TANZANIA: ACTION PLAN FOR DEVELOPING THE MORTGAGE FINANCE MARKET

Report on Legal and Regulatory Issues in the Mortgage Market in Tanzania

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LEGAL AND REGULATORY ISSUES IN THE MORTGAGE MARKET IN TANZANIA

1.0 Introduction

The Tanzania mortgage market is well underway, and developing along market based and competitive principles. While the existing legal framework appears to be adequate for the current nascent market, where only a few banks make mortgage loans to a small number of carefully selected borrowers, several key legal and regulatory issues will impede future growth of a more robust market, and a more fully developed and cohesive legal framework is needed. There is widespread concern that the current laws will not adequately meet the demands of rapid growth, especially if the future market is to include low-middle and middle income persons as well as wealthier borrowers. This concern is expressed by bankers who are active in mortgage lending, and is cited by other lenders as the reason their banks have not entered the mortgage market.

The most important law governing the mortgage market is Chapter X of the Land Act, as amended in 2004. Because the law is quite new and defaults have been few, the legal system remains largely untested, particularly as it relates to foreclosure and eviction. Some court intervention is required in all cases involving family residences. Although summary procedures are provided in the Civil Procedure Code (1986) to expedite mortgage-based litigation, these procedures are not reliably and consistently used. It also remains unclear how readily judges will enforce creditors' rights in a larger market. It is axiomatic that efficient procedures for seizing and selling mortgage collateral after default must be available to lenders for the primary market to expand adequately in response to demand and for a sound secondary or refinancing market to develop.

2.0 Categories of Issues to Be Addressed

The legal and regulatory issues affecting development of the Tanzanian mortgage market can be organized under three main headings: (1) issues of civil procedure and court jurisdiction affecting enforcement of mortgage rights, (2) issues of property rights and the formation of properties which can be used to secure mortgage loans, (3) issues which may affect the techniques for providing liquidity and long term funds to lending institutions, and (4) lack of public information about the mortgages system and creditors' and borrowers' rights. There are inadequacies and gaps in the legal and regulatory framework and the institutional structures relating to each of these topics.

This report addresses each of these issues, provides recommendations and an action plan for activities to remedy gaps and weaknesses in the legal framework. Suggested language for amendments to address the recommendations is included in Annex A, attached to this report. Annex B proposed the resources used to compile this report – the persons met, and laws and other documents reviewed by the legal consultants. An Action Plan to implement the changes recommended in this report is submitted separately.

3.0 Civil Procedure and Court Jurisdiction

Tanzania law provides that all mortgage foreclosure of a family residence requires court intervention. By contrast, the legal systems in most developed mortgage markets and in many developing countries[1] allow for foreclosure without litigation, and in some cases without any court procedure at all, as long as the lending documents provide for this and the debtor does not raise a credible challenge to the lender's action. Court action, when required, proceeds with a reasonable level of efficiency and certainty, often under special procedural provisions provided in the law.

In Tanzania, on the other hand, there is a widespread perception among lending institutions that the current legal and institutional framework affecting creation and enforcement of mortgages is inefficient and biased in favor of the rights of borrowers.[2] Some lenders, including those with regional or international presence, report that this is the primary reason they have not entered the mortgage market. It appears that there is at least some truth to this perception. Lawyers for those banks that are making mortgage loans report experiences in which their rights to obtain possession of and sell a mortgaged property were stymied or delayed by injunctions or other court interventions based on frivolous or extra-legal grounds, in some cases leading to years of litigation and ongoing lack of resolution of their claims.

This problem is exacerbated by several factors:

- the requirement of a court action to seize and sell residential property,
- the lack of clarity in the relevant laws regarded what courts are competent to hear mortgage-related litigation,
- failure of the relevant laws to set limits on what issues a debtor can raise, either to enjoin the lender from bringing an action to foreclose or to challenge the lender's rights to foreclose once litigation has been started by the lender and
- a significant case backlog in the courts.

Remedies for these problems exist in the laws of other countries, and specific actions to be taken are discussed below. It is important to keep in mind, however, that a strong mortgage system does not operate on the premise that it is easy to take away the property of the borrower. That is always a last resort for the lender as well as the homeowner, and most defaults in developed markets are resolved by negotiation and agreement, not by foreclosure. The key to bringing the debtor to the bargaining table is the incentive based on a credible

[1] Kenya is among the developing countries that allow for non-judicial foreclosure. *See* Kenya Mortgage Special Provisions Act, Cap. 304. Other emerging markets implementing non-judicial foreclosure or equivalent models include, to our knowledge, Mexico, Ukraine, Mongolia, Croatia and Pakistan.

[2] Many knowledgeable people believe there is no such thing as foreclosure in Tanzania. While there was foreclosure by power of sale in effect before the adoption of amendments to Chapter X of the Land Act in 2004, Chapter X now provides that court action is necessary for foreclosure of a family home and, in Section 125, states that the right of "a mortgagee to foreclose the equity of redemption in mortgage land is abolished." In fact, the law allows for foreclosure through repossession and/or sale of the property. "Foreclosure" is simply the termination of the debtor's rights to pay what he owes and reinstate good standing under the loan and to retain ownership of the property used to secure the loan, which ends upon sale of the property to a third party. What Tanzania does not have is "strict foreclosure," under which a court may deliver possession of a property free of the equity of redemption prior to execution sale, or "non-judicial foreclosure."

threat of efficient and speedy foreclosure through court proceedings that do not allow for endless delays on frivolous grounds.

3.1 Requirement of Court Intervention. Experience in many developed and developing mortgage markets indicates that implementation of a non-judicial enforcement process results in greater efficiency and avoids the delays and unwarranted judicial intervention which impede the smooth functioning of the market. Prior to the amendment of Chapter X of the Land Act in 2004, foreclosure by power of sale was permissible in Tanzania. The amended Chapter X permits foreclosure by power of sale but only for nonresidential property. Since family homes are the typical security for a developed primary mortgage market, and the best form of collateral for mortgage-backed securities in a secondary market, this change in the law was very unfortunate for development of the mortgage and real estate markets, and thus the overall economy in Tanzania.

The exclusion of family homes from non-judicial foreclosure apparently was included in the law in an effort to protect individual borrowers and their families from large commercial entities that might be over-eager to take away their property. In fact, experience around the world shows that lenders examine the law to determine if execution procedures are efficient and predictable when they are deciding whether to enter the market. The availability of non-judicial foreclosure thus results in a more competitive market. Ease of enforcement is also a factor in determining credit risk, so that a strong system results in lower interest rates, longer terms, lower down payments, and willingness to lend to persons other than the wealthy. So an enforcement system that requires long and expensive litigation before a lender can get access to the collateral securing a bad loan results in a smaller, less competitive market and less favorable terms for borrowers – hardly the pro-borrower result that the legislature probably had in mind when Chapter X was amended..

Problems with court-based enforcement in the case of Tanzania are exacerbated by inadequate judicial resources and growing case backlogs, suggestions of a pronounced judicial bias against creditors' rights, unclear and overlapping jurisdiction, and “forum shopping” on the part of debtors who seat injunctive relief in local courts.

Recommendation:

The legal team recommends that non-judicial mortgage enforcement procedures for residential property be restored in Tanzania. Experience in other countries clearly suggests that these procedures can have very positive affects on lender perceptions of their ability to control the risks of mortgage lending, without depriving debtors of adequate protection of their rights. A specific model with appropriate language is set out in Annex A.

3.2 Court Jurisdiction Issues. The relevant laws currently create confusion about which court holds jurisdiction over mortgage-related claims. Chapter X of the Land Act, as amended in 2004, provides in Section 140-(1):

> All proceedings instituted in court in relation to the exercise by the mortgagee of powers to sell or enter in possession of the mortgaged land shall be brought

in accordance with the provisions of the Civil Procedure Act, 1966 and tried by way of summary proceedings.

There are experts who believe, however, the procedural provisions of Chapter X are detailed enough to evidence the legislature's intention that mortgage enforcement would take place under Chapter X itself rather than the Civil Procedure Act, and that the procedures in the Civil Procedure Act are no longer in effect. This seems especially confusing because there are conflicts between Chapter X and the Civil Procedure Act. Moreover, it is not clear whether the summary procedures are in effect; in any case, they are often ignored in practice. One bank lawyer reported that the availability of summary procedures actually slows down litigation because they give debtors another issue – no matter how frivolous – to raise in court. Even if that issue is ultimately always going to be resolved in favor of the lender, delays ensue while it is being determined.

Under the Law On Settlement of Land Disputes, the Land Division of the High Court holds original jurisdiction in any case involving a claim for possession of land, which would apparently include any mortgage enforcement action, exceeding 50 million TZS. It holds appellate jurisdiction on smaller cases from the lower courts. At the same time, cases are brought by lenders in the Commercial Division of the High Court, as long as they meet the 50 million TSH threshold requirement, on the theory that regardless of the creditor's security interest in land rights, the underlying transaction is a commercial claim for collection of a loan. Essentially, experts say, the lender has a choice of divisions in the High Court, depending on how the pleading are written. Filing fees in the Commercial Court are considered high by lenders – 3 per cent of the amount at issue, but they are willing to undergo this expense because they are more confident of the outcome.

A problem described by a number of lawyers for mortgage lenders is the tendency of debtors to request a lower court to enjoin the lender's action after receiving a notice of intent to take legal action on the debt, partly arising from the expense of filing in the High Courts but also a result of "forum shopping" for a sympathetic judge. Borrowers file these actions in lower courts such as district, ward, or even village land and housing tribunals or with magistrates in the district where they live,[3] where the court costs and filing fees are low and the judges are likely to be more sympathetic to the debtor. Once an injunction is issued by a lower court, the High Court – whether the Commercial or the Land Division – usually defers to the lower court's jurisdiction, which leads to lengthy delays and a more uncertain outcome for the lender.

While mortgage cases may therefore be heard in virtually any court in Tanzania, lenders are generally satisfied with the efficiency and likelihood of a favorable outcome in either division of the High Court. One experienced and knowledgeable source stated that in the Commercial

[3] It should be noted also that the system of customary lands raises certain issues for mortgage lending which will not be addressed in this project. Among those issues are survey and registration of commonly owned lands, the right to pledge the land, and the forums for dispute resolution, all of which may present unique issues for mortgage lenders. Our conclusions and recommendations focus on land markets and housing rights in urban area, which are the main locus of mortgage lending in emerging markets. Experience in other countries has shown that it can be virtually impossible to enforce mortgages by sale of property in traditional communities, making mortgage security largely irrelevant. Housing lending may have to take other approaches in these communities.

Court, a judgment, possession and sale could be accomplished within two months after the statutory notice periods have expired. Lenders also feel that judges on both the High Court and Court of Appeals[4] have taken clear stands in favor of creditor's rights and against manipulation of the legal system to delay or prevent enforcement of legitimate security interests.

Recommendation:

The legal team recommends that jurisdictional issues for mortgage cases be clarified in the mortgage law. As the market grows and default litigation becomes more common, it will be even more important to develop a consistent approach and coherent body of case law to properly balance the rights of debtors and creditors and make enforcement of contractual terms predictable and efficient. If borrowers file an action for injunctive relief in a lower court, they should be required to post a bond or security deposit, and cases should be consolidated in one of the specialized divisions of the High Court once both parties initiate action.

3.3 Limitation of Defenses and Grounds for Challenge. Implementation of a non-judicial mortgage enforcement procedure, as recommended above, would not bar requests for court intervention prior to sale of the property, as practically all non-judicial procedures permit a claim to a court under defined circumstances to protect the rights of the debtor in case the lender takes action not in compliance with the law or the mortgage documents. Accordingly, a non-judicial procedure will not in itself prevent frivolous claims and demands to enjoin a property sale.

In developed markets it is an axiom of mortgage lending that there are very few defenses to a mortgage enforcement action. Essentially, the permissible defenses are: “I did not borrow the money,” or “I paid what I owed,” either of which must be supported by credible evidence provided by the debtor to merit injunction of the creditor’s claim. Courts in developed markets do not entertain frivolous or extra-legal claims or defenses to delay or suspend enforcement actions. Where courts demonstrate unwarranted sympathy or even a pronounced bias in favor of the borrower, it may be advisable to restrict permitted defenses that a debtor may raise, either to counter an action initiated by the lender after default or to enjoin the lender’s action after receipt by the borrower of notice of the lender’s intent to take action. A review of the current mortgage law under Chapter X of the Land Law suggests that this may be one of the weakest aspects of the current legal framework for mortgage lending in Tanzania.

Once jurisdiction has been granted, it is difficult to restrain the court's inherent equitable powers to entertain defenses, but it is possible to clarify in the law that the courts are expected to exercise restraint and to place the burden more clearly on the debtor to justify interventions in the process. This should be possible whether or not a non-judicial procedure is ultimately implemented.

As an example, a lawyer for one lender recounted the history of a case when the borrower was in default for 120 million TSH on a 300 million TSH loan. The debtor allowed the various notices from the bank to run, and the day before the last notice expired, he filed for an injunction, claiming that the debt had been paid. The court accepted this frivolous assertion without requiring any evidence. The ensuing litigation took three years to resolve. Another complaint is that courts will often enjoin a proceeding if a debtor denies his signature on a mortgage or other loan document. Why this occurs is difficult to understand, given that mortgage documents are subject to notary certification by law. Most legal systems will not allow a defense based on denial of a signature on a notarized and registered document unless the debtor can show that the document was fraudulently obtained, and place a heavy burden of proof on the party denying the signature.

Recommendation:

The law should delineate the defenses that a debtor may raise to counter an action by the lender for possession and sale of mortgage collateral. Similarly, the law should set out the grounds, standard of proof, and other conditions under which a court may grant an injunction against the lender's action.

Annex A provides specific language to implement this recommendation.

3.4 **Third Party Interests.** A frequent complaint of lenders is that the broad provisions of the mortgage law regarding protection of marital property permits debtors to manipulate the law. The typical case apparently involves the "undisclosed spouse," which can be a significant problem in a system which recognizes both "common law" or statutory marriages and polygamy, and in which civil records may not be accurate. The situation in Tanzania may be aggravated by the provisions of the mortgage law which place the burden on the lender to take "reasonable actions" to identify all interest holders, without defining the term and thereby allowing the courts to expand the definition to suit their purposes.

Recommendation:

Matrimonial or family rights have been an issue in many emerging mortgage markets for the same reasons noted in Tanzania. These issues have been dealt with in some cases by granting legal standing to challenge or defend against a mortgage action only to registered interests which can be discovered by an inspection of the public records, or placing the burden on the borrower to identify all interest holders at the inception of the loan by affidavit and excluding all undisclosed or subsequently arising interests. The proposed amendments to the law delivered with this report take the approach of allowing lenders to obtain and rely on affidavits of identified spouses who subordinate their claims to the mortgage claims, and to deny legal standing to any such person who is not identified by the borrower or otherwise identifiable through public records.

3.5 **Eviction.** After default, the value of the mortgaged collateral will be seriously compromised if the debtor and his family or other occupants refuse to vacate the premises. After a lender succeeds in getting a court order allowing sale of the property, the price on the market for occupied property will be much lower, and the lender or the purchaser must incur additional expenses to force the occupants to leave. At the present time, a lender with an order from the High Court authorizing sale of collateral must still go to a local court to arrange for eviction.

Recommendation:

The court with jurisdiction over the action allowing the lender to possess and sell the collateral should also have jurisdiction to enter an order of eviction. Assuming non-judicial foreclosure is more widely available, as recommended above, the lender should be able to obtain assistance with eviction from the relevant court on an expedited and *ex parte* basis if the debtor refuses to vacate after the lender's rights to power of sale have been properly exercised, including provision of notice requirements to the debtor.

3.6 Judicial Capacity Issues. In addition to jurisdictional issues, there are fundamental problems of human resources affecting the ability of lenders to move cases through the courts. The High Court is understaffed; until recently there were only 44 judges on the entire High Court, with three judges in each of the Commercial and Land Divisions. At the beginning of 2007, 20 new judges were appointed, but this will only add a few to the Commercial and Land Divisions, and they will require training and experience to get up to speed on the more sophisticated cases within the High Court's jurisdiction. Clearly, even this number is insufficient in a nation of approximately 37 million people.

The assessment team was advised that the average case backlog for High Court judges exceeds 500 cases. This is especially significant because the judges lack adequately trained staff and modern case management equipment. Without remedial action, these backlogs can only be expected to increase as economic and commercial development moves forward in Tanzania. Given these figures, any system of enforcement of creditors' rights that relies on court action, as required under current law for residential mortgages, will experience delays arising solely from backlog, and not from the quality of the law. Court backlogs are reason enough to consider non-judicial approaches to enforcement of security interests, as discussed above in Section 3.1. Even with the possibility of non-judicial foreclosure, however, some cases will inevitably wind up in court. Identifying the proper forum for hearing these cases and preparing the judiciary to handle them will remain a key to a robust mortgage market.

Recommendation:

More judges are needed for the Land and Commercial Divisions of the High Court. Training programs in mortgage law enforcement and in creditors' and debtors' rights should be designed and implemented for High Court judges. Instructions for implementing consolidation of cases should be included for all judges.

Specific language for addressing these jurisdictional issues is provided in Annex A.

3.7 Appeals of Judgments. Bank lawyers in Tanzania report that debtors very rarely take cases to the Court of Appeals after entry of a final decision against them in either a local court or a division of the High Court. Experience in other developing markets indicates that this may change after further growth of the market. Appeals of mortgage enforcement judgments can result in long delays in execution of judgment if these issues are not addressed.

Recommendation:

Debtors should be discouraged from filing frivolous appeals by provisions in the law that permit execution action to proceed despite appeal, requirements that appealing debtors post appeals bonds to indemnify creditors against losses caused by delay or property deterioration, and even financial penalties for frivolous or unsuccessful appeals. A first step would be to impose mandatory, and not discretionary, appeals bonds on any appeal to a a higher court which results in the suspension of execution sale of a mortgaged property.

4. Formation of Properties and Property Rights

In order for the mortgage market to grow substantially and function efficiently, there must be strong laws and institutions for establishing properties that are eligible to serve as collateral mortgage loans and for clarifying what rights and interests in the properties are held by various parties. This calls for clear, transparent, and reliable systems to register legal interests in properties, including mortgages.

At the present time in Tanzania, property rights are not adequately settled and are not efficiently recorded in a registration system. Fortunately, there is currently a great deal of activity underway geared toward improving the quality and registration of property rights. Experience in other countries shows that this will increase property values and investment in housing, and will also stimulate the mortgage markets. Several encouraging efforts are underway, however, to improve the current situation.

4.1 Issuance and Registration of Titles and Mortgages. Detailed analysis of the rules and procedures for issuance and registration of land titles is beyond the scope of this work. Moreover, the comprehensive assessment of the system by the Ministry of Lands to be begun in the near future with donor assistance is much better suited to this task, and to make recommendations now based on inadequate information would only tend to muddy the waters.

A preliminary review of the law on registration of titles suggests that it is a somewhat typical variation of the Torrens system, involving issuance and maintenance of paper documents (title certificates). There is significant evidence that many of the problems with the current system relate to institutional shortcomings, and not to the law itself. Examples include lack of human resources; lack of modern management systems and equipment; poor condition of facilities, in particular archival facilities; inadequate orientation toward customer service; and excessive centralization of facilities and functions. All of these issues would be addressed to one extent or another under the Ministry's prospective program.

Short term actions which can anticipate the results of the Ministry's ongoing assessment of the registration system, and on which the present work might focus, may include:

- Delegation of authority to issue titles and authorize mortgages to a more officials of the Ministry of Lands. Under current practice, a single official must sign and issue every new title and mortgage, which often takes several months. Lenders regard the authorization of mortgages as providing a measure of protection (not available when an equitable mortgage is made on the basis of the bank holding the title documents), but the process would be more efficient if the power were delegated to sub-officials.

- This same problem of excessive centralization of functions arises with respect to official approvals of mortgaging state-issued rights of occupancy, which must be approved by a single official. It is questionable why any approval of mortgaging a valid right of occupancy is necessary i. Similar problems in some other countries have led to a system under which a creditor is obliged only to notify the Ministry after the mortgage is registered.

- The device of the "offer" prior to issuance of the title has come under criticism as unnecessary and perhaps could be simplified or streamlined.

- Some countries, recognizing the importance of mortgage market development, have provided for accelerated registration of mortgages on titled properties. This benefit can be subject to additional fees, which creditors are usually willing to pay.

- A more fundamental change to the law could entail implementation of a concept of the "purchase money mortgage," which gives to the creditor a statutory but time-bound security interest immediately upon disbursement of funds, prior to actual registration of the mortgage agreement. Other systems permit a title holder and his mortgagee to register an "intention to mortgage," in the nature of a caveat, which provides priority and protection to a subsequently registered mortgage, permitting acceleration of disbursement.

- In the longer term, the concept of a "permanent mortgage" or land charge, which is rapidly becoming the predominant form of real estate security in Europe, could be explored.

4.2 Licenses in Informal Settlements. One important effort is now underway to improve tenure rights in unplanned areas in Dar es Salaam. Under this program, land occupancy rights are being issued in the form of two-year, renewable licenses to informal occupants. It is hoped that the licenses will provide enough security to informal occupants to encourage property improvement. There are approximately 220,000 housing units in unplanned settlements in the capital city, many of which are substantial homes occupied by families with middle class or even higher incomes. Since the program began almost two years ago, 71,000 applications have been files and 57,000 licenses have been issued.[5] It is expected that virtually all applicants will receive licenses, and that additional applications will be received as the populace becomes more familiar with the program.

Three municipalities or districts in Dar es Salaam have begun a program of first or “systematic” registration of properties in their respective jurisdictions. The land offices in the districts have created digitized maps of all properties in their respective areas, with a unique parcel

[5] These figures were provided by the Project Director of the Project Manager, Unplanned Settlement Property Registration Project in February 2007. It is anticipated that all of the licenses approaching the two-year limit will be renewed, as long of the licensee is current in payment of the land rent.

identification number assigned to each property. Boundaries are set by visiting the neighborhoods, speaking with residents, and examining documentation evidencing occupancy patterns. After the maps are prepared, residents are notified and have one month to lodge a dispute before the boundary is declared official and registered in the land records. There is an adjudication process to handle any disputes that arise. Registration of individual rights to the land under a license is done after payment of land rent for one year, about 3,000 TSH per year, depending on the location and the use of the land, and a license fee of about 5,000 TSH. The registration records in the three district land offices are open to the public, and the computerized records can be searched for a small fee.

One lender, CRDB, began in November 2006 to issue loans secured by the property license, with about 14 loans made so far. A second lender is considering a program to lend on the basis of registered licenses. The district land offices also register the mortgage rights in the records relating to the licensed property. None of the loans made so far have had a default. In addition, National Microfinance Bank has a microfinance program for loans to owners of houses on licensed land, but the loans are not secured by the license. The fact that banks are willing to consider a two-year license as security for a mortgage loan (with careful underwriting of the borrower, of course) indicates the strong interest among banks in the mortgage market. This should be encouraged by increasing the duration and quality of the tenure in informal settlements so that many more families with adequate means can qualify for loans to purchase or improve their housing.

Recommendation:

For long term and market-based growth of the real estate and mortgage markets, the Ministry of Lands should extend the term of the license beyond two years, and grant a more secure form of tenure, such as a land lease. This would avoid the administrative burden of having to re-register licenses every two years. Moreover, it would provide the home owners with a greater sense of security and more incentive to invest in the property and related infrastructure, which in term will make it more likely that owners of houses in formerly informal settlements will participate in the mortgage market.

According to the manager of the Unplanned Settlements Property Registration Project, under the Ministry of Lands and Human Settlements Development, the initial licenses were given for two years because the Land Act limits the term to two years unless the land is surveyed, so extending the term may require an amendment to the Land Act pending completion of surveying of large parts of Dar es Salaam under a new property registration and cadastre project.

4.3 Condominium Law. Privatization of apartment properties has been one of the factors leading to expansion of mortgage lending in many emerging markets. Apartments can provide benefits in terms of affordability, more efficient use of land and public services, and opportunities for government to divest its interests in publicly owned housing which it can no longer afford to manage and maintain. (This latter point seems to be reflected in recent initiatives of the Housing Development Corporation to divest some of its stock for redevelopment and sale.) However, successful privatization and private development of apartment properties requires a modern law on condominium (variously called condominium, horizontal property, or strata title law), which is presently lacking in Tanzania. Adoption of a law would facilitate registration of apartment properties and give greater security to lenders. It would also regulate the activities of developers of condominium property. Finally, by providing for an association of owners to manage and maintain the common property of the building, such a law would also help to ensure that apartment buildings maintain their value – an important factor when the term of a mortgage loan is likely to be 10-15 years or more.

Recommendation:

A law on condominium or strata title should be supported by the Ministry of Lands. A sample of an appropriate law is included in Annex A.

4.4 Relationship between Private Development of Housing and Mortgage Lending.

Commercial real estate firms are beginning to operate on a larger scale in Tanzania, and are developing financing arrangements with lenders for construction and mortgage finance. One integrated financial risk sharing and investment firm works with developers to advise on real estate finance and structured finance as well as corporate finance, capital markets, and asset management, and is interested in setting up a private non-bank institution to make mortgage loans. Among its services, it pre-qualifies purchasers of commercially developed residential properties for bank mortgages among several banks, comparing the terms for the potential borrower. The developer pays for these services, not the bank or the borrower.

Recommendation:

Financial market regulators should lay the groundwork for private non-bank financial institutions to enter the mortgage market. Regulations relating to capital requirements and risk management should be tailored to develop this market niche.

4.5 Coordination with Other Registration Activities. There is presently a great deal of activity in Tanzania under other projects geared toward improving the quality of property rights and increase investment in housing. The current assessment did not deal with registration issues in depth because of these prospective activities, and because the issues cadastre survey, provision of utility services to land, improvements in urban planning and land use controls, and issuance of building permits, all of which are causing problems to some extent, are too complex to analyze in the context of this work and cannot be resolved by simple amendments to the legal and regulatory framework. Most of these issues relate to the capacities of local government and the activities of semi-autonomous public corporations that may be difficult to influence.

In any case, it is important to coordinate efforts so that efforts are not wasted through redundant or conflicting approached. These other projects include:

- The Land Registry within the Ministry of Land, Housing and Human Settlements has recently issued requests for proposals from international and domestic consultants to review its institutional procedures and capacities, with an emphasis on process engineering and management systems, and to review and make proposals of improvement of the basic laws governing registration of property rights, being the Law On Land Registration, Law On Registration of Documents and Law On Transfer of Chattels. This effort, which is funded by the EU BEST program in cooperation with the World Bank's FSAP II project, will be implemented over the coming 18 months and will result in a comprehensive review of the registration system as well as recommendations for improvements. It is anticipated that the review projects will be followed by projects to support systems upgrading, legal and regulatory change, and institutional capacity building.

- The Property and Business Formalization Programme under the office of the President is implementing a land titling project building on the concepts popularized by Hernando De Soto, and is carrying out the project in cooperation with De Soto's Liberty Institute. The project is presently in the planning stages and intends to focus primarily on villages and rural areas.

- As discussed above, the Ministry of Lands is currently implementing a project of temporary licensing of land occupancy in unplanned areas, granting 2 year, renewable occupancy licenses to informal occupants.

- The Ministry of Lands "20,000 Plots" project is ongoing and has in fact far exceeded the original plan, resulting now in over 33,000 plots actually formed and titles, with another 8,000 in some stage of the pipeline. These plots can provide the product on which mortgage loans may be made, but more importantly the project is helping to identify and resolve some barriers to land plot formation.

- The National Housing Corporation is negotiating joint ventures with private developers to redevelop some of its approximately 5,000 residential buildings for sale.

- Several state pension funds have undertaken a handful of single family residential subdivisions in peri-urban areas on a mostly speculative basis.

Leaders of the projects for land and housing development, including the 20,000 Plots Program, the National Housing Corporation and representatives of the pension funds have advised that the main constraint on their development activities is the lack of mortgage finance for home purchasers and developers. A second major impediment is the lack of registered titles (it is estimated that approximately 80% of housing occupants lack titles today), the difficulty of obtaining a title, and the difficulty of registering mortgages. Further undermining the production of mortgagable properties, there is no horizontal property (condominium, strata title, etc.) law, excluding apartments from titling altogether. To increase mortgage lending it is necessary to increase production of mortgagable properties, which will entail making more land and titles available as well as facilitating the titling of existing properties.

5. Public and Other Stakeholder Information

At the present time, property owners in Tanzania are often poorly informed about their rights as owners or mortgage borrowers. As elsewhere in the world, for most citizens their home is the largest asset they will ever own. Information about their rights and obligations is especially important in the context of mortgage borrowing, when they are at risk of losing their ownership rights if they violate the terms of the mortgage contract. Given the length of time the mortgage loan will be in effect, the relative cost, and the complexity of the contract, information in a form that is easily understood is essential. There is also inadequate information about mortgage lending and the mortgage market for other stakeholders. Most of the market information, including experience with courts and other enforcement activities, is anecdotal.

This situation is not unusual during the early stages of mortgage sector development in emerging markets, but there are a number of steps that should be taken to begin to correct the situation now. These will increase confidence in the system among all stakeholders, and will help the market progress both competitively and with appropriate transparency.

5.1 Mandatory Consumer Disclosure. In Tanzania, as in other emerging markets, most potential mortgage borrowers lack adequate understanding of the nature of the mortgage relationship and the risks and obligations they are assuming in taking a mortgage loan. This keeps many persons from entering the market, even if they would be qualified for a loan. Lack of sophistication among those who do borrow may also lead some courts to view a mortgage as a contract of adhesion that takes advantage of certain segments of society; this might induce some judges to exercise their discretion excessively on behalf of debtors. Practices among lenders do not always take into account that borrowers who are well informed are more likely to understand and meet their obligations. For instance, in Tanzania the practice among mortgage lenders is to prepare contract documents only in English, when a sizable portion of the population may be more comfortable with translation in Swahili, the national language.

Evidence that responsible lenders intentionally seek to induce unsophisticated borrowers to take loans they cannot afford is lacking and most such stories undocumented. However, to avoid the perception that banks are overreaching and to make sure that consumers are informed of their rights and obligations before they take a loan, many countries have taken the step of defining by law the types of information which a lender must provide to a borrower when making a loan, thereby creating a "safe harbor" for lenders in which they are protected against the second guessing of courts and strong negative reaction among the public when the lender enforces its rights after default.

Recommendation:

Consumer protection provisions should be adopted in Tanzania, either through amendment to Chapter X of the Land Act, through separate consumer protection legislation, or by regulation by the Bank of Tanzania. Some language that could be included in Chapter X is including in Annex A. Also included is information about the Agreement on a Voluntary Code of Conduct on Pre-Contractual Information for Home Loans, which has been prepared by the European Union and adopted in many of the member countries. Discussion and consideration of this document among an industry group might be undertaken to prepare recommendations for further amendment to the law or adoption of a regulation by BoT.

It should be noted that the EU's Voluntary Code of Conduct is, in fact, voluntary, and may not be appropriate at this stage of market development in Tanzania. Other countries, the US being the main example, have adopted mandatory consumer protection regulations for mortgage markets (e.g., Truth in Lending Act, Regulation Z, supervised by the Federal Reserve Bank), and this approach, as well as the content of the US rules, may also be considered. Moreover, both the EU and US approaches should be reviewed critically in terms of content and approach, and it is not suggested that they are appropriate in their entirety for the Tanzanian market at this time.

5.2 Citizen Information. There is currently no system of citizen identification in Tanzania, although discussion about this issue is underway. Eventually, a full credit reporting system can evolve after the assignment of citizen identification numbers. As noted above, a registry of marriages should also be created and made available for public inspection. Only registered spouses should be permitted to challenge or defend against action based on a mortgage contract. Finally, further efforts should be made to assure that the real property register include the names of all interest holders, even holders of inchoate interests such as marital rights. This could be accomplished by regulations of the registry. We concede that none of these approaches assures disclosure of marital rights, but that taken together the citizens identification number, mandatory marital register and notation of all beneficial interests in the real property register could have a positive cumulative effect.

Recommendation:

Stakeholders in the mortgage market should encourage the creation of these registration systems as a first step in generating information about borrowers.

5.3 Mortgage Market Data. The Bank of Tanzania should begin to collate and publish aggregate statistics about the mortgage market in Tanzania – number and volume of loans, use of loan proceeds, payment status of loans, default actions, and the like. This will help provide reliable information rather than the anecdotal information now available.

Of particular interest would be the duration and outcome of enforcement actions against mortgagors in default. In 2005, a compilation of data about loan enforcement actions in the High Court was prepared and presented to the Tanzania Bankers Association by Justice L. B. Kalegeya of the Commercial Division of the High Court.[6]

Recommendation:

It would be very useful to update the information in the Kalageya Report, most of which covers the years 2000-2003, with a focus on mortgage loans and a comparison between duration of actions and outcome between the High Court and local courts.

[6] "The Role of Courts in Facilitating Loan Recovery: Tanzania Experience," paper presented by Justice L. B. Kalegeya, Commercial Division of the High Court of Tanzania, at a conference of the Tanzania Bankers Association, March 8, 2005.

5.4 Credit Reporting

As noted in the assessment team's Inception Report, a full service credit bureau is essential for sound risk management and underwriting. The Tanzanian Bankers Association has underway an initiative to start a credit information service, now under consideration in the Bank of Tanzania. Bankers support the establishment of a credit reporting bureau, and believe that the stumbling block may be issues of current privacy law, which banks feel they can address by including waivers from borrowers in their loan agreements.

Recommendation:

The Bank of Tanzania should proceed with regulations to facilitate the establishment of a credit reporting bureau. There are many good modern models of CRB legislation and regulations which can be critically reviewed. Attached to this report in Annex A is an outline of the policy issues that must be discussed and resolved in order to take the next steps. We believe that the modern trend is toward CRBs operated as membership organizations in the private sector, subject to appropriate regulation. However, we recognize that in some emerging markets Central Bank facilities have been useful first steps, and suggest only that if that approach is taken it be designed for gradual privatization.

5.5 Real Estate Market Information. Real estate markets function much more efficiently is there is a body of publicly available information about sales prices, tax assessment evaluation, market-price evaluations, average length of time to sell properties, and the like.

Recommendation:

Support the efforts of BEST to secure passage of a Real Estate Agency Regulation and the Land Valuation Law.

6. Regulation of the Mortgage Market

In developing a market-based mortgage finance system, there is a fundamental question of what issues to legislate, what to regulate, and what to leave to the market. Among these issues are lending terms, such as loan-to-value and debt-to-income requirements, whether property and life insurance are mandatory, and the like. Better international practice holds that these should be determined primarily by the market, through competition among lenders, with perhaps some incentive-based regulation in appropriate cases, such as asset risk weighting or default provisioning rules established by the central bank or adoption of minimum standards for participation in some segments of the secondary mortgage market. That way, lenders can compete in the way that suits their businesses best, but if they want to qualify for favorable treatment of their mortgage portfolios in terms of risk weights and for issuing certain types of mortgage-backed bonds or other mortgage securities, their loans will have to meet the standards imposed by regulation or by laws governing the secondary mortgage market. This is not to say that the Bank of Tanzania, in considering the risks to the banking system and financial markets which can arise from sudden expansion of mortgage lending, should not seek to diminish those risks by its usual supervisory methods, which may of course include appropriate pressures on banks to avoid excessive exposure to mortgage risks through very high loan to value or loan to income ratios or failure to obtain available insurance protection.

The issues of risk assessment in the mortgage market and appropriate regulatory approaches of the BOT were considered to be mostly beyond the scope of the present work and deserving of more detailed consideration in the course of the proposed long term project, and are therefore not addressed here. However, it can be noted that ne issue that was raised with the assessment team by a number of lenders was the Bank of Tanzania's 100 per cent provisioning requirement for loans in default over a certain number of days.[7] Bankers felt that the period was unreasonably short, given the delays in enforcement engendered by the law and the courts.

Recommendation:

BoT could examine its regulations for provisioning loans in default in discussions with the Banking Association, and consider either extending the time period or lowering the provisioning requirements for loans that meet certain quality standards, but this exercise could also be left to a more comprehensive consideration of regulatory issues recommended to be carried out in the following project. Other regulations relating to lending terms may perhaps be considered, but not necessarily, in the context of the following project, or in preparing for entry of mortgage-backed securities into the capital markets, or in preparation of consumer protection initiatives. If considered desirable to exercise more control over an emerging mortgage securities market, issuance of certain types of high quality securities could require that the underlying mortgage loans meet identified quality and underwriting standards . However, we would not recommend that all mortgage securities be subjected to this type of asset regulation, and believe that even with regard to mortgage securities market judgment should prevail in most cases subject to the usual investor protection provisions of the securities laws.

7. Access to Capital Markets

Historically, the development and implementation of a secondary market legal and regulatory environment in emerging economies has a long gestation period during which the primary market grows and becomes increasingly organized. It is prudent for regulators and lenders to look ahead to such development while the primary market is still developing and efforts are underway to properly legislate and regulate the primary market. That is because only mortgages that meet high standards of quality will be attractive to initial investors in mortgage securities.

Setting aside the question of liquidity and whether lenders can begin to develop mortgage lending on the basis of the current deposit base, it is advisable that the legal framework to allow banks access to capital markets for purposes of mortgage funding be put in place. This is a somewhat different issue than creation of state-sponsored liquidity facility, which presumably would have its own legislation. Rather, the objective should be to give individual lending institutions direct access to capital markets for financing their mortgage loans.

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[7] This was variously reported to the consultants as 90 days, 120 days, and 180 days.

The two main capital market vehicles used in mortgage funding today are secured bonds and self-amortizing "pass through" types of securities which depend for payment on the underlying cash flows of mortgages which are either sold or pledged to investors. The simple secured bond has been the preference of many emerging markets in recent years. A review of the commercial and securities market laws of Tanzania suggests that despite having several positive aspects not enjoyed by many emerging markets, the legal framework does not facilitate some types of mortgage securities used in today's markets.

The main benefit of the current legal system is that it is grounded in English common law, providing a flexibility in matters of contract and secured transactions that is sometimes difficult to achieve in civil law systems. For example, Tanzania has a developed common law concept of trust ownership, which can be very important in structuring mortgage securities transactions, or secured transactions generally. It is almost certain that a bank could issue a bond secured by a portfolio of mortgage loans today with little problem, and such simple credit market instruments might be well received in the market. However, some devices which would enhance the attractiveness of the bond in the market and which are typically used in more developed markets today are absent. For example, bond issuance is limited only to listed companies of significant size, eliminating the possibility of using the special purpose issuing entities that can provide significant protections to investors against the bankruptcy of the bond issuer. Similarly, the current draft of "unit trust" legislation, which has been used successfully elsewhere to issue mortgage asset backed securities, prohibits the trust from owning "real estate," which based on precedent in other countries would presumably extend to mortgage loans.

Recommendation:

The choice in many emerging markets often is whether to develop a specific law on mortgage securities, or to address the issues by amendments to existing laws and regulations. Because of its flexible common law heritage, it is likely that the latter approach would be more appropriate in Tanzania today. The work under the present project therefore consisted only of a review of the current and proposed laws and regulations governing securities markets.

There is presently a great deal of activity on updating the legal framework for the securities markets, including development of an integrated East African securities market having common laws and regulations. The assessment team was advised that the Capital Markets and Securities Authority is aware of ongoing development of a asset backed securities law in Kenya which can be tested and eventually adopted by Tanzania. Rather than make specific recommendations at this point, the assessment team suggests that market participants in Tanzania observe the process to develop a securitization law in Kenya, and then determine how it might be adapted for use in Tanzania. This will help avoid potential conflict with the ongoing East African market integration efforts.

It is our opinion that work on a law for high-quality covered mortgage bonds is premature, and much more work needs to be done to establish the primary market. In effect, such a law could be a distraction at this time and sit on the shelf for some years to come. Moreover, we believe that any bank that wishes to invest the effort could issue a simple mortgage-backed bond now on the basis of existing common law principles and securities market regulations, which would be advisable, indeed encouraged, before much further work is done on specific laws of mortgage bonds. It appears to us that any impediments to such instruments that currently exist could be resolved by discussions with the Securities Commission.

8. Need for Strong Leadership and Coordination of Reform Efforts

An important finding of the assessment team is the significant amount of work on laws, regulations and procedures relevant to development of mortgage markets that is ongoing in Tanzania today. As noted above, the BEST Program, which helped prepare the mortgage amendments to Land Act in 2004, and have more recently prepared an Estate Agency Law now before the Attorney General's chambers. BEST is finalizing a draft Land Valuation Bill, and has plans to start on a Sectional Properties Act during 2007. In addition, there are the modernization efforts of the Land Registry and the Capital Markets and Securities Commission, which focus on legislative and regulatory development; the Property Formalization Program, which is testing new methods of survey and titling for existing properties; the 20,000 Lots Program, which is struggling with difficult issues of land titling and provision of utility services; and the ongoing effort to develop a meaningful approach to formalization of informal settlements.

The importance of communication among the leaders of these efforts cannot be overemphasized. For example, there are significant overlaps between the work of the Property Formalization Programme and the Land Registry's comprehensive review of current survey and registration procedures. Likewise, the BoT's concern with bank liquidity has important interfaces with the CMSA's current efforts to modernize securities markets. An important outcome of the current work should be to develop mechanisms for coordination of efforts of those actors interested in development of property and mortgage markets to assure a comprehensive approach and avoid conflicts in future legislation. This can be accomplished through multi-sectoral workshops and technical teams or working groups to coordinate specific approach.

In addition to coordination, there is a critical need for leadership in carrying out the overall reform effort. Policy makers with a high level of public and political credibility are necessary to keep the program on track, especially because some of the reforms, such as revamping the property registration system, will take a number of years. Fostering a robust mortgage market may seem at first to concern only wealthy citizens and banks, but strong leadership can help ensure that the connection between mortgage finance and benefits to the general population – in the form of increased and more affordable home ownership and growth of the overall economy – is understood by all.