GCR GLOBAL CREDIT RATING CO.
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Kampala Capital City Authority

Uganda Local Authority Analysis **May 2015**

Rating class	Rating scale	Rating	Rating outlook	Expiry date
Long term	National	$A_{(UG)}$	Stable	May 2016
Short term	National	$A1\text{-}_{(UG)}$		

Financial data:

(USD'm comparative)

	30/06/13	30/06/14
UGX/USD (avg)	2,557.6	2,506.8
UGX/USD (close)	2,569.9	2,593.0
Total assets	192.9	202.6
Total debt	16.6	16.4
Total capital	172.7	181.2
Net debtors	22.9	24.5
Cash & equiv.	5.0	3.9
Total income	64.6	90.4
Net result	7.2	0.8
Op. cash flow	14.1	21.2
Net capex	17.8	20.6
Market cap.	n.a	
Market share	n.a	

Rating history:

Initial Rating (April 2015)
Long term: $A_{(UG)}$
Short term: $A1\text{-}_{(UG)}$
Rating outlook: Stable

Related methodologies/research:

Criteria for Rating Local Authorities, updated February 2015

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Summary rating rationale

- Kampala is the financial centre of Uganda, accounting for approximately 80% of industrial and commercial activity and contributing 65% to GDP. Thus, the city is considered critical to the country's prosperity, implying strong government support.
- Government support has also been demonstrated through the establishment of KCCA and the assignment of a minister to represent the city in the Cabinet. This implied and demonstrated support is an important supporting factor in respect of the ratings.
- KCCA has made good progress in updating its property register, licencing taxis and other businesses, and generally expanding the rates and fees base. Combined with improved debtors' collection, this has seen internal revenue rise from UGX40bn in F12 to UGX72bn in F14. Internal revenue is expected to rise sharply in the medium term, to comprise around 40% of total income in F16, thereby reducing the municipality's reliance on government grants.
- While the staff cost ratio (whether to total expenses or income) remains above the 35% benchmark that GCR considers prudent for public entities, the sharp downward trend in F14 indicates that new hirings are having a positive economic impact on KCCA.
- KCCA currently has no debt, but the city is considering future debt funding. This will only be for projects that are able to generate sufficient revenue to service the obligation. However, legislation caps debt funding at 10% of internal revenue, a limitation that will have to be eased if KCCA is to tap the commercial debt market.
- Although the much more stringent cash management efforts are positively noted, maintaining only negligible cash balances does expose the municipality to unforeseen liquidity requirements. In addition, it exposes KCCA to the financial health of the National Government, even if amounts have been allocated to the city.
- KCCA's financial position is constrained by the substantial socio-economic challenges faced by most of its residents. This has limited the amount of income the municipality can generate, while at the same time increasing the burden of service delivery.
- The improved operational capacity has engendered renewed confidence from development institutions, which are now engaging KCCA on potential projects. Maintaining their confidence is critical as KCCA will need their assistance in implementing the substantial infrastructure programmes that are necessary.

Factors that could trigger a rating action include:

Positive change: Sustained growth in internal revenue, making KCCA more self-sustainable, would be positively viewed. Demonstrated ability to bring large infrastructure projects to fruition.
Negative change: Reversal of the operational progress made at the municipality, potentially evidenced by rising expenditure on staff and consumption. Lack of progress in addressing the social and infrastructural needs of the city.

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Background

Kampala City was established as a municipality in 1947 and became the capital city of Uganda at independence in 1962. Aside from being the seat of Government, Kampala is also the financial centre of the country, accounting for an estimated 80% of Uganda's industrial and commercial activity and contributing around 65% to national GDP. It is also home to the country's major cultural and educational institutions. Bordering on Lake Victoria and surrounded by a series of hills, the city covers an area of 189km^2, of which 19km^2 is water. The city is divided into five urban divisions, being Central, Kawempe, Makindye, Lubaga and Nakawa. However, surrounding the city are several other municipal jurisdictions that rely on their proximity to Kampala for economic activity. Thus, while there are around 1.8 million residents of Kampala City, it is estimated that 3.5 million people enter the city for employment every day. Much of this, however, relates to the informal sector, accounting for around 1.5 million jobs.

Economic context

During 2014, the Uganda Bureau of Statistics revised its national accounts data, using GDP statistics rebased to 2009, from 2002 previously. This had the impact of increasing the size of the economy by around 20%. Adjustments were made to include the non-profit sector and cross-border informal trade, as well as a more accurate measurement of the agricultural and industrial sectors. At the same time a new national poll was conducted, which revealed a lower population of around 34.9 million people, compared to the 37 million that had previously been estimated. Together this had the impact of increasing per capita income from around USD510 per year to USD759.

Table 1: Key economic indicators (year ending June)	**2010**	**2011**	**2012**	**2013**	**2014**	**2015e**
Population (m)	31.0	31.9	32.9	33.9	34.9	35.9
GDP (USD'm)	17,933	17,947	24,034	24,642	26,505	27,936
GDP growth (%)	5.2	9.7	4.4	3.3	4.5	5.4
DGP per capita	579.0	562.0	731.0	727.0	759.0	
Inflation	9.4	6.5	23.4	5.8	6.9	2.6
Ave lending rate	18.2	19.2	24.6	24.8	22.1	n.a
UGX/USD	2,283	2,623	2,472	2,593	2,581	n.a

Source: World Bank Uganda Country Report, February 2015

Despite the apparent improvement to Uganda's financial position, economic conditions remain challenging. While GDP growth rose to 4.5% in F14 (F13: 3.3%), this remained well below the average 7.8% growth achieved in the five years between F07 and F11. In addition, the data revealed a worrying decrease in private sector investment in F14, which was only offset by rising public sector investment and consumption. Combined with lower than expected income to the National Treasury, Uganda's domestic borrowings increased to 16% of GDP from 10% in F12. Positively, the economy attracted robust levels of foreign investment and benefitted from improved tourist arrivals in F14, both of which helped support a slight decrease in the balance of payments deficit to 6.6% (F13: 7% deficit). Inflation also moderated through 2014, averaging 6.9% for F14, but reached a low of 1.6% in December 2014. While this saw the T-bill rate fall to 9.3% in F14 (F13: 10.3%), average lending rates remained high at 22.1% (F13: 24.8%). Looking ahead, inflation is expected to remain subdued through 2015, which should support a lower interest rate environment and firmer private sector activity. Combined with further infrastructure spend, GDP growth is expected to climb to 5.4% in F15 and 6.4% in F16.

Kampala is faced with enormous challenges due to the low socio-economic conditions of many of its residents and the inhabitants of the surrounding districts. These include high levels of unemployment, especially amongst the youth and a high incidence of people living below the poverty line. Only around 23% of Kampala's area is considered fully urbanised, with access to a full range of municipal services. The bulk of the area (around 60%) is semi-urbanised and comprises 62 informal slums, housing an estimated 560,000 families. The remainder of land area is still considered rural. The poor socio-economic conditions have placed significant pressure on the city's services, which has contributed to a deterioration of the infrastructure such as roads, schools and hospitals. Of the approximately 1,200km of roads in the city, only around 500km are tarred and only around 20% are considered in good condition. Most of the roads are in need of total reconstruction, but only 150km has been rehabilitated over the past three years, evidencing the scale of the infrastructure backlog.

Legislative environment

Much of Kampala's infrastructure backlog has resulted from years of neglect and underinvestment, combined with the rapid growth and urbanisation of the population. In addition, the city was plagued by corruption and maladministration, which severely impacted its ability to deliver services to residents. To stem the erosion, a study was commissioned by the Kampala Institutional and Infrastructural Development Programme in 2009, to investigate ways of corporatising the management of the city. The recommendations of this study culminated in the Kampala Capital City Act ("the Act"), which parliament passed in 2010. Under Section 4 of the Act, Kampala ceased to be a Local Government entity and under Section 3(2) of the Act, it became a Central Government entity administered by the Central Government. In practicality, this meant that Central Government would have direct authority over Kampala, with the Minister in charge of the Presidency, also being made responsible for the city. Thus, the old Kampala City Council ("KCC") was transformed into the Kampala Capital City Authority ("KCCA or the municipality"). The Act became effective on 1 March 2011. The key feature of the Act (and the one which provided the impetus to reform the city's operations) was the separation of the political arm of the city from the managerial functions.

The political arm of Kampala City ("the Authority") comprises 34 elected councillors, representing specific electoral districts, special interest groups (such as youth and persons with disabilities) and various professional bodies (architects, medical practitioners and the law society). At the helm of the Authority is the Lord Mayor who presides over all Authority meetings, performs various ceremonial functions and helps formulate strategies and programmes for the development of the city. Divisional Mayors are also elected to represent the five divisions in Kampala City. Primarily the role of the Divisional Mayors and elected councillors is to maintain contact with the residents of the electoral area, and thereby gain an understanding of the needs and challenges facing the populations, as well as overseeing the impact of programmes that have been implemented. Based on these interactions the councillors can then make recommendations and proposals to the Authority, which can be included in the KCCA's development plans.

In contrast to the political Authority, KCCA's Executive Director and the Deputy Executive Director are appointed by the State President on the recommendation of the Public Service Commission. This ensures independence from the political authority as their positions are not dependent on the councillors or the Lord Mayor. The administration of the KCCA is split into ten directorates, covering such areas as Engineering and Technical services, Public Health and Environment, Physical Planning, Legal Affairs, Treasury, Revenue Collection and Internal Audit. To each Directorate, a Director and Deputy Director are appointed, under whom a team of managers oversee the various aspects of the city's operations. Currently KCCA has over 400 staff members, of which only a small portion were employed by the KCC.

As per the Act, KCCA is responsible for the day-to-day management of the city, as well as its financial wellbeing and strategic direction. Thus, its responsibilities broadly include:

- Initiate and formulate policy, set service delivery standards and monitor the administration and provision of services.
- Enact legislation for the management of the City.
- Construct and maintain roads, storm drainage, street lights and other transport infrastructure.
- Support public institutions such as schools, hospitals, libraries, museums, public parks and the like.
- Promote economic activity within its jurisdiction, including the establishment of slaughterhouses and markets, as well as supervising and licencing street vendors and transport operators.
- Regulate and licence various types of establishments, including bars, clubs, and lodgings.

Although KCCA has the power to enact legislation, any ordinances passed have to first gain the approval of the Attorney General and then be signed off by the Lord Mayor. The municipality can also institute and collect on certain taxes, fees and charges, but in many cases the tariffs that can be charged are determined by the national government. Nevertheless, KCCA does have the power to raise certain fees, and is actively engaging the National Government on tariff rates where increases are deemed appropriate.

An internal audit directorate has been established to ensure that all operations within KCCA comply with the necessary legislation and that all business is conducted in an ethical manner. Besides conducting an annual financial review of KCCA, the Auditor General ("AG") also reviews the municipalities internal control systems and compliance with legislation. As at June 2013, the AG noted that certain requirements of KCCA under the Act had not yet been fulfilled, including the formation of standing committees under each directorate (to oversee its operations, and to review relevant bills and ordinances); a Public Accounts Committee (to examine the AG's report, internal audit reports, and the findings of government committees and to ensure the applicable recommendations are implemented), and a Metropolitan Physical Planning Authority (to oversee transport and infrastructural development, as well as all physical planning requirements).

The issue of standing committees has since been addressed, with the committees beginning work during the 2013/14 financial year. Other committees have also since been constituted or significant progress made towards their formation. Thus the AG gave KCCA an unqualified audit opinion for 2014, a first for the municipality.

Sources of income

The success of KCCA is most clearly evident in the rise in income. In F11, the year just prior to its formation, its predecessor, KCC, reported total income of just UGX98.8bn. Since then, income has increased rapidly, reaching UGX226.5bn in F14. Of this, UGX72.2bn was generated internally, compared to UGX39.5bn in F12, the first financial year under the new authority. While the municipality remains heavily dependent on government grant funding, the increase in grants is also a reflection of the improved performance of KCCA, which has given the National Treasury and other funders confidence that grant monies are being used appropriately. Grant funding is projected to remain around 60% of total funding over the short to medium term, albeit that as internal income rises more rapidly, grant funding will increasingly be used for capital projects.

Table 2: Sources of income	F12		F13		F14	
	UGX'm	%	UGX'm	%	UGX'm	%
Property rates	11,325.0	10.0	14,516.4	8.8	24,146.2	10.7
Parking fees	5,390.3	4.7	12,530.4	7.6	15,917.1	7.0
Business licences	8,766.3	7.7	13,268.4	8.0	12,926.4	5.7
Service taxes	9,076.7	8.0	8,697.4	5.3	11,401.5	5.0
Other	4,964.7	4.4	6,529.2	4.0	7,830.9	3.5
Total IGR*	**39,523.0**	**34.8**	**55,541.8**	**33.6**	**72,222.1**	**31.9**
Grants	71,895.6	63.3	88,160.3	53.4	154,112.9	68.0
Other	2,170.7	1.9	21,485.6	13.0	159.3	0.1
Total income	**113,589.3**	**100.0**	**165,187.7**	**100.0**	**226,494.3**	**100.0**

* Internally generated funds.

Grant funding

Not only did grant funding double between F12 and F14, but there was a shift in the type of grants received. The major increase in grants was to support the upscaling of KCCA, reflected in the large operating grants. To this end, substantial investments have been made in KCCA's IT infrastructure and developing more modern municipal management systems. However, as the organisation reaches critical mass and is able to generate increased internal revenue to cover operational requirements, such grants are expected to taper off. Thus, F14 saw a shift in spend towards capital projects funded directly from the National Treasury and through other government agencies. These included the development of a produce market (UGX21.1bn) and increased funding for roads (UGX12.4bn).

Table 3: Grant Funding (UGX'm)	F12	F13	F14	B15
Operational	27,452.4	63,091.9	78,747.7	67,074.8
Capital	44,443.2	25,068.4	38,090.1	77,653.5
Other gov. units	-	-	33,693.9	-
External funding	-	-	3,581.3	22,517.1
Total	**71,895.6**	**88,160.3**	**154,112.9**	**167,245.4**

Significantly, development institutions have renewed grant funding to the city and engaged the municipality on several projects, following a curtailment in such funding to the old KCC due to its inefficiency and corruption. In F14, this derived primarily from a solar light project financed by China, but included small amounts from several other agencies. The UGX22.5bn budgeted for F15 is to be provided by the World Bank for the initial phase of the Kampala Institutional and Infrastructure Development Plan (KIIDP2).

Funding from National Treasury is not provided directly to KCCA, i.e. it does not transfer cash to the municipality's accounts. Rather the National Treasury issues letters of commitment covering the amounts it has agreed to provide KCCA. When services are performed for KCCA, the service providers submit an invoice for payment, which is registered and confirmed by staff within the municipality. Thereafter it is loaded onto the National Treasury's payment system, and after another set of validations, is paid. For KCCA staff, the salary run is also submitted to National Treasury, which then transfers the necessary funds to KCCA for payment. However, for staff employed by the municipality but administered at the national level (such as teachers and nurses), the salaries are processed and paid directly through the central payroll system. This system does, however, directly expose KCCA to the National Government's financial strength. Thus, should the government be unable to meet its commitments, it is unlikely that KCCA would be provided with sufficient cash to settle its wages and expenses. Nevertheless, while actual annual transfers have been below initial commitments, the difference has been relatively low.

Property rates

Property rates are one of KCCA's primary sources of internal funding. Legislation allows the municipality to collect rates on all commercial properties and those rented out, but since 2005 owner-occupied residences have been exempt from rates. Nevertheless, KCCA managed to almost double rates income from F12 to F14, as a result of efforts to better identify and classify properties within the city limits, and capture them in the billing system. This included reclaiming land and buildings that belonged to the city but were being used by private persons or businesses, with no compensation paid to the city.

Expanding the rates pool by updating the rates roll to ensure all those liable for rates are identified and timeously billed has been a major focus of KCCA. Nevertheless, there remains numerous properties that have not been identified and correctly classified, or to which improvements have been done but not registered. A further constraint on the growth in rates' income has been the delay in conducting a municipal revaluation exercise. While legislation allows for revaluations to be conducted every five years, this has not been undertaken in Kampala for ten years. A revaluation is currently underway and should be complete by FYE15. Aside from increasing the property values upon which rates are charged, the exercise will help to accurately identify the nature and location of properties. Thus KCCA is budgeting for a substantial increase in rates income, from UGX24.1bn in F14 to UGX28.1bn in F15 and UGX30bn in F16.

Parking fees

Parking fees comprise two components being charges for parking along the road and in public parking lots within the city, and secondly the licence fees charged to taxi operators. Actual parking fees are collected by a private company, which pays a monthly fee of UGX150m to KCCA for the right (although this can reduce slightly due to various considerations). The contract was entered into by the old KCC and still has several years to run.

Similar to rates income, KCCA has concentrated on registering and licensing all taxi operators in the city. Not only has this allowed the city to generate income through greater compliance with license fees, but has also facilitated clearer insight into the industry. With more accurate data on the number of taxis operating in the city, KCCA has been able to upgrade taxi ranks and better plan infrastructure. Following a period of strict licence enforcement, KCCA now estimates that around 90% of taxis in the city are registered.

To increase income from these sources, KCCA is planning to raise the parking tariffs in the city, which will in turn increase the amount paid to it by the parking management company. In addition, the city is considering building a multi-level parking garage to address the lack of parking in the CBD. With regards licencing, KCCA is aiming for full compliance from the taxi operators. Together, these measures should help double the amount generated from parking fees from UGX15.9bn in F14 to UGX30bn by F16.

Business licences and service taxes
Licences fees are earned by the city through the licencing of all businesses. While licences are more easily applied to formal business, there is an effort to bring a greater number of street vendors and informal traders under regulation. This has led to the steady growth in fees in recent years. Also included in licence fees are restaurants, bars and gambling establishments. Service taxes are flat taxes levied on a variety of services. One of the largest contributors is the hotel tax, which is levied on each room night spent in a hotel.

Business license fees are projected to increase by around 50% from UGX12.9m in F14 to UGX19.2m in F16, as more traders are brought into the tax net and continued strong economic growth expands the number of businesses in the city. Growth in service taxes is, however, expected to be more gradual, rising to UGX12.9m by F16.

Other income
Other income comprises a host of items including market charges, refuse collection charges, fines and penalties, inspection fees and advertising/billboards, amongst others. Positively, while each individual item remains low, there has been a steady increase in income (across all categories) from these sources.

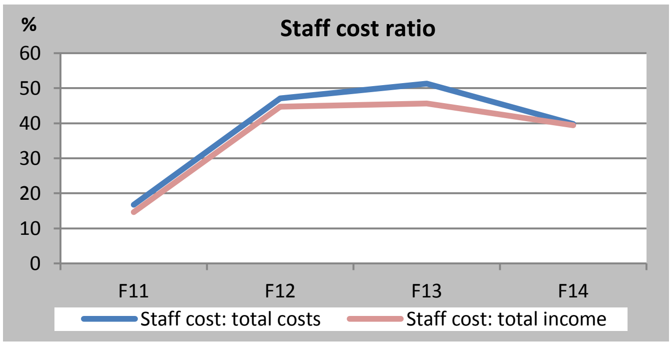
Accrued income
KCCA has, in the past, recognised revenue on a modified cash basis, with revenue billed but not collected accrued at the end of the year. Thus, accrued revenue in F13 related primarily to property rates and ground rentals, amounting to UGX19.1m. However, the municipality has shifted to an accrual basis of accounts and the amounts were recognised as revenue for F14. The AG had previously expressed concerns regarding the lack of documentation to support the accrued revenue balance, but KCCA has begun keeping the required ledgers.

Expenditure

Supported by higher income, KCCA has been able to raise the level of services it provides the city. This has resulted in a corresponding increase in expenditure over its three year history, particularly in terms of repairs and maintenance and other capital related items, such as design studies and plans, and monitoring and supervision (under other expenditure). While the proportion of staff costs remains high, consumption of goods and services has been flat (UGX21.5bn in F14 versus UGX23.2bn in F13), pointing to more prudent and sustainable expenditure patterns.

Table 4: Expenditure	F12		F13		F14	
	(UGX'm)	%	(UGX'm)	%	(UGX'm)	%
Salaries and wages	50,829.2	47.1	75,310.2	51.3	89,308.7	39.8
Grants & donations	7,739.0	7.2	5,589.6	3.8	7,590.7	3.4
Depreciation	0.0	0.0	979.8	0.7	2,673.0	1.2
Goods and services	17,908.0	16.6	23,192.3	15.8	21,516.8	9.6
Other expenses	11,835.0	11.0	6,966.0	4.7	36,931.0	16.4
Repairs & maint.	19,578.4	18.1	34,734.5	23.7	48,878.4	21.8
Prov. for bad debts	0.0	0.0	0.0	0.0	17,660.2	7.9
Total	**107,889.5**	**100.0**	**146,772.4**	**100.0**	**224,558.8**	**100.0**

Salaries and wages
Following the establishment of KCCA, the wage bill rose substantially from UGX14.5m in F11 to UGX50.8m in F12. This was the consequence of the increased headcount within the new municipality necessary to ensure a successful turnaround. In addition, the new hirings comprised a high proportion of skilled individuals and professionals, which required larger salary packages. While the gross value of staff expenditure rose sharply to UGX75.3m in F13 and UGX89.3m in F14, on a relative basis it decreased in F14. Thus, the ratio of staff cost to total costs peaked at 51.3% in F13, before decreasing to 39.8% in F14. In terms of total income, the staff expense ratio has been more moderate, with staff costs to income remaining relatively stable at 45% in F12 and F13, before declining to 39.4% in F14.



The AG has expressed concerns that less than an a third of the 1,332 posts that the Authority has approved have been fulfilled, with this likely to have a negative impact on service delivery. GCR does not, however, consider KCCA to currently have sufficient scale to justify such a high staff component, even if the funds were to be provided by the National Treasury. While the sharp downward trend in F14 indicates that new hirings are having a positive economic impact on KCCA, the staff cost ratio (whether to total expenses or income) remains above the 35% benchmark that GCR considers to be prudent for public entities.

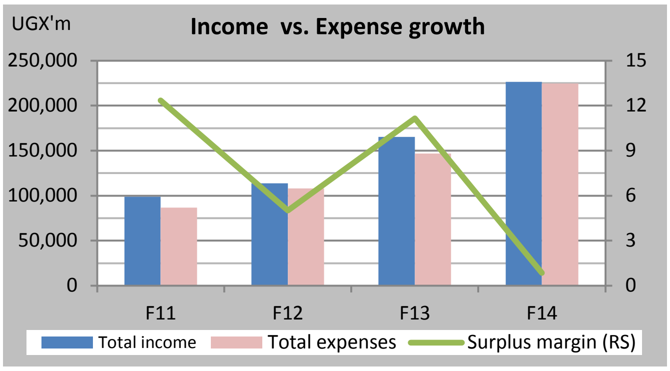
Repairs and maintenance
Positively the amount spent on repairs and maintenance has more than doubled from UGX19.6bn in F12 to

UGX48.9bn in F14. This reflects KCCA's efforts to rehabilitate much of the city's infrastructure, and where such repairs are done, to ensure they are of a high standard. Much of this has focussed on the road and drainage infrastructure, to ensure that even gravel roads are able to withstand the rainy season without the constant need for repairs. The city has also stepped up its inspection of roads and infrastructure to identify emerging problems, such as potholes, which can then be timeously repaired before they escalate and require major rehabilitation. However, management cautioned that the high maintenance cost was also a factor of the aging fleet of municipal vehicles, particularly large vehicle such as garbage trucks and construction equipment. Given the poor servicing history, these vehicles now require significant spend to ensure they are operable (even at low levels of reliability). To this end, the city is considering various options to renew its vehicle fleet. This includes outsourcing functions such as waste management to a private party, or alternatively maintaining the functions in-house but leasing vehicles on full maintenance contracts.

Grants
Grants paid relate to the public facilities that KCCA operates and maintains, but does not generate revenue from. These include hospitals, schools and some smaller institutions. Grant funding is provided from the National Government to KCCA, which then utilises the funding to maintain these facilities. Nevertheless, since its establishment, KCCA has ensured that the physical condition and service levels of these institutions has improved, reversing many years of decline. This has been achieved through refurbishments to certain facilities, and a more professional management approach. The municipality has also indicated that it may use internal funding (once collections reach targeted levels) to further improve hospitals and schools, and thus better serve its residents.

Financial performance

A four-year financial synopsis of KCCA is presented at the back of this report. Financial statements for F11 reflect the period immediately prior to the establishment of KCCA in its current form, and thus the accounts, while informative, are not strictly comparable. While financial statements for F12 and F13 were approved by the AG subject to certain qualifications, an unqualified audit opinion was provided for F14. An emphasis of matter was raised on the treatment of debtors, but this relates in part to legacy debtors and is being addressed through improved systems going forward.



As is evident in the graph above, both income and expenses have increased substantially since KCCA was formed in F12. Thus, operating revenue rose 37% to UGX226.5bn in F14, following a 45% increase in F13. Growth in expenditure rose by 53% in F14 to match available income (F13: 36%). Much of the increase resulted from UGX17.7bn in provisions for bad debt, with provisions in previous years not expensed through the income statement. As a result, KCCA reported only a negligible surplus of UGX1.9bn in F14 (F13: UGX18.4bn), translating into a surplus margin of less than 1% (F13: 11.1%).

When analysing operating income on a cash basis, receipts have been somewhat lower. In F13, the difference was attributed mainly to accrued revenue of UGX21.2bn and in F14 to a shortfall in grant income from other sources of around UGX24bn. While KCCA can direct funding from other grants to specific projects, in many instances it is paid directly to the contracting party and does not impact the cash flow statement. Thus, while an estimated UGX80bn was spent on capital projects in F14, only UGX51.6m flowed through KCCA's accounts.

Cash operating expenses have also been lower that those accrued in the income statement. This has allowed for relatively high cash surpluses from operations, which have then been utilised for capital projects, with small net cash outflows reported in F13 and a negligible inflow in F14.

Table 5: Cash flows (UGX'm)	F12	F13	F14
Receipts from op revenues	113,250.8	143,824.1	200,636.2
Payments from op revenues	(99,418.4)	(107,739.1)	(147,380.9)
Net cash inflow from ops.	**13,832.4**	**36,085.0**	**53,255.3**
capex	(6,379.6)	(45,505.3)	(51,640.2)
Net cash movement	**7,452.9**	**(9,420.3)**	**1,615.1**

Asset profile

Fixed assets
One of the major tasks faced by KCCA following its establishment was to compile an accurate asset register. KCC did not maintain a register and it was unclear what properties belonged to the council and should be transferred to KCCA, who was occupying these properties and what they were being used for. KCCA thus requested the AG to conduct an audit of which properties belonged to the municipality, whereafter

KPMG was commissioned to carry out a physical verification of the assets and their locations. The results of the two exercises were compiled into a single asset register that was submitted to the Government Valuer for revaluation. The net result was an almost ten-fold increase in the value of KCCA's fixed assets from UGX45.1bn at FYE12 to UGX420.9bn at FYE13. Newly identified properties and development activity helped raise the value of fixed assets to UGX448.4bn at FYE14. Of this around 95% relates to land and buildings.

Revenue collection and debtors

Having inherited a poorly performing debtors book, KCCA has invested substantial resources in improving the debtors function. This has included investment in information systems and other collections infrastructure, as well as the recruitment of new staff. Thus, KCCA spent UGX9.5bn of revenue administration in F14, compared to just UGX724m in F12, of which UGX6.9bn related to staff (F12: UGX234m; F13: UGX3.7m). This helped raise collections to UGX70bn in F14, from UGX55.5bn in F13, to slightly exceed the annual target of UGX68.2m.

Table 6: Debtors book (UGX'm)	F12	F13	F14
Opening balance	n.a	80,024.4	83,691.5
Adjustments	n.a	n.a	(3,667.1)
Additions	n.a	21,150.0	36,058.2
Collections	n.a	(14,507.9)	(33,557.7)
Written off	n.a	(2,975.0)	(12,266.8)
Gross debtors	**80,024.4**	**83,691.5**	**70,258.1**
Provisions	(25,585.1)	(25,107.4)	(7,025.8)
Total	**54,439.3**	**58,584.1**	**63,232.3**
Provision ratio (%)	32.0	30.0	10.0

* Includes collections for market fees, advertisements, local service tax and hotel tax, which were not included in F13.

As part of its debtors clean-up exercise, KCCA wrote off UGX12.3bn in debtors during F14. These related primarily to fees owed by traders at various markets that are considered irrecoverable. However, at the same time, improvements to overall debtors' management and collections have reduced expected future arrears, leading the municipality to return the flat provision for doubtful debts to 10%, from 30% in F13. This has been encouraged by the improved collection of outstanding debtors, which exceeded new debtors in F14. More significantly, current debtors were fully collected in the preceding period, with the debtors age analysis reflecting only long standing debtors. More than 95% of debtors have been outstanding for over one year. A large portion of these relate to government entities, with whom KCCA is engaged in payment discussions through the National Treasury. While no commitments have been given, there are positive indications from the Treasury that they may compel government agencies to settle their municipal charges.

Although collecting long outstanding debtors will provide KCCA with a strong cash injection that can be used for capital projects, what is more important for long term financial independence is that high collection ratios are sustained, thus providing a stable and predictable source of cash flow. This will greatly aid in the planning and rollout of new services and infrastructure.

Cash and equivalents

KCCA initiated a new account settlement and cash collection system in F12. Previously, the collection of rates, taxes and fees for KCC was undertaken by third parties and the money paid over to KCC. However, the system proved very inefficient and much of the money collected went unaccounted for. Under the new system, residents are required to pay their accounts to the city at one of banking chains with whom KCCA has signed a memorandum of understanding (which include all the major banking groups in the country). As per the MoU, the banks collect the payments on behalf of the city and retain the funds in dedicated bank accounts. Funds are then transferred to KCCA's collection account at the Bank of Uganda each Friday. While the banks do not charge a fee for the collection services, they do not pay the municipality interest on positive balances.

Another important development in the improved management of the city's cash was the reduction of bank accounts from over 150 to 15 at present. Having so many accounts gave rise to malfeasance, as there was little control over what money was in each account and who had signing power over the account. Currently, KCCA only has one collections account at each bank, and at the Bank of Uganda there are only two; one into which the commercial banks transfer their collections and the other being an expenditure account (into which collections are ultimately transferred). It is only against the expenditure account that cheques can be drawn and only by a limited number of people. Bank accounts may be opened for specific projects, but there must be a strong justification and permission must be granted from the necessary KCCA directors.

As at FYE14, KCCA had just UGX10bn in cash on hand (FYE13: UGX13bn), well below the UGX54.5bn at FYE11. As a result, cash on hand was just 16 days at FYE14, from 230 days at FYE11. While this is well below the 90 days benchmark that GCR considers prudent for municipalities, it reflects the particulars of KCCA's cash management strategy, whereby the National Treasury does not directly transfer KCCA budget, but rather meets its expenses as they arise. In addition, cash is purposely maintained at low levels, and generally allocated as it is received, to ensure that it is not misappropriated. Thus, although cash holdings had increased to UGX31bn at 1H F15, the majority is allocated to expenditure in the second half.

Funding

KCCA's accumulated surplus has increased substantially from UGX77.3bn at FYE12 to UGX470bn at FYE14. This was primarily the result of the aforementioned revaluation of the fixed asset base.

KCCA finances its operations through the cash it generates and government grants. Trade credit does provide an alternate source of financing, but this is short term and the city strives to settle creditors within the specified payment period. To this end, improved efficiencies in the invoicing system have resulted in a decline in long outstanding in creditors, which helped reduce trade creditors from UGX20bn at FYE12 to just UGX13.8bn at FYE14, despite the greater scale of expenditure.

Since its establishment, KCCA has not made any recourse to debt funding. The UGX42.6bn that continues to be reflected on the balance sheet relates to a loan dating back to 1991. The funding was loaned to the Government of Uganda and then on lent to KCC for a specific project that was completed in June 2000. The national government has since repaid its obligation, but KCC's obligation to the government was never serviced. In light of the above, and given its limited capacity to begin servicing the debt, KCCA has approached the Ministry of Finance to have the debt written-off. The ministry has indicated that it will write-off the debt, but has given no firm commitment regard.

KCCA is, however, considering raising debt funding for future projects. Management is currently engaging various parties to investigate projects that lend themselves to debt financing, with the determining factor being projects that would be able to generate sufficient revenue to service the obligation. Nevertheless, progress is being hampered by legislation that restricts the amount of debt a municipality can assume to 10% of internal revenue. Even with the strong growth in internal revenue, the small amount that could be raised limits the viability of any debt programme. KCCA has, however, begun initial discussions with treasury to ease this restriction, but the processes of changing the legislation and identifying a project suggests that any debt capital funding initiatives will only proceed in 12-18 months.

Forecast and outlook

KCCA is projecting strong growth in internal income in F15 and F16, on the back of the significant improvements made to the rates and licencing registers, as well as debtor's collection. This would see internal revenue rise to UGX94.5bn in F15 and UGX108.5bn in F16, to account for a higher 36% and 39% of total income respectively. Progress in this regard was made during 1H F15, with YoY internal income climbing by 20% to UGX37.2bn. While this was just 39% of the full year budget, management indicated that collections are generally stronger in the second half.

Table 8: 1H F15 and forecast income statement (UGX'm)	Actual		Budget	
	1H F14	1H F15	F15	F14
Income				
Property rates	3,459.6	6,300.3	28136.2	30760.6
Parking fees	12,160.6	12,904.0	20386.8	28749.2
Business licences			17354.3	19203.9
Services taxes	5,785.0	6,760.2	10426.3	12850.2
Other	9,141.1	11,251.4	18169.9	16892.8
Internal income	**30,546.3**	**37,215.9**	**94,473.5**	**108,456.7**
Grants	78,870.7	85,635.1	164,770.0	163,760.0
Total income	**109,417.0**	**122,851.1**	**259,243.5**	**272,216.7**
Expenditure				
Salaries and wages	(47,529.1)	(56,191.9)	-	-
Grants & donations	(4,967.6)	(4,741.7)	-	-
Goods and services	(13,210.9)	(14,618.8)	-	-
Other expenses	(5,682.7)	(6,538.9)	-	-
Repairs & maint.	(36,726.7)	(23,816.6)	-	-
Total expenditure	**(108,117.0)**	**(105,907.9)**		
Surplus/(deficit)	**1,300.0**	**16,943.2**	-	-

Staff costs rose by an annualised 25% in 1H F15, to account for a much higher 53% of total expenses. This was the result of the additional appointments during the period, which are expected to bolster collections going forward. Other expenses rose by around 10% on an annualised basis, reflecting the increased income available to fund core operations.

Growth in grant funding is expected to slow going forward, as KCCA become more self-sufficient. Thus total grants are expected to rise by just 9% in F15 and remain flat thereafter (barring any major government funded capex).

Capital expenditure

KCCA has formulated a five year capital investment plan to improve the infrastructure of the city. If implemented, the plan will cost an estimated USD1.8bn (UGX5.2trn) and cover objectives such as slum upgrades, street naming, road network reconstruction, an integrated public transport system, storm drainage and disaster management, and upgrading the city's healthcare schools and recreation facilities, as well as various economic development initiatives. The majority of funding (USD1.6bn) is allocated towards improving the transport infrastructure, with almost USD1bn needed to upgrade roads, build flyovers and improve junctions. A rapid bus transit project is also being strongly considered, as well as other means of public transport. However, such projects cannot be met by KCCA or the Government of Uganda and will require substantial funding from development agencies and other international donors.

In the short term, KCCA is projecting capex of UGX126.4bn in F15, rising to UGX149.6bn in F16 and UGX169.3bn in F17. Around 40% is allocated for maintenance, with the remainder to be used for new projects. The bulk of this spend will be directed towards roads and transport in an effort to ease the congestion in the city, with other major expenditure being on education and capacity building within the public sector.

Conclusion and rating rationale

Since its status was changed in F12, KCCA has made significant strides in improving its level of service delivery. This has been facilitated by a corporatised approach to managing the city, which has driven efficiencies and best practices throughout the organisation. The improvement is most clearly evident in the strong growth in internally generated income over the past three years, with significant efforts directed towards identifying individuals, business and properties that are liable for rates, taxes and fees, and updating the various databases and rates rolls accordingly. With greater accuracy in billings and increased compliance across the board, KCCA expects to post further strong growth in internal income over the medium term.

Nevertheless, KCCA’s financial position is constrained by the substantial socio-economic challenges faced by most of its residents. This has limited the amount of income the municipality can generate, while at the same time increasing the burden of service delivery.

Aside from raising internal revenue, the improved operational capacity of KCCA has engendered greater confidence in its ability to deliver on large infrastructure projects. Accordingly, both the Government of Uganda and various DFIs have been encouraged to more actively engage KCCA on potential projects. Maintaining the confidence of DFI’s is critical for KCCA, as it will need their assistance to implement the substantial infrastructure programmes that are necessary.

Strong government support is considered in support of the credit rating. Such support is implied by the critical role KCCA plays in Uganda, being the most populous city and the centre of economic activity. Thus, actions taken by KCCA have a direct and substantial impact on the national government as a whole. Moreover, this support is demonstrated by the active role played by the cabinet and National Treasury in managing the city’s finances, while at the same time providing the operational autonomy necessary to take tough action to improve Kampala’s fortunes. However, KCCA’s lack of cash holdings and reliance on the National Treasury to meet its funding commitments does expose to city to liquidity shortages, should Uganda experience economic difficulties.

Through improved income, KCCA is also building up the necessary capacity to support commercial debt funding. Currently, however, debt funding is capped at 10% of internal revenue, a limitation that will have to be eased if the municipality is to tap the commercial debt market. Thus, no substantial debt funding is expected in the short term, while KCCA has indicated that any issuance would only be done in support of a project that could generate sufficient revenue to cover its debt funding obligations.

Kampala Capital City Authority

(UGX in Millions except as Noted)

INCOME STATEMENT Year end: 30 June	2011	2012	2013	2014
Tax revenues	52,074.3	39,523.0	55,541.8	72,222.1
Grant funding	46,335.9	71,895.6	88,160.3	154,112.9
Other income	426.4	2,170.7	21,485.6	159.3
Total income	**98,836.6**	**113,589.2**	**165,187.7**	**226,494.3**
Bad debt write-offs and provisions	0.0	0.0	0.0	(17,660.2)
Expenses	(86,632.1)	(107,889.5)	(146,772.4)	(206,898.5)
Net interest & capital charges	0.0	0.0	0.0	0.0
Surplus/(deficit) before taxation	**12,204.5**	**5,699.7**	**18,415.4**	**1,935.6**
Transfer (to)/from treasury	0.0	(11,956.4)	16.2	0.0
Net surplus/(deficit)	**12,204.5**	**(6,256.7)**	**18,431.6**	**1,935.6**
BALANCE SHEET				
Funds, Reserves & Accumulated Surplus	**112,834.2**	**77,339.4**	**443,863.3**	**469,954.5**
Short term debt	0.0	0.0	0.0	0.0
Long term debt	42,570.4	42,570.4	42,570.4	42,570.4
Total debt	**42,570.4**	**42,570.4**	**42,570.4**	**42,570.4**
Non interest bearing liabilities	16,099.8	20,796.1	9,262.8	12,902.5
Total Liabilities	**171,504.4**	**140,705.9**	**495,696.6**	**525,427.4**
Fixed Assets & WIP (net of loans redeemed & other capital receipts)	45,094.1	48,993.9	420,937.9	448,350.3
Investments & other (excl. cash investments)	0.0	2,629.7	0.0	0.0
Net debtors	71,894.7	54,439.2	58,950.5	63,448.9
Inventory	0.0	1,660.1	2,842.0	3,633.4
Cash & cash investments*	54,515.6	32,301.9	12,966.2	9,994.8
Other current assets	0.0	681.1	0.0	0.0
Total Assets	**171,504.4**	**140,705.9**	**495,696.6**	**525,427.4**
CASH FLOW STATEMENT				
Cash generated by operations	26,801.1	1,318.0	45,341.0	60,148.8
Utilised to increase working capital	0.0	12,514.4	(9,256.0)	(6,923.4)
Cash flow from operations	**26,801.1**	**13,832.4**	**36,085.0**	**53,225.3**
Net capital expenditure	(3,437.9)	(6,379.6)	(45,505.3)	(51,640.2)
Net investment activity (excl. cash investments)	0.0	0.0	0.0	0.0
Borrowings: increase / (decrease)	0.0	0.0	0.0	0.0
Cash and cash investments : (increase)/decrease	(23,363.1)	(7,452.9)	9,420.3	(1,585.1)
Net debt: increase/(decrease)	**(23,363.1)**	**(7,452.9)**	**9,420.3**	**(1,585.1)**
KEY RATIOS				
Credit Protection Measures:				
Gross interest cover (x)	n.a.	n.a.	n.a.	n.a.
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.
Operating cash flow interest cover - gross (x)	n.a.	n.a.	n.a.	n.a.
Operating cash flow : net debt (%)	n.a.	134.7	121.9	163.4
Total debt : capital outlays (%)	94.4	86.9	10.1	9.5
Total debt : total income (%)	43.1	37.5	25.8	18.8
Net debt : total income (%)	n.a.	9.0	17.9	14.4
Net capex : total income (%)	3.5	5.6	27.5	22.8
Current ratio (:1)	7.9	4.3	8.1	6.0
Days cash on hand (days)	229.7	109.3	32.2	16.2
Days cash on hand (days) - excluding unspent conditional grants	229.7	109.3	32.2	16.2
Bad debt writeoffs : current debtors (%)	0.0	0.0	0.0	0.0
Efficiency:				
Staff expenses : total expenses (%)	16.7	47.1	51.3	39.8
Staff expenses : total income (%)	14.6	44.7	45.6	39.4
Distribution loss - water (%)	n.a.	n.a.	n.a.	n.a.
Distribution loss - electricity (%)	n.a.	n.a.	n.a.	n.a.
Debtors : tax, general & trading income (%)	73.1	48.9	40.8	27.9
Collection period (days)	266.7	178.3	148.8	102.0
Gross debtors: total income (%)	72.7	47.9	50.7	31.0
Net debtors: total income (%)	72.7	47.9	35.7	28.0
Growth Statistics:				
Increase in salaries and allowances (%)	n.a.	251.2	48.2	(2.3)
Increase in debtors (%)	n.a.	(24.3)	53.7	13.5
Increase in capex (%)	n.a.	85.6	613.3	10.0
Increase in net debt (%)	n.a.	n.a.	188.3	163.4

GLOSSARY OF TERMS/ACRONYMS USED IN THIS DOCUMENT AS PER GCR'S CORPORATE GLOSSARY

Bad Debt	When a business recognises that a debt is unlikely to be repaid. It is classified as defaulted and written-off as an expense in the profit and loss account.
Balance Sheet	Also known as Statement of Financial Position. A statement of a company's assets and liabilities provided for the benefit of shareholders and regulators. It gives a snapshot at a specific point in time of the assets the company holds and how they have been financed.
Capital Expenditure	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 Flow Statement	The cash flow statement shows the cash flows associated with the operating, investing and financing activities of a company, combining to explain the net movement in cash holdings.
Credit Risk	The possibility that a bond issuer or any other borrowers (including debtors/creditors) will default and fail to pay the principal and interest when due.
Current Ratio	A measure of a company's ability to meet its short-term liabilities and is calculated by dividing current assets by current liabilities. Current assets are made up of cash and cash equivalents ('near cash'), accounts receivable and inventory, while current liabilities are the sum of short-term loans and accounts payable.
Debt Financing	Raising capital by selling debt instruments such as bonds, bills or notes.
Economic Indicators	Statistical data about country's economy, such as unemployment figures, the Consumer Price Index (CPI), Gross Domestic Product (GDP), money supply and housing statistics. This data gives information about the future direction of output and demand in an economy.
Financial Year	The year used for accounting purposes by a company or government. It can be a calendar year or it can cover a different period, often starting in April, July or October. It can also be referred to as the fiscal year.
Fixed Assets	Assets of a company that will be used or held for longer than a year. They include tangible assets, such as land and equipment, stake in subsidiaries and other investments, as well as intangible assets such as goodwill, information technology or a company's logo and brand.
Income Statement	A summary of all the expenditure and income of a company over a set period.
Intangible Assets	The non-physical assets of a company such as trademarks, patents, copyright, information systems and goodwill.
Interest Cover	Interest cover is a measure of a company's interest payments relative to its profits. It is calculated by dividing a company's operating profit by its interest payments for a given period.
Interest Rate	The charge or the return on an asset or debt expressed as a percentage of the price or size of the asset or debt. It is usually expressed on an annual basis.
Liquidity Risk	The risk that a company may not be able to take or meet its financial obligations or other operational cash requirements due to an inability to timeously realise cash from its assets.
Operating Cash Flow	A company's net cash position over a given period, i.e. money received from customers minus payments to suppliers and staff, administration expenses, interest payments and taxes.
Operating Profit	Profits from a company's ordinary revenue-producing activities, calculated before taxes and interest costs.
Working Capital	Working capital usually refers to net working capital and is the resource that a company uses to finance day-to-day operations. It is calculated by deducting current liabilities from current assets.

SALIENT POINTS OF ACCORDED RATINGS

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

Kampala Capital City Authority 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 credit rating/s has been disclosed to Kampala Capital City Authority with no contestation of the rating.

The information received from Kampala Capital City Authority and other reliable third parties to accord the credit rating(s) included the 2014 audited annual financial statements (plus three years of comparative numbers), Five year strategy report, details of debtors facilities, Auditor General Reports 2013 and 2014, internal and/or external management reports, 2015 budgeted income statements, as well as legislative framework and corporate governance.

The ratings above were solicited by, or on behalf of, the rated client, and therefore, GCR has been compensated for the provision of the ratings