

CITIES ALLIANCE SHELTER FINANCE FOR THE POOR SERIES

THE ENABLING ENVIRONMENT FOR HOUSING MICROFINANCE IN KENYA

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ACRONYMS/ABBREVIATIONS

CTL	Community Trust Land
DFID	Department for International Development (UK)
EBS	Equity Building Society
FC	Ferro-Cement
GDP	Gross domestic product
GOK	Government of Kenya
GTZ	German Technical Cooperation Agency
HDI	Human Development Index
HFCK	Housing Finance Company of Kenya
ITDG	Intermediate Technology Development Group
K-Rep	K-REP, formally Kenya Rural Enterprise Programme
KDA	K-REP Development Agency
MFI	Microfinance institution
NACHU	National Cooperative Housing Union
NAHECO	Nakuru Housing and Environment Committee
NGO	Nongovernmental organization
NHC	National Housing Corporation
NISCC	Nairobi Informal Settlements Coordination Council
OECD	Organization for Economic Cooperation and Development
SSB	Stabilized soil blocks
TOL	Temporary Occupation License
UN	United Nations
UNDP	United Nations Development Program

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INTRODUCTION: SHELTER FINANCE FOR THE POOR

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 loans 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 by a generation of financial 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, outreach and sustainability. This is the framework applied to the five case studies examined under this initiative. The cases include Mibanco in Peru, SEWA in India, FUNHAVI in Mexico; a wholesale fund facility in Ecuador, and the policy, legal, and regulatory environments in Kenya. A synthesis paper identifies emerging policy recommendations on taking housing finance for the poor to scale. All are accessible on www.citiesalliance.org.

This research initiative is a lateral learning partnership with five networks of finance and housing institutions: ACCION International, CHF International, Frontier Finance, Plan International, and the Mennonite Economic Development Agency. Additionally, the initiative has six development agency partners: Inter-American Development Bank, U.S. Agency for International Development (USAID), The World Bank, the International Finance Corporation (IFC), the Urban Management Programme (UMP), and the Consultative Group to Assist the Poorest (CGAP). The Shelter Finance for the Poor initiative is funded by Cities Alliance, CGAP, IFC, and USAID.

The intention is that these findings will advance best practices, inspire replication and adaptation, and increase the availability and affordability of shelter finance for poor households.

The following case study examines the enabling environment for housing microfinance in Kenya, particularly urban areas, showing how various aspects are constraining its development.

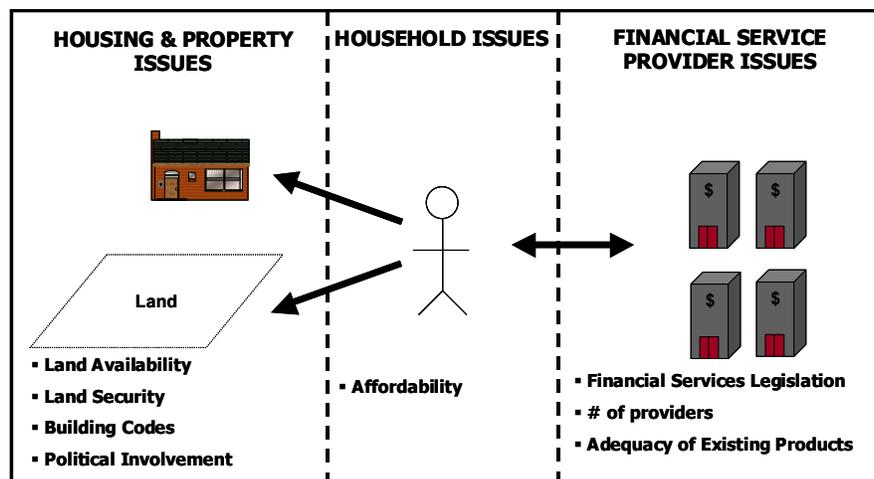
1 THE HOUSING CONTEXT IN KENYA

This report describes the elements of the enabling environment for housing microfinance, using the example of the urban areas of Kenya, particularly Nairobi, as a case study. This example permits an understanding of how the various elements of the enabling environment can promote or, in the case of Kenya, constrain the development of housing microfinance. Policy debates regarding the enabling environment for microenterprise finance tend to center on national financial services legislation and regulation. Issues such as acceptable ownership structures, institutional soundness and sustainability, depositor protection, minimum capital requirements, degrees of permitted intermediation, and usury laws are seen as the primary policy levers available to governments to influence and control the development of the sector (Hannig and Katimbo-Mugwanya, 2000).

The enabling environment for housing microfinance encompasses additional issues, however, including those that affect poor households' ability to acquire land, obtain legal rights to that land, and build a home upon it. These various issues 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 not only requires a good regulatory context for housing and property issues, but poor households must also have access to land, and be able to afford to build on it. Moreover, if financial services providers are constrained—by their sources of funding, restrictions in their charters, or by the government—they may be unable to develop appropriate housing microfinance products for poor households.

1.1 Kenya: Demographic and Economic Context

Since independence from Britain in 1963, Kenya has enjoyed a series of relatively stable governments. Its economy is one of the largest in the region in terms of GDP. As of the 1991 census, Kenya's population was estimated at 31 million.¹ Despite these strengths, Kenya faces several challenges. Its annual population growth rate is 3.2 to 3.3 percent, one of the highest growth rates 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

Kenya's economy has suffered an extended period of slow growth and contraction. The economy grew only 1.4 percent from 1996 to 2000 and experienced negative 3 percent growth in 2000. The country's GDP per capita of US\$ 1,400³ has been falling in real terms since 1996. Inflation has been high over the last half decade—as much as 36 percent—but has been held in check in recent years. It was 3.5 percent in 2000. The informal economy has grown with the decline of the formal economy and concomitant population increase, particularly in urban areas. According to the UN, the informal sector employs nearly one-third of the urban population and has been growing at about 6.5 percent per annum.⁴

The economic downturn has made poverty more widespread. According to the OECD, 52 percent of the population lives below the poverty line of \$1 per day,⁵ of which women and children make up the majority. Based on the United Nations Development Program'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 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.⁶

Although it is still largely rural, Kenya has experienced rapid urban population growth—as much as 5 percent a year by some estimates—largely a result of rural-urban migration. As of the 2000 census, 30 percent of the population lives in urban areas. By comparison, in 1948, when Kenya conducted its first national census, only 5 percent of the total population lived in urban areas. Such

¹ United Nations State of the World Population Report 2001. This number excludes over 200,000 estimated refugees from Somalia and Sudan.

² October 2002, OECD report on Kenya (<http://www.oecd.org/pdf/M00025000/M00025424.pdf>).

³ Ibid. Henceforth, all dollars are US dollars, unless otherwise indicated.

⁴ Nairobi Situation Analyses: Consultative Report, June 2001, p. 39.

⁵ October 2002, OECD report on Kenya (<http://www.oecd.org/pdf/M00025000/M00025424.pdf>).

⁶ Ibid.

rapid urbanization has put an enormous strain on an already stretched urban infrastructure, housing stock and services, and has resulted 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. The official statistics do not paint the full picture of Nairobi's density, however. More than half of Nairobi's population lives in informal settlements. These informal settlements comprise less than 5 percent of the total municipal area.⁷ Kibera, Nairobi's largest informal settlement, has approximately 500,000 inhabitants and is one of the most densely populated places in Sub-Saharan Africa.⁸ The high density is largely due to high occupancy rates. The average number of people per room in Kenya is two,⁹ but in the informal settlements the number is four or more, with entire families living in single 10-foot by 10-foot rooms.

1.2 Overview of Affordable Housing Finance Sector in Kenya

Where poor urban Kenyans already face a limited housing supply, rapid urban population growth is only making matters worse. The annual urban housing requirement is estimated at as high as 255,500 units per year¹⁰. Moreover, many existing structures are in dire need of repair. Government of Kenya (GOK) reports on the housing situation indicate that more than half of urban homes (53 percent) are substandard, failing to meet basic building codes.¹¹

The GOK has traditionally played a limited role in housing development . Its two main institutions for housing investments:

- National Housing Corporation (NHC), which is the primary government housing agency through which public funds are channeled to local authorities for the development of lower- and middle-income housing; and
- Housing Finance Company of Kenya (HFCK), a mortgage bank developed to serve middle- and low-income households of which the GOK had majority ownership share until 2000. In 2002, the government further reduced its investment in HFCK (now called Housing Finance) to 7 percent as part of a privatization process.

NHC has not financed the construction of new low-income housing since the early 1990s because of limited funding. The now largely privatized Housing Finance is an active mortgage lender but not in the low-income sector. As its own management admits "*...our role used to be to serve the medium and lower-income groups, but we seem to have left behind the lower-income.*"

1.2.1 Private-Sector Housing Finance

Because of the public sector's limited role, the private sector has become the main housing provider in Kenya. In 1998, over 95 percent of the residential structures in Kenya were built and

⁷ Nairobi Situation Analysis: Consultative Report, June 2001.

⁸ Development Impact Consulting, Kibera Urban Environmental and Sanitation Project Institutional and Financing Arrangements Draft Report 2, July 2000, p. 2.

⁹ 1996 Analytical Report Vol. X on Housing, Government of Kenya.

¹⁰ Anyango, 2001

¹¹ Ibid.

financed through the private sector.¹² However, the supply of formal housing-finance institutions is shrinking and geared toward upper-income households, leaving fewer options for poor urban dwellers.

Of the 20 to 30 housing finance providers that existed in the 1980s and early 1990s, only five institutions remain: Housing Finance, Kenya Savings and Loans, Equity Building Society (EBS), East Africa Building Society and Family Finance Building Society. These institutions primarily offer long-term mortgage loans with financing almost exclusively for home purchases. Financing for land and home construction is limited and is usually financed by the developers. Mortgage interest rates range from 15 to 24 percent with repayment periods between 7 to 15 years and an average repayment period of 10 years. The high interest rates are the result of limited competition and high T-Bill rates—until recently T-Bill rates were as high as 18 to 20 percent. The short loan terms are due in part to the fact that there is no secondary market and limited long term funding available for housing banks.

The products offered by these providers are generally available only to formal-sector workers or business owners with audited financial statements. Borrowers are required to pay a down payment of 20 to 40 percent of the appraised value of the property and pay all related legal and appraisal fees that typically total 10 percent of the loan value. Borrowers also must have legal title to the property. Consequently, poor and even middle-income families, especially those in the informal sector, cannot access these loans.

Although Kenya's microfinance sector is one of the oldest and most established in Africa – more than 50 institutions offer some form of microfinance to approximately 100,000 clients, very few institutions have formally entered into housing microfinance. EBS, the National Cooperative Housing Union (NACHU) and K-Rep are the notable exceptions. The other prominent microfinance institutions include Kenya Women Finance Trust (KWFT), WEDCO, PRIDE, FAULU, Small and Micro Enterprise Program (SMEP) have been experiencing strong growth of their microenterprise portfolios, but have yet to enter into housing.

1.2.2 Informal Settlements

The steady rural urban migration has led to the rapid growth of informal settlements, particularly in Nairobi. The settlements are highly irregular, built without planning, infrastructure, or basic services, including roads, sewers, water, and electricity. The predominant housing construction in the informal settlements is either mud walls built on a wooden frame and plastered over with cement with a corrugated iron roof or corrugated iron walls and roof. The preferred, though much more expensive building material is quarried stone. A one-room¹³ stone structure with a corrugated iron roof currently costs about \$900 to \$1,100,¹⁴ whereas a mud and wood-frame construction of the same size costs approximately \$350 to \$400 to build. Relative to average monthly income of \$65 to \$78, these construction costs represent five months total income for the mud construction and 14 months total income for the stone structure.

¹² Ibid.

¹³ Measuring 12-foot by 12-foot.

¹⁴ Exchange rate used: 78 Kenya shillings to 1US\$.

Most low-income Kenyans rent their houses, and nearly all residents in the informal settlements rent. According to the 1989 census, approximately 87 percent of houses are renter-occupied in Nairobi, with only 13 percent owner-occupied.¹⁵ More recent studies of Nakuru,¹⁶ the fourth-largest city in Kenya, as well as Huruma,¹⁷ show that this statistic varies from community to community, but remains greater than 50 percent in most areas. The rent charged varies based on unit location, the construction material used, and basic services provided. At the low end, poorly located 10-foot by 10-foot room built with mud walls, an iron roof and a dirt floor rent for as little as \$6.40 per month. The same room located closer to a major road rents for as much as \$13 per month. Adding access to basic services such as water, electricity, and a pit latrine can increase the rent to almost \$20 per month. Basic stone rooms with cement floors and no services start around the same \$20 per month. With services, a single stone room can rent for as high as \$64 per month.

Table 1. Approximate Monthly Rents in Nairobi’s Informal Settlements

	Basic Room	Basic Room with Cement Floor in a Good Location	Basic Room with Services
1 room mud and wood	\$6.40 - \$7.00	\$10 - \$13	\$18 - \$20
1 room stone		\$18 - \$20	\$26 - \$64

The tenants interviewed in the course of the preparation of this report made clear that few renters have formal rental contracts, “...we discuss and come to an understanding [about the terms of the rental].” This leaves them at the landlord’s mercy with respect to evictions and rent increases. Moreover, many rental structures are owned by absentee landlords. In an analysis of settlements in the Huruma area, absentee landlords owned more than 30 percent of rental structures.

The majority of the structure owners in the informal settlements do not have legal title to the land. However, most have some form of quasi-legal tenure, typically authorization letters from local government administrators, which were obtained through paying bribes or in return for political patronage. In a survey of the Huruma informal settlement,¹⁸ structure owners reported paying an annual fee of \$38 to the local administrators for “occupancy rights.” Cases 1 and 2 in Table 2 show the most common situations encountered in Nairobi’s informal settlements. Because the land was not purchased legally and/or the structures do not conform to government building codes and by-laws, the government does not officially recognize the settlements. It is common to find official maps and plans showing empty blocks of land in places where settlements exist, which makes it easy for the government to sell land that is home to an informal settlement. This leads to displacement of its residents.

Table 2. Complicated Ownership Situations in Informal Settlements

	Land Owner	Structure Owner	Resident
Case 1	Government	Absentee Structure Owner	Poor Family (renting)

¹⁵ The remainder live in housing provided by family or their employer. By comparison, the percentages for Kenya as a whole are 27 percent renter-occupied and 73 percent owner-occupied.

¹⁶ Mwangi (1997) p. 143.

¹⁷ Huruma Informal Settlements (2001).

¹⁸ Huruma Informal Settlements, Planning Survey Report (2001), p. 8.

Case 2	Government	Low- to Moderate-Income Family	Structure Owner + additional poor families (renting)
Case 3	Single Household	Single Household	Single Household + additional poor families (renting)
Case 4	Single Household	Single Household	Single Household

1.3 Conclusion

The environment in Kenya seems conducive to the development of housing microfinance. The expanding urban population and a limited housing stock suggest strong potential demand. Formal housing providers do not serve the low-income market and the microenterprise finance sector is established and relatively strong. Although the high percentage of renters limits the number of families who would qualify for a home improvement loan, the focus groups conducted for this report make it clear that most renters hope to eventually own their own home. Respondents who are renters see home ownership as *“a permanent investment. You can leave your house to your children and they won’t have to think about getting their own house later on.”*

Despite this apparent market potential, housing microfinance in Kenya is nascent. As Section 3 describes, K-Rep Group has been developing a housing microfinance product for almost five years with limited success. Similarly, the National Cooperative Housing Union (NACHU) has struggled for more than a decade to expand beyond a few small programs. Why are more MFIs not providing housing financing for their clients? Why are formal housing finance providers reducing their disbursements at a time when the need for housing—particularly among low-income households—is rapidly increasing? Why do so many more poor families end up renting rather than incrementally building their own home as in many other developing countries? The answers to these questions can be found at least in part by looking at the enabling environment for housing microfinance in Kenya, particularly at the issues of land acquisition, land security, building codes, political involvement and affordability, which is the subject of the next section of this report.

2 HOUSING FINANCE IN KENYA: OBSTACLES IN THE ENABLING ENVIRONMENT

Using the framework outlined in Chart 1 in the previous section, this segment assesses how the enabling environment in Kenya supports or constrains the potential demand for and the supply of housing microfinance. In general, if poor households fear that they will lose their home, there will be limited demand for housing microfinance. Similarly, if potential suppliers of housing microfinance are restricted by legal or financial constraints—or simply fail to innovate in their products and services—the supply of finance fails to materialize.

2.1 Housing and Property Issues

Housing and property issues include how poor households acquire land and build upon it. These issues include:

- *Land Availability*: the physical availability of land and the process for acquiring it;
- *Land Security*: the level of security households can establish on land they have acquired;
- *Building Codes*: the codes and regulations that affect what and how poor households can build on their land; and
- *Political Involvement*: the degree to which all of the above processes become politicized.

2.1.1 Land Availability

“Everything begins with the land, because you need somewhere to build the house.”

-- Focus Group Participant

The results from the focus groups make clear that poor Kenyans have a strong desire to own their own home. However, less than 20 percent of urban poor families have achieved this goal. This contrasts strongly with the authors' experiences in many other developing countries, particularly in Latin America, where often more than 80 percent of the urban poor own their own home, although they may not have a legal title deed to the property.¹⁹ Two possible explanations for this stark difference are:

- *Cultural Factors*: Given the strong tribal and rural roots of most Kenyans, residents in informal settlements may not acquire land in urban areas because of their strong connections to and/or ownership of land in rural areas. Residents of informal settlements may be satisfied with renting because they view their stay in the city as temporary.

¹⁹ Market research conducted by ACCION in Nicaragua, *Apoyo Opinión y Mercado* in Peru and FONDOVIP / USAID in the Dominican Republic.

- *Land-Acquisition Constraints:* Poor households' desire to acquire land is frustrated by the lack of available land, high land costs, and/or a cumbersome and expensive process to acquire land (whether by squatting or purchase).

The results of the focus groups conducted for this report reject the explanation that the low owner occupancy rates are due to cultural ties to tribal lands in rural areas. Whereas ties to rural land may have reduced the desire for home ownership in the past, these ties have weakened as entire generations have grown up in the informal settlements. All of the tenants interviewed expressed a strong desire to own their own home in an urban area. The primary reasons driving this preference are the proximity to their source of income and the possibility of sending their children to better schools.

In contrast, there is strong evidence that multiple factors combine to make it very difficult for poor Kenyans to obtain a basic plot of land. There are three basic ways that a household can acquire a plot of land—through purchase, grant, or squatting. In Kenya, all are difficult or impossible for poor families.

Challenges in Purchasing a Plot

For land purchase to be viable for poor households, the physical space needs to be available in plots of a reasonable size at an affordable price, and in a location that allows them to continue to earn their livelihood.

According to a UN report, 80 percent of residential land in Nairobi is occupied by only 20 percent of the population,²⁰ indicating that there is limited land available for the poor majority. The land that is available is relatively expensive. A quarter-acre plot of land within Nairobi city limits sells for \$6,300 or more, which is out of reach for most poor households. Sub-division can make the land more affordable—dividing a quarter acre plot into seven 25-foot by 55-foot lots would reduce the land cost to \$897—but additional factors make the subdivision process complicated and expensive. To purchase and subdivide a plot of land within the Nairobi city limits, the purchaser has to 1) pay for the land plus all of the associated fees including stamp duties and legal fees, 2) pay for the land to be surveyed, marked, and appraised by government agents, and 3) have a development plan approved by the municipal council. If the land is un-serviced, the owner also has to install all services to code and get approval from various government agencies and offices because the government is not able to cover the cost of installing services. The total cost of these additional fees and investments can easily double or triple the cost of the original plot, leaving the sub-divided lots with a cost of nearly \$3,000, or 42 times typical monthly earnings for a low-income family.. The high cost of buying and subdividing land in Nairobi has led would-be developers to look outside the city limits where a similar plot can be found for less than a quarter of the price. To further reduce costs, several organizations have also developed innovative legal structures, such as land-buying companies or cooperatives and Community Land Trusts, to avoid the time and expense involved in sub-division (see Box 1).

²⁰ Nairobi Situation Analyses, UN Habitat, June 2001, p. 28.

BOX 1. LAND-BUYING COMPANIES, COOPERATIVES, AND COMMUNITY LAND TRUSTS

Land-buying companies, cooperatives, and Community Land Trusts are different institutions developed for the same purpose: they allow individuals to pool their resources to purchase land—typically a large plot that is then subdivided into smaller parcels for their members or shareholders. In the case of land-buying companies and cooperatives, individual members receive title to their parcel once they have paid their shares and the subdivision process is completed. In the case of Community Land Trusts, the land title remains in the hands of the Trust; that is to say, there is only one title. The Trust leases the “subplots” to its shareholders or members. The shareholders own the structures and any improvements to the subplot. The residents evidence their right to their plot by their share holdings in the trust and lease. Although not having an individual title is difficult for some to accept, the Community Land Trust model reduces both the cost of subdividing and the total rent paid to the government for the leasehold by the community. The German Technical Cooperation Agency (GTZ), local government agencies, NGOs, and the residents of Tanzania-Bondeni Village implemented the Community Land Trust model in Kenya (Tanzania-Bondeni Village is an informal settlement in Voi, a small town outside of Nairobi).

For each of these three models, the institution is responsible for collecting payments or shares, identifying the land to be purchased, negotiating the price and, often, subdividing the plot and securing titles for the subplots. The institution may dissolve once the land is purchased or continue to exist, managing the land and common spaces.

Challenges with Land Grants

One way to overcome the land availability and cost issues would be for the government to grant plots of land to poor households. In the 1970s, the GOK, with World Bank support, implemented several “sites and services” schemes²¹ that were to provide subsidized, serviced land to poor households. However, most of these schemes were plagued with implementation difficulties, cost overruns, and corruption. In many cases the land went to wealthier families and not the intended beneficiaries. Given the financial situation of the GOK, and the negative history of this program, it seems unlikely that similar programs will be forthcoming in Kenya.

Challenges with Squatting

In most developing countries, poor households’ final recourse for acquiring land is squatting. Where land is available and government enforcement is lax (and there is a reasonable prospect that the government will recognize the right of possession), squatting often is an effective means for poor households to acquire land. In Kenya, however, even squatting is a challenge. Most unoccupied land in urban areas is either the property of the GOK or managed in trust for the national government. By law, only the Commissioner of Lands and the President can allocate

²¹ Non-Conventional Approaches to Financing Low-Cost Housing Schemes in Kenya (1988)

public land use.²² However, in many cases, the local Chiefs, who act as representatives of the Commissioner of Lands, illegally allocate land-usage rights. In exchange for these “rights,” the Chiefs receive bribes or favors . Thus, would-be squatters in Nairobi must pay for the right to squat and even then, these rights are available only to those who have political connections to the Chief. Given the substantial income generated by these “usage fees”, the Chiefs have a strong incentive to continue this practice and limit squatting to those who can pay.

For poor Kenyans seeking to acquire a basic plot of land in urban areas, the prospects are limited. As detailed above, this is a result of three forces: the high cost of available land, the delays and costs of sub-dividing land, and strong informal controls on squatting. These factors combine to limit the potential demand for housing microfinance. If the growing number of poor households moving to the cities each year are unable to acquire land—even through squatting—access to progressive-build housing microfinance will be of little use. Even if these households are able to access financing, high land prices and the high cost of installing basic services make most potential plots unaffordable.

2.1.2 Land Security

A key issue underlying housing microfinance is land security – the degree of confidence one has in their rights of ownership over a piece of property and their ability to enforce those rights. Households that have land security are more likely to take on debt to improve the value of their property. Land security also affects the supply of credit. Credit institutions need to be confident that a borrower has formal, recognized rights to a property and will not be evicted, abandon the property or default on the loan.

Two factors tend to influence a landowner’s level of land security, the legal rights the household has over the land, and how these rights are commonly enforced. In Kenya, as in other developing countries, land security is determined by the legal documentation that a land-owner possesses. There are multiple levels of documentation, each providing differing levels of land security. The least secure is a sales agreement and the most secure is a freehold title, followed by a leasehold title. However, the level of security provided by these different rights varies from city to city and on rural/urban lines. In rural areas, where there have been fewer evictions and demolitions, lower levels of documentation seem to provide sufficient security. In these areas, sales agreements are an acceptable form of land security. In urban areas however, residents with stronger forms of legal documentation, such as letters of allotment, are still reluctant to invest in their properties due to real fears of demolition or eviction. Table 3 lists the different levels, the process of acquiring that security, and the legal security it provides.

Table 3. Levels of Land Security in Kenya

²² By law, the Land Commissioner is supposed to auction off land to the highest bidder. However, according to various sources studying land allocation in Kenya is more often done behind the scenes and not at public auction.

	Description	Application Process	Legal Security
Freehold Title	The title-holder has absolute ownership of the property.	Increasingly difficult to obtain. Only available on grants of government land outside of city limits.	This is the highest level of security. Legally only in cases of free hold and lease holds where there are title deeds may permanent structures be erected.
Leasehold Title	The user is subject to paying rent and rates (taxes) on the land to the government.	Application to the City Council or County Council for allocation and then title issued by Commissioner of Lands. Second method is purchase from existing title owners.	The leaseholder has absolute rights to the property for predetermined number of years (99 for urban land and 999 for rural) and subject to the conditions on development and usage set forth in the lease.
Letter of Allotment	Viewed as a preliminary step to acquiring a leasehold or freehold title.	The application process can take approximately one year if the applicant has contacts. The process involves securing letters from City Council and Land Commissioner, having the property valued by the government appraiser, and paying up front rents and title fee.	Gives the right to start any development as an intermediate step to title ownership.
Temporary Occupancy License (TOL)	License to occupy government land on a temporary basis. The length of the term can be as long as 30 years. TOLs are mainly used for small businesses. However, many TOL holders develop structures that house their business and their family.	The Land Commission grants or in the case of Nairobi, the Nairobi City Council (the chief valuer in the directorate of City Planning) grants. Does not require formal surveyors or evaluators. Several government officials must sign off on document.	TOLs allow the holder to use the property for a predetermined amount of time (typically one year) and for predetermined purpose. Agreement may be terminated with a one-month notice.
Letter from Chief	A letter or other form of documentation (it can even be verbal permission) provided by administrative government officials that gives an individual the right to a plot of land.	None other than appealing to the local chief and often paying some fee.	No legal security, however it does provide some protection from eviction as long as the user remains in the favor of the authorizing government official
Sales Agreement	A written sales contract between the buyer and seller.	None	No legal security if the land does not have a title deed.

The most secure land tenure for the homeowners interviewed for this report was the title deed, followed by letters of allotment. Those with letters of allotment were less comfortable with their tenure status even though they have lived on their property for many years.²³ These households generally put up semi-permanent houses because of the potential risk of losing their investment (see Box 2).

Homeowners without a title deed have not elevated their land security because the land-titling process is costly, confusing, and lengthy—not because they feel they have relatively secure

²³ Between 5 and 10 years, some even longer than 10 years.

tenure. Moreover, it is not uncommon for multiple people to have claims to the same property. As one focus group respondent described, *“Following up on the title deed is the greatest headache. You go to the Lands Office, you go to the City Council. The City Council has the worst problems. If someone there hears you have a plot, they think it’s the whole world and they want to make things as difficult for you as possible. It can take years to get that deed.”*

BOX 2. LAND-TENURE CHALLENGES FOR MZEE OSMAN KUR

Mzee Osman Kur, a successful microentrepreneur, has lived all 68 years of his life in the Kibera informal settlement. His family was granted the land he currently lives on by the British colonial government, but they were never given formal title, despite government promises since 1964.

Some of the land on which his family settled has been awarded by the local chief to other residents over time, leaving Mzee and his family with approximately half of the original land. The Mzee’s plot is well developed, with several one-room units on the front of the plot rented to businesses and a separate structure where Mzee, three generations of his family, and several renters live. Despite the length of time Mzee and his family have occupied the land and his relative success as a microentrepreneur, all of the buildings on the plot are semi-permanent, built out of mud and stick walls plastered with cement. Although he could afford to invest in more permanent stone structures, Mzee explains that, *“I am not willing to invest too much in putting up stone structures because I can be evicted from here any time. I still do not have title to my land.”* Mzee and his family continue to make attempts to acquire their title, but there is no clear process to be followed and the local chief has expressed little interest in responding to Mzee’s requests.

There are existing laws to help regularize land security in Kenya. Theoretically, squatters should be able to secure property rights through adverse possession. According to the law, if a squatter lives continuously for 12 or more years on a piece of land without paying rent or having contact with the landlord, he or she acquires the rights to the land. In reality, however, no squatter has yet obtained property rights through adverse position. The first attempt to apply this law to is currently before the courts with no certainty of resolution.²⁴

Housing-finance institutions in Kenya, including those that reach poorer households such as EBS, require borrowers to have full title. In theory, this is to reduce the borrower’s incentive to default and provide a tangible asset for the lending institution to recover losses. The experience in Kenya suggests, however, that mortgage guarantees do not provide either of these benefits. With mortgage interest rates at around 20 percent and even higher rates on overdue balances, borrowers who fall behind on their loans face debts beyond the value of their home and beyond their capacity to pay. In these cases, defaulting and giving up one’s home can be preferred to making high monthly payments on a growing debt. In addition, the length of time and cost associated with placing a lien on a title and, in the case of default, foreclosing may exceed the invested capital, particularly on smaller loans. The growing number of foreclosures—coupled with the economic slow-down—has also led to rapidly declining market values. In the end, a mortgage guarantee can cost a lender more to foreclose than it would receive from the sale of the property.

²⁴ Shelter Forum Shelter Kit No. 1.

In sum, land security is critical to the enabling environment for housing microfinance, and affects both demand and supply. Particularly important are available forms of tenure and how these are enforced and accepted by financial services providers. In Kenya, few poor households have sufficient land security to give them adequate confidence to borrow and invest in building a permanent home. The potential market is further limited by unwillingness of lenders to consider accepting anything less than formal title as a guarantee, despite evidence suggesting that slow foreclosure processes and slumping resale markets for foreclosed homes limit the true value of a mortgage in terms of recovering capital in the event of a default.

2.1.3 Building Codes

Issues relating to land availability and land security can limit poor households' demand for and access to housing finance. However, even if these issues are resolved, building codes and standards may provide additional obstacles to accessing housing finance.

A myriad of acts, by-laws, and codes²⁵ combine to regulate the quality and construction of homes in Kenya. The articles of these legal documents set out the minimum standards for all urban structures. Whereas they are intended to protect people from dangerous constructions, these minimum standards effectively make illegal the most common form of home construction in Kenya and throughout most of the developing world—progressive building.

Kenya's building code is based on the historical English system, which does not consider the local reality, relying predominantly on expensive and/or imported materials and European-design standards (including roofs that can withstand minimum "snow loads"). To achieve the minimum housing standard, a house must be built out of stone and consist of at least two bedrooms, each measuring at a minimum 7 sq meters with a separate cooking area, including flue ventilation. Thus, the minimum acceptable house according to the "code" is well beyond the means of poor and, even many middle-income families. cAlthough some households do achieve the ideal construction described in the building codes over time, they have to do so by building illegally over the course of many years.

Kenya's current building code obstructs the development of housing microfinance in two ways. First, it creates the risk that households will lose their home unless they build to code, thereby reducing their willingness to invest in more permanent structures—and ultimately, reducing the demand for housing finance. Second, by not allowing families to build progressively towards the desired standards, it reduces the types of constructions that potential housing lenders can finance. For example, a poor household that wants to replace its one-room, mud and stick house with a stone one would be unable to obtain a building permit because the resulting room would not meet the minimum standards, despite the positive impact on the household's quality of life and improved quality of construction. With access to housing microfinance, this household might achieve a minimum-standard home after three or four loans. However, if inappropriate building codes are strictly enforced, potential housing microfinance lenders will be unwilling to lend. While the

²⁵ The Building Code (1968), the Public Health Act (1972), the Local Government Act (1977), the Revised Building By-Laws (1995), and the Physical Planning Act (1996).

government has not uniformly enforced the building code laws, there are cases of houses being demolished for not being built to code. This threat further magnifies the obstacle created by inappropriate building codes. On the other hand, if potential borrowers and lenders were convinced that the building codes were unlikely to be enforced, then they might be more willing to borrow and lend.

The Intermediate Technology Development Group (ITDG) (see Section 3 for a discussion on ITDG) has led an effort in Kenya to modify the building codes to reflect local building practices while encouraging safe and secure building practices. Code 95, which was passed by Parliament in 1995, permits building practices commonly used by poor households, including the use of alternative building technologies, outdoor cooking areas, and pit latrines. Despite this, Code 95 has not been widely adopted. It has to be approved by each city or town council before it takes effect. To date, only Nakuru Council has implemented Code 95, and even then, only in limited areas.

2.1.4 Political Involvement

A country's various laws, regulations, and building codes may be highly inappropriate for poor households, however, favorable interpretation or non-enforcement of these rules by local governments can help overcome the obstacles—at least in the short-term. In the medium-term, governments have the capacity to make these rules more favorable. Conversely, a well-designed and appropriate set of laws and regulations changes nothing if government officials do not implement and enforce them. In Kenya, cases of strict government enforcement of regulations leading to evictions and slum demolitions are well documented. The following two examples illustrate how the national and city government's involvement in housing and property issues has constrained the development of a housing finance market for the poor.

Slum Demolitions in Nairobi

Nairobi has a long history of slum evictions and demolitions to enforce land laws and building codes. As Gitau (1999) describes, “[e]victions and demolitions have existed in Nairobi since independence (1963). For example in the 1970s, nearly 39,000 people were evicted from the Eastleigh area when 6,733 dwellings were demolished by the City Council (Obudho, 1990). In 1990, Muoroto and Kibagare settlements were also demolished where an estimated 30,000 people were displaced (Alder, 1995). In 1994, approximately 6,000 residents were evicted from Mukuru settlement and their property destroyed. ...The Mukuru settlement is still under pressure of demolition (Daily Nation, January, 1999).” In interviews with slum dwellers in Nairobi and seven other urban communities, 50 percent of the population had experienced eviction or demolition (Yahya 1997).

In recent years, dialogue between advocacy groups, UN Habitat, and the Nairobi City Council through the Nairobi Informal Settlement Coordinating Committee has succeeded in convincing the Council to issue a moratorium on slum demolitions and there have been no major demolitions of informal settlements on government land since 1994. However enforcement of this moratorium has not been complete and demolitions have continued.

These evictions and demolitions were conducted in part to discourage people from breaking existing land laws and building codes. Yet, because the existing environment offers few alternatives, these actions have done little to discourage adverse possession and not building to code. Evicted households establish new slums elsewhere. There, with even more diminished resources, they are less willing to invest in high-quality, permanent structures that local authorities would presumably prefer. Although it would seem that both poor households and local authorities are interested in the elimination of slum housing, demolition without alternative solutions eliminates any chance that poor households will work their way out of the conditions described in the first section.

The effect of these demolitions on the potential for housing microfinance is threefold.

- *Reduced Capacity for Housing Investment Among Evictees:* Slum demolitions reduce poor households' asset base and their means of generating income for future housing investments, since their home-based businesses are also destroyed. As a result, these households are less likely to qualify for housing microfinance because they now require a larger loan to achieve a basic standard of living and have more limited income from which to either save or make loan repayments.
- *Reduced Willingness to Invest in "Permanent" Upgrades:* Slum evictions and demolitions also indirectly reduce demand for housing finance for the poor by creating the fear that previously unaffected households will be "next in line." As in the case of Mzee Osman Kur, even when poor households have the financial capacity to improve the quality of their home, they are reluctant to do so, for fear of losing the investment.
- *Reduced Willingness to Finance Slum Upgrades:* The insecurity created by slum evictions and demolitions increases the perceived risk faced by potential housing microfinance providers, which discourages them from lending unless both land and building plans are properly registered and up to code.

It is clear that strict enforcement of land and building laws often serves only to make the problem worse, unless households have a viable alternative.

Slum Rental Housing as an Income Source

Many of the absentee landlords of rental units in the informal sector mentioned in Section 1 are Members of Parliament and other influential Kenyans. As a UN report on the housing situation in Nairobi describes "... [many of the] investors [that is, non-resident structure owners] in popular settlements are often [sic] prominent public officials/personalities." These influential non-resident landlords earn significant incomes on these rental units. Estimates suggest that annual returns on investments in mud and wattle rental housing built on public lands in the slums can be as high as 150 percent depending on the location (Syagga, Miulla, and Karira-Gitau, 2002). Every year this situation results in a net transfer of wealth from poor households to non-resident structure owners of at least \$10 million in Nairobi alone.²⁶ Thus, the political elite have little incentive to change the

²⁶ Calculated based on estimates of the number of informal structures in Nairobi, the share that are rentals by non-resident landlords and average rents. Assumes a stock of approximately 75,000 non-resident landlord rental units and monthly rents of 900 Ksh.

status quo, since any improvements in poor households' ability to access land, acquire land tenure, and put up structures of their own reduces their rental income. This strong disincentive for change may be a factor in the slow implementation of Code 95 and other initiatives being advanced by civil society.

2.1.5 Summary of Housing and Property Issues

Although it is clear that land availability, land security, building codes, and political involvement are collectively constraining the ability of poor people to obtain and maintain a home of their own, it is also equally clear that these issues are not new, and not unique to Kenya. In the case of building codes, for example, a review study in 1980 recommended modifying building standards. The 1979 National Government Development Plan stated the following: "*all municipalities are to review their housing standards in order to make them appropriate for the settings to which they were to be applied and to reduce them to a minimum, consistent within the provision of low cost housing needs at reasonable cost.*" This was followed by similar recommendations by an Inter-Ministerial Committee in 1984 and the Cabinet in 1985.²⁷ Despite all of this attention, Code 95 has only been implemented in seven districts of one municipality.

Kenya is not alone among developing countries in having land-tenure systems that prevent poor households from acquiring land and title, and building codes that are completely inappropriate for how poor people build. However, stricter enforcement of these laws and codes in Kenya has reduced land security and, as a result, has reduced the prospects for housing microfinance. Perhaps the way forward for policymakers is not to modify or soften existing "preventative" legislation, but to take the advice of one US congressman who in the 1800's suggested that in dealing with an ever-increasing problem of squatters on public and private land, Congress "*instead of legislating for them, we are to legislate after them*" creating laws to match the realities encountered on the ground²⁸.

2.2 Household Issues

The preceding components of the enabling environment restricted poor households in the process of acquiring land and/or building a structure. However, even if land is available, a clear process for achieving land security is in place, building codes are modified to allow for alternative constructions, and political interference is minimized, a market for housing microfinance will fail to emerge if households cannot afford the land and buildings they want to acquire or build. This issue forms the core of the "household" issues relating to the enabling environment.

2.2.1 Affordability

Affordability of housing for low-income families is a function of the relationship between poor households' available income and the cost to acquire land, build a house, and install basic services. Assuming that households acquire land through legal means—purchasing it from a private party or the government, and pay the fees required to register the property—Table 4

²⁷ Nairobi Situation Analysis (2001).

²⁸ De Soto 2000

provides examples of what it might cost a poor family around Nairobi for an average-sized plot without access to services for some sample types of constructions.

Table 4. Examples of Land and Housing Costs in Nairobi and Surrounding Area

Type of Construction	Land Purchase Price	Construction Cost	Additional Expenses	Total
IN NAIROBI				
25' x 55' plot of land with 1 mud and wattle room and no services	\$897	\$385	\$118	\$1,400
25' x 55' plot of land with 1 stone room and no services	\$897	\$1,090	\$163	\$2,150
25' x 55' plot of land with stone basic unit with 2 rooms and service connections	\$897	\$2,564	\$339	\$3,800
OUTSIDE OF NAIROBI				
25' x 55' plot of land with 1 mud and wattle room and no services	\$256	\$385	\$89	\$730
25' x 55' plot of land with 1 stone room and no services	\$256	\$1,090	\$134	\$1,480
25' x 55' plot of land with stone basic unit with 2 rooms and service connections	\$256	\$2,564	\$310	\$3,129

The additional expenses column approximates the costs relating to the registration of the property (4 percent stamp duty, 1 percent surveyors costs, and legal fees) and construction-materials transport. Whereas the totals presented in Table 4 will vary from location to location, they provide a useful benchmark for assessing affordability, especially when compared with household income.

In terms of household incomes, a survey of households in the Huruma slum (Planning Survey Report 2001) on the outskirts of Nairobi calculates average income levels and monthly household expenditures as indicated in Table 5.

By calculating how long it would take the average household outlined in Table 5 to pay for the land and housing costs in Table 4, one can determine affordability. Assuming that a household continues to rent and has on average \$8 available each month for saving or loan repayment, it becomes clear that even for a one-room mud and wattle construction outside of Nairobi, the family would have to save for seven years before accumulating sufficient funds to complete this basic purchase and construction. In terms of borrowing, a poor family with only \$8 a month available for repayment could not qualify for any loan at commercial interest rates (> 14 percent per annum) to finance the complete construction of any of the housing options described above. This household could only afford to borrow for a complete housing solution if loans with a 24-year term were available at heavily subsidized interest rates (see Table 6).

Table 5. Estimated Household Income and Expenditure in Huruma

Income / Expense Category	Monthly Income / Expense in Ksh	Monthly Income / Expense in \$
Household Income	5,000 – 6,000	\$65 – \$78
Food Expenditure	2,500	\$32
Rent	700	\$9
Transport	1,000	\$13
Public Toilet Fees	200	\$3
Water	250	\$4
Total Expenditure	4,650	\$61
Net Income	350 – 1,350	\$4 – \$17

Table 6. Time Required to Save or Repay for a Complete Housing Solution

Construction	Total Cost	Years Required to Save²⁹	Years Required to Repay at Commercial Rates	Years Required to Repay at 4 % Interest
IN NAIROBI				
25' x 55' plot of land with 1 mud and wattle room and no services	\$1,400	14 years	Not Possible	22 years
25' x 55' plot of land with 1 stone room and no services	\$2,150	20 years	Not Possible	57 years
25' x 55' plot of land with stone basic unit with 2 rooms and service connections	\$3,800	34 years	Not Possible	Not possible
OUTSIDE OF NAIROBI				
25' x 55' plot of land with 1 mud and wattle room and no services	\$730	7 years	Not Possible	9 years
25' x 55' plot of land with 1 stone room and no services	\$1,480	14 years	Not Possible	24 years
25' x 55' plot of land with stone basic unit with 2 rooms and service connections	\$3,129	28 years	Not Possible	Not Possible

At first glance, Table 6 seems to indicate that an average poor household cannot afford to acquire the land and build a one-room mud structure and, therefore, that the key obstacle in the enabling environment for housing finance for the poor is not land, building codes or provider issues, but affordability. This initial analysis seems to suggest that housing loans for a complete unit (land and basic structure), offered on a commercial basis (>10 percent interest) are not viable for poor households. This logic is often used to justify creating grant programs or subsidized-housing programs for the poor. One should recognize that the analysis in Table 6 does not take into account three factors that can affect affordability:

- *Progressive Build vs. Complete Construction:* All of the calculations in Table 6 assume initial construction of a complete home.³⁰ Poor households, however, typically build their homes progressively. Although a family has insufficient income to qualify for a long-term loan, they often can, as illustrated in the analysis below, qualify for short-term loans for partial constructions.

²⁹ Assumes annual real interest rate of 1 percent.

³⁰ In fact, the constructions described in Table 4, with the exception of the two-room stone basic unit fall short of what is generally accepted as the "minimum" unit of construction.

- *Replacing Rental Expense with Rental Income:* Table 6 also assumes that poor households require a completed structure before they can move to their property. In reality, poor households often leave their rental unit to free up that monthly expense to investment in their own housing asset, even if it means living in a temporary shelter on their own property (see the NACHU discussion in Section 3 for an example of this). In addition, poor households will continue to live in a temporary structure and build more permanent rental structures for income. As outlined below, these common behaviors help to increase households' capacity to save or repay, making housing solutions more affordable.
- *Reducing Land and Construction Costs:* In addition to progressive building and eliminating rental expenses, every \$8 reduction in the cost of the housing solutions above reduces by a month the time required for a household to save. Low-cost building technologies, such as those developed by ITDG and discussed in Section 3, can lower construction costs. Similarly, if land could be acquired and sub-divided more easily with fewer fees and delays, the land component of the total cost might be reduced significantly.

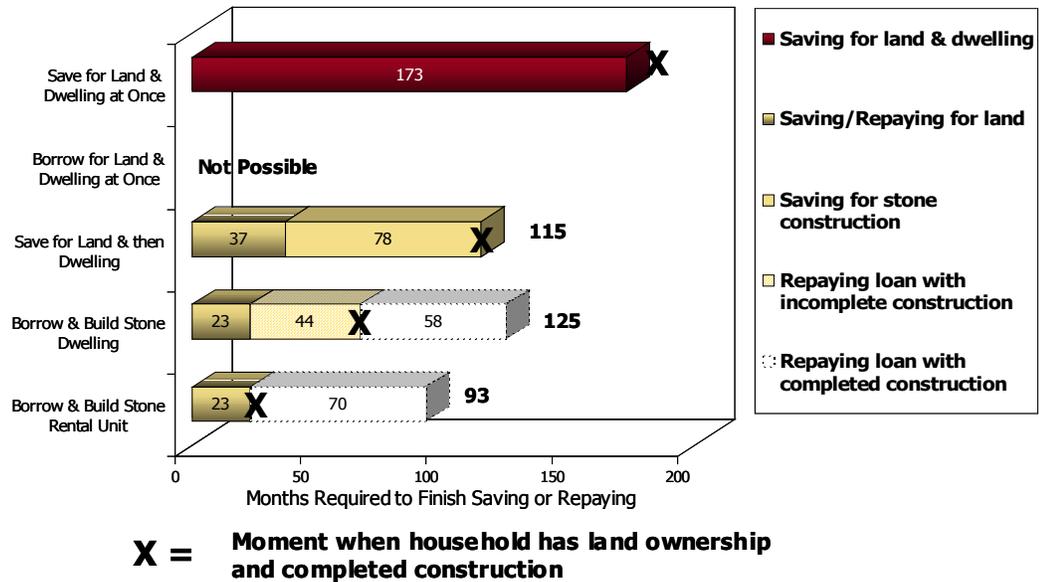
The following paragraphs briefly illustrate how two of these factors can significantly change the affordability equation for poor households and create possibilities for a housing finance market.

2.2.2 Achieving Affordability Through Progressive Building and Rentals

As illustrated in Table 6, financing a complete construction is beyond the reach of most poor households. However, most households build their home progressively. Instead of several thousand dollars, a family may only need several hundred dollars to get started. For example the one-room stone construction outside of Nairobi highlighted in Table 4 costs \$1,480 to build. With a net income of \$8, an average household would not qualify for a commercial loan and would have to save steadily for 14 years to accumulate this amount. However, if the construction is divided into parts, it becomes affordable. Through savings, poor households can reduce the time required to finance land acquisition and construction of a basic stone room from 14 years to 9.5 years, if they are willing to live in provisional housing on the purchased plot while they save for the construction.³¹ Borrowing can further reduce the time required to achieve a basic, permanent structure.. Borrowing \$300 at 25 percent annual interest to purchase the plot allows a household to move out of their rental housing immediately and use the reduced expense to repay the loan in less than two years (23 months). The same household could then borrow \$500 at 44 months to partially construct a single stone room in which to live. At the end of the 44 months, a subsequent loan for \$680 at 58 months would allow them to finish the construction in just over five years. The total time from initial construction to final loan repayment would be 10 years, four years earlier than if they would have saved to purchase land and construct the same home. If the household rents out the structure they can finish repaying the loan in less than eight years using the rental income to repay the loan. Chart 2 shows these different options.

³¹ If the household were to use alternative construction materials, the cost—and therefore the amount of time to save or loan amount and term—would be less.

Chart 2. Impact of Progressive Build and Rentals on Time to Acquire a Basic Dwelling



These options may sound unrealistic at first, particularly the idea that a family would build a structure and rent it out rather than inhabit it, even when they are living in provisional accommodations. However, the authors witnessed many households pursuing these different strategies during the field visit. Chart 2 demonstrates the economic rationale for doing so—a rationale that becomes even stronger when households are forced to finance the construction costs without access to formal financial services. Those who were able to overcome land and property obstacles built progressively and developed rental units. A description of NACHU’s experiences in financing progressive land acquisition and construction in its Bellevue Resettlement Project is provided in Section 3.

These experiences and the calculations presented earlier demonstrate that affordability is a relative concept, entirely dependent on the types of products offered. If, for example, the only loans available to poor Kenyans are for complete constructions, affordability becomes a limiting factor as poor households’ incomes are insufficient to cover the monthly interest charges, let alone repay the capital. If, however, the products offered are savings or housing microfinance loans, affordability becomes less of an issue.

2.2.3 Access to Basic Services

Poor households' vision of their preferred home (and indeed the vision of international donors and governments) includes access to these basic services. However, the government-run utility companies in Kenya have, in recent years, stopped installing basic service connections and infrastructure. As a result, individual landowners or groups such as land-buying companies must pay the costs of installing basic infrastructure. For poor households, these costs are prohibitive. Adding the cost of infrastructure provision to the land purchase and construction costs identified earlier either makes the amount unaffordable for many households, or adds another significant step in the progressive-build process (see Box 3).

BOX 3. THE PROHIBITIVE COST OF PROVIDING BASIC SERVICES

In NACHU's Bellevue Resettlement, more than 140 families combined savings with loans from NACHU to purchase a five-acre plot of land in an industrial sector outside of Nairobi. Although the land had limited road access and no services, residents were willing to move out of their rental units in the urban informal settlements, as one resident described, "...at least here the land is our own. What we have here today is not much, but little by little we can improve...and it is ours." One of the challenges for the community is installing basic services. The community must pay to have these services installed. The cost to connect the community to the local water system and install a water storage tank, for example, would be approximately \$60,000 or around \$400 per household just for a single spigot on a five-acre plot. Of course, once installed the local utility will begin to charge the community for their usage. NACHU has experienced similar issues with other services. Connecting another NACHU resettlement community to the main road is expected to cost almost \$70,000 or \$110 for each of the 620 families served.

As outlined above, the obstacle created by the high cost of installing basic services is magnified by the fact that the government requires a plot of land to have on-site access to basic services before a title can be issued. Without title, the range of financing options is severely limited.

There is some hope, however, in terms of this issue. Communities with sufficient numbers and support from advocacy groups have been able to negotiate cost-sharing concessions from the local council. In addition, if communities have access to financing for the lump sum required to make the initial infrastructure investment, individual households can use what they previously spent to buy water from expensive vendors or to pay for use of public toilets to repay the community loan. Returning to the average household presented earlier, they would have up to \$7 a month available to contribute towards repaying a loan that brought a pit latrine and basic water access to their community. If these services are available to a community of 150 households, for example, collectively they could repay as much as \$1,050 a month. If the initial loan to connect to the water system and build the pit latrines was for \$30,000 at 20 percent annual interest, the community could repay the loan in just over two years (27 months).

2.2.4 Summary of Household Issues

Household-related obstacles in the enabling environment limit households' ability to access housing (structure, land, and services) and housing finance (loans and savings). Limited incomes, particularly relative to the high cost of land, construction, and installation of services are a significant obstacle to creating a housing finance sector for the poor. The traditional housing finance approach of providing long-term mortgages for completely built homes cannot overcome this obstacle. However, the failure of this approach does not mean that affordability is insurmountable, or that housing finance for the poor can only succeed with large subsidies. Rather, by responding to how poor households currently overcome these obstacles—by building progressively and maximizing income generation from the assets that they have as they acquire them—governments and financial service providers can provide appropriate services.

For governments and donors, these lessons can be applied to the housing and property issues identified above. For example, could a land-tenure system be designed that allows poor households to receive title on an undeveloped property provided that, within a reasonable period of time, the family will upgrade the property to achieve a certain minimum standard? Could building codes be designed to reflect the building practices that most poor households have underway?

Although the development goals of governments, donors, and others may be to house all poor households in decent structures on their own land with access to basic services, it is important to recognize that all of these elements do not necessarily have to be in place at once. In fact, it is more financially viable for most poor households and their financial service providers to finance these improvements progressively. Once households have a plot of land of their own, they have an asset on which to build. Each additional improvement can be used to generate rental income, create space for a microenterprise, or simply improve the quality of life for the family.

2.3 Financial Service Provider Issues

The third and final category of enabling environment issues for housing microfinance concerns financial service providers. Assuming there is potential demand for housing finance, the question then becomes: what providers can supply this demand? In an ideal enabling environment, many different institutions, including banks, finance companies, or NGOs would provide flexible, affordable, quality savings and loans products to poor households. Unfortunately, Kenya is a long way from this ideal. The issues constraining the development of housing-microfinance options for poor households can be summarized as follows:

- *Financial Services Legislation and Regulation:* Two legislative acts, the Banking Act and the Donde Act, have a profound limiting effect on both the ability of institutions to enter the market and the types of products they can offer.
- *Lack of Providers:* Only three formal financial institutions currently provide housing finance to the poor, and in at least two of the cases, their coverage is limited to small projects in a few geographic areas. The lack of competition reduces the pressure on these institutions to innovate and improve their products and services. It also allows inefficient institutions to survive.

- *Inadequacy of Existing Products:* The products currently offered are generally inappropriate for poor households, or unsustainable, or both. Without improvements, an active market for housing finance for the poor will not exist in Kenya.

2.3.1 Financial Services Legislation and Regulation

In Kenya, there are three acts that regulate financial service providers: the Banking Act, the Building Societies Act, and more recently the much-disputed Donde Act. The goal of these acts is to create a framework for a healthy, competitive system with sufficient consumer protection, in practice, however, the net effect has been to reduce the number of providers and reduce the ability of those who remain to adapt their products and services to the changing market.

The Banking Act and the Building Societies Act established two categories of institutions that can provide housing finance: mortgage finance companies and building societies. Currently five housing-finance institutions exist. Two are mortgage finance companies (Kenya Savings and Loans—a division of Kenya Commercial Bank—and Housing Finance) and three are building societies (EBS, Family Finance, and East Africa Building Society). Of these five institutions, only EBS provides housing finance to poorer households, and even EBS' housing portfolio is directed to the upper-poor to middle-income market. The limited involvement of other players is due, in part, to the restrictions established by the Banking and Building Society Acts. These acts require that mortgage finance companies and building societies only lend against “real” guarantees, that is, mortgaged properties. Establishing a mortgage requires the borrower to have clear and legal land title to a house that is up to code. As previous sections described, obtaining title in Kenya is difficult or impossible for poor households, and the building codes are inappropriate for the kinds of structures that poor households can afford to build or finance. Similarly, these acts explicitly prohibit mortgage finance companies and building societies from financing the purchase of a plot of land without a structure. These regulations effectively prevent institutions from financing the progressive home construction that is likely to be undertaken by poor families.

The restrictions contained in these two acts profoundly limit institutions' ability to serve the housing finance needs of the poor. As management at both Housing Finance and Kenya Savings and Loans expressed, “...we would like to expand the range of market that we serve, however by our Charter we are limited in terms of what changes we can make. We simply can not accept guarantees other than a house, we are not even allowed to accept a vacant plot of land.” In fact, EBS, faced with impending bankruptcy in the early 1990s, chose to test the limits of these restrictions in order to expand its potential market (see Box 4).

Box 4. THE FALL AND RISE OF EBS

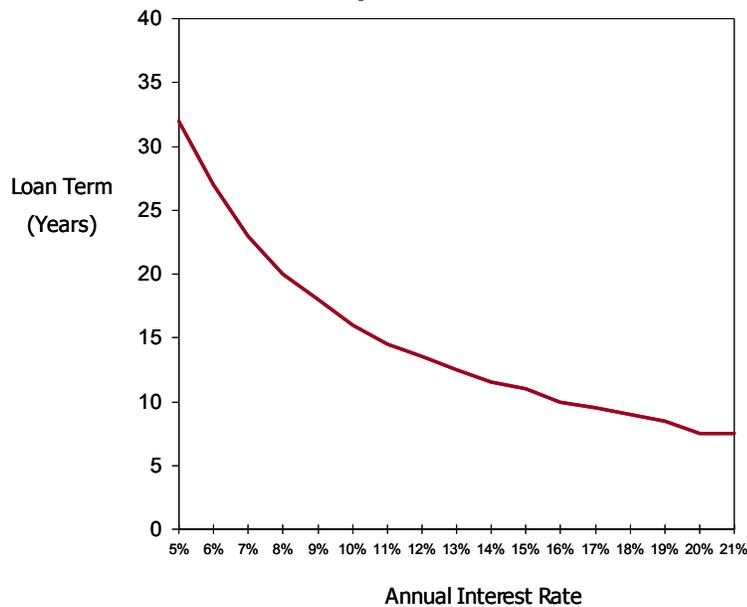
The Equity Building Society (EBS) was established in 1984 as a building society. In the mid-1990s, EBS and most of the 25 other building societies in Kenya were on the verge of bankruptcy. Their charters restricted them to lending for mortgages secured by liens on freehold or leasehold title. Given the difficulties in obtaining title, the potential market for this product was limited and became even more so as inflation skyrocketed to 156, then 180 percent and Government Treasury bills reached 83 percent. Even those households with title were not interested in a mortgage at more than 90 percent interest. While virtually all of the other building societies closed their doors, Equity Building Society chose to flout the laws governing building societies by offering more traditional microfinance loans for business development, agriculture, personal/consumer purposes, school fees and medical bills, and asset development.

Today, EBS is the largest microfinance institution in Kenya in terms of active clients, outstanding portfolio, and asset base. As of April 30, 2002, EBS had an outstanding portfolio of \$13 million and 20,492 active clients and recently received an “A” rating from the Central Bank of Kenya. While it is still registered as a building society, it now operates as a regulated, private, for-profit microfinance institution capitalized by shareholder equity investments and deposits. If EBS had not chosen to break out from the restrictions established in its charter, it would not be in operation today. However, EBS’s survival has not significantly increased the supply of housing finance for the poor. For housing, EBS continues to offer only a traditional mortgage loan affordable only to middle-income households. Mortgage loans make up just 6 percent of EBS’s portfolio and 6 percent of clients.

The Central Bank Amendment Act, more commonly known as the Donde Act, has introduced further constraints into the housing finance market. Passed in 2000 as a populist response to the high interest rates charged by commercial banks, mortgage companies and building societies, the Donde Act attempts to regulate the terms and conditions under which these institutions can lend. The act sets the minimum rate to be paid on savings at 70 percent of the government T-Bill rate, and the maximum interest that can be charged on loans at the T-Bill rate plus 4 percent. In addition, the total interest paid over the life of a loan cannot exceed the original capital borrowed. The intent of this legislation is to push lenders to reduce rates, and make loans more affordable for poorer households, while making savings more attractive as an investment opportunity. The Donde Act has not yet been implemented because the banks are challenging the act in court. However, its effect on the market is already being felt as banks and mortgage companies have begun to comply with the act in case the court challenge fails. Institutions have tightened their lending requirements focusing on only the most “creditworthy” (read: wealthy) borrowers and have stopped making loans with terms greater than seven years, since this would result in total interest costs exceeding the original principal, in violation of the Donde Act (see Chart 3).

Chart 3. Impact of Donde Act on Loan Terms

Maximum Loan Term Before Total Interest Exceeds Principal – Various Interest Rates



At the same time, these institutions are increasingly choosing to reduce the funds available for housing. As one branch manager at Kenya Savings and Loans described: *“The Donde Act limits my spread to 6 to 8%, but currently loan losses due to defaults on my housing portfolio are greater than this spread. So why would I invest my funds in such a risky, negative return business? I would rather take the guaranteed spread that I can earn from investing people’s deposits in government T-Bills.”*

While there are clearly problems with inefficiency and poor credit analysis in the Kenyan financial sector, the Donde Act, if implemented, would not resolve these problems. Rather than reducing costs or lowering rates to meet Donde Act requirements, most lenders seem committed to reducing lending, exacerbating the problem that the act was intended to solve in the first place, particularly for poor households.

2.3.2 Number of Providers

With all but one of the mortgage finance companies and building societies having been legislated out of providing housing microfinance, and the one remaining, EBS, with only 2 percent of clients and 6 percent of active portfolio in housing, where can poor Kenyans go for to finance the progressive development of their homes? The primary alternatives are MFIs and cooperatives.

K-Rep Group, through its development department KDA, is pilot-testing a housing-specific loan product. At the same time, the NACHU encourages and supports housing development through a variety of activities including housing construction and improvement loans. (Section 3 provides a more detailed description of these programs.) However, to date these programs have not developed sufficient scale. KDA’s program has 41 active borrowers, while NACHU has only several

hundred. Relative to the housing deficit identified earlier, this represents a miniscule share of the total market.

While the various constraints identified in previous sections play a role in limiting the supply of housing microfinance, they are only part of the explanation. Most of K-Rep Bank's existing microenterprise borrowers probably want access to loans for housing. Yet, after five years, KDA's pilot project has reached very few of them. While some of this may be attributed to difficulties in acquiring land, building code issues, problems with affordability, etc., it seems likely that, if K-Rep faced competition for its microenterprise clients, it would have found ways to overcome these obstacles and expand its housing-finance offerings. In short, this overall lack of competition leaves no incentive for the few existing housing finance providers to innovate and expand the accessibility of their products to the poor.

2.3.3 Adequacy of Existing Products

"We've heard of Housing Finance, East African Building, Equity, Family Finance, but we've not really followed up seriously on their terms and conditions. You know you have to have money first before you start talking to them."

-- Focus Group Participant

In addition to the dearth of institutions providing housing finance, the terms and conditions of the available products tend to disqualify poor households. High minimum-income requirements, strict guarantee requirements, and additional fees and expenses put traditional housing finance products beyond the reach of poor households. Under these conditions, a client would have to have an income of at least \$1,000 per month to qualify for a loan (see Table 7). Thus, even for those households that have overcome housing and property obstacles, there are few housing-finance options available. The options that do exist are generally unaffordable.

Table 7. Key Constraints of Existing Mortgage Products

Category	Constraining Conditions ³²
Use of Funds	<ul style="list-style-type: none"> ▪ Loans only available for complete construction of structures that meet building codes on land with clean title (implies on-site access to basic services). Estimated minimum value of such a home = \$25,000.
Income Requirements	<ul style="list-style-type: none"> ▪ Will only consider formal employment income or income of a registered company with audited financial statements. ▪ High estimates of monthly family expenditures (\$512 per family unit per month for KSL) used in determining income available for loan repayment. ▪ Will often only consider income from the primary income earner in the household.
Loan-to-Value Ratio	<ul style="list-style-type: none"> ▪ Loan can only finance 60 to 70 percent of the total cost of the home. ▪ Maximum loan amount should not exceed three times the borrower's annual disposable income.
Guarantee Requirements	<ul style="list-style-type: none"> ▪ Liens on freehold or leasehold title are the only guarantee option permitted, with the applicant paying all processing fees
Additional Fees and Commissions	<ul style="list-style-type: none"> ▪ Property and life insurance on the borrower (not available for non-permanent structures): 0.3 percent of loan amount. ▪ Stamp duty and mobilization fees: 6 percent of the loan amount (for property registration and bank administration) ▪ Legal and other fees: \$600 - \$900

It should be noted that EBS is trying to innovate by going down-market with housing loans. It is working with a developer on a low-income housing project in Thika, which is a small town northeast of Nairobi. The developer has identified a 12-acre plot on which it proposes to develop prefabricated houses for KSH \$3,800 to \$6,300. EBS would provide the mortgage financing. The developer is currently seeking construction financing for this project.

Virtually all of the institutions, from Housing Finance to NACHU,³³ claim not to have attempted further product innovation because of a lack of access to long-term, low-cost funds. If only, they argue, donors would provide access to this sort of funding, they could provide more accessible products to poorer households. It is clear that access to medium- and longer-term sources of funds is a prerequisite for the widespread growth of housing finance. However, lack of access to long-

³² Source: Interviews with Housing Finance, Kenya Savings and Loans and EBS, NSA 2001.

³³ K-Rep is a notable exception here.

term funds is not the only factor limiting product innovation. Microfinance and housing finance institutions also need to take more responsibility for developing and demonstrating new innovations. Perhaps with more clearly successful results from pilot tests, more donors would be more willing to commit long-term funds to scale-up a new product.

2.3.4 Summary of Financial Service Provider Issues

The existing financial services legislation and regulation in Kenya, albeit 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 framework that the laws establish is sorely removed from reality. The reality is that 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. 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 problem with such regulations is that they have reduced access to financial services, rather than protecting the interests of the public. The banks' response to the Donde Act is a classic example of a well-intentioned legislation that was too specific, causing a contraction rather than an improvement in the financial services market.

Similarly, the experience of EBS demonstrates what can happen when institutions have the flexibility (or take the initiative) to design their products according to market needs. When EBS followed the strict rules and regulations established for it by the government, it was on the verge of bankruptcy. By modifying its services to meet market demand while still managing its business prudently, EBS became one of the most financially sound financial services providers in the country—and has been able to provide services to a previously unattended or under-attended population. Nonetheless, even EBS still requires full-title for its housing loans.

Just as early microenterprise institutions broke traditional paradigms and designed innovative products to prove that microenterprise lending is sustainable, financial service providers interested in tapping into the substantial demand for housing microfinance in Kenya need to redesign traditional housing lending products to recognize how poor families build and the guarantees that they have available.

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 seeds for additional future improvements. They include: K-Rep Development Agency’s group-based housing-microfinance product, NACHU’s housing cooperatives and resettlement schemes, ITDG’s combination of low-cost building technologies and finance, and National Housing Corporation’s experiment with designing low-cost housing units with income generation in-mind. What all of these approaches have in common is that finance (loans or savings) is a crucial part of the approach. This is not to assert that financial services, by themselves, will create a better enabling environment, because non-financial services approaches can and are being attempted. In Kenya, the most notable of these is the collaborative effort, guided by UN Habitat, involving all stakeholders (City Councils, slum dwellers, NGO’s, etc.) called the Nairobi Informal Settlements Coordination Council (NISCC). However, these non-financial services approaches are beyond the scope of this paper.

3.1 KDA’s Housing Microfinance Product

The Kenya Affordable Shelter Project is one of the product-design efforts of KDA, a subsidiary of the K-Rep Holding Company that also includes K-Rep Bank, one of the largest microfinance institutions in Kenya. KDA ventured into housing microfinance based on a perceived need for housing finance among low- and middle-income populations. It noted the rising number of slums and slum inhabitants and the lack of housing finance for this market sector.

The project started in 1997, and KDA still considers the product in the design phase. As of May 2002 the project had:

- 13 registered groups with a total of 105 members
- 41 outstanding loans
- disbursed \$60,300 in loan capital, and
- maintained an on-time repayment rate of 81 percent.

The current pilot operates in a single town, Nakuru, with two staff members. The loans range from \$385 to \$3,300, and depend on construction cost and the applicant’s ability to repay. The interest rate is 15 percent flat and the repayment period is up to five years. Depending on the proposed loan use, KDA will allow up to a two-month construction grace period. By comparison, K-Rep Bank charges 18 percent flat on its business loan with a repayment period of 6 to 12 months.

The KDA uses the same group-lending methodology used by K-Rep Bank. The housing-loan group ranges from 10 to 30 members, and members are required to save at least 10 percent of the loan

amount. As with the bank's microenterprise loans, the housing loan clients must go through a group "mobilization" or training process and save for at least two months before receiving a loan.

The housing loans are highly secured. Security includes:

- group members guarantees
- savings equal to 10 percent of the loan amount disbursed. (The savings is held in a bank account jointly managed by the group and KDA)
- pledged personal assets of the borrower, and
- land on which the house is being constructed.

KDA does not necessarily require borrowers to have full title deed. For loans of \$1,300 or less, the borrower can use alternative documentation such as letters of allotment and sales agreement. The land security documentation is kept at KDA's offices. For loans greater than \$1,300, KDA requires a title deed. For these loans, KDA places a lien on the title. The borrower is required to pay all legal costs incurred in obtaining this lien.

The Kenya Affordable Shelter Project includes a technical assistance component. A junior architect assists clients in developing their construction budgets and design documents as well as conducting site visits to ensure construction quality. The number of visits depends on the type of construction and the client's building experience, but typically involves three to four visits throughout the construction process. The number of visits may be more a function of the limited number of current clients than of necessity.

In addition, the project disburses loans in tranches to ensure that they are used for the intended purpose. The initial tranche is based on what the junior architect estimates the borrower needs to get started. The second tranche is disbursed two months after the first disbursement and after the junior architect has visited the borrower and determined that the materials were purchased and that the construction has started.

The basic loan product has changed over time. Initially, KDA envisioned that the loans would only be used to construct homes and that it would only lend to clients who had title. Loans are now available for home construction *and* improvement. Working with its board, KDA has lowered its security requirement to allow letters of allotment and now sales agreements. Moreover, it is considering allowing clients who are part of land-buying companies and who have shares in a joint title, but do not necessarily have title to their property.

A second way the product has changed is that KDA initially started lending to individuals, but recognized that the title lien did not provide sufficient repayment pressure and reverted to using the group lending methodology common for other K-Rep loans. According to KDA's director, another cause for the poor performance on the individual loans was lack of understanding of individual lending methodology by the implementers. Other changes include shortening the repayment period from seven to five years to discourage payment fatigue, and increasing the interest rate from 12 percent flat per annum to 15 percent flat per annum to help cover costs.

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 more important than land title:* As KDA has discovered, requiring clients to have legal title so that a lien can be established excludes too many poor households, and given the high cost and uncertain rewards of selling reposessed 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.

3.2 NACHU Financing and Resettlement

NACHU is a Kenyan nonprofit 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.

The Bellevue Trust Land Project, which launched in 1994, involved the resettlement of 184 families from the informal community of Mitubma Village in Nairobi. NACHU helped the families form and register the Bellevue Housing Cooperative Society and identify the property, and provided a loan to the cooperative for 50 percent of the cost of the land. GOAL International, an international NGO, provided 40 percent funding for the land purchase and legal assistance. The cooperative members raised the remaining 10 percent mainly through revolving savings schemes. It took the community approximately a year to raise their share.

The NACHU loan is \$705 per quarter-acre plot. The interest rate is 15 percent with a maximum loan term of four years. NACHU retains the land title until all members have paid their share. Once the loan is paid in full, NACHU will start the process of securing individual titles for the subplots. The members essentially lease the land until they have paid their share in full. The housing cooperative is responsible for allocating the subplots to its members, collecting the funds to repay NACHU and managing the common spaces. The group completed the land purchase in 1998 and most of the families moved in almost immediately, despite the fact that the community is located well outside the city limits, about a kilometer from the main highway, and initially had no services. Using whatever additional income they had available, families began building on their plots. As of May 2002, when most families were just finishing repaying their land purchase loans, the types of constructions in Bellevue were highly varied. Households with more available income had succeeded in building stone structures, including a three-room stone cottage and a two-story stone "rooming-house." The majority of households, however, were living in provisional structures of corrugated iron or mud and wattle. Many had chosen to invest in building rental rooms of provisional materials rather than improving the structure in which they were living. Community members who have paid off their land purchase loans are now looking to NACHU for construction loans to help them improve their homes.

Without access to basic services, households in Bellevue were initially forced to buy water in 20-liter jugs and carry it in from more than 3 km away. They used the empty surrounding fields as temporary toilet facilities. With the help from another loan from NACHU, the community was able to collectively pay to install four pit latrines and bring in a fresh water connection. This loan is repaid out of usage fees charged by the community for the water and the toilets. Although most households had little additional borrowing capacity after the land purchase loan, they are able to pay these usage fees, because the installation actually reduced existing expenses.

NACHU's experiences in Bellevue highlight both the possibility of overcoming some of the land and housing obstacles outlined earlier by using a progressive financing model as well as many of the challenges:

- *Progressive land acquisition and building takes time:* Visiting Bellevue for the first time, four years after the initial land purchase, one is not immediately left with the impression of a successful housing program. Most of the structures are provisional, the roads in the community are dirt tracks, and the community itself is in a rather remote location. However, first impressions cannot always be trusted. Bellevue residents were unequivocal in their preference for their current living conditions versus the informal settlements where they used to live. Moreover, they expressed confidence in their ability to improve the community and their own homes over time—several construction/improvement projects were underway during our visit. While NACHU and the Bellevue Cooperative are struggling with many issues, the model may contain the seeds for a more broadly applicable solution.
- *Need for follow-up construction finance is vital:* Perhaps the biggest complaint of Bellevue residents was that NACHU had not provided follow-up loans to help them build once they finished repaying their land purchase loan. NACHU has resisted providing this sort of financing until all cooperative members have repaid their land repurchase loans, partly attributable to limited available loan capital.
- *Individual land titles are still a challenge:* Although NACHU has title to the overall Bellevue property, it still has several challenges to overcome in extending individual titles for each family. As outlined earlier, to grant individual titles, government surveyors would have to formally subdivide the land, services would have to be extended to each plot, and the constructions would have to meet building code standards. NACHU has managed to minimize some of the costs by lobbying the government to accept NACHU's existing subdivision.
- *Potential exists for community-based finance of basic infrastructure:* As discussed above, one obstacle to the enabling environment for housing finance for the poor is that households typically have to pay high prices on the informal market for basic services in order to be within regulations. NACHU's experience highlights another potential innovation—providing a loan to all of the members of the Bellevue community for the installation of water and latrines—or community-based financing of basic services.

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.

3.3 Combining Financing and Reduced Building Costs at ITDG

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 (see discussion of Code 95 in Section 2) and low-cost building technologies.

ITDG promotes two low-cost building technologies in Kenya, Stabilized Soil Blocks (SSBs) and Ferro-Cement (FC) construction. These approaches reduce the use of high-cost inputs such as cement and stone, and increase the use of locally available free materials, such as dirt, while maintaining the same levels of load-bearing capacity and safety standards. SSBs combine cement, water, and dirt. Using a specialized “brick-press,” they create a “brick-like” block that can be used to create quality, safe, attractive structures at 40 to 50 percent of the cost of a stone construction. Moreover, the process is straightforward, and local construction laborers can operate the brick-press. Not only does SSB reduce the materials cost, it also reduces transport costs for poor households because the SSB blocks are produced on-site, while stone or cement blocks must be brought in.

Using the example constructions presented in Table 6, use of the SSB technology can bring the cost of a one-room stone construction down almost to the level of a plastered, mud and wattle construction, while a two-room basic home becomes affordable for more households though still out of reach for the majority, unless they choose to rent it out and use the rental income for loan repayment (see Table 8).

Table 8. Impact of Low-Cost Construction Technologies on Affordability

Type of Construction	Construction Cost	Monthly Disposable Income Required to Save in 5 Years	Monthly Disposable Income Required to Repay in 5 Years (20 percent annual rate)
WITHOUT LOW-COST TECHNOLOGIES			
1 room stone unit, no services	\$1,090	\$17.71	\$28.88
Stone basic unit with 2 rooms and service connections	\$2,564	\$41.66	\$67.93
WITH LOW-COST TECHNOLOGIES			
1 room stone unit, no services	\$545	\$8.85	\$14.44
Stone basic unit with 2 rooms and service connections	\$1,538	\$24.99	\$40.75

While the cost advantages of ITDG's new technologies are clear, widespread adoption has not been automatic. Skepticism regarding new technologies, limited numbers of construction workers trained to use the SSB brick-press and limited access to finance have limited the use of ITDG's innovations. Despite the cost-reduction, a house built with SSBs or Ferro-Cement still requires a family to come up with a sizeable lump sum in order to pay the upfront cost of construction. To this end, ITDG is working closely with NACHU, KDA, and local savings and credit schemes like NAHECO (see Box 5) in order to further disseminate the technologies. However, the limited scale of these programs is acting as a further constraint for the expansion of the use of these technologies.

Box 5. NAHECO POOLS RESOURCES TO IMPLEMENT ITDG TECHNOLOGIES

Nakuru Housing and Environment Committee (NAHECO) is a self-help group of community-based organizations in Nakuru's informal settlements that was formed with help from ITDG. NAHECO provides business and housing loans using capital raised through member savings and earnings on loans. Group members, of which there are now 300, are required to save at least 100 Ksh (\$1.20) per month. As of May 2002, after only a year of operation, the organization has \$9,000 in loan capital of which \$3,000 represents capitalized earnings.

The interest rate is 18 percent flat per annum for housing loans and 15 percent flat per annum. The loan amounts are up to three times the amount the borrower has saved. The repayment periods depends on the loan amount. Loans of \$130 or less have a six-month repayment period. Loans for more than \$130 have a nine to 12 month repayment period. There is also a four-month grace period for construction. In its first year of operation, the organization has made six construction loans, one for owner-occupied housing and five for rental housing units.

3.4 National Housing Corporation's Pumwani High-rise Experiment

Although now somewhat dated, the NHC's 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. The Pumwani high-rise was built on slum land and was intended to house the families displaced by the construction and other low-income families. Recognizing past problems with low-income households selling their government-provided housing to higher-income households because of affordability issues, the NHC explicitly attempted to design the Pumwani flats with affordability in mind. However, in keeping with minimum quality standards and their desire for three-room units, NHC's architects could not reduce the per unit cost below \$11,783 (based on the 1990 exchange rate³⁴) given the intended financing mechanisms included an 18-year loan at a subsidized 7 percent interest rate, monthly payments for these units would be \$74. This amount was still considered beyond the means of most low-income households.

³⁴ 1990 exchange rate 22.915 Kenya shillings per 1US\$. Source: International Financial Statistics Yearbook 2001, IMF.

To overcome this affordability obstacle, NHC changed the design layout of the flats so that each of the three rooms 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. A big part of this apparent success is attributed to households renting one or two of the rooms out in order to make the loan repayments. Current room rental rates are as high as \$38 per month, 51 percent of the monthly repayment.

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:* Whether by lowering the cost of construction or increasing a family's ability to earn additional income, ITDG and NHC have successfully demonstrated that new technologies and creative designs can help reach lower-income households with higher-quality constructions, making commercial financing viable for a greater number of households.
- *Adoption of these technologies is not always automatic:* ITDG's challenges in disseminating its new technologies, despite their cost advantages, demonstrate that, as with any new technology, adoption is greatly influenced by traditions and cultural beliefs (e.g., "stone is the best building material") that are hard to predict and difficult to control.
- *Successful dissemination requires available finance:* For both ITDG and NHC, the final piece of the puzzle in getting their technologies in use is access to affordable finance.

While both of these approaches have remained fairly limited in scale, they do suggest some potential for combining innovations in housing microfinance with innovations in architecture and engineering in order to improve the housing situation of the urban poor.

4 EMERGING LESSONS

"...one takes their time building one's house. You start off by yourself with one room; when you get married you add on, when the children are born you add on."

-- Focus Group Participant

The enabling environment for housing microfinance in Kenya places significant obstacles in the way of poor households struggling to build a home of their own. From expensive land prices to serious problems with land security to rigid financial services legislation, virtually every component of the enabling environment restricts, rather than encourages, both the potential demand and the potential supply of housing microfinance. Poor households have few options other than renting. Land is unaffordable and squatting is uncertain and only possible by paying protection fees to the local Chief. If the poor are able to access land, they are unlikely to be able to obtain legal title to it and consequently may face the real possibility of eviction. Finally, if they do build, they face high building costs, including the cost of installing basic services, restrictive building codes, and limited finance options.

While many of these issues are present in many other developing countries, the enabling environment for housing microfinance in Kenya seems particularly difficult for two main reasons: the strict enforcement of existing land and construction legislation and the significant involvement of the ruling classes in providing and profiting as landlords to the poor under the status quo. By comparison, other Cities Alliance case studies have identified similar issues with enabling environments in Peru, Mexico, and India. However, in each case, successful housing microfinance programs have been developed. In Peru, for example, although most poor families lack title and fail to follow building codes with their constructions, lax enforcement of these issues allows them to have a sufficient level of land security to allow them to feel comfortable making permanent investments in their property and to allow Mibanco to lend to these households without fear of loan losses due to evictions.

KDA, NACHU, EBS, ITDG, the Nairobi Informal Settlements Coordination Council and others have initiated experiments that suggest possibilities for overcoming these difficulties. All of these experiments are either nascent or have yet to achieve scale. Yet in all of these experiences, there are lessons that may be useful for other countries facing similar enabling environment challenges. This section summarizes some of these lessons and opportunities.

1. Land security does not have to mean full, legal title.

Housing lending requires land security, but does not necessarily have to imply a full title deed. Rather, land security can be based on the degree of confidence households have in their ability to build on their property without fear of being evicted or having their construction demolished. Focusing on land security—rather than on legal title deeds—may allow governments, donors, and potential housing lenders to develop creative solutions that allow the poor to develop decent

shelter and, ultimately, to move towards full, legal title to a plot of land with an up-to-code home. For example, if governments agree not to evict poor households who have some form of partial tenure, such as letters of allotment, and lenders will accept these alternative forms of land security, housing microfinance is more likely to happen. Although it is not a complete solution, this change would possibly reduce the need to make complicated, wholesale changes to the enabling environment, such as modifying the titling process and building codes.

2. Mortgages are not necessarily the most secure guarantee.

Traditional banking wisdom argues that “mortgages are among the most secure and certain” of guarantees. Mortgaged portfolios require lower provisions and are assumed to have lower loss rates. However, the Kenya experience demonstrates that these assumptions are not true when trying to finance the housing needs of poor households. Even if poor households had titles to offer, the evidence suggests that using guarantees would, in fact, reduce portfolio quality. Institutions that only accept mortgage guarantees (either by law or by choice) tend to finance only completely constructed houses (most poor households are reluctant to “give up” their title for a smaller, housing-improvement loan), which require long loan terms for the monthly payments to be affordable. Given the instability in the Kenyan economy and uncertain employment market, few families, poor or middle-income, have confidence in their ability to follow through on such a long-term obligation. The longer the loan term, the greater the chance that a borrower might lose his job or that her business would fail and therefore be unable to repay the loan, creating greater risk for the lender. In addition, the long, drawn-out foreclosure process and the weak market for resale of foreclosed properties often create situations where repossession costs are more than the lender receives from the sale of the property. Furthermore, because of the unstable economy, financial institutions lack access to long-term funding sources, and therefore take on additional liquidity risk by financing long-term loans.

Thus, the legislated requirement that building societies and mortgage finance companies accept only title loans and the insistence of these and other financial services providers to accept only full and legal titles has two major effects: it not only limits housing-finance access to a small portion of the population, but also is likely to increase—rather than decrease—the risk in housing loan portfolios. Given the unstable economic environment and lack of availability of long-term funds, lenders and governments might consider that shorter-term loans for progressive-construction are less risky than long-term mortgages, regardless of the guarantee. If governments and lenders would be willing to revise the security requirements a greater number of poorer households would be able to access the formal financial sector to improve their homes and, at the same time, lenders and governments could potentially reduce the risk of their housing loan portfolios.

3. Progressive building decreases risk and increases affordability.

As the affordability calculations in Section 2 demonstrated, poor households can make more progress towards their ultimate goal of owning their own home by building progressively rather than trying to save or borrow for a complete construction. An average poor Kenyan household with monthly net income of \$8 would not qualify for a long-term loan at commercial rates and thus would need almost 15 years of steady saving to buy a simple one-room stone house. Yet the same household could achieve the same house in less than two years and pay off their debt in less than six years if they were willing to build progressively and live in provisional accommodations (similar

to their current living conditions) while they are building their home. For a potential lender, progressive lending can convert an unqualified borrower into a fairly low-risk borrower.

Poor households already build progressively. The challenge may be in convincing donors and lenders, who eager to see neat rows of completed houses, that partially developed lots with provisional structures are actually a more realistic, sustainable means of achieving the same end. Recognizing that poor households will acquire land and then build over time, land-titling processes and building codes might be adapted to allow legal recognition for partially constructed units. The benefits of progressive building in terms of affordability and financial services regulations and products have been addressed in previous sections.

4. A “progressive-build-friendly” policy environment may produce better results than strict enforcement of high-minimum standards.

The Kenyan government's response to the ever-worsening housing situation is to regulate a solution. The Donde Act attempts to fix the problems of an expensive and poorly functioning housing finance sector by mandating limits on interest rates. The sale of slum land and the demolition of slum areas attempt to discourage and eliminate houses that do not conform. Despite what may (or may not) be well-intended actions, regulating away the problem seldom produces the desired result. Instead, it compounds the problem by eliminating options for housing finance innovation. As an alternative, governments might consider developing progressive regulations designed to reflect the way that poor people can and do build. For example, building codes and titling processes that provide initial approvals conditional on the household completing progressive improvements over time would give lenders greater security in financing these progressive constructions, thereby increasing households' ability to live up to the progressive standards.

5. Long-term financing for housing providers is not a complete solution.

One complaint heard from several potential housing finance providers during the research was that the lack of low-cost, long-term money was preventing them from developing housing finance products for the poor. Given that few of these providers have demonstrated a strong understanding of the sector, the ability or willingness to innovate in their products, and/or the institutional capacity to achieve scale, it seems unlikely that an infusion of loan capital would result in widespread provision of housing finance. Access to longer-term funding (long-term in housing microfinance can be as short as five years) is certainly an issue for the scaling up of successful programs, but in the initial stages, providers and donors should focus on increasing the number of promising potential providers offering quality products.

6. There is a need for greater dissemination of existing experience.

Although housing microfinance is an emerging sector, there are a number of existing providers. More initiatives that allow practitioners to share experiences and emerging “good practices,” such as the Cities Alliance case studies, are needed to allow this new area to expand and grow more quickly.

7. After land, services are one of the biggest challenges in housing finance for the poor.

Although NACHU's experiences with community financing of water installation through service fees provides an interesting example for further experimentation, the problem of how to extend basic services to poor households remains a big challenge. Government-owned utilities tend to lack the long-term capital needed for significant infrastructure investments, even if they can recoup the investment from usage fees in the future. Housing microfinance may be a tool to help address this challenge.

8. Conditions on donor financing of microfinance institutions can reduce their ability to experiment with housing microfinance.

Despite emerging examples that housing microfinance has both important development benefits and can be profitable when well-managed, many MFIs that operate as NGOs (as is the case for most in Africa) are limited in their ability to experiment, because donor funding agreements require them to lend only to microentrepreneurs or lend at below market rates. By including these restrictions, donors may be unintentionally preventing key potential providers of housing microfinance from launching a program or achieving sustainability. Donors interested in expanding the reach of housing microfinance should consider how they can modify their contracts to increase MFIs' ability to innovate and experiment to create viable housing finance products. While NGO's should be subject to the same burden of proof as private providers in establishing a solid pilot project before receiving on-going funding, donors strict limitations on the use of their funds may not leave NGO MFI's with the capital necessary even to begin the experiment.

9. Combining financing with other advocacy, legal, or construction issues may be overly complicated for early-stage programs.

Given the many obstacles facing potential providers of housing microfinance in Kenya, several of the institutions studied have tried to include responses to each of the obstacles as part of their activities. NACHU for example, offers financing for land purchases and housing construction, provides engineering and architectural design technical assistance and legal advice on land purchase and obtaining titles, and advocates for the poor on housing issues. For organizations starting their financing operations, undertaking a wide-range of activities, financial and non-financial, is likely to be overwhelming. As with microenterprise finance programs, one of the keys to the growth of housing microfinance may well be the focus on finance first. Once the finance program is operating smoothly, institutions may be better equipped to expand the range of their activities or alternatively partner with organizations that are better suited to provide non-financial services.

In closing, the enabling environment for housing microfinance in Kenya is not conducive, at least in the short-term, for the development of widespread housing microfinance. Given the multiple layers of interacting constraints, it seems likely that combined financial and non-financial advocacy approaches will be necessary to break the current stalemate. Many talented and capable people are working hard to do so, and while not all of their stories and experiences could be related in this document, it is hoped that they will be successful and that changes will come. In the meantime, Cities Alliance hopes that this summary of the situation in Nairobi and Kenya may serve to highlight some of the key issues and provide some useful food for thought for others facing similar issues in other countries.

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