

CHAPTER 2: CREDIT FACILITIES

2.1 Introduction of the Unit of Learning/Unit of Competency

Credit facilities is a unit of competency covered in TVET level 6 banking and finance course qualification. This unit specifies the competencies required to process credit facilities. It involves conducting customer screening, advising client on credit, conducting security perfection, conducting credit appraisal, facilitating valuation of security and communicating credit decision. The significance of credit facilities to TVET level 6 banking and finance curriculum is to equip the learner with knowledge and skills to demonstrate accuracy, numeracy and communication skills, teamwork and self-management so as to fit well in the world of work.

The critical aspect of competency to be covered include: demonstrated ability to conduct customer screening and customer search, obtain consent of using security and credit administration approval, value the credit security, carry out joint registration and obtain approval to disburse. Basic resources required include; scanners, computers credit application forms, stationery, printer, internet connectivity, furniture and electricity.

The unit of competency covers 6 learning outcomes. Each of the learning outcome presents; learning activities that covers performance criteria statements creating trainees an opportunity to demonstrate competencies stipulated in the occupational standards and content in curriculum. Information sheet provides; definition of key terms, content and illustration to guide in training. The competency may be assessed through written test, demonstration, practical assignment, interview/oral questioning and case study. Self assessment is provided at the end of each learning outcome. Holistic assessment with other units relevant to the industry sector workplace and job role is recommended.

2.2 Performance Standard

Conduct customer screening, credits, valuation of security, credit appraisal and credit decision as per the KYC policy and customers need.


2.3 Learning Outcomes

2.3.1 List of Learning Outcomes

- a) Conduct customer screening
- b) Advise client on credit
- c) Conduct security/collateral perfection
- d) Facilitate valuation of security
- e) Conduct credit appraisal
- f) Communicate credit decision

2.3.2 Learning Outcome No 1: Conduct Customer Screening

2.3.2.1 Learning Activities

Learning Outcome No 1: Conduct Customer Screening	
 Learning Activities	Special Instructions
1.1 Obtain <i>customer details</i> (name, age, marital status, physical address, contact, nature of work) as per KYC policy 1.2 Identify purpose of the credit as per the customer needs 1.3 Request amount of credit is established as per customer needs	Written assessment Group discussion

2.3.2.2 Information Sheet No2 /LO1: Conduct Customer Needs



Introduction

This learning outcome covers: customer screening, KYC process, importance of KYC, customer needs, purpose of credit, classifications of credit, steps in customer screening and identification of customer needs.

Definition of key terms

Customer screening: It is the process of performing a search to get information on certain clients due to diligence.

KYC: It is the process of searching information. This is mostly done by banks.

Customer needs: These are the things a customer wants or expects in a product or service.

Content/Procedures/Methods/Illustrations

1.1 Customer details are obtained as per KYC policy

Customer details are information's about customers usually including their names, contact details and buying habits. The following is a process carried out by credit facilities to know their customers;

Customer Identification Program (CIP). The CIP requires that any individual conducting financial transactions needs to have their identity verified. The following are the minimum requirements needed to open an individual financial account:

- a) Name
- b) Date of birth
- c) Address
- d) Identification number
- e) Signature

Customer Due Diligence (CDD): This ensures that an organization is protected from terrorists, criminals who might bring about risk. CDD has three levels. They include:

- Simplified Due Diligence. These are situations where there is risk of money laundering and a full CDD is not necessary.
- Basic Customer Due Diligence. Information obtained for all customers to verify the identity of a customer.
- Enhanced Due Diligence. It is information collected for higher risk customers to mitigate associated risks. These are the details that tend to identify and know potential customers. They include:
 - a) Name
 - b) Age
 - c) Marital status
 - d) Physical address
 - e) Contact
 - f) Nature of work
 - g) Sex

Importance of KYC screening

The core purpose of customer screening is to add to the risk picture of your customer and specifically to identify if they:

- Understand nature of customers activities
- Subject to international sanctions
- Politically exposed persons
- Convicted or suspected criminals
- Reputational risk to the business

Other importance includes:

- The ultimate aim is to find out whether your customers are or could be linked to money laundering, bribery and corruption, terrorist financing. If they are to protect your business by taking erasure action or appropriate follow up action.
- Helps to know who to and not to give credit
- Minimizes risks of loss of money
- Establishes customer identity

KYC screening verification checks

- **Address:** This is the current location of a customer.
- **Identity:** This is the name, id, sex and customers identification.
- **Document:** These are the legal documents e.g. contacts, id, good conduct and other legal documents.

Elements/components of KYC screening

- Customer identification program
- Ongoing monitoring
- Mobile KYC
- Customer due diligence
- Corporate KYC
- E-KYC
- Global KYC compliance

Steps in customer screening

i. Concentrate on data quality

This step is concerned with clean customer records. It begins with accurate client's data. If it is inaccurate or incomplete, it could lead to poor name matching and high rates of false positive results. Proper client data such as date of birth, location, information to a standard first name/last name record. Make sure you screen against data that is up to date from reputable sources and curated for easy retrieval and filtering.

ii. Do not rely on search engines

Internet search is fast and free which is why many companies employ compliance analysts to screen prospects and partners using well known search engines. The problem with internet

- Results vary dramatically.
- No track records.
- It is difficult to filter results based on risk policy, customer segmentation.
- Irrelevant results lead to false positive rates of 95% or higher.

iii. Look beyond sanction

Well documented and publicly available. These lists are designed to restrict commerce with targeted foreign countries and regimes, terrorists, narcotics, traffickers, people engaged in activities related to weapons of mass destruction and other threats to national security.

iv. Keep monitoring post-boarding

Due diligence does not end. When business relationship begin, continuous monitoring is important in order to reduce risks.

v. Control scale and costs

Many organizations struggle with the cost compliance, both from financial and operational efficiency perspective.

Classification of credit

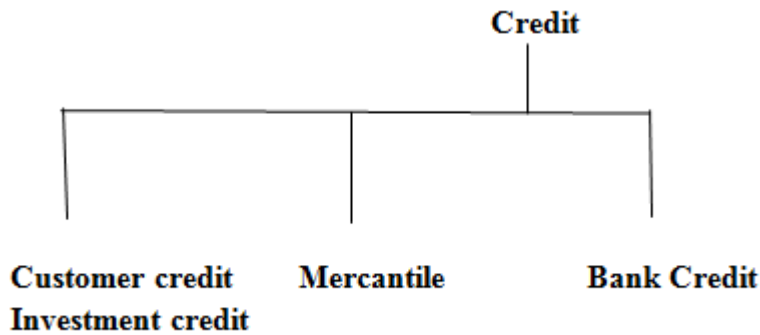


Figure 1: Classification of credit

Credit classification is discussed as follows:

- **Customer credit**

It is the kind of credit extended to consumers in order to facilitate the process of consumption.

- **Mercantile credit**

Also called commercial credit. It is a type of credit which one business may extend to another when selling goods on time for resale of commercial use.

- **Bank credit**

Refers to solely to the credit given by commercial banks to businessmen instead, to assist them in the operation of the business.

Table 2: Differences between mercantile and bank credit

Mercantile	Bank credit
It is an everyday occurrence for both small and large companies.	It is periodical by borrowers, at times annually.
Merely allows the buyer to have possession falls due and may or may not require security.	Banks lend money either on promissory note/ collateral.
It is extended only in connection with purchase of a definite bill of goods.	It is a standard practice extended in order to enable borrower to secure funds.
Does not consider greater precaution.	Takes a greater precaution before it extends credit.
Competition is stiff in mercantile.	It does not have a lot of competition.

1.2 Purpose of the credit is identified as per the customer needs

The ultimate purpose of credit entirely depends on the customer's need for the credit. The following are some of the purposes of credits:

Purpose of financial credit

- Surplus funds with some individuals and institutions are made available to the deficit spenders through the means of credit.
- A well-managed credit prevents inflation, recession and un-employment in the economy.
- Relieves the constraints imposed by balanced budgets on economic agents so as to meet the financial requirements of investors.

Credit is used for the purpose of:

- Buying
- Carrying or trading in securities

Money that an investor may borrow from a broker so as to buy securities. Purpose credit is secured by cash or securities in a margin account. An investor who buys with purpose credit, realizes huge profit if the price of the security is favorable. He/she also takes a great risk because it may not bring any gains. Purpose credit is also called margin loan. Being able to borrow money, allows you to obtain all the available resources that they may need to earn more money for the person who provided the credit. Purpose of credit ultimately depends on the customer needs and how much he/she needs the money for.

1.3 Amount of credit requested is established as per customer needs

The amount of credit given to customer as per their request depends on the capability of that client to repay the credit and all other factors that a bank consider while giving credit to their clients. The following are factors to be considered while giving credits

Factors to consider while giving credit request

- **Credit history:** This is the credit worthiness of a client. The past experience of credits. Their repayment history and the general history in terms of loans.
- **Customer legal documents:** These are the legal documents e.g. identification card, name, address and all the legal details that must be considered while giving credit.
- **Collaterals:** These are the securities that must be obtained in a situation where a large amount is requested by a customer. In situation where a large number amount is requested, then the value of customer loan/ request must be relatively same.
- **Customer background:** These are details where a bank may need to check where the customer will get money to repay the loan.
- **Customer guarantor:** This is a person who acts as an assurance that the loan will be paid. He/ she signs the customer request after it is authorized by the bank.
- **Statements and account balances:** This is the background check on the customer account balances and that of guarantors in order to solve the request by taking a loan.

Identification of customer needs

There are crucial things a customer need. They include:

- Fair price
- Good services. Good customer service has been proved time and time again to allow business too change more.
- Good product. Creating a solid product is obviously a major need for customer and you. Be confident about your products, be open to improvement suggestions and always aim to give the customer exactly what they need.
- Meet customer expectations. How much your customer feels valued by a company is often overlooked. Customer value is the one need we think most e-commerce stores overlook.
- Convenience. Your product or service needs to be a convenient solution to the function your customers are trying to meet.
- Experience. Using your product for needs to be easy.
- Design. The product needs to have a sleek design to make it relatively easy and intuitive to use.
- Reliability
- Performance
- Efficiency
- Empathy
- Compatibility

Conclusion

This learning outcome covered: customer screening, importance of KYC, steps in customer screening and identification of customer needs.

Further Reading



Read on customer screening by Richard North Peterson.

2.3.2.3 Self-Assessment



Written Assessment

1. Which one of the following is not an element of KYC screening?
 - a) Ongoing monitoring
 - b) Costing
 - c) Mobile KYC
 - d) E-KYC

2. Which one of the following is not true about KYC?
 - a) It is known as Know Your Customer
 - b) Its importance is to reduce business risks
 - c) It is a control scale
 - d) All of the above
 - e) None of the above
3. Customer need is the process of screening.
 - a) True
 - b) False
 - c) Not sure
4. Which of the following is a verification check?
 - a) Address
 - b) Identity
 - c) All of the above
5. Which of the following is not a customer need?
 - a) Fair prices
 - b) Good services
 - c) Good life
6. Classify the different categories of customer needs.
7. Analyse five customer needs.
8. Evaluate the steps used for customer screening.
9. Identify five elements of KYC screening.
10. Highlight and examine importance of KYC screening.

Oral Assessment

1. What does KYC stand for?
2. What is a customer want?

Practical Assessment

In a group of five students, select a bank of choice in your area or school, learn on how the customer screening is done and get to elaborate all the importance of customer screening.

2.3.2.4 Tools, Equipment, Supplies and Materials

- Writing materials
- Projector
- Computer
- Flip chart/white board

2.3.2.5 References



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2.3.3 Learning Outcome No 2: Advise Client on Credit

2.3.3.1 Learning Activities

Learning Outcome No 2: Advise Client on Credit	
 Learning Activities	Special Instructions
2.1 Inform customers on the repercussion of non-disclosure of information as per credit policy	Oral assessment
2.2 Inform customers on credit repayment amount as per credit policy	Lectures
2.3 Inform customers on credit repayment period as per credit policy	Presentation
2.4 Inform customers on credit repayment date as per credit policy	
2.5 Inform customers on interest rates and other costs as per credit policy	

2.3.3.2 Information Sheet No2/LO2: Advise Client on Credit

Introduction

This learning outcome covers: Categories of bank customer credit, types of credits offered by financial institutions, requirements for credit application, process of credit application, pros and cons and terms and conditions of credit.

Definition of Key Terms

Credit application: This is a contract between a customer/client and a bank for a request extension of credit. This request can be done orally or in a written form.

Credit: This is a contractual agreement in which a borrower receives something of value now and agrees to repay the lender at a later date with interest.

Interest rate: It is the amount of interest due per period. It is the rate at which the bank or other financial institutions charges their clients to take its credit.

Credit Policy: It is the set of principles on the basis of which it determines who it will lend money to or give its credit.

2.1 Customers are informed on the repercussion of non-disclosure of information as per credit policy

Bank customer is a person who buys goods or services from a bank. They can be categorized as follows;

Categories of bank customers

- **Individual customer.** This is an account opened in an individual's name. For example, an account opened in the name of 'A'.
- **Joint customer.** This is an account opened in joint names. For example, an account in the name of A and B. NB: A maximum of 4 individuals can jointly open an account.
- **Proprietorship firms.** This is a business done by one single individual. These firms can open current account and all types of term deposits with the bank but are not permitted to open savings deposit account.
- **Partnership firms.** This is one where more than one individual join together for a common business purpose. In the partnership firm, there can be minimum of two partners and maximum of twenty partners. However, when the partnership firm is engaged in doing banking business, there can be maximum of ten partners only. At the time of opening an account in the name of partnership firm, the copy of partnership deed has to be produced to the bankers. The partnership deed can be either registered or not registered. It has to be with the Registrar of Firms. Bankers do not demand registration of the partnership deed at the time of opening a deposit account. However, at the time of availing loan facilities with the banks, the deed has to be registered.
- **Companies.** Companies are perpetual bodies. They exist by means of collective efforts of different individuals called shareholders. Companies are classified into private limited company and public limited company. In the case of Private limited company and Public limited company. In the case of private limited the minimum members permitted is 2 and the maximum is 50.

At the time of opening an account, they have to produce the following copies: Articles of Association, Memorandum of Association, Certificate of Incorporation, Certificate of Commencement of Business and Board resolution.

Types of credit

- **Short term loan:** These are given against some security as personal loans to finance working capital or as priority sector advances. The entire amount is repaid either in one installment or in a number of installments over a period of time.
- **Demand loan:** This is a loan recalled on demand. It has no stated maturity. The entire loan amount is paid in huge sum by crediting it to the loan account of the lender.

- **Cash credit.** A client is first placed under a credit limit and allowed to withdraw within the limit on a given security. The withdrawing capability depends on the client's current assets, the stock statement of which is submitted to the bank as the basis of security. Interest is charged by the bank on the loan taken.

Terms and Conditions of Credit

- Include information about use of information provided on credit application. Make sure that the potential credit customer provides the complete and correct information on the application and is made aware of how the information provided will be used. The application certifies that the information contained is complete and accurate and understand that it is used to determine the amount and conditions of the credit to be extended.
- Include terms of payment and credit extension on credit application. This provides clear receipt of the terms by the customer and requires the customer to agree to your terms of payment.
- Get security for the credit applications. Security has to be provided for the loans offered. The inclusion of a personal guarantee as part of the credit application and a grant of a security interest. One can secure your extension of credit. If there is a security agreement or personal guarantees each document must be signed individually.

Repercussion is the bad effect that an action, event or decision has on the person or something. The customer /client should be made aware of the consequences they will face once they do not disclose information that is required for their credit application processing. Informing customers on the repercussion of non-disclosure of information is a process of educating the customers on the consequences of failing to disclose important information that could be used by the credit facilities to make credit decisions.

Process of credit registration

Credit application is a request for an extension. It can be done either orally or in written form usually through an electronic system. The application must legally contain all pertinent information relating to the cost of the credit for the borrower. Individuals have number of providers to choose from many emerging credit companies offering varying types of loans:

The following steps should be followed;

- i. The client will apply for credit from a credit provider
- ii. The credit provider will begin to process the consumer's application which will be sending enquiries to various credit bureaus.
- iii. The credit bureau will respond to the enquiry and will issue a report to the credit provider.

- iv. The credit provider will assess the report and decide whether the application is risk free and if it should be accepted or declined.
- v. When the provider decides to grant the client credit, the credit provider will be used in order to determine the interest rate the consumer qualifies for and the deposit that needs to be put down in order to borrow the credit.
- vi. The credit provider will notify the consumer of the terms of business.

Importance of informing customer on repercussions of non-disclosure of information

- It helps to build and develop trust
- It potentially allows free flow of information between the client and institution.
- It helps the customer be aware of the consequences to face if he does not disclose full information

For credit application based on the credit policy one should disclose the following information; their full names, national identification document or passport number, account number in which they hold in that bank, their occupation, monthly income, Phone number and a legal address, their location, name of a few known guarantors, or providence of a title deed or logbook under the name of the client. The consequences of a client not disclosing the above information may lead to the Financial Institution not processing the credit applied for. It may cause the customer to face a costly lawsuit and may face a criminal penalty for providing false documentation.

2.2 Customers are informed on credit repayment amount as per credit policy

The credit repayment amount is determined by how long the customer wants to pay the credit (the credit repayment period). There are various ways of informing customers about their credit repayment amount, they include; making calls, in person meetings (calling the client to the office to disclose on their credit repayment amount), writing official letters explaining the repayment amount to be paid and forwarding emails to the clients.

For example Ochieng requires a credit of Ksh 1,000,000 and the bank is offering the loan interest at the rate of 4% p/m and paying for 12 months

$$FV = 1,000,000 (1 + 0.04)^{12} = 1,000,000 (1.601) = 1,601,000$$

FV = 1,601,000 For a period of 12 months

The customer is expected to pay Ksh 200 for the loan acquired and the interest is shared equally among the 4 months. Credit payments refers to the amount of money that a customer ought to pay for his/her bank’s obligations. In Kenya different banks have different ways by which a customer can pay their debts this includes;

a) Equity gold card

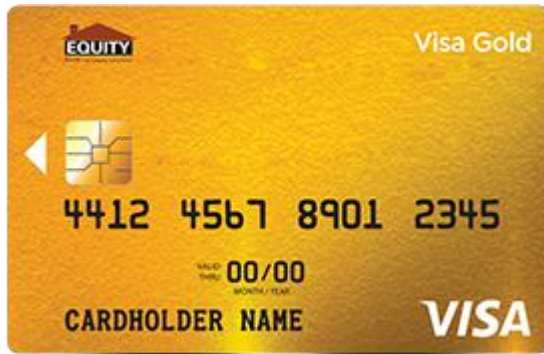


Figure 2: Equity Bank gold card
Source: businessdailyafrica.com

b) KCB platinum visa card



Figure 3: Platinum visa card. Ke
Source: kcbgroup.com

c) Standard chartered platinum card



Figure 4: Credit card.
Source: standardchartered.Sc.com

d) I &M visa infinite



Figure 5: I & M Bank
Source: imbank.com

e) Family bank visa card



Figure 6: Family bank credit card
Source: familybank.co.ke

f) Barclays signature visa card



Figure 7: Barclays credit card
Source: barclays.co.ke

g) National bank visa card



Figure 8: Visa classic national bank
Source: nationalbank.co.ke

h) MPESA cards



Figure 9: Mpesa visa card
Source: jamiiforums

2.3 Customers are informed on credit repayment period as per credit policy

Credit policy: It is a set of principles on the basis of each as it determines who it will lend money. The credit repayment period is determined by the customers but the bank itself has also limitations to time but depends on which type of credit one has taken. Monthly payments are often calculated based on the length duration your loan and the interest rate e.g. A credit given of Ksh. 100,000 paid with 10% interest rate for 1 year will have different monthly payments from one given Ksh. 100,000 12% interest rate for 2 years.

Information is passed to the client through Emails, phone calls, in person meetings and official letters.

Credit repayment period

$$\text{Interest (I)} \times \text{Principal (P)} \times \text{Rate (R)} \times \text{Time}$$

$$\text{Time} = \frac{\text{Interest}}{\text{Principal} \times \text{Rate}}$$

$$\text{Time} = \frac{200}{5,000 \times \frac{12}{100}}$$

2.4 Customers are informed on credit repayment date as per credit policy

Repayment period refers to the time between the first payment on a loan and its maturity. The customers should be well informed about their credit repayment period and should be in agreement whether payments should be monthly, quarterly, semiannually or annually according to the customers capability. They should also be made aware of when they should start paying the installments and the finishing time. Normally, the repayment date falls on the date which the credit was forwarded to them, for example if the client acquired the credit on the 23rd of November 2019 and is paying back on monthly basis, then he is expected to payback on the 23rd of every month till the last installment. This information is forwarded to the client by the bank through notifications on text messages, calls, letters or emails.

2.5 Customers are informed on interest rates and other costs as per credit policy

Interest rate is the amount interest due per period. It is the rate at which the bank lender or other financial institutions charge their clients to take up the loans.

A sample interest is computed only on the amount borrowed without compounding. The method of calculating interest assumes one payment at the end of the loan period. The cost is based on three elements; principle, rate and time.

$$\text{Interest (I)} = \text{Principal (P)} \times \text{Rate (R)} \times \text{Time (T)}$$

For example:

$$\text{Principle} = \text{Ksh. } 5,000$$

$$\text{Rate} = 12\%$$

$$\text{Time} = 4\text{moths}$$

$$5,000 \times 12\% \times 4 = 200$$

The Interest is 200

Conclusion

This learning outcome covered the categories of bank customers, types of credit offered by financial institutions, the required documents necessary for credit application, pros and cons, terms and conditions. It further states the consequences an applicant faces when they lack to give the required documents or they fail to produce legal details. It also demonstrates how interest rate is determined and how it is calculated and distributed. It explains how a bank settles on the repayment period and repayment date.

Further Reading



1. Read more on credit facility from Consumer credit Act 2006

2.3.3.3 Self-Assessment



Written Assessment

1. A loan backed by collateral is called a?
 - a) Line of credit
 - b) Dividend
 - c) Secured loan
 - d) Trade credit
2. Under COD terms the seller?
 - a) Extends credit to the buyer on open account
 - b) Extends credit to the buyer subject to bank approval
 - c) Requires the buyer to make partial payment at fixed intervals
 - d) Bears the risk of the buyers refusing the goods shipped
3. The government requires that the lender provide you with information on this rate
 - a) The prime rate
 - b) The national contract rates
 - c) The discount rates
 - d) The annual percentage rates
4. Which one of the following was not added as a category of exempt agreement by the Consumer Credit Act 2006?
 - a) Business
 - b) Charities
 - c) High net worth debtors and hirers
 - d) Investment properties
5. What is the interest rate that world class banks in London pay each other for Euro dollars?
 - a) London Interbank offered rate (LIBOR)
 - b) London Long-term bond rate (LLBR)
 - c) London Euro rate (LER)
 - d) London Euro bond rate (LEBR)

6. The interest rate used as an index in calculating rate changes to adjustable rate mortgages (ARM) and other variables rate short term loans is known as the
 - a) Federal Fund rates
 - b) Index Rate
 - c) Margin Rate
 - d) Prime Rate
7. Which of the following terms best applies to the short-term interest rate charged by banks to large credit worth customers?
 - a) Discount basis interest rate
 - b) Long term bond rate
 - c) Prime rate
 - d) Fed funds rate
8. Interpret credit policy
9. Classify and analyse five collaterals that are acceptable by a bank.
10. Discuss on non-disclosure agreement and evaluate its importance.
11. Classify ways in which a bank informs or communicates to a customer.
12. Elaborate the key factors that determines a customer's credit worthiness.

Oral Assessment

1. State the credit application process
2. What are the consequences of Non-disclosure?

Practical Assessment

In a group of 5 students perform the following task:

Mr. Kamau visits Equity bank and wants a loan amounting to Ksh. 100,000. Using the simple interest method, solve

- a. Principal 100,000 rate 12% within 12 months calculate the interest
- b. Principal 18,000 interest 1080 time and month calculate the rate
- c. Interest 2600 Rate 18% Time 12 months calculate the Principal

2.3.3.4 Tools, Equipment, Supplies and Materials

- Writing materials
- Calculator
- Projector
- Computer
- Flip Chart/white board

2.3.3.5 References



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2.3.4 Learning Outcome No 3: Conduct security/collateral perfection.

2.3.4.1 Learning Activities

Learning Outcome No 3: Conduct security/collateral perfection	
 Learning Activities	Special Instructions
3.1 Identify security as per bank policy 3.2 Ascertain acceptability of the security as per bank policy 3.3 Establish sufficiency of the security as per bank policy 3.4 Create legal documentation on the security as per bank policy 3.5 Conduct security visit as per bank policy 3.6 Verify ownership of the security as per bank policy Existence of <i>encumbrances</i> (Caveat Joint ownership) 3.7 Establish legality of ownership as per bank policy	Oral assessment Written assessment

2.3.4.2 Information Sheet No2/LO3: Conduct security/collateral perfection



Introduction

This learning outcome covers; collateral, acceptability of security, sufficiency of security, legal documentation, security visit, ownership of the security and legality of ownership.

Definition of key terms

Collateral: This is pledge of the borrower on a particular property to the lending firm in securing loan repayment. It effectively serves as a protection for the loan thus in case of default, the property is liquidated to repay the loan.

Legal: In relation to the collateral, legal implies that property that can be permitted by law to pledge on a loan repayment.

Collateral perfection: It relates to an agreement between the lender and the borrower that lets the borrower possess the pledged property at the same time ensuring that no enforceable security interest that can arise regarding the property.

Content/Procedures/Methods/Illustrations

3.1 Security are identified as per bank policy

With the revised loaning policies by the Central Bank of Kenya, any loan taken from a bank must have collateral to it. This is to ensure that the loan is secured to avoid high chances of non-performing loans in banks. Therefore, collaterals should be identified and attached on the loan applied for to complete loan application and issuance as per the bank policy.

Methods of valuing a security

- **Cost approach:** The property or asset value of the security is determined by the replacement or reproduction cost of the property. The valuers or the appraisers of the property consider the obsolescence and functional aspects of the security.
- **Market approach:** This method is applied to determine the property worth through the prevailing market prices. The adjustments and transactions in the market place determine the property value by the forces of demand and supply.
- **Income approach:** The expected cash generation from the asset is used to determine the asset value under this method. The investors therefore pay the amounts they expect to get from the asset annually.

Features of a security

- **Durability** a good collateral/security should be able to withstand adversities of wearing out such that it stays longer across the loan period.
- **Identification:** Good security should be readily identifiable to the class of properties it belongs to in order to make valuation easy.
- **Value stability:** Good security should maintain its price to avoid loan losses in case the asset was to be liquidated.
- **Standardization:** This is the ability of the security to be graded and meet the basic market standards of properties falling in its class.

3.2 Acceptability of the security is ascertained as per bank policy

Security acceptability by the bank should follow due process and should meet the required legal and physical standards. Therefore, ascertainment of the security acceptance should be from both the bank (loan issuer) and the loanee. The bank policy in regard to security check and acceptance carries the permanent importance to ensure that security interest does not conflict in the future.

Procedures for acceptability

- i. **Pledging of the property:** When an individual wants a loan from the bank, they state the property to be used in securing that loan in the whole repayment period.
- ii. **Securing valuation:** When the property meets the required features that a security should have, valuers do their noble thing of determining the property worth.
- iii. **Comparison of details:** Once the property worth has been ascertained the details are compared with the loan details to determine whether the property is worth securing the loan.
- iv. **Security acceptance:** When all the conditions have been met the property is approved with the loan details to determine whether the property is worth securing the loan.

Types of collateral

- **Real estate:** They are the most common types such as a home or a parcel of land for an individual.
- **Cash collateral:** It is a simple type of collateral where the loanee maintains active accounts with the loaning bank such that in the event of default, the bank liquidates the accounts to recover the loan.
- **Inventory collateral:** This type of collateral uses organizational stock as loan security where the inventory can be liquidated in the event of default.
- **Invoice collateral:** This type of collateral uses the sale bill or note showing future payment to secure a loan with the bank.
- **Blanket liens:** These are assets of a business and can be used in the acquisition and securing of a loan.

3.3 Sufficiency of the security is established as per bank policy

A security that is sufficient is an asset or property which meets all the requirements needed in securing a loan. Therefore, establishing the efficiency of a security is what will determine whether the loan to be issued will be fully covered or not. The security is thus important in the whole loaning process especially when it is sufficient as per the stipulated bank policy.

Importance of collateral

- High probability of repayment when borrowers have pledged their property, they do not feel good to lose such property thus will do all it takes to repay the loan.
- Profits in the event of loan default, the pledged property is liquidated and is usually disposed at an amount higher than the loan thus profit to the bank.
- Increase of bank assets; other pledged properties such as real estate can become part of the bank's assets in case the loanee defaults the loan.

3.4 Legal documentation on the security is created as per bank policy

Security documentation deals with capturing of security details in a manner permitted by the law to avoid any issues of interest conflict. Legal documentation follows due process of validation and capturing of details as they are regarding the security.

Legal aspects of collateral

- **Financial solvency:** A property pledged as collateral must have the ability to be converted to cash to repay the loan in event of default.
- **Financial legislation:** The property pledged as collateral must be able to be governed and regulated in the financial market.
- **Legal classification:** The property pledged as collateral must be among the properties permitted to be possessed by the law of the land.
- **Monetary value:** The pledged property must be having a financial worth than the conceptual worth attached to other properties.
- **Registration:** A pledged property must be registered under the provisions of the law and be possessed by the individual or the organization in need of a loan.

3.5 Security visit is conducted as per bank policy

A loan security can be movable or immovable. When a security cannot be carried and be brought to the bank, it is said to be immovable. This therefore requires that the bank has to visit the area where the property is situated to conduct necessary procedures such as valuation for purposes of better security perfection.

Methods of perfecting different types of collaterals

- Value exchange method: The contractual agreement between the two parties should show an exchange consideration for the loan offered by the bank.
- Debtor's rights method: This method requires that the individual or party taking a loan must possess the rights to own and transfer the property to the lender.
- Security agreement method: This, method requires that the bank (loan issuer) and the loanee, have a contractual document that can authenticate the property for attachment purposes.

Ways of perfecting a security

- Filing a financial statement with a relevant public office
- Possession of the collateral while the loanee retains its ownership
- By controlling the security
- Attachment of interest on the security

3.6 Ownership of the security is verified as per bank policy

Verification of ownership of a security is very important as it helps the bank to ascertain that the security belongs to the party seeking a loan. Therefore, the verification process is very simple as it requires presentation of proof of ownership examples being logbooks for cars, title deeds for land, receipts for items purchased. This ownership is verified by checking the originality of the documents presented and then approval of the documents.

3.7 Legality of ownership is established as per bank policy

Legality of ownership is centered on whether the property to be pledged is rightly acquired by loanee and can be used by the loanee as a security. To show legal ownership, the loanee must present proof of ownership and also ensure that the property is constitutionally permitted to be owned. The legality of ownership should also be shown by showing that the right process was followed in acquiring the property and that the property is directly ascribed to the party intending to request for a loan.

Conclusion

This learning outcome covered; collateral, acceptability of security, sufficiency of security, legal documentation, security visit, ownership of the security and legality of ownership.

Further Reading



1. Read on Legality of ownership contained in the following article: Steinberg, A. B. (2008). For sale-One level 5 barbarian for 94, 800 Won: The International effects of virtual property and the legality of its ownership. *Ga. J Int'l & Comp. L.*, 37,381
2. Read on supply of bank credit contained in the following publication: Accornero, M, Alessandri, P, Carpinelli, & Sorrentino, A.M. (2017). Non-performing and the supply of the bank credit: evidence from Italy. *Bank of Italy occasional paper*, (374).

2.3.4.3 Self-Assessment



Written Assessment

1. Which of the following is not a method of valuing a security?
 - a) 1st approach
 - b) Income approach
 - c) Consultation approach
 - d) Market approach

2. Which of the following is not a feature for security?
 - a) Identification
 - b) Value stability
 - c) Durability
 - d) Tangibility
3. Which of the following is not a type of collateral?
 - a) Cash collateral
 - b) Real estate
 - c) Copyright collateral
 - d) Inventory collateral
4. Which of the following is not an importance of collateral?
 - a) Collateral owners can sell
 - b) High payment profitability
 - c) Increase of bank assets
 - d) Profits for the bank
5. Which one is not a legal aspect of collateral?
 - a) Financial legislation
 - b) Form of the property
 - c) Financial solvency
 - d) Monetary value
6. Which one is not a method of perfecting various types of collaterals?
 - a) Market value method
 - b) Value exchange method
 - c) Security agreement method
 - d) Debtors rights method
7. Analyse the word collateral.
8. Classify procedure for collateral acceptability.
9. Elaborate on invoice collateral.
10. Demonstrate the importance of collateral to the borrower.
11. Plan ways of perfecting collateral.

Oral Assessment

1. Name the examples of documents that show legal ownership of a collateral.
2. Name examples of illegal collaterals.

Practical Assessment

In a group of five students visit a local lending firm and examine some loan collaterals in possession with the firm. Learn and compose a report on the features of such collaterals.

2.3.4.4 Tools, Equipment, Supplies and Materials

- Transport
- Writing materials
- Computer and projector
- White board and marker pens
- Sample collaterals like invoices and title deeds


2.3.4.5 References



- Accornero, M, Alessandri, P, Carpinelli, & Sorrentino, A.M. (2017). Non-performing and the supply of the bank credit: evidence from Italy. Bank of Italy occasional paper, (374).
- Agarwal, S, Chomsisengphet, S, & Wang, S.Q. (2016). Is secured lending secure? Evidence from small businesses
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2.3.5 Learning Outcome No 4: Conduct Credit Appraisal

2.3.5.1 Learning Activities

Learning Outcome No 4: Conduct credit appraisal.	
 Learning Activities	Special Instructions
4.1 Ascertain customer ability to pay as per bank policy 4.2 Ascertain customer risk profile as per bank credit policy 4.3 Establish purpose of credit facility as per bank policy	Written assessment Illustration

2.3.5.2 Information Sheet No2/LO4: Conduct Credit Appraisal

Introduction

This learning outcome covers: Principles of lending, preparation of financial position, income statement, cash flow statement, cash flow projection, ratio analysis.

Definition of key terms

Financial statements: They are also known as financial records. They provide a clear picture of financial activities and performance of business.

Ratio analysis: It is a calculation done using financial statements items to establish financial performance of a business. It can be profitability analysis, liquidity analysis and debt analysis.

Bank policy: These are the procedures established by individual banks which are part of central bank regulation, aimed at protecting customer's assets.

Credit policy: These are the procedures that provide guidelines on how banks issue credits to their customers/customers.

Content/ Procedure/ Methods/ Illustrations

4.1 Customer ability to pay is ascertained as per the bank policy

Bank policies in Kenya are developed by individual banks; however, the policies should be in accordance to Central Bank of Kenya regulations. Bank's lending policy is a part of general bank policies. It provides guidelines to banks on whether to give or not a loan to a customer. Customers' ability to pay is defined as the capacity of the customer to pay back money owed to the bank.

Procedure of ascertaining customer ability to pay as per bank policy

- i. Bank will establish current income of the customer. This can be done by requesting current pay slip for the employees' customer or financial statements for the corporate customers.

- ii. Bank should establish the existing debt level of the customer which may also include the customer listing their current liabilities.
- iii. Bank should proceed to request the credit history of the customer from the Credit Reference Bureau (CRB).
- iv. Bank should carry out a debt to income ratio where the debt to income ratio is high, then the customer has a high possibility of default.
- v. Bank should also consider the value of collateral that the customer is willing to provide as security for the loan. If the asset is of high value; then the customer will ensure a repayment to avoid auctioning his/her asset.
- vi. The bank should also establish the importance/purpose of the loan. This should answer the question such as why is the customer requesting a loan.
- vii. The bank should finally follow up to ensure that the customer uses the loan for the reasons the customer stated on loan application form.

Based on the procedures above, the bank will make a reasonable decision whether the customer has the ability to pay.

The bank must also put into consideration the principles of lending

The main business of a bank rather than taking deposits is issuance of loans. The following principles of lending are applied by banks to ensure that its operations remain afloat.

- Identification of the borrower: This entails application of Know Your Customers (KYC); where through application of these principles the loan/ amount lent is given to the right customer thus preventing fraud.
- The purpose of the loan: The bank should carry out an analysis on why the customer is requesting a loan. This will ensure that the bank is cautious on issuance of large amounts to new ventures.
- Amount of loan: The bank should exercise due diligence to ensure the amount given to the customer is neither under or over financed. Limited finance would lead to failure of the project to be financed whereas excess funds would result to diversion of the extra funds to other activities which may be a risk during repayment.
- Repayment period: The periods for repayment should be organized such that the bank is liquid enough to meet the demand of the depositors.
- Source of amount to be repaid: This entails clear details of the source/ plan of how the customer intends to repay the amount requested.

4.2 Customer risk profile is ascertained as per bank credit policy

Customer's risk profile; this is an uncertainty of outcome associated with a particular customer. A customer with a high-risk profile means that the probability of default by such customer is high.

Procedure of ascertaining customer risk profile

- i. **Establish risk categories:** The bank should come up with different categories of risk. This may be variant from different bank but should be within the CBK regulation e.g. standard/ normal risk and higher risk.
- ii. **Establish high risk indicators:** These are factors that the bank will use as bases to determine a high-risk customer profile. For business, the bank should analyze the financial statements e.g. nature of business.
- iii. **Relevance:** Ensure that the risk indicators are relevant to the bank clientele.

Analysis of customer risk profile

The bank should use various financial statements to analyze the risk level of a customer/ business.

Preparation of statement of financial position

The bank can use various financial statements to analyze the risk level of a customer/ business. In such cases, the bank can analyze to see the source of financing the business uses. If it has a high long-term debt financing then it can be categorized as high risk.

Table 3: Sample of financial statements

ABC Ltd Statement of financial position As at 31 st Dec 2019		
Fixed Assets	Sh	
Property, plant and equipment	XXX	
Premises	XXX	
Vehicles	XXX	XXX
Current Assets		
Inventory	XXX	
Trade receivables	XXX	XXX
Total assets		XXX
Non- current liabilities		
Bank loan (5 years)		XXX
Current liabilities		
Trade payable		
Accruals	XXX	
Financed by	XXX	XXX
Common stock		XXX
Total liabilities and equity		XXX

a) Income statement

Through the analysis of the income statement, the bank can establish the sources of revenue and carry out different analysis e.g. profitability analysis to see a trend of performance of the organization over time. If by comparing income statements of different periods the organizations profits have declined substantially, then it will be a red flag on issuance of another loan.

Table 4: Statement of comprehensive income

XYZ Ltd		
Income statement		
For the year ended 31 st December		
Revenue	Ksh	Ksh
Sales		XXX
Less: Expenses		
Cost of goods sold	XXX	
Depreciation expense	XXX	
Wage expense	XXX	
Interest expense	XXX	
Net income (profit)	XXX	XXX

b) Cash flow statement

This is also known as statement of cash flows. It shows how any change in items of the statement of financial position and income statement affect cash and cash equivalents. Cash flow statement shows effect on cash flow from operation, cash flow from financing and cash flow from investment. Net cash flow results from deducting cash flow financing and investment cash flow from operations. If the net cash flow is negative then it means that the company is not well financing its operations.

Table 5: Statement of the cash flows

ABC Ltd		
Cash flow statement		
For the year ended 31 st Dec 2019		
Operating activities	Ksh	Ksh
Sales receipts		
Less:	XXX	
Payment for products		
Payment for operation	XXX	
Taxes	XXX	
Net cash flows from operating activities		XXX
Investing activities		
Purchase of machinery	XXX	
Interest received	XXX	
Net cash flow from investing activities		XXX
Financing activities		
Short term debt		
Long term debt		
Net cash flow from financing activities		
Net increase (decrease) in cash		XXX
Cash at the beginning of the year		XXX
Cash at the year end of the year		XXX

Cash flow projection**Procedure of preparing cash flow projection**

- i. Prepare sales forecast for the business.
- ii. Add any other estimated cash inflow.
- iii. Less any estimated cash outflow as expense.
- iv. Result is the cash flow projection for the projection.

4.3 Purpose of credit facility is established as per bank policy credit facility

It is an agreement between the bank and the customer to allow the customer to borrow specific amount for different purpose for a particular period of time.

Purpose of credit facility:

Bank credit enables large scale production of goods and services because the corporate has enough funds to facilitate its business.

- Credit facility is essential to new ventures which may have difficulty rising initial capital.
- Credit facility is essential to business to finance its daily operations to avoid bankruptcy.
- Good repayment done regularly improves the credit scores of the company.

Ratio Analysis

This is an analysis done to establish operational efficiency, liquidity and profitability of a company by using details provided in the financial statement. Ratio analyses are used to establish a trend for the company by using information from financial statements from different periods.

Liquidity ratios: Are ratios used to show whether the company has the ability to pay its obligation when they fall due e.g.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$
$$\text{Quick ratio} = \frac{\text{Current assets} - \text{Inventory}}{\text{Current liabilities}}$$

Profitability ratios: Measures the ability of the company to generate profits from operations.

$$\text{Gross profit margin} = \frac{\text{Gross profit}}{\text{Sales}}$$
$$\text{Net profit margin} = \frac{\text{Net profit}}{\text{Sales}}$$
$$\text{Return of equity} = \frac{\text{Total asset}}{\text{Equity}}$$

Efficiency ratios: Measures how well a company puts its assets into use.

For example:

$$\text{Asset turn over} = \frac{\text{Sales}}{\text{Assets}}$$
$$\text{Inventory Turnover} = \frac{\text{Credit sales}}{\text{Cost of goods sold}}$$

Conclusion

This learning outcome covered: Principles of lending, preparation of statement of financial position, income statement, cash flow statement, cash flow projection, ratio analysis.

Further reading



1. Read on ratio analysis contained in the publication by Nassim,D., & Penman, S. H. (2001). Ratio analysis and equity valuation: From research to practice. *Review of accounting studies*, 6(1), 109-154.
2. Read more on cash flow projection based on the publication by Friend, E.H., & McCroy, R. T (1998). US. Patent No. 5,774,881. Washington, DC: U.S. Patent and Trademark office.

2.3.5.3 Self-Assessment



Written Assessment

1. Which one of the following is not a profitability ratio?
 - a) Gross profit margin
 - b) Net profit margin
 - c) Quick ratio
 - d) Return on equity ratio
2. Which among the following is not a financial statement?
 - a) Changes in equity
 - b) Cash flow projection
 - c) Statement of financial position
 - d) Statement of comprehensive income
3. Which among the following is an efficiency ratio?
 - a) Quick ratio
 - b) Asset turnover
 - c) Current ratio
 - d) Cash ratio
4. Which among the following is not true among importance of credit facility?
 - a) For financing new ventures
 - b) For financing old business operations
 - c) For production in large scale
 - d) None of the above
5. What is the correct answer among the following principles of lending?
 - a) Repayment period
 - b) Risk categories
 - c) High risk indicators
 - d) Relevance

6. Which among the following is not part of financial position statement items?
 - a) Profit
 - b) Capital
 - c) Asset
 - d) Creditors
7. Which among the following statement is not true?
 - a) Bank will establish current income of the customer during establishing ability to pay
 - b) Bank should not consider the value of collateral during lending
 - c) Bank should follow up on the way the loan is being used
 - d) Bank should carry out debt to income analysis during lending
8. Prepare the producers of ascertaining customer ability to pay.
9. Categorize the different principles of lending.
10. Analyse the procedure of ascertaining customer risk profile.
11. Compose the importance of liquidity ratios.
12. Demonstrate why a company should conduct ratio analysis during credit appraisal.

Oral Assessment

1. What is bank policy
2. Why is bank policy important?

Practical Assessment

In a group of at least three; predict the financial performance of the XYZ Company from the statement of financial position provided below: Concentrate on liquidity, profitability and efficiency ratios.

Table 6. Statement of financial position

XYZ Ltd			
Statement of financial position			
As at 31 st December			
	2013	2014	2015
Fixed assets	Kshs '000'	Kshs '000'	Kshs '000'
Land and building	11,460	12,121	11081
Plant and machinery	8,896	9020	9130
	20,356	21141	20211
Current assets			
Stock	1775	2663	3995
Trade debtors	1440	2260	3164
Cash	50	53	55
	3265	4976	7214
Current liabilities			
Trade creditors	390	388	446
Bank overdraft	1300	2300	3400
Taxation	899	1420	1195
Proposed dividends	1600	1696	1800
	4189	5804	6841
Net current assets	922	828	373
12% debentures	5000	5000	5000
	14434	15313	15584
Share capital	8000	8000	8000
Retained earning	6434	7313	7584
	14434	15313	15584

2.3.5.4 Tools, Equipment, Supplies and materials

- Writing material
- Projector
- Computer

2.3.5.5 References




- Arnold Z. (2014). Fundamental of credit analysis. Carlifornia Create space Independent publishing platform.
- Friend, E.H., & McCroy, R. T (1998). US. Patent No. 5,774,881. Washington, DC: U.S. Patent and Trademark office.
- Gerald L. (1997). The analysis and use of financial statements. Newyork. Wiley.
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- Nassim,D., & Penman, S. H. (2001). Ratio analysis and equity valuation: From research to practice. *Review of accounting studies*, 6(1), 109-154.

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2.3.6 Learning Outcome No 5: Facilitate Valuation of Security

2.3.6.1 Learning Activities

Learning Outcome No 5: Facilitate valuation of security	
 Learning Activities	Special Instructions
5.1 Appoint security valuer as per bank requirements 5.2 Obtain details of the security as per the location of the security 5.3 Prepare valuation report as per valuer information 5.4 Filed valuation report as per banking procedures 5.5 Make amendments on credit as per the valuation report	Group discussions Case study

2.3.6.2 Information Sheet No2 /LO5: Facilitate Valuation of Security



Introduction

This learning outcome covers: Valuations, types of valuation, categories of valuation, requirement for valuation, importance of valuation, and role of valuer, valuation report, and parties involved in valuation of a collateral, various methods/approaches of valuation.

Definition of key terms

Valuation: This is the process of establishing the market value of a company or asset.

Valuer: Refers to an individual who has been professionally trained and qualified to help establishing the worth/value of something (property).

Asset: This refers to a valuable item that is passed by an individual or an entity and is considered to hold economic value that would be beneficial in the future.

Content/Procedures/Methods/Illustrations

5.1 Security valuer is appointed as per bank requirements

Banks look for experts experienced and qualified and registered valuers and property consultants e.g. Amazon valuers limited member whose role is similar code of have training and practiced monitoring processes equal to valuation, banks employees or use them as external property valuers.

- The person complies with regulatory requirements governing registration or licensing.
- The person complies with yearly mandatory training requirements.
- The person complies with rules of conduct and code of ethics of their respective organization.

Ways of appointing

The valuer is considered experts in the specific property asset class or location (rural, industrial, retail and commercial) and be qualified appropriately. This step ensures that valuations are given by experienced valuers with no influence from banks. They are appointed for example through a meeting. A security is a financial instrument that is suitable to be bought or sold. A security valuer is termed as an individual that will help in determining the benefits and uncertainties that are associated with a security. The following are some of the importance of appointing security valuers.

Importance of appointing security valuers

- For initial funding process they are used to determine the value of the property.
- To determine variances in loan arrangements, for example an increase in the credit limit, when a variation in the loan facility is needed.
- To ensure current regulations are met during the course of a review of existing facilities for example agreed credit valuation valid and security position.
- During the course of the sale of assets subject to the bank's security, Valuers are needed.

Roles of a valuer

- Valuers help in offering advice and giving their opinion in relation to the security involved.
- A valuer helps in analyzing the market and generate a valuation report in relation to the security in question.
- A valuer will help in identifying and analyzing features that reflect the market value of the security
- A valuer should be up to date with the current affairs in order to sustain their knowledge.
- A valuer collects data that will in return help in making informed judgment. This will in return help in providing quality/reliable information to their client.

Parties involved in valuation of a collateral

A collateral is a property that a borrower uses to act as a guarantee while securing a loan. The parties involved during collateral valuation include;

- Borrower: This refers to the individual that is in need of a loan.
- Giver: This refers to the institution that is giving out/lending the money.
- Valuer: This refers to an individual that helps in establishing the value of a collateral and whether or not the collateral is fit to be used as security

Types of collateral

There are various types of collateral that an individual can use while borrowing, these are;

- **Real estate.** In this type of a collateral an individual may decide to use their house or title deed to act as a collateral, the items or properties used in this type should be of high value and do not depreciate in value.
- **Cash secured loan.** In this type of a collateral an individual may get a loan but still he/she maintains an active account e.g. in the non-deposit taking savings and credit cooperatives, an individual will deposit money in a fixed account then this money will act as a collateral when it comes to determining the amount of money they should get.
- **Inventory financing.** In inventory financing, the inventory will act as collateral in that if the individual fails to meet their obligation/ default the inventory used will be sold.

5.2 Details of the security are obtained as per the location of the security

Financial institutions always pay special attention to protect the personal details for trust. This is to ensure your information is fully protected. Banks have developed a protection procedure for clients' details. Details of security show the type of a security, date of purchase and the market value. They are explained as follows:

- **Types of the security:** The details of what type of a security are put into consideration alongside the location in which the security is located. Here the valuer considers whether the security depreciates or appreciates in value.
- **Date of purchase:** The valuer also captures the date of purchase of the security. This will help in determining the fair market value of the security in question.
- **The market value:** Details capturing the market value should also be presented. This will help in making informed judgment when it comes to decision making.

5.3 Valuation report is prepared as per valuer information

Valuation report refers to a report writing that captures the descriptions and the details of the security in question. It captures the risks and benefits that are associated with the security.

Methods of valuation

There are several methods that are used in valuation, this method includes;

- **Comparable analysis.** In this method of valuation, the valuer compares the current value of the business to the value of other businesses in the similar industry by looking at several ratios e.g. P/E ratio
- **Precedent transactions.** In this method the valuer will compare the business in question to other businesses that have previously been sold but are in the same industry.

- **Discounted cash flow analysis.** The valuer discounts the future cash flow back to the firm's Weighted Average Cost of Capital. (WACC)

Categories of valuation

- Relative valuation models. In this model, the fundamentals are used to determine the intrinsic value of a business.
- Relative valuation models. This done by comparing the company in question to other similar companies.

Types of valuation

Valuation can be of two types. These are;

- Pre-money valuation
- Post-money valuation

- **Pre-money evaluation**

This type of valuation refers to the loan of a company before it receives their next financing. This will help determine the equity share that investors are entitled to

- **Post money valuation**

In this type of valuation, it is considered to be the value of a company after it has received financing.

Importance of valuation report

- It assists banks and customers to know the value of the property to enable banks measure the loan available or that can be lend out.
- Valuation report is used by insures to determine the level of risks.
- To enable mortgaging of a property. Property valuation report is important when clients want to request loan against the security of valued property which is also accomplished when a loan for construction of a building is needed.
- For the purpose of tax. Property valuation is significant when determining the tax on property. Taxes covers: Municipal tax, wealth tax, property tax, vacant land tax and more others which the person has to pay to various department of government.
- When transferring property, the stamp duty is calculated on the ground of the value of the property.
- Important to value the property when buying or selling of property.

5.4 Valuation report is filed as per banking procedures

Valuation report is a type of report writing detailing the inspection and market value of the assisted survey. This can be made for physical property, for marketable securities and for liabilities.

Process of filing valuation report

- i. **Step 1:** First determine the purpose of the appraisal. Usually entails estimating of market value of the property such as other types of value including use value, value in use investment value, value in use, investment value, going concern, insurable value, assted value and failure.
- ii. **Step 2:** Secondly, should know the function of appraisal, is the client looking to buy property or mortgage, do you need to file insurance claim for damages, and will you appeal for property taxes? By knowing the purpose and function of appraisal will ensure correct interpreted results and complete picture to whomever is receiving the valuation report when complete.
- iii. **Step 3:** Thirdly, significant factor is the purpose of the property currently.

The steps of valuation process

- i. Understand the purpose and function of your appraisal
- ii. Comprehensive onsite inspection at your property.
- iii. Collect data on your property
- iv. Compose and submit your valuation report.

5.5 Amendments are made on credit as per the valuation report

The amendment proposes that the claims that the value adopted should not exceed the fair market value of the property as of the date of transfer. It is important to estimate the value of the asset planned to be invested upon, hence preparing valuation report includes;

- **Valuation purpose:** It is significant to identify the purpose of the valuation of the asset.
- **Date of valuation and issuance:** State the date the valuation is to be done and the date report is submitted. It serves as basis for the duration the asset is to be valued.
- **Asset description:** Present in details information on the asset undergoing valuation.
- **Data analysis:** Analysis that is vital in valuation comes from business reports and financial reports.

Importance of valuation

- Valuation helps one in acquiring knowledge when it comes to a company's assets.
- It helps to understand the value of the company putting into consideration the time value of money.
- It helps in making decisions in cases where mergers and acquisition could consider.
- It helps in knowing the true value of the company.

Table 7. Sample of valuation report

Valuation and appraisal report
Property: CLINIC HOSPITAL
Tenure: freehold, held as an investment
Net internal area: 640 sqm
Gross external area: 740 sqm
User area: apartment
Tenancy: duke on assignment from g.k.c for a term of 10 years from 16 September 2010 on internal and external lease as 100,000 plus VAT at year monthly in advance on the 5 th day of the month.
Rent reviews: ever quarter year the rent is updated to 50% of the install price variation index
Estimated market rent: 115,000 on similar terms
Estimated yields: initial yield 3.1 % (2010) ROA 3.4%. Annual debt service 8.5% equated yield 12 % (2014)
Valuation: 3, 400, 00(three million and four hundred thousand).

Ways of doing amendments

Where valuation roll has changed e.g. name has changed or changing of email address or where any error has been detected on notice printed from valuation roll information. National land agency must be advised. When claimed that name is incorrect on roll is incorrectly spelt national identification should be presented to prove claim and establish amendment. Request to change mailing address do not require supporting documents. The following are the main issues which will require changes to the valuation roll:

- Changes of ownership or possession.
- Subdivision of land
- Death of owner
- Change of postal address

Conclusion

This learning outcome covered: Valuations, types of valuation, categories of valuation, requirement for valuation, importance of valuation, and role of valuer, valuation report, and parties involved in valuation of collateral, various methods/approaches of valuation.

Further Reading



1. Read on factors to consider during security valuation and collateral management

2.3.6.3 Self-Assessment



Written Assessment

1. What are roles of a valuer?
 - a) To state the number of assets in a company
 - b) To establish the true of a company
 - c) To provide underwriting services
 - d) To offer advice on investment matters
2. Which among the following is not a method of valuation?
 - a) Comparable analysis
 - b) Ratio analysis
 - c) Precedent transaction.
 - d) Discounted cash-flows
3. Who among the following is NOT a party collateral valuation?
 - a) Borrowers
 - b) Giver
 - c) Valuer
 - d) Underwriter
4. Which among the following are types of valuation?
 - a) Pre-money valuation
 - b) Post money collateral
 - c) Post money valuation
 - d) None of the above
5. Which of the following explains comparable analysis?
 - a) Compare the value of the current and already sold out businesses
 - b) Compare the business value to valuation report
 - c) Compares the current value of business to other related business
 - d) Establishes the true value of the asset
6. Which of the following terms explains the term valuation?
 - a) Helps the company establish what to sell out
 - b) Establish the true value of the asset
 - c) Determine what to consider valuable in the company
 - d) None of the above
7. Which among the following are categories of valuation?
 - a) Absolute valuation
 - b) Pre money valuation
 - c) Post money valuation
 - d) All the above
8. Elaborate the term valuation and discuss its importance.
9. Demonstrate the roles of a valuer.
10. Categorize valuation.

11. Differentiate five reasons why valuation is important.
12. Analyse the methods of valuation?

Oral Assessment

1. State the categories of valuation.
2. Identify the issues which will require changes to the valuation roll.

Case Study Assessment

In 2007 after general elections Kenya had economic crisis, which led to financial aid and control by World Bank, China and International Monetary Fund. The companies and stock exchange were generally affected leading to economic problems in the country. During this special period in history companies were analysed and compared on how they were evaluated in the market, to their fair value. The Kenyan company e.g. Jane Ngigi, director of the Kenya Flower Council announced less of 10 billion Kenya Shillings. Many companies made losses e.g. Standard, Business Sunday Nation, the East African Limited, among others. During that period, PTs valuation and its fair value found to be close to market price quoted. Hence recommendation to investors was to hold.

2.3.6.4 Tools, Equipment, Supplies and Materials

- Writing materials
- Projector
- Computer
- Flipchart/white board

2.3.6.5 References



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2.3.7 Learning Outcome No 6: Communicate Credit Decision

2.3.7.1 Learning Activities

Learning Outcome No 6: Communicate credit decision.	
 Learning Activities	Special Instructions
6.1 Receive credit decision from approval authority as per standard operating procedure	Oral Assessments
6.2 Interpret credit decision as per standard operating procedure	Group discussions
6.3 Take action (approval, decline, security addition) as per standard operating procedure	

2.3.7.2 Information Sheet No2 /LO6: Communicate Credit Decision



Introduction

This learning outcome covers; types of credit decisions, channels of communication, importance of communicating credit decision.

Definition of key terms

Credit decisions: It is an expression of future payment for property transferred or of fulfillment or promises given.

Channel of communication: It refers to a physical transmission medium such as wire or logical connection over a channel.

Content/Procedures/Methods/Illustrations

6.1 Credit decision is received from approval authority as per standard operating procedure

Approval authority is the means an authority, government or otherwise that regulates credit decision. The following are some of the credit authority credit decisions.

Types of credit decisions

- a) **Revolving credit:** You are given a maximum borrowing limit and you can make charges up to that limit. You have to make a minimum payment each month, but the amount you pay can be any portion of your outstanding charges up to the full amount.
- b) **Charge credit:** It is commonly used by retailers for use exclusively in their establishment, charge cards are rare these days but they don't permit you to carry a permit a balance you must pay all charges in full every month.

- c) **Service credit:** Your contracts with service provider such as gas & electric utilities, cable etc. all are credit agreement. The companies provide their services to you each month with the understanding that you will pay for them after the fact.
- d) **Installment credits:** It is a loan for a specific sum of money you agree to repay plus interest and fees in a series of equal monthly installments over a set period of time.

6.2 Credit decision is interpreted as per standard operating procedure

Credit decision interpretation: It is referring to the process of understanding of the future payment for properties of promises given. These are commitments by someone or an organization to do or not do something with a fulfillment of not exposing.

Properties of the promises given

- It must be between two people or firms
- Must be a genuine agreement in relation to SOPs
- Must be mutual

Process of credit decision interpretation

- i. Understanding the customers operating environment or the business they are engaged in.
- ii. Interpreting quality of financial reports and accounts.
This is an indication of someone's capability to pay the loan given.
- iii. Analyzing the company's financial performance and condition: this is done through the spreading financial statements, balance sheet, income statement etc.
- iv. The cash cycle, seasonality & discovering borrowing causes and repayments source. This also helps to determine the ability of the lender to repay the money owed.
- v. Lastly, decision on credit is done after projecting financials of the business\one in question to fine tune the credit analysis.

6c's in credit business

- **Character:** Lenders have to know that business owner is a reliable individual who can be depended on to repay the loan. These characteristics are; credit history, education and work.
- **Capacity:** This is an evaluation of the company's ability to repay the loan. The bank needs to know how you will repay the funds before it approves the loan.
- **Capital:** A company's owner must have his own funds invested in the company before a financial institution will be willing to risk their investment.
- **Collateral:** Machinery, accounts receivables, inventory & other business assets that can be sold if a borrower fails to repay the loan are considered collateral.
- **Conditions:** This is an overall evaluation of the general economic climate and the purpose of the loan.

- **Confidence:** A successful borrower instills confidence in the lender by addressing all of the lenders concern on the other 5c's.

Process of credit decision strategy

A credit decision strategy is a sequential process followed by successful lenders both on the client-facing side and the credit approval risk side, to ensure they capture all the required information to assess the opportunity and the risk in lending to a particular borrower. The best practice is to have an elaborate and timely conversation between credits and sales. The process will continue. If critical hurdles are cleared until the most appropriate loan structure is determined, approved, accepted by client and booked. The final process is continuous monitoring of the relationship which is usually done to identify further cross-sell opportunities and monitor any changes in the risk profile. The loan/credit decision process is different and ranges from one company's policy to the other.

6.3 Action is taken as per standard operating procedure

Channel of communication action on credit decision is the act of finalizing the process by fulfilling the lenders' request. Before this is process is done, thorough check is done on the client's details to make sure that they fit to be given a loan.

Reasons for credit decision decline, approval or security addition

There are reasons that could result to credit decision, approval or decline. Approval of credit decision depends on the following factors:

- Credit worthiness
- Background information
- Customer history
- Financial capability
- Payment period

Credit decisions can be declined based on the following factors:

- Financial incapability
- Non-disclosure of customers' information
- Lack of capacity
- Poor customer credit history

Importance of credit decision action

- The bank lending the money is able to generate revenues
- For growth both the creditor and the debtor are able to grow their businesses.
- The creditors are able to gain interest rates from the credits given
- Some credits can benefit the debtor on cash flow to be able to start and run a new business.

Channel of credit communication

- **Face to face or personal communication:** Physical presence, the tone of the voice and facial expression helps the recipients of the message interpret that message as the speaker intends.
- **Mobile Communication channel:** A mobile communication should be used when a private or more complex message needs to be relayed to an individual or small group. This channel allows an interaction exchange & gives the recipient the added benefit of interpreting the speakers tone along with the message.
- **Electronic Communications channel:** Encompasses emails, internet, and social media platforms. It can be used as one-on-one, group or mass communication.
- **Written Method of communication:** Should be used when a message that does not require interaction needs to be communicated to an employee or a group.

Functions of communicating credit decision

- Control behavior
- Motivation
- Emotional expression
- Information

Importance of communication channels

- **Communication breakdown:** For effective communication channels must be clear and convey the correct message communication internally such as misunderstood directives between management & associate level employees can lead to breakdown of business bottom line.
- **Body language:** Communications must express their own words and body language in the same manner.
- **Clouding the message:** External communication should be as clear and concise as possible and not clouded with ambiguity
- **Cultural considerations:** What means nothing to one culture speaks volumes in another.

Conclusion

This learning outcome covered; types of credit decisions, channels of communication, importance of communicating credit decision.

Further Reading



1. Study more on banking beyond books by Waman Gokhale
2. Read more on law of banking by Dr. S.R. Myneni

2.3.7.3 Self-Assessment



Written Assessment

1. Credit decision is the expectation of future payment for property transferred.
 - a) False
 - b) True
 - c) Not sure
2. Which one of the following is a type of credit decisions?
 - a) Service credit
 - b) Charge credit
 - c) Revolving credit
 - d) ALL of the above
3. Which one of the following is not a 6c's in credit business?
 - a) Capital
 - b) Capacity
 - c) None of the above
 - d) All of the above
4. Channels of communication is a medium at which message is communicated. Is it true or false?
 - a) False
 - b) True
 - c) Not sure
5. Which one of the following is not a function of communicating credit decision?
 - a) Control behavior
 - b) Motivation
 - c) Educating
6. Categorize the channels of communication.
7. Evaluate the 6'c of credit.
8. Outline 6c's of credit decisions.
9. Discuss the types of credit decision.
10. Summarize the importance of giving credits.

Oral Assessment

1. What is channel of communication?
2. What does financial credit mean?

Project Assessment

Perform a research on credit decision done by a Lending institution. Indicate all the relevant details to be entailed for a credit decision to be made.

2.3.7.4 Tools, Equipment, Supplies and Materials

- Writing materials
- Projector
- Computer
- Flip Chart/white board

2.3.7.5 References



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Pearson, J.,&Nelson,P.(2000).An Introduction to human communication understanding & sharing (p.6)Boston,MA:McGraw.Hill

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