HOUSING MICROFINANCE AND THE EMPOWERMENT OF LOW-INCOME HOUSEHOLDS IN KENYA

By

ODONGO, Nicholas Ouma

THESIS

Submitted to

KDI School of Public Policy and Management

In Partial Fulfillment of the Requirements

For the Degree of

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ABSTRACT

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By

ODONGO Nicholas Ouma

It has been reported that only 10.2% of all Kenyan urban households can afford the cheapest newly built house constructed by formal developers. Majority of Kenyans have limited access to adequate housing and cannot afford an average loan to finance a decent house; this has pushed many low-income households into the slums. The country is left to grapple with an annual deficit of an approximate 200,000 housing units for its urban areas. With the affordability issue rife, credit reform has become a critical discussion point in Kenya and most other developing countries. In light of this, housing microfinance has emerged as an effective and sustainable solution responsive to the needs of the poor. Many sub-Saharan African countries including South Africa, Uganda, Angola, and Ghana have made significant policy efforts to exploit the HMF market. The purpose of this paper is to investigate the impact of HMF among low-income households (LIHs) in Kenya. And the aim is to draw attention to the effectiveness of HMF in addressing housing needs for the poor, thereby calling for government intervention in the housing microfinance sub-sector. To gather information about borrowers, microfinance institutions, and HMF portfolios, this study conducted a literature review of current research, surveys and databases. Data gathered was described and explored qualitatively to establish the socio-economic impact of housing microfinance on the borrowers. The results show that housing microfinance contributes to affordable housing through relatively cheaper credit; empowers home owners with dweller-control of the construction process; and improves the quality of homes of low income households.

The study also finds that HMF enhances household empowerment measured in terms of financial inclusion (more opportunities to access savings and credit services), social inclusion and economic security.

Finally, the paper advocates for a government-led integrated support structure for the HMF subsector as a means to address challenges faced by the poor in financing development. This support takes two forms; a housing microfinance loan guarantee system and institutional capacity building for HMF institutions. The housing microfinance loan guarantee scheme seeks to provide lenders with guarantees of loan repayment to assist in financing housing construction/ rehabilitation for the more risky and less profitable lower income households. HMF institutional capacity building seeks to assist HMF institutions in the areas of risk management and underwriting to minimize non-performing loans and remain profitable while providing a social good – housing.

Keywords: Housing microfinance, low-income households, affordable housing, household empowerment, adequate housing, financial inclusion, social inclusion, economic security, loan guarantee scheme

DECLARATION

I, ODONGO Nicholas Ouma, declare that this is my original work, unaided nor unsolicited. All citations, references and borrowed ideas have been duly acknowledged. I submit this research project as part of the requirements for award of the degree of Master of Public Policy (Finance & Macroeconomics) in the Graduate Faculty of KDI SCHOOL of Public Policy and Management, Sejong-si, South Korea. No part of this work whatsoever has been previously submitted for any awards or examinations elsewhere.

Student Signature & Name:

Date:

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TABLE OF CONTENTS

LIST OF TABLES

LIST OF FIGURES

LIST OF ABBREVIATIONS

Abbreviation	**Term**
CAHF	Centre for Affordable Housing Microfinance
DFID	Department for International Development - UK
DTI	Debt to Income Ratio
Exchange Rate	1USD = Kshs.101.36 (usually rounded down to 100 for quick conversion
Gini	Index of inequality
GoK	Government of Kenya
HMF	Housing Microfinance
KNBS	Kenya National Bureau of Statistics
KShs/ KES	Kenyan Shillings
LIH	Low Income Household
LTV	Loan to Value Ratio
NACHU	The National Cooperative Housing Union
p.a	Per annum
p.m	Per month
ROSCA	Rotating Savings and Credit Association

GLOSSARY

Affordable Housing	Housing deemed affordable (spending of at most one third of a household’s total income) to those with a median household income in a given jurisdiction.
Consumption smoothing	The process of managing spending in a way that ensures balanced spending even during periods of unsteady incomes.
Financial Inclusion	Access to affordable financial products and services that sustainably meet an individual/ business’ needs
Informal Settlements	Groups of housing units that are not compliant with existing planning and building regulations
Rental housing rate	The proportion of a population living as tenants (living in houses that they do not own, except by leasehold)
Social Inclusion	The process of improving citizen’s participation in societal activities by improving opportunities and abilities of the disadvantaged groups.

INTRODUCTION

Kenya

Kenya is commonly described as the economic powerhouse of East and central Africa, being the largest economy in that region. Following the post-election violence of 2007/2008 and over the years, Kenya has made significant reforms and strides toward political, socio-economic and sustainable growth & development. A new constitution in 2010 that spells out devolved governance, political reforms and institutional reforms all have led to sustained growth and development. However, there still exists significant development challenges; poverty, socio-economic inequality, vulnerability of the economy among others. Kenya made significant success in the MDGs including near universal primary education, and reduced gender gaps (UN 2015). With the Kenya Vision 2030 development blueprint and the incumbent president's Big 4 Agenda [Universal healthcare, Manufacturing, Food security and Affordable Housing], the country is poised for further sustained growth and development.

Demographics

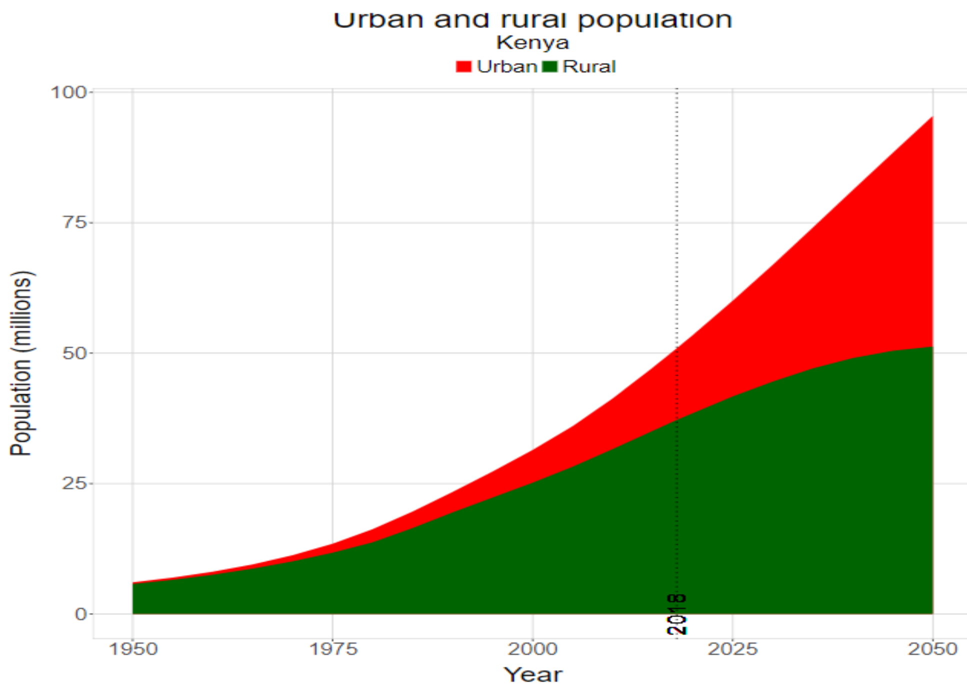
A youthful population[1] and a highly-skilled[2] workforce distinguish Kenya from her border neighbors. An estimated population of 50.95 million people and 2.52% population growth rate almost three quarters of this population is under the age of 30 with an average literacy rate of 74%. 73% of the total population is rural while the remaining 27% live in urban areas (UNDESA 2018) and urbanization rate stands at 4.3% p.a. Of the urban dwellers, UN Habitat (2015/2016) estimated that 56% live in informal settlements. The capital city Nairobi has a population of

[1] Youthful population defined as those between the ages of 15 and 24

[2] Highly-skilled workforce refers to the proportion of a population that has attained at least a tertiary education certificate (usually bachelor's degree)

approximately 6.54 million people and is also home to one of the largest slums (Kibera) in the world. On average, Nairobi experiences an annual rural-urban migrant rate of approximately 500,000 persons according to Real estate developer Daniel Ojijo (*Business Daily* April 20th 2018)

Figure 1 Kenya's Urban and Rural Population



Source: 2018 United Nations, DESA, Population Division

Figure 1 describes the rural-urban dimension of Kenya's demography. Urban population has been growing steadily ever since the pre-independence (before 1963) period. Today, more than two thirds of Kenya's population is rural. However, by 2050 rural and urban populations will almost balance out.

Economy

The current regime embarked on an extensive infrastructure development campaign since it came into power in 2013.

The country has witnessed extensive highway constructions, the Standard Gauge Railway (SGR) construction, expansion of airports, the Lamu Port South Sudan Ethiopia Transport corridor, Olkaria power plant and a host of other infrastructure development projects have set up Kenya as a fast transforming economy.

Kenya's GDP in current prices stood at USD 88.27 billion in the first quarter of 2018 and is expected to grow annually at 6%+ for the next 5 years. Inflation slowed down from 7.9% in 2017 to 4.85% in 2018 and is further expected to stabilize at 5% for the next 5 years and GDP per capita in current prices is USD 1,837 (statista 2018). The expanding middle class provide positive demographics for a developing economy and especially for the residential real estate sector.

Table 1: Kenya's Gini Index

Population Segment	**Income Share (%)**
Lowest 20%	4.7
Second 20%	8.6
Third 20%	12.8
Fourth 20%	19.7
Highest 20%	54.1
Highest 10%	38.8
Gini	**48.5**

Source: www.knoema.com

Table 1 shows the distribution of income/wealth among Kenya's income groupings; and effectively shows the inequality in the economy with the top 20% earners commanding more than half of the nation's wealth. The top 10% earners share among themselves more than one third of the nation's income.

Background

Many developing economies, realizing the depth of poverty-related issues, have poverty reduction as their central development pathway. Broadly defined as living under US$ 1.90 a day (World Bank, 2015) however, poverty manifests itself in a number of ways including malnutrition, limited access to educational opportunities, joblessness, lack of savings and more importantly lack of adequate and affordable housing – the key focus of this paper. Deprived opportunities among low-income households are primarily attributed to a lack of access to affordable credit. Consequently, low income households (for lack of adequate assets to be used as collateral in the formal finance institutions) are forced to rely on informal sources of finance which are relatively expensive, slow and unsustainable. Thus, the importance of assets and asset-building for poverty reduction cannot be overstated. Sufficient empirical evidence supports this fact towards improving the livelihood of poor people. Moser (1988) argues of the existence of a strong correlation between household vulnerability and asset ownership, which he suggests is of operational significance. According to World Bank (2000) in World Development Report, lack of assets is both cause and effect of poverty.

According to the Centre for Affordable Housing Finance in Africa (CAHF) only 10.2% of all Kenyan urban households could afford the cheapest newly built house ($ 17000) constructed by formal developers in 2015 and that 60% of Nairobi city dwellers live in slums (CAHF 2016). Overall, 99% of Kenyans cannot afford an average mortgage loan to finance a decent house translating to an annual shortage of approximately 200,000 housing units.

This has led to the growing interest in the area of affordable housing while practitioners are faced with the task of creating a housing finance environment that works more especially for *low income households* (2016).

Ferguson & Smets (2010) argued that in terms of providing *affordable housing*, traditional mortgage has failed to deliver.

Lenders and borrowers alike have turned to inventing new financing strategies for low-income households' (LIH) housing needs; among researchers, housing finance *affordability* is a matter of contemporary debate. Daphnis (2004) has convincingly argued that housing microfinance (HMF) remains the best solution to meet the housing needs of the poor. Thus since microfinance helps to avail credit more affordably to the LIHs, it reduces their vulnerability by empowering them in asset strengthening and building. On the other hand, Roodman (2013) claims that on average microcredit has zero impact on borrowers or may make worse-off the borrowers. The Department for International Development (DFID) reports that there is no evidence to support the claim that microfinance has positive impacts on the borrower (Duvendack M., Palmer-Jones, R. et al, 2011).

Considerable research has been carried out on microcredit, (Ferguson & Smets, 2010; CAHF, 2015/2016; Daphnis, 2004); However, most of these previous studies have largely focused on microfinance in general. According to Kihato (2014) the concept of *housing microfinance* has been overshadowed by the broad credit category. This research paper intends to examine housing microfinance in particular, as a unique form of microcredit; and its empowerment impacts on LIHs.

Following the success of Sinapi Aba Trust (SAT) housing microfinance of Ghana; this research builds on the firm belief that microfinance is an alternative and superior intervention mechanism for which a country can adopt as one of the main pro-poor development pathways. Housing microfinance (HMF) in particular is a successful approach to asset-building and strengthening among vulnerable households (Khandker, 2005; Stewart, R. et al, 2010). This is not to say that HMF is the 'perfect' solution to the inadequate housing problem; there is an equally indispensable need to train our attention to individual construction cost components including materials (cement, sand, concrete, steel, etc.) that make asset building an inaccessibly expensive affair. However, the policies to promote the market for HMF have a central role in driving provision and accessibility of adequate and affordable housing needs of low-income earners.

Statement of the Problem

Slums and informal settlements are a major challenge that urban cities worldwide continue to grapple with despite several interventions and programs. With increasing urbanization especially, and the relatively expensive housing prices in urban areas, proliferation of low-quality housing remains on the rise. This threatens human rights, human dignity and is a retrogressive force in an economy's quest for growth and development. During the United Nations Conference on Housing and Sustainable Urban Development (Habitat III) in Quito 2016, a *'New Urban Agenda'*[3] was adopted. Commitment was made to improve the housing conditions of urban dwellers in a sustainable fashion; however, the means and policy tools to arrive at this goal are left to the discretion of an individual state, appreciating each state's diversity and difference in resource endowments.

Given the Kenyan context, this study considers the different approaches towards raising resilient and sustainable cities – and aims to evaluate the concept of housing microfinance as a prospective policy tool towards this end. This paper identifies the strengths of housing microfinance over the other policy interventions towards housing development for low income households.

Significance of the Study

The purpose of this paper is to investigate and better understand the effectiveness and impacts of HMF on the provision of adequate and affordable housing to low-income households in Kenya. The paper will argue that HMF substantially impacts low-income households positively.

This research contributes to scholarly debate in the fields of microfinance and development studies. In addition, it will be of interest to researchers and academics in the fields of housing economics and affordable housing. It will be useful to policymakers and practitioners in the housing and finance sectors. This paper also highlights why 'formal' housing finance schemes have failed to increase access to housing finance and their unresponsive nature to the housing needs of the poor.

[3] The New Urban Agenda can be found at http://habitat3.org/wp-content/uploads/NUA-English.pdf

The paper aims to draw much-needed attention to the importance of housing microfinance as an alternative to 'formal' finance mechanisms, both for affordable housing and for financial inclusion. The paper will advocate for an improved support mechanism for the HMF sub-sector. The government should consider a risk-insurance mechanism for HMF institutions – to expand the HMF market.

Research Objectives

The objectives of this research work are two fold;

(i) To create an understanding of the socio-economic impacts[4] of HMF loans on low-income households. In particular this research paper asks whether increases in HMF loan issuance would lead to increased home ownership and/or housing construction activity among low income households.

(ii) To evaluate the effectiveness of HMF vis-à-vis other interventions by the government to address the housing problem.

Research Questions

This research paper will attempt to address the following questions:

1. For the first objective;
   a. Does HMF help in making housing affordable?
   b. Does HMF enhance financial inclusion and deepening? and
   c. Does HMF lead to poverty alleviation among low-income households in Kenya?
2. How effective is HMF compared to other government *interventions?*

[4] Socio-economic impacts of HMF are assessed in terms of housing affordability, financial inclusion and poverty alleviation

Hypothesis/ Theory

This research work is founded upon Habitat for Humanity's *Theory of Change for Housing Microfinance* (2017). HMF itself being a social enterprise should focus on outcomes rather than outputs. For this reason, Habitat for Humanity calls for the reporting of the impacts of investments by measuring such outcomes as improved livelihoods, increased community participation and social mobility.

Another central theory to this research work is Turner's *Dweller Control of the Housing Process*. Turner (1972) convincingly argued that the concept of affordable housing is much more than just the cost of construction itself. He introduced the concept of dweller control of the housing process – an equally important aspect of housing development. HMF institutions must be careful not to view housing as a product [he accused formal housing finance institutions of this] for that would make the house expensive; rather, most if not all of the housing decisions should be left to the potential dweller. Demand for housing finance is highly affected by the potential dweller control of the housing process that comes with it. He noted that housing is a derived utility, and so must meet the satisfaction of its consumer if its demand is to be sustained.

Research Methodology/ Design

This research work is designed as a case study of housing microfinance practice in Kenya. The paper will follow a non-empirical (qualitative) approach for its analysis. Secondary sources of data will be preferred as a means to discuss and analyze broader issues around housing microfinance and housing finance reforms in Kenya.

Desk review of data sets, and literature review of journals, published articles, dissertations and theses are the predominant analysis techniques employed in the development of this research work.

Within the framework of adequate and affordable housing, this research work will identify, discuss and examine relevant themes. Textual discussion will guide this paper to underscore the rationale for the call for a housing microfinance intervention policy in Kenya.

Study Delimitations

The scope of this research work is limited to microfinance exclusively offered for housing, to low-income households in the geographical boundary of Kenya. This study adopts the Financial Sector Deepening (FSD) Kenya's definition of low-income households as households earning less than USD $5/day. The study will also limit itself to theoretical as opposed to empirical evaluation of housing microfinance and its effectiveness in addressing the problem at hand.

Structure of the Research

The paper is divided into four sections. The first section reviews and summarizes literature on housing microfinance, the concept and model of a housing microfinance product. The section also gives a background overview of the housing sector, the microfinance subsector and the state of financial inclusion in Kenya. Section 2 presents the theoretical framework and model for analysis adopted by this research paper while section 3 discusses the findings & implications of the study, and lessons learnt. Policy recommendations regarding housing microfinance for the empowerment of the low income households are contained in section 3 as well. These are recommendations that might increase demand for and disbursement of HMF loans. Finally, the last section concludes the study, providing limitations of the study and potential areas for further research.

The next chapter will now proceed to summarize existing literature on housing microfinance, and the concept & model of a housing microfinance product. It will also provide a background study of the housing sector in Kenya, housing demand & supply, financial inclusion and the concept of affordable housing.

SUMMARY OF LITERATURE

The United Nations World Urban Forums[5] (WUF), for instance Vancouver (2006) and Nangjing (2008) have attracted global attention to the challenges of the urban poor, in particular housing. House rents are punitively high while mortgage interest rates have remained unsustainably high especially following the global financial crisis – two factors that have pushed the urban poor to substandard houses and others inevitably and eventually into slums. A case in point, the World Bank's (WB) 7th Global Housing Finance Conference held in Washington DC in May 2016 reports that 4 billion people from emerging countries and 150 million from developed countries cannot afford decent housing conditions (World Bank, 2016). Furthermore Perrot (2014) estimates that 1 billion of the world's population (primarily in Sub-Saharan Africa - SSA) live in slums.

Housing has a central importance to the quality of life with considerable economic, social, cultural and personal significance. Though a country's national prosperity is usually measured in economic terms, increasing wealth is of diminished value unless all can share its benefits and if the growing wealth is not used to redress growing social deficiencies, one of which is housing – Erguden, 2001.

Housing, being a major household expenditure, requires long-term financing. In most economies, such financing is offered by [6]'formal' financing schemes. However, these formal housing finance schemes have been tagged 'non-responsive' especially to the lower income category of households (households earning less than US $5 a day). Ferguson & Smets (2010) notably faults traditional mortgages that they have failed to deliver affordable housing. In fact, low-income households are known to have a high credit risk since they do not have adequate assets (collateral) to hedge their defaulting risk. Despite the desire of LIHs to save in order to invest long-term; their savings tend to be relatively limited.

[5] World Urban Forums (WUF) refers to United Nations' premier conference on urban issues, examining today's most pressing issues including housing. The WUFs held in Vancouver in 2006, and Beijing in 2008 extensively engaged on the issue of increasing slums in the developing world; noting that it is necessary to develop sustainable solutions to the housing problem that is responsive to low-income earners.

[6] 'Formal' financing schemes refer to mortgage loans offered through mainstream commercial banks

The most successfully used financial model used among LIHs is the Rotating Savings and Credit Associations (ROSCA) which unfortunately does not provide enough funds for a sustainable impact on their livelihoods. Consequently a majority of low-income households can only finance their houses through their own savings – a process that is slow, expensive, and punitive. This inspired the innovation of microfinance as a pro-poor development strategy, a concept that has gained a lot of interest among researchers recently. However, the area of microfinance for housing in particular is itself insufficiently researched and has suffered a lack of attention.

Kihato (2014) asserts that HMF has been overshadowed by the broad credit category. In addition, Habitat for Humanity (2015) notes that HMF as an emerging sector of microfinance is considerably less researched. This study adopts Daphnis' (2004) definition of Housing Microfinance as;

> *"A micro-enterprise loan used for housing, and for which the clients are low income and poor households that do not enjoy access to traditional housing finance."*

In their critical analysis of the concept of microfinance, Duvendack et al (2011) differ with recommendations of WUF and WB, questioning the effectiveness of microfinance. Although these studies front a persuasive argument for microfinance, they rarely focused on HMF as a special form of microfinance and generally failed to explain the observed impacts of housing microfinance. Duvendack et al found that previous impact evaluations of microfinance were misconceived, and the conclusions were rather inconclusive and unreliable. Their analysis claimed that microfinance's success was only pegged on its popularity among policy makers, lacking any clear evidence of any positive impacts to the borrowers. Similarly, Roodman (2013) claims that on average microfinance loans have zero impact on borrowers and that it may actually make the borrowers worse-off.

Although these authors raise legitimate concerns about microfinance as a whole, the findings may have been comprehensively convincing if they considered housing microfinance independently, in its own uniqueness.

In contrast, Habitat for Humanity (2015) finds that HMF products have been praised among the borrowers as being profitable relative to loans by other institutions. Several other authors (Ferguson et al., 2003; Daphnis, 2004; Bondinuba et al, 2016) argue for housing microfinance, presenting it as the most responsive and best solution to the housing needs of low-income households.

In evaluating the impacts of HMF, policy recommendations made in this paper will be informed and calls to action justified. Thus this present study attempts to provide theoretical evidence to support the claim that microfinance for housing has positively impacted low-income households.

THE HOUSING SECTOR IN KENYA

National Housing Policy 2004

Improving the shelter needs of Kenyans is a major concern for the Kenyan Government. Concerned with among other things the poverty of the masses and social unrest occasioned by inadequate housing conditions, the Kenyan government instituted a National Housing Policy in 2004.

This policy was designed to bring into control the deteriorating housing conditions countrywide and to address the deficit witnessed in the housing sector from sustained undersupply of housing units for low income earners, especially in urban areas.

The National Housing Policy 2004 documents an elaborate list of objectives and policy goals notably the *rental housing* as a strategy to stimulate investments in the housing sector. One of the major objectives of the policy is,

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"Enabling the poor to access housing and basic services and infrastructure necessary for a healthy living environment especially in urban areas, through facilitating progressive realization of the right to adequate housing by all." - Ministry of Housing, 2004

Regarding vulnerable groups of the society, among them low income earners, the government proposed *housing cooperatives*, *self-help groups* and *community-based credit schemes* as a way to bargain for affordable housing finance. Moreover, the policy document recognizes rapid population growth, high urbanization rates, increasing poverty rates, and the escalation of housing costs as some of the major challenges affecting the housing market; also on which account Kenya's shelter problem has gradually worsened leading to increased rise of informal settlements, housing overcrowding and the proliferation of slums.

The Policy document admits that mainstream mortgage finance schemes only work for the high income households; and in response, a ***mortgage guarantee scheme*** [to be administered by the National Housing Corporation] was to be set up to help low-income earners access mortgages affordably. Evident from its policy direction, the government has not attempted to make commitments to support micro financing schemes.

Informal Settlements in Kenya

Shelter is among the key indicators of development for any country. A proliferation of slums and shacks is regarded as a retrogressive force in a nation's quest for sustained development and goes on to reveal the unsustainable urbanization practices in a country. Informal settlements are a manifestation of social exclusion and is characterized by an agglomeration of dilapidated and congested houses - for which owners have no legal claim; neighborhoods cut from basic services like sewers, clean water & electricity connection, public spaces and green areas.

Table 2: Growth of Informal Settlements in Nairobi

Year	No. of Informal Settlements	Population	% of Urban Population
1971	36	167,000	33
1990	50	200,000	40-50
1993	78	789,991	55
1995	134	1,886,166	60

Source: NACHU, 1990; Matrix, 1993; and Ngau, 1995

Table 3: Proportion of Kenyan Urban Population living in Slums

Year	Proportion (%)
1990	54.9
1995	54.8
2000	54.8
2005	54.8
2007	54.8
2009	54.7
2014	56.0

Source: UN HABITAT Slum Almanac 2015/2016

Tables 2 and 3 describe the growth of informal settlements, and growth of population in those settlements respectively over the years. This reveals a trend that needs urgent attention. Beyond the social exclusion problem, informal settlements pose significant threats to the overall economy in terms of violence, environmental degradation, and health challenges among others that robs the gains made in the economy. One of the thorny issues surrounding informal settlements in the matter of security of tenure, or more precisely, the lack of it.

[Lack of] Security of Tenure

Slum dwellers often lack security of tenure for the land where they settle. As Amnesty International (2009) found, most of such land is owned by absentee slum-lords, or government-owned land reserved for infrastructure such as roads, railway tracks, electricity and sewer lines etc. Their lack of security of tenure leaves the informal settlers constantly exposed to forced evictions and/ or demolitions.

Lack of authentic ownership of land for where one constructs a house often leads to free-rider problems as well as a lack of commitment to develop the land. For one, unclear land ownership means that service providers are unable to recover service costs. Thus service disconnections and illegal reconnections are a common phenomenon in the slum areas.

Housing Demand, Need, and Supply

Housing demand in urban Kenya is severely constrained by low and volatile incomes, prohibitive financing options and a relatively high cost of housing. Among LIHs, home ownership is preferred to rental housing since the former increases their budget elasticity. However, given the trade-off between short-term liquidity and long-term investments, cheap rental housing (informal units/ slums) is convenient.

Annually, Kenyans demand approximately 244,000 housing units for urban dwellers and 350,000 units for rural dwellers (from all the market segments e.g. single-rooms, apartments, studios, bungalows etc.). However, only around 50,000 units are provided yearly and 80% of these are constructed for the wealthy upper class; only 2% is for the lower-income segments of the economy. The mismatch between demand and supply has led to an accumulated housing deficit of more than 2 million housing units. In addition, urban areas face population growth rates of 4.4%, which translate into 0.5 million new urban dwellers every year. This phenomenon continues to pile pressure on the already overburdened housing sector (WB, National Treasury 2017)

Housing Finance in Kenya

Households in Kenya have traditionally financed their housing needs through own savings. Many of the citizenry however bemoan the unaffordability of formal finance (mortgages) claiming that they only serve the high-income families.

Adequate and Affordable Housing

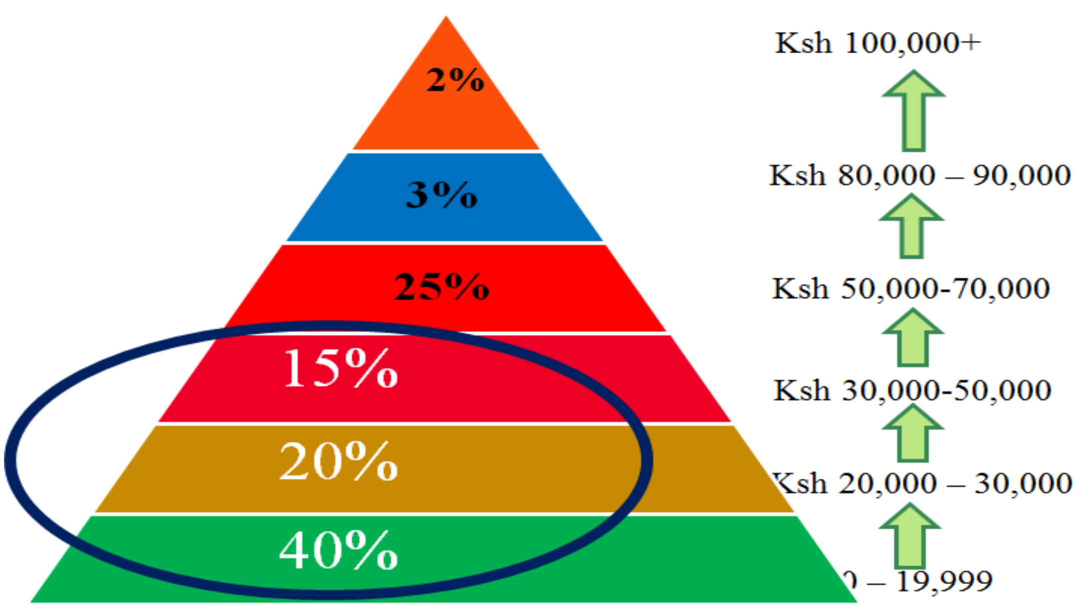
The UN Committee on Economic, Social & Cultural Rights (1991), defines affordable housing as'

"A house is deemed as 'an adequate housing' if it guarantees among other things security of tenure, affordability, habitability, accessibility, cultural adequacy, and availability of services like utilities and adequate sanitation."

A house is **unaffordable** if its cost threatens or compromises the dweller's enjoyment of other human rights. Universally, a threshold has been put at 30% of a household's total expenditure; if the average household spends more than 30% of its income for housing, then this is termed as unaffordable. Kenya's median household income ranges between KShs. 20,000 - 25,000. Figure 3 shows the monthly household income pyramid for Kenyans in 2017. 60% of Kenyans earn KShs 30,000 and below; representing the low income households, and a portion of middle-income earners.

The implication is that an affordable house should cost (30% of monthly income) between KShs. 6,000 - 8,000 (GoK 2017).

Figure 2 Monthly Household Income Pyramid 2017



Source: NACHU 2017

In the light of provision of housing, the Kenyan government recognizes that housing is a basic human right and that a minimum standard of housing (adequate housing) should be guaranteed for all. The National Housing Policy 2004 of Kenya actually adopts the definition of adequate housing from the United Nations.

Tenancy and Home Ownership

The Kenyan housing sector is characterized by 79.2% rental housing rates[7] for urban areas vis-a-vis 20.8% in rural areas. Owner occupier rates stand at 18.5% for urban areas and 81.5% for rural areas. The urban poor spend more than 30% of their incomes on rental accommodation. (Ministry of Lands and Housing KNH Survey 2012/2013).

Many governments around the world encourage homeownership including the US and Singapore with a few exceptions like Germany. Homeownership is justified based on claims of positive externalities including responsible citizenry, secure neighborhoods and increased household participation in the community. Kenya had for a long time advocated for homeownership until recently, going by the National Housing Policy 2004 that encourages rental housing if it that is the only means to adequate housing. Most importantly, shelter (a home) is a human right and everyone must be afforded one. Indeed scholarship on home ownership is vast and stimulating with scholars having varied sentiments on this subject. Regeneris Consulting (2010) finds that homeownership plays a powerful role in the economy. Housing wealth and assets significantly influences the economy in three ways; investment spending, consumption behavior, and indirectly through enterprise. Likewise, Rohe, W. M et al (2001) found that by improving individual satisfaction, home ownership increases a household’s latitude to invest in expansion and improvement of the home. Home owners may also customize their housing units and this increases their satisfaction.

[7] Rental rate refer to the proportion of a population that lives in houses for which they are not owners, under a legal agreement of lease

Home ownership increases home owners' risk taking appetite. Beneficiaries are able to take on additional loans. Land and/or housing is one of the most valuable collateral classes against loans. As poor households accumulate more assets, their risk tolerance increases.

In Kenya, home ownership is an aspect well entrenched in the culture and tradition of Kenyans however, owing to mortgage unaffordability, only just about 1% of the population are homeowners. The more than 90% are left to rentals for their housing needs.

A critical voice on homeownership though suggests that due to financial instability, low-income home owners may not really enjoy the satisfaction that comes with owning a home – maybe due to the fears of mortgage defaulting and the resulting foreclosure. This strengthens the present studies argument of HMF over mortgage as the desired housing finance scheme for low-income households.

Mortgages

Mortgage is a debt instrument for which the borrower has the obligation to pay it back with a predetermined set of payments (including the principal amount and/or interest). Mortgage is unique because it is backed/ secured by a collateral usually a specified real estate property.

In 2016, the average mortgage product charged an interest rate of 17.1% p.a, and a 10% required down payment. The Kenya Bankers Association (KBA) notes that there are 24 458 mortgages countrywide, with the average mortgage loan value being US$ 81 717.

Mortgage interest rates rose from 15.8% in 2014 to 17.1% p.a in 2016. Loan to Value (LTV) consistently remained below 90% while Debt-to-Income (DTI) stood at 40%; measures that further limit households' access to the already expensive mortgage loans.

Risk Management by Banks

Liberalization of home mortgage lending industry has led to the emergence of important new tools for housing market stabilization; **Loan-to-Value (LTV) and Debt-to-Income (DTI).** These 2 are also used to manage the lending risk.

Information asymmetry as market failure is a real issue in the credit industry, and as such a bank must maintain stringent requirements for loan qualification. Beyond demanding **collateral** (the asset liquidated to pay off the loan in the event of mortgage default) from loan applicants, banks also institute these two (LTV & DTI) lending risk management tools to minimize the incidence of credit default risk.

- ➢ A bank, when issuing a mortgage loan to a client, can only extend a loan up to a certain value of the collateral. This is loan-to-value (LTV)
- ➢ To ensure that clients are able to commit to their monthly loan repayment obligations; a bank must consider the client's income. Therefore, in our case above, a bank will only approve a mortgage loan to a borrower if the loan's monthly repayment obligations are 40% (or less) of the borrower's monthly income. This is Debt-to-Income (DTI)

It is these stringent measures that have excluded out low-income households from the mortgage market.

Illustration of the Unaffordability of Mortgage Loans

The minimum value of any mortgageable property (referring to the collateral) in Kenya in 2011 was US $ 40,000 (WB 2011). If the LTV ratio is 80%, then the maximum value of loan a bank can extend to a mortgage loan applicant is US $32,000 (i.e. 80% of US$ 40,000).

Assume an average mortgage interest rate of 14% and loan maturity of 15 years. For this case, loan amortization charts for *180 monthly installments* (15 years) indicate that this client should pay a monthly installment of US $ 426.15.

Now, in addition to LTV, assume a DTI of 40%; this means that US $ 426.15 should be 40% (or less) of the borrower's monthly income.

The implication is that the borrower's monthly income must be US $ 1065.375 (426.15 * 2.5). Hence to qualify for the minimum mortgage loan, one must earn at least US $ 1065.375 pm. (US$ 12784.50 annually) *and* own an asset whose market value is at least US$ 40,000.

From the Kenya National Bureau of Statistics (KNBS) income statistics, only 3% of Kenyans earned this much in 2016.

This illustration reveals how moral hazard and adverse selection risks work against poor households two-fold. Out of these 3%, just a handful own the mortgageable property of the value mentioned above.

This results in a financial exclusion of the poor; hence majority of Kenyans resort to different housing finance schemes for their housing needs.

Housing Microfinance (HMF)

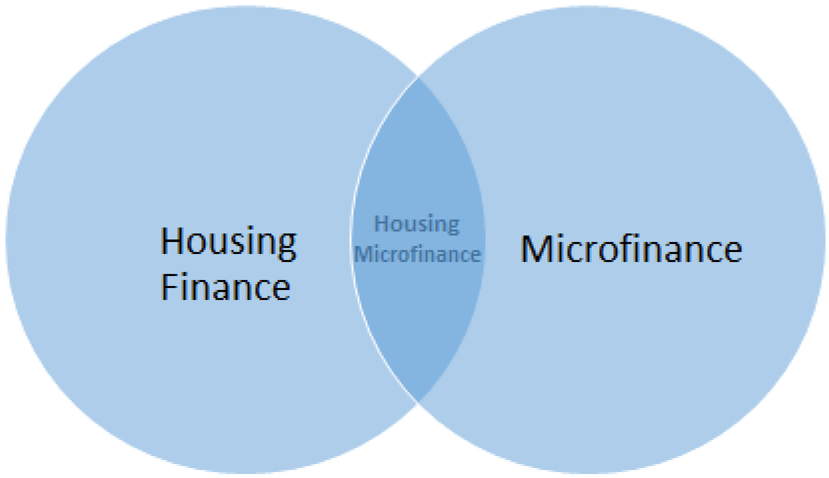
The strong association, throughout the developing world, between poor housing and low empowerment levels is well established; and recent studies find that access to credit/ finance by a household is important in this regard. To realize the dream of owning a home; households and institutions invented housing microfinance, as a scheme to advance micro loans to low income earners to help them realize this dream in an incremental fashion. Warnock V. C., & Warnock, F. E. (2008) suggests that HMF innovatively exploits this well-known but often neglected reality, that low-income households being neglected by traditional housing finance presents a unique market of their own.

One of the most convincing economic development strategies of the new millennium in the developing world is poverty reduction through expansion of credit access to the poor. The UN acknowledged this when it recognized credit access as an essential strategy to attaining MDG #1 of eradicating poverty when it declared 2005 as the International Year of Microcredit (Hermes & Lensink 2007).

The idea of housing microfinance is rooted in the socio-economic development paradigm; a mechanism between housing finance and microfinance in the provision of microcredit to low income earners to meet their housing needs (Merrill et al 2007)

Figure 4 illustrates the characteristic of housing microfinance as a subset between housing finance and microfinance.

Figure 3 Housing Microfinance



Adopted from Daphnis & Ferguson 2004

Mechanism of HMF Empowerment

Impact of housing microfinance loans on low income households is registered through the following major areas;

i. Housing affordability means that households are able to improve their housing conditions including more space for all the household members. The loans can also be used to build new houses - which is a source of wealth.

ii. HMF loans & services at relatively cheaper rates means that financial inclusion is improved and therefore consumption smoothing can be improved. Households will no longer need to liquidate their assets to meet sudden expenditures since they can borrow more easily.

iii. Safety, hygiene, security, and health are all improved once households are able to improve their houses.

iv. Social mobility and networking is increased when households are able to take part in societal activities without discrimination.

HMF is defined as a micro-enterprise loan used for housing, and for which the clients are low income earners and poor households that do not enjoy sufficient access to traditional housing finance. Kenya has a well-developed microfinance sector; however, it largely serves enterprise and consumer lending.

On the other hand, HMF works for households, who seek to build, repair, improve and/or expand their shelters incrementally. HMF offers a host of other banking services; insurance, savings, as well as technical support and capacity development. Typical HMF loan products are of smaller loan amounts, higher interest rates, shorter maturities (say 3 years), performance-based incremental loan disbursements, and social guarantees as alternative collateral, and have the feature of group lending. HMF also offers skill-based training and organizational support to their clients.

A number of institutions offer housing microfinance products in Kenya, including National Cooperative Housing Union (NACHU), Kenya Affordable Shelter Project (KASP) – a project of K-REP Development Agency, Pamoja Trust through their *Akiba Mashinani Trust*, Rafiki MFI, Jamii Bora MFI etc.

HMF also supports and builds on the practice of incremental housing – a characteristic of low-income households. Additionally, HMF institutions offer a variety of services to ensure that loan diversion is curbed and that low-income households do not make compromises during the construction process to the extent that their security and the quality of the housing structure is adversely compromised.

Economics of Housing Microfinance

Table 4: Illustration of the Economics of HMF

Product	Mortgage	HMF
Client	Ms. X	Ms. Y
Income	$ 1316/month	$ 1316/month
1992 Loan Issuance	1992: Mortgage loan of $ 25000 over 20 years at 15% interest rate	1992: 5 successive micro loans of $ 5000 each, repayable over 18 months at 40% interest rate
Installment	$ 380	$ 380
1999 Repayment Progress	1999: Repaid 40% of mortgage, outstanding debt, $ 15048	1999: Repaid 100%
Interest Paid	$. 21968	$. 6920

[Hypothetical Illustration]

Turner (1972) passionately argued for HMF, not only because of its responsiveness to LIHs but more so for its responsiveness to customer satisfaction. He introduced what has now come to be commonly known as *'Turner's 3 laws of housing'*.

Turner's 3 Laws of Housing

1. When dwellers control their housing process, it is better for them and the housing environment.
2. The important thing about a house is what it does in the life of the dwellers rather than what it physically is.
3. Dwellers can tolerate or accept a problem with their housing much more readily if it was as a result of their own action or choice as opposed to that of another.

Unlike the 'formal' housing finance schemes, housing microfinance satisfies all the 3 laws. In advocating for dweller-control of the housing process, Turner acknowledges that only HMF allows for this important element of dweller- satisfaction.

Risk Management by HMF Institutions

Housing microfinance involves small uncollateralized loans that pose a considerable risk to the profitability and sustainability of the HMF industry. A set of strategies has been identified as global best practices towards this end (Cornelis & Ruben 2008);

1. Peer Selection: Normally called Group Lending, this strategy rests on the group joint liability of each individual group member's debts.
2. Peer Monitoring: Peer selection ensures that group members have the incentive to control and exert peer pressure on each other to become good debtors. In this way, moral hazard is curtailed.
3. Dynamic Incentives: These include strategies like progressive lending that encourage loan beneficiaries to repay their initial loans in order to qualify for bigger loans.
4. Regular repayment schedules: These work to instill repayment discipline in a debtor and also serves as a signal the loaner of any potential delinquencies and this allows for timely pro-active mechanisms to avert defaults.
5. Collateral substitutes like mandatory or up-front savings ensure that moral hazard is limited; and loan beneficiaries develop a sense of discipline towards loan repayment.

Other concerns about HMF loans

Greater availability of loans could lead to more indebtedness. This may lead to a limited empowerment impact of HMF loans as households will shun away from debt.

Ill health and reduced ability to work and the subsequent loss of income place further strain on low-income households' willingness to take up debt.

Loan Purpose

Mortgages have been used for home renovations and to purchase homes both as a primary dwelling and an investment. However, housing microfinance loans are only used for home acquisition/ improvement for low-income households. This difference in purpose explains in large part the significant variation in interest rates applied on the two products (mortgages and housing microfinance loans).

HMF Product Characteristics

HMF products offered are quite similar and mostly targets urban low income households.

Table 5: Housing Microfinance Product Characteristics

Eligibility Requirements	Loan Conditions
Target Clientele Gender based Income based Rural/ Urban Region **Loan Purpose** New Construction Upgrading Land purchase **Property Rights** Land property/ use rights Structure property/ use rights	**Loan Specifications** Loan size (min & max) Disbursement schedule & method Loan term (min & max) Repayment schedule & collection method Interest Rates Fees **Loan Security** Collateral Savings/ deposit up-front Group vs Individual Linked vs stand alone Progressive linkage **Loan Services** Technical assistance Budgeting assistance Other services

Adopted from Cornelis & Ruben (2008)

Government Strategy and Incentives in Housing Development for Low-income Households

Governments around the globe have adopted different strategies and models towards addressing housing inadequacy among low income households. World Bank (2003) summarizes these into five models of housing development for low income housing initiatives:

1. Sites plus development plan and gradual implementation of services – settlements are planned and surveyed, lots allocated and occupied, and infrastructure gradually implemented.
2. Sites and services – mass production of serviced sites in large schemes for resettlement of urban squatters, usually in peripheral land in city outskirts and with basic starter housing units.
3. Comprehensive upgrading of existing settlements – wide range of improvements involving different types of infrastructure according to predefined area plan; this is integrated upgrading but undertaken in one go, usually in a two year time frame.
4. Development of new housing in new settlement – new infrastructure and housing units are built on empty land; or new housing units on available land in existing serviced areas.
5. Redevelopment of degraded existing structures – agreement reached with building landlords for building renovation.

The above models must meet some irreducible minimum principles; social inclusion, economic effectiveness, environmental sustainability and affordability & adequacy.

Slum Upgrading

This represents a new shift from slum demolition – that was common in the 1970s to 1990s; and respect for human rights was a big win here. As a matter of fact, reports indicate that slum demolition common in the 1970s, 80s, and 90s did not solve the ‘informal settlers’ problem, but only displaced it. In the 1970s, GoK constructed an estimated 10,000 rental units and demolished 7,000 units in a bid to get rid of the slums.

Unfortunately, this pushed the informal settlers to new areas where they established new makeshift dwellings. One slum demolished led to a new one springing up! And with increased rural-urban migration, the proliferation of slums and informal settlements only expanded.

Kenya Slum Upgrading Program (KENSUP)

To date the most comprehensive effort by the government to address the informal/ inadequate settlement problem remains the *Kenya Slums Upgrading Programme* (KENSUP)[8] that saw the Government of Kenya (GoK), UN-HABITAT and Cities Alliance partner to implement the USD 13 billion slum-upgrading project in the dense and unsanitary *Kibera* slums of Nairobi city. The program was initiated in 2003 "as a collaborative initiative that draws on the expertise of a wide variety of partners in order to address the slum upgrading issue", and was initially intended to benefit up to 5.3 million slum dwellers by 2020 (Mutheu, 2013). KENSUP follows model number 4 of the models for housing development for LIHs.

Keys for successful slum upgrading include recognizing the existence of the slum problem, a people-centered approach, government leadership, strengthening of a policy response, participatory approach and appropriate long term financial investment & inclusive financing options. Part of the failure is that the project only achieved 'slum relocating' as opposed to upgrading. Post-project surveys indicate that most beneficiaries of the project ended up renting their housing units and finding their way back into the slums.

For the new housing units, they have to pay KShs. 1,000 as opposed to the KShs. 500 they were paying in the slums monthly. This new surge in rent expenditure is obviously untenable for the low-income households living in slums.

[8] KENSUP http://housingandurban.go.ke/kenya-slum-upgrading-programme-kensup/

Kenya Informal Settlement Improvement Program 2011 (KISIP)

The project consisted of 4 partners; Government of Kenya, World Bank, Swedish International Development Agency (SIDA), and Agence Francaise de Development (AFD) with an initial project cost of $165 million. It was initiated in March 2011 [as 2 phases] and phase I is expected to be closed at the end of May 2018 (KISIP, 2017)

The primary objective of the project is to improve living conditions of informal settlements for 15 selected towns in Kenya. KISIP also engaged itself in planning for urban growth as well as institutional strengthening and investing in infrastructure & service delivery. Phase II is expected to run from July 2018 to June 2024.

The Dandora Community Development Project of 1972

This refers to a project aimed at delivering low-income housing units in Dandora estate, Nairobi. The project was characterized by owner-controlled construction process financed through a loan by the World Bank and implemented under the then Nairobi City Council. It was hailed as a success particularly for its cost achievements; however, the question of quality versus cost was to later haunt the project.

The inflexible minimum quality requirements for the building quality meant that the construction was too expensive for the low-income earners and the beneficiaries later abandoned the project on account of unsustainable construction expenditures. Finding a reasonable balance between housing affordability and the standards & cost of housing is the greatest challenge in the matter of housing lower income groups.

Social/ Public Housing Projects

These are houses that are developed by public corporations primarily for rentals and targeted towards the lower income segment of the society. Another one of social housing projects meant to address the informal settlement issue include the *Umoja Estate* of the 1970s and the *Kibera's Nyayo Highrise Estate* of the early 1990s.

However, the projects failed to meet their objectives by ‘technically’ missing their target of low income earners and instead ended up benefiting middle-class households as political patronage.

Poor maintenance is one of the major challenges rocking public housing projects. Critics note that in the Kenyan context public housing projects have always been targeted for public servants. In the 1970’s, the Nairobi City Council built Umoja Estate as a strategy to keep up with and house the bulging urban population. The housing units were constructed with a clear target on low income households. The project was designed to make the homes less expensive thus. However, as the city council of Nairobi became constrained in its budget, maintenance of the houses was overlooked - a classic challenge of public houses. (Habitat for Humanity 2013).

National Cooperative Housing Union (NACHU)

This is the representative body of affiliated housing cooperatives in Kenya. It operates as a cooperative unit and performs a number of roles to its member cooperative unions. These range from provision of housing support product services, housing microfinance loans, land acquisition support, house plans, advice on builders and artisans, material procurement and professional consultancy. NACHU originates HMF loans from members’ share contributions, thus, members’ HMF portfolio is limited in this aspect.

NACHU started operations in 1987 and draws its membership from active housing cooperative societies, potential urban low income and rural communities, investment groups, formal & informal sector workers and other special groups like youth & women-led cooperatives. Among other services, NACHU provides the following to its members;

1. Project Consultancy:- project management, quantity surveying, architectural & engineering services, land valuation, property management, feasibility studies and land survey
2. Financial Services: - micro mortgage loans, land & infrastructure loans, financial management solutions, and construction loans etc.

3. Community Mobilization and Training: - Lobbying, advocacy, awareness campaigns on societal matters like HIV/AIDS, and development & land policies.

NACHU housing products include;

- Real estate development through incremental building
- Block land purchases by groups for house development
- Group commercial building based on project capacity lending
- Individual self-built housing microfinance
- Financing individual plot purchase

Other institutions within the HMF sector include;

1) 4 large banks; Equity, Family, Cooperative and K-REP and 50 microfinance organizations.
2) NGOs like Pamoja Trust, Jamii Bora, Akiba Mashinani Trust (AMT), Slum Dwellers International (SDI), Hakii Jamii, Makao Mashinani Trust, Muungano wa Vijiji
3) Cooperative Societies including Nakuru Teachers Housing Cooperative. There are 1770 registered housing and 210 investment cooperatives in Kenya as of April 2017 (State Department of Cooperatives 2017). Housing cooperatives command and accumulated asset base of KShs. 21 billion (USD 0.21B).
4) SACCOs including Stima, Harambee
5) Other support actors [who are also the major sources of capital for HMF institutions] include Rooftop Canada, UN Habitat, Habitat for Humanity Kenya, FinMark Trust, Centre for Affordable Housing Finance in Africa (CAHF) and Shelter Afrique's Kenya Affordable Shelter Project (KASP).

The HMF industry is a small one in terms of key players; and the sector has not borne sufficient success in terms of scaling up its operations due to limited funding, over dependency on donor funding and high default rates. However, looking at the demographics of the urban poor households, the demand is way greater than the supply.

Market Development

Cap on Lending Rates

The Central Bank of Kenya on the backdrop of slowing inflation rate in 2018 (from 7.9% in 2017 to 4.85% in 2018) reduced the Bank Rate from 10.00% to 9.50% in March 2018. The intention is to spur credit growth in the economy in an attempt to improve the election fever-dampened economic growth in the electioneering 2017. However, weak private sector credit growth due to the *cap*[9] on commercial bank lending rates from September 2016 is likely to restrain financial sector deepening and the intended credit growth in the economy. For well-known reasons, this persistent cap will constrain credit access particularly for high-risk borrowers including SMEs and other individual small borrowers (www.statista.com).

The Big Four (4) Agenda

This refers to President Kenyatta's manifesto as he serves his second and last term as president of Kenya. He has referred this as the legacy he intends to leave as head of state.

The 4 agenda include food security, affordable housing, manufacturing and affordable healthcare; as the 4 core issues that the President thinks are the most neglected yet most important sectors of the economy.

Big Four (4) Agenda has reported that it intends to construct 30,000 housing units in Nairobi's low end estates of Shauri Moyo, Makongeni, Starehe and Park Road; a project that is welcome but of almost zero significance in bringing down house rents given an annual shortage of approximately 244,000 housing units (World Bank). In the next 5 years (2017 - 2022) the government plans to build 500,000 affordable housing units in all the 10 major cities in the country annually. Budgetary commitments are well underway to see this happen.

[9] The Impact of the Interest Capping on the Kenyan Economy - CBK, March 2018

Africa Tenancy Purchase Initiative (ATPI)

With the cap on lending rates, commercial banks have grown to be more risk-averse scaling down mortgages and loans. This has seen the rise of SACCO's rent-to-own schemes for their members. Notably, a group of 35 SACCOs including Safaricom, Nation & Kimisitu Saccos and Habitat Housing Cooperative have unveiled a housing loans plan dubbed the *Africa Tenancy Purchase Initiative* (ATPI) in which their members will benefit from **interest-free mortgages**. Under this scheme, the rent payments made by tenants is converted to make them homeowners **-** a portion of the monthly rent covers the buying price of the asset. The ATPI scheme was launched in July 2017 backed by UN Habitat, the State department for housing and urban development and will see partial credit guarantee for the housing projects from International Finance Corporation (IFC), and short-term financing from Co-operative Bank and Shelter Afrique. (Source: Daily Nation July 20th 2017).

Further, under the President's Big 4 Agenda the government has hinted at adopting the ATPI model to deliver some 800,000 affordable units by 2023 (Source: Business Daily 2nd April 2018)

"Government of Kenya's new tax incentives for builders of at least 400 affordable housing units, presents great opportunities in the housing sector." (CAHF October 2017)

This chapter has been dedicated to describe the framework and landscape of both housing development and housing finance for low income earners in Kenya. Several government interventions have been discussed and evaluated in terms of performance and effectiveness. The section also summarized the recent market development in the housing and housing microfinance sectors that directly affects the housing microfinance sector. The next chapter will discuss in detail the theoretical framework, and model for estimation adopted in this research study.

THEORETICAL FRAMEWORK

This study adopts the Habitat for Humanity's theory of change for housing microfinance.

THEORY OF CHANGE

Figure 4 Housing Microfinance's Theory of Change

INPUT		OUTPUT		OUTCOME		
				Short-Term	**Medium-Term**	**Long-Term**
Debt Capital Guarantee scheme Technical Assistance	→	HMF loans Housing support services	→	Improved housing conditions	Safety from hazards Health, Security Economic security Social inclusion	Well-being & happiness Growth and Development

Figure 4 describes the stages through which a housing microfinance loan as a program delivers empowerment to the low income households. Through the guarantee scheme, HMF institutions are able to offer more and bigger loans to 'risky & less profitable' borrowers; and other housing support services including housing design, construction and technical assistance, survey services etc. The outcome is in terms of improved quality of housing which among other things is a source of protection & security, a source of dignity, and an improved economic standing.

Microfinance Triangle

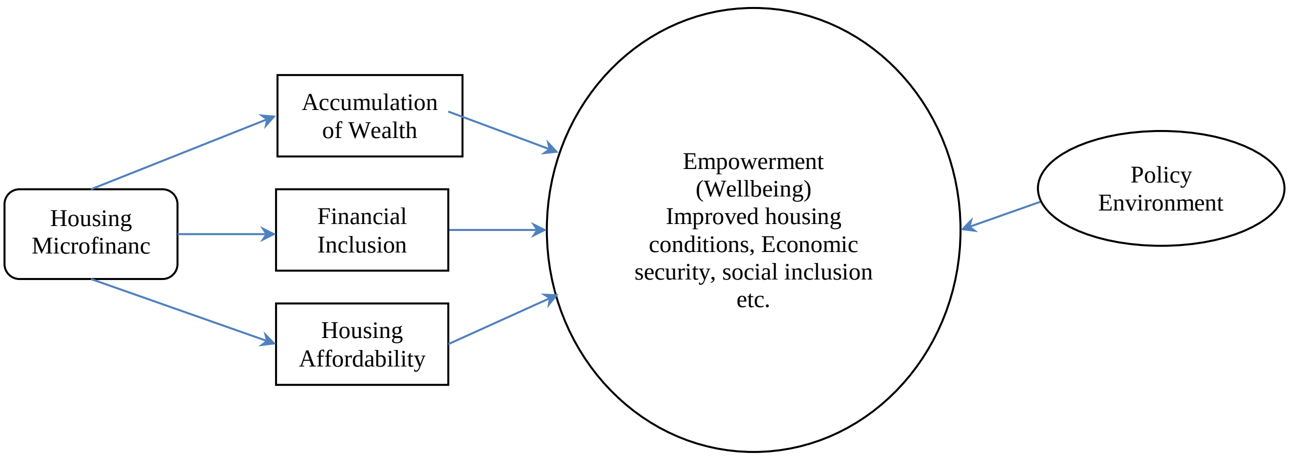
HMF is a subsector in the microfinance sector which has been found to simultaneously manage the 3 broad challenges of *Impact*, *Sustainability*, and *Outreach* faced by poor households and microfinance institutions (IFRI, 2002).

- Impact on beneficiaries' well-being through alleviation from poverty, and improved housing conditions
- Sustainability, measured by risk management and/ or credit guarantee;

- Outreach, measured by financial inclusion (increased number of loan beneficiaries down the income bracket, and increased value of loan amounts)

The best way to evaluate the impact of HMF loans on low-income households would be to examine their consumption expenditure trends e.g. *consumption smoothing*[10] which is a vital empowerment route for microfinance loans. However, this was not possible given that this current research relied on desktop review HMF portfolio and thus the researcher did not have access to consumption expenditure data.

Figure 5 HMF Empowerment Framework



In figure 5, accumulation of wealth is measured in terms of the additional value of the house from the housing renovation; financial inclusion is measured in terms of accessibility of bigger loans by subsequent borrowers as well as the addition of new first time-borrowers while housing affordability is measured in terms of reduced per period expenditure on housing (housing maintenance costs). In this framework, the policy environment (interest rates, inflation, construction costs, supply of housing etc.) will determine how much benefit is accrued to HMF loan beneficiaries.

[10] Consumption smoothing is a concept that refers to the way people try to optimize their lifetime standard of living by ensuring a proper balance of spending and saving during their different phases of life ; adopted from www.investopedia.com

The preceding chapter has described the framework within which HMF works to deliver affordable and adequate housing to low income earners in Kenya. The chapter also discusses empowerment mechanisms of housing microfinance for low income earners. The next chapter will discuss the ensuing institutional and market frameworks within which the HMF model will succeed sustainably.

DISCUSSION

Kenya and the world at large have experienced sustained periods of economic growth and reduction of poverty; notwithstanding, extreme poverty continues to persist (WEF, 2015). There exists a variety of interventions – both micro and macro – to address poverty and these are diverse given location, time and endowments. The challenge facing policy makers in their effort to target poverty is the simultaneous existence of multiple intervention mechanisms that stem from household heterogeneity. Knowing why a household is poor is necessary to define a proper policy. The heterogeneity of households thus may almost always lead to clear heterogeneous impacts of policies and programs. For instance, addressing on short-term poverty (through interventions like income supplements) may aggravate long-term poverty for one household while providing a platform to graduate from poverty for another household.

Barrett et al (2017) finds that ***asset accumulation*** can improve a household's living standards – through increased productivity and income earning potentials with little heterogeneity among households. This present study is based on this philosophy. The need for increased asset accumulation is even more important now as world leaders have committed to "ending extreme poverty by 2030"[11]. The focus on low income earners means that policy instruments must be tailored to respond to the special needs of this income group.

Evidence suggests that access to housing microfinance contributes to positive empowerment of low income households and the local economy too as hypothesized by the theory of home ownership (that it makes good citizens). The benefits are large enough to inform government policy and the fact that the current regime has identified affordable housing as one of its four top priorities goes to justify this point. The empowerment effect is observed as creation of wealth (housing asset), financial inclusion (greater access to financial services including debt), income growth and consumption smoothing during hard economic times.

[11] This refers to the Sustainable Development Goals (SDGs) #1

Microfinance is more efficient for housing development for the low-income market as it involves small scale transactions in credit and savings designed and affordable to most of this income group.

Low-cost Housing

Questions emerge over the objective of ‘low-cost housing’ programs. Are they meant as low construction cost, or low maintenance cost projects? Absolute low-cost construction is what leads to slums and dilapidated shacks in the first place.

Low-maintenance housing leads to strong, permanent and sustainable housing units that are usually adequate. Sustainable and adequate housing is expensive in the short-run but relatively cheaper in the long-run.

Criticism of State Interventions

Looking at the policy documents guiding the Kenyan housing sector, two things are evident; the GoK is doing a lot to solve the housing problem in the country (although a lot is not getting done); there is a lot of confusion and thus delays in the delivery of housing stock in the country owing to several fragmented statutory requirements, several conflicting regulators and a government that is ill-prepared to deliver on its promises. Governments needs to recognize the strategic and important socioeconomic investment nature of improving a nation’s housing stock. For instance, adequate housing is necessary in preventing social unrest occasioned by deprived and frustrated citizens especially those residing in slums and other informal settlements. A well-planned house of acceptable standards affords security, dignity and privacy to households and communities. An investment in housing is also economically important for improving livelihoods, improving labor force productivity, and raising incomes.

The National Housing Corporation (NHC) which has its origins in 1953 was set up with a mandate of implementing government housing policies and programs. However, without funding from the government, NHC resorted to loan financing and eventually its mandate was distorted.

While the rates at NHC for home ownership are favorable at 13% (compared to commercial banks 18%); construction and allocation of housing units is done privately and this has been met with resistance since previously set allotment rules have been flouted. Consequently, this inevitably contributed to the shrinking supply of social housing units; as NHC operated as a private firm.

Challenges of Developing Housing for the Low-income Market

Demand

Low income households in Kenya manage their finances by emphasizing on liquidity for unexpected spending needs – which is a common phenomenon (Zollmann 2014). With already tight budgets arising from high dependency rates and volatile incomes and spending needs, these households try to maintain liquid savings as well as open lines of credit to cope with unexpected needs such as illnesses and death in the family. The implication is that long-term investments are just a mirage as poverty trap becomes a reality. An average household in this income category allocates 8% of its monthly household budget on housing – approximately KShs 480 = USD 4.8 which can only afford the household a shack.

This highlights the need for more diverse financial solutions to help them deal with the trade-off between short-term liquidity and long-term investments. This paper finds that housing microfinance is one of the most effective interventions in this market segment for the provision of adequate and affordable housing. Mainstream mortgage is evidently costly for this income segment and so costly credit further strains the demand for better housing.

Supply

On the supply side, a host of factors stifle the provision of housing to the low income segment of the society;

- ➔ Lack of long-term funding for microfinance institutions; poor access to capital markets
- ➔ Scarcity of marketable land prices
- ➔ Increasing land and construction costs
- ➔ Insecurity [or lack of] of land tenure; prolonged legal tussles
- ➔ Lengthy and expensive property registration processes

Cost of Finance (Interest Rates)

To maintain credit discipline (minimize loan default), microfinance institutions levy *high interest rates* on the housing microfinance; and to increase outreach, they offer small loans. This however, may render HMF institutions unfriendly as they draw towards the mainstream banking rates; if state-intervention continues in lacking.

Recommendations

Recommendations are based on the *theory of collaborative approach to housing development*; which emphasizes a system of concerted efforts between the government, the private sector, the community (low-income households), and non-governmental organizations.

In the resulting report from World Bank's (WB) 7th Global Housing Finance Conference held in Washington DC in May 2016, the bank's main recommendation is to increase access to affordable finance to attain affordable housing. Perrot (2014) also notes that 70% of the world's population access shelter through progressive housing – which is an important aspect of housing microfinance.

Empirical evidence from World Bank (through the Global Housing Finance Conference) and the United Nations (through the World Urban Forums) point at microfinance as the miracle needed to achieve Sustainable Development Goal (SDG) #11 of Sustainable Cities and Communities, validating the findings by Daphnis (2004) which convincingly argued that housing microfinance (HMF) remains the best solution to meet the housing needs of the poor.

Institutional Framework for Affordable Housing Delivery in Kenya

There are three important aspects that influence the scale of low-income housing construction according to Ambrose & Barlow (1987). These are direct state provided capital investment, state support for both consumption & production of houses, and the profitability of the sector. For the private sector’s continual provision of such housing, the state must offer them sufficient and appropriate incentives (opportunities for profitability).

Kenya’s housing sector is relatively less developed and low-income households have very limited choices in terms of housing finance. Housing deficit is a serious challenge and must be urgently addressed to avoid any housing crisis. Thus it is convincingly evident that housing microfinance offers a solution, particularly for low-income earners. However, to achieve this, the government needs to create an enabling environment for housing microfinance institutions to function properly, seeing that they offer a *social good* (housing) and this means little profits. To encourage investments into the HMF subsector, the government needs to set up an insurance scheme for HMF loans and capacity improvements for housing microfinance institutions in underwriting and risk management.

The Government

To achieve its mandate of "Making adequate and affordable shelter available to all" the Ministry of Lands and Housing (MOLH) must do a lot more than it is currently doing. The government through its agencies has a mandate to widen the opportunities for home ownership as well as offering greater quality, flexibility and choice to those who rent.

To mitigate the problems of weak outreach and high loan default rates private finance institutions set transaction costs to sufficiently higher levels (to maintain credit discipline). This may render even HMFs unfriendly, if profitability is to be maintained. In Bangladesh for instance, the government and donors provide this support (credit guarantee), ensuring that the private sector provides such social goods while maintaining their profitability.

An enabling regulatory environment is one in which government policies are tied with state budgetary-allocations sufficiently and clearly focused on the low-income households' welfare. Under the HMF guarantee scheme, housing is viewed as a means for which the social mobility of LIHs is improved.

One other way to attract investment into the HMF sector is through incentives like tax cuts. In 2016 the government of Kenya (through the 2016 Finance Act) introduced a tax incentive of 15% corporate tax for developers who construct a minimum of 400 housing units.

The Private Sector

"Private sector housing is defined as any production which is not connected at all with the actions of the state, neither directly constructed by the state nor financially sponsored by the state, where production is not expected to have a social element." Kenya's housing production is mainly undertaken by the private sector; and this explains why social housing is not vibrant in Kenya since private institutions are after profits.

As for the private sector, an enabling environment and a number of incentives are necessary for their expansion into the housing microfinance sector. However, the private sector can invest in cheaper technology in order to bring down the cost of construction - and thus housing cost. Similarly, with the huge underserved market in the lower income segment, the private sector need to invent innovative housing finance products and lending channels.

The Community

The community has a responsibility as well towards the delivery of affordable and adequate housing in the country. Among other things, the community needs to mobilize households to form cooperatives that will be able to mobilize savings from members, borrow from financial institutions and invest in delivery of homes to their members.

Whereas it is true that supply of HMF loans is low, it is also true that low income households shy away from debt financing owing to the repayment obligations vis-à-vis a non-stable income stream. Thus it is necessary to ensure that households take up these loans; if the HMF guarantee scheme is to succeed.

Housing Microfinance Institutions

Housing Microfinance as defined by this research paper and supported by the theory of collaborative approach to housing development finds a niche at the intersection between housing market interventions of both the private sector and the state.

Recommendation to HMF institutions is that their products should not overly be market oriented as this threatens to break Turner's 3 laws of housing. Rather, their products remain effective as long as they are designed in a way that encourages dweller control of the housing process – in order to attract and maintain HMF demand while attaining customer satisfaction.

The implication is that HMF institutions should endeavor to do some *social good*; this underscores the imperative need for some form of credit guarantee scheme beyond the group lending methodology if both profitability and provision of a social good are to be achieved.

Housing Microfinance Guarantee Mechanism

This product will protect lenders against losses from loan default that is common with lending to low-income households without fixed income and collateral.

For instance, loans and guarantees offered by Rooftops Canada, CIDA and the Cooperative Housing Federation of Canada led to a significant increase in investments by Real Equity for All (Reall) in NACHU. This model could be adopted by the government in order to expand the HMF industry in terms of investments. This is the mechanism through which HMF issuance can provide social housing while maintaining profitability.

Mr. Mutagwaba of Tanzania's National Housing Corporation recommends that HMF should be driven by the government as one sure way to expand the HMF market and this will see the entrance of private firms into the subsector (CAHF 2013).

The following are some of the recommendations from the 16th June 2015 National Workshop on Exploring strategies for urban housing microfinance for India;

- *Housing microfinance is indispensable in reducing housing shortage in India and the mission to provide housing for all.*
- *There should be an enabling environment for housing microfinance to operate successfully. This includes a subsidy component that needs to be filled by the government in a way that guarantees. Observation is made that microfinance companies need to be able to access low cost and long term funds; and commercial banks need to set up a portfolio directed towards housing for low income borrowers.*

- *Risk mitigation strategies like insurance will go a long way to ensure profitability of HMF products.*

Areas for Future Research

Further research should be conducted to justify the policy recommendation for a state supported guarantee scheme for housing microfinance loans. This further research should be aimed at addressing the following;

Policy Oriented Questions

i. Are the benefits of HMF to participants sustainable and large enough to inform policy? That is, does HMF simply redistribute income?

ii. Are HMF socio-economic impacts great enough to justify government support of HMF over alternative uses?

iii. What are the limits to LIHs empowerment through HMF?

Having discussed recommended institutional and market frameworks for the success and sustainability of HMF this chapter has demonstrated the necessity for advocacy and technical support in the HMF market in Kenya. As a conclusion, the last section will summarize the key findings, and proposals for the housing microfinance sector.

CONCLUSION

Affordable housing is much more than constructing cheap houses or smaller houses that cost cheaply. It is about dweller satisfaction as well as dweller control of the housing process. This means that the concept of providing affordable houses to the low-income households is not simply a function of the cost of the housing. As a matter of fact, the concept of affordable housing carries empowerment

The paper sought to investigate the impact of housing microfinance (HMF) on low-income households, concentrating on the role of HMF in meeting the housing needs of the poor. While doing so, this study has accomplished a number of other goals.

Key Findings

From the ensuing discussion, it is evident that low-income households and HMF institutions in Kenya lack the support structure to ensure sustainable growth of the subsector – the kind of support structure that should be provided by a government in the quest for the provision of affordable housing to all. Second, housing practitioners (housing finance institutions) have a naive understanding, at best, of the concept of affordable housing as far as low-income households are concerned. These institutions focus more on ‘low-cost’ housing at the expense of dweller control of the housing process and dweller satisfaction on the constructed housing unit – 2 features that are well appreciated by low-income households. Third, in this pro-rich financial environment, low-income households are left to finance their homes using own savings, a process that is punitive and extremely costly. Despite the efforts of the government, rapid population growth, high urbanization rates and increasing poverty rates threaten any gains from these interventions.

This research has provided evidence that low-income households have been positively impacted by housing microfinance in terms of financial inclusion, wealth creation, reduced poverty, as well as economic empowerment.

First housing microfinance goes beyond the simple construction of a housing unit; it has a 3-fold unique contribution to the economy; Impact, Sustainability, Outreach.

- ✓ Impact on poverty alleviation, and housing affordability;
- ✓ Sustainability, measured by risk management and/ or credit guarantee;
- ✓ Outreach, measured by financial inclusion (increased number of loan beneficiaries and increased value of loans).

Second, dweller control of the housing process is paramount in the provision of housing – a feature that is well appreciated by low-income households. Hopefully, this paper stirs interest in the dweller control feature of housing finance schemes as a major research topic and an important factor in marketing of housing finance products.

Third, it has presented public housing as a social good, for which government involvement is necessary as private market may not provide sufficient housing units especially for the poor as demonstrated in the failure of formal finance (mortgage) to respond to the housing needs of the low-income groups due to information asymmetry between the lenders and borrowers. Concurrently, home ownership creates positive externalities for the society including greater economic participation by individual households, security, as well as individual household responsibility to the society. For these and other reasons, housing as a public good is underprovided and this calls for government involvement in its provision.

Other Findings

Credit guarantee schemes encourage HMF institutions to accept more risks and thus expand the HMF market.

Reducing real interest rates (for the HMF sector) not only encourages the marketing of HMF products but also leads to sustained financial inclusion of low-income households. However, for this to work it must be implemented concurrently with the credit guarantee scheme.

There is an urgent need to integrate *dweller control* of the housing process in the housing finance schemes.

Access to land is fundamental and as such advocacy efforts need to be put in place to ensure security of tenure is obtained when one acquires a piece of land.

Framework of Recommendations

Figure 6: Recommendation Framework

HMF Demand

- *Enormous potential (more than 80% of all urban households are excluded from mortgage financing)*
- *Potential for diversification of products depending on age, income, region etc.*

HMF Supply

- *Limited Supply of housing units*
- *Suppliers are small-sized; diseconomies of scale*
- *Current HMF products are low-income targeted*

Challenges & Developments

- *Growing middle class*
- *Interest rate cap*
- *Future growth of demand for HMF on the basis of sustained urbanization*
- *Real estate boom-bust*

Recommendation 1: Integrated government support mechanism in the form of a credit guarantee scheme and/or government-backed loans

- Great outreach & financial inclusion
- Reduced risks of default loss for HMF institutions
- Expansion of HMF market

Recommendation 2: HMF-oriented regulations from interest rates to institutional organization under the President's Big 4 agenda. Limit to government presence in the market is necessary to allow for dweller control of the housing process.

Rationale for Recommendations

Mortgages are known to be inaccessible and also poorly designed for low income earners; with the expectation of regular income streams – a phenomenon that is not a reality among low income earners. A better alternative for this market is needed to meet their housing needs. The combination between microfinance and incremental building provides great opportunities for housing microfinance to deliver housing to the LIHs. Several countries across Asia, Latin America and Africa have resorted to this as a poverty alleviation strategy.

However, sustainability of HMF is threatened by the risky nature of target borrowers, unless the HMF institution is a not-for-profit organization. This also explains why interest rates on HMF loans are exorbitant while loan amounts are kept low. The tragedy is that this technically limits financial inclusion as well as impact of HMF; perpetually affordable housing remains unaffordable to the poor.

For these and other broad reaching reasons, a government guarantee scheme needs to be put in place to ensure success of the impact of HMF as well as its profitability is maintained. From earmarked taxes, a government can set up a *housing microfinance fund* that may be used to guarantee loans from HMF institutions. The advantage will be recorded in terms of increased impact beneficiaries as well as growth of the HMF market. However, this is costly affair but the benefits outweigh the costs.

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