THE NATIONAL TREASURY AND MINISTRY OF PLANNING

REPORT TO PARLIAMENT ON ALL NEW LOANS CONTRACTED BY GOVERNMENT OF KENYA FROM 1ST MARCH 2018 TO 30TH JUNE 2018 AND NEW GUARANTEES ISSUED BY THE NATIONAL TREASURY IN THE FY 2017/2018

REPORT TO PARLIAMENT ON ALL NEW LOANS CONTRACTED BY GOVERNMENT FROM 1ST MARCH 2018 TO 30TH JUNE 2018

Section 1 - Introduction

1. This report on new loans and guarantees is prepared in accordance with section 31(3) of the Public Finance Management Act, 2012 and covers the period from 1st March 2018 to 30th June 2018. Section 31(3) requires that: " *At the end of every four months, the Cabinet Secretary shall submit a report to Parliament stating the loan balances brought forward, carried down, drawings and amortizations on new loans obtained from outside Kenya or denominated in foreign currency, and such other information as may be prescribed by regulations, specifying-*

    (a) The names of the parties to the loan;
    (b) the amount of the loan and the currency in which it is expressed and in which it is repayable;
    (c) the terms and conditions of the loan, including interest and other charges payable and the terms of repayment;
    (d) the amount of loan advanced at the time the report is submitted;
    (e) *the purpose for which the loan was used and the perceived benefits of the loans.*

Section 2 below gives details of the above required information.

2. Section 3 gives details of issued guarantee in accordance with Section 32 (3).PFM Act 2012, which requires that:...*"Not later than two months after the end of each financial year, the Cabinet Secretary shall publish and publicise a report giving details of the guarantees given by the national government during that year"*

Section 2 – Details of loans

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3. This section of the report contains three (3) new loans contracted between Government of Kenya and bilateral and multilateral creditors. One of the loans is from a bilateral lender and the other two are from multilateral lenders. The total value of the three new loans signed is the equivalent of Ksh 14,609,550,824 and none of the loans have been disbursed by the time of submitting this report. The proceeds from the loans will finance infrastructure projects in the energy, transport and agriculture sectors.

4. **Loan for Ol-Karia I Units 1, 2 and 3 Geothermal Power Plants Rehabilitation Project.**

a) The parties to the loan

The loan was signed on 16th March 2018 between Government of Japan as the lender and Government of Kenya as the borrower. .

b) Amount of the loan and currency

The loan amount and denomination is Japanese Yen 10,077,000,000(equivalent to Ksh 9,234,431,799) and is repayable in Japanese Yen.

c) The terms and conditions of the loan

The tenor of the loan is thirty (30) years and will be fully repaid on 20th March, 2048. Repayment is in twenty years (20) in semi-annual instalments commencing after ten (10) years grace period. The interest rate charged on the loan is 1.0% per annum plus a one-off front end fees of 0.2 % on the amount of the loan.

d) The purpose for the loan

The objective of the Project is to rehabilitate the existing Ol-Karia I Units 1, 2 and 3 Geothermal Power plant to enhance volume and security of electricity power supply in Kenya, thereby creating a conducive environment for investment and enabling sustainable economic growth in Kenya.

5. **Loan for Modogashe - Wajir Road Project**

a) The parties to the loan

The loan was signed on 15th May 2018 between Kuwait Fund for Arab Economic Development as the lender and Government of Kenya as the borrower. .

b) Amount of the loan and currency

The loan amount and denomination is Kuwaiti Dinars (KD) 7,000,000.00(equivalent to Ksh 2,304,316,000) and is repayable in Kuwaiti Dinars.

c) The terms and conditions of the loan

The tenor of the loan is twenty five (25) years and will be fully repaid on 31st May, 2043. Repayment is in twenty years (20) in semi-annual instalments commencing after five (5) years grace period. The interest rate charged on the loan is 1.5% per annum plus a fee of 0.5% on each disbursed instalment amount to meet administrative expenses.

d) The purpose for the loan

The project aims at meeting the increasing demand for transport of passengers and goods in the North Eastern region of the country thereby promoting trade activities with the neighboring countries and thus contributing to economic and social development in the project area. The project also aims to reduce vehicle operation and road maintenance costs as well as travel times.

6. Loan for Enable Youth Kenya Program

a) The parties to the loan

The loan was signed on 23rd May 2018 between African Development Fund (ADF) as the lender and Government of Kenya as the borrower. .

b) Amount of the loan and currency

The loan denomination and amount is in Units of Account (UA) 21,277,000 (equivalent to Ksh 3,070,803,025) and will be repaid in the currency (ies) of disbursement.

c) The terms and conditions of the loan

The tenor of the loan is thirty (30) years and will be fully repaid on 23rd May, 2048. Repayment is in twenty five years (25) in semi-annual instalments commencing after five (5) years grace period. The interest rate charged on the loan is 1.0% per annum plus a service charge of 0.75% per annum. A commitment fee of 0.5% is payable on undisbursed balance.

d) The purpose for the loan

The loan was advanced to help in skill building and capacity development for youth to be implemented over a period of 5 years aimed at empowerment of agricultural entrepreneurs. The specific objective is to create business opportunities and decent employment for young women and men along priority agricultural value chains. The loan's perceived benefit is to help in job creation, food security and nutrition, income generation and improved livelihoods for youths in both urban and rural areas.

Section 3: Report on new guarantees entered into in the Financial Year 2017-2018

(a) Name of parties to the guaranteed loan

7. The loan of USD 750 million (equivalent to Ksh 77.48 billion) guaranteed by the Government of Kenya is to **Kenya Airways Limited as the borrower** and the lenders are US Exim Bank and eleven (11) participating local banks.

(b) Principal amount

8. The guarantee is broken down as follows:

- A guarantee of USD 525 million to US Exim Bank in order to secure the restructured financing on certain long-term capital assets (seven(7) aircraft and one 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). The guarantee will relieve liquidity challenges to Kenya Airways over five (5) years.

- A guarantee of USD 225 million to eleven (11) local banks (being Equity Bank, Jamii Bora Bank, Kenya Commercial Bank, Commercial Bank of Africa, I&M Bank, National Bank, Diamond Trust Bank, Co-operative Bank, NIC Bank, Chase Bank and, Eco Bank) in order to secure aircraft engine refurbishments(which are capital expenditures) and ensure continued airworthiness of the aircrafts. The banks will get shares in Kenya Airways in consideration of converting their debt into equity.

(c) Terms and conditions applicable to the guaranteed loan

9. With full support of GOK and other stakeholders, Kenya Airways has negotiated a financial restructuring plan whose primary objectives are (i) to reduce the inordinate level of indebtedness and create a capital structure aligned to the company's asset levels. This will enable Kenya Airways to transact 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, while continuing to maintain the use of long term capital assets, principally aircraft, which are critical to the survival and growth of the airline. This substantial deleveraging will be sufficient to attract strategic investors.

10. The preferred financial restructuring option entails incentives to ensure that all relevant stakeholders of the company achieve a mutually beneficial outcome. 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 shareholders (v) a new equity issue for existing minority shareholders diluted as a consequence of the restructuring.

11. To facilitate the transaction, GoK will convert its debt of USD243 million plus accrued interest into equity. GoK will also provide the guarantee amounting to USD750 million to cover both the US Exim and local banks.

12. The guarantee is required to secure financing that will ensure Kenya Airways has the ability to continue to operate and maintain certain capital assets, principally aircraft that are critical to the operations of the airline. The guarantee protects GoK from any cash bailout and consequential request from stakeholders to receive cash from Kenya Airways. GoK will receive additional shares in Kenya Airways in consideration for providing the guarantee.

13. Although the total guarantee is sized at USD 750 million, the most likely worst case in going-concern scenario would be a USD 75 million drawdown 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 Kenya Airways 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 case of a liquidation scenario, the downside risk would rise to USD 280 million majorly on account of exposure under the guarantee to local banks, as the US Exim portion is asset backed (comprising newest fleet in Kenya Airways). In liquidation situation, the aircraft which will have value will be sold to meet the cost of debt from the US Exim Bank guaranteed portion with only a residual risk exposure to the Government.

15. In case the guarantee is called/ triggered, as per the international best practice, the Government can request for negotiations to allow a structured loan repayment process. In such a scenario the Government will not be required to repay the full amount (bullet amount of USD 280 million) but an amortizing repayment structure to ensure no huge fiscal shocks are experienced by GoK at the time of honoring the terms of the guarantees.

16. Finally, it is important to note that once Kenya Airways is restructured and is back to financial stability; it will be able to meet its obligations, mitigating GoK risk on the guarantee.