

# G:ENESIS



**Mobilising pension assets for housing needs –  
experiences in southern Africa**

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## EXECUTIVE SUMMARY

Almost every country in southern Africa suffers from a backlog of housing and especially low-income housing. In addition, in most countries only a small proportion of the population typically has access to traditional sources of housing finance like mortgage loans. A recurrent problem is a shortage of capital for the construction of new housing stock and for capitalising a healthy housing finance market, as well as a shortage of financing products that suit the circumstances of poorer people.

However, what is also true of most southern African countries is that each, to a greater or lesser degree, has a retirement fund industry, and that retirement funds are an effective and established means of aggregating large pools of long-term savings and of directing investment into the economy. The question at the heart of this paper is whether and how retirement funds might play a greater role in funding the construction of housing, particularly low-income housing, and in opening up access to housing finance products.

The FinMark Trust commissioned Genesis Analytics to consider this question in southern Africa with an emphasis on four countries, namely, South Africa, Namibia, Zambia and Botswana. The purpose of the paper is to locate all of the various models that connect pension funds to housing construction and housing finance in some way, to discuss the pros and cons of these models, and to capture lessons that might be shared with other regulators, policymakers and donors throughout the continent.

What this study shows at a general level is that despite the serious shortage of housing and poor access to housing finance in southern Africa and although pension fund assets are not insignificant, pension funds are still generally poorly connected in the minds of trustees, asset managers and policy-makers to the pursuit of better housing conditions. Little serious thought has to date gone into linking pension assets and housing. This is borne out by the acute lack of research on the topic. Additional research, especially in other parts of the continent where interesting models may be in play, will therefore be essential.

The pension / housing models in use in southern Africa can be divided into two groups:

1. Those that assist a pension fund member with finance for the purchase or construction of a home (end-user finance models); and
2. those to do with the investment strategy of pension funds in housing-related investments (investment models).

The two groups are not mutually exclusive. End-user finance is helpful for small home improvement loans and for assisting with financing options at the level of the individual. The investment models are useful for unleashing large capital flows into housing construction and the wholesale provision of housing finance across the economy.

## End-user finance models

There are two forms of end-user model: a) where the member borrows directly against his or her pension savings from the fund, and b) where the member takes a loan from a third party which is secured by the pension fund against the savings. Both of these models are permitted by law in South Africa, Namibia and Botswana though they are neither permitted nor prohibited by law in Zambia. There is a strong and growing preference for pension-secured lending (the second model) rather than direct lending from the fund (the first model).

There is an ongoing debate about the relative benefits and problems of end-user lending but, by the fact that most countries allow end-user models to operate, it is clear that policy-makers have generally been proponents. Proponents see pension loans and pension-secured loans as an integral part of the private sector's housing finance solution, one which enables fund members to release the equity that is "locked" in their pension funds to improve their living conditions. Proponents point out that pension loans and pension-secured loans are potentially a cheaper form of home-financing than other forms of credit like micro-finance, unsecured and even mortgage-secured bank lending, and can also act as a useful alternative form of financing where mortgage financing is not possible either because of under-developed mortgage markets or because of restrictions relating to security of land tenure which is essential for mortgage markets to work well.

By contrast, opponents view pension lending and pension-secured lending as a dangerous development that puts retirement savings at risk and compounds the state's burden of having to provide adequate social support for an aging population. One of the most compelling criticisms is that it is difficult to ensure in either of these models that the funds loaned are actually used for housing. Opponents also worry that if mass default of pension loans or pension-secured loans were to occur (for example in a financial crisis or recession) fund assets will be drawn down and investment performance compromised. Opponents also point out that "breaking up" pension assets into many small member-based loans has high administration costs and is a less efficient use of pension assets than investing the aggregated assets *en masse* in large-scale housing investments and housing finance opportunities.

Despite the statutory space existing in the region for providers to offer these products, take-up of end user models by funds and by members is still relatively low. There is significant room for growth of end-user model financing in all of the countries assessed. Pension loans and pension-secured lending do add another, and generally a cheaper, dimension to access to housing finance. That said, end-user models are not a panacea for a national housing finance deficit because pension penetration rates in southern Africa are typically less than 10% of working age population (South Africa at 35% and Mauritius at over 60% are exceptions) and thus the "scalability" of these products is limited. There is better scope for scaling-up the end-user model where a country has a universal national savings scheme in place. Then, theoretically, the model becomes scalable to all contributors to the scheme – in some cases this might be the entire working population. Other reasons for the poor levels of take-up include low levels of product awareness amongst members; the difficulty of ensuring that loans and



secured loans are actually used for housing purposes; the small pension savings available to most members; an absence of enabling legislation or confusing wording in the enabling legislation; and a strong mentality (although less so in South Africa) that housing finance should be synonymous with mortgage finance, rather than smaller loans that finance the incremental building of homes.

End user models work best where pension fund coverage is higher, where the practice is clearly enabled by legislation, where the wording in the act which establishes the practice is unequivocally clear and determined, and where property is held by more secure forms of tenure than communal or state ownership.

### **Investment models**

The investment models are characterised by the investment of a part of a fund's investment portfolio in housing-related investments. Two sub groups of the investment model were observed in southern Africa. In the first form, pension funds invest as part of their overall strategy in investments that are housing-related. This might include direct investment in the funding of low-income housing developments or other residential property developments; equity and debt investment in housing development companies; investment in funds and financial securities either listed or unlisted that are set up to invest in residential developments; the offering of bridging finance to smooth the project development cycle; or the use of a pension fund's balance sheet to credit-enhance a development project (only the first three were observed in operation in southern Africa).

This second relates to investment in housing *finance* opportunities i.e. pension assets are used to provide debt or equity financing to institutions that, in turn, provide housing finance such as banks, building societies or micro-finance institutions. The end beneficiaries of the finance might be individuals or developers, or the finance may be passed on as wholesale finance to other retail lenders to distribute.

African countries are typically capital-scarce with illiquid capital markets. The obvious benefit of large-scale investment by pension funds is that it helps to improve the availability of capital in housing and housing finance. Retirement funds are one of the few significant pools of domestic savings. Tapping into this pool for large-scale investment allows economies of scale to be achieved. Where investment by pension funds is also particularly useful is filling a long-term financing gap. Pension funds are one of the few institutional investors with long-term investment horizons; they have liabilities maturing in up to 30 years (as members retire) which can be matched to the long-term borrowing horizon of mortgage lenders, also 25 to 30 years. The matching of long-term pension liabilities to long-term mortgage assets can encourage the development of a long-term mortgage market where one does not exist.

The regulatory space exists in all of the countries assessed for pension funds to direct a portion of their assets to residential development investments and developers, and to invest in housing financiers. Nevertheless, the research shows that there is a general reluctance by

funds to look for these opportunities. Low-income housing is still regarded by many trustees and asset managers as unsound or higher risk investment (or a duty that falls to government). The reason for this attitude seems to be that mainstream asset consultants have little exposure to housing projects and developments and don't fully understand the returns that can be generated by housing and the broader social benefits that are created. Trustees, in general, have done little to educate themselves on the value, financially and socially, of more investment in low-income housing. Consequently they put minimal pressure on consultants and asset managers to apply their energies to finding or even designing suitable housing investments and projects, and asset managers therefore have little incentive to do so. It seems to be a challenge in every country to establish housing development as an asset class in the minds of trustees, despite a number of low-income housing developments showing excellent returns on investment in both South Africa and Zambia. That said, a number of trustees did express interest at least in principle of seeing more housing-related investment.

In general, the growth of various forms of investment models hold more promise than end-user models because the research suggests that the use of pension assets for investment in housing and housing finance is still surprisingly underexploited even though there is a general interest amongst trustees to find out more. The advantages of these models are numerous: the concerns about use-of-funds and scalability do not apply and it is arguable that breaking up pension assets at the member level into many small loans, with higher administration costs and opportunity for leakage, is a less efficient use of aggregated pension assets than investing the assets *en masse* in larger housing investments. Better economies of scale are achieved and the outcomes (more real houses, more mortgages, better capitalised construction companies) are more concrete and certain.

One repeated theme in the investment arena is a general perception amongst trustees that returns in the low-income housing market are lower and riskier than in other areas of the property market, and thus likely to be at odds with a pension fund trustees' primary mandate to maximise members' returns (especially in a defined contribution fund). To unlock pension assets for housing needs it will be necessary to overcome this perception. This is unlikely happen without either better market information on investment opportunities and returns in this market, or a degree of moral suasion from government either through a financial sector charter-like agreement, or the threat, real or otherwise, of prescribed assets. The subprime crisis, although not the same as low-income lending, has not helped the image of the lower end market. Low levels of investment in housing is also more likely in countries where government bonds offer secure, high returns. Asset managers have little incentive to take higher risks in more "exotic" low-income housing areas, when there are good, risk-free returns available in government paper.

# 1 INTRODUCTION

Almost every country in southern Africa suffers from a backlog of housing and especially low-income housing. In addition, in most countries only a small proportion of the population typically has access to traditional sources of housing finance like mortgage loans. A recurrent problem is a shortage of capital for the construction of new housing stock and for capitalising a healthy housing finance market, as well as a shortage of financing products that suit the circumstances of poorer people.

However, what is also true of most southern African countries is that each, to a greater or lesser degree, has a retirement fund industry, and that retirement funds are an effective and established means of aggregating large pools of long-term savings and of directing investment into the economy. The question at the heart of this paper is whether and how retirement funds might play a greater role in funding the construction of housing, particularly low-income housing, and in opening up access to housing finance products.

The FinMark Trust commissioned Genesis Analytics to consider this question in southern Africa with an emphasis on four countries, namely, South Africa, Namibia, Zambia and Botswana. The purpose of the paper is to locate all of the various models that connect pension funds to housing construction and housing finance in some way, to discuss the pros and cons of these models, and to capture lessons that might be shared with other regulators, policymakers and donors throughout the continent.

The research relied on desktop study combined with telephone interviews of key players in the region, which included financial services participants who are active providers of pension-supported loans, regulatory bodies, commercial banks, retirement fund trustees and retirement fund administrators. A list of interviewees is available at the end of the paper.

The methodology was not exhaustive either in terms of the countries examined or market players interviewed, but it does allow a broad-brush picture to be drawn of the state of pensions and housing in southern Africa, and will help to inform and guide interested readers on the potential of combining pension assets and housing provision.

The paper is set out as follows:

Chapter 2, following, provides an introduction for the reader to pension fund/housing models that were located in southern Africa by the research. A generic description of each model is provided, followed by a discussion of the models' strengths and weaknesses.

Chapter 3 describes in more detail how these models are put to use in South Africa, Botswana, Namibia and Zambia specifically, followed by a brief note on the situation in Mauritius, Mozambique, Malawi and Angola.

Chapter 4 is a summary of the lessons learned in the research, while Chapter 5 sets out some recommendations.

## 2 AN INTRODUCTION TO THE MODELS

The models in use in southern Africa can be divided into two groups:

1. Those that assist a pension fund member with finance for the purchase or construction of a home (**end-user models**); and
2. those that rest in the investment strategy of pension funds in housing-related investments (**investment models**).

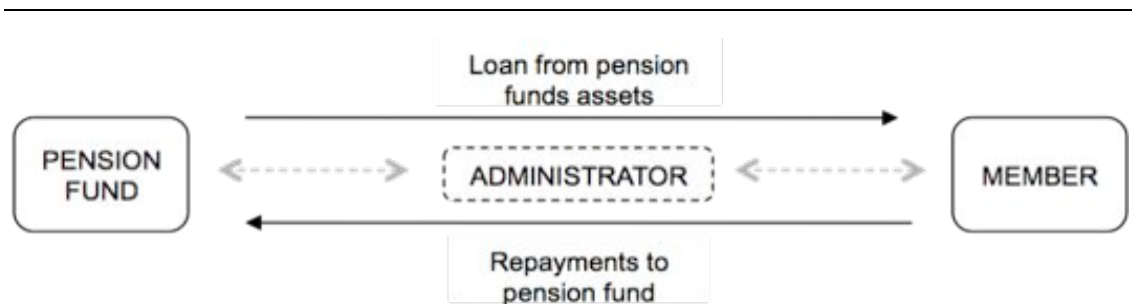
The former focuses on the individual member: a member of a retirement scheme may be able to make use of his or her accrued pension funds for the purposes of financing the purchase or improvement of a home. It is a form of individual finance.

The latter focuses on larger-scale investment interventions by pension funds in housing-related investments, broadly defined. It is a form of pension fund investment strategy.

### 2.1 END-USER FINANCE MODELS

There are two variations of the end-user model.

#### 2.1.1 DIRECT LOAN FROM FUND TO MEMBER



**Figure 1: Pension asset accessed directly by member**

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In the first form of end-user financing, the rules of the pension fund allow for a member to access a portion of his or her accrued pension benefits as a *direct loan from the fund*. The loan is usually paid as a cash transfer to the member's bank account and is restricted to anything from 30% to 90% of the member's accrued savings depending on local regulation and rules of the specific fund. The interest rate that can be charged on these loans is sometimes prescribed in the pension law. More often than not the service is arranged and administered through a designated administrator who

takes a fee for the service (usually around 1% to 2% of the loan). Some larger funds, especially large employer-based funds in South Africa, do not use administrators but run the service internally – but this requires considerable in-house administrative capacity.

### **Box: Defined Benefit v. Defined Contribution Funds**

#### **Defined Benefit Funds (DB)**

A defined benefit fund is one that specifies the benefits a member will receive on retirement. The investment risk falls on the fund which commits to pay a certain benefit, usually a proportion of salary at retirement, regardless of the performance of the fund's investments. Members' contributions are pooled and invested by the fund in a way that ensures it is able to meet the defined benefit liabilities. The additional gains or losses that the fund makes accrue to the fund.

#### **Defined Contribution Fund (DC)**

In a defined contribution fund the members' contributions are set at a specific rate (usually a percentage of salary) and these are ring-fenced and invested – the member is able to assess the performance of his or her individual contributions. On retirement, the individual member's benefit is the amount that he / she has contributed plus any investment return earned. The investment risk therefore rests with the member.

#### **Why it matters**

The distinction between DB and DC funds has a bearing on the appropriateness of various models. For example, if a loan is taken from a DB fund by a member or if a loan is secured against the member's funds, then on giving the loan (in the first instance) or on default (in the second), the fund's resources are drawn down; in the case of a DC fund the member's funds are ring fenced and only that member's specific pool of investible funds is affected, whereas in a DB fund the *overall* pool of investible resources is affected. This may compromise the potential for the fund to meet the DB commitments. In addition, in a DB fund, given that the investment risk lies with the fund, the trustees are under greater pressure to ensure that their investment returns are sufficient to meet liabilities. They are likely to be more conservative in their investment approach and could shy away from perceived "risky" investments such as low-income housing. Of course, once the DB commitments are fully-funded, the trustees have room to invest the surplus as they see fit and could therefore adopt a more "socially responsible" investment strategy without compromising the guaranteed benefits of the members. DC funds are also limited in their risk appetite by the need to maximise their members' returns.

The loan is secured by the fund either over the property in question (effectively a mortgage loan in favour of the fund) or, as is more common, over the member's accrued benefits. The member repays interest to the fund over the life of the loan and repays the principal on maturity, retirement or if the member leaves the fund. On default, the loan is "repaid" from the accrued benefits or, if the loan is secured over the property, by selling the property. Where the fund is employer-based, monthly repayments can be drawn directly from payroll.

This end-user model is less and less popular in the region especially with DB funds. Where members' contributions are pooled and invested together, individual loans to members reduces the investment pool and can compromise the funds DB commitment. The model is more appropriate in DC funds where members' funds are ring-fenced within the pool of pension savings. The member would then be drawing funds from her own benefits and the member's own behaviour (repayment) affects only her own retirement benefits. On the whole, it can be said that the model does not have good growth potential and there is a trend amongst trustees in the region to offer services to their members by offering to secure third party loans rather than providing the loan directly from the fund.

### 2.1.2 SECURING A LOAN FROM A THIRD PARTY

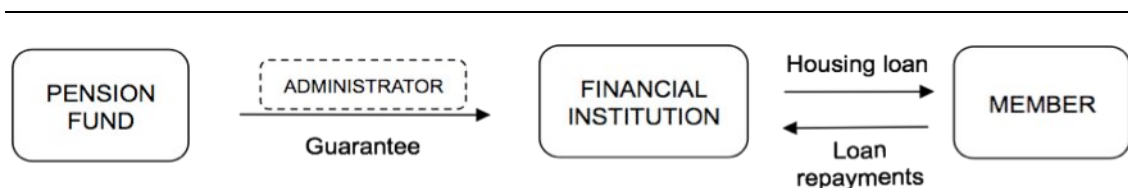


Figure 2: Pension assets used to secure a loan

In the second end-user model, the pension fund via an intermediary administrator provides a third party lending institution with a guarantee that the member's pension savings will secure a loan or part of a loan from the institution. It is common for the law or the pension fund rules to stipulate that the loan must only be for housing purposes such as the purchase of land or a house, or the improving of a house. The interest rate on the loans is generally negotiated and set by the scheme i.e. all members of the scheme will be eligible for the same interest rate. In theory the rate should be lower than other forms of housing finance like mortgage loans or microloans. The loan is paid back to the financial institution in instalments, sometimes as a direct deduction from the member's salary. As long as the member does not default, the fund's assets will not be disturbed. However, on default, the financial institution will institute a claim through the administrator who will deduct the outstanding balance from the member's accumulated savings before paying the remainder to the member.

### 2.1.3 OVERVIEW OF END-USER MODELS IN SOUTHERN AFRICA

Proponents of end-user products see pension loans and pension-secured loans as an integral part of the private sector's housing finance solution, one which enables fund members to release the equity that is "locked" in their pension and provident funds to take loans and secure loans to improve their housing conditions. Pension loans and pension-secured lending allow pension fund members to leverage otherwise deferred long-term savings for immediate benefit while (ideally) still preserving the benefits for the long-term. If the loan is paid back, then the member should enjoy the double benefit at retirement of a home *and* a pension. Proponents

argue that it is difficult to sustain the argument that long-term pension savings are more important than the immediate need for shelter. As Sing (2009) puts it:

*“Prudent regulation emphasises the need to preserve retirement savings for fund members’ old age. However, what is the use of being assured of a comfortable retirement without a roof over one’s head today?”* (p64)

This has additional relevance in countries where life-expectancy is dropping rapidly. For instance, the high incidence of HIV/AIDS in Botswana and South Africa means that a significant proportion of pension fund members in those countries will not live to retirement age. There is thus an element of equity in allowing members to benefit from their savings during their lifetimes by ensuring they have somewhere to live.

Proponents of these models also point out that pension loans and pension-secured loans are potentially a cheaper form of home-financing than other forms of credit like micro-finance or unsecured and even secured bank lending. Recent research in South Africa (Sing 2009) found that the average pension secured-loan attracted interest of the prime rate – 1%; cheaper than mortgage lending (at prime rate); and greatly cheaper than unsecured lend (prime + 5%).

What's more, pension-secured lending can act as an alternative form of financing where mortgage financing is not possible either because of under-developed markets or because of restrictions relating to security of tenure. In many African countries communal land ownership and other forms of tenure which are weaker than full titled freehold can prevent property being used as collateral for a mortgage loan. Pension-secured lending allows a loan to be collateralised by a secure asset (the pension savings) where land tenure may not be strong enough to allow for land-based security. This helps to increase access to finance for households who may have difficulty accessing it through other channels because they reside on communally or state-owned land.

*By contrast*, opponents of these products view pension-secured lending as a dangerous development that puts people’s retirement savings at risk and compounds the state’s burden of having to provide adequate social support for an aging population. One of the most compelling criticisms is that it is difficult to ensure that the funds are actually used for housing. Trustees of pension funds are invariably part-time representatives without the capacity to monitor the use of loans. There is a tendency among trustees to abdicate the responsibility for ensuring funds are used for housing either to the member, or in the case of third party loans to the administrator or third party lender itself. However, for their part, lenders and administrators have little incentive to ensure proper use of funds. Policing is expensive and the loan is in any event secured. The consequence is poor monitoring and enforcement of use of funds. It is common for long term savings to in fact be spent, not on housing, but on short-term consumption. This is a particular problem in Namibia. It is easy to imagine a situation where pension savings are spent out of necessity on health or education or even on immediate consumption like the purchase of food or clothing. Research in South Africa (Genesis 2008) suggests that at little as 33% of pension-secured lending is actually used for housing even



though most applicants warrant on application that it will be. In a worst-case outcome the member may be left at retirement with insufficient savings and little to show for it.

Opponents also worry that on mass default of pension loans or pension-secured loans (for example in a financial crisis or recession) the fund's assets will be drawn down and investment performance compromised. The reduced pool of funds inhibits the fund's ability to pay out member's benefits and would prejudice those members who had not taken or secured loans. In addition it is worth noting that pension savings are a formal sector asset that are "owned" by the fund but which the member has a unique and personal claim over. This personal right may be leveraged to build a housing asset, but this may be held by less certain, codified or secure ownership – for example, a house built on communal land or subject to traditional law may be subject to automatic partial ownership by a spouse (or spouses) or other family members. The implication is that where the member takes a pension-secured loan to build a house and defaults, he has swapped a strong and personal right, for an asset where he holds diminished rights of ownership.

Opponents also point out that "breaking up" pension assets into many small member-based loans has high administration costs and provides opportunity for leakage, and is a less efficient use of pension assets than investing the aggregated assets *en masse* in large-scale housing investments (see the section on investment models).

Pension lending and pension-secured lending is allowed by law in South Africa, Namibia, and Botswana but is neither permitted nor prohibited in Zambia. In jurisdictions where the models are permitted, there is a strong general preference for pension-secured lending via a third party than direct lending from the fund.

Take up of end-user products by funds and by members is variable but generally poor. Reasons for this include (see country sections as noted for more detailed explanation):

- Low levels of pension funds penetration: The pension penetration rates in southern Africa are generally low and typically less than 10% of working age population (South Africa at 35% and Mauritius at over 60% are exceptions). The benefits of pension lending and pension-secured lending only accrue to those who are members of pension funds and this is effectively the formally employed. Where formal employment is low, as it is in the southern African region generally, the reach of end-user financing models is limited. In other words the genuine "scalability" of these models as a means of opening up housing finance is weak.
- There are generally low levels of product awareness amongst non-industry players and general public (this was observed in all countries).
- Trustees are often reluctant to deal with the administration of providing a loan or secured-loan service. In Zambia for instance there appears to be a widely held belief in

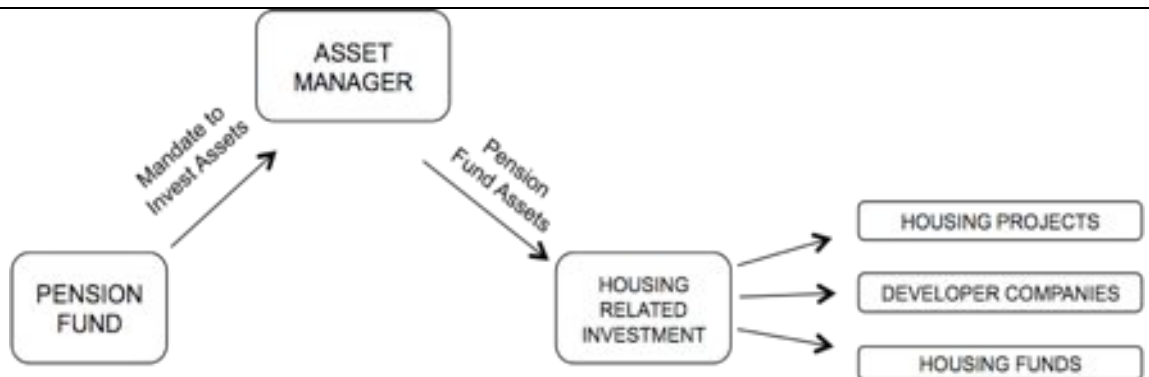
the industry that lending to members is a risky use of pension funds and that it is the role of financial institutions, not pension funds, to provide mortgage finance.

- A recurrent problem and concern in all countries across the region is the difficulty and cost of ensuring that loans and secured loans are actually used for housing purposes. Namibia demonstrates a particular problem of pension funds used for short term (and sometimes wasteful) consumption.
- Another recurrent concern by trustees across the region is that the loans that can be offered or secured are “too small to do any good”: the accrued savings of most southern Africans are low because they have low-paying jobs, and because members can only access a portion of savings at a time (anything from 30% to 90% depending on the fund’s rules). As a result, pension-based loans are almost always too small to fund the purchase of a house or land. In South Africa, in 2009, the average size of a loan was about R20,000 (or roughly \$2500). The cheapest new house on the market at the time cost was in the region of R200,000 (or \$25 000). In other words, on average only 10% of a purchase price could be financed by pension, and the loans are only useful for incremental housing improvement where building takes place in stages. Also, the loans will not always be able to fund a brick and mortar improvement but only a cheaper and weaker structure which may degenerate over time. If the house falls down and can no longer be used as a financial asset or as a social asset as a place of residence, then trustees are concerned that the member might be left with a diminished pension but no long-term financial or social asset to show for it. To guard against this, trustees should take responsibility for putting mechanisms in place to evaluate the nature and value of the investment at the outset and take comfort not only that the funds are going towards housing but that the investment is of a durable nature. The problem is that this is expensive and the parties invariably have neither the capacity nor inclination to do so.
- In some countries there is no enabling legislation in place (see Zambia) or the working of the act is too confusing or unclear. In Botswana the enabling legislation implies that loaned funds can be drawn down and this risk discourages trustees from offering the service.
- In some countries, like Namibia, there is also reluctance on the part of funds to grant housing loans to their members where the property in question is held under communal title or is owned by the state.

## **2.2 INVESTMENT MODELS**

Investment models don’t focus on the individual member *per se* but are characterised by the investment of a part of the fund portfolio in housing-related investments, broadly defined. Two sub groups were observed in southern Africa.

## 2.2.1 HOUSING PROJECTS, HOUSING DEVELOPERS AND HOUSING FUNDS



**Figure 3: Pension funds invest in housing: projects, developers and funds**

In the first form of investment model, pension funds invest as part of their overall strategy in investments that are housing-related, through the investment mandates which are passed to asset managers. There are a number of possible investment targets:

- Direct investment in the funding of low-income housing developments or other residential property developments i.e. a form of developer project finance. One example of this is the National Pension Scheme (NPS) in Zambia which invests directly in low-income housing developments. The NPS purchases the land for the development and finances its construction; the units are then sold to private buyers.<sup>1</sup>
- Equity or debt investment in housing development and construction companies – for instance in South Africa a number of companies that, as part of their operations, build low-income housing are listed on the Johannesburg Securities Exchange or Alt-X (examples include M3 Calgro, RBA and Basil Read); or
- Investment in funds and financial securities, either listed or unlisted, that are set up to invest in residential developments whether low-income or otherwise; or
- The offering of bridging finance to smooth the project development cycle; or
- The use of a pension fund's balance sheet to credit-enhance a development project thus enabling the project to secure cheaper funding.

<sup>1</sup> Interview with NPS

Note: only the first three above were observed in operation in the southern African countries studied.

## 2.2.2 INVESTMENT IN HOUSING FINANCE OPPORTUNITIES

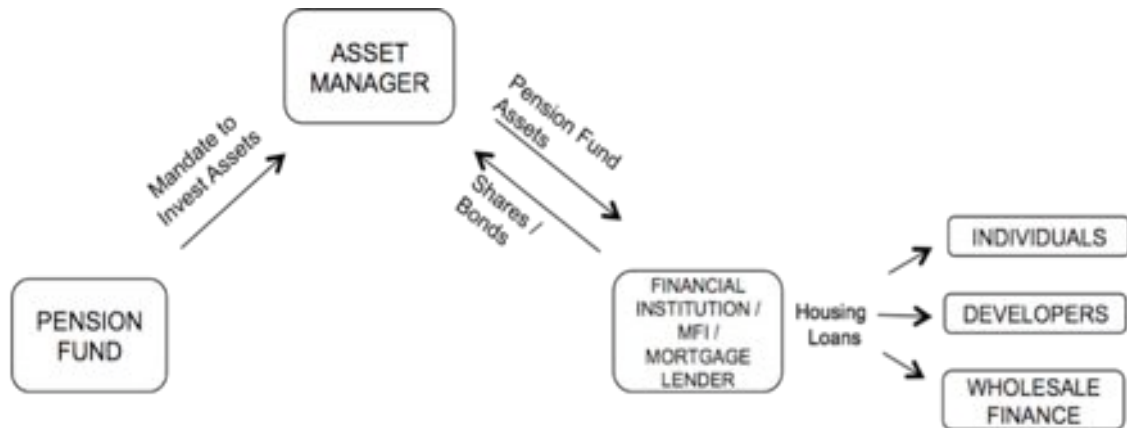


Figure 4: Pension funds invest in housing finance opportunities

This second investment model focuses on investment in housing *finance* opportunities. Pension assets are used to provide debt or equity financing to institutions that in turn provide housing finance such as banks, building societies or micro-finance institutions. The end beneficiaries of the finance might be individuals, developers, or the finance may be passed on as wholesale finance to other retail lenders to distribute.

## 2.2.3 OVERVIEW OF INVESTMENT MODELS IN SOUTHERN AFRICA

African countries are typically capital-scarce with illiquid capital markets (this is likely to get worse as foreign flows dry up as a result of the global financial crisis of 2008). The obvious benefit of large-scale investment by pension funds is that it helps to improve the availability of capital in housing and housing finance investment opportunities. Retirement funds are often one of the few significant pools of domestic savings and tapping into this pool for large-scale investment allows economies of investment scale to be achieved that smaller investors might shy away from. What is attractive about the investment model is that the outcome of the investment is *concrete* in the sense that pension funds directly support the construction of housing. These may be low-income houses but even if they are not, increasing the stock at other points of the market has positive effects for the housing market as a whole. Trustees and policy makers can take comfort that pension assets are being used to invest in long-term housing assets with concomitant social benefits.

The regulatory space exists in all countries examined for pension funds to direct a portion of their assets to residential development investments and developers. Nevertheless, the research shows that there is a general reluctance by funds across the region to look for

housing development opportunities despite a number of low-income housing developments showing excellent returns on investment in both South Africa<sup>2</sup> and Zambia.<sup>3</sup> It seems to be a challenge in every country to establish the asset class in the minds of trustees. Low-income housing is still regarded by many trustees and asset managers as unsound or higher risk investment or a duty that falls to government. This image has, unfairly, not been improved by the subprime mortgage crisis. While commercial banks have colonised the low-income housing space quite comfortably, pension funds are typically creatures of prudence, often governed by part-time trustees who defer to the advice of asset consultants. Most asset consultants have little exposure to housing projects, and don't fully understand the returns that can be generated by housing and the broader social benefits that are created. Trustees, in general, have done little to educate themselves on the value, financially and socially, of more investment in low-income housing. Consequently they put minimal pressure on consultants and asset managers to apply their energies to finding or even designing suitable housing investments and projects, and completing the circle, asset managers have little incentive to do so. Unlike banks in relation to their shareholders, trustees have a *fiduciary duty* to act in the best interests of their members, which is a higher standard of care and which is often interpreted as meaning they *must* maximise returns. The impression that low-income housing, or investment in housing MFIs is a lower-return or riskier investment, continues to preclude investment of this sort by most funds. As a result, there is across the region, a heart-felt perception amongst trustees that investing in low-income housing is risky, generates low-returns and is best placed, if at all, in a socially responsible investment (SRI) portfolio than the investment portfolio proper.

Where investment by pension funds can also be particularly useful is in filling a long-term financing gap. Pension funds are one of the few institutional investors with long-term investment horizons; they have liabilities maturing in up to 30 years (as members retire). This can be matched to the long-term borrowing horizon of mortgage lenders, also 25 to 30 years. The matching of long-term pension liabilities to long-term mortgage assets can encourage the development of a long-term mortgage market where one does not exist.

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<sup>2</sup> In South Africa pension funds invest in listed companies (such as Calgro M3 RBA and Basil Read) that are involved in the development of low cost housing. In addition there is growing interest in finding specific projects to invest in.

<sup>3</sup> In Zambia the National Pension Scheme invests a portion of its funds in high, medium and low cost property developments as a result of their attractive risk : return ratios.

## 3 COUNTRY SUMMARIES

### 3.1 OVERVIEW

The findings from five country studies are summarised in the following table and explained in detail in the rest of the chapter.

Country	OVERVIEW OF PENSION INDUSTRY				MODELS											
	Pension assets / GDP	Pension fund members*6	No. of Funds	Membership as % of working age population	END USER				INVESTMENT							
					Direct access to funds		Loan from fund		Security for bank loan		Property		Financiers			
Permitted?	Done?	Permitted?	Done?	Permitted?	Done?	Permitted?	Done?	Permitted?	Done?	Permitted?	Done?	Permitted?	Done?			
BOTSWANA	32%	123 000	128	11%	x	x	✓	x*1	✓	x*2	✓	x	✓	?	✓	✓
NAMIBIA	68%	115 000	450	10%	x	x	✓	✓	✓	✓	✓	x	✓	?	✓	✓
ZAMBIA	4%	> 600 000	300	< 10 %	x	x	✓*3	✓	x	✓*4	✓	✓	✓*5	?	✓	✓
SOUTH AFRICA	84%	10 700 000	13 300	35%	x	x	✓	✓	✓	✓	✓	x	✓	✓	✓	✓
MAURITIUS	> 17%	100 000	1000	> 60%	x	x	✓	✓	✓	✓	✓	✓	✓	?	✓	✓

**Table 1 : Overview of the models present in the countries under study**

\*1 In Botswana the law permits pension funds to offer direct loans, but the wording in the act has caused pension funds to refrain from offering this benefit; \*2 In Botswana the law permits pension funds to provide guarantees to a third party, but the wording of the act is reportedly confusing in so far as it implies that the loan money still has to come from the pension fund; \*3 The newer national pension scheme regulation does not permit this, however regulations governing older schemes in Zambia do; \*4 In Zambia the law neither permits nor prohibits this model, but banks are reportedly offering loans to individuals on condition that they are pension fund members; \*5 In Zambia a pension fund has to apply to the regulator if it wishes to invest in an unusual vehicle. We are unsure whether investing in a housing development company would be permitted or not; \*6 The official numbers may overstate the actual membership as double counting could arise because of possible overlap in membership between, firstly, occupational and individual pension cover; secondly, between state pension cover and private pension cover; and thirdly between present membership of an occupational fund and deferred membership of a previous employer's occupational fund.

## **3.2 SOUTH AFRICA**

### **3.2.1 CONTEXT**

South Africa is a middle income country with the largest economy in Africa. In 2007 GDP was \$282.6bn with an annual growth rate of about 5%. However, the global financial crisis slowed growth to 3.1%<sup>4</sup> by the end of 2008 and growth is expected to contract further in 2009. The population is 48m and the working age population is 30.5m people. The currency is the rand (\$1 = R9.7 on the 31<sup>st</sup> March 2009).

The pension fund industry is large and well-established with assets comprising 84% of GDP (or roughly R2.3trn or \$236.6bn). The pension industry is the second largest segment of the financial sector after commercial banks at 120% of GDP. There are roughly 13 300 registered retirement funds representing 10.7m members<sup>5</sup>, equivalent to 35% of the working age population). Membership is comprised of mainly middle-to-high income individuals. The Government Employees' Pension Fund (GEPF) is South Africa's largest fund owing about a third of total assets under management. As at March 2008<sup>6</sup> the GEPF had 1.4m members with net assets of R 707bn.

The industry is regulated in terms of the Pension Funds Act 24 of 1956 (with the exception of a few large funds like the GEPF that are established by separate statute) and is monitored by the Financial Services Board (FSB), an independent institution that oversees all non-bank financial institutions. Government has indicated its intention to introduce a compulsory national savings scheme for all formally employed workers, which is still in the design and consultation process.

With the prevailing shortage of housing stock amongst South Africans who can afford housing finance estimated as affecting some 625 000 households, coupled with the current contraction in the development of new residential property, indications are that pressures on housing supply will be exacerbated (Sing 2009). South Africa has a relatively large mortgage market. In 2002, there was \$55.8 billion outstanding credit of private households, of which 53% or \$29.6bn was for private mortgages. A further \$1bn was for mortgages extended by parastatals and non bank institutions. Despite this figure, one of the highest in Africa, the majority of households are still left out of the mortgage lending market. According to Melzer (2006) only 7% of the target market of the Financial Sector Charter (households earning about US\$180 - \$960 in 2008) will be able to access a mortgage.

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<sup>4</sup> Moneyweb Interview with Jeanre Fourie, 25 February 2009. Obtained from:

<http://www.moneyweb.co.za/mw/view/mw/en/page662?oid=275251&sn=Detail> on March 18, 2009

<sup>5</sup> There may be an element of double counting as individuals could, for example, be contributing to an employer-based funds, as well as a towards a retirement insurance policy.

<sup>6</sup> Information on the Government Employees Pension Fund (GEPF) is not included in reports published by the Financial Services Board. At the time of writing, the latest available GEPF report is as at 31 March 2008.

## 3.2.2 END USER FINANCE MODELS<sup>7</sup>

### 3.2.2.1 DIRECT LOAN FROM FUND TO MEMBER

Section 19(5) of the South African Pension Funds Act, 1956 allows a retirement fund to grant a loan directly to a member as long as the loan is used:

- To purchase a house;
- To buy land and to erect a dwelling on it;
- To make additions or alterations to or to maintain or repair an existing dwelling, or;
- To repay a third-party loan, secured by a mortgage bond over a property.

The loan is conditional on the property actually belonging to the member or spouse and being occupied by the member or a dependant. The fund cannot grant or secure a loan on more than one property.<sup>8</sup> The regulator, the FSB, has made it clear that there must be every intention to repay the loan and that it should not be used as a means to accord the member premature access to his or her retirement benefits. The intention should be to reinstate the full value of benefits by the time the member retires.<sup>9</sup> The maximum loan amount is set by the trustees of the fund at a cap of about 70% to 80% of the member's accumulated retirement savings, although up to 90% is permitted in terms of the Pension Funds' Act (section 19 (5) (c)).

Direct housing loans by pension funds amounted to a little over R1.7bn in 2005 (or about 20% of the end-user market).<sup>10</sup> The introduction of the National Credit Act in 2005 means that funds offering loans to their members must register as credit providers with the National Credit Regulator. The compliance and reporting requirements associated with registration have made this model less attractive than before and most funds are opting for the model discussed below which allows them to offer members a pension-secured loan but does not require them to be registered as a credit provider. There is limited scope for expansion of the direct loan model.

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<sup>7</sup> For an excellent introduction to the South African pension industry and pension-backed lending see Sing 2009.

<sup>8</sup> As is often the case with regulation, whilst the underlying intent is admirable (in this instance to facilitate access to housing finance but to preclude members from speculative behaviour), there are unintended consequences. The "one property" restriction prevents retirement fund members from potentially amassing a property rental portfolio, which could substantially augment wealth and generate additional income.

<sup>9</sup> The FSB clearly states their position in regulatory guidelines (Circular PF No. 92, 1997) issued to the retirement fund industry. - "In terms of section 1 of the Act, the purpose of pension funds is to provide annuities or lump sum payments on retirement to members or to the dependants of members upon the death of members. Permitting housing loans was not intended to offer a means of reducing these benefits by allowing a set-off to take place. Accordingly there must be a real intention to repay a loan so as to reinstate the benefits to full value by the time they become payable on retirement of the members."

<sup>10</sup> FSB (2005)



### 3.2.2.2 SECURING A LOAN FROM A THIRD PARTY<sup>11</sup>

The use of pension funds to secure a third party loan is permitted in South African law and is exercised on a larger scale than the direct loan model above. A 2001 amendment to the Pension Funds Act makes provision for a fund to

*“...furnish a guarantee in favour of a person other than the fund in respect of a loan granted or to be granted by such other person to a member”..*

for the purposes of purchasing a house, land on which a house will be erected or for alterations and repairs to a house. The Financial Sector Charter (FSC)<sup>12</sup> has added impetus to this market with 212,740 pension-backed loans originated between January 2004 and 31 December 2007. Using market share estimates embodied in a public submission by Alexander Forbes<sup>13</sup> and assuming market size to be in the region of R10bn, the size of larger pension-secured loan providers' operations has been estimated in the table below.

<b>NON-RETIREMENT FUND LOAN PROVIDERS</b>	<b>ESTIMATED MARKET SHARE (Alexander Forbes estimate)</b>	<b>ESTIMATED BOOK VALUE (Market size of R10 billion)</b>
ABSA	10%	R 1 billion
FirstRand	16%	R 1.6 billion
Glenrand	4%	R 400 million
HomePlan <sup>14</sup> (Alexander Forbes)	20%	R 2 billion
NBC	13%	R 1.3 billion
Nedbank	4%	R 400 million
Standard Bank	30%	R 3 billion
Other	3%	R 300 million
<b>TOTAL</b>	<b>100%</b>	<b>R 10 billion (\$1 billion)</b>

**Table 2: Provision of pension-backed lending by financial institution and market share**

*Source: Alexander Forbes; own calculations (cited in Sing 2009)*

<sup>11</sup>For an excellent summary of pension-secured lending in South Africa see Sing 2009.

<sup>12</sup> The Financial Sector Charter commits all financial institutions in South Africa to promoting Black Economic Empowerment (BEE) in the financial sector. Among other commitments, the institutions are committed to transformation in the area of finance provision for low income housing. The Charter came into effect in 2004.

<sup>13</sup> Market share estimates are based on information submitted by Alexander Forbes to the Competition Tribunal in the process of acquiring Absa's remaining stake in HomePlan (Pty) Ltd, the joint venture pension-secured loan business originally established by Alexander Forbes and Absa (SAFLII, 2008).

<sup>14</sup> Joint venture between Alexander Forbes (50%) and Absa Bank (50%). Alexander Forbes is in the process of acquiring Absa Bank's share of the pension-secured loan business. – Absa also has a proprietary in-house pension-secured loan unit.

The average value of pension-backed loans is about R20 000 to R25 000 (roughly \$2 500) based on Genesis Analytics calculations working with data provided by Absa, Alexander Forbes and FNB. This is relatively small compared to an average mortgage loan in the lower end of the market of R120 000. This indicates that pension-secured loans are probably used for home improvements or extensions than to build new dwellings or purchase land.

Secured loans are relatively cheap compared to other forms of housing finance. Sing (2009) calculates that pension-secured loans in South Africa on average attract an interest rate of prime-1%, compared to mortgage loans at prime and unsecured loans at prime + 5%. Although no information was gathered, microloans rates would be significantly higher than pension-secured loans. Research by Genesis (2008) indicates that it is the poorer sections of society who make use of pension-secured lending. The most regular users of the product are households earning between R3500 and R10 000 a month (roughly \$400 to \$1200 a month) while upper income households earning over R15 000 a month (roughly R1 800 and up) used primarily mortgage loans to finance housing.

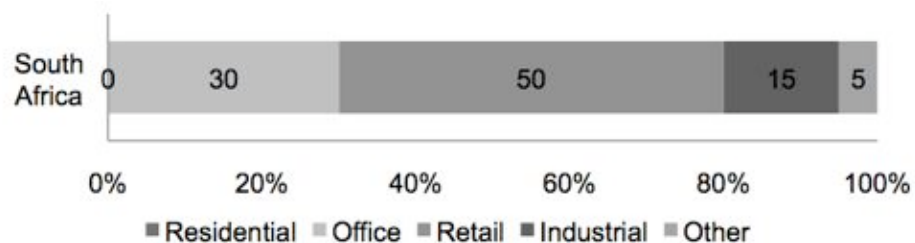
Although market participants indicated in interviews that most of the “low hanging fruit has already been picked” in this market, pension-backed lending is anticipated to grow. An Eighty20 report (2009) found that of the estimated 5.2m Financial Sector Charter households, 1.13m households could potentially access pension-secured housing finance. However, the implementation of National Credit Act has had a dampening effect on the number of people who will be able to access this form of financing, as the act introduced stricter lending and affordability requirements. Eighty20 (2009) estimates that 216 000 households would be disqualified on NCA grounds. Based on a market of 911 000 households for pension-secured loans and assuming that all qualifying households take up the opportunity, the estimated market potential is R18bn (\$1.85bn). This potential is likely to be reached through loan providers achieving deeper penetration within funds that already offer the loan product, than through signing up new funds that currently do not allow the product to be offered to their members. The largest fund in the country, the GEPPF, is considering introducing pension-backed lending to its members, although the trustees are concerned about the viable size of the loans based on the modest salaries and limited accrued savings of most members.

South Africa is also exploring the introduction of a national social security scheme which will extend retirement coverage to 6m people who are currently formally employed but don't belong to a retirement fund. Should the scheme be introduced, the possibility will exist to extend access to pension-secured lending to the majority of the formally employed population (although it would take some time for newcomers to build up meaningful savings).

### 3.2.3 FUND INVESTMENT MODELS

#### 3.2.3.1 INVESTMENT IN HOUSING PROJECTS, DEVELOPERS AND FUNDS

In terms of Regulation 28 (6) of the regulations to the Pension Funds Act 1956, pension funds can invest up to 25% of assets in immovable property, in claims secured by mortgage bonds, in property collective investment schemes, in shares in property companies. They can also invest up to 5% of assets in any single property, property company or property development project (Regulation 26 (6) (a)). The act does not differentiate between industrial, commercial, residential or low-income residential property investments. In other words, the regulatory space exists in law for pension funds to direct a portion of their assets to residential development investments and developers. However, there is little indication that pension funds take advantage of this allocation. The SAPIX/IPD index shows that direct property portfolios are held mainly in office, retail and industrial properties, while residential portfolios are almost non-existent, as shown in Figure 5 below.



**Figure 5: Breakdown of pension funds' property portfolios**

Source: SAPIX / IPD

Furthermore, interviews by Genesis Analytics (2008) conducted with five low-income housing developers affirm that it is banks who are major investors in low-income housing developments, rather than pension funds. What is more common is for funds, via their investment mandates to asset managers to hold equity in, or debt of, listed companies that are involved in the construction of low-income and RDP housing. Examples include M3 Calgro, RBA and Basil Read. These investments are driven by good investment opportunities, not because they are specifically helping to solve the housing backlog.

The GEPP as the largest fund by some way has only weak investment links to housing. At the time of writing 3% of the fund's portfolio was invested in property or about R20bn (\$2bn) though the fund did report that it would like to increase this portion. The property portfolio is invested in commercial, industrial and retail space with no residential investments. Interviews confirm the fund has no objection to residential investments but "just hasn't found opportunities yet".<sup>15</sup>

There is evidence of pension assets going into funds used to buy derelict inner city buildings and renovate them for rental to the low and middle income markets.<sup>16</sup> This model is also one of interest, although does not obviously provide direct housing benefits to the members of the fund (investment return aside). Other funds that channel investment directly into low-income housing developments do exist, for example the Housing Impact Fund managed by Old Mutual Investment Group South Africa.

### **3.2.3.2 INVESTMENT IN HOUSING FINANCE OPPORTUNITIES**

The regulations to the Pension Funds Act, 1956, specify that funds can invest 25% of their assets in immovable property, claims secured by mortgage bonds, property collective investment schemes as well as shares in property companies (Reg. 28(5)). They can also invest up to 5% in any one bank (Reg. 28 (1)(a)(i) as well as up to 5% in any unlisted company (Reg. 28(7)(a)). Therefore in terms of the law, a pension fund can invest in a bank or an unlisted company whose purpose is to grant housing finance. Pension funds do invest in the equity of commercial banks on a large scale.

There are 2 338 registered microfinance institutions and co-operatives in South Africa. Of these 99 are specialised in housing microfinance providers which include for-profit entities such as Lendcor, NGOs like the Kuyasa Fund, and housing trusts. It is estimated that between 10% (R3.2bn) and 33% (R10.7bn) of all microloans (by specialised and non-specialised institutions) are applied to housing needs. However, there is little indication that pension funds are providing wholesale funding to housing micro-financiers or investing in share ownership. The Kuyasa fund received grants from international donors like Cordaid, wholesale funding from banks such as FNB and ABSA, and specialised public funders such as the Rural Housing Loan Fund (RHLF). Lendcor, a for-profit micro lender also receives wholesale funding from the RHLF. Pension funds seem to bypass these opportunities altogether, even though they do offer the potential for excellent returns. It would appear that pension funds trustees depend on "conventional" asset consultants and asset managers for whom these investments appear exotic, who do not have access to the opportunities or who are not prepared to investigate the opportunities.

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<sup>15</sup> Interview with Head of Investments, on 21 May 2009

<sup>16</sup> Interview with Andrew Canter of Futuregrowth Asset Managers, on 23 March 2008

Nevertheless, the prospects for greater pension fund investment in housing are good in South Africa. There are three interesting dynamics at work. The first is the Financial Sector Charter, a commitment made in 2003 by the financial industry to provide, amongst other things, mortgage finance to low-income households. The targets set in the commitment (R42bn over five years) were met from 2003 to 2008 by commercial banks. However, pension funds were not signatories to the charter. The second tranche of the FSC is in negotiation at the time of writing – if it is agreed, it opens an opportunity to include pension funds in the new commitments. Similarly, in 2003 at the Growth and Development Summit, a national summit on developmental commitments of business, government and labour, a commitment was made by all signatories including pension funds to invest 5% of investible assets in projects of “high social value”. This was defined to include low-income housing. To date, this commitment has not been expressly met, partly because of apathy, partly because the initiative was cannibalised by the FSC, and partly because parties found there were not enough instruments or projects to invest in that would qualify as “high social value”.

Secondly, the socially responsible investment (SRI) sector is growing in profile and importance in South Africa, albeit at a disappointing pace. Targeted SRI would arguably include low-income housing and low-income housing finance.

Finally, there is a patent interest from the largest public funds especially the largest fund, the GEPPF, to invest more directly in “developmental investments” - this would include low-income housing and would serve to cut a path for other institutional investors to follow. This interest is partly driven by the international growth of SRI and partly by calls from the Left to prescribe a portion of pension funds assets into developmental or “high-social-value” investment (in line with the Growth and Development Summit commitment). The calls for prescription are likely to become louder.

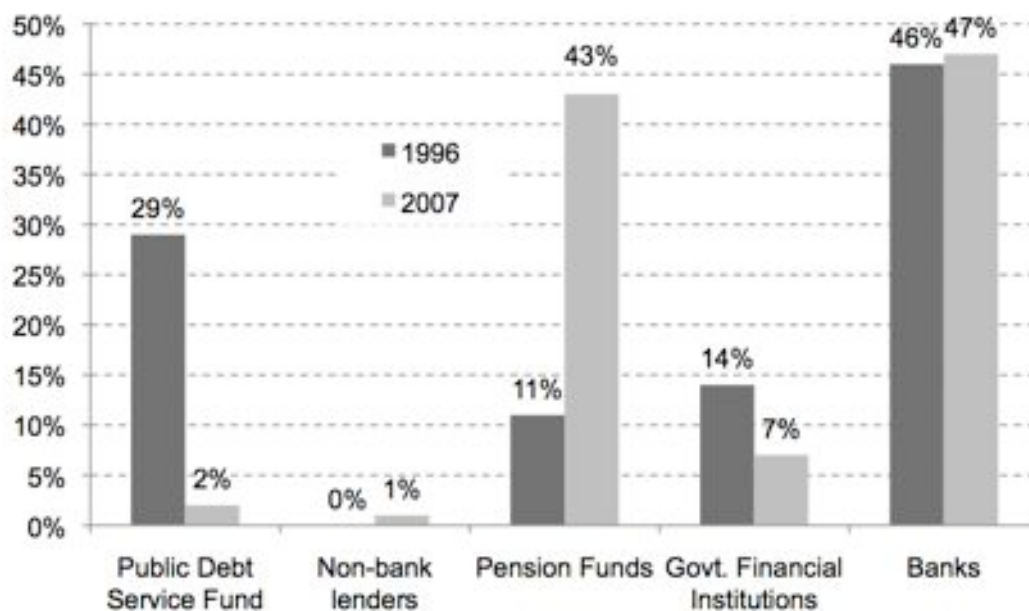
The prospects for the investments of pension funds to be combined with mortgage lenders are fair – the banks have shown themselves open to innovative schemes that serve the low-end of the housing market. It is possible to imagine a pension fund and bank entering into a joint venture where the fund provides capital and the bank provides its credit provision evaluation and distribution mechanisms to direct the funds to mortgages for pension fund members. However, this would depend on the impetus of a second tranche of the Financial Sector Charter, which is not certain at the time of writing.

### **3.3 BOTSWANA**

#### **3.3.1 CONTEXT**

Botswana has enjoyed strong growth due to the judicious management of its diamond resources. GDP measured \$11.8bn in 2007 with annual growth rates of 4%. This is expected to fall dramatically in 2009. Botswana has a population of 1.8m and a working age population of 1.1m. The currency is the pula (\$1 = P7.95 on the 31<sup>st</sup> March 2009).

The pension funds industry in Botswana has grown substantially over the past decade, primarily due to the transformation in 2001 of the DB government pension scheme to a DC scheme called the Botswana Public Officers Pension Scheme (BPOPF). In 2007 BPOPF had 90 000 members (73% of pension fund members) and controlled about 80% of total pension assets.<sup>17</sup> Figure 1 below illustrates the difference in the asset make-up by value of the financial system in 1996 and 2007 showing the rapid growth of pension assets.

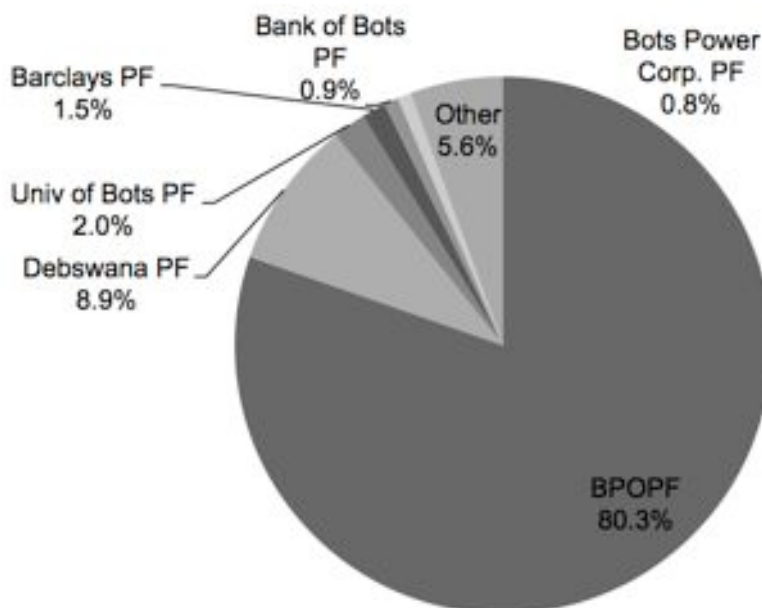


**Figure 6: Value of assets of the financial system in Botswana in 1996 and 2007**

*Source: Capital Securities, 2008*

In early 2009 pension assets were valued at approximately P30bn (\$3.7bn). There are about 128 funds in Botswana accounting for 123 000 members, or 11% of the working age population. The industry is dominated by DC pension funds, with only 10% being DB. There are both private and public pension funds in operation but owing to the substantial size of the BPOPF public schemes control the vast majority of assets. The largest private fund is Debswana Pension Fund for employees of the De Beers' family of companies. Figure 6 below gives an indication of the overall structure of the pension fund industry.

<sup>17</sup> Bank of Botswana, 2007



**Figure 7: Breakdown of pension funds in Botswana, by asset value**

Source: NBFIRA, 2008

Pension funds are registered in Botswana in terms of the Pensions and Provident Funds Act, 1988. Oversight sits with the Non-Bank Financial Institution Regulator Authority (NBFIRA) (since April 2008).<sup>18</sup>

It is estimated that 96 000 households, the majority of whom are low-income households, will need quality affordable housing in order to meet government targets of providing housing to all Batswana by 2016.<sup>19</sup> There has been considerable growth in lending for mortgages in Botswana. Year-on year, property loans from commercial banks to households rose by 22.5% in the year ending December 2006, and accounted for 23.6% of all lending to households. Nevertheless, mortgages still only reach a minority of the population. According to the Bank of Botswana, the value of property loans as at 2006 was \$288 million. Given a modest 3 bedroom home typically sells for \$ 48 780, the number of loans is approximately 5900 (Rudloff, 2007a). With approximately 260 000 urban households in the country, this is a small number.

<sup>18</sup> Jefferis, 2008

<sup>19</sup> von Rudloff, 2007. *Access to Housing Finance in Africa: Exploring the Issues. Botswana*. Report prepared for the FinMark Trust

### **3.3.2 END USER FINANCE MODELS**

#### **3.3.2.1 DIRECT LOAN FROM FUND TO MEMBER**

Section 18(4) of the Pensions and Provident Funds Act, 1988 states that:

*“A registered fund may, if its rules so provide, grant to a member a loan secured by a first mortgage of immovable property on which a dwelling-house has been or is to be erected for the personal residence of the member: Provided that the loan shall not exceed –*

*(i) the amount of the benefit to which the member would be entitled if he resigned voluntarily on the date on which the loan was granted, together with 50 per cent of the market value of the property; or*

*(ii) if the employer of the member guarantees the fund that he will meet any shortfall between the amount referred to in paragraph (i) and the market value of the property, the market value of the property.*

Although permitted by law, the take-up of this product by funds has been negligible even though a number of interviewees, including the regulator, report that demand is high among members. According to interviews the wording of the act above is considered confusing in that it appears to allow members to borrow more than their withdrawal benefits and to source these from the fund’s resources. This implies that the savings of other members could be used to provide the loan and that the overall investible assets of the pension fund might be diminished. The uncertainty has been enough for most funds to decline to offer the service. Funds also report that they are largely not technically equipped to advance these funds toward housing finance.<sup>20</sup>

Interviews with funds highlighted their general aversion to this model but many *were* interested in making pension assets available to members though pension secured loans provided through financial institutions – see below.

#### **3.3.2.2 SECURING A LOAN FROM A THIRD PARTY**

This product is also permissible in Botswana law. The take up, however, has also been negligible. This appears to be for three reasons. *Firstly*, the wording of the act is unclear. Section 32 of the Pensions and Provident Funds Act (an amendment made in December 2008) states that:

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<sup>20</sup> von Rudloff, 2007a. *Botswana: Access to Housing Finance*, Meeting notes from 17 October 2007 in preparation of report for Finmark Trust. ([http://www.finmark.org.za/documents/BtswA2HF\\_notes.pdf](http://www.finmark.org.za/documents/BtswA2HF_notes.pdf))



“(1) ...a member of a fund may, for the purpose of security for –  
 (a) a loan referred to in subsection 4 of section 18 of the Act; or  
 (b) money borrowed from his employer,  
 cede or pledge his rights to any benefits from the fund in writing, as the Registrar shall approve.

It seems that the intention of the amendment was to allow for housing loans from financial institutions to be secured against pension savings. Members of the industry do not think the wording is clear, however: the confusion is whether provision is extended to mortgage loans made by third parties, such as financial institutions, or only to loans made by the pension fund themselves (as provided for in section 18(4) of the Act). At least one major fund interprets the wording to mean that: “*in terms of the Act, the Fund must register a first bond against the property which by extension means that the money has to come from the fund and not a third party.*”<sup>21</sup> Given the uncertainty, Botswana’s pension industry has opted not to introduce the product.

*Secondly*, there is uncertainty as to the tax treatment of pension loans. When a member resigns or is dismissed and accesses his/her withdrawal benefit, a tax directive must first be obtained from the Receiver. If the member is in arrears, the Receiver will deduct the value of the tax owing from the withdrawal benefit before the funds can be used for any other purpose. Under these circumstances, if a pension fund was to supply pension-backed guarantees for a member and his/her withdrawal benefit was usurped by tax deductions, (a reportedly common experience) the pension fund would be left exposed.<sup>22</sup> One of the large administrators in Botswana suggested that a tax table be developed in order to make tax deductions from pension withdrawal benefits more predictable.

*Thirdly*, there are already a number of ways for Botswana to access housing finance including (1) the Botswana Building Society or a commercial bank with employer’s providing a guarantee for employees,<sup>23</sup> (2) accessing a housing loan from a long term insurance policy,<sup>24</sup> and (3) accessing funds from the Self Help Housing Agency.<sup>25</sup> One interviewee noted that most housing finance needs are met through the first two methods and the BBS approves around 95% of all applications received. The interviewee suggested that with access to finance available there is less pressure on pension funds to offer housing finance access to their members. This, however, contradicts the findings of a study commissioned by the Finmark Trust into access to housing finance in Botswana. This study notes that, despite the existence of the abovementioned channels, access to housing finance is still severely limited. The

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<sup>21</sup> Alexander Forbes interview, 5 March 2009

<sup>22</sup> *Ibid*

<sup>23</sup> Monthly repayments are deducted directly from the employee’s salary and paid to the bank. This system is said to work well with low default rates.

<sup>24</sup> The loan is based on the surrender value of the policy. These are apparently very popular loans.

<sup>25</sup> The Self Help Housing Agency (SHHA) was established in the early 1970s and provides free loans to the unemployed or low income individuals. In 1996 it was reported by the SHHA that up to 60% of the urban population of Botswana had been provided with shelter through this agency.

reasons cited for this include: (1) commercial banks and the BBS impose debt ratio limits on borrowers, (2) the government backed bank loans offered are only available to people earning above a certain amount, and (3) the Self Help Housing Agencies loans are only offered to people within certain income brackets: casual labourers earning below a certain amount cannot access these loans, and those earning above the upper threshold set by the SHHA and below the lower earnings threshold that banks require to provide loans are unable to access housing finance. In addition, the value of the SHHA loan has become inadequate to purchase a standard house (owing to house price inflation) and the shortage of available land has resulted in severe delays (of up to 15 years) from the time of application until the plot is allocated.<sup>26</sup>

Interviewed pension funds and other stakeholders stated their willingness to offer pension backed loans if the law could be clarified. It appears from interviews that the industry is also interested in the development of the third party loans model. Demand from members is also reportedly high. Take-up is blocked by confusion around interpretation of the act (especially regulation 32) and the tax treatment of loans. A number of institutions have reportedly applied to the regulator and government to amend/clarify the law, without success. It is unclear whether the issue lies with the regulator or the Ministry of Finance. If these issues are clarified there is room for growth in end user finance offerings in Botswana. Moreover, such is the dominance of the BPOPF that the take up of one fund would open the product to 73% of all fund members.

### **3.3.3 FUND INVESTMENT MODELS**

#### **3.3.3.1 INVESTMENT IN HOUSING PROJECTS, DEVELOPERS AND FUNDS**

Pension funds are allowed to invest directly in property as well as in housing developments, but prefer commercial to residential developments.<sup>27</sup> Besides the BPOPF, pension funds are relatively small and not large enough to invest in property developments. Some of the smaller funds invest in listed pooled property holding funds, which provide smaller, more liquid investment opportunities. The small value of industries assets (\$3.5bn) would indicate that there is not extensive capital available for major investment.

A general view was expressed in interviews that returns in low-income housing are thought to be low and potentially at odds with a pension fund's primary mandate to maximise members' returns.<sup>28</sup> A number of asset managers highlighted that housing investments are made on a case-by-case basis and are judged according to their risk-return relationship. If a low income housing development offered a suitable risk-return, they would in principle, be willing to invest.

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<sup>26</sup> von Rudloff, 2007b. *Access to Housing Finance in Africa: Exploring the Issues. Botswana*. Report prepared for the FinMark Trust

<sup>27</sup> von Rudloff, 2007a. *Botswana: Access to Housing Finance*, Meeting notes from 17 October 2007 in preparation of report for Finmark Trust. ([http://www.finmark.org.za/documents/BtswA2HF\\_notes.pdf](http://www.finmark.org.za/documents/BtswA2HF_notes.pdf))

<sup>28</sup> Von Rudloff, 2007a; Interviews

One of the problems with housing developments is a scarcity of available land in urban areas.<sup>29</sup> Thus it may be that there is a lack of suitable developments in which to invest, rather than unwillingness on the part of the asset managers to invest in low-income housing. This is reinforced by the fact that 70% of pension assets may be invested offshore as a result of a lack of local investment opportunities.<sup>30</sup>

### **3.3.3.2 INVESTMENT IN HOUSING FINANCE OPPORTUNITIES**

There are no legal restrictions on investing in mortgage lenders or financial institutions and many of the asset managers do invest in commercial banks and the Botswana Building Society. This is based on the returns yielded rather than as an explicit strategy to invest in housing finance.<sup>31</sup> Furthermore, Botswana Insurance Fund Management invests in Letshego, a large micro-lender that provides unsecured loans to employees of over 100 companies in Botswana. Reportedly, Letshego loans are frequently used to fund home improvements.<sup>32</sup> The precedent of investing in a MFI that helps to fund home improvement is now established with Letshego. Generally, however, it is fair to say that funds have a conservative view of investment, and there may be suasion by government to keep pension investments in low risk, traditional instruments.

## **3.4 NAMIBIA**

### **3.4.1 CONTEXT**

Namibia experienced good GDP growth (average 5.2%) over the last five years, attributable to good commodity prices. Growth is expected to fall dramatically in 2009. Namibia has a small population of 2m people and a working age population of just 1.2m people. The currency is the Namibian dollar (US\$1 = N\$9.7 at 31<sup>st</sup> March 09).

As at March 2007 there were 115 118 active fund members, accounting for less than 10% of the working age population.<sup>33</sup> According to the regulator, the growth rate of pension fund membership in Namibia may be declining, possibly because formal employment growth has stagnated from 2004.

There are 450 pension funds in Namibia with total assets of about N\$45bn (\$4.5bn).<sup>34</sup> Most of the funds are small. The dominant player is the Government Institutions Pension Fund (GIPF) which controls over 70% of assets and accounts for more than half of all fund members. It is a DB fund with assets of N\$30.5bn (\$3.1bn) and 72 000 members. Other sizeable funds include

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<sup>29</sup> von Rudloff, 2007b. *Access to Housing Finance in Africa: Exploring the Issues. Botswana*. Report prepared for the FinMark Trust

<sup>30</sup> von Rudloff, 2007a.

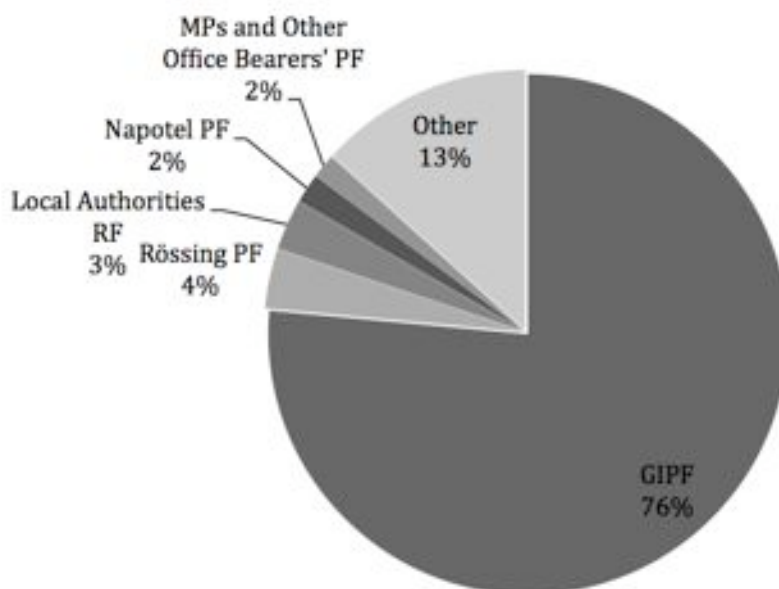
<sup>31</sup> Interview with BIFM, 12 March 2009

<sup>32</sup> *Ibid*

<sup>33</sup> NAMFISA, 2007; World Bank Human Development Report 07 / 08

<sup>34</sup> NAMFISA interview, 3 March 2009

Rössing Pension Fund, the Retirement Fund for Local Authorities in Namibia, and Napotel Pension Fund. Figure 7 below shows the market share by asset value of the largest funds illustrating the dominance of the GIPF.



**Figure 8 Pension funds by asset value, 2005**

Source: NAMFISA

Pension funds are regulated by the Namibia Financial Institutions Supervisory Authority (NAMFISA), which regulates pension funds in terms of the Pension Funds Act 24 of 1956 (this was originally based the South African pension act and pension law is still similar to that in neighbouring South Africa). The government is reportedly showing interest in the development of a national pension fund to cover all employees, though as of October of 2008 research into the development of the national scheme had not yet been commissioned.<sup>35</sup>

### **3.4.2 END USER FINANCE MODELS**

#### **3.4.2.1 DIRECT LOAN FROM FUND TO MEMBER**

Section 19(5) of the Pension Funds Act, 1956, allows a fund to give loans to members for housing purposes at the discretion of the trustees. The act allows for a loan of 30% of the individual's pension savings if it is used to redeem a mortgage loan for a property owned by the member or spouse, to purchase a house or land for the member or one of the member's

<sup>35</sup> The Namibian Economist, 2008

dependants, or to maintain or make alterations to an existing property owned by the member or spouse. The property must be inhabited by the member or one of the member's dependants. The loan value and interest (which is capped by legislation at 16% pa) must be repaid within 30 years in monthly or weekly instalments. The loan value cannot be more than 90% of the property's market value.

While the largest fund, the GIPF, does not offer this service to its members most other funds do, although the amounts lent in this way are small – as at March 2008 N\$78.5 million had been advanced as home loans to members by pension funds.<sup>36</sup>

There are reportedly a number of problems associated with this model. *Firstly*, the wording in the act stipulates that, on default, the repayment of the loan comes directly from the fund's resources. The resources of the fund and, by implication, the resources of other members are thus sometimes drawn down by exploitation of this clause. Abuse of this nature is said to be widespread and has caused the trustees and administrators of many funds to approach the regulator requesting that the clause be amended or removed. *Secondly*, it is reported that loans are frequently used for purposes other than housing. Enforcement of the use of funds condition is rare. *Thirdly*, pension funds will not provide housing loans to members who occupy dwellings on state land and who do not hold title over their properties (this is a common form of tenure in Namibia).<sup>37</sup>

Despite these problems pensions funds continue to offer pension loans because they would have yet to actively remove this provision from their rules i.e. there is a degree of inertia to overcome, and because reportedly the labour unions who are represented on the boards of trustees of many funds lobby hard for retention of the product as a service to their members.<sup>38</sup>

A strong sense is gained from interviews that the enabling legislation in Namibia has been abused and that the wording needs to be looked at carefully. In fact, the regulator intimated that it is considering removing the housing loan clause completely from the act. This has not happened yet partly because funds have voluntarily started to replace the loan models with security models – see below – and partly because members and unions have so far lobbied successfully to retain the service.

#### **3.4.2.2 SECURING A LOAN FROM A THIRD PARTY**

Section 37D (a) (ii) of the Namibian Pension Funds Act, 1956, makes provision for a pension fund to stand as guarantor for a housing loan by a third party for up to 70% of a member's savings. It is estimated that about 25% of pension funds offer this service and the facility is

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<sup>36</sup> NAMFISA Interview, 3 March 2009

<sup>37</sup> Interviews, 3 March 2009; 12 March 2009

<sup>38</sup> Interview, 3 March 2009

taken up in about 60% of cases. Nevertheless, values are small: roughly N\$100m has been guaranteed in this way, about 0.2% of total pension fund assets.

Pension funds tend to prefer this model of housing finance to directly providing loans to members because the resources of the fund are not drawn down; the risk of bad debt is lower because repayments are generally deducted directly from salaries; the interest rate on loans through a financial institution can be lower than the 16% offered in terms of the law by funds; and members can get a loan for 70% of their pension fund savings through a pension-backed guarantee as opposed to 30% when the loan is granted by the pension fund.<sup>39,40</sup> However, the roll out of this model is understood to be undercut by the fact that many employers guarantee employee's home loans and civil servants are given housing subsidies by the government; as well as by the fact that use-of-funds monitoring is difficult.

Where the pension fund is unable to recover loans from members they often request the administrator to write down the value of the pension fund's asset book, and write off the loans. Reportedly, members are pressured by unions to obtain loans and then insist that their employer instructs the pension fund to writes off the loans. If the pension funds were removed from the employer and had entirely separate mandates, or if the regulator was stricter about requiring trustees to playing their role with a real sense of sanction, this would not occur.<sup>41</sup>

Although there is still room for growth of this model, the low penetration levels of pension funds as well as the fact that the growth rate of fund membership in Namibia over the last three years seems to be "stagnant if not declining"<sup>42</sup>, suggest only limited growth is possible.<sup>43</sup> The service seems to have become politicised to a degree and some trustees said they were thus reluctant to introduce the product for their members.

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<sup>39</sup> Interviews, 3 March 2009;

<sup>40</sup> The trustees of a pension fund decide on the percentage of savings that members can be loaned. It became practice to keep this percentage low so as to limit the amount taken out of the market. The higher percentage allowed when taking a pension backed loan from a bank was apparently driven by the financial institutions that profited from providing loans. The only risk to the financial institution is that the pension fund assets are taxed (approximately 30%) on withdrawal (or redemption of the loan on default). The other 70% of the pension fund assets are guaranteed to the financial institution on default. This high percentage is reportedly prejudicial to both the member and the financial institution.

<sup>41</sup> Industry interview, 12 March 2009

<sup>42</sup> NAMFISA Annual Report, 2007.

<sup>43</sup> This statement is qualified by three factors: (1) the source data used each year was not obtained from the same funds, (2) transfers to umbrella funds could result in an apparent decline in membership, and (3) employment growth in the formal sector has stagnated since 2004.

### 3.4.3 FUND INVESTMENT MODELS

#### 3.4.3.1 INVESTMENT IN HOUSING PROJECTS, DEVELOPERS AND FUNDS

According to pension fund investment guidelines produced by NAMFISA, pension funds are allowed to invest up to 25% of total assets in property.<sup>44</sup> This would seemingly include low-income housing developments, however no evidence of this type of investment was actually found. Interviews with asset managers and pension fund trustees suggest that low-income housing developments are avoided because of a perception that the returns are not attractive. This may be because some housing developments are funded by donor grants and are not profit-seeking investments.<sup>45</sup> Moreover, some developments are built on state land and pension funds are not willing to invest in property on unproclaimed land.<sup>46</sup>

Regulation 28 of the Pension Fund Act, as amended in December 2008, stipulates that pension funds must invest at least 5% of assets in unlisted, local assets.<sup>47</sup> Some housing-focussed parastatals (like the National Housing Enterprise) and low-income housing developers have reportedly approached the larger pension funds to allocate a portion of this to housing projects. For reasons set out above, this has not happened, however there is, in principle, an interest by some trustees in investing in a more socially responsible manner, including in housing.<sup>48</sup> The GIPF reports that it is willing to invest in low-income housing but is blocked by the issue of proclamation of state land, the fact that government employees are already provided with housing subsidies, and that it cannot invest in the National Housing Enterprise because it is a parastatal and not a (listed or unlisted) company in which the GIPF can take an equity share.

There are two listed vehicles through which to invest in property in Namibia called Vukile Property Fund Limited and Oryx Properties Limited. Oryx and Vukile invest in premier retail, industrial and office real estate in order to provide high returns to its investors. If pension fund asset managers choose to invest in listed property they would tend to invest in Vukile or Oryx.

#### 3.4.3.2 INVESTMENT IN HOUSING FINANCE OPPORTUNITIES

Low cost housing in Namibia is supplied by the Build Together Programme and the Shack Dwellers Federation of Namibia. Additionally, private companies such as Fritze & Quell and Berechiah Building Contractors have reportedly started to build low cost housing in order to illustrate that low cost housing is a feasible investment for private developers. The Clay House

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<sup>44</sup> NAMFISA, 2006

<sup>45</sup> Interview, 12 March 2009.

<sup>46</sup> *Ibid*

<sup>47</sup> The motivation for Regulation 28 was to keep capital within the borders of Namibia; a large portion was apparently flowing into South African assets

<sup>48</sup> This agreement apparently broke down when the parastatal discontinued communication with the pension fund.

Projects and the National Housing Enterprise are also active in building houses in the low and medium cost housing segments. With this degree of action in the low and medium cost housing space (which accounts for more than 85% of the population) there is likely to be scope for pension fund resources to be channelled directly into low or medium cost housing developments by entering into agreements with private developers.<sup>49</sup>

There are no legal restrictions on the investment by pension funds in mortgage lending institutions. Investment in banks is widespread by pension funds because many of the Namibian banks are linked to South African parent companies and are therefore considered safe assets that satisfy the risk/return ratio requirements of many pension funds.<sup>50</sup> There are currently no building societies in which to invest in Namibia.<sup>51</sup> There are MFIs in operation that specifically support developmental activities such as small-scale business and incremental housing improvement. The GIPF has reportedly been approached by a number of MFIs to invest in terms of the Regulation 28's 5% unlisted, local requirement, although no investment has yet been made as the trustees are still looking into the merits of the arrangement.

The prospects of tapping more pension assets for housing-related investments are good in Namibia, and the investible assets under management are not insignificant (\$4.5bn). There is no regulatory blockage to pension funds investing in housing and housing finance institutions, and there is general interest in investing in housing developments as long as they can be shown to generate market-based returns. The view that returns in low-income housing are low, and thus potentially at odds with a pension fund's primary mandate to maximise members' returns, would need to be overcome. The recent amendment to Regulation 28 to stipulate that pension funds must invest at least 5% of assets in unlisted, local assets, provides good impetus to these prospects – and there is an interest amongst some of the larger funds to invest in a more socially responsible manner, including in housing.

## **3.5 ZAMBIA**

### **3.5.1 CONTEXT**

Zambia is a low-income country with an adult population of 11.4m people, of whom 5.9m are of working age. There is a housing backlog in Zambia of 1.5m to 2m housing units, as well as severe limitations to the accessibility of housing finance. Mortgage regulation has only existed

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<sup>49</sup> Kalili, N., Adongo, J. and T. Larson, (2008). *Overview of the Housing Finance Sector in Namibia*, Prepared for the Finmark Trust by the Namibian Economic Policy Research Unit. ([http://www.finmark.org.za/documents/AHFA\\_Namibia.pdf](http://www.finmark.org.za/documents/AHFA_Namibia.pdf))

<sup>50</sup> Interview, 12 March 2009

<sup>51</sup> Swabou existed as a building society until some years back when it merged with FNB to become FNB Namibia Holdings Limited.



in Zambia since 1996 and mortgage lending was effectively dormant until 2004.<sup>52</sup> The currency is the Zambia kwacha (\$1 = ZK5,622 on the 31<sup>st</sup> March 2009).

It is compulsory for all employees in the formal sector to contribute to the National Pension Scheme (NPS). Contribution to any other pension scheme over and above the NPS is optional. The assets and membership of the NPS are thus substantially larger than those of any other fund in the industry. In 2007, approximately 550 000 people were members of pension schemes; about 9% of the working age population. The majority are members of the three biggest schemes.<sup>53</sup>

There are around 300 pension schemes with assets of about ZK2.5 trillion (or \$436 million). The NPS controls approximately half of these assets. Other large schemes are the Public Service Pension Fund (PSPF)<sup>54</sup> and the Local Authorities Superannuation Fund (LASF).<sup>55</sup> The largest private schemes include Saturnia Regna, Zambian State Insurance Corporation (ZSIC), Mukuba Pension Scheme and Madison Pension Fund Trust. Figure 9 below illustrates the size of existing pension funds (public and private) as a proportion of total pension assets in Zambia (excluding the NPS's assets).

Although the vast majority of pension funds are DC funds, the asset value and membership of DB funds are larger because both the NPS and the PSPF are DB funds.

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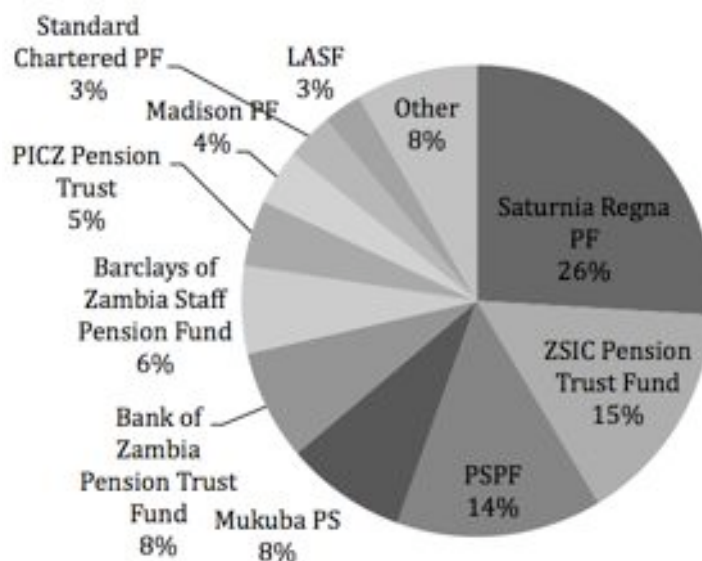
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<sup>52</sup> Finance Building Society Interview

<sup>53</sup> FinMark Trust, 2007

<sup>54</sup> The PSPF covers central government civil service members hired prior to February 2000, plus armed forces and teachers.

<sup>55</sup> The LASF covers local government employees, national health administration employees, ZESCO and water board employees hired prior to February 2000.



**Figure 9: Breakdown of pension funds in Zambia, by total assets, 2005 (ex NPS and civil service arrangements)**

*Source: Pension and Insurance Authority, 2005*

There are two important pieces of pension regulation in force. The Pension Schemes Regulation Act, 1996 regulates all schemes and requires them to be registered with the Registrar of Pensions and Insurance.<sup>56</sup> This act does not cover the NPS which falls under its own law, the National Pension Schemes Act, 1996. The PSPF and the LASF are also statutory bodies. The PSPF was created under and is governed by the Public Sector Pension Scheme Act of 1996, and the LASF was created under the Local Authorities Superannuation Fund Act of 1963. Since 1997 the Pension and Insurance Authority (PIA) became the oversight body and was established under the Pension Scheme Regulation Act (No. 28 of 1996) and the Insurance Act (No. 27 of 1997).

In Zambia, only 0.4% of the population currently have a loan from a bank, government scheme or employer to buy a house and this includes all loans for housing, not just mortgages. Only 0.1% of have a housing loan from a bank, and only 2.4% have at one time loaned to buy a house.<sup>57</sup>

### **3.5.2 END USER FINANCE MODELS**

<sup>56</sup> OECD, 2008

<sup>57</sup> Gardner, 2007b

### 3.5.2.1 DIRECT LOAN FROM FUND TO MEMBER

Interviews with pension funds in Zambia suggest that there is widespread interest among pension fund members to access pension assets for housing loans. The service is neither expressly permitted nor prohibited by the Pension Scheme Regulation Act or the National Pension Schemes Act. There are, however, a few exceptions to this general rule: the Public Sector Pension Scheme Act of 1996 does provide explicitly for the model and members of this scheme are able to, and do, access loans at concessionary rates from their pension benefits. In addition, previous ZNPF members (who now fall under the NPS) were able to directly draw on their pension funds with which they could fund extensions or renovations. Members who had access to this prior to the ZNPF being absorbed into the National Pension Scheme are still able to access this benefit, known as “Homeownership with Drawer Benefits”. The LASF reportedly also provide loans to its members at below market rates, however no further information could be sourced on this in literature or from interviews.)

Increases in inflation and house prices over the years have rendered the value of direct loans relatively unhelpful as a source of housing finance.<sup>58</sup> This is presumably an important aspect of why the direct loan provision has not been included in legislation covering the NPS. In addition, interviews highlight that there is a widely held belief in the industry that lending to members is a risky use of pension funds and that it is the role of financial institutions, not pension funds, to provide mortgage finance. Nevertheless, access to housing loans is said to be a popular benefit amongst members who are still able to access it.

### 3.5.2.2 SECURING A LOAN FROM A THIRD PARTY

No express permission for, or prohibition of, pension-secured lending is given in Zambian law. However, some pension-secured lending is observed in practice: some banks are reportedly granting housing loans to individuals on the basis of the applicant being a member of a pension fund, and contracting with the borrower to secure the loan over the funds. This is considered highly risky as pension fund assets are protected by law and, on default, a bank would not be able to access pension fund assets without the agreement of the fund.<sup>59</sup> Concern regarding such behaviour and the noted demand for housing loans by pension fund members has led the regulator to start developing regulations that will allow members to use their pension fund assets to meet housing needs.<sup>60</sup> Little information was obtained regarding the models being explored but given the above concerns it is probable that the regulator would take a relatively risk averse approach.

Apart from banks making use of pension fund assets as security, no other institutions appear to employ this model. A large pension fund manager highlighted that if a suitable vehicle were to

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<sup>58</sup> Interview, 10 March 2009

<sup>59</sup> Regulator interview, 17 March 2009

<sup>60</sup> *Ibid*

exist, they would be interested in employing this model.<sup>61</sup> A number of funds share this opinion.<sup>62</sup> Small pension assets (\$436m) and low levels of penetration mean this model does not have good “scalability”. However, the presence of a national pension scheme does open up the possibility of extending the service to the formally employed in time.

### **3.5.3 INVESTMENT MODELS**

#### **3.5.3.1 INVESTMENT IN HOUSING PROJECTS, DEVELOPERS AND FUNDS**

Both the National Pension Schemes Act and the Pension Scheme Regulation Act are conservative in their investment allocation allowances. The NAPSA act was altered in 2008 to allow for more “greenfields” investment but still tends to adopt conservative investment guidelines.<sup>63</sup> The safety of their member’s funds is of principal importance which is borne out by the historical emphasis placed on investing in government bonds as well as in their tentative approach to the development of new product offerings. Current *draft* legislation permits approximately 30% of a pension fund’s assets to be invested in property, including housing projects. Asset managers do already invest in property in commercial and retail investments, though minimally, if at all, in low-income housing. Asset managers cite the poor returns (or at least the perception of poor returns) of low-income housing investments as the key reason for this (although at least one fund reports that it has found good investment yields in low-income housing)<sup>64</sup>, as well as the fact that the return on government bonds is high (the three month Treasury bill rate is currently 15%). A significant proportion of pension fund assets are invested in government bonds leaving only a small pool of funds to be invested elsewhere. (It is worth noting that in Botswana, from 2006, pension funds were prohibited from investing in Bank of Botswana Certificates (Treasury bills), the effect of which was to direct pension funds’ liquidity into the economy).

Some employers report that they would like to use the employee pension fund to build housing for employees. However, this is restricted by a provision stating that only 5% of a pension fund’s assets may be used for the benefit of the employers. Mortgage institutions have reportedly recommended to the regulator that the 5% allowance be increased.<sup>65</sup>

#### **3.5.3.2 INVESTMENT IN HOUSING FINANCE OPPORTUNITIES**

Pension assets can be invested in traditional investment vehicles such as bonds, treasury bills, equities, property, or cash deposits and a fund wishing to invest in an unusual vehicle or investment must apply to the regulator for permission.

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<sup>61</sup> Interview, 4 March 2009

<sup>62</sup> Finmark Trust: [http://www.finmark.org.za/documents/Zambia\\_meetingnotesOct07.pdf](http://www.finmark.org.za/documents/Zambia_meetingnotesOct07.pdf)

<sup>63</sup> Interview, 10 March 2009

<sup>64</sup> Interview, 10 March 2009. This fund builds units and sells them; they do not keep the property on their books as this has proven to be administratively complex.

<sup>65</sup> Interview with Finance Building Society, 17 March 2009

Many pension funds do include the assets and bonds of banks and mortgage lenders in their investment portfolios. However, the high return offered on government bonds makes bonds the preferred pension fund investment, leaving few assets to invest elsewhere in the economy. Interviews with banks suggest that long-term lending funds that match mortgage lending are hard to come by in Zambia and it is a constant struggle to source long-term finance. The importance of pension fund assets in this regard is recognised and there is obvious frustration amongst mortgage lenders that the bulk pension fund assets flow directly into government bonds while there is such a need for liquidity in the mortgage market.

Zambia does display some interesting new models:

- The National Pension Scheme in Zambia is investigating a model that it calls the NPS Certification Scheme: it is negotiating with commercial banks to deposit a large portion of funds with the bank on condition the bank develops a range of financial products suited to the pension fund's members. The bank would become a "NPS Certified" institution. This is not focussed specifically on housing provision, but housing finance would form part of the agreement. Given the size of the pension fund referred to, if this model were to be adopted its benefits could be widespread with respect to housing finance.
- An interview with Finance Building Society highlighted another interesting variation. The FBS plays an important role in the market for housing finance in Zambia because unlike most banks it offers finance for home improvements in both rural and urban areas with no lower income limit on its loans. The pension fund invests in the building society with the understanding that the investment is passed through in the form of mortgages. The investment is secured on the individual mortgages given by the building society. However, only a small fraction of pension assets are invested in this way largely because asset managers are not willing to invest in long-term mortgage bonds through the building society when safer government securities are available. The mass of investment thus goes into three or four year-long arrangements which are unsuitable for mortgage finance.

A third *prospective* model was highlighted by the same building society: a pension fund buys bonds from the building society on condition that the funds are passed through to its members to finance purchase of units in a housing development, the construction of which is funded by the fund for its members. This provides the mortgage lender with the liquidity to provide mortgages, and pension fund members with access to housing finance, and divests the fund of the need to administer the loans. More information was not available and it is not clear if this is a deal in the making (in which case it would be interesting to investigate further) or just an idea. The development of the Lilayi housing project in Zambia used a similar, innovative model. Finance was raised by developers for the purpose of end-user housing finance and the funds were recovered from individual purchasers. Stanbic is administering the home loans provided

to individuals and is assessing home loan applications from those able to pay a 20% down payment. The project has attracted financiers such as the IFC, ADB and the DBSA.<sup>66</sup>

Zambia displays the most interesting models out of the four countries examined which indicates some thought is already going into housing investment.

### 3.6 OTHER COUNTRIES

Investigation in other countries in southern Africa brings to light the stark lack of research undertaken in this field. Very little literature is readily available, and, from what can be gathered from a preliminary desktop study, little consideration has been given to the concept of using pension assets to support housing requirements.

**Mauritius** shows the most promise with respect to innovation and progress in this field. The pension fund industry is composed of almost 1000 occupational pension schemes as well as two government schemes, the National Pension Fund (NPF) and the National Savings Fund. The NPF is the largest retirement scheme with MUR 38bn (\$1.1bn) in assets, covering over 60% of the total workforce and accounting for about 6% of financial sector assets.<sup>67</sup> Funds are permitted to grant up to 26% of their assets in loans to their members for housing and other purposes at subsidised (below-market) rates. The funds are compensated for the low rate by the employer. However, the costs of origination and administration mean that this model is largely unsustainable. In addition, funds have complete discretion in the investment of their surplus assets and the National Pensions Act (37) (iii) specifies that the need for national development should be a guiding principle in investments. Funds are also permitted to loan money to the Mauritius Housing Corporation (now known as the Mauritius Housing Company) that controls the largest share of the property development market. It is a parastatal body that provides housing finance loans, construction services, insurance and legal services to all income classes of the working age population. In 2007, the NPF invested 0.23% (MUR 87m, \$2.5m) of its assets in the corporation. The MHC offers a government-sponsored low-income housing loan at a low rate of 6.5%, targeted at households earning less than MUR 8500 per month.

A study undertaken by the World Bank in 2003 (Vittas, 2003)<sup>68</sup> indicates that pension funds in Mauritius are relatively heavily involved in the provision of housing loans, with 16% of all pension fund assets being invested in housing loans in 2001. Furthermore, it is noted that those pension funds investing in property and housing loans reported higher returns in 2001 than funds investing more heavily in company shares. This is promising for the development of housing investment models given that many pension fund trustees argue against investing in housing because of the perception of low returns.

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<sup>66</sup> Gardner, 2007

<sup>67</sup> FSAP, 2008

<sup>68</sup> Vittas, D., (2003). *The Role of Occupational Pension Funds in Mauritius*, Policy Research Working Paper 3033, The World Bank, Financial Sector and Policy Department.

Significantly less information was forthcoming in **Mozambique**. As at 2008 the social security system in Mozambique covered less than 10% of the economically active population.<sup>69</sup> The government is in the process of restructuring its pension policy and National Social Security Institute (INSS) with the view of establishing financial stability in the INSS. The INSS currently has a high level of unfunded liabilities. In Mozambique the housing finance market is extremely thin with only 3.8% of total bank credit being extended for housing loans.<sup>70</sup> This is primarily the result of the stringent lending criteria applied by banks. Additionally, banks are reluctant to lend for construction purposes and usually require another property as collateral, thereby restricting access to loans to a small proportion of the population.<sup>71</sup> A further complicating factor is that land cannot easily be used as collateral as only 99 year leases can be obtained for land – there is no private freehold ownership of land in Mozambique. Under these circumstances, pension funds are theoretically well placed to assist in the provision of housing finance by providing direct loans or guarantees for pension backed loans, as neither land nor property is required as a security for a pension-secured loan.

As of 2008, there were 600 private pension funds in **Malawi** with three fund administrators in operation. Only a small proportion of Malawians are covered by a pension scheme due to the lack of a working formal social security system in the country.<sup>72</sup> There is reportedly no active supervision and regulation of the pension market. A strategy is currently being developed to transform the structure of the pension industry specifically with regards to regulation.<sup>73</sup> A number of pension fund managers exist in Malawi (for example, Old Mutual, who manages its own scheme and those of other companies) who reportedly have large volumes of funds available which is invested in a range of instruments, including property. These institutions may be interested in investing in large scale housing developments, which would inject the liquidity into the housing market required by micro-financiers to advance housing loans to clients.<sup>74</sup> It is reported<sup>75</sup> that in Malawi only short term (one year) Treasury bills are offered, and, given their relatively high return banks and other non-bank finance institutions (presumably including pension funds) are more inclined to invest in these low-risk high-return assets than to provide housing loans.<sup>76</sup> Having said this, however, the returns on Treasury bills have been reducing over the past few years which is influencing banks (and, again, presumably pension funds) to diversify their investments.<sup>77</sup> This may make more pension fund assets available to be used to support housing needs in Malawi. At present, however, neither direct nor pension-backed loans are offered by pension funds or banks. In terms of investment

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<sup>69</sup> ILO (2008).

<sup>70</sup> Allen, C. and V. Johnsen (2008). *Overview of the Housing Finance Sector in Mozambique*. Prepared for Finmark Trust by Massala Consult. ([http://www.finmark.org.za/documents/A2HF\\_Moz.pdf](http://www.finmark.org.za/documents/A2HF_Moz.pdf))

<sup>71</sup> *Ibid*

<sup>72</sup> OECD/IOPS Global Forum on Private Pensions (2008).

<sup>73</sup> *Ibid*

<sup>74</sup> Thompson, L., and J. Agar, (2009). *Access to Housing Finance in Africa: Exploring the Issues. Malawi*. Prepared for the Finmark Trust by Kadale Consultants. ([http://www.finmark.org.za/documents/A2HF\\_Malawi.pdf](http://www.finmark.org.za/documents/A2HF_Malawi.pdf))

<sup>75</sup> Interview

<sup>76</sup> Thompson, L., and J. Agar, (2009). *Access to Housing Finance in Africa: Exploring the Issues. Malawi*. Prepared for the Finmark Trust by Kadale Consultants. ([http://www.finmark.org.za/documents/A2HF\\_Malawi.pdf](http://www.finmark.org.za/documents/A2HF_Malawi.pdf))

<sup>77</sup> Interview

into housing, an interviewee indicated that the Malawian Property Investment Company (MPICO) has in the recent past experimented with investing in “medium density” housing developments.<sup>78</sup> This was, however, unsuccessful as the construction costs were higher than what individuals were willing and able to pay for the units, largely owing to the high cost and inaccessibility of housing finance in Malawi: on the current terms offered by commercial banks, less than 1% of the adult population can access mortgage loans.<sup>79</sup> In addition, banks are reportedly not particularly innovative in development of medium and long run housing finance options, and only recently have banks started to offer 15 and 20 year loans. Again, however, these are only accessible to those who have suitable securities to pledge, and similarly to Mozambique, security of tenure of land is an issue as most land is customary land and cannot be used as collateral. Only 8% of land area is privately held, and is held predominantly by wealthier citizens. The effect of this and issues relating to time consuming and complicated construction processes has been to trap lower income households in poor quality accommodation with little or no security of tenure that they are unable to escape.<sup>80</sup>

Given the issue of collateral, a pension-backed loan product offering would be well placed in Malawi – as it would be in Mozambique – as the loan is linked neither to land nor a property, (although low pension coverage would limit the extent of its use.<sup>81</sup> Similarly, investment in by pension funds in housing developments appears to be a plausible model in Malawi as the funds have access to the finance required to secure private land, thereby overcoming the issue of security of tenure for residents. As it stands, however, information obtained from the limited literature on the topic and from interviewees suggests that there is minimal interest in or progress toward making use of pension assets to meet housing needs in Malawi.

In **Angola**, with very little information forthcoming from preliminary research on the pension industry and the investment of pension assets, it is difficult to assess the degree to which pension assets are used to meet housing needs, and the potential for this to be advanced going forward. The social security system in Angola covers less than 10% of the economically active population.<sup>82</sup> Many of the economically active employed in the private sector have been registered in privately managed and administered pension funds following a decree in 1998 permitting their employers to do so. This suggests that there could be scope to implement end-user or investment models, as it would be relatively simple (as compared to non-employer based funds where members are not linked in through employment contracts) for a pension fund trustees to manage loan repayment, monitor the use of the funds, or ensure that investment in housing developments does benefit the fund members.

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<sup>78</sup> Interview

<sup>79</sup> Thompson, L., and J. Agar, (2009). *Access to Housing Finance in Africa: Exploring the Issues. Malawi*. Prepared for the Finmark Trust by Kadale Consultants. ([http://www.finmark.org.za/documents/A2HF\\_Malawi.pdf](http://www.finmark.org.za/documents/A2HF_Malawi.pdf))

<sup>80</sup> Thompson, L., and J. Agar, (2009). *Access to Housing Finance in Africa: Exploring the Issues. Malawi*. Prepared for the Finmark Trust by Kadale Consultants. ([http://www.finmark.org.za/documents/A2HF\\_Malawi.pdf](http://www.finmark.org.za/documents/A2HF_Malawi.pdf))

<sup>81</sup> The low pension coverage is perhaps an issue to be dealt with separately. This would extend reach of pension backed or direct pension loan model in the future.

<sup>82</sup> ILO (2008).





## 4 SUMMARY

Based on the research in South Africa, Botswana, Namibia and Zambia, a number of high level conclusions can be drawn.

1. A key observation emerging from this study is that **there is an acute lack of research into this topic and little has been written about the use of pension funds for housing purposes**. Research that does exist highlights that pension fund assets are well placed to significantly improve access to housing and housing finance in Africa. Additional, focussed research is therefore essential for this potential to be harnessed and for concrete progress to be made in this field.
2. The two groups of models are not mutually exclusive. **There is scope for both end-user and investment models in these economies**. End-user finance is helpful for small home improvement loans and for assisting with finance at the member-level. The investment model is useful for unleashing larger capital flows into housing construction and the provision of housing finance.
3. Even though pension loans and pension-secured lending are generally allowed by law across southern Africa, **take up by funds, and absolute take up numbers by members, are relatively low**. It is clear, however, that pension loans and pension-secured lending do add another dimension to access to housing finance.
4. A strong mentality exists across the region that housing finance is synonymous with mortgage finance. Most practitioners still think of housing finance as something that allows the borrower to buy a house in one go, even though this is not feasible or affordable for most people across the region. **Pension-secured lending is a model that facilitates incremental housing improvement** and, while it may be possible for pension assets to be applied from a pension funds perspective, the housing supply chain is usually insufficiently flexible to use these effectively.
5. **As far as end-user models go, the second model (securing a loan) is widely preferable across southern Africa to most pension funds than the first (the fund giving a loan)**. This is because pension-secured lending does not draw down the fund's assets, at least not until default takes place, and because financial institutions are viewed as better placed to judge, supply and administer credit provision. It is fair to say that there is a noticeable move afoot in the countries away from the first model to the second – and even that the first is a dying model.
6. End user models work better where pension fund coverage is higher, where the practice is enabled by legislation, where the wording in the act which establishes the

practice is unequivocally clear, and where property is held by more secure forms of tenure than communal or state ownership.

7. **A recurrent concern about end-user models is ensuring that the funds are used for housing purposes.** There is a tendency among trustees to abdicate the responsibility for ensuring funds are used for housing either to the member, or in the case of third party loans to the administrator or third party lender itself. However, for their part, lenders and administrators have little incentive to ensure proper use of funds. Policing is expensive and the loan is, in any event, secured. The consequence is poor monitoring and enforcement of use of funds. It is common for long term savings to in fact be spent, not on housing, but on short-term consumption. If trustees were made responsible for use of funds, it would probably kill the model as few trustees would want take on the cost and responsibility of enforcement. One option would be to ask the member for higher standards of proof: where the loan goes towards property through the provision of proof of purchase or deposit; where the loan is for housing supplies, through provision of receipts. It would be also useful to explore the use of a voucher system, where the loan can only be redeemed at a building supply store.
8. **The end user models are relatively limited in their scalability in that they are accessible to relatively few, formally employed people.** Fund penetration in southern Africa is generally superficial - typically less than 10% of the working age population. There is better scope for scaling up the end user model where a country has a universal national savings scheme in place – then, theoretically, the model becomes scalable to all contributors to the scheme – in some cases this might be the entire working population. This is not to say that these models are not viable for those who are pension fund members, only that numbers accessing the service will always be limited while pension penetration is also so limited.
9. In general, the growth of various forms of investment models hold more promise than end user models because the research suggests that **the use of pension assets for investment in housing and housing finance is surprisingly underexploited.** The advantages of these models are numerous: the concerns about use of funds and scalability do not apply and it is arguable that breaking up pension assets at the member level into thousands of small loans, with higher administration costs and opportunity for leakage, is a less efficient use of aggregated pension assets than investing the assets *en masse* in larger housing investments. Better economies of scale are achieved and the outcomes (more stock, more mortgages, better capitalised construction companies) are more concrete and certain.
10. **One repeated theme in the investment arena is a general perception that returns in the low-income housing market are lower and riskier than in other areas of the property market,** which is likely to be at odds with a pension fund trustees' primary mandate to maximise members' returns. To unlock pension assets for housing needs it

will be necessary to overcome this perception. The subprime crisis, although not the same as low-income lending, has not helped the image of the lower end market as an abnormal place to do business. This perception will be hard to overcome. The problem is worse in countries where government bonds offer secure, high returns. Asset managers have little incentive to take higher risks in more “exotic” low-income housing areas. They are unlikely to do so without either better market information on opportunities and returns in this market, or a degree of moral suasion from government either through a financial sector charter-like agreement, or the threat, real or otherwise of prescribed assets.

11. It also seems that **pension funds have an important role to play in filling a long-term financing gap** which is likely to exist in many African countries. This can encourage the development of a long-term mortgage market where one does not exist. Again this is difficult where governments offer easy alternative medium and long-term investments.
12. **The most exciting specific opportunities lie in Botswana in opening the end user model.** There is an interest and demand from members but the market is currently dead, not because of prohibitive regulation but because of *poorly worded* regulation. The other big opportunity is in the investment model market in South Africa where a number of forces are converging apace to promote the use of what is a massive pool of pension savings in more developmental or “socially responsible” investments, including low-income housing.

## 5 RECOMMENDATIONS

Although this research suggests that pension fund assets are well placed to significantly improve access to housing and housing finance in southern Africa, an observation emerging from this study is that there is an acute lack of research on this topic. Additional research, especially in other parts of the continent where interesting models may be in play is therefore essential to allow other ideas and models to be disseminated.

It is clear that pension loans and pension-secured loans do add another, more affordable dimension to access to housing finance but only for those who can access their pension savings for this purpose. Policymakers who are interested in boosting the provision of housing finance should thus consider introducing end-user finance enabling legislation. The rights and powers of funds must be very clear in the enabling recommendations. In Zambia, or similar countries where the mortgage market is new and legislation neither permits nor prohibits end-user finance models, international best practice should be researched and followed so as to avoid making legislative mistakes that have inhibited to development of this market in the surrounding countries. Moreover, the thinking of housing policymakers needs to move beyond the view that housing finance should be synonymous with mortgage financing. Smaller pension-secured loans may suit poorer families who prefer to build a home incrementally.

While pension lending and pension-secured lending can bring benefits, it is recommended that proper use of funds for housing be monitored well. The temptation for poor families to use the loan for short-term consumption is great. The evidence suggests that many loans supposedly taken out, or secured by pensions, will not be spent on housing. One of the lessons of this study is that the trustees are best placed to take responsibility for the proper use of funds. Trustees should not automatically believe that administrators and third party lenders will ensure use of funds for housing. A voucher scheme, where the member can only access the funds in the form of a voucher to be redeemed at a building supply store, could overcome use-of-funds problems (although no evidence of this was seen in southern Africa). Importantly, the trustees need to ensure that funds are directed toward housing investments that are of a durable nature.

As far as investment goes, pension funds should be given the regulatory space to invest a *portion* of their portfolio in property, especially residential property. This is a necessary but not sufficient factor in encouraging more investment in housing. In addition, better market information on investment opportunities and returns in this market, or a degree of moral suasion on leading funds would be useful. Pension funds might, for example, be asked to disclose in their annual reports whether and how their investments are helping to solve the national backlog in housing. This would compel trustees to put additional pressure on asset managers to design suitable low-income housing related investments. (It is not recommended that these investments are prescribed, however.)

The fact that investments in low-income housing in certain areas or countries may offer higher returns than in others suggests that research into improving the return on low-income housing investments would be of value. The incentive of good returns could support, or replace, any moral suasion from government.

The presence of one large and dominant fund in a country (as is the case in most of the sub-Saharan African countries studied) provides an opportunity for certain investment trends to be set. If the largest fund in a country forges a path into socially responsible investing, it is more likely that other public and private funds will follow suit as a precedent would be set and a degree of security would be attached to the investments.

Government should also appreciate that social investments in new asset classes like housing are difficult to catalyse where government bonds offer secure, high returns. As has been done in Botswana, prohibiting pension funds from investing in treasury bills could help to direct pension fund liquidity into other investments, and the housing market in particular.

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## 7 INTERVIEW LISTS

### **SOUTH AFRICA**

Andrew Canter, FutureGrowth Asset Managers

Christine Glover, Housing Impact Fund, Old Mutual Investment Group South Africa

Rojie Kisten, Old Mutual Investment Group South Africa

Papillon Montswenyane, Angloplat Group HR for Housing

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