

How should financial institutions manage Loans using customary land as collateral?

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**Land and
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Making land work for us all

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Introduction

80% of land in Uganda is managed under the customary tenure system of property law¹. However, very few policies support customary tenure in relation to economic growth. Economic growth theory teaches that for development to occur, land must be used dually for subsistence and for generating capital. One method of generating capital is mortgaging land, which relies on documentation of ownership; land under customary tenure, however, is not titled, which increases the difficulty of obtaining a mortgage. In addition, misunderstandings about the nature of customary land ownership make financial institutions wary of using customary land as collateral for loans.

LEMU's 2013 Strategic Plan seeks to protect customary land rights while simultaneously ensuring economic land development. To implement this plan, LEMU sought to understand if and how banks accept customary land as collateral for loans and to inform banks on the operations and management of the customary land tenure system. Thus, LEMU conducted a rapid assessment in early 2012 of banks offering loans with customary land as collateral. Out of the 30 financial institutions identified (consisting of 23 banks, 3 credit institutions, and 4 microfinance institutions), **only five financial institutions issue loans using customary land as collateral** – Centenary Bank, Post Bank, Opportunity

Bank, Uganda Finance Trust, and Pride Microfinance. LEMU engaged these five financial institutions to understand their processes and procedures for loan applications. LEMU analysed these institutions on both the national level and the district level and conducted four workshops (one in Lango for loan takers, one in Lango for bank officers, one in Soroti for loan takers, and one in Soroti for bank officers) to give participants questionnaires about their customary tenure-related lending experiences. At these workshops, LEMU also instructed participants on the basic tenets of customary tenure and proposed ways in which the loan process could be made easier. In those five institutions, customary tenure loans were quite common; for example, one bank in Lango gave about 520 customary tenure loans out of about 700 total loans.

The purpose of this policy brief is to recognise financial institutions as major stakeholders in economic development and customary tenure issues, to demonstrate their need for a better understanding of customary tenure, and to recommend ways for them to extend loans on land held under customary tenure while simultaneously promoting economic development.

The nature of customary tenure loans

Generally, LEMU found that people take out loans for business purposes (62% of respondents), agriculture (20% of respondents), fees (16% of respondents), and home/personal use (2% of respondents). The loans given out by the

¹ The system is protected by the 1998 Land Act, which protects customary tenure as a legally valid system

financial institutions ranged in value from 100,000 to 17 million shillings. 68% of respondents had a fixed repayment period of 7 to 12 months. Additionally, the interest rates on loans were as high as 30% per year of the value of the loan.

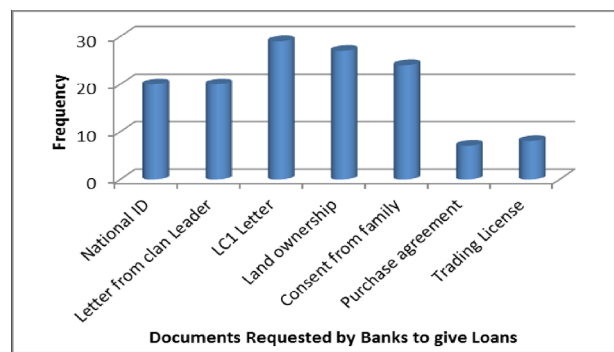
Financial institutions reported common collateral as both tangible (e.g., oxen and cattle) and intangible (e.g., land sales agreements, future crops, maps, photographs, and boundary trees, though only one bank uses GPS to create boundary maps to attach to the loan application file). Only one bank mentioned using CCOs for collateral; generally, financial institutions do not have enough faith in the legality and legitimacy of CCOs. Additionally, most financial institutions allowed people who paid back several loans to use the same collateral for future loans. For example, one loan taker in Lango told LEMU that he had taken out loans from the same financial institution ten different times, using the same land as collateral each time.

The process of giving out loans under customary tenure is lengthy, typically taking two to four months, since consent is needed from many different people, particularly the immediate family, the wife, and interestingly, the clan, whose role is to stop irresponsible land sales and yet do not own the land or have a share in it. Banks reported that they need loan papers to be stamped, and families do not have stamps -- but clans do. **Figure 1** demonstrates the documentation banks require for loans to be granted; notably, a letter from the LC1

is requested with the highest frequency, even when LCs do not have a role in land administration under the Land Act or customary tenure. Many banks reported to LEMU that they also require the consent of the Jago.

Figure 1:

Documents Required by Banks to Give Out Loans on Customary Land



Additionally, in some banks, the process of giving out loans is attenuated because the necessary forms and instructions for application are not given to applicants at the beginning of the process, but are given in piecemeal over time, which complicates the procedure.

Obstacles to accessing the loan process under customary tenure

Several obstacles make the loan process under customary tenure difficult to navigate and timeconsuming for both loan takers and bank officials. Such obstacles include:

1. Lack of understanding of customary tenure: Financial institutions admitted a lack of understanding about customary

tenure issues. One bank official told LEMU that processing anything less than a title is “*preventing people from moving with the times,*” and another bank official told LEMU that “*I am just learning about customary tenure now.*” This lack of knowledge can lead to misinterpretation of customary principles; for example, many banks noted strong reluctance in giving loans to women with land as collateral because of the belief that “*women do not own land.*” Additionally, though banks are interested in using certificates of customary ownership (CCOs) as documentation for loans, there is a hesitancy to do so because banks have not been assured of the legitimacy or legality of CCOs.

2. Difficulties upon default: Banks are very reluctant to give out mortgages on rural customary land because, upon default, they will probably not be able to sell the land. Not only do banks fear evicting people after default, but the clan discourages potential buyers. One bank official reported that potential buyers from outside of the clan are frequently threatened or harassed by clan members. As such, both banks and loan takers know that the land cannot be sold; the fear of losing the land, and the fear of getting a bad credit reputation and being unable to take out more loans in the future, appears to function as the true collateral for the loan. Additionally, after default, sometimes loan takers are mistreated. At other times, banks may attempt to sell family land that was not even the subject of the mortgage.
3. Complicity: Both parties to the loan may act corruptly and lengthen the process, creating additional economic burdens for either side.
 - (a) Bankers may require the payment of transport costs (even though banks already pay for such costs). Bankers may also retain part of a loan without explanation or with a promise of eventual repayment, which never occurs. For example, a loan taker in Lango told LEMU about being promised a million shillings but receiving less by 65,000 shillings. The loan taker explained that “it’s because the bank finds you at that time without money and therefore desperately in need for money to the extent that you cannot complain.”
 - (b) Loan takers may forge the same agreement to look original in application to multiple banks using the same collateral. When default then occurs, the banks collide. To solve this problem, the Central Bank created a system to record loan takers, which is accessible to every bank to verify that the applicant has not already taken out loans with that same collateral. This process seems to be effective; as one loan taker in Lango said, “I had sister banks and was getting loans from very many banks. But when they introduced financial cards, this became very tricky.” Additionally, loan takers may bring in some other women not their wives to stage consent and pose for

pictures; only when default occurs does the real wife appear and claim that the loan was invalid for lack of consent.

Conclusions

While it is widely believed that a title to land is needed to obtain a mortgage, LEMU's findings reveal that the problem lies in the number of people who have rights to family land, and not so much in the lack of a title. Not only is it difficult to get the consent of many people, but it is also difficult for banks to evict many people upon default, as banks do not desire to lose social standing or go to court². Thus, the best approach to the customary tenure mortgages is to only accept customary land as collateral when it has been bought by an individual or family. Additionally, when customary land is used in mortgages, both banks and loan takers acknowledge that it is very difficult to sell land upon default. Thus, the real, functional collateral appears to be not the land but movables (such as cattle) and the good name of the loan taker.

RECOMMENDATIONS

1) Banks should prioritise accepting purchased land as collateral. Banks currently spend significant time and money investigating land rights and obtaining consent. To streamline the process and avoid future conflicts upon default, banks should prioritise

accepting purchased land as collateral. Instead of documenting land at the time of mortgage and determining who has what land rights, banks could look to existing documentation from the sale, and would only need to speak with those involved in the sale (e.g., neighbors and clan members) to determine its legitimacy. This would eliminate the need to get clan or LC approval; only authentication of previously-made agreements would be necessary. This is a simple approach that reduces banks' vulnerability to fresh abuse; if there is later a challenge to the authenticity of the sale, the bank would only be a third party and not be directly challenged, further protecting the bank. This research demonstrates that the banks of Lango currently take this approach of customary tenure loans in demarcating mortgaged land and having sketch maps drawn. The main difference proposed here is that, in land that has been bought, the banks should require examination of sales documents to identify owners for consent, and should examine maps to identify the land. Additionally, banks could then easily identify the clan and LC authorities who participated in the sale.

2) Though banks should prioritise using purchased land as collateral, a second option could be that banks use inherited land as collateral, but only with thorough investigation. This thorough investigation can be done through family tree land rights analysis

² As is required under the Mortgage Act of 1999 to enforce mortgage upon default

and obtaining consent from the family instead of the clans, The clans can then be guarantors.

- 3) Banks should accept and promote the use of maps and boundary trees as evidence of ownership. Land rights are either those that are recognized by the state (e.g., title) or those that are socially accepted (e.g., maps and boundary trees). While customary land titles are not yet provided, banks should join the clans and LEMU in campaigning for proactive boundary tree planting and sketch map drawing to demarcate ownership of land. Where such customary proof can be accepted by the banks, banks should provide GPS to assist communities to know the size of the land they want to mortgage. Banks should also join in current lobbying efforts of encouraging the Government and other actors to accept maps as proper evidence of customary land rights. While maps may not be perfect, they are a great improvement to oral testimony that customary tenure traditionally relies upon.
- 4) Banks should make the loan process clear on the first day application is made. Applicants should be immediately informed of the steps of the process, the costs and fees necessary to complete the process, how long the process will take, and which documents are requested or required. This increases transparency and efficiency. Official costs should be published by the banks for all to access. Banks should aim for

the time taken to process the loan to be between two to three weeks.

- 5) Banks should join the Northern Uganda Land Platform to promote CCO policy change. Currently, banks have the option of recognising either legal title or socially-accepted mechanisms denoting ownership (e.g., maps and boundary trees). Currently, banks use sales agreements, maps and boundary trees in determination of land rights; these after sales methods are useful and effective, but lengthen the process due to lack of documentation. The CCO has the potential to provide both documentation and recognition of customary land rights. CCOs currently have many implementation challenges and have no operational registry. The Government needs to assure banks of the legality and legitimacy of CCOs. To follow up on these issues and promote this policy change, banks — as key stakeholders — should join the efforts of the Northern Uganda Land Platform to promote proper title for customary land. Also, banks should engage with churches and clans in the discussion of where a registry of land rights should be, with banks themselves potentially acting as a land rights registry.
- 6) Banks should prevent corruption tendencies that may arise between the credit officers and loan takers. This can be done by publicly stipulating the requirements and procedures during the loan process.

- 7) Banks should join LEMU in informing the public that, by acting corruptly, they entrench the belief that customary tenure is not good for economic growth, which will make it increasingly more difficult to get loans under customary tenure.
- 8) Banks should partner with LEMU to train employees and loan takers on customary tenure. Credit officers should be trained with the PPRR to understand customary tenure land rights and management, and should be capable of carrying out family land rights analysis to understand more accurately whose consent is required for mortgages and land sales. Further training of loan takers on running profitable businesses is also necessary to enable efficient use of the loan acquired; only this will enable good repayment of the loan.
- 9) Banks should promote the acceptance of both types of collateral - land and movable property. This research indicates that the acceptance of cattle and other movables as collateral functions well; additionally, this research indicates that, even when customary land is mortgaged, it is the person's "good name" that is mortgaged, since most people seek out multiple loans and must establish a good reputation of repayment and reliability, Banks are not really so much interested in the collateral but the person's ability to repay the loan; this practice seems to be functioning well and generally results in good rates of loan repayment, so it can be used as an interim solution while banks continue to learn how to process loans under customary tenure.

END

How should financial institutions manage Loans using customary land as collateral?

LEMU's Publications Include :

Policy Discussion Papers

1. Protection & land rights
2. Titling customary land
3. Landlessness
4. Does customary tenure have a role in modern economic development?
5. Linking land tenure and Agricultural Modernisation: Making PMA relevant for all.
6. Return or transformation? Land and resettlement of IDPs in Northern Uganda.

Information Leaflets :

1. Know the law on: Compulsory Acquisition
2. Know the law on: The consent clause
3. How is land under customary law managed?
4. Customary rules or excuses of land grabbers?
5. How can we minimise land conflicts?
6. Is your clan strong?

Position Papers

1. Will the Land (Amendment) Bill No.27 of 2007 help protect rights on customary land? A position paper by Cultural Institutions from Acholi, Arua, Lango, Nebbi, Teso and Land and Equity Movement in Uganda (LEMU)

Information Packs :

- Titling Pack (Will papers help me protect my land?)
- Let's face up to Land Grabbing Pack
- Accessing Land for Development Pack
- Protecting your Community Land Pack

Other Policy Papers:

- Fighting the wrong battles? - Towards a new paradigm in the struggle for women's land rights in Uganda
- Further submission to National Land Policy
- What land rights do people have under the rules of customary tenure?
- How can women's land rights be best protected in the National Land Policy?
- Charting the Way for Effective Land Dispute Resolution in Uganda.

Local Language Publication:

- Jwik lara kede Bura me wang kinga i Lango.
- Eipone Bo Ali Ipedoria oni Aitidisiar Amariao Ka Engunget Loka Alup Ko Teso?
- Epone mene kame wa twero dwodwoko kede atwomotwomun ne lobo lteso?
- Nutupitono ka nuiswana koidare loka alipok nuka ateker ka apedorosio nuka ikulepek alupok, 1st Omaruk 2009
- Cik me lobo tekwaro me Lango - nama 1 me mwaka 2009

Books

- Learning Report 1. Land rights : where we are and where we need to go
- Research Report : Land Matters in Displacement. The Importance of Land Rights in Acholi land and What Threatens Them.
- Research Report 1. A Land Market for Poverty Eradication?
- Research Report 2. Land transactions in land under customary tenure in Teso
- Ateso Principles, Practices, Rights and Responsibilities (PPRR) for Customary Tenure Management as of June 2009
- Principles, Practices, Rights and Responsibilities (PPRR) for Customary Tenure in Lango Region - No. 1 of 2009
- Principles and Practices of Customary Tenure in Acholiland, June 2008



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