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Strong foundations

A framework for assessing the role of the insurance sector in property market development

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UKaid
from the British people

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1 Introduction

Property markets matter for economic development and resilient cities. The property market contributes to economic development on at least two fronts. Directly, increased activity in property markets supports GDP growth and employment opportunities, through new construction, the supply of materials and equipment, renovation, maintenance and the provision of professional real estate services (Pirounakis, 2013). Indirectly, property markets support development by building resilient communities and cities. Consultations for this study highlighted that population growth and rapid urbanisation result in "inadequate housing conditions [for] the majority", while putting pressure on available land resources and basic services (Gencer, 2016; Taylor and Peter, 2014). As many African cities address their infrastructure and service gaps[1], there are opportunities for planning, designing and implementing sustainable urban development pathways. It is no surprise, then, that property markets are often a national policy priority for governments. In Southern Africa, Zambia, Mozambique and South Africa, for instance, have national ministries or directorates that focus, either in part or exclusively, on housing development[2].

Falling short of demand. Despite the demand for and importance of property, the formal supply and financing of property remains insufficient in sub-Saharan Africa. For instance, in the West African Economic and Monetary Union[3], about "800,000 new housing units are needed every year to address housing shortages" in the region, yet banks in these countries collectively only issue 15,000 new mortgages per year (World Bank, 2017). The lack of housing supply is significantly constrained by underinvestment. While there are many ready investors and more and more investing mechanisms are emerging, stakeholder consultations revealed that investors struggle to find "investment-ready" projects". High risks and financing constraints continue to curtail property market development across the continent.

A clear role for insurance – in principle. Well-functioning insurance markets enable productive risk-taking, mitigate the impact of exposure to insurable risks and support more appropriate risk management. In addition, insurance markets help to strengthen capital market development by contributing to capital accumulation and intermediation of funds in the economy (Chamberlain et al., 2017). The risk transfer and capital intermediation functions of insurance markets speak to the high risks and financing constraints that form critical barriers to property market development. This would lead one to expect that insurance markets are well positioned to support and complement urban property market development. Yet, experience across sub-Saharan Africa suggests that this role is not yet adequately articulated or leveraged. Though there is awareness of the respective roles of property markets and insurance markets in development and of the potential complementarity between insurance and property markets, consultations for this study indicated that limited research has been conducted specifically on the role of insurance

[1] Economic development of sub-Saharan African cities is oftentimes constrained by overcrowding, inefficient land use patterns, and disconnection from transport and other infrastructure (Lall et al., 2017).

[2] South Africa has had several housing policies which is executed un the Department of Human Settlements. Zambia has a Ministry of Housing and Infrastructure Development, and Mozambique a National Directorate for Housing and Urbanization. Source: http://housingfinanceafrica.org/search/housing+policy/

[3] Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo.

markets in supporting property market development.

Developing a framework to encourage discourse. While the main insurable moments in the property market value chain are generally known, there is a need for a more holistic understanding of the potential role that insurers can play in property markets – in terms of risk transfer, but also in overcoming finance constraints and influencing incentives to enable investment and productive risk-taking. Better understanding this role can support the development of the sector and, ultimately, help to better leverage property markets as an engine for economic growth. Therefore, this paper provides an overview of the value chain and actors in different property market segments and highlights the risks, constraints and incentives across the value chain to explore the current and potential role of insurance in property market development. The aim is to provide development practitioners, policymakers and industry stakeholders with a more granular understanding of the intersect between the two markets as basis for dialogue towards the development of the sector. The framework, tools and common language developed in this note can also be replicated in similar analyses or diagnostics on the linkages between insurance markets and other economic clusters or value chains.

Identify areas for future research. This note provides a high-level overview based on desktop research and select stakeholder interviews. There are many aspects that would warrant further research to deepen our understanding of the role of insurance in property market development and add to the evidence base. Specifically, the framework needs to be tested against real-world experiences through country case studies or diagnostics.

Scope

Resilient cities in Africa. Although the demand for property exceeds supply in both urban and rural areas, and housing conditions in rural areas are often dire, the functioning of the property market in urban areas will be the primary focus of this research. The presence of property developers and access to capital make urban areas a potentially viable market from an insurance point of view. Moreover, cities themselves may have scope to act as long-term development partners. This creates opportunities for property development and investment.

Supply side focus. The traditional approach to diagnostic market analysis is to consider demand, supply and regulation to form a holistic view of a particular market. While such an understanding is also important for the property market, the value chain – from a supply perspective – is the primary lens applied in this note, with consideration of the various actors and needs along the value chain.

Zambia case study. This note develops a generic framework, drawing on research across multiple sub-Saharan African countries. To illustrate the applicability of the framework, we conducted a mini case study in Zambia, which is referred to throughout the document. We also draw on evidence from MAP Zambia for examples[4].

[4] The Making Access Possible (MAP) Zambia Diagnostic can be accessed here: https://cenfri.org/map/zambia/

Structure

This note is structured as follows:

Section 2 describes the market segments, value chain components and actors that constitute the property market.

Section 3 identifies the risks and constraints faced by residential and commercial property market actors along the value chain.

Section 4 discusses the risk management and capital intermediation roles that insurance markets could play in property markets and explores the suitability of property investment mechanisms for insurance investment needs.

Section 5 concludes and highlights considerations for development practitioners, policymakers and industry stakeholders that seek to enhance the role that insurance markets can play in supporting property markets.

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2 Components of the property market

Property market segments

Not a homogenous market. Property market segments differ in terms of their performance and attributes. This has implications for the incentives, investments, risks and barriers experienced by the range of actors involved in each segment. The complexity of the property market lends itself to different analytical approaches. For this study, we segment first by use case, then by tenure status. This results in four distinguishable market segments as depicted in Figure 1:

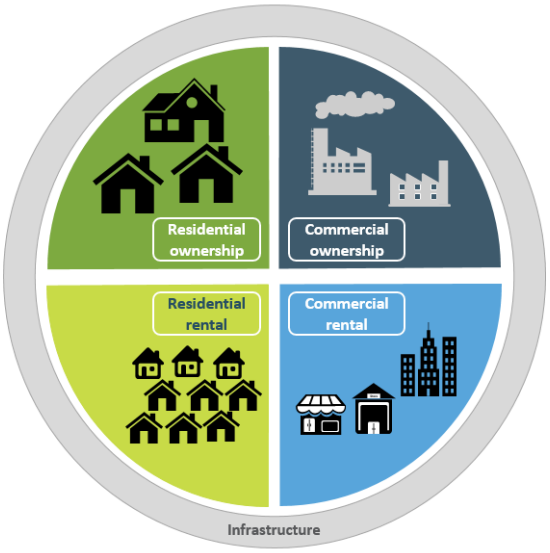

Figure 1: Property market segments

Use case: residential versus commercial. The most distinguishable characteristic of the property market is that some properties are built for residential use, while others are built for commercial use (CAHF, 2016; Zille et al., 2008). Infrastructure development cuts across the market segments and is critical in supporting both residential and commercial property market activity. Residential property ranges from informal settlements and government-subsidised housing to luxury single-standing homes, while the commercial property market segment includes office buildings, retail stores and industrial property[5].

Tenure status: ownership versus rental. The residential and commercial property market segments can be further distinguished by users' tenure status, i.e. whether the property is owner-occupied or made available to rent. This note will focus on the residential ownership and commercial rental market segments[6].

Value chain components

The property market represents a multifaceted ecosystem, with unique characteristics and dynamics for distinct market segments, and where different actors are involved across the value chain. The incentives, risks and barriers faced by the

[5] These are not exhaustive. For instance, commercial also includes hotels or special purpose properties, and there are many additional residential property types between subsidised housing and luxury homes. These in turn can also be subdivided based on the land used. For instance, inner city, suburban office and greenfields are all types of commercial property fitting into the commercial category above. The characteristics, dynamics and actors of different sub sectors can also vary. For instance, household driven residential developments tend to be incremental, while developers tend to focus more on the luxury market in the residential space. For an overview, see: https://www.propertymetrics.com/blog/2013/02/27/types-of-commercial-real-estate/.

[6] There is also a need for future research on residential rental markets, as it is a fundamental part of low-income housing.

actors at each segment of the value chain can significantly influence market outcomes.

What is a value chain? The property market value chain describes the range of activities undertaken by the various actors responsible for the delivery of residential and commercial property. For the property market to function, there are more parties involved than the person who owns or builds the property and the person who wants to buy it. First, suitable land must be identified, prepared and released for development. Depending on where the property is or will be situated, the land may also need to be zoned and assembled. The developer would need to obtain rights and protections by securing tenure status for the land, and the property must be connected to bulk infrastructure such as water, electricity and roads. Existing social and economic infrastructure (like schools and retail/commercial outlets) in the area precede, or develop on the back of, residential developments. Once a property is delivered, the process does not stop. Depending on the nature of the property and its intended use, tenants may need to be secured and managed on an ongoing basis, and ongoing maintenance and improvements will be required. The property may also be resold, transferred and occupied by new owners or tenants.

Interdependencies and upstream and downstream components. The various value chain components are dependent on one another. If one component fails or does not function optimally, it could have knock-on effects that can compromise the overall delivery of property in the market. Moreover, the primary value chain has both upstream and downstream linkages. For example, the construction process itself requires multiple parties and has its own upstream value chain (such as the supply of building materials). Other primary value chain components have their own downstream value chains (for instance, legal services that derive from the sale and transfer process).

Figure 2, below, maps out the components of the primary property market value chain and lists some upstream and downstream linkages for specific components. More detail on each component is included in Box 1 on the next page.

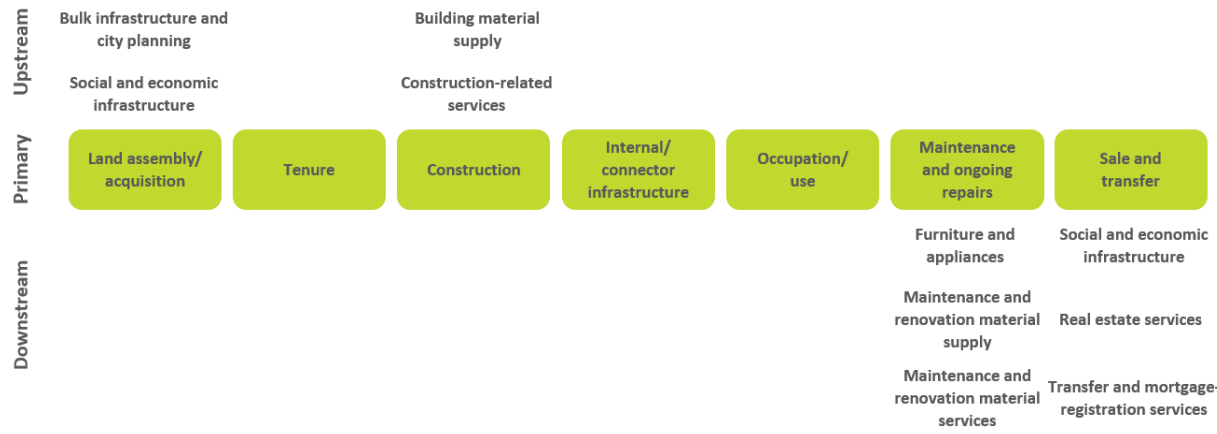

Figure 2: Property market value chain

Source: Author's own, based on CAHF (2015)

Box 1: Components of the property market value chain

The seven value-added activities along the property market value chain can be described as follows:

Component 1: Land assembly and acquisition. Residential and commercial property development begins with the assembly and acquisition of land at different levels of government, which involves the identification, preparation and release of appropriate land that is suitable for development (Housing Development Agency, 2013a). Following the identification of vacant, unused or underutilised pieces of land, an investigation is conducted into current ownership and zoning. Small pieces of adjacent land may have to be stitched together (through rezoning) to enable high-impact, low-risk developments to take place.

Bulk, social and economic infrastructure form an upstream component of land assembly and acquisition. Demand for property (and therefore land for development) is greatly influenced by accessibility of public services, such as water and electricity infrastructure, waste-water management, sanitation services and transportation networks (Graham, 2016). In addition to physical infrastructure, social and economic infrastructure can also increase demand for residential property and therefore make proposed property developments more feasible, if already in place. Social infrastructure describes the social services available to individuals and communities, such as schools, libraries, health facilities, emergency services, sports and recreation facilities, parks and squares. Economic infrastructure, on the other hand, describes the facilities and systems that support and encourage business activity. If these are not in place before a residential development starts, the increased activity after completion of the development may trigger development of social and economic infrastructure.

Component 2: Tenure. When the developer and potential owner are satisfied with the condition of the land, it is crucial to obtain rights and protections by securing tenure status. Land tenure relates to the way land is held or owned, may be formally or informally granted and comprises the rights and protections afforded to individuals or groups in relation to the land they hold. Ownership and rental are common tenure systems. Tenure may also be categorised as private, customary or public (Housing Development Agency, 2013b; Quan and Payne, 2008). Private tenure systems are the most formal, whereby land ownership is transferred through registration of title deeds. Under customary tenure systems, land is allocated by customary authorities. Public tenure systems are intended to enhance equal access to land for development, which typically involves rental of state-owned land or buildings.

Components 3 and 4: Property construction and connection to infrastructure. After the necessary approvals and property registrations have been obtained, the construction phase can commence. During the property construction phase, the municipality would need to ensure the availability of connector and internal infrastructure that links suburbs and property developments to bulk public infrastructure and basic public services[7].

Components 5 and 6: Occupation and ongoing maintenance. Property can be owner-occupied or income-producing. Once construction is complete, residential owners will typically occupy their properties, while commercial owners will rent out their properties to tenants for a fixed rental charge. Nevertheless, during its useful life, a property can be repurposed from being owner-occupied to being tenanted, and vice versa. To enhance the value of properties and ensure their suitability for occupation, maintenance and ongoing improvements will be undertaken continually.

[7] Connector infrastructure provides essential links between bulk infrastructure and individual suburbs or property developments. At a more granular level, internal infrastructure within a property development or suburb describes the items such as pipes, powerlines, streets, and sewers (Graham, 2016).

Component 7: Sale and transfer. A broker or real estate agent facilitates the sale of a house or commercial property at the request of the developer or owner. The potential buyer would need to finance the purchase either through a financial provider or from reserves. Additional professional services would be required to address the legal and tax requirements of the property sale. Lawyers, tax specialists and property brokers would participate in the transaction. Once the sale is transferred, the new ownership details are registered with the title deeds office. The sale and transfer process also occurs before occupation in the case where the owner and developer are not the same entity.

Property market actors

Actors vary by value chain component. Various actors are involved across the value chain, each facing its own constraints and incentives. The main actors along the primary property market value chain are the government, developers, financiers, investors, owners and users (Keogh and D'Arcy, 1999; Mooya, 2010). The participation of actors in specific components of the value chain is mapped in Figure 3 below.

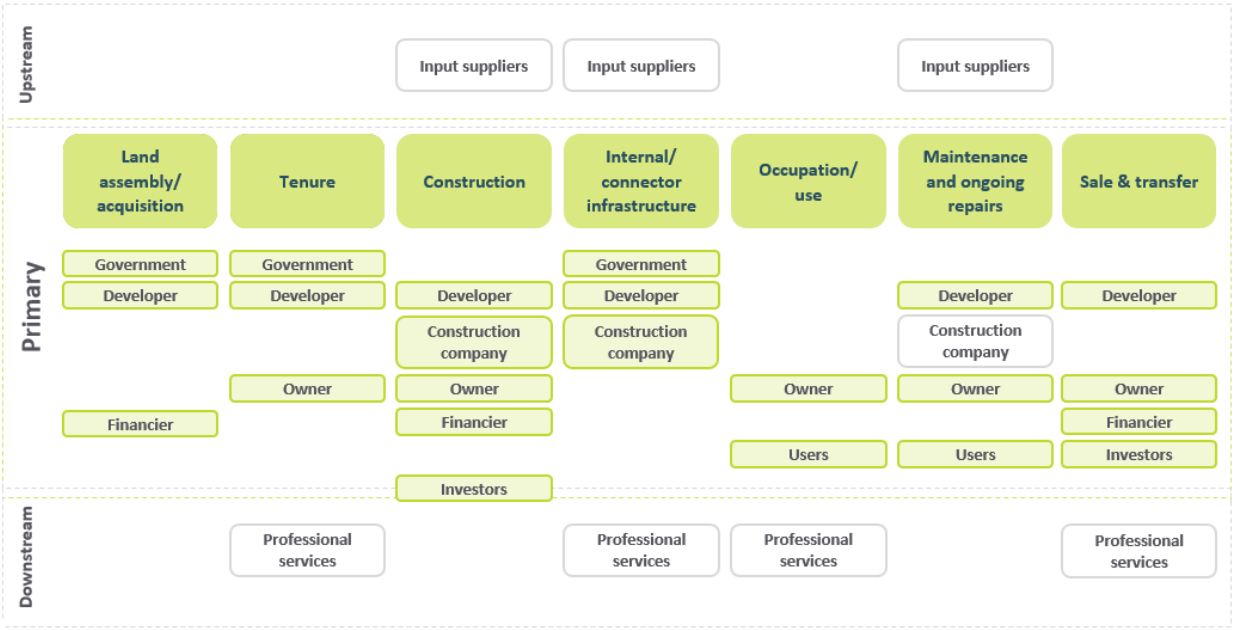

Figure 3: Mapping actors to the property market value chain

Source: Authors' own, based on Keogh and D'Arcy (1999), Mooya (2010)

Some more critical than others. Some actors are especially critical for the successful delivery of property. Notably:

- **Government**: The government plays a critical role in determining the regulatory and legal framework that governs economic activity in the property market. In addition, the supply of land available for residential and commercial use is determined by the government through zoning, land assembly and the provision of infrastructure and basic services that enhance the suitability of land for development (Zille et al., 2008). The government also administers or participates in processes like construction licensing, building plan approval, electricity connection and the sale and transfer process. The cost, number of procedures and time of these processes could significantly affect the viability of a development project. See the Zambia case study in Box 2 below.

- **Developers and construction companies:** Developers are responsible for initiating and overseeing the property development process (Bulloch and Sullivan, 2010). In doing so, they are the primary risk carriers and "market makers" without whom property market development would be based on the incremental actions of individual owners. Developers also play a critical role in coordinating the information and activities of the various actors across multiple stages of the property market value chain. Brueggeman and Fisher (2010) identify the key roles of developers to include site acquisition, construction, as well as refurbishment of property with a view to rental or sale. Developers can either manage construction in-house or it can be contracted out to a construction company.

- **Financiers**: The costs involved in property development are largely beyond the cash flow of individual households and even businesses. As such, most property developments require financing, though households and companies are not precluded from self-financing their own developments. Banks and other specialty lenders typically provide long-term property finance to meet this need.

Box 2. The role of government – the case of Zambia

The Zambian government played a significant role in unlocking property market development. Government funded projects and some public-private-partnership (PPP) projects contributed to the growth in commercial property development over the last twenty years. Similarly, the growth in the residential property market over the last 10 years followed a government decision to improve home ownership through the transfer of government houses to sitting tenants. This resulted in substantial self-financed investment by Zambian households to own residential properties. Since then, the Zambian government has been actively promoting private and public investment to support housing development primarily to improve the overall living conditions of the population. Experts within the real estate business also feel that the liberalisation of the market has played a significant role in the growth of the sector; resulting in increased private and public investments to address the shortages of housing and commercial space.

Source: interviews conducted by Manje (2018) as input to this study

- **Users:** The users of property – owners or tenants, firms or individuals – create the demand for residential and commercial space. Where property is owner-occupied, there is no separate tenant. Users are key actors, because the type of property that is demanded can drive, or discourage, investment and development. Sufficient demand is also required to create scale.
- **Investors and owners***:* Households and firms may choose to invest in property development to make a financial return[8]. Investments may be in the form of direct investments into residential and commercial property that is rented to tenants, or indirect investments into property market financial assets. Without investors, the rental market would be constrained or non-existent.

Box 3, on the next page, considers the different components and players in practice based on the Zambia case study.

The actors that operate in different components of the value chain face distinct risks and constraints. These are considered in Section 3.

[8] Because households and firms may also be users, investors can also be users and vice versa.

Box 3: Property market components and actors in Zambia

The main players in the property market in Zambia include private owners, commercial owners, developers, contractors and valuators.

On the commercial property front, there has been substantial public and private investments over the last two decades, mostly directed at modern shopping malls (retail), industrial space, office space and the hospitality sector[9]. Financing of major commercial properties is mainly provided by banks, government, insurance companies and local and foreign private investors. Where residential property is concerned, there is a large housing deficit[10] and the small mortgage market means that most residential properties are self-financed by individual owners (see Section 3 for more detail).

It is estimated that there are between 15 and 20 local and regional property developers in Zambia, involved in residential, commercial and industrial property[11]. However, most of these are relatively small, and as a group they are not playing a market-making role in addressing property market shortfalls, particularly for residential housing. There are about 70 "grade 1" registered contractors (September 2017[12]). These are mainly used by investors and developers. The rest of the market relies on informal, unregistered contractors, or owners who self-build their properties. Lastly, valuators also play an important role in the Zambian property market, providing valuation services required to obtain secured lending or insurance[13].

[9] See ZDA (2018).

[10] In the residential property market, Zambia has a large housing deficit (estimated at two million units), and about 60% of the existing urban stock is considered substandard housing. See ZDA (2018).

[11] For instance, the 2017 ZAMREAL property forum was attended by local and regional 120 companies, of which 50% reported to be from the property development sector. However, this included property consultants, hotels, and agricultural firms. From a scan of the attendance list, the number of property development companies that attended is likely between 15 and 20. See http://www.zamreal.com/2017/wp-content/uploads/2018/04/Zamreal-Brochure-2018.pdf. The largest is likely Real Estate Investments Zambia (REIZ), which holds 50,000 m2 of property, which includes restructuring of existing properties.

[12] First quality assurance level registration by the National Council of Construction.

[13] Financial institutions usually have panels of valuators, and most valuation firms are listed on these panels to provide valuation services for secured lending. Valuation firms determine the market value of properties that are either being purchased on secured lending, or for new properties that are being built with secured finance. This is done to determine the value of the property in case of liquidation (for banks), or to determine the reinstatement cost of the property for insurance purposes (the cost to rebuild the property in case of total loss). The major valuators and real estate agents are Knight Frank Zambia Ltd, Sherwood Greene, Pam Golding, CMM Property Consultants, Bitrust, Upmarket, Anderson and Anderson International, Seef, Government Valuation Department and Mac Associates (Manje, 2018).

3 Risks and constraints in property market development

Risks vs constraints. The activities undertaken by the various actors along the property market value chain are subject to risks[14] and constraints[15] that can affect both the demand for, or delivery of, commercial and residential property. Private-sector actors pursue opportunities by engaging in productive risk taking[16]. Whether they pursue the opportunity depends on the potential return on investment and their risk appetite. The risks they face can be minimised by proper risk management, risk mitigation and risk transfer. Constraints, on the other hand, are factors that keep actors from pursuing opportunities, regardless of their risk appetite.

Risks experienced along the value chain

Different risks arise at different parts of the value chain. Due to the complexity of the property market value chain and the distinct nature of the value chain components, the risk exposures and potential impacts vary among the respective actors across the different value chain components. For instance, during project conceptualisation, risk may be higher; but, as the project progresses and uncertainty decreases, risks can reduce. This also has an implication for the type of finance that can be used. During conceptualisation, a project often relies on equity, whereas debt financing is used for construction (Ahmed and Fang, 1999). Understanding the key risks that actors experience allows us to ascertain which risks are insurable and which risks may require alternative risk management or pre-emptive risk prevention strategies. Some of the risks identified will systematically affect all property market actors, while others will be idiosyncratic and related to the specific economic activities of particular actors. What is most important will vary depending on the context or nature of the property development or value chain component. Table 1 on the right highlights the key risks identified across the value chain.

[14] Risks are potential events that may negatively affect the progress or completion of property development. For the purpose of this paper, we define risk as "an uncertain event or condition that, if it occurs, has a positive or negative effect on one or more project objectives" (Project Management Institute, 2017, 2008).

[15] Restricting or limiting factors that will affect the performance of projects and processes (Project Management Institute, 2008). This includes financial and non-financial constraints.

[16] Of course, for owners who are not investing in the property market for a return, but rather to meet a basic need (accommodation), there is no productive risk-taking; rather, these actors are exposed to risks which may negatively affect their welfare (loss of assets), regardless of their investment decisions.

	Land assembly/ acquisition	Tenure	Construction	Internal/ connector infrastructure	Occupation/ use	Maintenance and ongoing repairs	Sale and transfer
Credit and refinancing	X		X	X		X	X
Macroeconomic	X		X	X	X	X	X
Political	X	X	X	X		X	X
Administrative	X	X	X	X			X
Schedule delay	X	X	X	X	X		
Theft			X		X	X	
Damage			X		X	X	
Climate change/ disaster	X		X	X		X	
Neighbourhood externality					X		X

Table 1: Mapping risks to the property market value chain

Source: Authors' own

Credit and refinancing risk. Credit and refinancing risks arise in all aspects of the value chain apart from tenure and occupation. Credit risk refers to the risk of default on debt repayments, whereas refinancing risk is the risk that prevailing loans will have to be financed at higher interests, or may not be refinanced at all (IMF, 2014). The capital-intensive nature of property developments makes debt financing the primary means to fund property market activity (Morri and Mazza, 2014). Property development projects may take years to complete. As such, large amounts of money are borrowed for long periods in order to finance activities along the property market value chain. This creates credit risk. In the housing space, long-term loans (mortgages) are typically used to enable home buyers to meet monthly payments on their mortgage. This exposes financiers to the risk that borrowers are unable to repay the funds. Financiers are also subject to asset-liability mismatches, which could cause prudential risk when using short-term deposits to finance long-term development projects (Asian Development Bank, 2008). Finally, refinancing risk may arise from adverse changes in macroeconomic conditions, changes in the risk appetite of the lender, administrative and schedule delays or even theft or damage.

Macroeconomic risk and political risk discourage investment, raise costs and decrease rental demand. Macroeconomic and political risks are prevalent across the value chain. Adverse macroeconomic events can have negative effects on the financing, construction and maintenance of

property[17] (World Bank, 2009a). Fluctuations in economic activity over the business cycle can also affect the property market. Retail business rentals are particularly sensitive to the business cycle, as commercial lease contracts oftentimes require tenants to maintain revenues above a stipulated threshold (McGaffin, 2017). Further, in difficult economic times, landlords, estate agents, and brokers may be subject to non-payment of rent by the lessee as stipulated by the lease agreement. An unstable political climate may further exacerbate macroeconomic risks. Concerns around land rights, approvals and tenure required for development and continued use of land disincentivise investment activity[18]. For example, although widely accepted and simple to administer, customary tenure is susceptible to loss of legitimacy or legal status in the context of urban property market development (Quan and Payne, 2008). Macroeconomic and political uncertainty therefore adds to the overall risk of property development.

Administrative- and schedule-delay risks also have cost implications. Administrative bottlenecks arise due to process inefficiencies around the implementation of particular policies and procedures within municipalities (NBI, 1996). Administrative and schedule-delay risks arise during most aspects of the value chain, apart from when maintenance and ongoing repairs are being undertaken. Administrative uncertainty can cause schedule delays outside of stipulated deadlines at various stages of the property development process. This is a risk, particularly if the development relies on debt financing. Schedule delays beyond the contractual or agreed completion date can result in cost overruns, forgone profits and postponement of use or occupancy of commercial and residential property. Input costs may escalate, while wages and interest expenses would need to be paid for longer than expected. Severe delays may even result in the abandonment of a property development. In addition, corruption can contribute to further administrative inefficiency and directly add to costs. Schedule delays can also occur due to inefficiencies during the development, engineering and construction phases (Ramanathan et al., 2012). Actors who are involved in the components before occupation and who have a financial stake in the development – for instance developers and investors – are most affected by administrative and schedule-delay risks. Stakeholder consultations highlighted that these risks are amplified in commercial property markets, due to their scale and duration and the amount of financing required to sustain operations.

Theft risk and damage risk cut across the value chain. Theft and damage risk arise primarily during the construction, use, and maintenance of property. Damage to property may be accidental or intentional and can begin even before the construction phase. Poor design, construction, and maintenance can contribute to structural problems that result in damage to property. Theft risk typically arises in the construction, occupation and maintenance segments of the property market value chain. During the construction phase, the flow of input supplies and easy accessibility of building equipment create the risk of theft and damage. During occupation and use, theft and damage – fire, for instance – can also increase risk

[17] For instance, currency fluctuations and inflation could affect the cost of financing, make international finance unobtainable, or adversely impact on the cost of inputs like building materials.

[18] Political risk arises from exposure to war, revolutions, government seizure of property and actions to restrict the movement of profits or other revenues from within a country (Gordon, 2008).

for owners or renters. This contributes to the cost of property occupation and maintenance, more so if the property is still being financed.

Climate change aggravates disaster risk. Climate change risk is relevant to most aspects of the value chain, with the exception of tenure, occupation, and sale. Rapid urbanisation in developing countries is placing pressure on cities in terms of infrastructure, housing and employment. At the same time, climate change and variability in weather patterns are undermining the food and water resilience of some cities, while damages from climate-related disasters are increasing. Climate change is therefore posing an increasing risk for the property market, meaning that the planning and design of urban areas and particular property market developments should increasingly factor in the possible droughts, water shortages and damage to property that can result from extreme weather conditions. This, in turn, has cost implications.

Despite facing similar risks, the emphasis is different for residential and commercial property markets. The risks outlined above manifest in both the residential and commercial property market value chains, but the severity of particular risks varies across the market segments. For example, in the commercial space, title and tenure seem to be less of an issue than in residential property markets. Residential property owners, in turn, may be subject to greater neighbourhood externality risk. Neighbourhood externality risk is predominately prevalent during the occupation or use of a residential property, and also during the sale process. For instance, changes in neighbourhood amenities and the increasing risk of neighbourhood decay may adversely affect housing prices (Hilber et al., 2002). Land assembly is more of an issue for commercial property development, which is location sensitive. For instance, identified land for commercial development often overlaps between different zoning areas. In addition, disputes between local residents and developers or investors can affect approvals and tenure required for development and continued use of the land.

Constraints experienced along the value chain

Apart from the risks outlined above, property markets face a number of non-financing and financing constraints. "Non-financing constraints" refer to constraints not related to credit, but rather to matters such as access to infrastructure, administrative processes and regulatory and market constraints. Such constraints may have severe cost implications, which can become even more burdensome when financing is constrained. Property markets require funding for securing land for new developments/construction, ongoing maintenance and improvements, as well as the purchase of existing properties. Due to the capital-intensive nature and long investment horizons of property market activity, limitations in funds available to various actors along the property market value chain constrain activity in the sector.

Table 2 highlights the key non-financing and financing constraints experienced along the property market value chain, each of which is discussed in more detail on the next page:

	Land assembly/ acquisition	Tenure	Construction	Internal/ connector infrastructure	Occupation/ use	Maintenance and ongoing repairs	Sale and transfer
Non-financing constraints							
Access to suitable land and infrastructure	X			X			
Administrative processes and regulatory constraints	X	X		X			X
Market constraints			X			X	
Financing constraints							
Limited developer finance	X		X				
Small and underdeveloped mortgage markets	X		X				X
Absence of non-mortgage market systems	X		X				X
Municipal underinvestment		X		X			X

Table 2. Primary constraints along the property market value chain

Source: Authors' own

Non-financing constraints have substantial cost implications. Non-financing constraints arise on three main fronts: (i) access to land and infrastructure; (ii) administrative and regulatory constraints; or (iii) market constraints:

- **Limited access to suitable land and infrastructure constrains development opportunities**. Having access to land is the most fundamental component of any property development. Further, access to and availability of bulk infrastructure and basic services affect the suitability of spaces available for development. The commercial property market is more location sensitive than the residential property market. Strategic pieces of land provide important linkages to economies and markets. The linkages to basic infrastructure, key facilities and amenities are particularly critical in earmarking parcels of land. Hence, limited availability of well-located land would constrain land assembly and acquisition.
- **Administrative processes and regulatory bottlenecks add costs**. Several administrative processes are involved in the property development value chain, which carry significant costs in their own right and can therefore make it difficult to successfully launch and complete a property development project. For instance, the World Bank Ease of Doing Business Index reports on the ease of getting a construction permit, the ease of obtaining an electricity connection and the ease of transferring a property. All three of these entail costs, which can have an impact on smaller property developers[19], especially. Furthermore, as property development relies extensively on debt financing, any procedural and administrative delays – such as time to obtain a building permit[20] – can have knock-on financing costs. Delays can occur from project conception through to construction and sales and transfer.

Municipal underinvestment constrains administrative capacity during land assembly and therefore contributes to delays in the commencement and completion of property development projects (National Treasury, 2008). Furthermore, formal ownership status is filed with the land or deeds registry within a particular jurisdiction. Thus, tenure status may be constrained by the administrative capacity of provincial and municipal governments. Delays in regulatory approvals and compliance with regulatory restrictions can affect the planned commencement date of the construction phase, while regulatory and administrative delays can also hamper the sale of residential property, which could ramp up the professional services fees incurred by the seller[21].

[19] For instance, the cost of a construction permit to build a warehouse in South Africa is about 1.6% of the value of the warehouse, while it is 3.1% in Zambia and 6.3% in Mozambique. In Nigeria and Zimbabwe, the cost can be between 18.5% and 22.5%. Similarly, the cost of getting electricity can vary widely: in South Africa, it is 147% of per capita income; in Zambia, it is 589% of per capita income and in Mozambique 2,817% of per capita income. This is still far lower than Uganda, where the cost of connecting to electricity is 7,508% (World Bank, 2018).

[20] For instance, the World Bank Ease of Doing Business Construction permit indicator includes the number of days it takes to get a construction permit to build a warehouse. In Botswana, it takes 106 days, while Mozambique is 118 days. It takes even longer in South Africa (149 days) and much longer in Zambia (184 days). This constraint does not seem to correlate closely with the overall level of economic development (for instance, in OECD countries, it takes 154 days) (World Bank, 2018).

[21] Registering a property in sub-Saharan Africa (SSA) carries the largest cost burden of 8% of property value, as compared to South Asia (6.9%), Latin America & the Caribbean (5.6%) or Europe & Central Asia (2.3%). Among SSA countries, the cost of registration is higher in Nigeria (10.5%) than in South Africa (7.6%), Ghana (6.2%) or Kenya (6%) (World Bank, 2018).

- **Market limitations fuel cost escalations and exacerbate delays**. The costs incurred during the construction phase may be escalated due to low competition, should the number of developers and contractors capable of undertaking property development projects be limited. Limited expertise and capacity also introduce delays, which, in turn, have cost implications. Maintenance and ongoing improvements may be constrained when the cost of materials increases far beyond what was expected during the construction phase.

Finance constraints impact on the supply and demand of property development. The absence or high cost of developer finance limits the resources available for property development projects. Small mortgage markets can also constrain the demand for residential[22] and commercial property, as well as the resale market (Morri and Mazza, 2014; World Bank, 2009b). Similarly, there is a lack of alternative (non-mortgage) financial tools such as housing microfinance[23], which also impacts on demand and the resale market. Municipal underinvestment in bulk projects constrains access to basic infrastructure and limits the administrative capacity of the government.

Various factors affect access to financing. Capital allocation is largely driven by risk and potential returns. In addition, our consultations highlighted the following factors that affect the availability and allocation of capital, and therefore access to financing mechanisms within property markets:

- GDP growth and the business cycle have an impact on property markets, as some property markets are directly exposed to the level of economic activity (for instance, hotels and malls). Prolonged constrained growth or highly volatile growth can therefore negatively affect investment (and access to finance) in these sectors. Because interest rates have a direct impact on property financing by virtue of dictating the cost of finance, monetary policy can also influence the availability of finance (BIS, 2005).
- Tax deductions and subsidies can also affect the availability of property finance. These are usually aimed at catalysing demand for property, but they can affect access to finance for specific sectors. For instance, tax deductions for commercial or higher-income properties can make those investments more attractive in relation to low-income housing, effectively decreasing the supply of finance to lower-income segments.
- The market for onselling (including up-selling or down-selling) a low-income home can be constrained; for example, in South Africa it is very difficult to progressively upsell from an informal home to a middle-income formally constructed home – even though there are multiple tiers of homes in between these two categories. This lack of liquidity in the onselling market constrains the overall demand for property in the gap market[24] and the overall appetite of financiers to provide financing to participants in this market.

[22] The absence of segment specific financing systems can also constrain particular sub-segments. For instance, the absence of non-mortgage finance systems for micro housing projects.

[23] Defined as "any micro financial tool to support investment in the components of housing, including land purchase or access, provision of or improvement to services, full or incremental house construction, renovation or maintenance" (Rust, 2009).

[24] A market defined as being too low income to be served by formal financial providers, but too high income to qualify for subsidised or government provided housing.

Box 4 highlights the key constraints that arose from the Zambia case study:

Box 4: Constraints in the Zambian property market

Although access to land and infrastructure, administrative and regulatory constraints, the business cycle, and lack of tax incentives and subsidies are all relevant in Zambia, the most pertinent constraints highlighted by industry players are market and finance related. These include the following:

- **Affordability**: High house prices and low affordability in Zambia are identified as a key market constraint.
- **Quality**: Financing constraints and over-reliance on informal, unregistered contractors or self-building have led to substandard buildings, particularly for middle and low-income home owners. Registered contractors are mainly used by investors and developers.
- **Financing**: Financing seems to be a challenge particularly for home owners. Although most banks and building societies in Zambia offer mortgages, most mortgages are for movable property (like equipment), and it has been estimated that there are fewer than 3,000 active mortgages for immovable property in the country (Cooper et al., 2017). Appropriate and affordable financing instruments are therefore lacking[25].

Construction costs: The availability of affordable building materials is considered as one of the long-term impediments in Zambia's construction sector.

Source: interviews conducted by Manje (2018) as input to this study

[25] The underdeveloped mortgage market is likely as a result of an overall constricted credit and capital market in Zambia. Banks lack access to longer term capital, which reduces the term of loans they can provide, but they also invest disproportionally in Treasury bills and government bonds, which offer good yields. Hence the incentives for investment in longer-term property market instruments are limited. At the same time, interest rates on credit is high, and most banks do not offer reduced interest rates for mortgages compared to other types of loans. For more information, see Cooper et al. (2017).

4 What role could insurance play?

The previous sections outlined the links and actors in the property market value chain and the risks, finance constraints and other challenges that they face. This section explores the current and potential role that insurance can fulfil to help overcome the various constraints and to better manage the risks. To do so, we first look at the in-principle functions of the insurance market in economic sector development, before turning to the particular needs that insurers can – or could – fulfil in the property market.

What are the functions of insurance markets?

Insurance markets unlock opportunities for economic growth. As documented by Chamberlain et al (2017), insurance markets contribute to economic growth and development through two primary avenues: by supporting risk management and through capital intermediation. However, this link is not automatic. The actual roles will differ per country, depending on the macroeconomic and political economy context and the stages of development of the insurance market. Where the insurance market intersects with a particular value chain (like the property market), the state of development of that particular value chain also affects the role that insurance can fulfil in practice. Below, we take a closer look at the generic role[26] of insurance in risk management and capital intermediation, respectively:

- **Insurance markets enable risk management and productive risk-taking**. In preparing for risk, economic actors may elect to acquire knowledge to understand risk exposures, obtain protection to mitigate potential losses or transfer the risk to those best suited to manage it (like insurers). The transfer of risks to insurers provides economic agents with a more stable basis for planning (Kessler et al., 2016; Zweifel and Eisen, 2012). This promotes entrepreneurial activity by allowing firms and individuals to focus on their core activities. In the property market, this means that insurance can enhance the willingness of property market actors to undertake risky ventures, while protecting innovators and investors from shocks. In addition to risk transfer, insurance markets also promote more proactive risk management. This consists of knowledge generation, preparation, risk reduction and coping (World Bank, 2013). Insurers do so by collecting information and by providing loss prevention, safety and risk management advice and services to customers[27]. For instance, insurers can require fire extinguishers and fire drills on building sites.
- **Insurance markets mobilise, pool and intermediate capital**. Insurance companies accumulate large amounts of premiums, which are paid in advance (Dickson, 1998; Gupta, 2014). In the case of long-term insurance policies, premium income is available for investment over long time horizons. Insurers also generate funds from investment income and maturing investments that need to be reinvested. Insurers are responsible for preserving the long-term value of their assets to meet their long-term liabilities as they fall due. Thus, by investing their assets, insurers mobilise and pool capital and intermediate it by investing in economic activities.

The rest of this section considers the role of insurance specifically in the property market, from

[26] not specific to property markets

[27] However, a key question is the relative size of the different types of risks versus the products available. It would seem that some of the most material risks are not covered or can only be covered for specific types of developments (see performance bonds above). In other words, although insurance can reduce risks, in many segments of the property market value chain these are not material enough to overcome the risk barriers to the development of new property.

three angles: the role in serving the risk management needs of the property market value chain, the role in helping to bridge property market financing needs and the scope of the insurance sector to boost investment in property markets.

Serving the risk management needs of the property market

Various offerings to address insurable risks. Insurance markets are well-suited to support the development of the property market. The risks faced by property market actors give rise to several risk management needs, many of which are insurable[28]. For instance, property market actors can take up insurance products such as political risk insurance, advance loss of profits insurance, credit insurance, construction insurance and commercial property insurance, among others. Insurers can also provide guarantees, such as performance bonds.

Not the only solution. Alternative risk transfer (ART) describes the use of risk management tools other than traditional insurance or reinsurance (Saxena and Villar, 2008). ART makes use of innovative insurance and capital market solutions, and risk trading is typically carried out in financial markets. ART therefore offer additional avenues for property market actors to manage their risks.

A closer look at insurance options. The remainder of this chapter focuses on the role of traditional insurance products and guarantees in the property value chain. Table 3 on the next page highlights the insurance products and guarantees that could be relevant for actors along various stages of the property market value chain, according to the risk management needs identified in Section 3. These are grouped and discussed further on the next page.

[28] The insurability of risks in the property market can be determined by whether: i) they are assessible, i.e. the probability and severity of losses are quantifiable, ii) they are random, accidental, and unintentional, and iii) a large enough pool of individuals are exposed to a risk exposure, such that they are able to form a risk community where risk is shared and diversified (Gordon, 2008; Gupta, 2014)

	Land assembly/ acquisition	Tenure	Construction	Internal/ connector infrastructure	Occupation / use	Maintenance and ongoing repairs	Sale and transfer
Political risk insurance	X	X	X	X	X		X
Advance loss of profits insurance			X				
Performance bond	X	X	X	X			
Extreme climate facility	X		X	X	X	X	
Credit insurance			X			X	X
Construction insurance			X			X	
Commercial property insurance			X			X	
Commercial liability insurance			X			X	
Business interruption insurance			X			X	
Engineering insurance			X			X	X
Rental protection insurance		X					X

Table 3: Insurance along the property market value chain

Source: Authors' own

Insurance cover for political risks. The macro-economic and political risk exposure along the value chain gives rise to the need for mechanisms and products that protect property market value chain actors from adverse macroeconomic events and political instability. Political risk insurance typically provides coverage for developers, international investors and financiers against war, revolutions and expropriation of property. Oftentimes, macroeconomic risk exposure is included in the coverage for political risk. The private insurance market is active in providing political risk insurance, with governments addressing the missing market where private-sector participation is inadequate. However, unlike typical insurable risks, political risks can unfold over extended periods, making it difficult to ascertain whether and when the risk event took place and to quantify the severity of the loss experienced. In addition, international investors may be able to influence the probability that an insured political event will take place (Gordon, 2008). This poses challenges to insurance contracting, information gathering and contract monitoring. Consequently, political risk insurance markets are burdened by transaction costs that undermine its profitability and viability.

Insurance cover for administrative- and schedule-delay risks. Administrative bottlenecks and schedule-delay risk exposure give rise to the need for financial and technical support to help cope with delays. Advanced loss of profits (ALOP) or Delay in Start Up (DSU) insurance provides coverage to developers, construction companies or financiers for the period of the delay – provided the delay arose due to a loss during the construction period (IFC, 2017). DSU is fairly widespread, and

banks oftentimes insist that developers take it up as a condition for obtaining debt financing (Munich Re, 2013). In addition to taking out insurance cover, developers may elect to utilise payment and performance bonds as a risk transfer mechanism. The insurer acts as a third-party guarantor between two external parties and agrees to cover cost shortfalls and overruns – irrespective of the reason for a risk materialising. For instance, if a project runs over budget due to bad quality, bad management or sometimes even fraud, the insurer is liable. Information on trustworthy developers and contractors is therefore critical to minimise the risk carried by the insurer. It is unclear to what degree performance bonds are being utilised in developing countries though.

Insurance cover for exposure to climate change and disaster risk. Private insurance for disaster risk management is widely available in developed countries; however, it is limited or non-existent in developing countries (Le Quesne and Tollman, 2017). Nevertheless, disaster risk insurance schemes are typically structured as public–private partnerships (PPPs). The government promotes and incentivises PPPs through legislation, subsidies and investment in risk awareness. Private insurers are primarily involved by providing capital and technical expertise, driving innovation, distributing products and services and educating consumers (World Bank, 2014). Coverage against extreme weather conditions can also be taken up at the national government level. For insurance, the African Risk Capacity (ARC) is a specialised agency of the African Union that helps member states to plan, prepare and respond to disaster risk, with the view to protect food security (ARC, 2016). An extreme climate facility triggers funding to countries that are already managing their weather risk through ARC Ltd and provides cover in the event of the increase in occurrence and intensity of weather shocks across Africa, such as extreme heat, droughts, floods or cyclones.

Insurance cover for credit risk exposure. Credit risk insurance protects lenders against bad debts arising from events that prevent borrowers from making payments on time, such as death and disability. Further, insurance companies protect against default by providing a range of insurance services to firms and households against property losses, damages and negative events affecting loan repayment abilities. Hence, insurance markets effectively help to lower credit risk and therefore contribute to the development of the property market by helping property market actors to secure financing.

Insurance cover for damage, theft and business interruption. Damage that arises during the construction segment is covered by construction all risk (CAR) insurance, which provides coverage for the costs and refurbishments from commencement through to extended maintenance. Further, if property development is interrupted, business interruption insurance insures property developers and investors for loss of profit until normal property development is resumed. Insurers provide the financial means for making up any losses incurred, while also enabling continuity of service by protecting production tools. Structural problems or damage arising from poor quality design, construction and maintenance are typically covered through engineering insurance that is embedded in engineering, procurement and construction (EPC) contracts.

Property risk insurance cover. Once a property has been occupied, there will be home owners' insurance or household insurance that covers the physical structure and contents of residential property, and property insurance for commercial property. Rental protection insurance may also be relevant, if a residential property is rented out. Similarly, commercial liability insurance is taken out by the commercial lessee to cover not only their own risk of business interruption, but also the property they are renting. "Property all risks

insurance" refers to all perils, except those specifically excluded in the insurance contract, for example war, wilful acts and defective design (IFC, 2017). A property insurance policy will typically include cover for damage caused by fire, lightning, explosions and aircraft impact. A basic fire insurance contract may also be entered into on a standalone basis.

Property insurance as business class constrained, linked to underlying property market development constraints. Although the insurance products described above exist in some markets, data is not available on the exact availability and take up in SSA of the specific types of risk cover noted above. Retail level products like credit insurance, credit life insurance and property insurance exist in most markets, but they are likely not realising their full potential. Commercial insurance for schedule delay exists in some cases, but the prevalence across markets is unclear.

As insurance markets in SSA are relatively underdeveloped[29], it is safe to assume that the penetration of property-market-related insurance cover is likely to be low in most countries. It also seems that the insurance market for already-constructed properties overshadows insurance to the construction industry itself. In South Africa, which has the most developed property market on the continent, engineering insurance[30] accounted for just under 3% of annual net written premiums for general insurance in 2015 (FSB, 2017). Property insurance as a business class[31], on the other hand, makes up about 33% of annual net premiums written. In Zambia, likewise, property insurance comprised 27.4% of non-life insurance gross written premium in 2016[32], compared to 8.7% for engineering insurance[33].

The small size of the property market itself and the constraints to property market development, limit the scale of insurance involvement[34]. For instance, CAHF (2017) finds that "outside of South Africa, there are very few developers with the capacity to deliver more than 500 [housing] units per annum for more than three years". This suggests a low demand for property-related insurance. Limited insurance, in turn, further constrains the development of the property market.

[29] For instance, in Zambia, Gross Written Premiums was only 1% of GDP in 2015, and general insurance accounted for about two thirds of this. In the same year, only 2.8% of all adults in Zambia had insurance cover (Cooper et al., 2017).

[30] This includes amongst others contractor or erection all risk insurance, electronic equipment insurance, machinery breakdown insurance and plant all risk insurance.

[31] This includes fire, other damage and theft, and while it excludes motor vehicles, airplanes and ships, it likely includes household contents and business equipment.

[32] However, as movable and immovable property insurance is jointly reported, the share of immovable property insurance of the overall property insurance business class is not known. It may be that immovable property comprises a small portion of the overall property insurance. For instance, using the financial performance figures from the state-owned insurance company, Zambia State Insurance Corporation (ZISC), private insurance (home owners) constituted 3% of the total gross underwritten premiums in 2016 and 2017. Madison General, one of the major general insurers also had 3% for the same years. The mortgage insurance market is also not tracked separately, but given the small size of the mortgage market, mortgage insurance penetration should be correspondingly low.

[33] Please note, although property insurance as a business class is the second largest business class in South Africa (after motor vehicle), and similarly the second highest in Zambia, this includes risks not related to buildings directly, like theft of movable assets (excluding motor vehicles, ships and airplanes). It is therefore not possible to distinguish the market for building related insurance in isolation.

[34] For example: mortgage insurance in South Africa is a big market. However, mortgage markets in other SSA countries are extremely limited (as per the Zambia example), and hence mortgage insurance in these markets would be correspondingly low.

Sound risk management practices are a prerequisite to successful insurance for property markets. An additional challenge to insurance tailored to the property market value chain, particularly in the earlier links of the value chain, is that insurance is not a panacea for the risks faced by property developers. Property development is inherently a risky business, and insurance cannot provide cover for all risks, especially if sound risk management is not applied by all parties involved. Even in developed markets, this is found to be problematic. A study of the risk management practices of 69 leading real estate development organisations in Europe (Wiegelmann, 2012), found widespread fragmentation, lack of formalisation and co-ordination, reliance on individual judgement, and a disjoint between individual risk management and the risk appetite of the organisation[35]. It is unknown what the corresponding practices in SSA are, but a lack of sound internal risk management practices will certainly detract from insurers' appetite to cover property-related risks and can therefore further undermine the viability of property market-related insurance as focus area for insurers.

Box 5 on the next page provides an overview of property insurance as a business class in Zambia.

[35] The study also found "limited substantive research" on risk management directly related to real estate development.

Box 5: The Zambian property insurance market

In Zambia, insurance companies offer property insurance cover on a number of particular property-related risks[36]. However, the regulator (and therefore insurers as well), only capture data on two business classes related to property market development: property and engineering[37].
The main property insurance clients in Zambia are mines, contractors, and government departments. Commercial property owners – particularly in office space, hotels and shopping malls – are also major consumers. Insurers observe that most property insurance is taken up when the client is required to do so to comply with contractual requirements. For instance, secured finance is usually only provided if Professional Indemnity insurance is in place.

Consultations with Zambian insurers suggest that insurance to the property market is constrained by several cross-cutting challenges. These include a low appreciation of insurance, low effective demand and the voluntary nature of property insurance outside of credit insurance (see Appendix 2 for more detail). It is suggested that bundling of property and other insurance would help to increase the attractiveness of this market segment.

Source: Interviews conducted by Manje (2018) as input to this study.

Helping to serve property market financing needs

Finance is important in catalysing property market development, which in turn would open pathways for the property insurance market to grow. The financing constraints covered in Section 3 imply that there are investment opportunities for the investable funds accumulated by insurers. Moreover, insurance may have a role in helping to secure access to financing for the property market. This section therefore sets out the financing mechanisms utilised by property market actors to give a sense of the needs that could be served by insurers, while the next sub-section explores why property market investment opportunities are not easily pursued by insurers.

Diverse property market financing needs. The different actors along the property market value chain have distinct financing needs. There are several instruments that can serve these needs, depending on the nature of the requirements. These can be divided into debt-based or equity-based instruments[38]. Equity and debt financing may be further divided into private or publicly traded instruments that represent directly or indirectly held property interests, respectively.

[36] Including fire, domestic package, asset risks, contractors, risks, erection risks, plant, computer and electronic equipment, machinery break down, bond, boiler and pressure vessels, office content, burglary and political violence.

[37] Definitions of these two classes are still under discussion between the Pensions and Insurance Authority and industry players. Engineering would include, among others, contractor or erection all risk insurance, electronic equipment insurance, machinery breakdown insurance and plant all risk insurance (South Africa definition).

[38] Equity represents money and resources provided by property owners that participate in the risk of a venture and share in the profit, whereas debt is finance provided by lenders that creates a fixed obligation on the borrower to repay (Isaac, 1996).

This results in four categories of property finance as summarised in Table 4 below and discussed in more detail in Box 6 on the next page.

	Private markets	Public markets
Debt/lenders	*Whole loan mortgages* *Housing microfinance*	Collateralised mortgage-backed securities (CMBS) and similar vehicles
Equity/owners	*Direct, private, real estate investments*	Real Estate Investment Trusts (REITs) and publicly traded vehicles

Table 4: The four quadrants of real estate financing

Source: Evans and Evans (2007)

Box 6: Property finance categories

Property finance can be conceptually divided into four distinct categories, as follows:

Private debt markets primarily comprise loans or mortgages made by banks or mortgage trusts. A mortgage represents a direct interest in a property as security for the loan offered (Ling and Archer, 2016). A whole loan mortgage describes a single mortgage that has not been securitised[39]. Mortgages are important financing mechanisms in both residential and commercial property markets. Project finance can serve as an alternative to mortgages for commercial property development, given the large financing requirement and long duration to complete development[40]. Housing microfinance is also a private debt market product. These are personal asset building loans provided by microfinance institutions (MFIs), in addition to their normal enterprise finance loans. These loans are "short-term, cash-flow-based loans for renovation and incremental construction purposes" (World Bank, 2009a).

Private equity markets represent direct investments into commercial and residential property.

Public debt markets comprise collateralised mortgage-backed securities (CMBS), as well as designated municipal bonds for property development. CMBS is made up of aggregated mortgage loans of varying terms and values. Unlike whole loan mortgages, an investment in a CMBS represents an interest in the pooled value of properties, as opposed to lending to a single property. To supplement local government authorities' own financing, municipalities may raise additional funds through long-term municipal bonds and loans (National Treasury, 2008; Peterson, 1998). These bonds usually have designated uses, like infrastructure projects. A municipal bond that is raised for the purpose of a public property development project is also a property finance mechanism.

Public equity comprises real estate investment trusts (REITs) and real estate mutual funds (REMFs). REITS are special companies that directly manage, operate and own a portfolio of income-producing property (JSE, 2016). Equity REITs invest in and own income-producing property, whereas mortgage REITs invest in and own property mortgages (Evans and Evans, 2007). In contrast, REMFs are mutual funds that hold a portfolio of real estate assets, including REITS (ICI, 2007).

[39] Securitisation is "the process of taking many individual assets and combining them into a group, or pool, so that investors may buy interests in the pool rather than in the individual assets" (Evans and Evans, 2007)

[40] Project finance describes loans provided directly to a project, not a company. The returns of a commercial property project are related to the project's ability to generate cash flows to compensate investors (Morri and Mazza, 2014)

Private debt markets failing to meet property market development needs. Although mortgage markets are one of the key drivers of property market financing, this mechanism is severely constrained in sub-Saharan Africa. In 2016, South Africa's outstanding mortgage value as percentage of GDP was 22%. In contrast, only five other mainland sub-Saharan African countries had percentages above 1.5%[41]. Private debt markets (particularly mortgage markets) are therefore typically severely constrained in sub-Saharan African markets, especially in ones where the financial sector is also under-developed[42]. In addition, mortgages in these markets often do not cover the full amount of the property, and rarely offer sufficiently long loan terms[43]**.** The issues seem to lie with the availability of longer term funding, and the alternative investment options available to banks. Banks primarily source funding through retail deposits gathered from households and firms. These short-term deposits can be withdrawn without prior notice, which affects the ability of banks to provide long-term financing. Banks also have to consider trade-offs in investing the long-term deposits that are available. In most markets with underdeveloped financial sectors, government T-Bills and bonds, as well as foreign deposits are the most popular instruments for banks to invest in[44].

Housing microfinance suited to low-income markets, but limited reach. Access to formal mortgage markets is typically even more constrained for low-income households – particularly those with volatile incomes that pose cashflow and credit risks for lenders. One alternative to a mortgage is a housing microfinance loan, which can be used for incremental building or repairs. However, even these loans fail to meet housing demand. For instance, less than 1% of adults in Zambia have a loan with an MFI, regardless of whether the loan is used for housing (Bank of Zambia et al., 2016). At this penetration rate, MFI loans certainly cannot address the gap that the mortgage market leaves. In many emerging markets, residential housing is therefore self-financed from savings or directly financed through informal mechanisms, such as friends and family, savings and lending clubs or cooperatives and landlords[45]. However, informal sources of housing finance are constrained by

[41] Botswana (18.2%), Namibia (6.6%), Rwanda (3.6%), Kenya (3.5%) and Zimbabwe (2.8%) (2012/2013 data). Countries like Zambia (1.3%), Uganda (0.9%, Nigeria (0.6%) and Ghana (0.4%) were even less. Statistics drawn from Hofinet (2016).

[42] For instance, in Zambia, it is estimated that there are less than 3000 mortgages for immovable property. This is extremely limited, given that there are 2.6 million households in Zambia (Cooper et al., 2017).

[43] For instance, in Zambia, 92% of bank mortgages are less than 5 years in term, and 37% of bank mortgages are less than ZMW 100,000 (just over USD 10,000) (Cooper et al, 2017).

[44] Mortgage banks present an alternative to commercial deposit-taking banks. These specialised institutions typically raise funds by issuing securities that are purchased by pension funds and insurance companies. However, although they sometimes offer shorter term and smaller sized loans, they generally do not resolve the constrained nature of mortgage markets in the markets mentioned. For instance, Zambia has several building societies, but they only serve 18,000 clients in total, and their average loan size is just over USD 1,500 (also see footnote below).

[45] Some countries also provide public low-income housing and/or subsidised low-income housing.

limited funding, scalability and inadequate risk management practices.

Private equity markets extremely small, and mostly not related to property market construction. Although private equity funds[46] offer opportunities for property market construction, and particularly for pooled ownership of commercial properties, this mechanism is likely not currently supporting property market development significantly in sub-Saharan Africa. Although a growth rate of 8% a year is expected for the region, the number of private equity deals that were completed from 2010 to the first half of 2016 is less than 50% of those conducted in the European private equity market in one quarter of 2016. The value of deals over the same period (2010 to 2016) was only 6.5% of the equivalent in Europe for one quarter in 2016. More importantly for property markets, private equity deals in Africa focus almost exclusively on large profitable companies (with a proven track record and annual turnover over USD 100 million) (Ibemere, 2017). Investments also mostly focus on energy, infrastructure, banking, commodities and increasingly consumer goods (Dupoux et al. 2016). Given the limited spread of property developers in the region (excluding South Africa), this implies that this channel of financing likely has limited impact on the financing needs of property market development.

Public instruments largely lacking or limited in nature[47]*.* Collateralised mortgage-backed securities and similar public debt vehicles seem to be largely absent from the market outside of South Africa, though a few feasibility studies have been conducted outside of South Africa[48]. In addition, the corporate bond market is also underdeveloped. For instance, Zambia does not have a secondary mortgage market and, although the Zambia stock exchange does issue corporate bonds, this market remains limited[49]. In countries where this market is well developed, it is very large and liquid, and it offers an easy way to inject funding into the property market.

Investment-grade municipal bonds that are earmarked for capital expenditure relating to property development or other infrastructure[50] are also absent or constrained in the region (Gorelick, 2018). Local capacity to issue these bonds, along with trust in public-sector expenditure and confidence in the local municipalities' financial capacity, would be critical factors, as would regulation in terms of "the roles and powers of cities' authorities to raise finance and the ability of

[46] Private Equity Funds are investment funds that have a finite life, typically 7–10 years. Because of this finite life, the fund manager is forced to eventually dispose of the assets and return the investors' capital (Ling and Archer, 2016).

[47] Mortgage loans are bundled and converted to securities. The underlying mortgages are given credit ratings and the mortgages are separated into tranches or classes based on their ratings. Institutional investors, such as insurance companies, pensions funds and mutual funds, typically purchase the investment-grade tranches. A corporate bond is a type of loan that a company uses to raise money from investors. In return, the company promises to pay the investor interest and repay the money. Other financial instruments in this category, like syndicated mortgages and performance-linked securities, also offer opportunities to invest in the property market

[48] For example, see Wambui (2014).

[49] Only 23 companies are listed on the stock exchange, of which only one is related directly to property and six are related to financial services.

[50] Improved municipal infrastructure has positive implications on the time and cost required to deliver property developments, and hence, increases the attractiveness of property investments.

central governments to adjust these" (Gorelick, 2018). Interviews with stakeholders from South Africa also suggests that municipal bonds for specific property developments are complex to implement and require many stakeholders and a long period to get off the ground[51].

Where public equity options are concerned, capital markets outside South Africa are typically "narrow, shallow and illiquid" (Chamberlain et al. 2017). REITs offer a solution for investors to invest in the property market in an aggregated, low-cost manner, while covering some of the risk related to property investments. Although the use of REITs seems to be increasing across the continent, it is still fairly limited. Some of the challenges faced by current REITs in sub-Saharan Africa include, but are not limited to, lack of legislation, lack of public understanding, investor scepticism and limited property market information (Kruger-levy and Bertoldi, 2017). Consultations with Nigerian insurers also highlighted that the attractiveness of REITs as investment vehicle is undermined in that income is calculated on rental yields, rather than the appreciation in property value offered by direct property investments.

Insurance not driving property financing, but does grow in parallel. It is clear from the discussion above that finance instruments for property market development are underdeveloped in sub-Saharan Africa, although particular instruments show promise in a few markets. Insurance, as a guarantee against defaults due to insurable risk events, could help to unlock access to finance and is indeed important for the part of the market that does attract financing. But as is apparent from the low penetration of insurance in this sector, this role does not yet come to the fore other than where the mortgage or MFI market is already operating, in which case insurance is then already a part of the package. We do not yet see evidence that it is the presence of insurance that is driving the growth of property lending. Rather, the development of the two markets go hand in hand.

The next section looks at the role that the insurance sector could play as a direct participant in property market investments.

Scope for insurance markets to serve property investment needs

Property market investment most relevant during early stages of insurance market development. Chamberlain et al. (2017) describe how insurance investment behaviour changes over stages of insurance market development (measured in terms of life premium as a percentage of GDP, plotted against average income level of the country). Most countries in SSA are in stages 1 and 2, with only a few having made the transition to stage 3 and beyond. In the first three stages[52], insurers rely mostly on real estate and bank deposits to meet their investment needs. Government securities are also prominent in stages 2 and 3. During these stages, the insurance market is dominated by short-term corporate asset insurance, where the long-term investment needs of insurers are far less than in later stages. However, as the insurance market develops, the share of life premiums to total premiums increases, as do the insurance industry's assets under management. As a result, insurers adopt a greater diversity of

[51] Interview with Stephen Smith, Senior Policy Advisor, ASISA (See Appendix 1).

[52] Stage 1: Establishment and corporate assets; Stage 2: early growth and compulsory; Stage 3: Retail expansion

instruments, including collective investment schemes, equity and corporate bonds, meaning that the proportionate investments in real estate, bank deposits and government securities decrease. Thus, in countries like Nigeria (stage 2) and Kenya (stage 3), respectively 20% and 17% of total insurance investments are allocated to property markets, while in South Africa (stage 4), less than 2% of insurance investments are allocated to immovable property (NAICOM, 2015; IRA Kenya, 2017; ASISA, 2016)[53]. However, while Kenya and Nigeria allocate a far higher proportion of investment to property, the overall amount that insurers invest in property in these markets is only 15% to 17% of those invested in South Africa. In other words, as insurance markets develop, investment in property markets continues to grow in absolute terms, despite a far greater reliance on other investment instruments.

Property markets are utilised more when capital markets are underdeveloped. The greater reliance on real estate investment at earlier stages of insurance market development is not necessarily because property market investments suit the needs of insurers. For instance, "non-life insurance products tend to generate short-term liabilities requiring investment in short-term and liquid assets" (Chamberlain et al. 2017). So, when non-life insurance dominates the market (in stages 1 to 3), insurers require short-term and liquid investment products (also see Box 7 below). While bank deposits meet these requirements, real estate investments typically do not. The heavy reliance on real estate in these stages is therefore largely a function of the limited investment options available. Investment options, in turn, are limited because capital markets in sub-Saharan Africa are typically underdeveloped.

Box 7: The investment needs of short-term versus long-term insurers

Chamberlain et al. (2017), quoting an earlier study by Kong and Singh, (2005), explain why the investment needs of general and life insurance differ:

"Insurers receive premiums on a regular basis in order to provide for liabilities that may occur at some point in the future. The nature and term of the liabilities are determined by the nature of the insurance *contracts and the level of investment guarantees included. Life insurance, contractual savings (particularly* where investment guarantees are included) and pension products create predictable and longer-term liabilities for insurers, requiring investment in long-term and illiquid assets. Non-life insurance products tend to generate short-term liabilities requiring investment in short-term and liquid assets. Through the process of asset and liability management, insurers match their liabilities with an investment portfolio of appropriate structure and duration."

[53] Stage 4 is the diversified retail stage, where life insurance premiums typically make up more than 75% of all premiums and insurance penetration is more than 5% of the adult population.

Regulatory guidelines often prescribe allocations to property investment. Insurance regulators often place mandates or limits on investment allocations to particular asset classes, including property. For instance, Nigeria requires at least 20% of its non-life funds and 40% of its life funds to be allocated to property. In Kenya, however, a maximum limit is prescribed. Before new regulations were passed in 2017, the maximum limit for property investments was 70%, although an additional 30% could also be invested in mortgages (20%) and REITs (10%) (IRA Kenya, 2015). However, in 2017, the overall exposure to property investments was reduced to 30% (IRA Kenya, 2017). Similarly, South Africa only allows 25% of insurance investment portfolios to be allocated to property. In both Kenya and South Africa, actual investment in property (as discussed above) is well below the ceiling allowance.

Insurance market investments could help serve demand for property. As discussed, insurers in less developed markets require short-term and liquid investment products. However, in relatively more developed markets, insurers actually require longer-term investment vehicles. Given that property markets are not meeting the demand for property in sub-Saharan Africa (see Section 1), there are substantial opportunities for investment across the continent. The insurance sector should be ideally suited to meet these in more developed markets given the long-term nature of the assets held. Why, then, does one not witness more investment into the property market by the insurance industry?

Property market investment options, by and large, do not meet the needs of insurance company investment portfolios. The reason that insurers maintain limited property market portfolios in more developed markets is, to some degree, that property market investment mechanisms do not suit the needs of insurance companies. Pension and insurance funds are managed by investment managers, who specialise in the efficient management (low management cost) of high volumes of funds. As the market develops and funds under management grow, it becomes even more pertinent to find efficient, low cost aggregated investment vehicles. Fund managers have specific parameters within which they work and have to make trade-offs to reach the returns targeted by the institutions they represent (see Box 8 on the next page). Property markets are, therefore, traded off against other investment opportunities[54]. In more developed markets, capital markets are ideal for these parameters, as they offer a diversified portfolio of aggregated investment mechanisms. However, property market investment mechanisms constitute a smaller proportion of the overall options available.

Outside of the capital market, the property investment options that are available may also not be ideally suited to the needs of insurance company investments. For instance, insurance companies can become directly involved in the credit market by issuing mortgages, as is the case of one South African insurer consulted for this study. However, this is not a natural or easy move for an insurer because, unlike banks, insurers are not typically set up to deal with credit risk management and other activities required for the direct issuing and management of mortgages[55]. Insurance companies can also choose to commission property developments directly. However, they then carry many of the risks associated with the development of property (see Section 3). If they want to maintain ownership and generate revenue through the rental market, they also carry the occupancy risk[56]. If they decide to develop the property to onsell for profit, they face the risk that potential buyers cannot secure mortgages to buy the properties[57].

[54] This could differ from country to country. Some countries have far fewer options for investment, so property markets may constitute a larger component of the available options in these countries.

[55] As discussed, insurance funds are managed by investment managers, who typically manage large volumes of funds at low cost. For instance, in the example above, one investment manager could typically manage around R12 billion. However, the same insurer may have more than 30 staff managing a similar-sized pool of mortgages.

[56] Like failing to secure occupants but also the ongoing risk of managing and loosing occupants.

[57] This was the reason why the South African insurer referenced above decided to enter the mortgage issuing space.

Insurers have a direct investment role in property markets, but fail to address demand sufficiently. From the above, the conclusion is that insurance companies already participate extensively in property market investment in less developed markets, but not to a degree that is meeting the demand for property investment[58]. Their investment also results more from a lack of alternatives than the suitability of property market mechanisms for insurance market investment needs[59]. Nonetheless, the insurance sector's investment role in property market development seems to be more direct than the risk-related role that insurers play, which develops more in conjunction with the property market, as opposed to driving property market growth.

Box 8: Investment considerations for insurers

Insurance companies have to meet future expected claims, where the timing and the exact size of the pay-out are not always known. They therefore have to invest premium income in order to generate the best return, while ensuring that enough cash or liquid investments are available to meet any unexpected or large claims. The viability of insurers often critically depends on this investment income – especially when insurers operate in a competitive market, where premiums reflect the high level of competition. Insurers aim to generate the best return they can by ensuring that the investments are not overly exposed to risk and by keeping the investment management costs at a reasonable level. Government bonds are therefore often attractive instruments for insurers. The return is guaranteed (low risk), yet it remains reasonable (above inflation), and these bonds can be liquidated in the resale market. Commercial bonds offer better returns but can be higher risk. Equities represent higher risk still, but offer good returns, especially if investing in early stage stocks (Montalbano, 2017).

[58] For instance, the investment role by insurance companies in Zambia is largely restricted to financing the construction of their own properties, which they offer to the market for commercial rental. Of the 36 companies involved in investment in property market development in Zambia (identified through stakeholder consultations), only one is an insurer, while another two were affiliated with an insurance company, and two more were involved with pensions (Manje, 2018).

[59] As the insurance market develops and funds under management grow, insurers increasingly adopt capital market investment mechanisms, as investment mechanisms used in earlier stages of development (like bank deposits) are no longer sufficient to absorb these funds. This would suggest that property investments, with their long-term profile, should be attractive. However, demand for property market investments is not yet being met, indicating that property market investment mechanisms are also not ideally suited to insurers' needs. For instance, consultations for this study revealed that although the investment industry in South Africa has been exploring avenues to direct more funding (including insurance funds) to meet property sector demand, it has proven to be a difficult and long-term process, which has not yet concluded.

5 Conclusion

Summary overview

This note set out to provide a basic understanding of the property market value chain and the risks, financing and other constraints faced by actors along the value chain in order to explore the role of insurance markets in supporting property market development. The discussion indicates a distinct need for specific risk-transfer mechanisms, as well as for financing – both of which insurance companies can in principle provide. Practice, however, differs from theory. This paper highlights the sub-optimal insurance participation in property markets – both in terms of risk transfer and investment – in SSA. Current participation is mostly limited to the provision of property insurance, plus some property investment.

This gap stems from two sources, both of which need further exploration:

1. **Limited ability of insurers to catalyse property market development through risk transfer.** There is a high degree of risk associated with various activities and components of the property market development value chain, suggesting a substantive need for insurance. Yet the development of the property market in SSA is so low that it limits the degree to which insurers can tap into property-related risks at scale, other than through general property insurance or credit insurance. In the absence of insurance solutions, the burden mostly rests on property developers to absorb risks. Thus, the scale and capacity of the property market itself – and its ability to implement risk management practices required by insurance – may act as an obstacle for insurers to viably serve this market. The absence of insurance, in turn, undermines the viability of the market, creating a vicious cycle.
2. **Limited opportunities for insurers to invest.** There is a lack of feasible investment-ready opportunities in the property market outside of direct property investments, partly because the current property market in the region is not well suited to the investment requirements of insurance companies (and other institutional investors). Insurers typically require aggregated investment mechanisms with efficient management costs. They also require a portfolio of investments with varying maturities in order to meet liquidity demands. Property market investment mechanisms largely do not meet these requirements and those that have been designed to address investor needs (such as REITs) remain underdeveloped due to regulatory restrictions or a lack of trust and awareness among investors. By and large, property market investments are not very liquid or aggregated.

Implications

The findings of this study suggest that the development community can promote the role of the insurance market in relevant economic sectors or industries (such as the property market) by entrenching a holistic value chain lens in dialogues between the insurance sector, regulators and stakeholders from the real economy sector.

The framework developed in this paper provides the language for understanding the linkages between the two markets. This framework now needs to be tested against real-world experience and adapted to suit the context in the particular country of engagement.

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7 Appendices

Appendix 1: Stakeholder interviews

Organisation	Country	Designation
Centre for Affordable Housing Finance	Kecia Rust	Executive Director and Founder
UCT Nedbank Urban Real Estate Research Unit	Rob McGaffin	Lecturer and Researcher
ASISA	Stephen Smith	Senior Policy Advisor
SAIA	Susan Walls	Insurance Technical Advisor
FSD Mozambique	Benedito Murambire	Investment Manager
FSD Mozambique	Esselina Macome	CEO
FSD Zambia	Lemmy Manje	Head of Financial Services

Appendix 2: Challenges in the Zambian insurance market

The Zambian insurance market faces several cross-cutting challenges that inhibit the potential role that the industry can play in property market development. These cross-cutting challenges include a low appreciation of insurance, low effective demand, and the voluntary nature of property insurance. The following challenges were raised in interviews conducted by Manje (2018) as input to this study:

- **Low appreciation of insurance:** Insurers feel that the majority of Zambians do not appreciate insurance. As a result, they argue that there is a need for increased awareness and demonstration of the value of insurance. However, delays in resolving claims and negative claims experiences of consumers with insurance also creates a negative perception of insurance which further inhibits sales.
- **Low effective demand:** Demand for insurance is further restrained due to financial challenges (low income or high overall expenses) of consumers and businesses. As a result, property owners usually opt not to transfer risk to insurers, and where insurance is purchased, it is usually only done when absolutely required; and even then, clients attempt to minimise the cost of insurance, rather than get adequate cover. This happens in two ways:
  - *Prioritisation of risks:* The perception of insurers is that both commercial and residential property owners seem to prioritise risks according to frequency of occurrence, rather than the severity of the risk. Therefore, the low frequency of occurrence of risks such as fire seems to outweigh the severity of such risks, and some owners would insure their property against theft or damage rather than get comprehensive insurance that includes fire. In other words, potential clients do not properly weigh up the cost versus the risks and benefits of having property related insurance products. Some of the general insurers also feel that risk exposure to property-related risks such as fire is not of concern or is not prioritised by most residential or commercial property owners. For example, in December 2016, one of the major chain supermarkets burned down and the owners had no insurance cover. In 2017, a large marketplace that houses micro and small enterprises also burned down without insurance cover.
  - *Undervaluation of property:* Although most insurance companies now require their clients to have professional valuation reports prepared by registered valuators when insuring their properties, in the absence of mandatory legislation as is the case with motor vehicle insurance, most clients just provide insurance companies with unjustified estimates which are usually below the insurance values[60]. This is often a source of disputes at the claims stage. Based on the views expressed by developers and real-estate agents, this is probably a factor of clients trying to reduce high premiums, as well as a lack of general appreciation of insurance. However, some clients do get their properties professionally valued for insurance purposes. For instance,

[60] However, encouragingly, some clients do get their properties professionally valued for insurance purposes.

property developers such as Real Estate Investments Zambia (REIZ) and Local Authorities Superannuation Fund (LASF) undertake annual valuations of their property portfolios for financial year-end accounting and insurance purposes.

- **Voluntary nature of property insurance beyond credit insurance:** Property insurance is required to obtain finance for developing or purchasing a property. In fact, the mandatory nature of insurance is cited as one of the main drivers of take-up. However, there is very little voluntary cover over and above that required on the credit exposure. In addition to undervaluation of properties to minimise premiums (discussed above), most borrowers also tend to discontinue their insurance cover once the loan has been liquidated. In response to low penetration levels, the insurance industry through the Insurance Association of Zambia submitted a draft discussion paper to the Pensions and Insurance Authority to consider making commercial buildings and industrial risks (fire and third-party insurances) as well as construction/erection risks (project insurance that include third-party risks) compulsory. However, no action has been taken on this.

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