

NAVIGATING THROUGH LOAN PROCESS IN NEPAL

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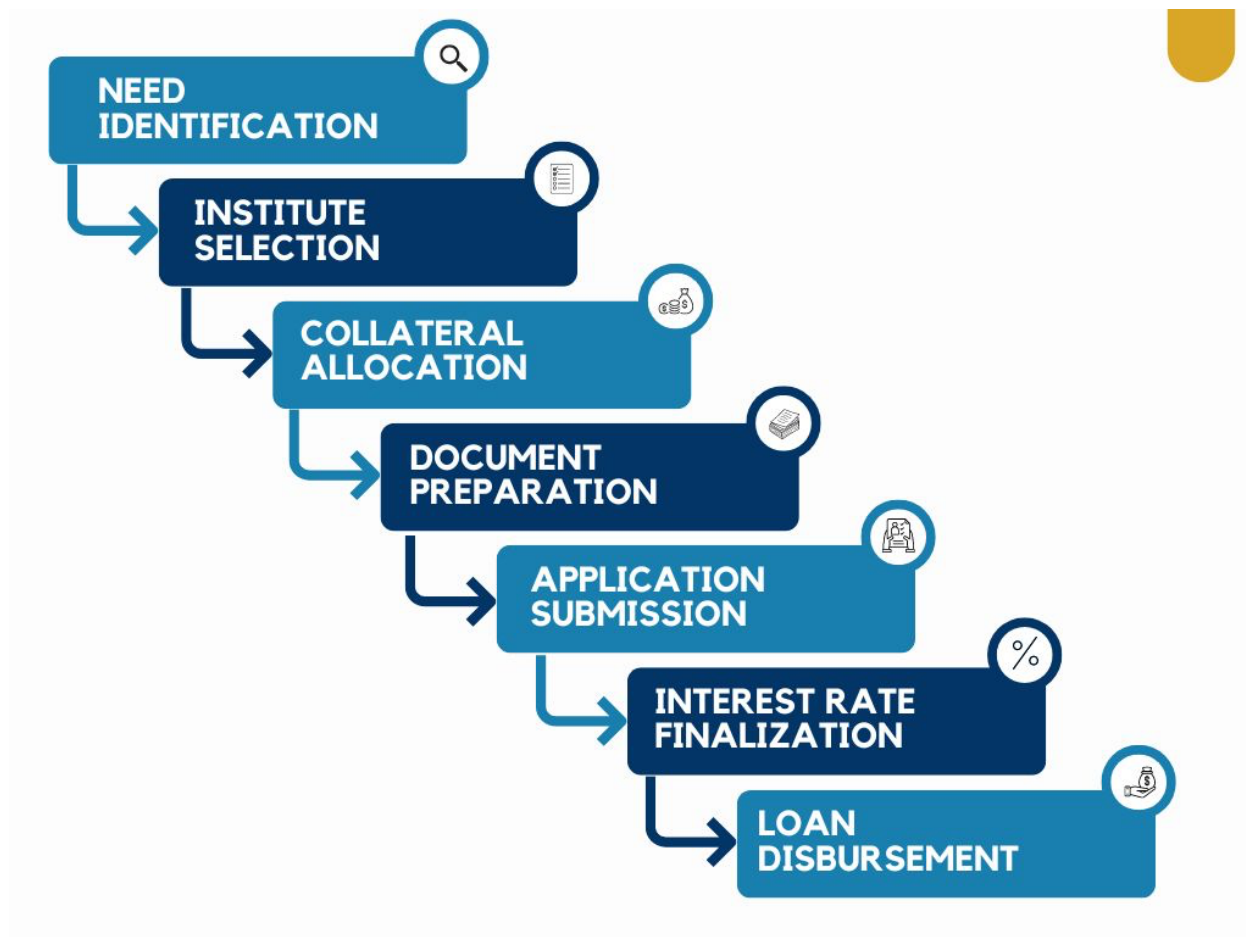
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Introduction

Debt can be a very powerful leveraging tool to help fulfil our wants, given that we don't reach beyond our means. It is also one of the major avenues of revenue for many banks and financial institutions (BFIs). Credit lending is highly regulated and closely observed by Nepal Rastra Bank. Hence, it is often tangled in a mess of stringent policies. Navigating through this labyrinth of policies can be confusing and tedious. In this guide, we streamline the entire loan-taking process for your convenience.

Loan taking process can be summarised as follow



Types of Loans

BFI's offer a wide array of loans to their clients. Each type of loan is aimed to cater to a specific need of the client. Some of the most popular types of loans provided by banks are:

1. **Term Loan:** In this type of loan, the client receives a lump sum of money, exchanged for a periodic interest payment over a period of time.
2. **Overdraft:** Overdraft is a privilege where the bank allows the withdrawal of an amount that exceeds the current balance of the account.
3. **Cash Credit Loan:** Cash Credit Loan is a short-term loan that businesses use to meet their working capital requirements.
4. **Trust Receipt Loan/Import Loan:** Trust Receipt is an important loan for businesses that import and export merchandise, in which the bank maintains the ownership of the goods until they are sold.
5. **Residential Personal Home Loan:** Commonly known as a mortgage, it is a type of loan used to buy a property that you plan to live in.
6. **Real Estate Loan:** Real Estate Loan is used to finance the acquisition of a property.

Depending on your needs, you can apply for a loan. Banks also offer very specific and niche loans, so if these loans do not directly align with your needs, you can research them on a bank's website. The types of loans banks offer are usually under the 'Services' section of the website. Under the 'Services' section, another sub-section labelled 'Loan' (or something similar) will be present, which briefs all the loans the bank offers with the requirements for eligibility.

Institutions selection

As mentioned earlier, there are many types of loans and products offered by BFI's. It could be overwhelming to check each and everyone of the banks for all their loans and products. We have shortlisted a few of them to best suit your needs.

- ***Electric Vehicle Loans:*** For those looking to purchase an electric vehicle, some banks offer competitive interest rates for four-wheeler electric vehicles. EV Companies have a MOU with banks to provide competitive interest rates.
- ***Low Base Rate:*** Among commercial banks, some institutions are known for offering the lowest base rates. However, be aware that stricter lending policies may make acquiring funds more challenging. Standard Chartered bank is one bank with the lowest base rate.
- ***Bike Loans:*** If you're considering buying a motorbike, certain banks provide specialised loans tailored for this purpose. Similar to electric vehicle loans banks and bike companies have MOU.
- ***Education Loans:*** Some banks offer education loans with up to a 4-year [moratorium](#) period, meaning you can defer your payments, although interest will continue to accumulate during this period.
- ***Large Project Loans:*** For corporate entities needing substantial funding, some financial institutions provide loan [syndication](#) services, where a group of lenders combines their resources to meet larger financial needs.
- ***Non-Collateral Personal Loans:*** There are also options for personal loans that don't require collateral, such as loans against salary or pension, available from certain banks.

Details on Collateral

Borrowers are required to keep some form of collateral to borrow funds. BFI's use Collateral in case the borrower defaults on their payment. Collaterals go through a '[*haircut*](#)'. *Haircut* refers to the reduction of assets value when it is kept as a collateral. For example, if a Rs. 100 worth of asset secures you Rs. 60 in loan, you have experienced a 40% *haircut*; i.e. 40% reduction of the original market value. Various Banks offer different types of collateral.

- Against Land: You can use land as collateral, but its value will have a 33% haircut. A valuator will determine the land's price based on a mix of 40% government rate and 60% market value.
- Against Shares: For shares haircut ranges from 30 to 40% for ordinary shares and around 40-50% for promoter shares. Some organisations offer different rates for ordinary and promoter, i.e. 30% and 50% respectively(SBL), whereas, some offer 40% indiscriminately(PCBL). The price for a *haircut* is based on either the average market price for the last 180 days or the prevailing market price, whichever is lower.
- Against Gold: Ornaments get a 30% hair cut normally whereas raw gold or silver will get around 20% *haircut* only.

As per Banks and Financial Institute act 2073, Section: 'Collateral Valuation Procedures',

“The collateral valuation must be conducted according to established norms, basis, and procedures. The Rastra Bank, Nepal's central regulatory authority, issues necessary directives concerning the methods, basis, and scope of such valuations. Should the Rastra Bank determine that the actions of an appointed valuator are unreliable, it holds the authority to mandate the appointment of a new valuator. This regulatory oversight ensures that the valuation of assets and liabilities is conducted transparently and accurately, safeguarding the interests of both the lending institutions and the borrowers.”

Further, in case that collateral's value has declined, banks might ask the borrower to add more assets as collateral to meet the collateral demand (*BAFIA - 2073, Section 53 Sub-section 2*).

The recent Government of Nepal's budget 2081-82 includes several provisions aimed at promoting entrepreneurship and supporting small businesses. These provisions are designed to facilitate access to loans, including ***non-collateral loans***, particularly targeting the agricultural sector and small-scale industries.

While the loan process is the same for the most part, the loan approval is based on the **merit of the project** rather than the asset base. As mentioned earlier, entrepreneurs, agricultures and small-scale industries are eligible for the loan. The merit is based on the job creation and economic impact potential. All of which should be clearly mentioned in the business plan which is to be submitted (*documents to be submitted discussed further below*). The government provides interest subsidies and financial guarantees to the financial institutes which encourages BFI's to participate in the scheme.

Documents Required

Since the loan lending process is very prudent and a strict set of requirements must be followed, the personal loan is provided against mortgaged collateral to meet immediate and contingent funding requirements within regulatory thresholds. The Personal Term Loan offers amounts up to Rs 15 Lakhs to Rs. 50 lakh with a loan period from 5 to 20 years, requiring additional purpose verification for loans exceeding Rs. 50 lakh. The Personal Overdraft allows for a loan amount up to Rs. 50 lakh with a loan period of 1 year, subject to renewal.

Eligible applicants must:

- Be Nepalese citizens,
- Either salaried or self-employed, with proof of income, salary slips, etc.

Required documents include personal identification, collateral-related papers, and income-related documents. There are some other requirements which differ among institutions such as:

- **Age:** Different institutions have different age requirements for their loans. Normally, the minimum age required ranges from 18 to 23 years up to 60 years old (differing by institution).
- **Documents Required:** Various loans require different documents to support the loan process. For example, SBI Nepal offers personal loans above Rs. 50 lakh requiring a PAN card of the borrower for identification and clear show of the intent and use of the funds. Loans taken against collateral must have proper collateral documentation.

To summarise, the documents include but aren't limited to:

1. Citizenship of borrower and guarantors
2. PAN card
3. Registration certificate of the company (if applicable)
4. Income related documents, whichever applicable/s:
 - a. Salary Certificate/ Payroll/ Remittance Slip
 - b. Rental Documents
 - c. Business Income Documents (Audited)
5. Total portfolio of shares and Loan/Overdrafts availed from other financial institution/s (if applicable)
6. Title deed, four boundary certificate and necessary details of the property being offered as collateral (if applicable)
7. Other documents as required by bank

Industrial/ Project loan

Industrial/ project loan is any loan that deals with the purchase of a plant, property etc of a project. Many sectors such as business, commerce, hydroelectricity etc use this loan, making it one of the most important loans. Normally the loan is secured against the project itself, i.e. the collateral for the project is the project itself. Since this loan is very popular amongst project developers, this section briefs about the industrial project loan separately,

Normally, documents required are:

1. Project and Financial Documentation:

- Project proposal with projected financial reports covering the loan tenure
- Audited financial reports

2. Supplier and Import Documentation:

- Proforma Invoice (for imported machinery/equipment/goods/raw materials)
- At least 3 quotations from suppliers (for domestically sourced machinery/equipment/goods/raw materials)

3. Property and Land Ownership Documentation:

- Title Deed (Lalpurja) and blueprint of cadastral map (Napi Naksha)
- Certificate from municipality stating the names of landowners of the four corners along with kitta numbers (Char-Killa Pramanit Gareko)

4. Legal and Authorization Documents:

- No Objection Letter (NOC) if the collateral is owned by a third party (Manjurnama)
- Resolution of partners/board of directors for availing banking facilities and mortgage authorization

5. *Tax and Income Proof:*

- Tax payment receipt of the borrower
- Copies of proof of rental income

6. *Company/Firm Documentation:*

- Article & Memorandum of Association/Partnership Deed
- Tax Clearance Certificate/PAN Card/VAT registration certificate

We will soon discuss how different loan tenure, intents etc might affect our repayment later on.

Interest Rates

Interest rate is the economic representation of the opportunity cost on the fund that bank provides us. While these rates differ institute to institute, presented below is the list of weighted average interest rates of commercial banks on various types of loan as of Mid-May 2024 (Magh 2081):

Description	Expected Interest Rate in (%)
Term Loan	10.76
Overdraft	11.94
Cash Credit Loan	10.67
Trust Receipt Loan/Import Loan	10.73
Residential Personal Home Loan (Up to Rs. 15 million)	10.62
Real Estate Loan	10.86

Subject to monthly change; refer to Nepal Rastra Bank for latest information on interest rates

Banks interest rates differ on the basis of the risk they undertake. Section below details how risk factors affect interest rates.

Types of Interest Rates

Banks generally offer two types of interest rates on loans: Fixed interest rates and floating interest rates.

- **Fixed Interest Rate:** Fixed interest rates are agreed upon interest payment rates which are constant throughout the loan period. It is wise to consider fixed interest rates for long-tenure projects. This allows for better projection of financials and is hedged against the uncertainties in the future. For example, as of June 26 2024, Citizen Bank offers a home loan with a 9.99% fixed interest rate.
- **Floating Interest Rate:** Floating interest rate is the rate which is subject to periodic adjustments. It is normally suited for a period when the interest rates are going down. Floating interest rates are determined as:

Floating interest rate = Base rate + Risk Premium (% per annum)

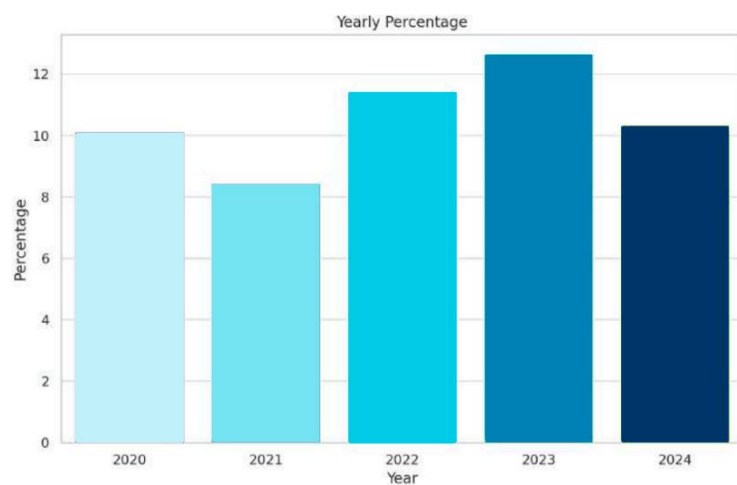
Risk premiums include a wide array of risk premiums. Risk premium is calculated as

Risk Premium = Maturity Risk Premium + Default Risk Premium + Inflation risk Premium

Base rate is the minimum bank will charge to a risk free client. Risk premium is what the bank charges for additional risk the client bears. Things such as age, income, purpose, tenure etc in case of a natural person and revenue model, business model, existing leverage, fixed assets etc for a company.

Interest Rate Trend

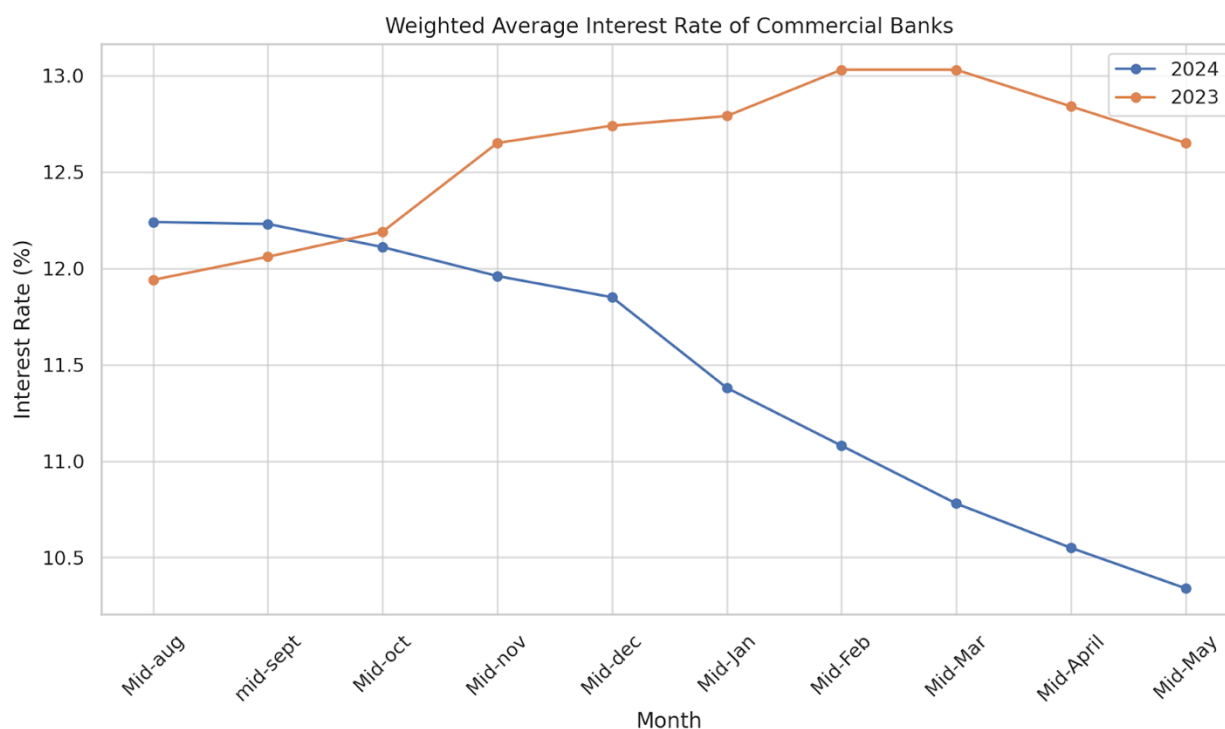
Y-o-Y Mid-May Interest Rate Trend



Source: Nepal Rastra Bank

We can see the average interest rates have been very volatile. As of 2024, the lending rates are very low.

Taking a look at the trend, it is apparent that the interest rates experience large volatility.



If we take a deeper look into the month-over-month breakdown of the interest rate, we can see that the interest rates are decreasing month over month. Interest rates are down over two percent compared to the same month in 2023. This strongly supports taking a floating interest rate as opposed to a fixed interest rate, since we can assess that the interest rates will continue to follow suit and stay low.

Loan repayment Schemes

BFI's offer different types of loan repayment schemes to best suit your financial capacities. Some of the popular loan repayment schemes are:

EMI: EMI stands for equated monthly installments. It is a loan repayment scheme where you'll have to pay a fixed sum of money, which covers both interest and principal. At the end of the tenure, the loan is fully amortized. EMI is a very common type of scheme when financing personal loans for vehicles, mortgages, etc. The schedule below shows a one-year EMI schedule:

Principal	NPR 100,000.00				
Time	1 year				
Interest Rate	10%				
EMI	(NPR 14,676.33)				
EMI Schedule					
Month	Month	Payment	Interest	Principal Reduction	New Balance
Mid-Jan	Magh	(NPR 14,676.33)	NPR 10,000.00	(NPR 4,676.33)	NPR 95,323.67
Mid-Feb	Falgun	(NPR 14,676.33)	NPR 9,532.37	(NPR 5,143.96)	NPR 90,179.70
Mid-Mar	Chaitra	(NPR 14,676.33)	NPR 9,017.97	(NPR 5,658.36)	NPR 84,521.34
Mid-Apr	Baishak	(NPR 14,676.33)	NPR 8,452.13	(NPR 6,224.20)	NPR 78,297.15
Mid-May	Jestha	(NPR 14,676.33)	NPR 7,829.71	(NPR 6,846.62)	NPR 71,450.53
Mid-Jun	Ashar	(NPR 14,676.33)	NPR 7,145.05	(NPR 7,531.28)	NPR 63,919.25
Mid-Jul	Shrawan	(NPR 14,676.33)	NPR 6,391.92	(NPR 8,284.41)	NPR 55,634.84
Mid-Aug	Bhadra	(NPR 14,676.33)	NPR 5,563.48	(NPR 9,112.85)	NPR 46,522.00
Mid-Sep	Ashoj	(NPR 14,676.33)	NPR 4,652.20	(NPR 10,024.13)	NPR 36,497.86
Mid-Oct	Kartik	(NPR 14,676.33)	NPR 3,649.79	(NPR 11,026.55)	NPR 25,471.32
Mid-Nov	Poush	(NPR 14,676.33)	NPR 2,547.13	(NPR 12,129.20)	NPR 13,342.12
Mid-Dec	Mangsir	(NPR 14,676.33)	NPR 1,334.21	(NPR 13,342.12)	NPR 0.00

EMI's are generally suited for people with regular income. It helps to budget your expenses better.

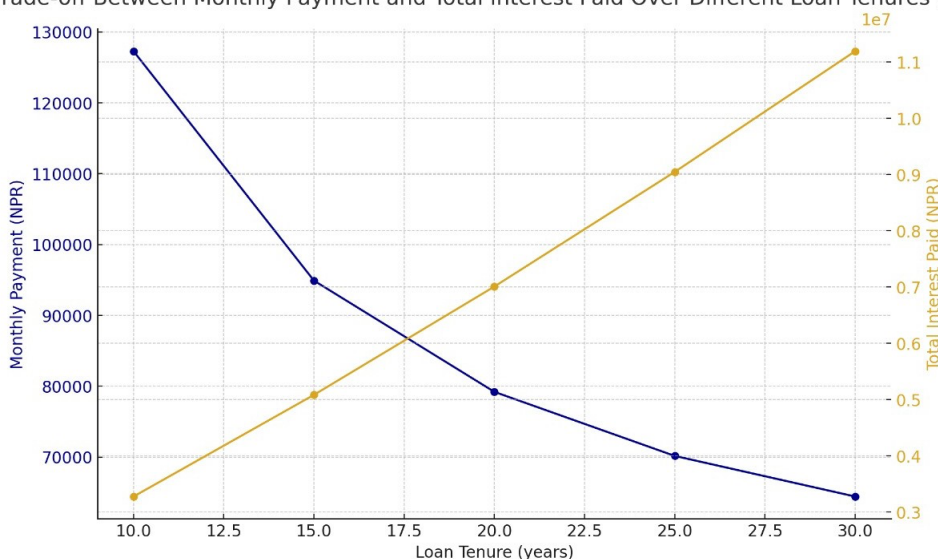
EQI: Equated Quarterly Installments, is very similar to EMI, with the only difference being that instead of having equal monthly loan repayments, there are equal quarterly loan repayments. EQI is generally suited for people/businesses with seasonal income (tourism, agriculture).

Balloon Payment: The Balloon Payment scheme is where the loan doesn't amortize over its tenure. Unlike EMI or EQI, the new balance at the end won't be zero. Hence, in the end, the borrower has to pay a large lump sum. It is commonly used in mortgages.

Loan Tenure

It is important to consider the loan tenure when taking a loan. Loan tenure is the duration over which the loan is agreed to be repaid. Having a long loan tenure means that the person will pay less each instalment but will pay more overall as the interest accumulates over time. However, to decrease the interest paid, you'll need to pay more each installment. This might put constraints on your cash flows and cause budgeting issues. The graph below shows a tradeoff between interest paid and higher instalment payments. The principal amount is NPR120,00,000 with a 5% interest rate. The tenure ranges from 10 to 30 years, showing the difference between interest paid and monthly instalments for each tenure.

Trade-off Between Monthly Payment and Total Interest Paid Over Different Loan Tenures (NPR)



As clearly seen, there is a trade-off between the size of instalments and interest paid. Bigger instalment sizes lead to less interest paid over the tenure of the loan and vice versa. Hence, it is important to accurately assess the loan tenure. A shorter tenure means you'll be debt-free quicker and you'll pay less interest in total, but as a trade-off, you'll have to pay larger instalments. On the other hand, having a longer tenure means you'll pay less in each instalment but will pay more total interest.

FAQ's

Q: Can I prepay my loan?

A: Yes you can. But there are prepayment penalties.

Q: How are loan repayments made?

A: Loan repayments can be made through various methods such as direct debit from your bank account, post-dated cheques, online banking, or cash/cheque deposits at the bank

Q: What are processing fees?

A: Processing Fees are the fees levied by the bank for the processing of loan application.

Q: Where should I contact for the Loan Process?

A: Contact your nearby bank for further information. Also here at KBC, we overlook and undertake the entire loan process, so for hassle free loan borrowing experience, call us at +977 9802348581.

Q: What is the maximum amount I can borrow?

A: The maximum one can borrow is dependent on your loan purpose, Value of collateral, value of the project, income etc.

Q: What is a loan tenure?

A: Loan tenure is the duration over which the loan has been agreed to be repaid.

Q: What happens if I miss a loan repayment?

A: Missing a loan repayment can result in penalties, additional interest etc. Continued failure to repay the loan will cause the seizure of the asset

Q: What is a guarantor, and when do I need one?

A: A guarantor is a person who agrees to repay the loan if the borrower defaults. You may need a guarantor if your creditworthiness is insufficient or if required by the lender's policies for certain loan types.

Glossary

1. Balloon Payment: A large payment due at the end of a loan term, which is not fully amortised by prior monthly or quarterly payments.
2. Base Rate: The minimum interest rate set by a bank below which it cannot lend to borrowers.
3. Collateral: An asset pledged by a borrower to a lender, used as security for the loan. If the borrower defaults, the lender can seize the collateral.
4. Credit Score: A numerical representation of a borrower's creditworthiness, based on their credit history.
5. Default: Failure to meet the legal obligations of a loan, such as not making the scheduled payments.
6. Equated Monthly Instalments (EMI): A fixed payment amount made by a borrower to a lender at a specified date each calendar month. EMIs are used to pay off both interest and principal each month so that over a specified number of years, the loan is paid off in full.

7. Equated Quarterly Instalments (EQI): Similar to EMI, but payments are made quarterly. EQI is typically suited for borrowers with seasonal incomes.
8. Fixed Interest Rate: An interest rate that remains the same throughout the loan period, providing consistency in loan payments.
9. Floating Interest Rate: An interest rate that can change periodically based on the base rate plus a risk premium. It is variable and can fluctuate over the loan period.
10. Guarantor: A person who agrees to repay the loan if the borrower defaults. The guarantor provides an additional level of security for the lender.
11. Haircut: The reduction applied to the market value of an asset when it is used as collateral. For example, a 30% haircut means the lender values the collateral at 70% of its market value.
12. Interest Rate: The percentage of a loan charged as interest to the borrower, typically expressed as an annual percentage of the loan outstanding.
13. Loan Syndication: A process where multiple lenders come together to provide various portions of a loan to a single borrower, usually for large projects or corporations.
14. Moratorium Period: A period during which the borrower is not required to make any loan repayments. Interest may still accrue during this period.
15. Overdraft :A facility allowing a borrower to withdraw more money than is available in their account up to an approved limit.
16. Prepayment: The repayment of a loan before its official due date. Prepayments can help save on interest but may incur prepayment penalties.
17. Principal: The original sum of money borrowed in a loan, or the remaining amount of the loan excluding interest.

18. Risk Premium: The additional interest charged by lenders to compensate for the risk of default by the borrower. It includes maturity risk premium, default risk premium, and inflation risk premium.
19. Weighted Average Interest Rate: The average interest rate on various loans, weighted by the loan amounts. This rate provides a composite measure of the interest expense.

Final Steps

Once you have identified the loan you want, visited the website of the institution, checked and gathered the required documents, we come to the final step. You'll have to start the process by either going to the institution or applying online.

Still confused regarding the loan process? Fret not! Our experts here at Kathmandu Business Consultants will assist you throughout your loan application. Our team of industry experts can accurately quantify your requirements and assist you from identifying your loan needs to gathering all the documents required, all tailored to your specific needs! Send us a message or give us a call at +977 9802348581.

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Thank You!

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