GCR assigns the County Government of Laikipia a national scale long-term issuer rating of BB+$_{(KE)}$; Outlook Stable.

Nairobi, 23 February 2021 – GCR Ratings ("GCR") has assigned the County Government of Laikipia ("Laikipia") a national scale long-term issuer rating of BB+$_{(KE)}$, with the Outlook accorded as Stable. At the same time GCR has assigned a national scale short term issuer rating of B$_{(KE)}$.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
County Government of Laikipia	Long Term issuer	National	BB+$_{(KE)}$	Stable Outlook
	Short Term issuer	National	B$_{(KE)}$	

Rating Rationale

The ratings on Laikipia balance low levels of leverage, increasing own sources of revenue ("OSR") generation and ongoing government support counterbalanced by its relatively small and undiversified status, high wage bill and relatively low development expenditure absorption and somewhat constrained liquidity. We have also negatively reflected the succession of qualified audit opinions.

Laikipia is the 15th largest county in Kenya by size. According to the GCP 2019 Report by the Kenya National Bureau of Statistics ("KNBS"), Laikipia County was the 3rd fastest growing county in the country between 2014 and 2017. The main economic activities are agriculture (43.7%), construction (7%), wholesale and retail trade (8.8%), transport and storage (7.3%) financial and insurance activities (7.7%) and public administration and defense (7.4%). The GCP was KES 81.1bn 2017 (at current prices) representing 1.1 % of the National GDP. The County has implemented a number of initiatives to strengthen its agricultural output and further diversify economic activity, which should support economic growth and continued improvements in social development indicators.

Management and governance is a slight negative ratings factor, reflecting a lack of clean audits since 2015/16. Nevertheless, GCR notes that there has been a reduction in the number and severity of the audit shortcomings, which would support rating progression if maintained.

Operating performance is a slight negative, balancing growing revenues including the contribution of own source revenues against high operating expenses, largely due to very high staff costs and relatively low development spend. Staff costs as a portion of total income was at 48.6% at FY2018/19, above the 35% benchmark set by the PFM (County Governments) Regulations 2015 in Section 25 (1) (b). Looking ahead, growth in OSR is likely to fall short of expectation due to COVID-19 disruptions, but Laikipia intends to bolster available income by reducing expenditure and improving debtors' collections.

Laikipia has not made use of debt funding over the review period and thus has no debt service track record aside from the operating leases, therefore leverage and cash flow is a positive assessment. However, the significant accounts payables suggest there have been some challenges in timeously settling creditors. Over the medium term, Laikipia is considering approaching the debt capital markets to raise debt of KES1.4bn for development projects such as infrastructure projects, serviced industrial parks and hospitals. The county needs to meet a number of fiscal requirements, for example ensuring that the wage bill is no more than 35% of total county revenues, the amount should not exceed 20% of the total county revenue and spending at least 30% of the actual expenditure on development projects.

GCR's liquidity assessment has been negatively impacted by the high level of accounts payables, which equated to KES953m at FY2018/19 (17.7% of total revenue). We also note that there is an amount of over KES900m in unverified accounts payables as at end FY19/20. The uses versus sources ratio is also below one. This possibly points to a weakness in the budgetary process in addition to matching of the timing between the projects and the receipts from the exchequer. Some progress in addressing the accounts payables is noted, and further sustained improvement in payments would positively impact the rating.

GCR has factored government support into the ratings. This is because Laikipia fulfils a critical social service, being at the forefront of improving the day-to-day quality of life for their citizens. Division of revenue to the counties is enshrined in the constitution, there are procedures for approving projects which are supported by the national government and the PFM Act 2012 Section 94 (1) (a) (i) states that failure to make payments and as when they fall due is a material breach which requires National Treasury intervention in terms of Article 225 of the constitution. The extraneous financial support consideration is also somewhat tempered by the constrained National fiscus.

Outlook statement

The Stable Outlook balances the economic growth in the county and OSR against the challenges that the county has had with its wage bill, less than 30% spend on development expenditure, and the accounts payables position.

Rating triggers

Positive rating action could arise if the county receives an unqualified audit opinion, reduces its wage bill close to the recommended 35%, improves its development budget utilization, meaningfully addresses its outstanding accounts payables and increases its OSR. Conversely, negative rating action could arise if the above factors are reversed and if the unverified accounts payables become payable without commensurate resources to address the liability.

GCR RATINGS

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Related criteria and research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Local and Regional Governments, June 2019
GCR Country Risk Scores, February 2021

Ratings history

County Government of Laikipia

Rating Class	Review	Rating scale	Rating class	Outlook	Date
Long Term issuer	Initial/last	National	$BB+_{(KE)}$	Stable	February 2021
Short Term issuer	Initial/last	National	$B_{(KE)}$		

RISK SCORE SUMMARY

Rating factors and sub-factors	Risk score
Operating environment	**7.00**
Double country risk score	8.00
Sector risk adjustment	(1.00)
Business profile	**(3.25)**

Entity profile	(2.25)
Operating profile	(0.50)
Management and governance	(0.50)
Financial profile	**0.75**
Leverage and capital structure	2.00
Liquidity	(1.25)
Comparative profile	**2.00**
Government support floor	2.00
Peer comparison	0.00
Total Risk Score	**6.50**

Glossary

Budget	Financial plan that serves as an estimate of future cost, revenues or both.
Capital Expenditure ("capex")	Expenditure on long-term assets such as plant, equipment or land, which will form the productive assets of a company.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Cash	Funds that can be readily spent or used to meet current obligations.
Country Risk	The range of risks emerging from the political, legal, economic and social conditions of a country that have adverse consequences affecting investors and creditors with exposure to the country, and may also include negative effects on financial institutions and borrowers in the country.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Diversification	Spreading risk by constructing a portfolio that contains different exposures whose returns are relatively uncorrelated. The term also refers to companies which move into markets or products that bear little relation to ones they already operate in.

Gearing	Gearing (or leverage) refers to the extent to which a company is funded by debt.
Interest	Scheduled payments made to a creditor in return for the use of borrowed money. The size of the payments will be determined by the interest rate, the amount borrowed or principal and the duration of the loan.
Issuer	The party indebted or the person making repayments for its borrowings.
Leverage	With regard to corporate analysis, leverage (or gearing) refers to the extent to which a company is funded by debt.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.
Loan	A sum of money borrowed by a debtor that is expected to be paid back with interest to the creditor. A debt instrument where immovable property is the collateral for the loan. A mortgage gives the lender a right to take possession of the property if the borrower fails to repay the loan. Registration is a prerequisite for the existence of any mortgage loan. A mortgage can be registered over either a corporeal or incorporeal property, even if it does not belong to the mortgagee. Also called a Mortgage bond.
Local and regional Governments ("LRG")	Government entities possessing revenue raising capacity that are responsible for the administration of public policy for a given jurisdiction. These include metropolitan councils, local municipalities (of all sizes), district councils and state governments.
Long term	See GCR Rating Scales, Symbols and Definitions.
Own Source Revenue	Own source revenue are those income streams that are directly under the control of the public entity, and may include property rates, business and other licence fees, hospitality fees, fines, or any other charges through which an LRG can generate income.
Principal	The total amount borrowed or lent, e.g. the face value of a bond, excluding interest.
Rating Outlook	See GCR Rating Scales, Symbols and Definitions.
Short Term	See GCR Rating Scales, Symbols and Definitions.

Transfers	Income received from a third party, most often a higher level of government or a donor. Includes exchequer releases, income provided by Government Departments, and or external parties such as development finance agencies.

SALIENT POINTS OF ACCORDED RATINGS

GCR affirms that a.) no part of the ratings was influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; and c.) such ratings were an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit ratings have been disclosed to County Government of Laikipia. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the ratings.

County Government of Laikipia participated in the rating process via face-to-face management meetings, teleconferences and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from County Government of Laikipia and other reliable third parties to accord the credit ratings included:

- Audited financial results for Laikipia to 2018/2019 (Plus three years of comparative numbers);
- County Integrated Development Plan 2018-2022
- Laikipia Annual Development Plans and
- County Debt management Strategy Paper
- Various procedure documents
- Gross County Product Report 2019.