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EFFECTS OF LAND ACT 2012 ON RECOVERY OF DELINQUENT LOANS BY COMMERCIAL BANKS IN KENYA

A SURVEY OF COMMERCIAL BANKS IN NAKURU TOWN

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Abstract
The Kenya's Land Act 2012 spells out the legal procedures that ought to be followed by banks before they dispose a defaulter's land. The Act has been observed to be a major hindrance to recovery of delinquent loans by banks due to the bureaucratic process that must be followed in the recovery process. It is against this backdrop that this study was carried out with the objective of establishing how spousal consent in land disposal affects recovery of delinquent loans. The study was limited to the 30 commercial banks operating in Nakuru town, Kenya. The study adopted a cross-sectional research design. The target population comprised of 154 credit officers working in these banks. A sample of 61 respondents was drawn using stratified random sampling method. A structured questionnaire was employed to collect data. A pilot study was conducted prior to the main study in order to assess both the reliability and validity of the research instrument. Descriptive analysis followed by inferential analysis was conducted on the collected data using SPSS. At the end, findings and implications were presented.
Keywords: Banks, defaulted loans, delinquent loans, land act 2012, spousal consent

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INTRODUCTION

In year 2005, the federal bank regulatory agencies in the United States (U.S.) became alarmed by the ever increasing concentrations of commercial real estate (CRE) loans in many commercial banks, specifically loans employed to finance construction and land development (CLD).In the light of foregoing, guidance were issued to demand commercial banks to tighten managerial controls (Bassett & Marsh, 2014). The enactment of thresholds in respect of CRE loans was found to be reflected in the banks' growth. The scholars further averred that, significant differences across loan categories in the loss rates on delinquent loans motivate the inclusions of charge-off rates as well.

A rise in the charge-off or delinquency rate indicates deterioration in the credit quality of the existing loan portfolio and requires banks to spend capital and income to cover current and expected future loan losses. As a result, lending standards also generally tighten in response to worsening loan quality, as banks' lending capacity shrinks (Bassett et al., 2014). Moreover, the deterioration in the quality of existing loans may also indicate a more general increase in the risk of new loans and a reduction in demand for loans if the deterioration is related to a broader downturn in economic conditions in markets served by the bank (Bassett & Marsh, 2014). It is argued that, delinquent loans are occasioned largely by failures of banks and also the financial crises in both developed and less-developed countries.

It is further opined that, the financial crises in sub-Saharan African nations were preceded by high non-performing loans – NPLs (Khemraj & Pasha, 2006). Focack (2005) observed that, loan delinquency in these countries was significantly attributed to economic growth, real exchange rate appreciation, real interest rate, net interest margins, among other factors. The author, moreover, blames the undiversified nature of some African economies for the strong association between macroeconomic factors and NPLs. Sileshi et al. (2012) analyzed the determinants of loan repayment performance among smallholder farmers in Ethiopia. The study findings indicated that 71.4 per cent defaulted partially in loan repayment.

In Kenya, the Land Act 2012 was signed into law alongside two other land statutes (the Land Registration Act, and the National Land Commission Act) by former President Mwai Kibaki on April 27, 2012 according to the Government of Kenya (GoK, 2012). The Land Act came to force on May 2, 2012. There are crucial stipulations of the Act that ignited jitters amongst players in the financial institutions especially commercial banks. This is in respect to recovery of delinquent loans from defaulters whose collateral is land. The most contested provision of the land laws is the entrenchment of spousal rights in the new statute when it comes to matrimony property, which the Land Registration Act classifies as either joint tenancy or tenancy in common. The requirement, it is lamented, would make things tighter for prospective home

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buyers who will be required to prove their marital status when applying for mortgage (CBK, 2012).

The interpretation of a survey report by the Central Bank of Kenya (CBK, 2012) is that, since there are no indications that amendments to the Land Act 2012 are imminent, commercial banks and other financial institutions seem to be increasingly adopting only one strategy regarding real estate industry; that is, keeping off. It is, needless to say, evident that financial institutions globally, regionally, and indeed in Kenya, specifically commercial banks, face financial challenges associated with delinquent loans. There are several studies that have been conducted in an attempt to establish the various causes of delinquent loans. However, the implication of Land Act as part of government regulations on recovery of delinquent loans among Kenya's commercial banks has been given a wide berth. It is against this backdrop that this study was undertaken.

Statement of the Problem

The Land Act 2012 came to effect on May 2, 2012 amid hue and cry from the commercial bank stakeholders. The Act demands that in the event an individual defaults in loan repayment, for which he or she had attached a given piece of land as collateral, then the commercial bank (lender) in question can only recover what it is owed after fulfilling certain stringent conditions. It is exemplified that, the spousal and tenants' (if any) consent must be sought. These among other conditions have hampered the efforts of commercial banks in recovering delinquent loans owed to them. The foregoing has culminated in the banks experiencing financial losses in terms of logistics, legal fees, provision for delinquent loans and opportunity cost in the process of loan recovery.

The commercial banks by being reluctant to award loans with land as collateral are bound to forego a significant amount of revenue. A credit survey conducted by the Central Bank of Kenya (CBK, 2012) supports this argument with its revelation that there is decreasing credit demand in real estate. It further established that, credit applications for building and construction dropped from 800 in March, 2012 to 428 in June, 2012. Moreover, the economy of Kenya is likely to bear negative economic consequences in the long run. Therefore, it was indeed very fundamental to undertake this study with the aim of advising the commercial banks and the relevant government authorities regarding the stipulations of the Land Act 2012.

Research Objective

To assess the implication of spousal consent on recovery of delinquent loans by commercial banks in Nakuru town

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Research Hypothesis

H_{01}: There is no significant relationship between spousal consent and recovery of delinquent loans by commercial banks in Nakuru town.

THEORETICAL FRAMEWORK

Credit Scoring Theory

The theory of credit scoring encompasses a number of considerations (Chatterjee et al., 2009). In line with this theory, the aforementioned proponents propose a theory of unsecured consumer credit where, borrowers have the legal option to default; defaulters are not exogenously excluded from future borrowing; there is free entry of lenders; and that lenders cannot collude to punish defaulters. It is argued that, limited credit or credit at higher interest rates following default is as a result of the lender's optimal response to limited information about the agent's type and earnings realizations. The lender learns from an individual's borrowing and repayment behavior about his or her type and encapsulates his reputation for not defaulting in a credit score.

The theory is taken to data estimating the parameters that match crucial data moments such as the overall and subprime delinquency rates. The theory is tested by illustrating how the underlying framework is broadly consistent with the way credit scores affect unsecured consumer credit market behavior. In tandem with the propositions of the credit scoring theory, Chatterjee et al. (2007) advise that, it is rational for a lender to assess the probability that a borrower will fail to pay back, that is, assess the risk of default. The credit scores range between 300 and 850. A higher credit score indicates a lower probability of default. In the U.S., for instance, scores under 620 accounts for approximately 25% of the population, and such scores are referred to as "subprime". There is sufficient empirical evidence that households with subprime credit scores are more likely to default.

Edelberg (2006) notes that, a credit score aggregates information from a borrower's credit record such as his payment history (especially the presence of adverse public records like bankruptcy and delinquency) and current amounts owed. However, the credit scores do not factor in information on race, tribe, nationality, gender, marital status, age, assets, remuneration, occupation, and employment history. Credit scores according to Chatterjee et al. (2009) seem to influence the extension of consumer credit in four major ways. First, credit terms like interest rates enhances with a person's credit score. Secondly, the presence of adverse public records such as delinquency lowers an individual borrower's score and removal could significantly raise it. Thirdly, taking on more debt (or paying off debt) seems to lower (or raise) credit scores. Lastly, credit scores are mean reverting. In context of the current study, credit scores could be

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employed to rate borrowers before advancing any credit facilities to them as a measure of mitigating delinquent loans by commercial banks.

EMPIRICAL REVIEW

Here, empirical studies that have so far been conducted specifically on spousal consent and recovery of delinquent loans by commercial banks are reviewed. The studies are reviewed from a global point of view which narrows down to the regional perspective and finally the Kenya's perspective.

Spousal Consent

A paper was prepared on agrarian change, gender and land rights in Tanzania (Tsikata, 2001). In the paper, it is noted that, the disregard of the fact that indeed in many communities by the Tanzania's National Land Policy (1995) that, women have some land tenure rights is problematic. The Policy, however, it is argued, acknowledges that each member of the family cannot dispose-off his share without either getting the consent of other family members and a right of pre-emption to other heirs. It is further averred that, simply making recommendation that, traditions or customary law and practice be observed with regard to family land ignores the fact that some crucial traditions of women's access to and control of land are not widely known. Traditions of male control are said to have become the dominant discourse on land rights despite the more complex character of realities on the ground.

The Gender Land Task Force (1998) recommended that the law provide for joint occupation and ownership between spouses and recognize the rights of spouses even where they have not been registered once they have contributed labor. Selling of such land without the consent of either spouse should be a punishable offence and the sale should be regarded as voidable at the instance of the spouse who has not been part of the deposition. According to the Task Force, this would accord women security in land and reward their investment in labor whatever the form of marriage.

Rugadya et al. (2004) analyzed gender and the land reform process in Uganda. They sought to outline the gains and losses for women in Uganda particularly in context of land issues. The authors noted that, the Poverty Status Report recommended that in order to increase production, competitiveness and incomes of most of Uganda's population through agriculture, it is vital to reinforce women's land rights beyond the consent clause as stated in the country's Land Act. The Report recognizes that enabling households to increase their incomes largely depends on the extent to which land matters are addressed for meaningful agricultural transformation.

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Rugadya et al. (2004) lamented that, in Uganda women have limited rights to consent on disposal of certain land assets. Women are argued to have a presumptive share of 25 per cent of the deceased husbands' land and usually have no right to a share on household assets in the event of divorce. Section 20 of the Land Act as enshrined in the Uganda's Constitution objects at enhancing the legal protection of women's interests. There are restrictions on sale, mortgage, and transfer of land upon which the family lives and derives its sustenance without express consent of resident spouse(s) and children prior to executing any transactions. This according to the Land Amendment Act (2003) is further strengthened by providing for the lodgment of a caveat on a certificate of title indicating the requirement for consent by the spouse claiming protection.

In Kaplan and Stratton's (2012) legal bulletin on the new land laws and matrimonial property, it is asserted that according to the Kenya Land Act 2012, a spouse who holds land or a dwelling house in his or her name individually charges, assigns or transfers that land or dwelling house, the lender, the assignee or transferee are under a duty to inquire of the borrower, assignor or transferor on whether the spouse(s) have consented to that charge, transfer or assignment. If the spouse dealing with the property deliberately misleads the lender or, the bulletin posits that, the assignee or transferee by the answers to the inquiries made, the disposition shall be void at the option of the spouse(s) who have not consented to the disposition. This therefore means a sale or charge is voidable, if spousal consent is not obtained.

Recovery of Delinquent Loans

Forecasting bank loans loss-given-default is a theme that Bastos (2009) delved into. In Portugal, banking institutions were invited to estimate credit risk capital requirements using an internal ratings-based approach. Bastos(2009) observed that in order to be compliant with the aforestated approach, banks must estimate the expected loss-given-default, that is, the fraction of the credit exposure that is lost if the borrower defaults. It is further asserted that, loss-given-default is frequently expressed by the recovery rate. It is noted that in the recent past, most of the published research pertains to recoveries on corporate bonds rather than loans (Altman, 2006).

Due to the reasoning that loans are private instruments, few data is publicly available to researchers. Recoveries on bank loans are usually larger than those on corporate bonds. This difference may be attributed to the typically high seniority of loans with respect to bonds and the active supervision of the financial health of loan debtors pursued by banks (Schuermann, 2004). Empirical studies on bank loan losses report distributions and basic statistics, such as means

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and quartiles, and examine the determinants of recoveries, the relationship between recoveries and the probability of default and the behavior of recoveries across business cycles. The geographic origins of empirical studies on bank loan recoveries include the U.S. (Gupton & Stein, 2005; Acharya et al., 2007), Europe (Caselli et al., 2008; Grunert & Weber, 2009) and Latin America (Felsovalyi & Hurt, 1998). Reported mean recoveries range from about 50 to 85% and the dispersion in recovery rates is generally high.

Fofack (2005) argued that in Sub-Saharan Africa, real exchange rate appreciation, net interest margins, and real interest rate were some of the factors associated with non-performing loans. Waweru and Kalani (2009) asserted in their study of commercial banks in Kenya, noted that, some of the causes of non-performing loans in Kenyan banks included national economic meltdown, reduced consumer buying ability and legal issues. In Kenya, few studies note that, though there are strict measures on credit risk management that have been put in place, loan recovery is still a challenge to majority of the financial institutions (Njiru, 2003; Silikhe, 2008). Essendi (2013) believes that, the foregoing explains the reason why most financial institutions are either stagnating in growth or are about to close business altogether.

Warue (2012) studied the factors that affect loan delinquency in microfinance institutions (MFIs) in Kenya. She explained that, a loan is delinquent when a payment is late; and that, a delinquent loan becomes a defaulted loan when the chance of its recovery becomes minimal. According to the author, concepts of non-performing loan and loan delinquency are similar. Effective lending process and procedures have far reaching effect on loan delinquency levels. If a borrower does not honor promises to pay, appropriate default recovery method procedures would have direct link to delinquency levels. Gatimu and Kalui (2014) assessed institutional factors contributing towards loan defaulting in MFIs in Kenya. The scholars argued that, the success in credit risk management is largely reflected in the proportion of delinquency's loans to gross lending. Factors such as credit policies, loan recovery procedures, and loan appraisal process were perceived to be the critical drivers of loan delinquency occurrence. Each of the aforestated factors was found to significantly affect loan delinquency performance in MFIs in Kenya.

Conceptual Framework

Figure 1 illustrated the conceptual framework. It is hypothesized that the spousal consent influences recovery of delinquent loans. The aforestated relationship is moderated by the Kenya's Constitution. Interpretatively, a change on either of the aforementioned independent variable is presumed to impact on recovery of delinquent loans by commercial banks in Nakuru

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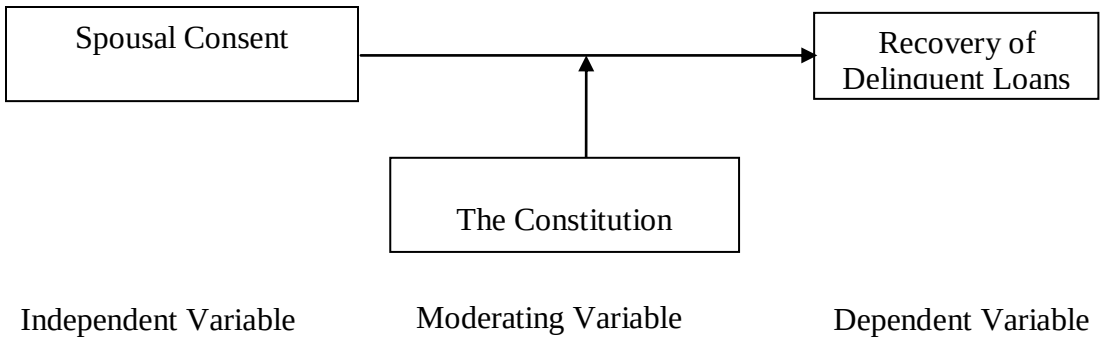
town, Kenya. In other words, the implementation of the spousal consent as spelt out in the Land Act 2012 must be within the stipulations of the Constitution.

Figure 1: Conceptual Framework



METHODOLOGY

Research Design

The study adopted a cross-sectional research design. Olsen and George (2004) noted that, in this kind of design either the entire population or a subset thereof is selected, and from these individuals, data are collected to help answer research questions of interest. It is called cross-sectional because the information about study variables that is gathered represents what is going on at only one point in time. The study was conducted within a specific time-period, that is, between January and March, 2015. The cross-sectional design also enabled the determination of relationship between the independent and dependent variables.

Target Population

The target population of the study constituted all credit officers/managers working commercial banks located in Nakuru town. There were a total of 154 credit officers/managers in the aforementioned banks. Credit officers were presumed to be the savviest with not only the Land Act 2012, but also recovery of delinquent loans. Credit officers are charged with getting customers for loans, assessing their credit worthiness, and recovering loans advanced to borrowers.

Sample Size and Sampling Technique

The first step in this section is deriving the sample size. This was done using Nassiuma's (2000) formula and stratified random sampling which is a form of probability sampling was employed to

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obtain the sampled respondents from the study population. In probability sampling, the findings are generalizable to the population of the study.

$$n = \frac{NC^2}{C^2 + (N-1)e^2}$$

Where

n = sample size;

N = population size;

C = coefficient of variation which is 50%

e = error rate (0.05)

Substituting these values in the equation, estimated sample size (n) will be:

$$n = \frac{154\,(0.5)^2}{0.5^2 + (154-1)0.05^2}$$

$$n = 60.87$$

$$n = 61 \text{ respondents}$$

The 61 sampled credit officers were drawn from the target population by use of stratified random sampling. That is, credit officers from each of the 30 commercial banks in Nakuru town constituted a stratum. Therefore, there were 30 strata in total. Within each stratum (commercial bank), respondents (credit officers) were drawn at random. Stratified random sampling reduced sampling bias since all commercial banks were part of the study while credit officers from each bank had an equal chance of being selected to participate in the study.

Research Instrument

The study used structured questionnaires to collect primary data from the sampled respondents. Olsen and George (2004) noted that, questionnaires are recommended in collection of data in cross-sectional studies. Moreover, Mugenda and Mugenda (2009) opined that, questionnaires are suitable research instrument when respondents are dispersed as exemplified by the cross-section of commercial banks in Nakuru town. The research questionnaires comprised of precise and concise questions which were also easy to understand and interpret. The questions therein were in tandem with the study objectives. On the other hand, the financial statements of the past three years were analyzed alongside other pertinent materials as a way of obtaining requisite secondary data.

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Reliability and Validity of the Research Instrument

Reliability test enabled the determination of precision and consistency of the questionnaire. The Cronbach alpha was used to test the instrument's reliability. The two constructs, that is, spousal consent and recovery of delinquent loans returned $\alpha = 0.762$ and $\alpha = 0.791$ respectively which implied that they were reliable. Validity illustrates the accuracy of the research instrument. In other words, a valid instrument is one that measures what it purports to measure. In this study, both content and construct validities were assessed. Content validity was determined by seeking expert opinions of university supervisors since it could not be statistically tested (Kimberlin & Winterstein, 2008). On the other hand, construct validity was tested using the Principle Axis Factoring (PAF) method. For the instrument to be considered valid, its constructs must have returned Eigenvalues greater than 1.000

Data Processing and Analytical Approach

The collected questionnaires were first grouped according to the banks from where they were collected. This was followed by data cleaning by getting rid of incomplete and/or inappropriately filled questionnaires. The cleaned data was then coded using the Statistical Package for Social Sciences (SPSS). Descriptive analysis was first carried out. This encompassed measures of distribution, variation, and central tendencies. This was followed by inferential data analysis which was in form of Pearson's product-moment correlation coefficient (PPMCC). The study findings were presented in form of tables of descriptive and inferential statistical results.

ANALYSIS & FINDINGS

Descriptive Findings

Firstly, the views of the credit officers regarding spousal consent and recovery of delinquent loans are outlined.

Spousal Consent

In this part the opinions of the credit officers of various banks in Nakuru town regarding spousal consent prior to land disposal were sought. Table 1 outlines the relevant findings. As the Table indicates, credit officers agreed (mean > 4.00) that the banks seek spousal consent before extending loan whose collateral is land; the bank seek spousal consent before auctioning land used as collateral by a defaulter; spousal consent must be sought before disposing land; selling of land without spousal consent is an offence punishable by law; process of seeking spousal consent is lengthy and costly; and that women have land tenure rights in Kenya. The foregoing concurs with Kaplan and Stratton's (2012) legal bulletin on the new land laws and matrimonial

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property. The findings contradict Rugadya et al.'s (2004) study where it was lamented that, in Uganda women have limited rights to consent on disposal of certain land assets. However, the credit officers disputed (mean = 2.35) that banks easily gets spousal consent when auctioning land used as collateral.

Table 1: Descriptive Statistics for Spousal Consent

		n	Min	Max	Mean	Std. Dev
i.	The bank seeks spousal consent before auctioning land used as collateral by a defaulter	47	4	5	4.41	.498
ii.	The bank seeks spousal consent before extending loan whose collateral is land	47	4.0	5.0	4.297	.4634
iii.	Spousal consent must be sought before disposing land	47	4	5	4.27	.450
iv.	Selling of land without spousal consent is an offence punishable by law	47	4	5	4.19	.397
v.	Process of seeking spousal consent is lengthy and costly	47	2	5	4.08	.640
vi.	Women have land tenure rights in Kenya	47	3	5	4.05	.468
vii.	Banks easily gets spousal consent when auctioning land used as collateral	47	1	5	2.35	.857

Recovery of Delinquent Loans

This section outlines the respondents' opinions regarding recovery of delinquent loans whose collateral is land. Table 2 shows the relevant results. The results indicated that, respondents agreed (mean ≈ 4.00) that involving interested parties in auctioning of defaulters land is a hindrance to recovery of delinquent loans; defaulter's land revaluation affects recovery of delinquent loans; and that Spousal consent influences recovery of delinquent loans from defaulters.

Table 2: Descriptive Statistics for Recovery of Delinquent Loans

	n	Min	Max	Mean	Std. Dev
Spousal consent influences recovery of delinquent loans from defaulters	47	3	5	4.27	.508

Inferential Findings

This section outlines the effects of spousal consent on recovery of delinquent loans from defaulters. As illustrated in Table 3, the spousal consent marginally affects recovery of delinquent loans. The relationship between the two variables was established to be negatively and weak and not statistically significant ($r = 0.038$; $p > 0.01$). The findings led to failure to reject

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the first null hypothesis which stated that there is no significant relationship between spousal consent and recovery of delinquent loans by commercial banks in Nakuru town. The findings implied that the spousal consent was not largely consequential when banks are recovering delinquent loans from defaulters. This may probably be due to the participation of all spouses when applying for loans.

Table 3: Correlation between Spousal Consent and Recovery of Delinquent Loans

		Recovery of Delinquent Loans
Spousal Consent	Pearson Correlation	.038
	Sig. (2-tailed)	.822
	n	47

Summary

It was observed that credit officers agreed that the banks seek spousal consent before extending loan whose collateral is land; the bank seek spousal consent before auctioning land used as collateral by a defaulter; spousal consent must be sought before disposing land; selling of land without spousal consent is an offence punishable by law; process of seeking spousal consent is lengthy and costly; and that women have land tenure rights in Kenya. However, it was disputed that banks easily gets spousal consent when auctioning land used as collateral. The spousal consent was found to marginally affect recovery of delinquent loans since the relationship between the two variables was established to be negatively and weak and not statistically significant ($r = 0.038$; $p > 0.01$). The results further indicated that spousal consent influences recovery of delinquent loans from defaulters.

CONCLUSIONS & RECOMMENDATIONS

It is concluded that commercial banks should seek spousal consent before extending loan whose collateral is land. In tandem with the stipulations of the Land Act 2012, spousal consent must be sought before auctioning land. Nevertheless, it is concluded that spousal consent is not very crucial in recovery of delinquent loans by commercial banks. On the basis of findings, following recommendations are made:

i. Commercial banks should always verify the marital status of all loan applicant s especially those ones that use land as collateral.
ii. In line with the study findings, it would be important to conduct further studies on the challenges hindering the implementation of Land Act 2012 in Kenya; the factors

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influencing recovery of loans by microfinance institutions; and the benefits of using land as collateral when applying for bank loans.

LIMITATIONS & SCOPE FOR FURTHER RESEARCH

The sensitivity of the data that was sought from the credit officers increased the skepticism of the respondents which would have otherwise compromised the study. The researcher, however, assured the respondents that their identity was never to be disclosed besides the study being limited to academic purposes. There might have been other aspects of the Land Act 2012 that failed to be captured by the study scope. In light of the foregoing, the study sought to assess in depth the effect of spousal consent of recovery of delinquent loans.

It would be crucial to research on how other stipulations of the Land Act 2012 impact on recovery of delinquent loans by commercial banks. For instance, it is important to assess the implications of land revaluation and related logistic, and also the involvement of interested parties such as family members, tenants and guarantors on recovery of delinquent loans.

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