

# **Innovative Financing For Improvement Of Slum Conditions**

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## **INTRODUCTION**

As many Kenyans struggle to put food on the table, they have additional responsibilities of assuring that their families can access suitable decent shelter. There are fundamentally four major challenges in putting up shelter. The first is land and second the tenure associated with that land. Like food housing is a human physiological need and therefore a human right. All persons regardless of their station in life, income, class, race, or religion need housing as a matter of necessity. Basically shelter protects us from the vagaries of nature like the weather and other elements that are man-made activities like theft.

The suppliers of finance in urban areas target people who can afford. The market forces, which should be ideal, have an ironic way of distorting the real needs as they operate where they make profit and declare dividends to their shareholders.

The income profile of the urbanites is bottom heavy 10% of the people earn 90% of the income, yet the 90% with the least income, are the most in need of financing. This is unfortunate as the people offering financing have a limited market within which to operate. The people who need financing are not at all attractive to the financier. It is evident in the number of up market houses neither rented nor bought.

In the housing financing set up the target market are the prime sites, which are found in exclusive estates in Nairobi, Mombasa, Kisumu, Nakuru, Eldoret. These are urban settlements, where a few people have large incomes. This limits the market threshold of the giver and the taker. Even within these towns and cities, there are locations which have a better attraction than others.

There are four key areas of Housing Finance. These are availability, accessibility, affordability and administration. Only the 10% market is accessible to financing. Over the years a number of organizations have come up with schemes to make mortgage accessible to their staff at concessionary rates. Such companies and institutions are few and therefore only limited a number of people access to such facilities. This leaves the majority of Kenyans all of whom need decent accommodation without options. Those whose employers do not have a scheme have very few other options, but at least they have a fighting chance if their incomes are decent.

In competing priorities, like school fees, food, clothes, shelter is also an essential. The major difference between other essentials and shelter is that the outlay is very substantial and often

requires savings over a lengthy period of time. Additionally, it will require a mortgage or loan. Conventionally, anyone with a well-paying job can get a mortgage from the high street banks. These days the banks have set up shop to sell their mortgage products outside their formal premises. How times have changed!

## **WHAT IS THE SITUATION ON THE GROUND?**

### **The People:**

The people who live in the informal settlements need decent shelter, they too have to pay school fees, buy food, clothes, rent or 'mortgage'. Typically they are on menial jobs, those who are lucky enough to have jobs, mainly working as watchmen, cooks, housekeepers.. Their incomes are very low. Many are below the poverty line of ONE US Dollar a day. They are the primary targets for the millennium development goals (MDG).

Many of the slum dwellers are self-employed and have no regular income. Many have no work and no means, they are merely 'looking around' and squatting with relatives. Conventional banks find them a huge and uncomfortable risk. In any case majority of slum dwellers do not measure up to the threshold for being considered for mortgage debt within the 'usual' arrangements. They too need shelter. Moreover many informal settlement people are dependants, under-age.

There are those who either dropped out of school or did not perform well enough to proceed with further studies. There are others who qualified but had no means to pay their way for higher learning. Yet there is another category of university graduates who have no opportunities and see no future. Perhaps it is a testimony to their training which geared towards being employees and not employers or self-employed for that matter.

This is an increasing number and an intriguing matrix of despondency and hopelessness. What if anything is the correlation between the rise in armed robberies and this set of circumstances?

### **The Land:**

The land belongs to the government and whoever occupies it is a sub-tenant of government. The land that slums occupy is about 6% of Nairobi's total land surface, yet the informal settlements house more than 60% of the city's total population. One gets the idea that the informal settlements are densely populated.

### **Infrastructure:**

There are no roads, no running water, no electric power, no sewers, very few schools, no hospitals, a few dispensaries, some areas have public toilets, but not enough; there are dance halls as well as churches and mosques, there are hotels, all sorts of enterprises, a rail way line

## **Dwellings:**

Mud wall houses, old GCI roofs, the floors are not damp-proofed, so there is a health hazard right there. The dwellings house six people on average typically in one room of 10' X 10'

## **Scope of Interventions sought**

It is self-evident that the informal settlements need physical infrastructure, like roads, sewers, bridges, bicycle paths, footpaths, and water is from a standpipe some distance from the house, and it is more expensive than in any formal estates in the city. On the other hand the houses themselves are in poor conditions. So, in order to make a true difference the intervention needs to be twofold; one to address the infrastructure both physical and social, and the other to focus on the dwellings and their basic amenities.

All classes of slum dwellers need decent shelter. The challenges are five-fold:-

- To determine what methods are viable for fund-raising for their housing needs.
- Once the strategy for fund-raising has been designed and adopted, then it will be necessary to identify professional micro-financiers who have experience and knowledge in lending to informal traders and dwellers. Perhaps they could also design for them means and ways of setting up small and micro-businesses so that they can grow them.
- It becomes necessary to draw up very innovative models and/or use models that have worked and been successful elsewhere in funding these special needs clientele.
- Does a legal instrument and framework exist in Kenya, and if not, can one be developed to cater for this category of deserving citizens whose crime is being poor
- What role will the central government and the local authority play in creating an enabling environment in which these programmes can take root and grow?

## **Determining what methods are viable for fund-raising for housing needs.**

### **Studies have shown that**

#### **Government Support:**

1. Directly by capital injection especially in the development of infrastructure (both physical and social). This is ideal, and development partners can be invited to join into such a worthy cause
2. Subsidies: provide land, and also waive any land rent payable
3. Policy change so that locally available building materials are used rather than insisting on the BSI
4. Tax free threshold: For example the first say 50K not to be taxed
5. Tax holidays: Suspend VAT or other taxes so that materials are more affordable. This needs to be time bound so that it speeds up the process
6. Pass a microfinance bill that caters for the small depositors

## **ISSUES IN HOUSING FINANCE OPERATIONS:**

The key issue in housing finance system is intermediation – the mobilization of a steady flow of funds for the system and making such funds available and accessible to those who need them most, the very poor and low income groups. Other issues include Risks that the system is prone to, which have to be addressed and taken into consideration in its operations. These are credit risk, cash flow risk, agency risk, system risk and political risk.

### **Mobilization of Funds:**

The success or failure of a housing finance system depends on the size and diversity of its funding resource base and on the continuity of flow of funds to it. The household sector is acknowledged as having the richest vein of untapped savings in most developing countries. Potentially, the household sector has a huge capacity to save and it is a question of tapping that potential. However, availability and access to appropriate and sustainable sources of funds remain the bane of housing in Kenya. This in part is because housing finance is compelled to compete with other investment opportunities in the financial markets.

### **Interest Rate (Cost of funds)**

The interest rate is the price of capital to the borrower and the return on capital to the saver or lender. The interest rate plays a substantial role in equating or matching the supply of and the demand for loanable funds. It has been argued that the strategic variable for the expansion of housing finance systems is the mortgage interest rate level and that this should be kept as close as possible to the market cost of funds, in order to be able to pay appropriate rate on deposit and mobilize funds.

Three components considered when computing interest rates to be charged include: real rate of return on deposit; the risk as well as the actual or expected rate of inflation; and the margin covering the operating costs of the financial institution. Insecurity, volatile markets and often high inflation rates and high default risks in unstable economies lead to high interest rates.

In most developing countries interest rates are usually too high to make long-term lending a viable way to finance housing. When investment in housing requires a loan of about three times the annual income of a prospective house owner, an interest rate of 33% would require one annual income just to cover interest alone. High interest rates make housing finance unaffordable and therefore inaccessible to large proportion of the population. Interest rates are influenced by the macro-economic environment.

### **The Legal and Regulatory Framework**

The basic role of the legal and regulatory system is to set the guidelines and rules of the game and to enforce the rules and guidelines through diligent oversight and supervision, so as to prevent abuse of and damage to the system.

Legal and regulatory aspects can put unnecessary constraints in the way of the development of housing financial institutions. This could be when one seeks to mobilize resources. Good examples are:

- Prohibiting household deposits except at fixed terms and rates
- Control of deposits and lending and mortgage interests rates
- Foreclosures rules that are sometimes detrimental to viability of housing financial institutions
- Greater flexibility and innovation should be infused into the design and operation of these regulatory mechanisms

### **Risk of Default or Credit Risk**

The risk of default is closely related to the large sums of money housing requires, when compared with the income of the borrower. Thus the ability of the borrower to repay the loan (credit risk) is factor to be considered. Defaults generate a cash flow and income problem for the lender. The long term also creates rising interest rates, where the cost of funds rises while the income remains the same, erodes disposable income.

Of late borrowers have had to deal with variable interest rates on mortgages. Rising interest rates (system risk) may make the payments on the loan unaffordable for the borrower and increase the risk of default for the lender.

### **The Mortgage Instrument**

The conventional for of securing a housing loan, through the institution of the mortgage is a highly formalized legal instrument. It requires a clear, registered title to the land and the registration of the mortgage in the lands registry, mostly handled by legal professionals. The process requires a valuation of the property. |This is costly and excludes all those who do not have a clear title to land. Moreover the financing institution is usually not able to easily convert mortgage property into liquid funds in case of default by the borrower. It has a low degree of liquidity.

The financing institution has to enter into lengthy and costly legal procedures before the property can be sold. In Tanzania, for example, the absence of a foreclosure law prevents mortgaged property from being easily converted into cash by the lending institution in case of default. Thus the mortgage contract lacks enforceability. This is one of the reasons that Tanzania has been without a formal housing finance system since 1995 when the Tanzania Housing Bank was closed for insolvency. If foreclosure and attachment are not easy and straightforward then lenders are exposed to great credit risk.

For the poor the mortgage instrument does not usually work for a variety of reasons:

- Because of the need for an acceptable title deed as collateral
- Because of the cost involved in valuation and registration
- Lending policies tend to set a minimum size of loan

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## **MACRO-ECONOMIC ENVIRONMENT**

High inflation and declining disposable income levels results in low levels of household savings. This affects the financial sector in general and the housing finance sector in particular as they are less able to save and mobilize resources. As inflation impacts on the prices of building materials, and the already tottering disposable incomes, the non-income and low-income earners can neither borrow nor build from their own resources.

## **INSTITUTIONS**

NGO's are tending to play a key role in financing of housing for the non-income and low-income groups. They have built credibility over the years especially amongst the slum dwellers themselves. This is because most governments have developed Housing Banks and/or Funds, but these are usually limited to financing middle and high income. In Kenya we have Housing finance, a joint venture between GOK and the CDC. Another is the National housing Corporation. Other actors are private banks and private developers.

## **GLOBALIZATION**

Policies to decontrol interest rates and foreign exchange rates have the net effect of opening up financial markets. Globalization has created an interface between housing finance and international market forces. In principle this has the potential of expanding the capital base but has also the risk of rendering the interest rates and exchange rates very volatile and unpredictable. In Zambia this resulted in high interest rates and continuous decline in the Kwacha, the national currency. This affected the economy, including housing provision. Between 1985 and 2000 the average interest rates for mortgages yo-yoed between 20% and 90%. This was at the behest of World Bank and the International Monetary Fund (IMF) in the so-called Structural adjustments Programmes that saw the withdrawal of subsidies without a safety net.

## **MICRO-FINANCE**

Micro-finance refers to finance mechanisms that offer opportunities to people to save very small amounts, not usually handled by finance institutions and offer small loans, usually for the purchase of inputs to small-scale entrepreneurs. Latin America has experienced improved housing when micro-credit was directed to women. This ingenious idea has not expanded widely into housing because of the lack of legal property rights to guarantee the loan.

Related to Micro-finance are Community Based Organizations (CBO's) which have begun to get organized in Kenya and are networking internationally and nationally. Saving groups have become a massive movement that could change the traditional fight against poverty. The government has tended to leave this to NGO's and thus no desirable legal framework is forthcoming to guide this style though it has great potential.

Some of the challenges in community-based housing are:

- Whether there should be subsidies or not and what type
- Whether loans should be to individuals or groups or organizations
- Should credit be limited to the very poor or also be extended to low income earners

## **SUBSIDIES**

It is a moral question whether indeed governments the world over recognize the need to enable their poorest citizens to access decent housing. Since this category of households cannot afford to pay market mortgage interest rates, subsidy in one form or another should be made an option. In South Africa, specifically Alexandra Township, those who can afford pay while those who cannot are assisted.

## **CONCLUSIONS**

In Kibera as elsewhere, it is clear that housing problems are essentially an income problem. It is the poor and people with very low income or no income at all who need support to get affordable housing. Majority of people living in Kenya do not have access to land or basic services and, in addition, they cannot afford a loan not even for the least expensive commercially built housing units. Therefore housing finance has to be a major element of our National Housing Policy, which is an important element of Welfare Policy

## **RECOMMENDATIONS**

The World Bank has suggested that unless positive real interest rates are charged to borrowers and paid to savers, the housing finance system will be in trouble. It further argues that the long term objective should be the creation of a housing finance system increasingly integrated into the larger financial system and based on savings mobilization and allocation at market interest rates. That the provision of adequate housing to families unable to afford it from their income is best pursued by direct means, such as well designed and targeted subsidies. At the same time those policy and institutional barriers currently inhibiting access to housing ought to be eliminated.

Housing institutions should, from the start, seek to enlarge and diversify the sources of their domestic resource mobilization as much as possible, and these should include household deposits, pension funds, mutual funds and insurance company funds, as well as devising other innovative schemes, including outreach programmes for the informal sector to mobilize domestic resources. In post World War II Germany, saving-for-housing schemes that combined contractual saving plans guarantee to provide housing loans when the saving plan has been fulfilled were very popular. Adapting saving-for-housing system to the needs of Kenyans is a viable proposition to deepen the financial system. Venezuela and Chile have similar. Household savings can be mobilized and brought into the system. The required outreach system could be an obstacle but Equity Bank, a locally-owned and operated bank has the necessary clout, others have proliferated but suitable legislative framework is needed.

Compulsory saving schemes can be introduced in the form of provident funds and social security funds. We have these in Kenya and they are a viable option if not politicized as was the case in the years up to 2002. Now they still need fiduciary discipline to reign them in and assure they are fulfilling their core mandate.

It is desirable that a stable macro-economic environment be maintained in terms of low inflationary levels for a healthy and sustainable operation and growth of housing finance systems.

### **Harambee System**

This is uniquely Kenyan and it has been used to harness everyone's contribution in cash, kind or labour, usually it is the latter, especially if one has no other means and it is appreciated and acknowledged

### **Merry Go Round**

This is also very successful and is organized through women's groups, both the rural and urban Kenya. It has enabled many invest in enterprise and in housing as well.

### **Land Tenure and Pricing**

Land is a major consideration in at least two ways. It is subject to legal instrumentation and deeds. Moreover it is expensive. So the local government and the local government must both get involved in setting aside public land

### **Progressing Housing Process**

Development of housing is a long process which can take several years. First you acquire the land or purchase a lot within the slum. Then you build a makeshift temporary dwelling to secure it, and gradually develop something to your liking. As the community becomes established, the people can get organized together and agitate the government for services. In the mean time, households usually obtain these services through clandestine connections to water, electricity lines, even trunk sewers

*The resulting house has tremendous use value and is a haven for radical uncertainty of sickness, job loss and other emergencies that the slum inhabitants have to live with constantly. - Bruce Ferguson*

## **Information and Counselling**

It is not enough to research and develop suitable materials and technology for the poor and lower income earners. It is like lighting a lamp and putting it under the bed. The knowledge needs to be systematically shared for the benefit of the community.

Housing guidance, information and counselling to the people on proven innovative, cost effective and appropriate building materials and technology options is imperative. There tends to be the attitude almost like that of the herbalist, not to share their knowledge with others, perhaps as a way of assuring commercial longevity in the business. In the process technicians die with the knowledge and know-how still in them and not shared. This explains why we find pockets of so-called development interspersed with ramshackle dwellings.

## **Encourage Informal Production Systems:**

Since the informal workforce cannot identify itself as appropriate to the requirements of the formal urban economy, it engages in informal economic activities that remain supportive of the urban production systems. Contrary to the general perception that informal settlements and economic activities undertaken there are not “productive” and do not make a significant contribution to the functions of the urban system the Kibera informal economy presents a strong forward and backward economic linkage with the formal economy

## **Free Housing for the People Below Poverty Line**

Noble as this method is most governments have failed to meet the vast needs for housing under this policy, Hong Kong, due to pressure on land succeeded in this. Perhaps they used a different approach.

## **In India they had the Minimum Needs Programme**

This was a fully subsidized programme in which the house and the entire cost of the unit are provided as a grant to the poor families.

The whole principle of free housing is to address issues of social equity and affordability of the beneficiaries. But these schemes have had very limited success for a variety of reasons:

- Inadequate resources within government, given its other priorities, but more pressing in the enormity of the challenge. Far too many people in need!
- Errors in identification of beneficiaries. There is the Nyayo High-rise Apartments, which were originally intended for the informal settlers but were taken over by politicians and top civil servants.
- Bad or absence of post-occupancy maintenance. In this country we do not at the moment have a national maintenance policy. This matter cuts across the whole country. Many public as well as assets are wasted through the lack of upkeep and where necessary improvement to match changing standards and tastes

The sharing of costs by the central government and the local authority: This suffers from the challenge of lack of sustainability and replication on a continuing basis. Both authorities do not have sufficient funds and may have other priorities. But if they looked at it as enabling taxpayers to pay more taxes and rates they may look at it differently.

### **Public Private Partnerships (PPP):**

Both the central and local governments have land and they could proffer this to the private sector who would develop it as part of their corporate social responsibility (CSR), and/or as an investment. The demand for these low-cost housing is large and expanding so with the right arrangements, it would become a hit. Moreover the demand (150 thousand) is very high seeing as the supply (30 thousands) less than the housing need

### **Access to Basic Infrastructure Facilities:**

This will reduce the marginality that many slum dwellers are subjected to. The roads need not be super highways but basic and eco-friendly. Water can be made more affordable and handier so that they can have the comfort and convenience of other citizens

### **City Planning:**

This tends to exclude the slum dwellers. In fact officially they do not exist. That is the tragedy. That those affected have no say on how and where they will call home. The notion of “growing a house” must be recognized and factored in

### **Building Codes and Norms:**

These need to be more accommodating and realistic. Not cast in stone like at the moment.

### **Options based on subsidy, loans and beneficiary contribution:**

Marginal contribution from the beneficiaries ought to take into account the difficulty in contributing even the so called marginal contribution by the poor. It has to be agreed that these be in cash, labour or in kind. This option ensures a stake among the beneficiaries in the putting up of the units, and also encourages a personal attachment to the house though physical contribution in the construction process.

### **Option based on subsidy and loans**

This could be direct or interest subsidy for the economically weak sector (EWS). It has been tried in Korea, Bangla Desh and India. Instead of re-inventing the wheel, the models could be adopted and modified to suit the Kenyan situation.

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