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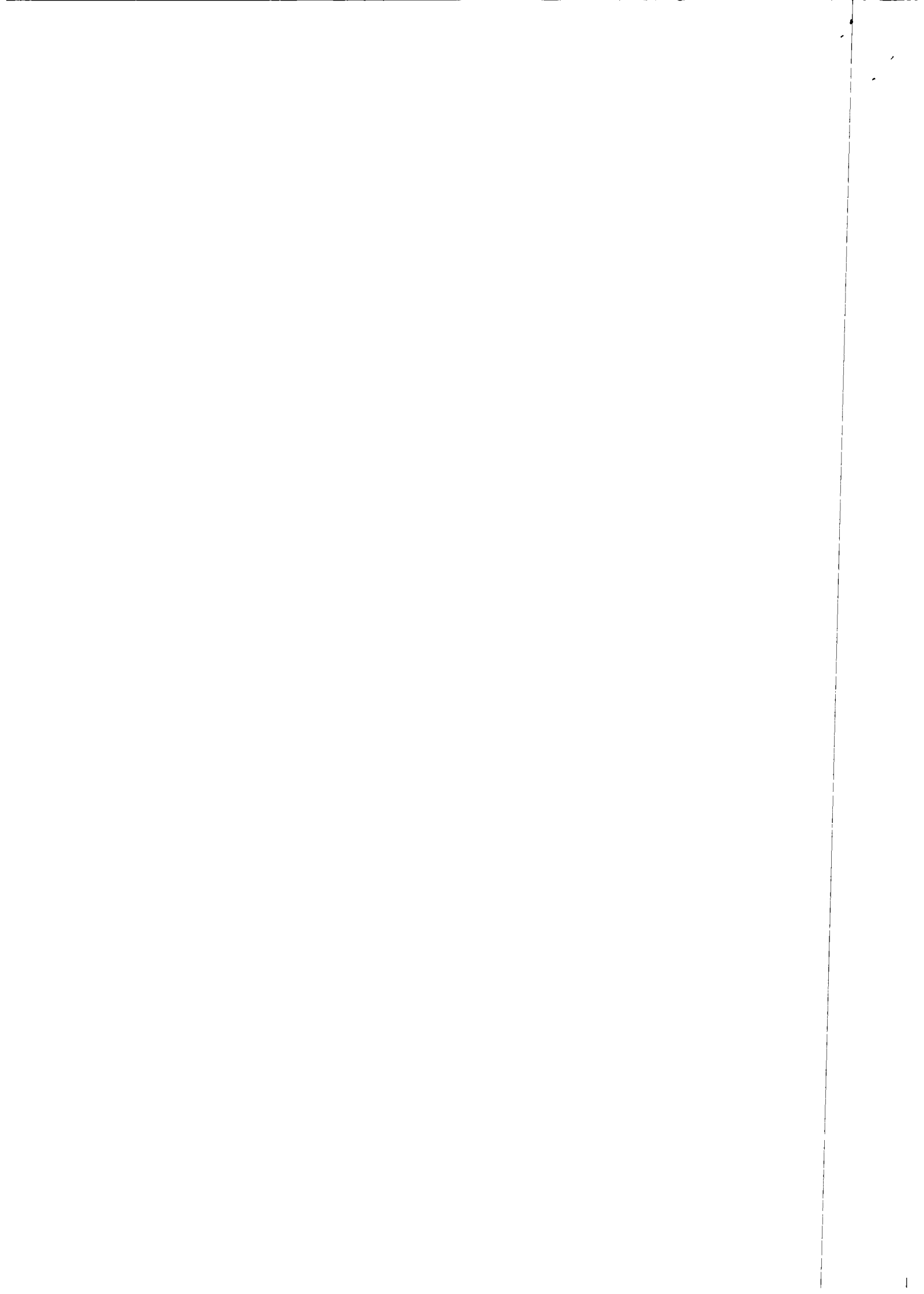
THE RESPONSE TO A STATEMENT BY THE
DEPARTMENTAL COMMITTEE AGRICULTURE, LIVESTOCK AND
COOPERATIVES
ON

THE STATUS OF AFC LOANS ISSUED TO FARMERS IN THE
LOWER EASTERN REGION

Kenya National Assembly
Parliament Buildings
NAIROBI.



18TH JULY, 2013



**RESPONSE TO A STATEMENT REQUESTED BY
THE HON. BISHOP ROBERT MUTEMI, MP
FROM THE CHAIRPERSON OF THE DEPARTMENTAL COMMITTEE ON
AGRICULTURE, LIVESTOCK AND CO-OPERATIVES**

Mr. Speaker sir,

*response to Bishop Robert Mutemi MP
Ense*

On Thursday, May 23, 2013, the Nominated Member Hon. Bishop Robert Mutemi, MP rose on the floor of the House and requested the Chairperson of the Departmental Committee on Agriculture, Livestock and Cooperatives to issue a statement on the Agricultural Finance Corporation (AFC) Loans issued to Farmers in Lower Eastern Region and consider write off of the same.

Mr. Speaker Sir,

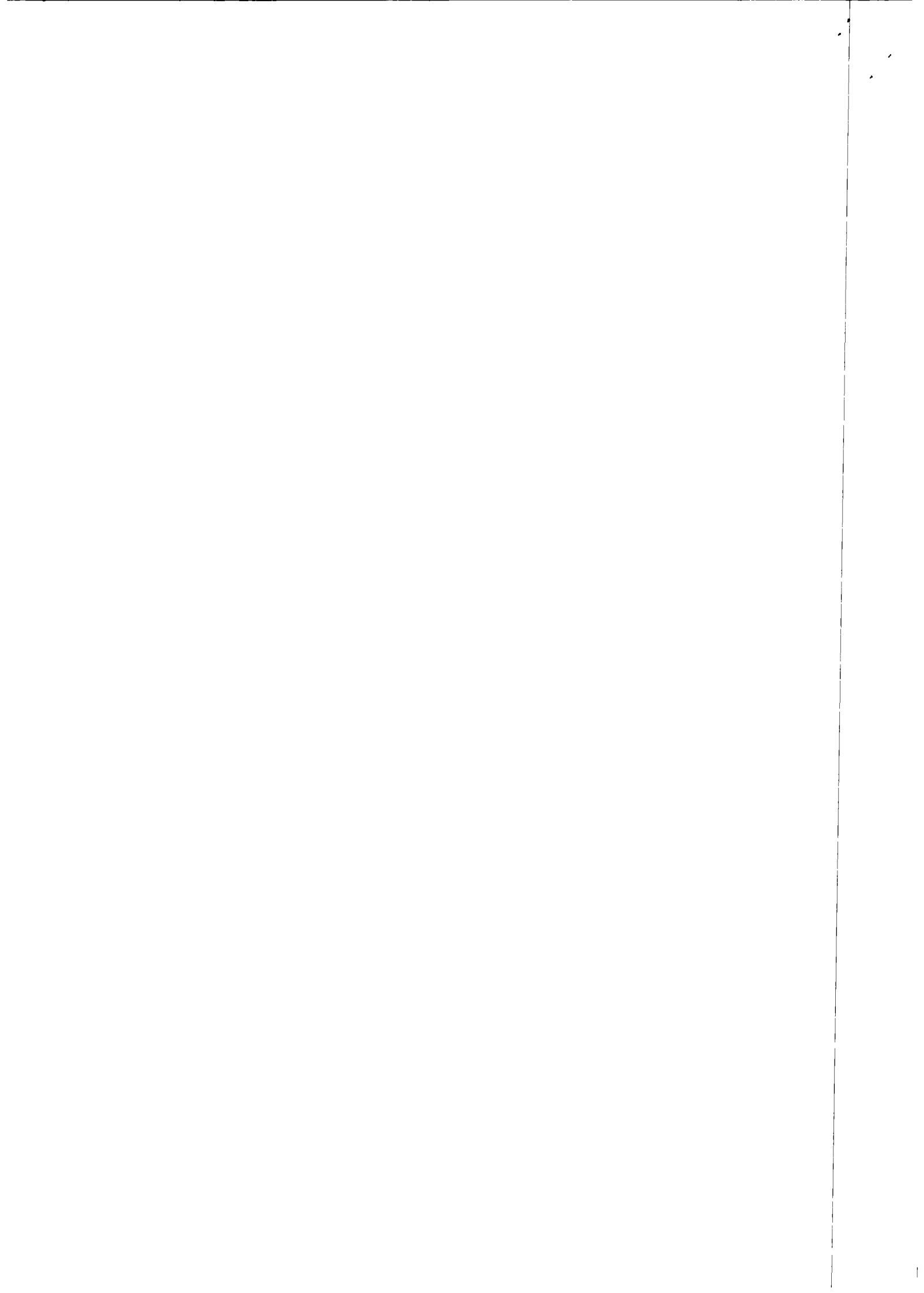
In the statement, the Member requested that: -

- a) I disclose the amount disbursed in form of loans to farmers in the Lower Eastern Region in the last 10 years;
- b) I state how much of the loans have been paid back and indicate the outstanding balance''

Mr. Speaker sir, the Committee summoned the Cabinet Secretary for Agriculture, Livestock and Co-operatives on the **June 11, 2013** to appear before it and answer to the Member's request.

Mr. Speaker sir, I wish to report to the House and give a detailed report on AFC loans with full information including: -

- i. A report on the write off implemented by AFC in 2004 on Government directive, following the passing of Sessional Paper No. 1 of 2002 by Parliament.
- ii. Lending Projections for 2013/2014 FY
- iii. Status report on the performance of loans granted across the country in the period 2004 to date.
- iv. Status report on the performance of loans granted in Lower Eastern Region from 2004 to date, and the options available for restructuring the accounts in arrears.
- v. Update on the utilization of the Kshs 700 million released to AFC following the award of a grant of Kshs 2.0 billion by Parliament for drought Relief (Hon. Ababu Namwamba Motion)



Paper laid to the
table of the House
on 18/07/2013



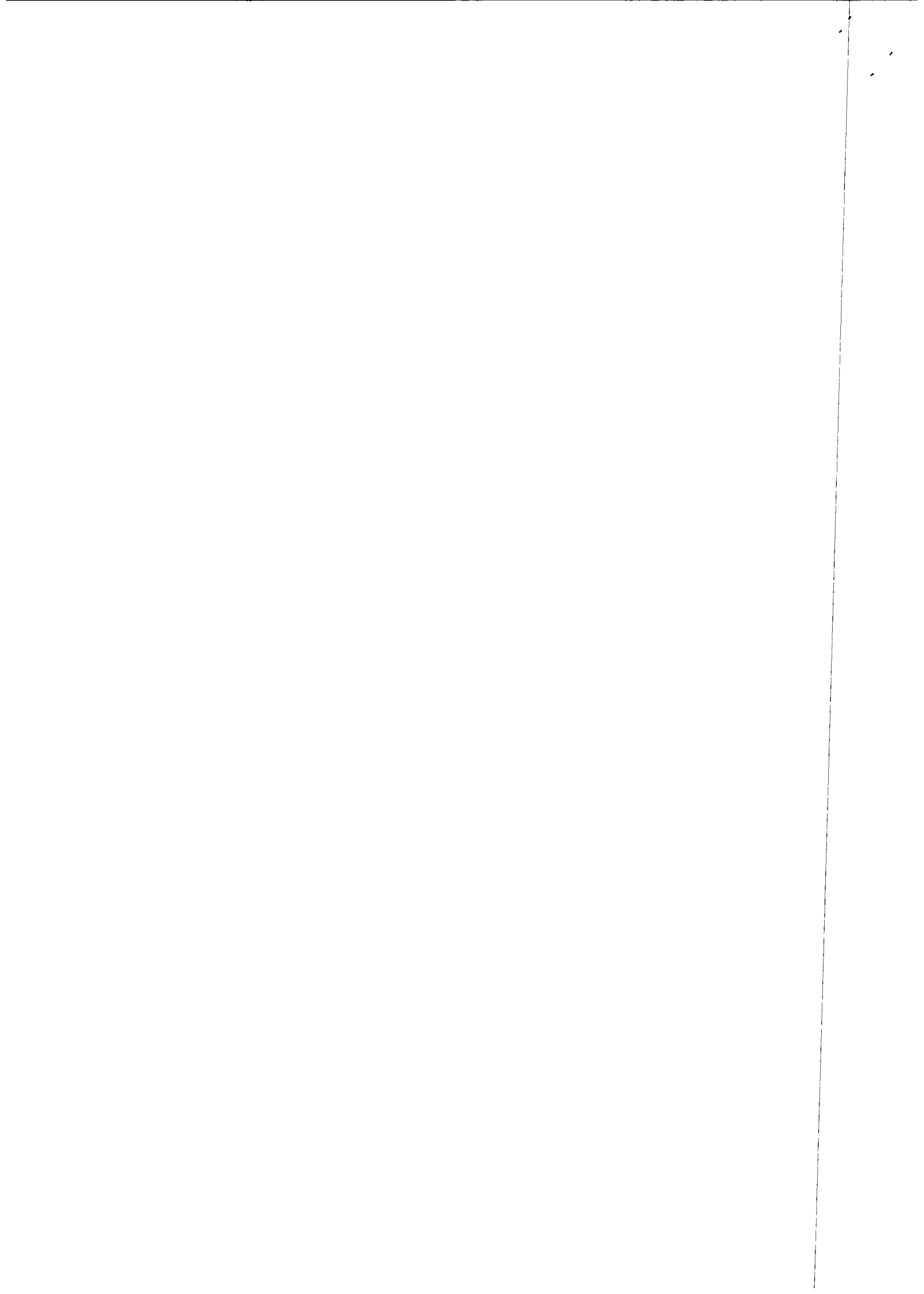
**REPORT TO PARLIAMENTARY DEPARTMENTAL COMMITTEE ON
AGRICULTURE, LIVESTOCK AND COOPERATIVES ON AFC LOAN WRITEOFF**

1.0 Preamble

The Parliamentary Committee on Agriculture, Livestock and Cooperatives, in its sitting of 10th June 2013, deliberated on a response by the Cabinet Secretary for Agriculture, Livestock and Fisheries on a Parliamentary Question raised by the Hon. Bishop Robert Mutemi. The Member had requested for a statement from the Chairperson of the Departmental Committee regarding the current state of Agricultural Finance Corporation loans, and for the Government to consider writing off loans to farmers in the Lower Eastern Region. The MP had further requested that the statement disclose the amount disbursed in the form of loans to farmers in the Lower Eastern in the last 10 years as well as the amount paid back and the outstanding balance.

Following its deliberations, the committee concluded that it will not be feasible to grant a blanket write off. Other reliefs may however be considered. The Committee requested for further information as follows in order to arrive at a final position:

- i. A report on the write off implemented by AFC in 2004 on Government directive, following the passing of Sessional Paper No. 1 of 2002 by Parliament.
- ii. Lending Projections for 2013/2014 FY
- iii. Status report on the performance of loans granted across the country in the period 2004 to date.
- iv. Status report on the performance of loans granted in Lower Eastern Region from 2004 to date, and the options available for restructuring the accounts in arrears.
- v. Update on the utilization of the Kshs 700 million released to AFC following the award of a grant of Kshs 2.0 billion by Parliament for drought Relief (Hon. Ababu Namwamba Motion)



- vi. Policy statement and strategy for dealing with appeals for write-off in future.

This report provides the requested for information as detailed below.

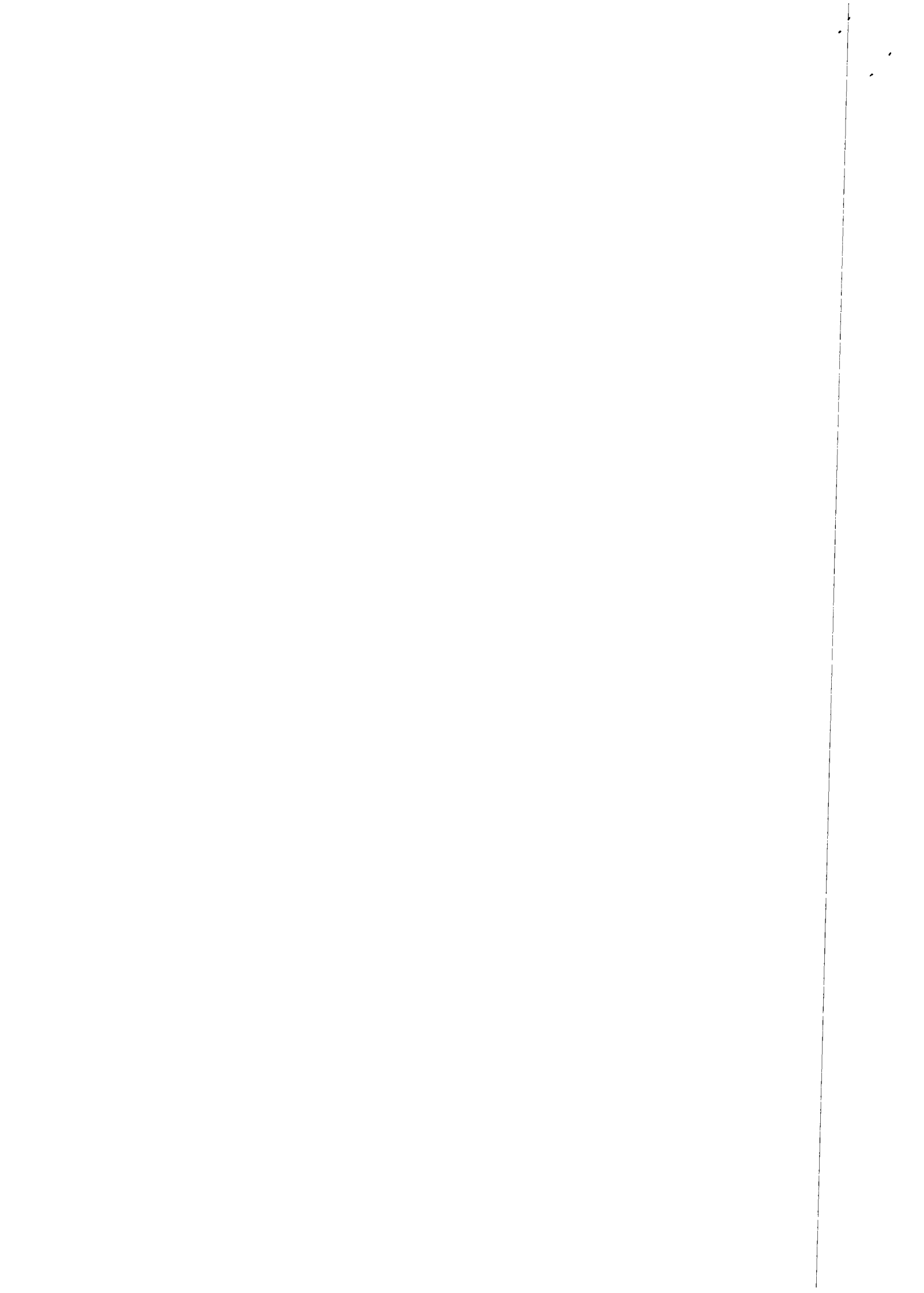
2.0 Report on the write off implemented by AFC in 2004 (Sessional Paper No. 1 of 2002)

Sessional Paper No. 1 of 2002 on Restructuring of Agricultural Finance Corporation (AFC) authorized write off of Kshs 5,187,150,488 in loans owed by farmers to AFC. The loans approved for write off were contained in a list placed before Parliament. They included the following categories:

- i. Loans granted under the seasonal credit scheme, and which had been affected by drought leading to inability by farmers to pay.
- ii. Loans granted under the seasonal credit scheme, where the crop was damaged by wildlife and the affected farmers had not been compensated by Government over the years.
- iii. Loans to Ramisi Sugar Factory outgrowers who had affected by collapse of the sugar factory.
- iv. A loan to Miwani Sugar Mills Ltd which had failed to pay following the liquidation and winding up of the Sugar Mill.
- v. Unsecured loans granted to pastoralists, and whose livestock had been lost to drought in 1984.
- vi. Loans which had become bad and doubtful over the years for various other reasons, and which the Corporation had been unable to realize securities held, most of which were rural.
- vii. Loans whose beneficiaries had been affected by land clashes in 1992 and 1997.

The breakdown is provided in table 1 below:-

Table I: Loan written off through Sessional Paper No.1 of 2002



	Category of Loan	Number of loans	Amount written off(Kshs)
1	Miwani Sugar mills ltd	2	201,620,931
2	Ramisi sugar cane loans	110	6,281,023
3	Scheme 12 loans (Coast Province)	97	31,252,033
4	Cases affected by Land clashes	88	35,825,761
5	Bad & doubtful debts	735	249,117,080
6	Unsecured loans	2,358	568,009,577
7	Seasonal Crop loans (Principal)	8,202	2,889,509,088
8	Seasonal Crop loans (Agency)	13,885	780,518,356
9	Ranch loans	352	425,016,640
	Total	25,829	5,187,150,488

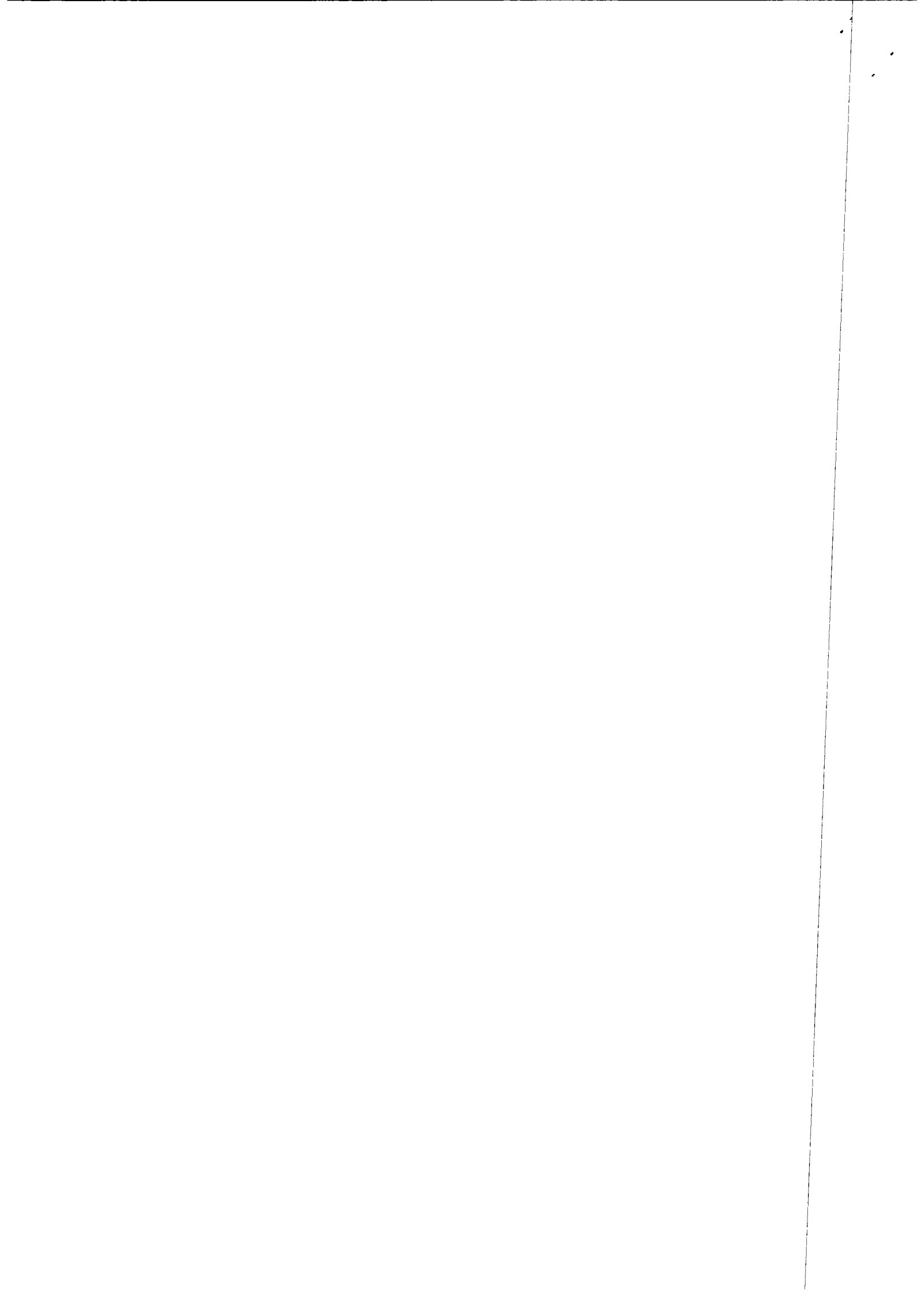
The breakdown of beneficiaries by AFC branch and county is presented in Annex I.

The Corporation was granted Kshs 1.3 billion in compensation for this write-off, leaving out the balance of Kshs 3.9 billion as outstanding. The funds were released in tranches of Kshs 260 million in five years commencing 2003/2004 FY through 2007/2008 FY.

3.0 Lending Projections for 2013/2014 FY

The Corporation has planned to lend out Kshs 2.057 billion in the 2013/2014 FY, as per its budget which has been approved by the Government. The projection is based on the resources available and collections from loan installments due in the financial year. This amount is against a demand of Kshs 20 billion and therefore leaves a shortfall of Kshs 17.3 billion. The demand and supply situation is analyzed in the table below:

Table II: Demand and Supply of AFC Loans – 2013/2014 FY



Kshs "million"

	Loan Purpose	Demand	Supply (2013/2014 FY)	Shortfall
1)	Seasonal Crop Credit (Maize & Wheat) – 10% of SGR	4,466	706	3,760
2)	Irrigation (24,000 acres)	1,400	300	1,100
3)	Smallholder Dairy (121,000 farmers & MSMEs)	4,250	856	3,394
4)	Livestock Off-take activities (ASALs)	1,300	300	1,000
5)	Machinery (1,000 tractors & Implements)	5,000	200	4,800
6)	Seed Production(Outgrowers)	2,180	200	1980
7)	School Based Loans (2,200 institutions)	1,440	200	1,240
	Total	20,036	2,762	17,274

The detailed summary on loan demand is presented in Annex II.

4.0 Status report on performance of loans granted in the period 2004 to date

The Corporation disbursed a total of Kshs 13.93 billion during the period under review. The funds were used to finance 60,225 farmers and agro-entrepreneurs to undertake various projects including the following:

- production of 200,000 acres of maize and wheat equivalent to 10% of the country's production of these crops for the period;
- off-take of 67,000 head of cows between 2006 and 2013, thus saving pastoral communities from losing these animals to drought;
- purchase of 40,000 high breed dairy animals, establishment of the necessary farm infrastructure and working capital;

- establishment of 10,000 acres of sugarcane leading to production of 686,000 MT of cane;
- Rehabilitation of 3,170 acres of coffee leading to production of an estimated 6.5 million kilos of coffee cherry.

The above activities in turn generated an estimated 300,000 jobs as well as family labour.

An amount of Kshs 11.18 billion has been repaid being a loan recovery rate of 80.2%. This is an indication that the projects financed were successful, therefore enabling the farmers to repay their loans.

Annex III - presents the breakdown of the disbursements and collections by AFC branch and by county.

5.0 Status report on the performance of loans granted in Lower Eastern Region from 2004 to date

AFC serves the Lower Eastern Region through two branches located in Machakos and Wote towns. In the period under review, the Corporation disbursed a total of Kshs 454.1 million in the form of loans to farmers in the region. Out of this amount, Kshs 90.9 million is outstanding in arrears. This is a repayment rate of 76% which is considered reasonable.

The funds were used to finance 2,298 farmers and agro-entrepreneurs to undertake various projects including the following:

- Coffee rehabilitation
- Livestock off-take activities
- Horticulture
- Small scale dairying
- Cotton production and processing

The Corporation has in place various options that can be considered to restructure the debts that are in arrears as discussed in (7.2) below.

6.0 Update on the utilization of the Kshs 700 million released to AFC for drought relief

The Government released Kshs 700 million to AFC during the 2012/2013 FY being part of the Kshs 2.0 billion awarded to the Corporation by Parliament for drought relief. The award was intended to cushion the farmers and Corporation from the effects of droughts which occurred in 2009 and 2010 resulting in inability by a number of farmers to repay their loans. The grant was meant to enable the Corporation to undertake the following:

- i. Implement a debt suspension programme and freezing of interest accrual for the affected farmers for a period of up to two years.
- ii. Compensate the Corporation for foregone interest and enable it to meet credit demand in lieu of the amount which would have been collected in loan installments from the suspended loans within the period.

The Corporation has committed the entire amount in new loans as intended. AFC has also identified an amount of Kshs 2.2 billion held by farmers whose loans were affected by drought. Out of this amount, the Corporation has already granted relief to 1,037 borrowers owing a total of Kshs 542.7 million. The relief has been in the following forms depending on the nature of the case:

- Granting of interest concessions, where a substantial portion of the accumulated interest is waived and the borrower pays the balance. The amount of interest to be conceded is determined through a formula approved by the Ministry.
- Debt suspension, where the borrower is granted a period of up two years within which to reorganize his farming business and recommence paying of the loan. Interest accrual is suspended during the period of debt suspension.
- Rescheduling of the loan, where a new repayment contract is agreed on, and where possible refinancing is done.

A breakdown of the cases that have benefited from debt relief on a county basis is provided in Annex IV. The corporation is analyzing the remaining cases and holding

discussions with the affected farmers to arrive at the best option for restructuring the loans. This is being done on a case by case basis.

7.0 Policy statement and strategy for dealing with appeals for write-off in future

7.1 Consequences of loan write offs

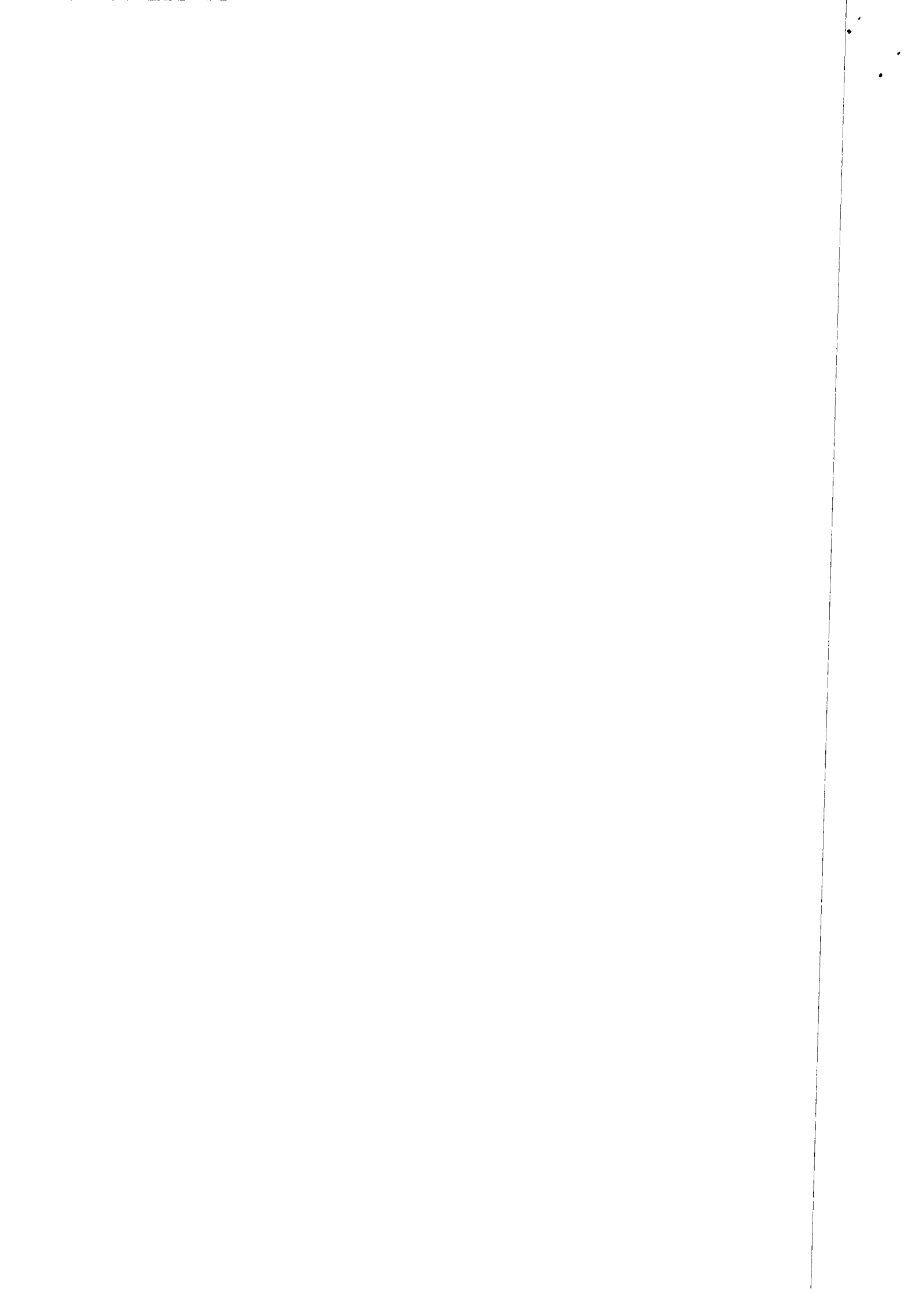
Although the Corporation recognizes that there are farmers who have been genuinely hit by drought and other natural calamities, the Corporation is of the view that blanket write-off of loans is not a viable option to address the problem. Blanket write-offs have had negative consequences on AFC as follows:

i. Erosion of the Corporation's Capital Base

Financial prudence requires that whenever AFC writes off loans under Government direction, the Corporation is compensated for this amount in order to maintain its revolving fund (indeed this position is reiterated by the Agricultural Finance Corporation Act (Cap 323, Laws of Kenya)). Due to budgetary constraints and competing needs, the Government has not been able to fully compensate AFC for write-offs in the past. A case in point is the Government directed write-off of 2004, where although the Corporation waived Kshs 5.2 billion in favour of farmers, only Kshs 1.3 billion was provided in compensation.

ii. Loss of Support from Development Partners

In its early days, AFC enjoyed strong support from development partners and international development banks. These partners provided the largest source of loanable funds for AFC supplementing Government budgetary allocations. As calls for write off have become frequent, AFC has begun to increasingly lose the support of international donor agencies and, as a result, loanable funds have substantially declined.



iii. Potential Impact on funds from other Government Agencies

A substantial amount of the funds lent out by AFC are from other Government agencies and special Funds. These include the Kenya Sugar Board, the Coffee Development Fund, and the Livestock Enterprise Fund.

Write-off of loans from these sources would erode these Funds and weaken the purpose for which they were established. This will lead to loss of confidence in AFC by these agencies.

iv. Creation of a negative culture in the borrowing clientele

Past write-offs have resulted in serious default risk problems. The impact on loan repayment discipline has become adverse. Borrowers, who have who had good repayment records previously, and who did not benefit from the write-offs, have been discouraged from repaying their loans. This has led to a poor credit culture among farmers.

It has also been established that, in a number of cases, appeals for write-off of loans tend to come from farmers who are potentially able but unwilling to pay. These are also borrowers who lack the discipline to meet their loan repayment obligations, because loan repayment commitments were not enforced in the past.

7.2 Viable Options for Rehabilitation of farmers facing debt repayment challenges

The Corporation proposes that in future all cases that run into debt repayment problems for whatever reason be handled on a cases by case basis, and each case on its own merit. AFC will employ the following options to assist farmers:-

(1) Debt Restructuring

Under this programme, AFC will be requested to consider rehabilitating debts to a performing status. Options to be considered include:-



i. loan rescheduling

Loan rescheduling will entail restructuring the repayment period to allow a longer period for repayment thereby giving the borrower time to reorganize his/her farming operations and cashflows.

ii. Suspension of interest accrual

Where interest has accumulated to a level that makes the loan become difficult to service, AFC will be requested to suspend further interest accrual.

i. Refinancing

Where repayment of the loan was caused by factors beyond the farmers' control, and where additional funding will rehabilitate the project, such cases will be considered for refinancing.

(2) Debt Suspension

For good borrowers who can be rehabilitated through innovative ways, AFC will consider restructuring the loan repayment period by suspending repayment of installments for a period of up to two years to give the borrower time to recover from any adverse effects that may have affected the performance of the financed project and therefore debt repayment ability.

7.3 Support Needed from Government – Agricultural Insurance subsidy

Drought and other natural calamities have been the main causes for crop failure and loss of livestock by farmers and pastoralists. Insurance services providers currently have solutions tailored to provide insurance against these calamities. However, because of the very low penetration of agricultural insurance in the country, the cost of the premium is very and therefore out of the reach of small scale farmers and pastoralists. In order for the cost of agricultural insurance to come down, it is necessary for government to initially provide a subsidy as a public good to enable attainment of scale. An insurance



Fund should be established for this purpose. The Fund can be operated within AFC. The risk of crop failure arising from drought and other natural calamities will therefore be transferred to the insurance industry which is best suited to be the risk carrier. Support to farmers to access insurance will forestall any future calls for write-off.

8.0 Conclusion

The Corporation has had a long history of Government directed loan write offs. Although this strategy has been well intentioned and meant to provide a relief to farmers affected by natural calamities, it is now obvious that it is not viable. The Corporation should be allowed to restructure debts that become depressed for any reason on a case by case basis, and each case on its own merit. This is the standard practice in the industry.

It is also clear that there is a need for Government to support the growth of the agricultural insurance sector. This is the more viable solution as it will provide farmers with a risk transfer mechanism and therefore serve to cushion them from natural calamities such as drought. The establishment of a Fund to subsidize the high cost of insurance premiums would be a good starting point. The Fund can be managed through AFC.

Lucas Meso, MBS
Managing Director
June 2013

