Lagos State Government of Nigeria

2022 Final Municipal Rating Review Report

Agusto&Co.

Research, Credit Ratings, Credit Risk Management

Lagos State Government of Nigeria

Rating Assigned:

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.

Outlook: Stable
Issue Date: 22 November 2022
Expiry Date: 30 September 2023

Previous Rating: A+

INSIDE THIS REPORT	

Analysts:

Ikechukwu Iheagwam
Ikechukwuiheagwam@agusto.com

Isaac Babatunde
isaacbabatunde@agusto.com

Agusto & Co. Limited
UBA House (5th Floor)
57, Marina
Lagos
Nigeria
www.agusto.com

RATING RATIONALE

- Agusto & Co. hereby upgrades the rating assigned to the Lagos State Government ("Lagos", "the State" or "LASG") to **"Aa-"** on account of the State's resilient financial condition, robust financial flexibility and very strong capacity to meet local currency obligations in a timely manner from its internally generated revenue (IGR) which accounts for over 70% of total revenue over the last three years. Also, the assigned rating reflects Lagos State's good and sustainable cash-generating capacity, acceptable expenditure profile and stable political environment elicited by the good working relationship amongst the tiers of government in the State. Although we note as a rating concern the rising stock of LASG's public debts, we recognize positively that the concessionary rates as well as the longer tenors for most of them have reduced the annual debt service burden. Overall, we opine that Lagos State remains one of the most strategic and economically viable states in the country that can function independently of the share of centrally distributed funds.

- In the financial year ended 31 December 2021 (FYE 2021), Lagos State recorded total revenue (including grants) of ₦770.8 billion, up by 17% from the prior year, while total expenditure rose to ₦840.7 billion (2020: ₦577.8 billion), resulting in a deficit of ₦69.9 billion (2020: deficit of ₦152.5 billion). However, if we adjust the net loss on foreign exchange transactions and non-cash depreciation, LASG would have reported total expenses of ₦685.3 billion and a surplus of ₦85.6 billion in 2021 (2020: deficit of ₦32.5 billion). In FYE 2021, LASG's posted a positive net operating cash flow of ₦313.9 billion (2020: ₦269.5 billion) and an overall net cash position of ₦6.5 billion (2020: ₦43.4 billion) reflecting a strong cash generating capacity. In line with the International Public Sector Accounting Standards (IPSAS) for recognizing and measuring assets and liabilities, the State's total identifiable assets and liabilities stood at ₦2.95 trillion (2020: ₦2.56 trillion) and ₦1.24 trillion (2020: ₦1.07 trillion) respectively as at FYE 2021.

- Lagos State's internally generated revenue (IGR) rose by 27% year-on-year to ₦573.1 billion in 2021, accounting for 75% of total revenue, mainly boosted by higher Pay-As-You-Earn tax (PAYE) as well as other taxes, levies and fines receipts. Over the last three years, the State's IGR has accounted for over 70% of total revenue, thus significantly reducing its dependence on centrally collected revenue from the Federal Government. In 2021, the State's share of statutory allocation (SA) increased by 7% to ₦54.7 billion (representing 7% of total revenue), while the share of value added tax (VAT) rose by 5% to ₦139.1 billion and accounted for 18% of revenue. Overall, Agusto & Co. notes positively the robustness in the State's revenue profile and anticipates further improvement in the near term bolstered by the ongoing State-led digital tax initiatives and increased economic and commercial activities.

- In the financial year ended 31 December 2021, Lagos State reported a total expenditure of ₦840.7 billion split into operating expenses (47%) and non-operating expenses (53%) in line with the IPSAS framework reflecting all expenses whether paid for or not. We note that personnel expenses and overhead costs (which are the main drivers of the State's recurrent expenditure) have been on the rise over the last three years due to higher inflationary pressures. However, LASG's personnel expenses to revenue ratio of 19% and overhead cost to revenue of 23% in 2021 were both in line with our benchmarks. Also, we recognize positively the State's commitment to infrastructure development evidenced by a capital spend of ₦214 billion in 2021 (representing 31% of total expenditure) up from ₦201.7 billion in 2020, mainly utilized for the construction and rehabilitation of roads, drainages and bridges to improve the operating environment in the State.

- As at 31 December 2021, Lagos State's total public debt stock rose by 15% to ₦1.16 trillion (split into domestic 52% and external borrowings 48%) and represented 176% of 2020 revenue, higher than the 50% threshold set for state governments by the Investment and Securities Act 2007. However, LASG's net debt as a percentage of free cash flow of 224%, debt service to revenue ratio of 21% and interest payment as a percentage of revenue of 9% in 2021, were all in line with our expectations and considered satisfactory.

- In the six months ended 30 June 2022 (unaudited), Lagos State reported total revenue (excluding grants) of ₦454.7 billion and this was significantly better than the H1'2021 performance. Going forward, we forecast total revenue to close at about ₦962 billion by the end of 2022 (representing a 25% rise from the prior year), with IGR accounting for 72%, while VAT, SA and other capital receipts will represent 16%, 6% and 6% respectively. As at 30 June 2022 (unaudited), the State obtained domestic commercial bank loans amounting to ₦172.6 billion and repaid ₦97.8 billion covering both domestic and external loans due in the period. As a result, the State's total debt (excluding gratuities, pensions & contractor arrears) stood at ₦1.27 trillion as at H1'2022 (split into domestic 58% and external borrowings 42%). As at the same date, the State's net debt as a percentage of free cash flow of 216%, interest payment as a percentage of revenue of 6% and debt service to revenue ratio of 22%, were all in line with our expectations and considered satisfactory. In our opinion, Lagos State's overall financial condition remains very strong and sustainable mainly buoyed by the resilient internally generated revenue.

- Going forward, the State Government remains committed to fostering a conducive environment where businesses and households would thrive by creating an enabling environment and prioritizing infrastructure development in critical sectors such as transportation, commerce and technology. Agusto & Co. notes that Lagos' strategic location, dynamic structural and institutional framework, and huge economic and commercial activities, provide the competitive advantage to become Africa's model megacity as well as an economic and financial hub in the medium term provided the threats to the security of life and property are greatly reduced.

- Based on the aforementioned, we hereby attach a **stable** outlook to the rating of the Lagos State Government of Nigeria.

Figure 1: Strengths, Weakness, Opportunities & Challenges

Strengths

- Stong internally generated revenue backed by an efficient and effective tax administration system
- Sustained commitment to infrastructure development
- Stable and peaceful political environment
- Commercial hub of Nigeria
- Strong cash generating capacity

Weakness

- Rising debt at sustainable level

Opportunities

- Rapidly developing innovation hub, entertainment and creative industry
- Increasing number of Special Economic Zones, particularly along the Lekki axis

Challenges

- Overstretched infrastructure due to growing population density
- Heightened insecurity generally in the country

MUNICIPAL PROFILE

ABOUT LAGOS STATE

Lagos State was created on 27 May 1967 and was Nigeria's administrative capital from 11 April 1968 until 12 December 1991, when the seat of Government was moved to Abuja. 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. The dominant language spoken in the State is Yoruba, however, Pidgin English (a diluted form of English) is also spoken by the majority of its residents.

Figure 2: Map of Nigeria highlighting Lagos State

The State comprises five administrative divisions – Ikorodu, Badagry, Ikeja, Lagos Island and Epe (IBILE), 20 Local Governments and 37 Local Council Development Areas. The Lagos Bureau of Statistics estimated the population of the State at 27 million people in 2020 with an annual growth rate of 3.2%. Lagos State has been inhabited by indigenous ethnic groups such as the Aworis, Egun, Binis and Eko. Nonetheless, the State has seen the proliferation of various ethnic groupings from Nigeria and West Africa, due to its welcoming and multicultural environment. The most populous local governments are Alimosho, Ajeromi/Ifelodun and Shomolu, while the State is also experiencing high population growth in the Ibeju-Lekki and Epe local governments due to the ongoing land reclamation projects, increasing number of residential dwellers and strategic projects been developed in the axis.

ECONOMIC PROFILE

Lagos State is the nation's commercial capital as it contributes a significant part to the country's Gross Domestic Product (GDP) and accounts for over 60% of Nigeria's commercial activities. In 2021, Lagos' GDP grew by 11.3% year-on-year to circa ₦26.58 trillion[1]. According to the Lagos Bureau of Statistics, the State has an unemployment rate of 14.3% in 2021, lower than the National average of 23.3%. The State has two airports (international and domestic, both located at Ikeja) and plays host to Nigeria's leading port, which is one of the largest and busiest in Africa (divided into three sections – the Lagos port, Apapa port & Tin Can port, each serving varying needs). Also, the Federal Government of Nigeria in July 2022 approved the designation of the Lekki Deep Seaport as a Customs Port and Approved Wharf.

The "THEMES" programme which is being implemented under the current administration covers the following areas: Traffic Management & Transportation, Health & Environment, Education & Technology, Making Lagos a 21st century Economy, Entertainment & Tourism and Security & Governance. This is the policy thrust that guides the State's economic blueprint which is geared towards making Lagos, Africa's model megacity and economic & financial hub in the near term.

[1] Lagos Bureau of Statistics, Ministry of Economic Planning and Budget - Lagos State Government

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 1999 Constitution of the Federal Republic of Nigeria to function independently and in a collaborative manner for the overall development of the State and the welfare of the citizens.

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

The Governor, Mr Babajide Olusola 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 a Fellow of the Nigeria Institute of Training and Development (NITAD).

In 2003, he was appointed as Special Adviser to the Deputy Governor on Corporate Matters; and 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 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 the first term of four years. He won the governorship ticket of the APC to contest the gubernatorial elections of Lagos State scheduled for 11 March 2023.

Table 1: Members of the Executive Council of Lagos State Government

Executive Council Members	Responsibility/Portfolio
Dr Kadri Obafemi Hamzat	Deputy Governor
Mrs Folashade Sherifat Jaji	Secretary to State Government
Mr Hakeem Muri-Okunola	Head of Service
Mr Tayo-Akinmade Ayinde	Chief of Staff
Mr Gboyega Soyannwo	Deputy Chief of Staff
Ms Ruth Abisola Olusanya	Commissioner, Agriculture
Dr (Mrs) Lola Akande	Commissioner, Commerce, Industry and Cooperatives
Mr Samuel Egube	Commissioner, Economic Planning & Budget
Mrs Folashade Adefisayo	Commissioner, Education
Mr Olalere 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 Akinola Abayomi	Commissioner, Health
Prince Anofiu Olanrewaju Elegushi	Commissioner, Home Affairs
Mr Moruf Akinderu Fatai	Commissioner, Housing
Mr Gbenga Omotosho	Commissioner, Information and Strategy
Mr Moyosore Onigbanjo (SAN)	Commissioner, Justice / Attorney General
Engr Tayo Bamgbose Martins	Commissioner, Physical Planning and Urban Development
Mr Hakeem Fahm	Commissioner, Science and Technology
Phar (Mrs) Uzamat Akinbile-Yusuf	Commissioner, Tourism, Arts & Culture
Dr Frederic Oladeinde	Commissioner, Transportation

Arch Kabiru Ahmed Abdullahi	Commissioner, Waterfront Infrastructure Development
Mrs Yetunde Arobieke	Commissioner, Wealth Creation and Employment
Mrs Cecilia Bolaji Dada	Commissioner, Women Affairs and Poverty Alleviation
Mr Ganiyu Olusegun Dawodu	Commissioner, Youth and Social Development
Mr Solomon Saanu Bonu	Special Adviser, Arts & Culture
Mr Oyerinde Olugbenga Olanrewaju	Special Adviser, Central Business District
Princess Aderemi Adebowale	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 Adetoke Benson-Awoyinka	Special Adviser, Housing
Mr Olatubosun Alake	Special Adviser, Innovation and Technology
Mr Afolabi Ayantayo	Special Adviser, Parastatals Monitoring Office
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
Mr Ogunlende Mobolaji	Special Adviser, Special Duties
Mr Bolaji Robert Kayode	Special Adviser, Local Government and Community Affairs

The Legislative arm is empowered by the 1999 Constitution of the Federal Republic of Nigeria as amended to legislate for Lagos State. The Speaker, **Rt. Hon. Mudashiru Ajayi Obasa** leads the Lagos State House of Assembly. All the 40 elected members of the 9th State House of Assembly belong to the All Progressive Congress (APC) political party and were elected for a term of 4 years expiring 29 May 2023.

The Judicial arm is empowered by the 1999 Constitution and laws of the State with the responsibility for the general administration of justice in the State. The Lagos State judiciary is made up of the State High Courts, Magistrate Courts and Customary Courts with 59 Judges and 153 Magistrates. The High Court of Lagos is the highest court of law in the State and **Hon. Justice Kazeem Olanrewaju Alogba** is the Chief Judge. 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.

Agusto & Co. notes that Lagos State's political environment has been relatively stable over the last two decades with a good working relationship among the three arms of government, which has created a conducive environment for businesses and households to thrive.

FINANCIAL CONDITION

ANALYSTS' COMMENTS

- *Lagos State Government prepared its Financial Statements for the year ended 31 December 2021 (the sixth in the series) in line with the International Public Sector Accounting Standards (IPSASs) Accrual Based Accounting.*

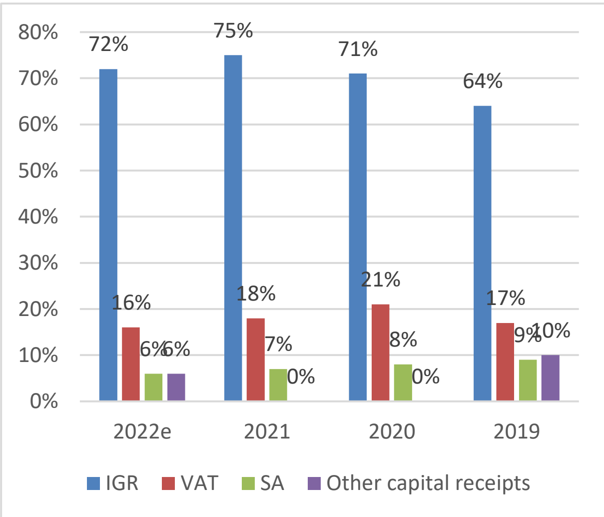
FINANCIAL PERFORMANCE

REVENUE PROFILE

Lagos State generated revenue from taxes on personal income, fines, licenses, fees and levies on business activities, as well as income from investments, altogether known as internally generated revenue (IGR). 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 and the Federal Government of Nigeria (FGN) for specific projects.

In the financial year ended 31 December 2021 (FYE 2021), Lagos State reported total revenue (excluding grants) of ₦766.9 billion, up by 21% from the prior year mainly due to higher internally generated revenue and share of VAT receipts. A review of LASG's total revenue for FYE 2021 showed that income from internally generated revenue (which increased by 27% year-on-year to ₦573.2 billion) accounted for 75% (2020: 71%), while statutory allocation centrally distributed by the Federal Government (grew by 7% to ₦54.7 billion) represented 7% and share of value added tax (which rose by 5% to ₦139.1 billion) accounted for 18% of revenue. In the same year, Lagos State received ₦3.9 billion as grants from multilateral agencies, bringing the total revenue (including grants) to ₦770.8 billion in FYE 2021 – 17% higher than the 2020 comparable figure of ₦658.6 billion, depicting the State's resilience despite the challenging macroeconomic environment.

Figure 3: Revenue Breakdown (2019 – 2022e)



Over the last three years, we note that 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, has grown at a compound annual growth rate (CAGR) of 4% to account for 54% of IGR in 2021. This is supported by the ongoing institutionalized revenue collection framework by the Lagos Internal Revenue Service (LIRS) which ensured timely and digital collection of personal income taxes. We also recognize that income from other taxes (such as withholding tax, stamp duties, tax on contract, entertainment tax and property tax) increased year-on-year cumulatively by 73% further demonstrating the robustness of the State's taxes collection framework. Finally, we note that income from other taxes[2], levies, fines & fees, investment income[3] and asset sales[4] all increased year-on-year to represent 20%, 16%, 3% and 0.5% respectively of IGR in the year. In our opinion, Lagos State has an effective and efficient tax administration and collection system which we expect to support its stable and sustainable IGR profile in the near to medium term.

[2] 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

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

[4] This includes income from land sales & regularization, sale of vehicle number plate, sale of housing units, survey fees, etc.

Whilst we have seen a steady rise in VAT income accruable to the State over the last three years (2019 – 2021) averaging 19% of revenue, we expect the State's VAT income to further grow in the short to medium term on account of increased commercial activities in the State and the country generally. Our expectation is premised on the FGN's revolutionized value-added tax administration system which encourages the online filing of tax returns, automation of collection and remittance of VAT as well as compliance-based system.

In the six months ended 30 June 2022 (unaudited), Lagos State reported total revenue (excluding grants) of ₦454.7 billion, with internally generated revenue accounting for 73% while the share of statutory allocation, VAT and other capital receipts represented 7%, 17% and 3% respectively. This was significantly better than the H1'2021 performance. However, we note that the State's actual total revenue receipt in H1'2022 was lower than the projections by 22%. Notwithstanding, we expect some improvement in income accruable to the State across all sources on the back of increased internally generated revenue from taxes, fines, levies and fees towards the end of the year. Also, we expect an uptick in VAT income due to the State on account of increased commercial activities as well as a modest rise in statutory allocation elicited by the higher crude oil demand and prices coupled with the local currency devaluation which should result in further accretion to the central pool of funds.

Overall, Agusto & Co. notes the flexibility in the State's revenue profile in FYE 2021 and H1'2022 and anticipates further improvement in the near term boosted by the ongoing state-led digital tax initiatives and countrywide increase in commercial activities. Therefore, we forecast that Lagos State's total revenue to close at circa ₦962 billion by the end of 2022, with IGR accounting for 72%, while VAT, statutory allocation and other capital receipts will represent 16%, 6% and 6% respectively.

In our opinion, Lagos State's overall revenue profile is good and sustainable and the State remains one of the most economically viable in the country with huge prospects for growth in the near to medium term.

CASH FLOW PROFILE

In the financial year ended 31 December 2021, Lagos State Government reported a total inflow of cash from operating activities of ₦763.3 billion (2020: ₦656.1 billion) which outstripped outflows resulting in net operating cash flow (OCF) of ₦313.9 billion (2020: ₦269.5 billion). Expectedly, LASG recorded a negative net cash flow from investing activities of ₦425.6 billion due to additions to property, plant and equipment and positive net cash flow from financing activities of ₦118.2 billion (2020: ₦86.2 billion) on account of increased borrowings in the period, resulting in an overall positive net cash position of ₦6.5 billion in FYE 2021 (2020: ₦43.4 billion).

In FYE 2021, LASG's discretionary cash flow (total revenue less mandatory payments[5]) to revenue ratio of 62% (2020: 59%) was in line with our expectation and compares better to Ondo (38%), Edo (56%) and Ogun (40%). Furthermore, LASG's net debt as a percentage of free cash flow[6] of 224% (2020: 242%) is within our benchmark. In our view, Lagos State has a good and sustainable cash-generating capacity.

[5] This refers to personnel expenses, public debt charges (interest payments) and transfers and subvention to parastatals
[6] This is also known as discretionary cash flow

EXPENDITURE PROFILE

In the financial year ended 31 December 2021, Lagos State recorded total expenses of ₦840.7 billion (2020: ₦811 billion) split into operating expenses (47%) and non-operating expenses (53%) in line with the IPSAS framework reflecting all 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 2021, the State reported an overall deficit (total revenue less expenditure) of ₦69.9 billion, down from a deficit of ₦152.5 billion in the prior year. However, if we adjust the net loss on foreign exchange transactions of ₦31.2 billion and non-cash depreciation of ₦124.3 billion, LASG would have reported total expenses of ₦685.3 billion and a surplus of ₦85.6 billion for FYE 2021 (2020: deficit of ₦32.5 billion).

Lagos State's total operating expenses rose by 29% year-on-year to ₦399.3 billion in FYE 2021 with personnel cost accounting for 37%, while general and administrative expenses (i.e., overheads) represented 36% and subvention to parastatals and transfers 27%. Although LASG's personnel expenses have been on the rise over the last three years at a compound annual growth rate (CAGR) of 11% to ₦146.3 billion, we note that the State's personnel expenses to revenue of 19% in 2021 and the three-year average (2019-2021) of 20% are both in line with our benchmark and considered to be good. This also compares favourably to other states in the country such as Ondo (36%), Edo (26%) and Ogun (40%). Similarly, the State's overhead costs have grown at a three-year CAGR of 13% due to higher inflationary pressures and represented 23% of revenue in 2021 and a three-year average of 19%. This is in line with our benchmark of not more than 30% and better than Ogun State (47%) but higher than Ondo (13%) and Edo (21%).

In FYE 2021, Lagos State's non-operating expenses consisting of capital expenditure (48%), depreciation on property, plant and equipment (28%), public debt charges (16%) and net loss on foreign exchange transactions (7%) declined by 12% to ₦441.4 billion from the prior year due to significant reduction in non-cash foreign exchange loss as no external loans were obtained in the year. Furthermore, Lagos State spent ₦214 billion (2020: ₦201.7 billion) representing 31% of total expenditure in 2021, mainly to facelift the infrastructural facilities connected with construction and rehabilitation of roads, drainages and bridges to improve the operating environment in the State.

In the six months ended 30 June 2021 (unaudited), Lagos State recorded total personnel expenses of ₦80.6 billion and overhead costs of ₦96.6 billion, which represented 18% and 21% of revenue respectively, which we consider to be satisfactory. In the same period, LASG spent ₦275.7 billion on capital expenditure which represented 50% of total expenditure, demonstrating the State's continued commitment to infrastructural development across various sectors with multiplier effects on the economy.

Going forward, we estimate that the State's personnel and overhead costs to revenue ratio will remain within acceptable limit even though we anticipate some elevated cost pressures on account of higher inflationary pressures. Furthermore, Lagos State intends to boost capital spending (to be partly funded by Bond issuances) on key sectors in a bid to improve the overall socio-economic condition of the State. We note that Lagos State earmarked total capital spending of ₦1.2 trillion (66% of the total budgeted expenditure) out of a total expenditure budget of ₦1.76 trillion in line with the Year 2022 approved budget. We estimate personnel and overhead costs to revenue ratios of 20% and 25% respectively by the end of 2022.

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

FINANCIAL POSITION

ASSET & LIABILITY STRUCTURE

The International Public Sector Accounting Standards (IPSAS) allow for a three-year transitional period for the recognition and measurement of assets and liabilities in line with IPSAS 33. Lagos State elected to adopt the transitional exemptions in IPSAS 33 and has complied with the extant guidelines and provisions stipulated by IPSASs except for the full consolidation of subsidiaries, associates and joint ventures in line with IPSAS 35. Therefore, LASG noted in the 2021 audited financial statement that it is unable to make an explicit statement of its full compliance with the accrual-based IPSAS as of 31 December 2021.

As at 31 December 2021, Lagos State's total identified assets stood at ₦2.95 trillion (2020: ₦2.56 trillion) split into non-current assets (96%) and current assets (4%). A breakdown of non-current assets showed that property, plant and equipment[7] accounted for 97%, while available-for-sale-investments[8] and other financial assets represented 2% and 1% respectively. Lagos State continues to use the cost model where annual depreciation charges apply to relevant asset classes periodically to measure its non-current and current assets with a view to full compliance with the IPSAS framework in the medium term.

As at FYE 2021, Lagos State's total identifiable liabilities stood at ₦1.24 trillion, up by 16% from the prior year mainly due to an increase in domestic borrowings in the year. As at the same date, total borrowings (comprising internal, external debts and bonds in issue) accounted for 94% of the State's total liabilities, while payables and other liabilities, retirement benefit obligations and finance lease obligations[9] altogether represented 6%. Further analysis revealed that LASG's total debt of ₦1.16 trillion (2020: ₦1.0 trillion) consisted of foreign borrowing (48%) and domestic debt 52% - split into local bonds in issue 24% and internal commercial bank facilities 28%. This represented 176% of prior year revenue which is higher than the 50% limit prescribed by the Investment and Securities Act (ISA) 2007. However, by virtue of exemption granted to state governments pursuant to the Executive Order 2016 (as amended in 2019), Lagos State is not in breach of the ISA provision.

As at FYE 2021, Lagos State's external debt portfolio comprised 25 facilities for various projects with different international institutions repayable in foreign currencies with an outstanding principal value of $1.35 billion (equivalent to ₦557 billion), with tenor between 20 and 40 years, moratorium periods of 5 and 13 years and concessionary interest rates between 0.75% and 2.37% per annum. In 2021, there was no new external debt obtained and the State repaid ₦18.3 billion due in the year. All the foreign debts are backed by irrevocable standing payment orders (ISPO) which serve as security for the facilities and outstanding balances are translated using the prevailing exchange rate at the reporting date. While we recognise that the concessionary rates coupled with the longer tenors reduce the State's annual debt service burden, the continued depreciation of the local currency negatively impacts the foreign loan balances as these borrowings were not hedged.

In 2021, LASG obtained ₦143.2 billion loans from commercial banks to finance various projects and repaid ₦52.8 billion due on internal loans. As at 31 December 2021, Lagos State had 43 facilities with different local commercial

[7] 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

[8] This represents LASG's investment in Quoted Securities (Julius Berger Nigeria Plc and Lasaco Assurance Plc) and Unquoted Investments in various companies as at 31 December 2021

[9] This refers 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 a 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.

banks with a cumulative outstanding principal value of ₦326.4 billion at an average interest rate of 5% to 13% per annum. Agusto & Co. notes positively the finance cost savings on the back of the ongoing restructuring of local borrowings especially in terms of lower interest rates to reduce the overall domestic debt service burden of the State.

In the financial year ended 31 December 2021, Lagos State exercised the early redemption option to repay the following existing bonds [₦47 billion 16.5% 7-Year due 2023, ₦46.3 billion 7-Year 16.75% due 2024 (Series II Tranche I) and ₦6.91 billion $6\frac{7}{12}$-Year 15.6% due 2024 (Series II Tranche III)] and issued a new ₦137.3 billion Series IV 10-year 13% fixed rate bond at a lower interest rate to finance the repayment of the liquidated bonds and fund the construction, rehabilitation and upgrade of selected roads in the State. As at FYE 2021, Lagos State had bonds in issue with a cumulative outstanding principal balance of ₦278.8 billion split as follows:

- ₦38.7 billion 10-Year 17.25% due 2027 (Series II Tranche II)
- ₦5.34 billion $9\frac{7}{12}$Year 15.85% due 2027 (Series II Tranche IV)
- ₦100 billion 10-Year 12.25% Fixed Rate Bond Due 2030
- ₦137.3 billion 10-Year 13% Fixed Rate Bond Due 2031

We note that all LASG bonds in issue are backed by monthly ISPO deductions on the State's share of statutory allocation and monthly remittance from the State's internally generated revenue. Also, the total cumulative amount in the sinking fund account of the respective bonds stood at ₦24 billion as at FYE 2021.

Based on the State's debt profile as at FYE 2021, LASG's net debt as a percentage of free cash flow of 224%, interest payment as a percentage of revenue of 9% and debt service to revenue ratio of 21%, were all in line with our expectations and considered satisfactory.

In the six months ended 30 June 2022 (unaudited), Lagos State obtained domestic commercial bank loans amounting to ₦172.6 billion and repaid ₦97.8 billion covering both domestic and external loans due in the period. As a result, the State's total debt (excluding gratuities, pensions & contractor arrears) stood at ₦1.27 trillion as at 30 June 2022, split into domestic (58%) and external borrowings (42%). This represented 164% of 2021 revenue which is higher than the 50% limit prescribed by the Investment and Securities Act (ISA) 2007. As at the same date, the State's net debt as a percentage of free cash flow of 216%, interest payment as a percentage of revenue of 6% and debt service to revenue ratio of 22%, were still in line with our expectations and considered satisfactory.

Going forward, we expect the State to continue to service the financial obligations mainly buoyed by its good internally generated revenue, strong track record of accessing the capital market and good credit history which it leverages to obtain financing at competitive rates and short notices.

OUTLOOK

The Lagos State Government's Year 2022 Budget of ₦1.75 trillion tagged "Budget of Consolidation" split into capital expenditure (66%) and recurrent expenditure (34%), is meant to further advance the THEMES[10] agenda and also align with the State's thirty-year development plan 2022 - 2052 of making Lagos Africa's model mega city, a global economic and financial hub that is safe, secure and productive. Furthermore, the State plans to promote economic growth through infrastructural renewal and development through this budget by focusing on sectors with huge job-creating potential such as agriculture, construction, technology and security. The State's 2022 Budget is expected to be funded largely with projected revenue of ₦1.23 trillion (with an IGR component of ₦815.3 billion) and the balance (₦521.2 billion) to be financed through a combination of external debts, domestic commercial borrowings and bond issuances.

The key priorities of the State's 2022 budget are to complete ongoing infrastructure projects; facilitate youth development, engagement and community sports through the completion of 8 stadia; rehabilitate schools to improve access to quality education; construct the 6-lane reinforced concrete Lekki-Epe expressway from Eleko Junction to Epe T-junction to ease smooth vehicular movement in the axis on account of the upcoming deep seaport and the Dangote Refinery; promote food security through the 5-year Agric road map to support farmers, create food banks and improve food distribution systems; and remain a major incubation and acceleration destination for technology solutions, amongst others.

Going forward, the State Government remains committed to fostering a conducive environment where businesses and households would thrive by creating an enabling atmosphere. Thus, LASG has prioritized development initiatives under the THEMES which cuts across critical sectors and plans to access funds from the debt capital market to fund selected projects in the State. Agusto & Co. believes that the successful execution of projects earmarked under this programme will result in an improved economic condition of Lagos State and the welfare of the citizens.

Overall, Agusto & Co. does not envisage a material decline in the State's ability to generate IGR or receive its share of centrally collected revenue from the Federal Government, which will impair the State's capacity to meet its local currency obligations as and when due. Therefore, we retain our opinion that Lagos State should be able to withstand any negative macroeconomic headwinds or unexpected disruptions due to its strong internally generated revenue and good economic profile.

Based on the above, we have attached a **stable** outlook to the Lagos State Government of Nigeria.

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

FINANCIAL SUMMARY

REVENUE & SPENDING	UNAUDITED		IPSAS		IPSAS		IPSAS	
	H1'2022		2021		2020		2019	
REVENUE	**₦'mns**	**%**	**₦'mns**	**%**	**₦'mns**	**%**	**₦'mns**	**%**
Tax revenue								
Personal Income Tax	257,723.0	57%	312,020.4	41%	292,479.9	46%	279,792.3	43%
Share of VAT collected centrally	78,431.0	17%	139,104.6	18%	131,970.2	21%	107,704.2	17%
Share of other revenues collected centrally (Stat. Allocation)	30,251.0	7%	54,729.7	7%	51,348.4	8%	58,142.3	9%
Other capital receipts (refund from Paris Club and refund by FGN for Road Construction)	15,547.0	3%	-		-		63,648.9	10%
Other taxes	-	-	114,878.5	15%	66,582.4	10%	68,208.8	11%
	381,952.0	**84%**	**620,733.1**	**81%**	**542,380.8**	**85%**	**577,496.5**	**90%**
Non-tax revenue								
Asset sales & other state capital receipts	-		19,214.61	3%	13,927.93	2%	8,972.28	1%
Investment Income	4,046.0	1%	3,694.9	0%	3,540.5	1%	3,239.0	1%
Others - levies, fines & fees	68,667.0	15%	123,297.0	16%	75,416.9	12%	54,571.0	8%
	72,713.0	**16%**	**146,206.5**	**19%**	**92,885.3**	**15%**	**66,782.3**	**10%**
TOTAL REVENUE	**454,665.0**	**100%**	**766,939.6**	**100%**	**635,266.1**	**100%**	**644,278.8**	**100%**
Of which internally generated revenue (IGR) is	***330,436.0***	***73%***	***573,105.3***	***75%***	***451,947.5***	***71%***	***414,783.4***	***64%***
Grants	306.0	-	3,890.1		23,297.7		483.9	
TOTAL REVENUE & GRANTS	**454,971.0**	-	**770,829.7**	-	**658,563.7**	-	**644,762.7**	
SPENDING								
Transfers (including pension costs)	72,393.0	13%	76,716.7	11%	56,559.3	10%	50,825.2	11%
Interest payments	25,393.0	5%	71,809.5	10%	56,881.7	10%	62,533.2	13%
MDA spending	453,004.0	82%	536,582.7	78%	454,981.3	80%	362,247.8	76%
TOTAL SPENDING	**550,790.0**	**100%**	**685,108.9**	**100%**	**568,422.3**	**100%**	**475,606.2**	**100%**
MDA spending is made up of								
Personnel costs	*80,628.0*	*15%*	*146,507.0*	*21%*	*146,383.0*	*26%*	*107,132.2*	*23%*
Purchase of goods & services	*96,619.0*	*18%*	*176,047.3*	*26%*	*106,880.8*	*19%*	*120,594.0*	*25%*
Capital expenditure	*275,757.0*	*50%*	*214,028.5*	*31%*	*201,717.5*	*35%*	*134,521.7*	*28%*
TOTAL MDA SPENDING	***453,004.0***	***95%***	***536,582.7***	***78%***	***454,981.3***	***80%***	***362,247.8***	***76%***
BUDGET BALANCE	(95,819.0)		85,720.7		90,141.4		169,156.5	
NOMINAL GDP	27,784,225.3		26,587,775.4		22,815,096.2		30,874,905.1	
BUDGET BALANCE AS % OF GDP	-0.3%		0.3%		0.4%		0.5%	
FINANCING								
Surplus of prior years								
Domestic borrowing (net)	85,727.0		136,640.7		93,195.2		(27,893.8)	
External borrowing (net)	(11,002.0)		(18,342.4)		(7,039.0)		(7,262.6)	
Other								
TOTAL FINANCING	74,725.0		118,298.4		86,156.2		(35,156.5)	
Foreign Loans- New Borrowings	-		-		10,692.2		1,543.9	
Repayment during the year	11,002.0		18,342.4		17,731.2		8,806.5	
Foreign loan balance	**534,712.9**		**557,073.9**		**543,125.2**		**428,723.3**	
Domestic- New Loans	172,601.0		280,604.6		225,296.7		116,090.3	
Loan due (repaid) within the year	86,874.0		143,963.8		132,101.4		143,984.1	
Domestic loan balance	**732,667.6**		**605,275.8**		**464,338.9**		**357,120.1**	
Total Loan Balance	**1,267,380.5**		**1,162,349.6**		**1,007,464.1**		**785,843.4**	

KEY RATIOS	UNAUDITED H1'2022	2021	2020	2019
Revenue				
IGR as % of GDP	1%	2%	2%	1%
Tax revenue as % of GDP	1%	2%	2%	2%
Total revenue as % of GDP	2%	3%	3%	2%
IGR as % of total revenue & grants	73%	74%	69%	64%
Tax revenue as % of IGR	78%	54%	65%	67%
Growth in tax revenue	23%	14%	-6%	7%
Spending				
Spending as % of GDP	2%	2%	2%	1%
Non-discretionary spending* as % of tax revenue	47%	48%	48%	38%
Capital expenditure as % of total spending	50%	31%	35%	28%
Payroll as % of revenue	18%	19%	23%	17%
Other overheads as a % of revenue	21%	23%	17%	19%
Budget balance/revenue	-21%	11%	14%	26%
Leverage				
Budget balance (₦'mns)	(95,819.00)	85,720.73	90,141.44	169,156.51
Debt as % of nominal GDP	5%	4%	4%	3%
Interest payments as % of total revenue	6%	9%	9%	10%
Principal due as % of Revenue	22%	23%	23%	18%
Financial flexibility				
Discretionary revenue** as % of total revenue	61%	62%	59%	66%
Net Debt as % of Free cash flow***	216%	224%	242%	177%
Non-discretionary Spending as % of total spending	32%	43%	46%	46%
Outstanding Debt/Revenue	139%	152%	159%	122%
Debt Service to Revenue	22%	21%	23%	24%
Discretionary cash flow divided by interest payment	10.88	6.57	6.60	6.78

* Non-discretionary spending is made up of statutory transfers, interest payments and personnel cost
** 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.

THIS PAGE HAS BEEN LEFT BLANK INTENTIONALLY

www.agusto.com

UBA House (5th Floor)
57 Marina Lagos
Nigeria.
P.O Box 56136 Ikoyi
+234 (1) 2707222-4
+234 (1) 2713808
Fax: 234 (1) 2643576
Email: info@agusto.com