REPUBLIC OF KENYA

MINISTRY OF FINANCE AND PLANNING

SESSIONAL PAPER NO. 1 OF 2002 ON RESTRUCTURING OF THE AGRICULTURAL FINANCE CORPORATION (AFC)

1. The following information is laid before Parliament, in accordance with the requirements of the Government Financial Regulations and Procedures, for consideration and approval.

2. AFC is currently in a very poor financial state. As at 30th June 2000 its total net assets were Kshs.2.078 billion while it owed the Government and Sugar Finance Corporation a total of Kshs.10.3 billion on account of loans (Kshs.3.184 million) and accrued interest (Kshs.7.158 billion). At that time, the total Government grants of 132.1 million had been eroded by negative reserves, which amounted to negative Kshs.509.4 million. It had accumulated losses before tax in excess of Kshs.918 million and its working capital (net current assets) was in excess of negative Kshs.2 billion. Also out of its total portfolio of Kshs.5.2 billion, Kshs.2.9 billion was already considered to be irrecoverable while about 80% of the total portfolio was in arrears. Its advances were dismal and loan collections (both principal and interest) were not adequate to cover staff and general administration costs. The poor performance and financial performance is attributed to the factors outlined below.

(i) **The poor performance of the Seasonal Crop Credit Scheme**, which has, over, the years suffered severely from the droughts leading to heavy losses as a result of bad and doubtful debts, which, in the absence of a crop insurance scheme, are borne directly by AFC. The scheme has effectively wiped out AFC reserves.

(ii) **Liberalization** which affected the input prices, maize marketing and AFC debt collection effectiveness, adversely.

(iii) **Write off of loans** amounting to Kshs.817.3 million for farmers in 1989 made on a Government directive then, to protect the farmers from severe drought impact. This write off contracted the Corporation's portfolio. In addition it worsened its financial position as AFC retained the corresponding loans (loans from which the funds had been lent to farmers) in their books awaiting write off by the Government. As such AFC continued to accrue interest on the amount owed to the Government without corresponding income from the farmers.

(iv) **Inability to enforce loan securities**. The nature of the securities, which in many cases have been farm-based make it difficult to enforce and thereafter to dispose off the security. The nature of lending e.g. in case of the Seasonal Crop Credit scheme also resulted in insufficient securities.

(v) **Negative interest rate spreads for the corporation:** For a long time (especially in the 80s) AFC was charging interest rates of between 12% and 14% p.a. at a time when it was receiving funds from the Cereals and Sugar Finance Corporation (CSFC) at a rate of 13.5% p.a. leaving very little or no spread to cover the Corporation's operating costs. This led to erosion of part of its capital resources.

(vi) **High overhead costs:** This is mainly as a result of an extensive network set up at a time when AFC had adequate resources that justified establishment of operation centres throughout the country. With diminishing resources and the resulting low level of activity the overhead costs have remained high, in spite of some restructuring measures taken to reduce them.

(vii) **Implementation of non-profit socio-economic objectives:** These include write off of loans to shield farmers from drought without immediate compensation and Government directed lending programmes at predetermined interests rates which do not provide adequate margins to cover operational, finance and other related costs.

3. In its meeting held in March 2002 the Cabinet discussed the proposed restructuring of AFC, and in view of the critical role played by AFC in poverty eradication and food security, through provision of farm credit, approved several financial and restructuring measure, which among other things, include:

(i) Write off from Government books of loans to AFC amounting to Kshs. 211,336,049 (made up of Kshs. 126,861,397 on principal and Kshs. 84,474,652 on interest) and from Cereals and Sugar finance Corporation Kshs 542,373,768 (made up of Kshs 278,338,443 on principal and Kshs .264,035,325 on interest): whereby, the corresponding loans to farmers amounting to Kshs. 817.3 million were written off by AFC in 1989 on Government directives;

(ii) Write off from Government books of loans to AFC amounting to Kshs 1,006,075,106 (being Kshs.563,108,706 on principal and Kshs442,966,400 on interest) and from Cereals and Sugar Finance Corporation loans amounting to Kshs (being Kshs6,726,064,221 being Kshs.1,075,627,881 on principal and Kshs. 5,650,436,340 on interest) due to GOK and Cereals and Sugar Finance Corporation from AFC whose corresponding loans from AFC to farmers are considered irrecoverable;

(iii) Conversion into equity of performing loans (principal and accrued interest) of Kshs.1,387,765,881;

(iv) Retention of 50% of performing redeemable loans amounting to Kshs.468,537,975 as loans from GOK to AFC;

(v) Injection of Kshs.1.302 billion as additional equity into AFC spread over the next five years to enable AFC re-invigorate its mandate, rebuild the corporation's lending capacity and reverse the downward trend; and

(vi) Other restructuring measures aimed at converting AFC in to an efficient organization that is able to discharge its mandate efficiently, effectively and viably.

4. The National Assembly is requested to note the total amount of Kshs.1,217,411,155 due from AFC to the Government and the total amount of Kshs.7,268,437,989 due from AFC to Cereals and Sugar Finance Corporation recommended for write off for AFC under Paragraph 3(i) and 3(ii) above and approve write off of the amounts.

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17TH APRIL 2002