THOUGHT LEADERSHIP Article

GIPF
Government Institutions Pension Fund
To guard, and to grow.

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Can I borrow from my pension?

The question of whether to borrow from one's pension or not is one of the questions many members of pension funds ask regularly. Section 19(5) of the Pension Fund Act, 1956 (Act No. 24 of 1956) makes provision for members of pension funds to borrow either directly or against their pension fund savings for the purpose of purchasing residential immovable property such as a house, land, doing renovations on existing residential immovable property or making a deposit towards a home loan. However, such a loan can only be if the rules of the pension fund allow it.

What is the purpose of retirement funds?

The purpose of retirement planning or funds is to look after members when they are on retirement, meaning, a pension is aimed at providing you with a safety net post-retirement age. Many employers around the world have made contributions to pension funds compulsory, thus compelling employees to save for retirement. If there is no employer sponsored pension scheme, where membership and contributions to pension fund are compulsory, it might make it difficult for individual members to adequately save for retirement.

Can members borrow directly from their pension?

This question always comes up in one way or another during member engagement sessions. Regrettably many pension funds do not allow members to borrow directly from their pension since it affects the growth of members savings. However, the provision of borrowing against their pension is permitted in many pension funds rules, hence members are always encouraged to read their pension fund rules and be knowledgeable about the issue of borrowing from their pension. Pension fund members also need to know that the money to be borrowed from any pension fund is in a form of a loan. Therefore, it can only be given if it can be repaid and if there is security/collateral.

In the case of the GIPF, the Fund already has what is termed the Mortgage-Backed Home Loan that is being administered by First Capital Housing Fund. With the current setup, the loan borrowed is secured by a mortgage bond on the property a member is buying, meaning the property becomes the collateral in case of a member defaulting. In addition to the above, GIPF is on the verge of launching a Pension-Backed Home Loan Scheme which was approved by the Board of Trustees in 2018. What is pending now is just approval from the employer and the set deduction codes.

How much can I borrow?

The issue on how much a member can borrow really depends on the type of security/collateral that has been provided to the pension fund. For the pension-backed home loan, the maximum amount to be borrowed is limited to 90% of the amount that the member would receive if he/she was to resign from the pension fund. Remember that what you would receive is an amount that would remain after deduction of income tax. Therefore, For the mortgage-backed home loan, the maximum amount to be borrowed is limited to 90% of the market value of the house that has been given as security/collateral. You can only borrow what you are able to afford in terms of monthly repayment. Above all, the fund rules determine the percentage to be borrowed against your pension net value. Therefore, the actual amount a member may borrow is determined by many factors and in accordance with the rules of that specific fund a member belongs to.

What are the advantages and disadvantages of borrowing against your pension?

There are many advantages of borrowing against your pension. The loan can be used to buy or build a residential immovable property either in a proclaimed or unproclaimed area (in the case of a pension-backed home loan), paying off an existing home loan, it also allows members to buy land at interest rates set in terms of the Act.

Borrowing against your pension can also have drawbacks such as the risk of having little or nothing at retirement if the loan is not fully paid up by the time you go on retirement. Similarly, if a member of a pension fund resigns, he/she needs to settle the home loan first before withdrawing or transferring to an approved fund unless the new fund has a similar facility. Another disadvantage of borrowing against your pension is that you need to have enough savings in your pension for you to qualify for a reasonable capital amount.

Therefore, taking funds from your retirement account or borrowing money against your retirement benefit may negatively affect your retirement savings, but there are instances when doing so makes sense. This is only when the funds you are borrowing are used for a good course such as buying shelter and not for consumption. We have witnessed members in the past who borrowed from their pension and then use the funds to buy “houses” that are on four-wheels. In the end, the four wheels will end up in a scrap yard and the pension benefit would have been significantly reduced.

In conclusion, while buying a home is an important acquisition, saving for retirement is an equally important venture. Therefore, you may want to consider other loan options for purchasing a home or paying other expenses before making a decision that might impact you negatively in the future. Our members are continuously encouraged to consider weighing all options before engaging in activities that will have a big and negative impact on their future pension savings.

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