

2805/302
LENDING
March/April 2025
Time: 3 hours



THE KENYA NATIONAL EXAMINATIONS COUNCIL
DIPLOMA IN BANKING AND FINANCE

LENDING

3 hours

INSTRUCTIONS TO CANDIDATES

*This paper consists of SIX questions.
Answer ALL the questions in the answer booklet provided.
Maximum marks for each question are as indicated.
Candidates should answer the questions in English.*

This paper consists of 4 printed pages.

**Candidates should check the question paper to ascertain that
all the pages are printed as indicated and that no questions are missing.**

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Turn over

1. (a) Outline **seven** circumstances under which a borrower may default on his loan repayment. (14 marks)
- (b) (i) Explain the meaning of credit administration as used in lending. (1 mark)
- (ii) Explain **five** objectives of credit administration. (10 marks)
2. (a) Baraka Limited, a fast growing manufacturing firm, has been a customer of XYZ Bank for the last five years. The Finance and Strategy Manager of Baraka Limited approached the bank for a Ksh. 2,400,000 loan to be used to purchase a new model equipment to increase production. The equipment will enable the company increase annual profit after tax as follows:

Year	Increase in annual profit after tax Ksh.
1	800,000
2	900,000
3	750,000
4	850,000
5	600,000

The cost of capital is 15%.

- (i) Determine the Accounting Rate of Return (ARR) for the investment. (5 marks)

$$ARR = \frac{\text{Average Profit}}{\text{Initial Investment}} \times 100$$
- (ii) Based on the ARR calculated in (i) above, explain whether XYZ Bank should advance the loan or not. (2 marks)
- (iii) Highlight **three** advantages of ARR in evaluating the viability of the investment proposal. (6 marks)
 ✓ Flexibility
 ✓ Simplicity
 ✓ Useful for planning & budgeting
- (b) (i) Outline **four** obligations of a borrower with regard to security pledged against a bank loan. (8 marks)
 ✓ Repayment
 ✓ Collateral
 ✓ Capital
 ✓ Creditworthiness
- (ii) Highlight **two** instances when a borrower may get an unsecured loan from a bank. (4 marks)

3. ✓ (a) Wema Limited, a non-deposit taking micro finance firm, has operated in Kenya for the last four years. As part of a strategic plan, the firm intends to diversify into banking. The firm has hired Jamal, a diploma holder in Banking and Finance to develop a bank lending policy for the first branch to be opened in three months' time. Explain six principles that should be considered when developing such a policy. (12 marks)

Profitability
Liquidity
Security
Stability
Solvency
Marketability

- (b) When conducting an evaluation of a personal loan application, banks normally perform a risk assessment.

- (i) Outline five methods that may be used to carry out such assessment. (10 marks)

✓ Fault Tree Analysis ✓ Hazard analysis ✓ Risk assessment ✓ SWOT analysis

- (ii) State three advantages of performing the assessment. (3 marks)

✓ Data collection
✓ Keeping records

4. (a) Outline five risks that commercial banks may be exposed to when advancing foreign currency loans to importers. (10 marks)

✓ Credit risk ✓ Exchange rate risk
✓ Market risk ✓ Documentation risk
✓ Interest rate risk

- (b) Boresha Construction Company has secured three construction contracts from reliable clients. The company is seeking Ksh. 30 million loan from Zuri Bank for the purpose of executing the contracts. The bank has requested the customer to provide a collateral security.

- (i) State five items that Boresha Limited may pledge as security. (5 marks)

✓ Collateral

- (ii) Explain five reasons why Zuri Bank requested for the collateral security. (10 marks)

✓ Minimizes risk ✓ Keeps up all financial obligations ✓ Better interest rates

5. (a) Outline five duties of a borrower to the bank. (10 marks)

✓ make payments on time ✓ Pay established fees
✓ Notify lender of changes to your contact

- (b) Dopha Limited, a textile firm in Kenya has been carrying out its business in a rented property. The firm intends to acquire freehold land and construct buildings for their business. They have sought a loan of Ksh. 100 million from Millenium Bank to finance the project.

- (i) Apart from mortgage loan, state five loan facilities that Dopha Limited may access from the bank. (5 marks)

✓ Bonds loan ✓ Bill of exchange
✓ Real estate ✓ Micro-finance
✓ Credit letters (LC) ✓ Trade finance

- (ii) Explain five disadvantages of Dopha Limited's move to acquire a bank loan to finance the project. (10 marks)

✓ Risk assessment ✓ Financial stability
✓ Reduction
✓ Credit facility

6. (a) Mosiko, a dairy farm enterprise intends to acquire better grade cows to increase milk production. The firm has made a loan application of Ksh. 2 million to Digital Bank to purchase the cows.
- (i) State three considerations that the bank should make when deciding a collateral security to accept. ✓ *Character of borrower* ✓ *Creditworthiness* ✓ *Ability to repay loan* (3 marks)
- (ii) After several months of prompt loan repayment, Mosiko stopped remitting the monthly installments. Explain the procedural steps the bank should take to recover the outstanding amount. ✓ (12 marks)

- (b) Supa Limited, a large manufacturing organization located in Nakuru town, applied for Ksh. 8 million mortgage loan from Delta Bank. As part of the loan evaluation process, the credit manager of Delta Bank instructed two credit officers to make a site visit to the organization. Explain five reasons for making such a visit. (10 marks)
- Business meeting*
Site inspections
check & training
quality products
conduct physical audit
Sales & marketing
Compliance & legal checks
adhere to industry regulations
present products/services to other org.
should ensure org. follow

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