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ABSTRACT

Three major constraints to the development of low income housing in Zimbabwe have been identified: land delivery, capacity in the construction and building materials sector, and housing finance. This report addresses the area of housing finance. Research to date indicates that demand for low income housing far outstrips supply, and linkages between low income borrowers and the traditional large investors need to be strengthened. Given this background, the study's objectives are to establish if access to financial resources is a constraint in satisfying demand for low income housing, and if so, to recommend a financial instrument best suited to tap available financial resources.

FINANCE FOR LOW INCOME HOUSING IN ZIMBABWE

Prepared for: USAID's Regional Housing and Urban Development Office for Eastern and Southern Africa

by: Merchant Bank of Central Africa Limited
(Registered Accepting House)

October 1989

TABLE OF CONTENTS

		Page
Executive Summary		i
1.	Background and Concept	1
1.1	Background	1
1.2	The Objectives of the Study	3
2.	Demand and Supply for Low Income Housing and the Role of the Building Societies	5
2.1	Demand	5
2.2	Supply	5
2.3	The Role of the Building Societies	6
2.3.1	Trends in Deposits	6
2.3.2	Mortgage Trends for Low Income Housing	7
2.3.3	Additional Finance Requirements	8
2.3.4	Constraints	10
2.4	Conclusion	11
3.	General Liquidity and Potential Additional Sources of Finace	13
3.1	General Liquidity	13
3.2	Liquidity in Building Societies	14
3.3	Potential Additional Sources	14
3.3.1	Pension Funds and Insurance Companies	14
3.3.2	Surplus and Blocked Funds	15
3.4	Conclusion	16
4.	Financial Instruments	18
4.1	Introduction	18
4.2	Menu of Financial Instruments	18
4.3	Suitability of the Financial Instruments	20
4.3.1	Negotiable Certificates of Deposit	20
4.3.2	Secondary Mortgage Market	22
4.3.3	Tax Free Shares	23
4.3.4	Specialised Building Society Paper to Attract Surplus Funds	25
4.3.5	Unit Trusts	26
4.3.6	Switched Blocked Funds	27
4.3.7	Prescribed Investments	28
4.3.8	Raising the 60% and 30% Prescribed Asset Requirements	29
4.3.9	Preference Shares	29
4.3.10	Extending Building Societies' Ordinary Share Capital Base	30
5.	Preferred Methods for Raising Additional Finance	31
5.1	The Preferred Option	31
5.2	Secondary Instruments	32
5.3	Discussion and Implementation	33
Appendix I	Assets and Liabilities of Building Societies	34
Appendix II	Liquidity Trends of Monetary Banks and other Financial Institutions	37
Appendix III	List of People/Organisations Contacted	38

EXECUTIVE SUMMARY

i. USAID's Regional Housing and Urban Development Office (RHUDO) for Eastern and Southern Africa is currently preparing proposals for a new Housing Guarantee (HG) project in Zimbabwe. Three major constraints have been identified to the development of low income housing in Zimbabwe, land delivery, capacity in the construction and building materials sector and housing finance. This study addresses itself to the area of housing finance.

ii. Research to date indicates that demand for low income housing far oustrips supply, and linkages between low income borrowers and the traditional large investors need to be strengthened. Given this background the study's objectives are to establish if access to financial resources is a constraint in satisfying demand for low income housing, and if so, to recommend a financial instrument best suited to tap available financial resources.

iii. Demand for low income housing is estimated at 38 000 units per annum. Given current supply, there is an estimated total shortfall of 26 000 units per annum.

iv. Immediate constraints to the provision of low income housing are foreign currency for the building materials supply sector and the construction industry and the lack of serviced stands. As these supply constraints ease, the finance constraint will progressively become more marked.

v. Financial resources generated by the Building Societies' existing instruments in tandem with finance from other traditional providers of low income housing, (Local Authorities) will satisfy a small part of the 26 000 unit shortfall.

vi. The outstanding financial requirement would have to be met by the development of a new financial instrument(s). It is estimated this financial instrument(s) would have to mobilise Z$290 million per annum over a 6 year period to 1995 if the total outstanding requirement was to be met. Even if supply side constraints eased to satisfy only 64% of the estimated demand (with existing constraints 32% of demand is being satisfied), an additional Z$92 million per annum would still have to be raised.

vii. The Zimbabwe economy is presently characterised by high levels of liquidity. Additional sources of finance that could be tapped to finance low income housing have been identified as Pension Fund and Insurance Company resources and surplus and blocked funds.

viii. The study's preferred method for raising additional finance is the Negotiable Housing Certificate of Deposit (NHCD). It appears that acceptable rates of return, matching yields on Government stock, can be offered to potential investors by a NHCD with terms of 1 to 3 years. The Building Societies indicate that they would be able to absorb this cost of money, without any readjustment to the level of their mortgage rates. NHCDs issued for periods of 3 years and above would require a floating issue rate. This in turn would necessitate a general liberalisation of interest rate policies. The issue of 1

to 3 year NHCDs is therefore feasible in the short term. The issue of long term NHCDs would depend on Government's overall capital markets strategy. It is proposed that Building Societies should only be qualified to issue NHCDs if they were satisfied that a fixed proportion of the resources raised could be reinvested in low income housing. The major attraction of the NHCD is that it would constitute an efficient long term instrument responsive to changes in demand for low income housing.

Secondary instruments that could be employed are, new preference share issues, special surplus fund deposits, switched blocked funds and unit trusts. The first three instruments are desirable in that they would attract investors at relatively low returns which would not require any readjustment in mortgage rates. Blocked and surplus funds cannot, however, be considered long term instruments and certain macroeconomic problems may be associated with their utilisation. It remains to be established if the preference share instrument would have statutory problems relating to their issue. The Unit Trust instrument is supported by a section of the pension fund industry who for 'social reasons' see merit in investing in a Unit Trust of low income mortgages. The success of this approach rests on its wider appeal to the financial institutions.

Given acceptance of the NHCD as the preferred instrument for mobilising additional finance, implementation requirements relating to legislation, the money market, and the link with low income housing will have to be further researched.

Background and Concept

1.1. Background

1.1.1. USAID's Regional Housing and Urban Development Office (RHUDO) is currently preparing for its second Housing Guarantee (HG) project in Zimbabwe. Disbursements on the housing project are planned for fiscal years 1991 and 1992. The length of the project programme is 5 years to 1996. USAID's HG projects operate as follows:-

USAID provides a 100% guarantee to private United States investors for housing investments in Zimbabwe. The level of the guarantee for loan investments to Zimbabwe has been set at US$25 million per fiscal year. USAID is therefore seeking to guarantee US$50 million over the two year period.

1.1.2. To ensure that the US$50 million is utilised to maximum advantage a number of constraints facing the development of low income housing have to be addressed. USAID's preparatory analysis had identified three major problem areas:-

a) land delivery
b) capacity in the construction industry
c) housing finance

1.1.3. The land delivery problem has been identified as relating to the relatively large plot sizes in Zimbabwe's urban areas. This has led to urban sprawl, putting tremendous strains on infrastructure and transportation.

1.1.4. Severe supply side constraints have been identified in the construction industry. The limiting areas relate both to the construction sector itself and the building materials supply sector. Plant and equipment in the construction sector is obsolescent, while demand outstrips capacity to produce building materials.

1.1.5. The non-government housing finance sector prior to independence was geared mainly to the provision of housing finance for the medium to upper income groups. Public sector finance being routed through local authorities to satisfy low income demand. This orientation was modified post independence through the promotion of individual home ownership schemes to satisfy the needs of the low income groups. A significant step was taken in 1986 when Government

allowed Building Societies to attract tax free deposits, linking the utilisation of these finances to the development of low income housing. Despite these policy changes there is a common perception that there is still a large shortfall in low income housing finance vis-a-vis demand.

1.1.6. USAID has retained three separate consultants to explore possible solutions to the above three constraints. This study's objective is to address itself to the housing finance constraint.

1.1.7. Previous housing finance work carried out for USAID include the following studies:-

- "Housing Finance in Zimbabwe" April 1985
- "Final Evaluation - Zimbabwe Low Cost Shelter Program" February 1988
- "Investigation of the Insurance and Pension Fund Sector as a Source of Finance for Housing" June 1989.

1.1.8. Conclusions from the previous work which are relevant to the present study are summarised as follows:

- The April 1985 study concluded that Zimbabwe's housing finance institutions could not meet the housing finance requirements of all Zimbabweans. The study went on to recommend that Building Societies be allowed to compete with the Post Office Savings Bank's (POSB) tax free status on investments and/or allowable ceilings. Looking longer term the study recommended that the concept of the secondary mortgage market be explored. (In 1986 the Government of Zimbabwe (GOZ) did allow Building Societies to attract tax free deposits, which in turn benefited the low income housing sector).

- The February 1988 study which was an evaluation of USAID's first HG project in Zimbabwe, recommended that GOZ in the form of the the Ministry of Public Construction and National Housing (MPCNH) should "examine ways to link local authorities with private sector financial resources, notably Building Societies". The recommendation stemmed from the perception that there was a gap between low income borrowers and the country's more sophisticated lending systems, which had been geared towards the middle and upper income groups.

- With the aim of exploring the potential of developing a link between low income borrowing and sophisticated sources of finance, the June 1989 study analysed the potential of pension fund and insurance finance. The study concluded that

there was an overwhelming demand for the creation of a secondary mortgage market, but that prevailing statutory conditions were not conducive to attracting finances from the pension and insurance funds into such a market. The study was not optimistic that statutory controls would be relaxed. In addition the study noted that there was a "magnitude and complexity of administrative task underlying the creation of a secondary mortgage market" that could inhibit its development.

1.1.9. Work to date therefore indicates that;

(a) demand for low income housing far outstrips supply.

(b) linkages between low income borrowers and the traditional large investors need to be strengthened, to meet this demand.

(c) considerable Government regulatory constraints effectively preclude the strengthening of these linkages.

1.2. The Objectives of the Study

1.2.1. The objectives of the study, given the background illustrated in 1.1, are twofold:-

(a) To establish if access to financial resources is a constraint to satisfying demand for low income housing;

(b) to recommend a financial instrument best suited to tap available financial resources for investment in low income housing, if finance is identified as a constraint.

1.2.2. In establishing if finance is a constraint the study is also required to ascertain the nature of the constraint, if any, and its relationship with any other identified constraints. In this context cognisance must be taken of the fact that the timespan of the HG project is effectively five years. Loans of US$25 million each are guaranteed during the fiscal years 91 and 92, but the implementation of the project is over a five year period. For the project to be successfully implemented therefore both short term and medium to longer term constraints need to be addressed.

1.2.3. Before recommendation can be made as to the most appropriate financial instrument, it is also important that a wide variety of potential instruments are researched. By adopting this approach there is obviously a greater likelihood of reaching the best of all possible recommendations.

1.2.4. In addition, the objectives of the study require that recommendation on a financial instrument(s) be based on a number of key factors. The recommended financial instrument(s) must:

- Be responsive to changes in demand for low income housing. An instrument which has a limited capacity to adjust to demand for housing finance is not a preferred instrument.
- Satisfy the requirements of Building Societies. An instrument, that, for example, raises the Building Societies cost of money to the extent that they cannot justify expanding low income mortgage commitments, is not a tenable instrument.
- Attract investor finance. An instrument that is incapable of attracting investor finance is clearly a non-starter.
- Attract additional sources of finance. Housing investment to date, has had limited sources of finance to draw upon. It is the study's objective to attempt to provide this form of investment with fresh financial resources, and in so doing expand choice of access to financial resources, and heighten ability to meet demand.

1.2.5. Finally, recommendations on financial instruments cannot be made in isolation. Analysis as to their effects on other sectors of the economy and the economy as a whole is required. In this regard it is the study's objective to minimise the diversion of financial resources from application in other priority areas of the economy. In this context diversion of resources away from Government requirements is to be discouraged. Equally, instruments with long term strengths are to be preferred to instruments, though solving short term problems create long term rigidities in the economy.

2. Demand and Supply for Low Income Housing and the Role of the Building Societies

2.1. Demand

No comprehensive data is available on demand for housing in Zimbabwe. However, there is general consensus that there is a critical housing backlog in both the rural and urban areas. In the urban areas the level of housing demand is increasingly being compounded by rural - urban migration and natural growth in urban populations. This situation manifests itself in over-crowding, poor housing conditions and an increase in the number of squatters with serious implications for sanitation, health and other enivronmental conditions.

In an attempt to meet demand, the Transitional National Development Plan (TNDP) covering the period 1983 to 1985, had set a target of 115 000 units to be constructed over the three year plan period. The First Five Year National Development Plan (FFYNDP) covering the period 1986 to 1990 aimed at completing 75 000 to 100 000 units over the plan period. The FFYNDP included an ambitious development programme for housing with the investment programme for the Construction and Housing sector set at Z$1 040 million, the second largest budget in the plan, representing 15% of total planned investment in fixed assets.

The Ministry of Public Construction and National Housing's (MPC&NH) 1986 study into the housing needs of Zimbabwe up to the year 2000, revealed that the total urban population of 2,265 million was in 1986 housed in an existing stock of 403 000 units. The housing shortage at that time was put at 150 000 units. In the same study, the projected urban population in the year 2000 was estimated at 4,83 million or 1 208 000 households. 1.2 million households with 4.1 persons per household would require an estimated additional 808 000 housing units. Thus, to eradicate the backlog and also cater for the annual growth in population, it was estimated that 54 000 units per annum would have to be constructed in the urban areas. Of the housing units to be constructed per year about 69% or 37 260 units, would be for low income households, 20% for middle income and about 10% for high income. There is no specific definition of low income housing but the maximum income range that qualifies for low income housing as applied by the local councils and Building Societies varies between Z$450 to Z$600 per month.

2.2. Supply

Financial sources for the provision of low income housing are the local authorities for rented accomodation; Central Government for civil servants' accommodation; and Building Societies for individual home-ownership. In addition there are a number of company assisted housing schemes.

During the TNDP period, only 13 500 total housing units were completed compared to a target of 115 000. For the period

July 1984 to June 1989, just over 60 000 low income housing units were completed giving an annual average of 12 000 units compared with the annual demand of about 38 000 units.

Local authorities' inability to provide serviced stands is the major supply constraint. Where serviced stands have been made available, construction of the super-structures has been constrained by the shortage of building materials. This is a result of foreign currency constraints for recurrent, replacement and expansion requirements in the building materials supply sector.

With current production for low income shelter averaging 12 000 units per year, compared to the annual requirement of about 38 000 per year, the annual shortfall in supply is therefore estimated at 26 000 units.

At an average cost per unit of about Z$10 000, the total amount required to meet the demand for Housing is Z$380 million per year. In terms of the current shortfall in supply of 26 000 units per year, additional funds amounting to Z$260 million would be required.

2.3. The Role of the Building Societies

2.3.1. Trends in Deposits

Table 2.3.1 below shows trends in building society deposits.

Table 2.3.1. Building Societies Deposits (Z$ million)

End of June	Permanent Shares	Class C Tax Free Shares	Subscription Shares	Fixed Deposits	Savings Deposits
1989	361,6	268,4	6,3	13,7	518,3
1988	232,5	181,6	6,6	18,1	440,3
1987	202,6	99,0	7,5	64,7	370,1
1986	223,6	-	6,7	85,1	321,2
1985	214,0	-	5,9	89,2	286,8

Source: Building Societies

Permanent Shares (including ordinary shares) - have a current dividend rate of 11,25% per annum. They are considered to be a medium term investment and redemption may be permitted on 6 months notice. Such notice may only be given, however, after a period of 18 months from date of issue. Shares redeemed within 4 years from date of issue are subject to a reduction in interim dividend.

Class C Shares - these attract a 9% tax-free return per annum. The maximum ceiling for individuals is Z$75 000 and Z$35 000 for companies and local authorities. They may not be redeemed within 2 years. 6 months notice of redemption must be given 18 months

after the purchase of shares, or 3 months notice from the second anniversary date, to qualify for the tax-free concession. Building Societies are required to make 25% of the new deposits available for low income housing, 25% of which is to be made available in loan form to Government's National Housing Fund. The National Housing Fund channels public finance into low income housing.

Subscriptions Shares - attract interest per annum at 9% over 24 months; 10% over 36 months; and 10,5% for 60 months and over. Maximum limit is Z$250 000 for individuals and Z$500 000 for companies and associations.

Fixed Deposits - carry fixed maturity dates at 9,75% per annum for 12 months and 10% per annum for 24 months. The minimum deposit is Z$50 and the maximum for individuals is Z$300 000; Companies and associations Z$600 000; municipalities $1 million.

Savings Deposits - attract interest per annum at 7,75% on call or 3 months at 8,75%; 6 months at 9,0% and 9 months at 9,5%.

Given the above mixture of deposits, the average cost of money for Building Societies is estimated at ± 9%.

During the past 5 years Building Societies have experienced a steady growth in total deposits, with the highest growth in 1989 of 33%. Most of the growth has taken place since 1987 due to the introduction of Class C Shares in November 1986. Permanent Shares have also exhibited strong growth due to their attractive rates of return. However, the less attractive fixed deposits have significantly declined from Z$89.2 million in 1985 to Z$13,7 million in 1989 whilst subscription shares have remained static. Of major concern to Building Societies is the fact that about 44% (1989) and 50% (1988) of their deposits are in savings deposits the majority of which are call deposits of individuals. These deposits are costly to administer as individuals are effectively using Building Societies as banks. In an attempt to reduce the number of such deposits some of the Building Societies have put a minimum deposit level of Z$50. [For further data on assets and liabilities of Building Societies, see Appendix (I)]

2.3.2. Mortgage Trends for Low Income Housing

Trends in Building Societies mortgages for low income houses is given in table 2.3.2 below:

Table 2.3.2 Low Income Housing Mortgages

End of June	1989		1988		1987	
	No.	Z$m	No.	Z$m	No.	Z$m
Mortgages	5578	54,4	4772	36,4	3145	21,5

Source: Building Societies

The above amounts represent 16,8%, 19,1% and 14,8% of total building societies mortgage advances during 1989, 1988 and 1987 respectively.

Before 1987, Building Societies were reluctant to lend directly to individuals for low income home-ownership schemes in view of the high costs associated with administering numerous small mortgages. Prior to 1987 funds for low income housing were channelled principally through local authorities. The turning point came about in 1987 following the introduction of the 9% Class C shares in November 1986. This lowered the cost of money for Building Societies by about 2%. In addition, in recent years the societies computing capacity was increased which enabled them to handle more business, at lower margins. As a consequence the building societies have been able to effectively expand their low income mortgage business.

Interest rates on Building Societies mortgages have not changed since 1981. The rates for the various types of mortgages are given below:

	%
Houses under Z$12 000	12,5
over Z$12 000	13,25
Non-owner occupied	13,75
Commercial, Industrial and flats	14,75

Two of the three Building Societies are currently advancing mortgages for low income housing at a reduced rate of 11,5%.

2.3.3. Additional Finance Requirements

Tables 2.3.3. (A) and (B) below give forecasts of the additional funds required to meet demand for low income houses and the expected shortfall, given present trends in finance availability.

Table 2.3.3 A forecasts additional funds required if all other supply constraints (serviced stands, building materials.) were solved and therefore all demand was to be met.

Table 2.3.3 B. forecasts additional funds required if supply side constraints are only partially solved.

Table 2.3.3 (A) Estimated Additional Funding Requirements to meet 100% of the Demand for Low Income Housing (Z$m)

	(i) Amount Required	(ii) Growth in Class C Share	(iii) 60% Available	(iv) Other Sources	(v) Net Shortfall
1990	380,0	107,3	64,4	60,0	- 255,6
1991	437,0	150,3	90,2	69,0	- 277,8
1992	502,6	210,4	126,4	79,4	- 296,8
1993	578,0	294,6	176,8	91,3	- 309,9
1994	664,7	412,4	247,4	104,9	- 312,4
1995	764,4	577,4	346,2	120,7	- 297,5

Table 2.3.3 (A) is based on the following assumptions:

(i) The amount of finance required is based on 38 000 units per year costing $10 000 per unit in 1990 with a 15% inflation factor per year.

(ii) Growth in Class C shares is estimated at 40% per annum. (Growth in Class C shares was 83% in 1988 falling to 48% in 1989, but is estimated to fall to 40% over the next 6 years given current net inflows of between Z$7 -9 million per month). This column gives us an indication of the financial resources available to building societies from Class C Shares, without the introduction of a new financial instrument.

(iii) It is assumed that all Building Societies mortgage advances for low income housing will be linked to Class C Shares. Building Societies have indicated that they are prepared to make up to 60% of the annual increase in Class C shares available to low income housing. This column therefore indicates the additional finance available for low income housing from the building societies, without the introduction of a new financial instrument.

(iv) Other sources of finance include local authorities, central government, and individual company housing schemes. Most of the local authorities stopped putting up rented accommodation as far back as 1984 annd are now only responsible for providing the serviced stands. It is assumed that these sources will continue to provide for about an estimated 6000 units per year as they have limited ability to raise more funds; and in view of government's policy to promote more individual home ownership schemes financed through Building Societies.

(v) The net shortfall is the amount of finance requried (i), less (iii) and (iv) the estimated finance available to low income housing from Building Societies without the introduction of a new financial instrument and finance available

from other resources. This column gives us an indication of the amount of finance any new financial instrument is going to have to mobilise, to meet all the demand for low income housing.

Table 2.3.3 (A) concludes that the average annual maximum additional finance requirements 1990 - 1995 for low income housing is Z$291,6 million. This is the amount of finance that any new instrument will be expected to mobilise to meet all demand.

Currently only about 32% of the demand for low income housing is being met. It is unlikely that non finance supply constraints will ease to such an extent as to allow all the demand to be met. The assumption made in Table 2.3.3 (B) below is that supply constraints will ease to a level which will allow 64% (double the present rate) of the demand for housing to be met. The same assumptions in Table 2.3.3.(A) relating to finance availability from building societies and other sources are assumed in Table 2.3.3.(B).

Table 2.3.3. (B)
Estimated Funding Requirements to meet 64% of Demand (Z$m)

	Amount Required	Available Funds	Shortfall
1990	243,2	124,4	- 118,8
1991	279,7	159,2	- 120,5
1992	321,7	205,8	- 115,9
1993	370,0	268,1	- 101,9
1994	425,4	352,3	- 73,1
1995	489,2	466,9	- 22,3

Table 2.3.3.(B) above indicates that if supply increases to meet 64% of demand from the current 32%, the estimated average annual additional finance requirements for the period 1990 to 1995 would be Z$92 million.

2.3.4. Constraints

The present demand for mortgage assistance for low income housing is so high that all Building Societies are currently lending more than the minimum requirement of 25% of Class C shares. All the Building Societies indicated that they are prepared to lend more provided serviced stands were made available. However in order to maintain viability and to offset the related high administration costs, it will be necessary for them to sustain and increase lending to the higher interest bearing portfolios, given that the margin on low income mortgages is on average only 2,5% compared to around 5% for commercial and industrial mortgages.

The conclusion that is drawn is that finance is not the primary constraint to providing low income housing in the short term. The short term primary constraints tend to be the shortage of serviced stands and foreign currency related. In order to facilitate increased lending, foreign currency requirements to the construction and building materials supply sector will have to be addressed in conjunction with the availability of serviced stands.

The following subsidiary constraints will also have to be dealt with:-

- Building Societies limited computer peripheral. It is anticipated that by end of December 1989 this would have been stepped up to 85 - 90% of their requirements through an external loan currently being negotiated. Such a capacity level will give the Societies unlimited processing capacity.
- Regulations preventing building societies from becoming developers. Building Societies are by regulation not allowed to engage in direct infrastructure development such as the servicing of stands. Many local authorities are said to be keen to let the societies undertake development of block land in order to speed up availability of stands. This is a matter which can be solved by amending the Building Societies act.
- Shortages of surveying personnel and equipment.

Once the primary foreign currency and serviced stands constraints diminish, the finance constraints will increasingly become more pressing.

If the supply side foreign currency and serviced stands constraints were reduced so that 64% of the housing requirement could be met, our estimates in Table 2.3.3 (B) indicate that the additional annual finance requirement would be Z$92 million. It is therefore imperative that a new mechanism be put in place that will channel additional resources into building societies.

2.4. Conclusion

2.4.1. The demand for low income housing is estimated at 38 000 units per annum. Given current supply there is an estimated total shortfall of 26 000 units per annum, for which additional funds will need to be raised.

2.4.2. Resources generated by the existing financial instruments available to Building Societies and from other sources of finance would meet part, but not all of this total shortfall.

2.4.3. The outstanding net requirement would have to be met by the development of a new financial instrument(s). It is estimated that this financial instrument would have to mobilise Z$291,6 million per annum over the 6 year period to 1995 if all the demand is to be met or Z$92 million per annum if current supply is doubled to meet 64% of the demand.

2.4.4. Mobilisation of these quantums of finance depends on the development of a new financial mechanism and the primary foreign currency and serviced stands constraints being overcome.

2.4.5. The mechanism to mobilise these funds should ideally be developed in tandem with efforts to overcome supply constraints. This should be implemented in such a way, that as supply constraints are eased, financial instruments are in place which can efficiently mobilise resources to satisfy demand.

General Liquidity and Potential Additional Sources of Finance

3.1. General Liquidity

General liquidity trends of Monetary Banks and other Financial Institutions are shown in Appendix (II).

All monetary banks and other financial institutions are currently holding excess liquid assets well above their statutory requirements. The excess liquid assets that reflect money that could be released for lending over and above amounts already in advances, amounted to Z$202,6 million as at end of December 1988, Z$216 million as at end of March 1989, and Z$245,7 million as at end of June 1989.
The high liquidity is a result of several factors which include the following:

- increased private sector credit creation
- bouyant foreign exchange earnings
- continued import compression

Given the liquidity in the money market, there has been limited requirement for banks to look for external funding which has resulted in the depression of money market rates. The 90 day NCD rate was trading in a narrow margin between 9,5% and 8,8% per annum during the first half of 1989 compared to 10,00% to 10,25% as at end of June 1988.

The BARD publication - "Zimbabwe Money and Capital Market Review" covering the first half of 1989, reports that despite the rapid increase in the rate of growth in domestic credit creation, the banks remain under-lent indicating that they could easily increase their loan portfolios without having to bid for deposits. In their estimation, commercial banks could increase their lending by as much as 14% without having to attract any further deposits. In an effort to offset the high levels of liquidity, the Reserve Bank issued Z$200 million special bills in November 1988. Of this amount Z$50 million was retired end of December 1988. BARD estimates that if the balance of Z$150 million were to be released, the banks could increase their lending by up to 20%.

However, the BARD review is of the opinion that the short-term outlook holds little change particularly as foreign exchange inflows are anticipated to be generally positive at least up to the end of 1989. On the other hand during the first half of 1989, foreign exchange outflows were estimated to be as much as Z$200 million less than for the same period in 1988.

In the long term, the outlook is dependent on the policies to be adopted by the authorities on trade liberalisation and the general easing of controls. If the liberalisation initiative comes to fruition, pressures would rise in the money market. An upturn in the economy would mop up the excess liquidity, given that the estimated shortfall in investment is approximately Z$0.5 billion if the 5 year plan targets are to be met, and half of this shortfall is estimated to require foreign currency.

3.2. Liquidity in Building Societies

The three Building Societies are currently relatively liquid and have been so over the past year. With effect from May 1984, Building Societies are required to hold liquid assets equal to 15% of their liabilities to the public. The actual ratio has on average remained above 20% reflecting excess liquidity that can be made available for lending to customers. As at end of December 1988, the actual ratio was as high as 25%. The short term outlook is that the liquidity situation is likely to continue for as long as serviced stands are not available and building materials are in short supply.

As indicated under Trends in Deposits in 2.3.1, a large proportion of Building Societies' deposits is "hot money" from savings deposits which are basically call money. If the investment climate picks up and inflation increases with the expected freeing up of the economy, the levels of these deposits are expected to fall. Assuming forecasts of reduced liquidity occur in tandem with a reduction in supply side constraints to the construction sector, the Building Societies would be in the position of having to meet increased housing demand with reduced financial resources. All the Building Societies therefore indicated the need to be allowed access to additional sources of finance to meet the expected increase in demand for mortgages in the medium to long term.

3.3. Potential Additional Sources of Finance

From the above it is clear that in the immediate future there is excess liquidity from which additional funds can be mobilised. The outlook on the liquidity situation depends largely, however, on Government's liberalisation policies.

The potential additional sources of funds that could be tapped have been identified as finance from pension funds and insurance companies and blocked and surplus funds. The characteristics of these sources of finance are discussed below.

3.3.1. Pension Funds and Insurance Companies

Pension Funds and Insurance Companies are traditionally long term investors. They are required to hold a minimum of 60% of their asset portfolio in prescribed assets, the balance is usually invested in loans, debentures, properties, equity and in the money market. In the case of non-life insurance the ratio is 30%. Below is a list of the prescribed securities.

- Government Stock
- Zesa Stock
- Municipal Stock
- AMA Stock
- AFC Bonds
- Treasury Bonds
- Government Development Bonds

Loans to local authorities or statutory bodies approved by the Registrar of Pension and Insurance funds.

The table below gives the assets of Pension and Insurance funds.

Table 3.3.1. Assets of Pension and Insurance Companies (Z$m)

	1983	1984	1985	1986*	1987*	1988*
**Insurance Assets	1124,7	1389,1	1712,2	1934,0	2400,0	2700,0
- % Prescribed	N/A	N/A	N/A	N/A	61,5	62,5
Pension Assets	625,2	725,2	842,2	966,0	1200,0	1500,0
- % Prescribed	N/A	52,9	51,5	50,7	58,3	59,6

Source: Annual Economic Review of Zimbabwe (1986)
* Provisional Estimates
** Life and Non Life

Pension and Insurance funds have experienced strong growth since independence. The prescribed asset ratios indicated above are not above the required 60% for pensions due to exemptions given to numerous small self-administered funds. However, the major pension and insurance funds interviewed reported that they were holding prescribed assets in excess of the requirement and in some cases as high as above 65%.

Table 3.3.1 indicates that the percentage of prescribed assets held by Pension Funds and Insurance Companies has been growing steadily since 1986. This indicates the growing liquidity situation of the finance institutions as they would normally wish to minimise their prescribed asset investments.

Because of the shortage of attractive long term investments and expectations that interest rates are likely to go up in the medium term, pension and insurance funds are investing more and more in short term securities. The institutions interviewed reported that they all had funds invested in short to medium term investments in excess of what they would normally consider desirable.

3.3.2. Surplus and Blocked Funds

(i) Surplus Funds - These are funds which are retained earnings of locally-incorporated foreign controlled companies. Such funds may be used to conduct normal business operations or to finance expansion of existing business operations. Where surplus funds have not been used in accordance with the above, they may only be invested with finance institutions at a rate of

5% per annum. In the case of building societies, such funds are restricted to a maximum of $50 000 on call at 5%. However, more could be invested if the deposits are linked to the provision of staff housing. As from 1 June 1989, surplus funds may also be invested in one year non-negotiable certificates of deposit issued by the Reserve Bank of Zimbabwe paying 7% per annum. The Reserve Bank will on-lend these funds available at concessionary rates to third parties for investment in development projects.

The pool of surplus funds has been increasing, particularly since May 1987 when remittable dividends for pre September 1979 foreign owned investments were reduced from 50% to 25% of after tax profits. The exact amount of surplus funds cannot easily be quantified since they can be used in the day to day running of the business. It is however estimated that there is presently in excess of Z$200 million idle surplus funds, a large portion of which is invested in commercial and merchant banks.

(ii) Blocked Funds - These are monies due and payable to non-residents which have been credited to blocked accounts in Zimbabwe or invested in either 6, 12, or 20 year 4% Government Bonds. They are a result of dividends blocked during the pre independence period and a combination of excess declaration of dividends by foreign owned companies above the 50% or 25% limits. Blocked funds are also a result of disinvestments by foreign owned companies and liquidated assets of emigrants during the post independence period. Such funds may not be reinvested without prior approval of the Exchange Control. Since July 1989, blocked funds can be liquidated on a switching basis whereby the non-resident owner of such funds will be paid externally by a potential investor in Zimbabwe at a discounted price agreed between the parties. The rate of discount varies between transactions, depending on the parties' own perceptions concerning exchange rates, inflation, political and economic risk, and usually reflects a significant discount over the face value of the blocked funds.

It is estimated that there is in excess of Z$700 million in blocked funds.

3.4. Conclusion

3.4.1. There are currently high levels of liquidity in the economy. The resources reflecting this liquidity could be tapped as additional sources of finance for low income housing.

FINANCIAL INSTRUMENTS

4.1. Introduction

4.1.1. Section 3 concluded that the maximum additional annual demand for finance for low income housing was Z$292 million per annum for the six year period to 1995 or Z$92 million per annum if supply is to be increased to meet 64% of demand. Section 4 identified four major sources of additional finance that could be tapped. These are pension funds, life and non-life insurances, surplus funds and blocked funds. The objective of this section is to:

(a) outline a menu of financial instruments that could be employed to mobilise the additional financial resources.

(b) examine the appropriateness or not of each of the financial instruments identified in (a) above, to the long term needs of low income housing finance.

4.2. Menu of Financial Instruments

4.2.1. Negotiable Certificates of Deposit Additional finance could be raised by the Building Societies through the issue of Negotiable Certificates of Deposit (NCDs). NCDs are presently issued by Commercial and Merchant Banks and Finance Houses and constitute an important method of raising finance in the money market. The term on NCDs varies from one month to five years. Their major attraction to investors is that they are tradeable and redemption is guaranteed by the banks and finance houses. They are not secured against any specific assets held by issuing institutions. The rate at which they are traded depends on liquidity in the market, with the bank rate set by the Reserve Bank and yields on Treasury Bills and one to five year Government stock, being their reference point. The Bank rate has been fixed at 9% since 1981. Current yields on Government Stock vary between 8.37% for stock with 2 months to maturity to 11.30% for stock with 5 years to maturity.

Table 4.2.1. Yields on Government Stock

iod to maturity rs	1	2	3	4	5	6	7	8	9	10
e (%p.a)	9,7	10,1	10,5	10,9	11,3	11,6	11,9	12,2	12,5	12,7

rce: Reserve Bank of Zimbabwe

4.2.2. Secondary Mortgage Market The issue of NCDs by Building Societies would increase the level of their liabilities. An alternative form of raising additional finance would be for the Building Societies

to onsell a portion of their assets (mortgages) to medium to long term investors. This involves the creation of a secondary mortgage market. A secondary mortgage market does not exist in Zimbabwe. The closest Zimbabwe comes to this form of finance is the trading of shares in a fund of industrial mortgages managed by Von Seidel Grindlays Trust. Secondary mortgage markets constitute an important instrument for raising housing finance in many developed countries. Given that Zimbabwe already has in place the infrastructure of a relatively sophisticated money market, the potential for developing a secondary mortgage market would appear to be strong.

4.2.3. Tax Free Shares The present system for attracting resources into Building Societies which benefits low income housing, is the 9% tax free Class C paid-up permanent shares (PUPS). Deposit levels are limited to Z$75 000 for individuals and Z$35 000 for companies. These ceilings on individual and company participation in PUPS obviously restricts the amount of finance that can be mobilised. Additional finance could therefore be attracted into these shares by raising the ceiling levels.

4.2.4. Specialised Building Society Paper to Attract Surplus Funds As indicated in 3.3.2, retained earnings of locally incorporated foreign owned companies commonly known as surplus funds, is an area of excess liquidity in the Zimbabwe economy. Returns on surplus funds are currently restricted to 5% and 7% per annum when invested in finance institutions and RBZ respectively. In addition there is a ceiling (Z$50 000) on investments in Building Societies. There is potential therefore to develop an instrument which would improve returns for surplus fund deposits with Building Societies. Alternatively the ceilings on surplus fund deposits could be raised.

4.2.5. Unit Trusts Unit Trusts with investments in property already exist in Zimbabwe. As the name of the instrument implies, the Unit Trust pools financial resources from various sources for reinvestment in specific projects or securities. The concept of Unit Trust investments in property could be extended to provide for Unit Trust investments in mortgages.

4.2.6. Switched Blocked Funds The current level of blocked funds is estimated at over Z$700 million. If an acceptable instrument can be devised for their investment in low income housing, they could constitute a large additional source of finance for the Building Societies.

4.2.7. Prescribed Investments Life assurance companies and pension funds are currently required to hold 60% of total assets in prescribed assets, while the

requirement is 30% for non-life insurance companies.

Investments in low income housing via Building Societies, do not currently constitute a prescribed investment. A method of raising additional finance would be to include investments in Building Societies as prescribed securities.

4.2.8. Raising the 60% and 30% Prescribed Asset Requirements A modification to 4.2.7. above would be to raise the 60% prescribed asset level and include investments in Building Societies in the definition of prescribed assets.

4.2.9. Preference Shares Preference share dividends are not taxable in the hands of the investor. Issues of preference shares by Building Societies could therefore prove to be an attractive instrument for raising additional finance.

4.2.10. Extending Building Societies' Ordinary Share Capital Base As detailed in 2.3.1 Building Societies have three classes of Permanent Shares. Class A of the Permanent Shares includes the ordinary share capital of the Building Societies. A classical form of raising additional finance is to undertake a rights issue and so expand the ordinary share capital base. The appropriateness or not of a Building Society rights issue is therefore an instrument to be explored in raising additional finance.

4.3. Suitability of the Financial Instruments

The purpose of this section is to examine the suitability of the instruments described in 4.2 in raising additional finance for low income housing. The appropriateness or suitability of the instruments is measured against the six following criteria:

(i) Applicability to Building Society needs.
(ii) Ability to attract investor finance.
(iii) Responsiveness to changes in demand.
(iv) Strengths (weaknesses) as long term instruments.
(v) Potential for raising additional sources of finance.
(vi) Effects on other sectors of the economy and the economy as a whole.

4.3.1. Negotiable Certificates of Deposit (NCDs) For the issue of NCDs to be successful the term and the rate of return on the certificates have to be acceptable to both the investors and the Building Societies. Initial examination of this option identified a potential problem.

It was proposed that NCDs would have to be long term to cover mortgages of up to 25 years for low income housing. In order to attract investors to purchase

the NCDs the rates of return on the NCDs would have to be competitive with yields on Government Stock with similar periods to maturity. 25 year Government Stock is currently attracting a 14.2% yield. Rates of return above 14,2% would raise Building Societies' overall cost of money to levels that would not support their portfolio of mortgages, with returns ranging from 11.5 to 14.75%.

Interviews with the three Building Societies indicated that the term of the NCD would not have to mirror the terms of new low income mortgages. Terms on the NCDs could vary between 1 and 5 years. In this range the longer term, 3 to 5 years NCDs would probably prove more attractive to the Building Societies. Raising 1 year money, however, was feasible with a well managed deposit and share portfolio.

Discussions with the finance institutions indicated a strong demand for 1 to 2 year NCDs. Interest in NCDs for periods longer than 3 years, would depend on the issue rate of the NCD being a floating rate. Currently NCDs are issued at a negotiated rate of return which is fixed for the life of the NCD. The NCDs are then traded at a discount in the money market. There is however concern amongst investors that if structural adjustment policies were to be implemented in Zimbabwe, interest rates would increase and the investor would be left holding a NCD with a face value of return well below prevailing market rates. This problem could only be overcome by allowing the issue rate of the NCD to float, and thus reflect changes in economic circumstances.

The finance institutions indicated that returns on NCDs should match yields on Government stock. Yields on Government stock currently vary between 9.7% and 11.3% for periods of 1 to 5 years of maturity. The reported view of the Building Societies was that this cost of money could be absorbed into their existing cost of money profile. (Cost of money currently varies between 7.75% and 11.25%). Problems would be encountered on 3 to 5 year NCDs however, if the investors insisted on a floating issue rate. Building Societies would be reluctant to issue NCDs at a floating rate whilst their mortgage rates were fixed.

The institutions emphasised that the attractiveness of Building Societies NCDs would be heightened if they were designated a prescribed asset within the present limits. Designating the NCDs as a prescribed asset would however reduce the level of finance available to Government, and could be construed as a diversion of resources away from other high priority areas of the economy.

With regard to the cost of money, the Building

Societies pointed out that their ability to absorb deposits at higher costs, also depended on their level of computerisation. The more they computerised the lower the margins they could accept.

The NCD is an attractive instrument when measured against the criteria of responsiveness to changes in demand, and strengths as a long term instrument. NCDs would only be issued by the Building Societies as and when they required additional finance. As established above the cost of NCD finance is relatively expensive compared to other sources of money. It is therefore unlikely that Building Societies will wish to raise this form of finance unless it is based on proven demand. Finally the NCD as a financial instrument has a long and successful record in Zimbabwe as a method of mobilising resources for commercial and merchant banks and finance institutions.

4.3.2. Secondary Mortgage Market As with NCDs, terms and rates of return on mortgages sold in a secondary mortgage market would have to be acceptable to both the potential investors and the Building Societies.

Building Societies reported that they could package mortgages to 5 years maturity for sale on the secondary market. Packaging mortgages with shorter maturity periods would prove administratively difficult. In any event the development of a secondary mortgage market would require the development of new financial expertise in both the Building Societies and the money market.

The Building Societies' inability, in the short term, to package mortgages for periods of less than 5 years coupled with the financial institutions' preference for short term instruments, mitigates against the establishment of a successful secondary mortgage market. The problem could be overcome if the rate of return on the issue of a 5 year mortgage package was allowed to float. It is unlikely, however, that the Building Societies would accept a 5 year floating rate if mortgage rates were fixed. Development of a viable secondary mortgage market thus rests upon the general liberalisation of Government's policy towards interest rates.

In addition there are some statutory considerations which would inhibit the development of a secondary mortgage market. Sale of mortgages represents a sale of assets. It is envisaged that the mortgages would be sold in the form of packaged bonds. These bonds would be subject to stamp duty, every time they were traded, which would limit their marketability. If a successful secondary market was to be established the authorities would have to exempt mortgage bonds from

payment of stamp duties.

In pursuing the concept of the secondary mortgage it is also important to ascertain what form of security the finance institutions or the investors would be seeking to obtain from the secondary mortgage market. In the first place the finance institutions stressed that the mortgages would have to be packaged and backed by the Building Societies. The finance institutions were not in the housing business and would not wish to deal with individual holders of mortgage bonds. On closer enquiry the required security of the potential investor was the Building Societies themselves and not the asset represented by the mortgage bonds. The prevailing view was that investment in paper backed by the Building Societies, was preferable to investment in paper backed by mortgages.

Finally, there are a number of administrative constraints associated with the development of a secondary mortgage market. On the one hand Building Societies would have to develop new management structures and skills to package and control the sale mortgages. On the other hand money market infrastructure would have to be formed to handle a new financial instrument. Neither of these systems could be in place overnight, and it is believed by both the Building Societies and the money market that a simpler instrument in the market might prove to be an important precursor to developing a fully fledged secondary market.

The major positive aspect of developing a secondary mortgage market is that the market would be highly responsive to demand. Mortgages would be packaged and sold by the Building Societies only when demand dictated an additional finance requirement. Once established the market would be able to meet the Building Societies additional finance requirements in an efficient market orientated manner.

Given present trends in liquidity, a secondary mortgage market could be expected to attract sizeable levels of finance. Finally, unless the marketed bonds constituted a prescribed asset, they would not present a diversion of funds away from other priority areas.

The concept of a secondary mortgage market is therefore appealing but its viability given prevailing economic conditions is to be questioned.

4.3.3. Tax Free Shares Raising the ceilings of Z$35 000 and $75 000 for companies and individuals respectively on tax free PUPS would be very attractive both to Building Societies and potential investors. The instrument is reported to have worked well since its

inception at the end of 1986. Currently the Building Societies estimate that they are attracting between Z$7 and 9 million a month through this mechanism. The major source of growth for tax free PUPS is the individual investor. The instrument is less exciting to the institutional investor. Pension funds with no tax liabilities do not benefit from the shares' tax free status. The ceiling on investments at Z$35 000 for companies is not attractive either to insurance companies or their counterparts in industry and commerce. The level of the ceiling would therefore have to be significantly increased if it was to have any effect on investment levels from these organisations.

Two negative aspects are associated with the raising of ceilings on tax free PUPS.

Firstly there is a perception that the current 9% tax free PUPS are diverting resources away from the Post Office Savings Bank (POSB). The POSB is a major source of finance for Government. Growth rates of POSB deposits 1984 to 1988 do give some support to this perception (See Table 4.3.3.)

Table 4.3.3.
Growth Rates in the POSB Deposits

End Of	(Z$ million) Total Deposits	% Growth Rate
1980	248,5	
1981	295,6	18,9%
1982	367,1	24,2%
1983	417,5	13,7%
1984	573,7	37,4%
1985	755,0	31,6%
1986	941,1	24,6%
1987	1 094,7	16,3%
1988	1 246,2*	13,0%

* Provisional

Source: Reserve Bank of Zimbabwe

Growth rates in POSB deposits did decline in 1987 and 1988 following the introduction of Building Society tax free PUPS in 1986. Growth rates were however declining prior to 1987 following a strong upward trend in 1984.

Secondly supply of these finances will tend to be inelastic and bear no relation to demand for low income housing or housing in general. In other words this instrument could create financial surpluses in Building Societies, which could be construed by Government as an inefficient allocation of resources.

Arising from the problem of lack of responsiveness to

demand, are the long term weaknesses of the instrument. On the one hand ceilings might constantly have to be adjusted to keep pace with changes in demand, or on the other hand the PUPS themselves may become less attractive as the economy develops, following a more market orientated approach, and the adjustment of interest rates.

To summarise, raising the ceilings on tax free PUPS could be a useful tool in mobilising additional finance in the short term. The instrument does, however, have long term weaknesses and could prove unacceptable to Government in that would divert resources from investment in the POSB.

4.3.4. Specialised Building Society Paper to Attract Surplus Funds

There are two options for mobilising surplus funds for investment in low income housing.

The first is to raise the Z$50 000 deposit ceiling. This has the advantage that it would raise additional finance for Building Societies without diverting resources away from the POSB. Surplus fund investors are not major depositors with the POSB. The major disadvantages of this approach are the same as those outlined for raising ceilings on tax free PUPS in 4.3.3. That is, an instrument is being created which has long term weaknesses and is not responsive to changes in demand for low income housing. In addition surplus fund money is considered to be "hot money" by the Building Societies, as it is on call and can be withdrawn at any time.

Surplus funds would have to be tied up in 1 to 5 year deposits to make them more attractive to the Building Societies. Surplus fund investors in their turn would require returns of above 5% in order to commit their funds for periods of between 1 to 5 years.

An alternative instrument therefore is to allow surplus funds returns of 7% to 9% if they are invested in Building Societies for periods ranging from 1 to 5 years. Interviews with holders of surplus funds produced a mixed response to this form of investment. As a general rule, surplus fund holders prefer to reinvest their funds on call for recurrent and project requirements. Some of the companies interviewed did, however, have hard core surplus funds which they would consider reinvesting in 1 year Building Society deposits at 7+%. The returns would have to be competitive with RBZ's Non-Negotiable Certificates of Deposit (NNCDs). Investments longer than 1 year were less attractive and remuneration would have to increase substantially over time (10 to 11% for 5 years) to mobilise these resources.

The general view, however, was that increasing returns to surplus fund holders would meet with some resistance from Government, in that dividend remittances from foreign held companies would increase. The only way of overcoming this concern would be to link surplus fund deposits with investment in low income housing. In this way Government would be assured that surplus funds were being productively utilised in an investment of low import requirement and with a relatively high multiplier effect. Surplus funds reinvested in manufacturing projects generally have a direct foreign exchange requirement of approximately 36%. Surplus funds reinvested in low income housing would therefore have less pressures on the balance of payments and consequently less inflationary effects.

The major negative effect of creating special 1 to 5 year surplus fund deposits with Building Societies is that these deposits would not be responsive to changes in demand for low income housing. The instrument therefore has long term weaknesses.

To summarise, surplus funds are an attractive form of raising additional finance for low income housing without diverting resources away from Government. Holders of surplus funds would however be reluctant to tie them up for long periods and any new instrument created would have inherent long term weaknesses.

4.3.5. Unit Trusts A unit trust investment in mortgages is an idea currently being pursued by some of the pension funds.

The concept is that a number of pension funds would pool their resources for reinvestment in low income housing mortgages. The unit trust would use existing infrastructure, that is the Building Societies to administer the mortgages, but would invest directly in the mortgages. The mortgages would constitute the security of the Unit Trust.

The protagonists of this approach indicate that they could commit a small but significant proportion of their investment portfolio to a unit trust for returns which would be below those prevailing on the market. (12% for 15 to 25 year money). In effect it is proposed that low income housing be directly subsidised (it is currently being indirectly subsidised by Building Societies), for social reasons which would have long term positive indirect effects on the pension funds and other financial institutions. This constitutes the major advantage of the Unit Trust instrument.

The major problem arises in attracting investors,

given that their return will be relatively low. Most of the finance institutions interviewed indicated that they were not prepared to commit their pension fund holders' resources to investments with below market returns. Returns would have to compete with yields on Government stock. (14.2% for 25 years to maturity). The unit trust without access to alternative deposits, as is the case with Building Societies, would immediately run into the problem of interest rate differentials. The problem is compounded in that Unit Trusts classically invest in a security with expected capital appreciation. This is the major attraction of Unit Trust investments in property. (Property is estimated to be appreciating at a rate of 2% a month in Zimbabwe). Mortgages do not appreciate over time. It could not be argued therefore, that in accepting lower than market rates of return the Unit Trust is being more than compensated by holding a security with high levels of capital appreciation.

To summarise, the concept of a Unit Trust investment in mortgages is in response to high demand for low income housing. Given fixed mortgage rates, for a Unit Trust of this nature to be feasible, the rate of return on investment would have to be below prevailing market rates. It is unlikely that institutional investors would be attracted to this form of investment, unless it is their policy to commit a certain portion of their investment portfolio to projects of a 'social nature'.

4.3.6. Switched Blocked Funds Ideally USAID would like to see at least the Z$ equivalent of its US$50 million invested in low income housing over the 5 year period of its second HG programme. At today's exchange rate this constitutes Z$114 million or Z$23 million a year. Blocked funds can currently be purchased at approximately 40% of their face value. The proposal for the utilisation of switched blocked funds is as follows:-

(i) 40% of US$50 million made available to GOZ on the HG programme would be utilised to purchase Z$114 million over a five year period.

(ii) GOZ would onlend these resources at say 8% to the Building Societies for reinvestment in mortgage loans for low income housing.

The major advantage of the system is that it overcomes the problem of interest rate differentials. Buildings Societies are able to access relatively cheap resources and continue to provide mortgages for low income housing without increasing the existing 11.5% and 12.5% mortgage rates. GOZ, the investor, is at the same time earning an effective 20% return on its investment, (the funds being bought at a discount of

60%) whilst the country extinguishes a substantial long term liability.

Major disadvantages of developing this instrument are:

(a) a scarce foreign currency resource is being utilised to purchase Z$'s. GOZ may consider this resource more efficiently utilised in overcoming foreign currency constraints in the construction industry. (US$ 30 million would still be available to the construction industry under this scheme).

(b) utilising aid monies for the purchase of discounted Z$'s may set an unwanted precedent and strengthen the development of a dual exchange rate.

In addition the switched blocked fund instrument could be criticised as not being responsive to changes in demand for low income housing. This problem could be overcome by GOZ only onlending to the Building Societies as and when demand arose. The blocked funds are, however, seen as a finite resource. The instrument therefore has long term weaknesses

To summarise, blocked funds represent a viable source of additional finance to the Building Societies whilst giving a very attractive return on investment to the investor. Availability of this form of finance could be controlled to meet demand for low income housing. The instrument does however have long term weaknesses, and does restrict the availability of scarce foreign resources for alternative uses.

4.3.7. Prescribed Investments Designating investments in Building Societies prescribed investments, would prove very attractive to institutional investors. These investments could be effected through existing instruments and/or any of the new instruments described in 4.2. Institutional investors believe that substantial additional finance could be raised in this manner, and it would give them a welcome alternative option for investment within their 60% prescribed portfolio.

For this to be attractive to GOZ, however, a link between the resources invested and funds available for low income housing would almost certainly have to be established. The general view in the money market was that GOZ would be very reluctant to prescribe Building Society investments as this would constitute a loss of resources with which to finance public spending.

The prescribed investment approach could be established as a long term instrument. Similar to the tax free ceiling option, supply of financial resources would not be responsive to changes in demand, unless GOZ constantly reviewed and revised its prescribed

status, dependant on demand for low income housing. This mechanism of operation would be cumbersome and unsatisfactory to the Building Societies, who would wish, as much as possible, to manage their own resources. As with the tax free PUPS approach this constitutes a major weakness in the instrument.

To summarise, investments in Building Societies designated prescribed investments would prove very attractive to institutional investors. It is unlikely however to be supported by GOZ as it would reduce the availability of resources to finance public spending.

4.3.8. Raising the 60% and 30% Prescribed Asset Requirements
Raising the prescribed asset requirements and including Building Society investments as a prescribed asset, is based on reports that institutions are currently investing in prescribed assets at above the prescribed levels. Consequently, as these institutions are so liquid the prescribed asset requirement could be increased to the benefit of investment in low income housing.

This alternative has substantial long term weaknesses. Present high levels of liquidity can be rapidly mopped up in the short term as a result of numerous economic influences, drought, decline in exports, trade liberalisation, devaluation and so on. This option increases controls on the economy which runs contrary to Governments stated liberalisation policy. In addition it does not encourage the institutions or the Building Societies to manage their funds in an optimal fashion, sensitive to changes in demand for low income housing. Management of resources is effectively centralised on Government.

4.3.9. Preference Shares Preference share dividends in the hands of the investor are not taxable. Preference share investments are therefore attractive to investors with high effective tax levels. As pension funds are not taxable, this instrument is not attractive to them. The effective tax rate in life insurance companies is estimated at 27% due to the nature of the tax calculation. Non-life insurance companies are subject to the standard 50% company tax rate.

The preference share instrument's primary attraction would therefore be to the non-life insurance and traditional company investor. There may be some attraction for life insurances but this would not be substantial.

The major advantage of this instrument is that investors could be attracted at relatively low returns, 6% for 1 year. This in turn would provide a source of finance for Building Societies which would

not require any readjustment in their mortgage rates.

The legal aspects of issuing preference shares and how they relate to the other three classes of shares presently on issue by Building Societies, would, however, have to be investigated further.

Problems in this approach are that the Building Societies may be confronted by investor resistance once the preference term went beyond 3 years. As is the case with NCDs and the secondary mortgage market the investor in preference shares is still looking short term. Secondly GOZ may be concerned that Building Societies may be able to draw on additional relatively inexpensive resources, which because of supply constraints would not be channelled into low income housing, but diverted to high income housing,whilst earning the Building Societies higher margins. The latter problem could be obviated by linking preference share resources to reinvestment in low income housing.

To summarise, preference share issues could be an effective instrument, acceptable to both non-life insurance company and traditional company investors on the one hand and the Building Societies on the other hand. By linking preference share issues to reinvestment in low income housing, Building Societies would be restricted to issuing preference shares once demand arose. In this way a long term and relatively efficient instrument could be developed.

4.3.10. Extending Building Societies' Ordinary Share Capital Base All the Building Societies indicated that extending the Class A share base through a rights issue or placing new shares was not a viable option. Class A shareholders had numerous other options for placing their resources in Building Societies, such as Class B and C shares, Deposits and Savings, which they would follow in preference to increasing their Class A shareholding.

Preferred Methods for Raising Additional Finance

5.1. The Preferred Option

The most acceptable instrument to emerge from Section 4.3 is the NCD.

Acceptable rates of return (9.7% to 11.3%) can be offered to potential investors for NCDs with period of 1 to 3 years. The Building Societies indicate that they would be able to absorb this cost of money without any readjustment to the level of their mortgage rates. The NCD by its nature is responsive to changes in demand for finance. The Building Society would only issue an NCD as and when the demand for mortgages exceeded traditional sources of supply of finance. It must be emphasised here that the NCD would simply provide the Building Society with another option for raising additional finance.

The tax free share ceiling, prescribed asset, surplus fund and blocked fund instruments described in 4.3 above all have shortcomings in the longer term. There are set limits to the resources that can be mobilised and the level of deposits with buildings societies will not be a function of demand for housing mortgages. The objective of introducing an instrument which will efficiently allow supply and demand for low income housing to come into equilibrium will not, therefore, be fulfilled. In contrast the NCD does provide a mechanism to equate demand and supply.

Difficulties are envisaged in marrying returns to the investor with prevailing mortgage rates for low income housing in the Secondary Mortgage Market and Unit Trust approaches. In addition the Secondary Mortgage Market has a number of statutory and administrative difficulties that would have to be overcome if an efficient market was to develop. Hurdles, whether they be attracting the investor or overcoming administrative and statutory requirements appear to be less daunting in the NCD approach.

The NCD instrument does however have two major problems.

Firstly, finance raised by the issue of existing NCDs is not directly linked to a specific form of financing offered by the banks and finance houses. The resources generated can be utilised to finance the general operations of these institutions. In allowing the Building Societies to issue NCDs the authorities may be concerned that the Building Societies will have access to an alternative form of finance, whilst the objective of introducing the instrument, namely providing more mortgage finance for low income housing, is not <u>necessarily</u> being achieved. This problem maybe overcome by specifying that the Building Societies will only be qualified to issue NCDs if x% of the value of the issue can be reinvested in low income mortgages. The level at which x is set will depend on:

(i) Building Societies' average cost of money
(ii) Building Societies' cash flow management, incorporating NCDs as a financial resource
(iii) Building Societies forecast mortgage profile.

In addition to the qualification requirement a limit on NCD borrowing will have to be prescribed to protect Building Society shareholders and depositors. In general discussions with the Building Societies, a limit set at 20% of total assets has been suggested.

Turning to the second major problem. It has been established that to attract investors to purchase building society NCDs with terms of 3 to 5 years, the issue rate of the NCD will have to float.

If the NCD rate is to float, mortgage rates would also have to be flexible to reflect changes in the economic environment. Implementation of the above depends on major revisions in Government's policy on capital markets, which, it is understood, they are currently considering in the context of their overall liberalisation policy.

Suffice it to say, that movement to a more flexible system of determining interest rates is to be recommended. This in the long term would provide an efficient mechanism for raising housing finance on the money market. However in the immediate term the above should not prevent the issue of NCDs for terms of 1 to 3 years at fixed rates.

Finally, the new financial instrument to be issued by Building Societies should be given a name. It is proposed that the instrument be called a **Negotiable Housing Certificate of Deposit (NHCD).**

5.2. Secondary Instruments

Given that our preferred option is the NHCD, secondary instruments could also be pursued to mobilise low income housing finance. These instruments are summarised in order of preference as follows:-

(i) Preference Shares. The issue of preference shares by Building Societies is attractive because:-
- they would attract investors at relatively low returns which would not require any readjustment in mortgage rates
- they would provide Building Societies with a long term instrument responsive to changes in demand for low income housing.

Only a limited number of investors, mainly non-life insurance companies and companies in industry and commerce would, however, be attracted to preference share issues. Further, the legal aspects of Building Societies issuing preference shares with regard to how they would relate to the present 'preference taxed and

tax free paid up permanent shares' would also have to be researched.

(ii) Surplus Funds. Surplus Funds are attractive in that:

- they could attract investors at relatively low returns which would not require any readjustment in mortgage rates
- they would not divert resources away from the POSB.

Holders of surplus funds would, however, be reluctant to tie up these fund for long periods (more than 1 year). In addition the surplus fund instrument would not be responsive to changes in demand for mortgages and has weaknesses as a long term financial instrument.

(iii) Switched Blocked Funds. Blocked funds prove attractive because:-

- their investment in Building Societies would not require any readjustment in mortgage rates and at the same time, the investor, in this case Government, would earn an attractive effective rate of return
- they would mobilise additional sources of finance while concurrently extinguishing a substantial long term liability of the country.

Utilising US$'s to purchase blocked funds will, however, restrict the availability of scarce foreign resources for alternative uses. Finally this method of raising additional finance cannot be viewed as a long term instrument as there are limited blocked fund resources.

(iv) Unit Trust. The attractiveness of unit trusts is based on the willingness of some pension fund mangers to invest a certain percentage of their portfolio for 'social reasons' in low income mortgages. The unit trust could become a long term instrument highly responsive to demand. It's success would depend on the attitudes of individual pension funds.

5.3. <u>Discussion and Implementation</u>

The proposed stages of discussion and implementation of the study's findings are as follows:-

Stage I Round-table discussions with Government, Building Societies, Money Market and Financial Institutions.

Stage II If as a result of Stage I discussions, the study's preferred option is endorsed, implementation requirements will then be detailed.

The implementation requirements foreseen at this stage are as follows:-

(i) Legislation The necessary legal steps to permit the Issue of NHCDs by Building Societies will need to be identified. The NHCD borrowing limit of Building Societies will be specified here.

(ii) Money Market Money market requirements for the issue of new paper will have to be ascertained.

(iii) Link with Low Income Housing Finally the prescribed qualification criteria for the issue of NHCDS' will have to be defined. As indicated in Section 5.1 qualification requirements will depend on the average cost of money, cash flow management and the mortgage profile of the Building Societies.

APPENDIX 1

BUILDING SOCIETIES: ASSETS

Z$ million

	Liquid assets									Loans and advances				
				Bills										
End of	Notes and coin	Balances with banks	Call money with discount houses	Treasury	Trade	Agricultural Marketing Authority	Central Government and municipal stock(1)	Other	Total	Mortgage	Other	Total	Other	Total
1980	3.3	5.6	5.1	4.7	2.4	-	119.4	2	142.5	359.2	63.5	422.7	31.1	596.3
1981	3.8	8.5	6.7	1.5	24.4	-	84.5	1.7	131.1	371.6	65.8	437.4	37.3	605.8
1982	3.1	16.5	5.2	0.1	53.4	-	85.3	1.9	165.5	375.9	68.4	444.3	33.6	643.4
1983	4.8	8.3	8.7	-	38.1	-	80.3	2.5	142.7	407.8	66.4	474.2	35.1	652
1984	4.4	2.7	5.2	0.2	38.7	-	56.2	3	110.4	431.6	62.2	493.8	39.4	643.6
1985	4.7	2.7	21.2	-	50.8	-	61.7	2.3	143.4	456.8	59.5	516.3	40.8	700.5
1986	5.6	5.4	5.2	-	66.6	-	84.2	5	172	502	57.2	559.2	47.5	778.7
1987	6.1	4.9	1.6	-	64.6	-	95.1	9.8	182.1	601.9	62.5	664.4	67.4	913.9
*1988	6.7	3.9	5.4	-	148	-	113	13.3	290.3	733.7	69.5	803.2	70.3	1163.8
*1989 March	7.2	0.3	4.7	-	120.4	-	114	19	265.8	779	72.6	851.6	102.4	1219.8
*1989 June	6.8	9.3	7.2	-	108.5	-	132	17.7	282.1	835.4	71.4	906.8	103.7	1292.6

1. Less than 6 years to maturity

Source: RBZ

* Provisional

BUILDING SOCIETIES: LIABILITIES **APPENDIX I**

Z$ million

End of	Deposits				Reserves	Other (1)	Total
	Savings	Fixed	Shares	Total			
1980	221.3	110	224.8	556.1	27.4	12.8	596.3
1981	232.3	68.1	258.6	559	29.5	17.3	605.8
1982	262.8	53.5	271.3	587.6	30.6	25.2	643.4
1983	262	43.7	285.7	591.4	35.2	25.4	652
1984	280.4	63.6	237.9	581.9	35.8	25.9	643.6
1985	313.6	87.9	224.5	626	42.9	31.6	700.5
1986	353.6	84.6	258.6	696.8	50.4	31.5	778.7
1987	396.4	37.9	376.2	810.5	60.1	43.3	913.9
*1988	511.4	10.5	518.2	1040.1	69.5	54.2	1163.8
*1989 March	508.1	12.3	573.7	1094.1	70.7	55	1219.8
*1989 June	518.3	13.7	637.8	1169.8	71.8	51	1292.6

Source: RBZ

(1) Includes loans, overdrafts and accrued interest.

* Provisional

ANALYSIS OF LIQUID ASSETS OF MONETARY BANKS AND OTHER FINANCIAL INSTITUTIONS

Z$ million

APPENDIX II

	Commercial banks			Accepting Houses			Finance Houses			Building Societie		
	Liquid assets held	Prescribed liquid assets(1)	Excess liquid assets	Liquid assets held	Prescribed liquid assets(2)	Excess liquid assets	Liquid assets held	Prescribed liquid assets(3)	Excess liquid assets	Liquid assets held	Prescribed liquid assets(4)	Exces liqui asset
	399.1	291.5	107.6	121.9	61.4	60.5	24.1	17.1	7	142.4	114.4	27
	452.7	381.5	71.2	98.3	57	41.3	41.9	32.8	9.1	131	114.1	16
	532.6	471.6	61.1	102.2	69.3	33	36.8	30.9	5.9	165.5	122.9	42
	511.6	409.3	102.3	89.3	61.4	27.9	43.9	34.6	9.3	142.7	122.6	20
	696.9	638.3	58.6	109.7	94	15.7	45	37.7	7.3	110.4	91.5	18.
	786.7	680.6	106.1	118	97.6	20.4	52.2	41.4	10.8	143.8	99.6	44.
	814.6	749.4	65.2	100.2	88.8	11.4	62.4	52.8	9.6	172.5	112.2	60.
	1027.5	906	121.5	125.3	107.8	22.5	88.2	65.6	22.6	182.8	132.8	[illegible]
8	1179.1	1111.9	67.2	172.2	160.2	12	88.6	82	6.6	291.1	174.3	116.
9 March	1219.3	1110.7	108.6	168.5	152.8	15.7	97.9	88.9	9	265.8	183.1	82.
9 June	1305.6	1172.1	133.5	168.1	151.3	16.8	105.5	97.6	7.9	282.9	195.4	87.

ce: RBZ

LIQUIDITY RATIOS OF MONETARY BANKS AND OTHER FINANCIAL INSTITUTIONS

	Commercial banks		Accepting Houses		Finance Houses		Building Societies	
of	Liabilities to the public Z$million	Liquid asset ratio %	Liabilities to the public Z$million	Liquid asset ratio %	Liabilities to the public Z$million	Liquid asset ratio %	Liabilities to the public Z$million	Liquid asset ratio %
	832.9	48	204.8	60	114	21	572.1	25
	1089.9	42	190	52	164.2	26	570.6	23
	1347.4	40	230.9	44	154.5	24	614.6	27
	1338.1	37	198	44	173.8	25	612.9	23
	1595.9	44	235	47	188.4	24	609.8	18
	1701.4	46	243.9	48	206.8	25	664.1	22
	1873.4	44	221.9	46	263.8	24	748.2	23
	2265.1	45	257	49	327.8	27	885.2	21
8	2776.6	42	404.4	43	421.2	22	1161.9	25
9 March	2811.5	44	364.4	44	459.2	22	1220.8	22
9 June	2909.6	45	392.5	44	509.5	22	1302.4	22

ce: Reserve Bank of Zimbabwe - Quarterly Economic and Statistical Review
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With effect from 21 June, 1984, commercial banks are required to hold liquid assets equal to 40% of their liabilities to the public as at the previous month end.
With effect from 21 June, 1984, accepting houses are required to hold liquid assets equal to 40% of their liabilities to the public as at previous month end.
Finance houses are required to hold liquid assets equal to 20% of their liabilities to the public as at the previous month end. Before April, 1981 this ratio was 15%
With effect from May, 1984, building societies are required to hold liquid assets equal to 15% of their liabilities specified in section 37(2) of the Building Societies Act (Chapter 189)

APPENDIX III

LIST OF PEOPLE/ORGANISATIONS CONTACTED

A. Public Sector

	Organisation	Contact
1.	Ministry of Finance Economic Planning and Development	Mr O M Tshabangu - Commissioner of Insurance and Registrar of Banks and Finance Institutions
2.	Ministry of Public Construction and National Housing	Mr P M Kodza - Director of Specialist Services
3.	Reserve Bank of Zimbabwe	Mr R V Wilde - Deputy Governor

B. PRIVATE SECTOR

	Organisation	Contact
1.	Anglo American Corporation Services Limited	Mr A B Wishart - Manager
2.	BARD Discount Company	Mr C Gurney - General Manager
3.	Beverley Building Society	Mr R J Key - General Manager Mr G Burmester - Ass General Manager
4.	Central African Building Society	Mr G D Hollick - Dep General Manager Mr A Matika - Secretary
5.	Coca Cola Export Corporation	Ms Kelly-Edwards
6.	Discount Company of Zimbabwe	Mr I Helby - Executive Director Mr N Mhlanga - Manager
7.	Fidelity Life Assurance of Zimbabwe (Pvt) Ltd	Mr Weeks - General Manager
8.	Founders Building Society	Mr K L Evans - General Manager Mr M Harrison - Ass General Manager
9.	Mining Industry Pension Fund	Mr S Nkomo - Chief Executive
10.	Old Mutual	Mr G Mellier Mr P Dangarembizi - Economist
11.	Rothmans of Pall Mall	Mr M Lynton-Edwards - Financial Manager
12.	Southampton Assurance	Mr V Muchatuta - Executive Director
13.	Union Carbide	Mr J H Fox - Financial Director