

APPENDIX 14

(FAKALAH 14)

**SUBMISSION
ROYAL LAND COMMISSION – TONGA**

ASSOCIATION OF BANKS IN TONGA (ABT)

August 2009

1. INTRODUCTION

The members of the Association of Banks in Tonga (ABT)¹ are "net contributors" to the Tongan economy and collectively support the view that components of current land practices under the Land Act² are in urgent need of reform.

These practices are negatively impacting the economic prosperity of Tonga and are reducing local and foreign investment in key industries such as Tourism. They are detrimental to Tongan individuals seeking finance for essential purposes such as housing, especially in non metropolitan areas as well as significantly impeding small to medium businesses access to Finance. The Act has forced Banks to significantly tighten lending policies against borrowings proposed to be secured by an allotment or a lease.

The Association of Banks in Tonga firmly believes that Tonga's future economic prosperity depends on entrepreneurial investment, particularly in the small business and tourism sectors. Current land tenure issues and laws discourage investors and lenders taking risk and have to date largely attributed to Tonga falling behind its peers in this vital area of economic development.

Consumers and investors are often required to "restructure" land interests to address these shortfalls, and the associated legal processes involved are lengthy, unreliable and commercially unviable. This has often led to the abandonment of finance applications and associated business ventures .

If not urgently addressed, these land practice issues will continue to erode investor and consumer confidence in Tonga.

2. OBJECTIVES

This Submission has three principal assertions:

- a) To effectively address the inefficiencies in land registration practices, certain provisions of the Land Act³ will need to be amended.
- b) Other systemic land registration issues that are not prescribed by the provisions of the Land Act should be treated as management issues and can be addressed within the management framework of the Ministry of Land itself and do not need a Commission inquiry to address them.
- c) The land tenure system discriminates against women and effectively denies equal access to finance to the significant proportion of labour force made up by women on the basis that Tongan women subject by birth are unable to inherit or own registered allotments.

3. RELEVANT PROVISIONS UNDER THE LAND ACT⁴

¹ Westpac Bank of Tonga, ANZ, MBf and TDB?

² Cap[132]

³ Cap[132]

⁴ Cap [132]

a) Town and tax allotments⁵

A town or tax allotment cannot be used to secure a loan other than for the purpose of improving that allotment. Consequently, allotment holders cannot utilise allotment holdings to secure finance for a second allotment, a business investment, or for personal borrowings. This restriction on loan purpose removes access to finance for many entrepreneurial purposes which would generally be secured by the family home in most developed countries.

Consumers and investors are often forced to either surrender allotments to create leasehold interests or enjoin another family member in order to secure further borrowings. The legal processes that are required to do this are inefficient and commercially unviable and often lead to abandonment of finance applications. Banks are being forced to further tighten lending due to the complexity and commercial uncertainty of the legal processes.

b) Restrictions on mortgages⁶

A town or tax allotment can only be mortgaged for a period of 30 years. International banking practices which have been recognised and adopted by the National Reserve Bank of Tonga⁷ require Banks to adopt sound credit risk management practices and procedures. In that regard, Banks would generally only take acceptable security assets to determine their market value. The market value of the security is used by Banks to determine the amount that will be lent against the security.

The 30 year restriction on mortgage terms effectively reduces the market value of an allotment from a lending perspective and therefore decreases the ability of consumers and investors to increase borrowings.

Consumers and investors are often forced to make alternative arrangements with Banks by agreeing to extend mortgage terms via a lease transfer in the event of default in order to be able provide acceptable security. The legal processes involved are extremely lengthy and commercially unviable and may force Banks to further tighten lending policies due to the uncertainty of enforcement rights.

In recent times cabinet approvals have been granted for lease terms expending to 99 years, however, there has been no change to the restriction on mortgages standing at 30 years. A lender needs certainty that the asset its has lent against is saleable in order to mitigate the risks associated with providing loans. The 30 year restriction in the event of a borrower default virtually leaves the lender at the mercy of a predatory buyers market. Lenders will therefore moderate / restrict the level of risk they are prepared to accept and consequently this will hinder the development of the Tongan economy.

c) Concept of severability⁸ - Town or tax allotments can be severed from buildings and fixtures.

⁵ sections 100(1)(iii) and 101(1)(ii)

⁶ section 100(1)(iii)

⁷ Prudential Statement No.1 Asset Quality Revised 2000

⁸ A Distress Warrant can be issued against a dwelling house on an allotment.

The concept that buildings and fixtures are owned by one person whilst the land upon which they are erected is owned by different person can reduce the market value of allotments because this concept has made it virtually impossible to ascertain ownership of residential houses.

Consumers and investors are often forced to convert allotment holdings to leasehold interests in order to be able to offer with certainty both land interests, building and other fixtures as security for loans. Again, the process of a straight out lease or a conversion of interests is lengthy, inefficient and commercially unviable and may lead to Banks further tightening of lending policies.

d) Leases- Tax allotments cannot be leased for more than 20 years.⁹

This restriction means that holders cannot fully leverage their interests in tax allotments when applying for loans as the 20 year restriction reduces the market value and loan to value ratio of the allotment.

Consumers and investors are often forced to convert tax allotments to leasehold interests or to subdivide allotments to raise funds. The legal processes involved are extremely lengthy and inefficient and often lead to the abandonment of finance applications.

e) Women - Only Tongan men subject by birth can own or inherit a tax or town allotment.¹⁰

Tongan women who earn good incomes do not have equal access to bank finance on the basis that they cannot own tax or town allotments. If a woman wishes to apply for a loan, the procedures involved in processing family holdings to allow her to jointly borrow with her brother or father or other male relatives are very cumbersome and often lead to either the abandonment of the application or the decline of the loan.

Women are often forced to lease land from their relatives or apply for a lease from crown land which involve processes that take up to 3 to 5 years. Banks are often forced to require women to enjoin a male relative in finance applications even when the male relative does not contribute to the repayment of the loan.

f) Persons who reside on a hereditary estate can be refused permission to reside in that estate by the estate holder.¹¹

Although section 34 of the Land Act requires an estate holder to admit to possession a title holder, the Minister of Lands is required to conduct prior consultation with the estate holder before granting an allotment. The process involved in obtaining a registered allotment on a hereditary estate is very onerous and often leads to loans not being granted to consumers because of

⁹ section 56(iv)

¹⁰ section 43(1)

¹¹ section 35(1)

the uncertainty in obtaining a registered title to allow the Bank to obtain a mortgage on the security.

g) Process for claims by an heir - Heir must claim within 1 year.¹²

Whilst it would be reasonable to expect that once the heir to an allotment has made a claim supported by the necessary documentation, the allotment should be immediately registered, the current practice is to let the 12 month period lapse before registration is affected. This practice has held up countless loan applications whilst waiting for the 12 month period to lapse. Whilst it is acknowledged that prudence demands a reasonable waiting period, a 12 month period is considered unreasonable. This practice should be reviewed and the pros and cons should be weighed carefully on the basis that it affects the ability of consumers to access finance timely.

h) Approval process for leases - Consent of Cabinet required for leases.¹³

The consent of Cabinet is a prerequisite for the grant of leases. This requirement has held up countless loan applications because of the length of time required to process Cabinet approvals. In some incidences it can take up to six or even 12 months. This process should be reviewed as to whether the Minister of Lands can undertake the approval of leases therefore reduces the processing time for lease approvals.

Legislation should also be amended to include a requirement / formula for compensation to the lessee for the value of improvements in the event the lease is not renewed on expiry.

i) Widows - Widows cannot lease or mortgage her deceased husband's allotment.¹⁴

Because widows cannot utilise their deceased husband's allotment to secure loans, they are unable to obtain full access to finance. This is true even if the widow has a good income and dependent children

Once the holder dies, an existing mortgage over the holder's allotment cannot be varied for further borrowings by the widow or the children unless the widow surrenders her rights to allow the heir to succeed. This process takes years to finalise and often leads to the widow not being able to access further finance on the existing mortgage regardless of whether she is able to service the loan.

An amendment to the Act should allow widows to mortgage their interest in the allotment with the consent of the heir or in the case of no heir mortgage her interest in the allotment without restriction.

j) Surrender of allotments – Once an allotment has been surrendered the allotment will automatically deemed to devolve upon the heir.¹⁵

¹² section 87

¹³ section 89

¹⁴ section 56 (ii)

¹⁵ Section 54

When a holder surrenders an allotment for the purpose of conversion to a leasehold interest in order to increase market value for borrowing purposes, the allotment is immediately deemed to devolve upon an heir regardless of whether the allotment is "family land" or land that has been acquired by the holder. If the holder does not have any issues then the holder's eldest brother would be deemed the "heir" of the allotment. This is regardless of whether the eldest brother had anything to do with the land being acquired.

The process for surrendering the allotment due to the fact that the "heir" has to be notified and provide consent becomes lengthy and sometimes would take years to finalise.

4. MANAGEMENT ISSUES– LAND OFFICE

The following management issues relating to land titles registration continue to hamper commercial transactions in Tonga. These issues are management issues and do not need a Commission inquiry to address. The Ministry of Lands should be strongly urged to urgently them as part of business as usual management or via a separately managed program of work.

k) Record keeping & database

There is no reliable database for land titles hence Land office staff often takes weeks and even months to ascertain land titles status. The lack of a proper record keeping system is highly risky and unreliable. It causes lengthy processing times for land transactions. Consumers, investors and Banks have little or no confidence at all in the credibility of searches and the reliability of land registration.

l) Manual system

The current manual system cannot cope with the increase in transaction volumes and hence contribute to the lengthy delays and high risk of errors.

m) Process flow

The Land office staff does not appear to have a consistent process to follow and often provide conflicting advice to customers on process flow.

n) Title search

Land office searches for titles are lengthy, inefficient and unreliable. A reliable and credible title search system is critical to commercial certainty and management of transaction risks. This should be addressed within the same work stream as the records management and database.

4. RECOMMENDATIONS

A. Amendments to the Land Act

The following amendments to the Land Act should be made:-

- 1) Section 7 – Replace “Every male Tonga subject by birth...” with “Every male or female Tongan subject...”
- 2) Delete section 35.
- 3) Section 43 (1) – Replace “Every male Tongan subject by birth” with every male or female Tongan subject by birth”.
- 4) Section 54 – Redraft this clause to allow allotment to be devolved according to the holder’s wishes if the land is not land acquired via devolution.
- 5) Section 56(ii) – Delete this subsection.
- 6) Section 101(1)(iii) – Replace 30 years with “at least 99 years”
- 7) Section 56 (IV) –delete this subsection.
- 8) Section 87 – Replace the words “12 months” with “ a reasonable period
- 9) Sections 100 (1) and Sections 101(1) - Delete subsections (ii) under each section.