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SOME MAJOR ISSUES IN FINANCING OF HOUSING IN KENYA

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SOME MAJOR ISSUES IN FINANCING OF HOUSING IN KENYA[1/]

Introduction

1. The purpose of this paper is to outline briefly some of the characteristic problems of capital formation in the housing sector of the Kenya economy. By suggesting what is involved in these problems, it is intended not only to create a basis for decision- and policy-making, but, by using facts and figures from the present situation in Kenya, also to suggest what the policy should be.

The productivity of investment in housing

2. It is taken for granted that economic growth at the rate of 6 per cent per annum as set forth in the "Development Plan 1966-1970" is desired and that funds used for housing should not only support this goal but be an instrument, - perhaps the most important - in transforming economic growth into tangible improvements for the people. The latter point has wide public support, but when it comes to the allocation of public funds it is often argued that investment in housing is unproductive and therefore does not add to economic growth.

3. Though research in this field has not as yet brought out quantified relationships between the amount of money invested in housing and the productivity of the labour force, it is clear that there are definite positive correlations between health and social stability on the one hand and the quality of housing on the other. Health and social stability are unquestionably two of the major contributors to increased productivity. Two other points must be made in this respect. First, the effect on productivity is much higher at the lower end of income scales than at the higher, i.e. for low-cost housing than for high-cost. Secondly, the higher the labour content of any particular production the bigger, consequently, the effect of improved housing on productivity. Both of these conditions are prevalent in Kenya today to such an extent that there is a strong case for channeling funds into housing, especially low-cost housing.[2/] The question is how much?

4. The "Development Plan" sets the need for housing at a rough 7,600 units in the urban areas of Kenya (the rural need is estimated as three times as high, but may be closer to five times). The figure for urban housing is, if anything, understating the real need, because in Nairobi alone the need is estimated at 5,000 units per year up to 1970. These figures for 'need' need to be investigated further

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1/ Prepared by Mr. N.O. Jorgensen, Housing Research Unit, University College, Nairobi, November 1967. The views expressed in this paper are not necessarily those of the secretariat of the Commission

2/ For the purpose of this paper low-cost means Shs. 5,000/- to Shs. 10,000/-

especially in regard to income distribution as that will have a major impact on the type and thereby the cost of houses, which are actually needed.

5. In economic terms "need" is not as meaningful as "demand". But to show that there is also a demand for housing suffice it to say that as long as a house costing Shs. 15,000 to build today brings in over Shs. 5,000/- in rent net, i.e. 30 per cent plus, then there is clearly a disequilibrium, because it means that a safe investment, which even has capital appreciation possibilities is paid off in less than three years, which is far better than similar safe investments, for which one can borrow money in the open market at 10 per cent. Unfortunately, however, those most in need of low-cost housing cannot borrow at this rate in the open market, - if at all. It is, therefore, that public funds should be channeled into this kind of housing with preference over any other type of housing. In nominal terms the figure is arrived at by multiplying the number of units needed by Shs. 10,000 as this is calculated to be the cost of a reasonable dwelling.

6. It should be mentioned in conclusion that the construction industry itself has a high labour content and would therefore benefit the economy as a whole by increased efficiency. Also, especially within construction industry, the piece-work and incentive schemes are as obvious as the benefits of economies of scale.

<u>Labour and other capacity problems</u>

7. Having argued for increased efficiency through better housing and pointed especially to the construction industry which has a high labour ratio it is only fair to admit that the present situation in Kenya is one with full if not over-utilization of capacity with a drastic drop in efficiency as a result. There is no need here to quote the clear indications of this, which are apparent in the sharp price increases for practically all items used in the industry, with labour in the lead.

8. This situation is not difficult to explain. There has been a definite slump in the construction industry since 1960 due to uncertainties about the future after independence and the simultaneous exodus of Asians and Europeans. This lasted up to 1965, when a definite boom started. It is a natural phenomenon that it takes time for a capital-heavy industry to adjust after a period of depression, but in this case it was a labour heavy industry; however, the exodus had hit the industry directly as 98 per cent of the construction workers were Asians. Due to the slump no new craftsmen were trained and the capital-heavy supply industries (metal-works, timber industry, transportation equipment, cement and ballast) are still adjusting.

9. A separate study of these capacity problems is presently being carried out at the Institute of Development Studies at University College, Nairobi, and with the results of that study available it will be safer to suggest solutions. For the time being a few general solutions seem clearly indicated:

10. The unemployment rate among unskilled workers especially in the urban areas is high, whereas skilled and semi-skilled manpower is in more or less short supply, - the shorter the higher skilled. In the constructiom industry even semi-skilled are in demand, it seems, though this may very likely turn out to be due to monopolizing within the industry. One conclusion, however, must be for a simplification of design and components on the one hand and large estate-type building programme on the other, where a few skilled persons can supervise many unskilled. If this means that local authorities must act as contractors, then be it so, but not without having advertised for tenders.

11. Only public bodies can eliminate the problem of available land, but this does not seem to be a pressing problem as much as that of providing buildimg materials. As far as this is not a manpower problem capital formation will, over time, help solve that problem. The Government can assist in this as is explained in relation to housing in a later section of the paper.

The effect on the balance of payments of residential construction

12. The argument that investments in housing adversely affects the balance of payments is true in the sense that relative to the quality of houses it has a large import content and does not create any new exports, nor does it substitute other imports. This is again a short sighted argumentation. To the extent that housing makes a smaller or larger contribution to increased productivity (as pointed out on the previous page) it makes the country in question more competitive vis-a-vis all other countries and thereby the balance of payments is influenced favourably. When social considerations are taken into account it seems trivial to refrain from investing in housing for foreign exchange reasons, - especially when holdings of foreign currency is sufficient. In Kenya, furthermore, the essential building materials are readily available and for low-cost housing the import content is at a minimum. This does not imply that standardization on local products could not be carried even further, - and should. In respect to a local product such as cement, an increase in the local construction out-put would add to the efficiency in the cement industry, which is also exporting, but not to full capacity as yet, consequently making it able to increase exports. A similar situation may be found within the wood-industry, provided there is a steady demand for its products.

13. If there is a possibility for importing capital for housing as will be explained later, the question of balance of payments deficits is much less significant.

Socio-economic preferences in respect to housing policy

14. By socio-economic preferences in this context is meant only those that has to do with financing of housing. To list but a few: Should it be a public or private responsibility and if both, how much each? Should private ownership or tenancy be the predominant feature? What should be the relationship between houses and flats, Quality versus price, Choice of financing schemes etc. Taxes on land versus tax on income?

15. In the interest of efficiency of capital and other resources the guideline in a free-enterprise society should be that as long as the private sector is providing all the houses needed in the various qualities and price ranges there is no reason for the public bodies to be concerned with residential construction other than setting minimum standards and providing services. If the need is not met by the private sector, such as is the case in Kenya today, then there seems to be two possibilities, which are supplementary rather than alternatives, namely to create incentives and facilities for private investment in housing and for public bodies to undertake to finance the 'deficit' themselves.

16. As for incentives to create more private capital formation, I refer to the following section of this paper, but for local and national governments own financing the present need is almost exclusively for low-cost housing, and in terms of numbers, this is where the total need is greatest. Government and local authorities may need to provide medium and high-cost housing for some of their employees under present terms of service, but in the long run this is hardly necessary nor desirable. In the first instance loan conditions are good, and still improving, for this type of housing and potential owners (civil servants). Secondly, maintenance and administration of staff housing is costly, and thirdly, it never gives the owners (typically: local governments) nor the individuals (civil servants and teachers) the advantage of a capital gain, which in turn would promote new capital formation for housing.

17. This leads directly to another pressing issue, that of ownership versus tenancy. Apart from the promotion of capital formation by capital gain the social benefits of ownership can hardly be

over-valued. Maintenance cost goes down, pride and satisfaction goes up, social stability improves and so does political stability. As for the latter, its significance on the mobilization of funds for housing or any other investment, from abroad or locally is perhaps the single most important factor.

18. The arguments for tenancy may advocate lower monthly payments and more effective control, but both of these items can be taken care of otherwise. As for monthly payments, which in fact may very well be the decisive factor for many families whether they will get a house or not, is largely a matter of 1) cost 2) interest rate and 3) repayment period. Cost can be kept down by standardization of construction elements and design, interest rates by removing some of the market deficiencies or by subsidies, and repayment period by rethinking by monetary policy-makers (see later). As for control of rents and standards the machinery is already there.

19. The issues of quality versus cost and flats versus individual houses are largely technical issues, but the financing aspect comes into the picture by the fact that people can only afford to pay from 20 - 25 per cent of their income for housing, which in the low-income group means Shs. 50 - Shs. 75/- per month, which at an interest rate of 10 per cent and a repayment period of 10 years or less, as is current conditions in the private sector, would limit the cost of a house or a flat to not more than Shs. 5,000/- and even with improved efficiency of labour and savings on method and materials this would hardly provide the owner with a satisfactory urban dwelling unless it was in the form of a flat in a mass-produced block. This was in case of private financing. If the public sectors took it upon themselves to either cut the interest rate (subsidising) or lengthen the repayment period, or both, the constraint of cost - given the same improved efficiency - would change to Shs. 9,000/- to 10,000/- which would provide him with a reasonable house, which would not only be socially more desirable, but also provide him with an asset, which when gradually acquired by him by his repayments, would enable him to raise capital for extensions and improvements with his house as security.

20. This leads us to the conclusion that until such times, when the private sources have adjusted their lending conditions to enable smaller monthly instalments, they should be left to cater for the medium- and high-cost housing for which the demand is also growing. The ratio of flats to houses in this category will automatically reflect the popular demand.

21. Tax on land (land rent and site value tax) could be reduced for co-operatives of low-cost housing areas. Instead progressive income tax could be raised along with tax on business premises and high-cost residential ~~plots~~.

Capital formation for housing

22. However much capital is needed for housing - and the Development Plan suggests almost £5 million for the present year increasing to £7 million in 1969/1970, with the private sector providing about half of that - it can safely be assumed that at present the private sector is not investing in low-cost housing 1/. Even if all of the public contribution of 2.5 million was used for low-cost housing - which it is clearly not - it would only provide 5,000 units - far short of the estimated need.

23. We have already touched on the issue of public versus private capital mobilization. In this section we will point out some of the possibilities open for both the public and private sector - separate and in co-operation. Taking the public sector first there are three ways, of which only the last one is of interest in this respect. For the sake of realism the other two must at least be mentioned, namely: Increase in the housing budget at the expense of other budget which I personally advocate, but how much and from where would depend on a review of the cost-benefit ratios of other expenditures. The other possibility would be increased taxation, which I also advocate in connexion with a new income policy of which there is much talk. But it is the third aspect of fiscal policy which has the more differentiated answers, such as: Tax premiums for savings, Depreciation allowances for residential housing, Public borrowing (locally and abroad), Subsidies to interest ~~rates~~ and repayment periods, Guarantees of loans from private institutions, Providing Discount facilities in the Central Bank etc. etc.

24. The private sector, consisting of individuals and institutions, have a high degree of potential of capital formation, especially for housing if political and economic conditions are stable. As for Kenya both of these conditions are present, but the institutional framework, even in the expatriate institutions, are "underdeveloped" and incentives are still missing.

1/ Not considering the investment in housing of sub shs. 5,000/- which is not of a desirable quality, but of which there is a great deal.

25. Starting with the individuals, it is realistic to assume that they cannot save the full cost of a decent house, ex ante. Theoretically they should be able to, of course, but it is neither psychologically nor socially a responsibility which they are expected to take. But given incentives, such as living in a house of their own, the majority of them will be able to save that amount in say 20 - 25 years time, - given that they choose a house of a cost commensurate with their income. According to the Central Province Survey individuals save on an average 14 per cent of their income under present conditions. Surveys in Nairobi shows a percentage of near 10 per cent. If credit facilities were available for housing so that only 5 - 10 per cent of the cost had to be met at the time of buying or start of construction of a house, ownership would be attractive to those who could save consistently for about two years (10 per cent of Shs. 2,500 x 2 years = 5 per cent of Shs. 10,000/-). Any housing policy should aim at this, at least. This would not only mean that people now forced into tenancy would be able to acquire a house of their own with the already mentioned advantages, but they would also increase their savings potential as they depreciate their borrowed capital by about 65 per cent of their monthly instalment (the rest being interest). The increased savings ratio together with the creation of assets of capital value which more often than not exceeds the incumbered liabilities is that potential of capital formation which ought to be exploited to the fullest.

26. Turning now to the institutions, which are supposed to be instrumental in channeling funds into the building sector the present conditions are that they will advance up to 60 per cent of value at 10 per cent over 10 years. Even at that they are experiencing growing waiting lists for loans. What is obviously needed is an increase in loanable funds. There are two ways of doing that. One is to create rediscounting facilities for first mortgages by the Central Bank, which in turn would encourage the commercial banks to do the same. Another way is to create a market for second and third mortgages and thereby passing the inevitable higher rates of interest on to ordinary savers, possibly with a Government guarantee to induce confidence. As a matter of policy such guarantees may be reserved for new houses only. This would encourage new construction and act against inflationary pressures of "consumption-loans".

27. For medium and high-cost houses the continental type open-ended societies referred to as Cooperative Loan Associations, should be promoted by legislation and otherwise. The principle of such institutions is to float bonds of their own with the collective security of member's houses.

28. For low-cost housing the closed-end societies of the American and British type could be promoted by Government either by creating such societies or let the National Housing Corporation act as such, - or by supporting the existing Building Society by guaranteeing loans to members when they have saved a certain amount. The arrangement with "First Permanent Building Society" which the Government has, is not only favouring one Society (or rather Company) vis-a-vis the others in the field, but it is also inadequate in its present form.

29. Co-operative Housing Societies are another potentially important source of capital formation as they become better organized and supervised. The basis on which they operate will be described in a subsequent paper, but briefly it is for a group of people to join, pool their money in shares of the Society and on this basis obtain additional funds for the provision of houses for their members. The National Housing Corporation ought to lend to such societies directly (as is provided in the laws of the Corporation, but not practised) and on the same terms as to local authorities, provided it is houses for members to occupy, if for letting they should of course lend at nearer commercial rates depending on the type of housing.

30. Apart from an improved institutional framework, what the private sector needs now for increased investment in housing is a clear housing policy with determined effort of implementation by the Government.