PD BAH 366

615-HG-007
AND
615-0225

K E N Y A

KENYA PRIVATE SECTOR HOUSING

(615 - HG - 007)

May 1983

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) — Amendment Number: ____
DOCUMENT CODE: 3

2. COUNTRY/ENTITY: KENYA

3. PROJECT NUMBER: 615-HG-007

4. BUREAU/OFFICE: AFRICA — 06

5. PROJECT TITLE (maximum 40 characters): KENYA PRIVATE SECTOR HOUSING

OFFICIAL PROJECT DOCUMENT

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 12 DD 31 YY 87

7. ESTIMATED DATE OF OBLIGATION (Under 'B:' below, enter 1, 2, 3, or 4)
A. Initial FY 83 B. Quarter __ C. Final FY 83

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 83 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant) SDA	( )	( )	(1,120)	( )	( )	(1,120)
(Loan) HG	(20,000)	( )	( )	( )	( )	(20,000)
Other U.S. 1.						
Other U.S. 2.						
Host Country					2,000	2,000
Other Donor(s)						
TOTALS						23,120

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1) HG	720		860		NONE		20,000		20,000
(2) SDA	720	860		NONE		1,120		1,120	
(3)									
(4)									
TOTALS								1,120	20,000

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 840 | 890

11. SECONDARY PURPOSE CODE:

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code	BU	DEL	COOP				
B. Amount							

13. PROJECT PURPOSE (maximum 480 characters)

TO DEVELOP PRIVATE SECTOR CAPACITY TO PLAN, FINANCE, BUILD AND MANAGE LOWER INCOME HOUSING IN KENYA.

14. SCHEDULED EVALUATIONS
Interim MM 01 YY 85 | MM 06 YY 86 | Final MM 06 YY 88

15. SOURCE/ORIGIN OF GOODS AND SERVICES
☐ 000 ☒ 941 ☒ Local ☐ Other (Specify) ____

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment)

17. APPROVED BY
Signature: Allison B Herrick
Title: DIRECTOR, USAID, KENYA
Date Signed: MM 05 DD 23 YY 83

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM | DD | YY

AID 1330-4 (8-79)

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GUARANTY AUTHORIZATION

PROJECT 615-HG-007

Provided From: Housing Guaranty Authority

For: The Government of Kenya

Pursuant to the authority vested in the Assistant Administrator, Bureau for Africa, by the Foreign Assistance Act of 1961, as amended (FAA), and the delegations of authority issued thereunder, I hereby authorize the issuance of guaranties pursuant to Section 222 of the FAA of not to exceed twenty million dollars ($20,000,000) in face amount, assuring against losses (of not to exceed one hundred per cent (100%) of loan investment and interest) with respect to loans, including any refinancing thereof, by eligible U.S. investor(s) acceptable to A.I.D and made to finance housing projects in Kenya.

These guaranties shall be subject to the following terms and conditions:

1. Term of Guaranty: The loans may extend for a period of up to thirty (30) years from the date of disbursement and may include such terms and conditions as shall be acceptable to A.I.D. The guaranty of the loans shall extend for a period beginning with the first disbursement of the loans and shall continue until such time as the Investor(s) has been paid in full, pursuant to the terms of the loans.

2. Interest Rate: The rate of interest payable to the Investor(s) pursuant to the loans shall not exceed the allowable rate of interest prescribed, pursuant to Section 223(f) of the FAA and shall be consistent with rates of interest generally available for similar types of loans made in the long term U.S. capital markets.

3. Government of Kenya Guaranty: The Government of Kenya shall provide for a full faith and credit guaranty to indemnify A.I.D. against all losses arising by virtue of A.I.D.'s guaranty to the Investor or from non-payment of the guaranty fee.

4. Fee: The fee of the United States shall be payable in dollars and shall be one-half percent (1/2%) per annum to the

outstanding guarantied amount of the loans plus a fixed amount equal to one percent (1%) of the amount of the loans authorized or any part thereof, to be paid as A.I.D. may determine upon disbursement of the loans.

5. Other Terms and Conditions: The guaranties shall be subject to such terms and conditions as A.I.D. may deem necessary:

Haunadene Johnson
Acting Assistant Administrator
Bureau for Africa

September 30, 1983
(Date)

Clearances:
PPC/PDPR/EA:PTowsley
AFR/EA:ESpriggs
AFR/DP:JElliott
GC/H:BVeret
PRE/H:JHowley
AFR/PD/EAP:SShah

PROJECT AUTHORIZATION

Name of Country: Kenya

Name of Project: Private Sector Cooperative Housing Finance

Naume of Project: 615-0225

1. Pursuant to Section 106 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Private Sector Housing Finance Project involving planned obligations of not to exceed $1,120,000 in grant funds over a four-year period from date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process to assist in financing the foreign exchange and local currency costs for the project. The planned life of the project is four years from the date of initial obligation.

This project will provide technical assistance, training and related commodity support to housing cooperatives and financial institutions to complement a $20 million Housing Guaranty program to the Government of Kenya. A maximum of two long-term technical advisors will be funded from this grant. One, the Cooperative Management Specialist, will assist the National Cooperative Housing Union (NACHU) develop necessary organizational, administrative and management skills. The second, the Cooperative and Low-Cost Housing Specialist, will have primary responsibility for assisting and training NACHU personnel to develop and package economically feasible housing cooperative programs eligible for long-term Housing Guaranty financing. In addition, it is anticipated that approximately 12 persons months of short term technical assistance will be provided to NACHU in the development of training, administrative, financial, and regulatory procedures and other selected technical areas as required. Short term training on the operation of secondary mortgage markets for ministry and housing finance institutions staff will also be provided. Commodity assistance, such as computer and audio-visual equipment, will be provided to the long-term technical advisors and the trainers, as needed.

3. The Project Agreement, which may be negotiated and executed by the officers to whom such authority is delegated in accordance with A.I.D. Regulations and Delegations of Authority, shall be subject to

the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

4a Source and Origin of Goods and Services

Except as provided herein or as A.I.D. may otherwise agree in writing, commodities financed by A.I.D. under the Project shall have their source and origin in Kenya or in the United States. Except for ocean shipping, the suppliers of commodities or services shall have Kenya or the United States as their place of nationality, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Project shall, except as A.I.D. may otherwise agree in writing, be financed only on flag vessels of the United States.

b Conditions Precedent

1. Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement to finance assistance to the National Housing Cooperative Union (NACHU), the Cooperating Country shall furnish in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing:

(a) an acceptable NACHU staffing pattern, hiring timetable and budget;

(b) evidence that NACHU has retained the services of a finance manager to serve as counterpart to the A.I.D.-funded Cooperative Management Specialist;

(c) evidence that NACHU has agreed to retain the services of a project technical manager to serve as counterpart to the A.I.D. provided Cooperative and Low Cost Housing Specialist, within one year from the signing of the Project Agreement;

(d) evidence that NACHU has agreed to provide adequate office space, transportation, secretarial support services and related equipment and supplies to the two long-term A.I.D. funded advisors.

2. Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement to finance technical assistance or training related to housing finance institutions or development of a secondary mortgage market, the Cooperating Country shall furnish to A.I.D., in form and substance satisfactory to A.I.D., except as A.I.D. may otherwise agree in writing, scopes of work and timetables for such training or technical assistance.

Date: 12/21/83

Assistant Administrator
for Africa

Clearances:
PPC/PDPR/EA:PTowsley ____Draft____
AFR/E:ESpriggs ____Draft____
AFR/DP:JElliott ____Draft____
GC/H:BVeret ____Draft____
PRE/H:JHowley ____Draft____
AFR/PD/EAP:SShah ____Draft____
GC/AFR:DRobertson ________
AFR/DP:HJohnson ________
DAA/AFR,GPatterson ________

Doc. 0532J

III. SUMMARY AND RECOMMENDATIONS

A. FINANCIAL PLAN

It is anticipated that the proposed project will provide $40 million in Housing Guaranty (GH) resources over a five year period. This paper focuses primarily on the first tranche of $20 million to be authorized in FY 83. The loan funds will come from the U.S. private capital market for a term of 30 years, with up to 10 years grace period. The rate of interest will reflect the rates for similar debt securities guaranteed by the U.S. Government. The loan repayment to the U.S. Government will be guaranteed by the Government of Kenya and the U.S. Government in turn will provide a loan repayment guaranty to the U.S. private lender.

A sum of $1,120,000 in Development Assistance grant funds will be provided to strengthen the cooperative housing movement and the housing finance system in Kenya. Approximately $940,000 million will be provided for technical assistance and training to strengthen housing cooperatives in Kenya, especially the apex organization, the National Cooperative Housing Union (NACHU) and approximately $180,000 for short-term training to the housing finance institutions. An additional $100,000 from HG fee income will be provided for technical assistance to the housing finance institutions.

The local contribution for housing construction will result from down payments by the program beneficiaries and will amount to approximately $2.0 million in the first tranche. The local contributions to the cooperative housing component totaling $215,000 will consist of NACHU staff salaries, office space and equipment, use of the facilities for training programs and the fees paid by cooperative members to cover the cost of NACHU assistance.

B. TERM OF PROJECT

The full life of the project is six years. The first tranche HG authorization of $20 million is requested in FY 83. The second tranche authorization of $20 million will be requested in FY 86, based on the progress in the implemen- tation of the project during the earlier tranch and studies of housing needs, informal housing finance and feasibility of an effectively operating secondary mortgage market.

C. DESCRIPTION OF PROJECT

The proposed project will expand the private sector's capacity to design, construct, finance and service low cost housing. During the first two tranches of the project, the primary emphasis will be to demonstrate that provision of low cost housing, costing about $3,700 - 7,400 (KShs 50,000 - 100,000) is a profitable business for developers and an appropriate function for cooperatives and that housing finance institutions should service this market in Kenya. The subsequent tranche of the program, depending upon the experiences and results of the first tranche and the studies referred to above, will also focus on establishing the conditions necessary for the functioning of a secondary mortgage market, and possibly on resource mobilization for primary financing of low cost housing.

At the outset, USAID and the Ministry of Works, Housing and Physical Planning (MWHPP) will establish eligibility criteria for HG funding, based on family income at the time of application for housing and on the principle of affordability. The housing units produced in the program will be affordable to the below median payment group although the owners may have to offset their housing costs by renting a room in their house to other poor individuals or families. These criteria will be widely publicized in Kenya. Interested housing finance institutions will be asked to submit preliminary Master Project Delivery plans indicating the projects they wish to finance and their resource requirements for each. USAID, in conjunction with the Government and the housing finance institutions, will establish a ceiling for the HG funds to be available to each institution applying.

Private developers working with the housing finance institutions will develop projects based on the eligibility criteria and the established ceilings. It will be their responsibility to acquire land, sub-divide it, do detailed layout and planning, get all the necessary approvals from government agencies, find the potential buyers and sell the housing units. Using the technical assistance provided, NACHU will develop projects with member cooperatives and submit them for financing to one of the participating housing finance institutions.

Each project will be submitted to USAID, who will review the project to ensure its compliance with the established criteria of eligibility and affordability. If the project meets the criteria and is within the fund ceiling, USAID will authorize disbursement of the HG funds to finance long-term mortgages after sale of the units. USAID will encourage participation by the housing finance institutions, the Cooperative Bank, several private developers and housing cooperatives.

Technical assistance will be provided to establish uniform mortgage instruments and procedures; and to establish the basis for a secondary mortgage market.

D. PURPOSES OF PROJECT

The goal of this project is to improve the quality of life of low income families through support for provision of user-financed social services. This goal will be accomplished through the development of a self-supporting, profit-making housing finance system capable of responding to the housing needs of low income families. Such a housing finance system will be made possible initially by the provision of U.S. funds and subsequently by mobilizing additional domestic resources and fuller participation of formal and informal sectors.

In addition, this project will, in the short run, provide foreign exchange support to the Government of Kenya. Because most building materials and skills will be available locally, the Government will have available 85-90% of the HG loan as untied foreign exchange, under relatively favorable terms and conditions, to finance needed equipment and materials.

In the long run, economic advantage to the Government will accrue by shifting responsibility for providing low cost housing from the public to the private sector. The program will provide the necessary tools for the private sector housing and investment institutions to fulfill such responsibility.

The purpose of the project is to develop the private sector's capacity to plan, develop and finance lower income housing.

E. BACKGROUND OF PROJECT

Kenya has an estimated population of 17.5 million (1981) which is growing at an annual rate of approximately 4%. This growth rate is among the highest in the world. If the current trend continues, Kenya's population is projected to total more than 38 million by the year 2000. Kenya's urban population of 2.4 million is growing at the rate of 7% per year and will double in approximately ten years. Only 14% of Kenya's population lives in urban centers at the present time, but the rate of growth will bring the urban portion to 20% by the year 2000.

Kenya's urban housing shortfall was established to be 140,000 units in 1979. As th number of new urban households will increase by an estimated 160,000 in the next five years, total housing requirements by 1988 will exceed 300,000 new units. Annual production has been about 6,500 units in recent years. The public sector, principally the National Housing Corporation and the Nairobi City Council's Housing Development Department, assisted by USAID and World Bank financing, has produced only about 5,000 units per year in the 1980's. The formal private sector has been building only about 1,500 units per year. The substantial gap remaining between formal production and demand has been filled partially by the informal sector through the provision of substandard housing.

The Government of Kenya has increasingly recognized that in order to meet national housing needs effectively, the role of the private sector will have to be expanded to include low income housing. In 1980, the Government sponsored a nationwide seminar to discuss the role of the private sector in housing. Subsequently, the Government requested HABITAT, the UN organization concerned with human settlements, to finance a study on how to expand the role of the private sector. USAID worked closely with the Ministry of Works, Housing and Physical Planning, HABITAT, and the study team on the effort. The study, completed earlier this year, identified eighteen feasible private sector projects which would require approximately $60 million (KShs 800 million) in financing. Subsequently the Government co-sponsored with USAID a seminar on secondary mortgage market operations which was attended by over 70 senior representatives from the private and public sector.

Under the first tranche of the proposed program, the Kenyan private sector will be involved in the formal production and financing of low cost housing for the first time. The cost of the housing to be produced in this project will average 1/3 of the cost of previously produced housing by the formal private sector. The infusion of HG loan funds is designed to demonstrate that low cost housing can be a profitable venture for housing finance institutions, as well as private builders and developers; and that the private sector is an efficient vehicle for the provision of such housing. The second tranche of the project will look at other available options, based on the various studies; and further consider this and other effective approaches to the problem of low cost housing.

Since this $40 million project will produce only a fraction of the units needed to satisfy the demand, it is essential that a means be developed to tap the financial resources of insurance, pension and other funds, credit unions, small savers and informal sector sources for the housing sector.

For long-term shelter sector considerations, it is also essential that options be explored for the future involvement of the informal sector in finance and solution production. Only a combination of approaches will finally and fully address the problems of low income housing in Kenya.

F. MAJOR CONDITIONS PRECEDENT AND COVENANTS

The HG loan shall be subject to the following conditions precedent and to such other terms and conditions as AID may deem necessary:

(a) Prior to any disbursements under the Guaranty, the Government shall, except as AID may otherwise agree in writing, furnish to AID, in form and substance satisfactory to AID:

- evidence that the Government of Kenya has adopted approrpiate reduced building and infrastructure standards for the Project;

- evidence that the Government of Kenya has approved such Sessional Paper(s) as may be necessary to effectuate the borrowing;

(b) Prior to releasing funds for an individual development, the Government shall furnish AID in form and substance satisfactory to AID, except as AID may otherwise agree in writing, an acceptable plan for such development which incorporates necessary information from the participating institutions, including specific project data concerning eligibility criteria for approval of mortgage, financing terms and conditions, unit cost data, cash flow, construction schedules, implementation plans and criteria for selecting details concerning eligible beneficiaries.

The Project Grant Agreement shall be subject to the following terms and covenants and major conditions, together with such other terms and conditions:

(a) Except as provided herein or as AID may otherwise agree in writing, commodities financed by AID under the Grant shall have their source and origin in Kenya or in the United States. Except for ocean shipping, the suppliers of commodities or services shall have Kenya or the United States as their place of nationality, except as AID may otherwise agree in writing. Ocean shipping financed by AID under the Grant shall, except as AID may otherwise agree in writing, be financed only on flag vessels of the United States.

(b) Prior to any disbursement, or the insurance of any commitment documents under the Grant Project Agreement to finance assistance to the National Housing Cooperative Union (NACHU), the Cooperating Country shall furnish in form and substance satisfactory to AID, except as AID may otherwise agree in writing:

   (i) an acceptable NACHU staffing pattern, hiring timetable and budget;

   (ii) evidence that NACHU has retained the services of a finance manager to serve as counterpart to the AID-funded Cooperative Management Specialist;

(iii) evidence that NACHU has agreed to retain the services of a project technical manager to serve as counterpart to the AID provided Cooperative and Low Cost Housing Specialist, within one year from the signing of the Project Agreement;

(iv) evidence that NACHU has agreed to provide adequate office space, transportation, secretarial support services and related equipment and supplies to the two long-term AID funded advisors.

(c) Prior to any disbursement, or the issuance of any commitment documents under the Grant Project Agreement to finance technical assistance or training related to housing finance institutions or development of a secondary mortgage market, the Cooperating Country shall furnish to AID, except as AID may otherwise agree in writing, scopes of work and timetables for such training or technical assistance.

IV. PROJECT RATIONALE AND DESCRIPTION

A. RATIONALE

1. Overview

The HG project addresses the need for an increase in the production of housing suitable for households of below median income. This increased production will be accomplished through the involvement of profit-making housing finance institutions, housing cooperatives, and private developers. In the past, low cost housing was provided primarily through the National Housing Corporation of the Ministry of Works, Housing and Physical Planning, the City Councils and the informal sector. The private sector is primarily concerned with upper middle income housing costing upwards of $18,500 (KShs 250,000). The monthly income eligibility requirement necessary to obtain financing for such housing is $500 (KShs 6,750) per month, while the median family income is $185 (KShs 2,500) per month. As shown in Annex I, over the past five years the public sector built approximately 5,000 housing units per year for lower income families, and the formal private sector built about 1,500 housing units per year for upper income people. This level of housing production is highly inadequate considering that annual new household formation is estimated at 32,000, in addition to an existing housing shortfall in 1979 of 140,000 units in the urban areas. The informal sector was forced to satisfy this huge unmet demand through the provision of substandard rental and squatter shelters.

During the next five years, an estimated 32,000 housing units will be required every year in order to meet the demand of new urban households, excluding the existing shortfall in housing. Most of this demand will come from households in the low income groups. Based on recent estimates, approximately 24,700 households in Nairobi alone are in the 40th - 50th income percentile. This is the specific target group for the proposed HG loan, a group that can afford a house costing approximately $3,700 - 7,400 (KShs 50,000 - 100,000). There has been <u>no</u> production of housing units in this price range over the past several years. Houses in this price range are not likely to be built in the foreseeable future without USAID's involvement.

Although USAID is maintaining a low profile during the project preparation stage, and has not publicized its intentions of making any capital financing available, several private developers and cooperatives have submitted project proposals to USAID. Some even prepared extensive studies to demonstrate their seriousness in participating in the program. USAID received five preliminary project proposals from private developers for production of over 4,300 housing units at a total cost of $29 million and a proposal from NACHU for over seven-hundred housing units at a cost of $4.6 million. In addition, USAID has discussed projects with three additional developers who have indicated their willingness to participate. USAID strongly believes that when the availability of HG financing is known, various additional project proposals will be received by housing finance institutions.

The $20 million program will provide financing for low income housing projects at a level sufficient to attract the private institutions, developers and cooperatives. This program will demonstrate that (1) sufficient profit potential exists for housing production at the lower level to interest the private sector, (2) both the risk of default and the transaction costs are within acceptable limits for these households earning below the median income. Furthermore, if additional local financial resources can be mobilized, the private sector can continue its increased production levels and begin to address the enormous demand for housing more effectively. It is anticipated that Kenya's public sector will continue to have the major responsibility for planning and implementing programs to serve those families at the lowest income levels. If the concept can be established, and sufficient profitability can be ensured, Kenya's private financial sector will begin to serve a majority of the population.

In other words, under this program, Kenya's housing finance institutions will provide mortgages of approximately $3,400 - 7,400 (KShs 45,000 - 90,000) for the first time. By bringing income groups within their clientele, the financial institutions will be able to attract additional sources of savings, broaden their business base and contribute to the solution of the critical housing problems of low income people. This HG program will help shift the responsibility for providing low cost shelter from the public to the formal private sector. The program will also strengthen the housing cooperatives with membership drawn from low income families.

2. Host Country Priorities and Programs

Kenya's Ministry of Works, Housing and Physical Planning (MWHPP) has the primary responsibility for the formulation of overall housing policy which is specified in the Fourth Development Plan, 1979-1983. USAID's prior and current involvement with the Government in housing is presented in Annex F.

Major shifts in the Government's shelter policy have evolved during the last decade: (a) a stronger commitment to provide shelter affordable by the urban poor, (b) more emphasis on cost recovery in the provision of low cost shelter, (c) more emphasis on the growth of secondary towns and smaller urban areas, (d) a stronger commitment to reorganize public sector bodies in order to expedite the process of the shelter delivery, and (e) more recently, greater encouragement for private sector participation in the development of low cost housing.

In the present Development Plan, the greater part of the Government's budgetary allocations for new shelter and related community facilities are earmarked for low cost housing in the form of site-and-service and upgrading programs. Medium and high cost housing is expected to be provided primarily through the private sector. The National Housing Corporation (NHC) is the main government agency under MWHPP responsible for the implementation of the government's low cost housing policy and programs.

However, during the past five years, the combined private and public formal sector production of housing fell far short of the estimated demand. The deficit has been filled by the informal private sector through the provision of substandard housing with few if any community facilities.

The Government has proposed the following initiatives to stimulate the formal private sector's participation in the development of low cost housing:

a. Encouragement of provision of long-term finance into the mortgage market by agencies such as the Housing Finance Company of Kenya, Savings and Loan Kenya Ltd., East African Building Society, insurance companies, and the National Social Security Fund, etc.

b. Provision of serviced sites on Government land either to individuals or to develop organizations, such as housing cooperatives.

c. Establishment of a tax incentive for savings in housing finance institutions.

d. Formation of housing cooperative societies.

In 1980, the Government sponsored a nationwide seminar to discuss the role of the private sector in housing. This seminar was followed by a request to HABITAT to formulate a program to attract the participation of the private sector in the financing and development of low cost housing. In June 1983 the Ministry of Works, Housing and Physical Planning and USAID sponsored a seminar on the "Establishment of a Secondary Mortgage Market in Kenya". Over 70 senior representatives of the public and private sectors attended and discussed ways to mobilize private financial resources for housing. The Government's opening remarks for this seminar are presented in Annex M.

In 1982, in the context of a severe economic slowdown, the Government formed the Working Party on Government Expenditures which recommended sharp reductions in public spending. Approval of the recommendations reinforced the Government's commitment to encourage greater private sector involvement in the shelter sector. The Minister of Works, Housing and Physical Planning, in a recent statement, emphasized the Ministry's intention to support fully the implementation of a program that would boost the existing mortgage market by way of stimulating private developers interest in small mortgage portfolios and low cost housing.

The proposed HG project is supportive of the Government's policy objective of greater reliance on the private sector. The project will induce the private sector to focus its superior productivity on the production of housing for lower income households.

3. <u>The Private Sector in Kenya</u>

Both formal and informal sectors make up the private housing sector. The formal sector is composed of developers, builders and individuals who construct conventional and relatively high cost housing units, which are financed through individual mortgages. The informal sector operates to produce vast numbers of substandard rental accommodations.

(a) <u>Formal Private Sector</u>

The private formal sector has tended to focus on providing houses for upper middle and upper income families costing between $18,500 - 40,000 (KShs 250,000 - 550,000). The housing finance institutions and private developers have been convinced that only families able to afford this type of housing represent a viable market and an acceptable financial risk for them.

Developers have concluded that their land holdings could not be subdivided profitably because city council approvals for reduced standard site developments can not be obtained within a reasonable time for low cost projects. In addition, financial institutions believe that the cost of loan processing and administration for low income family mortgages would be so high as to reduce their profit to an unacceptable level. Until recently, there has been enough demand for high cost housing to provide sufficient business for both the existing developers and financial institutions. This demand for high cost housing has now softened due to the economic recession. Private developers are looking for new markets and sources of capital, and the financial institutions are considering ways to reach a wider range of low income borrowers. Furthermore, past production levels of the private formal sector have been quite limited, due in large part to the limited amount of financial resources that have been used to expand production levels and the high price range of the houses. Untapped, but available, financial resources need to be attracted.

Housing cooperatives are a new and developing aspect of the formal private sector. Recently a number of housing cooperatives have been formed, but this is a new development in Kenya. The provision of cooperative housing has been relatively insignificant so far, primarily due to the lack of technical, financial and managerial capacity. The HG project will devote considerable resources to strengthen housing cooperatives in Kenya.

(b) Informal Private Sector

The informal housing sector has provided the bulk of the required shelter in urban areas. Presently, 30% of the urban population lives in slums and shanty housing in informal developments. Nairobi's Housing Development Department estimates that 350,000 residents live in illegal slums. The substandard houses in these areas are generally of one room, constructed of mud and wattle or timber and erected, at best, two feet from one another. These informal housing areas lack water, sanitation and drainage facilities, and generally lack other necessary urban services such as refuse removal, schools, etc. In Nairobi's Mathare Valley density levels reach 3,300 persons per hectare whereas recommended urban standards call for 200 to 400 persons per hectare.

In summary, the private sector has provided housing to the upper end of the income scale through the formal sector and to the lower end through the informal sector. Thus standard housing is guaranteed for upper end of the income scale by the formal sector whereas slum and squatter settlement housing is available to the lower end of the scale through the informal sector. At the current time, the vast numbers of families in the middle and lower middle income range are served by neither sector. The private sector needs to respond to these families.

4. Coordination with Other Donors

A number of international agencies are involved with the proposed HG program. One is the United Nations Center for Human Settlements (HABITAT), headquartered in Nairobi. The other is the Commonwealth Development Corporation (CDC), a British Government aid agency that lends funds or makes equity investments in mostly private sector, revenue-producing organizations.

HABITAT financed a study of potential private sector involvement in the production of low cost housing. During the preparation of this report, USAID worked closely with the HABITAT staff and with the study team. Much of the material developed in the HABITAT study has been utilized in the design work leading to this Project Paper.

In addition, HABITAT has developed a package of software which housing finance institutions can use to improve the efficiency of their accounting and mortgage operations. USAID plans to provide some short term technical assistance in computer

Commonwealth Development Corporation is a 50% owner of the Housing Finance Company of Kenya (HFCK) which, as the oldest and largest of the housing finance institutions, is considered a key to making the proposed program work. During the 1970s, CDC provided a considerable amount of long-term financing for middle and upper middle income housing in Nairobi through HFCK. At the present time, CDC is considering a new program of low cost housing in which it would act as the developer as well as provide the long-term financing through HFCK. Thus, CDC is very interested in this program and has been very supportive, both directly and through its Board Representative at HFCK.

The International Finance Corporation (IFC), in collaboration with USAID, is currently conducting an overall study of Kenya's financial sector including capital markets. USAID will coordinate activities with IFC as much as possible in that IFC's recommendations will influence the Government's response to the establishment of a secondary mortgage market.

USAID has maintained close coordination with the World Bank in the shelter sector. In the development of the public sector Small Towns Project (615-HG-006) (see Annex F), USAID, the World Bank and the British Overseas Development Administration (ODA) have been working together on different project elements since the conceptual stage. USAID will fund all training, and the World Bank will handle all monitoring and evaluation for the total small town project efforts.

5. <u>Relationship To CDSS and ABS</u>

U.S. assistance to Kenya is focused on three specific development objectives. These are: (a) increased agricultural production, employment and income; (c) reduced population growth; and (3) efficient delivery of basic social services. In the CDSS, this last objective embraces housing.

The CDSS states, "USAID will develop and demonstrate low cost approaches to the delivery of basic services (including health, water, nutrition and housing). Implementation in some instances will require government guidance and government structure, but will, in large part, be in the hands of the private sector; voluntary agencies and local community groups." This approach is an expression of the broader USAID aim, recognizing the Government's budgetary and managerial constraints, to promote private sector solutions to needs for investment, service delivery and technology transfer. The CDSS, in effect, anticipates the proposed program by declaring that, "among the projects which will implement this new emphasis, USAID is planning a new major initiative to involve Kenyan private sector financial institutions as well as private builders and developers in the packaging and delivery of housing for low income people."

The proposed HG project is an integral part of this strategy. It supports the policy objective of the Government to increase the private sector provision of housing, particularly at low income levels. It will support an expansion of the overall housing finance system in Kenya with emphasis on the private sector, and in so doing, should clearly lead to the improved provision of low income housing.

B. OBJECTIVES

1. Program Goal and Purpose

The goal of the program is to improve the quality of life of lower households through the support of user financed social services.

The program purpose is to develop the private sector's capacity to plan, develop, and finance low income housing.

Secondarily, this program will provide balance of payment support under relatively favorable terms and conditions.

2. Outputs

It is expected that the investment of $20 million will demonstrate the profitability and feasibility of providing low cost housing through the private sector. Since the private sector is motivated by expanding opportunities and profits, it is believed that the private sector will invest an increasing amount of its own resources where opportunities exist. This will result in the replication of the proposed project concept without additional outside assistance.

The following are anticipated achievements:

1. Private developers in Kenya will have planned and completed approximately 2,500 housing units for urban households of below median income.

2. NACHU will have demonstrated the capacity to plan, develop and contract out the construction of approximately 500 housing units for several member housing cooperatives.

3. For the first time, five private housing finance institutions will have provided approximately 3,000 mortgages for below median income households.

4. The following studies will have been completed; (a) a study of the primary mortgage market system with a view towards mobilizing its resources for low income families; and (b) a comprehensive study of basic housing needs in Kenya.

5. Steps will have been taken to develop the rules and regulations necessary for the operation of a secondary mortgage market.

6. Systems to direct significant proportion of mortgage funds to lower income housing will have been development.

7. The Central Government and town councils will have adopted appropriate building standards for housing and infrastructure.

8. Housing for below median income households will have been built on privately controlled land in growth areas of cities and towns.

The logical framework is attached as Annex C.

C. DESCRIPTION

1. Overview

The $20 million in HG loans will be used to encourage private developers, cooperatives and the housing finance institutions to initiate low cost housing projects costing approximately $6,600 (KShs 90,000) per housing unit at 1983 prices. Such houses are affordable to below median income families. For the first time the profit making institutions and developers will lower the price range of the housing units they produce from $18,500 - 48,000 (KShs 250,000 to 650,000) to approximately $3,700 - $7,400 (KShs 50,000 - 100,000). Approximately 3,000 housing units will be produced in this project.

First, up to 20% of project funds will be utilized for cooperatives. It is anticipated that the development of the cooperative projects will not move as rapidly as those of the private developers; consequently, only two or three of their projects are likely to be financed initially. Technical assistance to the apex housing cooperative, NACHU, will help develop the capacity for developing such projects.

Second, USAID believes that an input of $20 million worth of projects will be necessary to provide sufficient capital to the private sector to convince them that low cost housing is a profitable venture. If on the basis of the activities of the first phase, the private sector will begin to use its own resources to finance lower cost housing, this in itself, will be a major accomplishment of the project.

While the private sector is building lower cost housing , USAID will investigate and study (a) basic housing needs of Kenya, (c) informal and formal housing finance systems, and (c) other ways of mobilizing savings and investments for lower cost housing include the study of the viability of developing secondary mortgage market operations in Kenya. USAID and the International Finance Corporation have already embarked upon a study of the capital markets in Kenya. The results of this study will provide useful insights into the development of a secondary mortgage market. A special study, underwritten by USAID, will focus more closely on the laws, regulations, policies and commercial practices that directly relate to secondary mortgage market operations. If the secondary mortgage market is viable in Kenya, the following steps will be undertaken in the second tranche of the program.

i. Recommendation and development of laws, regulations, policies and procedures, necessary for the establishment of a secondary mortgage.

ii. Development of model/sample mortgage instruments approved by the sellers and buyers of the mortgage instruments.

iii. Development of sales, maturities, processing, administration and servicing procedures for the mortgage instruments.

iv. Development of standardized primary mortgage instruments by the housing finance institutions, to facilitate marketing in the secondary mortgage market.

2. <u>Program Implementation and Operation</u>

The HG loan funds in U.S. dollars will flow from the U.S. lender to the Kenya Ministry of Finance and then to the Central Bank. The Central Bank or Kenya Commercial Bank (Government owned) will open a special HG project account. The funds, in Kenya shillings, will be placed in this account, in an amount equivalent to the U.S. dollars released to the Central Bank.

The Central Bank will enter into sub-agreements with each of the housing finance institutions. These sub-agreements will spell out the eligibility criteria jointly, established by USAID and MWHPP, for HG funded projects and the terms of loan repayment. The sub-agreements will be consistent with the basic agreement between the Government and USAID. Furthermore, USAID, the MWHPP and the participating city planning office will negotiate reduced building standards and an accelerated project approval process. Once approved, the project will be widely publicized to ensure maximum participation by developers, NACHU, and individual housing cooperatives.

The amount of funds available to each housing finance institution will be determined by USAID and the Ministry of Works, Housing and Physical Planning on the basis of the institution's capacity to handle the project and its submission of a preliminary Master Project Delivery Plan. The Delivery Plan will include a preliminary list of eligible projects, schedules and cash flow. Preference will be given to smaller projects to spread the experience as widely as possible. Furthermore, projects submitted by cooperatives will be given preferential treatment. The housing finance institutions and building societies will work with private developers and NACHU to prepare and develop projects.

Beyond the initial allocation, USAID and MWHPP will not intervene in the decision-making process of the finance institutions or the developers. The housing finance institutions and the developers will conduct technical and financial feasibility studies. The housing finance institutions will provide a latter of commitment for the mortgage financing; the developer will acquire the land, attain necessary municipal approvals, build and finally sell the houses. The developers will use the latter of commitment as the basis for obtaining the construction financing from a commercial bank. The alloations of funds will be reviewed by USAID, and MWHPP periodically. Unused funds remaining within one institution will be reallocated to others.

Once the eligible beneficiaries have been selected and mortgage loans approved by the housing finance institution, a certified list of mortgages for the project will be submitted to USAID. USAID and MWHPP will review the project to ensure its compliance with the sub-agreements. On the basis of this review, USAID will authorize release of funds from the Central Bank to the housing finance institution. (A detailed program implementation and phasing schedule is presented in Annex G.)

3. Project Beneficiaries

a) Owners

Direct beneficiaries under this program will first include those households that purchase houses as a result of the financing provided. These beneficiaries will be households with incomes ranging from about $125 (KShs 1,700) up to the median urban household income of $185 (KShs 2,500) per month. The housing finance institutions will be required, by the sub-agreement between them and the Central Bank, to determine eligibility for purchasers on the basis of an income below the median level of KSh 2,500. The cooperative project houses will, by sub-agreements between NACHU and the cooperative, be provided for members of the cooperative with incomes below the median level.

Approximately 3,000 houses will be financed through the $20 million. The average number of people per urban household is 4.3, indicating that almost 13,000 individuals will directly benefit under this program.

b) Renters

In addition to the families who will purchase the housing, it is expected that about two-thirds of the units will have rental room. At an estimated occupancy of two persons per rental room, an additional 4,500 individuals will benefit from the program as renters.

Workers

The program will create construction employment which will result in more than 6,480 person years of employment.

About 30% of the construction cost is labor. Of that, a little more than 50% is at low skill levels, say KSh 25 per day; and the remainder at high levels averaging KSh 50 per day. Technical and supervisory staff is paid much more, but their aggregate wage bill is small because there are fewer work hours involved, perhaps 5% of the total labor input. Given these estimates, a projection can be derived as follows:

For each KSh	1,000,000	of total housing costs
there will be	250,000	for non-construction costs
	750,000	for construction costs
x	.30	for labor component
	250,000	labor costs
divided by	33	per day average wage
	6,750	days worked
divided by	280	days worked per year
	24	man years per KSh one million of investment.

4. Sustainability and Replicability

The achievements set forth in Section B above, will assure the program's sustainability and replicability over the long-term. The provision of the $20 million will demonstrate that low cost housing can be profitable for both housing finance institutions and developers.

Once this has been demonstrated and the sources of housing finance expanded, then both the housing finance institutions and developers will continue to serve the much larger market, because it presents the possibility of increased business and profit. USAID will explore alternatives and promote the establishment of systems to ensure continued infusion of mortgage financing to the low cost market. One means would be the requirement that sellers of pools of low cost housing mortgages commit the proceeds to additional low cost housing.

A fully-functioning NACHU, able to provide the services needed by new and existing housing cooperatives, should ensure that such cooperatives flourish and expand. Starting from the small existing base of housing cooperatives, there is considerable scope for expansion and improved operations. This example will, in turn, lead other low income groups whose members have some common affiliation to form housing cooperatives.

The project should contribute to a mobilization of resources for housing finance. There should be an increase in savings from low income families as below median income families perceive that they can, in fact, obtain mortgages from housing finance institutions. Savings occur both because of the new opportunities to obtain a mortgage eventually, and the identification with these institutions as ones which are demonstrating service to low income groups.

With growing experience with lower income mortgages, relative to collections and servicing, and with continuing USAID assistance in the development of a secondary mortgage market, investors should be willing to invest a portion of their funds in some variation of mortgage-backed securities. Thus, internally generated resources from individuals and institutions should ultimately reach a level where they meet a large percentage of requirements for housing finance.

V. COST ESTIMATES AND FINANCIAL PLAN

A. Housing Finance

It is envisioned that $20 million in HG resources will be disbursed over a four-year period.

The buyer will receive a long-term mortgage at the prevailing market interest rate. The prevailing interest rate will include the cost of loan funds to the institution and a reasonable spread to cover the service charge. The buyer will pay monthly installments to the housing finance institution. The housing finance institution, after deducting its servicing charges, will forward the payments on a periodic basis to the Central Bank, who will in turn repay U.S. dollars to the U.S. investor.

B. Technical Assistance and Training

To supplement the capital financing, grant funds will be provided as follows for technical assistance and training:

1. Up to $940,000 in DA grant funds will be provided for technical assistance and training to the National Cooperative Housing Union (NACHU). These funds will finance two resident advisors, specialized short-term consultants, and a series of training workshops. In addition, $180,000 will be used to provide short-term training and technical assistance to the housing finance institutions.

2. $100,000 from HG fee income will finance short-term consultants for assistance to the participating housing finance institutions and to NACHU to assist in the formation of a strategy to mobilize additional resources for low cost housing. This $100,000 will be supplemented by the RHUDO staff who will do much of the work on promoting and coordinating efforts with the various institutions which are to participate in this project.

The technical assistance budget appears in Table 1.

a) Assistance to Cooperatives

Participation by housing cooperatives is an important part of the program. Rather than attempt to provide assistance directly to individual cooperatives, USAID will provide TA and training support to NACHU, the apex organization. NACHU will, in turn, provide TA and training to its member housing cooperatives.

The proposed program will consist of two resident advisors who will work closely with counterparts in NACHU, short-term specialized technical assistance, and in-country training workshops. Financial advisors funded by HG fee funds to assist the housing finance institutions will also provide TA to NACHU on financial planning and management.

In close collaboration with USAID, the chief resident technical advisor will be responsible for overall coordination of the TA program to NACHU. This advisor will be a specialist in the development and management of cooperatives and low cost housing in the developing world. The second advisor will have experience in the development of low cost housing, with special skills in physical planning, construction management and self-help building techniques.

b) <u>Assistance to Housing Finance System</u>

Short-term technical assistance will be provided to assist those housing finance institutions that are interested in improving the efficiency of their operations, particularly so that mortgages of lower amounts can be effectively administered. For instance, HABITAT has software programs available for housing finance institutions, which can be adapted for use by Kenyan institutions. Some training can also be provided to selected candidates. For example, an officer who is the Deputy General Manager, of the Housing finance Company of Kenya will attend this year's Shelter Workshop which is offered by the Office of Housing and Urban Programs.

The short-term technical assistance and training in housing will include provision of assistance in establishing a secondary mortgage market. Some of the key areas which short-term TA can address include: (i) the preparation of rules and regulations to govern secondary market

TECHNICAL ASSISTANCE - BUDGET

TABLE 1

DA GRANT BUDGET

TA TO NACHU BY RECIPIENT OF COOPERATIVE AGREEMENT	FY-1984	FY-1985	FY-1986	TOTAL
(1) Long-term TA (2 years)	$ 95,000	$ 100,000	$ -o-	$ 195,000
(2) Long-term TA (3 years)	50,000	55,000	60,000	165,000
(3) Field OH on 1 & 2	123,250	131,750	51,000	306,000
(4) Short-term TA (12 mos.)	50,000	60,000	-o-	110,000
(5) Central office backstop	15,700	17,830	5,500	39,030
(6) Backstop travel	-o-	5,720	-o-	5,720
(7) Other direct costs (a)	5,000	10,000	5,000	20,000
(8) Two (2) vehicles (NACHU)	15,000	-o-	-o-	15,000
(9) Audio-visual equipment	3,000	-o-	-o-	3,000
(10) Microcomputer (NACHU)	5,000	-o-	-o-	5,000
(11) Training workshops	15,000	15,000	9,000	39,000
(12) Contingencies	7,200	10,000	20,000	37,250
TRAINING - SECONDARY MORTGAGE MARKET OPERATION				
Participant training and technical assistance	40,000	60,000	80,000	180,000
SUB-TOTAL	$ 424,150	$ 465,300	$ 230,500	
GRAND TOTAL				$ 1,120,000

Items 1 thru 12 are for NACHU support under the Cooperative Agreement Activities for NACHU, to be implemented by a contractor, and management by RHUDO/E&SA.

Participant training will be for Kenyan Financial Institutions, and managed by RHUDO/E&SA.

(a) Other direct costs include Workmen's Compensation; medical evacuation; temporary help; telephone, postage; duplication/printing; supplies and miscellaneous.

operations, (ii) the design of types of mortgage-backed securities, (iii) a feasibility study of the establishment of mortgage or mortgage pool insurance and the examination of the legal aspects of assigning mortgages as part of a security. It is also intended to develop a training program whereby officials from individual finance institutions and officials from the Central Bank and the Ministry of Financ(can be trained in the U.S. There they will gain exposure to the U.S. savings and loan associations and the secondary mortgage market, e.g., how it operates and is regulated. Short-term TA will also be provided to the housing finance institutions to assist them in developing a marketing strategy to capture savings from lower income families.

C. Local Contribution

All housing financed under the program will require a 10% down-payment by the beneficiaries. Counterpart funds for the grant will take in the form of staff members. Office space, as well as equipment will be provided to NACHU by the Government of Kenya and all other donors. This data is presented in Annex N.

D. Summary of Financial Inputs (In $000)

	HG	Grant ($000)	Local	Total
House Construction	20,000	-	2,000	22,000
TA (DA Grant to NACHU	-	940	215	1,155
TA (DA Grant to Housing Finance Institutions)	-	180	-	180
TA (HG Fee)	-	100	-	100
TOTAL	20,000	1,220	2,215	23,435

VI. IMPLEMENTATION PLAN

A. IMPLEMENTATION ARRANGEMENTS

The implementation plan for the project and the roles of the Government, Central Bank and USAID are discussed in this section.

1. Borrowing Procedures, Repayments and Flow of Funds

The Government of Kenya, through the Ministry of Finance, will borrow HG loan funds from a U.S. private lender. The Ministry of Finance will be the guarantor of HG loan funds and will assume the foreign exchange risk and repay the principal and interest on the HG loan to the lender in U.S. dollars. Pursuant to the approval of the project and authorization of HG loan guaranty, the Government will enter into the following agreements:

-Implementation Agreement between USAID and the Government

-Loan Agreement between the U.S. Lender and the Government

-Guaranty Agreement between USAID and the Government

-Paying and Transfer Agency Agreement between the designated U.S. Bank and the Government

At the same time, USAID will provide a U.S. Government Guaranty to the U.S. lender for repayment of principal and interest on the authorized HG loan amount.

The Ministry of Finance, acting through the Central Bank of Kenya or the government owned Kenya Commercial Bank , will enter into sub-agreements with participating housing finance institutions. These institutions will channel the funds to private developers following project approval and the selection of eligible homebuyers. The participating housing finance institutions will pay back the loan to the Central Bank of Kenya who, acting on behalf of the Ministry of Finance, will pay back the loan to the U.S. lender, in accordance with the loan agreement between the Government and the U.S. lender.

The HG loan funds will be used for long-term mortgage financing of eligible projects. Since housing finance institutions do not provide construction financing, private builder/developers will obtain construction financing from local commercial banks. However, in exceptional cases approved by USAID, HG funds may be advanced for construction financing, particularly for housing cooperatives or, in the event of a severe liquidity shortage, among commercial banks. The advance will be in the form of a short-term loan between the Central Bank and a commercial bank. In the event that HG funds are advanced for construction financing, there will be an absolute repayment requirement between the Central Bank and the commercial bank, regardless of whether the projects are ultimately deemed eligible for long-term financing. In accordance with Kenya practice, the developer will post a performance bond with the commercial bank. In any event, USAID will not be directly involved or associated with construction financing. Thus, USAID will have no risk or exposure associated with construction financing.

USAID has discussed and agreed in principal with the Ministry of Finance that the flow of HG funds will be in accordance with Figure A.

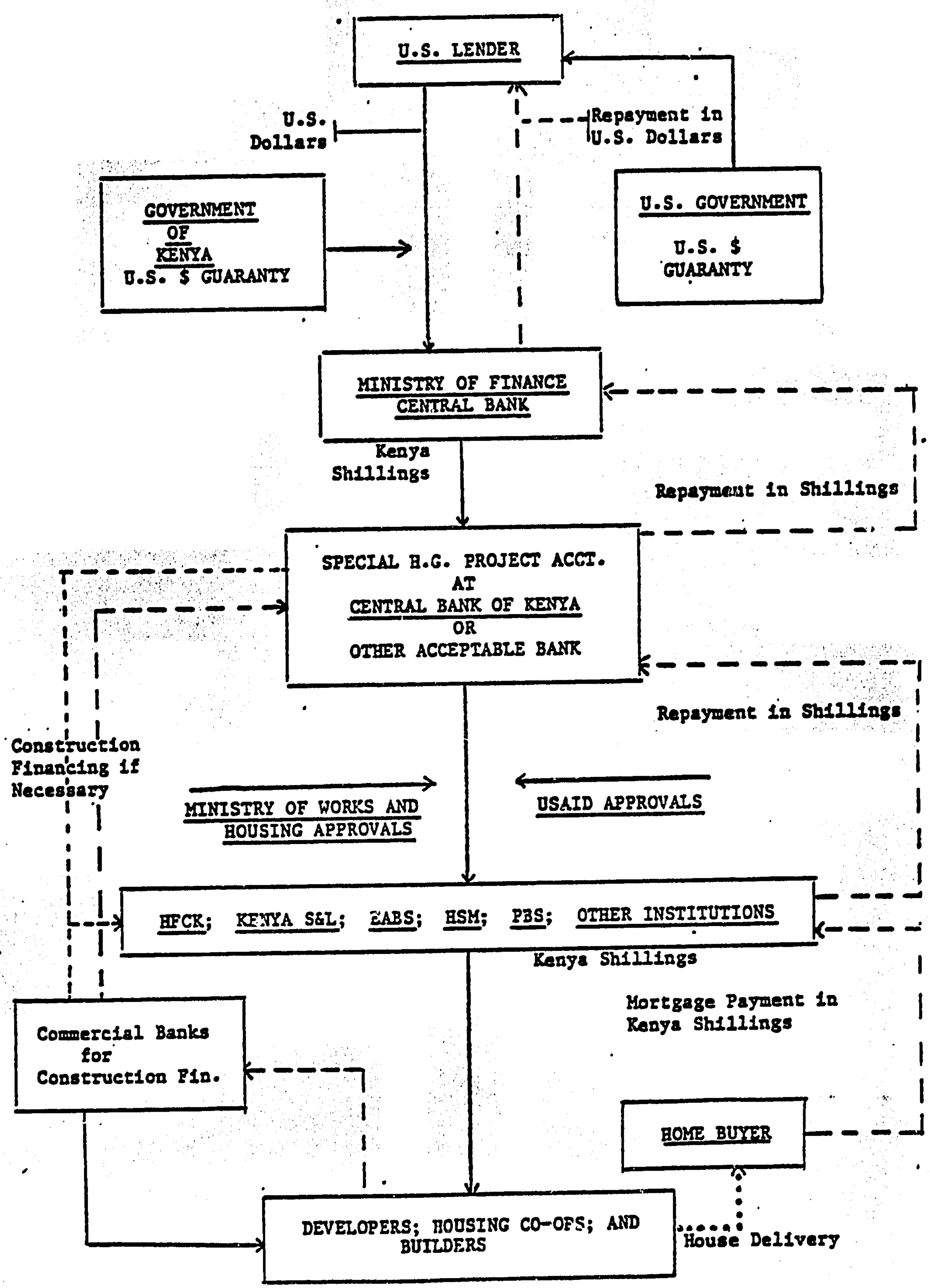
2. <u>Project Planning and Approvals</u>

This is a private sector project, which will rely on the initiative and imagination of the private sector and in which the developer and financing institutions will be at risk. Thus, the planning and approval process insofar as the Government and USAID are concerned will be minimal.

USAID, working in conjunction with the Ministry of Works, Housing and Physical Planning (MWHPP), will approve the eligibility criteria for mortgages and costs financed under the program. These criteria will be based on affordability but will include a maximum limitation. The program and its criteria will be announced through appropriate means. It will be up to the developers and cooperatives to come forth with projected and prospective buyers who will be

FIGURE A

FLOW OF FUNDS



acceptable to the housing finance institutions. The developer and cooperatives will have to do their own marketing and location planning. Appropriate site and project approvals will have to be obtained from the appropriate authorities.

However, USAID and MWHPP will work with the appropriate city council, MWHPP and other agencies of the government to attain prior approval for reduced standards and to assist the private developer and cooperatives in getting the necessary approvals.

3. USAID Management

Management and administration of this program will be the responsibility of the Office of Housing and Urban Programs, acting through the Regional Housing and Urban Development Office (RHUDO), which is located in Nairobi. RHUDO will designate the Project Officer and USAID will nominate a person as a point of contact for RHUDO/USAID liaison.

All program management, implementation and administrative actions, consistent with the approved Project Paper and the Implementation Agreement, will rest with RHUDO. However, USAID will provide policy guidance and direction with recommendations from RHUDO.

B. IMPLEMENTATION SCHEDULE

USAID approved, and authorized a $20 million HG program in September 1983. USAID and the Government will proceed to negotiate the Implementation Agreement. It is anticipated that the Implementation Agreement will be signed by the end of January 1984.

After the signing of the Implementation Agreement, the housing finance institutions, in close collaboration with the private developers and housing cooperatives, will begin project preparation. Interested housing finance institutions will enter into sub-agreements with the Central Bank of Kenya during the third quarter of FY 84. It is anticipated that the Government will sign the $20 million Loan Agreement with the U.S. private lender in the fourth quarter of FY 84.

VII. MONITORING PLAN

The Ministry of Works, Housing and Physical Planning will submit a detailed Monitoring and Evaluation Plan that is acceptable to USAID. This plan will be developed by the Ministry's Monitoring and Evaluation Division. USAID will provide the Division with technical assistance. This will ensure that the monitoring section of the plan will conform to the Office of Housing and Urban Programs (PRE/H) Evaluation and Monitoring Guidelines.

The monitoring process will include periodic progress reports to USAID from participating financial institutions, private developers, the National Cooperative Housing Union (NACHU) and the Ministry of Works, Housing and Physical Planning's Monitoring and Evaluation Division. These reports will include quantitative measures of physical progress and of progress in meeting institutional objectives, identification of problem areas, and related recommended strategies for meeting problems and objectives for the next quarter. In addition, and as an integral part of the monitoring process, USAID will receive scheduled reports from advisors and short-term consulants under the technical assistance program.

To ensure compliance with the eligibility criteria for mortgages and housing unit costs under this program, USAID will conduct random spot audits of mortgage applications and the developer's unit costs.

Recommendations for program modification resulting from the monitoring process will be transmitted to the Ministry of Works, Housing and Physical Planning as well as to individual financial institutions, developers and, through NACHU, to participating housing cooperatives.

USAID has adequate staff capacity to monitor this program as described above. RHUDO will also monitor the project progress and complete quarterly reports, as required on all AID projects.

VIII. PROJECT ANALYSIS SUMMARIES

A. INSTITUTIONAL ANALYSIS

1. Kenya's Private Housing Finance Institutions

The key implementing institutions in this HG project will be five housing finance institutions (this definition includes two institutions which, although partially publicly owned, operate without Government financial subsidy or appropriation). Since these two institutions do operate as private, profit making institutions, and since they finance the majority of housing construction, it is essential that they be included to effect lower sales prices of houses produced. Three housing finance institutions licensed under the Banking Act will participate in the HG program: the Housing Finance Company of Kenya, Savings & Loan Kenya Limited, and Home Savings & Mortgages. In addition, two building societies (comparable to U.S. savings and loans associations) will also be involved: East African Building Society and the Pioneer Building Society. Detailed descriptions of the five primary institutions will be found in Annex K. The role of these institutions in the secondary mortgage market is presented in Annex J. Participation in the program will be open to the Cooperative Bank and other institutions if they are interested and present acceptable master project plans.

Kenya's housing finance sector has been operating for nearly 30 years with considerable success. During this period these organizations have developed excellent staffs and facilities and profitable portfolios. However, they have restricted their lending to households at the upper end of the income spectrum. Nevertheless, in the last few years these institutions have experienced a significant business slow down as a result of depressed economic conditions in Kenya and the saturation of the upper income housing market in the major urban areas. These economic facts have combined to make the chief executives in these institutions receptive to a re-structuring of their traditional clientele and portfolios.

USAID has conducted numerous meetings with the senior management officials of Kenya's housing finance institutions during the last 12 months and has encouraged them to expand their operations to low income households. All of these officers have agreed that there is substantial unmet demand for housing in these low income categories. After some initial reluctance, the senior officials have come to believe that the default risks and transaction costs associated with doing business with households of below median income are acceptable, and that an appropriate profit can be made while serving this new target group. All five managing directors of Kenya's housing finance institutions have personnally given their support and encouragement to the new HG program and have asked to have their institutions included as approved lenders.

2. Housing Finance Institutions Lending Procedures and Practices

Kenya's overall financial sector is relatively well developed and has been characterized in recent years by rapid growth in both resources and numbers of institutions. Total assets and liabilities of the Kenya banking system were $1.7 billion (KShs 23 billion) at the end of 1982, a 17% increase over 1981 and 60% greater than four years earlier.

The Central Bank is the basic regulatory body for most financial institutions (building societies tend voluntarily to follow the Central Bank's rules and regulations), It sets minimum rates to be paid on deposits (currently 12.5%) as well as maximum interest rates for lending (currently 16%).

The five housing finance institutions have varied track records ranging from decades of experience to only a few years. The institutions also vary considerably in size, capitalization and loan processing ability. A number of general comments can be made, however, about their loan processing requirements and procedures.

Most of the institutions receive their capital through individual depository accounts on which interest is paid, longer term fixed deposits by investors (comparable to U.S. certificates of deposit), and the deposits of government corporations. In the last few years all of the institutions have had to maintain high liquid reserves as protection from potential heavy withdrawals from both individual and government clients. The Government has recently been pressuring its corporations to invest exclusively in Kenya Treasury Bills (which carry a generally lower rate of interest) to assist with public financing. The result has been that all institutions have had to restrict, to some extent, their lending levels to match reduced monies available for lending. As has been mentioned, all institutions are exceedingly keen to receive HG funds which would be free of this withdrawal pressure.

Kenya's housing finance institutions finance 70-90% of the lesser of appraised value or purchase price of homes and allow from 15 - 25 years as the normal loan amortization period. They permit from 25 - 35% of an applicant's monthly income to be allocated towards housing repayments. Rental earnings are accepted as part of the applicant's mortgage payment provided that the room or portion of the house to be rented has a separate entrance. Loan amounts have usually been restricted to three times the applicant's annual earnings.

All mortgage borrowers are required to purchase a mortgage life insurance policy which would retire the debt in case of death as well as hazard insurance for the structure. Kenya has no system for insuring mortgage loans against losses due to default.

At the present time Kenya's five institutions are making loans in the range of $22,000 - 55,000 (KShs 300,000 - 750,000). This market has dried up considerably and a number of the organizations are carrying a signficant portfolio (100 units plus) of unsold houses at this price range. Most senior management officials are candid in their appraisal that the market for upper middle income housing is now saturated and is not expected to revive for some years. These same officials are aggressively searching for new opportunities and are receptive to new ideas.

Both USAID and the senior management officials recognize that, in order for the housing finance institutions to be effective in broadening their scope of operations to include lower income households, a number of their procedures will have to be modified to cope with a significantly increased volume of loans.

Each institution is confident that it can process and close mortgage loans at a far greater rate than its lending capital has allowed in recent years. As an example, the Housing Finance Company of Kenya (HFCK), which funded an average of about 85 loans per month in 1982, has indicated that its current staff could easily handle three to four times that workload given the HG resources. USAID has estimated that with the addition of 100 loan cases per month (at an average loan size of $5,500), HFCK alone could easily process about $6.5 million a year under the HG program. HFCK believes that it could process these loans within its existing two interest point spread and make a satisfactory profit. In addition, HFCK believes that through its screening, it could select eligible applicants who would meet its credit worthiness test. These institutions believe, therefore, that with some modification of their existing practices, a loan program to households of below median income would be both profitable and within their acceptable risk standards. (Supporting details are presented in Annex K.)

One feature which the lending institutions will retain is the variable rate mortgage, which has been standard in Kenya for some years. These institutions have been prepared to adjust their portfolio upwards from 12% in 1980 to 16% in 1982. The officers believe that this feature will assist them cope with any increased risk or expense that they might encounter in the new HG program.

3. The Role of Commercial Banks in Construction Lending

The proposed HG program will deal primarily with long-term lending. Most construction loans under this program will be provided by the existing commercial banks operating in Kenya.

Presently 19 commercial banks operate in Kenya. Four are locally controlled while the others have a majority of foreign ownership. The giants in the commercial banking sector are Kenya Commercial Bank, Barclays Bank, and Standard Bank. A number of American and Arabian banks opened regional offices in Kenya during the last decade thus joining the more established European and Asian institutions.

A regular portion of the portfolio of Kenya's commercial banks is devoted to short term construction loans for residential developments. These construction loans are given only when the builder/developer can demonstrate possession of a valid long-term financing commitment from a housing finance institution. In considering requests for construction loans, Kenya's commercial banks evaluate the strength of the long term commitment, the professional and financial capacity of the builder/developer and the financial feasibility of the project itself. The also require the developer to post a performance bond for the successful completion of the project.

4. The Role of Pension Funds and Insurance Companies in the Program

At the present time neither pension funds nor insurance companies play a major role in Kenya's shelter sector. Nevertheless, both types of institutions could play a significant role in housing finance. USAID has "targetted" both categories of institutions for intensive discussions during the implementation period of this HG loan.

Kenya's 30 active insurance companies presently have few restrictions as to the composition of their investment portfolio. In the past, insurance companies and pension funds have invested heavily in the development of commercial real estate and the purchase of equity positions in private enterprises. Neither outlet appears especially promising at the moment. Since the supply of office space in Nairobi is quickly becoming saturated, insurance companies and pension funds are looking at residential real estate opportunities. Kenya reinsurance, a Government owned entity, has recently acted as a housing developer on a 204 unit project, providing 90% financing of homes priced between $23,000 - 30,000. Generally, however, insurance companies and pension funds do not have the specialized staffs that are necessary to enter the real estate development business. At the recent USAID seminar on the establishment of a secondary mortgage market in Kenya, insurance company and pension fund officials displayed keen interest in participating in such a domestic venture.

There is no primary lending for housing from Kenya's pension funds since, in order to maintain income tax exemption, fund contributors must not receive benefits prior to retirement. One housing finance institution, however, has negotiated the placement of a certain amount of pension fund money with it in return for agreeing to reinvest a certain amount in home mortgages for members. The National Social Security Fund (NSSF), which has assets of over $300 million, would be very interested in investing in higher income earning securities than Government Treasury Bills. Kenya's private pension funds and the Government's NSSF are actively searching for investment opportunities which will enhance their return. Pension fund representatives, like those from insurance companies, expressed the desire to learn more about how a secondary mortgage market might be established in Kenya. More on the role of these companies and funds in the secondary mortgage market is presented in Annex J.

5. <u>Participation of Housing Cooperatives</u>

In 1968 there were only 16 registered housing cooperatives in Kenya whereas today there are more than 70. Recognizing the inherent potential of housing cooperatives, the Government has recently supported the creation of the National Cooperative Housing Union (NACHU). NACHU will serve as the umbrella organization to foster and support the development of housing cooperatives.

NACHU was registered in 1979 under the Cooperative Law as the national apex organization (see Annex N, Section 7), and in February 1983 a general manager was appointed and core staff put in place. Additional staff is being provided by the Central Organization of Trade Unions (COTU), and a part-time cooperative housing advisor has been identified from HABITAT, the United Nations Center for Human Settlements. The organizational structure of NACHU is described in detail in Annex N.

As its first task, NACHU completed a base line study of 20 housing cooperatives with projects in some stage of preparation. It also prepared a set of draft criteria for project funding. The general manager of NACHU, the HABITAT advisor and representatives from COTU have all met with USAID on a number of occasions to determine how housing cooperatives could participate in the HG program.

Kenya's housing cooperatives are private in the sense that they receive no Government subsidies or appropria- tions. Housing cooperatives are often formed among employees of a single company. It is anticipated that some cooperative members may have incomes lower than those of other individuals participating in the HG program.

USAID has discussed the eligibility of housing cooperatives with the five participating housing finance institutions. Although these institutions had not made loans to housing cooperatives in the past, all were willing to consider how procedures could be developed which would enable a housing cooperative to apply for long term financing much as any builder/developer. The Cooperative Bank has also requested that it provide the mortgage financing from AID to the NACHU cooperatives. Their participation, if requested, will be determined by AID and the Central Bank at the time of the borrowing. They, as the housing finance institutions, must enter into a sub-agreement with the Central Bank. At the present time the chief impediment cooperatives face in participating in the HG program is their difficulty in securing construction loans from Kenya's commercial banks. Cooperatives will have difficulty demonstrating a construction and financial track record. Based on its worldwide experience, USAID believes that housing cooperatives can play a vital role in the shelter sector. Democratic housing cooperatives act as a socially and politically stabilizing force. Since their outreach activities are extensive among lower income households, housing cooperatives may be more effective in reaching below median income families in secondary towns than more established housing finance institutions. For all of these reasons, USAID believes that housing cooperatives should be encouraged wherever possible. Therefore, USAID is prepared to consider extending construction loans from HG funds in a number of carefully prepared cases where NACHU has been able to work closely with a particular housing cooperative. The construction funds would be provided by the Central Bank to a commercial bank which in turn would provide the funds to NACHU's builder.

All parties recognize that significant technical assistance will need to be provided to NACHU and, in turn, to individual housing cooperatives, if they are to play a role in this HG program.

This project requests grant funded technical assistance for NACHU that will provide two residents advisors, one for two years and one for three, and an additional 12 months of selected short-term technical assistance. The TA program will focus on institutional and project development as well as the training of NACHU counterpart staff. NACHU technical assistance is described in detail in Annex N.

NACHU should be self-supporting after three to five years, primarily from fees which it will charge housing cooperatives for the services it will perform. Membership dues will be a secondary source of income. More detailed forecasting of income and expenditures, and accompanying budget preparation, will be an early activity to be undertaken by NACHU. However, preliminary estimates of income indicate the following:

> At the completion of this project, it is assumed that NACHU will have developed a mortage portfolio. It is anticipated that NACHU will charge about a 3/4% management fee which will generate income of $22,500 per year by 1987. It is assumed that NACHU will have the capacity to develop at least 500 housing units each year for member cooperatives for which financing will come from the National Social Security Fund, the Cooperative Bank and housing finance institutions. It is anticipated that NACHU will charge a 5% development commission on its projects. The development of the 500 units costing KShs 80,000 each should

generate an annual $143,000 by 1986. Its total yearly income of $217,500 which should increase as NACHU's portfolio increases, and will be more than sufficient to support its core staff plus necessary operating expenses. More details on NACHU's projected income are presented in Annex N.

B. TECHNICAL ANALYSIS

1. Project Development Methodology

Since the proposed HG project breaks new ground in Kenya, USAID determined that it was necessary to do more during project preparation than merely sample the opinions of builder/developers, housing finance representatives and cooperative officials. USAID informally solicited a number of draft development programs for actual sites in Nairobi and other urban areas. These development programs were then discussed with representatives of the five housing finance institutions who commented on their feasibility.

At the same time, USAID was engaged in continuing technical discussions with both the Nairobi City Council and the Ministry of Works, Housing and Physical Planning and the Ministry of Local Government. These discussions concerned planning, building and infrastructure standards to be used in the two HG projects under development (Umoja II and Kenya Small Towns Shelter Project, described in Annex F). Based on these discussions, USAID is able to propose realistic, cost effective standards for this project.

During project development, therefore, USAID sought answers to the following questions through consideration of the other actual HG projects and the draft development programs drawn up specifically for this project.

- Was sufficient affordable land available in Kenya's major urban areas for development by private builder/developers or housing cooperatives?

- Could an affordable house be developed which would comply with the requirements of Kenya's private housing finance institutions?

- Did private developers have sufficient interest and profit potential as well as capacity to subscribe this HG project fully?

- Could Government and municipal approvals be structured to allow for speedy project development?

a. Land Availability

After a series of meetings with appropriate public and private individuals, USAID has concluded that the availability of affordable land is not yet a significant problem in Kenya's major urban areas. Even in Nairobi, which has witnessed a very substantial horizontal growth, there is still affordable land available for low cost housing within a reasonable distance from employment. Nairobi City Council's Planning Department estimates that there are approximately 2,200 acres of publicly owned land and an additional 1,000 acres of privately owned land within 15 kilometers of the city center. All of this land, either zoned or suitable for low cost, high density housing, is found in the eastern zone. There are thousands of acres of additional open land in the eastern zone beyond the 15 kilometer range, owned mostly by private individuals and companies. Mombasa and the other major urban areas have similar parcels of land available.

b. Development of an Affordable House

During the course of project development, USAID received house type plans from a number of private developers and housing cooperatives. Summary details of these plans are found in chart 3, and sample site and unit designs are found in Annex L.

Private developers/builders submitted house type designs which ranged from $5,900 - 7,400 (KShs 80,000 - 100,000) per unit while housing cooperatives presented designs in the $3,700 - 5,900 (KShs 50,000 - 80,000) range. Although these were preliminary designs and preliminary costs, it was USAID's opinion that all were feasible in the context of Kenya's existing shelter sector for "publicly financed" projects. In other words, similar house types and designs had been produced in Kenya before, but never built and financed by the formal private sector.

USAID believes that further cost reductions are possible within these prototype designs, particularly in reduced site and infrastructure standards. One example would be the use of clustered house designs with foot path access to main paved roads and only limited off-site car parking provided. Further reductions could be obtained through a reduction of the level of exterior and interior finishes and of the quality of the fixtures supplied with the house.

At this stage of project preparation, it did not seem wise to enter into any further negotiations concerning detailed design or cost reductions. Nevertheless, these negotiations, coupled with the very detailed cost analysis and standards review on the Umoja II project in Nairobi (615-HG-005) indicate that the development of an affordable house for the target group is feasible.

There is the concern that inflation could cause construction costs to exceed current estimates, thereby causing the units to be unaffordable, or not as profitable as expected by the developers. Before the actual borrowing of the HG occurs, developers and housing finance institutions will submit a list of proposed projects including their cost and construction period. AID will reconfirm at that time whether the units will still be affordable. If not, the borrowing will not be approved. If it is an affordable venture, the actual project approval will be on the basis of a fixed price contract for one year and negotiations will be held to determine the feasibility of a two year fixed price contract. In today's construction environment, contractors are agreeing to a two year fixed price contract with a cost increase of 4 to 5% on the bids to fix the price for two years. The developers are also required to post a performance bond.

c. Participation of Private Builder/Developers

USAID held detailed discussions with several groups of private builder/developers, and all expressed support for the project. More importantly, all seven groups actually spent money to prepare preliminary proposals for USAID's review; this action denotes a high level of support and commitment (See Figure B).

One principal reason for the enthusiasm private builder/developers have shown is the current severe depression in the construction sector. Kenya has a very well developed private construction sector which operates throughout East Africa and the surrounding countries. There are 280 firms registered with the Federation of Building and Civil Engineering Contractors, and 87 firms regularly construct projects valued at $1,000,000 and above.

At the present time, however, no new contracts are being awarded. Even more important, the Government is stretching out the payment period for existing contracts. The Federation estimates that its members are operating at 30 - 35% of capacity, and that employment among construction workers is down by 60%.

Kenya's private builder/developers need work. At this time they are willing to accept the somewhat reduced profit margins that will accrue from this project merely to get their employees back to work. USAID estimates from budgets submitted by the developers that the profit margin for HG financed housing development will be 10% to the builder/developers. The developers' continued operation in low cost housing will, of course, depend on their experience with this project.

As a result of this preliminary work, USAID anticipates no problem recruiting some of Nairobi's best builder/developers to participate in the HG program.

FIGURE 8
SAMPLE PROJECTS

DEVELOPER	SURESH KAIPLA ASSOCIATES	KENYA BUILDING SOCIETY	EAST AFRICAN ENGINEERING CONSULTANTS	[illegible] HOUSING COOPERATIVE	BAMBURI HOUSING COOPERATIVE	KARIOBANGI HOUSING COOPERATIVE	[illegible] HOUSING COOPERATIVE
PROJECT NAME	[illegible] Estate	Kayole	Garden Estate	To be determined	To be determined	Kariobangi Housing Cooperative	To be determined
SITE	316 acres, 13 kms from Nairobi City Center. Site is owned by Developer.	62 acres, 11 kms. from Nairobi City Center. Land is publically owned. City has agreed in principle, to transfer to Developer.	138 acres, 13 kms from Nairobi City Center. (this developer also has a 200 unit site in [illegible]).	139 dispersed plots in Kariobangi area - North Nairobi	74 acres in No. mainland, Mombasa 9 kms. from City Center, near Bamburi Cement factory. Site is currently owned by Credit Union, but will be transferred to co-op.	207 plots on 12 acres in the Mathare Valley - Nairobi	7.3 acres, in Mombasa. Land is owned by co-op.
LOCATION	Eastern Nairobi, zoned high-density residential.	Eastern Nairobi, zoned high density residential.	Northern Nairobi	Northern Nairobi; area is zoned for high-density, residential.	Suburban, near a main road	High-density area	Very high-density area. Is two [illegible] from Mombasa City Center.
DESIGN	cluster units with supporting infrastructure. Integrated income levels. Phase I is planned for 700 units on $130m^2$ plots. House will have 2 rooms, kitchen area and bathroom and is expandable.	Clustered units in integrated project of 1,300 units. AID-funded portion is 750 units on $100m^2$ plots with supporting infrastructure. House will have two rooms, kitchen area and bathroom and is expandable.	2000 cluster, attached units with supporting infrastructure. Phase I is planned for 800 units on $120m^2$ plots. House will have two rooms, kitchen area and bathroom and is expandable.	No standard design program, and is one of upgrading. Is owned outright, and is fully serviced.	600 min. core units at a density of 8-10 per acre. Units will be expandable.	Each unit will include up to six (6) rental units which will be built in rows.	Designs must be developed.
APPROXIMATE COST PER UNIT	Kshs. 105,000	Kshs. 80,000	Kshs. 100,000	Kshs. 75,000	Kshs. 50,000 - 65,000	Kshs. 75,000	Kshs. 50,000 - 60,000
TOTAL AID PORTION OF PROJECT COST	U.S. - $ 4.9 million. (Phase I)	U.S. - $ 4.0 million.	U.S. - $ 5.3 million (Phase I)	U.S. - $ 800,000	U.S. - $ 3,000,000	U. S. - $ 1.4 million	[illegible] U.S. - $ 100,000 for community facilities.
TOTAL DESIGN & CONSTR. PERIOD	3 years	23 months	20 months	36 months	24 months	Unknown	Unknown
DEVELOPER'S EXPERIENCE	Designed and developed 1,400 housing units.	Designed and developed over 5,000 housing units.	Design consultants have World Bank Urban II Project and have developed 4000 units.				

d. Streamlining Government Approvals

USAID will not get involved with detailed review of any house or site designs, engineering drawings or specifications for any of the projects. USAID will approve projects on the basis of unit and total project cost as well as affordability criteria. USAID will assist developers to obtain Government approval of appropriate standards and review procedures. Detailed review of plans and specifications will be the responsibility of municipal authorities and the housing finance institutions.

During the last few years with assistance from USAID and the World Bank, Kenya's planning, building and infrastructure standards have been extensively reviewed. A revised set of model standards has been produced which will shortly be presented to the Parliament for approval. Municipalities retain, however, wide latitude to adopt these revised standards for particular projects or not. To date, the revised standards have been used selectively by some municipalities for donor-funded projects. USAID has recently reached an accord with the Nairobi City Commission concerning adoption of revised standards for the Umoja II project. The revised standards have not been used to date for private development projects.

USAID intends to have as a Condition Precedent to the HG loan, a stipulation that the revised building standards be used by municipalities. The World Bank funded a major study which has been completed and discussed extensively with the Ministry of Housing and the Nairobi planning department. The standards proposed by this study along with the Urban II infrastructure and site standards (again from a World Bank project) are both appropriate for this proposed project an will provide for affordability.

The City's planning office has review criteria in place. This accounts for the environmental consideration presented in the IEE. The revisions of Urban II and the By-Law Study do not reject these important considerations for both a socially and physically acceptable environment.

Projects will be approved on the basis that water and sewers are available. Proper drainage pipes and ditches as well as on site drainage control (e.g., landscaping, retaining walls) will be provided. The site grading and final configuration will not contribute to any further polluting of neighboring areas or rivers. A separate study has been performed for the RHUDO Office on the appropriate use of open space and the relation of the house to play and communal areas. This study will be provided to the municipal planning officers and the developers to encourage them to utilize the concepts developed.

It is intended to form a Working Committee on Standards for this project composed of representatives from the Ministry of Works, Housing and Physical Planning, the Ministry of Local Government, USAID, and the participating municipalities. This group will consider mainly standards' issues relating to lot sizes, parking provisions, secondary road finishes, use of foot paths for house access, provisions for garbage collection and other services and reduced house sizes, amenities and finishes. These issues have been approved for the Umoja II project.

USAID will work with the municipal Physical Planning Departments to streamline the individual project approval process. At the present time the approval process can be a complicated procedure, and many private developers hire full time expediters to coordinate with public officers. USAID intends to draw up with the city or town an "administrative agreement" which will spell out ways to improve the review process. Those individuals furnished under the TA component of the project, together with the USAID Project Manager, will assist town officials to improve and modify their existing procedures.

The recent success in concluding an agreement with the Nairobi City Commission on the standards to be used and the approval process to be followed for the Umoja II project indicates that real progress can be made in this area.

C. ECONOMIC ANALYSIS

1. Economic Overview

During the first 10 years after Independence, Kenya achieved rapid economic growth. From 1964 until 1973, real Gross Domestic Product (GDP) grew at an average rate of 6.6% per annum, and per capita GDP rose at an average rate of nearly 3%. More recent developments are less promising and reflect both internal problems and Kenya's vulnerability to external factors, such as the collapse of the East African Community in 1977, the end of the coffee boom in 1978, international recession, substantial increase in petroleum and other import prices and periodic drought.

GDP growth averaged only 4.8% annually from 1974 to 1981 and fell to 3.3% during 1982. Per capita GDP fell somewhat to $325 using 1982 figures. Kenya will thus been unable to meet its original or revised economic targets set for the 1979 - 1983 Development Plan. Moreover, even if there is a halt in the decline of Kenya's terms of trade, the real growth rate in the plan period, will average only 1.8%, well below the 4% rate of population increase. In 1982 wage increases failed to keep pace with price increases, so that average real wages fell by 12.6% following a 1981 improvement of 3.6%. On average, Kenya's people will be less well off in 1983 than they were in 1978.

Nearly every major sector of the economy has shared in the last decade's general slowdown of economic activity. The manufacturing sector has seen its high levels of growth moderate somewhat to the present annual rate of 2.7% in 1982 (Economic Survey, 1983). Despite its rapid growth, the manufacturing sector remains relatively small, accounting for only about 14% of wage employment, 14.3% of GDP in 1981 and 14.1% of GDP in 1982.

During the last decade, Kenya's agricultural sector growth rate declined to 4.4%, from an annual average of 4.7% in the previous decade. Although growth in the sector was below that of the general economy, agriculture continues to occupy the most important position in the country, providing 65% of total employment, 67% of non-petroleum exports, 34% of total GDP, and 34% of inputs into manufacturing.

In accordance with the March 1983 IMF Stand-By Agreement, the Government has reduced the overall budget deficit from 6.5% in 1981/2 to 4.7% in 1982/3, primarily through expenditure control. In fact, the effect of controls on imports and expenditures achieved a reduction to 3%. The current account deficit of the balance of payments fell from 11% of GDP in 1981 to 8% of GDP in 1982 over 1981. Growth performance of the economy improved in 1982, partly due to increased agricultural production that was aided by good weather and new Government price incentives put in effect in 1982.

The contribution of the building and construction sector toward GDP in 1979-1982 averaged 3.9%. This sector generated an average of almost 5% of gross capital formation over the same period. Yet, in 1982, its 1% contribution toward GDP generated only 4% of gross capital formation. (See Table 2.)

The value of private residential building construction declined by 12% in 1982 over the average value of 1979-1981. That decline contrasted with the 9% increase in gross fixed capital formation in the same period. The value of private sector contruction completions in 1982 is estimated to have fallen in current price terms by 48% as compared with 1981. The poor performance in housing development is to be attributed not only to the slow growth in modern sector GDP but also to increasingly higher interest rates on loans and upward movements in construction costs. (See Table 3.)

TABLE 2

Statistics on Building and Construction

1979 - 1982

	1979	1980	1981	1982
Gross Fixed Capital Formation (GFCF)	540.45	622.52	725.45	686.96
GDP at Market Prices	2271.00	2632.00	3039.00	3420.00
Private Residential Buildings Completions	29.13	26.24	49.95	28.76
Gross Fixed Capital Formation in Building & Construction	25.68	33.41	32.90	27.62
Ratio of Building & Construction to GPD (%)	1.0	1.0	2.0	1.0
Building and Construction: Contribution to GDP at Constant 1976 Prices	3.9	4.0	4.1	3.5
Ratio of Building & Construction Completion to GFCF (%)	5.0	5.0	5.0	4.0
Annual Real (1976 prices) Growth in:				
(i) Building & Const. (%)		8.4	8.2	-10.4
(ii) GFCF at Constant '76 Prices (%)		2.7	4.0	-17.9
(iii) GDP (factor cost) (%)		3.3	5.5	3.3

Note: 1 Kenya Pound - 20 Kenya Shillings

Source: Economic Survey 1983

TABLE 3

Price Changes Related to Building and Construction (1980-84)

	1980	1981	1982	1983*	1984*
Interest rate on loans (maximum, percent)**	14.0	16.0	16.0	16.0	16.0
Inflation rate (Consumer prices, percent)	12.8	12.6	22.3	15.0	12.0
Residential buildings: Change in Cost indices (percent)	12.1	12.9	14.1	13.0	12.0

Notes: * Forecast

** Rate charged by commercial banks = 11.0
Other financial institutions = 13.0

Source: Economic Survey, 1983.

Direct expenditure by the Government on housing increased from $12 million in 1981/82 to $15 million in 1982/83, an increase of approximately 23% compared to an average annual rate of increase of 5.7% between 1977 and 1982. The budget of the National Housing Corporation was $8.3 million in 1982/83 for low cost housing.

The years ahead will be difficult for the Kenyan economy. Just how difficult will depend on some extent on trends in the world economy, which are difficult to predict at this time. Much depends on what happens to U.S. interest rates. If interest rates in the U.S. increase, the recovery in the U.S. may dampen. In that case, economic recovery of most developing countries including Kenya, would be adversely effected. However, if the interest rates in the U.S. remain roughly at their current levels, the U.S. economy improves, and there is resultant improvement in the aggregate GDP of the seven major industrial economies, the Kenyan economy can be expected to improve. Analysts expect that overall GDP of Kenya could reach the rate of population growth, at 4%, rather than lag behind it as was the case in 1982.

While there are indications that world economic recovery is underway, its strength and trends are very difficult to interpret at this time. Kenyan economic recovery is likely to have a 12 to 18 month lag behind OECD economic recovery. This recovery will initially affect the agricultural and export oriented sectors of the economy. The construction sector is likely to lag behind the agricultural and export sector as it has in the past. The depressed condition of the construction industry is not likely to change significantly until the Kenyan economy achieves a level of sustained economic growth.

The current depressed state of the construction industry and saturation of the market with upper-middle income housing presents a good opportunity to introduce the idea of private sector involvement in lower cost housing. It is expected that once the private sector builders gain experience in building lower cost housing units and find them profitable business propositions, they will continue to build similar housing utilizing domestic financial resources. Anticipated economic recovery will not be so great as to deflect the industry from low cost housing once the profitability has been established. The private sector will recognize the size of the market for lower cost housing and its profitability.

2. Kenya's Balance of Payments and External Debt

As IMF reports, during the period of 1977-1982, fluctuations in Kenya's external position reflected movements in the terms of trade, a period of expansionary fiscal and monetary policy and changes in official import policies. Following record-high prices in world markets for coffee and tea in 1977; the current account and overall balance of payments registered a surplus of U.S. $24 million and U.S. $245 million, respectively. As a result, net official reserves at the end of 1977, increased to U.S. $404 million, equivalent to about twenty-one weeks of the year's imports. In 1978, sharp declines in the world coffee and tea prices, together with increases in import demand which resulted from high earnings generated during the export boom of the two previous years, led deterioration in the current account was partially offset by higher capital inflows, mainly official long-term capital. However, the gross official reserves declined to about half the previous year's level, equivalent to ten weeks of imports.

In view of these balance of payment difficulties, the GOK tightened the import restrictions significantly in 1978. These restrictions, in conjunction with tight credit policies, led to a significant fall in imports in 1979. As a result of the reduction in imports and some rise in exports, the current account deficit declined to U.S. $406 million. This improvement, together with higher capital inflows, resulted in a balance of payment surplus of U.S. $162 million.

Following the relaxation of the import deposit scheme in late 1979, a sharp increase in imports coupled with the adverse effects of drought conditions on agricultural exports and further deterioration in terms of trade, resulted in wider deficits in trade and current accounts in 1980. While net capital inflows were aintained at high levels, the balance of payments registered an overall deficit almost equal in size to the surplus recorded in the previous year.

Preliminary figures for 1982 show a narrowing of the current account deficit from the 1980-81 highs, by one-seventh 1% to 8% of GDP. This improvement is due to the combination of improved non-oil export performance and during the last half of the year, the lightening of controls on imports. Higher export prices and volumes for coffee and tea led to an improved performance of traditional exports, while the beenficial effects of the devaluation boosted non-traditional exports. By mid-1982, the Kenya shilling had appreciated in real terms and private imports increased. This factor alone, with lower-than-expected capital inflows, and the effects of the political disturbances in August 1982, led the government to intensify restrictions on private imports in order to allocate the available foreign exchange. This has resulted in significantly reduced imports during the second half of 1982. In order to reduce reliance on quantitative import restrictions, the Kenya shilling was depreciated by an effective 42% since December 1982.

The HG loan will have a positive, though minor, effect on the balance of payments, as an estimated 85-90% of funds provided will be applied to local costs of construction. Disbursements of about $10 million per year beginning in 1985 will generate $8.9 to $9 million to finance imports or service external debt.

In summary, a recent GAO study (August 26, 1983) summarized the impact of HG program on Kenya as:

> "Negative economic impact seems minimal even under the present difficult economic situation facing Kenya. With less than 15% import content in low income housing and the staged disbursement of HG funds, imports would not appear to increase appreciably from a HG loan...[Provision of] untied foreign exchange through long term financing and a ten year grace period meets the criteria for Kenya's current preference for grants or concessional financing to alleviate its very serious economic constraints. The untied dollars are especially helpful in servicing Kenya's short term external debt."

3. Impact OF HG Program on Kenya's External Debt

Kenya's outstanding total medium- and long-term external debt stood at $2,564 million at the end of 1981 and was composed as follows: multilateral loans accounted for 35%, bilateral loans for 42%, loans from financial institutions were 22%, and funded debt 1%. Thus IMF's share of external debt increased from 5.3% in 1977 to 10.5% in 1981. During the 1977 - 1981 period, the share of multilateral (excluding IMF) and bilateral debt decreased, whereas debt to financial institutions rose very rapidly due to Eurocurrency loans disbursed in 1979 - 1981. (See Table 4.)

Table 4

Kenya: Medium- and Long-Term External Public Debt, 1977-81 1/

(In millions of U.S. dollars; end of period)

	1977	1978	1979	1980	1981
Total, excluding IMF (A)	1,144.9	1,366.8	1,736.7	2,165.3	2,300.7
Suppliers' credits	84.8	129.0	128.8	155.4	135.3
Financial institutions	150.2	302.4	504.9	718.4	744.2
Bonds	44.1	9.1	9.8	10.6	8.3
Multilateral loans	337.8	415.4	489.8	628.9	712.0
Bilateral loans	381.0	363.9	453.2	507.3	568.9
EAC debt 2/	147.0	147.0	150.2	144.7	132.0
IMF (B)	64.1	94.0	188.1	253.9	263.3
Use of Fund credit	57.9	68.1	142.7	194.3	203.7
Trust Fund	6.2	25.9	45.4	59.6	59.6
Total (A) + (B)	1,209.0	1,460.8	1,924.8	2,419.2	2,564.0
Debt service, excluding IMF (C)	77.4	122.0	150.4	211.1	293.7
Amortization	34.9	69.5	79.4	104.9	177.9
Interest	42.5	52.5	71.0	106.2	115.8
Debt service, IMF (D)	20.2	7.1	44.9	17.0	21.1
Repurchases	14.6	3.0	39.5	9.6	8.4
Charges	5.6	4.1	5.4	7.4	12.7
Total debt service (C) + (D)	97.6	129.1	195.3	228.1	314.8
Ratios (in per cent)					
Total debt/GDP	26.9	27.4	31.6	34.2	38.3
Debt, excluding IMF/GDP	25.5	25.7	28.5	30.6	34.4
Total debt service/Exports of goods and services	5.8	8.2	11.8	11.7	20.6
Debt service, excluding IMF/Exports of goods and services	4.6	7.7	9.0	10.9	19.4

Sources: IBRD External Debt Division; and staff estimates.

1/ Preliminary estimates.
2/ Refers to Kenya's estimated share of former EAC corporation debt (50 per cent of total).

It is difficult to predict the exact interest rate that the Government will have to pay for this HG loan since the rate will be determined by the U.S. capital market at the time the loan is made. Applying current U.S. market conditions, however, the HG loan will be for a period of up to 30 years maturity with 10 years grace on repayment of principal. The interest rate is likely to be approximately 12% for a fixed rate loan or approximately 10% for a variable rate loan. Compared with commercial borrowings available to the Government, the HG loan contains a "grant element" of approximately 13.5% for the fixed rate and approximately 30% for the variable rate, depending upon the type of loan taken. While the fixed rate loan has a smaller grant element under the present market conditions than the variable rate the debt service is more predictable.

Kenya's current debt service ratio is sufficiently large to require increased caution and prudent economic policies, but is moderate compared with that of other developing countries. Kenya's debt service ratio, as a percentage of exports, rose from 11.8% in 1979 to 22.1% in 1982. The proposed $20 million HG loan will add $2.25 million a year (9.36% of estimated 1985 payments) to Kenya's total debt payments beginning in 1985 through 1994 and $2.46 million per year from 1995 through 2014. The 1985 and 1986 ratios of debt service to export earnings of 23.5 and 21.6% respectively will be affected by less than five one hundredths of a point. (See Table 5). The figures assume that existing market conditions will remain basically unchanged and that a fixed rate loan is taken. However, if the interest rates climb significantly and reach a high level of 14% (as they did in 1982), the debt service will increase by $2.6 million or 0.42% per year. On the other hand, if the interest rates stablize at the variable rate of 9.7% (as it did early this year), the debt service will increase by $1.91 million or 0.33% per year. In any event, the trend in the debt service ratio will have only marginal effect.

TABLE-5. KENYA: DEBT SERVICE RATIO ON MEDIUM AND LONG-TERM PUBLIC AND PUBLICLY GUARANTEED DEBT FOR 1982 - 1986
(Millions of U.S. $)

Year	Total Debt	Total Debt Including HG Loan	Debt Service Ratio Excluding HG Loan
1982	358	-	22.1
1983	393	-	22.4
1984	448	-	23.2
1985	500	502.2	23.5
1986	507	509.2	21.6

Source: Kenya: Recent Economic Developments, IMF (February 1983)

If the Government were to borrow the same amount on the Eurodollar market, the interest rate would probably be 13.0% (or approximately two percentage points over the LIBOR August rate of 11%). This higher interest rate coupled with a shorter loan maturity, usually no longer than 5 - 7 years, would substantially increase Kenya's short-term total debt. Because the amortization schedule has no grace period, this would worsen the short term debt service ratio. In addition, should the interest rates drop or the Government gain access to a cheaper source of foreign exchange, the government has the option to prepay the loan contracted under the HG program.

The March 1983 IMF Stand-By Agreement states that the Government intends to limit the contracting of public and publicly guaranteed external borrowings on commercial terms in the maturity range of 1-12 years to U.S. $150 million and in the maturity range of 1-5 years to U.S. $100 million during the following 18 months. Similar restrictions can be expected in future years. The HG loan, with its 30-year term, falls outside the limitation. Kenya is complying with the IMF standby agreement and no debt rescheduling is anticipated in the foreseeable future. Kenya is currently meeting and is to continue to meet foreign debt obligations in the foreseeable future. Furthermore Kenya's debt service ratio is expected to begin a downward trend in 1986. This loan to Kenya presents no foreseeable negative impact on the HG reserve fund.

4. Interest Rates

The HG program will not affect Kenya's existing interest rate structure since the interest rates are controlled by the Ministry of Finance though the Central Bank. These rates are established within the context of the country's macro-economic policies.

Recent Government policy directs that the use of interest rates be used more flexibly to encourage domestic savings and capital formation. Bank deposit rates were raised in several stages from 5% to 10% between June 1980 and September 1981, and lending rates from 10% to 14%. Nevertheless, due to higher rates of inflation, real interest rates remained negative for savers during most of this period (depending on the exact type of price deflator applied), while borrowers normally paid only small positive rates of interest, if any. On December 10, 1982, the Government of Kenya again adjusted deposit and lending rates upward by 2.5 and 2 percentage points respectively, indicating a continuing commitment to the adjustment process. (See Table 6.) In its letter of intent to the IMF, under the current Stand-By Agreement, the Government indicated that it intends to keep interest rates under continued review to ensure that time deposit rates are kept positive in real terms. Success in reducing the budget deficit, and restraint in growth of the money supply, will contribute directly to reduced inflation and assist in the achievement of this objective.

The beneficiaries of the proposed HG project will pay the prevailing market interest rates, which currently stand at 16%. USAID believes that the Government is serious in its commitment to the IMF to adjust the interest rate structure to ensure positive return on time deposits. Thus, the lending rates will reflect prevailing economic climate in the country.

D. SOCIAL SOUNDNESS ANALYSIS

1. Kenya's Urban Shelter Problem

The magnitude and intensity of Kenya's urban shelter problem are immense. The public sector is

Table 6

TRENDS IN SELECTED INTEREST RATES, 1978-1983

	Year	Nominal Interest	Nairobi Consumer Price Index	GDP Deflator	Real Interest (CPI Deflator)	Real Interes (GDP Deflato
1. Commercial bank savings deposit	1978	5.0	12.6	3.3	-7.6	1.7
	1979	5.0	8.4	6.3	-3.4	-1.3
	1980	6.0	12.8	10.9	-6.8	-4.9
	1981	10.0	12.6	9.7	-2.6	0.3
	1982	12.5	22.3	14.4	-9.8	-1.9
	Mar.82-83	12.5	16.2	...	-3.7	...
2. Commercial bank loans and advances (max)	1978	10.0	12.6	3.3	-2.6	6.7
	1979	10.0	8.4	6.3	1.6	3.7
	1980	11.0	12.8	10.9	-1.8	0.1
	1981	14.0	12.6	9.7	1.4	4.3
	1982	16.0	22.3	14.4	-6.3	1.6
	Mar.82-83	16.0	16.2	...	-0.2	...
3. Post Office savings deposits	1978	5.0	12.6	3.3	-7.6	1.7
	1979	5.0	8.4	6.3	-3.4	-1.3
	1980	6.0	12.8	10.9	-6.8	-4.9
	1981	10.0	12.6	9.7	-2.6	0.3
	1982	10.0	22.3	14.4	-12.3	-1.9
	Mar.82-83	10.0	16.2	...	-6.2	...
4. Building society loans (max)	1978	12.0	12.6	3.3	-0.6	8.7
	1979	12.0	8.4	6.3	3.6	5.7
	1980	14.0	12.8	10.9	-1.2	3.1
	1981	14.0	12.6	9.7	1.4	4.3
	1982	16.0	22.3	14.4	-6.3	1.6
	Mar.82-83	16.0	16.2	...	-0.2	...

Source: Economic Survey, 1983.

providing approximately 2,500 housing units annually for the lowest income groups, and the private sector is providing from 1,000 to 2,000 units each year for households earning more than $500 per month (KShs 6,750). Beyond this limited housing supply, the vast majority of low income working people have no access to the necessary finance for home ownership. Lack of long-term housing finance to construct homes for the working population contributes to Kenya's extreme urban overcrowding. In Nairobi, over one third of the people live in slums and shanty towns. In the Eastleigh neighborhood, 43% of the families have only enough space fo a single bed. Another tangible indicator of the severity of the shelter problem is the overwhelming demand for low cost housing units. In Nairobi recently, 16,000 applications were received for 2,000 serviced sites in the Dandora project, 49,000 applications for 1,500 serviced plots in the Mathare North project, and 9,000 applications for 750 completed houses at Buru Buru Estate.

It is evident that the demand for low cost housing is far greater than can be satisfied by both the public and private sectors if they continue to operate in the present fashion. Without USAID's involvement, however, it is unlikely that the formal private sector will be able to enter the low cost housing market.

2. Urban Income Distribution and the HG Target Population

It is difficult to calculate the urban median income with exact precision. Different studies evidence varied estimates, depending upon the methods used, assumptions made and data considered. The USAID Project Design Team undertook a new effort to determine urban median income in its preparation for this project. The first step was to examine a number of earlier studies.

The Government's Central Bureau of Statistics published a social accounting matrix for the year 1976, which presented the correlation between the published wage earnings and total income. Using the matrix, the mean urban household income can be assessed. The median income can then be calculated by applying a median to mean ratio. This method provided the income distribution which follows in Table 7:

TABLE 7

1983 URBAN HOUSEHOLDS INCOME DISTRIBUTION

Cumulative Percentage of Households	Monthly Income Range (KShs)	Mean
0 - 20	0 - 950	750
21 - 40	951 - 1,700	1,250
41 - 60	1,701 - 2,900	2,300
61 - 80	2,901 - 4,300	3,750
81 -100	Over 4,300	10,000

The Project Design Team then compared these results with other relevant studies, namely that by DeVoy which predicted a median income level of KShs 3,074 ($228) and that by Lee which indicated a figure of KShs 2,300 ($170). The final conclusion of the team was that a conservative, but reasonable, figure for the urban median income to be used in this program is KShs 2,500 ($185).

This HG program is designed to reach households at or below the median income. Typical beneficiaries at the KShs 2,500 ($185) level will be persons employed as clerical workers, lower level administrative officers and clerks, construction workers, draftsmen, technicians, community workers, nurses, drivers, and those who are self-employed. The beneficiaries are likely to be close to the median income, because these are the people who can most easily afford a privately produced shelter unit.

It is anticipated that the bulk of the housing units financed under this program will be located in the major urban centers of Nairobi, Mombasa, and Kisumu. It is likely that private developers and financial institutions will target these areas where demand is considered greatest and private services most abundant.

3. Housing Affordability for the Target Group

Recent studies indicate that due to the extreme housing shortage, many lower income households are paying up to 35% of their income for housing and renting one room of their house to bachelors or low income families who cannot afford other accommodations.

Kenya's urban sub-letting phenomenon is all pervasive among lower income groups. It is now estimated that over 90% of the units in USAID's Umoja I estate (615-HG-003) are sub-let; 85% of the units in the World Bank funded Dandora project are sub-let; and 74% in USAID's Secondary Towns project are also sub-let. Households resort to sub-letting of one or more rooms to augment the monthly payments. Even though sub-letting reduces the amount of space available to the beneficiary family, they still occupy more area than may have been formerly the case. In Nairobi's informal housing areas, many families are required to share rooms.

Recognizing the realities of sub-letting by households of below median income, the Project Design Team specifically received the approval of the five housing finance institutions to include this offset in affordability calculations.

The following affordability model is presented as in Table 8 an example of the situation of a typical beneficiary:

TABLE 8

	KSh	$	KSh	$
Monthly Household Income	2,500	185	1,700	126
Affordability Monthly Housing Payment (35%)	875	65	595	44
Offset from Renting One Room	400	30	400	30
Total Affordable Payment	1,275	95	995	74
25 Year Mortgage at 16%	94,044	7,007	73,390	5,458
Deposit of 10% of Purchase Price	10,450	779	8,210	607
Total Affordable House Purchase	104,500	7,786	81,600	6,065

.25 [illegible] > 51,222

Families who do not sublet will be eligible if they have a down payment of 35% on a KSh 100,000 house. An income of KSh 2,500 a month is sufficient to carry a KSh 85,000 mortgage.

These calculations have been discussed with the housing finance institutions, private builder/developers and housing cooperatives. The following conclusions have been reached:

i. Housing finance institutions agree that 35% of the household's monthly income can be used as the basis for calculating payments;

ii. Housing finance insitutions agree that rents derived be used as an offset in the affordability calculations;

iii. Private builder/developers and housing cooperatives agree that house designs should recognize that sub-letting will take place and may act to stabilize the financial situation of low income households;

iv. Private builder/developers and housing cooperatives prepared model development plans containing housing units of two rooms incorporating reduced standards which could be built in the price range of $5,900 - 7,700 (KShs 80,000 - 105,000) depending upon the final design of the units; and

v. The affordability calculations presented above are reasonable and feasible for households of below median income in Kenya's major urban areas.

4. Profile of HG Beneficiaries

With over 350,000 people living in slums and shanty towns in Nairobi, and a 7% urban growth rate per year, low cost housing demand is enormous. The Project Design Team estimated that approximately 24,700 households in Nairobi earn from $125 to 185 (KShs 1,700 - 2,500) per month. A majority of these families are tenants living in sub-standard conditions. They will form the majority of the beneficiaries of this HG project.

The job categories of these beneficiaries have already been mentioned. Beneficiaries are likely to be in their thirties, living as tenants for a few years in town in sub-standard areas without water or sewers, paying high rent, and having no security of tenure or ownership rights. These are the people who are looking for an opportunity to own a home even if they have to sacrifice some other aspect of consumption. These individuals are prepared to rent out one of the two rooms in their houses because this is the only way they can afford to participate. Nevertheless, these individuals are improving their status and housing situation through their ownership of a unit financed under the HG program.

E. ENVIRONMENTAL ANALYSIS

An Initial Environmental Examination (IEE) was conducted in July 1983 for the proposed HG project. The environmental analysis, performed in accordance with the USAID Regulation 16, as amended in 1980, recommended a Negative Threshold Decision. This recommendation was approved by the Environmental Officér of the Africa Bureau. The IEE is attached as Annex H.

The Government enforces its own set of environmental regulations through the Public Health Act, the Building By-Laws, the Land Planning Act. Nevertheless, USAID will insist that as a condition of initial project approval, developers must submit adequate data concerning site location, soil types, topographical features, drainage and availability of infrastructure (both reticulated water supply and waterborne sewer systems will probably be used for all projects). USAID will ensure that this added water and sewer use can be accommodated by the existing systems and that there is adequate protection for downstream water supplies.

For housing developments proposed for Kisumu or Mombasa, particular attention will be paid to the need to eliminate standing water and to improve drainage to retard the incidence of malaria and, in Kisumu, schistosomiasis. Housing developments proposed for eastern Nairobi must include adequate investigation of the existence of highly expandable black cotton soil. This type of soil condition requires special building techniques, such as floating slabs, foundations raised on pilings, or the removal of the soil before construction.

IX. CONDITIONS AND COVENANTS

The HG loan shall be subject to the following conditions precedent and to such other terms and conditions as AID may deem necessary:

(a) Prior to any disbursements under the Guaranty, the Government shall, except as AID may otherwise agree in writing, furnish to AID in form and substance satisfactory to AID:

- evidence that the Government of Kenya has adopted appropriate reduced building and infrastructure standards for the Project;

- evidence that the Government of Kenya has approved such Sessional Paper(s) as may be necessary to effectuate the borrowing;

(b) Prior to disbursement of an individual development, the Government shall furnish AID in form and substance satisfactory to AID, except as AID may otherwise agree in writing, an acceptable Master Project Delivery Plan for such development which incorporates necessary information from each of the participating institutions, including specific project data concerning cash flow, construction schedules, implementation plans and details concerning eligible beneficiaries.

The Project Grant Agreement shall be subject to the following terms and convenants and major conditions, together with such other terms and conditions:

(a) Except as provided herein or as AID may otherwise agree in writing, commodities financed by AID under the Project shall have their source and origin in Kenya or in the United Staes. except for ocean shipping, the suppliers of commodities or services shall have Kenya or the United States as their place of nationality, except as AID may otherwise agree in writing. Ocean shipping financed by AID under the Project shall, except as AID may otherwise agree in writing, be financed only on flag vessels of the United States.

(b) Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement to finance assistance to the National Housing Cooperative Union (NACHU), the Cooperating Country shall furnish in form and substance satisfactory to AID, except as AID may otherwise agree in writing:

(i) an acceptable NACHU staffing pattern, hiring timetable and budget;

(ii) evidence that NACHU has retained the services o a finance manager to serve as counterpart to th AID-funded Cooperative Management Specialist;

(iii) evidence that NACHU has agreed to retain the services of a project technical manager to serv as counterpart to the AID provided Cooperative and Low-Cost Housing Specialist, within one yea from the signing of the Project Agreement;

(iv) evidence that NACHU has agreed to provide adequate office space, transportation, secretarial support services and related equipment and supplies to the two long-term AII funded advisors.

(c) prior to any disbursement, or the issuance of any commitment documents under the Project Agreement to finance technical assistance of training related to housing finance institutions or development of a secondary mortgage market, the Cooperating Country shall furnish to AID, in form and substance satisfactory to AID, except as AID may otherwise agree in writing, scopes of work and timetables for such training or technical assistance.

X. EVALUATION ARRANGEMENTS

The Ministry of Works, Housing and Physical Planning's Monitoring and Evaluation Division will submit a Monitoring and Evaluation Plan acceptable to USAID. USAID will provide the Division with short term technical assistance and direct USAID staff assistance. This will ensure that the evaluation section of the Plan conforms to the Office of Housing and Urban Program's Evaluation and Monitoring Guidelines.

The evaluation process will include: developing baseline data on potential beneficiaries of each sub-project and analyzing the pre-project capacity of each housing finance institution, private developer, NACHU, and participating housing cooperative.

The Monitoring and Evaluation Division will annually survey each institution for which adequate baseline data are available. These surveys will note any deviations from the program purpose, goals and schedules and will present a detailed factual basis for such revisions of the program as may be necessary.

RHUDO will perform annual evaluations and special evaluations on the first tranche of the program to determine if (i) projects are being successfully executed and completed within the target costs and schedule by the housing finance institutions, the developers and NACHU; and (2) if all necessary NACHU staff is in place. The RHUDO will also perform a survey of participating and non-participating housing finance institutions, developers, and NACHU to ascertain their role in a second tranche. It is on the basis of the evaluation and survey that the subsequent program will be developed.

RHUDO will also perform intensive evaluation and survey to review progress of the NACHU development and the TA provided.

The evaluation will, inter alia, concentrate on the success of the program to date in:

i. attracting additional housing finance institutions, developers, and housing cooperatives as participants;

ii. developing a viable secondary mortgage market;

iii. expanding the program to additional secondary and small towns;

iv. reaching the stated objectives spelled out in the logical framework;

v. establish the viability of NACHU; and

vi. changing policies and structures of both public and private participating institutions.

Doc. 0461F

UNCLASSIFIED RHUDO FILE

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ANNEX A

A-1

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ZNR UUUUU ZZH
P 291957Z JUL 83
FM SECSTATE WASHDC
TO AMEMBASSY NAIROBI PRIORITY 6605
BT
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29 JUL 83
TOR: 2313
CN: 35382
CHRGE: AID

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TAGS
SUBJ PID ISSUES REVIEW: KENYA PRIVATE SECTOR HOUSING PROJECT (615-HG-007)

1. THE ISSUES COMMITTEE REVIEWED THE PRIVATE SECTOR HOUSING PROJECT ON JULY 19. THERE WERE A NUMBER OF CONCERNS AND ISSUES RAISED WHICH COULD NOT BE FULLY RESOLVED AT THE MEETING, SUMMARIZED BELOW, TO WHICH THE COMMITTEE REQUESTS A RESPONSE FROM THE FIELD BEFORE MOVING TO ECPR. THE COMMITTEE AGREED THAT THE PP DESIGN SHOULD PROCEED AS SCHEDULED ON THE ASSUMPTION THAT THE DESIGN TEAM WILL ADDRESS THE ISSUES RAISED BY THE COMMITTEE AND THAT THE ECPR WILL BE HELD IN TIME TO COMMUNICATE ANY CONCERNS PRIOR TO COMPLETION OF THE PP. FYI, BOTH GARDNER AND VERTI OF THE PP TEAM ATTENDED AND PARTICIPATED IN THE ISSUES REVIEW AND THIS BACKGROUND

ILL BE USEFUL TO THE MISSION AND RHUDO. END FYI.

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2. THE ISSUES/CONCERNS RAISED AT THE REVIEW MEETING ARE AS FOLLOWS:

A. CURRENT KENYA HOUSING GUARANTEES: THERE ARE TWO HGS IN KENYA -- 615-HG-005 AND 615-HG-006 -- TOTALING $33 MILLION FOR WHICH NO DISBURSEMENTS HAVE BEEN MADE TO DATE. THE ISSUES COMMITTEE FELT THAT THE LACK OF PROGRESS ON THESE GUARANTEES SHOULD HAVE RECEIVED MORE ATTENTION AT THE PID STAGE AND CERTAINLY SHOULD BE ADDRESSED FULLY AT THE PP STAGE. SPECIFICALLY, WHAT LESSONS HAVE BEEN LEARNED FROM 005 AND 006? S;OULD WE CONTINUE WITH THESE HGS OR PHASE THEM OUT? IS THE SHIFT TO USING PRIVATE DEVELOPERS IN THE PROPOSED PID ENOUGH TO GIVE US CONFIDENCE THAT THIS PROJECT WON'T ENCOUNTER THE SAME DELAYS?

EC'D

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B. DEBT SERVICING: PPC QUESTIONED WHETHER KENYA SHOULD ASSUME RESPONSIBILITY FOR THIS HOUSING LOAN GIVEN THE FX SHORTAGES KENYA IS FACING AND WILL FACE FOR SOME TIME. ALTHOUGH THE USE OF US DOLLARS MAY BE ATTRACTIVE TO THE GOK IN THE SHORT RUN, THE GOVERNMENT WILL HAVE TO ACCEPT THE EXCHANGE RISK FOR THE LOAN AND CONVERT INTO DOLLARS THE PRINCIPAL AND INTEREST PAYMENTS. THE COMMITTEE REQUESTS THAT THE MISSION/RHUDO PROVIDE AN ASSESMENT OF THE GOK'S ABILITY TO SERVICE THIS LOAN IN THE CONTEXT OF

T

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ITS OVERALL BALANCE OF PAYMENTS PROSPECTS AND DEBT SERVICE BURDEN. THIS ASSESSMENT SHOULD ALSO PRESENT THE ANNUAL DEBT SERVICE BURDEN OF THE LOAN AND THE TOTAL COST TO THE GOK OVER THE LIFE OF THE LOAN.

C. INTEREST RATES: THE COMMITTEE REQUESTED THAT MORE INFORMATION ON LENDING INTEREST RATES BE PROVIDED AT THE PP STAGE. FOR EXAMPLE, WHAT RATES WILL BUYERS OF THE HOUSING UNITS PAY? WHAT ARE CURRENT INTEREST RATES IN KENYA AND WHAT ARE GOVERNMENT POLICIES AND PRACTICES ON INTEREST RATES AND HOW ARE THEY RELATED TO PROJECTED INFLATION RATES? IN THIS CONNECTION THE MISSION SHOULD REVIEW STATE 12586 OF SEPTEMBER 9, 1982 REGARDING CREDIT POLICY.

D. AMOUNT OF HG: THE PID REQUESTS LOP APPROVAL OF $50 MILLION FOR THE HG WITH A FIRST TRANCHE AUTHORIZATION OF $15 MILLION. THE COMMITTEE FELT THERE WAS NOT SUFFICIENT DETAIL IN THE PID TO JUSTIFY THE $35 MILLION BEYOND THE FIRST TRANCHE. FOR EXAMPLE, WHAT ARE THE PLANNED AMOUNTS AND TIMING FOR FUTURE TRANCHES. IS THERE SUFFICIENT

STIFICATION FOR APPROVAL OF A $50 MILLION HG NOW OR SHOULD WE LIMIT THE HG LEVEL TO $15 MILLION NOW AND CONSIDER THE AUTHORIZATION OF INCREASED LEVELS AT A FUTURE DATE? THE COMMITTEE ALSO WOULD LIKE MORE INFORMATION ON THE PLANNED DIVISION OF HG FUNDS BETWEEN PRIVATE SECTOR HOUSING DEVELOPMENT AND COOPERATIVE HOUSING DEVELOPMENT.

E. FINANCIAL/ECONOMIC CONSIDERATIONS: 1, THE COMMITTEE REQUESTED THE PP TEAM TO INCLUDE A MACRO-ECONOMIC BACKGROUND SECTION IN THE PP WHICH HIGHLIGHTS THE SIGNIFICANT ECONOMIC TRENDS IN KENYA AND RELATES THESE TRENDS TO THE HOUSING SECTOR. 2, THE BUDGET OF $1.4 MILLION FOR THE TECHNICAL ASSISTANCE AND TRAINING COMPONENT WAS NOT SUFFICIENTLY DETAILED EVEN AT THE PID STAGE FOR THE REVIEW COMMITTEE TO MAKE ANY JUDGMENTS ABOUT THIS COMPONENT AND THE COMMITTEE REQUESTS FURTHER INFORMATION ON THE PURPOSE, TYPES AND COST OF TA AND TRAINING REQUIRED TO ASSIST THE COOPERATIVE HOUSING MOVEMENT. 3, THE REVIEW COMMITTEE WAS IN AGREEMENT THAT THE PP MUST CONTAIN FINANCIAL AND INSTITUTIONAL PROFILE INFORMATION ON THE MAJOR PRIVATE HOUSING DEVELOPERS AND COOPERATIVES THAT WOULD BE EXPECTED TO PARTICIPATE IN THIS PROJECT. A QUESTION TO CONSIDER ON HOUSING DEVELOPERS IS WHETHER THEY WILL BE MOTIVATED TO PRODUCE THE PLANNED LEVELS OF LOW COST HOUSING SHOULD THE MARKET IMPROVE FOR HIGHER PRICED HOUSING DEVELOPMENTS. THE PP SHOULD ALSO INCLUDE AN ASSESSMENT WITH ILLUSTRATIVE

EXAMPLES IF POSSIBLE; OF THE ABILITY OF THE TARGET INCOME GROUP FOR PROJECT HOUSING TO REPAY MORTAGE LOANS.

F. BUILDING/INFRASTRUCTURE STANDARDS: THE PID INDICATES THAT MORE REALISTIC BUILDING AND INFRASTRUCTURE STANDARDS AND LAND ACCESS PROVISIONS WILL HAVE TO BE ADOPTED FOR HOUSING UNDER THIS PROJECT. IF NEW, AND PRESUMABLY LOWER BUILDING STANDARDS, MUST BE ACCEPTED, THE PP SHOULD INDICATE WHAT CHANGES IN STANDARDS ARE REQUIRED, WHAT AUTHORITIES MUST APPROVE THE CHANGES, AND IF ANY PROBLEMS ARE ANTICIPATED IN GETTING REVISED STANDARDS PASSED.

G. EVALUATION PLAN: NO EVALUATION PLAN WAS INCLUDED IN THE PID. THE REVIEW COMMITTEE FELT THIS SHOULD RECEIVE SPECIAL ATTENTION AT THE PP STAGE, ESPECIALLY IF A $50 MILLION HG APPROVAL IS SOUGHT. SUCH AN EVALUATION PLAN WOULD DETAIL THE TYPES OF ANALYSIS TO BE CARRIED OUT, THEIR TIMING, AND HOW THEY WOULD BE USED TO JUSTIFY FURTHER TRANCHES FOR PRE/H AND AFRICA BUREAU APPROVAL.

H. LOCAL CURRENCY GENERATIONS: THE REVIEW COMMITTEE DISCUSSED THE IDEA OF USING PL 480 AND CIP LOCAL CURRENCY GENERATIONS AS AN ALTERNATE SOURCE OF FINANCING FOR FUTURE HOUSING PROJECTS IN KENYA. THE COMMITTEE MADE NO DEFINITE DECISIONS OR RECOMMENDATIONS ON THIS SUBJECT BUT WOULD APPRECIATE COMMENTS FROM REDSO, THE MISSION, AND THE DESIGN TEAM ON THE POSSIBILITIES OF USING LC GENERATIONS FOR THIS PURPOSE IN THE FUTURE. COULD LC GENERATIONS BE UTILIZED IN FY 84 OR 85 FOR HOUSING ACTIVITIES PROPOSED UNDER THIS PROJECT?

I. PRIVATE VERSUS GOVERNMENT OWNED/CONTROLLED FINANCIAL INTERMEDIARIES: THE PID NOTES THAT ONE OF KENYA'S HOUSING FINANCE INSTITUTIONS, E.G., HFCK, WILL BE USED AS THE IMPLEMENTING AGENCY FOR THE PROJECT. THE PP SHOULD PROVIDE INFORMATION ON THE VARIOUS FINANCIAL INTERMEDIARIES CONSIDERED FOR THE IMPLEMENTING AGENCY AND PROVIDE JUSTIFICATION FOR THE INSTITUTION CHOSEN. REDSO AND THE MISSION SHOULD KEEP IN MIND THAT IT IS AID POLICY TO FAVOR PRIVATE INSTITUTIONS OVER GOVERNMENT OWNED OR CONTROLLED INSTITUTIONS AND THAT EXCEPTIONS TO THIS POLICY WILL HAVE TO BE FULLY JUSTIFIED. SEE A/AID MARCH 3 STATEMENT TO SENATE APPROPRIATIONS COMMITTEE. COPY SENT TO MISSION ON APRIL 4.)

J. IEE: THE IEE HAS ONLY JUST BEEN RECEIVED BY THE BUREAU ENVIRONMENTAL OFFICER AND WAS NOT REVIEWED BY THE ISSUES COMMITTEE. THE IEE WILL BE THE SUBJECT OF A SEPTEL TO BE SENT SHORTLY.

3. THE COMMITTEE REALIZED THAT MANY OF THE ISSUES RAISED IN PARA 2 COULD ONLY BE FULLY ADDRESSED AT THE PP STAGE. THE COMMITTEE DID REQUEST, HOWEVER, THAT REDSO AND THE MISSION PROVIDE A PRELIMINARY CABLE RESPONSE TO THESE ISSUES AND HOW THEY WILL BE DEALT WITH AT THE PP STAGE BY AUGUST 5 FOR CONSIDERATION AT THE ECPR LEVEL. SHULTZ

ANNEX B B-1

B-1

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O 050955Z AUG 83
FM AMEMBASSY NAIROBI
TO SECSTATE WASHDC IMMEDIATE 8642
BT
UNCLAS SECTION 01 OF NAIROBI 23355

CLASS: UNCLASSIFIED
CHRGE: AID 08/05/83
APPRV: RHUDO:FHANSEN
DRFTD: RHUDO:FHANSEN:AN
CLEAR: DIR/D/DIR
DISTR: DIR PROJ RHUDO-2
CHRON ECON

AIDAC

FOR PRE/H, WILLIAM MANN

E.O. 12356: N/A
SUBJECT: PID ISSUES REVIEW: KENYA PRIVATE SECTOR
HOUSING PROJECT (615-HG-007)

REF: STATE 213287

1. MISSION/RHUDO RESPONSE TO ISSUES RAISED IN REFTEL ARE AS FOLLOWS:

A. CURRENT KENYA HOUSING GUARANTY:

A NUMBER OF SIGNIFICANT LESSONS WHICH HAVE BEEN LEARNED FROM THE EXPERIENCE WITH THE CURRENT HG PROJECTS HAVE BEEN INCORPORATED INTO THE NEW PROJECT, WHICH IS FUNDAMENTALLY DIFFERENT IN THAT THE LOAN IS TO BE PROVIDED FOR PRIVATE SECTOR RATHER THAN PUBLIC SECTOR CONSTRUCTION AND MANAGEMENT. AT THE PRESENT TIME USAID BELIEVES THAT THE PROGRESS MADE ON THE TWO OUTSTANDING PROJECTS JUSTIFIES THEIR CONTINUED IMPLEMENTATION. PROGRESS ON THE NAIROBI CITY COUNCIL AND SMALL TOWNS PROJECTS WILL IN NO WAY AFFECT THE VIABILITY OF THE PRIVATE SECTOR 007 PROJECT. A MORE DETAILED DESCRIPTION OF THESE PROJECTS FOLLOWS.

(I) 615-HG-005: THE UMOJA II PROJECT DELAYS ARE UNFORTUNATELY TYPICAL OF MANY PUBLIC SECTOR PROJECTS. AFTER THE PROJECT WAS AUTHORIZED THERE WAS AN ELECTION AND CONSEQUENTLY A NEW MAYOR AND CITY COUNCIL. THE NEW ADMINISTRATION ENCOUNTERED MANY POLITICAL PROBLEMS WHICH, TOGETHER WITH THE HIGH U. S. INTEREST RATES PREVAILING IN 1981 AND 1982, IMPEDED PROGRESS TOWARD PROJECT IMPLEMENTATION AND THE HG BORROWING. FOLLOWING GOK DISSOLUTION OF THE NAIROBI CITY COUNCIL IN EARLY 1983 AND APPOINTMENT OF A 2-YEAR COMMISSION TO GOVERN THE CITY, NAIROBI'S HOUSING DEVELOPMENT DEPARTMENT WAS FINALLY ABLE TO RESUME ACTIVE PROJECT PREPARATION WITHOUT FURTHER FEAR OF POLITICAL INTERFERENCE. DURING THE LAST FEW MONTHS RHUDO HAS NEGOTIATED NEW TERMS AND CONDITIONS WITH THE COMMISSION WHICH REPRESENT A SIGNIFICANT DEPARTURE FROM PAST POLICIES AND WHICH WILL HAVE A POSITIVE IMPACT ON FUTURE SHELTER PRODUCTION FOR THE RAPIDLY EXPANDING LOW INCOME POPULATION. THESE NEW POLICIES FOR UMOJA II INCLUDE AUDITED PLOT ALLOCATION PROCEDURES, SUBSTANTIALLY REDUCED SITE, INFRASTRUCTURE, AND UNIT DESIGN STANDARDS WHICH

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PROVIDE A PHYSICALLY AND SOCIALLY ACCEPTABLE ENVIRONMENT BUT AT GREATLY REDUCED COST, AND THE ACCEPTANCE OF A QUOTE CONDOMINIUM UNQUOTE APPROACH WITH LIMITED SHARED SANITARY FACILITIES AND OPEN SPACES. THE NEW UMOJA II DESIGN IS CONSIDERABLY MORE APPROPRIATE FOR THE TARGET GROUP; IT WILL REDUCE THE FREQUENCY OF MIS-APPROPRIATION OF UNITS BY UPPER INCOME GROUPS AND RETARD THE FREQUENCY OF SUB-LETTING. THE UMOJA II SELLING PRICE WILL INCLUDE LAND COSTS SO THAT THE FINAL PRICE MORE NEARLY REFLECTS PREVAILING MARKET CONDITIONS. FOLLOWING RHUDC'S ACHIEVEMENT OF THESE SIGNIFICANT POLICY OBJECTIVES, THE UMOJA II PROJECT WILL BE RAPIDLY IMPLEMENTED. THE COMMISSION HAS AWARDED THE UMOJA II DESIGN AND ENGINEERING CONTRACT, AND THE WORK WILL BE COMPLETED BY JANUARY 1984. HG LOAN FINANCING THEN WILL TAKE PLACE AFTER THE CONSTRUCTION CONTRACTS ARE BID AND AWARDED.

(II) 615-HG 006: THE KENYA SMALL TOWNS SHELTER PROJECT IS NOW READY FOR HG FINANCING. THE DRAFT IMPLEMENTATION AGREEMENT WAS PREPARED IN THE FALL OF 1981 AND APPROVED IN MARCH 1982. THIS VERY COMPLEX SMALL TOWN PROJECT HAS TAKEN CONSIDERABLE TIME TO INITIATE SINCE EFFECTIVE COORDINATION HAD TO BE DEVELOPED BETWEEN THE SEVERAL MINISTRIES AND SMALL TOWNS INVOLVED. FURTHERMORE, AID, THE WORLD BANK AND CDA HAVE ALSO COORDINATED THEIR ACTIVITIES AND DIVIDED UP RESPONSIBILITIES AMONG THE DONORS FOR ALL THE TOWNS INVOLVED. THIS COORDINATION HAS NOW BEEN ACHIEVED, AND SPECIFIC SUB-PROJECTS HAVE BEEN IDENTIFIED AND THEIR FEASIBILITY DETERMINED. CONSTRUCTION OF THESE SUB-PROJECTS WAS TO HAVE BEGUN IN OCTOBER 1983 FOLLOWING GOK PARLIAMENTARY APPROVAL OF THE BORROWING GUARANTY. HOWEVER, THE PRESIDENT DISSOLVED THE PARLIAMENT IN JULY BEFORE THE PAPER WAS APPROVED. FOLLOWING ELECTIONS SEPTEMBER 26 AND THE CONVENING OF A NEW PARLIAMENT, IT IS ANTICIPATED THAT THE SESSIONAL PAPER CAN BE APPROVED SO THAT THE HG LOAN MAY BE CONTRACTED IN DECEMBER OR JANUARY.

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(III) WE ANTICIPATE THE PRIVATE SECTOR 615-HG-007 PROGRAM WILL MOVE QUITE RAPIDLY DUE TO THE INHERENT EFFICIENCY, PROFIT MOTIVATION AND INTEREST OF THE PRIVATE SECTOR FINANCIAL INSTITUTIONS AND DEVELOPERS. THE PROBLEMS ASSOCIATED WITH HG 005 AND 006 ARE NOT AT ALL RELATED TO HG 007, EXCEPT THAT THE AGREEMENTS REACHED ON REDUCING BUILDING STANDARDS FOR UMOJA II WILL HAVE A POSITIVE EFFECT ON THE REDUCED STANDARDS REQUIRED FOR 007.

B. DEBT SERVICING:

THE DEBT SERVICE RATIO, AS A PERCENTAGE OF EXPORTS, ROSE CONSIDERABLY FROM 11.7 PERCENT IN 1980 TO 23 PERCENT IN 1982. IT IS, HOWEVER, EXPECTED TO REMAIN AT THAT LEVEL IN 1983 THROUGH 1985 AFTER WHICH IT MAY START DECLINING. IF THAT TREND IS MAINTAINED, THEN IT IS VERY LIKELY THAT THE PROVISION OF THE HG LOAN WILL NOT LOWER THE GOVERNMENT'S ABILITY TO SERVICE ITS DEBTS. INSTEAD, IT WILL ENABLE THE GOVERNMENT TO BORROW LESS FROM NON-CONCESSIONARY SOURCES. UNDER EXISTING IMF STANDBY AGREEMENT OF MARCH 1983, IT IS ESTIMATED THAT GOK WILL NEED TO BORROW 130 MILLION DOLLARS ON THE EUROCRACY MARKETS.

AT THE BEGINNING OF 1982 THE AVERAGE TERM STRUCTURE OF EXTERNAL PUBLIC LOAN COMMITMENTS HAD A GRACE PERIOD OF 5.2 YEARS AND AN AVERAGE INTEREST RATE OF 6.1 PERCENT. THE HG LOAN PROPOSED AT 12 YEARS GRACE PERIOD AND REPAYMENT TERM OF 32 YEARS WILL ONLY ACT TO IMPROVE THE TERM STRUCTURE APART FROM EASING THE TIGHT FOREIGN EXCHANGE SITUATION IN THE ECONOMY. ITS IMPLICATIONS ON THE BALANCE OF PAYMENTS ARE THEREFORE POSITIVE.
THE CURRENT DEBT SERVICE RATIO, WHILE A CAUSE FOR PRUDENT ECONOMIC POLICIES, IS MODERATE COMPARED WITH OTHER DEVELOPING COUNTRIES. SO FAR IMF STANDBY LOAN AGREEMENT APPROVED IN MARCH 1983, WHICH SETS THE PERFORMANCE CRITERIA IN TERMS OF QUANTIFIED CEILINGS ON TOTAL BANKING SYSTEM CREDIT AND ON UTILIZATION OF CREDIT BY GOVERNMENT FOR BUDGET DEFICITS, ARE BEING MET. ASSUMING CONTINUING PROGRESS IN STRUCTURAL ADJUSTMENT PROGRAM, DEBT SERVICE CAN BE KEPT WITHIN A REASONABLE RANGE.

C. INTEREST RATE:

EXCEPT FOR THE DISCOUNT RATE FOR THE TREASURY BILLS, ALL OTHER INTEREST RATES ARE CONTROLLED BY TREASURY THROUGH THE CENTRAL BANK. THE OFFICIAL RATES ARE KEPT MUCH LOWER AND THEIR AJUSTMENT HAS NOT KEPT PACE WITH THE INFLATION RATE. THE OFFICIAL 16 PERCENT INTEREST RATE CHARGED ON LOANS IS MUCH LOWER THAN THE INFLATION RATE OF 22.3 PERCENT REPORTED IN 1982. BUT, THE OFFICIAL INTEREST RATE HAS BEEN ARTIFICIALLY PUSHED UP TO AS MUCH AS 28 PERCENT BY SOME FINANCIAL INSTITUTIONS WHICH ARE REPORTED TO BE CHARGING A VARIETY OF FEES OR POINTS. THE AVAILABILITY OF A

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CHEAPER SOURCE OF FUNDS SUCH AS FROM THE EG PROGRAM WILL HELP IN AMELIORATING THIS CREDIT SITUATION. THE ARTIFICIAL RATES DO NOT MATCH WITH THE MORE MODEST CHANGES IN THE CONSTRUCTION COST INDICES WHICH STOOD AT 14.1 PERCENT IN 1982 (SEE TABLE BELOW).

CONSTRUCTION OF PRIVATE DWELLINGS SLOWED DOWN BECAUSE OF HIGH MORTGAGE RATES AND FAILURE TO RAISE THE REQUIRED 10 PERCENT DOWNPAYMENT WHICH ON AVERAGE WAS KSH. 40,000. THE EG PROGRAM WILL THEREFORE PLAY A VITAL ROLE IN REDUCING PRESSURE ON INDIVIDUALS BY PROVIDING MORE APPROPRIATE PACKAGES WITH LOWER MORTGAGES RATES.

IT IS UNLIKELY THAT THE EG PROGRAM WILL AFFECT THE EXISTING INTEREST RATE STRUCTURE BECAUSE THE CREDIT CHANNELLED BY COMMERCIAL BANKS TO BUILDING AND CONSTRUCTION IS ONLY ABOUT SIX PERCENT OF THE TOTAL CREDIT TO ALL SECTORS.

TABLE 3: PRICES CHANGES RELATED TO BUILDING AND CONSTRUCTION (1980-84)

	1980	1981	1982	1983	1984
INTEREST RATE ON LOANS (MAXIMUM, PERCENT)	11.0-13.0(A)	14.2	16.0	16.0	16.0
INFLATION RATE (CONSUMER PRICES, PERCENT)	12.8	12.6	22.3	15.0	12.0

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RESIDENTIAL BUILDINGS: CHANGE IN COST INDICES (PERCENT) - -	12.1	12.9	14.1	13.0	12.0

NOTES: = FORECAST

(A) RATE CHARGED BY COMMERCIAL BANKS = 11.0
OTHER FINANCIAL INSTITUTIONS = 13.0

THE BENEFICIARIES OF THE PROPOSED HG PROJECT WILL PAY THE PREVAILING MARKET INTEREST RATE, WHICH CURRENTLY STANDS AT 16 PERCENT. WE BELIEVE THE GOK IS SERIOUS IN ITS COMMITMENT TO THE IMF TO ADJUST THE INTEREST RATE STRUCTURE TO ENSURE POSITIVE RETURN ON TIME DEPOSITS TO STIMULATE DOMESTIC SAVINGS AND CAPITAL INVESTMENT.

D. AMOUNT OF HG:

WE RECOGNIZE THAT THE EVENTUAL UTILIZATION OF 50 MILLION DOLLARS IN HG RESOURCES WILL DEPEND ON PROGRESS IN THE INITIAL PHASE OF THE PROGRAM. BUT WE BELIEVE THAT IN STRUCTURING THE PROGRAM CONCEPTUALLY AS WELL AS OUR DISCUSSIONS WITH THE GOK, THE KENYAN HOUSING FINANCE INSTITUTIONS WHO WILL PARTICIPATE AND THE PRIVATE DEVELOPERS WHO MUST GEAR UP TO PROVIDE SUBSTANTIAL CONSTRUCTION OF UNITS OF A TYPE THEY HAVE NOT BUILT BEFORE WE NEED TO HAVE AN UNDERSTANDING THAT IF THINGS PROCEED WELL, THE EVENTUAL PROGRAM WILL BE AT THE 50 MILLION DOLLAR LEVEL. THAT IS WHAT WE ARE TRYING TO ESTABLISH. WE EXPECT TO FULLY JUSTIFY FOLLOW-ON TRANCHES ON THE BASIS OF SOLID PROGRESS.
THE MORE SPECIFIC RATIONALE IS AS FOLLOWS:

1. PRIVATE DEVELOPERS INTERESTED IN LOW INCOME HOUSING WILL NEED TO PLAN LARGE ENOUGH PROJECTS TO JUSTIFY THE HIGHER RISK AND LOWER PROFIT MARGINS WHICH ARE PERCEIVED TO EXIST AT THIS LOWER INCOME LEVEL. DEVELOPERS HAVE INDICATED THAT THEY WILL PROPOSE FAIRLY LARGE PROJECTS IN THE 5-15 MILLION DOLLAR RANGE IN ORDER TO BENEFIT FROM THE SCALE. (E.G.: PRODUCTION TECHNIQUES, EFFICIENT MOBILIZATION OF MATERIALS AND THE TIMELY PROVISION OF OFF- AND ON-SITE INFRASTRUCTURE, WHICH ARE ESSENTIAL FOR PROJECT PROFITABILITY AND AN INCENTIVE FOR REPLICATION. IF DEVELOPERS CANNOT SEE THE POTENTIAL FOR PROFIT THE PROGRAM WILL NOT BE IMPLEMENTED. LARGER PROJECTS DO PROVIDE THE VOLUME WHICH MAKES AN ACCEPTABLE PROFIT MARGIN POSSIBLE. MINIMUM PHASED PROJECTS WILL HAVE TO BE APPROXIMATELY 500 UNITS, OR ABOUT 3.5 MILLION DOLLARS. IT WILL BE IMPORTANT TO START A NUMBER OF PROJECTS SIMULTANEOUSLY TO DIVERSIFY THE PROGRAM WITHIN THE PRIVATE SECTOR. IT IS IMPORTANT TO HAVE AS MANY OF THE HOUSING FINANCE INSTITUTIONS INVOLVED AS POSSIBLE SINCE THEIR DIFFERENCES WILL BLOCK TRANSFERABILITY OF EXPERIENCE WITH THIS PROGRAM. NOTABLE DIFFERENCES INCLUDE TWO REGULATORY ACTS AND BODIES, SOURCES OF REVENUE, PAID IN CAPITAL AND STOCK HOLDERS, TARGET MARKET GROUP, INSTITUTION SIZE AND ASSETS, AND OPERATING [illegible] IS THOROUGH; TO PROVIDE

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FINANCING AT A LEVEL SUFFICIENT TO ATTRACT THE LARGER, MORE EXPERIENCED INSTITUTIONS AND TO STRENGTHEN SMALLER INSTITUTIONS BY SUBSTANTIALLY INCREASING THEIR PORTFOLIO AND PROVIDING THEM AN ADEQUATE RETURN ON A MINIMAL SPREAD FOR SERVICING MORTGAGES. FURTHERMORE, IT IS IMPORTANT TO INCLUDE AS MANY DEVELOPERS AND CO-OPS AS POSSIBLE, PERHAPS THREE PER HOUSING FINANCE INSTITUTION. THIS AGAIN REQUIRES EARLY RECOGINITION THAT THE PROGRAM SHOULD BE CONCEIVED AS EVENTUALLY CALLING FOR FUNDING IN THE 50 MILLION DOLLAR RANGE.

2. ANOTHER IMPORTANT REASON FOR REQUESTING APPROVAL IN PRINCIPLE FOR LARGE HG PROGRAM IS THAT A SUBSTANTIAL VOLUME OF NEW, STANDARDIZED MORTGAGES HAS TO BE ORIGINATED AND "SEASONED" OVER A PERIOD OF TIME TO SUPPORT A SECONDARY MORTGAGE MARKET. MORTGAGE INSTRUMENTS UNDER THIS PROGRAM WILL BE NEWLY DESIGNED TO INCORPORATE STANDARDIZED FEATURES WHICH WILL MAXIMIZE THEIR ACCEPTABILITY TO INSURANCE COMPANIES, PENSION FUNDS AND OTHER INSTITUTIONAL INVESTORS. SUCH MORTGAGES WILL THEN BE USED TO ESTABLISH MORTGAGE POOLS WHICH PROVIDE THE UNDERLYING SECURITY FOR INVESTORS IN THE SECONDARY MARKET. AS NOW ENVISIONED, IT WILL BE NECESSARY TO "OVERCOLLATERALIZE" THE SECONDARY MARKET OPERATIONS. FOR EXAMPLE, TO PROVIDE THE CONFIDENCE AND BACKING FOR INSTITUTIONAL INVESTMENT THERE MIGHT HAVE TO BE 125,000 DOLLARS WORTH OF HIGH QUALITY MORTGAGES FOR EACH 100,000 DOLLARS RAISED IN THE SECONDARY MARKET. IN ADDITION, THERE WILL NEED TO BE ADDITIONAL MORTGAGES AVAILABLE TO SUBSTITUTE FOR MORTGAGES WHICH ARE PREPAID OR WHICH BECAUSE OF DELINQUENCY ARE NO LONGER ACCEPTABLE

SECURITY.

E. FINANCIAL/ECONOMIC CONSIDERATIONS:

1. MACRO ECONOMIC ANALYSIS

AS REQUESTED IN THE REFTEL, THE PP WILL CONTAIN A DETAILED DISCUSSION OF MACRO-ECONOMIC TRENDS AND CONDITIONS IN THE COUNTRY AND HOW IT RELATES TO THE HOUSING SECTOR. THE PROJECT PAPER WILL INCLUDE A DISCUSSION OF THE MACRO-ECONOMIC OVERVIEW, SCOPE AND MAGNITUDE OF THE HOUSING CONSTRUCTION SECTOR AND ITS RELATIONSHIP TO THE ECONOMY.

2. TECHNICAL ASSISTANCE BUDGET

THE PURPOSE OF THE TECHNICAL ASSISTANCE PROPOSED IN THE PID IS TO FURNISH ESSENTIAL SUPPORT TO THE KENYAN NATIONAL COOPERATIVE HOUSING UNION (NACHU). NACHU WAS FORMALLY CREATED IN 1979 WITH ENCOURAGEMENT FROM AID, AND AFTER SOME DELAY, HAS NOW BEGUN TO FUNCTION WITH A CORE STAFF AND OFFICE SPACE FURNISHED BY THE KENYAN NATIONAL FEDERATION OF COOPERATIVES. NACHU HAS RECEIVED SUPPORT FROM HABITAT, SEVERAL PVOS, AND MAY ALSO RECEIVE SUPPORT FROM THE CANADIAN COOPERATIVE DEVELOPMENT FOUNDATION FOR STAFF EXPENSES. NACHU IS DEVELOPING THE INSTITUTIONAL CAPACITY AND TECHNICAL SKILLS TO SPONSOR, DESIGN, AND PACKAGE COOPERATIVE HOUSING PROJECTS FOR PRESENTATION TO FINANCIAL INSTITUTIONS (INCLUDING THE COOPERATIVE BANK OF KENYA).
THE TECHNICAL ASSISTANCE PROPOSED WILL CONSIST OF TWO LONG-TERM COOPERATIVE HOUSING AND INSTITUTIONAL DEVELOPMENT ADVISORS. ONE PSC WILL FUNCTION AS A TECHNICAL PROJECT PACKAGER AND DEVELOPER AND THE SECOND PSC WILL ACT AS A MANAGEMENT AND ADMINISTRATIVE SPECIALIST WITH EXPERIENCE IN COOPERATIVE ORGANIZATIONS. THIS LONG TERM TA WILL BE SUPPLEMENTED BY SPECIALIZED SHORT-TERM TECHNICIANS AND SUBSTANTIAL SUPPORT FROM RHUDO/ESA STAFF. SUPPORT TO NACHU WILL ALSO INCLUDE PROVISION OF TWO PROJECT VEHICLES, AUDIO VISUAL EQUIPMENT FOR TRAINING ACTIVITIES, A MICROCOMPUTER FOR USE IN PROJECT ANALYSIS AND DESIGN, AND TRAINING WORKSHOPS.

A LIMITED AMOUNT OF EQUIPMENT FOR NACHU OFFICES IS ALSO INCLUDED IN THE PROGRAM.

- 1.	TWO LONG TERM RESIDENT ADVISORS (60 PERSON MONTHS)	800,000 DOLLAR
- 2.	SHORT TERM TECHNICAL ASSISTANCE (18 PERSON MONTHS)	340,000
- 3.	PROJECT MANAGEMENT, BACKSTOP AND SUPERVISION - -	150,000
- 4.	TRAINING WORKSHOPS -	50,000
- 5.	COMMODITIES - -	60,000
-	- - - TOTAL	1,400,000 DOLLAR

3. PROFILE OF MAJOR PRIVATE DEVELOPERS AND

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AFFORDABILITY ANALYSIS

AS REQUESTED IN THE REFTEL, THE PP WILL INCLUDE FINANCIAL AND INSTITUTIONAL PROFILE OF SELECTED PRIVATE DEVELOPERS, COOPERATIVES AND ALL OF THE HOUSING FINANCE INSTITUTIONS IN THE COUNTRY. THIS IS PARTICULARLY IMPORTANT BECAUSE ALL OF THE HOUSING FINANCE INSTITUTIONS ARE SUFFICIENTLY DIFFERENT IN TERMS OF OWNERSHIP, OPERATION, SOURCE OF FUNDS AND THE MARKETS WHICH THEY RESPOND TO. THEY DESERVE SEPARATE ANALYSIS. THE PP WILL ALSO CONTAIN AN ANALYSIS OF THE INCOME GROUPS AND THEIR ABILITY TO PAY THE MORTGAGE LOANS.

F. BUILDING/INFRASTRUCTURE STANDARDS:

THE PP WILL INDICATE WHAT CHANGES IN BUILDING STANDARDS ARE REQUIRED.

G. EVALUATION PLAN

THE PP WILL DETAIL THE EVALUATION PLAN TO BE CARRIED OUT BEFORE AUTHORIZATION IS REQUESTED FOR SUBSEQUENT TRANCHES AND WILL DISCUSS THE TIMING NECESSARY TO MAINTAIN PRIVATE SECTOR MOMENTUM AND INTEREST.

H. LOCAL CURRENCY GENERATION:

USAID AND GOK HOLD REGULAR DISCUSSION ON GOVERNMENT PROGRAMS TO BE FUNDED BY CURRENCIES GENERATED BY PL 480 AND PROGRAM GRANTS. THE SHILLINGS ARE ALLOCATED FOR THE BUDGET YEAR IN WHICH THEY WILL BECOME AVAILABLE TO GOK ONLY AGAINST PROGRAMS THAT ARE INCLUDED IN THE FINAL BUDGET. THE PRIORITIES FOR KENYAN FINANCIAL YEAR

1983/84 WOULD NOT ACCOMMODATE A SHELTER PROGRAM, BUT FOR 1984/85 IT WOULD BE POSSIBLE TO INCLUDE PROGRAMS IN SHELTER COMMUNITY DEVELOPMENT AND ENHANCEMENT OF LOCAL GOVERNMENT PLANNING AND MNAGEMENT CAPACITY, TO THE EXTENT THESE ARE INCLUDED IN THE BUDGET. IT WOULD BE MORE APPROPRIATE, HOWEVER, TO APLLY SUCH FUNDS IN CONJUNCTION WITH HG 006, THE SMALL TOWNS PROJECTS, AS 007 IS DESIGNED TO DEVELOP A FINANCIAL SYSTEM THAT IS INDEPENDENT OF GOVERNMENT INTERVENTION AND SUPPORT. THE OBJECTIVES OF 007 CAN BE MET WITHOUT THE GOVERNMENT'S SUPPORT FROM CIP GENERATION, WHEREAS THE ADDITION OF NON HG ELIGIBLE ACTIVITIES TO 006 WOULD GREATLY IMPROVE THE ATTAINMENT OF THAT PROJECT'S GOAL, TO STRENGTHEN THE ROLE OF SMALL TOWNS.

I. PRIVATE VS GOVERNMENT OWNED/CONTROLLED FINANCIAL
- INTERMEDIATIES:

ALL HOUSING FINANCE INSTITUTIONS, MOST OF WHICH ARE PRIVATE, ARE TO BE INCLUDED IN THE PROJECT. AS SUGGESTED IN REFTEL, THIS ISSUE WILL BE ADDRESSED IN THE PROJECT PAPER. BARROP
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AID 1020-28 (1-81)
SUPPLEMENT 1

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

(INSTRUCTION: THIS IS AN OPTIONAL FORM WHICH CAN BE USED AS AN AID TO ORGANIZING DATA FOR THE PAR REPORT. IT NEED NOT BE RETAINED OR SUBMITTED.)

Life of Project:
From FY 83 to FY 88
Total U.S. Funding $50 million HG loan
Date Prepared: August 25, 1983

Project Title & Number: Kenya Private Sector Housing 615-HG-007

PAGE 1

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program or Sector Goal: The broader objective to which this project contributes: (A-1)	Measures of Goal Achievement: (A-2)	(A-3)	Assumptions for achieving goal targets: (A-4)
1. Improve the quality of life of lower income households through the promotion of user financed social services.	1. Increased number of housing financed and built by the private sector for lower income families.	1. Records of housing finance institutions. 2. Survey data on housing prodution.	1. Continued commitment of the private sector and housing cooperatives to provide lower income housing.

AID 1020-28 (7-71)
SUPPLEMENT 1

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project:
From FY 83 to FY 88
Total U.S. Funding $50 million HG Lo
Date Prepared: August 25, 1983

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PAGE

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Purpose: (B-1) 1. Develop the private sector's capacity to plan, develop and finance lower income housing.	Conditions that will indicate purpose has been achieved: End of project status. (B-2) 1. Approximately 3,000 housing units for urban households of below median income, built and sold by private developers and cooperatives. 2. Approximately 3,000 mortgages for below median income households provided by the housing finance institutions. 3. Systems developed to channel loans into lower income housing. 4. Strengthened NACHU, developing housing programs for member cooperatives.	(B-3) 1. Records of housing finance institutions. 2. Data on housing construction. 3. AID evaluations.	Assumptions for achieving purpose: (B-4) 1. Willingness of local authorities to reduce standards for lower cost housing. 2. Availability of cash in private hands which is not being currently placed in the housing finance system and willingness of the people to move their savings to obtain a mortgage. 3. Sufficient profit margins for all range of housing for the mortgage backed securities.

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AID 1020-28 (7-71)
SUPPLEMENT 1

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

C-3

Life of Project:
From FY ________ to FY ________
Total U.S. Funding ________
Date Prepared: ________

Project Title & Number: Kenya Private Sector Housing 615-HG-007

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Outputs (C-1)	Magnitude of Outputs: (C-2)	(C-3)	Assumptions for achieving outputs: (C-4)
1. Long-term housing finance in the range of KShs. 50,000-90,000 per unit at current prices.	1. Approximately 3,000 new loans.	1. Records of housing finance.	1. GOK draws down HG loan.
2. Construction of new housing units affordable to families below median income.	2. Approximately 3,000 new housing units.	2. Data on new housing construction.	2. Cost of construction and interest rates do not increase substantially.
3. Stronger NACHU to develop and build housing for cooperative members.	3. Stronger NACHU-cooperative organization.	3. USAID evaluations.	
4. Procedures developed to channel mortgage money into housing affordable by lower than median income families.	4. Agreement on procedures to channel Kenyan housing finance to lower cost housing.		

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project:
From FY ________ to FY ___
Total U.S. Funding ____________
Date Prepared: ____________

Title & Number: Kenya Private Sector Housing 615-HG-007

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Project Inputs: (D-1)	Implementation Target (Type and Quantity) (D-2)	(D-3)	Assumptions for providing inputs: (D-4)
1. HG loan.	1. $20 million loan.	1. Lender and borrower reports.	1. HG loans authorized by A.I.D.
2. Two long term technical advisors for NACHU.	2. DA grant funds $725,000 (long-term TA).	2. AID Evaluation reports.	2. Grant funds available in early 1984.
3. Short term technical assistance for NACHU - 12 months.	3. DA grant funds $160,000 (short-term TA).		3. HG fee funds available from
4. Feasibility studies for secondary mortgage market.	4. HG fee income $75,000.		
5. Short term consultants to housing finance institutions.	5. HG fee income $25,000.		
6. Training for housing finance institutions.	6. DA grant funds of $235,000.		
7. Local contributions.	7. $2 million in down payments.		
8. RHUDO staff input.	8. One person year of USDH input.		

THE HOUSING GUARANTY PROGRAM

Statutory Check-List
The Government of Kenya

PROJECT NO. 615-HG-007

ANSWER "YES" OR "NO"; PUT PP PAGE REFERENCES AND/OR EXPLANATIONS WHERE APPROPRIATE.

A. General Criteria Under HG Statutory Authority

Section 221(a)

Will the proposed project further one or more of the following policy goals?	YES
(1) Is intended to increase the availability of domestic financing by demonstrating to local entrepreneurs and institutions, that providing low-cost housing is financially viable;	YES P. 19-24
(2) Is intended to assist in marshalling resources for low-cost housing;	YES P. 19
(3) Supports a pilot project for low-cost shelter, or is intended to have a maximum demonstration impact on local institutions and national — and/or;	YES P. 19
(4) Is intended to have a long-run goal to develop domestic construction capabilities and stimulate local credit institutions to make available, domestic capital and other management and technological resources required for low-cost shelter programs and policies?	YES P. 19

Section 222(a)

Will the issuance of this guaranty cause the total face amount of gurantys issued and outstanding at this time, to be in excess of $ 1,743,100,000?	NO
Will the guaranty be issued prior to September 30, 1983?	YES

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STATUTORY CHECK-LIST - Cont'd.

Section 222(b)

Will the proposed guaranty result in activities which emphasize:

(1) Projects providing improved home sites to poor families on which to build shelter and related services; or — YES P. 20-24

(2) Projects comprised of expandable core shelter units on serviced sites; or — YES P. 41

(3) Slum upgrading projects designed to conserve and improve existing shelter; or — NO

(4) Shelter projects for low-income people designed for demonstration or institution building; or — YES P. 19-24

(5) Community facilities and services in support of projects authorized under this section to improve the shelter occupied by the poor? — NO.

Section 222(c)

If the project requires the use or conservation of energy, was consideration given to the use of solar energy technologies, where economically or technically feasible? — N/A

Section 223(a)

Will the AID guaranty fee be in an amount authorized by AID in accordance with its delegated powers? — YES

Section 223(f)

Is the maximum rate of interest allowable to the eligible U.S. investor(s) as prescribed by the Administrator, not more than one Per cent (1%) above the current rate of interest applicable to housing mortgages insured by the Department of Housing and Urban Development (HUD)? — NO

Section 223(h)

Will the Guaranty Agreement provide that no payment may be made under any guaranty issued for any loss arising out of fraud or misrepresentation for which the party seeking payment is responsible? — YES

STATUTORY CHECK-LIST - Cont'd.

Section 223(j)

(1) Will the proposed Housing Guaranty be coordinated with, and complementary to other development assistance in the host-country? **YES**

(2) Will the proposed Housing Guaranty demonstrate the feasibility of particular kinds of housing and other institutional arrangements? **YES P. 19-24**

(3) Is the project designed and planned by AID so that at least ninety per cent (90%) of the face-value of the proposed guaranty will be for housing suitable for families below the median income, or below the median urban income for housing in urban areas, in the host-country? **YES**

(4) Will the issuance of this guaranty cause the face-value of guarantys issued with respect to the host-country, to exceed $ 25 million in any fiscal year? **NO**

Section 238(c)

Will the guaranty agreement provide that it will cover only lenders who are "eligible investor(s)" within the meaning of this section of the statute at the time the guaranty is issued?

B. Criteria Under General Foreign Assistance Act Authority

Section 620/620A

(1) Does the host-country meet the general criteria for country eligibility under the Foreign Assistance Act, as set forth in the country eligibility check-list prepared at the beginning of each year? **YES**

(2) Is there any reason to believe that circumstances have changed in the host-country so that it would now be ineligible under the country statutory check-list? **NO**

STATUTORY CHECKLIST

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY: The responses contained in the Structural Adjustment Program Grant (615-0213) Program Assistance Approval Document approved on June 24, 1983, remain valid.

B. GENERAL CRITERIA FOR PROJECT

1. FY 1982 Appropriation Act Sec. 523; FAA Sec. 634A; Sec. 653(b); Second CR FY 83, Sec. 101(b)(1).

(a) Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project;

(a) Advice of program change will be forwared Congress in early FY 84 and before obligation of any funds.

(b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than $1 million over that amount)?

(b) Not in FY 84 Congressional Presentation. Notification will be necessary.

(c) If the proposed assistance is a new country program or will exceed or cause the total assistance level for the country to exceed assistance amounts provided to such country in FY 84, has a notification been provided to Congress?

(c) The total assistance level proposed for FY 1984 will not be exceede

B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance County Criteria

a. FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

No.

(d) If the proposed assistance is from the $85 million in ESF funds transferred to AID under the Second CR for FY 83 for "economic development assistance projects", has the notification required by Sec. 101(b)(1) of the Second CR for FY 83 been made?

N/A

2. FAA Sec. 611(a)(1). Prior to obligation in excess of $100,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

(a) Yes.

(b) Yes.

3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

No further legislation is required.

4. FAA Sec. 611(b); FY 1982 Appropriation Act Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973?

N/A

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's

N/A

capability effectively to maintain and utilize the project?

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

No. It is a country-specific activity.

7. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

The project is specifically designed to faster private initiative and competition and encourage development of cooperatives, saving and loan associations, strengthen then free labor unions through provision of labor unions co-op housing and it will discourage monopolistic practices

8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Grant-funded technical assistance will draw on U.S. private sector firms and consultants.

9.	FAA Sec. 612(b), 636(h); FY 1982 Appropriation Act Sec. 507. Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and othe services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.	Local contributions from cooperatives will total approximately one-half of the grant amount in addition local organizations will contribute the costs of staff and assistance.
10.	FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?	No.
11.	FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	Yes.
12.	FY 1982 Appropriation Act Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?	This assistance is not for the production of any specific commodity for export.
13.	FAA 118(c) and (d). Does the project comply with the environmental procedures set forth in AID Regulation 16?. Does the project or program take into consideration the problem of the destruction of tropical forests?	Yes. A negative determination was approved by the Africa Bureau environmental officer.

14.	FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)?	N/A
15.	FAA Sec. 128; Second CR FY 83, Sec. 101(b)(2). Has an attempt been made to finance productive facilities, goods, and services which will expeditiously and directly benefit those living in absolute poverty under the standards adopted by the World Bank?	Yes, through provision of technical assistance and HG credit funds for cooperatives which assist the poor.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology; spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural	All funds will be utilize to support cooperatives to provide housing for the poor in the large small urban areas, the pre housing prorjects are labor intensive, encourage self-help expansion. The project is only to benefit families with incomes below the median level and women will have equal access to participate training visits to other countries on coops will be undertaken.

and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

b. FAA Sec. 103, 103A, 104, 105, 106. Does the project fit the criteria for the type of funds (functional account) being used? Yes.

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)? Yes.

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)? Yes.

e. FAA Sec. 110(b). Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"?

No.

f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes.

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the project people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in government processes essential to self-government.

The cooperative apex organizations, and all member cooperativers are Kenyan. Local training and assistance will be utilized to maximum extent practicable.

5C(c) - STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. Procurement

1. FAA Sec. 602. Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?

   Yes.

2. FAA Sec. 604(a). Will all commodity procurement financed be from the United States except as otherwise determined by the President or under delegation from him?

   Yes.

3. FAA Sec. 604(d). If the cooperating country Kenya does not discriminate discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?

   against U.S. marine companies.

4. FAA Sec. 604(e); ISDCA of 1980 Sec. 705(a). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such

   N/A

commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)

5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of countries otherwise eligible under Code 941, but which have attained a competitive capability in international markets in one or these areas? N/A

6. FAA Sec. 603. Is the shipping excluded from compliance with requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent that such vessels are available at fair and reasonable rates? N/A

7. FAA Sec. 621. If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the Yes.

fullest extent practicable? If the facilities of other Federal agencies will be utilized, are they particularly suitable not competitive with private enterprise, and made available without undue interference with domestic programs? — N/A

8. International Air Transport. Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U. S. carriers be used to the extent such service is available? — N/A

9. FY 1982 Appropriation Act Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? — Yes.

B. Construction

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services to be used? — N/A

2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? — N/A

3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the CP)? — N/A

C. Other Restrictions

1. FAA Sec. 122(b). If development loan, is interest rate at least 2% per annum during grace period and at least 3% per annum thereafter? — N/A

2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? — N/A

3. FAA Sec. 620(b). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the communist-bloc countries? — Yes.

4. Will arrangements preclude use of financing:

a. FAA Sec. 104(f); FY 1982 Appropriation Act Sec. 525: (1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practive abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; (4) to lobby for abortion?

(1) Yes.

(2) Yes.

(3) Yes.

(4) Yes.

b. FAA Sec. 620(g). To compensate owners for expropriated nationalized property?

c. FAA Sec. 660. To provide training or advice or provide any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?

Yes.

d. FAA Sec. 662. For CIA activities?

Yes.

e. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?

Yes.

f. <u>FY 1982 Appropriation Act, Sec. 503.</u> To pay pensions, annuities, retirement pay, or adjusted service compensation for military personnel?	Yes.
g. <u>FY 1982 Appropriation Act, Sec. 505.</u> To pay U.N. assessments, arrearages for dues?	Yes.
h. <u>FY 1982 Appropriation Act, Sec. 506.</u> To carry out provisions of FAA section 209(d) (Transfer of FAA funds to multilateral organizations for lending)?	Yes.
i. <u>FY 1982 Appropriation Act, Sec. 510.</u> To finance the export of nuclear equipment, fuel, or technology or to train foreign nationals in nuclear fields?	Yes.
j. <u>FY 1982 Appropriation Act, Sec. 511.</u> For the purpose of aiding the efforts of the government of such country to represss the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?	Yes.
k. <u>FY 1982 Appropriation Act, Sec. 515.</u> To be used for publicity or propaganda purposes within U.S. not authorized by Congress?	Yes.

ANNEX E

REPUBLIC OF KENYA
MINISTRY OF FINANCE

Telegraphic Address: FINANCE-NAIROBI
Telephone: 338111
When replying please quote
Ref. No. EA/FA 9/29/01
and date

THE TREASURY
P.O. Box 30007
NAIROBI
KENYA

14 September, 1983

Mrs Allison B Herrick
Director
USAID Mission to Kenya
P O Box 30261
NAIROBI

Dear Allison,

PROPOSED US $50 MILLION HOUSING GUARANTEE LOAN

As you are aware in the recent past the Ministry of Works & Housing has been involved in establishing ways and means of encouraging the private sector to play a greater role in the country. In this effort, the Government in collaboration with the United Nations Centre for Human Settlements, has already completed a detailed study on the role of the private sector in housing development in Kenya.

One of the main findings that emerged from the study was that the availability of a long-term finance continues to be a major bottleneck to the development of private-sector housing. Without the accelerated involvement of the private sector, particularly in lower cost housing, the prospects for effectively addressing the housing challenge are rather daunting.

In view of the above, the study recommended that the public sector should facilitate the procurement of long-term finance for on-lending to private developers. The first step in the implementation of this recommendation has been discussed at length between the Ministry of works and Housing and the Regional Housing and Urban Development Office of USAID. As discussed by the Ministry of Works and Housing and USAID a US $50 million Housing Guarantee Loan to be used to finance low cost housing through housing finance institutions would be a most effective means of assisting the Government in achieving its goal.

9/16
REC'D 9/16
ACTION TO: RHUDO

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The purpose of this letter is to request your consideration of a US $50 million loan for this purpose. In addition we would appreciate your consideration of a grant funded technical assistance to assist in the institutional, procedural and training related aspects of the project.

Yours Sincerely

James G Karuga

J G Karuga
Financial Secretary

c.c. The Permanent Secretary
Ministry of Works & Housing
P O Box 30260
NAIROBI (Att. Mr J B K Mwaura)

ANNEX F

USAID'S PRIOR AND CURRENT INVOLVEMENT IN IN KENYA SHELTER PROGRAMS

A. COMPLETED PROJECTS

1. USAID has completed three HG projects in Kenya during the past fifteen years. These have resulted in the construction of approximately 4,350 housing units in Nairobi and eleven secondary towns.

1. Kimathi Estate (615-HG001)

The first project, Kimathi Estate, was initiated in the late 1960's to serve middle-income families. The estate was extremely popular and the 343 units were quickly purchased and occupied by Nairobi families. The legal documents that were drawn up served as models for all future tenant purchase schemes throughout the country. The estate has had no delinquency or management problems.

2. Umoja I (615-HG-003)

Following the "new directions" legislation in 1975, USAID determined that HG resources would be used to finance shelter projects for below-median income families. Thus, USAID designed companion HG projects in Kenya that encouraged and supported the Government of Kenya to shift its housing policy towards provision of low income housing. These projects financed "expandable core houses" that were built to lower standards and were affordable by families of below median income. In the "core house" approach shelter is delivered that is immediately inhabitable, i.e. it affords the basic necessities in terms of privacy, sanitation, cooking and formalized land tenure. The site is laid out and individual houses are designed to allow later efficient expansion at low cost, as the allottees' priorities for expenditure dictate.

Umoja I, developed through the Nairobi City Council (NCC), was one such project. It financed three-thousand expandable housing units during the late 1970's at a total cost of $10 million. The actual construction of these core housing units was highly successful, especially considering that NCC had only built upper and middle-income housing previously. The concept of cost recovery was a central feature of the project. This was new to the NCC whose previous projects had been highly subsidized. Private owners have aggressively expanded their units, investing about $5 million in private resources. At the same time, more more than three quarters of all the core houses have been completed.

The Umoja I project revealed another aspect of the Kenya shelter sector -- the almost universal practice of partial or total unit subletting. Umoja I was conceived as an owner-occupied development, but has become a predominantly rental scheme. Although Umoja I remains a stable neighborhood, its socio-economic characteristics have changed. House rentals income substantially exceeds mortgage payments.

3. Secondary Towns (615-HG-004)

Another companion HG project, Secondary Towns, was developed through the parastatal National Housing Corporation (NHC). This project financed approximately one-thousand (1,000) core housing units in the eleven largest municipalities, excluding Nairobi. Most of these units have also been expanded by their owners using private resources. This project represented the first attempt by the Government of Kenya to construct housing nationwide, which was affordable and recovered substantially all of its costs for the lower income groups. In most project towns the NHC took charge of all aspect of project development. Then it turned over project maintenance and management to the towns themselves. This system was fairly successful in terms of project development, but towns were somewhat unprepared for their long-term role. In the last few years, USAID and the Government have assisted local officials to manage these projects more effectively.

B. Current Projects

1. Umoja Phase II (615-HG-005):

The $25 million Umoja Phase II Project, developed through Nairobi City Council (NCC), was approved in 1979. The Implementation Agreement was signed in February 1982. The project will consist of three subprojects providing housing, community facilities and employment generating activities. This project will complete the development of this area and comprise a virtual new town for Nairobi's eastern section.

Umoja II has suffered significant project delays which may be typical of some public sector projects. Severe political in-fighting within the NCC and between the NCC and the national Government has impeded progress towards project implementation and the HG borrowing. An investigation of

NCC Housing Department. In early 1983, the Government dissolved the NCC and replaced it for the next 2 years with an appointed Commission. Nairobi's Housing Development Department has finally been able to resume active project preparation without further fear of political interference.

During the last few months, USAID has negotiated new planning principles and building standards with the Commission. Representing a significant departure from past policies, these innovative principles carry out the original intention of the PP. USAID was to finance a project involving housing that would be more appropriate for the target group, less attractive to rent out fully and priced closer to the prevailing market compared to housing in previously financed projects. One of the new policies for Umoja II is substantially reduced site, infrastructure and unit design standards, providing for a physically and socially acceptable environment but at greatly reduced cost. Others include audited plot allocation procedures and a "condominium" approach in which households share sanitary facilities and open spaces. The shelter units to be provided will have a sales price of between $3,000 - 4,000 (KShs 40,000 - 55,000).

The Commission has awarded the Umoja II design and engineering contract which will be completed in January 1984 and result in the preparation of final plans and specifications. Construction contracts will be let at that time and the HG loan financing will take place early in 1984.

2. Kenya Small Towns Shelter and Community Facilities (615-HG-006):

This $16 million HG project is designed to upgrade significant portions of 15 small towns (populations ranging from 5,000 to 20,000) which serve as administrative and trading centers in rural areas. The project's objective is to strengthen the capabilities of these small towns to plan and manage their development requirements The project will provide necessary technical assistance and training.

This project was authorized in 1980. The Implementation Agreement was negotiated in 1981 and signed in 1982. The project is now ready for HG financing.

This complex HG project will have five major elements: shelter units, capital improvements, community facilities, employment generating activities and training of local authority staff. It has taken significant time to develop the necessary coordination between the several ministries, donor organizations and small towns involved.

Furthermore, USAID, the World Bank and Overseas Development Administration (ODA) have coordinated their activities and divided up their responsibilities for all the towns involved. Early in 1983 each town was visited by a technical assistance team composed of representatives from the Ministry of Works and Housing, the Ministry of Local Government, the National Housing Corporation and USAID funded technical advisors. Specific eligible sub-projects have now been identified and their financial and technical feasibility determined. Construction of the sub-projects was to have begun in late 1983 following a borrowing under the HG program. However, the President recently dissolved the Parliament earlier than expected. It had not yet approved the Government guaranty necessary to the project. Following the convening of the new Parliament in September, the guaranty will be approved, and the HG loan will be contracted at the end of this year.

ANNEX G

PROGRAM IMPLEMENTATION SCHEDULE

FOURTH QUARTER FY 1983

1. Approval of the $20 million project paper, and authorization of $20 million HG.

2. Authorization of $1.12 million in grant funds for technical assistance.

FIRST QUARTER FY 1984

1. Letter of Advice to the Government of Kenya issued by the Office of Housing and Urban Programs (PRE/H).

2. Draft Implementation Agreement prepared by USAID for review by the Government.

3. USAID, the Ministry of Works and Housing (MoWH) and participating towns discuss specific recommendations of By-Law Standards Study to modify Urban II Standards and approval process.

4. USAID, representatives of housing finance institutions and MoWH concur on eligibility criteria for disbursement of HG loan funds and on monitoring and evaluation procedures.

5. Eligibility requirements for participation in the program widely publicized.

6. Developers, National Cooperative Housing Union (NACHU) and housing finance institutions initiate discussions on projects and on funds required.

7. NACHU staff counterparts (except project engineer) to work with USAID funded technicians on board.

8. Issue notice in Commerce Business Daily to solicit expression of interest to provide Technical Assistance to NACHU.

9. Publish and issue the RFP for Cooperative Agreement.

10. Receive and review the RFPs.

SECOND QUARTER FY 1984

1. Cooperative Agreement signed with the selected organization for Technical Assistance to NACHU.

2. NACHU and each Housing finance institution prepares a preliminary master project delivery plan and submit to USAID and MoWH.

3. USAID, MoWH, NACHU and housing finance institutions establish allocation of $20 million of HG funds.

4. USAID and Central Bank of Kenya develop, and USAID approves language of agreements for Central Bank loans of funds to housing finance institutions.

5. MoWH, USAID and Central Bank establish loan fund accounting and administration procedures.

6. Central Bank and financing institutions conclude implementation agreements with USAID concurrence.

7. Advisers begin work with NACHU.

8. USAID works with and provides consultants for a total of two person moenths' assistance to housing finance institutions on fees, lending procedures, savings promotion, etc., for low income families.

9. Carry out basic housing needs study.

THIRD QUARTER FY 1984

1. Housing finance institutions submit final Master Project Delivery Plans to USAID and MoWH

2. USAID, MoWH, and local governing bodies as necessary, concur on standards for projects.

3. Sessional Paper proposing Kenyan Government quaranty submitted to and approved by Parliament.

4. Following formal Government request to select an Investor, USAID approves final Master Project Delivery Plan and authorizes Government to select an Investor.

5. Bids from U.S. investors requested.

6. The Ministry of Finance and U.S. Investor negotiate Loan Agreement.

7. Developers complete design of projects and obtain necessary permits.

8. NACHU assists member cooperatives to plan for and undertaken housing developments.

9. Consultants study mortgage instruments, etc. as basis for development of secondary mortgage market and means of mobilizing finance to low-cost housing.

10. Carry out study of informal housing finance and construction sector and its role in low cost housing.

FOURTH QUARTER FY 1984

1. Government of Kenya borrows $20 million.

2. Loan agreements signed between Central Bank and housing finance institutions; loan funds committed.

3. Housing finance institutions provide letters of commitment to developers and NACHU.

4. Developers complete acquisition of land and initiate construction.

5. Consultants to housing finance institutions assist in establishing implementation systems.

6. Developers initiate sales program.

7. Carry out a study of the formal housing finance system and its role in providing lower cost housing.

FY 1985

1. Training in the United States on secondary mortgage markets for representatives of Government and housing finance institutions (7-10 persons for 2-3 months each).

2. Construction of projects continues.

3. Developers and cooperatives submit list of completed, and sold to housing finance institutions, who, in turn, submit the list to USAID.

4. USAID reviews the list, confirms eligibility of houses and purchasers and approves disbursement from the Central Bank to housing finance institutions.

FY 1986

1. USAID and MoWH perform evaluation of all sub-projects in progress, to determine the progress, attainment of goals, final disbursement date etc.

2. Evauation of KACHU performance.

3. Decision on next HG project and amended project paper prepared and submitted to AID.

ANNEX H

ENVIRONMENTAL THRESHOLD RECOMMENDATIONS

PROJECT COUNTRY : KENYA

PROJECT TITLE : PROJECT 615-HG-007

FUNDING : HG Loan $20,000,000 - FY 1983
$1,120,000 - FY 1984

IEE PREPARED BY : PRE/H

ENVIRONEMENTAL ACTION RECOMMENED:

In the absence of site specific projects to be included in this program and based upon the Project Identification Document (PID), this Initial Environmental Examination has been conducted on the basis of experience with similar, previously-implemented, low-cost housing projects in Kenya.

In that context the following environmental actions are recommended:

1. Specifit guidelines assuring environmental soundness of the projects must be incorporated in the policy framework and project eligibility criteria to be developed by the G.O.K. Ministry of Works and Housing.

2. Clearly defined criteria for new site selection must be made available to projects sponsors, developers and builders in order to eliminate effectively any negative impacts on land-use and environmental systems in the area.

3. On new construction sites, low cost, effective alternatives for the provision of potable water and the disposal of waste water must be explored. The effective operation and maintenance of water and sewage systems will also be very important in order to assure continued environment soundness within the project.

4. Preparation of a site for construction must include the means to retain vegetation cover, to assure adequate drainage, and to prevent soil erosion.

5. Each proposed project must undergo an individual environmental evaluation as part of the technical review. Identified problems will be addressed through site selection and site design.

With the provision that the Project Paper will appropriately emphasize the recommended environmental actions and include guidelines to assure the environmental soundness of the project, it is recommentat that

NEGATIVE DETERMINATION BE GRANTED.

CONCURRENCE:

Bureau Environmental Officer

APPROVED: ________

DISAPPROVED: ________

DATE: ________

CLEARANCE: GC/AFR: ________ DATE: ________

ANNEX 7C

INSTITUTIONAL FINANCING OF HOUSING UNITS IN KENYA
1979-1982

Year	Institution: NATIONAL HOUSING CORP.		Institution: NAIROBI CITY COUNCIL		Institution: EAST AFRICAN BUILDING SOCIETY		Institution: PIONEER BUILDING SOCIETY	
	No. of Units	Av. Price Per Unit Kshs	No. of Units	Av. Price Per Unit Kshs	No. of Units	Av. Mtge. Per Unit Kshs	No. of Units	Av. Mtge. Per Unit Kshs
1979	4,085	32,000	-o-	-o-	257	217,620	-o-	-o-
1980	3,527	17,820	3,388	53,275	1,388	214,720	-o-	-o-
1981	2,735	21,710	3,089	38,660	221	318,300	-o-	-o-
1982	2,928	48,920	2,097	30,230	140	584,535	157	286,625

Year	Institution: HOME SAVINGS & MORTGAGE		Institution: KENYA REINSURANCE CORPORATION		Institution: HOUSING FINANCE CO. OF KENYA		Institution: SAVINGS & LOAN KENYA, LTD	
	No. of Units	Av. Price Per Unit Kshs	No. of Units	Av. Price Per Unit Kshs	No. of Units	Av. Mtge. Per Unit Kshs.	No. of Units	Av. Mtge. Per Unit Kshs
1979	-o-	-o-	-o-	-o-	525	179.660	346	167,890
1980	-o-	-o-	-o-	-o-	1,100	202,650	238	290,000
1981	-o-	-o-	67	230,630	928	231,290	195	317,270
1982	21	475,000	635	230,630	1,031	267,120	308	223,655

SOURCE: ANNUAL REPORTS OF INSTITUTIONS

TOTAL UNITS PRODUCED PER YEAR

	1979	1980	1981	1982
Total	5,213	9,641	7,235	7,317
Public	(4,085)	(6,915)	(5,824)	(5,025)
Private	(1,128)	(2,726)	(1,411)	(2,292)

ANNEX J

DEVELOPMENT OF A SECONDARY MORTGAGE MARKET

Housing finance institutions have the ability to attract new savings. However, their resources and the level of their mortgage orginations are quite limited relative to the needs of Kenyans for housing finance In order to generate further resources, the creation of a secondary marketing mechanism is under consideration. The basis for a secondary mortgage market is a sound primary market.

1. Primary Mortgage Market

Most mortgage markets in developing countries have started with a government agency that administers FHA type mortgage insurance and insurance of savings accounts. The agency also regulates 1) mortgage terms (particularly maximum loan-to-value ratios), 2) minimum liquidity ratio, 3) minimum ratio of net worth to assets or liability, etc. Additionally, it makes liquidity loans and frequently flows foreign loan and grant funds to its supervised institutions.

However, in Kenya the growth of the mortgage market and of savings has been accomplished without this governmental activity. Kenyans save in financial institutions without insurance of accounts and despite the failure of one building society in 1961 (which led the Government and the Commonwealth Development Corporation to recapitalize it as Housing Finance Company of Kenya). But the lack of such insurance both retards the growth of savings and makes the institutions feel the need to carry more liquidity, thus allocating a smaller percentage of assets and savings to housing finance. Liquidity runs about 20% of assets versus approximately 7% in the U.S.

The lack of mortgage insurance does not appear to impede current mortgage lending for current types of construction as it does in other countries. No institution mentions it as a requirement for lending. However, its lack is a major reason why the institutions appear nervous about lower cost housing and lower income borrowers. Partial reinsurance with Kenya Reinsurance (a governmental entity) helps the creditability of the insurance industry, but does not appear on the surface to have caused the insurers to become speculative. Mortgage insurance can lower down payments, help create new alternative mortgage instruments and improve the secondary markets. That the savings and mortgage markets are as strong as they are in Kenya with the absence of both savings insurance and mortgage insurance is testimony to the desire of people to save and of the determined home purchaser to avoid default and foreclosure. A 1968 law, unimplemented, permits mortgage insurance.

Kenya is atypical for developing countries in that there is a strong and growing insurance sector. The sector orginates and services mortgages and does some development. Its investment portfolio is not regulatorily proscribed. Furthermore, it wants to increase its participation in housing finance through deposits with specialized lenders, direct lending and investment, and secondary market activities. In most developing countries the Central Bank jealously guards the Government's predominant, frequently exclusive, access to the capital markets. In Kenya the Central Bank supports growth in housing finance.

2. Secondary Mortgage Market

In Kenya there is a small, but growing volume of long-term and short-term transactions among the parastatal organizations and between them and the private specialized mortgage lenders. These activities mark the beginning of a secondary mortgage market operation.

It is tempting simply to encourage this long-term/short-term, unsecured market to grow and to continue to ignore the issues of collateral and maturity matching. However, the relationship that is missing is the sufficient provision of long-term funds from both the parastatals and the diversified investors to the private specialized mortgage lenders. Long maturity transactions will permit the truly efficient mobilization of funds for housing in Kenya. The institutions involved seem receptive and feel housing has national and institutional priority. These attitudes of support showed up strongly in a seminar on the potential of a secondary mortgage market operation," conducted July 6, 1983 in Nairobi and attended by 70 of the country's financial leaders.

There are three basic ways to ensure that lenders will have a sufficient cash flow from mortgage lending to service long-term borrowing (in addition to their savings interest requirements). They are: 1) net worth of the borrower, 2) mortgage default insurance from a financially dependable third party, and 3) the amount of collateralization. The absence of collaterization (or sufficient alternative protection) may cause failure of an overaggressive institution. If sufficiently large and embarrasing the failure could cause damage to the mortgage finance system. Collateralization permits the private sector lenders to compete with parastatals for funds from diversified investors. The secondary mortgage market in Kenya should begin by "overcollaterization". This would mean pledging (preferably with a third party fiduciary) a pool of mortgages in excess of the borrowings. Thus, after allowing for defaults and prepayments, there would continue be sufficient cash flow to this mortgage pool to service the debt, including principal repayment.

In the U.S. there is much concern about maturity matching to protect against interest rate risk. It derives principally from the danger that short-term liabilities will rise in cost more than long-term fixed rate mortgage assets rise in yield, causing a negative yield spread between financial assets and liabilities. The solution to this problem in Kenya, as in England, is the periodic raising of both rates on all outstanding mortgages and rates on outstanding savings accounts. This maintains the mortgage lender's spread, and indicates that the Government, which sets rates through the Central Bank, remains willing to resist political pressure from homeowners to delay mortgage rate increases. The increases cause some rise in defaults, thus arguing further for over collateralization of mortgage-backed securities. Actually, diversified investors such as insurance companies, pension funds, savings and credit societies and others have a comparatively dependable and rising source of revenue, i.e. contributions or deposits. They are, thus, better able to accept interest rate risk than are the specialized mortgage lenders who rely upon voluntary short term savings and Government rate changes. This is the crux of the need for the secondary mortgage market.

The specialized mortgage orginators could sell whole mortgage loans with servicing released to the buyer or retained by the seller. Transactions could be in mortgage loan participations, where the seller retains 10-20% ownership in each mortgage and responsibility for mortgage servicing. This protects the buyer further, since the seller continues to be a co-owner and not just the buyer's servicing agent. Transactions could be in mortgage-backed bonds where, instead of a buyer-seller relationship, there is a lender-borrower one. The mortgage originator is obligated to pay interest and principal on the the bonds, including full principal by bond maturity, whether or not sufficient funds are collected from the mortgage collateral. The specialized originator retains the mortgages, retains the default and interest rate risks and and acquires the bond payment obligation.

A Guarantied Mortgage Certificate (GMC) is between a straight participation and a mortgage-backed bond. The buyer requires a contractual fractional interest in a pool of specific mortgages with the homeowners' contractual interest rates, monthly payments, maturities and prepayment options. The maturity of the GMC depends on the prepayment pattern of the pool of mortgages. However, the seller/servicer/co-owner guarantees that the GMC buyer will get his share of the minimum contractual monthly mortgage payments, on time even if the homeowner/borrowers are delinquent, in default or in foreclosure. In this way, the seller/servicer/co-owner retains the full credit and collection responsibility with his homeowner/borrower and thus bears the default risk. The GMC buyer assumes his proportionate share of the interest rate risk. This is the risk that in a falling interest rate market homeowners may finance to prepay. Thus the investor will not be able to reinvest the proceeds at as high a yield as the average of mortgages in the GMC pool. This risk seems comparatively small for Kenyan secondary market diversified investors to bear at this time. There is an expressed priority for housing, and falling rates are normally associated with favorable exchange and balance of payments, increased employment and economic activity and reduced fiscal deficits. The benefits to investors in this environment should far outweigh the limited exposure to interest rate risks from GMCs.

In summary, relatively uncomplicated mortgage packaging and pooling and pool/GMC servicing can stimulate the development and growth of mortgage-backed securities and a strong secondary mortgage market. Increasing the breadth and depth of the existing mortgage market can help bring increased mortgage credit to below-median income households in Kenya.

There are several other important issues relating to the successful initiation of a secondary mortgage market:

a) Law: A Kenyan law requiring the mortgagee's consent prior to the transfer or partial assignment of the lender's lien needs to be changed.

b) Yield: To attract buyers, a secondary market purchase must offer a rate of interest competitive with alternative investments such as Government Treasury Bills and term deposits at financial institutions. At present, finance institutions offer rates as high as 16.5%. Mortgage assets based on portfolios yielding the current 16% would have difficulty competing with such rates while enabling the seller to maintain some kind of servicing spread.

c) Liquidity: Not all purchasers of mortgage backed securities are likely to be willing to hold such an investment for its full term. Unless there is a great demand to purchase these instruments, which is unlikely in the early stages of a market, the buyer will look to the seller for a guaranty of repurchase. Such a guaranty would pose potential liquidity problems for the seller.

d) Investor Confidence: Investor confidence in the selling institution is a critical factor in the secondary market. All five of the Kenyan housing finance institutions are profitable and appear to enjoy both a good public image and the respect of financial community. The three older institutions, Housing Finance Company of Kenya, East African Building Society, and Savings and Loan Kenya Limited, by virtue of their greater net worths and larger loan portfolios, offer more security to potential buyers.

The government is pressuring both the insurance companies, and pension funds (particularly the National Social Security Fund) to use their resources for socially more important areas such as housing. To date, both of these have heavily invested their resources into commercial office buildings. This office space market is now becoming over supplied.

Furthermore, there are pressures from the insurance holders and pension fund employees for their respective funds to provide mortgage financing. This has led a few of insurance companies and pension funds to develop and finance their own projects.

Since both insurance companies and pension funds will be seeking new investment opportunities, it is reasonable to assure they would be interested in participating in a secondary mortgage market. Certainly they very actively participated in the seminar on the subject. While the secondary mortgage market does not provide the rate of return enjoyed on office building developments it does offer a secure and reasonable rate of return. Furthermore, if offers a service for their members since the invested funds could be directed to be reinvested for housing for the members (e.g. pension fund employees) and even require the purchasers to obtain life and fire insurance from the investing insurance company.

3. Development Strategy

The strategy of the proposed HG project for the development of a secondary mortgage market is as follows:

1. Establish a mortgage instrument that is common to all housing finance insitutions.

2. Require the Housing Finance Company of Kenya and/or Kenya Savings and Loan to package a pool of mortgages generated by the HG loan.

3. Develop a security instrument such as a bond, to be over-collateralized by the pool.

4. Develop sales, maturity, processing, administration and servicing, etc., procedures and regulations for the security instrument.

5. Convince National Social Security Fund and/or Kenya Reinsurance to purchase the instrument.

6. Instruct the seller to use the funds to generate similar low-cost mortgages. This would establish the principle of an over-collateralized mortgage-backed security instrument. However, the guaranty for the investment is the Housing Finance Company of Kenya or Kenya Savings and Loan. This should be of interest to the funds because of the Government directive to them to support low-cost housing.

7. Either establish a pool insurance (as opposed to an individual mortgage policy) as a guaranty for the security instrument backed by a pool of mortgages, or obtain legal approval to offer newly-designed mortgages as a guaranty for the security instrument.

8. Convince other housing finance institutions to package a pool of mortgages with one of the guaranties already developed (see 6).

9. Obtain the housing finance institutions' concurrence on a form of security instrument to be backed by the pool (could be the same as developed in (3)) and offer it for sale.

10. Convince the other insurance companies and the pension funds, along with other potential investors, to invest in the security instrument.

ANNEX K

HOUSING FINANCE IN KENYA

A. THE KENYA FINANCIAL SECTOR

1. Introduction

Kenya's financial sector is fairly well developed relative to the country's overall stage of development. In recent years it has been characterized by rapid growth in both resources and number of institutions. Nineteen commercial banks operate presently in Kenya, four are locally controlled and the others have majority foreign ownership. The giants in the commercial banking sector are Kenya Commercial Bank (KCB), Barclays Bank, and Standard Bank. A number of American and Arab banks established regional offices in the 1970's and 1980's, some joining the more established European and Asian institutions in providing full commercial banking services. The growth of non-bank financial institutions has been notable, increasing from 23 in 1981 to 32 at year end 1982. Over the last four years these institutions' assets have grown at an average compound rate of 28.4% annually, much faster than the commercial banks.

Total liabilities and assets of the Kenyan banking systems were KShs 23 billion at the end of 1982, a 17% increase over 1981 and 60% greater than four years earlier. Kenya has no system of depository insurance yet, the last failure of a financial institution took place in 1961. In that particular instance was resolved the Commonwealth Development Corporation took over the bankrupt institution. Depositor confidence in the banking system can be rated as high. Kenya has a traditionally high savings rate, and the public is generally well informed on the subject of depository yields and alternatives. Savings deposits grew by 11.3% in both 1979 and 1980, by 18.8% in 1981 and 12.3% in 1982. Expansion of time deposits declined from a 27.9% growth rate in 1979 to only 7.5% in 1982.

The regulatory framework for the financial sector is somewhat ambiguous. The Central Bank is the basic regulatory body for financial institutions licensed under the Banking Act. Issuance of the actual banking licenses comes from the Ministry of Finance. The Central Bank sets minimum rates to be paid on deposits, currently 12.5%, as well as the maximum interest rate on lending, which is presently 16%. Financial institutions submit periodic internal financial statements to the Central Bank, as well as an annual report produced by an independent certified auditor. The Central Bank regulates the liquidity position of Kenyan financial institutions (except for the Building Societies and housing finance institutions); the requirement is currently 24% of net deposits. Half of all reserves must be invested in Government Treasury Bills, presently paying 13.5%, with a 90 day maturity. Any deposits in excess of statutory mimimum requirements yield 15% interest with 90 day maturity. Current actions on the part of the Central Bank reflect attempts on its part to consolidate its position and better exercise existing regulatory powers. Recent pronouncements by the Central Bank Governor indicated concern over some of the lending practices and effective interest rate charges of the non-bank financial institutions. However, the impact of more effective central regulation on the continued growth of the non-bank financial institutions remains to be seen.

2. Housing Finance Institutions

a. Institutions Licensed Under the Banking Act

Three institutitons are licensed under the Banking Act: Housing Finance Company of Kenya (HFCK), Savings and Loan Kenya Limited (SLK) and Home Savings and Mortgages (HSM) The "License to Conduct the Business of a Financial Institution" awarded these three institutions authorizes them to carry on business in the manner of any other banking entity with a few basic differences.

First, these institutions do not offer current (checking) accounts, as do the commercial banks. Secondly, the Central Bank allows institutions investing exclusively in home mortgages an "essential services" exemption from the reserve requirement to which similarly licensed institutions are subject.

These institutions' methods of attracting deposits are similar to other institucuons, and both their lending and deposit rates are competitive.

1) Housing Finance Company of Kenya (HFCK)

HFCK is the largest Kenyan housing finance institution, with assets of KShs 1,186 billion at December 31, 1982. It started operations in 1965 as successor to the First Permanent East Africa Building Society, a multi-national society. Ownership is equally divided between the Government and Commonwealth Development Corporation (CDC) with each holding 300,000 shares (KShs 12 million).

HFCK has been consistently profitable while enjoying very strong deposit growth over the last four years. The company has 185 employees, with 8 in each of its 3 branches, and 161 in its Nairobi headquarters. The last figure suggests that some streamlining is possible, especially when compared to the number of employees relative to asset levels. The company's loan portfolio contained 7,195 accounts at June 30, 1983.

As housing finance institution providing an "essential service" (i.e. housing finance), HFCK is exempted from the Central Bank's reserve requirement. Nevertheless, the company's December 31, 1982 financial statement reflected that 21.3% of assets were held in reserve.

2) Savings and Loan Kenya Limited (SLK)

Formerly doing business as the Savings and Loan Society, Ltd., SLK was acquired in 1970 by Kenya Commercial Bank (KCB), which is 100% government owned. Total assets at December 31, 1982 were KShs 459 million.

Profits have grown steadily over the past five years, as have deposits, the profit and deposits in 1982 were KShs 20 million and KShs 452 million respectively.

Like HFCK, SLK is exempted from reserve requirements provided it invests exclusively in home mortgages, and, accordingly, it maintains very little money in reserves.

SLK has a total of 40 employees, with one branch in Mombasa. It had a portfolio of 2,112 loans as of December 31, 1982. The institution's activities are closely monitored by the KCB.

3) Home Savings and Mortgages Limited (HSM)

HSM began operations in July, 1982. Total deposits are KShs 59 million, plus share capital of KShs 5 million contributed by the manager and three other individuals. It is a privately held corporation.

HSM appears to be well established after a year of operations, having attracted some 1,250 small savings accounts. Twenty-one mortgages have been originated, at an average loan amount of KShs 475,000. An additional 22 loans are in process.

Despite having been granted the "essential service" exemption from liquidity requirements, HSM has chosen to maintain over 50% of its assets in liquid reserves. This policy is prompted by the short term nature of its deposits and the extremely competitive environment among financial institutions for such funds, which could result in deposit outflows. HSM has a 12 person staff in its Nairobi office. Despite a strong expression of interest in the AID program, HSM's current lending practices do not easily accommodate lower income households. The institution charges a KShs 5,000 application fee, which is collected after several discussions with the applicant and an 80% probability of making the loan has been established. A charge of 5% of the loan amount is assesed up front for "administration".

b. Building Societies

The two operational building societies in Kenya, East African Building Society (EABS) and Pioneer Building Society (PBS), are governed by the 1956 Building Societies Act. They are licensed by the Registrar of Building Societies and supervised by the Attorney General's Office. Managers of these institutions indicated that application has been made for licensing of four additional societies.

These institutions operate similarly to the British mutual building societies. They have no reserve requirements. All investments outside of voluntarily maintained reserves are in long term home mortgages, or interim loans for the construction of residences. Like the other housing finance institutions, they offer competitive rates on a range of depository accounts, but do not provide a checking account service.

Both of the societies have their own development affiliates through which they have built various housing projects.

1) <u>East Africa Building Society (EABS)</u>

EABS opened for business in 1959 and at December 31, 1982 had built up total assets of KShs.598.5 million. EABS is a mutually owned society with shareholders (depositors) receiving dividends in the form of interest on their deposits.

EABS has consistently registered profits and enjoyed strong asset growth in recent years. The society has 81 employees and operates five branches in addition to its administrative office.

EABS' mortgage portfolio consists of approximately 1,500 loans, and with much of their deposit growth having taken place in the last four years, their average loan balance of KShs 269,000 is considerably higher than that of HFCK.

As an institution registered under the Building Societies Act, EABS is not required to maintain reserves, but as a practice, keeps at least 20% of its assets liquid.

2) Pioneer Building Society (PBS)

PBS began operations in 1980 and by year end 1981 (December 31, 1982 statement unavailable) had assets of KShs 65.3 million. Like EABS, it is mutually owned, licensed through the Registrar of Building societies, and supervised by the Attorney General. PBS has 4 branches and a total of 54 employees. Two additional branches are planned.

Precise current data was not available as to the number of loans originated by the society to date. The average loan amount of recent disbursements has been approximately KShs 400,000.

The institution reacted quite postively to AID policy goals of reaching below median income borrowers, as well as to the idea of adjusting underwriting guidelines to better accommodate such applicants.

c. Insurance Companies

Insurance companies offer considerable potential for participation in the housing finance system, particularly through the operation of a viable secondary mortgage market. As of May, 1982, thirty insurance companies were doing business in Kenya. The companies are licensed through the Registrar of Insurance Companies and supervised by the Attorney General's office. A proposal for a new Insurance Companies Act awaits the reconvening of Parliament after the September, 1983 elections. If enacted, the new law would establish a Controller of Insurance Companies within the Treasury.

Currently, the companies have very little restrictions on investments portfolios. Development of commercial real estate and the purchase of equity positions in private enterprises have been typical investments for insurance companies in the past. However, a lack of sound opportunity in the investment market combined with increasingly attractive yields on short term bank acccounts in the past few years has led to maintenance of high cash balances with the depository institutions.

A number of the companies originate mortgage loans, but generally restrict this service to life insurance policy holders. Kenya Reinsurance, a government owned entity, has acted as a housing developer on a 204 unit project, providing 90% financing of homes priced between KShs 314,000 and 413,000. Figures as to the assets of the insurance industry and the percentage of those invested in housing are not available. However, the industry as a whole is described as strong and growing by members of the financial community.

d. Pension Funds

Pension funds are an attractive source of resources for Kenyan financial institutions. Because of their tax free nature, the yield requirements of the depositors are somewhat less than savings accounts.

There is no primary lending from the pension funds for housing since in order to maintain income tax exemption, contributors to the funds may not receive benefits prior to retirement. However, one mortgage lender has negotiated placement of pension funds in his institution, with an agreement on his part to reinvest a certain percentage of that money in home mortgages for the fund's contributors.

The largest fund in Kenya is the National Social Security Fund (NSSF). The NSSF has, by government direction, made long term loans to HFCK and SLK. At present however, the fund is investing most of its resources in Government Treasury Bills. At year end 1981, the NSSF was the Government's largest domestic creditor holding KShs 4.5 billion worth of debt.

e. Commercial Banks and Construction Lending

The principal source of bridge or construction financing on a project scale in Kenya is the commercial banks.

Since few of the banks have large mortgage lending departments, builder/developers of residential real estate projects negotiate a commitment for long-term financing with one of the housing finance institutions.

In considering a request for a construction loan, the lender evaluates the terms and conditions of the end loan commitment, feasibility of the project, as well as the professional and financial capacity of the builder/developer to complete it.

Principally because of strong pressure on the capital market from Government borrowings and a reserve ratio increase from 18 to 24%, the banking community has been experiencing a liquidity squeeze.

3. Institutional Capacity to Handle HG Funds

The three institutions licenced under the banking act and the two building societies have the capacity to process and close mortgage loans at a far greater rate than their lending capital has allowed for in recent years. Housing Finance Company of Kenya (HFCK), which funded an average of about 85 mortgages per month in 1982, indicated that their current staff could easily handle three or four times that workload given the resources. Based on the level of loan originations for the first seven months of 1983, HFCK's output in this year should be approximately equal to 1982's. With the addition of only one hundred loan cases per month to HFCK's existing workload, based on a hypothetical average loan amount of KShs 75,000, HFCK alone could comfortably handle KShs 90 million (US$ 6.6 million) per year.

The East African Building Society (EABS) originated an average of twelve loans a month in 1982 and is currently running at about that pace for 1983. However, like the other housing finance institutions, its level of originations is much more a reflection of limited money available than personnel constraints. EABS management said it could process "twelve loans a day", emphasizing that making loans in large project schemes allows for very fast output since such aspects such as property appraisal, inspection and preparation of documents become far less time consuming.

Home Savings and Mortgages (HSM), with a total staff of twelve, indicated that it could handle "fifty to one hundred cases per month with no difficulty". Likewise, Savings and Loan Kenya and Pioneer Building Society have the ability to accelerate loan production significantly with no increase in staff.

The housing finance institutions have purposely restricted lending levels in the last year in order to maintain high liquid reserves as protection from heavy withdrawals. The combination of parastatal agencies withdrawing funds under Government pressure to invest in treasury bills and intense competition for deposits among the financial institutions themselves, has prompted the housing finance institutions to keep reserves at a high level voluntarily.

The prospect of receiving HG funds, which would be free from this withdrawal pressure, is very attractive to all of the housing finance institutions.

B. THE FINANCE OF HOUSING

1. Lending Criteria and the Market Served

The general lending policies of Kenyan housing finance institutions are similar. Their requirements for mortgage applicants are, on the whole, reasonable. However, the relatively high cost of houses available for purchase, combined with high interest rates, has effectively limited lending to persons with incomes considerably above the median family income level of KShs 2,500 per month.

a. Loan Amounts

Loan to value ratios (LTVRs) are generally limited to 80% or less of the lesser of the purchase price or appraised value of a house. A few of the housing finance institutions finance up to 90% of value but the sizes of the loans usually have limits scaled according to the corresponding LTVR limits. For example, Savings and Loan Kenya currently limits its LTVRs as follows:

70% financing for loans up to KShs 500,000
75% financing for loans up to KShs 487,000
80% financing for loans up to KShs 400,000
85% financing for loans up to KShs 340,000
90% financing for loans up to KShs 270,000

None of the institutions funds mortgages in excess of KShs 600,000.

b. Terms of Loans

Amortization periods of loans have traditionally been 15 or 20 years. However, institutions will occasionally allow a 25 year loan term. None of the Kenyan housing finance institutions ruled out the possibility of a 30 year amortization, but the overall reaction was one of reluctance, due to their skepticism over the construction quality of low cost units. The lender's concern is that the unit it is to mortgage must have an effective life sufficient to adequately secure a 25 to 30 year loan.

c. Life and Hazard Insurance

A life insurance policy in the lender's name is required of all mortgagees in an amount equal to the outstanding principal on the loan. All applicants must pass a physical examination to obtain this coverage, and loans to older borrowers often require subsequent physical examinations at specified ages to maintain the policy.

Hazard insurance coverage (fire, storm damage, etc.) is required by all lenders as well, in an amount equal to or greater than the loan. As in the case of mortgage life insurance, lenders arrange block policies with independent insurance companies, under which the lenders, acting as agents, collect the annual premiums in monthly installments along with principal and interest payments from the borrowers. The premium due, less the agent's commission, is remitted by the lender to the company, assuring maintenance of coverage, and generating some income for the lender as well.

d. Mortgage Insurance

Kenya has no well established system for insuring mortgage loans against losses due to default. Only one institution, the Housing Finance Company of Kenya (HFCK), has a provision for insuring its loans. The mechanism is really more of a reserve fund maintained for possible losses than an insurance plan per se.

Formerly the HFCK had a 75% LTVR limit. In order to allow a wider income range to qualify for financing, it has permitted 90% loans. The risks of making 90% loans are quite real. Housing finance institutions often allow over six months of arrearages to accumulate before referring the case to an attorney for legal action. In such a case, at a public sale, a property might easily sell for less than the lender's total investment.

For example, on a purchase price or appraised value of KShs 100,000, HFCK could make a KShs 90,000 loan. A 75% LTVR loan would have been KShs 75,000, so the additional principal of KShs 15,000 is assessed a 12.5% premium, or KShs 1,875.

ILLUSTRATION:

Sales Price:	KShs 100,000
90% LTVR:	x .90
Loan Amount:	KShs 90,000
Less 75% Loan:	[75,000]
Principal Subject to Premium:	15,000
Premium Assessment:	12.5%
Premium Collected:	KShs 1,875

The KShs 1,875 can be paid in cash at time of loan closing or added to the loan amount. The loan amount would then become KShs 91,875, from which the lender disburses net proceeds of only KShs 90,000. The KShs 1,875 is taken as income spread over a 5 year period. The premium income is accounted for separately so that the institution knows precisely how much it has collected as protection against losses due to default.

The HFCK says that it has not yet needed to tap this reserve fund to cover such a loss. Thus all the premiums collected to date have been available to increase the reserve.

This method appears to be a very practical solution to over-coming lenders' resistance to making 90% loans, especially to lower income borrowers. Furthermore, it is another potential source of income to the housing finance institutions, as the experience of the HFCK has shown. This system may not offer the direct protection on a loan by loan basis that an institution would enjoy under a mortgage insurance policy. However, assuming that relatively few properties will wind up at public sale, as is true in Kenya, the premium fund will accumulate relatively quickly and constitute adequate protection to the lender. USAID will explore the adoption of this practice by all lenders participating in this program, as a means of reaching households below the median income level.

e. Income Considerations

Kenyan lenders generally will not make a loan whose principal sum is more than three times the borrower's annual income. At the same time, the monthly mortgage payment itself tend to be more conservative in deciding what percentage of gross monthly income self-employed persons may commit to servicing a mortgage loan. In cases of married applicants, most lenders will consider 100% of a spouse's income in their evaluation, if the property is owned jointly.

The issue of considering rental income as a reliable source in evaluating the credit worthiness of lower income households is critical to qualifying greater numbers of these applicants. (See Part VIII. D.3.).

Underwriting procedures also include verification of the applicant's credit history and savings performance at any financial institutions where he has done business.

The three older, more established housing finance institutions firmly acknowledged that their lower income borrowers had been their best payers, and that their problem loans had proven to be those to upper income households who often did not regard their residence as the investment priority it is for poorer families.

Overall, the housing finance institutions were favorably inclined towards consideration of rental revenues as part of an applicant's mortgage payment, providing that the room or part of the house to be rented had a separate entrance.

f. Beneficiaries

The average principal amounts of mortgages originated by Kenyan lenders in 1982 reflects that only middle and upper income households were served.

Institution	Avg. loan size (KShs)	# loans 1982	Total Disbursed 1982 (KShs)
HSM	475,000	21	10.5 million
EABS	578,000	140	81 million
HFCK	267,000	1,031	275.4 million
SLK	203,650	308	62.7 million
PBS (est.)	400,000	unavailable	unavailable

However, the housing finance lenders are generally favorably disposed towards considering applications from lower income households. They have indicated that they would consider relaxing some of their lending practices on such points as loan to value ratios, amortization periods and the percentage of monthly income to be allotted for mortgage payments.

2. Mortgage Instruments and Their Characteristics

a. Adjustable Rate Provision

The standard "Charges" or mortgages written by Kenyan lenders are most notable for the rate adjustment provision they contain. Subject to four months' notice (some institutions are changing this to one month) a lender can increase or decrease the borrower's payment "based on the rate of interest commonly chargeable in Kenya having regard to such circumstances as it considers to be relevant ..."

While sounding a bit arbitrary, in practice this power has only been invoked when the cost of funds (savings accounts) has increased to the point where the mortgage rates had to be increased to allow the lender a positive spread. Furthermore, the Central Bank limits the rate which housing finance institutions can charge, which has prevented abuse of the adjustment provision.

b. Front Loading of Interest

Rather than straight amortization of principal in monthly installments, most lenders reset monthly payment levels each year based on the outstanding principal balance of the loan at the start of the the twelve month period. By calculating payments in this manner (called front loading) the amount of interest contained in each monthly installment is maximized and the lender enjoys a slightly higher effective yield.

Pioneer Building Society (PBS) requires a full year's payments in advance. This method, by having use of the cash for the entire twelve month period, further enhances PBS's yield.

c. Negative Amortization

Some lenders have a policy of capitalizing any arrearages which have not been paid up at years end, by adding the amount overdue to the loan balance and resetting the payment accordingly at a higher level. This is tantamount to negative amortization which is characteristic of Graduated Payment Mortgages.

d. Graduated Payment Mortgages (GPMs)

GPMs were discussed with the Kenyan lenders as a possible means of making housing affordable to more families. The concept appears to have some potential for application in the Kenyan market. The lenders feel it would be accepted by a good many Kenyans, but the present recessionary state of the economy tends to undermine two basic premises of the GPM:

i. That the borrower's income will increase steadily in coming years, effectively reducing the mortgage payment as a percentage of gross monthly income;

This may be true of a relatively small number of young professionals in certain careers, overall, the Kenyan job market is weak and those with jobs, for the moment, cannot anticipate progressive wage raises.

ii. That the value of the property will steadily rise;

While this certainly has been true in the past decade, appreciation of property prices has generally levelled off somewhat in the past year. In the upper income range, prices have dropped considerably. Thus, an 80 or 90 percent GPM becomes a bit more risky for the lender.

3. Mobilization of Resources

a. Savings and Term Deposits

The Kenyan housing finance institutions offer from three to six categories of depository accounts. Each institution offers two or more accounts that fall into the category of savings plans. These accounts have no fixed term. Their yields range from 12.5% to 14%. While some carry minimum and or maximum balance requirements, their main characteristics are volume of transaction restrictions whereby the depositor is limited in the amount of money and frequency of withdrawals allowed. The lowest yielding savings plan might permit one or two withdrawals weekly, with little or no notice to the institution. Withdrawals are limited to relatively small sums. Higher yielding savings accounts may require a month's notice prior to withdrawal.

Fixed term accounts carry yields from approximately 13.5% to as high as 16.5%. Terms vary from three months up to two years. With interest rates having been and still showing some upward pressure for the past several years, depositors tend to favor the shorter term on fixed deposits in anticipation of rolling the account over at a higher hield.

The two non-private housing finance institutions, Savings and Loan Kenya, Ltd. and Housing Finance Company of Kenya, are authorized under the 1981 Finance Act to sell Housing Development Bonds. Maturities vary from 6 to 36 months, and yields range from 12.5 to 14%. The interest received is tax free. Balances are restricted to KShs 500,000 per depositor.

Some Kenyan financial institutions also receive deposits into "provident fund accounts" made up of monthly pension contributions from employers. Such deposits earn around 12%.

Housing finance institution managers have observed that small denomination savers represented the most stable type of deposit, and that the larger account holders shop around, frequently moving their money to the institution offering the best rate.

Non-bank financial institutions generally offer a similar range of accounts and rate scales, with the major exception being that commercial banks are authorized to offer current (checking) accounts on which no interest is paid. The commercial banks thus enjoy a lower cost of funds than other financial institutions since approximately 40% of their deposits come from these interest free acounts.

With mortgage yields at 16%, some of the deposit rates paid by the housing finance institutions are uneconomical. However, the assessment of various loan fees and application charges enables these institutions to earn an effective annual yield somewhat greater than 16%, and usually several percentage points over their cost of funds. Thus, the housing finance institutions have continued to pay competitive rates for deposits, and all enjoyed net growth of savings in 1982.

a. Direct Loans

Excluding the ownership capital of the five housing finance institutions, only Housing Finance Company of Kenya (HFCK) and Savings and Loan Kenya Ltd. (SLK) have non-depository sources of funds. The HFCK has received long term loans from the Government of Kenya, the Commonwealth Development Corporation, Kenya Reinsurance Company and the National Social Security Fund (NSSF). These loans constitute about 27% of HFCK's liabilities and are especially important to that institution since they carry rates below today's cost of attracting savings. SLK has borrowed long term money from Kenya Reinsurance and the NSSF.

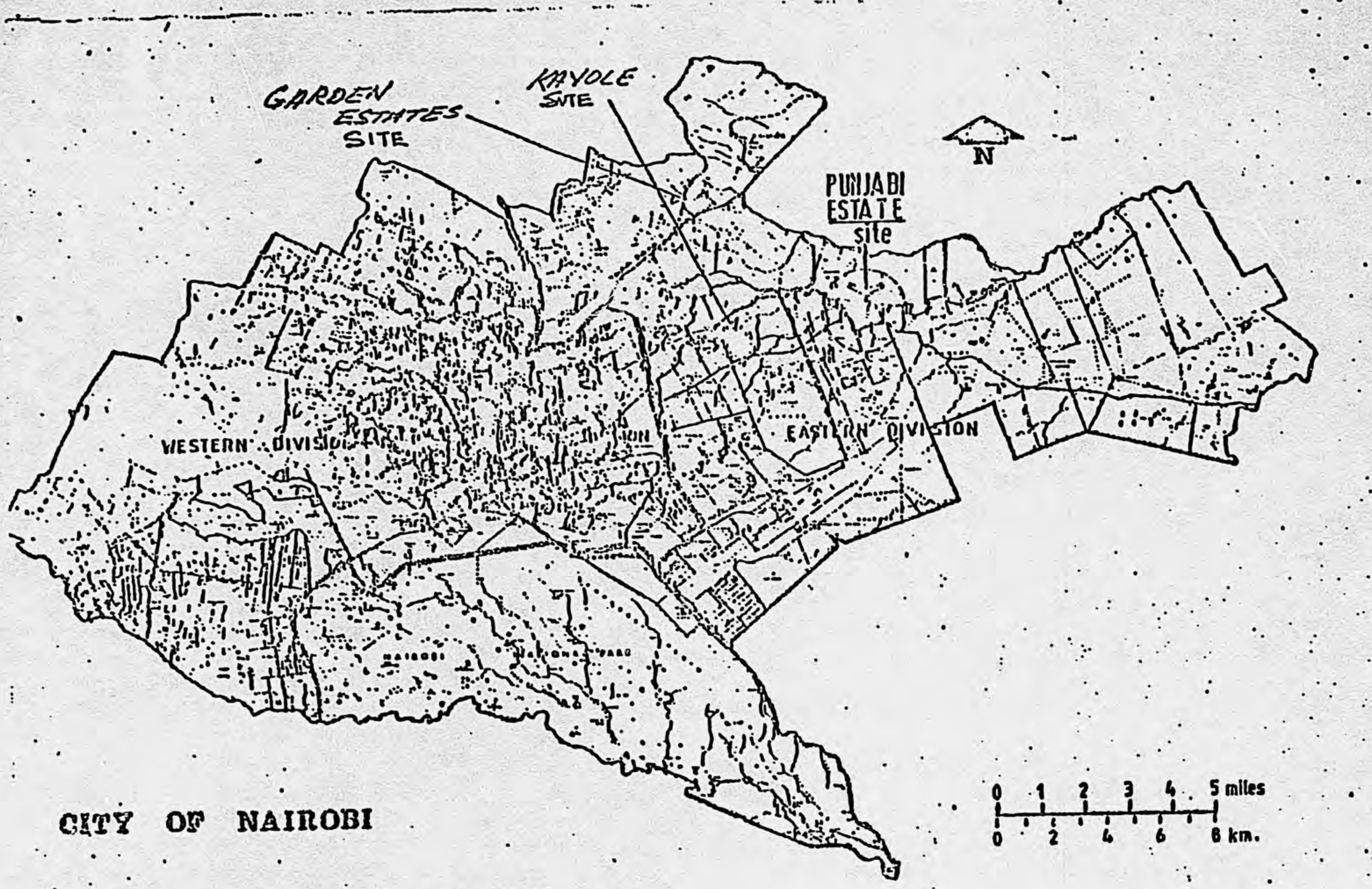
TABLE K.1

HOUSING FINANCE PROCEDURES IN KENYA

INSTITUTION	ASSETS KShs	HIGHEST LOAN TO VALUE RATIO	LONGEST AMORTIZATION	PERCENTAGE OF INCOME ALLOWED FOR HOUSING REPAYMENT	INCLUDES RENTAL INCOME	APPLICATION FEE
Housing Finance Co. of Kenya	1,186B	90% of lesser (a) appraised value, or (b) purchase price	25 yr.	35%	Yes	KShs 150-400 for loan origination
Savings & Loan Kenya, Ltd.	459M	90% of LTVR	25 yr.	25%	Maybe	2.0% loan commitment fee; KShs 300-500 for loan processing
Home Savings Mortgages Ltd.	60M	80% of max. LTVR	20 yr.	N/A	Yes	KShs 5,000 appraisal fee; 5% of loan for administration
East African Building Soc.	600M	70% of lesser: (a) appraised value, or (b) purchase price	15-20 yr	25%	Maybe	N/A
Pioneer Bldg. Society	65M	80% of LTVR	20 yr.	Flexible	Yes	1% of loan for front-end fee

ANNEX L

A SITE AND UNIT DESIGN TYPICAL OF THOSE TO BE FINANCED BY THE PROJECT.

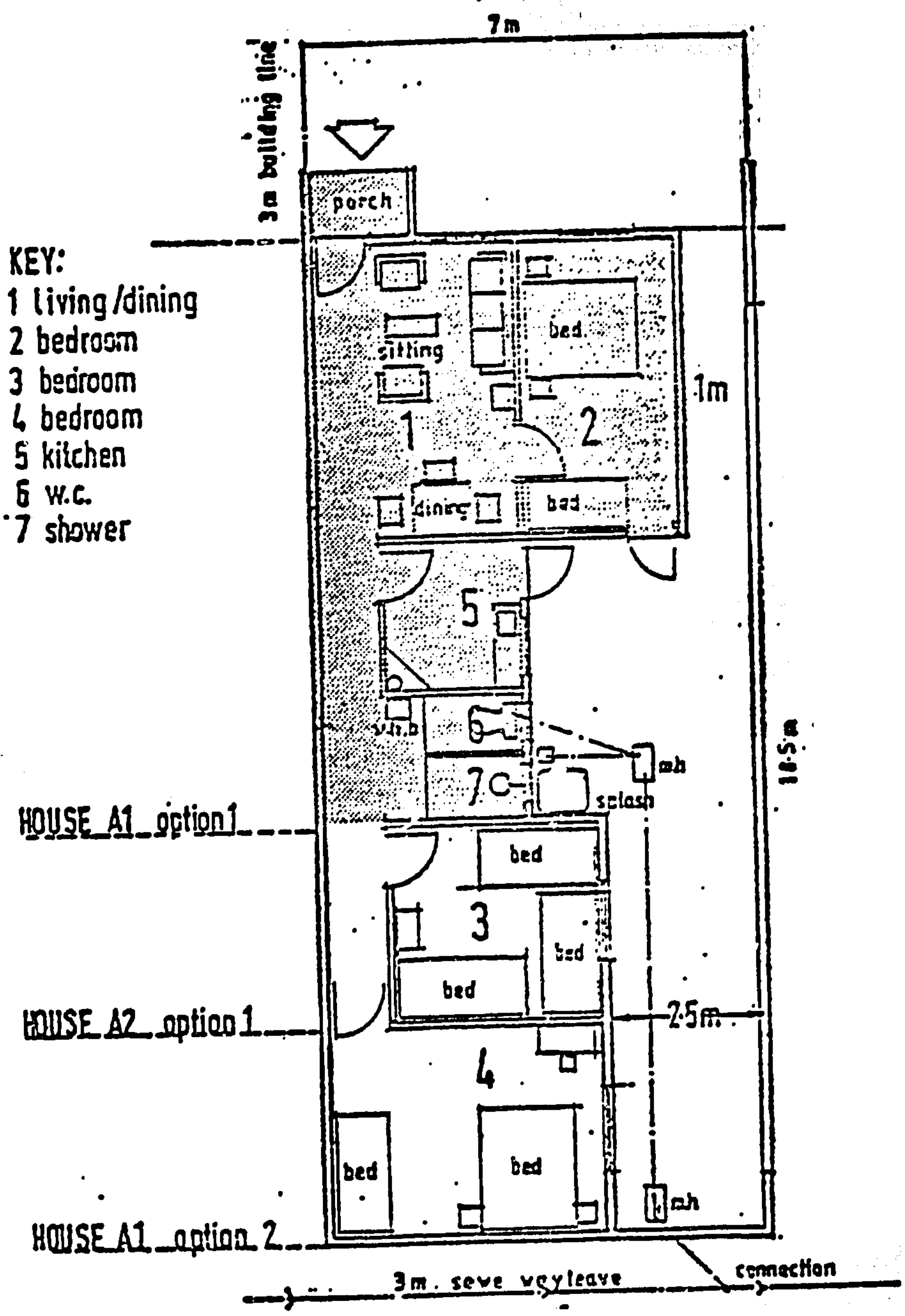


LOCATION OF THREE OF THE PROPOSED PROJECTS

PUNJABI FARM DEVELOPMENT PHASE I
Low Cost Housing Scheme. HOUSE TYPE 'A'

sheet 10

KEY:
1 living/dining
2 bedroom
3 bedroom
4 bedroom
5 kitchen
6 w.c.
7 shower



typical plan

SURESH KAPILA ASSOCIATES p.o. box 40636 nairobi

scale 1:100

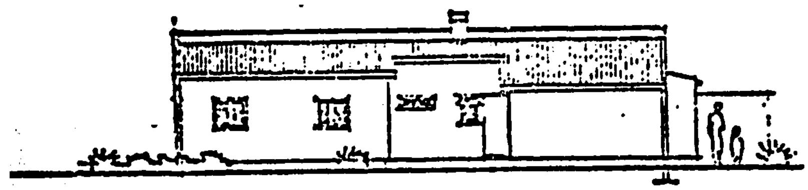
115

L-4

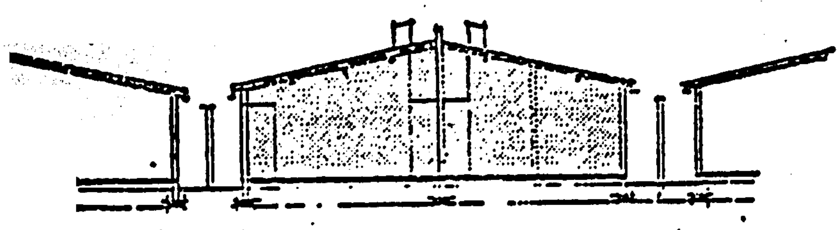
PUNJABI FARM DEVELOPMENT PHASE I

Low Cost Housing Scheme: HOUSE TYPES 'A'

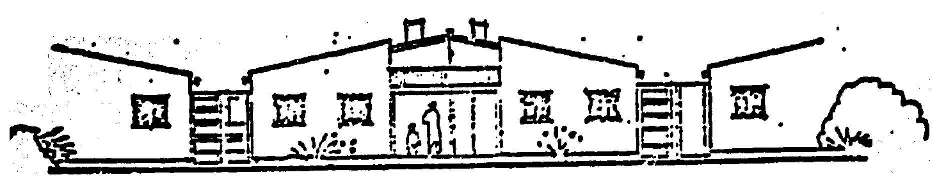
sheet 9



typical side elevation



typical section

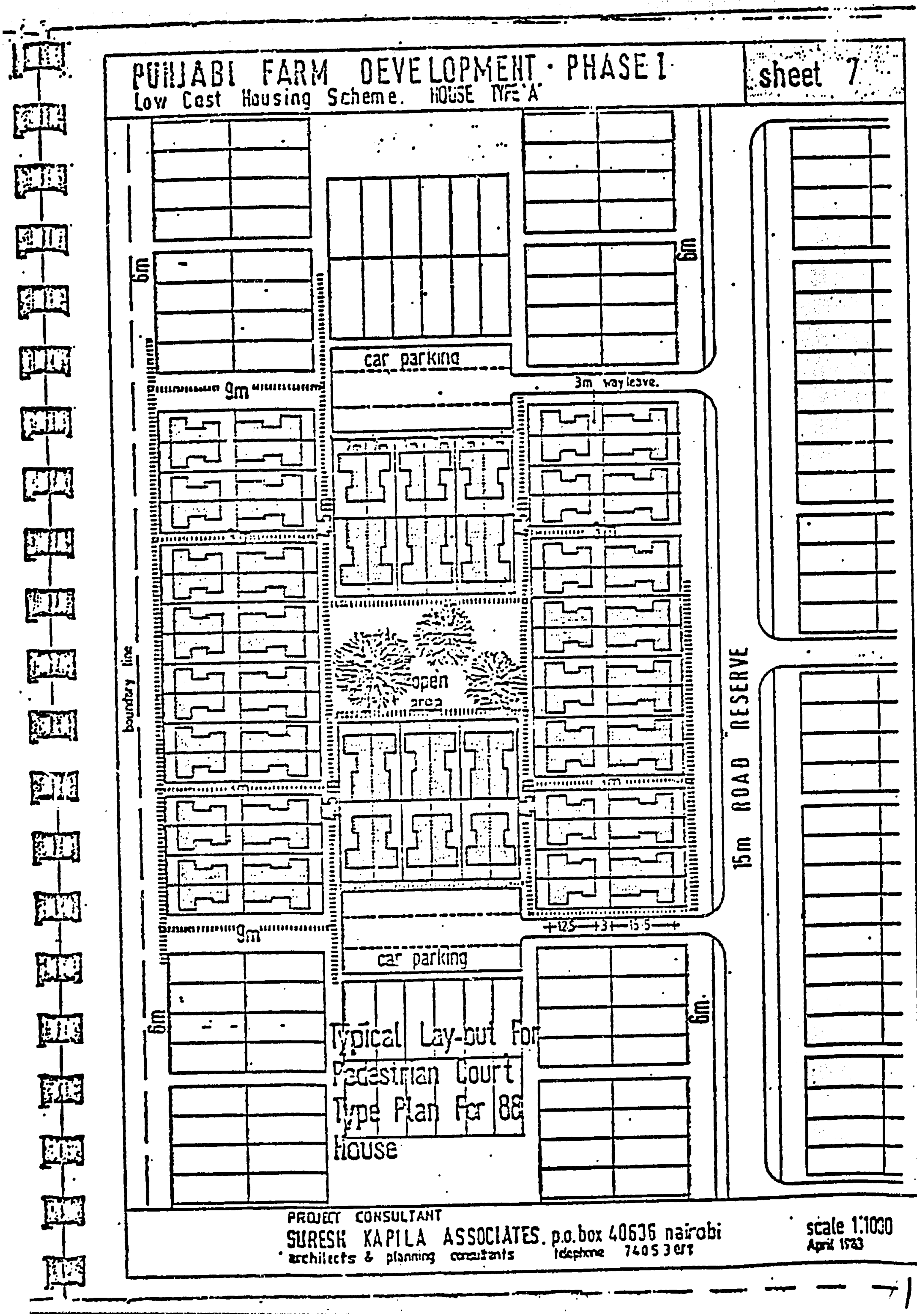


typical front elevation

PROJECT CONSULTANTS:
SURESH KAPILA ASSOCIATES p.o. box 40636 nairobi.
architects & planning consultants. telephone 740530/1

scale 1:200
Feb 1983

L-5


PUNJABI FARM DEVELOPMENT · PHASE I
Low Cost Housing Scheme. HOUSE TYPE 'A'
sheet 7
6m
9m
car parking
3m way leave.
open area
boundary line
15m ROAD RESERVE
Typical Lay-out For Pedestrian Court Type Plan For 88 House
PROJECT CONSULTANT
SURESH KAPILA ASSOCIATES. p.o.box 40636 nairobi
architects & planning consultants
telephone
scale 1:1000
April 1983

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ANNEX M

STATEMENT BY HON. C. W. RUBIA, EGH., M.P., MINISTER FOR WORKS AND HOUSING DURING THE OPENING OF THE SEMINAR ON THE OPERATIONS OF A SECONDARY MORTGAGE MARKET IN KENYA ON 7/8/83 AT SERENA HOTEL

Mr. Chairman, Distinguished participants, Ladies and Gentlemen,

First of all I would like to thank the USAID for agreeing to co-sponsor this seminar in conjuction with my Ministry. Those of you who are in the housing industry will recall that towards the end of 1980, soon after the creation of the then Ministry of Urban Development and Housing, I convened a seminar which for the first time in the history of the housing industry in Kenya brought together both the public and the private sector to exchange views on the problems and opportunities in the industry. At that time, my major concern was the extremely high cost of housing to all income brackets and the availability of both short and long term finance. I made an appeal to the two sectors to deliberate on the problems that were contributing to the high cost of housing, the problems of financing, and make recommendations to my Ministry on the best ways of alleviating difficulties in the industry.

I am glad to inform you that my appeal to the industry was taken seriously both at the domestic level and at the international level. In this respect, it is worthy to note that the United Nations Centre for Human Settlement (HABITAT), whose headquarters are here in Nairobi, took the first step in promoting the spirit of the seminar, by supporting a detailed study of the seminar recommendations and proposing a programme of action for the Government. The study was completed in May 1983 and it is in response to its recommendation that we are gathered here today.

The Regional Housing and Urban Development Office (RHUDO) of USAID has seriously taken up the study recommendations and we are currently reviewing proposals for partial implementation of the report in two critical ways. Firstly, RHUDO as a short-term measure, has initiated a mortgages project whore primary objective is to boost the existing mortgage market by way of stimulating private developers' interest in small mortgage portfolios and lower cost housing than they have hitherto undertaken. It is expected that this project will support the implementation of the pilot projects that are proposed in the study and initiate the first phase of a much larger programme which my Ministry hopes to launch on a countrywide basis as soon as resources permit. Secondary, RHUDO through this seminar wishes to start the process of involvement in the search for long-term solutions to the current shortgage of mortgage finance in our economy. Strategies for achieving greater mobilization of domestic capital for short and long-term housing finance should be considered in full appreciation of the fact that, external funds can only play a catalytic role. The domestic resource base should ideally maintain any acquired momentum and sustain the supply of mortgage funds for the economy.

It is in this context, Mr. Chairman, that I see this seminar as extremely useful. The Secondary Mortgage Market, is but one of the instruments that enhance the mobilization of domestic capital by making investment in real estate comparable in both risk and turnover to the other competing demands on household savings. It is an instrument which, I am informed, has not been tested in Kenya. The initiative your agency has shown in trying to test it in our economy is commendable. I believe that strengthening of existing institutions, by way of increasing their capacity to become more innovative is in line with our general objective of keeping up to date with the increasing complexity of our economy. I would therefore, like to extend my Ministry's support to your initiative and remind the participants that there are several tools which should be considered and examined for possible use by our mortgage market, longer-term mortgage repayment periods, adequate insurance and mortgage underwriting facilities are some of the examples which one could mention. A revision of the eligibility criteria to widen the spectrum of mortgage borrowers and revision of current security, collateral or title documents could, in fact be other factors that have gone into complicating the mortgage market operation in our economy today. Clearly, Mr. Chairman, the efficiency with which the primary mortgage instruments operate in an economy will determine the effectiveness of a Secondary Mortgage Market. Not only does our economy require a greater volume of long-term money, but it also requires that even the little that is available be affordable to the majority of would be borrowers. The majority of households that have deposits with our mortgage institutions are by and large those with an income approximating the median.

Although their individual savings are small, the total volume of savings by these households is enormous. As we develop mechanisms of ensuring minimal risk to investors in housing, I am convinced that we shall increasingly attract a larger volume of small individual savings. Your deliberations today will bear even better fruit if they will concentrate on the small scale depositor or investor as the backbone of the Secondary Mortgage Market system itself.

Meanwhile, Ladies and Gentlemen, I would like to take this opportunity to mention that I will soon be announcing the launching of the Kenya Urban Housing Survey to be undertaken next month. The objectives of the survey are:

(a) To provide data for describing the characteristics of the present housing stock - quantity, quality, value, location, etc.

(b) To provide data for estimating housing demand and willingness to pay for housing and services and the capacity to pay from various income groups.

(c) To provide data for analysing the supply side of housing development in our urban areas.

Finally Mr. Chairman, I would like to wish the participants an enjoyable day and fruitful deliberations. I would like to thank RHUDO for the honour they have accorded me in asking me to address you, and to thank you all for having been able to attend this very important seminar.

Thank You

Ministry of Works & Housing,
P.O. Box 30260
NAIROBI.

ANNEX N

THE NATIONAL COOPERATIVE HOUSING UNION (NACHU)

1. Background

NACHU enjoys strong support from the Government of Kenya which views NACHU as an important means of helping housing cooperatives, by helping low-income families undertake successful projects in the construction of new, and upgrading of old, housing. Through the Ministry of Cooperative Development, the Government is furnishing staff support to NACHU. The trade unions through the Central Organization of Trade Unions (COTU) are also supporting NACHU actively. The Kenya National Federation of Cooperatives (KNFC) is providing office space for NACHU during its start-up period. Growing numbers of housing cooperatives are turning to NACHU for assistance and guidance in the development of their projects.

NACHU, which was established in 1979, did not really start functioning until 1983. It is timely now to provide support to NACHU to ensure that it will become an efficient packager of successful housing programs for Kenya's housing cooperatives. Housing cooperatives are an attractive alternative to costly, top-down government programs. Cooperatives will permit reaching lower income households in the smaller cities that cannot interest profit motivated private developers. They will also provide an excellent opportunity for true beneficiary participation in the planning, design and execution of shelter programs. NACHU will require considerable assistance and support if it is to discharge its duties effectively and serve as an efficient vehicle for helping housing cooperatives realize their potential as an important element in low cost shelter production.

NACHU's principal functions during the next few years can be grouped in three general categories, for purposes of illustration. There are <u>internal</u> functions, which are those related primarily to NACHU's own establishment and consolidation as an institution. There are <u>general</u> functions, which are essentially those activities which NACHU will be expected to undertake on behalf of the whole cooperative housing community. Finally, there are the <u>project specific</u> tasks which NACHU will carry out on behalf of individual housing cooperatives at their request. The Housing Guaranty project will provide assistance to each of the functions as they relate to NACHU's role in developing and managing housing projects for member cooperatives.

A. <u>Internal Functions</u>

1. Recruitment and training of additional staff as they are required.

2 Development of a medium and long-range workplan for housing development projects.

3. Development of a fee structure and schedule of charges for NACHU services (for eventual self-sufficiency) in the context of a detailed budget and cash-flow projection.

4. Design of an appropriate evaluation system to track NACHU's progress toward goals of self-sufficiency and effectiveness in project management.

5. Development of an ongoing and comprehensive training program for NACHU staff at all levels, including participation in workshops and seminars outside Kenya.

B. <u>General Functions</u>

1. Studies of existing cooperatives to determine their status, need, and NACHU's options for constructive intervention.

2. Identification of specific projects and delineation of technical assistance needs for each.

3. Identification of sources of finance for housing projects to be carried out with assistance from NACHU and arrangement for financing.

4. Development of suitable legal options for cooperative housing programs (single-mortgage, cooperative housing development corporations, etc.) and accompanying documentation required.

5. Work with legal advisors and the financial community to devise suitable debt instruments for financing cooperative housing projects,

6. Preparation of a comprehensive training and management education program for officials and members of housing cooperatives, to include:

a. Development of promotional and audio-visual material for use by community organizers.

b. Preparation of pre- and post-occupancy manuals on project management.

c. Development of materials, handbooks and workshops on self- and mutual-help for expanding of minimum-shelter and core-housing units by beneficiaries.

d. Development of forms, and procedures for the execution of home improvement loan programs.

e. Development of training materials for estate managers, boards of directors and specialized committees.

e. Design of collection programs and procedures with suitable instruments and documents.

C. <u>Project Specific Functions</u>:

1. Socio-economic studies of members of housing cooperatives to identify their preferences with respect to housing types and options for community equipment and facilities, and their potential for self- or mutual-help programs, bearing in mind affordability issues and financial viability of projects.

2. Appropriate site plans and unit types to minimize costs and maintain the highest degree of flexibility and potential for future development of projects.

3. Assistance to housing cooperatives to secure suitable contractors to undertake project development either through NACHU or directly; helping in supervision of construction.

4. Formation of new housing cooperatives, adoption of by-laws and registration by the Ministry of Cooperative Development.

5. Assistance in locating and acquiring land, securing interim and long-term financing for projects, engaging suitable contractors, and liaising with local authorities and national housing agencies.

2. NACHU Structure and Functions

To provide for this broad range of responsibliities and services, NACHU's Board of Directors (see Section 5, below) has developed and approved the following basic structure, with the primary functious as summarized:

COMMITTEE

GENERAL MANAGER

ADVISORS

INTERNAL AUDITOR

COOPERATIVE ORGANIZATION AND COMMUNITY DEVELOPMENT DEPARTMENT	PROJECT DEVELOPMENT DEPARTMENT	FINANCIAL AND ADMINISTRATION DEPARTMENT
Responsible for organizing, sponsoring and endorsing Housing Co-op Societies; Educating members; and providing social inputs. Assumes the consideration of the human element throughout the development process.	Responsible for making arrangements site planning; organizing house design and supervising self-help and mutual help construction effort (in cooperation with Organization and Community Development Department); Controls tendering and construction where required along with other technical services.	Responsible Financial for planning for co-ops; economic Analysis for housing projects; budget, fiscal and personnel matters of NACHU itself; loan servicing for housing co-ops on behalf of lender; liaison with housing financ institutions; and estate management services (in cooperation with the Cooperative Organization Community Development Dept.

Basic core staff are in place now at NACHU, with the General Manager appointed in early 1983, an acting director of the Cooperative Organization and Community Development Department seconded shortly afterward, and essential support staff hired. NACHU has received technical support from HABITAT in carrying out a base-line study of housing cooperatives in Kenya.

Financial support for NACHU is currently being provided from several sources, including the Ministry of Cooperative Development, the Kenya National Federation of Cooperatives, the Central Organization of Trade Unions, the African American Labor Center, and several private organizations. Membership dues from member housing cooperatives are an increasing source of income.

NACHU should be self-supporting after a period of three to five years, primarily from fees which it will charge housing cooperatives for the services it will perform. Membership dues will be a secondary source of income. More detailed forecasting of income and expenditures are presented in Table N-1, preliminary Budget preparation and final development of fee structure will be an early activity to be undertaken by NACHU.

Financing for projects prepared by NACHU for its member housing cooperatives will come from several sources. Member households will make downpayments or initial investments in the form of owned land. Savings and credit societies (Credit Unions) have indicated a willingness to divert some of their assets to housing finance. Societies are already lending to individuals for housing purposes and now have begun to finance housing on an institutional basis. HABITAT is carrying out a major study on how the societies can provide long-term finance to housing cooperatives. Major Kenyan financial institutions, including the Cooperative Bank, insurance companies and the National Social Security Fund, have indicated their intertest in participating in the long-term financing of projects. Their participation will be facilitated by project initiatives to develop a viable secondary mortgage market in Kenya. Substantial HG financing under the project will be available to housing cooperatives as an important source of long-term financing. Additional savings are expected to be mobilized when low-income Kenyans are convinced that housing is an attainable goal through NACHU and its housing cooperatives.

3. Technical Assistance

The project will support NACHU during its start-up period to ensure that the organization achieves its potential to direct housing finance to low cost cooperative programs. To this end, a Cooperative Agreement will be executed with a provider of technical assistance suitable for the needs of NACHU. The Cooperative Agreement is deemed the most appropriate vehicle for the provision of technical assistance, in light of USAID's intent to maintain substantial oversight of the assistance to be furnished.

The Cooperative Agreement will provide for two long-term resident advisors to work on a full time basis with NACHU during the critical period in which it is becoming established as a significant housing delivery organization. NACHU counterpart contributions will include staff salaries; office space, services and activities; entry fees and share capital for member cooperatives, Ministry of Cooperative Development annual budget allocations; and support from COTU. Additionally, specialized short-term technical assistance and backstopping from the main office will be provided by the cooperating agency.

One Resident Advisor will be a specialist in cooperative and low-cost housing with experience in the development and management of cooperatively organized low-cost housing programs in developing countries. This advisor will also have skills in institutional and administrative management and planning in addition to extensive cooperative-specific experience. The advisor will have considerable responsibliity for working closely with NACHU staff on project technical and feasibility studies with local housing cooperatives and will, therefore, need substantial project-specific experience. The advisor will have a strong background in housing cooperatives in Africa with skills in cooperative housing finance, cooperative organization and management, cooperative legislation and cooperative training and education. The advisor will prepare administration manuals and regulatory procedures for member cooperatives. He or she willl also train NACHU staff.

The second advisor will be primarily responsible the the planning, design, construction management and contracting for specific housing projects to be developed by NACHU for member cooperatives. This advisor is to have experience on the costing of material and labor for design and construction and have experience with the control and scheduling of sub-contractors. He will set up procedures for the contracting of design and construction as well as for inspection and certification for payments of work in place. He will train a counterpart and provide assistance to member cooperatives on cost effective land purchase, site design, house design and site maintenance. He will also provide assistance on home improvements and establish a set of house design with expansion capabilities.

Short-term technical assistance will be provided at a level of twelve person months during the three-year term of the Cooperative Agreement. The planning of specific short-term inputs will be carried out within the first quarter of the technical assistance program. Consultants will be provided from the co-op agreement recipient staff or recruited by them from individuals with expertise in low income housing development in Africa.

Some of the specific short-term inputs which may be required are:

a) Advice on the development of the fee structure and schedule of charges for NACHU and the most appropriate financial relationship between NACHU and the cooperative projects it supports.

b) Investigation of opportunities for creating employment in the development of cooperative housing programs, especially in single-parent households, to facilitate their participation in programs.

c) Assistance in the preparation of training materials.

d) The use of micro-computers for low cost project feasibility studies, financial planning and physical design.

e) The use of electronic data processing in both NACHU and client record keeping, i.e., corporate management as well as estate management for housing cooperatives.

f) Consultation on the development of innovative financial approaches/mechanisms to make cooperative housing more affordable by low-income families,

g) Legal advice on contracting procedures and rules, regulations and responsibilities of NACHU and its cooperatives.

A financial management expert funded by HG fee funds will provide support on the development of accounting procedures, portfolio administration, financial planning, budgeting and auditing procedures.

While housing cooperatives in Kenya are primarily an urban phenomenon, they are by no means limited to Nairobi; the recently-completed Base Line Survey carried out by NACHU in mid-1983 identified housing cooperatives (and cooperatives in formation) in Nairobi, Nyeri, Meru, Nakuru, Eldoret, Kisumu and Mombasa. Thus, NACHU will have considerable need to mobilize field staff to work with cooperatives located at some distance from the main NACHU office in Nairobi. The Cooperative Agreement contemplates furnishing NACHU with two project vehicles for outreach and field work.

Dramatic reductions in cost and increases in the power and flexibility of small computers have recently made the acquisition of such equipment a very cost-effective investment for housing agencies. Access to an in-house microcomputer will not only assist NACHU in handling its own budgets and accounts, but will also be invaluable for project design, feasibility analysis, modelling, affordability calculations, socio-economic studies and projections and project accounting. Furthermore, the Office of Housing and Urban Programs of A.I.D. has embarked upon the development of a series of housing software packages which are expected to greatly increase the capabilities of the national housing organizations with which it is working throughout the developing world. The Cooperative Agreement therefore includes the purchase of an Apple II Microcomputer and necessary accessories to ensure that NACHU will be able to share and contribute to the growing network of low cost housing and financial management software which is being developed.

Audio-visual equipment has been included in the Cooperative Agreement for NACHU to increase the effectiveness of training and of the promotion of cooperative activities.

4. Illustrative NACHU Projects

The creation of NACHU is a response to the rapid growth of housing cooperatives in Kenya with the perception that while cooperatives are able to do a great deal for themselves on a self-help basis, they need the assistance of a professional organization to ensure that self-help efforts are used as efficiently as possible. There are now 80 registered housing cooperatives societies compared to about 25 two years ago. Most of the members have a common bond, be it the workplace or residence in a tightly knit community. The majority of cooperatives are based upon trade unions or on savings and credit societies (credit unions). The latter are an important source of credlit for low-income groups. As noted above, savings and credit societies are also able to invest in housing cooperatives. NACHU has recently carried out a base-line survey as a first step in identifying the first cycle of projects to be supported. The following are profiles of some of the dynamic and active cooperatives which would be assisted by the HG funds and by technical assistance under the Cooperative Agreement. Several of their projects can be implemented immediately.

A. Thika Municipal Council Employees Cooperative Housing Society TMC

The majority of the members have low incomes. They belong to a savings and credit society which has financed (a) the acquisition of land costing KShs 268,560, (b) the transfer fees costing KShs 7,200, (c) annual land rent of KShs 96,000 paid to the Commissioner of Lands, (d) surveyors for KShs 257,400 and, (e) detailed engineering design costing KShs 300,000 . The members of the saving and credit society formed a cooperative housing society to be the legal body which would undertake development. It is clear that a great deal of finance was raised solely from the contributions of low income members and this provided a sound base from which to seek long-term funds to develop the site. NACHU has already assisted in this process and will be providing advice on the development of the 312 plots which will house about 600 low income families. The development will probably consist of minimum services and core housing. The cooperative will decide how to opportion the balance of its investment between infrastructure and superstructure.

B. Kariobangi Housing Cooperative Society - Nairobi

The society was formed by low income earners and has 526 members. Through savings it has purchased 207 plots for its members. Members are assisted in turn to develop their houses as sufficient finance is accumulated from savings. The society will sub-let rooms in a member's house until the loan has been repaid. The main difficulty is the lack of long-term finance to enable the site to be developed rapidly. A HG loan could assist in achieving this along with the savings of the members. Although composed of low income and uneducated people, many of whom are self-employed, the cooperative has good leadership and is an extremely responsible organization. It also runs a nursery school for the members' children.

C. Marura Cooperative Housing Society - Nairobi

The 127 members of this cooperative were landless squatters who were provided with land by the Government. They use the cooperative as a financial instrument to help one member at a time build a house, often using self-help labor. They have a sound community spirit and are well managed. Together with Kariobangi they could form an excellent opportunity for NACHU to intervene to speed the pace of their development through rapid construction.

D. Bamburi Portland Cement Credit Union - Mombasa

The 783 member credit union is formed by employees of the cement factory in Mombasa. Members are also members of a trade union. The credit union has purchased a site of 74 acres and intends to develop this for low income workers who are presently living in substandard conditions. The purchase was achieved by suspending all loans from the savings and credit society for 9 months, a significant financial sacrifice which demonstrated their organization and commitment. The society now wants NACHU to assist in forming a cooperative housing society and to develop the site. NACHU will accord this project high priority as it can be implemented quickly.

E. Kisauni Housing Cooperative - Mombasa

This cooperative was formed by a group of squatters in order to purchase and develop the 7.5 acres of land they were occupying. It has 56 members. Land purchase is now complete and was done entirely through the savings of the members at a cost of KShs 5,800 per member, i.e., a total cost of KShs 324,800. They now wish to upgrade the site and the temporary dwellings which they inhabit. This will involve proper subdivision, installation of affordable services and improvement of dwellings. Community facilities are also required. While most members are self-employed they have demonstrated a record of sound financial management. NACHU feels that this would be most suitable for an early intervention, which could also demonstrate how cooperatives can contribute to squatter upgrading in Kenya.

F. Nakuru Teachers' Housing Cooperative - Nakuru

This cooperative has been promoted by Nakuru Teachers' Savings and Credit Cooperative and has 1,000 members. It is an example of many other housing cooperatives formed by teachers throughout Kenya. There is finance available through the Savings and Credit Cooperative, which has a turnover of 1

X 161

million per month. 10% of this goes to a reserve account for housing, mainly to enable members to meet downpayments. NACHU will assist the cooperative to acquire land and to develop housing projects based on its strong financial position and its demonstrated management and leadership qualities. This project will come in the second cycle of NACHU projects.

5. NACHU Board of Directors

MEMBERS

NACHU MANAGEMENT COMMITTEE

(1) Mr. Philip Mwangi COTU (K) P. O. Box 13000 NAIROBI P. O. Box 1161 NAKURU	Chairman
(2) Mr. A. M. Mugo NSSF P. O. Box 40326 NAIROBI	Treasurer
(3) Mr. A. H. Ogada MININSTY OF COOPERATIVE DEVELOPMENT P. O. Box 40811 NAIROBI	Member
(4) Mr. G. A. Owuor MINISTRY OF WORKS AND HOUSING P. O. Box 45958 NAIROBI	Member
(5) Mr. A. A. Adongo KENYA NATIONAL UNION OF TEACHERS P. O. Box 30407 NAIROBI	Member
(6) Mr. H. N. Omwanda KENYA NATIONAL FEDERATION OF CO-OPS P. O. Box 49768 NAIROBI	Member
(7) Mr. A. F. Osman MINISTRY OF LANDS, SETTLEMENT & PHYSICAL PLANNING P. O. Box 30089 NAIROBI	Member

(8) Mr. Francis Nyagari — **Member**
KENYA UNION OF SAVINGS
& CREDIT CO-OPERATIVES
P. O. Box 28403
NAIROBI

(9) Mr. Simon Gitobu — **Member**
HOUSING FINANCE COMPANY OF KENYA
P. O. Box 30088
NAIROBI (he represents the interest)

10. Mr. Kadzo Kogo — **Member**
NATIONAL CHRISTIAN COUNCIL OF KENYA
P. O. Box 45009
NAIROBI

11. Mr. Karanja Wanyeki — **Member**
THIKA MUNICIPAL COUNCIL EMPLOYEES
HOUSING COOPERATIVE SOCIETY
P. O. Box 240
THIKA

(12)Mr. Muma Odongo — **Member**
KIDIRUBAN HOUSING COOPERATIVE SOCIETY
P. O. Box 580
KISUMU

(13)Mr. D. R. Ongalo — **Member**
MINISTRY OF FINANCE
P. O. Box 30007
NAIROBI

(14) (Late J. Boy of COTU) — **Member**

(15)Mr. Justus Mulei — **Member**
COTU (K)
P. O. Box 13000
NAIROBI

6. NACHU's Certificate of Recognition

TABLE N-1

NACHU: STAFF BUDGET PROJECTION

	FY 84	FY 85	FY 86	FY 87	FY 88
General Manager	$ 9,000	$ 9,800	$10,800	$11,800	$13,000
Financial Manager	8,500	9,290	10,200	11,200	12,400
Cooperative Manager	6,200	6,800	7,500	8,300	9,100
Project Manager	-	8,900	9,700	10,600	11,900
Management Advisor	AID	AID	AID	-	
Construction Advisor	AID	AID	AID	AID	-
Coop Assistant	-	-	-	4,400	4,800
Book-keeper	-	2,600	2,900	3,200	3,500
Book-keeper	-	-	2,900	3,200	3,500
Draftsmen	-	-	4,000	4,800	5,400
Secretary	3,500	3,900	4,300	4,700	5,200
Secretary	-	3,500	3,900	4,200	4,700
Messeger	1,150	1,270	1,400	1,500	1,690
Office Rent	13,200	13,200	14,520	14,520	16,000
Miscelaneous	5,000	6,000	7,000	7,000	7,000
Consulting Services	20,000	40,000	60,000	50,000	40,000
TOTAL EXPENSES	$66,600	$105,300	$139,000	$139,320	$138,200

INCOME

	FY 84	FY 85	FY 86	FY 87	FY 88
GOK and NFKC	26,000	30,000	30,000	20,000	-
AFL-CIO	18,000	32,000	30,000	-	-
Donors	24,000	?	?	?	?
Proj. Dev. Fees	-	85,000	143,000	171,400	143,000
Portfolio M'gt Fee	-	-	8,400	22,500	39,400
TOTAL INCOME	68,000	147,000	211,400	213,900	182,400

Note: Project Development Fee: 5% of sales price (FY 85, 300 units, FY 86, 500 units, FY 87, 600 units, FY 88, 500 units).

Portfolio M'gt Fee: 0.75% on total mortgages in the portfolio, assumption is NACHU will manage 70% of mortgages (90% of sales price).

Donors: Ford Foundation, possibly with Canadian Development Foundation in 1983 and beyond.