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REPUBLIC OF KENYA

MINISTRY OF FINANCE

SESSIONAL PAPER NO. 2 OF 1987

KENYA GOVERNMENT GUARANTEES OF BANK LOAN FACILITIES EXTENDED TO:-

(i) NATIONAL CEREALS AND PRODUCE BOARD;

(ii) KENYA AIRWAYS LIMITED;

(iii) THE KENYA FURFURAL COMPANY LIMITED (IN RECEIVERSHIP);

(iv) THE KENYA CHEMICAL AND FOOD CORPORATION LIMITED (IN RECEIVERSHIP);

(v) SOUTH NYANZA SUGAR COMPANY LIMITED;

(vi) KENYA MEAT COMMISSION;

(vii) KENYA FLOURSPAR COMPANY LIMITED (LIQUIDATED) ; and

(viii) EAST AFRICAN AIRWAYS CORPORATION (LIQUIDATED);

BY SOME LOCAL BANKS SPECIFIED HEREBELOW:-

THE GUARANTEE (LOANS) ACT (CAP. 461)

In accordance with the provisions of the Guarantee (Loans) Act (Cap. 461), the following information is laid before the National Assembly:-

In its endeavour to promote development in Kenya, the Government supported financially a number of promissing projects by persuading the local banks to participate in raising the capital for the projects. Such projects like Kenya Furfural Company Limited in Eldoret, Kenya Chemical and Food Corporation in Kisumu, and Kenya Fibre Corporation in Nanyuki, had seemingly very positive feasibility studies. Unfortunately, it transpired that a number of these projects after take-off, started developing financial problems due to various reasons such as marketing, poor management, underutilisation of capacity etc., etc. Projects whose capital was raised by way of loans secured on Government letters of awareness, were subsequently unable to service their debts.

In other cases, the Government issued letters of awareness to support parastatals which sought overdraft facilities from local banks.

Such parastatals like the Wheat Board of Kenya, Maize and Produce Board, both of which were amalgamated to form the National Cereals and Produce Board and Kenya Airways Limited, have played a strategic role in our National economic development. It was considered of national interest to support these organizations whenever they sought immediate financial assistance.

Substantial sums of money advanced to various companies remain still unpaid, and overdraft facilities for a number of parastatals have assumed an upward trend which has been a major cause for concern for the smooth operations of the banks involved. The Government has moral obligation to honour its committments in letters of awareness to the banks by way of guarantees.

The Controller and Auditor General has in the past, brought up the issues of letters of awareness in his report for financial years 1977/78, 1978/79 and 1980/81. The Parliament adopted and approved the recommendations of the Public Accounts Committee as shown below:-

1977/78 AND 1978/79 (Para. 193)

"The Committee expresses its total disapproval of the manner in which Ministry of Finance committed the Government to guarantee overdraft facilities to Kenya Airways Limited, without prior Parliamentary Authority as required by the Loans Guarantees Act. The Committee recommends that the Treasury seek full legal advice from the Attorney General with a view to protecting Government money".

1980/81 (Para. 173)

"The Committee noted that a Sessional Paper on the whole of Finance Management of Kenya Airways is being prepared for presentation to Parliament and will take care of all issues raised there before".

The Attorney General advised that there is only one way in which the Government can be bound to honour the borrowings by bodies corporate. This is set out in Cap. 461, Section 3 of the Laws of Kenya, where it is clearly stipulated that the Government may with the prior approval of Parliament guarantee the borrowing of a local authority or body corporate.

Now therefore, the Government commitments on letters of awareness and the proposals thereto are as follows:-

1. NATIONAL CEREALS AND PRODUCE BOARD (N.C.P.B.)

a. The Government proposes to guarantee the due repayment by NCPB of bank loans amounting in all K£.19,325,000 and made up as follows:-

Name of the Bank	Principal Amount in K£.
Kenya Commercial Bank Limited	8,325,000
National Bank of Kenya Limited	4,000,000
Barclays Bank of Kenya Limited	7,000,000
	19,325,000

b. Interest is chargeable on the bank loans at the maximum going rate (currently 14% per annum) for Commercial Bank loans as determined, from time to time by the Central Bank of Kenya. Such interest is calculated on daily balances and is debited monthly by way of compound interest.

c. The bank loans are repayable in quarterly instalments over a period of two years from January, 1986.

d. NCPB is a body corporate duly established by and existing under the National Cereals and Produce Board Act, 1985. The functions of NCPB under the Act are:-

(i) to regulate and control the collection, movement, storage, sale, purchase, transportation, marketing, processing, distribution, importation, exportation, disposal and supply of maize, wheat and scheduled agricultural produce;

(ii) to buy, store, sell, import, export or otherwise acquire and dispose of maize, wheat and scheduled agricultural produce in such manner, such quantities and on such terms as it may, from time to time, deem necessary to fulfil the requirements of producers and consumers in Kenya;

(iii) to advise the Minister on the proper production of maize, wheat and scheduled agricultural produce in relation to the needs of Kenya, and the extent to which control over the exportation and importation of maize, wheat or scheduled agricultural produce is desirable or necessary;

(iv) to do any other act which is connected or incidental to the foregoing.

In fulfilling its functions, NCPB is mandated by the Act to comply with any general or special directions given to it by the Government.

e. All the property and liabilities of the former Maize and Produce Board and the Wheat Board of Kenya were transferred to and became vested in NCPB on the date of commencement (i.e. 16th August, 1985) of the National Cereals and Produce Board Act, by virtue of Section 33 thereof;

f. Out of the said bank loans, a total of K£.18,000,000 was raised by the former Maize and Produce Board from a Syndicate consisting of all the above mentioned commercial banks, to finance the purchase of produce from farmers all over the country. The loan was originally for a period of two years from the date of drawdown or the 31st March, 1983, whichever was the earlier. The balance of K£.1,325,000 was raised by the former Wheat Board of Kenya from Kenya Commercial Bank Limited to finance its wheat production operations. The approvals of the bank loans were all subject to Government guarantees being furnished to the said local banks by way of security.

g. Prompt payment of farmers for their produce delivered to NCPB and the promotion of wheat farming are both important aspects of the national food policy and security. The Government has a vital interest in such matters as part of its long term plan of ensuring national self-sufficiency in food production.

2. <u>KENYA AIRWAYS LIMITED (KA)</u>

a. The Government proposes to guarantee the due repayment by KA to Kenya Commercial Bank Limited of a long term loan amounting to K£.8,250,000.

b. Interest is chargeable on the long term loan at the maximum going rate (currently 14% per annum) for commercial bank loans as determined, from time to time, by the Central Bank of Kenya. Such interest is calculated on daily balances and is debited monthly by way of compound interest.

c. The long term loan is repayable in eight (8) years by equal monthly instalments.

d. KA is a body corporate duly organized and existing under the Companies Act (Cap. 486).

e. KA has a share capital of Shs.100 million and is wholly Government owned.

f. KA is the national airline and was formed on 22nd January, 1977 in consequence of the break-up/disintegration of the former East African Airways Corporation (in liquidation).

g. The long term loan was raised, initially by way of overdraft facilities, to finance the existing operations of KA and its approval was subject to Government guarantee being furnished to Kenya Commercial Bank Limited by way of security.

h. KA, as the national airline and flag carrier, plays an important and critical role in the promotion and sustenance of our nationhood; the tourist industry; and the export trade, especially of perishables.

i. By virtue of KA being a wholly owned Government entity and for the reasons stated in sub-paragraph (h) above, the Government is interested in the financial and operational viability and well being of KA.

j. The Kenya Commercial Bank Limited is a wholly owned Government bank and is expected by the Government to operate on commercial lines.

3. <u>THE KENYA FURFURAL COMPANY LIMITED (IN RECEIVERSHIP) (KFC)</u>

a. The Government proposes to guarantee the due repayment by KFC of (i) a bank loan of K£.750,000 from Kenya Commercial Bank Limited (KCB) and (ii) another bank loan of K£.500,000 from Barclays Bank of Kenya Limited. The two bank loans add up to a total of K£.1,250,000.

b. Interest is chargeable on the two bank loans at the maximum going rate (currently 14% per annum) for commercial bank loans as determined, from time to time, by the Central Bank of Kenya. Such interest is calculated on daily balances and is debited monthly by way of compound interest.

c. The bank loans are repayable in seven (7) years by fourteen (14) equal half-yearly instalments.

d. KFC is a body corporate duly organized and existing under the Companies Act (Cap.486).

e. KFC was incorporated on 7th December, 1976 and, pursuant to an Investment Agreement dated 21st January, 1977 and made between the Government, Industrial Development Bank Limited (IDB), Agricultural Development Corporation (ADC), Development Finance Company of Kenya Limited (DFCK), Kale-Agro Industries Limited, Lewis and Peat Limited, Escher Wyss GmbH and Foster Wheeler (Process Plants) Limited, it was agreed to establish and operate, through KFC, a factory at Eldoret for the manufacture of furfural and ecetic and formic acids, from maize cobs.

f. The authorised and issued capital of KFC of Shs.115 million is held as follows:-

Investor		Percentage Holdings
Government		31.4%
IDB		6.5%
ADC		8.4%
DFCK		15.8%
Lewis and Peat Limited		24.8%
Escher Wyss GmbH		1.9%
Foster Wheeler Limited		1.9%
European Investment Bank		9.0%
Kale-Agro Industries Limited		0.3%
	TOTAL	100.00%

....../8

g. The bank loans were initially raised by way of overdraft facilities to finance the operations of KFC and their approvals were subject to Government guarantees being furnished to the two commercial banks as security.

h. The KFC factory was constructed at Eldoret and was commissioned for operations in 1977. The factory, however, ceased production in January, 1982 due to financial (cash flow) problems. The secured creditors, IDB, DFCK and KCB (for other debts) therefore, appointed Receivers and Managers over KFC.

i. Efforts are being made to dispose of the KFC factory, failing which, a new company would be formed to take over the assets of KFC and operate the factory.

4. KENYA CHEMICAL AND FOOD CORPORATION LIMITED (IN RECEIVERSHIP) (KCFC)

a. The Government proposes to guarantee the due repayment by KCFC to the Kenya Commercial Bank Limited of the following loans and/or banking facilities amounting in all to K£.12,170,101.05 equivalent:-

Type of facility	Principal Amount and Currency	K£. Equivalent as at 5.11.85
Overdraft	KSh.30,000,000	1,500,000
*Foreign Bank Guarantee	US$ 12,000,000	9,515,101.05
Promissory Notes	Ksh.13,100,000	655,000
Receivers' Account	Ksh.10,000,000	500,000
		12,170,010.05

....../9

*The Foreign Bank Guarantee was in respect of funds raised from a syndicate of six (6) foreign banks led by UBAF Bank Limited and consisting of the following:-

Name of Bank	Principal Amount in US$
International Energy Bank Limited	3,000,000
Roywest Banking Corporation Limited	3,000,000
UBAF Bank Limited	2,500,000
Banque de L'Indochine de Suez	1,000,000
Banque Belge Limited	1,500,000
International Commefcial Bank Limited	1,000,000
	12.000,000

b.(i) Interest is chargeable on the loan amounts due in local currency at the maximum going rate (currently 14% per annum) for commercial bank loans as determined, from time to time, by the Central Bank of Kenya. Such interest is calculated on daily balances and is debited monthly by way of compound interest.

(ii) Interest is chargeable in US Dollars on the loan amount which is still due in US Dollars (currently US$ 6,972,666.68) at 13/8 per annum above LIBOR (London Interbank Offered Rate). A transfer fee equivalent to 3/8% is also payable.

c.(1) The amount representing the Foreign Bank Guarantee of US $12 million (equivalent to K£.9,515,101.05 as indicated in sub-paragraph (a) above is repayable in four and a half (4½) years by nine (9) equal half-yearly instalments.

(iii) The balance of the loans amounting to K£.2,655,000 is repayable in seven (7) years by fourteen (14) equal half-yearly instalments.

d. KCFC is a body corporate duly organized and existing under the Companies Act (Cap. 486).

e. KCFC was set up on 30th June, 1977 as a joint venture between the Government, Chemfood Investment Corporation S.A. and Advait International S.A. for the purpose of establishing and operating a factory at Kisumu for the manufacture of power alcohol (ethanol); bakers yeast; citric acid; and vinegar and the by-products thereof such as ammonium sulphate, gypsum and methane gas.

f. KCFC's paid up share capital of Ksh.170 million was subscribed for as follows:-

Shareholder	Percentage Holdings
The Government	51%
Chemfood Investment Corporation S.A.	34%
Advait International S.A.	15%
	100.00%

g. The loans and banking facilities were raised to finance the setting up of the said factory at Kisumu and their approvals were subject to joint and several guarantees being furnished to Kenya Commercial Bank Limited by the Government and the two other shareholders. The guarantees of the other shareholders have been obtained.

h. The construction of the KCFC factory was not completed due to project cost estimate ascalations. Kenya Commercial Bank Limited, therefore, appointed Receivers/Managers over KCFC under the terms of their debenture in January, 1983.

5. SOUTH NYANZA SUGAR COMPANY LIMITED (SONY)

a. The Government proposes to guarantee the due repayment by SONY to the National Bank of Kenya Limited of a loan amounting to K£.2,250,000.

b. Interest is chargeable on the loan at the maximum going rate (currently 14% per annum) for commercial bank loans as determined, from time to time, by the Central Bank of Kenya. Such interest is calculated on daily balances and is debited monthly by way of compound interest.

c. The loan is repayable in seven (7) years by fourteen (14) equal half-yearly instalments.

d. SONY is a body corporate duly organized and existing under the Companies Act (Cap.486).

e. SONY has a share capital of Ksh.276.5 million, 98.9% of which is owned by the Government, Industrial Development Bank Limited and Industrial and Commercial Development Corporation.

f. SONY was set up in 1976 as a joint venture between the Government and the Mehta Group International Limited for the purpose of establishing and operating a factory at Awendo, South Nyanza District, for the manufacture of mill white sugar and the by-products thereof.

g. The SONY factory was completed and commissioned in January 1980 and has been operating ever since.

h. The loan was raised in the form of two bridging loans amounting to K£.1,500,000 and K£.750,000 respectively and approval in both cases was subject to Government guarantee being furnished to the National Bank of Kenya Limited by way of security.

..../12

i. The National Bank of Kenya Limited is a wholly owned Government commercial bank and is expected by the Government to operate on commercial lines.

j. SONY has brought much needed development in a rural area of South Nyanza District. The factory employs 1250 people directly and has 6000 outgrowers attached to it. The Government earns revenue from the operations of SONY through payroll taxes and sales tax on sugar.

k. The development of the sugar industry is an important part of the national development effort and drive towards self-sufficiency in food production. Sugar provides much needed support to the tourist industry and is an important raw material for soft drinks and other food processing and pharmaceutical industries in the country.

6. <u>KENYA MEAT COMMISSION (KMC)</u>

a. The Government proposes to guarantee the due repayment by KMC to the National Bank of Kenya Limited of a loan amounting to K£.2,000,000.

b. Interest is chargeable on the loan at the maximum going rate (currently 14% per annum) for commercial bank loans as determined, from time to time, by the Central Bank of Kenya. Such interest is calculated on daily balances and is debited monthly by way of compound interest.

c. The loan is repayable in seven (7) years by fourteen (14) equal half-yearly instalments.

....../13

d. KMC is a body corporate duly established by and existing under the Kenya Meat Commission Act (Cap. 363). The powers and functions of KMC are set out in great detail under Section 8 of the said Act and include the ownership of abbatoirs and carrying on the business, on a wholesale basis of, butchers, dealers and merchants in livestock and carcasses.

e. The loan was raised to finance the operations of KMC and approval was subject to Government guarantee being furnished to the National Bank of Kenya Limited by way of security. The National Bank of Kenya Limited is a wholly owned Government commercial bank.

f. KMC plays an important role in the development of the livestock industry in the country.

7. FLOURSPAR COMPANY OF KENYA LIMITED (IN RECEIVERSHIP) (FCK)

a. The Government proposes to guarantee the due repayment by FCK to the National Bank of Kenya Limited of a loan amounting to K£1,500,000.

b. Interest is chargeable on the loan at the maximum going rate (currently 14% per annun) for commercial bank loans as determined, from time to time, by the Central Bank of Kenya. Such interest is calculated on daily balances and is debited monthly by way of compound interest.

c. The loan is repayable in seven (7) years by fourteen (14) equal half-yearly instalments.

d. FCK is a body corporate duly organized and existing under the Companies Act (Cap. 486).

e. FCK was set up on 14th May, 1971 as a joint venture between ICDC and International Minerals Corporation (a United States firm) and its subsidiaries for the purpose of mining and processing flourspar within the Kerio Valley.

f. FCK was duly established and started its mining operations in early 1970s. However, as a result of financial problems caused by over supply of flourspar in the world market, the secured creditors, namely Kenya Commercial Bank Limited, National Bank of Kenya Limited, ICDC, Citibank N.A. and National Housing Corporation appointed receivers/managers over FCK on 11th May, 1979. A new company in the name of Kenya Flourspar Company Limited was subsequently formed to take over the assets of FCK. The new company has been operating well without major problems.

g. The loan was raised to finance the operations of FCK and approval was subject to Government guarantee being furnished to the National Bank of Kenya Limited by way of security.

8. EAST AFRICAN AIRWAYS CORPORATION (IN LIQUIDATION) (EAA)

a. The Government proposes to guarantee the due repayment by EAA to the National Bank of Kenya Limited of a loan amounting to K£1,985,957.

b. Due to receipts from the Official Liquidator, the amount outstanding on the account has since reduced to about K£1,069,811.7.

c. Interest is chargeable on the loan at the maximum going rate (currently 14% per annum) for commercial bank loans as determined, from time to time, by the Central Bank of Kenya. Such interest is calculated on daily balances and is debited monthly by way of compound interest.

d. The loan is repayable in seven (7) years by fourteen (14) equal half-yearly instalments.

e. EAA is a body corporate duly organized by and existing under the East African Airways Corporations Act as applied to Kenya by virtue of the Treaty for East African Co-operation Act (Cap. 4).

f. The loan was raised to finance the air transport operations of EAA prior to the break-up of the former East African Community.

g. EAA was one of the Corporations established under the auspices of the former East African Community.

9. CONTINGENT LIABILITY

The current total contingent liability of the Government in respect of guarantees given under Section 3 of the Guarantee (Loans) Act (Cap. 461) (Other than those specified in the schedule to the Act) amounts to K£ 478,072,497. With the guarantee of the sums stipulated in Clauses 1(a), 2(a), 3(a), 4(a), 5(a), 6(a), 7 (a) and 8(a) above amounting in the aggregate to K£ 47,814,912 as herein proposed, the total contingent liability of the Government will be hereby increased to K£ 525,887,409 of which K£ 94,729,409 is in respect of covenants expressed in Kenya currency as per paragraph (a) and K£ 431,158,000 is in respect of covenants expressed in foreign currency as per paragraph (b) of Section 3(3) of the Act.

HON. PROF. G. SAITOTI
MINISTER FOR FINANCE

7/11/86

DATED AT NAIROBI THIS .... DAY OF OCTOBER, 1986.