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**THE POSITION OF UGANDAN BORROWERS UPON DEFAULT
ON BANK LOANS: WHAT BORROWERS NEED TO KNOW ABOUT
POST-LOCKDOWN FORECLOSURES OF DISTRESSED
PROPERTY IN UGANDA.**

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1. Introduction

Recent data from the World Bank showed that Uganda's real GDP grew by 2.9% in the Financial year 2020, less than half of the 6.8% recorded in the financial year 2019, due to the effects of the Covid-19 pandemic with the GDP expected to grow at a similar level in the Financial year 2021 thereby painting a grim picture of the months ahead. Consequently, upon revision of the Covid-19 measures issued in June, 2021; besides relaxation of various restrictions, it became evidently clear that the reinstatement of restrictions to combat the second wave of the pandemic had financially impacted Borrowers in Uganda. As some of the restrictions on public transport were lifted, debt recovery was back on the agenda for most Banks in Uganda.

2. What is "distressed property"?

Distressed property can be defined as property under foreclosure or is being sold by a Bank to recover monies under a credit facility due to the property owner defaulting on their loan obligations. As we move out of the second phase of the pandemic, we highlight how existing measures have impacted borrower's rights and what potential buyers of distressed property need to know before closing any transaction.

3. When does property become distressed?

Ugandan Banks are required to classify their loan portfolios in accordance with the criteria set forth in the Financial Institutions (Credit Classification and Provisioning) Regulations, 2005. A credit facility with a pre-established repayment plan is considered non-performing when the principle/ interest is due and unpaid for 90 days or more. The definition in the regulations serves as a guide for Banks when determining Non-Performing Loans ("NPLS").

Furthermore, Financial institutions are required to make provisions for Non-performing loans depending on the classification of the loan. It is noteworthy that in dealing with NPLs, the conduct of Financial Institutions is guided by the principles that underlie Bank of Uganda's Financial Consumer Protection Guidelines.

In contrast with the Statutory local reporting requirements, IFRS 9 which commenced in January 2018, requires a Bank to not only assess loans that have already gone into default but must also identify and assess the probability to determine which Borrowers are likely to default, what the expected losses are and how that impacts on the capital they must hold to provision for those potential losses. This gives Banks enough planning in dealing with NPLs.

Consequently, it can be argued that property becomes distressed when a loan is Non-performing and the Bank commences procedures for realisation of their money through sale of the pledged property. However, during the period of the lockdown, management of NPLs was in addition to existing regulations guided by the Bank of Uganda credit relief measures.

4. Credit Relief measures: an overview

In anticipation of the economic shocks caused by the Covid-19 pandemic, Bank of Uganda ("BOU"), the Central Bank in its supervisory role extended the one-year credit relief measures of April 2020, for another 6 months. Additionally, in the monetary policy statement of August, 2021, BOU noted that the Credit Relief Measures (CRMs) shall expire on 30th September, 2021, but BOU shall on a case- by- case basis, put in place policy interventions for those sectors that remain under lockdown.

The credit relief measures in brief provided for the following;

- Repayment holidays for a maximum of 12 months
- Loan tenor extensions
- Suspension of payment of arrears as a pre-condition to restructuring of loans

- Supervised Financial Institutions (SFIs) were advised to obtain proof of consent to all restructuring offers presented to borrowers in order to obtain the proper authorizations.
- SFIs were also permitted to make unsolicited offers for a restructuring to their customers during this 12-month period.

These credit relief measures proved to be a timely intervention with recent statistics showing that up to UGX 7.9 trillion worth of facilities were restructured thereby mitigating the impact of the pandemic on distressed borrowers with NPLs.

By and large, the discretion left to SFI, meant that a Borrower had to rely on the SFI to have sufficient expertise to determine what kind of loans qualified for relief.

Inevitably the technical and complex nature of managing loans would eventually give rise to a concern that too much power to decide the fate of Borrowers had been placed in the hands of the Banks, rather than the regulator.



While the credit relief measures suspended the operation of some statutory provisions, the measures did not subordinate the current regulations in dealing with Non-Performing Loans but provided some direction to deal with the prevailing circumstances in the Country and reiterated BOU's overarching regulatory mandate to ensure the economy's stability as well as consumer protection.

5. Assets provided as security

The kind of assets given as security in Uganda usually depends on the type of financing. However, the security arrangements most popular among Banks in Uganda are usually;

- a) An asset debenture with a fixed and floating charge over fixtures.
- b) Mortgages over real estate. Other forms of security include: Motor vehicles, shares, Bank accounts, contractual rights, insurance proceeds and Intellectual property.

6. Perfection of security interests

a) Mortgages

Mortgage financing is a loan in which land is used as collateral for repayment of a loan obligation by way of a charge, or lien over any estate or interest in land.

In Uganda, any person holding land in any recognisable form of tenure has the power to create a mortgage over his/her land. The charge or lien can be by way of deposit of title or registration of one's interests at the relevant land offices. It is formal where it is registered and the mortgage takes effect thereon and informal where the mortgage interest is not registered but there exists a clear undertaking to charge the Borrower's land with the repayment of the loan.

b) Chattels

A Borrower may also obtain a loan on moveable property through the Security Interest in Moveable Property Registry System ("SIMPO") which enables lodging of security interests in collateral such as motor vehicles in a secure manner. SIMPO replaced the manual Chattels Registry and its financial inclusion objective is aimed towards allowing those who cannot access credit because they do not own real property (land) to access credit.

7. Key risk areas

a) Matrimonial homes

In a situation where the land to be charged is land on which is situated the ordinary residence of a Borrower and his/her legally married spouse, the prior consent of the spouse has to be obtained before charging such land.

The basic idea is that both spouses in a valid marriage are given an opportunity to make an informed decision over mortgaging a matrimonial home and absence of this can nullify the transaction as the other spouse does not have depository power over that land.

Consequently, any prospective Lender has two major concerns namely:

- To establish the marital status of the potential Borrower and;
- Whether the said security is a matrimonial home.

For a potential buyer of Bank property, due diligence must be made to ascertain whether spousal consent was given prior to the Bank charging the matrimonial home.

In mitigating the risks involved with dealing with a matrimonial home, the following can be done:

a) Banks should additionally require Borrowers to submit statutory declarations or single status letters as further evidence of the marital status and should take reasonable measures to substantiate the information in the documents provided.

b) For a spouse whose name does not appear on the Certificate of Title, prudence may require obtaining registration on the title as a Joint tenant or Tenant in common. In the event that your spouse deems to be uncooperative, lodging a caveat may be an alternative to bar any land transactions on the land.

b) Dealings in Company land

For Companies, the proper authority authorised to act on behalf of the Company before a security is perfected has to be ascertained. Banks need to ensure they deal with the proper persons appointed by the Company in order not to have such a transaction nullified. This requirement should however, rarely present a problem for Banks because a person dealing with a Company is not required to inquire on whether or not the Directors have authority; but recent Court decisions may require Bankers or a potential buyer of distressed property to carry out greater due diligence than before.



8. Commencement of debt recovery

Measures to enforce a charge on a mortgage can only be commenced where the Borrower is in default for a period of 30 days from the date the obligation to pay becomes due. Upon default, the first notice requires the Borrower to rectify the default in payment within 45 days, adequately informing the borrower of the nature and extent of the default.

Where the Borrower defaults on these timelines, the Bank may proceed with the following options;

a) Foreclosure

Upon lapse of the 45 days' notice under the Mortgage Act, before exercising the power to sell the mortgaged land, the Bank is required to serve the Borrower with notice to sell, and cannot proceed to complete any contract for the sale of the mortgaged land until twenty-one (21) working days have lapsed from the date of the service of the notice to sell. The Bank is further required to ascertain the current market and forced sale value of the property made 6 months prior to the sale.

In a well-received intervention for the Borrowers, the High Court in the case of *Sendagire Stephen and anor v DFCU Bank Limited and anor HCCS No.26 of 2008* laid down the best practices that underpin a lawful foreclosure and these include;

- The Bank should not act in secret, should obtain the best price and act in good faith.
- The Bank should establish the value of the property before sale to establish the current market value and forced sale value. Additionally, the Bank should not sell under forced sale or undervalue.
- Before sale, the property should be advertised after the Borrower has been notified
- A Public auction should be the preferred mode of sale because it is competitive. In the event that a sale is to be concluded by private treaty, it is preferable that the Borrower is involved and given access to information.

b) Additional measures

The Bank has the option to appoint a receiver of the income of the mortgaged land, lease the mortgaged land and exercise the power of entering into possession of the mortgaged land by taking physical possession of the land or a part of it or taking control over the land. This may also be done by an order of Court.

9. What next for the Borrower after debt recovery has commenced?

Hardly anybody would disagree with the statement that Borrowers need protection from Banks. However, protecting the Borrowers is further complicated by the ability of Banks to accommodate some kind of exposure without undergoing significant loss on their part.

A few of the options available for Borrowers are highlighted below;

a) The right of redemption

The Borrower has an option to redeem their property if they are able to repay their obligations in time.

At any time before an agreement is reached between the Bank and any purchaser of the security, the Borrower may discharge the mortgage in whole or in part by paying to the Bank all monies secured by the loan at the time of the discharge.

b) Application to Court for relief by the Borrower

The Borrower may apply to Court for relief against the exercise by the Bank of any remedies after the service of the relevant notices as discussed above.

This application for relief is not taken to be an admission by the Borrower or any other person applying for relief.

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c) Injunction granted by Court

Court may grant an injunction to restrain a Bank from taking further steps against the mortgaged property upon payment of a security deposit of 30% of the forced sale value of the mortgaged property.² This Requirement recognises that the protection of the Borrower cannot be considered in isolation from the rights of a Bank to recover on a Non-performing credit facility. That requirement notwithstanding, the Court retains the discretion to determine whether or not a spouse should make the security deposit.

10. Debt recovery involving chattels

For moveable property, the security interest becomes enforceable upon default and a notification is required to be served upon the Borrower to pay the money owing, and in case this is not remedied then a default and enforcement notice are registered. The Bank, being the secured creditor, may then sell the collateral by auction.

11. Conclusion

In a nutshell, Borrowers should always keep in mind that a credit facility is based on a contractual relationship which is underpinned by two fundamental principles namely; Freedom of contract and Caveat emptor which means that when Borrowers enter into loan financing agreements with the Banks, they are bound by the terms of these agreements that they sign, and that in the event of default therein, all property pledged as security will be sold to recover all outstanding money.

It is therefore imperative on a Borrower to always monitor their loan obligations and renegotiate with the Bank whenever they are having difficulties with compliance with the terms of the Loan Agreements. Consequently, in order for Banks to reduce risk exposure from the defaults arising from the second lockdown of June 2021, they need to adopt a proactive approach of identification, assessment and effective management of loans before they become permanently irredeemable.

Therefore, with the current economic situation, we are unlikely to see an end to Borrowers taking advantage of loopholes in the loan process to avoid payment of their loan obligations.

Further information

Every effort has been made to ensure this information is up-to-date as of the date of the publication. It is not intended to be a full and exhaustive discussion of the law in any area. This information is not intended as legal advice and may not be used as such.

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