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Formal Private Sector Housing Finance Institutions and Low-Income Groups in Zimbabwe: Peculiar Requirements, Operations and Realities

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ABSTRACT

Private sector housing finance institutions have a mandate given to them by investors. They have to make a profit. This means safeguarding against risks and avoiding decisions that endanger profitability and investors' funds. In pursuing this mandate, housing finance institutions are often seen as unrealistic, inflexible and insensitive capitalist organisations which do not understand the special circumstances of the low-income groups, most of which cannot meet their stringent eligibility criteria and rigid lending terms. This study wishes to highlight the situation in Zimbabwe by focusing on the peculiar needs and circumstances of private sector housing finance institutions and appraising their lending performance so far.

Introduction

The conditions of low-income groups and the requirements of formal housing financiers are said to be incompatible. On one hand, low-income groups cannot meet the (reasonably?) stringent requirements for eligibility and loan terms; on the other, finance institutions cannot appreciably compromise and bend over backwards to accommodate these groups since doing so would unnecessarily increase risks and jeopardise profitability (Bourne, 1981).

In Zimbabwe, the issue has assumed racial overtones with local pressure groups accusing the private financiers of racism and bias against black persons, who after decades of discrimination cannot satisfy the financiers' demands. Repossessions and evictions in low-income areas, which normally come after a breach of contract (usually failure to pay), are viewed in this (racial) light.

This situation has been compounded by politicians joining the condemnatory choruses against formal finance. The complaints against formal finance include

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exorbitant interest rates, tough eligibility criteria, difficult lending terms and insensitivity to the circumstances of defaulters. These terms and conditions are seen as maladies. It is alleged that they limit the access of low-income groups to formal institutional finance, thereby depriving them of a chance to improve their socioeconomic situation in the urban areas.

The Structure of the Formal Housing Finance System

By developing world standards, Zimbabwe has a well developed housing finance system (Mafico, 1991). There are four building societies, three of them well established (Kamete, 1994). These institutions mainly practice the deposit-taking system (Boleat, 1987) where voluntary deposits are used to make loans available to those who need them. The two processes (deposit-taking and lending) are done at variable interest rates. The newest building society, can, according to current terminology be described as indigenous, a term that denotes predominantly black (Zimbabwean)-owned businesses. This institution practices something that is close to the contractual system where prospective house builders and buyers have to have accounts with the bank in order to qualify for a housing loan.

Public sector funds from the Treasury are channelled through the National Housing Fund (NHF), which on-lends to local authorities at concessionary interest rates. Government also operates Housing Guarantee Funds which give full and partial guarantees to public servants and private sector employees, respectively. The guarantees are used to cover the need for downpayment. At the time of writing the Fund was literally broke due mainly to reduced government allocations, defaulting local authorities and decapitalisation as a result of uneconomic lending rates (Mafico, 1991; Kamete, 1994).

The situation just described means that, outside the informal market, it is only to private sector sources that house builders and buyers have to look for housing finance. The situation goes against the three tier scenario put forward by Renaud (1987). According to Renaud a typical housing finance situation should have an upper income segment served entirely by the private sector, a middle group and civil servants group whose needs are addressed by the public sector and at the bottom of the pyramid there is *"...a large and private incremental housing market which has no access to formal finances ..." (1987:183).*

Without formal public funding sources to serve their needs, the low-income groups are forced to source funding from formal private sector finance institutions where they have to compete with high and middle income groups for the same funds. It is against this background that observations have been made that detail the poor chances of low-income groups to get access to private housing finance. In the light of this, it is advisable to sketch the relationship between the low-income groups and private sector housing finance institutions.

The Relationship Between Low-Income Groups and Formal Private Sector Housing Financiers

How the low-income groups relate to financiers has a bearing on their access to private funds. Obviously, this relationship is strictly business and impersonal. Prospective home-builders and buyers apply for loans. The applications and applicants are then assessed and interviews held. The decision reached can be one of the three indicated below:

- The application is rejected outright;
- The application is approved in whole;
- The application is approved with modifications on some details, usually the amount requested.

Assuming that the application is approved, lending terms are then drawn up, mostly on standard agreement forms with differences only in name, amounts, dates and some other minor details to 'individualise' the agreement. This means that the terms of lending are impersonal apart from names, addresses and amounts.

If the applicant accepts the terms, which is invariably the case, agreement forms are signed. The business relationship thereafter continues with the borrower being expected to meet the monthly mortgage payments. Failure to do so results in warnings and reminders. If the borrower continues to fail to meet his/her part of the contract, a final reminder is sent and thereafter the house or building under construction is repossessed, evictions are effected and the fixed asset is auctioned to recover the costs.

Changes can be made to the original agreement if, for example, interest rates change. In the past three years, mortgages have been increased and reduced following corresponding changes in interest rates and the withdrawal of a government subsidy on the rates.

The Peculiar Circumstances of the Financiers

Private financiers for housing purchase or construction have certain demands, both external and internal, placed upon them. The former type of demand comes from borrowers, the government and investors.

Borrowers 'demand' loans to finance the construction or purchase of a house. They are the market. To satisfy them the financier has to have the money. This group is made up of the weakest stakeholders, if indeed, they may be called stakeholders. Since they are not direct stakeholders they cannot control the financier nor substantially influence him. They can merely negotiate, which in a typical situation of scarcities, like that within Zimbabwe, is literally translated into

begging. If the borrower is from the low-income group the financier can afford to ignore anyone from the group without major inconvenience.

The government places demands on the building societies through a well-structured regulatory environment. This is done in the name of the national (public) interest, which includes raising of revenue and controlling inflation. Even after the onset of macro-economic structural adjustments in 1990, the financial system in Zimbabwe is still heavily regulated. Apart from their profits being subject to the usual taxation, building societies face controls in areas such as deposit and lending rates as well as reserve and liquidity ratios. A proportion of their funds has to be invested in government bonds. They still operate within the 1965 Building Societies Act.

The most influential external demands emanate from investors who are normally shareholders and depositors. This group wants a reasonable return from money invested in the institutions. By the nature of their operations building societies are very sensitive to the needs of this group because they constitute the most important stakeholders in the enterprise. It is the investor who makes the finance institutions a reality by putting in some funds as shares or deposits. Indeed if these people were to withdraw their contributions the institution would collapse. Even governments appreciate the importance of this group. Some of the controls on building societies are designed *"...to ensure that they are run...with little risk to investors"* (Rakodi, 1995:205).

It is, therefore, the external demands from the investors that translate themselves into the internal demands which comprises mainly the goals that the institution sets in order to continue existing. The overriding demand is profit. This indeed is the reason for their existence. In pursuing this overall goal, the institutions adopt objectives that maximise benefits while minimising costs. This superior goal demands efficiency and effectiveness in the mobilisation, disbursement and recovery of funds. The three processes will now be discussed.

Mobilisation of funds

This process involves the accumulation of funds through shares and deposits. Investors and depositors need to be assured that they get a good – though not necessarily the best – return for their investment. This is assured through competitive rates of interest. In Zimbabwe, these rates are controlled by government. The current rate of 16 percent is not competitive considering that the POSB offers rates of 17 and 20 percent, tax free, on Savings and Fixed Deposit accounts, respectively. Commercial Bank Savings accounts also offer higher rates. The competitiveness of the building societies was improved in 1986 with concessions in the Paid Up Permanent Shares (PUPS) accounts where higher tax-free interest rates are offered (MPCNH, 1991; Mafico, 1991). This concession also required that the building societies devote a quarter of the funds raised from the PUPS to low-income housing.

Disbursement

In disbursing funds for loans, the financiers have to ensure favourable interest rates and security. The Zimbabwean government, in an effort to 'protect' the (low-income) borrowers, controls the lending rate on mortgages. Up to 1994, there was a state subsidy on mortgages. In 1994 this was as high as three percent. This meant that of the eighteen percent interest rates payable then, the borrower actually paid fifteen percent. The effect of the controls on mortgage interest rates was to make money relatively cheaper than it would been.

In keeping with the risk minimisation concept there is a need for security against the loan. Collateral and/or sureties are a necessity. The government-funded Housing Guarantee Fund guaranteed a portion or all of the loan for non-public and public servants, respectively. The long nature of the loan requires that the product be sufficiently durable to last the loan period. In Zimbabwe, the period is fixed by legislation to a maximum of 35 years.

This means, therefore, that funds will be allocated to people who are deemed to be suitable in keeping with the goals of the institutions. This suitability is determined by assessment of the application forms and in the personal interviewing of the applicant. Eligibility criteria have to be set up to ensure proper accountability and rational decisions. All four building societies adhere to these stringent procedures and practices. Eligibility criteria include gainful employment, fixed assets or acceptable guarantors, proper title deeds, a minimum income and acceptable building standards for the house being bought, or approved plans (meeting minimum standards) for the house to be constructed. These conditions have the effect of ensuring that the financiers have something to fall back on and recover their investment in the event of a default.

Even after approval of the application, lending terms have to be agreed on. Normally the terms revolve around repayment amounts and period. This introduces an element of certainty and predictability which is essential to the smooth and efficient running of any organisation. Sanctions and rewards are built into the agreement to act as incentives and disincentives.

The terms in most cases include the following: fixed period (usually 25 years *)* *[1]* and fixed monthly instalments. The mortgages are usually calculated as a percentage (normally 25%) of the borrower's monthly income.

An element of legality is essential to protect (principally) the institution, hence the contractual nature of the whole agreement. This stipulates the outcomes should any party flout the terms. Usually failure to pay results in evictions and repossessions. This is all necessary for good management, for continued existence, for getting depositors' confidence, and for promoting investors' interests.

Recovery

The recovery of money from borrowers ensures the continued survival of the institutions. Money is lent on the understanding that the borrower eventually pays up the capital plus interest. Almost all items in lending terms have to do with repayments. Hence the instalments, the payment period and the recovery factors are all intricately linked to the recovery of funds. Evictions and repossessions show the force behind recovery and its importance to the financier. Zimbabwean financiers are strict on repayments. The increasing number of evictions and repossessions is evidence of this. Almost every month, an appreciable number of houses are auctioned, sometimes at ridiculous prices.

Rigid, Uncompromising and Unrealistic?

In the light of strong criticism against them, the attitude of formal private sector housing finance institutions needs to be appraised.

In describing two of the building societies, Rakodi referred to one as *"the most innovative"* and another as *"the most conservative"* (1995:214). The third established building society at one time received a letter of protest about racism from indigenous pressure groups. It appears, therefore, that Zimbabwean lower-income households have a choice among the reluctant conservative, the enterprising, and the racist.

Of the 30,000 houses financed by building societies by 1985, there was hardly any lending for low-income housing (World Bank, 1985) Rakodi lists the *"mixture of more or less valid reasons"* (1995:214) for this as: lack of security of tenure due to the absence of title deeds; low building standards; the high cost of administering a large number of small loans; fear of a high default rate and lack of resources and experience. Taking the low-income housing sector as a whole, these reasons appear to be perfectly valid.

Building societies did not have enough money due to their inability to mobilise deposits, which failure was caused by uncompetitive and controlled interest rates. What little they could mobilise was allocated to the only sensible destination, high- and middle-income housing and commercial property development. For private institutions with private agendas, this was perfectly sensible and realistic.

The aversion to unnecessary risks forced building societies to avoid untested ground, that is, low-income housing. The risk was complicated by their lack of experience and fear of the (largely) unknown. In private enterprise, this is perfectly reasonable. To compound the risk was the lack of traditional means of surety, that is, security of tenure and acceptable standards of construction. In such uncovered situations the fear of default becomes more intense since there would be nothing to pounce on in cases of defaults.

It seems, then, that there were good grounds for the building societies' disinterest in investing in low-income housing. Some attention was paid to these details. Statutory Instrument 308 of 1986 permitted building societies to issue nine percent tax free Paid Up Permanent Shares (PUPS) for two years. The PUPS were designed to mobilise private sector funds for housing by enhancing building societies' competitiveness in attracting deposits. There were conditions attached to these apparent concessions. At the end of each financial year each building society was required to make up to a quarter of the money invested in these shares available for low-income housing. By the end of the first quarter in 1986, the total capital balance in all these shares was Z$ 254 million (MPCNH, 1991). This constituted about a quarter of their total shares and deposits. In a way this addressed the building societies lack of competitiveness in mobilising funds.

An improvement was noted in the period 1987 to 1989 in loans advanced to low-income housing. During this period 14 355 loans valued at Z$ 118.5 million were disbursed for the purchase or construction of houses in the low-income areas.

Since then the participation of building societies in low-income housing has been on the rise, especially with the coming in of international finance which started with an experiment by the United States Agency for International Development (USAID) and the United Nations Development Programme (UNDP) in Gutu and KweKwe (Mutizwa-Mangiza & Rakodi, 1989). The Urban I Project managed to get building society support to develop lending for low-income housing (Rakodi, 1995). The two largest building societies are now involved in the internationally funded projects in many urban centres of the country.

Despite this apparent change of perspective, several observations can be made on the conduct of building societies as far as low-income housing is concerned. Rakodi observes that there has been little change in the lending instrument. The criteria for eligibility and lending terms are basically the same. The change is more notable on the part of the environment than the lender: the mobilisation of funds has improved, the same also goes for gainful employment. There is more formal sector employment in Zimbabwe than anywhere else in Sub-Saharan Africa, construction standards for low-cost housing have "improved," security of tenure is now ensured, and, most important, there is someone (the public sector and/or the international agent) to share the now greatly reduced risks. Moreover the fear of defaults proved to be unfounded (Rakodi, 1995).

However, the reluctance of building societies to finance low-income housing can still be noted. The amount disbursed to low-income housing is still much smaller than *"the funds available and the scale of the problem"* (Rakodi, 1995:216). This amount has never reached 20% of the total loans (MPCNH, 1991).

Conclusion

The formal private sector housing finance institutions have peculiar requirements and realities most of which are largely plausible. Their reluctance to lend to low-income householders for the purchase and construction of housing is understandable. It has been noted that the attitude is changing. This change, however is more due to improvements in the lending environment than to a change in the perspective and operations of the financiers.

The kindest remark one can make is that while the reluctance to get seriously involved has no apparent racist connotations, and is full of business sense, it is unfortunately ridden with conservatism. It has can be traced to inordinate fear, overcautiousness and lack of an innovative and enterprising spirit. This can be attributed to the regulated environment the private financiers have been working in for decades. However, this excuse is cancelled out when it is pointed out that they only take the "risks" in certain special cases, for example:

- when they are forced to, as demonstrated by their acceptance of the condition to finance low-cost housing attached in the PUPS;
- when someone has guaranteed them safe risks, which is shown in their readiness to participate in private-public partnerships;
- when the environment improves, as shown in their lending to low-cost housing after the construction standards were improved and security of tenure was introduced after independence;
- and after their fears have been proved wrong, which is demonstrated by the relatively few defaults among low-income groups (Rakodi, 1995).

In actual fact, conservatism still reigns. This does not make any sense since besides profits, business is about risks and innovations. It is also about getting political and public approval.

Notes

[1] Building societies compete for deposit with the Post Office Savings Bank (POSB), a source of government funds. Some of the controls, such as those on taxation and interest rates are meant to improve the competitiveness of the POSB.

[2] The Building Societies Act (1965) restricts the loan period to 35 years.

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