CIVIS

Shelter Finance for the Poor Series

Cities Alliance
Cities Without Slums

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The Enabling Environment for Housing Finance in Kenya

Series Introduction

From shacks in the shantytowns of Lima, Peru, to tin-roofed mud huts in the slums of Gujarat, India, insecurity of tenure and uneven income streams force the poor to build their homes tentatively, one wall at a time. Yet the poor lack access to financial institutions and financial products tailored to the way they build. This, despite the fact that in so many developing cities around the world a majority of the population lives in slums—60 percent of Nairobi's population, 82 percent of Lima's population—and that most housing is built informally and progressively.

The Cities Alliance launched the Shelter Finance for the Poor Initiative to focus on the still nascent practice of financial institutions providing housing finance to poor clients on commercially viable terms. These loans are distinct from mortgages in that they are typically not for the purchase or construction of new units, but rather for home improvement and progressive building. They are being offered as a new product line largely by a generation of microfinance institutions that built their success on providing working capital loans to the urban poor, and are now looking to expand and diversify their products. To date, few of these experiences had been viewed through the prism of scale and sustainability. This is the framework applied to five case studies examined under this initiative: Mibanco in Peru, SEWA Bank in India, FUNHAVI in Mexico; a wholesale fund facility in Ecuador, and the enabling environment for shelter finance in Kenya. A synthesis paper identifies emerging policy recommendations on taking housing finance for the poor to scale.

The objective of the Series is to look at shelter financing in practice through the prism of scale, sustainability, and outreach to the poor, and learn about best ways to encourage and promote this emerging practice.

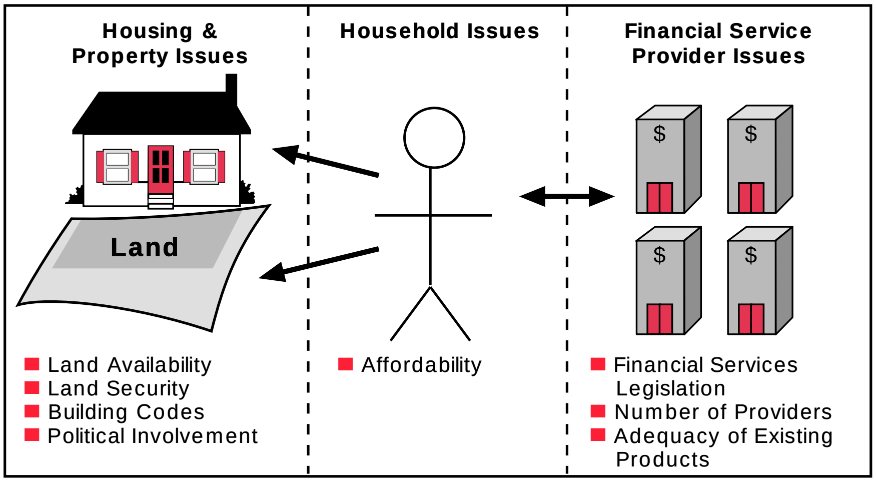
Introduction

Unlike the other studies in this series, which focus on existing housing microfinance products, this assessment analyzes the policies, laws, and regulations that affect the establishment and delivery of housing microfinance. By presenting an analysis of the enabling environment in Kenya, this report aims to contribute to the growing body of knowledge on housing microfinance. It is based on findings from an assessment conducted by Accion International and CHF International in May 2002.

The enabling environment for housing microfinance can be grouped into the following three broad categories:

- **Housing and Property Issues:** The set of laws, regulations, processes and institutions that define whether and how poor households can acquire land and build a home upon it.
- **Household Issues:** The income levels of poor households relative to the cost of housing and households' ability to finance the necessary steps in acquiring land and building a home.
- **Financial Service Provider Issues:** The laws and regulations that define the activities of financial service providers, the number of providers that serve the poor and the appropriateness of the housing finance products relative to the needs and means of the poor.

Chart 1. Enabling Environment Issues for Housing Microfinance



As described in Chart 1, a positive enabling environment for housing microfinance is one in which poor households have access to affordable land with a reasonable hope of obtaining secure tenure; building codes and building costs do not prevent households from erecting permanent structures; and financial services providers have few constraints on their ability to provide appropriate loans and savings products to help finance these structures.

Background

Since independence from Britain in 1963, Kenya has enjoyed relative political and economic stability. It has one of the highest GDPs in the region . However, the country faces several challenges. As of the 1991 census, Kenya's population was estimated at 31 million.[1] Its annual population growth rate is 3.2 to 3.3 percent, one of the highest in the world. It also has a relatively young population. As of the 1991 census, 44 percent of its population was under 15 years of age.[2] The economy grew only 1.4 percent from 1996 to 2000, experienced negative 3 percent growth in 2000, and the country's GDP per capita of US$1,400 has been falling in real terms since 1996.[3]

With poverty increasing, the quality of life in Kenya is declining. According to the Organisation for Economic Cooperation and Development (OECD), 52 percent of the population lives below the poverty line of $1 per day,[4] of which women and children make up the majority. Based on the United Nations Development Programme's (UNDP) Human Development Report 2001, Kenya is among the poorest of nations with a Human Development Index (HDI) rank of 123 out of the 162 countries. The country's population is also struggling with HIV/AIDS. Over 1 million Kenyans have died from AIDS-related diseases to date, and another 2 million are estimated to be living with the disease. As a direct consequence of the AIDS epidemic, average life expectancy is falling and is now below 50 years of age.[5]

Rapid urbanization is placing an enormous strain on an already stretched urban infrastructure, housing stock, and services, and resulting in the proliferation of informal housing settlements. Nairobi, Kenya's capital and largest city, comprises a quarter of the country's urban population. The population density in Nairobi is 3,079 persons per sq km compared to 49 persons per sq km for the country as a whole, and more than half of its population lives in informal settlements.

[1] United Nations State of the World Population Report, 2001. This number excludes over 200,000 estimated refugees from Somalia and Sudan.
[2] African Economic Outlook – Country Study: Kenya, OECD, October 2002.
[3] Ibid. Henceforth, all dollars are US dollars, unless otherwise indicated.
[4] African Economic Outlook – Country Study: Kenya, OECD, October 2002.
[5] Ibid.

Housing Finance in Kenya: Obstacles in the Enabling Environment

In many ways the situation in Kenya would seem conducive to the development of housing microfinance. The expanding urban population and limited housing stock suggest strong potential demand. The microenterprise finance sector is established and relatively strong. Despite this apparent potential, virtually every component of the enabling environment—from land security to affordability to financial legislation—restricts, rather than encourages, both the potential demand and the potential supply of housing microfinance. Consequently, housing microfinance is virtually non-existent in Kenya.

Most poor Kenyans want to have a home of their own. However, their ability to take the first step towards achieving this dream – acquiring a plot of land – is extremely limited due to three interrelated factors: the high cost of available land, obstacles to affordable alternatives (such as communal ownership or subdividing), and strong controls on squatting. The few households that are able to acquire a simple plot are constrained by limited land security. Obtaining freehold or leasehold title (the highest form of land security in Kenya) to their land can be a life-long battle with government bureaucracy. Without legal title, households face the real possibility of eviction. When the poor do build, they face high building costs, including the cost of installing basic services, restrictive building codes and limited finance options.

The existing financial services legislation and regulation in Kenya, whilst intended to ensure financial discipline, impose an unnecessarily strict system, specifying which institutions can provide which types of products to which types of customers. This is based on a limited view of how residential housing construction occurs. It assumes two primary means of housing construction: 1) developers acquire big tracts of land, build houses, and then sell completed houses to individual buyers; or 2) individuals acquire their own plot of land and build complete homes on that land. Financial services are designed to support these two kinds of construction. Commercial banks are permitted to lend to developers over two to three years to allow them to get through the construction phase. Mortgage companies and building societies are permitted to provide long-term mortgage loans to individuals to purchase units from developers, or less commonly, to build their own complete units. The problem with these regulations is that it has reduced access to financial services, rather than protecting the interests of the public.

The existing legal and regulatory framework ignores how the poor build. Poor households most often acquire land without title through squatting, inheritance, or subdivision, and progressively build structures and add services as they acquire sufficient capital. As such they are unable to access housing finance. Such variations and improvisation actually require corresponding innovation in housing-finance products. However, such changes are only possible with flexible legislation and regulations that do not rigidly define who lends to whom on what terms and conditions.

The end result of these obstacles to the enabling environment is clear. Both demand for and supply of housing microfinance are severely constrained in Kenya. At every step in the progressive-build process, from acquiring land to building a basic unit to obtaining financing, poor households face limited options or active enforcement of restrictive legislation. Even if demand were to materialize, legislation restricts potential providers from innovating to serve the needs of these potential clients.

Responses to Housing Finance Obstacles

Just as Kenya provides a useful case study of the varied obstacles to creating an enabling environment for housing microfinance for the poor, so too does it provide some interesting examples of the different ways in which individuals, institutions, and governments use financial services to deal with these obstacles. While none of the examples in this section can be considered "best practice," they are worth highlighting because they may contain the seeds for additional future improvements.

K-Rep Development Agency's group-based housing microfinance product

The Kenya Affordable Shelter Project is one of the product design efforts of the K-Rep Development Agency (KDA), a subsidiary of the K-Rep Holding Company that also includes K-Rep Bank, one of the largest microfinance institutions in Kenya. In 1997, it launched a pilot that still operates in a single town, Nakuru, with two staff members. Loans range from $385 to $3,300, with a flat interest rate of 15 percent, and a repayment period of up to five years. As of May 2002, the project had 13 registered groups with a total of 105 members, 41 outstanding loans, had disbursed $60,300 in loan capital, and was maintaining an on-time repayment rate of 81 percent.

In five years of pilot operations, KDA's housing microfinance program has not achieved any meaningful scale, but has demonstrated some key lessons:

- **Land security is more important than land title:** As KDA has discovered, requiring clients to have legal title excludes too many poor households, and given the high cost and uncertain rewards of selling repossessed properties, does not actually guarantee the capital at risk.
- **Significant guarantee requirements do not ensure on-time repayment:** Despite KDA's substantial guarantee requirements, its late repayment rate is still quite high.

National Cooperative Housing Union's housing cooperatives and resettlement schemes

The National Cooperative Housing Union (NACHU) is a Kenyan non-profit organization that assists housing cooperatives through advocacy, mobilizing communities, technical assistance and training, and offering loan capital for housing solutions to cooperative members. In contrast to KDA's pure-finance approach, NACHU has attempted to address the land availability and security issues outlined earlier in addition to providing financing by combining a savings and lending program with resettlement. While it is pursuing this approach in several communities, the most advanced project is in Bellevue, a five-acre community west of the Nairobi city limits. Launched in 1994, it involved the resettlement of 184 families. The NACHU loan is $705 per quarter-acre plot, the interest rate is 15 percent, and the maximum loan term is four years. NACHU retains the land title until all members have paid their share.

Although it is limited in scale, NACHU's Bellevue experience provides valuable insights into how creative housing finance can overcome obstacles relating to land availability, access to basic services, and affordability:

- Progressive land acquisition and building takes time;
- Need for follow-up construction finance is vital;
- Individual land titles are still a challenge; and

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> *"The existing legal and regulatory framework ignores how the poor build."*

- Potential exists for community-based finance of basic infrastructure.

Intermediate Technology Development Group's low-cost building technologies and the National Housing Corporation's Pumwani High-rise Experiment

The Intermediate Technology Development Group (ITDG) is an international NGO dedicated to developing and identifying low-cost technology that can be easily implemented by poor communities around the world. In Kenya, ITDG has sought to increase housing affordability through changes to building codes and low-cost building technologies. The organization promotes two low-cost building technologies in Kenya, Stabilized Soil Blocks and Ferro-Cement construction which significantly reduce housing construction costs while maintaining material quality.

Although now somewhat dated, the National Housing Corporation's (NHC) 1990 experience in designing and building the Pumwani high-rise, a low-income housing project, provides a useful example of using structure design to increase affordability. To make the flats affordable, NHC changed the design layout so that each of the three rooms of a flat had access to the main hallway and, thus, could be easily used as a rental unit if the owner so desired. This relatively small change had a big impact: government estimates suggest that more than 90 percent of the original low-income allottees are still in their Pumwani apartments and default rates on the loans have been less than 5 percent.

Both the ITDG and NHC experiences illustrate important lessons for the design of housing microfinance programs in Kenya and possibly other countries where affordability, and expensive, imported building materials are key obstacles:

- Low-cost building technologies and designs can improve the affordability calculation;
- Adoption of these technologies is not always automatic; and
- Successful dissemination requires available finance.

Conclusion

This study reveals some of the multiple layers of interacting constraints to the enabling environment for housing microfinance, and concludes that in the near term, the enabling environment in Kenya is not conducive for the development of widespread housing microfinance. It seems likely that combined financial and non-financial advocacy approaches will be necessary to break the current stalemate.

The Kenya assessment, however, provides several emerging lessons that may help governments and donors to create environments that enable the widespread development of housing microfinance, thereby increasing poor households' ability to access decent shelter. These include:

1. Land security does not have to mean full, legal title. Land security—the degree of confidence that a household will not be forcefully evicted—can be more relevant and available for poor households than legal title deeds. Potential housing lenders can service poor households with secure tenure not based solely on full, legal title.

2. Mortgages are not necessarily the most secure guarantee, particularly when financing the housing needs of poor households. Given the instability of poor households' incomes, high foreclosure costs, weak resale market for repossessed properties, and liquidity risk of longer term loans, mortgage guarantees in Kenya and many developing countries provide substantially less real security for lenders than in developed markets. In these environments, shorter-term loans for progressive construction with household asset guarantees are often less risky than long-term mortgages.

3. Progressive building increases affordability. Given poor households' limited incomes and high costs of land, building and housing, smaller short-term loans that support progressive building practices already employed by the poor can make housing loans more affordable. An average household with $8 available for housing every month would not qualify for a commercial loan to build a complete single-room home and would have to save steadily for 14 years to complete such a construction. With successive loans for land purchase and progressive

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construction, the same household could move into a completed single room construction within two years and finish repaying the loan within eight years.

4. A "progressive-build-friendly" policy environment may produce better results than strict enforcement of high-minimum standards. Strict housing and financing laws (and enforcement of these laws) that establish high minimum standards that are unachievable for poor households can reduce rather than increase the quality and volume of housing available to the poor. Instituting regulations that reflect how the poor build can encourage lenders to develop innovative products, improve the quality of the guarantees taken by these institutions and allow the poor to improve their living conditions.

5. Long-term financing for housing providers is part, but not all of, the solution. While lack of access to medium- and long-term funding does restrict providers' ability to lend for housing, financial institutions should demonstrate promising pilot project results as a precondition to increased access to capital for housing finance.

6. Greater dissemination of existing experience is needed. Initiatives that allow practitioners to share experiences and emerging "good practices" are needed to help expand and grow housing microfinance services more quickly.

7. After land, services are one of the biggest challenges in housing finance for the poor. Acquiring possession of a plot of land is the first major hurdle in obtaining housing for poor families. Obtaining access to basic services, such as water, electricity and sewage, is an equally daunting obstacle. More research is needed into how community or progressive forms of finance can assist households in getting access to services as well as housing.

8. Conditions on donor financing of microfinance institutions can reduce their ability to experiment with housing microfinance. Many donor-funding agreements require microfinance institutions to lend only to microentrepreneurs or lend at below market rates. Donor contracts should allow microfinance institutions to create viable housing finance products that have the greatest reach, potentially including the working poor.

9. Combining financing with other advocacy, legal, or construction issues may be overly complicated for early-stage programs. Housing microfinance providers should focus on developing their financial product and partner with organizations that are better suited to provide non-financial services.

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