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A STUDY OF THE POTENTIAL ROLE OF PENSION FUNDS IN HOUSING PROVISION IN KENYA

BY

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NOVEMBER 2000

DECLARATION

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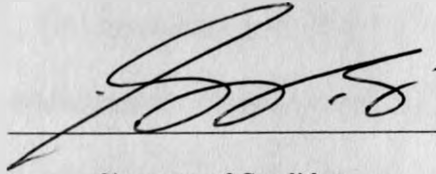

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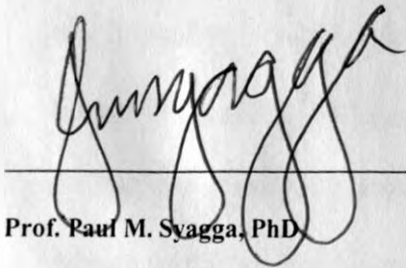

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ABSTRACT

This study examines pension funds investments in Kenya with special reference to the potential role that this sector can play in financing housing production especially for members of the pension fund. Pension funds are known to accumulate huge sums of money. Most of this money lies idle until pensioners retire. The accumulated returns from the investments of these funds are by then amounting to millions of shillings. On the other hand, most of the pension fund contributors live in poor environments, are unable to own houses and are subjected to more suffering after retiring. Pension funds in Kenya have thus invested negligible amounts into housing, even less in housing for their members.

Given the importance of housing as a socio-economic good and the many problems existing in the housing sector, this study set out to seek ways in which pension funds in Kenya can be applied as an additional source of finance for housing. The study examines the stocks of accumulated funds held by and the investment portfolios of the three case studies of NSSF, East African Industries and University of Nairobi. This study also established the proportion of the assets that these funds have invested in housing. Views of members of these funds were sought in order to establish their preferences on how their funds are managed and invested.

To obtain the required information, the researcher conducted oral interviews and administered questionnaires to the fund managers of the case studies.

Official records like annual reports of accounts of the Funds were also examined in detail where they were available. In addition, the researcher interviewed members of these funds (contributors) by use of questionnaires. Data was analysed by textual description with the aid of frequency tables and charts.

The main findings of the study supported the view that pension funds have not played a significant role in housing supply in Kenya, although this sector holds a momentous accumulation of funds. A great potential thus exists for pension funds to play a greater role in housing provision. The study also established that members of pension funds would wish to see their funds invested in affordable housing that they can acquire even before they retire. The study recommends, therefore, that the Retirement Benefits Act be amended to include a clause requiring pension funds to devote a proportion of their investible funds in housing for their members. Investment of funds should also be handled by investment consultants in order to prevent loss of funds in bad investments.

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DEDICATION

To my mother, **HANNAH WAITHIRA GITHUKU**, for all her self-sacrificing love.

List of Abbreviations

KENYA	-	Government of Kenya
EAI	-	East Africa Industries
UON	-	University of Nairobi
UNPS	-	University of Nairobi Pension Scheme
NSSF	-	National Social Security Fund
NHC	-	National Housing Corporation
HFI	-	Housing Finance Institution
HFCK	-	Housing Finance Company of Kenya
EABS	-	East African Building Society
S&L (K) Ltd	-	Savings and Loan Kenya Limited
CDC	-	Commonwealth Development Corporation
USAID	-	United States of Agency for International Development
EEC	-	European Economic Commission
RBA	-	Retirement Benefits Act

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CHAPTER ONE

INTRODUCTION AND PROBLEM STATEMENT

1.1 Introduction

The housing sector is a key factor in the socio-economic development of any state. The sector influences labour mobility, helps in the control of inflation and influences government budgets through taxes and subsidies. It also directly affects investments in other sectors. It forms a major market for the firms which manufacture products like cement, steel, iron sheets etc. It has been reported that for every one job in residential construction, two more jobs are created in other sectors, thus playing an important role in creation of employment. According to the World Bank (1993), housing investments in the developing countries alone comprise 2-8% of Gross National Product (GNP) and 10-30% of capital formation. As an asset, housing makes up 20-50% of reproductive wealth in most countries. Housing is also a major motivation for household savings and it significantly influences household consumption.

Despite the above important roles played by the housing sector, the worldwide state of housing is pathetic. The United Nations Centre for Human Settlement - Habitat, (1990) estimates that over one billion people in the world live in inadequate housing with an excess of 100 million people living in conditions classified as homelessness. The World Health Organization (WHO, 1989), estimates that 1.2 billion people in developing countries do not have access to

drinking water and 1.8 billion people live without access to adequate sanitation.

Socially, housing has a direct relationship with the health of the population. The majority of the world's urban populations are housed in crowded, poorly constructed structures with unsafe (fire-prone) materials without adequate supply of safe drinking water. Drainage, sewerage and waste disposal systems are usually non-existent. As a result, the urban poor always suffer health hazards like diarrehoerial diseases. Poor housing also accentuates poverty in that the several incidences of illness and even death deprive households of man-hours of labour which would otherwise be utilized in earning a living. Conversely, good housing means better health, higher rates of labour-force participation and higher incomes for households. Extra rooms are rented, thereby improving incomes and thus alleviating poverty.

The housing problem is therefore enormous, causing all nations without exception, to have some form of obligation in the shelter sector. This is exemplified by the following actions: creation of ministries or housing agencies, allocation of funds to the housing sector in national budgets and formulation of housing policies and programmes. These actions notwithstanding, the World Bank (1993) reports that for many years, governments considered housing as just a welfare issue and thus approached housing by merely making small provisions in national budgets for provision of housing for low income people. The same source indicates that many

developing countries spend only an average of 2% of their national expenditure on housing provision.

Governments continue to adopt international strategies like the Global Shelter Strategy (GSS) of 1988 which recommended that governments shift from engaging in shelter production to guiding performance of the housing sector as a whole. Governments are therefore expected to play the role of formulating policies and regulations, providing infrastructure and an enabling environment to ensure that the housing sector operates effectively.

The Kenya Government's adoption of the GSS has led to the government playing a very reduced role in shelter production. Budget allocations to the National Housing Corporation (NHC) which is the government's housing agency have been reduced drastically in the 1990s. Local authorities including the Nairobi City Council no longer construct houses for rental or sale to urban dwellers. This state of affairs has led to a worsening of an already desperate urban housing situation. According to government estimates, 20% of Kenya's population of about 31 million people live in the 182 urban centres spread throughout the country. As a result, urban services including housing have been constrained in all urban centres in Kenya with over 75% of the urban population living in informal settlements or slum areas (Kenya, 1995).

The Kenya Government has thus effectively left the private sector to supply the estimated 60,000 housing units per annum that are required for urban

housing. By 1997, the private sector was only able to meet 20% of this annual need (Kenya, 1997). It therefore means that innovative measures have to be undertaken in order to increase supply of finance in the housing sector and also apply appropriate mechanisms in order to meet the needs of the poor and the disadvantaged. Long term finance, like funds held by life endowment insurance companies and pension and provident funds, have been suggested as appropriate sources of housing finance (Habitat, 1994). If properly invested, pension funds can be used to provide affordable housing for their members and others who may rent or buy houses developed with pension funds invested in the housing sector.

1.2 Problem Statement

The primary objective of pensions and provident funds is to provide social security to members in old age. However, one social need which is also a basic need, housing, remains unsatisfied for most Kenyan workers both before and after retirement. The same workers' savings in pension funds are reported to have grown to Ksh.140 billion in assets (Daily Nation, April 13,1999). In a situation where more than 60% of Kenyan urban population reside in slums (Lamba, 1995), it would be expected that money belonging to workers such as pension funds would be utilized to alleviate their (workers') housing needs.

However, little, if anything has been done in using pension funds to provide housing for members. What has happened with most pension funds is that

money is invested in other sectors like commercial property, shares, securities etc. Many of the pension funds in Kenya are now known to own substantial shares of such investments yet to many workers the basic need of housing remains unfulfilled.

One reason for the above scenario is the fact that legislation regulating operations of pension schemes like the Income Tax Act restrict members' access to their funds before they attain retirement age. When the funds invest in housing, the houses so funded are usually beyond the affordable levels of the majority of the members of the funds. An example is the type of houses recently developed by the largest provident fund in the country, the NSSF at Embakasi in Nairobi. These housing units are the cheapest that the fund has developed in Nairobi. The flats in this estate are being sold by the Fund for between Kshs.2.25 and Kshs.4.5 million per flat as a tenant purchase scheme at an interest rate of 15%. The repayment period is 15 years and monthly instalments range between KShs. 28,000/= and KShs. 41,000/= These figures show the impossibility of NSSF members to purchase these houses developed by their fund, given the fact that over 90% of NSSF members are low income earners viz., those earning between KShs. 2,000/- and Kshs.10, 000 - per month according to the Statistical Abstract of 1996.

The extremely difficult conditions existing in the housing markets in Kenya now call for Pensions Funds to gear investible funds into housing that can benefit their members even before they retire. Housing finance markets in

Kenya are such that the majority of workers are shut out of actively participating in these markets. In the 1970s and 1980s the greater percentage of urban housing was provided by public agencies including the central government through the National Housing Corporation. local authorities and international donors like the World Bank, USAID and European Economic Commission. Such public housing schemes were mainly site and service schemes like the Dandora. Umoja and Mathare schemes in Nairobi. These schemes were generally affordable to the majority of the workers since the terms of sale were also affordable. As an example. the NHC charges 12% for its loans while interest rates for materials cost for an estate like Dandora was as low as 6%. These favourable conditions made the public housing schemes very popular usually attracting over three (3) times the number of applicants compared to the available units.

Despite the popularity of publicly financed housing schemes. the late 1980s saw a change in housing finance policies. The Government adopted the role of a facilitator while the private sector was left to take the leading role in housing finance. Hence. commercial banks. insurance companies, mortgage companies and co-operative societies now provide 80% of Kenya's formal housing finance. Mortgage companies are however the main suppliers of long term finance for housing with the leading three being Housing Finance Company of Kenya. East African Building Society and Savings and Loan (K) ltd. The leading mortgage company, HFCK. has in the past decade, financed an average of 900 housing units per year (HFCK Annual Reports). This is a

paltry number compared to an estimated urban housing need of 60,000 units (Kenya, 1996).

Housing Finance Institutions convert savings deposits into long-term mortgage finance. These institutions have to compete for deposits in the market with other financial institutions. Hence, they are constrained as to the amount of money they can avail for lending. That notwithstanding, lending conditions enforced by these companies effectively bar majority of the workers from borrowing finance to construct or purchase houses. These conditions include:-

- Requirement for a title deed or lease for real property to act as collateral for the loan. In many urban centres in Kenya, affordable land is untitled since groups of people organize themselves into co-operatives and purchase huge chunks of land. Subdivision and registration usually take time and ownership documents usually comprise of share certificates.

- Mortgage companies usually lend a maximum of three times the applicant's annual income. This amount is usually too low compared to the level of incomes of workers with the cost of housing. As an example, taking the upper scale of low income workers to be approx. 10,000/- per month, such an applicant would be entitled to Ksh.360, 000/- mortgage loan. On the other hand, a two bedroomed flat in Komarock Estate costs

not less than Ksh.850, 000/-. Affordability is therefore a limiting condition to procurement of mortgage finance.

- Mortgage interest rates have, in the past ten years oscillated between 14-28% for owner occupied houses. Currently the average mortgage rate of interest is at 22%. This means that a loan of KShs. 1 million which would enable one to purchase a two bedroomed flat in Nairobi's low income estates would require a minimum monthly repayment of KShs.22,000/=. If the rate of interest came down to 10%, the monthly repayment would drastically reduce to a minimum of KShs.10,000/- per month. High interest rates have thus deterred many workers from gaining access to mortgage finance.

With such a restrictive finance market most urban workers are abandoned to live in slums, far away from their places of work. The few who manage to acquire plots build houses incrementally, which is a lengthy and costly method. In the meantime, pension funds carry out their investment activities in total disregard to their members' needs and preferences. Some funds invest heavily in money markets and have consequently become highly liquid. This liquidity has sometimes led to some of the funds being misapplied by sponsors and other interested groups especially during times of financial difficulties. Examples of these include: University of Nairobi owing its Pension Scheme over Sh.300 million in unremitted contributions by December, 1998 (The East African, December 21-22, 1998), the Kenya Posts and Telecommunication Corporation failing to account for KShs. 9.5 billion in accumulated workers'

pension (Daily Nation, December 21,1998), and the NSSF reportedly buying land at highly inflated prices thus pushing up land values to levels that a depressed economy cannot justify (Daily Nation, June 14, 1998). According to Mutero (1992), the buoyancy of pension funds make them very attractive to governments as a source of funding recurrent expenditure especially in periods of economic depression.

It is true that some pension schemes in Kenya are well managed and they have engaged in some quite profitable investments, thus ensuring safety of their members' retirement benefits. However, the majority of pension schemes, especially public schemes are reported to have faired very badly in their investments. As a result, security of their members' benefits have been jeopardized. Most of the benefits that would accrue to their members if their funds were invested in housing are thereby missed.

According to the proposed retirement benefits rules and regulations found in the newly enacted Retirement Benefit Act of 1997, pension schemes will be allowed to invest a maximum of 30% of their funds in real property. If funds invested half of this portion in housing, it would mean 15% of KShs. 140 billion which comes to KShs. 21 billion. If the funds constructed housing units costing about KShs. 1 million each (including land and utilities), this would mean an increase of 21,000 housing units to the housing stock. Such an increase in supply of housing would bring down the unnecessarily high prices of houses in the market. The overall effect would therefore make housing

more affordable to the workers. Members of pension funds who can purchase houses developed by their pension funds may benefit in terms of improvement of household incomes (extra space can be let out). better health and capital growth since real estate appreciates in value. having a hedge against inflation unlike liquid cash.

The above situation underscores the need for pension Funds to channel funds into workers' housing. This study will attempt to establish the potential of pension schemes in Kenya to invest more appreciably in housing that can directly benefit their members even before they retire.

1.3 Study Objectives

The study objectives are to:

1. Examine the stocks of accumulated pensions funds and their investment portfolios.
2. Establish what proportion of the funds is invested in housing. why this proportion and the potential of these funds in financing housing provision.
3. Investigate members' views on their Funds' investments.
4. Make necessary recommendations on how best pension funds can be invested in order to have a positive impact on housing provision.

1.4 Study Hypothesis

This study hypothesizes that:

The housing sector has attracted only a small proportion of pension funds investments due to lower returns from the sector, than from alternative investments.

1.5 Research Methodology

1.5.1 Research Design

This study is a descriptive survey of three selected pension schemes (NSSF, EAI and UNPS) in providing housing in Kenya. It aims at establishing the extent to which the funds have invested in the provision of housing (especially to their members), their potential in housing provision that remains unutilized, and their members perception of the funds' investments.

1.5.2 Population, Sample and Sampling Techniques

The population in this study is defined as all the registered pensions or provident funds in Kenya. There are over one thousand registered pensions or provident funds in the country. The pension funds of NSSF, EAI and UNPS were selected from this population mainly on the basis of convenience.

NSSF was selected because it is the largest Fund in the country. Almost every worker in Kenya is a member of NSSF. Also, it is a public fund and representative of the public managed pension funds so that a change in the

housing provision policy of the fund is likely to affect a very large number of Kenyans.

The East Africa Industries Pension Scheme is a medium-sized Fund and is purely private. A study of this fund gives insight into privately managed pension funds. The University of Nairobi Pension Scheme was selected to represent funds run on a semi-public basis.

The information concerned with the funds investments was obtained from the funds' management while information on the members needs and views was obtained from the contributors' to the funds.

NSSF has over 2,600,000 members; EAI has about 900 while UNPS has 2560 members. A sample of 50 respondents from each fund was targeted. A two-stage cluster sampling method was used to select the respondents for the UNPS and EAI. A list of the departments in the institutions was made and from it 10% of the departments selected. The members of staff in the selected departments, who are members of the pension funds were listed and selected by a simple random sampling technique.

However, the respondents for the NSSF were selected by a convenience sampling method because the NSSF members are drawn from all over the country. It was considered that NSSF members concentrated in one organization would be most accessible and would provide sufficient data on

the peoples housing needs and views concerning Pension Funds investments. The University of Nairobi was selected for this purpose. The respondents were selected by sampling the departments and then the workers as it was done with the UNPS and EAI.

1.5.3 Data Collection

The data was collected from the pension and investment managers of the funds by oral interviews with the aid of a checklist. Where possible the official reports and accounts of the funds were examined.

The managers provided information such as the members' contributions, investment portfolio, and returns from the investments. A questionnaire was also used to interview the fund members on their views on the investment of their funds and their housing needs. The researcher conducted all the interviews personally between July 1998 and May 1999. Appendix A and B show the checklist questionnaires respectively.

1.5.4 Variables in the Study

Various factors influence the potential of the Funds to invest in housing.

1.5.4.1 Stocks

Stocks of pension funds refers to the amount of accumulated money in Kenya Shillings held by the Funds. These stocks are mainly from members' contributions and investment income. The proportion of the stocks available

for investment is the difference between the total stock and the expenses such as benefits payments to members, administration costs of the scheme etc. Therefore the larger the amount of stocks in a Fund, the larger the potential of the fund to invest is likely to be.

Funds' stocks do not have a proportionate increase in pensioners' benefits. This is because pension is calculated using a predetermined formular which takes many years to be reviewed. In the case of provident funds, benefits are calculated from the amount of contributions and compound interest earned over the years. The interest rates usually remain fixed for years. Stocks grow with minimal, if any, change in the members' benefits payments.

1.5.4.2 Proportion of Funds Invested in Housing

The proportion of funds invested in housing has a bearing on the amount of funds devoted to other forms of investments. Investment portfolios of pension funds will give the percentages of funds devoted to different assets. The higher the proportion of funds devoted to other investments, the lower the proportion invested in housing and vice versa.

Various factors influence Funds' apportionment of investible funds among competing investment assets.

1.5.4.3 Returns

Returns from an investment may be defined as the profit derived from a capital outlay in a given period. usually a year. Returns are therefore expressed as a percentage of capital. Returns are a major factor in investment decisions.

The level of returns from competing assets influences the proportion of funds which a Fund will invest in housing. In calculating returns from an investment. firms either apply the discounted cash flow criteria where the nett present value and internal rates of return are determined or the non-discounted cash flow where the average rates of return techniques are determined. as detailed in Chapter 2.

Other factors influencing Funds investment decisions and which have a direct bearing on the proportion of Funds to be invested in housing include risks. political interference in Funds management and investments. the nature of real estate investments. level of competence of funds investment managers. long set traditions. and statutory control of fund investments among others.

Risk may be defined as the probability of not receiving predicted future incomes from an investment and realisation of the capital at the end of the investment period (Hargitay et al, 1993). Usually the higher the estimated risk of an investment. the less the funds that are likely to be put in the investment.

In the past, public pension funds in Kenya have been reported to invest their funds in institutions such as banks belonging to persons with political influence. As a result some Funds have lost millions of shillings in collapsed banks and projects. This may imply that less money is left available for investment in real estate and in housing.

Real estate is a very illiquid investment in that the process of selling the asset is long and costly. Returns from real estate are also determined by many factors including location, management etc. These factors discourage some funds from investing in housing.

Apparently arising from public hue and cry over questionable investments of some pension schemes and the uncertainty in the security of retirement benefits the Government has sought to control the pensions sector through the Retirement Benefits Act of 1997. Under the Act, scheme funds may not be used to procure mortgage by members (see details of those provision in Section 4.2). The Act is set to revolutionalise the management and investments of pensions sector in Kenya. It will therefore directly affect the proportion of funds invested in housing and also the methodology of channelling these funds into the housing sector.

1.5.4.4 The Potential to Invest in Housing

The potential of pension funds to play an active role in housing provision may be defined as the Funds' unharnessed financial resources that can be channelled into housing investment.

The potential is the remainder of "stocks" after all the Funds' expenses have been met. A Funds' potential to invest in housing may also change with a change in policy regarding investment assets allocation.

1.5.4.5 Members' Views on Funds Investments

Members of pension funds are a major stakeholder in the funds both as contributors and as beneficiaries. Their opinions on how their Funds should be managed and invested should be considered in investment decisions. Members' views will largely depend on how well informed they are about the goings-on in their Funds. Are their views taken into consideration by the management? How are the members interests represented in the running of the funds?

In this study the views of the members are compared with investment practices of Funds inorder to measure the level of disagreement between members' views and Funds' practices.

1.5.4.6 Members' Housing Need

Housing need is defined as the extent to which the existing quantity and quality of housing falls short of that required to provide every household with acceptable accommodation irrespective of affordability. In estimating the required quantity of housing four main factors are important: natural growth in the population which leads to formation of new households; restoration of depleted housing stock; relocation factor which is a function of the rate of migration and effective demand for new dwellings due to change in household incomes. Estimation of housing quality includes factors like floor area per person, number of persons per room, occupancy rate, accessibility to water and other infrastructure, type of building materials etc.

This study has however adopted a much simpler view of housing need. The reason for this is that the study is concerned with members of pension funds, majority of whom do not have own houses. It is also an established fact that an acute housing need currently exists in Kenya with a great proportion of urban dwellers living in informal settlements.

In this study, members' housing need is indicated by the proportion of members who are currently renting houses and are planning to use their retirement benefits to purchase or build own houses. The bigger the proportion the greater the need. A large proportion would imply that the majority of members of pension funds in Kenya, would want their Funds to invest in housing which they could afford to purchase even before retirement.

1.5.5 Data Analysis

The data is analysed by textual description with the aid of frequency tables, pie charts and graphs. The contribution of the members to the pension funds and payments of the retirement benefits by the funds are compared to give an indication of the investible funds available in each of the three funds examined.

The current investment portfolios of the funds are described and compared with each other, and with the ideal fund portfolio mix recommended by Blake (1992) and Hargitay et al (1993). The funds investment in real estate is further split to show the proportion of the real estate that is currently allocated to housing. The members housing need and preference for investment of their pension funds are also computed and compared with the current investment practices.

1.6 Scope of Study

The scope of this study is limited to examining the investment practices of pension funds in Kenya with special reference to their investments in real estate and housing in particular. This arose from the conviction that prudent investment of pension funds can play a significant role in provision of housing which members of pension funds are in dire need of. Greater investment in housing would not by any means lead to loss of security of retirement benefits. The study therefore starts by examining investment theories and how other countries have successfully channelled pension funds into housing

development. On the basis of this information, a framework is developed to serve as an ideal model for prudent investment policies of pension funds and appropriate investments.

In order to establish the need to channel these funds into housing, the study has also examined sources of housing investment in Kenya. The extent of the pension sector in Kenya has been broadly examined. A lot of interest has been expressed in relation to management of pension funds. However, this study aims at laying emphasis in housing development by choosing to invest some of its funds in this asset. The proportion that a fund allocates to housing compared to other assets will determine the number of houses that will be funded by the particular pension fund. Appropriate investment portfolio mixes and application of investment principles would mean better returns, security of income and capital as well as more houses built or financed by the funds.

1.7 Organization of Study

This study is organized into six chapters. The first chapter is introductory, containing the introduction, problem statement, study hypotheses, objectives, research methodology, scope of study, significance of study, organization of study and definition of terms.

Chapter Two consists of a review of literature related to pension funds investments. This chapter gives details of general investment theory, pension

fund classifications, their management and investment practices. It also includes detailed information on how other countries have channeled their pension funds into housing development. On the basis of this information, a framework is developed against which pension funds role in housing provision in Kenya can be examined.

Chapter Three contains background information on sources of housing investments in Kenya. It gives the contribution made by public and private sector housing finance institutions and from this, the need to channel pension funds into housing is realized.

Chapter Four discusses pension funds investments in Kenya in general. It shows the regulatory framework within which they operate, their general size and areas of investment. This chapter therefore shows there are funds in the pensions sector that can be channeled into housing provision.

Chapter Five consists of data analysis using information collected from the case studies. Chapter six evaluates the findings of the case studies and develops conclusions and recommendations of the study.

1.8 Significance of Study

Until recently, pension funds in Kenya, were governed by several pieces of legislations. Management of their assets was also diverse. Some were managed by fund managers, trust companies, insurance companies, direct

management and banks. Little research has been done in the area of pension fund investment. Since a big proportion of the population whether working or retired has a stake in pension fund assets, this study will make a contribution by providing a descriptive analysis of pension funds investment. It will therefore shed light on where pension funds invest their money and how their investment behavior can result in greater benefits to members.

The study will reveal the potential of pension funds to make a greater contribution to housing development. This is important because at this time, more and diverse sources of finance for housing are greatly needed. The study will also seek the views of pension funds members on the investment policies and management of their funds. This has not been done before.

1.9 Definition of Terms

Pension Scheme

A pension scheme is a social security scheme whereby funds contributed either by employer or jointly by employer and employees are set aside and invested for the sole purpose of paying benefits to employees on retirement, early termination of employment, disability or paying benefits to dependants on an employee's death.

Some pension schemes offer pensions related to salary at or near retirement (also known as "defined benefit scheme"). Others offer pensions related to contributions paid (known as defined contribution schemes), (Blake, 1992). In

Kenya, the latter schemes are known as provident funds. On retirement a member of a provident fund is paid his contributions plus the employee's contributions together with interest earned from investments or at an interest agreed on in advance. With pension schemes, members are paid benefits calculated on the basis of a set formula. Benefits usually include a lump sum/gratuity plus monthly payments until death and payments to dependants some specified years after death. In this study the terms pension and provident funds will be used interchangeably.

Sponsor and member

Companies and institutions organize pension schemes for their employees. The companies are known as "sponsors" while the employees are known as "members" of the scheme.

Housing

The term housing has been used both as the process and the product of creating shelter for humans. Normally shelter consist of one family dwelling. It can be a flat or in a row of houses then known as a housing unit or dwelling unit. In this study housing is applied to mean all kinds of dwellings that provide shelter to a family and that meet the minimum approved standards to accord security and protection from whether elements.

Low cost housing

Low cost housing is one that costs relatively less to construct or buy and is affordable by the low-income groups. It is not necessarily for the poor but

costs less to build and gives the desired satisfaction. Jorgensen (1982) defines low cost housing as one costing not more than 2.5 times a household's annual income.

Low income groups

According to the Statistical Abstract of 1996, low income groups are households earning between KShs. 2,000 and KShs. 10,000 per month based on 1986 price indexes. This is the meaning adopted in this study.

Middle income groups

The 1996 Statistical Abstract classifies middle income groups as those households earning between KShs. 10,501 and KShs. 44,000 per month based on 1986 price indexes.

High income groups

Households earning more than KShs. 44,000/= per month according to Statistical Abstract of 1996.

1.10 Study Limitations

(i) A major limitation has been the lack of literature and documented or written material on the subject of pension funds as it relates to housing. The few materials available merely talk of general pension schemes and their management. There are very few authors who have categorically written, researched or commented on the potential of pension funds in housing development.

(ii) The East African Industries' management denied the researcher access to the members. The management asked for questionnaire to administer on behalf of the research, however, only three questionnaires were returned duly completed. This study will therefore not include the views of EAI pension fund members. A comparison of the views of members of private pension schemes and their housing needs cannot therefore be compared with those of their counterparts in public pension funds.

(iii) The researcher also intended to interview some retired members of NSSF and UNPS. Due to difficulties in tracing these retired members the researcher intended to interview retired members of NSSF visiting the NSSF headquarters to collect their benefits. However, this endeavour was thwarted by NSSF management who refused the research to carry out such interviews in their premises. As a result only four retired members of NSSF were interviewed. A few retired members of UNPS who have rejoined University employment on contract were also interviewed. For this reason, it was not possible to get sufficient information on how pensioners are fairing in terms of housing and their views on the benefits they received from their pension schemes.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

Pension schemes were developed out of concern for the elderly. The elderly needed to be helped to maintain the same living standards as when they were in employment. The elderly also needed to be given a share in economic growth. In most developed countries, it is considered a Government responsibility to relieve poverty. In order to alleviate poverty and prevent destitution with the elderly citizens, laws were enacted in Europe as early as the 16th century. The Poor Relief Act of 1576 followed by the Poor Law Act of 1601 were enacted in Britain. These Acts required church parishes to levy a rate for the poor. In the United States of America, the Virginia Poor Laws Act was enacted in 1646. The first legislation of this kind was enacted in Denmark in 1891. Under this legislation, aged people over 70 years were to be paid regular pension financed from taxation. Similar laws were passed in New Zealand in 1898 and Australia and France in 1905 (Wilson, 1974).

With the development of industrialisation in the late 19th century and early 20th century, the existing provisions became inadequate. Mutual aid societies developed. In these, the members collected regular contributions to provide assistance to one another in time of sickness, pay for funerals or support widows and children of deceased members. In time, these societies became

commercial insurance firms. Some of these friendly or fraternal societies gave rise to private pension arrangements also known as occupational schemes (Wilson, 1983).

Today, pension funds are financed from regular contributions by both the employee and the employer. The funds protect the members and their families from a number of risks or contingencies which interrupt, reduce or terminate income or which place additional burden on the income. These include retirement, death, injury, sickness among others. Almost all pensions are based on salaries/wages immediately prior to retirement. Pension funds divorce retirement payments from the liabilities of the employer. This affords an employee added protection in that a company that goes into liquidation leaves the pension fund in existence and claimants against the company cannot be paid from the pension fund.

2.1.1 Development of Pension Schemes in Third World Countries

Most third world societies have traditionally cared for the sick and the elderly. This was done by communal labour which helped in agricultural tasks while the extended family cared for the elderly persons' daily needs.

Social changes in the family set-up especially in urban areas have greatly changed these practices. Social security systems usually cater for those who were formally employed. With the high unemployment rates, it is no wonder

then, that most of the elderly urban dwellers in third world cities are poor and destitute.

Precursors of modern day social security schemes in most developing countries were the pensions paid to military and civilian officials of imperial governments for loyal service. Mutual benefit societies and private occupational schemes catered largely for expatriate workers in the colonies. International agencies like the International Labor Organization (ILO) played an important role in the development of legislations to provide for social security in developing countries especially after the Second World War. With political independence such legislations were expanded to include all workers although some still contain clauses discriminating against the native and colonial workers. Thus, national provident funds were established in Nigeria in 1961, Tanzania in 1964, Kenya, Ghana and Zambia in 1965 and Uganda in 1967 (Midgley, 1984).

Other private and semi-public pension funds were set up as trusts being formed by legal instruments but operating within provisions of the controlling Acts of Parliament.

2.2 Fund Management

There are various types of pension schemes in operation today.

2.2.1 State Pension Schemes

Under this scheme, the state pays pension to workers, usually civil servants, from the consolidated fund or a National Insurance Fund set up for such purpose. The scheme is usually non-contributory. Payment is usually in form of lump sum plus periodic payments until death.

2.2.2 Contributory Schemes

This is a contributory scheme where the employee and employer contribute a certain percentage of the employee's salary towards retirement benefits. The scheme operates under a Social Security Act. Funds are invested by a social security fund and retirements benefits depend on the amount of money accumulated and returns on investment by the date of retirement. Payments are usually lumpsum and hence the term "pay-as-you-earn" schemes.

2.2.3 Occupational Pension Schemes

Occupational pension schemes are usually organized by companies or organizations for whom people work. The employers are the sponsors of such schemes. Usually, joining the scheme becomes a condition of employment. These schemes are established under trust deeds drawn in any way that suits the employer. A board of trustees controls the affairs of the fund. However, the trustees operate under regulatory limitations by the relevant Acts of Parliament. As an example, the Social Security Act (1990) of Great Britain, limits self-investments of pension funds in parent companies to 5% of fund

assets. The 5% covers shares, loans, property and also money owed by the parent company to the scheme (Blake, 1992).

Pension offered is related to the final salaries of employees on retirement, and hence the terms, "final salary or defined benefit pension schemes". In Britain, occupational pension schemes offer one sixtieth of final salary for each year of service up to a maximum of 40 years. This leads to a maximum of two thirds of final salary at retirement. An alternative is one eightieth of final salary plus a tax-free lump sum equal to one and half times annual salary at retirement. Occupational pension schemes in Britain are adjusted annually in line with retail price inflation.

2.2.4 Personal Pension Schemes

This type of scheme is organized for individual or groups of individuals by institutions like insurance companies or banks rather than for organizations or companies for whom these individuals work. Hence, the scheme is called "portable" since they are not related to the place of employment. The scheme is also available for self-employed persons.

Pensions offered is generally related to the contributions made and the growth of the investments, consequently, the terms "defined contribution schemes" (UK), or "money purchase schemes" or "individual retirement accounts" in the U.S.A.

A well managed pension fund will be able to meet its pension obligations, both in short and in the long run. as well as in unprecedented cases (e.g. in staff retrenchment schemes. untimely deaths due to accidents or criminal activities). It is therefore imperative that funds which are not required immediately be invested inorder for the scheme to meet its pension obligations.

Some countries have statutory bodies supervising the management and investment of pension funds. An example of this is the Occupational Pensions Board of the United Kingdom (OPB). However OPB is not in favour of strict control over the schemes' funding and investment controls. Instead, the OPB has given pension funds in the United Kingdom the following guidelines to ensure they meet their obligations:

1. Funds' managers are required to prepare annual reports and accounts. Auditors and actuaries are to take part in the monitoring process to ensure objectivity and professional guidance.

2. Information should be released by the manager to members of the scheme on request. Reliable information should be availed to members of a scheme the same way as to shareholders in a company.

3. Members and other beneficiaries of a scheme should be entitled to pass information to a trade union or other associations which represent their interests.

4. Members' participation in schemes should be encouraged to ensure a code of good practice.

Pension funds may opt for "insured fund management" where the fund allows an insurance company or a bank to undertake the task of investing the contributions to the pension fund. This is popular with small pension schemes. The other alternative which is usually preferred by large pension schemes is the "Direct Investment". Under this arrangement, an investment manager is employed by the fund to carry on the day to day investment operations. However, a board of trustees make the broad investment policies including choice of investment assets and proportionate capital outlays while the investment manager is given flexibility to operate within the limits set by the board of trustees. Some pension funds have a mix of both direct and contractual investment whereby they have an investment manager who liaises with an insurance company or bank who invest their funds.

2.3 Fund Investment

2.3.1 Investment Theory

Investment may be defined as the acquisition of assets by the investor, with a view to satisfactory returns in the future (Hargitay, et al 1993). Capital is in the process exposed to risk and the greater the risk, the higher the rate of return expected from the investment.

Further, investment is to do with creation, enlargement and protection of wealth. Capital is committed in assets in exchange for benefits to be received in the future. These may be in form of income flow or capital gain or a combination of both.

In choosing an investment project, investment managers apply appraisal techniques to measure economic worth of the project. The essential objective is to maximize the investor's wealth. Porterfield (1965) outlines the following characteristics as essential for a sound investment evaluation criterion:

(i) It should consider all cash flows to determine the profitability of the project.

(ii) It should provide for an objective and unambiguous way of separating good projects from bad projects.

(iii) It should help in ranking projects according to their true profitability.

(iv) It should recognize that bigger cash flows are preferable to smaller ones and early cash flows are preferable to later ones.

(v) It should be a criterion that is applicable to any conceivable investment project independent of others.

2.3.2 Investment Appraisal Techniques

The techniques are broadly categorized into non-discounted cash flow criteria and discounted cash flow criteria. The non-discounted cash flow criteria consists of the Accounting Rate of Return or Average Rate of return (ARR)

and the pay back period (PB). The discounted cash flow criteria consists of the Net Present Value (NPV) and Internal Rate of Return (IRR).

1. Accounting Rate of Return (ARR)

This method takes into account the average annual profits derived from historical data. The yearly returns are divided by the periods (usually number of years).

Thus:

$$R = \frac{1}{n}(R_1 + R_2 + R_3......+R_t)$$

Where: R = Accounting rate of return

R1, R2 ......Rt = observed rates of return in periods 1, 2 ....t

n = total number of periods

2. Payback Period

This technique simply considers the periods, usually in years, that it takes the project's net cash inflows to recoup the original investment. The usual decision rule is to accept the project with the shortest payment period.

3. Net Present Value (NPV)

This is derived from estimating the future expected cash inflows and calculating their present value. If the present value of the cash inflows is greater than the present value of cash outflow or capital outlay, the NPV is

considered positive and the project is acceptable. A negative NPV means that the project's future earnings are not able to meet the cost of the capital outlay and the project is therefore not worthwhile.

Thus:

$$NPV = \sum \frac{Ci}{(1+r)^i}$$

Where: c = net cash flow in the period

i = period number

r = discounting rate.

NPV recognizes the true value of money. Cash flows arising at different times differ in value and can only be compared if their equivalents or present values are found out.

4. Internal Rate of Return

IRR is also known as the discounted cash flow yield, marginal efficiency of capital, trial and error method and actuarial rate of return (Lucey, 1996).

The IRR may also be defined as the rate that gives zero net present value. Where the IRR is above the cost of capital, the project is accepted. Conversely, where the IRR is below the cost of the capital, the project is rejected.

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2.3.3 Investment Decision and Portfolio Theory

The criteria for choice of alternative investment must be rational and theoretically sound, yet simple and pragmatic. However, the presence of uncertainty tends to reduce the effectiveness of even the best of criteria.

In making investment decisions, the investment manager must ascertain the goals and objectives of the investor. These differ from investor to investor. An individual investor will have different objectives from an institutional investor like a pension scheme. Some of the goals and objectives of institutional investors are:

1. Security of Capital

This means protecting the original investment and protecting the purchasing power of the capital. This is usually the most important consideration. The investor desires to preserve the value of capital as a prerequisite to future income. Total loss of capital may be difficult to replace.

2. Security of Income

This is in form of dividends and interest earned by the investment. The more stable income stream is preferred.

3. Marketability and Liquidity

Marketability is whether an asset can be bought or sold easily. As an example, shares of a large company sell faster than those of a small company. Liquidity

is the ease with which an asset can be converted into cash. Some managers set aside a portion of their portfolio to maintain the required level of marketability and liquidity.

4. Taxation

Investors who are liable to high rates of income tax must consider very carefully the various options available to reduce or defer tax burden on their incomes.

After establishing the objectives of the investor, the investment manager is faced with the problem of choosing a collection of individual investments or bundles of investments, that taken together, have the most desirable characteristics with respect to risk and expected return. As the writer of the Babylonian Talmud put is some 1500 years ago, "man should always divide his wealth into three parts:, one third in land, one third in commerce and one third retained in his own hands" (Hargitay, 1993). Thus the portfolio approach to investment can be traced back to ancient history.

2.3.4 Fund Investments

Generally, institutional investors like pension funds choose between five available forms of investment:

1. **Cash and Money Market Securities**

These are held in short term deposits or money market securities until some suitable long-term investment opportunity arises. In Kenya commercial banks and other financial institutions offer cash deposits for short periods of three months, six months and yearly.

2. **Fixed Interest Bonds**

These are popular because their capital value is guaranteed at maturity, albeit in norminal terms. Increasing degrees of inflation, however, make fixed interest bonds a disadvantage. To deal with this, Britain introduced index-linked gilts in 1981 where the value of bonds are adjusted according to changes in the inflation index (Blake, 1992).

3. **Shares**

Pension funds invest in shares of local and international companies. Prices of shares are more volatile than bonds and they therefore have a higher capital gains value.

4. **Tangible Investments**

Tangible investments such as antiques, precious stones, jewelry, paintings, furniture etc. These produce no interest. Investment in these items therefore rely on capital value increases in order to produce adequate returns.

5. **Real Property**

Investment in real property include commercial buildings as well as housing. The main advantage of investment in real property is that property values and rentals tend over the long term to grow in line with inflation and therefore generally represent a sound investment. Blake (1992) outlines many

disadvantages of investment in real property by pension funds. Some include the fact that, real property investment requires more careful selection than other forms of investment. Real property is also difficult to re-sell partly because of the heavy expenditure outlay required for a single property. The fixed nature of real estate makes it vulnerable. For instance, a desirable property comprising of shops may suddenly become undesirable as a result of redevelopment, if the centre of economic gravity of a town shifts away. Real property needs careful management to obtain good tenants, keep fully let and apply good maintenance standards in order to maximize rental income. The indivisibility of property makes this form of investment unsuitable for small pensions.

Assets-mix maximizes returns while minimizing risks. Before 1970 when inflation and interest rates were predictable and stable, a stock/bond ratio of 60/40 in the U.S.A. was considered an optimal mix. In the 1970s, inflation and recession caused real value of these investments to plunge. Real estate and foreign investments consequently proved to be popular to counter the effects of inflation (Nevaer, et al 1987). Real estate provides stable levels of current income and appreciation to generate positive returns in periods of high inflation. Foreign investments reduce volatility associated with domestic financial markets or foreign capital markets may be faring well while domestic markets may be stagnant.

If an investor concentrates on only a few securities, the total risk may be unacceptably high. Hence, the investor must keep balancing between risk-free securities like treasury bonds and equities which have higher risk profiles but matched by greater growth potential.

Investment managers attempt to limit exposure of the investor to a particular risk associated with a particular asset. As an example, Hargitay et al. (1993) asserts that it is generally accepted not to invest more than 20% of total value of fund in real property. The same work categorizes investors in terms of their response to risk as follows:

1. Investors who are not risk averse invest largely in speculative stocks.
2. Investors who are cautious and risk averse invest in balanced portfolios containing fixed interest securities, well diversified equities and real property.
3. Strong risk averse investors invest in guilts, convertible debentures and only small, if any, on equities.

2.4 Fund Investment in Real Estate

In developed countries like Britain, the late entry of real property in investment portfolios of institutional investors has been due to other reasons and not to non-availability of property as an investment. Macleary et al (1988) explains the problems of investment in property as related to problems of methods of asset pricing and measurements of variables necessary to satisfy explicit asset

pricing models. In other words, it is necessary to be able to subject investment in real property to the same appraisal techniques and analysis methods that have long been used in analysis of other non-property investments.

An often-quoted problem is the inability to measure risk in real property investment. However, Hargitay et al (1993) points out that risk, which is generally regarded as the probability of not achieving a predicted rate of return, is difficult to measure in all types of investment assets. Risk is quantitatively measured by variability of actual returns from the expected returns.

In real property, the large number of variables involved in property development and the sensitive nature of the residual method of valuation make risk a major factor in considering investment in real property. Consequently, investment in already built and let property is considered less risky as key variables are reduced and the method of assessment is less sensitive.

2.4.1 Variables in a Typical Real Estate Investment

1. Rental value and rental growth

In areas of active property markets, comparables are readily available, thus making it easy to estimate future rents and growth. Past evidence of growth rates may be a guide. However, changes in economic growth and inflation among other factors, may cause a difference in future income and expectations.

2. Yield on sale and timing of sale

Although real property is a long-term investment, it is not retained in the portfolio indefinitely. It is sold at a price hoped to be higher than the initial capital outlay.

3. Age and obsolescence

The age of property determines the future magnitude of capital expenditure on refurbishment or complete redevelopment. It is also important to note the relationship between the investment value and the site value.

4. Lease structure

Included in this item are timing of rent reviews, duration of leases and tenant covenants. All these have a bearing on uncertainty and income flows. Properties with reversionary interests are more uncertain since leases may fail to be renewed.

5. Liquidity, management cost, taxation and inflation

Liquidity concerns the ease of selling the asset, the length of the transaction and its cost. A prime property is less risky than a secondary one.

Modern valuation methods are in use in assessing the above variables and it is thus possible to evaluate the value of real property like other non-property assets. So long as these methods are applied by qualified people, real property can and should be included in investment portfolios of institutional investors like pension funds. In the United Kingdom for example, institutional investors have increased their investment in real property as a useful means of diversifying and spreading investment risk especially when inflation is on the rise.

Investment decisions of institutional investors have been influenced by more reasons than merely "maximizing returns while minimizing risks". One objective has been the social benefits accrued from investments in social-economic sectors like housing. Many insurance companies and pension funds have invested in housing for the benefit of their members/contributors while at the same time receiving positive returns on their investments.

2.5 Pension Funds Investment in Housing

Lavier et al (1987) points out that contract savings plans with life insurance companies and pension funds are excellent potential sources of funds for housing. The regular nature of the payments into these funds without expectation of receiving benefits in near future, the fact that payments of benefits to beneficiaries can be estimated with some certainty, all make these funds appropriate sources of long term finance for housing. However, the question is what influences a pension fund's investment policy to invest in housing or not?

The type of investment strategy of liberalized pension schemes largely depends on trustees who normally set limits of the proportion of the fund devoted to a broad asset category. Blake (1992) further explains that since in law the first concern of pension funds is to safeguard the long-term interests of their members and beneficiaries, this has led to some narrow interpretation of the obligations of the pension funds. This includes investing mostly in short term investments instead of investing in long term investments which create

future real resources, investing mainly in the financial sector which is dominated by large firms, hence lower risks, than in the capital goods sector that provides the engine for growth in the economy. Housing is included the capital goods sector. It is now an accepted fact that housing has a valuable multiplier effect on an economy, generating employment and providing a market for locally produced building materials. These are some of the very desirable advantages of investment in real property that have to be offset against the disadvantages that are not faced by investment in purely financial assets.

It is not surprising then, that pensions funds world over, have either, on own volition, or through Government intervention, continued to invest in housing. In Japan, 80% of the annual net increase in the pension reserve deposits is used to finance housing, environmental sanitation facilities, welfare facilities, small enterprises and agricultural and fishing industries, all geared towards raising the living standards of the nation. It is believed that investment in employee housing, while not seemingly directly profitable has helped Japan attain a remarkable level of industrialization and productivity (Sweet et al. 1976).

Various models of injecting pension funds into housing have been applied in both developed and developing countries. Some have worked very well while others have experienced problems. Many lessons have been learnt from these

models, and thus one may develop a model suitable to one's environment from these experiences.

2.5.1 Developed Countries

Denmark

In Denmark, the Danish Pension Fund (DJOP) is a private pension fund which puts a big proportion of its assets in the housing sector. At any one time, this fund invests at the minimum, 15% of its assets in housing for its members. About 10% of these are mainly blocks of flats bought or built in major urban areas for members to rent, and 5% are for loans to members for their own houses or flats. Allocation is purely on seniority basis, i.e., the number of years one has been a member of the fund. It is worth noting however, that building, purchasing and administration of the estates is contracted to private real estate business people to manage. Rents, interest rates and other costs are all at market prices. Mortgage loans to members run for a period of 25 years and a grace period of 5 years during which period only interest is paid. This helps members during these first difficult 5 years of the life of a mortgage (Jorgensen and Mutero, 1992).

The Danish Pension fund has considerable exposure to housing markets through mortgage related bonds. In 1987, Danish Pension funds had 63% of assets in mortgages or mortgage association bonds (Davis, 1993). In 1992, total investment in housing amounted to 55% of assets. In their study on how to finance housing on affordable terms for members of the NSSF; Jorgensen

and Mutero compare this level of investment in housing of the Danish Pension Fund with NSSF's. As at 1992, the latter's amounted to 5% of investment assets. The study did not, however, indicate what kind of housing was financed and who benefited from this investment. The study also pointed out, that the Danish Fund is the same size as the NSSF in terms of annual contributions.

The Danish Pension Fund therefore contributes to the housing sector by injecting funds through various means including; direct loans to members, development of flats to rent and buying mortgage bonds from housing finance institutions. It avoids making investment mistakes by leaving the actual real estate transactions and construction to real estate business people.

United States of America

A central feature of housing finance in the United States of America is secondary mortgage operations. The Federal Mortgage Association was established in 1938 to provide refinance facility by buying up mortgages from savings and loan institutions while raising funds through debentures which were fully guaranteed by the federal Government. The finance system was deregulated in 1981. This allowed the private institutions to participate and expand the secondary mortgage market. The new instrument, the Collaterized Mortgage Obligation attracted new investors to mortgage backed securities. These included pension funds, insurance companies and international investors. An example of the volume of funds chanelled through secondary

mortgage market instruments are participation certificates issued by the Federal Home Loan Mortgage Corporation which rose from US$ 56 billion in 1983 to US$ 99 billion in 1985 (Habitat, 1989).

France

Lea and Renaud (1995) reported that contractual saving schemes have had big success in France, Germany and Austria. France established its first savings for a housing system in 1965. The government subsidizes the schemes by tax exemptions on interest earned and a bonus of 3.5%. One of the savings systems in France "locks in" funds for five years before one can borrow or withdraw. The system has attracted many savers and funds. By 1983, 9.3 million accounts had been opened in these schemes with a total net outstanding balance of savings of French Francs 222.8 billion of which 51% had been lent for housing and the balance invested in the financial system (Habitat, 1989).

2.5.2 Developing Countries

South Africa

Another private sector fund that merits mention is South Africa's Old Mutual Insurance Company. This company carries pension funds for several major private enterprises with thousands of members of all income groups. Being the largest of its kind, the company has made arrangements with a number of building societies to advance loans from its pension funds to members on special conditions. These allow a member to take a loan with specified limits

and pay only 25% of his/her income a month towards repayment of the loan. The difference between the monthly fixed annuity payment and 25% of borrower's income is paid by the insurance company's pension fund. This arrangement continues until the members' income has risen, so that 25% of it now exceeds the monthly mortgage payment. The difference now goes back to the pension fund, so that by the time the member retires, the pension amount is maintained. The parameters involved in calculating the loan sum allowable are: age; income, credit in pension fund and inflation rate. If a member wants a larger loan than allowed under these rules, negotiations with the building society can result in a higher percentage than 25% of present income being paid. This system makes loans accessible to members who otherwise would not qualify because of 'affordability' criteria.

The South African experience is a good lesson in terms of flexibility. It allows borrowers to have access to finance which they otherwise would not afford early in their working life. The government supplements the subsidy by a "first-time home buyer's subsidy" which reduces the interest element of repayment by one third over the first five years. This, according to Jorgensen and Mutero, may not be possible in Kenya where interest rates were deregulated in 1991. It however illustrates a break with the traditional and misconceived approach to housing subsidies, namely, shifting the subsidy from the house to the owner and limiting it to the first 5 years (Jorgensen & Mutero, 1992).

Nigeria

Pension funds are reported to "occasionally provide finance (for housing in Nigeria) as do industrial and commercial bodies for employees" (UNCHS, 1991). This means that there is only limited use of pension funds in the housing sector in Nigeria. This is partly because of the limited development of mortgage finance institutions, most of which are in their early stages of development. There is therefore inadequate housing programmes due to the absence of developed commercial sources of housing finance.

Philippines

During the period 1987 to 1992, the housing need for Philippines was estimated to be 3.4 million units. Affordability was a great problem due to low levels of household income (UNCHS, 1991).

In Philippines, provident funds which comprise 6% of an employees gross salary, and are contributed jointly by the employer and employee are remitted to the Home Development Mutual Fund (HDMF). These funds are channeled into long-term mortgages and attention is given to low-income groups. House loans to members carry interest rates that increase with the size of the loan. The difference between the highest and the lowest is 3%. In 1991, interest rates charged ranged between 9 and 16%. Non-members are also able to borrow money for home-ownership through "Social Mortgage Window" which has been integrated with the Unified Home-lending Programme

(UHLP). The latter oversees the operations of private and public institutions which originate mortgages.

A secondary organization, National Home Mortgage Finance Corporation (NHMFC), employs the funds collected by the HDMF to buy mortgages originated by eligible banks. In this way, provident funds are used to increase the flow of funds to the banks to create further mortgages. The NHMFC secondary mortgage market was formed in 1981 and by 1983, it had purchased 15000 mortgages from private HFIs with funds from HDMF. The secondary mortgage market enables HFIs grant loans at fixed rates of interest because of the regular flow of funds.

The HMDF's bulk of its investment portfolio is in housing. The original objective was to provide end-user finance. However, it expanded into construction, lot purchase, home improvement, refinancing of existing loans and redemption of foreclosed property. Through financing land acquisition and site development, the Fund hoped to reach the lowest 30% of the population. Development loan to this group is at 12% interest rate.

The success of the Philippines conversion of workers' provident funds into housing finance can be seen by the fact that between 1988 and 1990, a total of 31,665 housing units were built with assistance from HDMF and NHMFC (Habitat, 1991).

Two difficulties arise from this experience. One, the subsidized interest rates are not in line with integrating housing finance into the rest of the financial system. By not allowing market returns, the policy constraints the efforts to develop a secondary mortgage market. Two, the low contributions of workers relative to the typical mortgage loan means that only a small number of workers, reportedly 2% in 1990, of membership can benefit each year (Habitat, 1990). On the whole, however, the channeling of pension funds into the housing sector together with the increased attention that the Government has given the sector has led to a significant increase in housing production in the Philippines.

Singapore

The Central Provident Fund (CPF) of Singapore contributes to financing of shelter through allowing contributors partial withdrawal of their contributions for house purchase. The CPF was established in 1955 as a comprehensive social security system. All employers and employees contribute 20% of workers salaries to individual accounts in the CPF. Contributions and interest income are tax exempt.

By 1990, the resources of the CPF equaled 76% of the Gross Domestic Product (Habitat 1996). From 1968, individual workers were allowed to withdraw from their CPF accounts for purchase of public flats developed by the Housing Development Board, a public company. From 1981, workers were allowed to withdraw money for purchase of private housing and from

1989, withdrawals could be made for upgrading of flats and shelter improvement in general. By 1995, US$ 2397 million had been used in financing house purchase and improvement with funds withdrawals from the CPF.

Sri Lanka

Pension funds are used to finance housing in Sri Lanka with the reasoning that, "they are infact peoples' savings and in that way are being used for housing people" (Knight, 1985). The Government employees pension fund was established in 1971. It has provided funds for housing through various means; purchase of debentures in housing to make housing financial institutions make affordable loans to members, allowing members make partial withdrawals for purchase of housing (subject to the house not being sold). Members can withdraw as much as 90% of the deposits and the monthly contributions are used to pay the loan.

Turkey

In Turkey, pension funds are not the main players in provision of housing finance. There are both public and private pension funds. Public pensions are sometimes directed by the Government to invest certain portions of their funds in housing. Whereas privately owned funds are not so regulated, one of the largest private funds has been devoting funds towards housing finance (Beskok, 1988).

The main source of finance for housing in Turkey is the Mass Housing Fund established in 1982. This fund was set up exclusively to provide finance for housing. The main sources of funds are surtaxes on certain goods and services. The fund does not mobilize savings from households but is rather a fiscal scheme by the Government to ensure a steady flow of finance for housing. The fund was introduced against a background of near collapse of conventional housing finance systems following accelerating inflation and increases in market interest rates to between 40 and 50 percent. conditions under which long term housing finance became too expensive for low income and middle income households. Creation of the fund demonstrates how important the Government of Turkey takes housing to be in relation to other services.

Mexico

Pension funds are the largest source of housing finance in Mexico. Government intervention in 1972 came up with a programme to meet the need for 2.3 million housing units. The objectives were not only to increase the supply of housing units but also to stimulate the growth of the economy and reduce unemployment (Sweet and Walters. 1976).

The above programme led to the creation of INFONAVIT (Institute of the National Housing Fund for Workers). This is a banking organization with considerable autonomy and is controlled by workers, employers and the federal Government. Employers including the government pay 5% of the

payroll into the fund. The contributions are credited into the accounts for workers but they are "locked in" for the first ten years. After this period, workers can withdraw without interest and invest in the economy for their own retirement.

INFONAVIT provides finance for newly constructed housing. Employees may apply for loans after meeting a set of requirements based on age, total contributions, number of years worked and number of dependants among others. Newly constructed houses are allocated on lottery basis. Target groups are households earning between 2 - 5 times the minimum wages. Interest on loans is below market rates. In 1994 for example, the society charged between 11 - 15% interest, inflation was at 10% and market rates of interest were between 24 - 26%. Repayment of loans do not exceed 25% of the borrower's wage income (Diamond and Lea, 1995).

These favourable terms make it the best financing mechanism for most of the low to moderate income people. The result is high demand for loans. Sweet et al (1976) reported, that during the first 3 years of INFONAVIT's incorporation, over 4 million workers registered as members.

Since the success of the programme depends on the degree of recovery of the loans and rechanneling of the funds back into the construction of housing, INFONAVIT uses direct debiting and payroll deduction to collect its mortgage payments. By using these means, there is high success in loans recovery.

Table 2.1 shows the contribution of pension funds in production of housing units in Mexico as compared to other sources of finance. The other major organization is FOVISSTE which is part of the Central Bank. It is funded directly by the Central Bank and loans from the World Bank. FOVISSTE makes loans available to housing developers through commercial banks. It also refinances households by providing partial guarantees against default for loans.

Table 2.1 Housing Investment in Mexico: Number of Housing Units, 1990 - 1994.

Year	1990	1991	1992	1993	1994
Pension Funds	114.522	105.516	124,010	145.010	172.000
Fovi	30.720	30.772	24,638	22,089	47,721
Others	246.862	238.350	151.858	167.871	271.879
TOTAL	**392,104**	**374,638**	**300,506**	**335,191**	**486,600**

Source: Sweet et al (1976)

These figures show that pension funds contributed 5% of the total housing units constructed in Mexico during the 5 years period. The multiplier effect of housing in the general economy is reported to be 2.3.

On the other hand, too much government intervention and involvement in construction directly led to the demise of mortgage banks in Mexico. The Government thus made major reforms in 1991 which saw the freeing of the financial market and privatization of banks.

Brazil

The Mexican model was influenced by the Brazilian model which has had considerable success in applying pension funds to finance housing production. In Brazil most housing finance is done through the National Housing Bank or BNH. The bank gets its funds from 1% tax from major employers, 4% compulsory savings from rent by landlords, and direct budgetary contributions from the government. Major investments are also placed with the bank from the "Time on-the-job guarantee Fund" (FGTS) which requires that employers deposit an equivalent 8% of an employee's payroll into an account for each employee. FGTS is a social security fund for workers. Its massive funds are indicated by the fact that by 1987, this fund had accumulated US$ 10 billion (Habitat, 1990).

Finance for housing was channeled through loans to families to purchase houses. Interests on loans were at between 1% and 10%. Repayment was to be no more than 25% of borrower's income. Emphasis was laid on low-income housing. BNH later established a savings and loan system to finance middle income housing. Employers could also obtain finance from BNH on an equal-sharing basis with employer's contribution usually being in form of land. BNH later financed integrated urban and local government planning, sanitation, water and sewerage, training of personnel, activating building materials and construction industry, electricity supply and highways modernization. During the first 9 years, BNH completed 1 million dwellings (Sweet et al, 1976). Some of the worst slum communities in and around major

cities have been eliminated as a result of these programmes (Theodore, 1970). This is an impressive achievement. BNH has thus contributed greatly in stimulating, strengthening and an integrating organization that increases employment opportunities, augments family income, improves community and urbanization facilities, raised levels of living standards and provides more savings for expanding the cycle of investment.

The Brazilian model has encountered certain problems namely;

- Questions as to the ability of FGTS to continue as the major source of funding the National Housing Plan as well as fulfilling its original mandate of social security payments.
- Social cost of eliminating slums where slum dwellers are not willing to move to new locations, and resentment arising from forced moves.
- Housing finance in Brazil is known for its "indexation" of savings and loans. This means that adjustments are made to balances of loans and savings according to changes in the consumer price index. This tool is useful in countries with high inflation to safe-guard the value of money assets and has the good effect of keeping interest rates lower than would otherwise be the case while savings carry a positive real rate of interest thus making savings worthwhile. According to Malpezzi (1992), indexation only provided partial protection as it was based on wages, whose changes lagged behind increases in the general price level. As a result, returns on savings turned negative. The government also manipulated the index with

the result that real rate of interest became negative by upto 50% per year. Savers consequently looked for other investments to place their money in.

Despite the above problems, Brazil has managed to consistently channel funds into the housing sector. Pension funds continue to play a major role in financing housing. In 1986, 67.5% of the total national human settlements investment amounting to US$ 1 billion was funded by BNH using social security, and FGTS funds (Habitat, 1990).

Chile

In Chile, the current social security system was introduced in 1991 based on individual capitalization accounts. Although social security is mandated and regulated by the Government, it is managed by specialized private pension fund management companies. In 1994, the total funds of the pension system stood at US$ 22.3 billion or 43% of the Gross Domestic Product (Lea & Bernstein, 1995).

Pension funds are channeled into housing finance through secondary mortgage markets. Home loans are thus issued in form of mortgage backed certificates which are traded in the stock exchange at market prices. Pension funds purchase these mortgage certificates / bonds and by so doing, more funds are availed to the mortgage originating companies. These funds are then availed to borrowers thus creating further mortgages. Purchasing of mortgage bonds also transfers the risks of ownership of mortgage loans to a third party and this

allows for separation of origination, servicing and fund-raising aspects of mortgage finance. This division of labour reduces relative cost of mortgage loans.

According to Dimitri (1995), Pension Funds in Chile purchased 62% of mortgage bonds in 1994. Pension funds and insurance companies together accounted for over 90% of these bonds. Mortgage bonds comprised 16% of total investment portfolio of the pension system in Chile in 1990.

Conclusion

Ways of Channeling Funds into Housing

Depending on the size and needs of each fund, funds can choose any or a combination of the following ways of channeling investment funds into housing.

Table 2.2 Various Ways of Fund Investment in Housing

Mode of Fund Investment in Housing	Country
Direct loans to members (loan repayment not exceeding 25% of borrower's income).	South Africa
Mortgage loans to low-income groups (interest rates increase with the size of loan). Participation in the secondary mortgage market.	Philippines
Partial withdrawal of savings from provident fund accounts for members to purchase or improve own dwellings.	Singapore
Purchase of debentures from HFIs.	Sirilanka
Finances construction of houses. Direct loans to members at subsidized rates of interest.	Mexico
Finance from compulsory savings and special housing taxes. Loans to low and middle income families for house purchase (repayment not more than 25% of income). Financing local government planning, sanitation, water and sewerage, activating building materials and construction industry, electricity supply and highways modernization.	Brazil
Secondary mortgage markets.	Chile, U.S.A.
Direct loans to members. Development of rental flats. Purchase of mortgage bonds from Housing Finance's (Secondary mortgage market).	Denmark
Compulsory savings schemes.	France

Ideal Portfolio Mix

Developed from experiences of the countries discussed above, the following is the recommended investment portfolio mix for pension funds (See Blake 1992, Hargitay,1993).

Table 2.3: Ideal Fund Portfolio Mix

Model portfolio mix of pension funds	
	% of total assets
Government bonds/securities	20
Cash	5
Equity	50
Real property	15
Offshore	10

Source: Blake (1992) and Hargitay et al (1993)

In this chapter pension funds are seen to have been extensively used to fund housing development in both developed and developing countries. Literature is however lacking in showing how these funds balance investments in housing with other forms of investments. It is important that pension funds apply sound investment principles with appropriate investment portfolio mixes. This will enable funds continue funding housing development as well as continue to meet their primary objective of providing social security in a sustainable manner.

Pension funds' participation in housing provision is generally a result of governmental initiatives and interventions. It has generally not been reported

how many members of these funds benefit from the funds investments in housing or how they feel about their funds' investments. This study will attempt to investigate these issues in Kenya.

CHAPTER THREE

SOURCES OF HOUSING INVESTMENT IN KENYA

3.1 Introduction

Involvement in housing finance in Kenya has been a joint endeavor of both the public and the private sectors. Through its many plans and sessional papers, the Government has since independence outlined plans of action and has also endeavored to provide the necessary institutional and legal framework for the private sector to participate in housing finance. As a result, there is a Government Ministry dealing with housing, a Government parastatal which serves as the government's main housing agency and an array of financial institutions that deal with housing finance.

Despite the appreciable effort put forth by both the public and private sectors, the two sectors have only managed to finance 20% of Kenya's urban housing need (Kenya, 1989). The rest is financed using informal means including household savings, borrowing from family and friends, gifts and self-help groups. This latter form of finance means that construction of houses is incremental and usually sub-standard. The structures often lack the basic infrastructure of water, sanitation and roads. It is estimated that 75% of Kenya's urban population live in such sub-standard settlements. This chapter

examines the different sources of housing finance in Kenya, highlighting their role in the supply of adequate housing.

3.2 Housing Policies and Plans

3.2.1 Sessional Paper No. 5 – Housing Policy for Kenya

The housing policy of 1966/7 recognized the contribution of good housing to the health and productivity of the Kenyan labour force. The Government therefore set out to accord high priority to provision of sufficient housing for Kenyan workers. The housing situation in the main towns had reached a critical stage with the onset of independence. There was need to provide for slum upgrading and replenishment of obsolete stock of housing. The Government was to organize in collaboration with local authorities, a program which sought to develop housing projects which provided not only essential housing but also a healthy environment for the urban dweller at the lowest cost to the occupants. This would include dwellings with the essential amenities for a decent family life.

The Government intended to mobilize capital for public housing programs while giving encouragement to the private sector to fully participate in the provision of housing. In an effort to encourage low income families to acquire decent housing at prices which would otherwise be beyond their reach, use would be made of the aided self help technique in urban site and service schemes.

According to the policy, the government would make use of external finances through donor agencies but it also recognized the inadequacy of these resources. Hence some of the finances would be internally sourced. Local authorities were encouraged to raise finances for housing development. External finance and technical assistance would be used to support training programs and the development of suitable financial institutions.

The housing policy appreciated the role of co-operatives in mobilizing finance for housing development and the Government intended to give every encouragement to co-operative societies to increase their involvement in the housing sector. Through this method, groups of workers in industry and agriculture would be enabled to own decent housing at reasonable costs.

The Government was to give loans to local authorities for development of houses in their areas of jurisdiction. They were to supplement these funds by raising loans from non-government sources.

The sessional paper provided for the setting up of a National Housing Authority which would be responsible for implementing Government housing programmes under the supervision of the Minister in charge of housing. As a result, the National Housing Corporation (NHC) was set up and it has been the Government's chief agency through which funds intended for low cost housing are channeled to local authorities, housing co-operatives and other public housing development organizations.

The Government was to raise funds for development of rental housing for low-income groups. It would also, through the NHC, provide loans to assist house owners carry out repairs to existing houses. There was need to support research into building techniques and development and use of local materials in order to get the greatest number of houses built at cheapest cost. The Housing Research Development Unit of the University of Nairobi was set up as a result of this policy.

3.2.2 Successful Development Plans

Successive government plans outlined policies and intentions to tackle the increasing housing need. The government recognized the inadequacy of public funds to cater for the urban population which was estimated at 640.000 people at independence in 1963 and growing at the rate of 5.95% per annum (Kenya, 1970). The government thus emphasized the need for more effort to be put into site and service schemes by local authorities, review of building standards to allow use of cheaper building materials and boost flow of funds in housing through private savings and overseas donors.

By the 1970s, the country's urban housing need had risen to 10.000 housing units per year, of which 70% was for low-income households. Total expenditure to meet this need was projected at Kenya pounds 53 million. Finance was to be supplied by both the public and private sectors. The following table shows the production of dwelling units both by public and

private sectors compared with the formation of new urban households during the period 1976 to 1982.

Table 3.1: Production of Dwellings by Public & Private sectors Compared with Formation of New Households. (1976 - 1982).

	1976	1977	1978	1979	1980	1981	1982	% Total 1976-82
National Housing Corporation Houses	317	916	1.544	4.085	3.527	2.755	2.928	36.0
Site & Service	2.128	355	1.077	2.389	2.454	2.719	2.550	28.4
Ministry of Works, Housing & PP	254	106	359	156	482	471	49	4.2
Other Public Sector	1,068	193	257	221	481	206	443	6.4
Private Sector	791	742	835	2.716	2.065	1.918	2.083	25.0
TOTAL	3.558	2.312	4.072	9.567	9.009	8.069	8.053	100.0
Estimated No. of New Households	23.700	25.600	27.600	29.800	32.100	34.700	37.400	210.900
New Dwelling Units as % of New Households	15.0	9.0	14.7	32.1	28.0	23.3	21.5	20.5

Source: Kenya (1989), Development Plan 1989 - 1993.

The above figures show that the public sector provided 75% of all formal housing units constructed during this period with the remaining 25% being provided by the private sector. Compared to formation of new households. the total number of houses provided during this period was just 20%. Each year saw a deficit of more than 20.000 housing units.

3.2.3 National Housing Strategy 1987-2000

The national housing strategy was to guide the programmes and actions aimed at producing the maximum number of satisfactory dwelling units to meet urban and rural requirements between then (1987) and the beginning of the next century.

The policy encouraged the gradual shift of the role of government from one of direct developer of housing for lower income households involving moderate subsidies to one of working with and facilitating the development of housing by private entities charging market prices. There was an emphasis on Government to specialize in performing those activities which only the government can provide, such as, land transfer and infrastructure provision. Cost recovery was to be advocated. Lower income groups would be the focus of government actions in providing a greater share of the government's financial and administrative resources. International donor resources would be required into this group.

The resources of the informal sector would be exploited and encouraged to contribute more to production of acceptable housing. For example, adoption of more realistic subdivisions and building standards would make such present informal housing quite close to meeting minimum standards.

From 1987, the government shifted the emphasis from financing shelter provision to providing an enabling environment for greater private sector

participation. The 1990s have seen a progressive decline of government budgetary allocation for housing including the rural housing loans. Instead, the 1994 Development Plan outlines the following strategies:

i) Reduce borrowing from private banks in order to release more funds into the shelter sector.

ii) Increase access of NSSF funds to shelter.

iii) Encourage the role of cooperatives in shelter development.

iv) Review legislations that limit banks from fully participating in real estate investment.

v) Request insurance companies to set aside certain percentage of their investible funds for housing development.

vi) Mobilize private sector funds for housing to supplement government funding.

vii) Establish employer/employee contributory housing funds to create revolving funds for housing development.

By 1997, the accumulated urban housing need was estimated at 96.600 units while the rural housing need was 234.000 units. The required capital to meet the urban housing need alone was Kenya pounds 16.6 billion (Kenya. 1997). The total formal sector resources only cater for 20% of this need, leaving the rest to informal financing. It is no wonder then that slums keep flourishing in Kenya urban centres.

A review of government development plans and housing policies since Sessional Paper No. 5 of 1966 to-date show a poor performance of the housing sector which has always fallen far below the stated policies. According to Malombe (1981), the government-stated objectives are not accompanied by related programmes and resources. For this reason, many objectives are repeated in successful plans. An example is the review of the building code which was reviewed over a long time but not approved until 1995, despite the intention to do so as early as 1966. Other examples include establishment of a secondary mortgage market which is yet to be done, access to NSSF funds, improvement of infrastructure and accessibility to serviced land for housing development. Transactions in land ranging from property transfers to procedures of approval of building plans are still too complex, inefficient, and unnecessarily lengthy.

3.3 Public Housing Finance Institutions

3.3.1 National Housing Corporation

The NHC was established in 1967 as a body corporate to serve as the Government's main agency for house delivery. It was an extension and enlargement of the Central Housing Board created in 1953. The NHC has a board of directors but its operations are supervised

by the Minister in charge of housing. The Corporation is regulated by the Housing Act which is the establishing legislation.

The main objective of the Corporation is to supplement government effort in providing supply of housing with emphasis being put to low income housing. The corporation does this in several ways: -

(i) Gives loans to local authorities with funding from the Ministry of Housing in order for the local authorities to increase their stock of housing.

(ii) It develops rental housing which are administered by local authorities.

(iii) Develops and manages housing to supplement capacities of local authorities.

(iv) Encourages research and development in housing.

(v) Develops housing for mortgage with HFCK providing long-term finance for mortgages to individual households.

(vi) It operates a rural housing loan scheme to assist develop adequate housing in rural areas.

(vii) It provides technical assistance to local authorities.

The NHC does not accept deposits from members of the public. Its sources of finance for housing have been allocations through government budgets and loans from international donors. The latter are channeled through the Ministry of Finance and then the Ministry of Housing before disbursement to the Corporation. The corporation borrows from the Government at an interest of 7.5% for 40 years and consequently lends to local authorities at 8% interest. Site and service loans are usually for 20 years period. The Corporation also develops tenant-purchase housing schemes and advances loans at 12% interest.

Rural housing loans are also at 12% interest and the maximum loan one can take is 200,000/= (1997 figures).

The NHC accelerated housing productions during the first several development plans. The Corporation was responsible for production of 30% of all formal housing being supplied. By 1970, it had helped to construct, either directly or through site and service schemes, a total of 30,481 housing units. However, by this date the urban housing need alone, was estimated at 74,000 units (Kenya, 1979). Activities of the NHC have always lagged behind the required number of houses. The main problem has been inadequate finance as government allocation to housing has continued to dwindle. As an example, government approved expenditure for housing for 1994/95 fiscal year was Kenya Pound 21.21 million. This fell to Kenya Pound 9.46 million for the year 1995/96. Actual expenditure is, however, always lower than the approved estimates (Kenya, 1996). International finance for housing has also not been much in recent years. Thus, in 1995, the Corporation was only able to complete by direct construction, 42 housing units at a cost of KShs. 44 million. Schemes completed in 1995 included infill houses at Uhuru Gardens and Otiende maisonettes in Nairobi. These are for upper middle income groups. The other completion was at Kiboko mortgage scheme phase II in Thika. At the end of 1995, the NHC was constructing 47 schemes comprising 4,604 housing units which were at various stages of construction. By this time annual urban housing need had reached figures in excess of 60,000 housing

units. A summary of NHC's constructed buildings during the period 1991-1995 is shown in table 3.2.

Table 3.2: Housing Units Completed by the National Housing Corporation

1991-1995

Units Completed	1991	1992	1993	1994	1995*	Total
Provinces						
Nairobi	2	..	..	952	42	
Coast	68	..	23	66	..	
North-Eastern	..	..	..	..	..	
Eastern	128	..	..	..	..	
Central	..	40	..	..	..	
Rift Valley		40	..	..	..	
Nyanza	..	..	..	..	..	
Western	90	102	..	..	..	
Total Number	288	182	23	1.078	42	
Value of Units Completed Kenya pounds '000						
Nairobi	140	..	..	17.478	2,175	
Coast	551	..	487	768	..	
North-Eastern	..	..	..	..	..	
Eastern	389	..	..	..	..	
Central	..	154	..	..	..	
Rift Valley		639	..	..	..	
Nyanza	..	..	..	..	..	
Western	319	307	..	..	..	
				258	..	
Total Value	1.399	1.100	487	18.504	2,175	

Source: Economic Survey 1996 (Kenya)

Comparing production of housing by NHC in recent years to previous years as represented in Table 3.2, it is evident that the government has shifted production of housing to the private sector. The latter is now producing 80% of all formal housing while the public sector produces 20% (Kenya, 1996).

The current opinion including that of international housing agencies and donors like Habitat and the World Bank is that there should be less direct

participation of Governments in housing production. Instead, governments should concentrate on providing enabling environments in which the private sector can thrive. However, it is still imperative on the government to provide acceptable shelter to the poorest groups of the population. Sud (1987) avers that "housing needs of the genuinely poor people are addressed through well designed and targeted welfare programmes. These subsidy programmes should be kept transparent in the budget and limited in scope". Housing programmes by the NHC are subsidised in that the interest on loans for tenant purchase schemes is only 12% compared to market rates on long-term mortgages which currently range between 26-30%. However, these houses do not go to the targeted groups. Examples are the Kibera and California slum upgrading schemes which did not go to the targeted groups (Syagga & Malombe, 1995). The main reason for the problem has been that by the time the projects are completed, the cost is usually way above the affordability levels of the targeted groups. For instance, the Nyayo High Rise flats at Kibera cost between KShs. 400,000/= - 500,000/=. Monthly repayments range between KShs. 5,000 and 6,000 per month. This is not affordable by the Kibera slum dwellers who were the target group. In this connection, Sud (1987) suggests that governments focus on developing realistic housing standards. These should ensure that houses developed for the poor are within their reach.

The Corporation's activities are further hampered by its poor loan recovery record. This means that less funds are available for recirculation. According

to the Corporation's Annual Reports, loan arrears to local authorities rose from KShs. 6.3 million which was 2.8% of total loans advanced in 1972 to KShs. 429 million or 30% of total loans in 1989. Recently, the High Court in Nairobi granted the NHC orders authorizing the Corporation to collect rents from tenants of Kariokor and Madaraka Estates which the Nairobi City Council built with loans borrowed from the Corporation and for which arrears totaled KShs. 709,282,300 by April 1998. The total debt owed to the Corporation by the Nairobi City Council stood at KShs. 1,155,153,988 by the same date (Daily Nation, April 28th 1998).

3.3.2 Ministry of Public Works and Housing

The other main government agency for production of housing is the Ministry of Public Works and Housing. This Ministry has undertaken construction of houses for civil servants pool housing as well as institutional houses for the armed forces, hospitals and schools. The Ministry also built the Kariokor civil servants tenant purchase scheme with long-term mortgage finance arranged with the HFCK.

The Ministry has, however, not done much in form of housing construction due to the general decline of government development activities as a result of the recent crippling financial problems. Houses constructed by this Ministry were let to civil servants at economic rents which are usually nominal rents. This sort of subsidy is not sustainable. Further, according to the World Bank

(1983), public housing worldwide is known to cost more than privately owned housing where market mechanisms are applied as control measures. Projects undertaken by the Ministry of Public Works give credence to this since many of the projects take too long to complete and this results in heavy cost overruns. It is just as well then that the Government has shifted from direct provision of housing to investment in infrastructure and even there, the performance has been disastrous. In this way, available resources will be spread to a wider proportion of the population.

3.3.3 Local Authorities

The major local authorities have housing departments which handle planning, technical design and administration of housing programmes. In the case of Nairobi City Council, the Housing Development Department was responsible for major projects like Dandora and Umoja Estates.

Local authorities finance housing from revenue collection of which rates collection form the main revenue base. They also borrow money from the Ministry of Public Work and Housing through the National Housing Corporation. Additional funds are negotiated from international donors through the Government. Of these, the World Bank is the largest while other donors include USAID, Commonwealth Development Corporation and European Economic Commission.

Production of housing by local authorities has greatly slowed down in recent years. In Nairobi where more than 67% of the population live in slums and squatter settlements, the Council has not engaged in shelter production since the Umoja II project in the early 1980s. This project was funded by the USAID. The major problem has been mobilization of finance for housing. Donor funding has reduced, while the local authorities have poor revenue collection records. As an example, the Government and individuals owe local authorities large amounts in rates and service charges. The fact that rates are based on unimproved site values does not provide a maximum revenue base for local authorities (UNCHS, 1990).

The other problem hampering housing finance mobilization by local authorities is the heavy subsidization. Rents are based on historical costs and they are, therefore, much lower than open market rents of equivalent housing. For example, a 3 bedroomed City Council flat in Buru Buru is rented at KShs. 5.000/= per month while an equivalent flat currently rents for KShs. 15.000/= per month in the open market. According to Kiamba & Syagga (1988), the Dandora Site and Service Scheme Phase I was subsidized by 63.8%. This level of subsidy is difficult to sustain and cannot generate money for further housing development.

In addition to the problems of mobilization of finance, local authorities in Kenya are immersed in myriads of problems including corruption, mismanagement and political bickering that have not afforded them time and

resources to concentrate on provision of services to the residents. Recent public land allocations by the local authorities have caused hue and cry from the public. Local authorities would thus require drastic changes in their policies and commitment if they are to make appreciable contribution to housing supply.

3.3.4 International Housing Finance Agencies

International finance has catered for public housing through donor agencies that have made loans to the government or served as guarantors to loans by their national banks. The World Bank is the largest of the foreign donors. In Kenya, the World Bank financed the Dandora site and service scheme at a cost of US$ 14 million (Karingi, 1989). The loan was at 9% interest. This scheme serviced 6000 plots. The Kayole and Mathare North Site and Service schemes in Nairobi were also funded by the World Bank. The schemes comprised 6,100 and 1,500 plots, respectively. The World Bank's experience in the projects has been that provision of physical housing does not offer an appreciable solution to the shelter problems of the urban poor. It has, therefore, laid emphasis on providing infrastructure and basic services to benefit the lowest income group (Habitat, 1994).

The Commonwealth Development Corporation (CDC) is another major donor agency in the area of housing and provision of technical assistance to governments and housing agencies. CDC is also noted for its willingness to join local housing finance institutions and forming partnerships for

development of housing. In Kenya, the CDC is well known for its partnership with the Kenya Government in the formation of the HFCK. Together with HFCK, they developed the massive Buru Buru housing estate in Nairobi.

USAID negotiates for loans and serves as a guarantee to loans given by American banks to the Kenya Government. The USAID funded Umoja Phase I and II projects with 3,500 and 4,478 plots, respectively. USAID has also given technical assistance and direct funding programmes geared specifically to the poor. The EEC funded Huruma Site and Service project comprising 890 plots.

There has been a growing awareness among the donor agencies of the importance of community participation in decisions and implementation of housing projects. A negative side of foreign funding has been observed to be the effect that these loans have on the debt servicing capacity of a country. With the exchange rate fluctuations, the long gestation and repayment periods, these loans become unfavourable to borrowers in the long run (Karingi, 1989). Local mobilization of finance for housing is therefore preferred.

3.4 Private Sector Housing Finance

Kenya's financial market is currently quite active. There are 51 commercial banks, 23 non-banking financial institutions, 5 building societies, 39 insurance companies, 1 capital market authority, 1 stock exchange market, several pension funds including NSSF and 2670 savings and credit cooperative societies (Kenya, 1997). All these institutions are or could be involved in

housing finance. At the moment the main players in the housing finance sector are mortgage companies also known as housing financial institutions, commercial banks, insurance companies and co-operative societies. However, this sector has over the years only managed to make a relatively low contribution to the supply of housing in Kenyan urban centres (20% on average according to the Development Plan 1989 – 1993, Kenya).

3.4.1 Mortgage Companies

Mortgage companies or Housing Finance Institutions (HFIs) in Kenya are the main supplier of long-term finance for purchase or construction of houses. HFI's mobilize funds from short-term deposits, shares, housing bonds and institutional investors like pension funds, government departments and parastatals and convert these into long-term loans to individuals and developers for purchase or construction of houses. The main HFI" operating in Kenya today are Housing Finance Company of Kenya (HFCK), Savings and Loan (Kenya) Limited and East African Building Society (E.A.B.S).

3.4.1.1 Housing Finance Company of Kenya

The HFCK is the largest Housing Financial Institution in Kenya. It was incorporated in 1965 as a national mortgage company and converted into a financial institution under the Banking Act of 1978. HFCK was established from co-operation of the Government of Kenya and Commonwealth Development Corporation (CDC) who together provided the initial lending capital. The company was to later mobilize savings from the general public.

The primary objective of the company was to supplement Government policy of promoting savings and mortgage facilities. It was to make loans available to people wishing to acquire their own housing in Kenya's main urban centres (Kenya. 1971). However. the company's recorded contribution has been low. For instance. during the initial years of operation. the company funded an average of 250 housing units per year (Kenya, 1971). With improved economic performance. the company's deposits increased and so did the loan disbursements. According to the company's Annual Reports. the period between 1985 to 1990 had a total of 5604 housing units financed at a total cost of KShs. 2.016.800.261. This is an average of 900 housing units financed every year at an average cost of KShs. 352.800.000 per year. Table 3.3 indicates that there is an increased level of activity by HFCK.

Table 3.3: HFCK Deposits Compared with Mortgage Disbursements (1995-1997)

Year	**Deposits KShs. '000**	**Mortgage Assets KShs. '000**	**Mortgage Disburse-ments – KShs. '000**	**Housing Units Financed.**
1995	5.513.000	4.582.000	1,138.000	930
1996	6.951.000	5,826.000	1,731.000	1149
1997	7,773.000	7.582.000	2,196.000	747
Totals	20.236.000	17.990.000	5.065.000	2826

Source: HFCK Annual Reports

The main problem faced by the lenders and borrowers of mortgage finance has. however. been with the lending terms and conditions. The following are HFCK's terms and conditions that a prospective borrower must meet before qualifying for a loan.

Lending Conditions

(i) The house offered as security must be a durable structure made of stones or concrete blocks.

(ii) The property to be used as collateral must be registered and have a title deed.

(iii) Application is made in a prescribed form obtained from HFCK at a fee (currently at KShs. 500/=).

(iv) The minimum loan is subject to the borrower's ability to repay the loan. This is calculated at 3 times annual gross income of the borrower or not more than 25% of borrower's income to go into mortgage repayment.

(v) The borrower must furnish the company with proof of regular income. This is usually in form of a letter from the employer specifying the salary of the borrower or audited accounts for previous 3 years of business people or self-employed persons.

(vi) HFCK requires a first legal charge against the title.

(vii) The borrower must maintain a mortgage-related account with HFCK with a credit minimum balance equivalent to one month's repayment.

(viii) The Company finances upto 90% of the purchase price or cost of construction. The borrower must therefore meet the 10% of the cost from other sources.

(ix) The applicant must produce documentary evidence of age since the Company does not lend to persons who have reached retirement age, which in most organizations is 55 years.

(x) Loans are usually for a term between 5 and 15 years repayable in equal monthly installments consisting partly of capital and interest.

(xi) Loans normally range from a minimum of KShs. 50.000/= to a maximum of KShs. 7.5 million per family.

(xii) In case of building loans, further conditions include:-

- Plan of the building approved by the relevant local authority.
- Building specification from the Architect.
- Estimated cost of the building from a contractor or a quantity surveyor.
- An agreement between the applicant and the contractor specifying the duration of the construction. The company gives a grace period of 8 months for construction after which full repayment of loan starts. However, interest is accrued on the amounts released to the borrower during this period. Money is released in installments after inspection and valuation reports made by the company's valuer on the work done at each stage.

Other Costs

(i) Valuation of the property to be mortgaged is done by the company's valuer at a fee which is paid in advance. Currently, the cost of valuation is KShs. 5,000 for the first 300.000 of the purchase price/construction cost and an additional KShs. 500 per every KShs. 100.000 thereafter. Where the loan is for

construction, an additional KShs. 1,500 is charged for every inspection prior to release of the next installment.

(ii) Legal fees for preparation of the charge by advocates is payable by the borrower. Where the HFCK advocates act for the borrower, legal fees and stamp duty usually amount to approximately 10% of the purchase price.

(iii) Other costs include stamp duty payable to the government and currently standing at 4% of the purchase price upon transfer of ownership or ½% duty on mortgage.

(iv) Where the amount of loan exceeds 75% of the valuation or cost of building, the company charges an excess premium calculated at 12.5% of the advance in excess of 75% of value. This amount is paid in cash before the loan is advanced.

(v) HFCK insists on underwriting two types of insurance covers on behalf of the borrowers. These are House-owners Insurance Policy and Group Mortgage Protection Scheme. The borrower has no say in the choice of the insurance company.

Although the Government still owns a substantial share capital (KENYA 30.4%, CDC 30.4 and the public 39.2%), in HFCK, the company operates on similar lines as building societies and as a profit-making enterprise.

HFCK and other financial institutions could finance more houses with greater mobilization of funds. Income levels of the urban dwellers, with many living

below the poverty line are a deterrent factor against mobilization of funds for financing housing (Jorgensen, 1982). The rates of interest offered on savings deposits could also be a disincentive to greater savings mobilization. Currently, HFCK offers between 6% and 11% interest on different savings accounts. This range is remarkably lower than the base-lending rate of interest which currently stands at 22% for owner-occupied housing. Housing bonds are issued at negotiable rates of interest. These are fixed terms of minimum 1 month to 1 year. Interest earned on housing bonds are tax-free and this makes them attractive to high-income investors. The Housing Bond Certificates are available in denominations of KShs. 100,000, 250,000, 500,000 and 1,000,000. This investment facility is not accessible to the great majority of savers due to the high minimum deposit.

3.4.1.2 Savings and Loans (Kenya) Limited

Savings and Loan is the oldest Housing Finance Institution in Kenya, having been incorporated in 1949 as a building society. It was changed into a limited company in 1962 and was later acquired by the Kenya Commercial Bank in 1972 to become the banking group's housing finance arm. Until recently, the Kenya Commercial Bank was wholly owned by the Government of Kenya. The Government of Kenya has been progressively relinquishing its interest by releasing its shares for sale to the public.

Savings and Loan operates on the same principles as the HFCK. The company offers several savings and fixed deposit accounts to mobilize funds from

depositors at interest rates which compete with or are similar to those of HFCK. However, Savings and Loans advances 90% for loans amounting to KShs. 500,000, 85% for loans upto KShs. 650,000 and 75% for all other amounts.

Interest payments on loans are calculated on reduced balance of the capital. However, repayments are in fixed monthly installments consisting of interest and capital. Savings and Loan has like the HFCK catered for the medium and high-income group and not for low-income groups.

3.4.1.3 East African Building Society

EABS is a privately owned society incorporated under the Building Society Act EABS has concentrated on lending to the high-income groups. It mobilizes funds from deposits from the public and institutional investors just like the other Housing Finance Institutions.

The general lending conditions are similar to the ones outlined for HFCK. However, the company lends upto a maximum of 70% for construction loans and 80% for house purchase. Currently, the society is charging 28% interest on loans of upto KShs. 1.5 million and 29% for amounts exceeding the amount.

3.4.2 Problems with Mortgage Finance

Problems with mortgage financing in Kenya are two-fold. Housing Finance Institutions themselves face problems of mobilizing enough funds to channel them to financing of housing. The crowded finance market makes mobilization of finance to be quite competitive. Funds held by HFI's in the form of deposits are short-term in nature (Habitat, 1991). Savings accounts require only 7 days notice to withdraw money while deposit accounts have maturity periods ranging from 7 days to 3 years. Conversion of these deposits into 15 to 20 years mortgages is a major problem for HFIs.

In Kenya, HFIs have traditionally obtained fund deposits from Government departments through personal contacts (UNCHS, 1994). These form of funds are suitable for housing finance since they are large and can afford longer term deposits. It is however noteworthy that in the 1980s, many financial institutions collapsed after the Government suddenly directed the withdrawal of funds from the financial institutions. Similarly, pension and provident funds are suitable for housing finance since they are large, buoyant and can afford long-term deposits. However, these same qualities endear the funds to the Government as sources of loans to finance recurrent and development expenditure. Consequently, availability of these funds for housing finance can be severely restricted (Mutero, 1993).

The runaway inflation experienced in Kenya has compounded the problems of HFIs in funds mobilization. Official inflation rates were reported to be 21% in 1991, an all record-high of 28% in 1992 (Kenya, 1994), which dropped by 4.1% by 1995 (Kenya, 1996). This high inflation has resulted in high prices of consumer goods and the peoples' propensity to save is highly reduced. On the other hand, people with high incomes tend to invest in investments that have a hedge against inflation. All this reduces the capacity of HFIs to mobilize savings from the population.

Recently, the Government of Kenya increased domestic borrowing with treasury bonds being sold at 26% and over. This has meant stiffer competition for available funds. HFIs have also invested some of their money in treasury bonds for quick profits thus reducing the money available for mortgage lending.

It is clear from the above discussion that mobilizing funds for shelter financing has not been easy for the HFIs. The question however remains, even with sufficient funds, would housing finance be accessible to the majority of Kenyans, especially the low income groups given the stringent lending requirements of HFIs? Further, are these conditions unavoidably necessary? The following discussion gives answers to these questions.

Special Problems with Low Income Groups

A casual glance at the lending conditions of HFIs immediately leads to the realization that it is impossible for the low income groups to meet the conditions and hence these groups have no access to mortgage finance. It is not suprising then that the HFIs only cater for the medium and high-income groups. The major problems with the lending conditions include:

Collateral

A title deed to the property to be mortgaged establishes ownership to the piece of land or property. This offers the lenders unquestionable security so as to foreclose property in the case of default. This requirement excludes many would-be borrowers who have land without title deeds. In many urban centres in Kenya the majority of low-income groups and indeed people with medium incomes buy land in co-operatives. The land is then subdivided into individual portions. Since land registration and titling in Kenya is a lengthy and cumbersome process, it means that for long periods, these plot owners will not have access to mortgage finance.

HFIs have proved to be too rigid in their operations. Adjusting the collateral requirement to accommodate collective security where the head title is mortgaged as in the case of cooperative society loans may solve this problem. The notion that "poor people are poor payers" was proved wrong by the former Rural-Urban Credit Society which used to lend to low income earners using

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collective security. The borrowers were willing to pay interest at 2% higher than the market rates for loan periods of 5 to 7 years long. Default rates with this financial institution were low (Jorgensen, Kelly and Mbugua. 1987). The experience of this financial institution proves that it is possible to lend housing funds without registered titles.

The fact that the house must be of approved standards and made of stone or concrete blocks disregards the fact that even shacks that do not meet the building standards are occupied and rentable. They are economically viable and can. therefore, be funded (Habitat. 1994). However. Local Authorities in Kenya have shown undue reluctance to apply the now relaxed Kenyan Building Code which allows the use of cheaper local materials. Relaxation of this requirement of 'permanent' structure by HFIs would afford access to finance for many plot owners who may thereafter upgrade their shelters.

Affordability

The affordability calculation of three times a household's income is stringent since it disregards future incomes which may partly be derived from subletting extra space. HFIs in Kenya also use fixed annuity repayments where equal periodic (usually monthly) repayments combine interest and capital redemption. This automatically shuts off many applicants since the repayments are usually very high in the beginning of the loan term.

Since many households' incomes increase over time, graduated repayment mortgages (GRM) could be more appropriate as is common in Europe and

U.S.A. This repayment schedule starts with lower repayments and increases as family incomes improve. Studies in Kenya indicate that many defaults in mortgage repayments occur during the first 3 years (Jorgensen & Mutero, 1992). There could therefore be a case for HFIs in Kenya to apply GRMs. However, the borrowers may be given a choice since some may prefer the loan burden to decrease as the years pass. In the meantime, the fixed annuity and disregard for future incomes of households continue to shut off many applicants of mortgage finance who would otherwise qualify for the loans.

Requirement for proof of regular and formal income is also a deterrent to many households who are employed in the informal sector like the "Jua Kali" industries and other small businesses. To qualify for a loan, applicants in this sector would require audited accounts of their businesses, bank statements or income tax returns as proof of income. The level of sophistication of these requirements is beyond the education background of these households and they are therefore excluded from participating in mortgage financing.

Interest Rates

The Kenya Government liberalized interest rates in 1991. Interest rates are now determined to a large extent, by the interaction of demand and supply, lender perception of the relative risks associated with the loans and Government policies and regulations (Barlowe, 1986). HFIs have on the whole kept their interest rates lower than commercial banks and non-banking financial institutions. Currently HFIs are lending at interest rates of between

26% to 30%. A loan of KShs. 1 million borrowed at 26% for a period of 15 years would require repayment at KShs. 22,102/= per month excluding insurance premiums. This kind of repayment is affordable to only the high income earners while KShs. 1 million is only able to purchase at most. a two bedroomed flat in Nairobi's low income estates. It is not surprising then that houses targeted for low-income groups end up being bought by higher income earners. This has happened even in site and service and slum upgrading schemes like California and Kibera High-rise flats in Nairobi (Syagga & Malombe, 1995).

Pre-Mortgage Costs

Pre-mortgage costs including deposits, up-front costs of valuation, legal fees and others sometimes add up to 40% of the cost of the house. This necessitates further borrowing of bridging finance from commercial banks which charge even higher interest rates than HFIs. The costs have proved prohibitive to many borrowers seeking mortgage finance.

Mortgage Instruments

Mortgage instruments are complex legal instruments, and sophisticated skills are required for their formation and administration. For this reason, the unsophisticated low income earners hold financial institutions with awe mainly due to their education and cultural backgrounds (Habitat, 1994). In Kenya, HFIs have done little to break these barriers by simplifying mortgage instruments to allow urban wage earners and informal sector workers to

understand terms and conditions of loans. In Denmark, a financial institution presents a prescribed mortgage form to a borrower who has it stamped by a registrar of the court at a fee. Application of such a procedure in Kenya would reduce the legal fees and simplify transfer and legal documents (Obudho, 1988).

An examination of the major Housing Finance Institutions in Kenya has revealed that it is necessary to increase mobilization of funds in order to increase available finance for shelter development. On the other hand, HFIs have to be more flexible in their lending terms and conditions in order to access mortgage finance to lower income groups. This will be equitable since the majority of their depositors are small-scale depositors. The other players in private sector housing finance supply are commercial banks.

3.4.3 Commercial Banks

Commercial banks concentrate on business and industrial lending. They are not involved in long-term mortgage financing since the Banking Act precludes them from making loans of long-term durations. Commercial banks' involvement in housing finance is therefore restricted but takes several forms.

First, the banks are the major suppliers of construction finance to developers. This finance is in the form of bridging loans since a developer must furnish the bank with a commitment for long term financing from a reputable institution before the development loan is advanced.

Secondly, commercial banks advance long term house loans to their staff members at subsidized rates of interest and for long periods of upto 25 years. Some commercial banks like Kenya Commercial Bank have formed subsidiary Housing Financial Institutions. In this way the banks considerably contribute to supply of housing finance.

On the whole. however. the contribution of commercial banks to the housing finance supply in Kenya has been quite low. A study conducted in 1989 showed that out of the KShs. 25 billion in loans and advances made by commercial banks only 5% were in loans for construction and building which included commercial and industrial construction. The contribution to the residential factor was therefore negligible (Karingi. 1989).

3.4.4 Insurance Companies

Insurance companies have long-term funds especially in terms of life insurance premiums which can be converted into finance for shelter. Some insurance companies like Insurance Company of East Africa (ICEA) and Kenya Reinsurance Corporation have engaged in housing construction both for sale and rental purposes. However, most insurance companies like American Life Insurance Company, Pan African Insurance Company and Kenya National Assurance (now under receivership), have preferred lending to individual policy holders for construction or purchase of houses. Their impact on housing finance has remained limited.

3.4.5 Co-operative Housing Finance

A housing co-operative is a means by which a group of individuals can combine their resources to obtain improved housing. There are over 120 housing co-operatives in the country which are registered under the Co-operative Societies Act. Most housing co-operatives are subsidiaries of savings and credit societies. The co-operative framework allows for a great variation in types of housing co-operatives depending upon the needs and preferences of a particular scheme. The most common types of housing co-operatives are:

- Limited objective housing co-operatives: These co-operatives are temporary in nature having been established for performance of specific services such as acquiring and sub-diving land with title to the plots given to each member individually. Once the objective is satisfied, the co-operative is dissolved.
- Multiple – mortgage housing co-operatives: These deal with schemes where individual members own their dwellings but where all common areas and facilities are owned co-operatively by the owners of the units. This type of co-operative is more practical for financing under the legal tenure and financing systems in Kenya.
- Tenant Housing Co-operatives: They build and own the project and lease the dwellings to the members. In this type of co-operative the members do not have any share of the property except a voice in the day-to-day management of the dwellings.

- Mutual-ownership housing co-operatives: Blankets mortgage co-operatives are where the co-operative retains title to the land, dwelling and facilities and in turn enters into lease occupancy agreements with its members within the project. Such an agreement provides a security of tenure to a member whilst also establishing his obligations to the co-operative society.

The official bankers and lenders to housing co-operatives is the Co-operative Bank of Kenya. The Bank is owned by over 2670 credit and savings and co-operatives (Kenya, 1997). Its activities are governed by the Co-operative Societies Act and supervision is carried out by the Central Bank and the Ministry of Finance in conjunction with the Ministry of Co-operatives.

In 1989 the bank had over KShs. 2 billion on deposit, mostly short term, from the Co-operatives and Savings Societies that make up its ownership (Karingi, 1989). It also gets some loan resources from international donor/aid agencies. The Co-operative Bank of Kenya began to accept savings, investment and fixed account(s) deposits from individual savers in 1982 although such savers cannot borrow. Loans are made only to member credit and savings societies at 15% for periods of 12 to 36 months. With funds from international agencies, lending terms are based on individual agreements between the Ministry of Finance and the Agency. The Co-operative Bank of Kenya is not allowed to engage in long-term lending by the Co-operative Societies Act.

The housing co-operatives have formed a union, known as National Co-operative Housing Union Limited (NACHU). NACHU was established in 1979 to perform the functions of a technical services organization on housing in response to the great need for decent housing among low income Kenyans. NACHU's objective is to mobilize the latent potential of groups to undertake housing projects by developing mutual self-help through housing co-operatives.

Basically, NACHU provides a range of professional services to housing co-operatives. These services are in organizations, planning, design, intermediary, estate and financial management. The union is establishing a national financial system for housing co-operatives. This will enable savings made within primary housing co-operatives to be re-lent for project development using NACHU as an intermediary. In this way funds mobilized for housing from housing co-operatives can be used most effectively.

Nachu also negotiates for loans from International donors and the Co-operative Bank and then gives loans to individual housing co-operatives. In the recent past, NACHU negotiated for a 200 million loan with NSSF and deposited this amount with the Co-operative Bank for short and long term finance to housing co-operatives (Habitat, 1994).

The co-operative sector is an important source of finance for housing in Kenya. In 1994, the total share capital of savings and credit societies was

Kenya Pound 118 million (Kenya, 1997). The sector has many advantages as a sources of housing finance. These include: -

- Ability to reach the poorest households since there is usually no requirement for collateral and loans are given against the block title.
- Transaction costs are low.
- It allows community participation.

On the other hand, housing co-operatives are wrought with many problems including:

- Management difficulties since most of the members have low education backgrounds.
- Scarcity of finance to purchase land and building materials due to the low-income levels of members.
- Lack of financial resources to make long-term loans to members. NACHU makes short-term loans of 4-5 years.

Conclusion

Housing investments in Kenya have been from both public and private sources. However, public housing finance has been on the decline in recent years. The private sector mainly dominated by mortgage companies. have too many pre-mortgage conditions to be met by prospective borrowers. These have essentially shut out the majority of pension fund members from participating in housing finance markets. The co-operative housing finance

which is more accessible to workers is wrought with management problems and inadequate funds.

In view of the above, it is imperative that more innovative sources of finance for housing be identified. Pension funds have been successfully applied elsewhere as an alternative source of housing finance that can effectively benefit its members.

CHAPTER FOUR

PENSION FUNDS INVESTMENTS

4.1 Introduction

Like in other third world countries which were under colonial rule, pensions schemes in Kenya were first established to cater for the colonial officers. Pension schemes such as which included native workers were first established in the country in 1965. Today, the pension sector has greatly expanded. The newly established Retirement Benefits Authority has so far registered some 1100 pension schemes and provident fund and registration is still continuing.

Funds controlled by this sector run into billions of shillings. Pension funds have therefore become a major force in the financial sector. Such funds include the National Social Security Fund (NSSF), pension schemes of major government parastatals, commercial banks and giant private manufacturing companies like the Kenya Breweries, British America Tobacco, East African Industries, among others. These funds have invested heavily in real estate as well as in other forms of investments. Usually, investments are carried out directly by an appointed investment manager while others opt for a combination of in-house investment management and outside consultancy with trust funds investment firms.

Some smaller companies and non-governmental organizations (NGOs) operate pension schemes for their workers. Management and investment activities of such funds are usually handled by private trust funds management companies and insurance firms.

4.2 Regulatory Framework

Before the enactment of the Retirement Benefits Act in 1997, pension schemes in Kenya had very few regulatory restrictions as far as investments were concerned. Being trust funds, pension funds came under the Provisions of Trustee Act (Chapter 167) with trust deeds of each scheme regulating the operational details of each individual scheme. The Trustee Act outlines the authorized investments that trustees of trust funds can engage in. These include debentures in public bodies, stocks and shares of companies quoted in the stock exchange whose paid up share capital is not less than KShs. 10 million, shares in building societies, real estate and fixed interest securities. This is supposed to ensure that there is secure investments of trust funds. However, trust deeds of individual schemes tend to supersede the Trustee Act in the operations of the schemes.

Investments of pension funds are irrelevant to the Pension Act (Chapter 189) which regulates pensions, gratuities and other allowances for officers in government service. Funds to meet these allowances, are charged to the consolidated fund and no money is set aside for this purpose, hence no investments are carried out. Restrictions are, therefore, to do with the

administration of the scheme. Under this Act, the pension paid to a retiring officer does not exceed two thirds of the highest emoluments drawn by the officer at any time during his or her employment. It also provides that pension can only be assigned or transferred to settle a government debt or court order for maintenance of a wife or minor child and not for any other debt. This is supposed to protect the pension so that retiring officers' benefits remain secured until retirement.

Prior to the Retirement Benefits Act of 1997, registration of pension funds was under the Income Tax Act (Chapter 470). Like the Pension Act, Income Act restrictions are largely on administration of funds rather than investments of the funds. For instance, the Act restricts the maximum contributions by both employees and employers to 30% of the employee's salary. In order to safeguard the retirement benefits, the Act provides that no money be paid to the employee out of his retirement benefits while still in the service of the employer. Consequently, no pension is payable to the employee until he attains the retirement age or upon earlier retirement or on account of infirmity. Employees cannot therefore benefit even indirectly, from the fund before retirement. This clause has been expounded and made more specific in the Retirement Benefits Act as discussed below.

Due to its size and national status, the National Social Security Fund (NSSF) was established by The National Social Security Fund Act (Chapter 258). Besides providing for the constitution and appointment of a Board of Trustees,

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the amount of standard contributions by both employers and employees, the Act also gives general guidelines on investment of the fund.

Section 27(1) of the Act provides that "all monies in the fund which are not for the time being required to be applied for the purpose of the fund shall be invested". Investment assets are determined by the Board of Trustees and approved by both the ministers incharge of Labour and Finance. The NSSF Act was amended in 1997 to bring the investment activities of the Fund under the provisions of the Retirement Benefits Act.

The Retirement Benefits Act (1997)

Apparently arising from public hue and cry over questionable investments of some pension schemes and the uncertainty in the security of retirement funds, the Government has sought to control the pensions sector through the Retirement Benefits Act. This Act is set to revolutionalise the management and investments of the pensions sector in Kenya.

All pension schemes are now expected to be registered with the Retirement Benefits Authority duly constituted under the Act. Managers of the pension scheme are also to register with the Authority. According to section 25 (d) of the Act, no manager will be registered with the Authority if he does not have according to the authority "professional capacity to manage scheme funds". This means that some funds which were being directly managed by appointed

managers may have to appoint firms specializing in the management of scheme funds. Already, trustee departments of some commercial banks like the Kenya Commercial Bank who also manage pension funds are registering with the Authority. Insurance companies who have also been managing many pension funds have to register as separate entities if they wish to continue in this business.

Under Section 33 of the Act employers, with the approval of their employees can remit their contributions into a scheme of their choice and thus withdraw funds form the previous scheme in which they were contributors. It is expected that this clause will result in a mass exodus of contributors from ill-managed schemes. This brings into focus the continued survival of the NSSF if many employers make use of this clause.

It is perhaps in the investment policies of pension schemes that the effect of the Retirement Benefit Act will mostly be felt. Section 37 of the Act provides for the Authority to make regulations that will regulate investment policies of a scheme. The schemes are to submit to the Authority a statement of all investments of the schemes at prescribed intervals.

While the Income Tax Act specifies that members of a scheme cannot be paid any pension before retirement, Section 38 of the RBA is more specific when it states that:

1. "No scheme funds shall be:-

(a) Used to make direct or indirect loans to any person; or be

(b) Invested contrary to any guidelines prescribed for that purpose or be

(c) Invested with a bank, non-banking financial institution, insurance company building society or other similar institution with a view to securing loans, including mortgages at a preferential rate of interest or for any other consideration to the sponsor, trustees, members or the manager of such scheme".

This section of the Act may as well sound the "death-knell" of the deposit-linked schemes operated by the Housing Finance Company of Kenya and some pension funds. Under these schemes, the housing finance institution offers pension funds of private and public corporations which are not allowed to lend to individuals, the opportunity to deposit funds and in return, HFCK provides mortgage to members of the funds at preferential interest rates. The pension fund concerned is able to determine the interest rate charged to borrowers (UNCHS, 1989).

Whereas Section 38 seems to target the deposit-linked housing scheme, this does not mean that pension funds cannot invest in housing if the fund trustees deem this investment viable. As discussed in Chapter 2, many countries around the world are successfully using pension funds as a source of housing finance. The Government of Kenya's National Plan of Action on Shelter and Human Settlement of 1995 explains that limited finance for housing

development is being contributed partly by lack of access to suitable funds like the NSSF and other provident funds. In a similar vein, without going against the provisions of this section, pension funds may still fund construction of affordable houses which their members can purchase at market rates of interest. In any case, given the size of pension schemes, the funds invested in greater proportions in housing and the increased supply of housing in the market would bring prices of houses downwards without necessary subsiding the interest rates.

The fact that the RBA seeks to control past abuse of pension funds is a welcome change. However, too much control is bound to meet with resistance. Already, industry players in this sector have resisted the Act's provision against pooled management where several small funds are pooled together to attain portfolio diversification and economies of scale (Daily Nation, April 13,1999). Further repeals on this Act may be expected when the Authority starts to operate.

4.3 Sources of Funds

Pension fund incomes are derived from contributions from both the employer and employee as well as incomes from investments. The amount of contributions are a percentage of the gross annual salary. The Income Tax Act restricts the total contributions from both employer and employee to a maximum of 30% of the employee's gross salary.

Some funds are, however, non-contributory by the members. These include the Central Government and Central Bank of Kenya pension schemes. In both schemes, employees only contribute 2% of their salary for widows and orphans pension. The retirement benefits are secured 100% by the employers' contributions. Both employers set aside 27.5% of an employee's pensionable salary to the pension scheme. In the case of the Central Government, the amount is remitted to the Consolidated Fund under the Treasury. In the Central Bank scheme, the pension contributions are invested by the Board of Trustees of the scheme inorder to fund the retirement benefits.

Other funds set their equal contributions for both employees and employers. University of Nairobi and Moi University employees, for instance contribute 5% while the employers contribute 15% of employee's gross salary to make a total of 20%. ICDC, Mumias Sugar Company and Coffee Board of Kenya each have an employee/employer contribution ratio of 5% to 21% making a total of 26% of employee's gross salary. Kenya Power and Lighting has a 5% to 25% ratio bringing a total of 30% which is the maximum allowed by the income tax act (Minet ICDC Insurance Brokers Ltd. Report, 1999).

With immature funds, contributions far exceed the benefits being paid in form of benefits. With good investments, some funds are also able to pay their members' retirement and other benefits out of investment incomes. This gives an indication as to how pension funds can accumulate to huge sums of money. Without a central body regulating pension funds in Kenya until the new RBA,

it has not been possible to establish the exact size of the pensions sector in Kenya. However, data gathered from the Income Tax Department, major fund management trusts and insurance companies point out that the pensions fund sector in Kenya has assets worth KShs. 140 billion. According to current records, both pensions and provident funds registered with the Income Tax Department total 2843. Some of these funds may not be active. Others are also very small. However, other funds like public funds which do not need tax exemptions are not registered with the department. This shows how vast the sector is.

4.4 Types of Benefits

Pension schemes operate "defined benefits schemes" whereby retirement benefits are based on the employee's salary during the last year of service. The benefits include a lump sum and reduced monthly pension which in most cases work out to 2/3rds of the gross salary. In provident funds, retirement benefits are "defined contribution" or pay-as-you-go schemes. This means that the retiree is paid the lump sum of his contributions together with the employer's contributions and the compound interest earned.

For most organizations the normal retirement age is 55 years while few others have 60 years. However, employees are given an option of early retirement on attainment of 50 years and 45 years for most organizations and some senior

categories of civil servants respectively. Voluntary early retirement benefits also include a lump sum of accrued pension and reduced monthly pension.

Other benefits include ill health early retirement which is usually just a lump sum of accrued pension. Death in service benefit is usually a lump sum (UON, three times basic annual salary plus refund of employees contributions with compound interest at 5%; Central Government, two times basic annual salary; and Central Bank of Kenya, 1/120th of the member's pensionable salary at date of death for each month of pensionable service with a minimum of one year's pensionable salary). Some organizations take a group life assurance policy for their pensionable staff. The death in service benefits for ICDC, Mumias Sugar Company, Coffee Board of Kenya and Kenya Power and Lighting are four (4) times basic salary at death plus a refund of the employee's contributions plus accrued compound interest.

If an employee dies after serving for more than 5 years in most organizations (10 years in some), the beneficiaries also receive reduced monthly pension for some specified years (3 years full pension and 7 years half pension in some funds). The same applies to death in retirement where the beneficiaries continue to receive pensions for some specified years after the death of the retiree. Usually, those who leave the service before the minimum pensionable service (5 or 10 years depending on the fund), will just receive a refund of their employee's) contributions plus the accrued interest.

Pension benefits are therefore many and varied. When employees are certain of the security of their retirement benefits, it serves to boost their morale at work thus increasing productivity. Security of retirement benefits is, however, no longer assured especially with public funds. There are reports of illegal borrowings from these funds, and bad investments including, money which has been lost with collapsed financial institutions among other malpractices (Daily Nation, February 7th 1999). An example of such mismanagement is the case of Kenya National Assurance pension fund. The staff of this insurance firm which collapsed some years ago have never been paid their pensions. A pension fund's assets should be separate from the assets of the sponsor. This ensures that members get their benefits even if the sponsor collapses. The RBA was evidently established to check on such misappropriation of pension funds.

4.5 Fund Investment

Trustees and fund managers of pension schemes who do direct fund management of their funds, determine the minimum returns that their invested funds must attain. Fund managers proceed to advise the trustees on the different investment assets and their viability. It is the trustees' responsibility, to choose viable investment assets and allocate proportionate amounts of funds to be invested in each asset. In Kenya, many medium and large size funds do direct fund management.

Other funds contract insurance companies and private fund management firms to manage their funds. Insurance companies in Kenya reportedly manage about KShs. 10 billion of pension funds, mainly belonging to Government parastatals (Daily Nation, April 13th 1999). Other private sector players include Barclaytrust with a reported scheme portfolio of KShs. 4 billion, Stanbic Ltd., Kenya Commercial Bank Trustee Department among others.

Fund managers in this latter group have greater freedom in the choice of investment assets than in direct fund management. The trust company or insurance company should however inform and obtain the approval of the trustees of the fund when they invest or dispose major assets like in real estate. When the funds are small, they are pooled together to attain economies of scale. The trust company may hence invest in real estate with funds belonging to several funds which may not have been possible with single funds. Returns are then distributed on pro-rata basis.

Areas of Investment

Privately managed funds have generally been found to be more active and efficient in the investment market. The main investment assets are treasury bills, stocks and shares, real estate, fixed deposits and cash deposits. The previously high return on treasury bills saw a big attraction of pension fund investments in this asset. Stocks and shares in big companies like, Firestone, Kenya Airways and banks have also attracted many institutional investors in the recent past.

Fixed cash deposits are popular with public fund managers who generally seem to be either high risk averse or lacking in clear investment policy. Placing money in fixed deposits is easy and returns are guaranteed. Inflation is, however, known to greatly erode the value of these funds.

Investment in real estate by pension schemes have been relatively small. Private trusts will prefer to invest in office blocks which are easier to administer. Buildings like Barclays Plaza, Stanbank House, Phoenix House, Bruce House, Hazina Plaza, NSSF building are examples of buildings owned by pension schemes.

Investment in Housing

An examination of various fund investment practices reveals that fund managers seem to be primarily concerned about the growth and security of fund capital and incomes inorder to meet retirement and other benefits of the members. The RBA's Sections 37 and 38 enhance this view by being primarily concerned about the efficient investment of funds. This could explain the low attention given to housing investment by fund investments. Private fund managers hardly invest in housing. The only big housing scheme is the Imara Daima Housing Estate developed by the BAT pension scheme and sold to its members and also other members of the public.

Public pension schemes have been more active in housing investment. NSSF has taken the lead in massive investment in direct construction of houses in

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Nairobi both for rent and sale (See Chapter 5). Recently, the public sector has been grappling with the problem of housing of its staff members, previously housed by the employer in leased houses. The Government stopped the practice of leasing houses by its departments and parastatals in the 1997 budget speech. Even before this, the Government could hardly afford the high rents being charged for these leased houses. As a result, several public organizations have come up with innovative use of pension funds to assist their members acquire their own houses as an alternative to employer housing. The arrangement under these staff-assisted mortgage scheme involve depositing money with the HFCK at a lower than normal market rate of interest and in exchange, members of the pension scheme can take mortgages for purchase or construction of houses at a preferential rate of interest. The housing finance institution also charges an administration cost which is added to the borrower's interest. Organizations which currently have made such arrangements include Kenya Power and Lighting Company (members borrowing at 6%), University of Nairobi (10%), Kenya Airways and Kenya Posts and Telecommunications Corporation also have a staff mortgage scheme where members borrow directly from the pension scheme. The borrowers pay interest at 5% for 15 years. The Kenya Revenue Authority is the latest entrant into these deposit-linked mortgage schemes with HFCK.

Criticism against these mortgage schemes include:

1. That the pension schemes lose money by investing funds at below market levels.

2. That only a few members benefit since many cannot meet the conditions set by the HFCK including prepayment for various fees and charges.

3. That with the new Retirement Benefit Act, the staff assisted mortgage schemes are illegal.

The Retirement Benefits Act does not, however, rule out funds investment in housing so long as the investments obtain fair market returns. If pension funds in Kenya invest the recommended 15% of their assets in real estate, and 50% of that goes to housing, this would mean approximately KShs. 10.5 billion going into housing investment. This amount is 2/3rds of finance required for Kenya's Urban Housing need estimated at KShs. 16.6 billion (Kenya, 1997).

If this money is used to develop new low cost housing, members of these funds and other members of the public would purchase affordable housing while the fund would also get fair returns from their investment.

Conclusion

The Regulatory Framework has endevoured to protect workers' funds in controlling the administration of pension funds. The emphasis of the various laws has been on the administration of funds rather than on their investments. Pension funds in Kenya have nontheless invested in various assets in the investments markets and some funds have accumulated large stocks of funds.

However, this growth is not matched with the growth or improvements in members' retirement benefits.

It is therefore important that pension funds be used in a way that will increase benefits to members. Applying pension funds to housing that is affordable to members is an appropriate way of benefitting members even before they retire.

CHAPTER FIVE

DATA ANALYSIS AND PRESENTATION OF RESULTS

5.1 Introduction

This chapter presents data analysis and results from the field survey. Information was collected using questionnaires administered on the fund managers of three pension schemes, namely, National Social Security Fund (N.S.S.F), East African Industries (E.A.I) and University of Nairobi Pension Scheme (U.N.P.S). Face to face interviews with these managers were also conducted as well as an in-depth study of policy documents and annual reports and accounts of the pension schemes. In addition, members of the pension schemes were also interviewed in order to get their view of the investment policies and practices of the pension funds. Copies of the questionnaires administered on the fund managers and members are attached as appendix A and B respectively.

Using the information from the field, there is a detailed analysis of how and where pension schemes invest their funds, with particular interest in funds' investment in the housing sector.

The following is a brief background information of each of the pension funds studied.

5.2 Organizational Structures of the Pension Funds

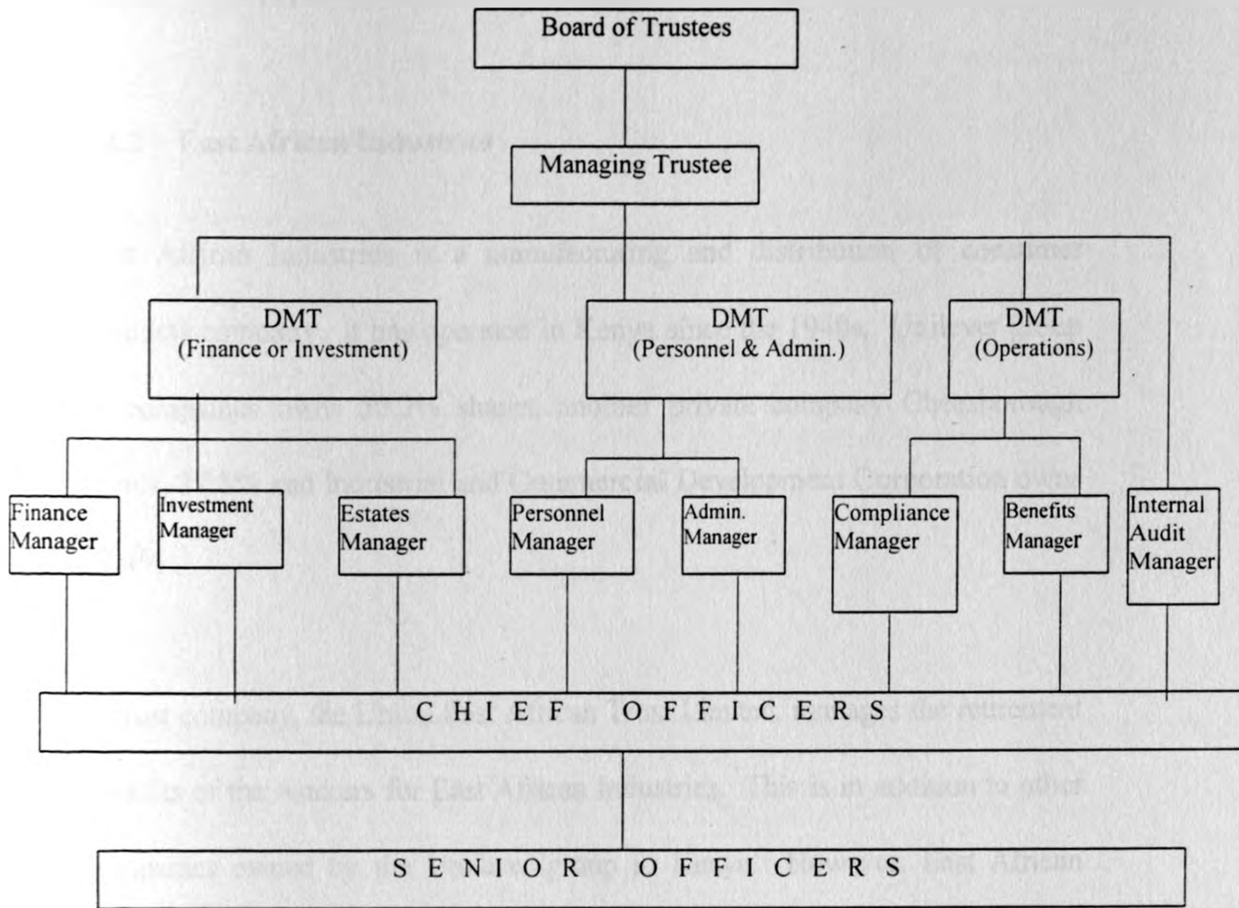
5.2.1 National Social Security Fund

NSSF is a provident fund which was established in 1965 by an Act of Parliament the National Social Security Act (Cap 258 of the Laws of Kenya). The Fund's primary objective was to provide social security to workers on retirement. To start with, NSSF operated as a department of the Ministry of Labour. In 1988, the Act was amended to transform the fund into a state corporation with autonomous powers. A further amendment was made to the Act in 1997 in order to incorporate the provisions of the newly enacted Retirement Benefits Act.

NSSF is managed by a Board of Trustees comprising of nine members. The Minister for Labour appoints a chairman from among this group. Two of the members are permanent secretaries in charge of finance and labour respectively. The Central Organization of Trade Union (COTU) and the Federation of Kenya Employers are also represented in the board in order to represent workers and employers respectively. This composition is expected to accommodate the interest of the three main stakeholders, the government, the workers and the employers.

The Managing Trustee of the fund is responsible for the day to day management of the fund. Chart 5.1 presents the organizational chart of the N.S.S.F.

Chart 5.1: NSSF's Organization Chart



Source: Compiled by Author

The personnel manning the different departments in the NSSF were found to have the relevant academic background and are well trained in their respective disciplines.

The NSSF draws its members from all corners of the country. According to the NSSF Act, every employer with five employees and above must register with the fund. By 1997, a total of 47.434 employers with some 2,498.201 employees

were registered with the Fund. The funds' headquarters is in NSSF building in Nairobi. It has opened 41 branches in major towns throughout the country.

5.2.2 East African Industries

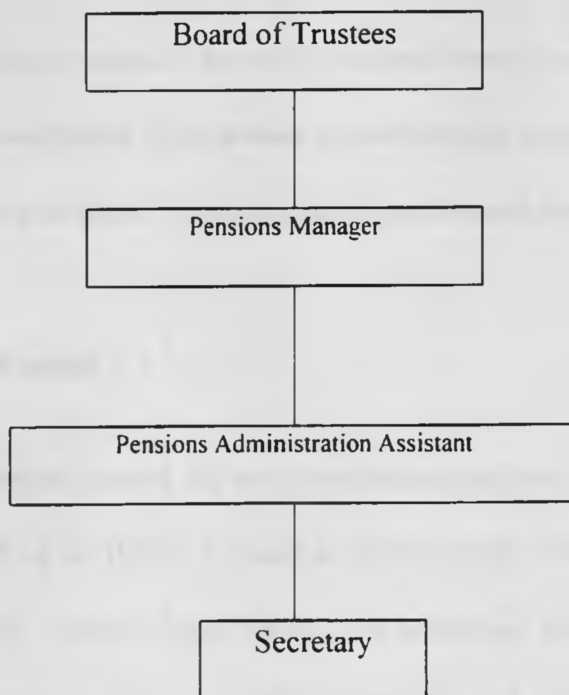
East African Industries is a manufacturing and distribution of consumer products company. It has operated in Kenya since the 1940s. Unilever group of companies owns 50.3% shares, another private company Cheesborough Ponds, 19.8% and Industrial and Commercial Development Corporation owns 29.4%.

A trust company, the Union East African Trust Limited, manages the retirement benefits of the workers for East African Industries. This is in addition to other companies owned by the Unilever group in Kenya. However, East African Industries owns 98% of the Trust company and for the purposes of this study therefore, the pension scheme will be referred to as East African Industries (EAI).

The company runs two retirement benefits schemes, a pension fund and a provident fund. The pension scheme has a total of 635 active members and 211 retirees. The provident fund has 403 members but it is being phased out such that no new employees are allowed to join the provident fund.

The trust company is managed by a Board of Trustees which comprises the chairman of the East African Industries, the human resources director, the commercial director, technical director, and one director of a subsidiary company. The day to day running of the scheme is managed by a skeleton staff which liaises with the Board of Trustees and Barclaytrust Limited who handle the investment functions for the scheme. Chart 5.2 shows the organizational structure of E.A.I.:

Chart 5.2: EAI's Pensions Management Organization Chart



Source: Compiled by Author

Several other functions are contracted to private firms with the pensions manager co-ordinating all these functions on behalf of the Board of Trustees.

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These are:

	Function	Consultant
(a)	Investment	Barclaytrust Limited
(b)	Custodian (custody of titles, share certificates, securities)	Barclaytrust Limited
(c)	Auditors	Peat Marwick
(d)	Legal Advisors	Kaplan and Stratton Advocates.

This system ensures that operations of the pension scheme remain separate from the company activities and funds. The sponsor cannot therefore access pension. The management of the trust funds is also handled by professional personnel.

5.2.3 University of Nairobi

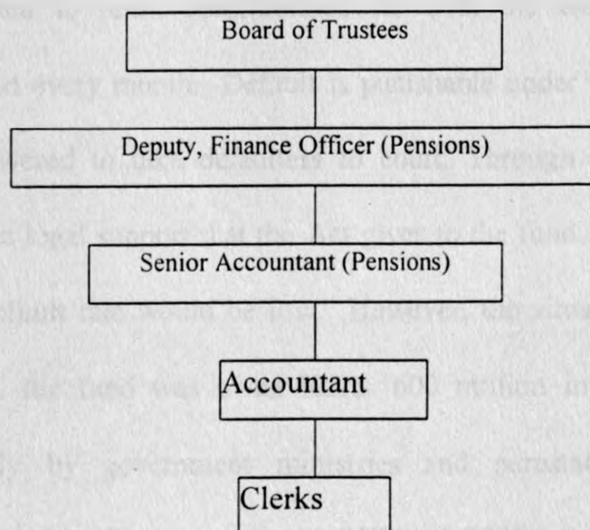
The University of Nairobi started off as a constituent college of Federal University of East Africa in 1963. It became the University of Nairobi in 1970. The University, whose main function is education and research development, has expanded over the years. Currently, the University of Nairobi has a student population of about 15,000 and a workforce of some 7,000 both academic and support staff.

The unionisable staff of the university, who are the majority, are members of the NSSF. The rest of the staff, both academic and administrative staff are

members of the University of Nairobi Pension Scheme (U.N.P.S). The total membership for this scheme is currently at 2,581 members.

UNPS was set up in 1987 by a Trust Deed. Before then, the university's retirement benefits were being managed by the Kenyan National Assurance Company. UNPS is managed by a Board of Trustees appointed by the sponsor. The Trust Deed specifies that the board must have a minimum membership of seven. The chairman of the University Council, in which the control and administration of the university is vested, is also the chairman of the Board of Trustees. Other members include the Vice-Chancellor, the Deputy Vice-Chancellor in-charge of Finance and Administration, two Council appointees and the other two drawn from University top administration. The day to day activities of the scheme are run by a Pension Section which is a section in the Finance department under the Deputy Vice-Chancellor in-charge of Administration and Finance. The organizational structure of UNPS is shown in Chart 5.3:

Chart 5.3: UNPS Organization Chart



Source: Compiled by Author

The top officers manning the operations of the fund were found to be conversant and are trained in accountancy and financial principles. However, the structure denies the scheme the autonomy desirable for a pensions fund and instead operates like any other department in the university under the oversight of the Deputy Vice-Chancellor in-charge of Finance.

5.3 Funds' Incomes

Pension funds accumulate assets for the sole purpose of paying retirement benefits to workers. Pension fund incomes come mainly from contributions from employers and employees, rents, dividends and interest from the investment assets of the funds. Contributions to the funds are through the check-off system.

NSSF members totaled 2,498,201 in 1997 and employers were 47,434. Members currently contribute a maximum of 80/= per month and the employer contributes an equal amount for each employee. Under the NSSF Act, each employer is expected to remit contributions for both the employer and employee to the fund every month. Default is punishable under the law and the NSSF is empowered to take defaulters to court. Through a check-off system and given the legal support that the Act gives to the fund, it would be expected that the default rate would be low. However, the situation is very different. In 1997, the fund was owed KShs. 600 million in unremitted contributions mostly by government ministries and parastatals. This notwithstanding, the fund collects an average of KShs. 1.3 billion every year.

NSSF being a provident fund operates a pay-as-you-go scheme. Members benefits are paid on retirement, death, resignation or disability. Each member maintains an account with the fund in which both his contributions and those of his employer are credited. Benefits paid include compound interest earned. Currently the fund is paying a compound interest of 15%. This means that funds investments should ideally earn more than 15%. According to information obtained from the Fund's benefits manager the maximum that has been paid to members of NSSF has been KShs. 200.000/=.

Table 5.1 shows N.S.S.F's contributions and total benefits paid for the period 1988 - 1997. The table shows a huge surplus of contributions over the payments of over KShs. 5 billion for the ten years period. The amount of contributions for the period 1988 - 1993 were about 2 - 5 times the amount of benefits paid each year. This surplus amount. less administration costs is the amount that is made available for various investments including investment in housing.

Table 5.1 : NSSF's Contributions and Benefits Payments for 1988 – 1997

Year	Contributions Collected (KShs.)	Amount Paid (KShs.)
1988	1,143,988,814.45	234,714,840
1989	1,202,861,851.00	248,269,960
1990	1,366,466,518.45	437,263,000
1991	1,401,357,089.60	522,454,000
1992	1,273,105,786.45	655,573,000
1993	1,293,987,783.05	671,828,000
1994	963,115,365.90	707,482,000
1995	1,212,231,009.35	776,682,000
1996	1,388,195,664.90	1,058,041,146
1997	1,233,380,411.70	1,526,854,183
Total	**12,478,690,294.85**	**6,839,162,129**

Source: Compiled by Author

Whereas the NSSF's contributions far exceed the benefits paid to members the Fund's income and expenditure account show liabilities exceeding income by some KShs. 2.017 billion. The high deficit experienced by the NSSF is partly explained by the high staff and administration expenses totalling KShs. 1.23 billion or 24 % of fund income, both contributions and income from investments (NSSF Income and Expenditure Accounts, 1997). These high administration costs, coupled with the large amount of uncollected funds drastically reduce the amount of funds available for housing investments.

In order to reduce this high deficit NSSF has proposed to double contributions by both the employers and employees. However, this had been met by a lot of

resistance as seen in the representation made by the employers' association, the Federation of Kenya Employers (FKE) which appeared in "Daily Nation" of December 14, 1998. The FKE argues that it is unjustifiable for the fund to increase contributions while it currently collects just 60% of the contributions due. The fund seems not to have fully utilized the force of law and its network of offices countrywide, to collect the outstanding standard contributions. This is another reason why the fund is experiencing a deficit in its income/expenditure account. This means that surplus funds that could be availed for housing investment are reduced.

In the case of EAI, members of the pension scheme contribute 7.5% of their gross salary to the fund while the employer contributes an equal amount. Retirement benefits are based on one sixtieth (1/60) of final pensionable pay X years of pensionable service. EAI's pension fund contributions almost equal the benefits payments. The total contributions for the ten years period is KShs. 256,400,619 compared with the benefits which totalled KShs. 248,251,110 for the same period. This is shown in table 5.2 below:-

Table 5.2 : EAI Pension Fund Contributions and Benefits Payments for 1988 – 1997

Year	Contributions Collected (KShs.)	Amount Paid (KShs.)
1988	9.033,768	4,233.365
1989	10.655.228	6.078.539
1990	13,187,557	3.104.004
1991	20.033.475	8.390.762
1992	19,355.822	10.873.296
1993	27,812.819	28.022.444
1994	42.673.660	55.674.745
1995	38,032.202	37.628.760
1996	40,510.883	25,779,562
1997	35.105.205	68,465.633
Total	**256,400.619**	**248,251,110**

Source: Compiled by Author

EAI's pension fund has reduced its surplus by the employer taking a contribution holiday, viz. the employer is currently not contributing to the fund. Although it was not possible to get the income and expenditure accounts of the EAI fund, it was learnt that benefits are paid from investment income. Investment of funds is managed by Barclaytrust at a fee of 0.3% of the fund being managed. With a skeleton staff of a manager, assistant manager and secretary as mentioned earlier, the funds liabilities besides benefits payments are minimal.

EAI's provident fund members contribute 10% of their gross salary and the employer contributes an equal amount to the fund. Retirement benefits include all contributions made plus compound interest earned. The Fund's benefits payments are higher than the contributions received during the ten year period (1988 - 1997). The total benefits paid out for the 10 years period was KShs. 79,757,725/= compared with contributions received of KShs. 6,854,550/=. This is explained by the fact that the sponsor is phasing out the provident fund. New members of staff are mandated to join the pension scheme. Staff retrenchment in 1997 increased the number of beneficiaries from 103 in 1996 to 395 in 1997 (400% increase!) and the amount of benefits rose from KShs. 6,539,824 to KShs. 21,867,106/=. The fund had to liquidate some investment assets inorder to pay the benefits.

Table 5.3 : EAI Provident Fund Contributions and Benefits Payments for 1988 – 1997

Year	Contributions Collected (KShs.)	Amount Paid (KShs.)
1988	345,342	2,890,711
1989	192,774	1,970,220
1990	206,976	6,670,817
1991	221,817	3,702,610
1992	300,565	5,197,986
1993	258,916	10,087,963
1994	955,951	11,222,242
1995	2,288,166	9,608,246
1996	581,986	6,539,824
1997	1,502,057	21,867,106
Total	**6,854,550**	**79,757,725**

Source: Compiled by Author

UNPS members contribute 5% of gross salary to the pension scheme while employer contributes 15%. Pension benefits are based on a predetermined formular because the scheme is a "defined benefits scheme". Currently, pensions on retirement include both a lumpsum and a monthly reduced pension. UNPS's surplus of contributions over benefits payments is great, sometimes as much as 30 times like in 1991 and 1996 as seen in table 5.4 below:

Table 5.4 : UNPS Pension Fund Contributions and Benefits Payments for 1988 – 1997

Year	Contributions Collected (KShs.)	Amount Paid (KShs.)
1988	-	185,553.40
1989	-	678,896.45
1990	34,531,000.00	2,060,164.15
1991	38,150,000.00	1,318,313.20
1992	40,499,000.00	2,288,611.90
1993	50,056,000.00	2,168,163.55
1994	55,616,000.00	3,018,929.30
1995	59,948,000.00	1,824,638.90
1996	72,102,907.20	2,656,818.45
1997	82,334,328.20	6,002,727.50
Total	**433,237,235.40**	**22,202,816.80**

Source: Compiled by Author

Income and expenditure accounts of the UNPS for 1997 show a total income of KShs. 174,572,000 against total expenditure of KShs. 21,351,000 leaving a surplus of KShs. 153,221,000. The surplus is thus over 700% the amount of expenditure. It is noted that administration costs of UNPS are almost nil

because they are borne by the Sponsor. According to Blake (1992), the employer and employees of the UNPS may go on contribution holiday or increase the pension paid to beneficiaries, in order to reduce this surplus. Alternatively, the Fund can invest a higher proportion of its surplus funds in real estate including housing in order to diversify its investment portfolio which is mainly in cash deposits. Such a diversified portfolio would also help reduce investment risks.

However, in order for the funds to maintain 'healthy' accounts and ensure security of retirement benefits for the members and their dependants, pension funds must invest their funds prudently. The following section will examine the investment portfolios of the NSSF, EAI and UNPS pension/provident schemes.

5.4 Funds Investment Portfolios

The study set out to examine funds' incomes together with their investment portfolios in order to establish their potential in investing in housing provision. Pension fund investors in Kenya have an array of investment assets in which to put their investible funds.

In all the three funds the investment and pension managers interviewed gave the main concerns of their investment decisions as:

(i) returns on the investments

(ii) capital realization

(iii) security of capital and income.

Various tables are used to show the different portfolio mix of the three funds studied. A comparison of the portfolios as they were in 1989 (the earliest period records could be retrieved), are compared with the situation in 1997 to see whether there have been major changes in the trends of investment. It was however not possible to get past data for NSSF. Data obtained was only for 1997.

NSSF has invested over half of its investible funds in real estate. The reasons given for this include the objective to develop property and sell to members of the public thus enhancing capital realization. NSSF's estates in Mountain View, South B and Embakasi have been offered for sale to the public however, the sales have been very slow due to their high prices. The fund also considers real estate investment as a good hedge against Kenya's volatile inflation. The fund perceives that whereas returns on real estate may seem to be low in the beginning, the returns steadily grow with time thus overtaking other forms of investment. Section 5.5.1 discussing returns derived from the fund's housing investments show that NSSF has not yet realised this objective.

Treasury bills and bonds got 16% of the funds' investible funds. It would have been expected that the high interest on bills during that period could have attracted the fund to invest more in treasury bills. Out of cash deposits, loans and debentures, a total of KShs. 2,227,164,000 was reported to be non-

performing or doubtful investment. This amounts to 4% of the investment portfolio. The figure includes investment in banks which have collapsed and stocks bought from Nairobi City Council.

Table 5.5 : Asset Allocation for NSSF in 1997

Asset	Amount KShs.'000	% of Total Investment
Land & buildings	29,015,830	55
Equities	7,703,821	15
Treasury bills and bonds	8,706,099	16
Cash deposits	7,199,358	13
Loans & debentures	498,656	1
Total	**53,123,764**	**100**

Source: Compiled by Author

Asset allocation for EAI's both pension and provident funds show a similar trend. The biggest portion, 49% and 41% of pension and provident funds respectively was invested in real estate in 1997. This seems to arise out of a desire for secure investment with a hedge against inflation.

A striking change is seen in investment in treasury bills and overseas (offshore) equities. In 1989, the two funds did not invest in these two assets. The dramatic rise in treasury bills returns from 1993 stretching well into the late 90s must have accounted for the funds' decision to invest in the bills. By 1997, the pension fund had invested 10% while the provident fund had 9% of assets invested in treasury bills.

Offshore or overseas trading accords institutional investors a global diversification which reduces systematic risk that results from the common

effect that the performance of the economy in a country has on all firms. Investing in countries with superior economies also increase returns (Blake, 1992). The removal of exchange controls in Kenya in 1994 accounts for EAI pension and provident funds' entry into overseas equities investment. The amount invested in this asset is 30% and 26% for pension and provident funds respectively.

Table 5.6 : Asset allocation of EAI Pension Funds in 1989 and 1997

Asset	1989		1997	
	Amount KShs. '000	% of total assets	Amount KShs. '000	% of total assets
Land & buildings	70,943	54	880,500	49
Equities	34,912	27	174,187	10
Treasury bills & bonds	-	-	169,236	10
Cash deposits	24,476	19	25,206	1
Offshore	-	-	554,037	30
Totals	**130,331**	**100**	**1,803,166**	**100**

Source: Compiled by Author

Table 5.7 shows the asset allocation of EAI provident fund in 1989 and 1997.

Table 5.7 : Asset Allocation for EAI Provident Fund for 1989 and 1997

Asset	1989		1997	
	Amount KShs. '000	**% of total asset**	**Amount KShs. '000**	**% of total asset**
Land & buildings	37,222	39	166,000	41
Equities	17,869	19	78,948	19
Treasury bills and bonds	-	-	34,743	9
Cash deposits	39,173	42	20,157	5
Offshore	-	-	20,157	26
Total	**94,264**	**100**	**406,230**	**100**

Source: Compiled by Author

By 1990, the UNPS was only three years old. The fund had invested in only two assets, namely; cash deposits and treasury bills. By 1997 however, the portfolio had diversified to five different assets. However, over 50% of the investible funds was still invested in cash deposits. Of the 512 million cash deposits, 165.9 million or 32% of cash deposits was held by collapsed institutions, Kenya National Assurance and Kenya Finance Bank. This may be listed as "doubtful investment" since recovery of the capital is in doubt and no returns are being earned by these deposits.

Loans and debentures took up 33% of the portfolio. Chuna Co-operative Society which is the Fund members' co-operative society borrowed KShs. 30 million at an interest rate of 22.5% which is a reasonable market comparison. The balance of KShs. 287.6 million which comprise 30% of total portfolio was held by the sponsor, University of Nairobi as outstanding remittances. It was understood that this money is not earning any interest. This no doubt results in an average poor performance of the portfolio. The study found out that this state of affairs arises from a conflict of interest since the pension department is a wing of the sponsor's Finance department. The sponsor therefore has direct access to the pension funds. Large accumulation of idle money has thus led to mismanagement.

Table 5.8 : Asset Allocation for University of Nairobi Pension Fund for 1990 and 1997

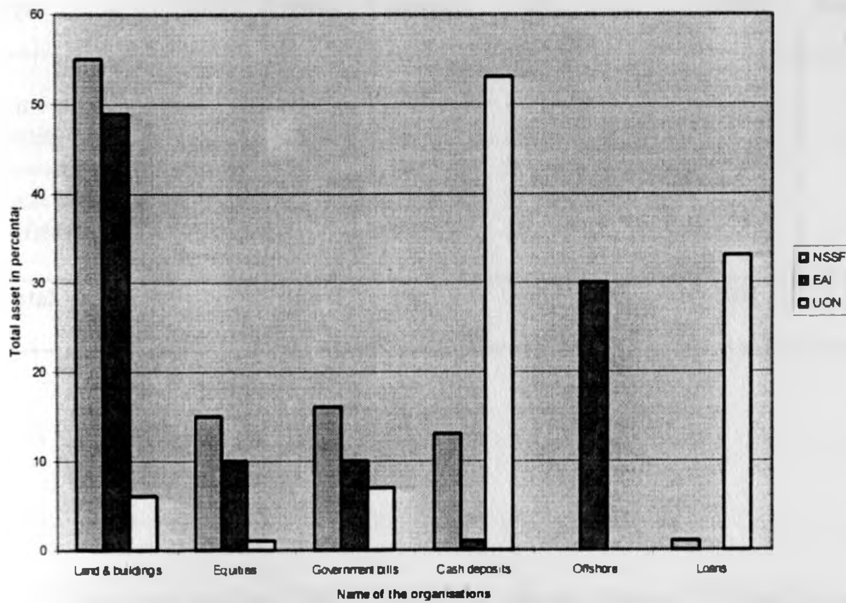
Asset	1990		1997	
	Amount Kshs. '000	% of total asset	Amount Kshs. '000	% of total assets
Land & buildings	-	-	75.212	7.6
Equities	-	-	12,000	1
Treasury bills and bonds	16,000	7	66,000	7
Cash deposits	221,000	93	512,000	53
Offshore	-	-	-	-
Loans & debentures	-	-	317.648	33
Total	**237,000**	**100**	**965,648**	**100**

Source: Compiled by Author

Chart 5:4 compares asset allocation of small (UNPS) and large (NSSF and EAI) funds. Small funds such as UNPS seem to hold more of their assets in cash and other liquid assets than large funds. UNPS holds a lower proportion of its assets in real property which is illiquid and indivisible as compared to other assets. The reason for this may be due to a desire to invest in less risky, more liquid and more divisible assets than afforded by real property. The UNPS pensions manager explained that the property and equities market in the country does not provide the fund with the required risk diversification. On the other hand, the investments manager of NSSF and EAI's pensions manager considered real property as a good hedge against inflation and as a good means of diversifying risk. This chart shows the different attitudes towards risk and the different requirements for liquidity by small and large funds. The smaller the fund, the higher the need for liquidity and the greater the risk averseness and hence the greater the proportion invested in cash deposits. Conversely, the larger the fund,

the less the need for liquid assets, the greater the need for risk diversification and hence the greater the proportion invested in illiquid assets and the less the amount invested in liquid assets.

Chart 5.4: A comparison of funds' asset allocation for 1997 – asset by asset



Source: Compiled by Author

Comparison with the Ideal Fund Portfolio

A comparison was made between the current funds investment portfolios with the ideal portfolio developed in Chapter Two, in order to establish how far the portfolios deviate from what is perceived to be ideal.

Table 5.9: Comparison Between the Funds Portfolios and the Ideal Portfolio

Item	NSSF %	EAI Pension %	EAI Provident %	UON %	Ideal Portfolio %
Land & buildings	55	49	41	6	15
Equity	15	10	19	1	50
Government bills/bonds	16	10	9	7	20
Cash deposits	13	1	5	53	5
Offshore	-	30	26	-	10
Total	**100**	**100**	**100**	**100**	**100**

Source: Compiled by Author

Two of the case studies. NSSF and EAI devote almost 50% and over of their investible funds in real estate. The study hypothesized that very little funds are invested in housing by pension schemes. Section 5.5 establishes what proportion of the real estate investment is devoted to housing provision. The main deviation from the ideal portfolio at NSSF is in the area of real property where the fund deviates by 40% above the recommended 15%.

NSSF has under-invested in equities, with a deviation of 35%. Cash deposits are 2 1/2 times the proportion recommended by the ideal portfolio. The proportion

for government gilts (16%) is also very close to the recommended 20%. Nothing has been done in the area of offshore investments.

EAI is similar to NSSF in over investing in real estate, 34% and 36% above the ideal, for pension and provident funds respectively. The reason given for this was that the funds invested heavily in real estate in the 1970s and 80s due to a restrictive financial market. The funds' attempts to diversify have been slow due to the lengthy procedure of disposing real estate. It was understood that the funds are currently in the process of disposing of much of their real property assets to bring the assets close to the desired level.

Investment in local equities is also poor when compared with the ideal, reflecting 40% and 31% deviations for the pension and provident funds respectively. EAI funds have been very active in the overseas equity markets with 30% and 26% of the pensions and provident funds portfolios held in this asset. This may be explained by the fact that the firm is partly owned by an Overseas Company, the Unilever group of companies. The funds would thus have good information about excellent prospects in foreign companies. The owners may also feel more confident investing in foreign companies than in local companies. This probably explains the paltry proportions that the funds devote to equities in local companies as compared to foreign equities (10% to 30% for pensions and 19% to 26% for provident funds).

Funds like NSSF and even small ones like UNPS should venture into buying equities in foreign companies. This was made possible in 1994 when the government abolished exchange controls. Investing abroad will afford the funds diversification of their portfolios thus reducing risks since the performance of national economies are not perfectly correlated. Investing in countries which may be doing better economically will also result in higher investment returns. It is therefore advisable for funds to hold a global portfolio.

Not only has UNPS failed in participating in the international money market but its cash assets exceed the recommended proportion by 48%. Progressive Funds hold cash in short-term deposits until some longer-term investment opportunities arise. The same is true with fixed-interest bonds which are desirable due to their guaranteed capital value, at least in nominal terms. The problem with these assets is erosion of their value by increasing inflationary trends.

UNPS has also not participated in the local equities market (1% as opposed to the recommended 50%). The pensions manager explained the reason for this as "the Nairobi Stock Exchange not being well-developed". Perhaps the other funds studied feel the same way, thus explaining their substantial deviations from the ideal portfolio. However, it is felt that the exchange is active enough for local funds like UNPS to invest more in local companies.

Investment in government gilts is also 13% below the ideal proportion of 20%. It is noteworthy that UNPS did not take advantage of the high interest rates

offered on treasury bills from 1993 to 1998. In 1997, the bills were earning over 20% interest which was much higher than cash deposits which are pegged to treasury bills returns.

Going by the above rule, the EAI pension fund was found to be the most active in investment activities. This may be explained by the general profit-oriented nature of their operations, being a private enterprise. The funds are also invested by an agency (Barclaytrust Ltd.) specializing in funds investments. The UNPS was found to hold the most passive investment policy with the fund appearing to be insensitive to market changes in its favour (e.g. removal of exchange controls in 1994 and high returns on treasury bills as explained above). The Board of Trustees at NSSF was also reported to set the proportion of investment assets. The Fund could still be more active in its investment policy to include other assets like equities in foreign companies while lowering the proportion on real property investment. All the three Funds have to adjust to fit in the new investment portfolio mix set by the RBA. Under the Act pension funds must invest a maximum proportions of funds as shown below:

RBA's Recommended Portfolio Mix

Item	**Maximum Proportion of Investible Funds (%)**
Land & buildings	30
Equity	70
Government bills / bonds	70
Cash deposits	5
Offshore	7

Source: RBA Draft Rules, 1999

NSSF and EAI will have to dispose of some of their assets in real estate while UNPS will have to reduce investment in cash deposits.

5.5 Funds Investment in Housing

The main reasons given for heavy investment in real estate in NSSF (55% of portfolio) and EAI (54% and 39% of pension and provident funds portfolios respectively) included:

1. Real estate investment provides a hedge against inflation since property values and rentals tend to grow in line with inflation over a long period.
2. It ensures capital realization or security of capital.
3. Inadequate alternative long-term forms of investments.

By 1997, NSSF had spent KShs. 7.9 billion on commercial properties, mainly office blocks. The Fund had on the other hand spent KShs. 13.45 billion on residential properties which included construction of some 5,000 housing units and purchase of undeveloped land. The Fund's investment in housing comprised 62% of investment in real estate.

EAI's pension fund investment in real estate is mainly in commercial and industrial property. The major properties include Barclays Plaza jointly owned by the fund and the Barclays Bank Staff Pension Fund on a 50/50 basis. Others include the Phoenix house also in Nairobi city centre comprising of shops and offices. Some industrial properties include the Gailey and Roberts

warehouse and offices in Nairobi's Industrial area and some two properties in Nakuru and one in Mombasa.

The fund has only invested in a few residential properties comprising ten flats plus two bungalows in Nairobi and two bungalows in Mombasa. Asked about the low investment in housing compared to other properties, the pensions manager explained that the fund considers administration of residential properties as more problematic than commercial properties. Returns from residential properties were also considered lower. It is worth noting that the fund uses professional estate management firms to manage its real estate.

EAI had spent about KShs. 14 million in housing investment compared to KShs. 944 million invested in commercial office buildings and industrial and warehousing properties. EAI's investment in housing comprised only 13% of investment in real estate.

The UNPS's only direct investment in housing is one building purchased by the Fund in Hurligham in 1994. 60% of the space in this building comprises residential flats while the rest comprises of shops and offices. A unique feature of UNPS' investment in real estate is the deposit linked mortgage scheme operated with the Housing Finance Company of Kenya (HFCK). Under this scheme, the UNPS deposits an amount with the HFCK at a negotiated rate of interest lower than the market rate of investment on such fixed deposit accounts. In return, members of the pension scheme obtain mortgage loans from the

institution at preferential rates of interest. Currently, the Funds' deposit account with the HFCK for this scheme earns 6% interest while the members obtain mortgage loans at 10%. The 4% difference is supposed to cover administration costs of the HFCK.

By 1997, the fund had invested a total of KShs. 236.172.840/= in the scheme. It had financed 109 members to purchase already built houses and 87 members to build new houses. Although the security of the loans remains the property purchased or built by the member, the fund is directly contributing to members' acquisition of houses and increasing the housing stock by providing the back-up funds which remain tied to the scheme as long as the loans remain unpaid. UNPS's investment in housing is therefore 92% of real estate investments and 29% of total investment portfolio. This is a considerable proportion.

Table 5.10 Proportion of Funds Invested in Housing

Name of Fund	Amount Invested in Housing by Dec. '97 KShs. '000	No. of Housing Units Funded by Dec. '97	Total Amount Invested in Real Estate by Dec. '97 KShs. '000	Housing Investment as a % of Real Estate Investment (%)	Total Investment Assets Dec. '97 KShs. '000	Housing Investment as a % of Total Investment Portfolio (%)
NSSF	13.420.000	5000	21.378.261	62.7	53.123.764	25.3
EAI	138.691	14	1.082.408	12.8	2.209.396	1.8
UNPS	286.313	228	311.345	92	982.860	29.1

Source: Compiled by Author

NSSF's investments in housing is not as insignificant as envisaged at the beginning of this study. Considering the fact that about 10,000 housing units

are built in Kenyan urban centres per annum, financed by both private and public finance institutions, the over 5000 units built by the NSSF in the past few years is a commendable contribution.

5.5.1 Returns From Housing Investments

All the three Fund Managers agreed that returns from Fund investments is a major factor influencing choice of investment. The researcher examined the returns from the three funds' housing investments and compared them with returns from the Funds' commercial real properties, and also from other investments.

Table 5.11 shows NSSF's investment in real estate. Returns from these investments are calculated for those properties which are recording any income. It is to be noted that the majority of NSSF's residential properties are not recording any income.

The Fund is struggling to find buyers for the sprawling Nyayo Estate at Embakasi and the 104 housing units at Mountain View houses. Few other flats are like those purchased at Kibera High Rise Estate are occupied by NSSF staff. The rest of housing investments were found to be in form of undeveloped residential land.

The two properties found to be recording any income were the Hazina Estate leased to the Government and the State House Road bungalows recording 4% and 1.1% returns respectively.

The returns notwithstanding, the rents derived from these properties are competitive market rents. Hazina Estate was leasing at KShs. 15,000/- for 2 bedroomed and KShs. 23,000/- for 3 bedroomed flats. The State House road bungalows leased at KShs. 190,000/- and 240,000/- per month respectively. Low returns can be attributed to overpricing of properties during purchase or construction time. NSSF's commercial properties were doing better with returns ranging from between 4.3% to 12.5%. The average return on commercial properties was found to be 8.7%.

Table 5.11: NSSF's Real Properties showing Cost and Returns.

Property		Cost KShs.'000	Annual KShs. '000 Rent or Sale Price	% Return
A	Commercial (Shops & Offices)			
	Social Security House – Nbi.	4,408.011	293.183	4.6
	Bruce House – Nbi.	583.055	62.458	10.7
	Hazina Towers – Nbi.	590.864	25.745	4.3
	View Park Towers	872.225	54,091	6.2
	Social Security House – Msa.	182.633	16.939	12.5
	Hazina Plaza – Msa	458,791	40.000	8.7
	NSSF House Annex– Nbi*	513.073	-	-
	Mokta Daddah Street – Nbi*	349.609	-	-
	Residential Properties			
	Hazina Estate (400 houses with shopping complex)	1.842.358	74.047	4.0
	Prudential Estate – Nairobi	13.125	-	-
	Kibera Highrise Estate – Nairobi	117.609	-	-
	Ojijo Road – Nairobi	181.081	-	-
	State House Road (2 bungalows)	471.900	5.160	1.1
	Milimani Flats	103.562	-	-
	Nyayo Estate, Embakasi* (4,774 housing units for sale)	8,759.636	-	-
	Mountain View Estate – Kangemi*	812,476	-	-
	(104 houses for sale)	381,045	-	-
	Kitisuru Plot	221,567	-	-
	Lenana Road Plot	66.278	-	-
	Hospital Road Plot	46.680	-	-
	Kileleshwa Plot	405.400	-	-
	Karen	50.952	-	-
	Machakos Town Plot			

NB: Figures brought to 1997 levels.

Source: Compiled by Author

All EAI Pension's commercial properties investments are performing better than housing investments with the former recording an average of 9.38% in returns while returns from housing investments average 6.15%. Table 5.12 gives these details.

Table 5.12: EAI Pension and Provident Funds' Real Estate in 1997 Showing Cost and Returns.

	Property	Cost KShs.'000	Annual Rent/ Sale Price KShs. '000	Returns %
A	**Commercial & Industrial**			
	Phoenix House – Nbi	168,230	16.113	9.5
	Gailey & Roberts Property	204,000	20,016	9.8
	209/7353 – Nanyuki Rd(Nbi)	186,000	20,520	11
	Nakuru Block 6/20	144,00	1,440	10
	Nakuru Block 3/85	7,200	662	9.1
	Kisumu Block 3/125	54,000	4,824	8.9
	LR 1/196 Mombasa	36,000	2,696	7.4
	Residential Properties			
	LR 8528 Farasi Lane	31,200	1,584	5
	LR 7258/42 Gigiri	22,800	1,584	6.9
	205/42 – Kirichwa Road	26,400	1,728	6.5
	1870/VI/135 – Mvuli Road	19,200	1,152	6
	Block 3592/1/MN – Msa	14,400	1,008	7
	Block 3591/1MN – Msa	14,400	1,008	7

NB: Figures brought to 1997 levels.

Source: Compiled by Author

The University Pension Fund's building at Hurligham shopping centre has residential apartments occupying about 2/3[rds] of the building. Out of the KShs. 4,505,000/- netted as rental income in 1997, rent from the apartments was only 2,880,000/-. This is because half of the apartments remained vacant for most of the year. The building was then managed by people inexperienced in real estate management. If the cost of the building, KShs. 75,212,108 (brought to 1997 index) is apportioned between residential and commercial user on prorata basis, housing records 5.7% returns. The commercial portion , with an annual income of KShs. 1,65,000/- gives a return of 6.5%.

Table 5.13 compares average returns from housing with returns from commercial properties owned by the three funds.

Table 5.13: A Comparison of Average Returns from Housing with Average Returns from Commercial Properties.

Fund	Average Returns from Housing Investment (1997) %	Average Returns from Commercial Properties (1997) %
NSSF	2.55	8.7
EAI	6.55	9.38
UNPS	5.7	6.5

Source: Compiled by Author

When returns from housing investment were also compared with returns from alternative investments where Funds usually put their funds, housing was found to perform poorly.

Table 5.14 Shows returns from Government treasury bonds and bank deposits for the past 10 years. Returns on bank deposits are pegged to returns on the treasury bonds. For the ten year period, interest rates on bank deposits were therefore slightly lower by 2 to 4 points below the Treasury bond rates, depending on size of deposits and period of investment. Returns on both cash deposits and treasury bonds were therefore much higher than returns from housing investments. Information from the Nairobi Stock Exchange show that in 1997 shares in financial and commercial trading companies recorded average yields of 18 - 20%.

Table 5.14: Nominal Interest Rates on Treasury Bills (1988 - 1997)

Year	Interest Rate %
1988	15.0
1989	15.5
1990	19.0
1991	19.0
1992	17.0
1993	39.3
1994	17.9
1995	21.7
1996	21.5
1997	26.4

Source: Compiled by Author

From the foregoing, the hypothesis that lower returns are derived from the housing sector than from other forms of investments is accepted. This could be the main reason why pension funds have not had an impact in housing development in Kenya. Other reasons include:

5.5.2 Other Reasons

- Although the NSSF considers itself as having an obligation, as a public body, to assist in alleviating the housing problem in the houses constructed by the Fund are too expensive for members of the Fund to afford. The Fund's 140 houses at Mountain View Estate in Nairobi are being sold at between KShs. 8 and 10 million each. This shows that the Fund gives no

consideration to the possibility of its members acquiring houses developed by the Fund.

- The UNPS' investment in housing was found to be mainly influenced by the sponsor's desire to solve employees' housing problems and hence the investment in the special staff mortgage scheme and little else having been done in form of housing investments.
- EAI considers administrative and management of housing investment costs to be higher than for commercial properties and hence the preference for commercial properties.

5.5.3 Potential of Pension Funds to Invest in Housing Provision

NSSF's potential to invest more effectively in housing is greatly hampered by the Fund spending too much money on undeveloped residential land. By 1997, the Fund had spent KShs. 1.17 billion to purchase undeveloped residential land. Houses constructed by the Fund are mainly high and medium cost housing.

The fund could work closely with local authorities to acquire cheap land for developing low cost housing with affordability level of their members. This has been done by the Kenya Building Society in Komarock in Nairobi. A two bedroomed flat of approximately 450 square feet cost approximately KShs. 1 million. If NSSF utilized the KShs. 13.42 billion on such low cost housing, some 13,000 housing units could have been developed by the Fund by 1997, instead of the 5,000 it has now developed.

NSSF's Funds that can be availed for housing investment are further reduced by the high staff and administrative expenses. This amounted to KShs. 1,232,037,000 in 1997. This comprised 32% of the Fund's total income for the year and 99% of the total contributions collected for that year! (See table 5.1). The Fund's "doubtful investments" mostly in collapsed financial institutions totalled KShs. 2,227,164,000 in 1997. This was 58% of total income for that year. If the Fund reduced its management costs and it was more prudent in its investment decisions, more funds would be available for housing investment.

The EAI pension and provident funds spend 90% of contributions on investments. If only 30% of these funds were invested in housing, some KShs. 10 million would be set aside every year for housing investment. The amount would be much higher if part of the investment income is also channelled into housing development.

UNPS' potential for greater investment in housing lies in the Fund reducing the proportion it invests in cash deposits and amount held by the sponsor in unremitted contributions. For 1997 alone, these amounts totalled KShs. 829,648,000/-. If 30% as required by the RBA is invested in housing, some KShs. 248,894,400/- would immediately be channelled to housing investment. All the three Funds record high potential for funding housing development.

5.6. Members' Views on Funds Investments

In all the three Funds, views of members on investment of their funds are not sought by the Boards of Trustees. In the NSSF, members' views are expected to be presented by the two representatives from the Central Organization of Trade Union (COTU) who are members of the Board of Trustees. However there is no evidence that these representatives seek their members' opinion on investment of funds. NSSF members learn of the activities of the Fund through Newspaper reports, radio broadcasts and circulars distributed at Agricultural Shows and branches of the Fund. No provision is made for members to respond to such information.

At the EAI, members' views are never sought. Members are never informed of the investment activities of their pension and provident funds. At the UNPS, some two senior officers are in the investment committee where they also double up as members' representatives. However, members' views are never sought when making investment decisions. The UNPS occassionally informs members on the activities of the Fund through circulars circulated to members.

5.6.1 Investment Preference

When the members were asked to choose the investment they would wish to be given preference by their Funds given a choice of bank deposits, shares (equity), treasury bonds and housing as alternatives, the results obtained are as shown in table 5.12 below.

From the survey, 29 out of the 46 respondents in NSSF or 63.1%, prefer that housing investment be given priority in the funds investment portfolio. At UNPS, 24 out of 34 respondents or 70.6% prefer housing to other forms of investments. Members in both funds felt that the funds could be invested in housing which they could afford to either buy or lease.

The second preferred investment asset with NSSF respondents was equity (shares) with 23.9% while UNPS' second preference was treasury bills with 13.9%. Bank desposits scored 13.0% and 5.9% at NSSF and UNPS respectively. This may indicate members' awareness of the effect of inflation on cash deposits and hence not advisable to invest too much in this asset. On the other hand, members may be wary of the losses that funds have incurred in financial institutions, which have sunk with millions of shillings belonging to the Funds.

Table 5.15: Members' Investment Preference

Variable	Organization	
	NSSF %	UNPS %
Bank Deposits	13.0	5.9
Buying Shares	23.9	8.8
Treasury Bonds	0	14.7
Houses for Sale / Rent	63.0	70.6

Source: Compiled by Author

5.6.2 Members Intended Use of Pension Money

When asked about their intended use of retirement benefits, most of the respondents in NSSF and UNPS intend to use the money to start or expand businesses. 66.6% of NSSF respondents and 48.6% of UNPS respondents chose

this option. This may be explained by the feeling that at retirement, one is too old to engage in building a house. Because of their low incomes, NSSF members expect low retirement benefits which would not be sufficient to build or buy a house and only 11.9% of the respondents therefore, plan to build a house with the retirement money. This result emphasizes the need for pension funds to assist their members acquire houses before they retire. 14.2% plan to buy land. In the case of members of UNPS, plans to buy or build a house comes second to business with 28.6% making this choice. The relatively higher incomes of the UNPS members may explain this preference since they may view housing as an investment.

Table 5.16: Members Intended Use of Pension Money

Variable	Organization	
	NSSF %	**UNPS %**
Start Business	66.6	48.6
Buy Land	14.2	0
Buy / Build a House	11.9	28.6
Pay School Fees for	4.7	2.8
Others	233	20

Source: Compiled by Author

5.6.3 Members' Mode of Housing

Table 5.14 shows how the members of NSSF and UNPS are housed. 86.3% are housed in rented houses, 9% occupy their own houses and only 4.5% are housed by the employer at the NSSF. This may explain why 63.1% of NSSF respondents prefer that their pension money be invested in housing which they can afford to buy. They see this as their only hope of ever owning a house. Out of the 36 respondents in the UNPS, 51.4% occupy their own houses. 34.3% are

in rented housing while only 14.3% are housed by the employer. Table 5.14 shows the mode of housing for the two funds.

Table 5.17: Members' Mode of Housing

Variable	Organization	
	NSSF %	UNPS %
Housed by Employer	4.5	14.3
Rented house	86.3	34.3
Owner-occupied house	9.1	51.4

Source: Compiled by Author

The big disparity between the number of members occupying their own houses in the NSSF and UNPS may be explained by the members' levels of income. NSSF's members' level of income does not enable them to buy or construct houses in Nairobi. 95.6% of NSSF members who were interviewed were in the low income brackets earning below KShs.10.500/= per month. This income cannot meet mortgage repayments and are therefore shut out of the mortgage finance market. The harsh economic conditions with high cost of living do not allow sufficient savings by this group to accumulate to a level which they can use to buy or build a house. On the other hand the high proportion of house ownership in UNPS can be explained by the reasonable level of members' income. 75% of the respondents in UNPS were middle income earners and 19% are in the high-income bracket. Only 5.6% were in the low-income bracket. This means that 94% of the UNPS members can afford at least low cost to medium cost housing and hence the relatively high level of ownership of housing. Table 5.15 compares income levels of the members of the two funds.

Table 5.18: Members Level of Income

Variable	Organization	
	NSSF %	UNPS %
KShs. 2000 - 10,500	95.6	5.6
KShs. 10,500 - 44,000	2.1	75.0
KShs. 44,000 and above	2.1	19.4

Source: Compiled by Author

A few members of NSSF and UNPS who have retire were also interviewed. All these respondents have either put their retirement benefits into business, purchase of land and one has banked the money in fixed deposit. All the retired members felt that the fund should have built houses for sale to the members before they retired. This is in agreement with serving members.

CHAPTER SIX

FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

6.1 Findings

Pension Funds hold large amounts of money with their assets value estimated at KShs. 140 billion. Most of these monies lie idle as seen in UNPS holding 53% of its assets in bank cash deposits.

- Pension funds invest only small proportions of their assets in housing provision. For example, NSSF had invested 25%, EAI 1.8% and UNPS ...% of their assets in housing by 1997.
- Privately run pension funds have more diversified portfolios and are more sensitive to changes in the investments market than are public and semi-public Funds. Private funds thus hold less idle money as seen in EAI pension fund investing only 1% of its assets in cash deposits.
- Investment principles are applied more in private pension funds than are applied in public and semi-public funds. Clear investment policies are in public funds where investment decisions are at the whims of fund managers and trustees. As a result, investments of the former record higher returns than similar investments by public funds.
- Public pension funds are poorly managed thus affecting members' benefits. Examples of this include the delays experienced by NSSF members in receiving their retirement benefits. This happens despite NSSF collecting contributions from members amounting to two to five times the amount of

payments made each year. Semi public and private pension funds record better management of funds as seen in speedy payment of retirement benefits and low staff and administration costs (compare EAI's cost of management of funds which is at 3% of total funds with NSSF's 24%).

- Housing investments record lower rates of return than alternative investments like treasury bonds, shares and bank deposits. Housing investments by private funds record relatively higher returns than those belonging to public funds.
- Pension fund managers are primarily interested in the growth of the funds and security of capital and income. However, members' benefits do not grow at the same rate as the funds. Consequently, pension payment formulas for pension schemes and compound interest applied for provident funds like NSSF are rarely reviewed.
- Pension funds do not involve their members in the management and investment decisions of their Funds. Members' views and their preferences are never sought even where workers are represented in the boards of trustees.
- Low-income workers cannot afford to buy or build their own houses and they desire that their pension funds invest in houses which they can afford to buy.
- Pension funds have great potential to invest in housing provision more appreciably than they are doing at the moment.
- Pension funds members' views on the management and investment of their funds greatly differ from how these are run.

- Public pension funds manage their investments including real estate investments while private funds prefer specialist consultants to manage their investments.

6.2 Conclusions

- The insignificant contribution pension funds have made in housing provision is as a result of idle funds held by the sector. Low returns from housing investments have also discouraged pension funds from investing in housing.
- Mismanagement of public pension funds have reduced the potential of funds to invest in housing.
- Qualified investment consultants are required for efficient management of the sector since they have huge financial resources.
- Housing investments by pension funds can record higher returns if they are managed by qualified real estate managing agents rather than direct management by fund managers who may lack the relevant qualifications.
- The profit-oriented nature of operations of private sector funds cause them to operate in total disregard of members' social needs like housing. A lot of vested interests exist in the public sector funds causing them to also ignore members' housing needs.
- Pension fund members' need to be allowed greater participation in the running of their funds if their basic needs such as housing are to be met.
- Continued growth of pension funds will hardly improve the lot of Kenyan workers if the main objective of the Funds remain to secure retirement

benefits for workers. Great accumulation of pension funds have caused temptations leading to misappropriation of these funds especially in public sector funds.

From the foregoing, this study has established that pension funds in Kenya, both public and private have invested very low proportions of their funds in housing. This is due to low returns derived from housing investments compared to other investments. Other factors also contribute to this low investment in housing. In view of this, the study hypothesis that housing sector has attracted only a small proportion of pension funds investments due to lower returns from the sector is therefore accepted.

6.3 Recommendations

- In order to alleviate the housing problem, the Kenya Government must step in and harness the potential of alternative sources of housing finance like Pension Funds. This can be done by amending the Retirement Benefits Act to mandate Pension Funds to devote a percentage of their assets in housing for their workers. This has been done in countries like Mexico, Brazil and the Philippines as discussed in Chapter 2. This is necessary since the Government and Local Authorities have in the past decade removed themselves from directly participating in shelter provision. International finance for housing has also diminished. The government still has a responsibility to ensure that its citizens are adequately housed. An effective way would be to ensure that workers' money, which is what pension funds

factors make alternative investments very vulnerable in comparison to real estate investments.

- Pension funds should increase their investment in housing and fund construction houses which most of their members can afford. Construction and management of the housing funded by pension funds should be left to qualified people in the building industry in order to keep costs down. Members can be assisted to acquire the houses by either giving them loans or by tenant purchase schemes.
- Pension funds investments should be managed by professionally qualified people or companies in strict accordance of the RBA provisions. Real estate managers should manage Funds' investments in real estate. Investment principles must be seen to be applied in public pension funds.
- Fund members should be more informed about the investment of their funds through regular circulars and accounts reports. While it is appreciated that most members are not qualified to make useful contribution in investment matters, transparency enhances trust and also helps to curb mischief on the part of fund managers and trustees. Wilson (1983) suggests that fund members should be supplied with information about their fund the same way shareholders are informed about their companies. In this respect, Funds should hold annual general meetings where members views can be gathered.

6.4 Areas of Further Research

1. The effect of the Retirement Benefits Act on pension fund investments in housing in Kenya. This will be necessary after some time because for the first time. the Pensions Sector will be controlled by one piece of legislation. The new rules governing Fund investments will also require that pension funds reschedule their investment portfolios. The new Act also provides for greater participation of members of pension funds in the management of the funds. With increased member awareness and participation in the funds decision making process. members' desire of housing provision by their funds may see marked changes in the proportions of funds that Pension Funds devote towards housing investments. The RBA rules and regulations are about to come into operation and the present research could therefore not cover this area.

2. Pension funds for workers in the informal sector. The current pension bodies including NSSF only cover people in formal employment. Workers in the informal sector also require security in old age. The informal sector is increasingly becoming an important participant in the Kenyan economy, supporting an increasing large part of the population. It would be important to find out how this sector can be covered by pension schemes.

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APPENDIX A

QUESTIONNAIRE FOR FUNDS INVESTMENT MANAGERS.

1. How many members does the fund have? ....

2. i) What percentage of salary do members contribute? ....

   ii) How much does the employer contribute per employee (%)? ....

   ....

3. How are retirement benefits for members calculated?

   ....

   ....

4. Give the retirement benefits position for the past 10 years.

Year	Contributions Received	No. of Persons Retired	Amount paid
1988			
1989			
1990			
1991			
1992			
1993			
1994			
1995			
1996			
1997			
TOTAL			

5. How has the Fund coped with recent staff retrenchment schemes (if any), vis a viz unexpected rise in retirement benefits?

   ....

   ....

   ....

6. As an investment manager. what are your primary objectives?

....

....

7. What fraction of the contribution goes into investment?

....

8. Where has the fund invested its investible funds in the past five (10) years?

Type of Investment	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Short Term Deposits										
Amount										
Returns (%)										
Long Term Deposits										
Amount										
Returns (%)										
Equities (Shares)										
Amount										
Returns (%)										
Housing Bonds										
Amount										
Returns (%)										
Real Property										
Amount										
Returns (%)										
Government Bonds										
Amount										
Returns (%)										
Others (Specify)										
Amount										
Returns (%)										
TOTAL										

9. Categorise investment in Real Estate

Type	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
Commercial Property, Shops and Offices.										
a) No. f Units										
b) Cost										
c) Income										
Residential Property										
a) Bungalows										
No Of Units										
Cost										
Income										
b) Maisonettes										
No Of Units										
Cost										
Income										
c) Flats										
No. Of Units										
Cost										
Income										
d) Others (Specify)										
No. Of Units										
Cost										
Income										
Industrial Property.										
a) No. Of Units										
b) Cost										
c) Income										
Others (specify)										
a) No. Of Units										
b) Cost										
c) Income										
TOTAL										

b) What has influenced the Fund's decision on investment in housing?

....

10. How has the Fund engaged in financing its members to acquire housing?

	Construction & Sale to Members			Staff Mortgage Scheme/ Direct Loans			
Year	No. of Units	Cost	Sale Price	No. of Units	Amount spent	Interest Charged to Members	Others (Specify)
1988							
1989							
1990							
1991							
1992							
1993							
1994							
1995							
1996							
1997							
TOTAL							

11. Does the Fund own residential land? Yes/No

a) If yes

i) Location (Estate) Acreage Date acquired Cost

....

....

ii) Is the land serviced? Yes/No

iii) What does the Fnd intend to do with the land?

....

b) Has the Fund worked with Local Authorities to acquire residential land? Yes/No

If yes, indicate results:

No. of acres acquired	Location	Cost	Developed (No. of Housing Units)	Beneficiaries

12. a) Describe how investment decisions are made?

....

....

b) How are the views and preferences of members considered in investment decisions?

....

....

13. Section 37(1) of the Retirement Benefits Bill states that "Every scheme shall have a prudent investment policy in the investment of the funds of the scheme so as to maintain the capital funds of the scheme and to secure market rates of return on the investment of such funds". Section 38(1) states that "No scheme funds shall be (a) used to make direct or indirect loans to any person or (c) invested with a bank, non-banking financial institution, insurance company, building society or other similar institution with a view to securing loans, including mortgages, at a preferential rate of interest or for any other consideration to the sponsor, trustees, members or the manager of such scheme"

a) What are your views on these provisions of the Act.

....

....

b) How are the provisions going to affect your general investment policy and investment in housing in particular:

....

c) Do you think these sections of the Act should be amended and if so why?

....

14. Give general comments on how to alleviate housing problems for Kenya urban dwellers/workers.

....

....

15. What are the general problems facing the Fund with regard to fund utilisation, investment in real estate and operational management?

....

....

....

....

APPENDIX B

QUESTIONNAIRE FOR MEMBERS OF PENSION/PROVIDENT FUNDS.

SECTION A

1. a) Designation/Profession...

   b) Place of work (Organisation) ....

2. Age last birthday ....

3. Level of Education (Please tick)

   a) KCPE or below b) KCSE ('O' Level)

   c) 'A' Level d) University degree and above

4. Income from employment (Total emoluments) (tick appropriately) per month.

   i) KShs. 2000/- to 10,500 ....

   ii) KShs. 10,501/- to 44,000/- ....

   iii) KShs. 44,000/- and above ....

5. Years of service in pensionable terms .... (years)

6. Housing

   Please state mode of housing

   i) Housed by employer .... Location ....

   ii) Rented house .... Location ....

   Rent per month ....

   iii) Owner-occupied house .... Location ....

7. If (iii) above, did you get a loan for purchase or building of the house?

Yes / No.

If yes, what was the source of the loan?

Source	Amount KShs.	Interest %	Repayment Period
a) Personal Savings			
b) Bank Loan			
c) Mortgage Institution (e.g. HFCK)			
d) Loan from friends/relatives			
e) Loan from employer			
f) Loan from co-operative society			
g) Others (Specify)			
TOTAL LOAN			

ii) Was this method of financing satisfactory? Yes/No ....

Give reasons for above answer ....

....

8. What is the distance of your house to your place of work? ....

b) Give reasons why you chose to live here? ....

....

SECTION B

9. a) How much do you contribute to the Pension fund per month?

KShs. ....

b) Employer's contributions per month KShs. ....

10. What is the retirement age according to your terms of employment?

.... years.

11. a) How much pension do you expect to receive on retirement:

i) Lumpsum .... (KShs.)

ii) Monthly pension .... (Kshs.)

iii) Bonuses .... (KShs.)

b) What do you plan to do with your retirement benefits (pension)? Please tick ( ) appropriately.

i) Start a business ....

ii) Buy land ....

iii) Buy/Build a house ....

iv) Pay School fees for children ....

v) Others (specify) ....

12. a) How are your interests in the Pension Scheme safeguarded?

i) Through employer ....

ii) Through Representative ....

iii) Others (Specify) ....

b) If you think the interests are not well safeguarded, how would you suggest that the interests be safeguarded? ....

13. a) How are you informed of the investment activities of the Pension Fund?

i) Through Circulars from Fund ....

ii) Through Members' representatives ....

iii) Through newspapers ....

iv) Others (Specify) ....

b) If not informed, how would you want to be informed? ....

14. How do you think Pension Funds should be invested? (Please tick your priority area).

a) Bank deposits

b) Buying shares

c) Treasury Bonds

d) Commercial Buildings

e) Houses for sale or renting to members.

15. What are your views on employer-assisted mortgage schemes?

....

16. How do you think the problem of urban housing in the country can be solved?