MAKING FINANCIAL MARKETS WORK FOR THE POOR

ACCESS TO HOUSING FINANCE IN AFRICA: EXPLORING THE ISSUES

ZAMBIA

Report of a scoping study commissioned by FinMark Trust

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with input from Kecia Rust

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BACKGROUND TO THE SERIES

Since 2002, the FinMark Trust has been pursuing its mission 'to make financial markets work for the poor' in the Southern African Customs Union (SACU) countries: South Africa, Botswana, Namibia, Lesotho and Swaziland (BNLS). Based in Johannesburg, the FinMark Trust is an independent trust provided with core funding by the South African office of the UK Department for International Development (DFID).[1] Last September, FinMark Trust received a three year extension to its mandate, to continue with its work in SA but also to broaden its operations and services into the rest of Africa.

FinMark Trust's goal is still focused: To support systemic change in the way Africa's financial markets operate so that they work more effectively for the poor, whether consumers or producers.

As a first step, FinMark Trust has already promoted the application of FinScope™, its survey of individual usage of financial services, in nine African countries.[2] FinScope™ will provide baseline data to stimulate policy change and support innovation by commercial providers seeking to deliver products and services sustainably to consumers who are currently outside the formal financial system. FinMark Trust will build on the impact of FinScope™ by promoting and supporting change processes across the continent.[3]

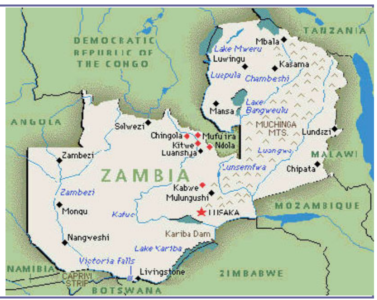
For FinMark Trust's housing finance theme[4], understanding the nature of an 'access to housing finance' question on the wider African continent, and targeting what areas of enquiry are relevant in an African context, has been challenging. Certainly, there are many local and international players already operating throughout Africa. What role can the FinMark Trust play in this environment?

This report is the first of a series of studies which will explore access to housing finance in various African countries. It is meant as an input into a larger debate about how to enhance access to housing poor by low and moderate income earners throughout Africa. Comments and contributions can be sent to the FinMark Trust's Housing Finance Theme Champion, Kecia Rust on Kecia@iafrica.com.

The FinMark Trust hopes that its research into access to housing finance in Africa will begin to shed some light on the key issues facing the poor as they seek to mobilise the finance necessary to access adequate and affordable housing.

Country Profile: Zambia[5]

- **Population:** 11 million (UN, 2005)
- **Capital:** Lusaka
- **Area:** 752,614 sq km (290,586 sq miles)
- **Major language:** English (official), Bemba, Lozi, Nyanja, Tonga
- **Major religions:** Christianity, indigenous beliefs, Hinduism, Islam
- **Life expectancy:** 38 years (men), 37 years (women) (UN)
- **Monetary unit:** 1 Kwacha = 100 ngwee
- **Main exports:** Copper, minerals, tobacco
- **GNI per capita:** US $450 (World Bank, 2005)



[1] For more information, visit www.finmark.org.za. Also visit the FinScope™ website: www.finscope.co.za and the Financial Diaries website: www.financialdiaries.com.

[2] FinScope™ is a nationally representative study of consumers' perceptions on financial services and issues, which creates insight to how consumers source their income and manage their financial lives. The sample covers the entire adult population, rich and poor, urban and rural, in order to create a segmentation, or continuum, of the entire market and to lend perspective to the various market segments. FinScope™ explores consumers' usage of informal as well as formal products and builds a picture of the role that the informal sector can play in the financial markets of developing countries. Since FinScope™ is a perceptual study, it also encompasses attitudes, behaviours, quality of life factors and consumption patterns. See www.finscope.co.za

[3] By 2012 it is intended that some 20 countries in Africa will have the survey. Repeat studies will take place on 2-3 year cycles, enabling trends within countries to be monitored and providing the basis for cross-country comparison especially around access to finance. FinScope™ data will provide financial service providers and regional integration initiatives with comparable, standard and reliable data about demand for financial services across borders. (FinScope™ Africa Brochure)

[4] To go to the housing finance theme page, go to www.finmark.org.za, click on "themes" and then click on "housing finance".

[5] From FinScope™ website.

Exploring housing finance in ZAMBIA

In late 2006, FinMark Trust commissioned consultant David Gardner to visit Zambia and update findings of a more extensive study into Zambia's housing finance sector that he had undertaken in 2004. His visit included meetings with key practitioners in the housing finance sector. Following closely on the heels of the launch of FinScope™ Zambia[6], the intent of this report is to provide a general overview of the housing finance sector in Zambia. To this end, this report is neither definitive nor exhaustive – but rather a basis for engaging in further discussion regarding the housing finance sector in Zambia. Comments, challenges and perspectives are welcome.

Comments should be directed to the FinMark Trust's Housing Finance Theme Champion, Kecia Rust, by email to Kecia@iafrica.com, or on +27-83-785-4964.

Brief overview of Zambia's macro economy

Since the advent of the new democratic dispensation in Zambia in 1991, there was a decade of slow but noticeable improvement in the country's economy. Over the last five years, Zambia has entered a period of more sustained economic growth, with improved (yet still not stable) economic fundamentals.

From a very poor base of a command economy, negative growth, very high inflation and effectively no capital market activity, the economy is now starting to show the benefits of the political, regulatory and financial reform process that has been undertaken over the last decade. Most recently, Zambia has just completed the fifth year of the Highly Indebted Poor Country (HIPC) Programme. It has been through this process that the country has made its greatest strides.

Whilst reform agendas are still being actively pursued, and there are still causes for concern in the structure, regulatory framework and economic activity, the last two years has seen a substantial change in investment sentiment from both within and outside Zambia's borders.

ZAMBIA (US$m, unless otherwise stated)	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**
Population (millions)	10.2	10.3	10.5	10.8	11.1	11.1	11.1
Nominal GDP at market prices (US $ m)	3,132	3,239	3,640	3,776	4,318	5,448	7,269
Real GDP growth rate, %	4.9	3.7	4.9	3.3	5.1	5.4	5.0
GDP per capita, USD	307.1	314.5	346.7	349.6	389.0	490.8	654.9
Private Consumption as % of GDP	81.4	87.4	87.1	86.8	81.1	63.8	68.7
Average exchange rate: ZMK to USD	2388	3111	3608	4307	4743	4772	4464
Inflation rate, %	20.6	30.1	18.8	26.7	17.2	17.5	15.9
Prime lending rate (average for year), %	40.3	39.1	45.8	45.3	40.5	30.9	28.2
Domestic credit to government (US$ m)	290.3	433.7	495.5	405.0	24.5	23.3	51.6
Domestic credit to private sector (US$ m)	292.1	363.2	339.5	218.8	255.9	260.0	472.4
Merchandise exports as % of GDP	24.1	23.0	24.3	24.3	24.6	32.6	29.7
Merchandise imports as % of GDP	27.8	30.2	34.4	31.9	32.3	31.7	29.7
Capital account of balance of payments (US$m)	153	153	222	236	240	239	2080
Foreign direct investment as % of GDP	5.2	3.8	2.0	8.0	8.0	6.7	6.6
Overall balance on balance of payments	-334	-418	-289	-331	-275	-343	70
Terms of Trade (percentage change)	-7.9	-4.3	-1.3	-7.3	4.4	21.4	5.5
Forex reserves: months of import cover	0.5	1.0	0.8	2.1	1.3	1.2	1.6
Total external debt as % of GDP	204.6	193.0	199.7	171.8	151.6	130.0	n.a.
Total external debt service as % of exports	14.7	15.7	13.1	10.9	14.6	18.3	6.7
Central bank discount rate (end of year), %	46.2	44.1	52.5	34.0	20.2	18.3	17.1
Growth rate of M2 money supply, %	28.8	77.9	13.1	29.3	23.5	25.8	1.2

Source: Bank of Zambia

[6] FinMark Trust engaged in an arrangement with the UK Department for International Development (DFID) and the Swedish International Development Agency (Sida) to support the Financial Sector Deepening Plan (FSDP) Secretariat's nationwide household survey on the use of, and demand for, financial services in Zambia. The survey design, instrument, sampling procedures, data structure and analysis was adapted from the successful FinScope™ survey. Field work was carried out in late 2005 and, following data capture and extensive analysis, the results were launched on 8 November 2006.

Key issues facing the Zambian economy include the following:

Economic Growth: The growth rate has been at a constant 5% for the past three years, and was projected to increase slightly during 2006 on the back of good agricultural yields. However, at these rates of growth it is still not sufficient to commence mopping up the large unemployed population.

Inflation: According to the Bank of Zambia, inflation dropped from over 30% in 2002 to 15.9% in 2005. This was projected to reduce further during 2006: the target was to manage inflation to less than 10%.

Exchange Rates: In general terms, the Kwacha has been strengthening against major currencies over the last two years. This is a reversal of the consistent devaluation over the period 1999 to 2004. However, while the trend seems to be downward, there have been some periods of substantial devaluation[7]. This continues to create uncertainty in the capital markets and continues to hamper efforts to mobilise external sources of financing in Zambia.

Interest / Lending Rates and Treasury Bill and Bond Yields: Prime lending rates reduced from very high levels (46% in 2001) to 28% in 2005. This has now reduced substantially over the last year. A quick review of the yield rates for T-bills and bonds over the last three years indicates the major strides being made in the economy:

Table: Lending Rates and TBill Yields

Indicator	2005 Avg	2006 Avg	Jan '07
Prime Lending Rate	28.2%	21.6%	21.0%
Commercial Bank Lending Rate	34.5%	27.9%	27.3%
T-Bill (91 day)	15.2%	9.5%	9.0%
T-Bill (364-day)	N/A	11.1%	11.0%
Bond (3 Year)	N/A	13.9%	12.2%
Bond (5-Year)	N/A	15.9%	13.6%

Brief overview of the regulatory framework for finance

Certain financial sector regulatory reforms have been undertaken over the last few years which have improved the regulatory framework for housing finance. Most notably, the establishment of Commercial Courts has created a streamlined procedure for dealing with Properties in Possession. Certain banks indicated that they have now had the opportunity to test these procedures, and are generally happy with their functioning.

Legal Framework for the Banking Sector: The Companies Act, the Bank of Zambia Act, and the Banking and Financial Services Act are the primary statutory instruments governing the banking sector. In addition, it is necessary for banks to comply with the provisions of the Securities Act.

Bank of Zambia (BoZ): The BoZ is the regulatory authority for both bank and non-bank financial institutions. BoZ undertakes a regulatory, prescription and enforcing role. BoZ has specific units managing the affairs of the Banking Sector and Non-Bank sector. More recently, the BoZ has been driving the process of implementing the Financial Sector Development Plan (FSDP), using some of its own resources along with financing provided by donor agencies.

Financial Sector Development Plan for Zambia: The FSDP was drafted in 2004, with the aim of providing a blueprint for financial sector reform over the period 2004 to 2009. The FSDP identifies six key weaknesses that require attention over the five-year period to assist to stabilise and grow Zambia's financial sector[8]:

[7] The Kwacha devalued from ZK3000 / US$; to ZK4000 / US$ over a six month period.

[8] Financial Sector Development Plan (2004), pi. In recognition of the strategic importance of financial sector development, the government of Zambia launched the Financial Sector Development Plan (FSDP). The FSDP represents a comprehensive strategy that has been formulated to address the current weaknesses in the Zambian financial system, and its limited role in the economy. FSDP aims to build a stable, sound and market-based financial system that would support efficient resource mobilisation necessary for economic diversification and sustainable growth. It will also serve as a coordinating framework for a number of parallel sub-sector strategies and efforts aimed at modernising and deepening the Zambian financial system.

1. Low levels of financial intermediation
2. A poor credit culture
3. Multiple and potentially conflicting roles of government in the financial sector
4. Weak regulatory framework for non-bank financial institutions, insurance and pension funds
5. The undeveloped capital market;
6. The lack of long-term development and housing finance; and
7. The limited number of monetary policy instruments.

It is clear that these deficiencies all have direct impact on housing financing. It is therefore critical that the FSDP process be supported in order that these key impediments are rectified, in order to facilitate the growth of the housing finance sector.

Employment, Household Incomes and Banking in Zambia

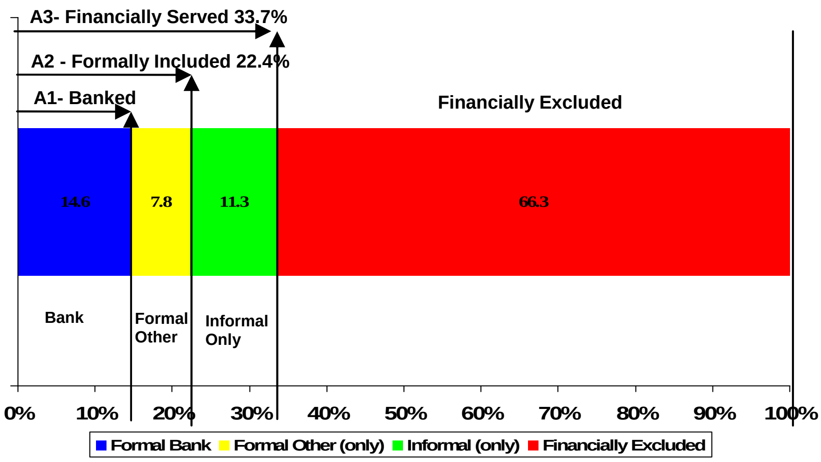
A minority of Zambians are employed in the formal sector. FinScope™ Zambia found that only 16% of the Zambian population was salaried while 24% earn no income at all. Thirty six percent of Zambians are self-employed in the informal sector, 11% housewives, and 12% students.

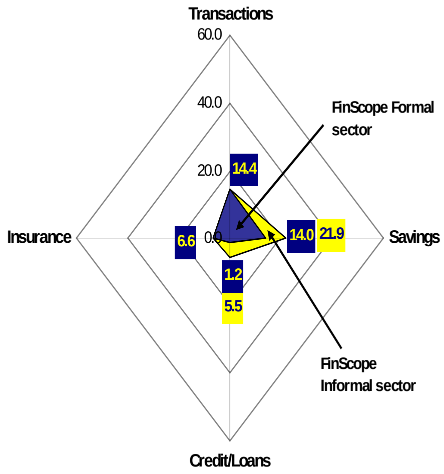
Table: Comparison between FinScope™ sample and the Zambia Census 2000

FinScope Sample	Zambia Census 2000
51% Male, 49% Female	Total Population: 50% Male, 50% Female 16+: 50.1% Male, 49.9% Female
41.8% 16-25 years, 73.4% 16-35 years	Total Population: 21.1% 16-25 yrs, 34.5% 16-35 yrs 16+: 40.4% 16-25 yrs, 65.9% 16-35 yrs
68% Rural, 32% Urban	Total Population: 65% Rural, 35% Urban 16+: 64% Rural, 36% Urban
16.8% owns the accommodation they live in; 28% lives in accommodation owned by household member	Total Population: 77.9% lives in accommodation owned by household member
74.4% uses coal/wood/charcoal	Total Population: 62.3% uses coal/wood/charcoal
36% self-employed in informal sector; 16% full-time salaried; 11% housewives, 11.7% students	Economically active population (12 years+): 39.7% self employed, 30.6% salaried, 16.1% housewives/home makers, 18.9% full time students
24% no income, 55.6% K300,000 or less	From 2004 Living Conditions Monitoring Survey: 24% earning on average K150,000 and K300,000, 7% less than K50,000
51% Married, 36% Single	
42% Head of Household	
44.5% main income earners	
10% no formal education, 29% some secondary education	
43% in traditional/low cost rural accommodation; only 2.7% in high cost urban accommodation	

From a housing finance perspective, few self-employed people earn sufficient to qualify for a home loan. This leaves the 16% of all Zambians that are formally employed (2.2-million) as the potential market for housing finance. However, of these, 40% are currently un-banked.

FinScope™ Zambia found that access to financial services among adult Zambians is extremely limited, with informal financial products and services playing a significant role. The following graphs below show the landscape of access to financial products and services overall (the multi-coloured access strand) and with respect to specific categories of financial services. Drawn from FinScope™ Zambia, they illustrate that 66.3% of the adult population in Zambia is financially excluded, while the access of a further 11.3% of the adult Zambian population is limited to informal products and services. Less than a quarter of the adult Zambian population has access to financial services. Among this population, the most activity is with respect to savings and transaction services. The use of credit (housing or other), whether formal or informal, is recorded by FinScope™ Zambia as being extremely low (5.5%).





FinScope™ Zambia obtained the following monthly income profile for Zambian households. The table, below, also considers the loan affordability of the various income groups, assuming a 20 year mortgage at 15% interest:

Table: Monthly Household Income Profile and Affordability

Monthly Income	US$ Equiv[9]	% pop.	Loan affordability @ 15% over 20 years[10]
No Answer / Don't Know	-	21%	-
No Income	-	24%	-
< K50 000	$13.12	5%	-
K50 000 – K150 000	$39.37	15%	Up to $835
K150 000 - K300 000	$78.74	11%	Up to $1671
K300 000 - K450 000	$118.11	6%	Up to $2506
K450 000 +	$118.11+	18%	Over $2506
TOTAL		**100%**	

Source: FinScope™ Zambia

The calculations in the table above indicate that housing affordability is very constrained. Even in the highest income category, housing affordability is still minimal compared to the costs of the limited number of housing products available on the market.

Housing demand & supply in Zambia

All interviewees mention a huge, untapped 'housing need' in Zambia. Effectively no new formal accommodation has been built for over a decade, and the rapidly urbanising population further adds to urban housing requirements. The National Housing Policy of 1996 estimated a housing shortage of 846 000 units, and common consensus is that this shortage has now grown to over a million units (at five people per household, roughly half the population).

Housing Need vs. Demand

It is important to consider the nature of this housing 'need'. Little effort has been put into defining a profile of demand in Zambia, whether according to current housing conditions, tenure preferences or income / affordability. In addition, there is little empirical work that has been done to identify the current housing strategies adopted by Zambian households. The following must therefore be borne in mind:

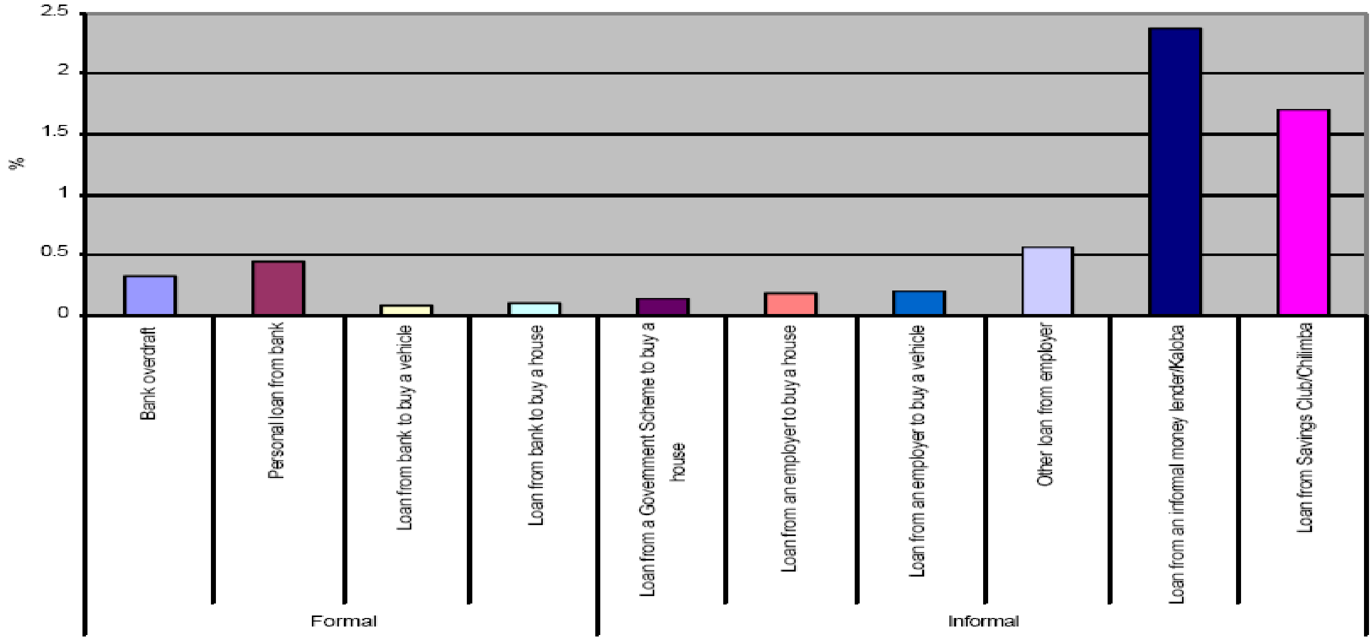
- Effective demand for housing (willingness and ability to purchase housing) exists, but is a fraction of the stated 'need'.
- Zambia has extremely low levels of formal employment, and only 60% of those formally employed are also banked. This suggests that eligibility or demand for mortgage credit is low. According to FinScope™ Zambia, only 0.4% of the population currently have a loan from a bank, government

[9] **US$1,00=K3810,10 on 20 May 2007**
[10] Calculated with http://www.mortgage-calc.com/mortgage/howmuchborrow.html

scheme or employer to buy a house (only 0.1% have a housing loan from a bank), and this includes all loans for housing, not just mortgages. A further 2.4% did at one time have a loan to buy a house.

- Formal incomes in Zambia are low. Therefore, even amongst the formally employed, only a proportion could mobilise sufficient income to effectively afford the cost of formally constructed housing. Even the 18% of the population that earns over K450 000 per month can only afford a mortgage of over US$2506, at 15% interest over 20 years.
- The vast proportion of the 'need' is from households with limited or no formal employment, very low incomes and no social security net from the state.

Table: loan use from formal and informal loan providers (note low percentages)



Housing Supply

There are very few housing developments of any reasonable scale offering suitable, affordable housing products being developed at present. Seemingly, a well-functioning housing supply sector is beset by a range of obstacles, and is still a way off. Major impediments to housing supply include (amongst others):

- Land titling and transfer problems. Primarily, this originates from a centralised, convoluted, and inaccurate land registry system;
- Very poor engineering service reticulation and bulk infrastructure installations (water, roads, sewer, electricity, solid waste removal)
- Resource-poor and ineffectual local governments with very limited capacity to administer services, and effectively no capital resources to extend or improve infrastructure networks
- A limited building materials supply industry that has not been required to support any significant development for decades[11].
- A limited local professional and artisan skills base; and
- A nascent and inexperienced housing finance sector hampered by the non-availability of long-term, reasonably priced capital for housing lending.

There is a common and growing sense amongst many people interviewed that scale development of new housing in Zambia (and most likely in many parts of Africa) will only result from large-scale,

[11] However, it must be said that a number of relatively large commercial developments have been undertaken, and the materials supply sector is actively expanding its capacity.

comprehensive neighbourhood or new town-type urban development initiatives. Such programmes would encompass all the requirements of a successful development (including land purchase, planning, subdivision, titling and transfer, bulk and internal infrastructure development, management and maintenance and housing construction). Committing any one of these vital components of a successful development to the vagaries of the currently responsible bodies (be they national, state or provincial government entities or specially formulated bodies)

The few, isolated pockets of housing development that are being undertaken happen in spite of almost insurmountable obstacles facing them. They are in essence all pilot projects of questionable replicability, mostly being developed due to the extraordinary commitments and financial backing from a multitude of players. Key developments currently underway include:

Lilayi, Lusaka	The Lilayi development in Lusaka is a 5 000-unit development that commences construction in January, 2007. To get to the point of turning earth on site has taken the extraordinary commitment of the key players over five years, 47 different legal agreements, a complex financing mechanism and the backing of a range of international players including DFID, USAID and others.
Mwena New Town	A new mine in Zambia requires the development of an entire town in the surrounding area to support its labour requirements. Numerous players, including the government, the mine owners, NAPSA (sources of capital), PABS (loan administration), and others are in discussions to determine a structure through which to develop and dispose of housing for employees.
Maheni (Quickbuild Construction, UK)	Maheni is a proposed development of between 1000 and 2000 houses. Land has been allocated to the developers, who aim to develop a type of prefabricated construction on the land. Status of the development is not known at present. FBS indicated they may be financing agents for the development.
National Housing Corporation	Once the major housing developer in Zambia, the NHC now undertakes limited new developments annually (involving a few hundred units maximum). These are also developed via a financing mechanism that is unlikely to be replicable, and which includes hidden subsidies. The projects are generally targeted at public sector employees.

Demand for Housing Finance

As noted above, demand for housing finance is extremely limited by the low levels of affordability and eligibility for bank credit. Until recently the demand for housing finance (at prevailing parameters) was effectively nullified. High inflation (and hence eroding real incomes), very high interest rates and the inability to secure financing at a term beyond a year were major constraints on the growth of housing finance. With the slowdown in inflation, improvement in exchange rates, drops in bank lending rates and increasing availability of longer-term financing, a more viable market for housing finance is now developing, integrally linked with the housing developments underway.

Krishnamurthy, CEO of Finance Bank also mentions the decrease in employer-sponsored housing schemes with below-market interest rates, due to the improvement in the prevailing lending conditions.

The demand for housing finance originates from three main sources:

- New Housing Purchase: The ability of Zambian households to identify and purchase new accommodation for purchase is constrained both by the limited availability of housing finance, as well as by the constrained housing supply sector. FinScope™ Zambia found that 3.2% of households accessing loans (formal and informal, housing specific or personal) used the credit to buy a home.
- Secondary Market Transactions: This is however limited by the lack of housing options, which constrains the ability of Zambian households to change their housing circumstances by selling existing accommodation and progressing up the ‘housing supply ladder’.
- Construction / Refinancing Requirements: Households that already own accommodation, but cannot obtain financing to improve their accommodation seek financing to release the equity in their

accommodation, as well as to improve their current housing conditions[12]. FinScope™ Zambia found that 7.3% of households accessing loans (housing loans or other, formal and informal) used the credit to renovate or extend their homes; and 0.9% used the credit to purchase land.

Zambia's Housing Finance Sector

Significant improvements in the sentiments of the banking sector towards housing finance have occurred over the last two years. In 2005, only one bank was considering entering the home loan market, two specialist building societies had limited (problematic) home loan portfolios and previous home loan portfolios of the state-owned banks were in disarray. Currently, three of the largest banks have actively commenced housing finance portfolios, two Building Societies are growing their lending portfolios and a number of other players are considering entering the home loan market.

The level of financial intermediation in Zambia is currently low, but growing. Up until recently, a major proportion of banks' earnings were via forex trading and returns on government securities. The decreasing returns on these instruments and the growing competition, along with increasing sources of capital, is now increasing the volume of intermediation substantially.

Key players in Zambia's housing finance sector

Zambia's housing finance sector includes development banks, pension & provident funds, commercial banks and building societies, micro finance institutions and the insurance industry. Most recently, a particular housing development has also seen the establishment of a Special Purpose Vehicle to facilitate the complex financing arrangements necessary. These sector players are explored briefly, below:

Development Banks

Numerous development banks with a presence on the African continent have recently extended activities to Zambia. This in itself illustrates the changed sentiment over the last few years. A number of development banks are entering into financing arrangements which include the capacitation of commercial banks for housing lending.

Development Bank of Zambia (DBZ)	DBZ has recently had a restructuring of its balance sheet through the removal of non-performing loans. It is recapitalising via equity investments from two new shareholders, Exim Bank (India), and the DBSA (10%). Sources of long-term credit remain its greatest challenge.
Development Bank of Southern Africa (DBSA)	The DBSA is taking an equity stake in the Development Bank of Zambia, and is also talking to other institutions about the prospects of engaging in the housing sector.
African Development Bank (ADB)	ADB is known to be interested in lending to housing finance institutions. No specific initiatives are known at present.
Shelter Afrique (SA)	Perhaps the most active of the development banks in the Zambian sphere, SA has already committed some facilities to housing players in Zambia.

Pension & Provident Funds

Pension and provident funds are a major potential source of capital in Zambia. Managing the combined retirement assets of around 550 000 Zambians, the capacity of public and private sector funds is estimated to be greater than ZK2,5-Trillion (US$ 600-million) [13], a large proportion of which must be invested within Zambia.

[12] It is noted here that few commercial banks currently offer Construction Loans. This is an area that could be targeted for development.
[13] The three major pension funds account for 530 000 members. According to Charles Mpundu, NAPSA has current reserves of ZK1,3-trillion, and this is probably similar to the capacity in the private funds.

It is true that large amounts of the funds' resources have not been paid over by government, but existing reserves are still significant. In addition, outside of the commercial banks, they are one of the only other players in the housing finance arena in Zambia, albeit at a very small scale. However, various factors constrain the access to these funds for housing lending.

- The Public Sector Pension Fund (PSPF) is the only pension fund legally able to provide mortgage finance in Zambia, and only to its members. PSPF has recently developed a proposal with Finance Building Society for FBS to make mortgages available to its members, based on a guaranteed repayment.
- Local Authorities Super-Annuation Fund (LASF) is a social security fund. LASF is allowed to provide limited volumes of mortgage finance to its members. Such mortgages are provided at below-market rates. However, insufficient capital in the LASF has constrained its ability to expand its housing lending.

Prospects for the release of a portion of such funds for housing lending are looking positive. This is improved by the need for fund administrators to optimise returns on contributions (a factor that was not considered important until recently), and the stringent offshore investment criteria. One impediment is the taxation regime that applies to the pension funds in relation to housing lending. This should be reviewed in the context of incentivising funds to make investments into housing. A second impediment is the current investment guidelines. Certain interviewees indicated a need to review these to provide more latitude for the application of these funds, for example in housing.

Commercial Banks

A handful of commercial banks (mostly subsidiaries of international banks) dominate the retail banking sector in Zambia. Of the fourteen registered commercial banks, six are subsidiaries of international banks. These are the only financial institutions that have a real presence, extended branch network and financing capacity of any consequence. The key players with respect to housing financing are briefly discussed below:

Zambia National Commercial Bank (ZANACO)	Zanaco was a wholly government-owned bank, but is in the process of seeking equity partners to expand its capital base. Zanaco intends to commence mortgage lending. Discussions have been held with FBS for them to administer the loans on Zanaco's behalf. ▪ African Banking Corporation (ABC): ▪ Cavmont Capital Bank Ltd:
Barclays Bank	Barclays launched its home loan product in January, 2006. Currently, the product has a twelve year maximum term, an interest rate recently set at 17% per annum. Currently, the portfolio comprises 80 loans with an average value of about ZK200-million (US$50 000). Barclays has almost utilised the capital raised from its first 12-year bond issue of US$10-million in 2004. Barclays has set up dedicated home loan branches in key locations to attract business. It is estimated that 35% of loans are for housing purchase, 40% for equity release, and the remaining 25% re-mortgages. Currently, there are no defaults in the portfolio. The assessment criteria require 40% of personal income for servicing a bond.
Stanbic Bank	Stanbic is thinking of entering the home loan market in 2007.
Standard Chartered Bank	Standard Chartered launched its mortgage product in 2003-04. Initially, it had a slow take-up due to high interest rates and a 20% deposit requirement, which few Zambians had due to a poor savings culture. The poor response forced Standard Chartered to withdraw from this market. With the improved economy and interest rates, they are now considering re-entering this market in 2007. They believe they should be able to offer up to 20 year terms, with interest in the mid-teens.

Building Societies

Building societies are required to have a liquidity ratio of 15%. According to the BoZ, all Building Societies were substantially under-capitalised until recently.

- Zambia National Building Society (ZNBS)[14]: ZNBS is currently not offering long-term loans, as they still face serious administrative and financial constraints resulting from their historical lending practices. Non-performing loans now comprise less than 10% of the mortgage portfolio. This portfolio includes about 3 000 loans with an average size of ZK45-million (US$10 000 to $12 000)

  ZNBS now offers a new ‘Building Materials Loan’ product (essentially, a two-to-three year unsecured loan at 24% interest for building materials purchase) based mainly on payroll deductibility. In addition, home improvement loans have been offered over the last two to three years. 300 loans have been approved in the last two years.

  ZNBS claims that its previous home loan portfolio is performing better. However, its historical book still has a very high proportion of non-performing loans. Government has however taken over a huge current account deficit in order to improve the footing of the building society. The ZNBS shareholders are now required to recapitalise the building society. The IFC is in discussions with government regarding its recapitalisation. Apparently ZNBS declared a profit last year for the first time.

  ZNBS has recently secured a ZK10-billion line of credit from the ZNCB, which it aims to channel to its lending requirements. There is also a government proposal to utilise Public Sector Pension Fund resources to provide capacity for ZNBS’ housing lending. The status of this proposal is not known.

- Finance Bank (& Building Society)[15]: FBS currently has a housing finance portfolio of ZK31-billion (about US$8-million), comprising about 500 loans. This has developed from a zero base in September 2004. FBS projects a lending volume of US$500 000 per month going forwards.

  Mortgage products have a ten-year term, and range from US$20 000 to $125 000 (ZK80-million to ZK500-million). Current interest rates are between 25% and 28%, but there is now pressure to reduce interest further. The difficulty faced by FBS is that it is still bound by the forward risk cover arrangements on its sources of finance. This limits its ability to reduce its interest rates to rates being mooted by other banks (15% to 18%).

  Borrowers must be members of FBS, and are then eligible to obtain Kwacha-denominated mortgages (if Zambian citizens), or US$ based mortgages if they are non-residents. All borrowers are required to take out a Mortgage Protection Policy.

  FBS have used a combination of the following resources to achieve this rapid growth:
  - Limited savings from members (all borrowers are required to be a member of the Building Society);
  - Capital sourced from pension funds and insurance companies
  - Commercial bank resources: BTA Bank and Shelter Afrique[16] have both made US$1-million loans available to FBS. These dollar-denominated loans were swapped with Zanaco and Barclays, and some forward cover was used to ascertain FBS’s Kwacha liability.

  To finance their future growth, Shelter Afrique has pledged a further US$2-million facility to FBS to grow its portfolio. FBS will again swap this (using Zanaco). Talks have also been held with DBSA and Norfund. FBS estimates its Non-Performing Loans (NPLs) to be in the order of 1% to 2% of its portfolio, and although they have not yet had to go through a foreclosure process yet, they are happy with the Commercial Court arrangements for dealing with defaults.

- Pan African Building Society (PABS): PABS is currently undertaking limited housing lending. The Building Society has managed to extend its lending portfolio through a ‘twinned financing’ arrangement via a competition proposal call through DFID. As winning bidders, they obtained US$50 000, which they were required to match with financing procured from another player.

[14] Most information based on interview with Visscher Bbuku at the BoZ.
[15] Interview with Mr S Krishnamurthy (Chief Executive Officer).
[16] Shelter Afrique has provided the money in Dollars to FBS, at 8% interest over a ten year term. This exposes FBS to exchange rate fluctuations, such as the recent almost 30% devaluation over a period of six months.

Micro-Finance Institutions (MFIs)

There are arguably over 100 MFIs operating in Zambia. Many are NGOs, but more recently there has been a growth of commercial institutions that have commenced operations, many with a presence across Africa.

Microfinance regulations were issued for the first time in early-2006. The aim of these regulations was to give credibility and structure to the sector, in order to improve the chances of MFIs obtaining financing from other financial sectors.

The Association of Microfinance Institutions of Zambia (AMIZ) is a representative body, but it is not compulsory for MFIs to belong to this association. About 30 MFIs are members.

- First-Tier MFIs (Deposit-Taking): There are five or six deposit-taking MFIs in Zambia, including FINCA, Pride Zambia, Microfin and Bayport. These institutions are required to have a minimum capital requirement of ZK250-million.
- Second-Tier (Non Deposit-Taking): Second-tier, or non deposit-taking MFIs are required to have a ZK25-million minimum capital requirement. There are numerous MFIs in this category[17].
- Third-Tier (Small): There are a range of small, community credit institutions that have delegated supervision requirements.

Institution	%
Cetzam Opportunity Microfinance Ltd	23.9
Pride Zambia Ltd	18.7
Bayport	13.9
National Savings and Credit Bank	10.1
FINCA Zambia Ltd	9.9
Microfin Africa Zambia Ltd	7.0
Blue Financial Services	6.2
Agricultural Support Programme	5.7
Pulse Holdings Ltd	3.2
Salvation Army – Lusumpuko Women's Micro	2.2
Keepers Zambia Foundation	2.2
Cooperative Society	1.7
Women for Change	1.6
Evangelical Fellowship of Zambia	1.5
Women Finance Co-operative Zambia Ltd	1.1
African Banking Corporation Zambia Ltd	1.1
Red Cross	1.0
Young Women Christian Association	0.9
Disable group	0.8
Lusu Mission	0.7
Mashebo Trust Mission Guard	0.7
Harmos MED Ltd	0.6
Africa Enterprise Trust Zambia	0.4
Care International	0.4
Netfin	0.3
Church Health Association of Zambia	0.3

Base: =218 valid responses; N=121 valid cases

Insurance Institutions

With respect to housing, perhaps the most important insurance available is bond life cover. Madison and other insurers offer such policies. FinScope™ Zambia reports, however, that only 1.1% of adult Zambians currently have life insurance. Another 0.7% used to have life insurance but do not currently. Property insurance is accessed by an even smaller proportion: 0.8% of the adult Zambian population have it now, and 0.3% used to have it.

Lilayi Housing Project: Special Purpose Financing Vehicle

In order to overcome the many pitfalls facing housing development in Zambia, the Lilayi Project has developed a complete development solution. The project has been structured from the beginning as a stand-alone community, with most of its services and facilities being developed as a part of the scheme. In addition, it will be piloting a new, decentralised procedure for the transfer of title, which relies on local offices rather than the Department of Lands. The project kicks off with three basic products: a US$25 000 one bed unit, a US$35 000 two bed unit and a US$45 000 three bedroom unit.

Given the absence of housing finance players in the market over the last four years, the Lilayi Housing Development took an alternative approach to ensuring it could arrange take-out financing for purchasers. They will raise their own capital for end-user finance, and will then recoup the funds from the individual purchasers. 'finance repayments are indexed annually in advance, in order to give borrowers Kwacha stability for the period of a year. Re-indexing cannot exceed 20%. Stanbic will administer the home loans on Lilayi's behalf. Originally few financiers were interested in the scheme, with the exception of OPIC. However, at present approaches have been made by IFC, ADB, DBSA and others

[17] Blue is an example of a non-deposit taking MFI. Blue is a South African-owned microfinance institution that has expanded its operations into many southern and east African countries (Telephone Interview with CEO of Blue (Zambia), Derek De Villiers). During the interview, he mentioned that Blue intended to start a mortgage finance instrument during 2007 in South Africa, Botswana, Zambia, Tanzania and Uganda.

Capital markets

Whilst still generally considered ‘thin’, Zambia’s capital markets are showing signs of maturation. For decades, the financial sector revolved around the issuance of T-bills alone.

Treasury Bills and Bonds

Significant changes have occurred in the volumes of T-Bills issued, and the returns on these instruments. For decades, T-bills offered financial institutions a low-risk, high-yield financial instrument that, in the words of one financial sector player, *‘negated their need to do real banking’* in order to ensure reasonable returns. The regular supply of short-term, high-yield T-bills were partially a consequence of the macroeconomic conditions, and more recently were also partially to blame for hampering the deepening and lengthening of capital instruments in Zambia’s economy.

The issue of T-bills and bonds has been capped, and returns have dropped substantially[18]. This has forced financial institutions to look to other financial instruments to generate required returns. With current 90-day T-bill rates set at below 10%, it is not surprising that many banks are now looking towards the housing finance sector as a means to diversify their portfolios.

There is talk that BoZ may float some longer-term bonds in order to stimulate the availability of longer-term, Kwacha-denominated facilities. However, this could not be confirmed.

Stocks & Bonds

While the Lusaka Stock Exchange (LUSE) has very few listed stocks and bonds, there are signs of gradual capital market expansion. Specifically, when good bond issues are made available, they have all been over-subscribed by a factor of two or three. The appetite for such instruments is high. This can also be seen by the over-subscription of T-bills and Bonds, which are currently offering mediocre returns.

Housing finance-related bond issues	Barclays floated a $10-million bond in 2004/5[19], and the success of this has lead to other actual and rumoured bond issues on the LUSE. Specifically, in relation to housing finance, Barclays and Stanbic both indicate they will use future bond issues to obtain long-term sources of funding for their home loan portfolios. FBS may also take this route, with a US$5 to $10-million bond sometime in the future.
Lilayi Housing development	As noted earlier, Lilayi has also gone to the markets (albeit through a more complex mechanism) to finance its capital needs for the ambitious housing project. This will include proposed municipal bond issues to mobilise resources for the provision of services in their areas of jurisdiction.
Municipal bonds	An initiative is under way that aims to source financing from the capital markets for infrastructure development by the five major city councils in Zambia. The mechanism proposed is a Special Purpose Vehicle with an independent board and management structure that will aim to ‘guarantee’ the success of the venture. It is believed that this bond will be in the order of US$10 to $20-million, and that Stanbic may be arranging the issue.

Offshore Funds

Two years ago, a regular lament amongst housing finance players was the inability to secure dollar-based facilities in Zambia, in order to provide more stable, longer-term sources of capital for home loan finance. The few such facilities that had been extended had generally led to the local financial institutions having to secure forward cover at significant cost in order to militate against exchange rate volatility. In certain cases, these early experiments in offshore financing lead to defaults by the borrowing financial institutions.

[18] Charles Mpundu of NAPSA claims that in many cases, with the low returns offered on T-bills and bonds, and taking into account costs withholding tax, handling fees and levies, negative real returns on T-bills are a very real prospect.
[19] Indications at the time were that this was to finance its home loan portfolio, but it is not clear whether this did in fact occur.

Two years on, there are many signs of change. Numerous development banks and commercial banks have extended facilities to local institutions, or have expressed their willingness to do so. Known facilities include:

- African Development Bank
- Shelter Afrique

There is talk that the Development Bank of Southern Africa is seriously considering various facilities.

Pension and Provident Funds

The large public sector pension and provident funds (Public Sector Pension Fund and LASF), and increasingly the private provident funds have large, untapped capital resources at their disposal.

While they claim to be more open to mechanisms that could facilitate the flow of funds into the housing sector, their appetite for housing-related lending has been dampened by some failed forays into housing over the last few years. In the early days of financial sector reform, the pension funds made lines of credit available to various institutions, including FBS, ZNBS and others. Apparently, some of these facilities are still liabilities on their balance sheets. These therefore stand in the way of fresh (and hopefully, more sustainable) ventures into unlocking capital for housing lending.

Future challenges for access to housing finance

Notwithstanding the major strides that Zambia has made over the last few years with respect to the prospects for housing finance, a number of key concerns still exist. These fall broadly into two categories: overall economic and housing sector performance, and housing affordability.

Economic and housing sector performance

Regulatory Environment: There are still aspects of the Building Societies Act that are under scrutiny. The BoZ's stated intent is to 'modernize' the Building Society sector, but it is the belief of the Building Societies themselves that the proposed regulations misinterpret the intent of Building Societies and force them into a pure banking mindset. Two specific areas of focus are to extend the financial instruments that Building Societies can offer from mortgages only. In addition, a more controlled corporate governance requirement and liquidity requirements are proposed.

Capital Markets: Limited sources of local, long-term (over three years) capital is considered to be one of the greatest impediments to the growth of the housing finance sector specifically, and the economy in general. Indications that this situation is easing do exist, but it remains a critical area for intervention.

Sovereign Rating: Zambia currently does not have a credit rating from the major international rating agencies. This does inhibit the views of the country from a potential investor perspective. It is suggested that a concerted effort should aim to obtain such a rating for Zambia.

Inflation & Interest Volatility: It is almost safe to say that the days of macro inflation and exorbitant interest rates are gone. However, there have been recent blips on the interest and inflation graphs that remind us that Zambia's macroeconomic conditions are not yet stable, although they are clearly improving. Encouraging high levels of indebtedness (especially in relation to long-term housing financing at medium to high interest rates) must be approached with caution until Zambia has a proven macroeconomic track record.

Housing affordability

Employment Profile: Zambia still has a polarised household income structure. FinScope™ Zambia suggests that unemployment levels are high, with 24% earning no income at all. A large proportion of formally employed people work for government, and in most cases earn very low incomes. The pressures placed on current employment through the need for public sector reform is a problem. In addition, some financial institutions have indicated that relying on public employers for payroll deductions for finance has its problems too, with certain cases of default being reported.

Longevity: It is well known that Zambia has one of the lowest life expectancy of any country in the world. This places pressure on financial institutions with respect to the ability of the average Zambian to service a long-term mortgage. General perceptions are that, with readily available mortgage protection insurance and due to the high regard Zambians place on housing, most bondholders that pass away prematurely will be covered by contributions by family in order retain their housing.

Household Incomes: Household income levels are generally very low, even amongst the formally employed. Below a very thin band of higher-income earners are the majority of formally employed people whom would battle to qualify for a bond large enough to purchase a small house with formal title. Only 18% of Zambians earn above US$118,11 per month.

Over-Indebtedness: Economic liberalisation and macroeconomic stabilisation have lead to the widespread availability of consumer credit and a consumerist society. Daily, Zambians are presented with more opportunities to buy consumer goods using short-term credit .There appears to be a risk of over-indebtedness, which may present challenges to the current business models followed by MFIs.

Way Forward

This brief overview of the housing finance sector in Zambia has raised many questions and has suggested many areas for further investigation. Critically, the scoping study identified that there is very limited (largely outdated) data on the dynamics of Zambia's housing sector, both from the supply-side and demand-side. In addition, whilst existing, approved housing plans are quite comprehensively set out, the affordability context of Zambia's population makes them relevant for only a small minority. The housing and housing finance debate would be immesurably richer if it were based less on anecdote and more on sound analysis[20]. The following recommendations are proposed:

- **Data**: A first priority must be to build a new set of diagnostic tools on the Zambian housing sector, and then to ascertain the real dynamics of Zambia's housing sector using qualitative and quantitative analysis. This should include at least:
  - Status Quo analysis (what are current housing conditions & arrangements)
  - A Supply-Side Assessment (how is housing supplied & financed, what is the supply capacity)
  - A Demand-Side Assessment (based on effective demand)

  The logical outcome of this would be the basis for developing a real, pragmatic housing strategy for Zambia – or at minimum, a sound empirical basis on which housing actors on the supply and demand side (and possibly regulatory side) can base future work.

- **Approaches and Instruments - Reaching the Poor**: Current housing finance developments focus on the relatively 'easy pickings' of offering mortgages to high net worth individuals. However, this will in no way meet the vast demand for housing within Zambia's middle and low-income households. The real test will be what happens when these easy pickings are exhausted. Already, the secondary target of refinancing existing owned accommodation is beginning to be targeted. Given the very thin

[20] For example, the documentation all talks about a 'housing demand of 800 000 to one million units', but it is difficult to obtain a reasonable calculation or quantification of this anywhere. Ambitious delivery targets have been set out, but the private sector is expected to deliver housing because there are no capital budgets. Other questions include: How much can households afford to invest in their housing? What is current practice in this regard? What is a 'household'? How many households can afford what for housing? And what are their housing aspirations? There is limited knowledge of how people really operate with respect to housing transfers, rental and sales values, how many actually have de facto or de jure tenure over their land, how the kinship living arrangements work, etc. Zambia has one of the highest AIDS mortality rates in the world, yet no research appears to have considered how this affects housing (and will affect future housing lending and developments). Finally, how do Zambians house themselves? And how do they finance this process? Given the low levels of housing affordability and absence of formal housing finance mechanisms that are relevant to such low income people, the limited extent of informal (shanty) housing in Lusaka is surprising. Households seem to manage to build at least basic brick and mortar structures. No one really knows why they feel secure enough to do so, and where they get the means to do so, and how they actually make this happen. It is difficult to build a housing financing framework on this knowledge vacuum.

market for conventional mortgage finance products, attention to alternative housing financing mechanisms (smaller, non-mortgage instruments), and alternative construction processes (incremental) and their consequent finance demands, is timely.

- **Alternative Delivery Systems for Conventional Housing Finance**: With few commercial banks offering true construction loans[21], and with the very constrained housing supply sector in Zambia, an opportunity exists to facilitate the development of such instruments by commercial banks. Many more Zambians own land than will be likely to be able to identify and purchase new housing. This therefore offers a major growth area for housing finance, and for the ultimate growth of housing supply in Zambia.

  The potentials and pitfalls of 'equity release' financing should also be considered[22]. For example, there is some evidence that in Zambia refinancing is being used to either upgrade existing accommodation, or to purchase additional accommodation that in turn increases the rental stock in the country. The extent to which this outweighs inflated consumerism is unknown.

- **Pension / Provident Fund-Backed Housing Finance**: Specific interventions around pension and provident fund-backed housing lending are starting to emerge in Zambia. Without a doubt pension and provident fund resources offer the largest untapped source of captial that could be directly and relatively easily linked to housing purchase and improvement by thousands of ordinary employees[23]. The benefits that such mechanisms could offer pension and provident fund members is also significant, given the low average returns on pension investments and the high and rapidly escalating costs of housing.

- **Alternative Housing Tenure Approaches**: Within the bounds of their land laws, an assessment of alternative tenure approaches that may be considered for housing in Zambia would be valuable. This could assess the existing frameworks, problems and prospects for the growth of the Freehold, Leasehold, Rental, Social Housing and Sectional Title tenure mechanisms in Zambia.

- **Finance Techniques and Capacity Building**: As a very new sector in Zambia, there is a general lack of detailed knowledge and expertise of the complexities of housing finance amongst many players. Key areas for development include credit criteria and assessment, housing loan portfolio risk management, and micro-lending prospects and pitfalls.

- **Development Packaging (Supply-Driven Housing Financing)**: Recently, in Zambia and elsewhere in Africa, there seems to be a growing belief that the only mechanism through which to develop accommodation on scale is via specialist institutions established to undertake (and quite possibly manage over time) the packaging and development of entire communities. This includes procuring or packaging development and end-user financing, securing land, undertaking titling and transfers, developing, maintaining and managing consumption and rated services, constructing housing and facilitating the development and operation of socio-cultural facilities. These developments need to be monitored and regularly assessed for their efficiency, effectiveness and ultimate impact in addressing housing need.

Conclusions

There are clearly significant opportunities for the growth of a housing finance sector in Zambia. From a very poor base of a command economy, negative growth, very high inflation and effectively no capital market activity, Zambia's economy is now starting to show the benefits of the political, regulatory and

[21] The ZNBS offers a construction loan derivative, but this is essentially a small, unsecured loan intended to support the purchase of building materials.

[22] To the author's knowledge, little if any analysis has been done in South Africa regarding the volume, uses, impacts and risks relating to the massive spate of housing refinancing. Whilst it adds to the Banking Council targets, no doubt, it is unknown to what extent it adds to the volume or value of housing stock. Perhaps this is another area that requires analysis that would be beneficial both in South Africa and Zambia.

[23] In addition to this, the major constraints facing pension and provident funds in Zambia imply that at present many funds are earning negative returns. Pension & Provident fund-backed housing finance at least offers Zambians the opportunity of participating in a sector that is likely to grow at least at the pace of inflation (and most likely significantly above it), whilst in addition improving their living conditions.

financial reform process that has been undertaken over the last decade. There is a general trend towards stabilisation and growth, even though there is still periodic exchange rate and interest rate instability.

Specifically, the housing finance sector is showing signs of development and growth. A few banks and Building Societies have commenced housing lending and have small but growing mortgage portfolios, and others are considering entering the market.

The overwhelming focus on mortgage finance, however, necessarily excludes the vast majority of Zambia's population from accessing housing finance to improve their housing opportunities. This highlights the need for the development of appropriate housing finance products that meet the needs of the entire Zambian population and not just the very few who can afford mortgage finance. Opportunities in respect of incremental housing delivery and financing, and the attention and performance of the micro finance industry, are critical areas for development. Further, specific approaches to encouraging housing investments from the pension and provident funds warrants investigation.

Appendix: Key players involved in Zambia's housing finance sector

Department of Finance & National Planning, BoZ and FSDP: The Financial Sector Development Programme Steering Committee is chaired by Evans Chibiliti, the Secretary to the Treasury / Minister of Finance. The Implementation Committee is chaired by Dr Kalyalya, the Deputy Governor of the Bank of Zambia

Banking Sector Representative Bodies

- *Bankers Association of Zambia (BAZ):*The BAZ is a representative body that develops and represents the views and interests of the commercial banks.
- *Association of Microfinance Institutions of Zambia (AMIZ):* AMIZ is a relatively new and under-resourced representative body for Zambia's growing Microfinance institutions. Currently, it is a loose affiliation that requires strengthening before it will have any effect on the outcomes of the FSDP or the forthcoming Non-Bank regulations.

Pension Funds: The Association of Pension Fund Managers (APFM) represents the combined interests of the major pension funds (NAPSA, PSPF and LASF, including some smaller funds). Chair: Charles Mpundu from NAPSA.

Aid Agencies: The most important aid agencies working in fields related to housing finance are briefly discussed below. There are a wide range of initiatives, and the list below is by no means exhaustive

- *USAID:* The USAID mission in Zambia is in the process of realigning its areas of focus. However, within its current and future framework, housing is a peripheral area. Its focus falls mainly on economic growth in the agricultural sector. However, USAID did sign a US$10-million loan guarantee for Lilayi. The Mission is unlikely to become directly involved in the housing field in the medium term.
- *US Treasury*: The Urban Institute is finalising an assessment into the prospects for stimulating the flow of Mortgage Financing in Zambia, Uganda and Tanzania under the auspices of the US Treasury. It is currently not clear whether this will lead to any specific US-backed initiative in Zambia.
- *DFID and SIDA*: Together, DFID and SIDA have allocated financing to the secretariat that is managing the process of Financial Sector Reform.
- *FinMark Trust*: FinMark Trust's recent FinScope™ study in Zambia has made an important impact on the financial sector.
- *World Bank /IMF*: The IMF is in discussions with BoZ regarding the recapitalisation of the ZNBS.
- *OPIC*: OPIC has committed a facility to the Lilayi housing development.