limit, the draft guarantee document has been approved by resolution of both Houses of Parliament;
>
> (g) the Cabinet Secretary takes into account the equity between the national government's interests and the county government's interests so as to ensure fairness;
>
> (h) the borrower complies with any conditions imposed by the Cabinet Secretary in accordance with the regulations;

(i) the Cabinet Secretary has taken into account the recommendation of the Intergovernmental Budget and Economic Council in respect of any guarantee to a county government, and

(j) the loan is made in accordance with provisions of this Act and any regulations made thereunder

(3) Parliament may approve a draft loan guarantee document as provided by subsection (2)(f)(ii) only if satisfied that –

(a) the guarantee is in the public interest,

(b) the borrower's financial position is strong enough to enable the borrower to repay the loan proposed to be guaranteed and to pay interest or other amounts payable in respect of the loan, and

(c) the loan is geared towards stimulating economic growth in a county government

(4) To enable Parliament to decide whether or not to approve a draft loan guarantee document as provided by subsection (3), the Cabinet Secretary shall prepare and submit to each of the House of Parliament a paper that --

(a) gives details of the loan that is proposed to be guaranteed, including the amount of the loan, the terms of repayment, and the details of the interest or any other amount payable under the loan;

(b) specifies the national government's total contingent liability under guarantees given under this section, and

(c) specifies any other information that the Cabinet Secretary considers relevant

2.3 Sessional Paper No. 3 of 2017

In a summary, the Sessional Paper contains the following information

1 That the current government of Kenya's shareholding is 29 8% which is expected to rise to between 43% and 48% on conversion of USD 243 million debt after restructuring KLM, which has current shareholding of 26%, is expected to have between 8% and 9% after restructuring

2 KQ business has grown significantly over the last 15 years with the highest growth being recorded between the years 2011 and 2015 During the period, its aircraft fleet increased from 32 to 45 The purchase of these planes was however financed through loans obtained from the Citibank N A , JP Morgan Chase Bank N A through a special purpose vehicle christened Tsavo Aircraft Financing LLC, a Delaware limited liability company, as the lessor The loans were guaranteed by the Export-Import Bank of the United States (US

Exim), an official export credit agency of the Unites States. Several local banks also provided short term facilities to the KQ in order to finance pre-delivery payments of the planes.

3. Due to change in market dynamics in 2012, the airline started experiencing down turn in its profits that culminated into huge loans in the years that followed. This called for a financial restructuring that begun in earnest in 2015.

4. Under the proposed financial restructuring, the Government of Kenya (GoK) would convert its debt of US$243 million plus accrued interest to equity. GoK would also provide a guarantee amounting to US$750 million to cover both US Exim and the participating local banks to the tune of US$525 million and US$225 million, respectively. These guarantees are a contingent liability required to secure financing that would ensure that KQ has the ability to continue to operate and maintain certain capital assets, principally aircraft, which are critical to the operation of the airline. The guarantees avoid any cash bailout and consequential request from all stakeholders to receive cash. GoK would receive additional shares in KQ in consideration for providing the guarantees.

5. Once KQ is restructured and back to financial stability, it would be able to meet its financial obligations and mitigate GoK risk on the guarantees.

6. The current total contingent liabilities of the Government of Kenya in respect to the Public Financial Management Act, 2012 (PFMA) section 58(2)(f) amount to KShs 57.68 billion and with the proposed guarantee of the sum equivalent to KShs 77.48 billion the aggregate amount would be KShs 135.16 billion. Including the KShs 77.48 billion guarantee, the net present value of national public debt to GDP ratio would be 47.8% (the ratio is 46.9% before taking into account the guarantee). This is, therefore, within the debt limit.

7. The National Assembly is requested to approve the Government Guarantees amounting to USD750 million (equivalent to KShs 77.48 billion) as follows:

(i) A guarantee of USD 525 million to US Exim Bank in order to secure the restructured financing on certain capital assets (seven (7) aircraft and one (1) aircraft engine (six (6) Boeing 787-8 aircraft, one (1) Boeing 777-300ER aircraft and one (1) General Electric GEnx-1/B70/75 spare engine) to ensure their continued use, operation, and maintenance.

(ii) A guarantee of USD 225 million to local Kenyan banks in order to secure the financing for the continued use, operation and maintenance of capital assets, principally aircraft

3.0 MEETING WITH THE CABINET SECRETARY FOR THE NATIONAL TREASURY

On 14th June 2017, the Cabinet Secretary for the National Treasury, Mr Henry Rotich, appeared before the committee to brief the Committee on the contents of the Sessional Paper The Committee had earlier on 10th June 2017 met with a team from the National Treasury National Treasury and the Kenya Airways led by MS Esther Koimet and Mr Michael Joseph to consider the Paper. From the two meetings, the Committee observed that the Sessional Paper had met the requirements provided under Section 58 of the Public Finance Management Act of 2012 as itemized in the table below

	Relevant Section of the PFM Act, 2012	Has the Requirement been met? Justification
1.	**Section 58. Power of Cabinet Secretary to guarantee loans**	
	Subsection (1): Subject to subsection (2), the Cabinet Secretary may guarantee a loan of a county government **or any other borrower** on behalf of the national government and that loan shall be approved by Parliament	The borrower is **Kenya Airways PLC (KQ)**, a limited liability company It is a private borrower It is a government-linked corporation in accordance with the definition under section 91(a) of the PFM Act, 2012
	Subsection (2): The Cabinet Secretary shall not guarantee a loan under subsection (1) unless-	
	(a) the loan is for a capital project,	The guarantee will secure loans procured for the purchase of aircraft, which are long-lived capital assets ((seven (7) aircraft and one (1) aircraft engine (six (6) Boeing 787-8 aircraft, one (1) Boeing 777-300ER aircraft and one (1) General Electric GEnx-1/B70/75 spare engine) and (i) pre-delivery payments for some of the aircraft and (ii) the capital

		expenditure required for the long-term operation and maintenance of the aircraft fleet)
	(b) the borrower is capable of repaying the loan, and paying any interest or other amount payable in respect of it;	Once the balance sheet restructuring is fully implemented, Kenya Airways will be able to meet its obligations. It has been determined that there is a business case, as well as an economic case, for GoK to support KQ restructuring and provide the requisite guarantees. Indeed, implementation of the operations component of the turnaround plan is already bearing fruit, with KQ posting progressively improved results.
	(c) in the case of a private borrower, there is sufficient security for the loan;	The obligations that GoK is guaranteeing are ultimately secured by the aircraft and other assets of the company.
	(d) the financial position of the borrower over the medium term is likely to be satisfactory;	The restructuring is designed to create a viable business. It has been determined that there is a business case, as well as an economic case, for a restructured KQ. Indeed, implementation of the operations component of the turnaround plan is already bearing fruit, with KQ posting progressively improved results.

	(e) the terms of the guarantee comply with the fiscal responsibility principles and financial objectives of the national government. **(Fiscal Responsibilities under Section 15 of the PFM Act, 2012)** **<u>Subsection</u>** (2) In managing the national government's public finances, the National Treasury shall enforce the following fiscal responsibility principles—	
	(a) over the medium term a minimum of thirty percent of the national and county governments budget shall be allocated to the development expenditure.	The guarantee is a contingent liability and does involve any revenue transfers.
	(b) the national government's expenditure on wages and benefits for its public officers shall not exceed a percentage of the national government revenue as prescribed by regulations;	Not applicable in the context of the guarantee sought.

		(c) over the medium term, the national government's borrowings shall be used only for the purpose of financing development expenditure and not for recurrent expenditure,	The guarantee will secure loans procured for the purchase of aircraft, which are long-lived capital assets ((seven (7) aircraft and one (1) aircraft engine (six (6) Boeing 787-8 aircraft, one (1) Boeing 777-300ER aircraft and one (1) General Electric GEnx-1/B70/75 spare engine) and (i) pre-delivery payments for some of the aircraft and (ii) the capital expenditure required for the long-term operation and maintenance of the aircraft fleet)
		(d) public debt and obligations shall be maintained at a sustainable level as approved by Parliament for the national government and the county assembly for county government,	The guarantee is within the limit set by Parliament Regulation 26(1)(c) of the PFMA regulations specifies that the national public debt shall not exceed 50 percent of Gross Domestic Product (GDP) in net present value terms Including the KShs 77.48 billion guarantee, the net present value national public debt to GDP ratio will be 47 8% (the ratio is 46 9% before taking into account the guarantee)
		(e) fiscal risks shall be managed prudently, and	The guarantee ensures that there is no cash outflow and the KQ restructuring is designed to create a viable business that enables KQ to play its important role in the economy
		(f) a reasonable degree of predictability with respect to the level of tax rates and tax bases shall be maintained, taking into account any tax reforms that may be made in the future	Not applicable

	(3) For the purposes of subsection (2)(c), short term borrowing shall be restricted to management of cash flows and in case of a bank overdraft facility it shall not exceed five per cent of the most recent audited national government revenue.	The guarantee is a contingent liability and does not involve any cash outflow.
	(4) The National Treasury shall ensure that the level of National Debt does not exceed the level specified annually in the medium term national government debt management strategy submitted to Parliament.	The guarantee is within the limit set by Parliament. Regulation 26(1)(c) of the PFMA regulations specifies that the national public debt shall not exceed 50 percent of Gross Domestic Product (GDP) in net present value terms. Including the KShs 77.48 billion guarantee, the net present value national public debt to GDP ratio will be 47.8% (the ratio is 46.9% before taking into account the guarantee).
	(5) Regulations made under this Act may add to the list of fiscal principles set out in subsection (2).	The Regulations under PFM Act, 2012 have been complied with.
	(f) where Parliament has passed a resolution setting a limit for the purposes of this section— (i) the amount guaranteed does not exceed that limit; or (ii) if it exceeds that limit, the draft guarantee document has been approved by resolution of both Houses of Parliament.	The guarantee is within the limit set by Parliament. Regulation 26(1)(c) of the PFMA regulations specifies that the national public debt shall not exceed 50 percent of Gross Domestic Product (GDP) in net present value terms. Including the KShs 77.48 billion guarantee, the net present value national public debt to GDP ratio will be 47.8% (the ratio is 46.9% before taking into account the guarantee). Not applicable, as the limit will not be exceeded.

	(g) the Cabinet Secretary takes into account the equity between the national government's interests and the county government's interests so as to ensure fairness;	Not applicable, as KQ is a private borrower.
	(h) the borrower complies with any conditions imposed by the Cabinet Secretary in accordance with the regulations;	The Guarantee Agreement provides certain compliance and reporting conditions for KQ to the Cabinet Secretary on a periodic basis.
	(i) the Cabinet Secretary has taken into account the recommendation of the Intergovernmental Budget and Economic Council in respect of any guarantee to a county government; and	Not applicable, as this is a not a guarantee to a county government but to a private borrower.
	(j) the loan is made in accordance with provisions of this Act and any regulations made thereunder.	The loan is in compliance with the Act
	Subsection (3): Parliament may approve a draft loan guarantee document as provided by subsection (2)(f)(ii) only if satisfied that—	
	(a) the guarantee is in the public interest; (b) the borrower's financial position is strong enough to enable the borrower to repay the loan proposed to be guaranteed and to pay interest or other amounts payable in respect of the loan; and (c) the loan is geared towards stimulating economic growth in a county government.	Subsection (3) is not applicable. Subsection (3) is founded on subsection 2(f)(ii), which is not applicable as the guarantee is within the limit.
	Subsection (4): To enable Parliament to decide whether or not to approve a draft loan guarantee document as provided by subsection (3), the Cabinet Secretary shall prepare and submit to each of the House of Parliament a paper that—	

	(a) gives details of the loan that is proposed to be guaranteed, including the amount of the loan, the terms of repayment, and the details of the interest or any other amount payable under the loan; (b) specifies the national government's total contingent liability under guarantees given under this section; and (c) specifies any other information that the Cabinet Secretary considers relevant	Not applicable. Subsection (3) is founded on subsection 2(f)(ii), which is not applicable as the guarantee is within the limit.
2.	**Regulation 202: Pursuant to the provisions of section 58 of the Act, the capital project expenditures of—**	
	(a) county governments for which a guarantee is requested, shall meet the following requirements— (i) the borrower shall demonstrate that the project could not be financed on reasonable terms and conditions without a government loan; (ii) provide the projected cash flow clearly setting out projected disbursement schedule and repayment plan; (iii) the borrower shall contribute a substantial portion of project funds from their own resources and in any case not less than fifteen (15) percent;	Not applicable, as Regulation 202(a) applies to county governments, whereas KQ is a private borrower.

	(iv) a national government entity or county government that defaults on a loan shall be put on an agreed financial recovery programme by the National Treasury; (v) it is a feasible project that has been approved by the national government entity or county government entity as may be required by national or county legislation; (vi) the application of the guarantee shall be submitted with a draft loan agreement; and (vii) any other guidelines consistent with the Act as may be gazetted by the Cabinet Secretary;	
	(b) national governments entities for which a guarantee is requested, shall meet the following requirements— (i) the national government entity shall demonstrate that the project could not be financed on reasonable terms and conditions without a loan; (ii) provide the projected cash flow clearly setting out a projected disbursement schedule and repayment plan; (iii) the national government entity shall contribute at least fifteen (15) percent of the project cost from their own resources; (iv) it is a feasible project that has been approved by the governing body as required under these Regulations;	Not applicable, as Regulation 202(b) applies to national government entities, whereas KQ is a private borrower.

	(v) concessionality of the proposed loan is fully evaluated by the national government and is determined to be at the acceptable level of grant element as per the borrowing strategy, (vi) satisfies all the fiscal responsibility principles set out in the Act and these Regulations, (vii) the National Treasury has confirmed that the lender is of good credibility and standing with the Government of Kenya, and (viii) any other guidelines as Cabinet Secretary to the National Treasury may prescribe in a government gazette	
3.	**Regulation 203.** Pursuant to the provisions of section 58(2)(a) of the Act, and in addition to provisions under regulation 202, the following procedures shall apply in relation to a national government entity	
	(a) before seeking a national government guarantee, the governing body of the national government entity shall approve the borrowing including its terms and conditions	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower However, it should be noted that the guarantee is for the purpose of restructuring existing loans and new facilities in support of the capital assets
	(b) after approval by the governing body, the Chief Executive Officer of the entity shall submit the proposed loan agreement and a sessional paper to the Cabinet Secretary responsible for the national government entity for approval of the borrowing, including its broad terms and conditions,	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower However, KQ has availed the financing agreements to GoK for which GoK is stepping in to provide the guarantees The Sessional Paper has been approved by the Cabinet and submitted to the National Assembly

	(c) upon approval under paragraph (b), the Chief Executive Officer shall submit the final draft loan financing agreement and the approval of the governing body and the Cabinet Secretary responsible for the entity to the Cabinet Secretary requesting for the guarantee of the final loan financing agreement;	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower.
	(d) the Cabinet Secretary may reject a request for loan guarantee with reasons and communicate the same to the concerned chief executive officer;	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower.
	(e) upon approval of a loan guarantee request, the Cabinet Secretary shall seek the legal opinion of the Attorney General.	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower. The Attorney General has continued to provide legal expertise and guidance as the guarantee agreements are being finalized.
	(f) upon receiving the views of the Attorney-General and taking them into account, the Cabinet Secretary to the National Treasury shall submit a sessional paper to Parliament with recommendations seeking its approval.	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower. However, the Sessional Paper has been approved by the Cabinet, and takes into account the views of the Attorney General. It is now before the National Assembly.
	(g) the Cabinet Secretary shall communicate the decision of Parliament on the draft loan guarantee to the respective chief executive officer; and	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower. However, this will be done once the National Assembly communicates its decision on the request for approval.

	(h) upon approval by Parliament the Cabinet Secretary to the National Treasury shall issue a loan guarantee.	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower. However, this will be done once approval is granted by the National Assembly.
4.	**Regulation 204.** Upon recommendation by the Cabinet Secretary to the National Treasury, Parliament may approve a draft loan guarantee document as provided under section 58(2)(f) of the Act, only if it is satisfied that—	
	(a) the guarantee is in the public interest;	The guarantee secures the survival and growth of Kenya Airways and the aviation sector in Kenya, which is critical to the Kenyan economy.
	(b) the borrowers financial position is strong enough to enable the borrower to repay the loan proposed to be guaranteed and to pay interest and other charges based on projected revenue streams;	The restructuring is designed to create a viable business that is able to meet its debt obligations
	(c) concessionality of the proposed loan is fully evaluated by the national and county governments and is determined to be at the acceptable level of grant element as per the borrowing strategy;	Not applicable
	(d) the loan investments are geared towards stimulating economic growth in a county government; and	Not applicable. However, the KQ restructuring is designed to create a viable business. It has been determined that there is a business case, as well as an economic case, for a restructured KQ. Indeed, implementation of the operations component of the turnaround plan is already bearing fruit, with KQ posting progressively improved results. It is critical that Government supports the restructuring efforts of Kenya Airways as there are significant benefits to the country. Kenya Airways, as a strong home-based carrier, is fully aligned with

		the government's ambition for Nairobi as an integrated regional hub, due to its geographically optimal location. Notably, a. The Government has made significant investment in developing and upgrading aviation infrastructure (e.g. airports, air navigation, etc.) to support the vision. b. The development of the KQ network, creating an efficient gateway to and from Nairobi, enhances Nairobi's attractiveness as an international centre of business and investment. Currently, there are in excess of 35 headquarters of international institutions based in the city. c. The development of the KQ network with its renewed focus on Africa creates all the gateways to and from Nairobi, making it an efficient aviation hub supporting the Vision 2030 objective to also make Nairobi a financial, as well as conference tourism, hub and increase the access to key tourism destinations. d. As a national carrier and a recognized African brand, KQ represents the country, and indeed the continent, in the global aviation industry. e. In other jurisdictions, airlines are at the centre of country positioning strategy. Indeed, the integrated regional hub strategy is strongly pursued by countries such as the Gulf States, Turkey, China and Ethiopia.
	(e) all legal issues relating to financial agreements, tripartite signing, and subsidiary agreements are fully addressed.	The Attorney General has continued to provide legal expertise and guidance as the guarantee agreements are being finalized.

4.0 COMMITTEE OBSERVATIONS

The Committee having considered the Sessional Paper, observed as follows:

4.1 Compliance with the PFMA requirements

The Sessional Paper met all the requirements set out in Section 58 of the Public Finance Management Act of 2012 and its regulations on power of the Cabinet Secretary to guarantee loans as well as Section 196 of the PFMA on adherence to the debt limit of 50% of GDP in NPV terms.

4.2 Kenya's debt stocks

The Kenya's total borrowing was fast approaching the set limit of 50% of GDP in Net Present Value (NPV) terms. Currently, the country's debt stock to GDP is 47.8% in Net Present Value (NPV) terms; which is KES 4.306 trillion in nominal terms against a total nominal GDP of KES 8.2 trillion for the end of 2017. If Kenya were to exhaust this limit, the country would not be able to borrow in the event of a shock. The status of Kenya's debt is itemized in the table below.

	Debt Category	**KES**	**% of GDP**
1.	Total Concessional Debt (Multilateral plus Bilateral Debt)	1,519,649,822,614.74	18.5%
2.	Discounted Concessional Debt	1,139,737,366,961.06	13.9%
3.	Commercial Banks Debt (Suppliers Credit plus Commercial Banks Debt plus International Sovereign Bond)	648,256,895,204.63	7.9%
4.	Kenya Airways Guarantee	77,475,000,000.00	0.9%
5.	Total Commercial Debt (3+4)	725,731,895,204.63	8.8%
6.	Total Domestic Debt as at 25th May 2017	2,060,809,161,974.76	25.1%
7.	Total Nominal Public Debt and Publicly Guaranteed Debt (1+5+6)	4,306,190,879,794.13	52.4%
8.	**Total Net Present Value of Public and Publicly Guaranteed Debt as a % of GDP (2+5+6) (see note 1)**	**3,926,278,424,140.45**	47.8%
9.	**Memo Item: Nominal GDP Estimate for end of 2017 –(see note 2)**	**8,210,193,368,244.45**	

Source: The National Treasury

4.3 Status of the previously guaranteed loans

The committee noted with concern that some of the entities that the government had guaranteed loans had defaulted meeting their obligations. As a result, the government was called upon to service those loans. Such guarantees are itemized in the table below:

Borrower	Quarter I		Quarter II		Quarter III		Cum. March 2017	
	Projected	Actual	Projected	Actual	Projected	Actual	Projected	Actual
EAPC	-	-	-	199	361	200	361	400
TARDA	156	164	-	-	134	158	290	321
KBC	-	-	361	366	26	17	387	383
Total	**156**	**164**	**361**	**565**	**520**	**375**	**1,038**	**1,103**

Source: Quarterly Economic & Budget Review March 2017

4.4 Kenya airway's shareholding

The current shareholding of KQ was as follows:

Organization / Individual	No. of Shares
Permanent Secretariat to the Treasury	445,920,557
Koninklijke Luchvaart Maatschappij (KLM) Royal Dutch Airlines	400,020,026
Standard Chartered Nominees LTD Non-Resident A/C KE11752	143,000,000
Mike Maina Kamau	64,398,940
Standard Chartered Nominees LTD A/C 9187	21,543,657
Vijay Kumar Ratilal Shah	15,328,400
Standard Chartered Nominees LTD A/C 9230	14,530,773
Standard Chartered Kenya Nominees LTD A/C KE002749	11,264,538
Galot International LTD	10,609,482
Ismail Gulamali	10,424,100
Other shareholders	359,428,562
Total	**1,496,469,035**

After restructuring, the shareholding of Kenya Airways was expected to be as follows:

	Shareholder	(%)
1.	Government of Kenya	43 - 48
2.	KLM	8-9
3.	Local Bank Trust	33-38
4.	Other Shareholders (including minority shareholders)	4-16

4.5 Inherent benefits of Kenya Airways to the country

Kenya Airways, as a strong home-based carrier, is fully aligned with the government's ambition for Nairobi as an integrated regional hub, due to its geographically optimal location. Notably, a The Government has made significant investment in developing and upgrading aviation infrastructure (e g airports, air navigation, etc) to support the vision

b The development of the KQ network, creating an efficient gateway to and from Nairobi, enhances Nairobi's attractiveness as an international centre of business and investment Currently, there are in excess of 35 headquarters of international institutions based in the city

c The development of the KQ network with its renewed focus on Africa creates all the gateways to and from Nairobi, making it an efficient aviation hub supporting the Vision 2030 objective to also make Nairobi a financial, as well as conference tourism, hub and increase the access to key tourism destinations

d As a national carrier and a recognized African brand, KQ represents the country, and indeed the continent, in the global aviation industry

e In other jurisdictions, airlines are at the centre of country positioning strategy Indeed, the integrated regional hub strategy is strongly pursued by countries such as the Gulf States, Turkey, China and Ethiopia

5.0 COMMITTEE RECOMMENDATION

Having considered Sessional Paper No.3 of 2017 on Government guarantee of USD 750 Million (equivalent of KES 77.48 billion) in support of restructuring of Kenya Airways, and pursuant to the provisions of Section 58 (1) of the Public Finance Management Act of 2012, the Committee recommends that:

c) The National Assembly approves Sessional Paper No.3 of 2017 on Government guarantee of USD 750 Million (equivalent of KES 77.48 billion) in support of restructuring of Kenya Airways.

d) The National Treasury should report to the National Assembly semiannually on the performance of Kenya Airways PLC with a clear status of the airline's loan portfolio.

Signed ....**Date** 15th June 2017

(HON. BENJAMIN LANGAT, C.B.S, M.P)

CHAIRPERSON, DEPARTMENTAL COMMITTEE ON FINANCE, PLANNING & TRADE

MEMORANDUM OF OBJECTS AND REASONS

The principal object of this Bill is to amend the Law of Contract Act, Cap. 23. It proposes to amend the law so that in case of a default by the principal borrower, the creditor should first realise the assets of the principal borrower before proceeding to realise the assets of the guarantor.

Clause 1 of the Bill provides for the short title.

Clause 2 of the Bill provides for the amendment to section 3 of the Act to provide that before a creditor pursues a guarantor in law, he should first realise the assets of the principal debtor.

Statement on the delegation of legislative powers and limitation of fundamental rights and freedoms
The Bill does not delegate legislative powers to the Cabinet Secretary. It does not limit fundamental rights and freedoms.

Statement that the Bill concerns county governments
The Bill does not affect the functions of the county governments and is therefore not a Bill concerning counties for purposes of the Standing Orders.

Statement that the Bill is a money Bill within the meaning of Article 114 of the Constitution
The enactment of this Bill shall not occasion additional expenditure of public funds.

Dated the ...., 2017.

Hon. Benjamin Langat
Member of Parliament.

Section 3 of the Law of Contract Act which it is proposed to amend-
Certain contracts to be in writing

(1) No suit shall be brought whereby to charge the defendant upon any special promise to answer for the debt, default or miscarriages of another person unless the agreement upon which such suit is brought, or some memorandum or note thereof, is in writing and signed by the party to be charged therewith or some other person thereunto by him lawfully authorized.

(2) No suit shall be brought whereby to charge any person upon or by reason of any representation or assurance made or given concerning or relating to the character, conduct, credit, ability, trade or dealings of any other person, to the intent or purpose that such other person may obtain credit, money or goods, unless such representation or assurance is made in writing, signed by the party to be charged therewith.

(3) No suit shall be brought upon a contract for the disposition of an interest in land unless—

(a) the contract upon which the suit is founded—

(i) is in writing;

(ii) is signed by all the parties thereto; and

(b) the signature of each party signing has been attested by a witness who is present when the contract was signed by such party:

Provided that this subsection shall not apply to a contract made in the course of a public auction by an auctioneer within the meaning of the Auctioneers Act (Cap. 526), nor shall anything in it affect the creation of a resulting, implied or constructive trust.

(4) Subsection (3) shall not apply to a contract made in the course of a public auction nor shall anything in that subsection affect the creation or operation of a resulting, implied or a constructive trust.

(5) The terms of a contract may be incorporated in a document either by being set out in it or by reference to some other document.

(6) For the purposes of subsection (3)—

"disposition" includes a transfer and a device, bequest or appointment of property contained in a will;

"interest in land" means any estate in or charge over land, or any estate in or charge over the proceeds of sale of land;

"party" includes any agent, auctioneer or advocate duly authorized in writing to act in the absence of the party who has given such authority;

"sign", in relation to a contract, includes making one's mark or writing one's name or initial on the instrument as an indication that one intends to bind himself to the contents of the instrument and in relation to a body corporate includes—

(a) signature by an attorney of the body corporate duly appointed by a power of attorney registered under the Registration of Documents Act (Cap. 285);

(b) the affixing of the common seal of the body corporate in accordance with the constitution or the articles of association of the body corporate, as the case may be, in which case no further attestation shall be required;

"transfer" includes a mortgage, charge, lease, conveyance, assignment, assent, vesting declaration, vesting instrument disclaimer, release and every other assurance of property or any interest therein by any instrument other than a will or a codicil.

(7) The provisions of subsection (3) shall not apply to any agreement or contract made or entered into before the commencement of that subsection.

Pro-Forma Capital Structure and Financials

	Actual	Forecast			
	16/17A	17/18E	18/19E	19/20E	20/21E
EBITDAR	164	170	178	214	235
EBITDAR Adj.: IT & LHR Slot	–	–	–	–	–
Adjusted EBITDAR	164	170	178	214	235
Changes in NWC and Other	48	(220)	(19)	(41)	(32)
Funds from Operations	212	(49)	159	173	203
GoK New Money	100	–	–	–	–
KLM Working Capital	–	–	–	–	–
Release of Trapped Cash from Op. Lessors	–	–	–	–	–
KLM New Money	–	–	–	–	–
Transaction Fees	–	–	–	–	–
CF Before Debt & Lease Payments	312	(49)	159	173	203
Financing Lease Payments	(166)	(136)	(130)	(126)	(122)
Operating Lease Payments	(61)	(62)	(61)	(74)	(93)
Unsecured Debt Payments	(44)	(141)	(48)	(48)	(45)
Free Cash Flow	41	(389)	(80)	(75)	(57)
Balance Sheet					
Financing Leases	904	793	686	578	470
Operating Leases @ 7x	427	436	430	521	649
Bank Debt	231	120	97	72	48
GoK Debt	243	243	243	243	243
Letters of Credit	66	66	66	66	66
Fuel Hedges & Overdue Creditors	101	25	25	25	25
Total Debt	1,972	1,683	1,547	1,505	1,502
(Net Cash) / Funding Need	(89)	300	379	455	512
Net Debt	1,883	1,983	1,926	1,960	2,014
Net Financial Debt / Adj. EBITDAR	*11.45x*	*11.65x*	*10.81x*	*9.16x*	*8.56x*
Theoretical Implied Credit Rating	*Ba3*	*B1*	*Ba3*	*Ba2*	*Ba2*
Total Facilities DSCR	*1.30x*	*n.m.*	*n.m.*	*n.m.*	*n.m.*
Adj. EBITDAR Debt Service Cover	*0.61x*	*0.50x*	*0.74x*	*0.86x*	*0.90x*

Post Restructuring

(US$m, FYE Mar)	Actual	Forecast			
	16/17A	17/18E	18/19E	19/20E	20/21E
EBITDAR	164	170	178	214	235
EBITDAR Adj.: IT & LHR Slot	–	3	3	3	3
Adjusted EBITDAR	164	173	181	217	238
Changes in NWC and Other	48	(125)	(19)	(41)	(32)
Funds from Operations	212	48	162	175	206
GoK New Money	100	–	–	–	–
KLM Working Capital	–	8	–	–	–
Release of Trapped Cash from Op. Lessors	–	54	17	15	–
KLM New Money	–	25	–	–	–
Transaction Fees	–	(40)	–	–	–
CF Before Debt & Lease Payments	312	95	179	190	206
Financing Lease Payments	(166)	(110)	(92)	(94)	(100)
Operating Lease Payments	(61)	(50)	(44)	(80)	(112)
Unsecured Debt Payments	(44)	(10)	(5)	(5)	(5)
Free Cash Flow	41	(76)	38	12	(11)
Balance Sheet					
Financing Leases	904	821	753	682	603
Operating Leases @ 7x	427	352	310	557	787
Bank Debt	231	–	–	–	–
GoK Debt	243	–	–	–	–
Letters of Credit	66	126	143	158	158
Fuel Hedges & Overdue Creditors	101	25	25	25	25
Total Debt	1,972	1,324	1,231	1,423	1,573
(Net Cash) / Funding Need	(89)	(14)	(51)	(64)	(52)
Net Debt	1,883	1,310	1,180	1,359	1,520
Net Financial Debt / Adj. EBITDAR	*11.45x*	*7.58x*	*6.52x*	*6.27x*	*6.38x*
Theoretical Implied Credit Rating	*Ba3*	*Ba2*	*Ba1*	*Ba1*	*Ba1*
Total Facilities DSCR	*1.30x*	*0.41x*	*1.50x*	*1.24x*	*1.04x*
Adj. EBITDAR Debt Service Cover	*0.61x*	*1.01x*	*1.28x*	*1.22x*	*1.10x*

Source: KQ Business Plan
Note: Net Cash balance post restructuring excludes undrawn amount of new $75m revolver facility. Assumes KZX remains on KQ's balance sheet.

REPUBLIC OF KENYA

THE NATIONAL TREASURY

SESSIONAL PAPER NO. 3 OF 2017

GOVERNMENT GUARANTEE OF USD 750 MILLION (EQUIVALENT TO KES 75.26 BILLION) IN SUPPORT OF RESTRUCTURING OF KENYA AIRWAYS

1. In accordance with the provisions of the Public Financial Management Act, 2012, section 58 (1) of the Laws of Kenya, the following information is laid before the National Assembly for consideration and approval.

2. The Kenya Airways PLC (formerly Kenya Airways Ltd) is a limited liability company established under the Companies Act in which the Government owns 29.8% of the issued ordinary shares. It is, therefore, a Government linked corporation.

3. Kenya Airways PLC (KQ), the Kenyan National Carrier has grown significantly over the last 15 years - from a turnover of KShs 25 billion in 2002 to KShs 100 billion in 2011. In the same period, profitability improved significantly - at one point KQ had the second highest operating margin globally.

4. In 2011, on the back of this significant growth, KQ embarked on a fleet modernization, financing and expansion programme based on a market outlook largely based on the projected business expansion and growth into Asia. This saw the fleet growing from 32 aircraft in 2011 to 45 in 2015.

5. Of the total fleet growth, seven (7) aircraft and one (1) aircraft engine (six (6) Boeing 787-8 aircraft, one (1) Boeing 777-300ER aircraft and one (1) General Electric GEnx-1/B70/75 spare engine) were primarily financed from loans obtained from two international banks, namely Citibank N.A. and JP Morgan Chase Bank N.A., through a special purpose vehicle christened Tsavo Aircraft Financing LLC, a Delaware limited liability company, as the lessor. The loans

were guaranteed by the Export-Import Bank of the United States (US Exim), an official export credit agency of the Unites States

6. In order to finance pre-delivery payments for some of the ordered aircraft, Kenya Airways obtained short term facilities from eleven (11) local banks, being Equity Bank, Jamii Bora Bank, Kenya Commercial Bank, Commercial Bank of Africa, I&M Bank, National Bank of Kenya, Diamond Trust Bank, Co-operative Bank, NIC Bank, Chase Bank and Eco Bank.

7. In the post 2012 period, however, the overall market context changed significantly, marked by downturns in traditional tourism source markets for Kenya, terrorism related advisories impacting Kenya, increased costs from the fleet acquired, and unprecedented competitive pressures, the results of which led to significant losses that have eroded the capital of the company thereby threatening its survival and occasioning the need to restructure KQ, both operationally and financially

8. With full support and indulgence of the Government and other stakeholders, the Kenya Airways PLC has negotiated a financial restructuring plan whose primary objectives are (i) to reduce financial leverage, i.e , to reduce the inordinate level of indebtedness and create capital structure aligned to the company's asset levels to enable KQ to trade on its own balance sheet going forward, and (ii) to increase the airline's liquidity to ensure that it can operate normally like any other corporate going forward. This substantial deleveraging will be sufficient to attract strategic investors.

9. The financial restructuring is supported by the turnaround plan initiated in 2015 The turnaround is already bearing fruit, as demonstrated by the full year results for 2016/17 The operating margin improved by KShs 5 billion to KShs 900 million from an operating loss of KShs 4 1 billion

10. The preferred financial restructuring option entails a Solvent Consensual Inter-Conditional Restructuring, which creates the incentives to ensure that all the relevant stakeholders of the company contribute to the restructuring to achieve a mutually beneficial outcome It is inter-conditional on every one of them agreeing to the restructure The restructuring framework is expected to

yield permanent and temporary liquidity of approximately US$ 1 billion and reduce the debt from over US$2 billion to almost US$1.2 billion.

11. To facilitate this transaction, GoK will convert its debt US$243 million plus accrued interest to equity. GoK will also provide a guarantee amounting to US$750 million to cover both US Exim and the participating local banks to the tune of US$525 million and US$225 million, respectively. These guarantees are a contingent liability required to secure future funding of KQ. They avoid any cash bailout and consequential request from all stakeholders to receive cash. GoK will receive additional shares in KQ in consideration for providing the guarantees.

12. Although the total guarantee is sized at US$750 million, the most likely downside case in a going-concern scenario is a US$75 million draw down on the guarantee to the local banks in 10 years under the financial structure. This would arise in the event that the share price of KQ does not fully recover to the value that a sale of the shares held under the financial structure does not meet the debt service obligations of the banks.

13. However, in a liquidation scenario, the downside rises to US$280 million, mainly on account of exposure under the guarantee to Kenyan banks, as the US Exim portion is asset backed (comprising the newest fleet in KQ). In a liquidation situation, the aircrafts which have value would be sold with only a minimal residual risk exposure to GoK.

14. It is important to note that once KQ is restructured and is back to financial stability, it will be able to meet its financial obligations, mitigating GoK risk. It has been determined, through an independent third party, that there is a business case for a restructured Kenya Airways. The independent third party has also supported the restructuring proposal by KQ's transaction advisors.

15. In addition, Kenya Airways, as a strong home-based carrier, is fully aligned with the government's ambition for Nairobi as an integrated regional hub, due to its geographically optimal location. Notably,

a. The Government has made significant investment in developing and upgrading aviation infrastructure (e.g. airports, air navigation, etc.) to support the vision.

b. The development of the KQ network, creating an efficient gateway to and from Nairobi, enhances Nairobi's attractiveness as an international centre of business and investment. Currently, there are in excess of 35 headquarters of international institutions based in the city.

c. The development of the KQ network with its renewed focus on Africa creates all the gateways to and from Nairobi, making it an efficient aviation hub supporting the Vision 2030 objective to also make Nairobi a financial, as well as conference tourism, hub and increase the access to key tourism destinations.

d. As a national carrier and a recognized African brand, KQ represents the country, and indeed the continent, in the global aviation industry.

e. In other jurisdictions, airlines are at the centre of country positioning strategy. Indeed, the integrated regional hub strategy is strongly pursued by countries such as the Gulf States, Turkey, China and Ethiopia.

16. It is also worth noting that countries normally intervene and save their airlines when they are in financial distress. Examples of airlines restructured with significant sovereign support include Olympic (Greece), Japan Airlines, Air New Zealand, South African, Malaysian and Pakistan International Airlines.

17. Against this background, it is critical that Government supports the restructuring efforts of Kenya Airways.

18. The current total contingent liabilities of the Government of Kenya in respect to the Public Financial Management Act, 2012 section 58 (2) (f) amount to KShs 57.68 billion and with the proposed guarantee of a sum equivalent to KShs 75.26 billion the aggregate amount will be KShs 132.94 billion. This, together with the stock of outstanding debt, is within the debt limit set by Parliament.

19. The National Assembly is requested to approve the Kenya Government Guarantee amounting to USD750 million (equivalent to KShs 75 26 billion), for the restructuring of Kenya Airways PLC, as follows -

(i) A Guarantee of USD 525 million to US Exim Bank in order to deliver liquidity savings to KQ over five (5) years

(ii) A Guarantee of USD 225 million to local Kenyan banks, primarily to support working capital requirements

HENRY K. ROTICH, EGH
CABINET SECRETARY/NATIONAL TREASURY

DATE 6th June 2017.

REPUBLIC OF KENYA

THE NATIONAL TREASURY

SESSIONAL PAPER NO. 3 of 2017

GOVERNMENT GUARANTEE OF USD 750 MILLION (EQUIVALENT TO KES 77.48 BILLION) IN SUPPORT OF RESTRUCTURING OF KENYA AIRWAYS

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3. Kenya Airways PLC (KQ), the Kenyan National Carrier has grown significantly over the last 15 years - from a turnover of KShs 25 billion in 2002 to KShs 100 billion in 2011. In the same period, profitability improved significantly - at one point KQ had the second highest operating margin globally.

4. In 2011, on the back of this significant growth, KQ embarked on a fleet modernization, financing and expansion programme based on a market outlook largely based on the projected business expansion and growth into Asia. This saw the fleet growing from 32 aircraft in 2011 to 45 in 2015.

5. Of the total fleet growth, seven (7) aircraft and one (1) aircraft engine (six (6) Boeing 787-8 aircraft, one (1) Boeing 777-300ER aircraft and one (1) General Electric GEnx-1/B70/75 spare engine) were primarily financed from loans obtained from two international banks, namely Citibank N.A. and JP Morgan Chase Bank N.A., through a special purpose vehicle christened Tsavo Aircraft Financing LLC, a Delaware limited liability company, as the lessor. The loans were guaranteed by the Export-Import Bank of the United States (US Exim), an official export credit agency of the Unites States.

6. In order to finance (i) pre-delivery payments for some of the aircraft and (ii) the capital expenditure required for the long-term operation and maintenance of the aircraft fleet, Kenya Airways obtained loan facilities from eleven (11) local banks, being Equity Bank, Jamii Bora Bank, Kenya Commercial Bank, Commercial Bank of Africa, I&M Bank, National Bank of Kenya, Diamond Trust Bank, Co-operative Bank, NIC Bank, Chase Bank and Eco Bank.

7. In the post 2012 period, however, the overall market context changed significantly, marked by downturns in traditional tourism source markets for Kenya, terrorism related advisories impacting Kenya, increased costs from the fleet acquired, and unprecedented competitive pressures, the results of which led to significant losses that have eroded the capital of the company thereby threatening its survival and occasioning the need to restructure KQ, both operationally and financially.

8. With full support and indulgence of the Government and other stakeholders, the Kenya Airways PLC has negotiated a financial restructuring plan whose primary objectives are (i) to reduce financial leverage, i.e., to reduce the inordinate level of indebtedness and create capital structure aligned to the company's asset levels to enable KQ to trade on its own balance sheet going forward, and (ii) to increase the airline's liquidity to ensure that it can operate normally like any other corporate going forward, while continuing to maintain the use of long-term capital assets, principally aircraft, that are critical to the survival and growth of the airline This substantial deleveraging will be sufficient to attract strategic investors.

9. The financial restructuring is supported by the turnaround plan initiated in 2015. The turnaround is already bearing fruit, as demonstrated by the full year results for 2016/17. The operating margin improved by KShs.5 billion to KShs.900 million from an operating loss of KShs.4.1 billion.

10. The preferred financial restructuring option entails a Solvent Consensual Inter-Conditional Restructuring, which creates the incentives to ensure that all the relevant stakeholders of the company contribute to the restructuring to achieve a mutually beneficial outcome. It is inter-conditional on every one of them agreeing to restructure their financing arrangements. This will be through one or more of (i) reducing / deferring debt payments (ii) conversion of debt into equity (iii) reducing or eliminating the requirement to make cash deposits (iv) providing new equity by KLM through cash and contributions in

kind valued independently (v) a new equity issue for existing minority shareholders diluted as a consequence of the restructuring **(See Annex 1).**

11. The restructuring framework is expected to yield permanent and temporary liquidity of approximately US$ 1 billion and reduce the debt from over US$2 billion to almost US$1.2 billion.

12. To facilitate this transaction, GoK will convert its debt of US$243 million plus accrued interest to equity. GoK will also provide a guarantee amounting to US$750 million to cover both US Exim and the participating local banks to the tune of US$525 million and US$225 million, respectively. These guarantees are a contingent liability required to secure financing that will ensure that KQ has the ability to continue to operate and maintain certain capital assets, principally aircraft, that are critical to the operation of the airline.. The guarantees avoid any cash bailout and consequential request from all stakeholders to receive cash. GoK will receive additional shares in KQ in consideration for providing the guarantees.

13. Although the total guarantee is sized at US$750 million, the most likely downside case in a going-concern scenario would be a US$75 million draw down on the guarantee to the local banks in 10 years under the financial structure. This would arise in the event that the share price of KQ does not fully recover to the value that a sale of the shares held under the financial structure does not meet the debt service obligations of the banks.

14. However, in a liquidation scenario, the downside would rise to US$280 million, mainly on account of exposure under the guarantee to Kenyan banks, as the US Exim portion is asset backed (comprising the newest fleet in KQ). In a liquidation situation, the aircrafts which have value would be sold with only a minimal residual risk exposure to GoK.

15. It is important to note that once KQ is restructured and is back to financial stability, it will be able to meet its financial obligations, mitigating GoK risk on the guarantees. It has been determined, through an independent third party, that there is a business case for a restructured Kenya Airways. The independent third party has also supported the restructuring proposal by KQ's transaction advisors.

16. In addition, Kenya Airways, as a strong home-based carrier, is fully aligned with the government's ambition for Nairobi as an integrated regional hub, due to its geographically optimal location. Notably,

a. The Government has made significant investment in developing and upgrading aviation infrastructure (e.g. airports, air navigation, etc.) to support the vision.

b. The development of the KQ network, creating an efficient gateway to and from Nairobi, enhances Nairobi's attractiveness as an international centre of business and investment. Currently, there are in excess of 35 headquarters of international institutions based in the city.

c. The development of the KQ network with its renewed focus on Africa creates all the gateways to and from Nairobi, making it an efficient aviation hub supporting the Vision 2030 objective to also make Nairobi a financial, as well as conference tourism, hub and increase the access to key tourism destinations.

d. As a national carrier and a recognized African brand, KQ represents the country, and indeed the continent, in the global aviation industry.

e. In other jurisdictions, airlines are at the centre of country positioning strategy. Indeed, the integrated regional hub strategy is strongly pursued by countries such as the Gulf States, Turkey, China and Ethiopia.

17 It is also worth noting that countries normally intervene and save their airlines when they are in financial distress. Examples of airlines restricted with significant sovereign support include Olympic (Greece), Japan Airlines, Air New Zealand, South African, Malaysian, and Pakistan International Airlines.

18. The Government of Kenya has provided financial support to Kenya Airways in the past, including (i) investing KShs 4.7 billion in a rights issue in 2012 that increased the Government's shareholding from approximately 23% to 29.8% and (ii) loans totaling USD 243 million in during the period 2015-16.

19. Against this background, it is critical that Government continues to support the restructuring efforts of Kenya Airways.

20 The current total contingent liabilities of the Government of Kenya in respect to the Public Financial Management Act, 2012 (PFMA) section 58(2)(f) amount to KShs 57.68 billion and with the proposed guarantee of the sum equivalent to KShs 77.48 billion the aggregate amount will be KShs 135.16

billion. Regulation 26(1)(c) of the PFMA regulations specifies that the national public debt shall not exceed 50 percent of Gross Domestic Product (GDP) in net present value terms. Including the KShs 77.48 billion guarantee, the net present value of national public debt to GDP ratio will be 47.8% (the ratio is 46.9% before taking into account the guarantee) This is, therefore, within the debt limit set by Parliament (**see Annex 2**).

21. In addition to the guarantee meeting section 58(2)(f) of the PFM Act, 2012 and Regulation 26(1)(c) of the PFM Regulations, it also satisfies the conditions imposed under Regulation 204 (**see Annex 3**).

22. The National Assembly is requested to approve the Government Guarantees amounting to USD750 million (equivalent to KShs 77.48 billion) as follows:-

    (i) A guarantee of USD 525 million to US Exim Bank in order to secure the restructured financing on certain capital assets (seven (7) aircraft and one (1) aircraft engine (six (6) Boeing 787-8 aircraft, one (1) Boeing 777-300ER aircraft and one (1) General Electric GEnx-1/B70/75 spare engine).

    (ii) A guarantee of USD 225 million to local banks in order to secure aircraft engine refurbishments which are capital expenditures ensuring continuing airworthiness of the aircrafts

HENRY K. ROTICH, EGH
CABINET SECRETARY, NATIONAL TREASURY

DATE 13th June 2017.

Annex 1: Indicative shareholding Post Restructuring

	Shareholder	Percentage Range (%)
1.	Government of Kenya	43 - 48
2	KLM	8-9
3	Local Bank Trust	33-38
4.	Other Shareholders (including minority shareholders)	4-16

Note: Negotiations are in final stages, so these figures are subject to revision.

Annex 2: Total Net Present Value of Public and Publicly Guaranteed Debt as a % of GDP

	Debt Category	Kes	% of GDP
1.	Total Concessional Debt (Multilateral plus Bilateral Debt)	1,519,649,822,614.74	18.5%
2.	Discounted Concessional Debt	1,139,737,366,961.06	13.9%
3.	Commercial Banks Debt (Suppliers Credit plus Commercial Banks Debt plus International Sovereign Bond)	648,256,895,204.63	7.9%
4.	Kenya Airways Guarantee	77,475,000,000.00	0.9%
5.	Total Commercial Debt (3+4)	725,731,895,204.63	8.8%
6.	Total Domestic Debt as at 25th May 2017	2,060,809,161,974.76	25.1%
7.	Total Nominal Public Debt and Publicly Guaranteed Debt (1+5+6)	4,306,190,879,794.13	52.4%
8.	**Total Net Present Value of Public and Publicly Guaranteed Debt as a % of GDP (2+5+6) (see note 1)**	**3,926,278,424,140.45**	**47.8%**
9.	**Memo Item: Nominal GDP Estimate for end of 2017 –(see note 2)**	**8,210,193,368,244.45**	

Note 1: this value is discounted concessional debt (25%) plus commercial debt plus domestic debt.

Note 2: GDP value used is based on medium-term projections taking into account that the guarantee in long-term.

Note 2: **Requirements of the Public Finance Management Act, 2012 and the PFMA Regulations and Responses**

	Relevant Section of the PFM Act, 2012	Has the Requirement been met? Justification
1.	**Section 58. Power of Cabinet Secretary to guarantee loans**	
	Subsection (1): Subject to subsection (2), the Cabinet Secretary may guarantee a loan of a county government **or any other borrower** on behalf of the national government and that loan shall be approved by Parliament.	The borrower is **Kenya Airways PLC (KQ)**, a limited liability company. It is a private borrower. It is a government-linked corporation in accordance with the definition under section 91(a) of the PFM Act, 2012.
	Subsection (2): The Cabinet Secretary shall not guarantee a loan under subsection (1) unless-	
	(a) the loan is for a capital project,	The guarantee will secure loans procured for the purchase of aircraft, which are long-lived capital assets ((seven (7) aircraft and one (1) aircraft engine (six (6) Boeing 787-8 aircraft, one (1) Boeing 777-300ER aircraft and one (1) General Electric GEnx-1/B70/75 spare engine) and (i) pre-delivery payments for some of the aircraft and (ii) the capital expenditure required for the long-term operation and maintenance of the aircraft fleet)
	(b) the borrower is capable of repaying the loan, and paying any interest or other amount payable in respect of it,	Once the balance sheet restructuring is fully implemented, Kenya Airways will be able to meet its obligations It has been determined that there is a business case, as well as an economic case, for GoK to support KQ restructuring and provide the requisite guarantees Indeed, implementation of the operations component of the turnaround plan is already bearing fruit, with KQ posting

		progressively improved results.
	(c) in the case of a private borrower, there is sufficient security for the loan;	Yes, the obligations that GoK is guaranteeing are ultimately secured by the aircraft and other assets of the company.
	(d) the financial position of the borrower over the medium term is likely to be satisfactory;	Yes, the restructuring is designed to create a viable business. It has been determined that there is a business case, as well as an economic case, for a restructured KQ. Indeed, implementation of the operations component of the turnaround plan is already bearing fruit, with KQ posting progressively improved results.
	(e) the terms of the guarantee comply with the fiscal responsibility principles and financial objectives of the national government. **(Fiscal Responsibilities under Section 15 of the PFM Act, 2012)** <u>**Subsection**</u> (2) In managing the national government's public finances, the National Treasury shall enforce the following fiscal responsibility principles—	

	(a) over the medium term a minimum of thirty percent of the national and county governments budget shall be allocated to the development expenditure	The guarantee is a contingent liability and does involve any revenue transfers.
	(b) the national government's expenditure on wages and benefits for its public officers shall not exceed a percentage of the national government revenue as prescribed by regulations;	Not applicable in the context of the guarantee sought
	(c) over the medium term, the national government's borrowings shall be used only for the purpose of financing development expenditure and not for recurrent expenditure,	The guarantee will secure loans procured for the purchase of aircraft, which are long-lived capital assets ((seven (7) aircraft and one (1) aircraft engine (six (6) Boeing 787-8 aircraft, one (1) Boeing 777-300ER aircraft and one (1) General Electric GEnx-1/B70/75 spare engine) and (i) pre-delivery payments for some of the aircraft and (ii) the capital expenditure required for the long-term operation and maintenance of the aircraft fleet).

		(d) public debt and obligations shall be maintained at a sustainable level as approved by Parliament for the national government and the county assembly for county government;	Yes, the guarantee is within the limit set by Parliament. Regulation 26(1)(c) of the PFMA regulations specifies that the national public debt shall not exceed 50 percent of Gross Domestic Product (GDP) in net present value terms. Including the KShs 77.48 billion guarantee, the net present value national public debt to GDP ratio will be 47.8% (the ratio is 46.9% before taking into account the guarantee).
		(e) fiscal risks shall be managed prudently; and	The guarantee ensures that there is no cash outflow and the KQ restructuring is designed to create a viable business that enables KQ to play its important role in the economy.
		(f) a reasonable degree of predictability with respect to the level of tax rates and tax bases shall be maintained, taking into account any tax reforms that may be made in the future.	Not applicable.

	(3) For the purposes of subsection (2)(c), short term borrowing shall be restricted to management of cash flows and in case of a bank overdraft facility it shall not exceed five per cent of the most recent audited national government revenue.	The guarantee is a contingent liability and does not involve any cash outflow.
	(4) The National Treasury shall ensure that the level of National Debt does not exceed the level specified annually in the medium term national government debt management strategy submitted to Parliament.	Yes, the guarantee is within the limit set by Parliament. Regulation 26(1)(c) of the PFMA regulations specifies that the national public debt shall not exceed 50 percent of Gross Domestic Product (GDP) in net present value terms. Including the KShs 77.48 billion guarantee, the net present value national public debt to GDP ratio will be 47.8% (the ratio is 46.9% before taking into account the guarantee).
	(5) Regulations made under this Act may add to the list of fiscal principles set out in subsection (2).	The Regulations under PFM Act, 2012 have been complied with.
	(f) where Parliament has passed a resolution setting a limit for the purposes of this section— (i) the amount guaranteed does not exceed that limit; or	Yes, This is within the limit set by Parliament. Regulation 26(1)(c) of the PFMA regulations specifies that the national public debt shall not exceed 50 percent of Gross Domestic Product (GDP) in net present value terms.

		Including the KShs 77.48 billion guarantee, the net present value national public debt to GDP ratio will be 47.8% (the ratio is 46.9% before taking into account the guarantee).
	(ii) if it exceeds that limit, the draft guarantee document has been approved by resolution of both Houses of Parliament.	Not applicable, as the limit will not be exceeded.
	(g) the Cabinet Secretary takes into account the equity between the national government's interests and the county government's interests so as to ensure fairness;	Not applicable, as KQ is a private borrower
	(h) the borrower complies with any conditions imposed by the Cabinet Secretary in accordance with the regulations,	The Guarantee Agreement provides certain compliance and reporting conditions for KQ to the Cabinet Secretary on a periodic basis.
	(i) the Cabinet Secretary has taken into account the recommendation of the Intergovernmental Budget and Economic Council in respect of any guarantee to a county government; and	Not applicable, as this is a not a guarantee to a county government but to a private borrower.
	(j) the loan is made in accordance with provisions of this Act and any regulations made thereunder.	Yes, as indicated in this matrix
	Subsection (3): Parliament may approve a draft loan guarantee document as provided by subsection (2)(f)(ii) only if satisfied that—	
	(a) the guarantee is in the public interest;	Subsection (3) is not applicable. Subsection (3) is founded on subsection

	(b) the borrower's financial position is strong enough to enable the borrower to repay the loan proposed to be guaranteed and to pay interest or other amounts payable in respect of the loan; and (c) the loan is geared towards stimulating economic growth in a county government.	2(f)(ii), which is not applicable as the guarantee is within the limit.
	Subsection (4): To enable Parliament to decide whether or not to approve a draft loan guarantee document as provided by subsection (3), the Cabinet Secretary shall prepare and submit to each of the House of Parliament a paper that—	
	(a) gives details of the loan that is proposed to be guaranteed, including the amount of the loan, the terms of repayment, and the details of the interest or any other amount payable under the loan; (b) specifies the national government's total contingent liability under guarantees given under this section; and (c) specifies any other information that the Cabinet Secretary considers relevant.	Not applicable. Subsection (3) is founded on subsection 2(f)(ii), which is not applicable as the guarantee is within the limit.
2.	**Regulation 202: Pursuant to the provisions of section 58 of the Act, the capital project expenditures of—**	

	(a) county governments for which a guarantee is requested, shall meet the following requirements— (i) the borrower shall demonstrate that the project could not be financed on reasonable terms and conditions without a government loan; (ii) provide the projected cash flow clearly setting out projected disbursement schedule and repayment plan; (iii) the borrower shall contribute a substantial portion of project funds from their own resources and in any case not less than fifteen (15) percent; (iv) a national government entity or county government that defaults on a loan shall be put on an agreed financial recovery programme by the National Treasury, (v) it is a feasible project that has been approved by the national government entity or county government entity as may be required by national or county legislation; (vi) the application of the guarantee shall be submitted with a draft loan agreement;	Not applicable, as Regulation 202(a) applies to county governments, whereas KQ is a private borrower.

	and (vii) any other guidelines consistent with the Act as may be gazetted by the Cabinet Secretary,	
	(b) national governments entities for which a guarantee is requested, shall meet the following requirements— (i) the national government entity shall demonstrate that the project could not be financed on reasonable terms and conditions without a loan; (ii) provide the projected cash flow clearly setting out a projected disbursement schedule and repayment plan; (iii) the national government entity shall contribute at least fifteen (15) percent of the project cost from their own resources; (iv) it is a feasible project that has been approved by the governing body as required under these Regulations, (v) concessionality of the proposed loan is fully	Not applicable, as Regulation 202(b) applies to national government entities, whereas KQ is a private borrower

	evaluated by the national government and is determined to be at the acceptable level of grant. element as per the borrowing strategy; (vi) satisfies all the fiscal responsibility principles set out in the Act and these Regulations; (vii) the National Treasury has confirmed that the lender is of good credibility and standing with the Government of Kenya; and (viii) any other guidelines as Cabinet Secretary to the National Treasury may prescribe in a government gazette	
3.	**Regulation 203.** Pursuant to the provisions of section 58(2)(a) of the Act, and in addition to provisions under regulation 202, the following procedures shall apply in relation to a national government entity—	
	(a) before seeking a national government guarantee, the governing body of the national government entity shall approve the borrowing including its terms and conditions.	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower. However, it should be noted that the guarantee is for the purpose of restructuring existing loans and new facilities in support of the capital assets.
	(b) after approval by the governing body, the Chief Executive Officer of the entity shall submit the proposed loan agreement and a sessional paper to the Cabinet Secretary responsible for the national government entity for approval of the borrowing, including its	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower. However, KQ has availed the financing agreements to GoK for which GoK is stepping in to provide the guarantees. The Sessional Paper has been approved by the Cabinet and submitted to the National Assembly.

	broad terms and conditions;	
	(c) upon approval under paragraph (b), the Chief Executive Officer shall submit the final draft loan financing agreement and the approval of the governing body and the Cabinet Secretary responsible for the entity to the Cabinet Secretary requesting for the guarantee of the final loan financing agreement;	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower.
	(d) the Cabinet Secretary may reject a request for loan guarantee with reasons and communicate the same to the concerned chief executive officer;	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower.
	(e) upon approval of a loan guarantee request, the Cabinet Secretary shall seek the legal opinion of the Attorney General.	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower. However, we confirm that the Attorney General has continued to provide legal expertise and guidance as the guarantee agreements are being finalized.
	(f) upon receiving the views of the Attorney-General and taking them into account, the Cabinet Secretary to the National Treasury shall submit a sessional paper to Parliament with recommendations seeking its approval.	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower. However, the Sessional Paper has been approved by the Cabinet, and takes into account the views of the Attorney General. It is now before the National Assembly.
	(g) the Cabinet Secretary shall communicate the decision of	Regulation 203 is not applicable, as KQ is not a national government entity but a

	Parliament on the draft loan guarantee to the respective chief executive officer; and	private borrower. However, this will be done once the National Assembly communicates its decision on the request for approval.
	(h) upon approval by Parliament the Cabinet Secretary to the National Treasury shall issue a loan guarantee.	Regulation 203 is not applicable, as KQ is not a national government entity but a private borrower. However, this will be done once approval is granted by the National Assembly.
4.	**Regulation 204.** Upon recommendation by the Cabinet Secretary to the National Treasury, Parliament may approve a draft loan guarantee document as provided under section 58(2)(f) of the Act, only if it is satisfied that—	
	(a) the guarantee is in the public interest;	The guarantee secures the survival and growth of Kenya Airways and the aviation sector in Kenya, which is a critical to the Kenyan economy.
	(b) the borrowers financial position is strong enough to enable the borrower to repay the loan proposed to be guaranteed and to pay interest and other charges based on projected revenue streams;	The restructuring is designed to create a viable business that is able to meet its debt obligations
	(c) concessionality of the proposed loan is fully evaluated by the national and county governments and is determined to be at the acceptable level of grant element as per the borrowing strategy;	Not applicable

(d) the loan investments are geared towards stimulating economic growth in a county government; and	Not applicable. However, the KQ restructuring is designed to create a viable business. It has been determined that there is a business case, as well as an economic case, for a restructured KQ. Indeed, implementation of the operations component of the turnaround plan is already bearing fruit, with KQ posting progressively improved results. It is critical that Government supports the restructuring efforts of Kenya Airways as there are significant benefits to the country. Kenya Airways, as a strong home-based carrier, is fully aligned with the government's ambition for Nairobi as an integrated regional hub, due to its geographically optimal location. Notably, a. The Government has made significant investment in developing and upgrading aviation infrastructure (e.g. airports, air navigation, etc) to support the vision. b. The development of the KQ network, creating an efficient gateway to and from Nairobi, enhances Nairobi's attractiveness as an international centre of business and investment Currently, there are in excess of 35 headquarters of international institutions based in the city. c The development of the KQ network with its renewed focus on Africa creates all the gateways to and from Nairobi,

		making it an efficient aviation hub supporting the Vision 2030 objective to also make Nairobi a financial, as well as conference tourism, hub and increase the access to key tourism destinations. d. As a national carrier and a recognized African brand, KQ represents the country, and indeed the continent, in the global aviation industry. e. In other jurisdictions, airlines are at the centre of country positioning strategy. Indeed, the integrated regional hub strategy is strongly pursued by countries such as the Gulf States, Turkey, China and Ethiopia.
	(e) all legal issues relating to financial agreements, tripartite signing, and subsidiary agreements are fully addressed.	Yes, the Attorney General has continued to provide legal expertise and guidance as the guarantee agreements are being finalized.