

Lagos State Government of Nigeria

2020 Municipal Final Rating Report



Lagos State Government of Nigeria

Rating Assigned:

A+

This is a municipal with good financial condition and strong capacity to meet local currency obligations in a timely manner

Outlook: Stable

Issue Date: 21 December 2020

Expiry Date: 30 September 2021

Previous Rating: A+

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RATING RATIONALE

- Agusto & Co. hereby affirms the “A+” rating assigned to the Lagos State Government (“Lagos”, “the State” or “LASG”) on account of the State’s resilient financial condition and strong capacity to meet local currency obligations in a timely manner from its internally generated revenue (IGR) and share of centrally collected revenue. However, we note the adverse impact of COVID-19 pandemic on businesses and households which culminated into a recession in 2020 (as Gross Domestic Product declined for two consecutive quarters, Q2’2020: -6.10% and Q3’2020: -3.62%) and the attendant impact on LASG’s finances given its significant contribution to the nation’s GDP. In addition, we note negatively the poor compliance with the land use charge law by Lagos residents and closure of many businesses during the COVID-19 pandemic lockdown which led to a reduction in internally generated revenue in the State as well as the heightened civil unrest which resulted in the destruction of properties and loss of lives in various part of Nigeria and Lagos, in particular. Nonetheless, we note that Lagos State remains one of the most economically viable states in the country that can function independently of the share of centrally distributed funds.
- In the financial year ended 31 December 2019 (FYE 2019), Lagos State recorded total revenue (including grants) of ₦644.7 billion, marginally lower by 1.3% than the prior year, while total expenditure declined to ₦577.8 billion (2018: ₦649.6 billion), resulting in a surplus of ₦66.9 billion. In the same period, LASG’s posted a positive net operating cash flow (OCF) of ₦241.4 billion – down by 12% from the prior year and recorded total identifiable assets and liabilities of ₦2.4 trillion (2018: ₦2.52 trillion) and ₦957.5 billion (2018: ₦1.09 trillion) respectively as at FYE 2019.
- In FYE 2019, Lagos State’s internally generated revenue (IGR) declined by 3% to ₦414.8 billion (representing 64% of total revenue) from prior year mainly due to marked reduction in land use charge levies elicited by non-compliance with the new Land Use Charge Law 2018, which has now been revoked. In the same period, the State’s share of statutory allocation (SA) dipped by 3% year-on-year to ₦59.7 billion but value added tax rose by 9% year-on-year to ₦107.7 billion. SA & VAT accounted for 9% and 17% respectively of total revenue. Agusto & Co. notes positively that Lagos State remains one of the most economically viable states in the country that can function independently of the SA, which is highly susceptible to externalities.
- As at FYE 2019, Lagos State’s total borrowings of ₦785.5 billion represented 121% of 2018 total revenue, which is higher than the 50% threshold set for state governments by the Investment and Securities Act 2007 (ISA). However, we note that the State qualifies under the terms of the Exemption Order 2019, which spares states from the operation of Section 223 of the ISA. Nonetheless, the State’s net

debt as a percentage of free cash flow of 177% and interest payment as a percentage of revenue of 10% in FYE 2019, are both in line with our expectations and better than many states in the country.

- In the nine months ended 30 September 2020 (Q3'2020), Lagos State's internally generated revenue stood at a low ₦310.9 billion¹ due to lower non-PAYE related income and we estimate IGR to close circa ₦398.5 billion by the end of 2020, which will represent a 14% decline from the 2020 revised budget estimate. Similarly, LASG's share of SA also trended southward at ₦39.5 billion for Q3'2020, falling below prior-year comparable figure by 9%. However, VAT accruable to LASG in Q3'2020 remained upbeat at ₦93.8 billion and is poised to print at about ₦125 billion by the end of 2020, which will be about 16% higher than FYE 2019 level. While we attribute the decline in the State's overall revenue in 2020 to the weak macroeconomic environment, the continuous spread of the COVID-19 pandemic, the slow restart of businesses post lockdown as well as the recent civil unrest which resulted in huge damage to properties and loss of lives in the State, we believe that the State still has potential and the framework to ramp up IGR in the medium term.
- Overall, we forecast Lagos State's total revenue to dip by 8% from the prior year to ₦595.6 billion by the end of 2020, with IGR accounting for 67%, while VAT, SA and other capital receipts will represent 21%, 8% and 4% respectively. In our opinion, Lagos State's revenue profile is robust, stable and sustainable.
- In November 2020, the Governor Mr Babajide Sanwo-Olu presented the Year 2021 Budget of ₦1.15 trillion tagged "Budget of Rekindled Hope" split into capital expenditure (60%) and recurrent expenditure (40%), to further advance the THEMES agenda across all areas with particular emphasis on youth employment by focusing on sectors with huge job-creating potential such as agriculture, construction, technology and security. Similar to the 2020 budget of ₦1.169 trillion (later revised to ₦920.5 billion on account of Covid-19 pandemic), the State's 2021 Budget is expected to be funded largely with revenue of ₦962.5 billion (with IGR component of ₦795.7 billion). Agosto & Co. notes that the State historically operates a deficit budget, which is financed through a combination of external sources such as external loans, domestic commercial loans and bond issuances.
- Going forward, the State Government remains committed to fostering a conducive environment where businesses and households would thrive by creating an enabling atmosphere. Thus, the State has prioritized development initiatives under its policy trust of THEMES², which cuts across critical sectors. Agosto & Co. believes that the successful execution of projects earmarked under this programme will result in an improved economic condition of Lagos State in the medium term.
- Based on the aforementioned, we hereby attach a **stable** outlook to the Lagos State Government of Nigeria.

¹ Ministry of Economic Planning and Budget, September 2020 (Year To Date) Budget Performance Report dated 28 October 2020

² THEMES - Traffic Management & Transportation, Health & Environment, Education & Technology, Making Lagos a 21st century Economy, Entertainment & Tourism and Security & Governance

Figure 1: Strengths, Weaknesses & Challenges

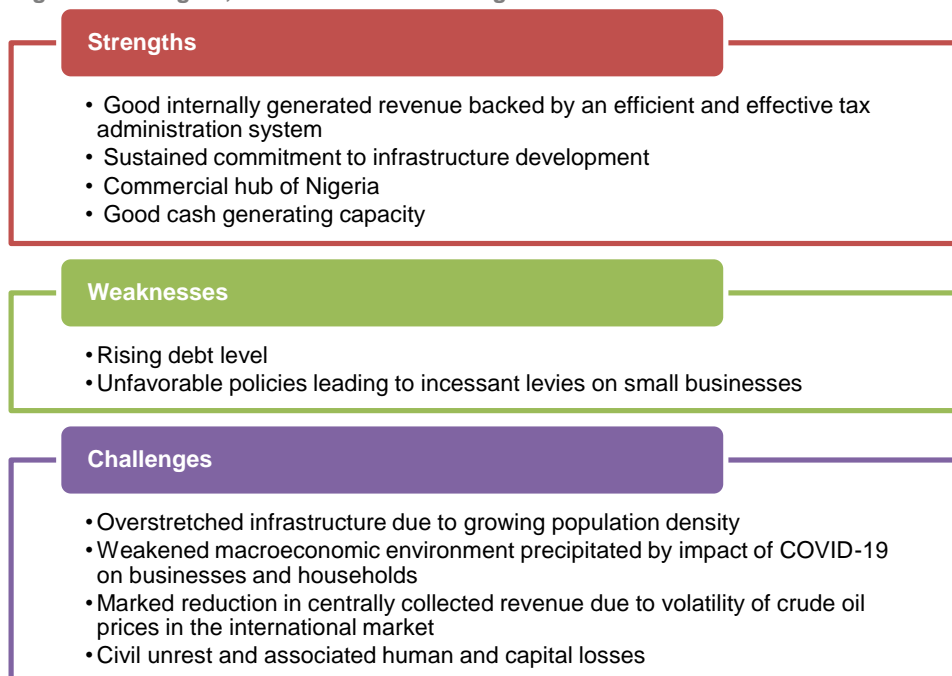
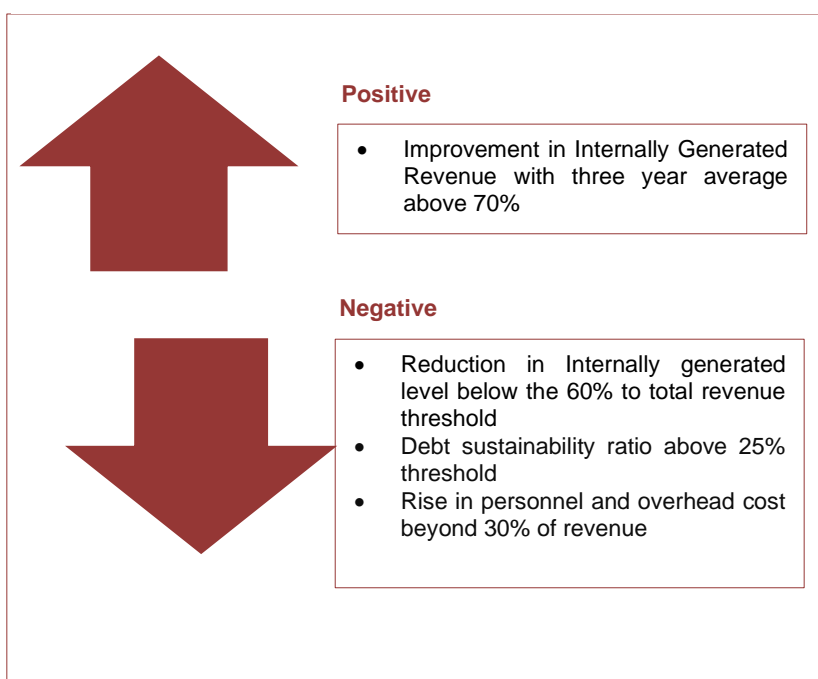


Figure 2: Rating Triggers

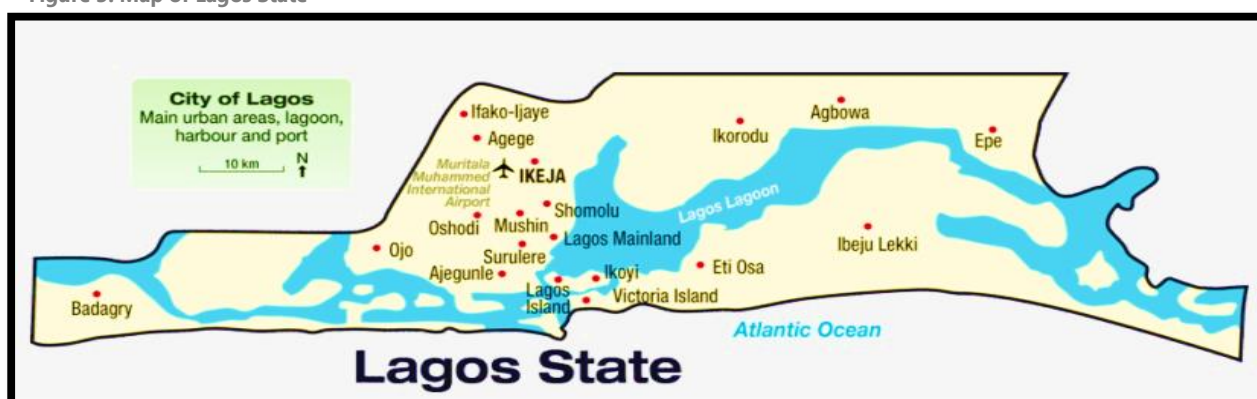


MUNICIPAL PROFILE

ABOUT LAGOS STATE

Lagos State was created on 27 May 1967 through the States Creation and Transitional Provisions Decree No. 14 of 1967, which divided Nigeria's Federation into 12 states. The State was Nigeria's administrative capital from 11 April 1968 until 12 December 1991, when the seat of Government was moved to Abuja.

Figure 3: Map of Lagos State



Lagos State is the smallest state in the country by landmass occupying 3,577 sq. km. The State is bounded in the North and East by Ogun State, in the West by the Republic of Benin and stretches over 180 kilometres along the Guinea Coast of the Bight of Benin on the Atlantic Ocean. Lagos consists of several landmasses separated by creeks, lagoons and rivers. The dominant language spoken in the State is Yoruba. Pidgin English (a diluted form of English) is also spoken by the majority of its residents.

The State comprises five administrative divisions³, 20 Local Governments and 37 Local Council Development Areas. According to the Lagos Bureau of Statistics, Lagos is estimated to have a population of about 25.6 million people and population density of 892,990.6/ sq.km as at the end of 2018. The most populous local governments in the State are Alimosho, Ajeromi/Ifelodun and Shomolu. Due to the small landmass, the State is experiencing high growth in areas such as Ibeju-Lekki and Epe on account of ongoing land reclamation projects and an increasing number of residential dwellers. According to the National Bureau of Statistics Q2'2020 Unemployment report, Lagos boasts of the largest active labour force of 6.8 million in the country and has an average literacy rate of 58.2% in 2019, higher than the national average of 43.5%.

Lagos State is the commercial capital of Nigeria as it contributes about 30% to the Nation's Gross Domestic Product (GDP) and accounts for over 60% of Nigeria's industrial investments, foreign trade and commercial activities. In 2019, Lagos' GDP was estimated to grow by 4.2% to ₦30.8 trillion⁴ and GDP per capita at \$3,244.27 (2018: \$3,212.82). The State has two airports - one international and one domestic, both located at Ikeja. Also, the State plays host to Nigeria's leading port, which is one of the largest and busiest in Africa. The Lagos port is divided into three - the Lagos port, Apapa port & Tin Can port, each serving varying needs.

Under the leadership of the Governor, Mr Babajide Sanwo-Olu, the State has prioritized economic growth and development under the policy trust programme of "THEMES" with the aim to making Lagos, Africa's model megacity and economic & financial hub. The THEMES programme which will be implemented over the four-year tenor of this administration covers the following thematic areas: Traffic Management & Transportation, Health & Environment, Education & Technology, Making Lagos a 21st century Economy, Entertainment & Tourism and Security & Governance.

³ The five administrative divisions are known as IBILE – Ikorodu, Badagry, Ikeja, Lagos Island and Epe

⁴ Lagos Bureau of Statistics, Ministry of Economic Planning and Budget - Lagos State Government Socio-Economic Characteristics 2018/2019

POLITICAL STRUCTURE

There are three arms of government in Lagos State, namely the Executive, the Legislative and the Judiciary. Each arm is empowered by the constitution of the Federal Republic of Nigeria to function independently and in a collaborative manner for the overall development of the State and welfare of the citizens.

The **Executive arm** of the State Government is responsible for daily administration and is led by the Executive Governor, Mr Babajide Olusola Sanwo-Olu, who is assisted by the State executive council.

The Governor, Mr Babajide Sanwo-Olu holds a Bachelor's degree in Surveying & Geo-Informatics and a Master of Business Administration (MBA) in Management, both from the University of Lagos. Mr Sanwo-Olu is also an alumnus of the Harvard Kennedy School of Government, London Business School and the Lagos Business School. In addition, he is a member of the Nigerian Institute of Directors (IOD), Chartered Institute of Personnel Management (CIPM), and Fellow of Nigeria Institute of Training and Development (NITAD).

In 2003, he was appointed first as Special Adviser to the Deputy Governor on Corporate Matters; and later as Special Adviser to the Executive Governor on Corporate Matters in 2004. Later, he was appointed acting Commissioner for Economic Planning & Budget from 2004 to 2005 and became the substantive Commissioner for Commerce and Industry in 2007. Mr Sanwo-Olu was appointed the Chief Executive Officer of the Lagos State Property Development Corporation (LSPDC) in 2016. On 29 May 2019, he was sworn in as the elected Governor of Lagos State under the All Progressive Congress (APC) political party for a term of four years.

Table 1: Executive Council of Lagos State Government

Name	Responsibility/Portfolio
Dr Kadri Obafemi Hamzat	Deputy Governor
Executive Council	
Mrs Sherifat Folashade Jaji	Secretary to State Government
Mr Hakeem Muri-Okunola	Head of Service
Mr Tayo-Akinmade Ayinde	Chief of Staff
Mr Gbolahan Lawal	Commissioner, Agriculture
Mrs Lola Akande	Commissioner, Commerce, Industry and Cooperatives
Mr Sam Egube	Commissioner, Economic Planning & Budget
Mrs Folashade Adefisayo	Commissioner, Education
Mr Lere Odusote	Commissioner, Energy and Mineral Resources
Mr Tunji Bello	Commissioner, Environment and Water Resources
Mrs Ajibola Ponle	Commissioner, Establishment, Training and Pensions
Dr Rabiu Onaolapo Olowo	Commissioner, Finance
Prof Akin Abayomi	Commissioner, Health
Mr. Anofi Olanrewaju Elegushi	Commissioner, Home Affairs
Mr Moruf Akinderu Fatai	Commissioner, Housing
Mr Gbenga Omotosho	Commissioner, Information and Strategy
Mr Moyo Onigbanjo (SAN)	Commissioner, Justice / Attorney General
Dr Wale Ahmed	Commissioner, Local Government and Community Affairs
Dr Idris Salako	Commissioner, Physical Planning and Urban Development
Mr Hakeem Fahm	Commissioner, Science and Technology
Engr Tayo Bamgbose-Martins	Commissioner, Special Duties & Inter-Governmental Relation
Mrs Uzamat Akinbile-Yusuf	Commissioner, Tourism, Arts & Culture
Dr Frederic Oladeinde	Commissioner, Transportation
Architect Kabiru Ahmed Abdullahi	Commissioner, Waterfront Infrastructure Development

Mrs Yetunde Arobieke	Commissioner, Wealth Creation and Employment
Mrs Bolaji Dada	Commissioner, Women Affairs and Poverty Alleviation
Mr Segun Dawodu	Commissioner, Youth and Social Development
Ms Ruth Bisola Olusanya	Special Adviser, Agriculture
Mr Bonu Solomon Saanu	Special Adviser, Arts & Culture
Mr Oyerinde Olugbenga Olanrewaju	Special Adviser, Central Business District
Princess Aderemi Adebawale	Special Adviser, Civic Engagement
Mr Oladele Ajayi	Special Adviser, Commerce and Industry
Mr Joe Igbokwe	Special Adviser, Drainage Services
Mr Tokunbo Wahab	Special Adviser, Education
Mrs Toke Benson-Awoyinka	Special Adviser, Housing
Mr Tubosun Alake	Special Adviser, Innovation and Technology
Mr Afolabi Ayantayo	Special Adviser, Political and Legislative Affairs
Mrs Solape Hammond	Special Adviser, Sustainable Development Goals and Lagos Global
Mr Oluwatoyin Fayinka	Special Adviser, Transportation
Hon Ayuba Ganiu Adele	Special Adviser, Urban Development
Engr Aramide Adeyoye	Special Adviser, Works & Infrastructure

The Legislative arm of the State Government is empowered by Section 90 of the Constitution of Federal Republic of Nigeria as amended and endowed with powers to legislate without hindrance for Lagos State. The Speaker, **Rt. Hon. Mudashiru Ajayi Obasa** leads the Lagos State House of Assembly. All the 40 elected members of the House (for a term of four years) belong to the APC political party.

The Judiciary is the arm of government empowered by the constitution and laws of the State with the responsibility for the general administration of justice in the State. The High Court of Lagos is the highest court of law in the State and **Hon. Justice Kazeem Olanrewaju Alogba** serves as the Chief Judge. The Lagos State judiciary is made up of the State High Courts, Magistrate Courts and Customary Courts. The High Court system in the State comprises the Criminal Division, the Lands Division, the Family and Probate Division, the Commercial (Fast Track) Division, the General Civil Division, the Special Offences Courts and the Sexual Offences Courts.

FINANCIAL CONDITION

ANALYSTS' COMMENTS

- Lagos State Government has prepared its Financial Statements for the year ended 31 December 2019 in line with the International Public Sector Accounting Standards (IPSASs) following the end of the three-year IPSASs transition period (1 January 2016 to 31 December 2018)

FINANCIAL PERFORMANCE

REVENUE PROFILE

In accordance with the International Public Sector Accounting Standards (IPSAS), Lagos State categorizes revenue into non-exchange and exchange transactions. Revenue from non-exchange transactions includes personal income tax (Pay-As-You-Earn), direct assessment, levies, fees and fines as well as share of centrally collected revenue (statutory allocation and value added tax), while Revenue from exchange transactions comprises capital receipts, investment income, interest income and income from other services.

Lagos State Government's sources of internally generated revenue include taxes on personal income, fines, licenses, fees and levies on business activities, as well as income from investments. Also, the State receives a monthly share of income from the Federation Account and Value Added Tax Pool as well as grants from development institutions for specific projects.

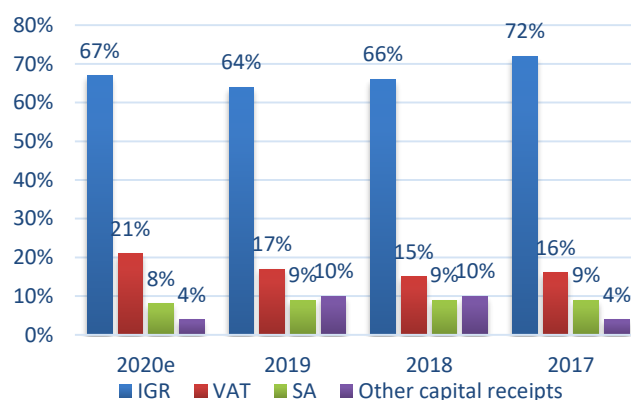
In the financial year ended 31 December 2019 (FYE 2019), Lagos State's total revenue declined marginally by 1.3% to ₦644.7 billion, mainly due to the drop in non-tax revenue related to levies. This decline is principally linked to the uncertainty which surrounded the collection of land use charge under the Land Use Charge Law 2018 which was later revoked in August 2020 by the State Government due to widespread dissatisfaction with the revised rates and non-compliance by property owners.

A breakdown of Lagos State's total revenue for FYE 2019 showed that income generated from internally generated revenue (which declined by 3% year-on-year to ₦414.8 billion) accounted for 64% (2018: 66%), while statutory allocation centrally distributed by the Federal Government (dropped by 3% year-on-year to ₦59.7 billion) represented 9% and share of value added tax (rose by 9% year-on-year to ₦107.7 billion) accounted for 17% of revenue. In addition, other capital receipts (refund from Paris Club and refund by FGN for road construction) accounted for 10% of the State's revenue in FYE 2019, similar to the previous year, whereas grants related to primary health care from multilateral agencies represented less than 1%.

Agusto & Co. notes the decline in the State's overall revenue in 2019 and expects this to continue in the near term on account of the weak macroeconomic environment impacting receipts from the FGN, the decline in GDP leading to a second recession in five years, the continuous spread of the COVID-19 pandemic (with Lagos as the epicenter) as well as the recent civil unrest which resulted in damage to properties and loss of lives in the State. We expect the aforementioned to culminate into a marked reduction in the State's total revenue in the short term.

Although Lagos State's Pay-As-You-Earn tax (PAYE), which is considered the most stable and sustainable source of revenue for state governments in Nigeria, grew by 12% y-o-y to account for 67% of IGR in 2019, income from other taxes⁵, levies, fines & fees⁶,

Figure 4: Revenue Breakdown (2017 - 2020e)



⁵ The taxes include direct assessment, capital gain tax, entertainment tax, withholding tax, tax penalties, property tax, stamp duties, development levy, business premises, tax on contract and other tax receipts

investment income⁷ and asset sales⁸ all declined year-on-year to represent 16%, 13%, 1% and 2% respectively of IGR in the period. As at end of September 2020 (Q3'2020), Lagos State's total IGR etched at a low ₦310.9 billion⁹ due to lower non-PAYE related income. Thus, we estimate that the State's IGR will close circa ₦398.5 billion by end of 2020, which will represent a 14% decline from the 2020 revised budget estimate of ₦461.7 billion and 4% lower than the FYE 2019 IGR. Notwithstanding, Agusto & Co. notes positively that the effective and efficient tax administration and collection system in the State coupled with the deployment of e-revenue collection systems, constant training of personnel and monitoring of critical revenue ecosystem remains the bedrock of LASG's stable and sustainable IGR profile.

In the financial year ended 31 December 2019, Lagos State's share of value added tax (VAT) remained upbeat growing by 9% to ₦107.7 billion, buttressed by increased commercial activities in the State in the period as well as the revolutionized value added tax administration system which has enabled compliance by taxpayers, encouraged the on-line filing of tax returns and continuous automation of collection and remittance of VAT to the government. Premised on the implementation of the new VAT rate which increased by 50% from February 2020, we expect sustained improvement in VAT accruable to Lagos State and this is evident by the Q3'2020 VAT collection which amounted to ₦93.8 billion. Therefore, we estimated VAT to print at ₦125 billion by end of 2020, which will be about 16% higher than FYE 2019 VAT level.

In 2019, the State's share of statutory allocation declined by only 3% to ₦58.1 billion as stable crude oil production volumes coupled with a higher exchange rate for converting crude oil receipts moderated the negative impact of volatility in crude oil prices in the international market in the period. As at end of September 2020, LASG's share of statutory allocation amounted to ₦39.5 billion and we project full-year 2020 to close at ₦48.2 billion (9% higher than the State's 2020 revised budget estimate) and represent a 17% decline from FYE 2019, due to drop in crude oil prices precipitated by the reduction in global demand.

Overall, we forecast Lagos State's total revenue to dip by 8% from the prior year to ₦595.6 billion by the end of 2020, with IGR accounting for 67%, while VAT, SA and other capital receipts will represent 21%, 8% and 4% respectively. In our opinion, Lagos State remains one of the most economically viable states in the country and its revenue profile is robust, stable and sustainable.

CASH FLOW PROFILE

A review of the Lagos State Government's Statement of Cash Flows for the financial year ended 31 December 2019, showed that inflow of cash from operating activities of ₦644.2 billion (2018: ₦627.7 billion), surpassed outflow of cash for operating activities of ₦402.8 billion, resulting in net operating cash flow (OCF) of ₦241.4 billion (2018: ₦275.4 billion). Similar to the prior year, LASG reported a negative net cash flow from investing activities of ₦237.5 billion (2018: ₦199.2 billion) and negative net cash flow from financing activities of ₦34.9 billion (2018: ₦38.7 billion), resulting in an overall negative net cash position of ₦31 billion in FYE 2019. Nonetheless, the State's discretionary cash flow (total revenue less mandatory payments¹⁰) to revenue ratio of 66% in 2019 (2018: 67%) and net debt as a percentage of free cash flow¹¹ of 175% (2018: 159%) are both in line with our expectations and better than most states in the country such as Ogun (55% & 85%), Edo (60% & 194%), Niger (41% & 190%) and Ekiti (41% & 237%).

In our opinion, Lagos State has a good and sustainable cash-generating capacity strongly supported by its internally generated revenue.

⁶ This relates to fines and fees, licenses and land use charge (LUC) – this significantly dipped by 82% from the prior year due to the proposed changes to the LUC rates which met strong resistance and non-compliance by affected property owners

⁷ This represents dividend income on State Owned Enterprises, interest income on short term deposits and income from investments

⁸ This includes income from land sales & regularization, sale of vehicle number plate, sale of housing units, survey fees, amongst others

⁹ Ministry of Economic Planning and Budget, September 2020 (Year To Date) Budget Performance Report dated 28 October 2020

¹⁰ This refers to personnel expenses, public debt charges (interest payments) and transfers and subvention to parastatals

¹¹ This is also known as discretionary cash flow

EXPENDITURE PROFILE

In line with the International Public Sector Accounting Standards, Lagos State classifies expenditure into operating and non-operating expenses, whether paid for or not. Operating expenses include salaries, wages & employee benefits, transfers & subventions to parastatals and general administrative expenses, while non-operating expenses consist of capital expenditure, public debt charges, and depreciation on non-current assets and net loss on foreign exchange transactions.

In the financial year ended 31 December 2019, Lagos State reported a total expenditure of ₦577.8 billion (2018: ₦649.6 billion) mainly due to lower spending on capital projects, thus resulting in an overall surplus (total revenue less expenditure) of ₦66.9 billion, up from ₦3.4 billion in the prior year. The State's total expenditure in 2019 was split into operating expenses (48%) and non-operating expenses (52%).

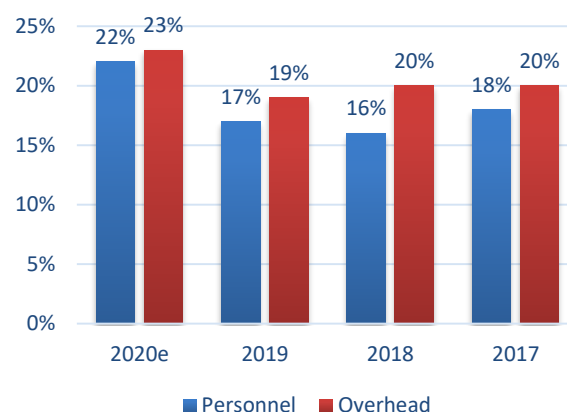
During the FYE 2019, LASG's total operating expenses rose marginally by 2% to ₦278.6 billion with personnel cost¹² accounting for 38%, while general and administrative expenses (i.e. overheads¹³) represented 36% and subvention to parastatals 19%. Although personnel expenses rose by 5% in absolute terms y-o-y to ₦107.1 billion due to higher salaries and wages occasioned by the new minimum wage implementation, it remained within our expectation in proportion to revenue at 17% (2018: 16%). On the flip side, LASG's overhead costs declined in absolute terms by 8% and represented 19% of revenue in FYE 2019, which we consider to be good. We note positively that Lagos State's personnel and overhead costs as a percentage of revenue in FYE 2019 are lower than many states in the country - Ogun (26% & 11%), Edo (22% & 25%), Ekiti (23% & 38%), Niger (42% & 22%), Benue (39% & 38%) and Plateau (29% & 23%).

In FYE 2019, the State's non-operating expenses consisting of capital expenditure (45%), depreciation on property, plant and equipment (35%) and public debt charges (20%) declined significantly by 20% to ₦299.2 billion from the prior year due to reduction in capital expenses as some scheduled projects were not undertaken in the review period. Agusto & Co. notes that Lagos State spent ₦134.5 billion (2018: ₦209.9 billion) on capital projects which represented 21% of revenue in FYE 2019 (the lowest in the last five years, where the average was 45%) and compares favourably to Ogun (18%) and Benue (9%) but less to Edo (44%), Ekiti (23%), Niger (33%) and Plateau (23%). However, LASG's public debt charges as a proportion of revenue remained within acceptable limits at 10% in the same period.

In the nine months ended 30 September 2020, Lagos State reported total expenditure of ₦528.7 billion mainly driven by personnel expenses (22%), overhead cost (24%) and capital expenditure (30%). Going forward, we expect Lagos' expenditure levels to remain within our benchmarks in the short term and thus we estimate personnel and overhead costs to revenue ratios to print circa 22% and 23% respectively by the end of 2020. Also, we expect Lagos State to increase capital spending in line with the 2020 revised Budget in a bid to improve the overall socio-economic condition of the State, especially following the aftermath of the wanton destruction of properties and loss of lives that occurred in October 2020 on account of the civil unrest.

In our view, the State's overall expenditure profile is satisfactory.

Figure 5: Personnel & Overhead Costs to Revenue (2017 - 2020e)



¹² This comprises wages, salaries and employment benefits of civil servants and public office holders in the State

¹³ This consist of general and administrative expenses such as consultancy & professional services, general office expenses, special duties expenses, security expenses and maintenance services

FINANCIAL POSITION

ASSET & LIABILITY STRUCTURE

In line with the International Public Sector Accounting Standards (IPSAS), Lagos State elected to adopt the transitional exemptions in IPSAS 33 which allows for a three-year transitional period for recognition and measurement of assets and liabilities. As at 31 December 2019, Lagos State had complied with the extant guidelines and provisions stipulated by IPSASs except for full consolidation of subsidiaries, associates and joint ventures, hence the State is not able to make an explicit statement of its full compliance with the accrual basis IPSASs as at FYE 2019.

As at 31 December 2019, Lagos State's total identified assets stood at ₦2.4 trillion (2018: ₦2.52 trillion) split into non-current assets (97%) and current assets (3%). The State's pool of identified non-current assets comprised property, plant and equipment¹⁴ (97%), available-for-sale-investments¹⁵ (2%) and other financial assets (1%). Agusto & Co. notes positively that Lagos State has continued to use the cost model¹⁶ consistently to measure its non-current and current assets in line with relevant IPSASs.

As at FYE 2019, the State's total identifiable liabilities stood at ₦957.5 billion, down by 12% from the prior year mainly due to a reduction in sundry liabilities in the year under review. A breakdown of Lagos State's total liabilities as at 31 December 2019 showed that total borrowings (comprising internal loans, external loans and bonds in issue) accounted for 82%, while payables and other liabilities (including sundry payables), retirement benefit obligations due to employees and finance lease obligations¹⁷ represented 13%, 4% and 1% respectively. As at the same date, the State's total borrowings of ₦785.8 billion (2018: ₦797.4 billion) consisted of foreign loans (54%), internal loans (24%) and local bonds in issue (22%).

As at FYE 2019, Lagos State's external loan portfolio comprised 24 active loan facilities for various projects with different international institutions repayable in foreign currencies with an outstanding principal value of \$1.39 billion (equivalent to ₦428.7 billion), with tenors of 20 to 40 years, moratorium periods ranging from 5 to 13 years and at concessionary interest rates between 0.75% and 2.37% per annum. All the foreign loans are backed by irrevocable standing payment orders (ISPO) which serve as security for the loans. In our opinion, the concessionary rates coupled with the longer tenors offered by these agencies, reduces the annual debt service burden on the State, save for continued devaluation of the local currency as these loans were not hedged by the State.

During the year under review, Lagos State restructured all its existing internal loans with the various local banks to a uniform interest rate of 14% per annum (from the previous interest rate range of 18% to 22%) and tenor of 54 months effective from November 2019. Thus, the State had 24 internal loan facilities with a cumulative outstanding principal value of ₦187 billion at an interest rate of 14% as at 31 December 2019 (and further reduced to 12% subsequent to the year-end). Agusto & Co. notes that this restructuring will result in cost savings and reduce the debt service burden of the State in the near term.

As at 31 December 2019, Lagos State had three discrete bonds in issue, following the redemption of the erstwhile ₦80 billion Bond in November 2019, with an aggregate outstanding principal balance of ₦170.5 billion: ₦87.5 billion 7-Year 13.5% due 2020¹⁸; ₦47 billion 16.5% 7-Year due 2023; and ₦97.3 billion Series II Bond (made up of ₦46.3 billion 7-Year 16.75% due 2024- Tranche I, ₦38.7 billion 10-Year 17.25% due

¹⁴ This refers to property plant and equipment such as infrastructure assets, land and buildings, plant and machinery, office equipment, furniture and fittings, computer equipment, motor vehicles and capital work in progress

¹⁵ This represents LASG's investment in Quoted Securities and Unquoted Investments as at 31 December 2019

¹⁶ Under the cost model, annual depreciation charges using applicable rates will apply to relevant asset classes on a periodic basis

¹⁷ This relates to lease agreements with five independent power generation companies in the State – Akute Power Limited, Island Power Limited, Alausa Power Limited, Mainland Power Limited and PIPP LVI Genco Limited – with minimum lease term of ten years each. The lease agreements state that the power generation companies are to build and operate power plants which would provide electricity to LASG, with a minimum 97% guaranteed availability, thus they have been treated as finance lease in line with relevant IPSASs.

¹⁸ The final principal and coupon payment on the ₦87.5 billion Bond is due 27 November 2020

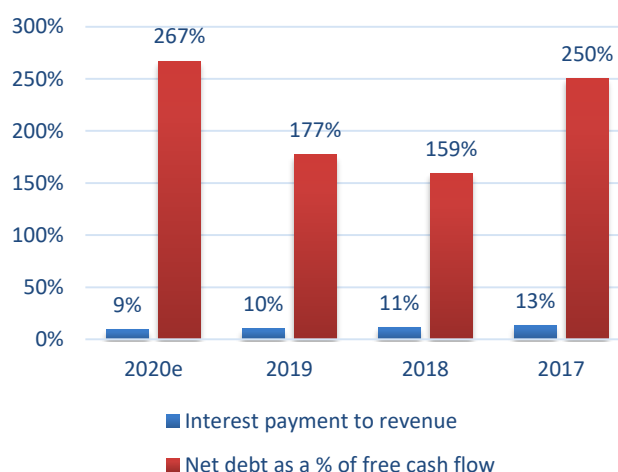
2027-Tranche II, ₦6.91 billion 6⁷/₁₂-Year 15.6% due 2024- Tranche III and ₦5.34 billion 9⁷/₁₂-Year 15.85% due 2027- Tranche IV). Furthermore, we note that all the bonds in issue are backed by monthly ISPOs on the State's share of statutory allocation and internally generated revenue. Also, the total cumulative amount in the sinking fund account of the respective Bonds stood at ₦3.6 billion as at FYE 2019.

Based on the State's debt profile as at FYE 2019, LASG's total public debt of ₦785.8 billion represented 121% of 2018 revenue, which is higher than the 50% borrowing limit set by the Investment and Securities Act 2007 (ISA) for state governments in Nigeria. However, we note that the State qualifies under the terms of the Exemption Order 2019, which frees states from the operation of Section 223 of the ISA. Nonetheless, LASG's net debt as a percentage of free cash flow of 177% and interest payment as a percentage of revenue of 10% in 2019 are both in line with our expectations and considered satisfactory.

Subsequent to FYE 2019, Lagos State issued a ₦100 billion 10-year Bond in January 2020 to finance infrastructural development projects in line with the THEMES policy, thus aggregate debt level rose to ₦984.6 billion as at 30 September 2020. Nonetheless, we estimate that the State's net debt as a percentage of free cash flow and interest payment to revenue will close at 267% and 9% respectively by the end of 2020, which are still within our benchmarks of 400% and 20% respectively.

Agusto & Co. expects the State to continue to service its financial obligations principally supported by its good internally generated revenue and acceptable debt sustainability ratio of less than 25%.

Figure 6: Interest Payment to Revenue and Net Debt as a % of free cash flow (2017 - 2020e)



OUTLOOK

The year 2020 has been beset by several challenges globally and locally, which has impacted the State's economic profile as well as its overall financial condition. Firstly, the State has the largest number of COVID-19 cases in the country, which elicited complete and later partial lockdown of commercial activities for several weeks in the year. Also, the recent civil unrest in October 2020, which culminated into the destruction of properties and loss of lives has further placed a huge recovery burden on the State in terms of infrastructural facilities and restoring public confidence of a favourable operating environment for businesses and households. Agusto & Co. notes that the knock-on effect of these have impacted the State's financial condition in 2020 (evidenced by the sub-par nine months to September 2020 financial performance when compared to the 2020 revised budget and 2019 performance) and we estimate that some of the adverse effects such as loss of revenue from tolls, lower collections from land use charge, amongst others will linger in the near term. Notwithstanding, we believe that continued good working relationship amongst the three arms of government in the State will help to restore public confidence in the near term.

During the nine months ended 30 September 2020, the State recorded total internally generated revenue of ₦310.9 billion, the share of SA amounted to ₦39.5 billion and VAT income etched at ₦93.8 billion. Overall, we forecast Lagos State's total revenue for FYE 2020 to close at ₦595.6 billion (which will represent an 8% decline from the prior year) with IGR accounting for 67%, while VAT, SA and other capital receipts will represent 21%, 8% and 4%.

Under the leadership of Governor Babajide Sanwo-Olu, the State remains focused on birthing favourable social and infrastructural conditions to foster economic growth, which is the trust of the "THEMES" policy. The THEMES is LASG's six strategic development pillars focused on - Traffic Management & Transportation, Health & Environment, Education & Technology, Making Lagos a 21st century Economy, Entertainment & Tourism and Security & Governance. Projects under the THEMES framework accounts for a significant part of the 2020 revised capital expenditure budget and the Government plans to achieve even development across the State through these thematic areas and consequently improve the economic condition of Lagos in the medium term.

Going forward, the State plans to further optimize its borrowing cost by renegotiating its existing interest rates with lenders and bondholders (subject to early redemption clauses in the respective bond Trust Deeds), given the prevailing low-interest regime in Nigeria. Also, the Governor has indicated intention (to pass an Executive Order) to repeal the Public Office Holder (Payment of Pension Law 2007) which provides for payment of pension and other entitlements to former governors and their deputies. Agusto & Co. notes that the aforementioned initiatives if successful will reduce the cash flow burden on the State in the short to medium term. In November 2020, the Governor presented the Year 2021 Budget of ₦1.15 trillion tagged "*Budget of Rekindled Hope*" split into capital expenditure (60%) and recurrent expenditure (40%), to further advance the THEMES agenda across all areas with particular emphasis on youth employment by focusing on sectors with huge job-creating potential such as agriculture, construction, technology and security. The State's 2021 Budget is expected to be funded with revenue of ₦962.5 billion (internally generated revenue estimated at ₦795.7 billion) and other sources to make up the balance.

Overall, we envisage some deterioration in Lagos State's ability to generate IGR or receipt of its share of SA from the Federal Government in the short to medium term. However, this will not impair the State's capacity to meet its local currency obligations as and when due. We have attached a **stable** outlook to the Lagos State Government of Nigeria. Our outlook reflects the potential impact of the aforementioned challenges on the finances of the State and the economy in the near term. We believe that Lagos State will be able to withstand this adverse impact to a large extent than other states in the country due to its strong internally generated revenue and good economic profile.

FINANCIAL SUMMARY

REVENUE & SPENDING	MGT A/C		IPSAS		IPSAS		IPSAS	
	30-Sep-20		2019		2018		2017	
REVENUE	N'mns	%	N'mns	%	N'mns	%	N'mns	%
Tax revenue								
Personal Income Tax	264,033.0	56%	279,792.3	43%	250,011.7	38%	234,089.0	46%
Share of VAT collected centrally	93,841.0	20%	107,704.2	17%	99,055.2	15%	80,231.7	16%
Share of other revenues collected centrally (Stat. Allocation)	39,821.0	9%	58,142.3	9%	59,743.1	9%	43,331.7	9%
Other capital receipts (refund from Paris Club and refund by FGN for Road Construction)	23,759.0	5%	63,648.9	14%	64,275.2	14%	18,216.6	4%
Other taxes	<u>33,896.0</u>	<u>7%</u>	<u>68,208.8</u>	<u>15%</u>	<u>65,046.6</u>	<u>14%</u>	<u>60,139.5</u>	<u>9%</u>
	455,350.0	97%	577,496.5	97%	538,131.7	90%	436,008.5	83%
Non-tax revenue								
Asset sales	-		8,972.28	1%	18,226.43	3%	10,020.35	2%
Investment income	209.0	0%	3,239.0	1%	4,624.2	1%	10,122.0	2%
Others - levies, fines & fees	<u>12,831.0</u>	<u>3%</u>	<u>54,571.0</u>	<u>8%</u>	<u>91,134.4</u>	<u>14%</u>	<u>53,305.0</u>	<u>10%</u>
	13,040.0	3%	66,782.3	10%	113,985.0	17%	73,447.3	14%
TOTAL REVENUE	468,390.0	100%	644,278.8	108%	652,116.7	108%	509,455.8	98%
<i>Of which internally generated revenue (IGR) is</i>	310,969.0	66%	414,783.4	64%	429,043.3	66%	367,675.9	72%
Grants	-	-	483.9		906.1		1,541.8	
TOTAL REVENUE & GRANTS	468,390.0	-	644,762.7	-	653,022.9	-	510,997.6	
SPENDING								
Transfers (including pension costs)	44,066.0	10%	50,825.2	11%	38,330.2	7%	38,189.7	7%
Interest payments	38,013.0	9%	62,533.2	13%	72,453.6	13%	65,613.2	11%
MDA spending	<u>360,635.0</u>	<u>81%</u>	<u>362,247.8</u>	<u>76%</u>	<u>444,572.4</u>	<u>80%</u>	<u>474,651.4</u>	<u>82%</u>
TOTAL SPENDING	442,714.0	100%	475,606.2	100%	555,356.3	100%	578,454.3	100%
<i>MDA spending is made up of</i>								
Personnel costs	96,469.0	22%	107,132.2	23%	101,901.1	18%	92,238.7	16%
Purchase of goods & services	104,795.0	24%	120,594.0	25%	132,715.7	24%	104,241.7	18%
Capital expenditure	<u>159,371.0</u>	<u>36%</u>	<u>134,521.7</u>	<u>28%</u>	<u>209,955.6</u>	<u>38%</u>	<u>278,171.0</u>	<u>48%</u>
TOTAL MDA SPENDING	360,635.0	81%	362,247.8	76%	444,572.4	80%	474,651.4	82%
BUDGET BALANCE	25,676.0		169,156.5		97,666.6		(67,456.7)	
BUDGET BALANCE AS % OF GDP	0.1%		0.5%		0.3%		-0.2%	
FINANCING								
Surplus of prior years	3,430.2		3,396.3		3,362.6		(196,759.1)	
Domestic borrowing (net)	60,864.0		(27,893.8)		(31,921.9)		15,937.0	
External borrowing (net)	(9,528.0)		(7,262.6)		(6,547.4)		6,696.8	
Other								
TOTAL FINANCING	54,766.2		(31,760.2)		(35,106.6)		(174,125.3)	
Foreign Loans- New Borrowings	-		1,543.9		-		13,840.0	
Repayment during the year	9,528.0		8,806.5		6,547.4		7,143.2	
Foreign loan balance	533,929.5	-	428,723.3		438,249.1		454,414.0	
Domestic- New Loans	130,000.0		116,090.3		45,000.0		137,387.0	
Loan due (repaid) within the year	69,136.0		143,984.1		76,921.9		121,450.0	
Domestic loan balance	450,823.4	-	357,120.1		359,180.8		390,168.7	
Total Debt	984,752.9	-	785,843.4		797,429.9		844,582.7	

KEY RATIOS	30-Sep-20	2019	2018	2017
Revenue				
IGR as % of GDP	1%	1%	1%	1%
Tax revenue as % of GDP	2%	2%	2%	2%
Total revenue as % of GDP	2%	2%	2%	2%
IGR as % of total revenue & grants	66%	64%	66%	72%
Tax revenue as % of IGR	85%	67%	58%	64%
Growth in tax revenue	-21%	7%	23%	18%
Spending				
Spending as % of GDP	1%	1%	2%	2%
Non-discretionary spending* as % of tax revenue	39%	38%	40%	45%
Capital expenditure as % of total spending	36%	28%	38%	48%
Payroll as % of revenue	21%	17%	16%	18%
Other overheads as a % of revenue	22%	19%	20%	20%
Budget balance/revenue	5%	26%	15%	-13%
Leverage				
Budget balance (₦'mns)	25,676.00	169,156.51	97,666.57	(67,456.69)
Debt as % of nominal GDP	3%	3%	3%	3%
Interest payments as % of total revenue	8%	10%	11%	13%
Principal due as % of Revenue	31%	18%	18%	24%
Financial flexibility				
Discretionary revenue** as % of total revenue	62%	66%	67%	62%
Net Debt as % of Free cash flow***	327%	177%	159%	250%
Non-discretionary spending as % of total spending	40%	46%	38%	34%
Outstanding Debt/Revenue	210%	122%	122%	166%
* Non-discretionary spending is made up of statutory transfers, interest payments and personnel costs				
** Discretionary revenue is total revenue minus non-discretionary spending				
*** Free cash flow is defined as revenue minus non-discretionary spending				

RATING DEFINITIONS

Aaa	This is the highest rating category. It indicates a municipal with impeccable financial condition and overwhelming capacity to meet local currency obligations in a timely manner.
Aa	This is a municipal that possesses very strong financial condition and very strong capacity to meet to meet local currency obligations in a timely manner.
A	This is a municipal with good financial condition and strong capacity to meet local currency obligations in a timely manner.
Bbb	This refers to municipal with satisfactory financial condition and adequate capacity to meet local currency obligations in a timely manner.
Bb	This refers to municipal with satisfactory financial condition but ability to meet local currency obligations in a timely manner may be contingent upon refinancing.
B	This refers to a municipal that has weak financial condition and ability to meet local currency obligations in a timely manner is contingent on refinancing.
C	This refers to a municipal with very weak financial condition and cash flows to meet obligations are inadequate therefore likelihood of default is high.
D	Municipal In default.

Rating Category Modifiers

A "+" (plus) or "-" (minus) sign may be assigned to ratings from 'Aa' to 'C' to reflect comparative position within the rating category. Therefore, a rating with + (plus) attached to it is a notch higher than a rating without the + (plus) sign and two notches higher than a rating with the - (minus) sign.

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