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Role of Pension Backed Mortgages in Affordable Housing in Kenya:

A Case Study of Public Sector Pension Schemes in Nairobi

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Abstract

Access to affordable housing is a challenge to many public sector employees who retire without a home despite having worked and saved towards pension. One of the initiatives by the Government of Kenya (GOK) to increase access to housing is by amending the Retirement Benefits Act (RBA) to allow pension funds to be used as collateral for purchase of a home. The uptake of Pension Backed Mortgages (PBMs) by public sector employees in Kenya has, however, been low. This study sought to evaluate the role of Pension Backed Mortgages (PBMs) in provision of affordable housing among public sector workers in Nairobi City in Kenya. The population comprised of pension scheme administrators, financial institutions, RBA officials and Civil Servants who are pension contributors. Purposive sampling was employed targeting scheme administrators, pensioners, managers of financial institutions and Retirement Benefits Authority. Data were obtained from primary and secondary sources and analyzed and presented in tables and diagrams. Findings indicate that uptake of PBMs by public sector workers in Kenya has remained low, even after amending the Retirement Benefits Mortgage Regulations to allow pensioners to use about 60% of pension savings as collateral. This is attributed to factors such as: high mortgage interest rates, lack of awareness on use of pension funds as collateral, lengthy mortgage processes, lack of serviced land, stiffer requirements limiting access to long term loans and, process elements such as financing, planning, external environment, execution, and construction. The study concludes that the uptake of pension backed mortgages has not significantly contributed to provision of affordable housing in Kenya, and recommends vigorous public sensitization, creation of awareness, and legal reforms geared towards enhancing and streamlining use of pension funds for wider access to affordable housing among public sector pensioners in Kenya.

Keywords: Affordable housing, Kenya, Nairobi, Pension Backed Mortgages, Retirements Benefits Authority.

INTRODUCTION

Housing plays a major role in the socio-economic development of any country. The housing sector has an impact on labour mobility and control of inflation. It also influences the government budget through taxes and subsidies. In addition, housing directly affects investment in other sectors. According to World Bank (2016), housing investments in developing countries constituted 2-7% of the Gross National Product (GNP) and 10-25% of capital formation. As an asset, housing makes about 20-45% of the wealth in majority of the countries. Housing is also a key motivation for household savings, and significantly affects the level of household consumption.

The state of housing is a concern to governments all over the world. This is because housing is a basic human right. The General Assembly of the United Nations recognized this right in 1948 through adopting and proclaiming the Universal Declaration of Human Rights (United Nations, 1948). In 1966, the committee on the Economic, Social as well as Cultural Rights Convention, further reinforced the right to housing. The subsequent convention of 1991 emphasized the right to housing by outlining, under the General Comment No. 4, that adequacy or quality of housing is not just having a roof on one's head (UN-CESCR, 1991). There is need to go deeper and be explicitly defined to incorporate security of tenure, availability of services, affordability, location and cultural adequacy (UN-Habitat, 1966).

The United Nations Human Settlement Programme estimates that there are more than one billion

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people globally with inadequate housing, with over 100 million people living in conditions classified as homelessness (UN-Habitat, 2015). The issue of housing is thus quite important and majority of countries globally have an obligation in the shelter sector. This is exemplified by a number of actions such as: creating ministries or housing agencies, allocation of funds to housing sector in the national budgets, and formulating policies and programs for housing. The World Bank (2015), indicates that, for a number of years, governments have considered housing as a welfare issue and approached it by merely making small provisions in the national budgets for provision of housing for the low-income people. In addition, most developing countries use about 2% of the national expenditure on provision of housing. Governments continue to use international strategies, such as the Global Shelter Strategy (GSS) of 1988 that recommended governments to change from direct engagement in shelter production, to creation of an enabling environment to enhance performance of housing sector in general. Governments are, therefore, expected to play a major role in regard to formulation of policies and regulations, and offer infrastructure and enabling environment to ensure that housing sector operates in an effective manner.

The adoption of GSS by the Government of Kenya has resulted to its reduced role in shelter production. Budget allocations to the National Housing Corporation (NHC), a government's housing agency, have continued to reduce drastically over the years. The county governments including, Nairobi City County, therefore, no longer construct houses for rental or sale to the Nairobi residents. This state of affairs has resulted into poor state of housing in the city, where more than 90% of its population live in poor housing conditions (CAHF, 2012).

UN-Habitat (2017), indicates that 60% of urban dwellers in Kenya live in slums and other squatter settlements. A big percentage are the public sector employees who have failed to secure accommodation from the public and private formal housing schemes (UN Habitat, 2017). This scenario continues despite the government having put in place various policy initiatives, including the recently enacted Housing Policy of 2017. Indeed, it justifies the need to look at pension funds as an alternative to offering affordable housing to public sector workers using Pension Backed Mortgages (PBMs), which is an alternative form of housing finance where the mortgage is secured by a member's retirement savings instead of a mortgage bond.

The key goal of pension funds is to offer social security in old age. Housing is a basic social need which has remained unmet for a majority of workers, both before and after retirement, yet in most countries, pension funds are invested in other sectors and activities in total disregard of the needs and preferences of its members. Some of the funds are invested heavily in the money markets that have subsequently become liquidated, resulting into misappropriation of funds, whereas housing is neglected. In most developing countries, pension funds have not fully been utilized for the welfare needs of its members. In Kenya, for instance, where over 60% of the urban population resides in slums, it is expected that pension funds for workers are used to alleviate their housing needs, yet as indicated by Were (2012), out of the 32,099 civil servants in Nairobi County, only 2,083 have benefitted from the pension funds for housing provision. This indicates a dismal uptake of pension backed mortgages, despite the enactment of the Retirement Benefits (Mortgage Loans) Regulations 2009, which offered members a chance to attach up to 60% of accrued benefits as security to get mortgage from financial institutions. Before 2009, RBA restricted members to access pension funds for purposes of acquiring housing. Neither did it allow pension scheme administrators to issue direct or indirect loans to members, or to invest with a financial institution with a view of securing mortgage loans.

Further, the Retirement Benefits (Occupational Retirement Benefits Schemes) Regulations prohibited assignment of benefits for whatever purpose (Chirchir, 2006). This blanket restriction was however modified, such that the Retirement Benefits (Mortgage Loans) Regulations gazetted in 2009, subsequent to an amendment of the RBA Act, permitted the use of 60 percent of accrued benefits as a guarantee for a similar amount to the financial institutions or an authorized lender. Despite this milestone in the use of pension funds for home acquisition, home ownership in Kenya is still low, with high demand for housing and a low uptake of pension backed home loans. Since the introduction of pension backed home loans in the mortgage industry in Kenya in 2009, only 2,440 (0.06%) out of the 406,623 pension members have taken the opportunity (Republic of Kenya (ROK), 2009). This low percentage of the uptake of pension backed mortgages has raised the question of the role pension backed home loans have played towards provision of affordable housing, especially among public sector workers in Kenya. Hence, the need for a study to evaluate the role of pension funds in affordable housing provision.

The main objective of the study was to evaluate pension backed home loans with a view to understand their role in meeting housing demand for public sector workers in Kenya. The specific objectives were; to establish the extent of uptake of pension backed home loans by pensioners in the public sector, identify challenges faced by pensioners, pension scheme administrators and lenders in the use of pension to secure home loans, and the role of pension backed home loans in provision of affordable housing in Kenya.

THEORY

Housing is a basic human right and efforts to alleviate housing problems have preoccupied many governments since time immemorial, albeit with little success. In Kenya, housing policies and strategies, which have been put in place over the last 30 years, have failed to provide adequate and affordable housing. According to Kieti (2015), interest charged on loans is a key factor affecting home ownership, limiting accessibility to mortgages by a majority of the urban population. The search for alternative collateral instruments and savings mobilization mechanisms led to the emergence of Pension Backed Housing Finance (PBHF), which is a model for housing finance that is evolving from pension fund capitalism. According to Cytonn investments report, the concept of PBHF is to enable pensioners acquire housing finance collateralized by accrued pension benefits and/or the use of the latter as capital (equity) for mortgage (Cytonn, 2019a).

Different countries have developed measures focused on pension scheme funds as a way to address the increasing demand for housing. In 2017, assets in Retirement Benefits Schemes totaled 50.7% of the Gross Domestic Product (GDP) in the Organization for Economic Cooperation and Development (OECD) countries, and 19.7% of total GDP in the non-OECD jurisdictions. This is a clear indication that retirement benefits contribute largely towards the growth of economy. However, it is clear that a majority of the non-OECD countries are still lagging behind in the use of pension funds towards housing provision (Cytonn, 2019b).

Blake (2002), notes that economies characterized by the pools of contractual saving funds, such as pension funds, are vital in tapping new funds for housing. Providers of housing finance are therefore keen on using pension funds as they typically represent a large pool of domestic savings. In addition, the liabilities and assets of pension funds are generally long-term in nature, hence, matching the long-term financing requirements of housing investments rather than the short-term depository institutions (Lanier et al., 1987). Afrane et al. (2014), also noted that pension assets have the potential of spreading repayment over a comparatively longer period compared with the short-term mortgages of say 15 years, hence reducing the probability of nonpayment.

According to Sing (2009), there are two forms of pension backed housing finance: pension loans and pension-secured/backed loans. Pension loans model allows pension members to effectively utilize their accrued pension equity as capital for financing homeownership, or as a down payment for a mortgage. The loans are issued directly from the fund and secured in two ways: over the member's secured accrued benefits in a direct contributory scheme, or as a mortgage loan in favour of the fund over the property in question (Short et al., 2009). Pension Backed Mortgages (PBMs), on the other hand, is an alternative form of housing finance where the mortgage is secured by a member's retirement savings instead of a mortgage bond. Fund administrators act as guarantors and funds are not transferred from the fund (Sing, 2009).

The pension industry across the world has embraced use of pension backed housing loans to give chance to pensioners to use their pension savings towards purchase of immovable property, or for home improvement/renovations. The role pension funds play in financing housing vary from country to country. In South Africa, Ling (2009), noted that pension secured loans are essential in home improvement projects rather than in buying new homes. The Pension Fund Act in the country enables retirement funds to offer direct loans to the members or furnish the guarantee from the loan of a member (South African Government, 1956).

In Singapore, home ownership is high since citizens are encouraged to own homes. This is also a way for the government to ensure that citizens have roofs over their heads and are rooted to their country. Employees are required to make mandatory monthly contributions to the Central Provident Fund (CPF) to take care of their retirement. The fund has been enhanced to allow members to withdraw their savings to finance purchase of public houses, making Singapore a country with the highest home ownership rate of 91% in 2013. One of the biggest advantages of the CPF system is that it allows members to make pre-retirement withdrawals to finance home purchase, tertiary education for their siblings and service mortgages. This arrangement of home financing scheme has increased home ownership, and most CPF members are able to fully own their own homes prior to retirement.

In Denmark, the Danish Pension Fund contributes towards housing provision through injection of funds by different means, including issuance of direct loans to members, development of flats to rent, and purchase of mortgage bonds from the housing finance institutions. The fund invests the minimum, that is 15% of the assets, towards housing for the members. In addition, about 10% of the money is used to put up blocks of flats in urban areas for members to rent and 5% for loans to members to put up their own houses or flats for renting.

Despite many countries having a fairly developed financial sector, housing market development has been constrained by unstable macroeconomic fundamentals and weak institutional and regulatory framework (Karley, 2003). Literature reviewed has indicated that the role of pension backed home loans in provision of housing, both in developed and developing countries, is a system that has broken down due to unlimited number of challenges and failure of the system to work together in a synergistic manner.

The challenges that hinder delivery of affordable housing through pension backed loans are as follows:

Interest Rates

This is the rate of return on investment. Return on equity positively correlates with changes in interest rates, thus, for the case where retirement funds are invested in equities and money market, both asset classes will lose if interest rates decrease and vice versa (Flannery and James, 1984). The prevailing interest rates in the market affect profits for lending institutions, such that when the rate is low, maybe due to government regulations, there is the tendency for the financial institutions to look for alternative investments for profit making. When the rates are high, few mortgage loans will be taken by investors. Interest rates therefore play a critical role in assessing housing growth in any given market (Muguchia, 2011).

Unfavorable Policy Interventions and Regulations

Government policies influencing household incomes and savings have direct impact on the uptake of pension secured mortgages since borrowers' choices remain heavily influenced by such policies. Policies targeted at housing, such as tax policies, price and rent regulations, financing, land use and construction restrictions, improve the quality of housing or home ownership rates.

Investment of pension funds in housing is mainly determined by the prevailing legislative and regulatory framework in a given jurisdiction. The prevailing legal or regulatory regime may restrict or promote investment of pension funds in housing, thus influencing the type of housing finance investment or investment instrument that is adopted by pension schemes. In many countries, inadequate legal and regulatory framework regulating alternative investments has been quoted as one of the key reasons for a lack of pension fund investment in housing sector (Mutero et al., 2010).

Awareness

Creation of awareness promotes understanding on the various policies and regulations. It also provides information and guidance before investment decisions are made. Furthermore, it is important to create awareness and enhance market transparency regarding pricing and contractual terms to help borrowers obtain loans that best fit their needs. Indeed, financial education for all households, at all stages of a life cycle, ought to be encouraged (World Bank, 2018).

Income

Low levels of income, coupled with high cost of living and poverty levels, limits household savings. The size and stability of income, and security of employment determines a member's ability to repay the money borrowed, and amount and frequency of contribution towards pension. The capacity and potential of a member to repay a loan is therefore assessed based on these indicators (Afrane et al., 2014). To ensure a secure and continuous flow of income, lenders usually restrict the total sum advanced to a multiple of two to three times the applicant's salary (Cranston, 2002).

Availability of Land

Availability and high cost of land translates to high cost of property in the market, thus limiting investment in real estate. With low income, coupled with high poverty levels, the 60% of pension savings for civil servants in most cases cannot be sufficient to cater for mortgage deposits and closing costs, thus locking out many pensioners from accessing pension backed mortgages.

An interactive framework showing the various components and inputs towards affordable housing provision through pension backed home loan system and challenges therein is presented in **Figure 1**.

RESEARCH METHODS

The research design was both qualitative and quantitative, which involved use of both secondary and primary data. Secondary data was obtained from review of related literature from texts and journal articles, as well as document reviews from mortgage institutions and Retirement Benefits Authority. Primary data was obtained from questionnaires and interviews conducted on a sample of 391 pension scheme administrators, pensioners, credit control managers of finance institutions and an officer from Retirement Benefits Authority. Purposive sampling method was used to select the pension schemes targeting public sector workers that were included in the study. Given an estimated population of less than 10,000, **Formula 1** was used to determine the sample size:

$$nf = n/1+n/N;$$

Where:

nf = required sample size for a population< 10,000.

n = required sample size for a population> 10,000, which is 384 according to Mugenda and Mugenda (2003) and Arleck and Settle (2005).

N = estimate of population, which is a total of 130 public sector pension schemes in Kenya according to reports from the Retirement Benefits Authority (2015).

Based on **Formula 1**, then:

$$nf = 384/1+384/130 = 97$$

After identification of the 97 administrators, each provided a reference of 3 beneficiaries (pensioners) of the scheme for further inquiry, giving a total of 291 pensioners. In addition, respondents were drawn from credit control departments (credit control managers) from two financial institutions, i.e. Housing Finance and CFC Stanbic Bank, for the purpose of interview (1 chosen from each bank). The selection of the two finance institutions was based on purposeful sampling; the two were the original banks to venture into pension backed home loans lending. The RBA was represented by one manager in charge of regulation of schemes.

The data from the field was first edited, coded and then entered to the SPSS software for analysis. Qualitative data was analyzed by thematic/content analysis, while quantitative data was analyzed by

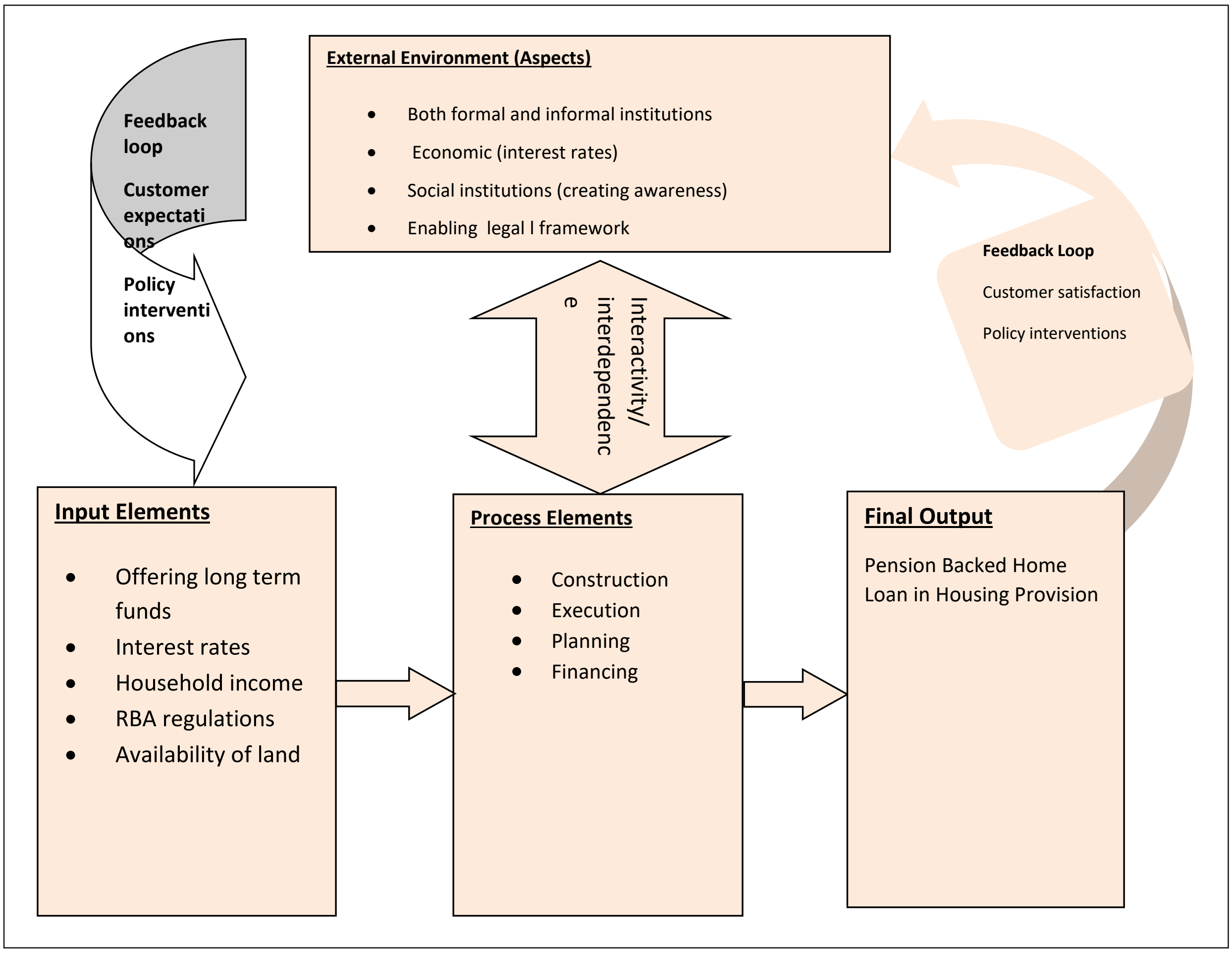

FIGURE 1
Framework for provision of housing through Pension Backed Mortgages (PBMs)
Source: Field analysis 2020

descriptive statistics, such as, the mean item scores and frequencies. Descriptive analysis was vital in understanding the basic features of the study and drawing conclusions and recommendations.

RESULTS AND DISCUSSION

Uptake of Pension Backed Mortgages (PBMs) among Public Sector Workers

The main objective of the study was to evaluate pension backed home loans system with a view to understand their role in affordable housing provision. **Table 1** shows that PBMs system has not played a significant role in enabling civil servants in Kenya to access housing. It is apparent that, even after the enactment of the Retirement Benefits Mortgage Regulations 2009, the uptake of pension backed home loans has remained relatively low, for instance, between 2019 and 2020, only 5 pension secured loans, representing 3.1% of total mortgages, were issued to public workers, and only 56 loans issued between 2014 and 2018. Arguably, it is possible that the program suffers from lack of goodwill and collaboration among key stakeholders to align the provisions of the Retirement Benefits Mortgage Regulations of 2009 against the promoted goals of Pension Backed Home Loans, particularly in clustering the use of pension scheme savings as an admissible deposit.

The findings show that pension backed home loan as a system has not been effective and in the process, has failed to meet the housing demand for civil servants.

Findings from the reviewed literature had revealed that pension backed home loans constitute various components, such as the housing inputs as actors, innovation, interest rates, RBA regulations, access to land, provision of long-term funds and other process aspects such as financing, external environment, social institutions, planning, facilitative legal climate, external environment and institution of public feedbacks; all with an influence on the role of PBMs in affordable housing provision.

Challenges in the Uptake of Pension Backed Home Loans

The study sought to identify challenges faced by pensioners, pension scheme administrators and lenders in the use of pension to secure home loans. **Table 2** provides a summary of the challenges faced in the process of enhancing the uptake of Pension Backed Home Loans. The findings indicate that poor design and execution, requirement of down payment, lack of affordable mortgage finance, limited building materials, high levels of poverty, lack of awareness of PBMs system, limited access to land, and lack of long-term funds to meet the demand for housing are the major challenges in the uptake of pension backed home loans.

The pensioners interviewed indicated that the Retirement Benefits Authority Act has fallen short of guaranteeing access to affordable housing. One of the reasons for this is that it has stringent requirements that require registering the first mortgage as security before trustees can issue their guarantee as outlined

TABLE 1: Uptake of Pension Backed Home Loans

Year	Frequency (no. of loans)	Percentage (%)	Valid %	Cumulative %
2009 - 2013	85	58.5	58.5	58.5
2014 - 2018	56	38.5	38.5	96.9
2019 - 2020	5	3.1	3.1	3.1
Total	**146**	**100**	**100**	**100**

Source: Field analysis 2020

TABLE 2: Challenges in the uptake of Pension Backed Home Loans

Challenges	Responses		Percent of Cases
	N	Percent	
Poor design and execution	146	16.25%	100.0%
Upfront costs and down payment	146	16.25%	100.0%
Lack of affordable mortgage finance	146	16.25%	100.0%
Shortage of building materials	146	16.25%	100.0%
High poverty levels	146	16.25%	100.0%
Lack of awareness	146	16.25%	100.0%
Lack of access to land	146	16.25%	100.0%
Lack of long-term funds to meet demand for housing	146	16.25%	100.0%
Total	**1168**	**100.0%**	

Source: Field analysis 2020

under Section 7(1)a of the Retirement Benefits (Mortgage Loans) Regulations 2009. This fails to contemplate the plight of a borrower for all the upfront costs that include, but not limited to, legal fees, stamp duty, valuation charges and sale agreement charges; all requirements as outlined under Section 4d of the regulations. One of the respondents noted that the section on the redemption of a guarantee, as outlined under Sections 11(2) and 11(3), in case of repayment default by a specific member has largely not been actionable. In the past, mortgage institutions have tried to move proposals to allow trustees to redeem guarantee. Arguably, this means that the regulatory mechanism has been largely faulty as it inhibits members from successfully assigning their 60% of all accumulated benefits as security for mortgage loan attainment.

CONCLUSION

This study has shown that pension backed home loan system has failed to meet the needs of public sector employees who are pension contributors. The uptake of the loans has remained relatively low even after the 2009 amendments to the RBA Act to provide for the use of 60% of pension savings as collateral for mortgages. Banks still prefer to have the actual house or land as security rather than the 60% of pension savings, thus barring many pensioners since raising the 20% initial mortgage costs is still a hurdle. Among the challenges hindering the effective use of PBMs are; the poor design and execution of the system, structure of the loan system, lack of awareness among pensioners, high poverty levels thus no income is left for retirement saving, high mortgage costs, lack of cheap building materials, limited access to long-term funds and lack of affordable land. However, in a bid to improve home ownership through use of pension funds, the government recently amended the Retirement Benefits (Mortgage Loans) (Amendment) Regulations 2020, allowing partial access to pension benefits, i.e. use of 40% of the retirement savings to purchase a residential house. There is therefore need for creation of awareness since even with the 2009 amendments, most pensioners are not aware that the law provides that they can use 60% of their pension savings as collateral for home ownership mortgages. Those who are aware have a misconception that 60% of the accumulated benefits can actually be accessed and withdrawn for purposes of purchasing a home/land or for home improvement. The pensioners are therefore skeptical to take mortgages backed with their pension savings, since they are afraid to lose both the property and their hard-saved pension money to mortgage lenders in case of foreclosure.

RECOMMENDATIONS

The amendments to the RBA Act to provide for the use of 60% of pension savings as collateral for mortgages is a noble idea and should be supported in order to achieve its objective. Creation of proper legal and institutional framework to oversee implementation of the Retirement Benefits (Mortgage Loans) Regulations 2009 and the recent amendments to it, i.e. the Retirement Benefits (Mortgage Loans) (Amendment) Regulations 2020 allowing use of 40% of the member's benefits to purchase a residential house, is necessary. There is need to create more public awareness on the use of pension funds for home acquisition. Structures also need to be put in place to encourage or advocate for scheme trustees to amend their trust deeds in order to allow members to utilize their pension savings towards home ownership. The scheme administrators should also be encouraged to borrow funds from other sources, such as the newly created Kenya Mortgage Refinancing Company, so as to broaden their investments and be allowed to offer long-term mortgages at relatively low interest rates and better terms and conditions. There is also need for legal reforms to encourage saving towards retirement and to boost uptake of pension backed mortgages.

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