THE LAND REFORM IN TANZANIA: OPPORTUNITIES FOR AGRICULTURE AND MORTGAGE FINANCE

Introduction:

The primary role of the banking industry is financial intermediation i.e., mobilizing funds from surplus units and making it available for investment to deficit units. This is the classical or traditional function of a banking institution. The main source of funds in a bank is customers' deposits. These are liabilities for which the law, through Bank of Tanzania, seeks to protect. The Banking and the Financial Institutions Act, 1991 the Bank of Tanzania Act, 1995 and several regulations promulgated under the two legislations provide prudential benchmarks to be adhered to by banks for the purpose of minimizing incidence of bank failures.

To-date, there are 27 banks and non-bank financial institutions operating in the market which are members of the Tanzania Bankers Association (TBA). Even though some of the members are 'specialized' such as those dedicated to the corporate segment of the market, the trend however, shows that there is an increasing appetite for the retail market. This trend is evidenced by the number of branches/outlets opened every year and banks' inclination towards products and services with specific appeal to the mass market or personal customers (e.g. personal loans and cash dispensers or ATMs). Moreover, with the stabilization of the macro-economic fundamentals, interest rates on loans and advances depict a significant downward trend. The implication of these developments is clear. There is intense competition at the market place. The competition, coupled with evolving customer sophistication, is forcing banks to transform their processes from being *customer oriented* to a relatively advanced level of *customer convenience*. This explains why TBA members view the on going land reforms as a window of opportunity that must be taken for purposes of diversifying and enhancing their investment portfolios.

The nature of the banks liabilities (deposits) is also an important factor. The tenure of any credit facility granted by a bank is determined by the tenure of its funding source. For instance, a 7-year term loan cannot be wholly funded by liabilities payable on demand, as this will eventually result into liquidity crunch due to a mismatch of maturities. The hallmark of all this is the indispensable requirement to preserve and uphold safety of customers' deposits whilst with the same vigour, deploy the borrowed funds in profitable (but secure) investments such as loans and advances with a view to, among others, adding value to the shareholders' investment.

The pivotal role of agriculture in Tanzania cannot be understated. It is said about 80% of our people depend on it directly. In GDP terms, agriculture contributes about 50%. Yet the quality of life of our farmers has not improved. Equally so, is the status of housing and home ownership. The speed of urban migration is increasing at accelerated pace. We are told; about 70% of people in sub-Sahara Africa live in unplanned and unhealthy dwellings. The situation in urban and peri-urban centres in Tanzania is no exception. Yet, the urban migration trend cannot be reversed, as it is a natural phenomenon and necessary stage in human development all over the world.

The most intriguing aspect however is that, even for the few with limited financial means or with access to finance, have not been able to own a home. Hence, herein lies a dilemma, which should be translated into a challenge to all of us.

Statistics released by the Bank of Tanzania indicate that in year 2003, the total liquidity held in the banking system was Tshs. 2.5 trilion. Out of this amount, only Tshs. 800 billion representing 40% was invested in loans and advances. In addition, less than 6% of Tanzanians had access to credit with the agricultural sector performing miserably by accessing less than 1%. On the other hand, investment in government paper though depicting downward trend, continues to feature prominently.

So, the big question is, what role should banks play in revamping our agriculture and housing sectors? More often, we have heard overtones that prefer short cuts i.e., to shoulder blame onto the banking industry for its “greedy”, which is evident from the “obscene” profits banks announce in the newspapers every year. The easiest and oft-quoted rip-off is the apparent yawning gap between deposit and lending rates.

The objective of this presentation therefore, is to try to share with stakeholders some of the things that banks should do, or are not doing enough and those that need to be done. In the same token, we will also try to identify, things that the Government and various stakeholders should consider doing with a view to improving our agriculture and housing sectors. In short, this is a joint soul searching exercise the outcome of which, I hope, will create an enabling or conducive environment for the development of the two sectors.

PART I
AGRO-FINANCE

Bank’s attitude towards Agro-finance:

There is a myth in Tanzania that, banks consider agriculture sector too risky to qualify for financing. Is there any truth in this claim-cum-excuse? Perhaps, this question can better be answered by identifying critical factors a financier usually considers before taking a decision to finance agriculture:

- Ability of the business to generate sufficient income.
- Adequate property rights, which a lender may have recourse in case of default.
- Administration costs in managing the loan.
- Underwriting.
- Efficient (and smooth) mechanism of enforcement of contractual obligations.

i) *Ability to generate income:*

Bankers always look at the business financed as the main and primary source of repayment. In short, the business must be capable of generating sufficient revenue to cover its own costs, loan repayment and be able to create a margin of profit.

Available agricultural statistics tell us that, out of 44 million hectors of arable land available in Tanzania, only 0.1 million hectors is under medium and large-scale farming. *The Agricultural Sector Development Strategy (2001)* issued by the Ministry of Agriculture and Food Security states that, despite abundance of unutilised land, Tanzanian agriculture is dominated by small-scale subsistence farming. Smallholders who operate between 0.2 and 2.0 ha. and traditional agro-pastoralists who keep an average of 50 heads of cattle use approximately 85% of the arable land. The Report goes on to adumbrate; the average per capita holding is only 0.12 ha. *The major limitation on the size of land holdings and utilization is the heavy reliance on the hand hoe as the main cultivating tool. This "hand-hoe syndrome" among Tanzanian smallholder farmers is both a cause and symptom of rural poverty. We are further informed that, whereas there were 18,000 serviceable tractors twenty years ago, to-date the number has gone down to 6,000.*

Well, the facts speak for themselves. It is therefore inevitable that we must move away from clearly unprofitable smallholder farming and focus our attention to medium and large-scale farming also referred to as commercial farming. The following are the inherent advantages:

- Economies of scale
- Ability to use modern technology
- Ability to create employment
- Informed owners and competent managers have ability to attract finance
- Ability to produce all year around through irrigation

Lets look at this example, a farmer with a huge tractor is ploughing the plains of Dumas in Texas with enough power and technology to plough 50 rows at one time while another 'farmer' in Mbozi District works to plough one row in his field with the help of his oxen. Both farmers come home late at night but the work they had accomplished for the day will be drastically different. The farmer in Mbozi farms 2.5 hectors of land hoping to use what he harvests for feeding his family in his village. The farmer in Dumas farms 500 hectors of land, which is 200 times the size of the farmer's land in Mbozi, and uses his harvest to make a living and to sell to grocery stores throughout the United States. Such is the difference.

From the arguments and example given above, it is evident that commercial farming has the ability to mechanize its operations, hire skilled labour, use appropriate fertilizers and pesticides, prefer efficient transportation and secure storage facilities. More important, commercial farmers are likely to adopt modern marketing strategies with a view to penetrating the world market. From the banker's point of view, these advantages make commercial farmers "bankable".

Factors affecting performance in Agriculture:

Tanzania farmers (peasants) like all farmers in the developing world are faced with a number of problems affecting their performance, consequently the output. Here below are few of them:

- Supply factors such as rainfall;
- Low prices;
- Limited access to markets;
- Limited access to inputs;
- Uncertain transport and infrastructure; and
- High transaction cost.

It is against this background commercial farming especially medium scale farming is strongly recommended and if adopted, its notion will completely transform our mind-set on landholding with its intrinsic ‘commodity’ status especially when we consider our socio-political and cultural orientation where land was/is always regarded as a social good with great deal of sentimental value attached thereto. Hence, alienating land by way of sale becomes very difficult. But commercial farmers will tell you point blank that land is held only for its productivity and ability to sustain revenue in order to meet its obligations including loan repayment.

(ii) Adequate property rights:

Land tenure in Tanzania is in the form of a right of occupancy and leasehold. There is no freehold system. The primary legislation governing land ownership is the Land Act, No. 4 of 1999 as well as Village Act, No. 5 of 1999. Under the Land Act, there are several categories of land but the most relevant is general land. This is the land that a right of occupancy or leasehold may be granted by the Commissioner for Lands upon application and fulfilment of certain conditions. On the other hand, Village Land is administered at grass root level for which a Certificate of Title can be granted to the holder.

Chapter X of the Land Act, No. 4 of 1999 relating to mortgages has been of concern to bankers as its provisions tended to inhibit bankable projects especially mortgages from accessing finance. After a spell of 3 years’ dialogue between the Government and various stakeholders, the entire Chapter X was replaced by the Land (Amendment) Act No. 5 of 2004. The Act will be supplemented by regulations, which are currently under preparation.

As we all know, lenders require security for their advances. In agro finance therefore, security can be the land, properties constructed thereon, plant and machinery and crops stored in a warehouse. This wide range of collateral cover is quite appealing to bankers as it is easy to enforce. Consequently, property rights - in all its forms of collateral - must be clearly defined and should not be let to chance. For, it is a fact of life that any farmer who fails to discharge his obligations to a lender due to his inability to mitigate the risks - be they against vagaries of weather or mismanagement - should give way to another farmer who is capable doing better. In such cases sentiments if allowed, become a moral hazard.

(iii) Administration costs and underwriting

Agriculture as a business can only be profitable if administration costs are manageable and risk of loss is capable of being contained. A medium and large-scale farmer incurs more expenses than a smallholder farmer but as aforesaid, the major difference is economies of scale. A commercial farmer can underwrite a good number of risks inherent in farming. It is this capability that enables him to qualify for bank financing. Financing agriculture only makes sense if the financing is used for commercial purpose and not for subsistence or consumption.

(iv) Type of financing:

It has been said, the type of bank finance directed to agriculture is inadequate and in most cases unsuitable. It is unsuitable because short-term funding in the form of overdraft is preferred in total disregard to the seasonality of crop farming. As mentioned previously, due to competition at the market place, banks are engaged in packaging their financial products in order to suit specific customer requirements. No bank in today's world has a policy of extending credit that will see the borrower going under! This is contrary to common sense, prudential rules on risk management and above all, rules on provisioning!

On this score, whilst we concede that the quantum of bank finance channelled into agriculture is patently inadequate (less than 1% of loanable funds), but the relevant financial products offered can hardly be said to be unsuitable. The restrictions on the quantum are caused by limitations that lenders face and which this intervention is seeking to address.

(v) Enforcement Contractual Obligations:

Under the current legal regime, i.e. the Courts (Land Disputes Settlement) Act No. 2 of 2002, the following institutions are empowered to resolve land disputes:

(i) Ward Tribunals;
(ii) District Land and Housing Tribunal (DLHTS);
(iii) High Court Land Division;
(iv) Court of Appeal

Disputes are not a novelty in any business and agriculture is no exception. In this regard, it is imperative that courts entrusted with powers to adjudicate business disputes emanating from agriculture are quick and effective in determining cases before them. The following problems associated with our courts have been cited as hampering agro-finance:

- Unwarranted/unlimited injunctions;
- Delays in concluding cases filed in court;
- Arbitrary decisions such as awarding a decree with the rate of interest that is not market related;

- Delivering judgments that are patently suspect.
- Judges/Magistrates (and advocates) lack technical insight on practical aspects of banking and rules governing banking business.

Whereas statistics are not readily available, it is estimated that at present, there are about 1,000 cases pending in our courts for which banks are a party with an estimated amount of Tshs 60 billion tied up! This is not a good thing to any financial system and equally so, to the economy of a country. There is a need therefore, for all the parties to address this crucial area within the framework of the on going judicial sector reforms.

The way forward:

It is our argument that we need to have a fresh look at our strategies if we are to revamp agriculture. The following though not exhaustive, is a starting point:

- At policy level, adopt commercial farming as a solution to rural poverty and food shortage. The misconceived fear of creating landlessness (like the Zimbabwe land question should be dispersed).
- Government to provide targeted incentives such as tax relief, improved infrastructure, etc.
- Introduce specific credit guarantee schemes for agriculture.
- Property rights to be simplified and defined and enforcement of contractual rights streamlined.
- Promote commodities boards.
- Promote crop insurance.
- Provide special incentives such as favourable power tariff to support industries that add value to agriculture (e.g. packaging, transport, canning etc.).
- Establish technology centres to support agriculture.

On this score, we commend recent Government’s efforts of reviewing the hire purchase and leasing legislation as well as the initiative of trying to formalize property rights in the informal sector for the purpose of facilitating access to credit to wider segment of our people. We hope, when concluded these initiatives will further support credit extension to agriculture. Once this is done, there should be no reason at all why lenders will still be hesitant to finance agriculture be it for purchase of input, machinery, transportation, commodity finance or pre-export, the sky is the limit!

PART II
MORTGAGE/HOUSING FINANCE

What is a mortgage?

The classical mortgage finance must be distinguished from a mortgage of existing property used as collateral for bank financing. In this presentation, a mortgage is referred to as a method of acquiring home ownership. In other words, a mortgage being an ‘unproductive’ venture, is a long-term commitment whose purpose is to confer to a borrower the ability to acquire a home. Since a mortgage can be of a term of 10 - 30 years, uncertainties and events abound that may change the position of the parties for the better or for the worse.

Lets take the following example; a young salaried graduate acquires a 20-year mortgage for a property located in Tabata (primary trading). Ten years later, he manages to climb the ladder in his career such that Tabata area is no longer to his status. He decides to sell the mortgage and acquire another mortgage (secondary trading) on a relatively expensive house in Mikocheni area. Upon retirement, he finds himself with his wife only as the kids have been sent to a boarding school. So, he decides to sell the Mikocheni property and acquire a two-bedroom apartment in Upanga (secondary trading). The difference/profit realized between the sale of the property and the cost for buying the apartment is used to augment his retirement benefits. But he can only do so, if there is swift mechanism allowing him to dispose a mortgage and buy another!

Lending to the Construction sector:

In a research conducted some 5 years ago, we are informed that lending to the construction sector was a paltry sum of 1.64 of the total banks loan portfolio. The reason given is that commercial banks tend to shun away from long-term exposures. It has also been established that about 98% of housing stock in urban area is built on an incremental basis. As a result, there are a number of unfinished structures some of which will never be finished. All this implies that, idle/dead capital is tied up in a wasteful “investment”. Corollary to existence of white elephants is the increasing rate of unplanned settlements, which seem to provide solution to the lower end of the market.

The absence of a specialized housing finance institution since the demise of THB has been cited as the main reason. This could be partly true; but even with the presence of THB the appetite for housing finance was still very high. The question to be addressed is whether Tanzania needs a specialized housing finance institution or an enabling environment for existing institutions to venture into mortgage financing. It is our view that even if there were a specialized institution offering mortgage products (home loans), the need for an enabling environment cannot be wished away. After all, there is ample evidence showing that commercial banks can ‘invade’ the mortgage market. ABSA for instance, is said to command 35% of the South African mortgage market. What then is lacking?

Advantages of mortgage finance:

Mortgages can play a very important role in the economy. The following are some of the advantages:

- Promotes positive return on investment as opposed to the method of building houses on incremental basis some of which are never finished;
- Facilitates financial intermediation through secondary trading;

- Investment in housing supports growth in the construction industry which in turn stimulates the economy and creates employment;
- Housing is one of the three human basic needs, the other two being food and clothing. As such, housing is both a social and merit good.
- Helps to fight corruption and wasted time used in supervising the fundis;
- Creates orderly urban development; and
- Availability of affordable accommodation pushes down rents thus alleviating the problem of overcrowding

Prerequisites for mortgage financing:

The following factors are crucial for a vibrant mortgage market to flourish:

- Monetary policies targeting inflation
- Appropriate legal framework
- Efficient land delivery mechanism
- Swift process of enforcing mortgage disputes (summary process!)
- Availability of medium and long-term funding.
- Fiscal incentives
- Credit information

Monetary policy:

Stable macroeconomic condition is a key factor in mortgage financing. Mortgages have proven to be a disaster during times of high inflation. Since mortgages are long-term commitments, the applicable interest rate usually is variable with a close bearing to the rate of inflation. It is necessary therefore for the Government to consistently pursue anti inflation monetary policies.

Appropriate legal framework:

The law relating to mortgages was codified in the Land Act No. 4 of 1999. As mentioned earlier, lenders saw Chapter X of the Act as inhibiting mortgage financing. An appropriate legal framework required to support mortgage financing must be able to:

- Define and recognize property right *vis a vis* third parties spouses included.
- Recognize that an undeveloped parcel of land has value since the first drawdown is covered by that value.
- Respect the sanctity of contract. Courts intervention is limited to interpretation and enforcement of the wishes of the parties.
- Have efficient and swift dispute resolution mechanism that will facilitate transfer of the mortgage to another person at minimum cost.
- In urban setting, recognize horizontal landholding as a means of facilitating mortgage over blocks of flats.

Consequently, the recent amendments to the Land Act must be viewed in the context above. We have heard, especially in the media, that banks sought the said amendment to the law in order to allow them repossess land and transfer it to foreigners thus leaving destitute Tanzanians landless! This, we think, is part of socio-political legacy that usually takes time to go. One keep on wondering whether persons holding such views are aware that, a bank is by law prohibited from owning/acquiring immovable assets whose value is more than 50% its core capital. Again, the Land Act prohibits foreigners from holding land unless same is held for investment purpose under *the Tanzania Investment Act, 1997*. But it is also a fact of life that the natural consequence of default on a mortgage is disposition of the property to another person who is capable of fulfilling obligations created under it. Otherwise, home ownership through mortgages will remain a pipe dream.

As intimated earlier, courts have special role in the mortgage market. In this regard, courts are required to play a supportive role as opposed to obstructive role. Again, rules of procedure such as the much-awaited *Land Regulations* (2005?) must facilitate quick and cost effective process of resolving disputes; otherwise the cost of a mortgage will be prohibitive therefore unappealing. A call is therefore made to the land courts to play a pioneering role in this regard.

*Condominium Law***:**

These are set of rules governing relationship of parties who hold land horizontally. Such rules are a must in urban setting where construction of apartments and block of flats is necessary in order to cater for the medium and lower end of the population. Accordingly, the Government should consider introducing condominium or sectional titles law. Such legislation is poised to facilitate property development in urban areas. At the moment, there is complete legal vacuum in this area.

Land Delivery System:

Mortgage finance can only work in an environment where there is an efficient land delivery system. Serviced land should be available to property developers who in turn, can link up with finance houses such as banks. Lack of serviced land also affects property rights. It is imperative therefore for the Government to ensure that serviced land, even if its availability attracts a premium, is readily accessible to a developer for passing it over to the consumer – the mortgagor.

Credit Information:

It is a cardinal banking principle that, a lender must make an informed decision when approving or declining a credit facility to its customer. As such, it is imperative for him to be seized with adequate information relating to the prospective borrower. Recent amendments to the Bank of Tanzania Act provide for the credit reference system and make it mandatory for all banks to submit information on borrowers to the credit reference data bank. At this stage, the Tanzania Bankers Association has established its own Credit Information Bureau. This not withstanding, the following impediments have been identified:

- Lack of national ID thus making it difficult to identify persons.

- Lack of storage and retrieval of data in important registries such as BRELA, Registrar of Titles, Registrar of births, deaths and marriages and court registries.
- Inability by banks to divulge information of defaulting customers due to legal limitations.

Conclusion:

A case is therefore made to the Government to consider addressing the issues raised herein with a view to creating an enabling framework for a vibrant agro-finance and mortgage market to happen in Tanzania. In the same vein, banks are specifically called upon to engage directly in the two sectors. Funds should be set aside to finance farming (as opposed to commodity finance) and agribusiness that add-value to agriculture. As for mortgages, it is our recommendation that the mortgage regulations should now be finalized. At the same time, condominium rules should be worked on together with the rest of the recommendations made in this presentation. The responsibility for all this rests squarely with **all** stakeholders in which case we are obliged to forge a smart partnership.

Thank you.

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