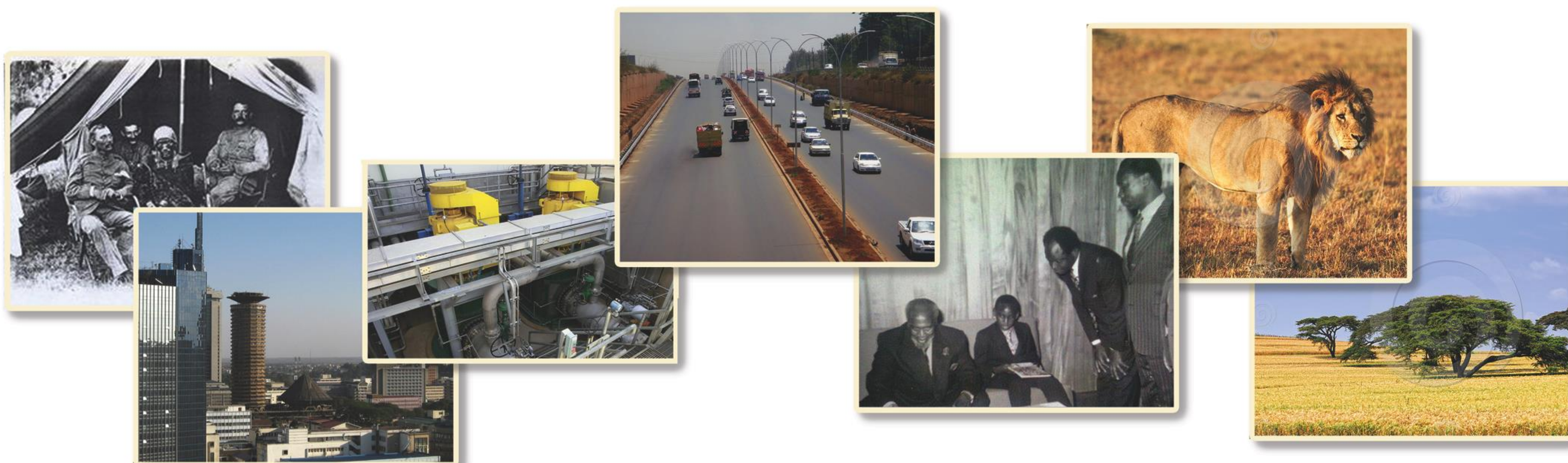
PKF Taxation Services Ltd

County Borrowing and Investment Opportunities for Revenue Generation



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May 2014

Presentation Scope

1) Borrowing Opportunities

2) Investment Opportunities

3) Conclusion

4) Q&A

Introduction

- Revenue raised nationally must be shared equitably between national and county governments.

- County governments may also be given additional allocations from the national government's share of the revenue, either conditionally or unconditionally.

Funding County Governments

How do counties fund their operations?

- Counties have two main sources of funding:
  - revenues they raise on their own, and
  - revenues transferred to them by the national government.

Funding County Governments…cont’d

- Revenues from national government, which must be at least 15% of revenues collected by national government, will be the larger share.

- Counties may also receive funding in form of loans or grants from donors.

Funding County Governments…cont'd

- Allowable taxes for County Governments expressly provided for under the Constitution are property rates and entertainment taxes

- These are presently insufficient to augment amounts received from national government.

Funding County Governments…cont'd

- The Constitution also gives the Commission on Revenue Allocation (CRA) responsibility for assisting counties (and national government) to find new sources of revenue.

Funding County Governments…cont'd

- The Constitution creates an Equalisation Fund which receives 0.5% of all national revenue each year.

- The Equalization Fund may be disbursed to Counties as a conditional grant. The CRA must make a recommendation on this.

- If the money is given to counties as a conditional grant, then it will be part of their revenues.

Funding County Governments…cont'd

- The rules guiding public finances are mainly contained in Chapter 12 of the Constitution and in the Public Finance Management (PFM) Act 2012.

Funding County Governments…cont’d

- The County Treasury is responsible for guiding all economic and fiscal policy at county level.

- This includes:
  - projecting how much revenue the county is likely to raise,
  - managing the budget process,
  - managing all of the county’s revenues,

Funding County Governments…cont'd

- tracking all county assets,
- controlling and issuing debt and
- opening and managing county bank accounts.

- Each of these responsibilities comes with reports that must be filed by specific deadlines.

Borrowing Opportunities

- The principle governing County financing is that the main source of government finance is revenues, not loans.

- Counties may only borrow funds:
  - Where National government approves the Loan; and
  - With the approval of the National Assembly

Borrowing Opportunities

- Rationale for restricting County Borrowing is to encourage fiscal responsibility.

- County borrowing has the effect of increasing spending today based on futures earnings yet to be earned.

- Net effect of reducing borrowing is reduced future earnings

Borrowing Opportunities

- The best argument for borrowing is investment.

- All borrowing should be studied to ensure that it will lead to increased income in future to pay back the loans.

- Borrowing is expensive, so even if the money is used for investment, it may not pay off if the cost is too high.

Borrowing Opportunities

Loans

- A County Executive Committee member for finance may, on behalf of the county government, raise a loan for that County Government's purposes.

- The loan may be raised either within Kenya or outside Kenya.

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Borrowing Opportunities

- In borrowing money, a County Government should ensure that its financing needs and payment obligations are met at the lowest possible cost in the market that is consistent with a prudent degree of risk, while ensuring that the overall level of public debt is sustainable.

- Borrowing should not exceed the limit set by the County Assembly.

Borrowing Opportunities

- A county may make:
  - Longer-term borrowing for capital projects, such as infrastructure, and
  - Short-term borrowing to manage cash flows.

Borrowing Opportunities

Longer-term borrowing

- The Constitution and PFM Act limit the degree to which counties can take on debt.

- Counties may only borrow long-term for capital expenditure.

Borrowing Opportunities

- The borrowing must be consistent with the goals of the County Fiscal Strategy Paper and debt management strategy.
- Must be approved by the County Assembly and the National Assembly

Borrowing Opportunities

- All loans that a County wants to obtain must be guaranteed by the National Government, i.e., the National Government agrees to pay off the loan if the County fails to do so.

- County governments will have to request a formal guarantee from the National Government before taking out a loan.

Borrowing Opportunities

- Before approving any loan guarantee, the National Treasury will consult the Intergovernmental Budget and Economic Council, which is a body consisting of all the County Executive Committee members for finance.

- All loan guarantees provided by the national government have to be approved by Parliament.

Borrowing Opportunities

Short-term borrowing

- Short term borrowing - Borrowing by a County government by way of Treasury Bills, bank-overdraft or other instrument to cover temporary cash shortfalls and is repayable within twelve months.

Borrowing Opportunities

Short-term borrowing

- Short-term borrowing for cash flow is allowed, but restricted.

- Counties may borrow for no more than a year for this purpose, and the amount that may be borrowed is no more than 5% of the County's last audited revenues.

Borrowing Opportunities

Securities

- County Governments may issue securities, whether for money that it has borrowed or for any other purpose.

- The County Executive Committee member for Finance may issue securities on behalf of the County Government, for money borrowed by the County Government

Borrowing Opportunities

- County Government securities:
  - may be issued in one or more series; and
  - may be issued in accordance with loan agreements entered into in accordance with regulations developed by the County Executive Committee member for finance and approved by the County Assembly

Borrowing Opportunities

- A secondary trading (leading to a change in the ownership of a County Government security before its redemption date) of county government securities may be carried out as prescribed.

Borrowing Opportunities

Grants or Donations

- Donation - a gift or a contribution

- Grant - the provision of financial or other assistance by a development partner which is not repayable and:
  - where public money is paid to or used by a grant recipient;

Borrowing Opportunities

- which is intended to finance the development of projects or delivery of services or otherwise assist the grant recipient to achieve goals that are consistent with the policy objectives of the county government; and

- where the grant recipient is required to act in accordance with any terms or conditions specified in a grant agreement.

Borrowing Opportunities

- With the approval of the County Executive Member for Finance, the County can accept grants and donations.
- These grants may be given directly to the County Government or to a County Government department or office (entity).

Borrowing Opportunities

- Once approved, receipt of these grants must be reported to the County Treasury.
- They must also be appropriated through the county budget process.
- County offices are not free to accept grants without informing the County Treasury and requesting authorization as part of the County budget process.

Investment Opportunities

Lending

- A County Government entity may lend money.

- Lending will happen primarily in instances in which County Government budgets have a surplus.

- The County Executive Committee member for finance should ensure that a security given in respect of a loan in the name of the County Government.

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Investment Opportunities

Joint Infrastructure Investments

- County Governments may engage in joint infrastructure investments.
- Regulations approved by Parliament will prescribe such financial relations.

Investment Opportunities

Private Public Partnerships

- PPP’s are a generic name applied to different types of contractual agreements between Governments and the private sector for the purpose of public infrastructure development and services provision.

Investment Opportunities

Private Public Partnerships

- PPP’s are largely used for public infrastructure e.g., roads, railways, prisons, government buildings, power generation, or water and waste treatment facilities.
- Are now increasingly used to finance “soft infrastructure,” e.g. schools, hospitals, and health services.

Investment Opportunities

County Corporations

- Counties may establish any County corporations they would like, subject to the approval of the County Executive Committee and only after taking into account the views of the County Treasury on the financial implications of creating the corporation.

Investment Opportunities

- Once created, a County may only further invest in such a corporation with the approval of the County Executive Committee as a whole, and again taking into account Treasury recommendations.

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Recommendations

- Counties may raise funds through the Capital Markets. This offers unique opportunities to raise funds through Initial Public Offerings (IPOs), project financing, asset backed securities, and bonds.

- For this to happen, however, counties will have to introduce laws allowing them to fund projects through the capital market.


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TIME FOR QUESTIONS