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BRIEF ANALYSIS OF THE LAND BANK ANNUAL REPORT, 2006/07

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1. Introduction

The Land and Agricultural Development Bank (Land Bank) is a development financial institution within the agricultural sector and its mandate is provided by the Land and Agricultural Development Bank Act (Act 15 of 2002). It provides a range of finance options for its clients, which include wholesale as well as retail financing for commercial and developing farmers, co-operatives and other agriculture – related businesses. The Bank also manages the funds transferred from the Department of Agriculture for the Micro Agricultural Financial Institutions of South Africa (MAFISA). The Land Bank is exempted from the payment of income tax and it does not pay dividends to its shareholder. The imputed income tax and dividends are "ring fenced" and used to fund the development loan book.

The current focus of the Bank on commercial farmers presents a challenge which must be met by strategies to shift the emphasis to development financing to support the development mandate, and focussing in particular on the black emerging farmers and agribusiness. The purpose of this paper is to assess the performance of the Land Bank in delivering on its mandate and meeting its targets set out in its Corporate Plan for 2005/06 financial year. This will be done by analysing the Land Bank's 2005/06 Annual Report.

2. Mandate of the Bank[1]

The mandate of the Land Bank is to support agricultural development, and that makes the Bank different from other banks and financial institutions that lend money for farming, processing and marketing in South Africa. The mandate and the objectives of the Land Bank as outlined in the Land and Agricultural Development Bank Act (Act 15 of 2002) Act are to:

- Provide agricultural financial services.
- Enhance productivity, profitability, investment and innovation in the agricultural and rural financial systems.
- Deracialise agriculture and bring aboard farmers from previously marginalized groups in the mainstream of agricultural sector.
- Promote and support agrarian reform, land redistribution and development programmes.
- Promote and support commercial agriculture.
- Promote food security.

3. Overview of Performance

3.1. Highlights

- In supporting the Joint Initiative on Priority Skills Acquisition (JIPSA), the Land Bank has been able to provide bursaries to 48 previously disadvantaged students at the tune of R3.2 million.

[1] The information below is sourced from the Land Bank, 2004/05 Annual Report.

- It has provided finance to a number of Black Economic Empowerment Consortia in the agricultural sector.

3.2. Challenges

The Bank has been faced with the following challenges:

- Improving access to various categories of agricultural entrepreneurs.
- Alignment of its objectives and resources to successfully meet the needs of farmers, and in particular those of emerging farmers.
- It has to grapple with the fundamental imperative to strengthen and maintain its financial sustainability, while at the same time expanding its developmental role.
- Recovering debt for farmers who are not able to pay loans incurred from the Bank. Policies and procedures for writing off debts are at the development stage and will soon be presented to the Board of Directors for approval.

In order to deal with the above challenges, the Bank adopted a turnaround strategy to ensure that profitability, sustainability and capital adequacy is maintained in the Bank. In order to accelerate the strategy and to help the development lending of the Bank, the National Treasury made R1.5 billion loan guarantee and a cash injection of R700 million to the Bank.The following are the key pillars of the turnaround strategy:

- **People Management and Empowerment:** This is to ensure that the Bank has properly skilled people in the right jobs, and there is proper selection, recruitment, training, development, coaching, mentorship and retention processes.
- **Capital Adequacy:** This is to ensure that the Bank has the right level of capital to perform its mandate and that this capital is grown in a sustainable way. The aim of the Bank is to build capacity to have a capital adequacy ratio of 20%.
- **Systems:** It is to ensure that the Bank has proper information system to supply management with timeous, relevant and reliable information to make management decisions.
- **Risk Management:** It is to ensure that the wide risks of the Bank are properly monitored and managed.
- **Revenue and Cost Model:** The Bank to design and implement strategies on revenue and costs to ensure quality, consistency and sustainability of results.
- **Brand & image:** It is to ensure that the Bank is seen in a favourable light by stakeholders.

3.3. Key Developments

Following the completion of an analysis of the high failure rate of projects in the emerging market sphere, the Land Bank identified a number of areas that needed special attention. These included:

- The structuring of funding to ensure that farmers have access to other supplementary resources, for example grants to augment the funding requirements.
- Active facilitation of linkages between farmers and the market.
- The creation of an enabling environment for emerging farmers to benefit from skills transfer, market access and penetration of strategic networks.

3.4. Targets and Outputs

Corporate key performance targets were set as part of overall business strategy to improve efficiency and productivity. The targets are incorporated in the corporate plan of the year under review. The key indicators and targets as well as performance results are reflected below:

Table 1: Objectives, Indicators and Targets

Objectives	**Key Performance Indicator**	**Target**	**Performance Results**
Growth in value loans			
Retail Book	Value of commercial and development farmer loans over prior year	Growth of 7.6%	Declined by 18.0%
Wholesale Book	Value of corporate client loans over prior year	Growth of 10.8%	Growth of 20.1%
Business efficiency	Ratio of expenses to income	Ratio below 93%	81%
Loan Book quality	Value of non-performing loans as a percentage of total Loan Book	NPL's of less than 5.7%	15.3%
Net Interest Margin	Value of net interest as % of average Loan Book	Net Margin interest not less than 2.2%	2.75%
Return on Assets	Ratio of net profit/loss to total loan book	-0.1%	-0.6%
Return on equity	Ratio of net profit/loss to equity	-1.2%	-9.86%
Capital Adequacy	Capital Ratio	Capital ratio not less than 8.8%	5.95%

Source: Land Bank Annual Report, 2006/2007

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The table above shows that the Bank has failed to achieve most of its targets for 2006/07 financial year.

The bank recorded the following achievements during the review period:

- The Wholesale Book recorded a growth rate of 20.1%, which exceeded the target of 10.8%.
- The ratio of expense- to- income dropped to 81%. Although this means that expenses of the Bank are still high, however it has manage to reach its target that the ratio of expenses- to-income should be lesser than 91%.
- The Bank was able to reach a net interest margin of 2.75 %. The target was to have net interest margin that is higher than 2.2%.

During the period under review, the Bank has failed to achieve the following targets:

- The Retail Loan Book decreased by 18% instead of growing by 7.6% as targeted. The decrease in the total Retail Loan Book can be ascribed to the migration of clients to commercial banks where a wider range of products and facilities are at their disposal.
- The value of non-performing loans increased to 15.3% instead of dropping to less than 5.7 %. This is huge increase of non-performing loans will have impact on the debt written off.
- Return on assets dropped further instead of improving. The target was to have at least a ratio of net profit/loss to total loan book of -0.1% by 31 March 2007 but instead it was -0.6%, which implies further move away from profit to losses.
- The target to have a ratio of net profit/loss to equity of -1.2% was not achieved instead it dropped further to -9.86%.
- Capital adequacy ratio was 5.95%, which was less than the 8.8 % that the Bank wanted to achieve or exceed by 31 March 2007.

During the period under review, the Bank granted loans for land development to the value of R358.9 million. However, the uncertainty whether this falls within the mandate has resulted in a moratorium being placed on the approval of any new development loan. Further, internal investigations were launched into the MAFISA pilot project after process deficiencies and fraudulent transactions had been detected. A moratorium has been placed on the granting of any new MAFISA loans until the control environment has been sufficiently strengthened.

4. Financial Performance

During the period under review, the Land Bank Group realised a loss of R100 million. This is a third consecutive year that the Bank suffered losses. In 2005/06 the Bank had a loss of R125 million and of R207 million in 2004/05. In addition, operating expenses have increased by 5.7% between 2006 and 2007. The main contributor for the increase was the annual salary increments. At the same tine, the non-interest income has decreased by R184.3 million from the previous year, of which R182. 3 million was a reinstatement of the security against loans written off during 2006. As a result, the cost to income ratio has increased by 20% from 2006 to 2007.[2] Profitability of the Bank remains under strain because of declining net interest income.

[2] Land Bank, 2006. Annual Report 2006/07. p. 41

In terms of capital adequacy, the Bank was not doing well. From 2005, the capital adequacy of the group was equal or below 10%. Government therefore issued an undertaking to guarantee the obligations of the Land Bank in excess of assets to the extent of R15 billion. Furthermore, Government announced that the Land Bank would receive a capital injection of R700 million by 31 October 2007. This will further strengthen the capital adequacy of the Group.[3]

5. Report of the Auditor General (AG)

The AG presented an unqualified opinion with matters of emphasis. The AG raised the following concerns:

- **Uncertainty over the Land Development Loans:** Due to the fact that the land development loan falls outside the mandate of the Land Bank, the AG could not conclude on the validity of contracts entered into.
- **Internal Control**: Credit policies and procedures to effectively manage the monitoring and control of Land Development Unit (LDU) loans were not approved and implemented resulting in significant deficiencies identified during the audit of LDU loans.
- **Uncertainty-non-compliance with applicable legislation**: The Land Bank has entered into non-agricultural land development transaction, which falls outside of the core mandate of the bank. The AG did not obtain evidence that the appropriate approval was obtained by the Bank to enter into non-agricultural activities.

6. Conclusion

For the three consecutive years, the Bank has suffered losses. In 2006/07 the Bank suffered a loss of R100 million and in the two previous financial years it was R128 Million (in 2005/06) and R207 million (2004/05). In addition, the Bank needs to work hard to improve its Retail Loan Book, which has declined sharply by 18% in 2006/07. The Retail Loan Book has been declining since 2005.

7. Issues of Concern

- It is reported in the Annual Report that fraudulent transactions have been detected on MAFISA loans, which has resulted on moratorium, placed on granting of new MAFISA loans. What has been done to address this problem and ensure that the moratorium on MAFISA is cancelled? So far, how many loans have been distributed through MAFISA?
- The Retail Loan book has been declining since 2005. In 2004/05, it dropped by 6.5% and in 2005/06 it dropped further by 9.6%, while in period under review it dropped significantly by 18%. This seems to be a trend. What strategy the Bank has developed to break this trend?
- The Bank aims to achieve a capital adequacy of 20%. In the period under review a capital adequacy of 5.95% was achieved which is less that 8.8 % minimum target for year and far away from reaching the target of 20%. It is the capital injection from the National Treasury that will be able to strengthen the capital adequacy of the Bank. Does this mean that from now on

[3] Land Bank, 2006. Annual Report 2006/07. p. 42

the Government will provide capital needed for the Bank to support its developmental mandate?

- One of the deliverables of the bank as stated in the 2006/07 Corporate Plan is to ensure meaningful participation and ownership in agriculture by previously disadvantaged individuals through funding to BEE transactions.[4] The Bank should provide a list of BEE deals it supported and the amount it provided.
- There a is concern that some of the emerging farmers the Bank has supported have shut down and the Bank has taken over of those farms. The Bank should provide a list of those farms and indicate to whom those farms have been sold. Does it provide Government first choice of refusal? Have the Bank placed moratorium on selling struggling projects and if so, what impact will this have on the Bank's income?
- The Land Bank has been involved in non-agricultural activities, which fall outside its mandate. Do you think there is a need to review the Land Bank Act in order to cover this mandate?
- For the fourth consecutive year, the Land Bank has received a qualified opinion from the AG because the AG could not verify the financial position of the Bank due to uncertainty over the validity of land contracts upon which the Bank issued loans. How is the Bank going to address this issue?
- The turnaround strategy is now at its second year of implementation. What impact the strategy has had on the performance of the Bank? Is there clear evidence that the business status of the Bank is improving because of the strategy and in what way?
- For the 2006/07 financial year, the Bank provided bursaries to 48 students from previously disadvantaged background for the value of R3.2 million. In 2005/06, it provided bursaries to 42 students for the same amount. Does this mean that for 2006/07 the Bank has provided each student with lesser amount compared to 2005/06 while the fees have increased?
- It is a concern that regional and area leadership of the Bank is male dominated. What strategies have the Bank adopted or going to adopt to promote employment equity?
- Allegations of financial mismanagement in the Bank have led to the resignation of Alan Mukoki, the Chief Executive Officer (CEO) and Xolile Ncamane, the Chief Financial Officer (CFO). It is these two and the other three executive managers who have received bonuses for 2006/07. On what basis did they receive bonuses? Does the policy on performance in the Bank cover staff below top management level?

Sources

Land Bank, 2006/07 Annual Report.
Land Bank, 2005/06 Annual Report.
Land Bank, 2004/05 Annual Report.
Land Bank, 2006/07 Corporate Plan.

[4] Land Bank, 2006/07 Corporate Plan. p. 28