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UNITED STATES OF AMERICA

Auditor General

AUDIT OF

NATIONAL HOUSING CORPORATION OF KENYA

(615-HG-004)

This $5 million housing guaranty project, proposed to build nearly 1,400 units of low-cost housing in a dozen of Kenya's large secondary cities and towns, has fallen far short of meeting its objectives. Although the Government of Kenya has, over the period of this project's implementation since 1975, assumed a posture more favorable to serving the shelter needs of its lower income citizens, it has not adopted a formal housing policy to this effect. More importantly, much remains to be done to bring the delivery of housing services, and the capacity of institutions involved in delivering those services at national and local levels, up to acceptable standards to merit further AID housing guaranty loan support. Prior to the approval of further AID housing guaranty authority for use in Kenya, effective measures should be taken to correct the deficiencies described in this report and our prior report (No. 3-615-80-19) on a companion housing guaranty project, Umoja Housing Estate, Nairobi, Kenya.

Audit Report Number 3-615-80-22

Issue Date September 5, 1980

Area Auditor General East Africa
Agency for International Development

NATIONAL HOUSING CORPORATION OF KENYA

HOUSING GUARANTY PROJECT 615-HG-004

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EXECUTIVE SUMMARY

Introduction

In 1974, AID authorized two Housing Guaranty loans (615-H-003 and 004) to provide shelter for lower income families in Nairobi and in a dozen of Kenya's larger secondary cities. The total guaranty authority issued at that time was $15 million, of which $10 million was allocated to the Nairobi City Council's proposed construction of Umoja Estate (615-HG-003) the subject of audit report No. 3-615-80-19, dated June 27, 1980.

This report deals with the remaining $5 million housing guaranty (HG) loan (615-HG-004) to the National Housing Corporation (NHC) of Kenya. The loan was designed to construct nearly 1,400 units for below-median-income families on 13 sites located throughout the country in 12 secondary cities and towns. A follow-on project (615-HG-006) for a proposed amount of $15 million in HG loan funds is currently at the Project Authorization Paper preparation stage with presentation for AID/Washington approval planned for FY 1980.

Scope

The earlier stages of this project were included in the findings of Memorandum Audit Report No. 3-615-77-17, dated March 31, 1977. That report contained no recommendations. Later developments were included among the findings of a report by the General Accounting Office of the U.S. Congress (GAO Report No. ID-78-44, dated September 6, 1978) on the worldwide AID Housing Investment Guaranty Program. In 1979, the AID Office of Housing (DS/H) funded a number of quite detailed and well prepared studies of the shelter section in Kenya generally, and of certain program aspects in particular, which provided much useful information for our review.

Inasmuch as the IBRD (World Bank) is funding a comprehensive study of the National Housing Corporation -- including its powers, operations and organization -- by the firm of Coopers & Lybrand, we have restricted our own organizational review of NHC to those matters affecting the implementation of project 615-HG-004 only. Our purpose was to gauge the extent to which (a) loan 615-HG-004 had met the objectives set forth in its authorization six years ago, (b) how well AID and NHC management had addressed the deficiencies noted in the 1979 consultants' study reports, and (c) how these two factors have affected preparations for the undertaking of loan 615-HG-006 which is being proposed for AID/Washington approval later this fiscal year.

We visited seven participating town councils and examined such AID and NHC records and interviewed such officials from both organizations as we deemed necessary to the conduct of our review. Our findings were made available to both Regional Office of Housing (RHUDO/E&SA) and NHC officials during our review; and at the completion of our work a draft report was transmitted to RHUDO/E&SA, USAID/Kenya, U.S. Embassy/Nairobi, and AID's Office of Housing in AID/W (DS/H). The consolidated response to our draft report (prepared by RHUDO/E&SA and USAID/Kenya, with inputs by DS/H) appears as Exhibit E of this report, and where considered pertinent their response also appears in the body of this report.

Findings, Conclusions and Recommendations

Project 615-HG-004, National Housing Corporation of Kenya (NHC), has fallen far short of meeting its proposed objectives. Although the Government of Kenya (GOK) has, over the period of this project's implementation since 1975, assumed a posture much more favorable to serving the shelter needs of its lower income citizens, it has not adopted a formal housing policy to this effect. More importantly, much remains to be done to bring the delivery of housing services, and the capacity of institutions involved in the delivery of those services at national and local levels, up to acceptable standards to merit further AID housing guaranty loan financing support (pages 50 to 57).

The project is seriously behind its proposed implementation schedule. The delays resulted from inadequate coordination among GOK agencies and insufficient NHC capability to implement the project. Consequently, the number of units proposed to be financed by the HG loan will have diminished by one-third when the project is completed, while prices have risen substantially above the levels proposed in the original AID project authorization document (pages 8 to 16).

Home loan repayments to participating town councils by buyers of HG funded units under the project are seriously in arrears. The problem of arrearages is attributable mainly to the inability or unwillingness of local authorities to adequately enforce the home loan repayment provisions of the buyers' Tenant Purchase Agreements. This situation adversely affects the already serious cash flow position of most local authorities and could potentially impair NHC's own cash flow (pages 16 to 22).

We estimate that at least three-quarters of the HG units occupied thus far under the project have been completely rented out by their owners. Entire subletting is banned in the project Implementation Agreement and in the buyers' Tenant Purchase Agreement. The wholesale subletting practice revealed by our review is attributable to the buyers' non-compliance with the terms of their Tenant Purchase Agreements and the failure of participating local authorities to enforce the prohibition against subletting.

The speculative advantage available from renting out units, which grows proportionally as units are expanded, appears difficult to resist. Because rentals being paid by subtenants are substantially higher than monthly loan repayments, we doubt that most subtenants would qualify as below-median-income families in Kenya. Therefore, we conclude that this practice subverts one of the project's principal objectives (pages 23 to 31).

Neither the residents of HG funded units nor the local authorities participating in the project have taken adequate measures to maintain their units or sub-project sites. This problem is compounded by the high proportion of renters (rather than owners) who now reside in the HG funded units. Thus, enforcement of both property maintenance provisions as well as the ban against subletting units is needed if these conditions are to be rectified (pages 31 to 37).

Financial management of HG funded sub-projects at the local level is seriously in need of review and strengthening. A recent report by the GOK Controller and Auditor General reveals that financial mismanagement at the local level is widespread in Kenya. Any future efforts to assist these authorities in delivering housing services to their citizens will have to take this system deficiency into account (pages 38 to 41).

The failure by several town councils to contract for adequate insurance coverage of HG funded sub-projects has resulted from administrative oversight at the local level. Given the precarious state of finances of most of Kenya's towns, it is doubtful that they should implicitly assume a risk against casualty loss by not insuring their HG funded sub-projects. It would also appear to be in the best interests of NHC, as the HG loan creditor vis-a-vis these councils, to urge them to contract for insurance coverage without delay (pages 42 to 44).

The Kenyan public has not been made aware of AID's contribution to the shelter needs of provincial centers because project 615-HG-004 has not been given any publicity since its inception five years ago. Consequently, substantial goodwill and understanding which might have been generated by this $5 million HG loan project has been lost (pages 44 to 45).

Project 615-HG-004 has generally failed to meet the shelter needs of below-median-income families because income eligibility limits -- set several years ago and based on an AID funded consultant's work -- were too high, and AID officials did not verify these data before adopting them for project use. When the high incidence of subletting is added to this situation, it is clear that project 615-HG-004 (proposed to meet the shelter needs of lower income families) has in effect become a middle and upper-middle income rental scheme. We therefore question the eligibility for HG loan funding of more than 200 incomplete two-room units whose sales prices and monthly payments will clearly be affordable by upper income Kenyans only (pages 45 to 50).

We have made recommendations designed to assist both AID and NHC officials to address the deficiencies described in the body of this report in such a way as to improve the chances for successful implementation of proposed large follow-on HG projects in Kenya. While the problems described in our report will require more than simple solutions, we are confident that an adequate application of time and effort by the staff of the AID Regional Office of Housing located in Nairobi, working in collaboration with their Kenyan counterparts, will result in the adoption of more effective and efficient ways and means to address the serious needs of Kenya's shelter sector. However, we believe that effective measures should be implemented to correct the deficiencies described in this report and in audit report No. 3-615-80-19 prior to AID/Washington approving further housing guaranty loan authority for use in Kenya.

Auditees' Comments to the Draft Report
and AAG/EAFR Responses Thereto

The auditees (RHUDO/E&SA, USAID/Kenya and The Office of Housing, DS/H) made the following general comments to the draft report:

> "We have reviewed the subject report on our first Secondary Towns Project in Kenya, and we recognize that you have made a conscientious effort to analyze a complex set of problems, and we agree with many of your observations. However, we must take exception to many of your conclusions and recommendations. The goal of institution building is paramount in all housing guaranties, but it is an objective not easily attained. If it were, we would quickly be out of business. It is only by a succession of projects and by a long period of involvement that we can ever expect to reach our goal."

AAG Response:

It is neither unusual nor unexpected that the audit and program development functions come to differing conclusions based on the same information. The audit perspective originates from three basic criteria:

- Sound administrative principles.
- Good business practice.
- Normally accepted accounting standards.

Thus, our conclusions and recommendations are intended to reflect how a "prudent manager" might react in the

face of conditions described in our report. We believe that we understand quite clearly the RHUDO/USAID position and sympathyze with their desire to "get on with the job" Where this desire conflicts with the foregoing audit criteria, however, it is our responsibility to demur if we disagree, and to offer alternative courses of action.

"AID aims in this regard have become much more comprehensive since this project was conceived. At that time, the main aim was to support a shift in GOK's de facto housing policy toward increased production of affordable housing for the poor. The project was substantially delayed (and due to inflation, fewer houses were built) because of the intense and protracted debate in GOK over the eventual decision to increase investment in lower cost housing.

"After GOK made this crucial decision, further time was then required for NHC to alter its design criteria and dwelling designs. There were other problems with the project, but its objective was attained. The new policy still stands, and implementation of it is improving and accelerating."

AAG Response:

We cannot accept the argument that the project was delayed because of an internal GOK policy debate. Surely this debate had been resolved at the time the project Implementation Agreement was executed by the GOK Ministry of Housing & Social Services, the National Housing Corporation, and AID; or the parties would not have agreed to proceed in accordance with a planned three-year drawdown schedule from a private U.S. lender. If this is not so, then the decision to go ahead under the foregoing circumstances was indeed ill-advised. Furthermore, we would point to the exemplary record of project implementation under the companion Nairobi City Council project (Umoja - 615-HG-003) which was authorized at the same time but does not appear to have been affected by any protracted policy debate.

As regards design of units, we are constrained to point out that incorporated into the joint 003/004 Project Paper was an Annex ("E) describing "Land and Technical Considerations" which included seven pages of data on the types of NHC units to be built, their size and location by town, and proposed floor plans. Also included was the following assurance:

"Both NHC and the NCC (Nairobi City Council) are adequately staffed technically to do most of their own architectural and engineering work."

We therefore find the reference to altering NHC's design criteria and dwelling criteria to be enigmatic at best. Presumably, AID housing officials and NHC were in agreement on these project details before execution of the project Implementation Agreement.

"Further, in a comparative analysis of NHC low-cost housing schemes, consultants to the GOK just concluding an exhaustive study of NHC have found that along every critical dimension - technical, administrative and financial - the USAID scheme has been the most successful NHC scheme in recent years."

AAG Response:

As internal AID auditors we are empowered only to review development activities sponsored by this agency which we must judge on their merits, and in accordance with the planned objectives that formed the basis for their authorization by AID. The foregoing comparision is therefore inapplicable for the purposes of our review.

"When the administrative deficiencies were recognized, it was also seen that radical remedies were required and a wholly new approcah was designed for the follow-on project, incorporating extensive training and technical assistance. Based upon several recent studies (including the current detailed study of NHC and its work with others involved in shelter production for secondary towns), the new approach is expected to guide our next project to success in meeting more ambitious goals.

"The audit report argues and recommends that institutional capacity and service delivery should be much improved before further HG assistance is provided. We see the same problems in this project and expect genuine GOK commitment to correct them. However, we cannot accept the notion that AID should not press for speedy implementation of our follow-on project. Delaying development assistance delays development. This is a high price to pay and not worth paying except when basic issues must be resolved, as at the outset of this project.

"We believe that delay in a succession of projects would be irresponsible when the only goal is clean-up of one nearly completed project. Not only would long-term gains be lost,

but also the clean-up would be slowed by abrupt AID interruption of this accelerating program. We see no benefit whatever to be gained in this case from delaying development. Therefore, this notion should be expunged wherever it appears in the subject report."

AAG Response:

Given our perspective and criteria described above, we cannot at this time agree with the USAID/RHUDO plan to seek authorization and implementation of follow-on HG projects in Kenya, in view of the serious deficiencies cited in this and our previous report (No. 3-615-80-19) on the Nairobi City Council sponsored Umoja Housing Estate. In both projects we noted serious administrative problems at both the institutional borrower and local authority levels -- which, we believe, should be addressed before another housing project is undertaken. As we understand the 006 proposal, training and technical assistance planned thereunder applies to towns other than those which participated in the 004 project. Yet, what towns in Kenya are better staffed and able to address these problems successfully than those already assisted under projects 615-HG-003/004. In summary, it is our view than an honest attempt by AID housing officials and their GOK counterparts to correct the deficiencies reported on in these two projects will provide indispensable experience in the design of successful follow-on projects. While we cannot accept the proposition that delaying development assistance always delays development, we do feel quite strongly that delaying corrective actions serves no useful development purpose and may harm chances for successful follow-on efforts. For these reasons we have seen fit not to "expunge this notion" from our report.

"Nowhere in the audit report is there any substantive acknowledgement of the real achievement of this scheme, nor is appreciation demonstrated for the political and policy context in which this program (designed six years ago) has been implemented.

"We believe that the report characterizes NHC as a failure as an institution and the HG project as a failure as a low-cost housing scheme. Quite to the contrary, housing specialists in Kenya view HNC as a remarkably dynamic housing institution

attempting difficult schemes under difficult circumstances and the USAID scheme as a pioneering effort in shifting GOK policy to one of support for low-cost, affordable housing.

"It is so often only by observation as to how a project is carried out that we or the host country government recognize where there are shortcomings in the institutions with whom we are dealing, and it is then that we must provide an infusion of technical assistance. That NHC, or the local authorities would need extensive assistance was not obvious from the rapid growth rate of NHC's prior production. Therefore, a conscious and sound decision was made to let Kenyans implement this project without resident advisors, recognizing that they would make some mistakes. They did, and GOK recognized this over two years ago. Political factors delayed significant corrective aciton until recently, but it has now begun."

AAG Response:

We believe that we have dealt at sufficient length with the issue of attainment of objectives; in fact, the entire last section of the report deals with this subject. Furthermore, we have been unable to find among the extensive comments the auditees' have made to the draft report any listing of the project's "real achievement". Moreover, it is the policy of the Auditor General not only to include whatever balancing information might be applicable in statements of project deficiencies -- as we have done in the report -- but also to provide ample opportunity and full play for the comments of AID management in reply to audit findings. This we have also done so that our readers may arrive at their own conclusions as to the efficiency, effectiveness, and economy with which the activity subject to audit has been, or is being, carried out. In conclusion, we can only cite the opinion of the authors of the RHUDO commissioned, DS/H published Kenya Shelter Sector Study Report of August 1979 who stated: " . . . the team supports the view that objectives of project 004 on the whole were not achieved."

Other comments made by the auditees' are incorporated into the body of this report where considered pertinent. A verbatim copy of their response is provided in Exhibit E.

BACKGROUND

The Republic of Kenya

A country of roughly 225,000 square miles, Kenya lies astride the equator in eastern Africa between the Indian Ocean and Lake Victoria. Estimates of the country's population at the present time range to over 15 million persons, and growing at an alarming 3.5 - 4% yearly. At this rate, the country's population will approximately double by the end of the century. While still predominantly rural in nature, Kenya's rate of urbanization (the natural increase of population in urban places augmented by in-migration from rural areas) is more than double its over-all growth rate. The towns, comprising little more than 10% of the country's population, are doubling their population every ten years. The natural result has been an increase in urban poverty, mushrooming shanty settlements, and a sharp rise in the demand for housing and related social services.

AID Shelter Sector Strategy

According to the USAID/Kenya Country Development Strategy Statement, "AID will provide financing and technical assistance to develop large-scale, low-income public and private shelter projects to demonstrate that a) costs are fully recoverable, b) recoveries can be reinvested in other similar projects, and c) institutional improvement in shelter policy, planning, design and administration can be replicated on a broad scale.... On the public side, it will concentrate on strengthening the capacity of local authorities to implement and administer their own low cost shelter programs and the capability of national-level institutions to formulate coherent policies, engage in long-term program planning, acquire serviced land, and provide infrastructure and essential community facilities."

AID Housing Program Management

The Agency's shelter sector resource transfers are authorized in Foreign Assistance Act Sections 221, 222, 223, and 238 which provide for an AID all-risk (except against investor's fraud) full faith and credit guaranty on behalf of the U.S. Government to eligible U.S. investors on loans made in support of AID approved shelter projects in less developed countries. The program is intended to be financially self-sufficient, supporting itself from fee income associated with loan guaranties authorized. The Office of Housing is located within AID's Development Services Bureau (DS/H) and provides policy guidance and program support to six regional field offices worldwide. The regional office of housing (RHUDO) with program cognizance for AID housing projects in East & Southern Africa is located in Nairobi, Kenya, and is staffed by three U.S. direct hire and one foreign

service national professionals. As regards shelter projects in Kenya, the USAID/Kenya Mission Director advised us he regards the RHUDO staff in Nairobi as his "housing division" insofar as his country program is concerned. The responsibility for planning, design and implementation of Housing Guaranty Projects lies principally with RHUDO. This office has been active in Kenya since 1975, although the first housing guaranty project dates back to the 1960's. Over the past two years, RHUDO/E&SA has funded a series of studies dealing with general and specific Kenya shelter sector topics from which certain information presented in this report has been drawn.

Kenya's Secondary Cities

According to Kenyan legislation and practice, the capital city is the only urban area in the country that has been elevated above the legal status of "town". As can be seen from the following table, however, a number of "towns" have grown rapidly over the past decade, although Nairobi and Mombasa alone account for 80% of the nation's urban population.

STATUS AND POPULATION GROWTH OF MUNICIPALITIES[1/]

	Population (000) 1969	1978	Annual growth rate
Nairobi	509	959	7.3%
Mombasa	247	401	5.6
Kisumu	57	115	8.0
Nakuru	47	78	5.7
Eldoret	18	47	11.1
Thika	23	47	8.0
Kitale	12	24	8.35
Kakamega	6	18	12.65
Nyeri	10	23	9.6
Embu	4	14	15.0
Meru	5	12	11.55
all municipalities	938	1,736	7.1%

1/ Adapted from the 1979 DS/H funded Kenya Shelter Sector Study, p.11.

In response to our draft report, the auditees commented:

> "Several factual errors were noted in reviewing the subject report.... Again, as in the HG-003 audit report, out-of-date statistics are cited. The current AID estimates of population growth rate and urban share

are 4 and 15 percent, not 3.5 and 10 percent. The data in paragraph 2 of page 3 and in the table on page 4 are suspect and perhaps should be deleted or revised. The latest census preliminary report (which is also suspect) puts only 60 percent, not 80 percent, or urban population in Nairobi and Mombasa. The census also identified several towns, not listed in your table, with populations exceeding 10,000.

"Instead of the Kenya Shelter Sector Study, we suggest you consult the significantly more recent Kenya Shelter Strategy Statement (pages 4 and 5) prepared by RHUDO and USAID/Kenya."

AAG Response:

We cannot accept the characterization of these report data, and others referred to by the auditees' in this section of their comments, as "factual errors." In the case of the growth rates, our estimates are based on conservative, albeit authoritative, source documents. To assert that the growth of urban places in Kenya is taking place at a rate approximately quadruple the overall rate - when a multiple of two is the norm for developing countries - is frankly more suspect than the auditees' comments already labeled by them as suspect. The above table is meant to be illustrative and not exhaustive of all Kenyan towns of a certain size. The footnote which appears below the table in the text accurately identifies the source of this information as RHUDO's own study report.

Local Authorities

Local governmental institutions in Kenya vary greatly in size and resources. Although cities like Mombasa and Kisumu are relatively well staffed, smaller towns must often rely on the provision of expertise in technical areas from central government agencies like the Ministries for Local Government, Housing and Urban Development, etc. While they may vary in size and capability, almost all local authorities have one thing in common: their dependency on the central government to fund their operations. About ten years ago, the main source of revenue for local authorities was transferred from the towns to the central government. An inadequate tax base and weak revenue administration have caused local officials many financial problems. Smaller councils in particular find it very difficult to meet their current expenditure budgets, despite being responsible for some fifty public services. While some central funds are available to help meet the fiscal needs of local authorities, it is increasingly clear that these sources are not sufficient to cover the gap between local needs and locally generated resources.

The National Housing Corporation (NHC)

Although housing services remain the responsibility of local authorities, funding is provided by NHC through long-term loans by which some town councils are able to generate a surplus for general expenditures. Among its functions as the nation's prime housing development agency, the NHC:

- Acts as a conduit for loan funds from Government of Kenya (GOK) and foreign donor agencies.

- Provides technical assistance to local authorities in the areas of construction design, tendering and supervision.

- Develops and manages housing estates where local authorities may not be adequately staffed to do so.

- Supports and encourages research activities in housing through the Housing Research & Development Unit of the University of Nairobi.

- Stimulates private sector participation in housing by acting as a developer of middle income mortgage housing schemes.

Established in 1967, NHC acts as the principal operating arm of the GOK Ministry of Housing & Urban Development. Thus, it sponsors housing projects not only on its own behalf but also on behalf of the Housing Finance Corporation of Kenya, which attends to the needs of upper and middle income sectors of the population. NHC derives its funding from GOK grants and loans and from donor agencies such as the Commonwealth Development Corporation and AID. The offices of the National Housing Corporation are located in Nairobi.

In response to our draft report, the auditees commented:

> "We are unaware of any housing estates managed by NHC, as noted in line 6, except three of its own, in Nairobi where the local authority is as able as any...."

AAG Response:

Thus, NHC does manage some projects on its own. Furthermore, the findings contained in companion report No. 3-615-80-19 demonstrate that the assert: regarding Nairobi City Council's management capabi. ties may not be correct.

NHC Project 615-HG-004

Authorized in tandem with a Nairobi-focused counterpart project (Umoja Estate Housing, Project 615-HG-003), this $5 million HG loan was designed to finance the construction of 1,381 units of low-cost housing in 12 urban areas of Kenya outside the capital city. Although the NHC's project submission was made late in 1973, it was not until 1975 that the AID-guaranteed loan agreement between NHC and the Federal Home Loan Bank of New York was executed and the project officially began. Loan terms included an interest rate of 8.7% over a 29-year term, to which an AID guaranty fee of 0.5% on the declining balance is added to cover program expenses -- making a total cost of HG-loan funds of 9.2% to NHC. In turn, NHC relends this money at 9.5% for 26 years to participating local authorities, retaining 0.3% for its operating expenses. A final relending is made by the local authorities themselves to the homebuyers at a rate of 10% per annum over 26 years, which leaves them 0.5% for project administration and management expenses.

As originally conceived, the NHC was to have complete supervisory control over project implementation in 7 of the 12 participating towns. The remaining 5 local authorities were to receive "wholesale" loans (in the words of an HG Program financial consultant) and would manage their own respective projects. Actual construction was performed by private contractors in accordance with NHC tendering and contract award procedures. Provision was made in the AID project authorization document for construction financing to be made available from HG loan funds. Sales prices were originally estimated to range from a low of the local currency equivalent of $2,495 per unit to a high of $3,696, depending on size.

The houses themselves may be described as "core" units in that they are expandable to three-rooms. The basic unit includes a shower, kitchen area and toilet. About two-thirds of the units were built as two-room units while the remainder were left as basic one-room "cores." In all, three design variations emerged to suit the various cultural and climatic conditions of the towns and regions in which they were to be located. Projects originally planned for HG financing are located on sites in or near the participating towns, are provided with certain basic infrastructure works and utility hookups, and range in size from 38 to 180 units.

Project Objectives Described

Although the production of low-cost housing affordable by below-median-income families was an important project goal, the AID project paper makes it clear that:

"The most important objective of the AID guaranteed loans is to help the GOK implement a housing policy with emphasis in favor of the poor by demonstrating that lower cost houses can be built despite the rises in building materials and other construction costs. The accomplishment of the objective should have a significant impact on the GOK housing policy, particularly with respect to lower income housing. It is highly unlikely that the lower income housing program would proceed as projected without the input of the HG program or the proposed World Bank site and service core housing program. With HG funds, however, the program as outlined in this paper should be able to give an impetus and establish a new direction for the GOL's policy for lower cost housing."

Project Status

Although all funds have been disbursed by the U.S. investor for some time now, over 20% of the HG loan principal plus accumulated interest remains to be released to NHC from an escrow account. This situation results from the fact that not all the projects currently planned for HG funding have been completed to date, as described in a subsequent section of this report.

Nevertheless, RHUDO/E&SA has already taken preliminary steps to gain AID approval for a large follow-on project (615-HG-006) through the National Housing Corporation. Building on lessons learned during the as yet incomplete implementation of its 004 predecessor, the follow-on project proposes the construction of between 1,500 and 2,000 core units and serviced sites* in eleven urban centers with populations ranging from below 10,000 to over one-half million inhabitants. Also included in the proposed HG loan package is funding for certain community facilities and infrastructure works. Additionally, an employment generation component has been added which includes examination of opportunities to introduce and/or improve informal small business enterprises at shelter project sites. The prime focus of the follow-on effort, however, is to improve the shelter planning, financing, implementation, and management capacity of the Ministry of Housing and Urban Development, the National Housing Corporation and local authorities. Technical assistance in the form of AID grant funded advisory services to the NHC and local authorities, together with the possible involvement of several Peace Corps Volunteers to provide resident guidance at the local level, round out the essential elements of the proposed follow-on project proposal.

A map of Kenya showing the location of towns mentioned in the report follows on the next page.

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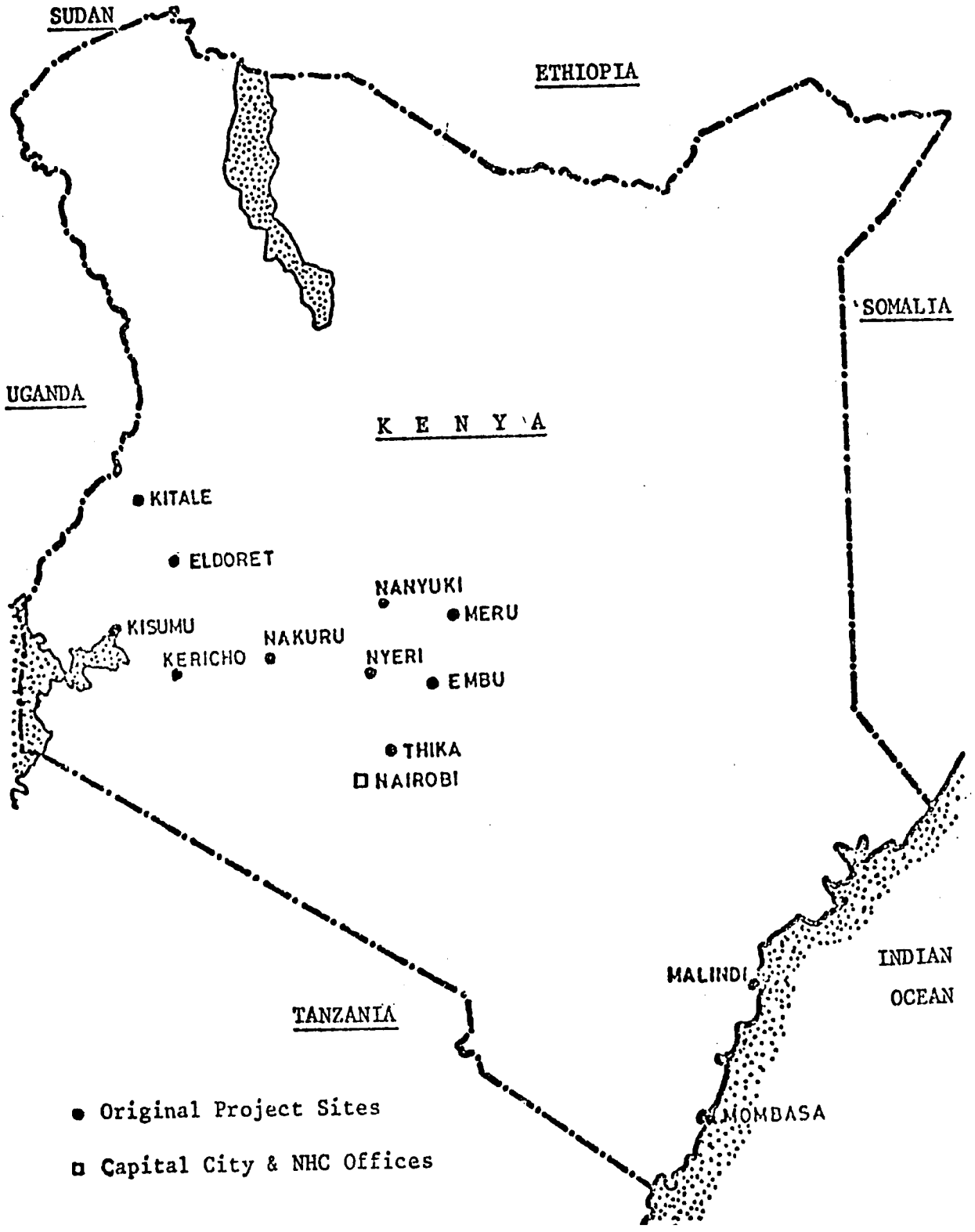
* A plot of land with boundary limits and water, utility and sewerage hookups provided.


SUDAN
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NAKURU
KERICHO
NYERI
EMBU
THIKA
NAIROBI
MALINDI
INDIAN
OCEAN
TANZANIA
MOMBASA
Original Project Sites
Capital City & NHC Offices

AUDIT FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

Delayed Project Implementation

Housing guaranty project 615-HG-004 is seriously behind its planned implementation schedule. The inability of the National HOusing Corporation of Kenya to adequately coordinate the efforts of GOK agencies and local authorities involved in the project is a principal factor in these delays. The number of units financed has decreased substantially while unit prices have increased considerably as a result of several deficiencies.

In response to our draft report, the auditees stated:

> "As noted ... in our general remarks we believe that some of the delay was due to policy change favoring lower income beneficiaries and that much of the cost increase was unforeseeable. We would therefore suggest saying, in paragraph 1 ... unit prices have increased considerably due to a combination of delay due to policy change, administrative deficiencies and unforeseen inflation."

AAG Response:

In reply to similar comments offered earlier by the auditees, we stated that we cannot accept the proposition that policy debates took place after the Implementation Agreement was signed. We understand further that cost estimates usually include contingency factors. Among the unforeseeable events affecting this project was a substantial devaluation of the Kenya shilling that should have produced more local currency than anticipated for the project.1/ This factor contributed to the production of more units than planned in companion project 615-HG-003, Umoja Housing Estate, Nairobi. We have retained this summary paragraph in its draft form for these reasons.

Project Authorization & Loan Agreement Execution

According to housing guaranty program financial reports, the $5 million dollar loan, 615-HG-004, made to the National Housing Corporation was authorized for an AID guaranty in June 1974. The loan agreement between the Federal Home Loan Bank of New York (U.S. investor) and NHC was executed one year later. According to the terms of the loan agreement,

1/ Unfortunately, delayed project implementation did not permit NHC to benefit from this exchange windfall.

NHC was given three years in which to draw down the full principal amount. According to RHUDO/E&SA project records, however, NHC was unable to meet this time frame for a variety of reasons; and therefore three of the four disbursements made by the investor were placed on deposit in an escrow account maintained at a U.S. commercial bank in the name of NHC. Disbursements from escrow to the NHC may be made only with AID's prior approval.

Project Financial Status

As of June 30, 1980, the record of investor disbursements into escrow and directly to NHC, and NHC drawdowns from the escrow account stood as follows:

Investor's Disbursements Into Escrow		NHC Drawdowns From Escrow		
Date	Amount	Date	Amount	Purpose
4/29/76	$ 500,000	2/22/77	$ 461,555	Construction Advance
8/31/77	1,000,000	1/27/78	20,000	Repayment of Principal & interest to investor
5/31/78	3,000,000	1/15/80	3,000	Payment of bank fees
		5/9/80	2,910,579	$1 million construction advance and purchase of Tenant-Purchase Agreements (home loan contracts).
Total disbursed into escrow	$4,500,000		$3,395,134	Total of drawdowns from escrow to date
Direct:		Direct:		
5/31/77	500,000		500,000	Direct from investor
			$3,895,134	
		6/30/80	1,104,866	Balance on deposit*
TOTALS	$5,000,000		$5,000,000	

* Plus an as-yet undetermined amount of interest earnings estimated at this writing to approximate $1 million.

Construction Status

Delays in disbursement of the loan amount described in the preceding table reflect delays in completion of the various projects financed with HG loan funds. A companion project, 615-HG-003, sponsored by the Nairobi City Council, financed the construction of more than 2,900 units of similar low-cost housing, and was completed in 1978. In contrast to that record of timely project implementation, the status of construction under 615-HG-004 as of March 31, 1980 (although no significant changes had occurred up to 6/30/80) may be derived from the following table:

NATIONAL HOUSING CORPORATION - AID LOAN 615-HG-004
SUMMARY OF CONSTRUCTION PROGRESS
AS OF MARCH 31, 1980

Project Site	Number of Units by Size & Price: One Room Unit Number	One Room Unit Sales Price 1/	Two Room Unit Number	Two Room Unit Sales Price	Grand Totals	Status: Not Started	Under Construction	Completed
Nanyuki	12	$3,427	26	$5,547	38			38
Eldoret	31	3,733	65	4,933	96			96
Kitale	22	4,267	38	5,600	60			60
Embu	23	4,867	28	6,133	51			51
Nyeri	18	4,267	41	5,467	59			59
Kericho	17	4,400	29	5,600	46			46
Nakuru	40	4,267	80	5,600	120			120
Thika	34	4,000	66	5,067	100			100
Kisumu	71	5,667	109	7,133	180		180	
Meru	16	4,800	28	6,400	44		44	
Mombasa:								
Likoni	-	-	124	8,800	124	2 2/	122	
Kisauni	-	-	3/	N/A	3/	-	-	
Malindi	-	-	4/	N/A	4/	-	-	
Totals	284		634		918	2	346	570

1/ Sales prices @ US$1.00 = K.Sh 7/50
2/ Pending removal (long delayed) of several gravesites
3/ Eliminated from HG funding earlier this year: units too expensive and insufficient HG loan funds remain (84 units)
4/ Withdrawn from HG funding in 1978 due to lack of demand and converted to a rental scheme (51 units)

Effect of Delays

The problems encountered and the resulting delays in the project's progress have had two principal results: a significant decrease in the number of units built on eleven sites as opposed to the number originally planned for construction to thirteen sites; and a substantial increase in the cost of units to their purchasers. These results are reflected in the following tables:

	No. of Units: Planned 1/	vs. HG Financed 2/	Shortfall: Number	%
One Room	460	284 3/	176	38
Two Room	921	634	287	31
Totals	1,381	918	463	34

1/ Based on a proportion of $\frac{1}{3}$ one-room and $\frac{2}{3}$ two-room units, approximately.
2/ As currently envisaged, including those under construction.
3/ One unit was paid for in cash and therefore not eligible for HG funding.

	Sales Prices		Increase	
	Proposed vs.	Actual[1]	Amount	%
One Room	$2,495	$4,578	$2,083	84
Two Room	3,696	6,413	2,717	73

1/ Weighted averages based on units sold to date and prices approved thus far for those still under construction.

Factors Causing Delays

According to a 1979 HG program consultant's report:

> "Problems arose in unit design, land acquisition, bid tendering, cadastral surveys, coordination with 12 different municipalities, marketing analysis, and overestimation of the abilities of various municipalities to implement housing programs."

To this must be added the dysfunctions encountered in NHC's dealings with other GOK agencies, as noted in the AID funded Kenya Shelter Sector Study Report of 1979:

> "Delay is inherent in the design of the project. The NHC is the chief administrator and borrower. As such, it lends money to 12 city councils (which) . . . are located in 6 different provinces; each province has to approve government activity in its area. Province approval adds another time-consuming layer to an already cumbersome approval process.
>
> "A threshold problem . . . was the role of two central government agencies: the Physical Planning Department and the Commissioner of Lands . . . All . . . areas (outside Nairobi) have to receive the approval of the physical Planning Department when they propose development schemes. . . Further, the sub-division of land owned by the Central Government must be approved by the Commissioner of Lands. These two sets of approvals became intensely time-consuming."

At this point we make note of the case of Meru (one of the three remaining unfinished sub-projects). The subproject site plan as approved by the Meru Council, NHC and the GOK Commissioner of lands has resulted in an embarrassing "double encroachment" situation. On one side, the site intrudes into a road right-of-way, while on another side several units were separated from the rest of the site by a wall built by country officials who threatened to demolish the units as illegally constructed on country and not municipal land.

In the case of the two largest Councils (Mombasa and Kisumu) which participated in the project, relations between local officials and NHC deteriorated to the point of acrimony and mutual accusation over responsibility for project delays. Although several councils were originally scheduled to implement their own projects, only these two finally remained in this category -- the remainder were implemented by NHC. The delays resulting from frequent disagreements have caused one of the Mombasa sub-projects to be eliminated as too costly. The other two sub-projects remain incomplete with the highest unit costs approved by AID, to date, and expected to climb still higher. In the words of the Shelter Sector Report:

> "In retrospect, it is possible that administrative chaos might have been lessened if (these) towns had been able to contract directly with USAID."

To which we would add: and losses by homebuyers avoided. In Kisumu, for example, the buyer completed their 10% downpayments in 1978 but have yet to be admitted to their HG funded units due to "administrative chaos."

In response to our draft report, the auditees commented:

> "It is not clear that elimininating NHC's role would have expedited implementation in Mombasa and Kisumu where it was largely a local authority responsibility anyway. On the contrary, as they were largely responsible for two of the three slowest sub-projects, instead of eliminating the NHC role, it should, perhaps, have been increased. We doubt that by eliminating NHC, we would have seen losses by homebuyers avoided."

> AAG Response:
>
> Although the conclusion is ours and, we believe, a reasonable one, the citation in the report text is drawn from a RHUDO financed, DS/H published study report -- one of whose authors is now an American direct-hire RHUDO professional employee. We leave our readers to conclude which set of RHUDO comments to accept.

Finally, the amount of local currency which became available from the exchange of dollars disbursed from escrow into Kenya shillings has fallen from over eight shillings to the dollar at one point during the past half-decade of the project's implementatin to less than 7.3 shillings to the dollar at present. During the same period, inflation and construction costs have increased at a rate of between 10% - 15% per annum, thereby reducing even further the purchasing power of HG loan funds, some 20% of which have yet to be disbursed from escrow.

Potential HG Loan Surplus

Among the effects of project delays and the elimination of two sites there has emerged the possibility of a surplus of loan funds, as indicated below:

No. of one-room units = 284 @ total cost of	$1,300,105 (assumes $1 = KShs. 7.5)
No. of two-room units = 634 @ total cost of	4,066,257
Total cost of project (to date).	$5,366,362, of which
up to 90% is eligible for HG loan financing, 1/.	$4,829,726, leaving a
potential surplus of	$ 170,274

To this must be added approximately $1 million interest earnings on a substantial amount of HG loan funds left on deposit in escrow for more than two years. It is not clear to us at this writing what the disposition of any surplus loan funds or interest earnings should be.

RHUDO/E&SA officials have advised us that they expect costs to continue to rise on the units which remain unfinished thereby absorbing the estimated potential surplus. They have requested AID/Washington to contact the escrow agent and advise NHC of the amount of interest earnings on HG loan funds deposited in the escrow account.

Conclusion

Housing guaranty project 615-HG-004, National Housing Corporation of Kenya, is seriously behind its proposed implementation schedule. These delays resulted from inadequate coordination among GOK agencies and insufficient NHC capability to implement the project. Consequently, the number of units proposed to be financed by the HG loan will have diminished by one-third when the project is completed, while prices have risen substantially above the levels proposed in the original AID project authorization document.

Recommendation No. 1

RHUDO/E&SA obtain from the Office of the AID Assistant General Counsel for Housing (GC/H) an opinion as to the disposition of (a) any potential HG loan surplus which may become available under 615-HG-004, and (b) interest earned on HG loan funds left on deposit in escrow under the same project.

1/ After subtracting the 10% homebuyer downpayments

In response to our draft report, the auditees stated:

"RECOMMENDATION I: There cannot be any substantial HG loan or escrow surplus. You note that there is a potential loan proceeds surplus of about $1,700,000, if no further cost increases are experienced. However, we have learned recently that the cost of the Kisumu project will increase due to unforeseen difficulties in completion of the infrastructure. A reasonable guess as to the amount of this increase is $140,000, leaving a net potential loan savings of only about $30,000.

"Although, the escrow amount has earned over $800,000 in interest, NHC payments of interest to the investor and AID fees have exceeded such earnings by an amount approaching $100,000. Therefore, the NHC has had to pay some $900,000 out of its current funds to cover money as it sat unusable in the escrow account This reduction in current funds has reduced the ability of the NHC insofar as its regular operations and has cost them additional amounts through the loss of other housing investment opportunities. Any loan savings or interest earnings of the escrow account will only serve to offset a portion of these total costs to NHC and to restrict their use would only injure the NHC.

"Also, the DS/H Manual Order on "Escrow Policy for Housing Guaranty Loan Disbursements" specifies that the net proceeds resulting from the investment of escrowed funds will accrue to the general or specific benefit of the project, so no special inquiry would be needed, even if a surplus existed. Therefore, we believe that this recommendation is pointless and should be stricken."

AAG Response:

The reader will note that we are recommending only that RHUDO obtain a legal opinion on the matters of a potential loan surplus and interest earned on escrowed loan funds. Given the foregoing comments, it appears that a potential for a loan surplus ("savings" is considered inappropriate in this context inasmuch as these are not AID funds and cannot be deobligated) does in fact exist. If the potential becomes reality, some disposition of surplus funds, regardless of their amount, will have to be made. Thus, this part of our recommendation has been retained.

As regards interest earnings, we must take note of the fact that prior to the most recent drawdown of loan funds from escrow in May 1980, NHC formally requested that such drawdown include not only loan principal but also a proportionate amount of accrued interest earnings. However, NHC's request was denied by the AID office of Housing and this was communicated to NHC by RHUDO in a letter dated May 19, 1980, which stated, in part: "The decision was made to defer sending the National Housing Corporation the accrued interest on $2,910,579 until policy issues are resolved." We have received no advice from RHUDO that a formal resolution of those policy issues has been achieved, a copy of which, we assume, would have been attached to the extensive comments on our draft report if such determination had been made. We shall therefore retain this part of our recommendation until such time as we have been furnished a copy of the formal legal determination of this matter. In passing, we note that NHC's payment of interest to the U.S. lender is in accordance with the terms of the loan agreement under this project. Such payments are not related, in our view, to the disposition of interest earned on amounts deposited into escrow, which resulted from NHC's inability to meet the drawdown schedule established in the loan agreement.

Recommendation No. 2

RHUDO/E&SA, in conjunction with USAID/Kenya, include among the conditions precedent to disbursement of any funds under follow-on project 615-HG-006 with the National Housing Corporation a requirement for formal acknowledgements from all GOK agencies affected by the new project that provisions have been made to ensure its expeditious implementation.

In response to our draft report, the auditees stated:

"RECOMMENDATION 2: This is in fact two recommendations:

"(A) It is appropriate in all AID agreements to have a covenant for expeditious implementation, backed up by administrative, financial and technical plans, and in fact these plans usually

are required to be prepared and approved prior to the first disbursement. Since this is standard operating procedure we do not see the point of including it among the recommendations. Monitoring of RHUDO implementation of this recommendation 2 (A) would only duplicate established DS/H reporting procedures and gain nothing."

AAG Response:

One of the principal findings of the team that made the Kenya Shelter Sector Study (alluded to earlier in this report) had to do with a lack of inter-GOK agency coordination. The study authors went on to recommend that, in order to avoid the problems such lack of coordination caused, " . . . some type of 'fast track' processing would seem essential before AID consents to extend a loan." Thus, our recommendation merely reflects and confirms a valid concern expressed earlier in a RHUDO-funded, AID Office of Housing published study report. We believe that such a condition precedent continues to be both valid and significant, and have therefore retained it as a report recommendation.

"(B) No sub-programs in project 615-HG-006 will be in municipalities capable of implementing their own projects. Further, by-passing NHC would aggravate the administrative problems rather than ease them, ensuring increased delay, and it would profoundly contradict the basic collaborative strategy developed by RHUDO with GOK. Thus recommendation 2 (B) is inapplicable to the planned project 006."

AAG Response:

During the course of our audit we learned from conversations with RHUDO officials that lending directly to certain municipalities had not been definitely ruled out for future HG loans. Given the information in the RHUDO/USAID response, we have deleted this part of our draft recommendation from the report.

Home Loan Repayment Arrearages

A review of books and records at the offices of five participating local authorities in Kenya where HG funded units had been completed and occupied, revealed home loan repayment arrearages ranging from six percent to eighty-nine percent when amounts paid were compared with amounts owed

to date. Neither the project's sponsor, NHC, nor RHUDO/E&SA personnel had inspected such books and records prior to our visit. A build-up of payments in arrears endangers the project's cost recovery objective and exacerbates the already serious cash flow positions of most local authorities in Kenya.

The Repayment Obligation

Upon being allocated units under this AID/NHC project, homebuyers make downpayments of from 10% to 30% of the unit price and execute a Tenant Purchase Agreement[1] with their local municipal authority. According to the terms and conditions contained in this agreement:[2] "The balance of the purchase price . . . together with interest on the amount of such balance for the time being remaining unpaid at the rate of (10) percent per annum shall be paid by (312) equal monthly installments of principal and interest combined . . . each to be paid on the first day of every calendar month . . . ."

Using an exchange rate of U.S.$1.00 = KShs. 7.5, monthly payments of principal and interest on loans for units visited during audit were:

1 Room Unit	$28 to $36
2 Room Unit	$40 to $46

Both type units were included in subprojects that had been inhabited from 27 to six months, reflecting cost increases over the same period.

Arrearages Estimated

Based on our review of town council books, records and report summaries, the following estimates of arrears were computed:

Nakuru	26%
Kericho	56%
Kitale	89%
Eldoret	6%
Nanyuki	21%

1/ Unlike normal U.S. practice, the sale of units under loan project 615-HG-004 does not involve the execution of a "fee simple" title deed or mortgage loan. There are many forms of landholding in Kenya which result from historical custom and practice; however, a large amount of the land is owned by various Kenya government bodies. Under this "Tenant-Purchase Agrement", homebuyers receive a 26-year loan after the repayment of which they are granted a long-term (66 to 99 years) lease on their premises.

2/ See Exhibit A for full text. This form of agreement was given inter-ministerial approval for general use by the NHC almost a decade ago.

The total amount of arrearages in equivalent dollars at the above mentioned exchange rate was $54,693. The significance of this amount is only appreciated when divided by an average monthly payment amount (approximately $40) -- leaving arrearages of 27%, equal to 1,367 monthly payments. The most extreme example seen was in Kitale where half the 60 homebuyers had not completed one full monthly payment during the first ten months of occupancy.

We noted that homebuyer loan payments were highly irregular, that is, very few purchasers were complying with their monthly obligation. Also worthy of note is the absence of any penalty interest provision from the agreement. Hence, buyers are not penalized in any way for non-compliance with their monthly repayment obligation. Local authorities are unable to compensate for lost revenue which they might have a legitimate right to obtain if contractual provisions had been provided for assessing penalties on late home loan payments.

Provisions Unenforced

The Tenant Purchase Agreement contains the following provisions in cases of loan payment default:

> "If default shall be made in payment of any of the installments of principal and interest . . . for fourteen days after the same shall have become due and payable then the whole of the purchase price or the balance thereof remaining unpaid together with the interest thereon as aforesaid shall forthwith become payable and be paid by the Purchaser to the Council on demand; but so that interest at the rate aforesaid shall continue to accrue until the actual date of payment of the principal."

In our interviews with local officials we learned that these provisions are enforced in practice only after payments fall into default for three months or more. At this point dunning letters are sent to the purchasers by the town council or by an attorney retained for this purpose by the council. However, the provision allowing the local authority to "call the loan" in full is not generally resorted to.

Impact of Arrearages

Local authorities are indebted to the NHC for the total cost of their projects less the amount of downpayments received from the buyers. This debt is reflected in a loan agreement between the NHC and the participating local council which requires quarterly repayment of loan principal and interest at 9.5% per annum over a loan term of 26 years. As most town

officials interviewed stated that their normal financial condition was one of cash flow deficit, the build-up of home loan repayment arrears only worsens an already serious financial "crunch" experienced by most local authorities in Kenya. The loan repayment obligations of participating local authorities to NHC and other GOK agencies which make loans available to them could also be affected by this situation. The NHC, for its part, must make periodic repayment of its debt to the investor in U.S. dollars, which it buys with local currency through the Central Bank of Kenya. Since this dollar repayment carries both AID and GOK guaranties, the impact of arrearages would not be permitted to affect HG loan repayments to the U.S. investor. Nevertheless, their effect on the finances of local authorities, and possibly those of the NHC, could be potentially serious.

Our recent audit Report (No. 3-615-80-19, Umoja Housing Estate) on a large HG funded companion project in the city of Nairobi disclosed a similarly serious repayment arrears problem. An HG program consultant, the local office of Coopers and Lybrand, in a report on Umoja made to RHUDO/E&SA in 1979 stated that:

> ". . . experience has shown that despite the timely and accurate production of accounting records, it is, in the final analysis, the design and implementation of stringent debt collection procedures that ultimately affect the level of arrears."

It is doubtful that, without periodic monitoring and an input of technical assistance, local authorities will design and implement stringent debt collection procedures inasmuch as neither the NHC nor RHUDO/E&SA have urged participating town councils to adopt such procedures under this project to date.

NHC Response

Our statement of preliminary findings on this matter was transmitted to NHC by RHUDO/E&SA and discussed at a meeting with NHC, RHUDO and AAG representatives present. NHC's Deputy General Manager for financial matters, a British expatriate resident of Kenya for three decades, while expressing surprise at the extent of the arrearage problem, welcomed our audit findings and stated he would communicate them to the proper GOK agencies and ministries having cognizance over local government affairs. We were advised that as presently constituted and staffed, however, NHC is not in a position itself to take action or provide assistance to the participating councils to correct any management deficiencies.

Conclusion

The problem of arrearages under HG loan project 615-HG-004 is attributable mainly to the inability or unwillingness of local authorities to adequately

enforce the home loan repayment provisions of the buyers' Tenant Purchase Agreements. This adversely affects the already serious cash flow situation of most local councils and could potentially impair NHC's own cash flow. Neither NHC nor RHUDO/E&SA have addressed themselves adequately to this problem. Consequently, we are making the following recommendations:

Recommendation No. 3

Prior to authorizing any further disbursements from escrow, RHUDO/E&SA, in conjunction with USAID/Kenya, coordinate with the NHC to amend the form of Tenant Purchase Agreement to be used under HG loan project 615-HG-004 and the proposed follow-on project to provide for addition of penalty interest charges on payments overdue more than two months in an amount at least equal to the cost of capital to the local council which executes this agreement.

In response to our draft report, the auditees stated:

"RECOMMENDATION 3: Tenant Purchase Agreements (TPAs) have been signed for most of the 004 units and cannot be changed without separate negotiations with hundreds of allottees. Attempts to modify the form now for the remaining units would substantially delay occupancy and result in loss of revenue. The losses would be greater than the gains. The basic problem is not with the agreement, but with lack of enforcement, which is the responsibility of the local authorities, and therefore, of the Ministry of Local Government, not NHC. This recommendation should be stricken and the related discussion amended to reflect the actual conditions."

AAG Response:

There is no suggestion in the text of our report that already existing Tenant Purchase Agreements be modified, nor does the recommendation refer to such agreements. On June 24, 1980, a meeting was held at the offices of NHC among NHC, RHUDO and AAG officials during which there took place an extensive discussion of the perceived deficiencies in the form of NHC Tenant Purchase Agreement. At that time, the NHC Deputy General Manager for Finance stated that he was in basic agreement with our comments on the deficiencies pointed out by the audit, and

would be pleased to process such changes in the TPA as AID might reasonably request. It seems clear from the auditees' comments, however, that no such requests have been made by AID housing officials during the intervening months. While we agree that non-enforcement is the main issue, we also believe that NHC's form of TPA suffers from a series of flaws and omissions which should be corrected both for units as yet unoccupied under project 004 and any proposed AID-financed follow-on project with NHC. We would also point out that a similar recommendation was made under our prior report No. 3-615-80-19, Umoja Housing Estate, with no serious objections made to it. We have therefore retained the recommendation in this report.

Recommendation No. 4

Prior to authorizing any further disbursements from escrow, RHUDO/E&SA, in conjunction with USAID/Kenya, coordinate with the NHC and such other GOK agencies as they deem appropriate to convoke a meeting of Town Clerks and Treasurers of participating local authorities under loan project 615-HG-004 to discuss the problem of home loan repayment arrearages and methods available to combat this problem.

In response to our draft report, the auditees stated:

"RECOMMENDATION 4: The government is currently conducting a major study of NHC and one of the central issues is how arrearages can be reduced. Several recommendations have been made which are under discussion and RHUDO is now considering appropriate steps to take for this project. These steps may include the meeting recommended but a final joint decision has not yet been made.

"Therefore, the recommendation should be revised to reflect this fact.

"In any event, the steps will involve the local authorities and MLG, not NHC. Therefore, the opening "prior to authorizing any further disbursements from escrow" should be stricken, as the events are in no way tied."

AAG Response:

We find it difficult to imagine how this problem may be combated unless and until the local authorities responsible for loan repayment enforcement are contacted and urged to take steps that will lead to homebuyers' compliance with their repayment obligations. Given the importance of cost recovery under AID sponsored, self-liquidating housing projects, we feel it is incumbent upon the RHUDO, as AID project managers, to take the initiative in sponsoring such a meeting. The reader will recall that some of these projects have been occupied for periods of up to two and one-half years at this point. It seems clear to us that firm action is required quickly before bad habits become further ingrained in the minds of project beneficiaries and those responsible for its management at the local level.

As to the timing of the recommended meeting, we understand that this loan is fully guaranteed as to repayment of principal and interest by the GOK. Thus, it is the central government, of which the NHC is as much a part as the Ministry of Local Government (MLG), that should take interest in this matter inasmuch as it is the GOK that (a) will benefit from the dollar financing related to this project and (b) is liable for anything less than full cost recovery. Finally, we would ask: why would prudent project managers wish to delay in coming to grips with this problem? Consequently, we have retained our recommendation as originally presented.

Subletting Entire Units

Visits to project sites and interviews with local officials revealed that a large majority of the units financed under project 615-HG-004 have been rented out to persons other than the buyers originally selected as eligible by NHC and participating town council officials. This practice violates the terms of the project Implementation Agreement and the conditions of the Tenant Purchase Agreements. In our view, it also calls into question the project's objective of serving the shelter needs of lower income families.

Subletting Banned by AID

The following prohibition is contained in Article I of the project Implementation Agreement entitled "Definitions."

> "The dwelling unit must be occupied by the purchaser, who at the time of purchase represented in writing that (i) he intends to occupy the dwelling unit as his principal place of residence, (ii) he has not purchased the dwelling unit for purposes of speculation, and (iii) he does not own another housing unit in Kenya."

AID's intent is reiterated in Article II of the same agreement entitled "Covenants of Borrower" (NHC), as follows:

> "Tenant Sublet. In the event the tenant purchaser sublets the housing unit for speculative purposes, the Borrower shall strictly enforce the terms of the Tenant Purchase Agreement."

Tenant Purchase Agreement Less Clear

Paragraph 2 of the project Tenant Purchase Agreement, which deals with loan repayments as quoted in the previous section of this report, ends with the following sub-paragraph:

> "2(d) If the Purchaser shall sublet the whole or part of the Premises, the amount of each monthly installment thereafter due shall be increased by a surcharge equal to ten per cent thereof during the period of such subletting."

Paragraph 7 of the same agreement goes on to provide:

> "7. Until the transfer of the Premises in accordance with Clause 3 hereof has been completed the Purchaser hereby covenants with the Council as follows:
>
> (a) To reside in the Premises.

(b) Not to sell or assign the Premises or any part thereof and not to sublet the whole of the Premises during the first five years of this Agreement;

(c) Notwithstanding Clause (b) above not to sell assign sublet charge or part with the possession of the Premises or any part thereof at any time during the period of this Agreement without the prior written consent of the Council first being obtained which consent shall not be unreasonably with-held; PROVIDED THAT if the Purchaser has sold or assigned the Premises as aforesaid he shall be required to pay forthwith the balance outstanding of the purchase price accrued interest and all other monies due under this Agreement;"

Coming as it does before the prohibition contained in paragraph 7, the financial provisions for subletting (which is, in our view, permissible only for good reason and with the formal prior consent of the local council), detract from the force of the subletting ban contained in the homebuyers' agreements. Furthermore, we believe that limiting this subletting ban to the first five years of occupancy is not in accordance with AID's intent as contained in the project Implementation Agreement signed between AID, the GOK Ministry of Housing & Social Services, and the NHC. Nevertheless, the form of Tenant Purchase Agreement cited in this report was presumably approved by cognizant AID officials at the time because it appears appended to the project Implementation Agreement as an Exhibit.

Results of Site Visits

Due to limitations of time and staff, it was not possible for us to perform a statistically valid sample of residents in the five completed projects visited. Our estimates of subletting and rental income which appear below were derived from interviews with such residents as we found at home during our visits and from information provided by officials of participating town councils.

Town	No. Units	Est. No. Sublet	%	Average Mo. Pay't	Monthly[1/] Rental Income Range
Nakuru	120	100	83	$42	$47 to $80
Kericho	45	40	89	42	47 to 60
Kitale	60	50	83	41	53 to 67
Eldoret	96	80	83	37	47 to 67
Nanyuki	38	30	79	40	60 to 80
Totals	359	300	84%		

1/ Dollar equivalents @ K.Sh. 7.5 = US$1.00

Effects of Subletting

It is not possible for us to be precise as to the effects of subletting becuase it is clear that no one knows exactly how extensive this situation is. However, a 1978 study of subletting made by RHUDO-funded University of Nairobi researchers on companion project 615-HG-003, Umoja Housing Estate, Nairobi, disclosed that:

- Renters are more likely than buyers to have family incomes exceeding the limits imposed by AID under the eligibility criteria for homebuyer screening and selection.

- Buyers are more likely than renters to take care of their units.

To this assessment we would add that there is no evidence to suggest that buyers who sublet their units are any less delinquent in their home loan repayments than buyers who reside in them. In fact, since it is sometimes impossible for the local authorities to contact these people (who may be absentee landlords), they are more difficult to pursue in cases of home loan payment defaults. Finally, we would add that the ability of many renters to pay up to double the monthly payment required of buyers indicates that a substantial portion of renters would not have qualified under the project's income eligibility criteria.

Sanctions Unenforced

A reading of the final two paragraphs of the project Tenant Purchase Agreement makes it clear that sufficient sanctions exist under which local officials are able to enforce the subletting ban contained elsewhere in this agreement.

> "8. In the event of the Purchaser failing to perform and observe any of the aforementioned covenants and conditions on his part to be performed and observed of failing to pay the sum demanded by the Council, in accordance with Clause 2 hereof the Council may give the Purchaser one month's notice to quit the Premises and at expiration of that time the Council shall be able to take possession and either:
>
> (i) sell the Premises; or
>
> (ii) maintain possession and assume the management thereof without being liable for any loss occasioned thereby. . . ."
>
> "9. Any action taken by the Council under Clause 7 of this Agreement shall be without prejudice to any right of action or claim the Council may have against the Purchaser arising out of any antecedent breach of any covenant or condition hereunder."

Our visits with town council officials made it clear, however, that no attempt has been made by any council visited to enforce the subletting prohibition. (Actions taken by local officials against subtenants resulted from arrearage in loan payment situations only.) This is somewhat surprising given the fact that local authorities may levy a surcharge of 10% in cases of legitimate subletting. As in the case of Umoja Housing Estate, Nairobi, however, we learned that no town council we visited had ever been requested by, or granted formal permission to, any homebuyer to sublet his/her unit.

NHC Loan Agreement Silent

The text of the form of loan Agreement (see Exhibit B for full text) used by NHC with participating local authorities under this project makes no mention of the subletting ban contained in the 615-HG-004 Implementation Agreement. An examination of this document reveals it to be more a simple promissory note than a loan agreement. Consequently, it does not reflect or communicate to local officials AID's intent under the project, nor the terms and conditions under which the project is to be implemented.

Confusing Language

Another possible cause of inattention to the subletting ban on the part of buyers, in our view, lies with the profusion of "legalese" in which the Tenant Purchase Agreement is couched, and the fact that no translation thereof is provided in the Swahili language. In our interviews with project residents we found that it was impossible to communicate with many of these persons without having recourse to an interpreter. It is therefore considered unlikely that these same persons, or persons of similar economic and educational backgrounds, would be able to understand the terms and conditions of the Tenant Purchase Agreement found at Exhibit A.

Speculation vs. Shelter

The principal cause of the subletting situation, in our opinion, lies with the profits available from this practice (as noted in the table presented earlier in this section), and the acute demand for housing in all urban areas of Kenya. While this is an understandable motive, speculative use of HG funded premises is not permissible under this, or any AID sponsored HG project, without adequate justification or prior formal consent of the project sponsor.

RHUDO/E&SA's View of Subletting

In response to a similar subletting situation in the Umoja Housing Estate project in Nairobi, RHUDO/E&SA formally advised us that:

"It is the view of RHUDO that subletting in Nairobi cannot be stopped. It is accepted practice by households of all income levels and is viewed as a legitimate and desirable means to enhance income.

"It is the further view of RHUDO that unless a small army of social workers is hired to continually police the occupants of all units, enforcement of this provision will amount to nil. There are perhaps innovative ways to contain it, e.g., ID cards, but it cannot be stopped completely. There may be ways to regulate it, e.g., surcharge for permission, and some ways will be tested in Umoja II."

Assuming RHUDO's comments apply to subletting in urban places generally, and not merely to Nairobi, our own view, expressed in response to the foregoing statement, differs substantially from that of the Regional Office of Housing. To what point, we would ask, was the considerable time and effort expended in ensuring that fair, random allocation of units was made, if the persons qualified as eligible buyers planned to make speculative rather than shelter use of their homes?

Speculative use of units is specifically and rigorously banned in the project Implementation Agreement and the Tenant Purchase Agreement signed by the homebuyers. We believe this proscription is based on the buyers' need for shelter, which all candidates for units under this project certified to on their notarized application forms. It is also our view that AID's Housing Investment Guaranty Program is designed primarily to provide shelter, not income, to eligible lower income families. At the same time it seeks to strengthen the institutional framework within which projects funded by HG resource transfers can eventually be replicated through the mobilization of local human and capital resources in the less developed countries where AID authorizes use of this development tool. The conversion of HG funded housing units into income-producing fixed assets by persons who have certified to both their need for shelter and their ability to pay for HG funded homes does not, we submit, coincide with the HG Program's principal development objectives.

Finally, we believe RHUDO's statement reveals that it accepts the status quo as regards subletting, despite the fact that we have seen no evidence of any serious attempt on the part of either local or AID/HG program officials to enforce the subletting ban contained in contractual agreements under this project or under companion project 615-HG-003.

In response to our findings in this area, we were advised by RHUDO and NHC officials that NHC lacks the statutory authority either to enforce this ban itself or cause participating local authorities to enforce same. While this may be true, we point out that NHC and the GOK accepted

the enforcement obligation when they executed the project Implementation Agreement with AID five years ago. Therefore, we feel it to be incumbent upon NHC and the GOK Ministry for Housing and Urban Development, in conjunction with other GOK agencies (such as the Ministry for Local Government), to devise ways to make the subletting ban effective.

Conclusions

The problem of complete subletting of project 615-HG-004 units is attributable to the buyer's non-observance of the terms and conditions of their Tenant Purchase Agreement and the failure of participating local authorities to enforce same. The speculative advantage available from renting out units appears difficult to resist. Given the amount of income needed in order to be able to afford the rentals currently being paid for these units, we believe that the majority of current subtenants would not qualify as eligible lower income buyers. We further point out that even if subtenants do qualify, a University of Nairobi study of a similar subletting situation in Nairobi revealed that, as a class, their incomes tend to be substantially higher than those of the original buyers. For these reasons, we conclude that the practice of subletting detracts substantially from the project's purpose of meeting the shelter needs of lower income families and should not be condoned.

Recommendation No. 5

RHUDO/E&SA, in conjunction with USAID/ Kenya, formally advise the National Housing Corporation and the GOK Ministry of Housing and Urban Development that it cannot authorize further disbursements from escrow under project 615-HG-004 until such time as the NHC and participating local authorities:

(a) have determined which units under the project are inhabited exclusively by persons other than those entitled to reside there under the terms of the Tenant Purchase Agreement, and

(b) have taken effective measures to enforce the ban on unit subletting, including, as appropriate, reallocation of HG funded houses in cases where buyers refuse to reside in their units without good reason and proper authorization by the cognizant local authority.

In response to the draft report, the auditees stated:

"RECOMMENDATION 5: Renting and subletting are a way of life in Kenya. We beleve that incremental measures must be taken in both projects 004 and 006 to regulate the most disadvantageous features of total renting. We know that the "need" for shelter is never absolute and that whenever subletting is profitable, there is a tradeoff between the alternative benefits of improved shelter and improved income. Absolute prohibition does not appear possible at this time.

"There will be continued efforts to minimize this problem through more attention paid to purchaser selection, community development and tenant education programs as well as possible regulatory measures such as surcharges for subletting.

"However, this is a long-term effort and therefore it will be counter-productive to make further disbursements from escrow dependent on elimination of total subletting. This recommendation should be revised to reflect the above."

AAG Response:

Presumably, the renting and subletting "way of life in Kenya" has not sprung up during the past half decade of project 615-HG-004's existence. The practice was obviously known when the project Implementation Agreement, including its rigorous prohibitions against total subletting, were entered into. Despite these undeniable facts, the foregoing comments seek, in our view, to rationalize the status quo while offering only a vague exhortation "that incremental measures must be taken in both projects 004 and 006 to regulate the most disadvantageous features of total renting." What are these "incremental measures" and why have AID and GOK officials taken virtually no action to date to enforce the ban on total subletting under any AID sponsored housing projects in Kenya.

We reiterate our position to the effect that AID should not continue to support housing projects whose intent is to serve lower income groups and for which it establishes rigorous selection criteria to achieve that goal, only to see these efforts virtually obliterated through the wholesale rental of projects by allottees who many times never even take up residence in their units before subletting them to third parties. We would further point out that AID's shelter initiatives are conducted under a housing guaranty, and not an income guaranty, program. We know of no AID activity authorized under the Foreign

Assistance Act of the United States which has as its objective speculation by the beneficiaries of AID assistance, nor do we believe speculative use of AID benefits should be condoned.

We would also point out that the GOK has proclaimed a basic "One man, one house" shelter policy. Unless it acts to eliminate the practice of wholesale subletting, however, we see this as a meaningless proclamation.

It would seem to us that the RHUDO and USAID/Kenya have two choices in this regard: (a) demand enforcement of the prohibition against subletting by GOK officials responsible for compliance with this ban, or (b) reconsider their approach to serving the shelter needs of Kenya via the sponsorship of rental housing. The latter would be of greater benefit to local authorities and could better lend itself to reaching lower income groups than the present program format. Because it is our view that the time for action on this matter has long since passed, we are retaining our recommendation as originally presented.

Recommendation No. 6

RHUDO/E&SA, in conjunction with USAID/Kenya, coordinate with the NHC and such other GOK agencies as may be affected to amend:

(a) future project 615-HG-004 and 006 form of Tenant Purchase Agreements to: (i) reposition sub-paragraph 2(d) thereof under paragraph 7 and clarify its intent as permitting subletting for good reason only, (ii) eliminate the limit on the subletting ban which now applies to only the first five years of occupancy, (iii) insert under paragraph 7 a provision for forfeiture by the buyer of record of all monies paid in respect of amortization of their loans (including downpayments and monthly home loan payments) in such cases where such buyers are found not to reside in their units without having obtained prior written consent from their local authority to sublet same, and (iv) provide homebuyers with a colloquial Swahili language translation of the Tenant Purchase Agreement; and

(b) the form of loan agreement between the NHC and participating local authorities so as to include all the significant terms and conditions of the AID Implementation Agreement under the current and proposed follow-on projects, including the ban on subletting of HG funded units.

In response to the draft report, the auditees stated:

"RECOMMENDATION 6: We fully agree that revision of the TPA should be addressed prior to implementation of 006 and will be the subject of GOK/RHUDO discussion in the near future. Clarification of the entire document, and vernacular translation, are certainly good ideas. However, as stated above, we do not feel it would be prudent to try to change the TPAs for this project. The other points in recommendation 6 must be either subordinate to the goal of clarity or subject to negotiation with the aim of harmonizing the text with the real intent of AID, GOK and the parties. Therefore, this recommendation should be revised.

AAG Response:

As noted elsewhere, the NHC has stated that it will be pleased to process such changes in its form of Tenant Purchase Agreement as AID may reasonably request. Nor does time appear to be a factor in achieving such changes for units still to be occupied under project 004 (again, we are not suggesting that TPAs in force be modified). Consequently, we are retaining the recommendation as originally presented.

Project Maintenance Conditions

Four out of five project sites visited showed little evidence that either the residents or local authorities had made efforts to maintain the appearance of subproject sites after these had been opened for residence. Council officials are not carrying out inspections of HG funded unit interiors. Consequently, the project's image as a whole together with that of its sponsors -- AID and NHC -- is being adversely affected by these unsightly conditions.

Homebuyers' Maintenance Responsibility

According to sub-paragraph 7(e) of the project Tenant Purchase Agreement, purchasers of HG funded units agreed:

"To maintain the Premises in good substantial repair and condition and to permit the Council its representatives or agents with or without workmen and appliances to enter upon and view the conditions of the Premises and to give

or leave on the Premises 21 days notice in writing to the Purchaser of all defects and want of reparation then and there found which the Purchaser shall be liable to make good. If the Purchaser shall not within the space of such 21 days as aforesaid proceed diligently with the execution of such repairs then and in such case Council shall be at liberty to enter upon the said Premises and execute such repairs and the cost thereof shall be a debt due from the Purchaser to the Council."

As regards maintenance of public areas at subproject sites, we could find no mention of an undertaking by any GOK agency in the project Implementation Agreement requiring maintenance of public areas. However, we consider this to be a public service responsibility common to municipal authorities generally. In addition, good commercial practice on the part of the holder of a residual interest in site ownership (town councils) would, in our view, counsel adequate site maintenance practices in an effort to conserve property values and local government image.

Results of Site Visits

Residents interviewed generally complained that the units, and especially the basic one-room core, were too small. Given average Kenyan family size of between 5-7 members (in one case 12 persons were found to be living in one unit) in comparison with the dimensions of HG funded units (See Exhibit C), this complaint is understandable, but at the same time considered economically unavoidable. A possible exception has to do with the kitchen area, aptly described by one resident as a "corridor with shelves." Unfortunately, the location of this area will not permit expansion without moving interior unit walls. Comments were also received as to the inadequate security offered by unbarred, louvred windows installed in the homes. RHUDO/E&SA has advised us that these complaints have already been taken into account in design of follow-on project units. Subproject sites generally did not have paved streets nor were they provided with street lights, as these were considered too costly when factored into unit prices. Finally, site occupancy seems to have been generally delayed by the failure of electrical installations to meet power company code requirements.

Untidy Conditions

All but one (Kericho) of the five inhabited sites visited were observed to be lacking in public and individual maintenance practices. Generally, house lots were found to be untended, some with weeds growing up to window-sill height. Where this was not the case, residents had planted small vegetable gardens and enclosed their yards with varying materials, including roughly hewn board palisades up to 15' high.

Uniformly, even in the one relatively well kept project site we visited, open storm drains had been left unpaved at the edge of dirt roads in and around project sites. These had become weed-choked, filled with uncollected trash and silted-up, especially at points where they pass through cement culverts at intersections and lot entryways. The silting leads to rainwater runoff erosion of adjacent roadways, especially on hillside sites. Although adequate drainage has been provided next to roadways, no provisions for lot drainage had been made. Several residents of units set in lots fashioned from hillside terraces complained that rainwater accumulates in uphill lot corners and sometimes causes flooding of their homes during heavy rains. In the case of the nearly completed Kisumu site, the local housing engineer stated that the rocky hillside conditions would not permit certain units on terraced lots to be expanded without further expensive rock removal to permit laying of wall foundations and floor slabs. No local officials in any town visited had ever conducted an inspection tour of occupied HG funded units. (See Exhibit D for a selection of photographs depicting these conditions.)

Nanyuki: An Extreme Example

The first subproject site to be occupied under project 615-HG-004 more than two years ago is located in Nanyuki. The number of homes built there was 38, of which 12 were one-room and 26 were two-room units; the site is three kilometers from town by road but closer by direct walk. Among the conditions we noted at this site were:

- Several unoccupied units around which neighboring residents had obviously been depositing their trash.

- Waist-high weeds growing throughout the project site.

- Storm drainage ditches were chocked with weeds and clogged with rubbish and discarded building materials.

- Electric power hookups had not been provided to 26 of the units despite their having been occupied for 27 months at the time of our visit.

Official Neglect

In response to our inquiries we learned that a substantial number of buyers had apparently never occupied their units. Ten of these were reportedly rented by their owners to the Kenya Railways Corporation for staff housing at rental rates approximately double the monthly loan payment obligation. No trash cans were in evidence anywhere on the project site, and trash collection services by the Town Council apparently did not exist. Local officials had made no efforts to enforce any of the provisions of the buyers' Tenant Purchase Agreements except as regards loan repayment. Nanyuki officials who accompanied us to the site admitted the unsightly conditions were caused by inadequate municipal site maintenance, and the fact that almost all residents were

renters who did not take care of their units. Finally, the Town Engineer stated (and we later confirmed in Nanyuki subproject records) that the site had never been formally turned over to the town by NHC. Correspondence in town files indicates that NHC offered to make final site delivery twice in the past, but Nanyuki officials never replied. The Town Engineer stated he had sent a memo to the Town Clerk (City Manager) stating that, in his view, the subproject's electrical installations had not been completed to his or the power company's satisfaction. Those 12 units connected to power lines, we were advised, enjoy this service because either the owners or the residents paid about $150 out of their own pockets to have a licensed electrician rectify electrical construction defects. As noted earlier, however, 26 units remained without power more than two years after their occupancy.

Project Image Affected

Conditions such as those decribed above can only lead to rapid deterioration of HG funded projects into slum settlement conditions. The lack of care and maintenance of units and public areas not only detracts from the image of the project and its sponsors (AID and NHC), but also makes renovation of unkept units more costly in cases of repossession.

Communications Gap

The overriding cause of the above described conditions would appear to lie with a lack of adequate communications among NHC, building contractors, local officials, homebuyers and residents. Although NHC provided architectural and engineering construction supervisory services during the period when units were being built, these services appear now to have terminated prematurely with no provision for post-occupancy site management assistance from NHC. Such services are listed among NHC's functions as noted in the Background section of this report.

Cognizant RHUDO officials also acknowledged to us that they had made no site inspections of occupied sub-projects with an eye to correcting any deficiencies. Nevertheless, we did take note of several reports in RHUDO files dealing with trips to participating towns. The main purpose of those trips appears to have been development of a data base for presentation of a proposed follow-on project for AID/HG authorization.

We were advised by RHUDO that NHC plans to supervise the work of electrical subcontractors more closely in the future and that ways of helping NHC to improve its construction supervision capacity are also being considered. Finally, RHUDO and NHC officials plan to explore the feasibility of including project management fees in the monthly loan payments made by homebuyers.

In response to our draft report, the auditees stated:

> "Cognizant RHUDO officials" were surely misunderstood. While we have made more visits before occupancy we have also made them after occupancy. None of these visits were concerned with the preparation of the follow-on project."

AAG Response:

We have seen no evidence in the files that the RHUDO has conducted post-occupancy site inspections of sub-project financial and physical management, or formally brought such deficiencies to the attention of NHC or local officials.

Conclusion

The conditions at inhabited 615-HG-004 project sites generally demonstrate a lack of upkeep and maintenance by both residents and participating local authorities. Inattention by the latter to normal street cleaning and trash collection responsibilities, together with non-enforcement of upkeep provisions contained in Tenant Purchase Agreements, caused these problems to grow worse with passing time. As units are gradually expanded by their owners, the incidence of subletting can be expected to increase. If this practice is not curbed now, we doubt that unit and project site upkeep can ever be brought up to acceptable standards. Finally, we believe these conditions affect the image of AID and NHC as project sponsors.

Recommendation No. 7

RHUDO/E&SA, in conjunction with USAID/Kenya, formally advise the NHC that it cannot approve any further drawdowns from escrow under project 615-HG-004 until: (a) a joint inspection of all project sites completed to date has been made and reported on by cognizant RHUDO, NHC and local officials; (b) steps have been taken to rectify any remaining construction defects such as those found in Nanyuki, including, as appropriate, just compensation to owners who have gone "out-of-pocket" to rectify any such defects; and (c) local authorities have been formally requested to take action to comply with their project maintenance responsibilities, including periodic unit inspections and enforcement of Tenant Purchase Agreement maintenance provisions.

In response to the draft report, the auditees stated:

"RECOMMENDATION 7: As incomes of local authorities increase and other basic needs of tenants are met, it is reasonable to expect improvement in both public and private grounds maintenance. We intend to make site visits to urge attention and action in this area. We believe improvements will be made in some towns, and RHUDO is taking steps to define the actions required to clean up this project, but objects to the suggestion that the specific actions proposed in this recommendation are necessarily appropriate elements in a coherent clean-up plan. Further, it is pointless to tie this clean-up to drawdowns when the problems are largely beyond the control of NHC. Therefore, this recommendation should be revised accordingly."

AAG Response:

Although almost three months have passed since the conditions in Nanyuki were first made known in writing by an AAG memorandum to the RHUDO, we have been advised that no RHUDO officials from among the three direct-hire American, one Kenyan and one personal services contract professional employees in that office have verified conditions at this project site - an easy one-day round trip by car from Nairobi. This situation confirms our view (noted elsewhere) that the RHUDO is overly preoccupied with program development with not enough time devoted to the problems of implementation. We would therefore hope that the improvements to be made "in some towns" will include hooking-up electricity for 26 Nanyuki families who have been without power for almost two and one-half years "while steps are being taken to define actions required to clean up this project." As to the issue of linking corrective action to drawdowns, we reiterate our view that it is the entire GOK which guaranties repayment of the dollar loan and benefits from it. Given the lack of attention thus far to the serious conditions affecting the Nanyuki project, we see such linkage as a last resort in drawing attention to Project 004's deficiencies. Thus, the recommendation has been retained as originally presented.

Recommendation No. 8

RHUDO/E&SA, in conjunction with USAID/ Kenya, include in the proposed 615-HG-006 loan Implementation Agreement a covenant whereby National Housing Corporation of Kenya agrees to obtain an undertaking from

local authorities participating in that project that normal maintenance services will be provided after the HG units are occupied.

In response to our draft report, the auditees stated:

"RECOMMENDATION 8: The Local Government Act and the Landlord Tenant Act require all municipalities to provide public services and maintain their housing stock. However, the provision of such public services and maintenance is inhibited throughout the world by lack of funds. Rapid growth of the urban sector, very limited taxing capabilities and high inflation have even left New York City and Washington far behind in this area. Nevertheless, it is a long-term goal of AID's shelter programs to improve urban communities in this area through technical assistance inputs.

"Deficiencies in local authority funds, staffing or practices cannot be remedied merely by signing a covenant. Constituency pressures on local government, plus GOK support accompanied by an infusion of AID technical assistance may help, but this is a long term problem. Therefore, this recommendation is superfluous and would be offensive to the GOK and should be stricken."

AAG Response:

In the previous comment the reader will recall seeing the following opening statement: "As incomes of local authorities increase and other basic needs of tenants are met, it is reasonable to expect improvement in both public and private grounds maintenance." This comment and the one to Recommendation No. 8 appear to directly contradict one another.

A simple and unoffensive solution to the problem could be achieved by merely adding such an undertaking to the NHC's form of loan agreement with local authorities. We do not, in any event, view a formal commitment to post-occupancy maintenance as superfluous given the record under projects 615-HG-003/004 to date, and are therefore retaining our recommendation as we did in our prior report on the Umoja Housing Estate. In response to that recommendation we would recall that RHUDO stated:

> ". . . we feel that AID should seek full cost recovery and not suggest burdening the General Fund. Therefore, we will insist that Nairobi City Council determine its total cost of services to Umoja Estate and charge enough to cover these costs."

How, we would inquire, was this to be accomplished if not by a specific Implementation Agreement provision?

Post-Occupancy Financial Management

In addition to the problem of unacceptably high home loan repayment arrearages described in an earlier section, we noted a number of financial anomalies during our visits to participating local authorities. The discovery of these financial management deficiencies indicates a need for NHC and AID follow-up and inspection if local authorities are to benefit from their participation in project 615-HG-004.

Local Collection and Accounting Procedures

As noted earlier in this report, local authorities to whom audit visits were made generally had not adopted an aggressive collections policy in pursuit of delinquent loan repayments. Home loan payments are uniformly made at the town hall cashier's office against a numbered receipt. The amount of payments together with their corresponding receipt numbers are then posted to a general ledger maintained for HG funded projects by each town. Our site visits disclosed that summaries and analyses of these ledgers are only infrequently made, in most cases at the end of the accounting period.

Bookkeeping Errors Noted

In Nakuru we noted that, although a substantial number of units had been occupied since September 1979, all payments made by buyers prior to January 1980 were carried as "advance payments" for reasons best known to the Town Treasurer. In Kericho, where one unit was paid for in cash, the monthly sub-project billing total was not reduced to reflect the cancellation of this debt. A transposition of numbers during two months in 1979 had substantially understated the loan receivable amount due the town. There was no indication of higher level review of subproject ledger amounts in order to correct errors.

Incomplete Tenant Purchase Agreements

In two towns we noted that the space on the form of Tenant Purchase Agreement, where the number of monthly loan repayments was to be filled in, had been left blank, although the agreements had otherwise been completed and executed by the towns and the buyers. In one of these towns officials stated they were uncertain whether the term of the loan was for 20 to 26 years, or if the interest rate to the buyers was 9% or 10%. NHC officials advised us that they had noted this deficiency, and were in the process of returning the agreements to the towns for completion.

Debt Repayment to NHC

Although eight subprojects had been occupied by residents for periods of from six to 27 months at the time of our review, NHC financial records disclosed that only five loan agreements with participating town councils had been executed. We were prevented from verifying the repayment records of the five towns making HG loan repayments because we were advised that NHC subsidiary records had not been reconciled with the general ledger since the last audit by the GOK Controller/Auditor General in 1976. In at least one instance, a comparison of NHC records with those found at one participating town showed that the amount reported as due on NHC records was substantially less than the amount NHC had communicated to that particular council. The council had not made any payments to NHC although two had been owing for six and three months, respectively, at the time of our visit.

Overcharges

Two kinds of overcharges were detected during our review; both are borne by the homebuyers. In two towns, local officials either had not seen or had ignored NHC's computation of monthly principal and interest charges to be paid by buyers, and had proceeded to compute these payment amounts themselves with the following results.

Town	Actual vs. AAG-Computed Charges Per Month by Unit Size[1/]	
	(1 Room)	(2 Rooms)
Kericho	$41 vs. $36	$52 vs. $46
Kitale	$46 vs. 35	$60 vs. $45

The second type of overcharge lies with the NHC's computation of monthly charges to be used by participating towns in collecting home loan principal and interest payments from buyers. NHC officials acknowledged to us that in calculating this charge they made use of a quarterly loan amortization table, per Commonwealth practice. Nevertheless, the Tenant Purchase Agreements signed by the homebuyers speak only of "equal monthly installments of principal and interest combined." The effect of NHC's computation, when compared with a monthly amortization table over the 26-year life of these loans, is to overcharge buyers by about 1-1/2 monthly payments. NHC officials indicated that they were willing to modify their method of loan payment computation for HG funded units, and had already taken steps to rectify the overcharges being made by the two towns which are shown in the foregoing table.

1/ Rounded to the nearest whole dollar @ U.S.$1.00 = KShs. 7.5.

Outreach Needed

It is obvious from the above described conditions that more must be done by both RHUDO/E&SA and NHC to assist towns to protect their own and their residents' financial interests under project 615-HG-004 and the proposed follow-on HG loan project. Again, we feel that a significant communications gap between AID, NHC and local officials has been allowed to open in respect to financial management of HG funded sub-projects. That this situation must be addressed now is made clear in a recently issued audit report on all of Kenya's local authorities by the GOK Controller/Auditor General. According to excerpts which appeared in local newspapers in May of this year, the report disclosed the following areas of financial mismanagement:

- "Serious weaknesses in financial control, particularly inadequate internal control and supervision over receipts and expenditure."

- "Incomplete, or poorly maintained, records relating to accountable documents and tax control of receipt books."

- "Poorly maintained subsidiary revenue and other records such as registers relating to plot rents, rates and private telephone trunk calls, stores ledgers, inventories, vehicle work-tickets and petrol records."

It is consequently obvious that the financial management deficiencies revealed by our own site visits are merely sympotomatic of a more generalized condition nationwide in Kenya. The effects of this situation leave responsible local managers without the necessary information upon which to base budgetary planning and decision-making, compound local authorities' already serious cash flow positions, and adversely affect the provision of services generally, to which housing and housing project management are no exceptions.

Conclusion

In the words of the GOK Controller/Auditor General, as quoted in the local press, when commenting on his recent report on financial management by Kenya's country, town, municipal and city councils:

> "The situation clearly calls for a drastic and far-reaching review and a strengthening of local authorities' financial administration."

Recommendation No. 9

Prior to authorizing any further disbursements from escrow under project 615-HG-004, RHUDO/E&SA, in conjunction with USAID/Kenya, coordinate with NHC and such other GOK agencies as it deems appropriate to make joint inspection visits to town councils participating in the project to ensure that adequate financial management practices are being followed for each sub-project including, but not limited to, accounting for collections from homebuyers and remittances to NHC.

In response to our draft report, the auditees stated:

"RECOMMENDATION 9: Local authority financial administration reform is the subject of potentially extensive technical assistance and is part of the overall development effort which AID is assisting through the Housing Guaranty Program. The financial problems of Kenya's secondary towns are not unique, nor are the situations mentioned in the Draft Audit Report. These local authority problems are completely beyond the purview of NHC, and the suggested position would be completely inconsistent with our analysis of, and overall approach to this long term problem. This recommendation, if it is followed, would impair relations with NHC and would not contribute to a solution of the problem. In sum, it would be counter-productive and should be stricken."

AAG Response:

We seriously doubt that participation in a round of inspection visits having as its object a review of part of its own portfolio is beyond "the purview of NHC." Certainly prudent management practices, in our view, would counsel that both AID and responsible GOK officials verify the findings of our report as regards post-occupancy financial and physical project management. As we have been advised that no firm date has been set for a final drawdown from escrow under this project, time would not seem to be a crucial factor in arranging such visitations. We are therefore retaining the recommendation as originally presented.

Sub-Projects Not Insured

Four out of five subprojects visited and occupied under loan 615-HG-004 were found to be uninsured. Given the somewhat precarious financial situation of most local authorities visited, the assumption of risk against casualty and catastrophic loss implied by their failure to insure HG-funded units is considered to be ill-advised.

Administrative Oversight

In four of the five towns visited where HG funded units had been occupied for some time, officials advised us no provision had been made to insure these units against either casualty loss or death of the tenant-purchaser ("mortgage life insurance"). The same officials advised us that they agreed insuring housing units was in accordance with good commercial practice, and that it was customary for them to contract for such coverage. But because of apparent administrative oversights in each case, this had not been done in the case of HG-funded units.

Insurance Not Required

In our own view, such oversights came about partly because no requirement to contract for insurance coverage is contained in either the project 615-HG-004 Implementation Agreement or the form of NHC loan agreement which appears at Exhibit B. Furthermore, although the Tenant Purchase Agreement insurance provisions contained in paragraph 7(d) do not limit the type of coverage available in any way, they are optional and not mandatory:

> "7(d) That at all times during the continuance of this Agreement the Council may in its own or some other agency and at the expense of the Purchaser insure and keep insured for such amounts in such names and with such insurers as the Council may from time to time select any buildings or any effects or property of an insurable nature (whether affixed to the freehold or leasehold or not) being or forming part of the said Premises;
>
> (i) against loss or damage by fire and
>
> (ii) against such other risks as the Council may from time to time think expedient.
>
> AND that the monies which may become due on claims in respect of such insurance shall at the option of the Council be applied either in or towards the satisfaction of the principal interest accrued and all other moneys due under this Agreement or in rebuilding or reinstating the Premises destroyed or damaged;"

Potentially Serious Effects

We hardly find it necessary to point out the benefits of adequate insurance coverage, especially when the cost of this protection may be passed on to the purchasers of units at reduced group premium rates. We would only note here the liability that town councils implicitly assume when they fail to contract for adequate insurance coverage is made all the more serious by the dire financial straits in which most local authorities in Kenya currently find themselves. They are simply not in a position to financially absorb any form of substantial loss, which should be of concern to their HG loan creditor, the National Housing Corporation.

Conclusion

The failure by several town councils visited to contract for adequate insurance coverage of HG funded sub-projects is attributable to local neglect and the absence of any requirement to do so under project 615-HG-004. It would appear to be in the best interests of the NHC to urge participating local councils to contract for this coverage without delay.

Recommendation No. 10

RHUDO/E&SA, in conjunction with USAID/ Kenya, (a) amend the project 615-HG-004 Implementation Agreement to include a requirement that HG funded units be covered by fire and casualty insurance with either the NHC or the local authority as beneficiary; (b) request NHC to amend its form of tenant purchase and loan agreements under this and follow-on projects to require such coverage at a minimum, and (c) request NHC to urge participating local authorities to contract for adequate insurance coverage of already occupied HG-funded units without delay.

In response to our draft report, the auditees stated:

> "RECOMMENDATION 10: We accept the intent of this recommendation and will take steps to ensure that such insurance is obtained where it is practical. However, we reserve judgment as to the specific documentation required to secure compliance, and we recognize that such insurance may not be available on reasonable terms for all sub-projects. Therefore, this recommendation should be revised accordingly."

AAG Response:

We recall at this point that the cause for the deficiency in this case is administrative oversight, not unavailability or unaffordability. All officials interviewed stated it was their practice to insure council-managed houses. In the one case where the AID assisted sub-project had been insured (Eldoret), repayment delinquency was only 6%, the lowest arrears among all towns surveyed. Thus, we conclude that the cost of this coverage is not prohibitive. We are therefore retaining the recommendation as drafted.

Absence of Publicity

The majority of residents, because they are renters, are unaware of AID's financial assistance to their subproject. None of the eight project sites inhabited to date had been formally inaugurated, nor had an opening ceremony been held with U.S. Government officials present. An opportunity to enhance the image of the United States and foster greater Kenyan-American goodwill and understanding in provincial centers has consequently been lost.

A.I.D.'s Contribution Not Disseminated

As was made clear in the third finding section of this report, a large majority of project residents interviewed were subtenants. These people were surprised to learn that A.I.D. had financed their housing units; none had spoken to a U.S. official previous to our audit visit. Local officials advised us further that no ceremony of any kind had accompanied the opening of these projects for residency.

Administrative Oversight

RHUDO/E&SA officials acknowledged that, in contrast to its companion project (Umoja Housing Estate in Nairobi), no ceremonies had ever been organized to inaugurate A.I.D. sponsored housing projects in the provinces; but could offer no good reason why this lapse had occurred. NHC officials advised us that such ceremonies were not customary, but that they would gladly organize project inaugurations at A.I.D.'s request. Such ceremonies, it was further acknowledged, would enhance NHC's own image which has suffered of late from frequent criticism in the local press. Finally, the then Charge' d'Affaires, U.S. Embassy, who had been in Nairobi for three years, stated he could not recall being briefed on this project (again in contrast to its Nairobi companion project), and agreed that such ceremonies would be beneficial to the U.S. image in Kenya.

Conclusion

The Kenyan public has not been made adequately aware of AID's contribution to shelter needs in provincial centers. Consequently, substantial goodwill and understanding which might have been generated by this $5 million HG loan project has been lost.

Recommendation No. 11

RHUDO/E&SA, in conjunction with USAID/Kenya, coordinate with NHC and the U.S. Embassy to organize project opening ceremonies, as appropriate, at the remaining sites to be inhabited under 615-HG-004, and for all future site inaugurations in Kenya.

In response to our draft report, the auditees stated:

> "RECOMMENDATION 11: We agree with the intent of this recommendation but reserve judgment as to the best form of publicity in each case. It is general Mission policy to achieve publicity. We have been talking to ICA and Embassy officials about future publicity for AID shelter projects. However, the final decision in each case rests with the Country Team."

AAG Response:

We deem the recommendation to be accepted by management in its present form, and are annotating our records to show this recommendation is closed.

Unit Allocations

Project 615-HG-004 has not generally served the shelter needs of below-median-income families, as intended. AID's reliance on faulty income data gathered by a consultant employed to develop income eligibility criteria was the main cause of this failure to meet one of the project's principal objectives. Additionally, some local authorities refused to observe even the erroneously high income statistics developed by the consultant, and unilaterally raised their income eligibility criteria even further, especially for two-room units.

Results of Site Visits

Original homebuyer application forms were available to us at only two of the total of seven town council offices visited. A total of 30 applications (10%) were selected at random and surveyed with the following results:

- In two cases persons who declared family incomes above AID/NHC eligibility limits were allocated units.

- Eight applications were not accompanied by an employer salary certification.

- One application appeared to have been altered to eliminate the salary of one spouse.

- Among the successful applicants we noted a substantial number of teachers and civil servants, many of whom enjoy a GOK provided house or housing allowance.

In addition, local officials uniformly stated that AID's determination of median income eligibility as regards two-room units (about two-thirds of the total number built or to be completed) far exceeded what was locally considered to be median family income when this criterion was adopted about three years ago, and remains high to this day. Despite the overly high income limit set for two-room units, in at least two cases, local officials unilaterally agreed to raise the upper income eligibility criterion by another 25% (from about $200 to $250 per month).

Faulty Data Base

According to the findings of the DS/H funded Kenya Shelter Sector Study Report of 1979:

> "No specific studies of incomes, costs or rent propensities were commissioned by either the NHC or AID for any of the 12 towns in the NHC project. The method agreed to and adopted by both parties was to use (the RHUDO/E&SA commissioned) Real Estate Research Corporation's study of Nairobi household income distribution (performed to determine income eligibility criteria for companion project 615-HG-003, Umoja Estate) and to trend the material accordingly for the more rural towns. A surprising development was that data obtained from the Central Bureau of Statistics apparently demonstrated that the median income for these rural towns (such as Nanyuki) was "equivalent" to that of Nairobi! The income data was therefore not trended downwards at all.

"In accordance with this formula, NHC wrote the following to AID in February, 1977 setting forth the Nanyuki result:

> 'In accordance with the household income distribution in Nairobi as set out in the Study prepared by the Real Estate Research Department, the 50th percentile income for Nairobi is Shs. 1,555/- per month[1/] for 1976, and we agreed that we could use a similar figure for Nanyuki.'"

Study Findings Not Verified

RHUDO/E&SA officials admitted to us that the income eligibility criteria which emerged from the study referred to above were seriously in error. They also stated that the limits were set by the consultants, and accepted by RHUDO, in good faith -- their faultiness having been determined by subsequent, more reliable studies. While we have no cause to doubt the veracity of these statements, it would not seem unreasonable, in our view, to have expected RHUDO and/or NHC to verify these income limits with local officials prior to adopting them. However, this apparently was not done. Had such verification taken place, the following information, excerpted from the 1979 trip report of a RHUDO Foreign Service National (Kenyan) employee who traveled to Nanyuki, would undoubtedly have come to light:

> "Income distribution for the town has been assumed to be:
>
> High income group (5 percent of population) earns over ($250 per month).
>
> Medium income group (20 percent of population) earns between ($75-$250 per month).
>
> Low income group (75 percent of population) earns less than ($75 per month)."

The source of this data was the Nanyuki Development Plan 1977-1992 issued in November 1977.

After RHUDO officials became aware of the erroneous nature of their originally adopted income eligibility data, they made no effort to correct the project's upper income limits.

1/ about $200.

Incomplete Units Affordable?

Assuming sales prices remain as currently approved, monthly principal interest payments for two-room units remaining to be completed may be computed as follows:

	Meru	Kisumu	Mombasa
Sales Price	$6,400	$7,133	$8,800
Less 10% Down	640	713	880
Loan Balance @ 10% for 26 years	$5,760	$6,420	$7,920
Monthly Payment @ $9.01 per thousand	$51.90	$57.84	$71.36

The total number of incomplete two-room units at these three sub-project sites is 218, or 28% of the total of all units to be built under the project. RHUDO officials have advised us that they plan to accept these units as eligible for housing guaranty loan funding. Using 25% of family income as a benchmark for monthly housing costs, we believe these units will be affordable to upper income families only in each town.

Conclusions

Project 615-HG-004 generally failed to meet the shelter needs of below-median-income families in the towns where sub-project sites are located. Income eligibility criteria, based on faulty data, were set too high; in addition to which some local authorities ignored these limits and set even higher limits without AID or NHC approval. When the high incidence of subletting described in the third finding section of this report is taken into account, it is clear to us that this project -- designed to meet the shelter needs of lower income families -- has in effect become a middle and upper-middle income rental scheme. Units remaining to be completed under this project, based on our projection of monthly principal and interest loan repayments, would appear to be affordable by upper income families only. Their eligibility for HG loan funding under this project is therefore questionable.

Recommendation No. 12

RHUDO/E&SA, in conjunction with USAID/ Kenya, justify the eligibility for funding of two-room units remaining to be completed under project 615-HG-004 prior to approving any further disbursements from escrow to the National Housing Corporation of Kenya.

In response to our draft report, the auditees stated:

"RECOMMENDATION 12: This recommendation is apparently based on the present program limitations regarding participant income levels. Since the "New Directions" legislation was enacted on December 20, 1975, and not made retroactive, it is not applicable to this project 004 authorized on June 28, 1974. Therefore, the 90 percent rule has no applicability to this project and the recommendation should be stricken.

"In addition, RHUDO has taken continuous steps to hold down the costs on this project and make the units affordable. Early in 1980 RHUDO notified the borrower that it would be necessary to delete from the HG program the highest cost sub-program in Mombasa. This section was carried out. Also, in Meru, a price freeze was negotiated so that any further increases in project cost will not be borne by the allottees."

AAG Response:

The recommendation is based on the fact that participant income limitations bear no relationship to the below-median-income target group the project sought to serve. The report text explains how this came about and how the RHUDO has taken no action to correct the situation since it became aware that the data used as a basis for setting participant income limits was seriously in error. The situation is compounded by the fact that a large majority of the units have been sublet to families able to afford monthly rentals of from two to three times the monthly loan payment.

As to the technical argument regarding "New Directions" legislation, we would point out that AID Policy Determination No. 55, revised October 22, 1974, states, in part:

> "To the extent possible, AID shelter resources -- grants, loans, and guaranties -- will be invested in projects either directly benefiting low income groups (i.e., the poorer half of a given country or city urban population), or indirectly benefiting such groups through the development of national housing policy and housing institutions."

As a copy of the prior Policy Determination is not available in Nairobi, we are unable to judge how the predecessor determination might have affected this project. Clearly, however, the "New Directions" spirit pervades both the project paper and the above Policy Determination.

As to the elimination of the Kisauni site in Mombasa, we understand that this was done because funds would not be available under the $5 million HG loan to cover this project. We understand the case of Meru to be one where NHC has assumed responsibility for the multiple errors described in the body of this report having to do with site boundaries. Although it seems clear that RHUDO has demonstrated concern over the rise in unit prices, it is equally clear that it has not been very successful in holding prices down. However, the point of our recommendation, which we are retaining, has to do with the affordability, and not the cost per se, of incomplete two-room units.

Attainment of HG Country Program Objectives

Although progress has been made in persuading the Government of Kenya to focus greater attention on serving the shelter needs of its lower income inhabitants, the GOK has not adopted a formal housing policy to this effect. The experience of project 615-HG-004 has pointed up rather than corrected the weaknesses and inefficiencies of national and local housing delivery systems. Thus, while much has been learned from the shortfalls in meeting this project's objectives, much more remains to be done, in our opinion, before AID and NHC can hope to successfully implement a large, proposed, scattered-site, follow-on project.

Specific Project Objectives Not Met

The preceding sections of this report have shown that, although more than 900 housing units may eventually be produced as a result of project 615-HG-004, this total falls far short of the number planned, and far

short of the production efficiency achieved under companion project 615-HG-003, Umoja Estate, Nairobi. What is more, whereas prices were held more or less to planned levels in Umoja, inflation, implementation inefficiencies and inter-agency dysfunctions have increased unit prices under the NHC project to the point that many units were and are not affordable by the below-median-income project target group. The record of unacceptably high accumulations of home loan repayment arrearages certainly postpones, and possibly calls into question, attainment of the project's cost recovery objective. Adoption by AID and NHC of unverified income eligibility limits recommended by a RHUDO consultant in 1976, compounded by the wholesale subletting of HG funded units, in our view, obviates any claim that the project generally served the shelter needs of below-median-income families in the towns participating in the project. Consequently, we agree with the conclusion arrived at by the authors of the Kenya Shelter Sector Study Report to the effect " . . . the team supports the view that objectives of project 004 on the whole were not achieved."

Shelter Sector Goals Remain Distant

More serious, perhaps, than this result are the results of our analysis of AID's impact on the Kenyan shelter sector. Under both projects 615-HG-003 (Umoja Estate) and 004 (NHC), the deficiencies of the GOK Borrower/Administrator have proven to be even more critical than the problems encountered in the physical implementation of the projects. Worse yet, the inability or unwillingness of local authorities to make any meaningful attempt to honor the terms and conditions contained in project Tenant Purchase Agreements through:

(a) the adoption of effective collections procedures;

(b) the enforcement of prohibitions on total unit subletting;

(c) taking steps to keep projects reasonably well maintained and adequately insured; and

(d) generally following accepted financial management and commercial practices that would protect their own and local citizens' interests;

do not auger well, in our view, for the successful implementation of any future projects. Finally, although the GOK has assumed a posture much more favorable to serving the shelter needs of its lower income citizens, it has yet to adopt a formal housing policy in this sense, much less provide for the development of an adequate institutional base from which shelter services can be delivered.

Three Main Causes

The National Housing Corporation of Kenya: As part of the description of the scope of this report we noted that it was not our purpose to make an organizational assessment of NHC because this task had already been funded by the World Bank under its Kenya Urban II project as part of preparations for the follow-on Urban III effort. Unfortunately, we are not able to report on any of the consultant's findings and recommendations because this study has only just gotten underway after an 18-month delay caused by political factors which fall outside the purview of this report. The 1979 Kenya Shelter Sector Study Report does, however, make a number of pertinent observations on NHC, as follows:

> "NHC has been lending for projects all over the country for a long time but it may be that for this project, NHC was too much involved. If NHC in the future is to administer large numbers of projects it has to find a way of reducing its administrative burdens by delegating more responsibility to the local councils. This overburden on the NHC seems to be the underlying reason for the conclusion of a consultant for the U.S. National Savings and Loan League who placed responsibility for the delay on the NHC:
>
> > 'The NHC seems to have continuous difficulties with keeping the project costs and unit selling prices within the income range of the target population. . . .NHC seems to readily accept the events as they come without making any effort to change them to the benefit of the program.'
>
> "The NHC had great difficulty managing a scattered site project; yet surely in their second decade of existence, the NHC should have been aware of potential problems from previous experience.
>
> "In Malindi there was such total sales resistance that the project was withdrawn from the AID package and converted into a rental scheme. Here NHC was also competing with itself - a sizeable site and service scheme was opened almost simultaneously with the tenant purchase site."
>
> > (At this point we would interject that most town officials we spoke with -- strapped as they are for funds -- prefer to develop rental housing because of its income-producing characteristics. Their relative lack of interest in Tenant Purchase schemes derives from the fact that they produce little income.)
>
> "It was the Central Government (the Treasury) which had designated the NHC as the lender [Borrower/Administrator] for this portion of the Kenya Housing Guaranty Program. Corrective measures therefore, should stem also from the Central Government."

Indeed, GOK intervention seems essential to bringing some order to NHC's affairs. We were advised by the NHC's Deputy General Manager for financial matters that he had been unable to fill several vacancies in his departmentfor almost six months due to an unfortunate political impasse. In effect, NHC has been unable to function as a corporate body since January 1980 when a new Chairman of its Board of Directors was appointed by the GOK. As it happened, however, the outgoing Chairman, the Permanent Secretary in the then Ministry of Housing and Social Services, is a board member ex officio by virtue of the terms of the National Housing Act. NHC has consequently been left with one too many Board members -- a situation that has persisted to this writing and appears to defy resolution.

In 1979, a consultant funded by DS/H made the following assessment of NHC:

> ". . . given the problems the NHC has and is experiencing in implementing the HG program, the anticipated NHC growth over the next two years could be painful unless methods are developed to expand the NHC capacity to deliver shelter on a nationwide basis.
>
> "One major possibility for achieving this capacity is to decentralize NHC operations through the establishment of a branch office network throughout the provinces of Kenya. In this way, each office would devote its full attention to just the programs in its assigned area. This would facilitate communications with municipalities, facilitate and thus improve construction supervision and implementation, and strengthen the NHC presence in its customer areas and thus improve delinquency control."

More than one year later, NHC has not acted upon this suggestion.

Local Authorities: Mention has already been made in the preceding sections of the perceived deficiencies of local government bodies in Kenya relating to subproject post-occupancy and financial management. The Kenya Shelter Sector Study Report cited above makes the following observations about the participation of local authorities in project 615-HG-004.

> "Even though Kenyan municipalities (other than Nairobi) are prohibited from entering into direct borrowing obligations with foreign agencies without the consent of the Treasury, it seems that their assent to the terms of the Implementation Agreement could have been secured simultaneously with its execution by the NHC and USAID. As it was, no such agreement had been obtained until some years after the project officially began. Immediate involvement of the local authorities in some capacity would have been helpful.

"This general problem of involving the local authorities in the formulation and implementation of national housing policy has recently been discussed in a Ministry of Housing & Social Services publication (Preliminary Report: Kenya Urban Housing Needs and Demand Study, 1978). Some conclusions from this report follow:

> 'It appears that housing policy is formulated from the top (i.e. the Ministry of Housing plus the National Housing Corporation) without referring to the local authorities.
>
> 'There is a lack of communication between the Ministry and the local authorities concerning housing issues.
>
> 'It was obvious. . . that some local authorities were not very conversant with what housing involved and therefore neglected it. Only the revenue collection from housing was important.

"The problem, therefore, of improving NHC/local authority coordination is much broader than that seen in this project. It is recommended, therefore, that this aspect of 'institution building' be promoted and advanced by any future USAID project with local authorities if the basic agreements are handled through a central government agency."

Here again, we find a series of observations which confirm our own findings and observations -- little appears to have changed since they were put to paper two years ago.

While we find ourselves in strong agreement with the recommendation contained in the last paragraph quoted above, we have been advised by a reliable NHC source that the weakness of local authorities in Kenya is not a matter of happenstance. Ever since independence in 1963, the powers and revenue bases of regional and local government bodies in Kenya have been eroded by the actions of the central government to the point where local authorities are now entirely dependent on the central government for financing their operations. The reasons behind this centralization of power and resources by the central government result from tribal and political factors which, again, fall outside the purview of this report. Nevertheless, this state of affairs cannot be ignored in the preparation of an implementation plan for the proposed follow-on project.

AID Project Management: During the course of our reviews of AID projects 615-HG-003 and 004 we have come to appreciate not only the professional skills and abilities of RHUDO/E&SA staff (and the support they receive from USAID/Kenya), but also the cooperative attitude they have displayed toward our audit efforts. It has been our impression,

formed as a result of an association with the personnel of this office over the past six months, however, that far too much of their time is taken up with the exigencies of new program development in their East and Southern Africa area of responsibility, and far too little left to adequately monitor and take a needed strong hand in project implementation. The fact that we were the first AID officials any project residents and many local officials concerned with this project had ever spoken with after five years of project implementation, strengthens our impressions on this score, although RHUDO staff quite readily agreed with our assessment. While it may be true that an emphasis on program development is fairly generalized within AID, at the expense of concern with project implementation, such a rationalization will neither resolve the problems of project 615-HG-004 nor can it improve AID's image which, in our view, has not fared well in the management of this project.

Conclusions

Project 615-HG-004, National Housing Corporation of Kenya, has fallen far short of meeting its proposed objectives. Although the GOK has, over the period of this project's implementation since 1975, assumed a posture much more favorable to serving the shelter needs of its lower income citizens, it has not adopted a formal housing policy to this effect. Much remains to be done to bring the delivery of housing services and the capacity of institutions involved in the delivery of those services at the national and local levels up to acceptable standards so as to merit further AID/HG financial support.

Recommendation No. 13

AA/AFR, in her capacity as Chairperson, Housing Guaranty Review Committee for Africa, through the Office of Development Resources (AFR/DR), formally advise the Office of Housing (DS/H) and USAID/Kenya that the issuance of further housing guaranty authority to Kenya shall be contingent upon the prior implementation by both AID and the GOK of effective measures designed to address the deficiencies described in this report and in Audit Report No. 3-615-80-19.

In response to our draft report, the auditees stated:

RECOMMENDATION 13: There is nothing startling about the identified deficiencies in project 004. The institutional problems identified are common to municipalities worldwide; a long term goal of the Housing Guaranty Program is to alleviate these problems through a planned schedule of technical assistance and training.

Institutional change does not come about quickly nor is it aided by an interruption in communications. The Office of Housing and USAID/Kenya are beginning to provide significant assistance to involved central government ministries and parastatals. The value of this assistance is increased with renewed contacts for additional programs. Interfering with the planned schedule of Kenya Housing Guaranty Projects will substantially slow down and hinder the efforts already underway. Far from aiding the existing HG-004 project, prohibiting the planned follow-on program would have significant detrimental effects.

The long term institutional strengthening and change will only be accomplished through an equally long term AID interaction. Interfering with this process through the untimely blocking of an innovative shelter and community facilities program for smaller towns would be a major mistake.

The considerable technical assistance built into the proposed project will focus on institution building at the central and local levels. The resources made available under the proposed project will supplement those available from GOK and go a long way towards assisting Kenyans to address their shelter sector problems. For these reasons, we believe the recommendation as stated is unsound and contrary to progressive development practice, and should be stricken.

AAG Response:

The foregoing comments appear to be a restatement of the auditees' views expressed earlier (see page iv to viii of the Executive Summary). The reader will note that our last recommendation is directed to the agency's Assistant Administrator for Africa, or her designee in the matter of authorizing housing guaranty authority for Kenya. Presumably, these officials are quite able to come to their own conclusions about the advisability of proceeding with further HG projects in Kenya at this time, or whether to postpone issuance of such authority until such time as they are satisfied that the RHUDO, in conjunction with USAID/Kenya, has made sufficient efforts to address the deficiencies described in this and our recent companion report (3-615-80-19) on housing guaranty activities in Kenya.

In conclusion, we would also point out that the GOK has yet to take effective measures to correct the serious irregularities mentioned in our companion report (3-615-80-19) on Umoja Housing Estate, Nairobi. This situation continues to

see high GOK officials retaining non-HG funded plots on the project site, while those entitled to this land have yet to learn what will become of their claims to the plots and the deposits paid for them. The Embassy has sent an Aide Memoire to the GOK on this matter but the foregoing conditions persist. Should AID support the GOK with additional housing guaranty loan authority until and unless this matter has been resolved? We leave this issue for agency policy makers to resolve, while retaining our recommendation as drafted.

BEST AVAILABLE DOCUMENT

National Housing Corporation

TENANT PURCHASE AGREEMENT

AN AGREEMENT made the..... day of .....

One thousand nine hundred and.....BETWEEN

.....

a local authority constituted in accordance with the Local Government Regulations 1963 (hereinafter called "the Council" which expression where the context so admits shall include its successors and assigns)

of the one part and.....

of .....

(hereinafter called "the Purchaser" which expression where the context so admits shall include his personal representatives heirs and assigns) of the other part.

WHERE IT IS AGREED as follows:—

1. The Council will sell and the Purchaser will purchase free from encumbrances ALL THAT leasehold parcel of land situated in the.....

and containing .....

or thereabouts known as.....

being the Premises comprised in a lease registered in the Land Registry at.....

as Title No..... TOGETHER WITH the buildings and improvements erected and being thereon (hereinafter called the Premises") for the residue of a term of.....

years from the..... day of.....19..... at an annual rent of Shillings ..... SUBJECT to the convenants and conditions set out in the said lease.

2. The purchase price of the Premises shall be shillings .....

.....

(Shs.....) which shall be paid by the Purchaser to the Council as follows:—

(a) The sum of Shillings.....

(Shs.....) by way of deposit and part payment of the purchase price shall be paid on or before the execution of this Agreement (receipt whereof is hereby acknowledged by the Council);

(b) The balance of the purchase price amounting to Shillings.....

.....

(Shs.....) together with interest on the amount of such balance for the time being remaining unpaid at the rate of..... per cent per annum shall be paid by..... equal monthly instalments of principal and interest combined the amount of which shall be shillings.....

(Shs.....) each to be paid on the first day of every calendar month the first such payment to be made on the.....day of .....

.....One thousand nine hundred and.....

..... thereafter until the whole balance owing shall have been paid.

PROVIDED THAT:

on any of the aforesaid days the Purchaser after giving three months' notice in writing to the Council or on payment of three months' interest in lieu thereof may tender payment of the whole or part of the balance then outstanding being a minimum sum of one thousand shillings (Shs. 1,000/-) or multiple thereof.

(c) If default shall be made in payment of any of the instalments of principal and interest mentioned in Clause 2(b) above for fourteen days after the same shall have become due and payable then the whole of the purchase price or the balance thereof remaining unpaid together with the interest thereon as aforesaid shall forthwith become payable and be paid by the Purchaser to the Council on demand; but so that interest at the rate aforesaid shall continue to accrue until the actual date of payment of the principal.

(d) If the Purchaser shall sublet the whole or prt of the Premises, the amount of each monthly instalment thereafter due shall be increased by a surcharge equal to ten per cent thereof during the period of such subletting.

3. Upon payment of all sums under Clause 2 above and all other sums due under this Agreement the Council will execute a transfer of all its right title and interest in and to the Premises hereby agreed to be sold, to the Purchaser or as the Purchaser may direct.

4. So soon as this Agreement has been executed and the Purchaser shall have paid the said deposit he shall be let into possession of the premises and shall thereafter be responsible for and shall discharge all outgoings of whatsoever kind in respect of the Premises whether payable by an owner or by an occupier or otherwise howsoever. Upon a default by the Purchaser in discharging any such outgoings, the Council may discharge them and add all amounts so expended to the purchase price and/or recover the same as a debt due from the Purchaser.

5. The Council sells the property as beneficial owner.

6. The Purchaser having been afforded an opportunity of examining the property shall be deemed to have full notice and knowledge of the nature and extent of the same including the proper position of the beacons (if any) which are or may later be established on the Premises and the Purchaser shall be required to sign a beacon indemnity certificate.

7. Until the transfer of the Premises in accordance with Clause 3 hereof has been completed the Purchaser hereby covenants with the Council as follows:-

(a) To reside in the Premises.

(b) Not to sell or assign the Premises or any part thereof and not to sublet the whole of the Premises during the first five years of this Agreement;

(c) Notwithstanding Clause (b) above not to sell assign sublet charge or part with the possession of the Premises or any part thereof at any time during the period of this Agreement without the prior written consent of the Council first being obtained which consent shall not be unreasonably withheld; PROVIDED THAT if the Purchaser has sold or assigned the Premises as aforesaid he shall be required to pay forthwith the balance outstanding of the purchase price accrued interest and all other monies due under this Agreement;

(d) That at all times during the continuance of this Agreement the Council may in its own or some other agency and at the expense of the Purchaser insure and keep insured for such amounts in such names and with such insurers as the Council may from time to time select any buildings or any effects or property of an insurable nature (whether affixed to the freehold or leasehold or not) being or forming part of the said Premises:

(i) against loss or damage by fire and

(ii) against such other risks as the Council may from time to time think expedient.

AND that the monies which may become due on claims in respect of such insurance shall at the option of the Council be applied either in or towards the satisfaction of the principal interest accrued and all other moneys due under this Agreement or in rebuilding or reinstating the Premises destroyed or damaged;

(e) To maintain the Premises in good substantial repair and condition and to permit the Council its representatives or agents with or without workmen and appliances to enter upon and view the conditions of the Premises and to give or leave on the Premises 21 days notice in writing to the Purchaser of all defects and want of reparation then and there found which the Purchaser shall be liable to make good. If the Purchaser shall not within the space of such 21 days as aforesaid proceed diligently with the execution of such repairs then and in such case Council shall be at liberty to enter upon the said Premises and execute such repairs and the cost thereof shall be a debt due from the Purchaser to the Council;

(f) Not without the previous consent in writing of the Council to erect or permit or suffer to be erected on the Premises of any part thereof any new buildings or erection and not to make nor allow to be made any alteration or addition to the Premises or to any buildings or erections erected unless such consent as aforesaid has been obtained;

(g) To pay all stamp duty other charges legal and other fees which become payable in respect of this Agreement and of any transfer of the Premises to the Purchaser;

(h) To pay all charges taxes rates and other assessments whatsoever raised or levied on the premises under any Act law by - law or other regulation whether enacted by the Central Government or by the Council or other local authority.

(i) To perform and observe the covenants and conditions set out in the schedule hereto.

8. In the event of the Purchaser failing to perform and observe any of the aforementioned covenants and conditions on his part to be performed and observed or failing to pay the sums demanded by the Council, in accordance with Clause 2 hereof the Council may give the Purchaser one month's notice to quit the Premises and at expiration of that time the Council shall be able to take possession and either:-

(i) sell the Premises; or

(ii) maintain possession and assume the management thereof without being liable for any loss occasioned thereby.

All the moneys so recovered thereby shall be applied by the Council towards payment of the purchase price accrued interest and all other moneys due under this Agreement.

PROVIDED THAT:

(i) If the sum recovered under (i) above shall be in excess of the balance of the purchase price accrued interest and all other monies due as aforesaid such excess shall be repaid to the Purchaser;

(ii) If the sum so recovered as aforesaid shall be less than the balance of the purchase price accrued interest and all other monies due as aforesaid such balance shall be forthwith recoverable by action.

9. Any action taken by the Council under Clause 7 of this Agreement shall be without prejudice to any right of action or claim the Council may have against the Purchaser arising out of any antecedent breach of any convenant or condition hereunder.

SCHEDULE

IN WITNESS whereof the Council has authorised the Town Clerk to set his hand hereunto and the Purchaser has hereunto set his hand the day and the year first above written.

SIGNED by the Town Clerk

.....

In the presence of:

.....

SIGNED by the said Purchaser

.....

In the presence of:

.....

Form of Loan Agreement of the

NATIONAL HOUSING CORPORATION OF KENYA

THIS AGREEMENT is made the day of One thousand nine hundred
BETWEEN the National Housing Corporation (hereinafter referred to as the Corporation) of the one part AND
(hereinafter referred to as the Local Authority) of the other part.

WHEREAS the Local Authority has, in accordance with the provisions of the Local Government Regulations 1963 respecting the raising of loans by it, borrowed from the Corporation, and the Corporation in exercise of the powers conferred upon it by the Housing Act 1953 (hereinafter referred to as the Act) has lent to the Local Authority, subject to and in accordance with the provisions of the Act and the terms and conditions hereinafter set forth, the sum of

(hereinafter referred to as the Loan); for the construction of houses in

AND WHEREAS under subsection (1) of section 7 of the Act the Local Authority is required to repay such loan as therein provided:

AND WHEREAS under subsection (2) of section 7 of the Act every loan made by the Corporation shall bear interest at such rate as the Corporation may prescribe:

NOW, THEREFORE, THIS AGREEMENT WITNESSETH AND IT IS HEREBY AGREED AS FOLLOWS.-

(1) That the loan shall bear interest at the rate of 9. 5 per centum per annum as from the first day of

(2) That the said sum of Kenya Pounds

together with interest thereon at the rate aforesaid shall be repaid by the Local Authority to the Corporation by one hundred and four (104) equated quarterly instalments of principal and interest of Kenya Shillings
each, the first such instalment to become payable on the day of and subsequent instalments to become due at the expiration of each completed period of three calendar months thereafter.

(3) If the Local Authority shall fail to pay any equated instalment on the due date or within ten days thereafter the whole balance of the principal sum then remaining owing shall become immediately due and payable.

(4) If any interest required by this document to be paid shall not be paid by the day on which the same shall become payable and on notice in writing being given to the Local Authority then without prejudice to any or all of the rights and remedies accruing to the Corporation consequent on such default and without rendering such interest other than overdue and immediately payable without demand the interest

BEST AVAILABLE DOCUMENT

so in arrear shall thenceforth itself bear interest at the rate of 9.5 per centum per annum computed from the date the same became payable to the date on which it is in fact paid and may at the sole discretion of the Corporation be at any time capitalised and added for all purposes to the principal sum and bear interest accordingly until actually paid. All powers and remedies conferred by the law or by this Agreement and all rules of law or equity in relation to the said principal sum of Kenya Pounds

and the interest thereon shall equally apply to such overdue interest whether capitalised or not and to the interest thereon which shall itself become interest bearing and subject to capitalisation at the discretion of the Corporation if still outstanding at the expiration of Three Months from the original default.

IN WITNESS thereof this Agreement has been executed the day and the year hereinbefore first written.

THE COMMON SEAL of the)
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was hereunto affixed in the)
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presence of:)
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.....) .....
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.....) .....
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THE COMMON SEAL of the)
NATIONAL HOUSING CORPORATION)
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was hereunto affixed in the)
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presence of:)
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.....)
MINISTER FOR HOUSING AND)
SOCIAL SERVICES)
)
A N D)
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CHAIRMAN)
NATIONAL HOUSING CORPORATION)
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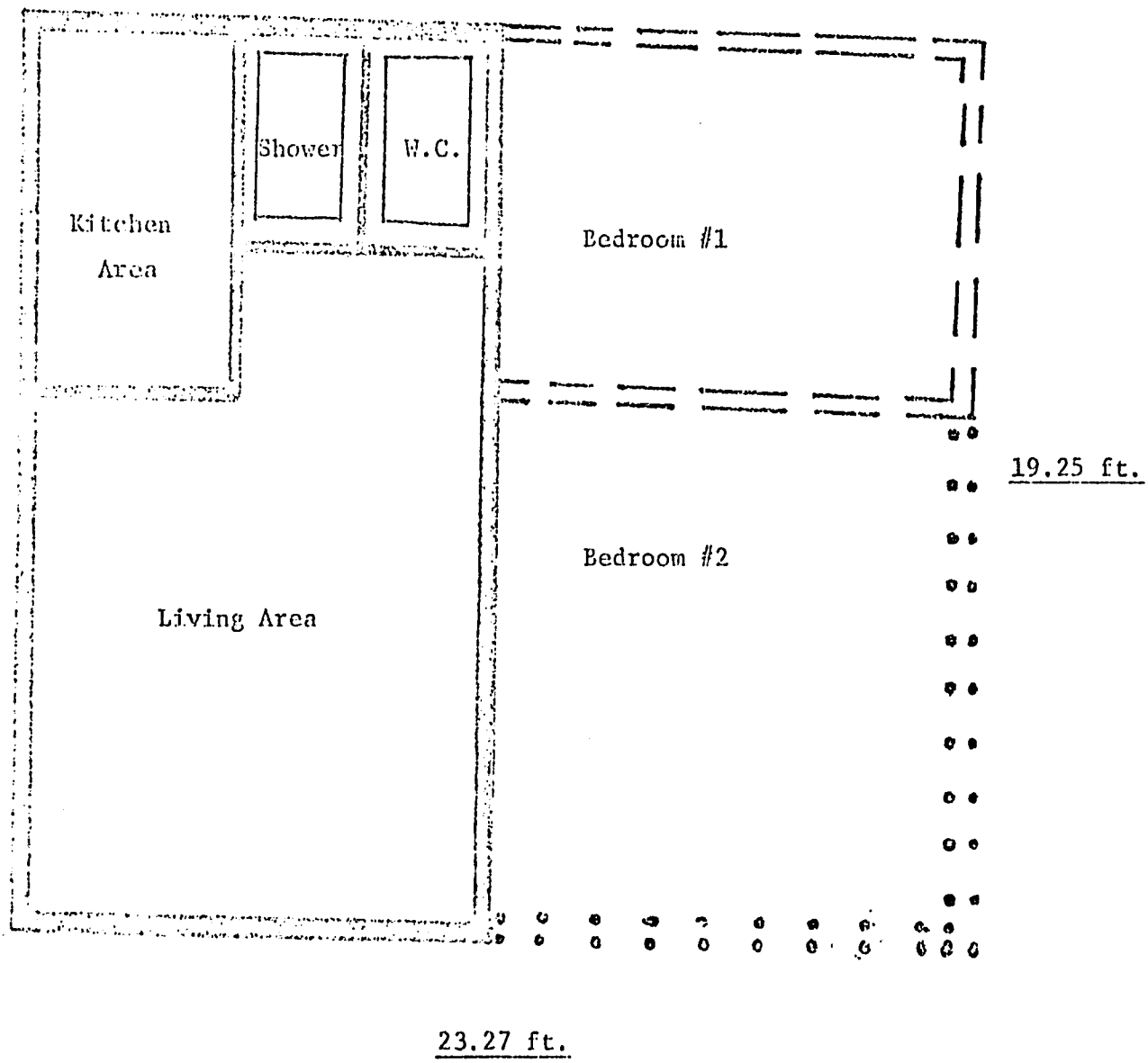
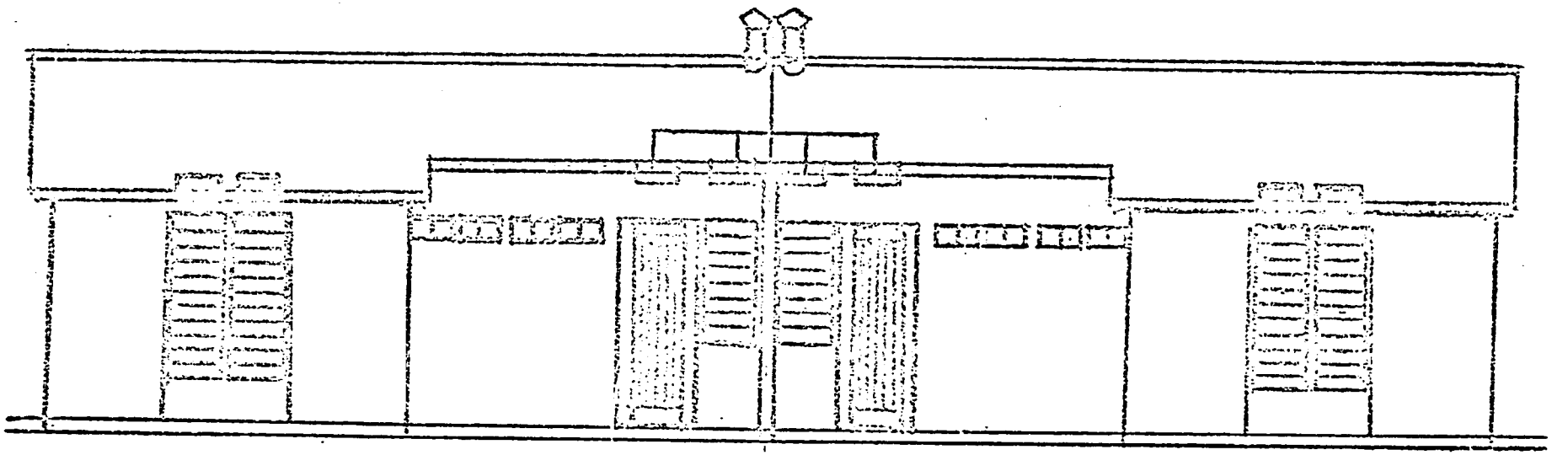
PROJECT 615-HG-004

EXPANDABLE CORE UNIT

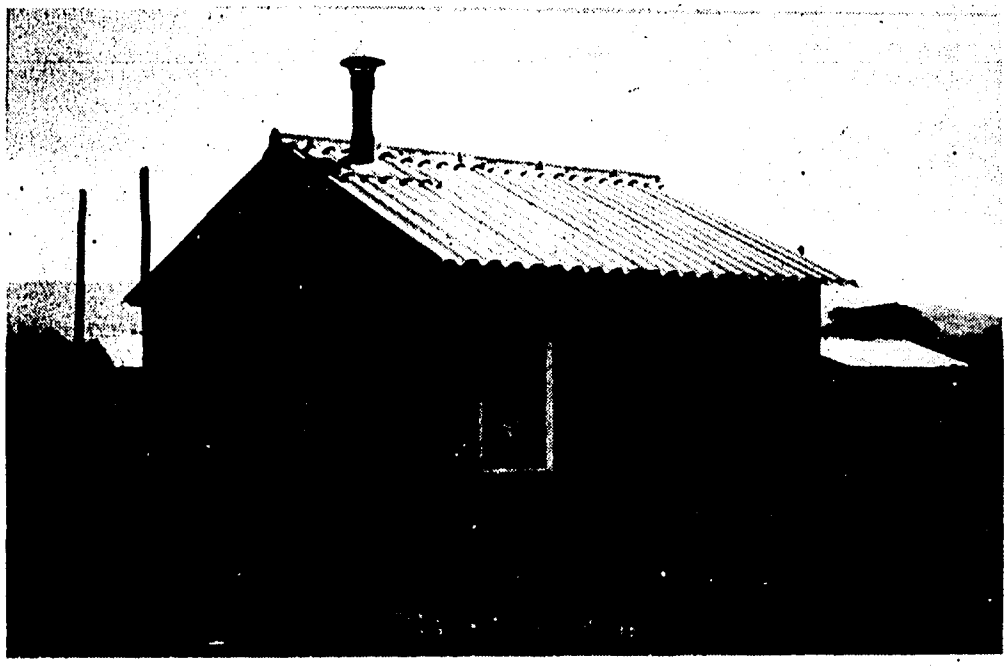


PROJECT 615-HG-004

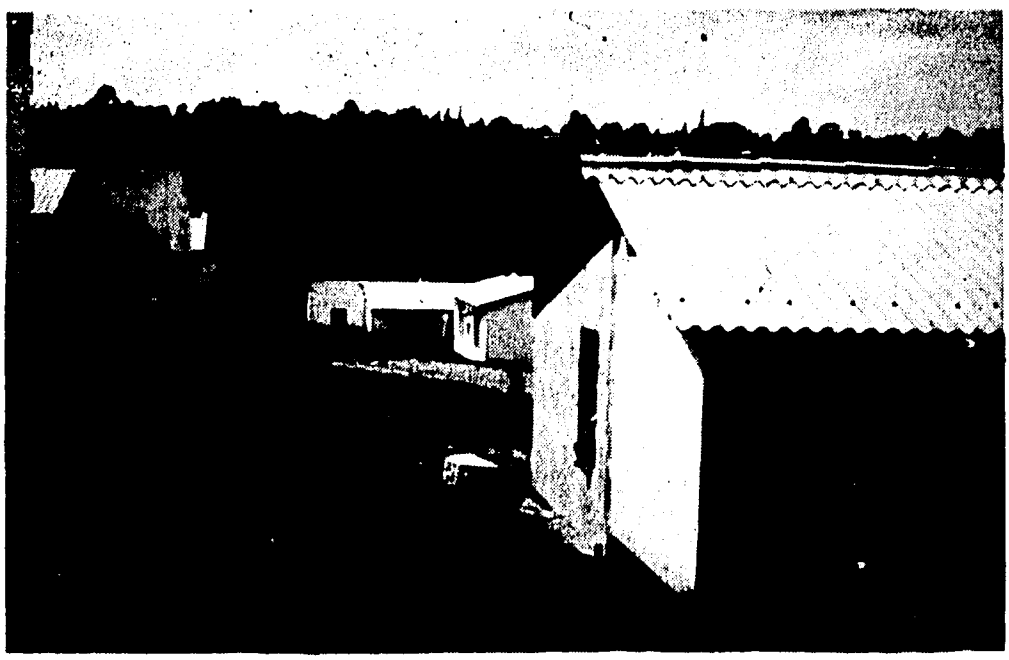


FRONT ELEVATION

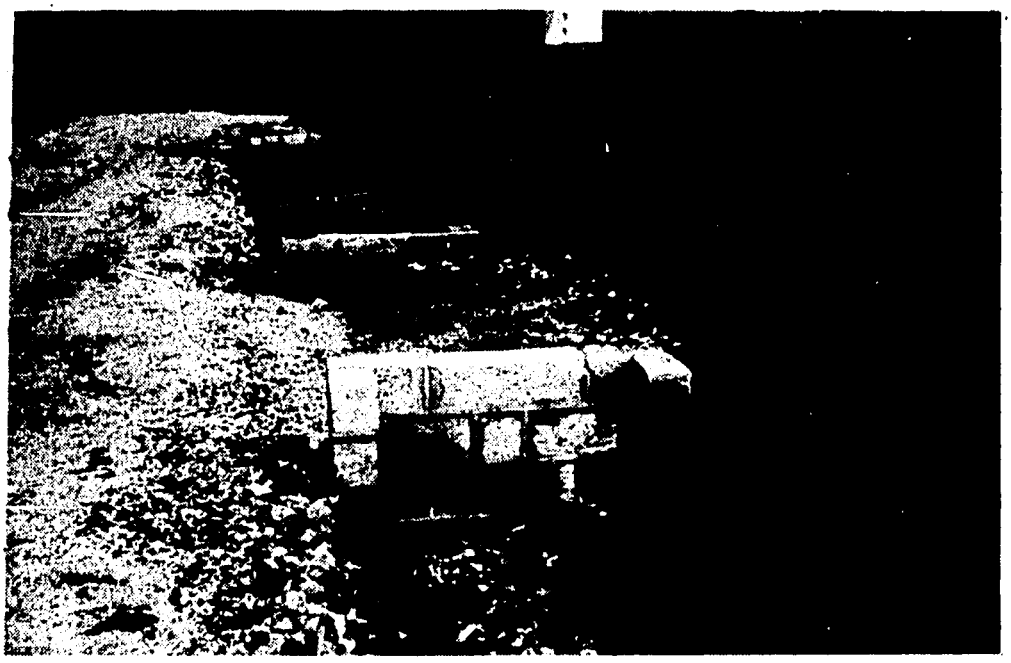
Photographs Of Project Site Conditions



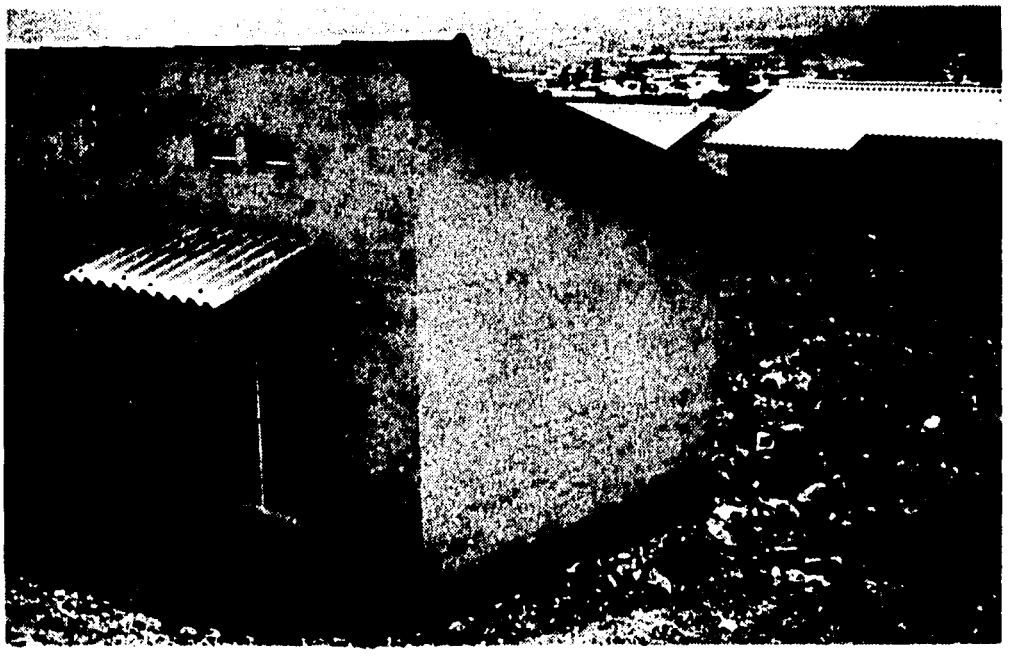
NAKURU: A Basic One-Room Core Unit



KERICHO: Unit Being Expanded On Terraced Hillside Plot



KERICHO: Open Storm Sewer Clogged With Silt

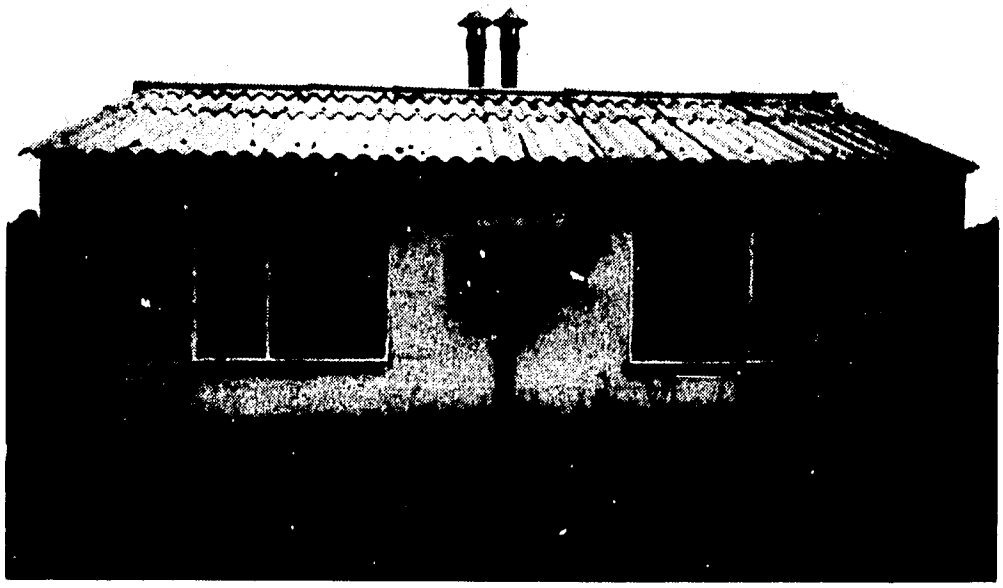


KISUMU: Rocky Terraced Plots Will Hamper Unit Expansion

KISUMU: Completed Units Remain Unoccupied Due To Delays In Infrastructure Work (Lake Victoria Visible From Site)

NANYUKI: Area In Front Of Unoccupied Units Has Become Trash Dump

NANYUKI: Open Storm Sewer Collects Discarded Building Materials



NANYUKI: A Basic Core Duplex - Absence Of Meters Indicates Power Hookups To Units Not Completed

UNITED STATES GOVERNMENT

memorandum

DATE: August 28, 1980

REPLY TO ATTN OF: James T. Grossmann
Acting Assistant Director, RHUDO/Nairobi

SUBJECT: Report of Audit of 615-HG-004

TO: Mr R. D. Cramer, AAG, USAID/Kenya

Thru': Mr W. Lefes, Acting Director, USAID/Kenya

BEST AVAILABLE DOCUMENT

We have reviewed the subject report on our first Secondary Towns Project in Kenya, and we recognize that you have made a conscientious effort to analyze a complex set of problems, and we agree with many of your observations. However, we must take exception to many of your conclusions and recommendations. The goal of institution building is paramount in all housing guaranties, but it is an objective not easily attained. If it were, we would quickly be out of business. It is only by a succession of projects and by a long period of involvement that we can ever expect to reach our goal.

AID aims in this regard have become much more comprehensive since this project was conceived. At that time, the main aim was to support a shift in GOK's de facto housing policy toward increased production of affordable housing for the poor. The project was substantially delayed (and due to inflation, fewer houses were built) because of the intense and protracted debate in GOK over the eventual decision to increase investment in lower cost housing.

After GOK made this crucial decision, further time was then required for NHC to alter its design criteria and dwelling designs. There were other problems with the project, but its objective was attained. The new policy still stands, and implementation of it is improving and accelerating.

Further, in a comparative analysis of NHC low-cost housing schemes, consultants to the GOK just concluding an exhaustive study of NHC have found that along every critical dimension - technical, administrative and financial - the USAID scheme has been the most successful NHC scheme in recent years.

Nowhere in the audit report is there any substantive acknowledgement of the real achievement of this scheme, nor is

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(REV. 7-76)
GSA FPMR (41 CFR) 101-11.6
5010-112

appreciation demonstrated for the political and policy context in which this program (designed six years ago) has been implemented.

We believe that the report characterizes NHC as a failure as an institution and the HG project as a failure as a low-cost housing scheme. Quite to the contrary, housing specialists in Kenya view NHC as a remarkably dynamic housing institution attempting difficult schemes under difficult circumstances and the USAID scheme as a pioneering effort in shifting GOK policy to one of support for low-cost, affordable housing.

It is so often only by observation as to how a project is carried out that we or the host country government recognize where there are shortcomings in the institutions with whom we are dealing, and it is then that we must provide an infusion of technical assistance. That NHC, or the local authorities would need extensive assistance was not obvious from the rapid growth rate of NHC's prior production. Therefore, a conscious and sound decision was made to let Kenyans implement this project without resident advisors, recognizing that they would make some mistakes. They did, and GOK recognized this over two years ago. Political factors delayed significant corrective action until recently, but it has now begun.

When the administrative deficiencies were recognized, it was also seen that radical remedies were required and a wholly new approach was designed for the follow-on project, incorporating extensive training and technical assistance. Based upon several recent studies (including the current detailed study of NHC and its work with others involved in shelter production for secondary towns), the new approach is expected to guide our next project to success in meeting more ambitious goals.

The audit report argues and recommends that institutional capacity and service delivery should be much improved <u>before</u> further HG assistance is provided. We see the same problems in this project and expect genuine GOK commitment to correct them. However, we cannot accept the notion that AID should not press for speedy implementation of our follow-on project. Delaying development assistance delays development. This is a high price to pay and not worth paying except when basic issues must be resolved, as at the outset of this project.

We believe that delay in a succession of projects would be irresponsible when the only goal is clean-up of one nearly completed project. Not only would long-term gains be lost,

but also the clean-up would be slowed by abrupt AID interruption of this accelerating program. We see no benefit whatever to be gained in this case from delaying development. Therefore, this notion should be expunged wherever it appears in the subject report.

RECOMMENDATION 1: There cannot be any substantial HG loan or escrow surplus. You note that there is a potential loan proceeds surplus of about $170,000, if no further cost increases are experienced. However, we have learned recently that the cost of the Kisumu project will increase due to unforeseen difficulties in completion of the infrastructure. A reasonable guess as to the amount of this increase is $140,000, leaving a net potential loan savings of only about $30,000.

Although, the escrow amount has earned over $800,000 in interest, NHC payments of interest to the investor and AID fees have exceeded such earnings by an amount approaching $100,000. Therefore, the NHC has had to pay some $900,000 out of its current funds to cover money as it sat unusable in the escrow account. This reduction in current funds has reduced the ability of the NHC insofar as its regular operations and has cost them additional amounts through the loss of other housing investment opportunities. Any loan savings or interest earnings of the escrow account will only serve to offset a portion of these total costs to NHC and to restrict their use would only injure the NHC.

Also, the DS/H Manual Order on "Escrow Policy for Housing Guaranty Loan Disbursements" specifies that the net proceeds resulting from the investment of escrowed funds will accrue to the general or specific benefit of the project, so no special inquiry would be needed, even if a surplus existed. Therefore, we believe that this recommendation is pointless and should be stricken.

RECOMMENDATION 2: This is in fact two recommendations:

(A) It is appropriate in all AID agreements to have a covenant for expeditious implementation, backed up by administrative, financial and technical plans, and in fact these plans usually are required to be prepared and approved prior to the first disbursement. Since this is standard operating procedure we do not see the point of including it among the recommendations. Monitoring of RHUDO implementation of this recommendation 2 (A) would only duplicate established DS/H reporting procedures and gain nothing.

(B) No sub-programs in project 615-HG-006 will be in "municipalities capable of implementing their own projects". Further, by-passing NHC would aggravate the administrative problems rather than ease them, ensuring increased delay, and it would profoundly contradict the basic collaborative strategy developed by RHUDO with GOK. Thus recommendation 2 (B) is inapplicable to the planned project 006.

RECOMMENDATION 3: Tenant Purchase Agreements (TPAs) have been signed for most of the 004 units and cannot be changed without separate negotiations with hundreds of allottees. Attempts to modify the form now for the remaining units would substantially delay occupancy and result in loss of revenue. The losses would be greater than the gains. The basic problem is not with the agreement, but with lack of enforcement, which is the responsibility of the local authorities, and therefore, of the Ministry of Local Government, not NHC. This recommendation should be stricken and the related discussion amended to reflect the actual conditions.

RECOMMENDATION 4: The government is currently conducting a major study of NHC and one of the central issues is how arrearages can be reduced. Several recommendations have been made which are under discussion and RHUDO is now considering appropriate steps to take for this project. These steps may include the meeting recommended but a final joint decision has not yet been made.

Therefore, the recommendation should be revised to reflect this fact.

In any event, the steps will involve the local authorities and MLG, not NHC. Therefore, the opening "prior to authorizing any further disbursements from escrow" should be stricken, as the events are in no way tied.

RECOMMENDATION 5: Renting and sub-letting are a way of life in Kenya. We believe that incremental measures must be taken in both projects 004 and 006 to regulate the most disadvantageous features of total renting. We know that the "need" for shelter is never absolute and that whenever subletting is profitable, there is a tradeoff between the alternative benefits of improved shelter and improved income. Absolute prohibition does not appear possible at this time.

There will be continued efforts to minimize this problem through more attention paid to purchaser selection, community development and tenant education programs as well as possible regulatory measures such as surcharges for subletting.

However, this is a long-term effort and therefore it will be counter-productive to make further disbursements from escrow dependent on elimination of total subletting. This recommendation should be revised to reflect the above.

RECOMMENDATION 6: We fully agree that revision of the TPA should be addressed prior to implementation of 006 and will be the subject of GOK/RHUDO discussion in the near future. Clarification of the entire document, and vernacular translation, are certainly good ideas. However, as stated above, we do not feel it would be prudent to try to change the TPAs for this project. The other points in recommendation 6 must be either subordinate to the goal of clarity or subject to negotiation with the aim of harmonizing the text with the real intent of AID, GOK and the parties. Therefore, this recommendation should be revised.

RECOMMENDATION 7: As incomes of local authorities increase and other basic needs of tenants are met, it is reasonable to expect improvement in both public and private grounds maintenance. We intend to make site visits to urge attention and action in this area. We believe improvements will be made in some towns, and RHUDO is taking steps to define the actions required to clean up this project, but objects to the suggestion that the specific actions proposed in this recommendation are necessarily appropriate elements in a coherent clean-up plan. Further, it is pointless to tie this clean-up to drawdowns when the problems are largely beyond the control of NHC. Therefore, this recommendation should be revised accordingly.

RECOMMENDATION 8: The Local Government Act and the Landlord Tenant Act require all municipalities to provide public services and maintain their housing stock. However, the provision of such public services and maintenance is inhibited throughout the world by lack of funds. Rapid growth of the urban sector, very limited taxing capabilities and high inflation have even left New York City and Washington far behind in this area. Nevertheless, it is a long-term goal of AID's shelter programs to improve urban communities in this area through technical assistance inputs.

Deficiencies in local authority funds, staffing or practices cannot be remedied merely by signing a covenant. Constituency pressures on local government, plus GOK support accompanied by an infusion of AID technical assistance may help, but this is a long term problem. Therefore, this recommendation is superfluous and would be offensive to the GOK and should be stricken.

RECOMMENDATION 9: Local authority financial administration reform is the subject of potentially extensive technical assistance and is part of the overall development effort which AID is assisting through the Housing Guaranty Program. The financial problems of Kenya's secondary towns are not unique, nor are the situations mentioned in the Draft Audit Report. These local authority problems are completely beyond the purview of NHC, and the suggested position would be completely inconsistent with our analysis of, and overall approach to this long term problem. This recommendation, if it is followed, would impair relations with NHC and would not contribute to a solution of the problem. In sum, it would be counter-productive and should be stricken.

RECOMMENDATION 10: We accept the intent of this recommendation and will take steps to ensure that such insurance is obtained where it is practical. However, we reserve judgement as to the specific documentation required to secure compliance, and we recognize that such insurance may not be available on reasonable terms for all sub-projects. Therefore, this recommendation should be revised accordingly.

RECOMMENDATION 11: We agree with the intent of this recommendation, but reserve judgement as to the best form of publicity in each case. It is general Mission policy to achieve publicity. We have been talking to ICA and Embassy officials about future publicity for AID shelter projects. However, the final decision in each case rests with the Country Team.

RECOMMENDATION 12: This recommendation is apparently based on the present program limitations regarding participant income levels. Since the "New Directions" legislation was enacted on December 20, 1975, and not made retroactive, it is not applicable to this project 004 authorized on June 28, 1974. Therefore, the 90 percent rule has no applicability to this project and the recommendation should be stricken.

In addition, RHUDO has taken continuous steps to hold down the costs on this project and make the units affordable. Early in 1980 RHUDO notified the borrower that it would be necessary to delete from the HG program the highest cost sub-program in Mombasa. This action was carried out. Also, in Meru, price freeze was negotiated so that any further increases in project cost will not be borne by the allottees.

RECOMMENDATION 13: There is nothing startling about the identified deficiencies in project 004. The institutional problems identified are common to municipalities worldwide; a long term goal of the Housing Guaranty Program is to alleviate these problems through

a planned schedule of technical assistance and training.

Institutional change does not come about quickly nor is it aided by an interruption in communications. The Office of Housing and USAID/Kenya are beginning to provide significant assistance to involved central government ministries and parastatals. The value of this assistance is increased with renewed contacts for additional programs. Interfering with the planned schedule of Kenya Housing Guaranty Projects will substantially slow down and hinder the efforts already underway. Far from aiding the existing HG-004 project, prohibiting the planned follow-on program would have significant detrimental effects.

The long term institutional strengthening and change will only be accomplished through an equally long term AID interaction. Interfering with this process through the untimely blocking of an innovative shelter and community facilities program for smaller towns would be a major mistake.

The considerable technical assistance built into the proposed project will focus on institution building at the central and local levels. The resources made available under the proposed project will supplement those available from GOK and go a long way towards assisting Kenyans to address their shelter sector problems. For these reasons, we believe the recommendation as stated is unsound and contrary to progressive development practice, and should be stricken.

Other

Several factual errors were noted in reviewing the subject report. In addition to the changes in conclusions and recommendations cited above, we believe that the following errors should be corrected:

Pages 1, 3 and 4: Again, as in the HG-003 audit report, out-of-date statistics are cited. The current AID estimates of population growth rate and urban share are 4 and 15 percent, not 3.5 and 10 percent. The data in paragraph 2 of page 3 and in the table on page 4 are suspect and perhaps should be deleted or revised. The latest census preliminary report (which is also suspect) puts only 60 percent, not 80 percent, of urban population in Nairobi and Mombasa. The census also identified several towns, not listed in your table, with populations exceeding 10,000.

Instead of the Kenya Shelter Sector Study, we suggest you consult the significantly more recent Kenya Shelter Strategy Statement (pages 4 and 5) prepared by RHUDO and USAID/Kenya

Page 5: About ten years ago, a major, but not "the main" source of revenue was transferred from the towns to the central government. They had, and still have powers to levy poll taxes, property tax and agricultural and other business taxes, and they still receive substantial though declining grants in lieu of GPT. In all their revenue collection activities, many local authorities suffer from weak administration as much as from a weak tax base. Therefore, we suggest that it would be more accurate to say on line 10 that, "An inadequate tax base and weak revenue administration have caused local officials many financial problems".

Page 6: We are unaware of any housing estates managed by NHC, as noted in line 6, except three ot its own, in Nairobi, where the local authority is as able as any. Please note that the eleven urban centers have populations ranging from 5,000 to 15,000. Also, on the fourth line from the bottom, we would add the words "urban development and" before the words "shelter planning".

Page 11: As noted above in our general remarks we believe that some of the delay was due to policy change favoring lower income beneficiaries and that much of the cost increase was unforeseeable. We would therefore suggest saying, in paragraph 1 "... unit prices have increased considerably due to a combination of delay due to policy change, administrative deficiencies and unforeseen inflation".

Page 15: In the first table, the second column would more correctly be captioned "Financed" instead of "Built". 1,053 units were built (subject to your footnote) but 135, on two sites, were not HG financed.

Page 17: It is not clear that eliminating NHC's role would have expedited implementation in Mombasa and Kisumu where it was largely a local authority responsibility anyway. On the contrary, as they were largely responsible for two of the three slowest sub-projects, instead of eliminating the NHC role, it should, perhaps, have been increased. We doubt that by eliminating NHC, we would have seen "losses by home-buyers avoided".

Page 21: The first town cited, no doubt, is Nakuru.

Page 40: Regarding the communication gap which you correctly identify, we would also mention the beneficiaries and other residents.

Page 41: "Cognizant RHUDO officials" were surely misunderstood. While we have made more visits before occupancy we have also made them after occupancy. None of these visits were concerned with the preparation of the follow-on project.

In the penultimate sentence, it is not clear which "this practice" is. We agree that prompt action is needed to correct maintenance problems. We do not agree that subletting is necessarily synonymous with poor maintenance.

LIST OF REPORT RECOMMENDATIONS

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Recommendation No. 1 — 13

RHUDO/E&SA obtain from the Office of the AID Assistant General Counsel for Housing (GC/H) an opinion as to the disposition of (a) any potential HG loan surplus which may become available under 615-HG-004, and (b) interest earned on HG loan funds left on deposit in escrow under the same project.

Recommendation No. 2 — 15

RHUDO/E&SA, in conjunction with USAID/Kenya, include among the conditions precedent to disbursement of any funds under follow-on project 615-HG-006 with the National Housing Corporation a requirement for formal acknowledgements from all GOK agencies affected by the new project that provisions have been made to ensure its expeditious implementation.

Recommendation No. 3 — 20

Prior to authorizing any further disbursements from escrow, RHUDO/E&SA, in conjunction with USAID/Kenya, coordinate with the NHC to amend the form of Tenant Purchase Agreement to be used under HG loan project 615-HG-004 and the proposed follow-on project to provide for addition of penalty interest charges on payments overdue more than two months in an amount at least equal to the cost of capital to the local council which executes this agreement.

Recommendation No. 4 — 21

Prior to authorizing any further disbursements from escrow, RHUDO/E&SA, in conjunction with USAID/Kenya, coordinate with the NHC and such other GOK agencies as they deem appropriate to convoke a meeting of Town Clerks and Treasurers of participating local authorities under loan project 615-HG-004 to discuss the problem of home loan repayment arrearages and methods available to combat this problem.

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Recommendation No. 5 — 28

RHUDO/E&SA, in conjunction with USAID/ Kenya, formally advise the National Housing Corporation and the GOK Ministry of Housing and Urban Development that it cannot authorize further disbursements from escrow under project 615-HG-004 until such time as the NHC and participating local authorities:

(a) have determined which units under the project are inhabited exclusively by persons other than those entitled to reside there under the terms of the Tenant Purchase Agreement, and

(b) have taken effective measures to enforce the ban on unit subletting, including, as appropriate, reallocation of HG funded houses in cases where buyers refuse to reside in their units without good reason and proper authorization by the cognizant local authority.

Recommendation No. 6 — 30

RHUDO/E&SA, in conjunction with USAID/ Kenya, coordinate with the NHC and such other GOK agencies as may be affected to amend:

(a) future project 615-HG-004 and 006 form of Tenant Purchase Agreements to: (i) reposition sub-paragraph 2(d) thereof under paragraph 7 and clarify its intent as permitting subletting for good reason only, (ii) eliminate the limit on the subletting ban which now applies to only the first five years of occupancy, (iii) insert under paragraph 7 a provision for forfeiture by the buyer of record of all monies paid in respect of amortization of their loans (including downpayments and monthly home loan payments) in such cases where such buyers are found not to reside

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in their units without having obtained prior written consent from their local authority to sublet same, and (iv) provide homebuyers with a colloquial Swahili language translation of the Tenant Purchase Agreement; and

(b) the form of loan agreement between the NHC and participating local authorities so as to include all the significant terms and conditions of the AID Implementation Agreement under the current and proposed follow-on projects, including the ban on subletting of HG funded units.

Recommendation No. 7 — 35

RHUDO/E&SA, in conjunction with USAID/ Kenya, formally advise the NHC that it cannot approve any further drawdowns from escrow under project 615-HG-004 until: (a) a joint inspection of all project sites completed to date has been made and reported on by cognizant RHUDO, NHC and local officials; (b) steps have been taken to rectify any remaining construction defects such as those found in Nanyuki, including, as appropriate, just compensation to owners who have gone "out-of-pocket" to rectify any such defects; and (c) local authorities have been formally requested to take action to comply with their project maintenance responsibilities, including periodic unit inspections and enforcement of Tenant Purchase Agreement maintenance provisions.

Recommendation No. 8 — 36

RHUDO/E&SA, in conjunction with USAID/ Kenya, include in the proposed 615-HG-006 loan Implementation Agreement a covenant whereby National Housing Corporation of Kenya agrees to obtain an undertaking from local authorities participating in that project that normal maintenance services will be provided after the HG units are occupied.

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Recommendation No. 9 — 41

Prior to authorizing any further disbursements from escrow under project 615-HG-004, RHUDO/E&SA, in conjunction with USAID/Kenya, coordinate with NHC and such other GOK agencies as it deems appropriate to make joint inspection visits to town councils participating in the project to ensure that adequate financial management practices are being followed for each sub-project including, but not limited to, accounting for collections from homebuyers and remittances to NHC.

Recommendation No. 10 — 43

RHUDO/E&SA, in conjunction with USAID/Kenya, (a) amend the project 615-HG-004 Implementation Agreement to include a requirement that HG funded units be covered by fire and casualty insurance with either the NHC or the local authority as beneficiary; (b) request NHC to amend its form of tenant purchase and loan agreements under this and follow-on projects to require such coverage at a minimum, and (c) request NHC to urge participating local authorities to contract for adequate insurance coverage of already occupied HG-funded units without delay.

Recommendation No. 11 — 45

RHUDO/E&SA, in conjunction with USAID/Kenya, coordinate with NHC and the U.S. Embassy to organize project opening ceremonies, as appropriate, at the remaining sites to be inhabited under 615-HG-004, an' for all future site inaugurations in Kenya.

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Recommendation No. 12 — 48

RHUDO/E&SA, in conjunction with USAID/ Kenya, justify the eligibility for funding of two-room units remaining to be completed under project 615-HG-004 prior to approving any further disbursements from escrow to the National Housing Corporation of Kenya.

Recommendation No. 13 — 55

AA/AFR, in her capacity as Chairperson, Housing Guaranty Review Committee for Africa, through the Office of Development Resources (AFR/DR), formally advise the Office of Housing (DS/H) and USAID/ Kenya that the issuance of further housing guaranty authority to Kenya shall be contingent upon the prior implementation by both AID and the GOK of effective measures designed to address the deficiencies described in this report and in Audit Report No. 3-615-80-19.

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