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PUBLIC AND PRIVATE SECTOR
PARTNERSHIPS IN HOUSING:
A BACKGROUND PAPER

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EXECUTIVE SUMMARY

Excessive government intervention in investment, production and distribution is now recognized as deleterious to economic development. Tunisia, Malawi, Kenya, Cameroon and the Ivory Coast have each outperformed other countries in their region over the past two decades primarily by reliance on market systems and private enterprise backed by supportive government policies. In the face of harsh economic realities, countries as diverse in their political philosophies as the People's Republic of China and the United States are rethinking their national development policies as are most African countries.

The role of housing in national economic development strategies is potentially significant. As much as 30% of GNP is attributable to shelter and related services in most countries. Housing construction alone is estimated to supply about 10% of all jobs in developing countries. Experience also suggests that the prospects of improved housing conditions and security of tenure generate savings at all income levels beyond those invested in shelter itself.

Direct government intervention, building houses with public funds, has failed to provide decent shelter and basic services to the most needy in virtually every African country. If conditions are to be improved for large numbers of people, the task is beyond the resources of the public sector alone. Given appropriate incentives, private sector resources can also be directed toward the task.

In Africa, the private sector should be defined to include both formal sector institutions and the informal sector, e.g. individuals and small scale enterprises which employ labor on a casual basis. In some situations, people could build their own houses if given access to land, essential services and credit. In some cases, private sector builders could provide shelter solutions for the full range of housing needs if restrictions were removed. In other instances, outside assistance may be required to stimulate the growth of a private sector housing industry.

Access to the financial and human resources of the private sector is the primary reason to consider public/private partnerships. The potential for generating investment capital for shelter from individual and institutional savings far exceeds that available from public funds. While technical and managerial expertise can be found both in the public and the private sectors, the performance of private sector management is continually judged by an unequivocal "bottom line" which provides a discipline generally missing from the public sector. In structuring public/private partnerships, care must be taken not to completely remove the market risk aspects of the proposed undertaking as this would undermine the basic force behind management efficiency.

In housing finance, public/private partnerships are intended to: increase available funds; substitute private funds for public funds; target funds to meet specific objectives; reduce administrative costs; and enhance management efficiency. The advantages and limitations of a number of alternatives are discussed. Direct government loans to the private sector is one approach. Private sector administration of loan funds provided by government is an alternative. Variations on the on-lending approach include blending government funds with private funds, using government funds to subsidize interest rates, and providing government guaranties for private sector loans. These approaches have the advantage of lowering the cost to government and increasing the total resources available for housing.

Government may also organize a secondary mortgage market, institute compulsory savings schemes, sell housing bonds, or create other similar housing investment programs. Such an approach may require government guaranties in order to attract investors but has the advantage of making long-term mortgages liquid and meeting long-term investment horizons of institutional investors such as pension funds and insurance companies.

In some circumstances, a government guaranty may be used to reduce risk to private financial institutions so that they are willing to make loans they would not otherwise make, such as loans with small downpayments. Other techniques available to government include relaxing credit restrictions or providing exemptions from tax obligations or interest rate regulations to specified housing finance institutions or to institutions making specific types of loans. These approaches involve actions which disturb market mechanisms and can have unintended effects, such as increasing the money supply and stimulating inflation. Tax concessions also have direct budgetary impact which should be carefully evaluated.

Public/private partnerships intended to increase housing production can take several forms, including direct contractual agreements between the parties and mutually supportive independent actions. In lieu of direct construction, governments may contract with private developers to build housing units, an approach commonly used in Africa, or may contract to purchase completed units, an approach known as turnkey construction. Such approaches are effective in increasing production but seldom result in sustained cost savings.

Government may decide to provide assistance to private developers directly with land acquisition or infrastructure or indirectly through incentives such as takeout mortgage commitments or tax concessions which will lower their costs or their risks encouraging them to build housing units they would not otherwise build. Government intervention in land markets should be avoided where possible as costs are generally increased. In situations where land availability is a significant constraint to housing development, where land tenure is in question or where land markets do not exist, government involvement may be essential. In such circumstances, the approaches used by private land developers

may still apply. These include simultaneous negotiation on many parcels in various locations as a means of introducing price elasticity, and the purchase of options which is the right, but not the obligation, to acquire a parcel at some future time. Land-pooling is an approach which brings land currently under multiple ownership together for purposes of development. Government may join such a partnership by providing the infrastructure which makes development possible in exchange for receiving the proceeds of sale from a percentage of the serviced land.

The most controversial issues associated with infrastructure are cost recovery and standards. Some level of services is essential to any housing development. Development standards and planning standards, as well as building standards, affect costs, and therefore affordability. Appropriate standards are essential if low income units are to be affordable, but the standards should provide a framework for upgrading so that low income housing developments can, over time, be incorporated fully into the urban network. In the case of roads, storm water drainage and major trunk lines for water supply, it may be more appropriate to use indirect cost recovery techniques such as property taxes or utility rates than direct recovery through the sale of lots or houses. Questions of whether on-site infrastructure for housing development should be installed by government agencies or by private developers must be answered in terms of local consideration of resources and timing.

Removal of regulatory restrictions or the streamlining of approval processes may be equally effective in stimulating private sector housing development. Rent controls are a prime example of governmental regulations which inhibit production of housing. The existence of uneconomic rents not only discourages construction of new rental housing but affects the ability of both the public and the private sectors to properly maintain the existing stock.

The key to formulating successful public/private partnerships is to assure that the objectives of both parties are compatible. It is not always enough to view profit as the sole motive of the private sector nor assume eliminating risk is essential or desirable to motivate the private sector. In risk evaluation, for example, private lenders seek multiple layers of protection from risk while private developers when perceiving an opportunity assume a risk in order to realize a profit. Financial incentives may be effective in stimulating certain types of private investments, but removal of restrictions or modification of regulations may be more effective and less costly in terms of public resources.

Public/private partnerships can be initiated using a number of approaches. Formulating a comprehensive national strategy aimed at creating a vital private sector housing industry is one approach. Strengthening public sector capacity, particularly at the local government level where local input and administration may be essential to efficiently meet local housing needs, is

another approach. Central governments as diverse as China and the US have realized the importance of using local governments and communities to implement public/private partnerships. Kenya is currently undertaking a concentrated effort to strengthen local governments in order to create an environment where new initiatives such as schemes to leverage funds through public/private partnerships can be introduced into virtually every local authority in the country. Establishing new, special focus institutions and programs to target public and private attention on a specific problem or geographic area is an alternative approach being implemented in Zanzibar. The Stone Town Preservation and Development Authority has been created to target resources on upgrading shelter conditions in a deteriorating historic neighborhood.

The simplest and perhaps the most effective way to initiate a program of public/private partnerships in many African countries is for government to analyze the present efforts of the informal private sector and to seek ways to enhance its performance. This is the basic concept behind sites and services projects which provide assistance to individual households during the house consolidation period and virtually all neighborhood upgrading projects. Both Kenya and Zimbabwe have used this approach in sites and services projects.

Other approaches include public/private partnerships with more limited objectives, such as using public funds to leverage private investment, a strategy that has been used in the US and the UK. Incentives to direct private initiatives toward production and financing of lower cost housing units is another option which Barbados, Zimbabwe, and now recently Kenya have tried.

In exploring alternative approaches to initiating public/private partnerships, African government officials have several viable options appropriate to housing programs. In some countries, the most reasonable approach will be to begin with existing private sector housing activities and to find ways of stimulating and encouraging an expansion of these efforts or a broadening of the market segment being served. In other countries more dramatic first steps will be needed before the private sector can be expected to participate in housing. In all cases, policies should be examined, public and private sector capabilities assessed, existing programs evaluated, housing needs determined, and the overall economic environment which affects shelter ascertained in order to develop strategies and programs which address the constraints as well as the incentives needed to build vital public/private partnerships in the housing sector.

There are six case studies included in the paper. Each case study includes a description of a specific type of program and an evaluation of the approach to public/private partnerships which has been used.

INTRODUCTION

Many of the bi-lateral and international donor organizations have expressed the need to rethink the development strategy which dominated the 1970s and their role in it, seeking specifically to find ways to restore an effective balance between reliance on the public and the private sectors in bringing about changes and to stimulate the economic growth needed to achieve development objectives. It has become apparent that the relative neglect of markets and of private enterprise, which took place during the 1970s as a consequence of the then prevalent strategy for achieving accelerated development through direct public sector controls, was costly in terms of missed opportunities (Bremer, et.al., 1985).

While excessive government intervention in investment, production and distribution functions is now recognized by many economists and by the major international donor agencies as deleterious to economic development, this does not imply a proposed return to the laissez-faire policies of the 1950s and early 1960s. The development lessons of that era include a healthy skepticism of the motivations which drive private sector enterprises, particularly monopolies and very large trans-national corporations.

The development experience of a few African countries during the 1960s and 1970s offers lessons for others considering private sector or mixed public and private sector approaches to development. Tunisia in North Africa, Malawi in Southern Africa, Kenya in East Africa, the Cameroon in Central Africa, and the Ivory Coast in West Africa all share, to a substantial degree, common characteristics derived from the performance of their public sectors (Bremer, et.al., 1985). These characteristics include:

- a high degree of policy reliance on market systems and the private ownership of enterprises;
- fiscal, monetary, exchange rate, wage, and trade policies that have been relatively neutral avoiding price distortions that elsewhere resulted in severe misallocation of resources, loss of efficiency, and reduced growth;
- an economy relatively open to international trade and to foreign investment largely because of the policies described above;
- broadly competitive and easy-to-enter markets, in part due to the open nature of their economies; and
- relatively efficient, honest, and cost-effective public administration.

Each of the countries cited above has outperformed all others in its region in terms of economic growth over the past two decades. Recent empirical studies clearly indicate that domestic policies are important in determining growth performance and that the effectiveness of development assistance depends on the presence of

a policy environment that is hospitable and conducive to growth (IBRD, 1983).

Rethinking National Development Policies

The 1980s has seen a shift toward economic pragmatism in the development policies of many governments covering the broadest possible spectrum of political philosophies. In the People's Republic of China, a national policy of privatization is being implemented, market mechanisms are being introduced within a tightly controlled economy, state-owned enterprises are being forced to deal with economic realities, the growth of private businesses is being actively encouraged, and foreign private sector investment is aggressively solicited. This dramatic shift in economic policy does not, however, constitute a change in political philosophy. The current leadership in the PRC has charted a bold plan to stimulate economic growth by creating a vital private sector while maintaining the controls necessary to avoid potential abuses and minimize inequities which might otherwise result from a rapid shift in the control of large capital assets. These issues are discussed in greater detail in the China Case Study, presented later in this paper.

During this same period, the United States has cut back on federal spending, reduced taxes, and modified many government regulations which restricted private sector activities in an effort to stimulate growth of the economy. Because of changes in federal policies, local governments have recognized that they must leverage their more limited public assistance through partnerships with the private sector. The "new federalism" in US intergovernmental relations has sought to have local governments establish their own priorities in housing and community development (see US Case Study). Federal laws have continued to set broad public policies for the provision of social programs. Local initiatives have recognized the potential of public/private partnerships and demonstrated that they can provide better programs and more projects efficiently when government removes private sector restrictions.

Since 1983, the Government of Zanzibar has adopted policies on land and urban redevelopment which represent a significant departure from policies of the recent past. The rights of private owners have been codified, recordation of land ownership is underway, and the role of private investment is recognized as central to the newly approved urban redevelopment strategy described in The Zanzibar Case Study section of this paper. To a greater or lesser extent, similar reassessments are underway in many African countries as the recent deterioration in worldwide economic conditions has forced reexamination of development policies.

Housing and Economic Development

In the scheme of national economic development, the provision of shelter is not an insignificant factor. The shelter industry

accounts for a substantial proportion of most countries' employment and gross national product. In the US, as much as 36% of GNP is attributable to housing and related services and in most countries, the figure would exceed 30%. In developing countries, residential construction represents about one-third of all construction and about 15 to 25 percent of gross fixed capital formation. In comparison to agriculture and manufacturing, the two main sources of income and growth in developing economies, construction has been an important contributor to growth. In the 1960-77 period, construction grew at an average annual rate of 7.1 percent compared to 2.8 percent and 7.6 percent for agriculture and manufacturing respectively. This growth rate is over twice that of total GDP for the same period where GDP increases averaged 3.5 percent per annum. (Nathan, 1985)

Housing is also a major creator of jobs, both directly and indirectly. In 1976, housing construction is estimated to have supplied about 10 percent of jobs in developing countries. Because of its labor intensive character, construction creates a high level of employment per unit of investment. Indirectly, construction also generates demand for construction materials, furnishings, and related goods and services which translates into jobs in the manufacturing and services sectors. While little quantitative material is available on indirect job creation, a review of studies conducted in several countries indicates that the estimated income multiplier for housing construction would be about two. In other words, a specific expenditure on housing will generate twice that amount in national production and income, or each housing construction job created will result in indirect creation of another housing related job assuming that the non-construction job is as labor intensive as housing construction. (Nathan, 1985)

Some economists have suggested that governments should limit investment in housing to avoid diverting scarce savings and investment resources from other sectors, but the evidence does not support this conclusion. Experience suggests that the prospects of improved housing conditions and security of tenure can generate substantial savings at all income levels, savings well beyond those invested in shelter (Christian, 1980). In addition, access to home ownership has been informally linked to greater investment of time in housing improvement which translates into formation of "sweat equity" capital. Through home improvement, the individual is able to transform labor into a permanent asset where wage employment and other income producing opportunities are not available. The incremental approach to home building common in most developing countries is a clear example of this process.

Thus, the shelter sector can be a powerful factor in economic growth as a creator of critical employment and a stimulant to investment while also benefiting society directly through improved living conditions.

WHY USE PUBLIC/PRIVATE PARTNERSHIPS?

In the provision of housing few, if any, governments can claim unblemished success. The failure of governments to meet popular expectations is manifest. Governments of all political philosophies have failed to provide decent shelter and basic services to millions of their most needy citizens. The World Bank has concluded that this is largely due to misguided efforts to tackle the shelter problem by direct intervention, building houses with public funds (Serageldin, 1984). In many countries, people can build their own houses if given access to land, essential services and credit. Thus one might conclude that the public sector should get out of the business of building houses completely and address the institutional and other constraints which have an impact on the shelter problem.

For some countries, the answer to such development constraints as limited public resources, inadequate levels of production, and shortages of technical and managerial skills may lie within their own indigenous private sector. In other cases, outside assistance may be required either from donor organizations or from foreign enterprises in order to stimulate the growth of a domestic private sector housing industry.

In the African context, the private sector should be defined to include both formal sector institutions and organizations, and what is usually called the "informal sector," meaning individuals and small scale enterprises that are not formally registered, do not keep proper accounts, and employ labor mostly on a casual basis. In the industrialized countries, the informal sector plays a very small role; in most LDCs, the situation is quite different. A recent UN study reports that, in the Philippines, 86% of the increase in housing stock was produced through "informal means;" in Brazil, 82%; in Venezuela, 77%; in Colombia, 64%; and in Chile, 44% (Ramachandran, 1984). While precise percentages are not available for most African countries, knowledgeable observers would agree that the situation is not dramatically different. For the foreseeable future, most new housing and most improvements in shelter conditions throughout Africa, particularly for the lowest income groups, will be provided by the informal sector. If conditions are to be improved for large numbers of people, governments must recognize this reality and adjust their policies and programs accordingly. Policy makers must face the fact that the task of providing adequate shelter is beyond the resources of the public sector. The resources of the formal and informal private sector are potentially much greater than those available to the public sector. Given appropriate incentives, private sector resources can be directed toward the task of providing adequate shelter for all segments of the housing market.

Private sector resources include both financial and human assets.

The potential for generating investment capital for shelter from individual and institutional savings far exceeds that available from public funds. Governments should encourage savings and avoid monetary policy which discriminates between shelter and other sectors in terms of access to funds. In many countries, government itself is a major competitor for scarce supplies of private savings. Thus, reduction in the level of government borrowing may in some countries be an essential step in the process of assuring an adequate flow of funds to shelter and other sectors of the economy. In order to accomplish this, government must cut its own direct expenditures while implementing a strategy to increase the level of private funds directed toward the same goal.

Another primary reason for governments to seriously consider public/private partnerships is to gain access to the technical and managerial expertise of the private sector and to impose on particular activities conditions which encourage efficiency. There is no inherent reason why government-owned enterprises or parastatal organizations cannot be as efficiently run as privately owned ones. In the shelter area, the Korean Housing Bank is an example of an efficient government parastatal which operates like a private sector financial institution accepting deposits, raising money from sales of bonds, making a full range of housing-related loans, and providing a number of other housing services. In fact, there are a number of African examples of very well run government-owned or partially government-owned organizations, such as the Botswana Water Authority which operates on a full cost recovery basis, including the amortized cost of its capital investments, much of which is borrowed in international markets, or the Commercial Bank of Malawi which is jointly owned by two parastatals but operates like a private sector company in response to market conditions.

To the extent that government-owned enterprises are run like privately owned ones, there may not be any clear distinction with respect to efficiency of operation or cost of doing business, but most government-owned enterprises are not subjected to the pressures of the marketplace, nor is the performance of management judged by an unequivocal "bottom line." It should also be said that certain types of privately owned enterprises may also lack the discipline of the marketplace which leads to management efficiency, notably firms which depend primarily on cost reimbursable government contracts and monopolies of all types. But these are the exceptions, just as market oriented public enterprises are exceptions. For the most part, privately run enterprises pay the highest salaries to attract the best technical and managerial staff available and continually judge the performance of that staff on the basis of results. For these reasons, the private sector can usually perform a particular task more efficiently and at lower cost than a public agency. In structuring public/private partnerships, care must be exercised, therefore, not to remove completely the market risk aspects of the proposed undertaking as this would undermine the basic force behind management efficiency.

While the private sector may have greater resources which could be applied to shelter and be more efficient in delivery, it, like the public sector, has also failed to meet the need for decent housing in most countries. Unlike governments, the private sector is not responsive to public expectations or social need. A private sector enterprise may be highly successful by producing a product for a very limited segment of the market while ignoring a broad range of unmet demand. Persuading the private sector to expand its services to address the needs of a broader market often requires public intervention. Thus, in order to achieve significant improvements in shelter conditions, the public sector and the private sector must cooperate as neither can be expected to succeed in isolation.

WHAT ARE THE ADVANTAGES, AND LIMITATIONS, OF SPECIFIC APPROACHES?

Cooperation between the public and private sector may take either of two distinct approaches. A formal partnership presumes a contractual agreement for joint efforts. An equally valid approach involves no formal agreement between parties but separate and mutually supportive actions toward a common objective. In its broadest sense, public/private partnerships may incorporate both approaches.

In this section both types of partnerships will be discussed under two broad categories: Housing Finance and Housing Production.

Housing Finance

In the financial area, public/private partnerships in housing have several primary objectives from the public sector policy point of view: (1) to increase funds available for housing; (2) to substitute private funds for public funds; (3) to target funds in order to meet specific objectives; (4) to reduce the administrative cost to the public sector; and (5) to enhance expertise and efficiency by substituting private sector management for public sector management.

The following discussion relates these objectives to various types of public/private partnerships, and presents some of the major advantages and disadvantages of each from both the public and private sector viewpoints. Different types of loan and investment partnerships are described, as well as guaranties and other incentives which have primarily indirect rather than direct costs to government.

Special Purpose Government Loans:

Government loans for construction, site development, or purchase of housing (mortgage loans) by the private sector which have specific policy determined characteristics (specific beneficiary, region, income level) are one form of public/private partnership. These partnerships have the advantage of using private sector expertise, both formal and informal, which removes the project implementation task from the government and may result in cost savings. Also, the private sector builders and financial institutions may not be willing to assume the risk associated with such development. The availability of a government loan can reduce this risk by assuring financing for a specific rate and term. In addition, these loans may represent the only available funds for this development when financial institutions do not have other resources available to lend or are unwilling to take the risk of lending for different purposes or on different terms from their normal practices. Kenya has engaged in this type of program lending funds borrowed by government to low-income households for serviced site purchase and building using informal sector methods

(see Kenya Case Study presented later in this paper).

Contrasted with these potential advantages, government loans have the disadvantage of being costly. The government must either use budget resources or borrow funds. In a period like the present where most governments are experiencing deficits and have heavy debt servicing obligations, the cost to government of providing loans may indeed be high, particularly if other uses of these funds are seen as more productive in the economy or the cost of borrowing funds to lend exceeds the earnings from these housing loans. Long term mortgages have an even higher cost unless they are funded by long-term borrowed money, particularly if government is required to borrow in the future at rates higher than it earns on the mortgage loans. More importantly, government also has an opportunity cost associated with long-term lending because funds are recovered slowly and in an inflationary environment have less value when received.

Government has a number of options as to sources of funding if a government mortgage lending program is pursued. In some developing countries, employment taxes and compulsory savings schemes have been used as a source of public sector long-term funds for housing. Jamaica, Peru, Chile, and Mexico, for example, have created social housing funds for mortgage loans by levying payroll taxes on employees and employers; Brazil and the Philippines have utilized required savings schemes for employees which can earn interest. Whether or not these techniques create a cost effective funding source depends on such factors as effectiveness of collection and the rate, terms, and repayment experience on mortgage loans made or purchased, in relation to the cost of funds. Poor program design and administration leading to inadequate collection rates and margins between the cost of funds and mortgage lending rates have resulted in poor performance and threats to the financial viability of these funds in some countries including Jamaica and Peru. Brazil, however, has had notable success using compulsory savings to create a fund which purchases mortgages made by public and private sector financial institutions. (Chilson, 1983) Other sources of long-term funds include public and private pension funds, sale of housing bonds to the private sector (see further discussion below), and international loans such as AID's Housing Guaranty program and World Bank loans.

Administration of a government loan program also presents some difficulties. Loans must be originated, serviced, and collected. This loan administration can be expensive in manpower terms. Also, poor administration can result in losses when loans are not repaid. This can be a serious problem, particularly if "government" loans are perceived by borrowers as "gifts" rather than loans which must be repaid. Losses on government loans are a fairly common phenomenon in the world.

On-Lending Government Funds:

Another public/private partnership which addresses a number of the

problems with direct government lending is government providing funds to private sector financial institutions to on-lend. While generally still using costly budget or borrowed resources, the servicing costs and the risk of loss can be transferred to the financial institutions. Once experience is gained, the private financial institutions may decide to use their own funds for similar loans, and thus the overall supply of funds for housing can be increased. This is one of the main justifications for this form of public/private partnership. This type of partnership is underway in Barbados (see Case Study presented later in this paper).

A variation of this concept is for government funds to be used for on-lending in combination with private sector financial institution resources to meet specific objectives. Thus government funds are leveraged and in effect provide seed money to encourage involvement of private financial institutions. Many techniques can be used including buydowns, blending, guaranties, and grants. In the buydown technique, public funds are used to subsidize the interest rate on private sector loans in order to make loans affordable. In blending, government resources are made available to fund part of the loan at a lower interest rate so that the combined (blended) interest rate on the loans is lower which makes the loan more affordable and creditworthy. Under the guaranty technique, government funds are set aside to guaranty all or a portion of loans made with private sector funds, thus encouraging private lending by reducing risk to the lender (see more detailed discussion below). Grants to purchasers reduce the amount of money which private financial institutions must supply as well as improve the creditworthiness and affordability of the private loans.

All of these techniques have been employed successfully in public/private partnerships in the US under the Urban Development Action Grants (UDAG) program where local governments apply to the federal government for funds for specific partnership programs. Also, for these partnerships local governments have allocated Community Development Block Grant (CDBG) funds which they receive from the federal government on an annual basis. The US experience has shown that substantial private sector funds can be obtained to supplement scarce government resources (see United States Case Study for examples of specific projects using these techniques).

The United States, among the industrial nations, is not alone in turning from financing direct production of housing to partnerships with the private sector. Great Britain has moved away from government providing housing directly through local authorities which build rental housing (council housing) under contracts with private builders. Faced with declining availability of funds, Great Britain has sought ways to obtain private sector funds. Grants are being provided to builders to buy, renovate, and sell council housing to private households with mortgages from private financial institutions. Thus, councils reduce administrative and management costs as well as receive some payment from builders. Grants, initially totalling 90% of

improvement costs, have been scaled back to 75%. British private building societies are participating directly in these renewal efforts by providing special lending allocations for the various government sponsored home improvement and house purchase schemes, including finance to builders. For example, in the Local Authority Support scheme, building societies have taken over the previous funding role of local councils allocating funds for first time buyers and those in need who qualify under the scheme, so that they are assured of a mortgage. In the last 10 years, one building society alone has provided almost 700 million Pounds Sterling in lending for this scheme. (Hughs, 1985, and Fazey, 1985) This is similar to how local authorities in the US initially used CDBG funds, primarily as grants supplemented with private sector funds. Gradually, local governments in the United States have discovered that through leveraging techniques, such as those mentioned, the UDAG and CDBG funds can be lent and reused to generate large sums of private sector money which supplement government resources.

In both Zimbabwe and Kenya, efforts are being made to attract private sector participation in financing low income housing, in view of governments' lack of resources to fund and build housing directly (see Kenya and Zimbabwe Case Studies). In a number of other African countries, including Malawi and Senegal, direct building by government of civil servant and other rental housing has come to a virtual standstill because of limited government funds. Also, heavy subsidies in terms of low rental rates are a drain on resources which in some instances have hindered efforts to maintain the housing stock. These are situations where new approaches, including public/private partnerships using government funds as seed money, might help alleviate the problem, for example, by facilitating rehabilitation and sale of government housing or encouraging private sector lenders to lend money for new construction, either formal or informal.

When government funds are to be on-lent for specific purposes or on specific terms different from the normal lending practices of private financial institutions, these institutions may be reluctant to participate unless incentives are provided. Such incentives could include tax exemptions, credit control and other regulatory exemptions, or favorable interest rates. Any incentive has a cost to government which should be weighed carefully before being implemented. Incentives may have a budget impact (e.g. tax exemptions). They may distort the operation of financial markets and have unintended effects, such as increasing the money supply, contributing to inflation. Also, such incentives may not be necessary once financial institutions become experienced. It may be better to try to avoid incentives until they are proven necessary. Likewise, ascertaining that these benefits accrue to the people who truly need assistance is important. Buydowns, blending, and grant techniques are in effect subsidies, and if these technique are used, the cost must be carefully calculated to determine if it is necessary in order for the policy objectives to be met.

Housing Investment Programs:

Housing investment programs are another example of a way in which government and the private sector can work together to provide funds for housing. Examples include secondary mortgage market activities and investment of government insurance and social security type funds in private sector originated mortgages through purchase of housing bank or building society securities. In secondary mortgage market activities, the government may purchase private sector mortgages from financial institutions, or buy, package, and resell mortgages to the public, to private insurance companies, to pension funds, or to government social security or insurance funds. Likewise, mortgages made by the public sector or housing bonds may be sold to the public and to private sector institutions. Government may choose to guaranty a portion or all of the mortgages it sells, whether originated by the public or private sectors.

The principal objective of all these investment activities is to increase funds available for housing finance. For example, in secondary mortgage market activities, long-term mortgages are made liquid. Instead of financial institutions or government holding long-term mortgages, proceeds from sales of these mortgages become available to make additional mortgage loans. This can be an encouragement to financial institutions to make loans because the risk of holding long-term loans is lessened. Also, an investment vehicle is created which meets the long-term investment horizon of institutions such as pension funds and insurance companies.

To be effective, these investment programs must be structured so that private sector institutions can earn a reasonable profit, mortgage terms respond to market demand, the programs are competitive with alternate investments, and these institutions can be assured that the program will be available over time. For these programs to be attractive, the volume of mortgages purchased and sold must be sufficient to warrant the expense of administering as well as packaging the loans for sale. Brazil, for example, has successfully used a government-sponsored secondary market program. Through a compulsory savings scheme funded by employer contributions, a savings/unemployment fund, the Fundo de Garantia do Tempo de Servico (FGTS), was created in 1966 which purchases mortgages originated through public and private sector lenders under established procedures. The Brazilian Housing Bank, established in 1964 with responsibility for implementing the national housing plan, administers the program. With resources totaling US\$45 billion in 1982, the FGTS has made a substantial contribution to meeting the housing finance needs in Brazil. As fund resources were increasingly tapped for social security payments in the 1970s, the Brazilian Housing Bank supplemented FGTS resources with the sale of real estate bonds, thus using another housing investment vehicle to mobilize funds for housing. (Chilson, 1983)

In the Philippines, however, the Home Development Mutual Fund (HDMF), a compulsory savings program where resources are invested

in mortgages originated by other institutions, has not had the same positive results as the Brazilian program. Because resources collected have not been sufficient, stiff mortgage qualification procedures have been imposed to maintain the financial integrity of the fund. As a result, few contributors can qualify for loans. In addition, lack of uniform underwriting and lending procedures for institutions originating mortgages has resulted in unnecessary complexities of administration. (Chilson, 1983)

Government Guaranties:

For housing bonds and other securities, whether public or private, to be seen as attractive investments, investors must be confident that the issuing institution is sound and can repay the obligation fully in a timely manner. Likewise, purchased mortgages must be sound with reasonable expectations of timely repayment. Concern about the quality of mortgages purchased may necessitate government providing a guaranty. With a guaranty which minimizes risk, investors may be willing to supply funds which they would not do in the absence of a guaranty. However, such guaranties can be costly to government if the loans are not sound. When undertaking to guaranty mortgages, as is the case with purchase and sale, government needs to have the expertise to evaluate the quality of the loans and assure that they are properly serviced. Without this expertise, such activities are unlikely to be successful because investors will not have confidence in the programs.

Government may also provide guaranties to financial institutions for all or part of loans that meet specific criteria. The objective of these guaranties is to reduce risk to the financial institution so that it is willing to make loans that it otherwise would not make, a loan with a 10% downpayment for example. The FHA program in the US is an example of this type of guaranty as is the guaranty program in Zimbabwe (see Zimbabwe Case Study). As long as the underlying loans are good, this type of guaranty is a low-cost, effective way to mobilize private sector housing finance.

Regulatory Incentives:

Other actions which government can take to increase money available for housing from the private sector include regulations that favor this type of investment by financial institutions. For example, where credit controls exist, exemptions can be made on rate or amount lent if loans are made for shelter or to specific groups. Specialized housing finance institutions or small local institutions, such as co-ops and credit unions, may be exempted from rules governing other financial institutions. For example, reserve requirements might be lowered or interest rate ceilings on deposits raised to increase savings available for investment in housing loans. In the US during the 1960s and early 1970s, the government rules allowing savings and loan associations to pay higher interest rates on deposits than commercial banks made vast sums available to finance housing. The disadvantage of such actions is that market mechanisms are disturbed which can have

unintended effects such as increasing the money supply and contributing to inflation. This type of action involves a policy decision to favor one sector or group over others which may present political problems, and in the long term, distortions in the economy in ways which are hard to predict in the short term.

A dramatic example of the unintended effect of regulatory incentives is the impact which deregulation of interest rates US financial institutions could provide depositors had on savings and loan institutions. In order to compensate depositors in an inflationary environment, government deregulated maximum interest rates and the savings and loans were forced to raise the rate of interest paid to match those offered by money market mutual funds. Unlike commercial banks, they were unable to adjust interest rates on their loan portfolios which consisted mostly of long-term mortgages. The losses which resulted significantly weakened a large portion of the savings and loan industry.

Tax Concessions:

Government can also use tax policy to stimulate housing investment. For example, government can exempt institutions that make housing loans from some taxes in order to encourage them to make such loans. Adjusting taxes to favor some over others has the same drawbacks as the regulatory actions previously mentioned. In addition, there is a direct cost to government from foregone taxes. Clearly this type of action must be carefully considered for its budgetary impact relative to the possible benefits to be gained from making more resources available for housing finance.

What is clear from this review of alternative approaches to public/private partnerships in housing finance is that many options exist for cooperative efforts to increase funds available for shelter. All of the approaches have advantages and all have drawbacks. Whenever partnerships are developed, it is important that both government and private sector participants carefully consider the benefits to be derived and the costs associated with implementation.

Housing Production

The availability of finance is not always a sufficient incentive to assure an adequate level of housing production, particularly for low income households. Public/private partnerships intended to affect housing production directly can take a number of forms. These range from joint venture projects where public sector agencies enter into contractual agreements with private sector enterprises for the purpose of developing and selling or renting housing units, to programs where the public sector provides some specific service such as land assembly or the installation of infrastructure on behalf of private sector developers, to programs where incentives such as loans, loan guaranties, grants, or tax concessions are offered by the public sector to stimulate private sector initiatives. Removing obstacles such as unrealistic

building or planning standards and disincentives such as rent control may be equally important means of stimulating private sector housing production.

Turnkey Construction:

Direct contractual partnerships aimed at increasing housing production have one advantage over less direct relationships in that precise numbers of units to be built are known. Such partnerships may be of a limited nature where the government simply agrees to purchase completed units at a set price, referred to as "turnkey" projects, or of a broader nature where specific roles are defined for each partner and where the finished units are sold or rented with the partners sharing profits or losses on a predetermined basis. While partnerships of this type are usually effective in terms of increasing production, US experience with the turnkey program suggests the need for caution as unit costs actually increased above the cost of units built either directly by the public sector or by the private sector alone (see US Case Study). The apparent reason was the removal of market mechanisms in that the guaranteed purchase price was negotiated rather than being set by what individual buyers were willing to pay. Even bidding did not cut costs as the developer/builders found working with the additional government regulations and reporting requirements which accompanied the program to be sufficiently onerous that their costs were indeed increased. Thus, after completion of the initial round of demonstration projects, the per unit costs of turnkey projects climbed sharply.

*The turnkey approach has also been used in LDCs with similar results. For example, the state-owned social housing fund in El Salvador used deposits from a general workers' pension fund to contract with private sector builders and developers for the purchase of housing units which were then rented to low and moderate income families. Within a few years, the program had produced an impressive number of units, but the fund was technically bankrupt as the costs of units it had contracted to purchase exceeded what could be recovered through rental income. When direct government budgetary allocations became necessary to sustain the fund, the construction program was suspended.

Despite the problems associated with turnkey projects, they still have a potential advantage over the approach used by many African housing agencies which contract with private sector builders to construct public housing units. Most of these agencies use quantity surveys to establish the basis for a fixed price construction contract, but the "fixed" price seldom remains unchanged as the contracts provide for cost increases under certain circumstances. Some of the more common causes for increased cost are directly attributable to the failure of government agencies to perform their responsibilities efficiently. Such causes include lengthy government review procedures or failure to provide utility hook-ups when they are needed, or failure to make prompt payment as construction progresses. These experiences suggest that a turnkey approach

which removes government entirely from the construction process may be comparatively more efficient than other approaches to government contracting with private builders.

Land and Services:

Rather than enter into contractual partnerships to develop housing units, governments may decide to provide a specific service to private developers which will lower their costs or their risks or in some other way encourage them to build housing units which they would not otherwise build. Serviced land is essential to new residential development. In many urban areas, the availability of suitable land is a constraint on private sector housing development. Government may choose to intervene by acquiring property and making it available, either as serviced or unserviced plots to private developers who agree to build housing for certain prescribed markets (see Barbados and Kenya Case Studies). The difficulty with this approach is that when government sets project guidelines, usually upper limits for unit cost or for eligible purchaser income, the private builder generally perceives this to be a directive to build units which will be sold at a specific cost level, i.e. the government guidelines often replace the developers' judgement as to what type of unit or what price unit the market will buy. Tragically, the result is often that too many units are produced at a cost which is only affordable by a very small segment of the intended target group.

While government intervention in the land market may be essential to provide secure tenure or speed housing production in some situations, unnecessary intervention should be avoided, particularly in land acquisition, as this will most likely inflate the cost of land and thus the cost of housing. In countries with overlapping land tenure systems where title is difficult to establish, some form of government involvement may be essential in order to provide the mortgage security required by lenders. In any country with a functioning land market, the private sector developer should, in most cases, be left to acquire the land. An important concept of the private land developer is that there are always a number of equally suitable sites for development. Since land for shelter generally consumes 50-70% of an urban area, many alternate parcels are seen as suitable for shelter development. In acquiring land for new projects, a private developer will simultaneously negotiate on many parcels of land comparing the advantages of each against market factors and the willingness of the seller to complete a transaction. By looking at an entire region for potential development sites, private land buyers induce greater elasticity in the equation than a buyer focusing on a particular parcel or a small area. (Kitay, 1984)

Another method of land acquisition used by private land developers is the purchase of options to buy a parcel at some future time. In order to make such a transaction attractive to the landowner, the future acquisition price is set significantly higher than the current value. The cost of acquiring the option is generally related to the landowner's carrying costs which may be quite low

for undeveloped land. The annual cost for land options in the US is generally less than five percent of the current land value. Thus for a relatively low cost, the land buyers are able to control far more parcels than if they actually acquired the land. (Kitay, 1984) Since land markets are highly speculative, this approach also helps reduce the developer's risk by providing control of many parcels simultaneously. Since land values increase rapidly just prior to development, the cost of the unused options are offset by the rapid increase in the value of the site actually acquired. Where land markets are functioning in this manner, the public sector would be well advised to leave land acquisition to the private sector and provide assistance in some other aspect of the process. In countries where no real land market exists, other solutions should be considered.

A public/private partnership approach to acquiring land for development known as "land pooling" or "land adjustment" may be effective in some cases. In such programs, the private sector, usually several landowners, contribute the land while the public sector provides the infrastructure which makes development possible. The Korean Land Development Agency has used this approach quite successfully. A development plan is prepared creating three categories of land within the project area - public land for roads, schools, and other public facilities which will remain in public ownership, usually 15 to 25 percent of the total area; the private land that will be sold by the government at a public sale to recoup its out-of-pocket costs for servicing the entire area, usually 15 to 25 percent; and the private land that will be returned to the original owners in amounts proportional to original ownership shares, usually 50 to 70 percent of the total area. (Kitay, 1985) Such programs may be initiated either by the government or by the land owners. The chief advantage of this approach is minimal expense to government in contrast to direct land acquisition programs. Land owners benefit in that the increased value of their remaining serviced land far exceeds the value of the unserviced land they had when the project began. The legal procedures involved in implementing a land adjustment program are, however, complex and time consuming. Other prerequisites are: cooperation from all levels of government; appropriate enabling legislation; a reasonably efficient cadastre or title registration system; well trained, objective appraisers of real property; and highly skilled negotiators and administrators. Consequently, the land adjustment or land pooling approach may be too cumbersome for most situations but could be given serious consideration in countries such as the Ivory Coast, Kenya and others where most of the prerequisite conditions exist.

Even when land itself is not a constraint, the availability or the cost of infrastructure and essential urban services may restrain land development. Often the issue is related to costs and how they are to be recovered rather than to who will actually do the installation. Where realistic standards exist and public utility lines are nearby, it is usually feasible for private developers to install on-site infrastructure and recover the costs directly from

buyers as a part of the sales price. When planning standards, land costs or other factors raise the cost of a serviced site so high that it is not affordable by the target group, other approaches must be found. In such cases, the public sector may assume responsibility for providing all or some portion of the infrastructure and recovering the costs through property taxes over a longer period of time. Roads and surface water drainage are particularly suitable to this approach as they can be developed in stages as the tax based source of revenue increases. However, this approach involves public subsidies and, consequently, has significant budgetary impacts on the public sector. Thus, the costs must be carefully assessed and weighed against the public benefit or the cost of alternate approaches.

Monetary Incentives:

Incentives to builder/developers are another option which governments have to stimulate private sector housing production. The types of incentives available to governments parallel those discussed in the previous section on private financial institution participation in housing, but the benefits in this case accrue to the private developer rather than to the financial institution. The direct types of incentives include loans, loan guaranties, grants, and tax concessions. The indirect ones include removing disincentives such as unrealistic building or planning standards, streamlining approval processes, and deregulation of rental housing. In each case, a monetary incentive is something which improves the likelihood that the developer will make a profit on the venture. Any action which reduces risk or uncertainty or eliminates delays will reduce cost to the developer and thus increase the likelihood of profit. In a tight money market, loans may be made directly to developers or through private financial institutions for construction costs. Concessionary interest rates or interest deferral plans may be needed in order to make housing projects attractive. Loan guaranties to developers in the form of take-out mortgages for eligible purchasers may be an effective incentive in situations where limited mortgage money availability makes home purchase difficult. This approach was used in Barbados and is being tried in Kenya (see case studies).

Direct grants to developers can also be used to encourage them to undertake projects which would not otherwise be economically viable. In Great Britain, this approach is being used to rehabilitate dilapidated rental housing units owned by local governments. The buildings are sold to private developers at a nominal cost, and grants are provided equal to about one-third to three-quarters of the cost of the needed rehabilitation work. The developer obtains the balance of the funds from private commercial lenders and sells the completed units to pre-qualified low income purchasers who obtain mortgages from private building societies. The programs in Liverpool and in Wandsworth have made units available for sale at prices as low as 10,000 to 15,000 Pounds Sterling to purchasers with incomes as low as 4,500 Pounds Sterling. But concern is growing in Britain that this approach will only work with the more desirable public rental housing units

leaving local governments to cope with those units the private developers do not want. (David, 1985)

The US experience with monetary incentives is also instructive for governments considering a similar approach. A review of the UDAG and CDBG programs shows that government initially went too far in providing private developers with incentives beyond what was really needed to stimulate the desired effect (see US Case Study).

Tax concessions for a specific type of project are another means of stimulating private sector actions desired by governments. In the US, a rehabilitation tax credit and an historic preservation tax credit have been used to stimulate private investment in upgrading the existing building stock. Special accelerated depreciation schedules which increase the allowable deductions in the early years of a project have also been used as an incentive for construction of low and moderate cost rental housing projects. While such approaches do encourage increased housing production, they are costly to government and should be carefully evaluated in terms of their economic and social returns. A strong case can be made that the tax credits given for preservation of historic structures and for rehabilitation of other older properties have increased government revenues on a net basis when increased property taxes are considered, but most other tax concessions have resulted in significant losses of revenue to the government.

Regulatory Incentives:

The key to developing an effective program for stimulating private sector housing production is to identify the constraints and disincentives present in a particular situation. In some cases direct monetary incentives may be essential; in other cases regulatory ones which indirectly affect costs may be of even greater importance. No better example could be found than the deleterious effect which rent control laws have had on both the production and maintenance of rental housing in many US cities.

As a result of regulations which restrict a landlord's ability to adjust rents in response to market conditions, private developers have been unwilling to invest in rental housing leaving government as the sole provider of new rental housing units. In those cities with the most restrictive laws, privately owned rental buildings have fallen into disrepair or been abandoned completely, thus reducing the rental housing stock.

A similar maintenance problem exists in many African countries where rents charged in government-owned housing are so low that the revenue generated is not sufficient to cover maintenance and administrative costs, much less to amortize capital investment. Movement toward rents based on economic factors rather than social or political concerns is essential if governments are to sustain their own rental housing programs without massive subsidies. If the private sector is to be persuaded to build rental housing then market forces must be allowed to set rents.

The same concerns for public welfare which prompt governments to intervene in rental rate structures often lead to unrealistic planning subdivision and building standards. In many African countries, such standards were established prior to independence and are based on European models. In some cases, the standards have not even been adapted to tropical or subtropical conditions. In very few instances do the standards reflect social and economic conditions of the country. Yet governments are often reluctant to adopt realistic standards. The result of this attitude is that the cost of new residential development is unnecessarily high and unaffordable for a large proportion of the population. Unless government is to provide subsidies, the costs must be lowered. Alternatively, illegal settlements, i.e. those built without regard to standards, will proliferate undermining the objective of government regulation, which should be to protect public safety and allow for orderly future development.

In both Botswana and Malawi, an approach to the issue of standards has been adopted which may be useful in other countries. In Malawi, various grades of residential areas are designed each having different development standards. In Botswana, the process is less formal but the effect is similar. Low income areas are planned on the basis of progressively upgradable standards. In these areas, house plots are marked only with corner stakes and road rights-of-way are graded. At this point, house plots can be sold. While the purchaser of such a plot gets little more than what is available in rural areas, the framework for future urbanization has been established. Subsequently, water lines can be added either to supply standpipes or individual connections. Eventually, the road right-of-way can be paved and other services added. This flexible approach to regulatory standards allows private sector builders to provide shelter solutions affordable to all segments of the housing market.

HOW CAN PUBLIC/PRIVATE PARTNERSHIPS BE INITIATED?

Formulating and implementing projects which rely on building successful public/private partnerships require that LDC government officials and development assistance agency staff come to understand the objectives, motivations, and operating procedures which distinguish the private sector from the public sector; and, within the private sector, the differences between private lenders, stockholders, or equity investors, and private builders and developers. It is not enough to view profit as the sole motive of the private sector, nor is it accurate to assume that eliminating risk is essential, or even desirable, in seeking to motivate private initiatives in housing.

The private sector is far from monolithic in its viewpoint. In the critical matter of risk evaluation, private sector lenders differ dramatically from private sector developers - for risk is at the heart of the entrepreneurial function in development while most other key players shun risk. The function of the entrepreneur, by definition, is to perceive an opportunity and assume the necessary risk in order to realize a profit. By contrast, lenders seek multiple layers of security in order to avoid risk. Lenders are seldom entrepreneurs; generally they see their function as fiduciary, investing other people's money in the safest possible manner.

Developers, on the other hand, expect to assume risk, but will also expect sufficient freedom of action to be confident they can achieve their objectives. Developers' assessments of the types of limitations and options potential projects offer are often of equal importance in determining their willingness to proceed with the investment as are the financial risks and the potential profit. Financial incentives may be effective in stimulating certain types of private investments, but removal of restrictions or modification of regulations may be more effective and less costly in terms of public resources.

The key to formulating a successful public/private partnership is to assure that the objectives of both parties are compatible, i.e. that a project is structured so that achieving the desired result will serve the interests of both parties. A project which is structured so that time delays or cost overruns in the construction of housing units do not adversely effect the profit margin of the developer will not be subjected to the normal incentives which make private sector builders more efficient than public housing agencies in producing lower cost housing units. On the other hand, public agencies are not motivated by financial incentives nor should builders suffer economic penalties due to delays in completing construction which are outside of their control, such as lack of timely utility hook ups, inspections, or public agency review processes. Understanding these differences should allow project planners to tailor public/private

partnerships to fit the requirements of each party without undermining the objectives of the joint effort.

A range of approaches will be discussed in this section from full-fledged national strategies to create a vital private sector housing industry to public/private partnerships with more limited objectives, such as using public funds to leverage private investment or incentives to direct private initiatives toward production of lower cost housing units. Establishing new, special focus institutions and programs to target public and private attention on housing will also be analyzed as will the approach of building on the efforts of existing private sector housing activities.

Formulating a National Strategy for Privatization

Public/private partnerships have little or no chance of success in the absence of a generally supportive policy environment. For example, in a country where rents are artificially held at a level so low that they do not cover the cost of maintenance and debt service much less a fair return on equity, no form of public/private partnership will change the fact that heavy government subsidies will be required to build any new rental housing or that the existing rental housing stock will not be maintained without similar infusions of public funds.

Governments which wish to attract private sector participation in housing finance and housing production must first examine national policies to determine if they are conducive to private sector investment. Government fiscal, monetary, exchange rate, wage, and trade policy all have potential for price distortions which result in misallocations of resources, loss of efficiency and contraction of private sector investment which will reduce growth in the economy.

Formulating a national strategy which will be supportive of private sector initiatives can be a major undertaking, but one which can achieve dramatic results. A review of events in the People's Republic of China since 1984, when urban economic reforms were approved by the Central Committee of the Communist Party, reveals a country that is willing to make major concessions in its planned economy to attract foreign investment and stimulate the creation of private enterprises. The basic purpose of the economic reforms was to introduce market mechanisms within a state-controlled economy and begin to seek a new balance between each of these economic forces in achieving modernization.

China has recognized the importance of partnerships with private foreign investors in joint venture enterprises and even emphasized this principal in its Constitution. In order for its national strategy of economic reform and its policies that are supportive of private sector initiatives to be successfully implemented, China has undertaken extensive rewriting of its laws with an emphasis on supporting foreign private sector initiatives. These laws seek to give protection to private sector partners and to

distinguish responsibilities and controls.

China's economic reforms and privatization efforts are massive in terms of their implications for modernization and their impact on the largest single population in the world. In its first year of implementation, many of the reforms created inequalities and abuses in the marketplace. Subsequent changes in laws and regulations promulgated by central government have been aimed at ameliorating these conditions. China has been able to deal swiftly with problems associated with its urban economic reforms, but it is currently attempting to find a delicate balance between support for the introduction of market economic forces and liberalization of its centrally planned economy. The China Case Study provides additional analysis of these issues.

In more limited ways, both Barbados and Zanzibar have also taken the approach of beginning with a national strategy or plan for increased privatization of the housing sector. In both cases, broad policy issues were debated by government until a consensus was reached. The consensus resulted in legislative and policy changes which affected program activities and responsibilities of government agencies and led to new initiatives aimed at stimulating private sector housing activities and to modification of inhibiting regulations (see Barbados and Zanzibar Case Studies). The weakness of the Barbados project was in fact at the broad strategy level where several naive assumptions were made. Initially, it was assumed that the scarcity of housing finance was the major obstacle to private sector production of low cost housing units. Based on this assumption, a course of action was planned which focused on assuring a reliable flow of capital into this segment of the housing finance market. The program has been quite successful at attracting the participation of private financial institutions and improving liquidity of housing finance, but production of low cost units has not increased. This can be attributed to the initial lack of a strategy for attracting the participation of private builder/developers and for directly addressing issues such as planning standards and regulatory processes which have limited efforts to produce low cost units.

Assisting Local Government Development Efforts

In order to effectively implement a national strategy for improving housing conditions, whether or not public/private partnerships are part of that strategy, the public sector must have the administrative capacity and funds to pursue that strategy. Central governments as diverse as those of China and the United States have found that local government and local communities can more efficiently meet local housing needs than central government agencies, and are pursuing programs where local input and administration are essential.

In the United States, the federal government has moved from direct intervention in the housing market to providing funds to local communities which develop programs with local private groups and financial institutions. In this way, local governments have been

able to obtain financial participation from the private sector and, in effect, leverage public sector funds and obtain private sector expertise so that more housing activity can occur to benefit targeted low income households and areas than would be possible using only government resources. One of the key factors in making these programs successful has been the presence of local governments and community groups capable of participating in these partnerships. The US Case Study provides a number of examples of public/private partnerships which describe the roles of local governments and communities.

Most African countries do not have in place an administrative system which links policy decisions at the national level with project planning and capital budgeting at the local government level. In the absence of such a system, no national program of any kind can be effectively implemented. Centralization of authority has been most governments' approach to the lack of a system for effectively influencing local development decisions. This has resulted in weak and ineffectual local governments in most African countries. While those countries whose legal and governmental systems followed the British model are in a somewhat better situation in this respect than those whose systems are based on the highly centralized French model, virtually all African countries suffer from over-centralization of authority and from a lack of technical and managerial skills in local governments.

Central government agencies all across the Continent have struggled with the problems of implementing a nationwide shelter program in the absence of effective local government counterpart agencies. In 1983, the Government of Kenya, with assistance from USAID, initiated a program aimed specifically at improving local government capacity to plan and deliver housing and urban services. Naturally, a key element of the program was training for local officials in a variety of areas including accounting and record-keeping practices aimed at improving revenue collection, management practices, budgeting and project planning. But the first step was to establish a standardized reporting system linked to local government budget preparation as a prerequisite for receipt of development funds from central government. The objective of the program was to establish a system which could serve as a vehicle for training local officials in the process of establishing development priorities by evaluating the costs and benefits of specific projects including their impact on local revenues.

While the specific reporting system developed for Kenya's local governments may not be directly transferable to any other country, the concept is transferable and the need for a system which accomplishes the objectives is shared by virtually every African country. The system established should itself be policy neutral. Its primary objective should be to improve capacity and efficiency at the local government level and to facilitate implementing central government's development policies, priorities, and programs throughout the country. The approach used in Kenya was

as follows. The Ministry of Local Government prepared and distributed to all local authorities a simple reporting form, a set of guidelines for completing the form, and a letter signed by the Permanent Secretary indicating that each local authority was expected to complete a Local Authority Development Program (LADP) using the forms and guidelines provided. The letter indicated that preparation of the LADP was essential to preparation of Kenya's overall National Development Plan and that the LADP process would be used to identify and evaluate projects for funding. The first round of LADPs received were quite impressive evidence that given a clear set of guidelines, even the least sophisticated local authority can prepare a reasonable development program. As the program continues, manuals are being prepared to assist with preparing feasibility studies, managing projects, and preparing annual development estimates. A sound planning and review process is now in place providing the Government of Kenya with a system whereby new initiatives such as schemes to leverage public funds through public/private partnerships can be introduced into virtually every local authority in the country.

Establishing Special Focus Institutions and Programs

In countries where stimulating local government initiatives remains a distant objective or where housing problems have reached a critical stage, some dramatic new initiative may be the most effective way to focus attention on unmet needs and new opportunities for public/private partnerships. Creation of a new special focus institution and formulation of programs aimed at solving clearly defined problems may be an effective means of attracting private sector involvement.

In Zanzibar a strategy was developed to reverse the economic decline and physical deterioration of the Stone Town, the historic center of settlement in Zanzibar (see Case Study). In 1983, a detailed plan was prepared outlining policy changes, legal and administrative reforms, and physical improvements needed to stimulate redevelopment. A policy dialogue was initiated within government which led to significant changes, including identifying a clear role for domestic and foreign private investment. The policy changes required legal and administrative reforms to clarify and protect individual property rights which had become ambiguous as a result of past government action. The strategy included identifying the privatization of housing and the upgrading of housing conditions as the focal points of a lead sector approach to economic revitalization for the area.

A Stone Town Redevelopment Authority was created to focus attention and target resources on the problem of redevelopment. The limited public funds available were to be used for emergency repairs, in life threatening situations, and to purchase materials needed to initiate a self-help home improvement program. A program to sell publicly-owned housing units, about one-third of the total housing stock, was to be initiated. Loan programs and other incentives for private investment were proposed. To date, only modest progress has been made due to the lack of loan funds

needed to launch the major program of upgrading, but institutional and administrative and regulatory reforms are in place. The staff of the newly created development authority has cautiously begun the program of selling public housing units to tenants on a pilot basis in spite of the lack of long term mortgage funds. The emergency repair program is underway and a number of private projects have begun. The redevelopment authority has also initiated discussions on several public/private joint venture projects with foreign investors, and is soliciting resources to expand its program from bilateral and international assistance agencies.

Reinforcing Present Efforts of the Informal Private Sector

The simplest and perhaps the most effective way to initiate a program of public/private housing partnerships in many African countries is for government to analyze the present efforts of the informal private sector and to seek ways to enhance its performance. This is the basic concept behind sites and services projects which provide assistance to individual households during the house consolidation period and virtually all neighborhood upgrading projects. Case studies of two such projects, one in Kenya and another in Zimbabwe, are presented later in the paper.

The Government of Kenya in 1977 initiated a program to provide serviced sites to low income households in an area of Nairobi known as Dandora and loans to assist purchasers with building their own houses. The program was not intended to replace, but to assist the informal approach to house building which dominates the provision of low income housing. Government loans made available under the program were quite small, approximately enough to purchase materials to build a two room house. Labor was to be provided directly by the beneficiary or paid for by them from savings or from loans obtained through traditional informal sector lending arrangements. Project experience in Dandora suggests that the combination of secure land tenure and small government loans can be effective in stimulating informal sector housing production. Within a period of six years, private investment in the Dandora area exceeded government funds. Ninety percent of the households had built more than the basic two room units and the total built area exceeded the aggregate size of the basic units by 225 percent. Experience with repayment of the government loans has been reasonably good, although delinquency rates have increased in recent years as general economic conditions have deteriorated.

The Zimbabwe Case Study provides potentially significant variations on the approach used in Kenya. The objectives are largely the same, to provide support for informal sector house building activities. The basic difference is the use of formal private sector financial institutions to administer the loan funds with the additional objective of mobilizing new sources of continued lending to the sector. In the Kwekwe project, the funds came in approximately equal contributions from three sources, a USAID Housing Guaranty Loan, direct Government allocations to the

National Housing Fund, and the Beverly Building Society (BBS). The Ministry of Public Construction and National Housing (MPCNH) services the land, allocates the plots and provides construction finance to the householders. Upon completion of the house, the BBS issues a mortgage which repays MPCNH for the construction loan. The municipality is responsible for recovering the cost of infrastructure from the beneficiaries through taxes and user fees to repay MPCNH. In a new project just getting underway, cost recovery for both servicing the land and building the unit will be accomplished through the BBS mortgage. In this case, the BBS will repay the municipality for the cost of the serviced site and then advance funds to the borrower for self-help house construction using informal sector builders.

Some variation on this approach to public/private partnerships is viable in virtually every African country. A program of assistance which makes use of a system already in place has distinct advantages over programs which depart radically from the norm. In formulating a successful program, the key will be a clear understanding of how the informal sector actually works in a particular country and what are the real constraints which affect it. Often they will be financial, in which case the approaches described may serve as useful models, but the constraints will just as often prove to be regulatory and administrative requirements or unrealistic standards.

Refocusing Efforts of the Formal Private Sector on Low Income Housing

In many African countries, the formal private sector is quite active in building and financing housing for the middle and upper income market. An opportunity exists in these situations for public/private partnerships aimed at demonstrating the viability of expanding private sector activities to serve the low income housing market.

The United States has adopted this approach. Its recent efforts are directed at involving private sector institutions in programs supporting improvement of low income housing, a market not generally served by these institutions. The government provides funds which are leveraged at the local level through local public/private partnerships. Local government, community groups, and financial institutions have participated together in these programs. Through such techniques as buydowns, blending, guaranties, and grants, public funds are used, in effect, as "seed" money. This seed money provides incentives to private sector financial institutions to provide their own funds for loans affordable to low income households, loans which these institutions would not have been willing to make in the absence of such incentives. Examples of these techniques are presented in the US Case Study.

The range of incentives available to government for involving the formal private sector is discussed elsewhere in this paper, but three actual examples of programs initiated for this purpose are

examined here from the standpoint of how they are organized and how they differ in terms of their impact. All three programs emphasize housing finance although two of the three also deal directly with builder/developers as well as with financial institutions.

The Zimbabwe program is strictly a loan guaranty approach with the government underwriting the repayment risk of low downpayment loans made to eligible beneficiaries by private sector financial institutions. In order to induce building societies to make loans to lower income families who cannot afford the 25 percent downpayment required by the normal lending practices of these institutions, the government has agreed to guaranty the top 20% of the loan with the borrower placing 10% down and the lender taking the remaining 70% risk. The 70% risk represents a slight reduction from the 75% loans which these lenders normally make. The building societies make the loans to purchasers of existing housing or to builders of new housing units as stand-by commitments for eligible purchasers. The government's liability for a guaranty ends once the borrower has amortized 20% of the loan. The program has proven quite successful in stimulating private housing investment and its cost to the government has been very low (see Zimbabwe Case Study for greater detail).

In Kenya, a slightly different approach is being tried. Developers apply to participating private sector lenders or to the National Housing Corporation (NHC). Letters of commitment for stand-by mortgages are then issued to selected developers in order to assist them with obtaining construction financing. Upon completion of the units, buyers apply for loans from the participating financial institutions who simply on-lend funds provided by NHC and then service the loans and repay the government. The funds are presently limited to those borrowed by the government under a USAID Housing Guaranty loan. Leveraging was not initially built into the program, although over time, this may be possible. Interest appears to be high but the program is too new for any final evaluation.

In Barbados, a similar approach failed to stimulate builder/developer participation until more aggressive, direct measures were taken. In this case, a plan was devised whereby the National Housing Corporation (Barbados) would provide builders with serviced lots as well as the stand-by loan commitments. The cost of the lots were then repaid from the mortgage loan proceeds, thus cutting the carrying costs to the developer. It also became clear that planning standards, particularly minimum lot sizes, had to be reduced in order that developers could produce affordable units. Despite a slower start than originally anticipated, the project is now considered quite successful. Financing arrangements instituted under this program have attracted new private sector resources to serve the low cost housing market. The Barbados Case Study provides a more complete description of the program.

HOW CAN A COUNTRY DETERMINE WHICH APPROACH IS APPROPRIATE?

In exploring alternative approaches to initiating public/private partnerships, it appears that African government officials have several viable options appropriate to housing programs. In some countries, the most reasonable approach will be to begin with existing private sector housing activities and to find ways of stimulating and encouraging an expansion of these efforts or a broadening of the market segment being served. In other countries more dramatic first steps will be needed before the private sector can be expected to participate in housing. In these cases, policies should be examined first with programs growing out of a strategy which addresses constraints as well as incentives needed to build a vital private sector housing industry.

The previous section presented several alternative approaches to initiating public/private partnerships:

- Formulating a national strategy for privatization is an approach aimed at creating a policy environment that supports development of the private sector. In the absence of a policy environment conducive to private sector activities, opportunities for success of public/private partnerships will be very limited. Where the private sector has the capacity, opportunities for successful partnership ventures can be pursued.
- Assisting local government development efforts is another approach aimed at creating the capacity within the public sector to develop and participate in public/private partnerships. Without capable public sector partners, at either the central or the local government level, projects with the private sector may have limited success, because of such factors as weak project design, slow regulatory reviews, inadequate funds or poor administration of funds. Strengthening public sector capacity may be essential in many cases to implement successful public/private partnerships.
- Establishing special focus institutions and programs is an approach directed at creating comprehensive policies and programs incorporating both public and private sector actions to deal with a specific problem or area. In other words, it is an attempt to solve a number of interrelated problems with a fully integrated effort which includes public and private sector participants. To be successful in this approach, the public and private sectors must have the technical capacity to implement projects, including, most importantly, the funds to undertake the projects.
- Reinforcing present efforts of the informal private sector is an approach designed to tap the skills and resources of an important part of the private sector and increase their capacity to produce needed shelter. What is needed here is an

understanding of what public sector actions are required to stimulate the informal sector to increase and improve the quality of its efforts.

- Refocusing efforts of the formal private sector on low income housing is an approach which uses existing private sector capacity and, through coordinated actions with the government, creates conditions where formal private sector institutions can see benefits in changing their normal ways of operating. For this approach to be successful, program design must take into consideration the capacity and requirements of both the public and private sectors, in such areas as risk, amount and type of incentives which may be required, the cost vs benefit of such incentives, and the administrative skills of participants.

In determining how to initiate public/private partnerships in housing and what approach would be most effective in achieving public policy objectives, governments need to assess carefully the situation in the country in general and the shelter sector in particular. Simply put, governments must establish policy objectives, determine the capabilities and the limitations of the public and private sectors, and adopt approaches, with private sector input, that reflect these assessments.

While some of the following questions refer specifically to housing, most could usefully be applied to an assessment aimed at developing public/private partnerships in virtually any sector which contributes to economic development:

- What is the capacity of the public sector?
 - What programs is government currently pursuing? How effective are these programs in meeting objectives and why have they succeeded or failed?
 - What budget and other financial resources are available? Are funds adequate to administer current programs or to add others?
 - What organizations have responsibilities in the shelter area and are the roles clear, well defined and coordinated?
 - What is the level of technical expertise in shelter development and finance? Do particular institutions need to be strengthened? If so, how?
 - What policies, regulations and standards affect the shelter sector? Are they effective or should they be revised, and if so, in what ways? How do they facilitate or hinder private sector participation in housing?
 - What housing incentives are being provided? What subsidies? What is the cost of subsidies and incentives? Are they necessary?

- What is the capacity of the private sector?
 - In what areas does the private sector operate and what is its technical expertise in land development, construction and financing? Which areas could be strengthened?
 - Are private sector firms well-managed, profitable and investing in the local economy? What factors affect this performance?
 - Is capacity widespread among many firms and individuals or is it confined to a few organizations operating in particular areas, i.e. what level of competition exists? Do public sector entities compete with private sector firms?
 - Do private sector firms have adequate access to manpower, equipment, materials, land and money? What factors affect private sector access to these inputs?
 - Does the private sector have the resources and capacity to expand activities? In what areas:
 - What is the capacity, both technical and financial, of the informal sector? In what areas is the informal sector active?
 - What is needed, if anything, to strengthen private sector capacity to provide shelter?

- What is the relationship between the public and private sectors? What is needed to facilitate the two sectors working together in partnership?

- What is the shelter situation in the country?
 - What additions to the housing stock and what level of upgrading are needed to meet current and future needs?
 - How much of the needs are being met? By the private sector? By the public sector?
 - What are the impediments to needs being met?
 - What are the constraints on converting shelter needs into effective demand?

- What is the economic situation and how does it affect the shelter sector? How are different population groups affected?

- What has been the role of international assistance organizations? How effective has this assistance been? What type of assistance is needed and what can be expected in the future?

An assessment of this type can provide the base for determining a strategy for initiating successful public/private partnerships. To determine specific programs in the housing area, questions such as the following will need to be answered:

- What are appropriate private sector and public sector roles in providing housing services?
- What are the key constraints to public/private partnerships and how can they be overcome?
- How can the private sector participate and its input be considered in the design and development of policies and programs?
- How can housing finance and equity investment levels be expanded, particularly for low income households?
- What incentives, including subsidies, are needed, if any, for private sector participation? What will these incentives cost?
- Can pilot programs be used to test specific partnership ventures, and if so, in what areas?
- What level of technical and financial assistance is needed? What potential sources exist? How much can realistically be expected?
- How and when should public/private partnerships be evaluated?

In all cases, policies should be examined, public and private sector capabilities assessed, existing programs evaluated, housing needs determined, and the overall economic environment which affects shelter ascertained in order to develop strategies and programs which address the constraints as well as the incentives needed to build vital public/private partnerships in the housing sector.

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BARBADOS: STIMULATING PRIVATE INITIATIVES IN HOUSING

Barbados, a developing island nation in the Caribbean, has undertaken a public/private sector effort to provide housing finance for low and moderate income households. The Barbados experience illustrates one way in which the government can work with private sector builder/developers and financial institutions to improve access of poorer households to homeownership and to improve the quality of housing. While the institutional structures may differ in Barbados from those found in some African countries, there are many similarities and the Barbados project offers an opportunity to analyze the results of a public/private partnership that could be adopted, perhaps with modifications, in many African countries. Because of the small scale of its population and economy, the direct effect of the Barbados project and the reasons for successes and failures are more apparent than in larger, more complex systems. In fact, the Kenya projects which are described in another case study have similar objectives of involving the formal private sector construction companies and financial institutions in provision of housing for the population that traditionally has not previously been served by these private sector enterprises. While the funds for this project, like the Kenya project, initially came from a USAID Housing Guaranty loan, one major objective of the project is to demonstrate to Barbadian financial institutions that lending to lower income households can be a profitable activity for which financial institution funds can be used. As a result, financing for the housing sector would be increased without additional expenditure by the government.

Housing Characteristics and Investment

Barbados is a small island country with a population of 250,000 persons, about 70% of whom live in urbanized areas. In 1980, the housing stock consisted of 67,138 units which ranged from small, wooden houses without indoor plumbing or water to large masonry houses and apartments with all amenities. Seventy-two percent of all households own their own homes, but about 42% of these households own "chattel houses" which are wooden houses which can be moved and are built on non-permanent foundations located on rented house spots. The land comprised of individual rental spots is known as a tenantry. The Tenantry Freehold Purchase Act of 1980 gives tenants who had rented their house spots for five years or more the right to purchase the lot they rent. About 22% of all households rent the units they occupy; 25% of these live in publicly owned housing provided by the government's National Housing Corporation (NHC).

In 1983, residential construction, representing about 3.6% of GDP, totaled US\$49 million of which 40% was attributable to new construction and 40% to renovations and improvements. Materials represent 50-60% of housing costs and 50-80% of materials must be imported. Housing starts have declined in the 1980s to about 1,000 units/year, reflecting lack of growth in the overall economy, the increase in unemployment, and the drying up of mortgage financing, the latter due primarily to government efforts

through interest rate controls to slow inflation and limit import of building materials which require scarce foreign exchange.

The Public Sector

Prior to the 1980s, the public sector's role in the delivery of housing included policy making by the Ministry of Housing and Lands (MOHL) and production by the NHC of four types of shelter solutions: (1) home improvement loans for workers; (2) construction and management of low income rental housing; (3) direct construction of low and middle income residential housing; and (4) a modified sites and services program. These activities were financed with capital budget allocations and bond issues which provided liquidity to the Barbados Mortgage Finance Company (BMFC), a subsidiary company of the largest government-owned commercial bank, and with public contributions to the General Workers Fund. These activities accounted for about 20-25% of the shelter market.

In the 1980s' environment of limited government resources, the government needed to rethink its role in housing and develop more cost effective programs and institutional arrangements. As a result, government redirected policy by formally adopting a White Paper, defining the public sector's role as providing serviced land, facilitating financing, and revising the regulatory standards and process which control new housing construction. Primary objectives include a commitment to homeownership for individuals at all levels of society, provision of serviced house spots, and transfer of freehold title to tenantry house spots. The policy assigns major responsibility for producing new housing for low and moderate income people to the private sector. The NHC is phasing out of its direct public housing builder role, rationalizing its own operation, including the management of public rental housing, developing a cost effective sites and services program and instituting community upgrading activities.

In addition, using funds from the Housing Guaranty loan project described below, the government has created a revolving loan fund to finance low and moderate income households' housing needs through private sector managed companies. Creation of a government directed secondary mortgage market is also under consideration.

The Private Sector

Traditionally bank trust companies, including the government-owned BMFC and to a more limited extent insurance companies, provide long-term mortgage financing primarily to higher income households. Trust companies raise funds through issue of medium-term commercial paper and investment of the National Insurance Fund resources in their instruments. Commercial banks and credit unions make 2-5 year loans for home improvements at rates ranging from 12% to 22%. As a result of National Insurance Fund resources being diverted to finance the government budget and Central Bank credit controls, little money has been available for long-term

mortgages in recent years. Home improvement lending has benefited from less restrictions.

Builders in Barbados can be divided into three major groups: large, intermediate, and small scale builders. The large builders develop subdivisions, selling lots to individuals or building houses for sale. The 20 to 25 medium scale builders build custom masonry houses for all income levels and quality timber houses for lower income families. They also do major home improvements. The small scale builders operate essentially in the informal sector, primarily in the home improvement field and have been a major factor in the overall upgrading of the Barbados housing stock. These small builders generally provide only labor, with the customer providing the materials and sites. All builders have been adversely affected by the shortage of mortgage finance which has resulted in few housing units being built and sold.

Upper and middle income households typically use the services of the formal sector builders and borrow when funds are available from trust companies and commercial banks to finance construction and improvements. Lower income households use informal sector builders and finance housing activities through cash savings, or credit unions, and possibly through a commercial bank. Most lower income building is accomplished on an incremental basis, over time as income permits.

The Public/Private Partnership: "Private Initiatives in Housing"

In 1983, the government of Barbados borrowed US\$10 million through the USAID Housing Guaranty program to undertake a program of providing housing finance through the private sector. The specific purposes of the program were to facilitate the ability of the private sector, both institutions and individuals, to provide new homes and home improvements for low income families by making financing available to do this, which would at the same time assist government in reducing its role, and to provide financing for the implementation of the Tenantry Freehold Purchase Act so tenants could purchase house spots and make improvements to their chattel houses.

The project allocates funds to three specific components: (1) US\$3 million to finance the purchase of new homes; (2) US\$5 million to finance basic structural improvements for existing homes; and (3) US\$2 million to finance tenants' purchase of house spots they rent.

The proceeds of the loan were used to establish the Housing Credit Fund (HCF), located in the Ministry of Housing and Lands, to on-lend the Housing Guaranty funds to private banks, trust companies, credit unions, the BMFC and the government-owned Barbados National Bank. These well established financial institutions use their normal commercial lending procedures to make loans to families earning below the median income of US\$8,000 per year.

This project has made substantial progress toward achieving its

objectives. As of August 1985, approximately US\$4.2 million had been lent to target group families by participating institutions. About 2,100 families had improved their housing situation.

Over 2,000 improvement loans averaging US\$1,700 have been made to the target group. Over 50% of beneficiaries had incomes of less than \$5,000 per year. Six commercial banks and three credit unions are participating with all but about 100 home improvement loans being made by purely private sector banks.

Mortgage loans totalling US\$720,000 have been made to 49 beneficiaries. Most of these loans were made by the BMFC to households that completed the lengthy and complex process of arranging to build their own houses. Few homes built by developers have been financed. No tenantry lot purchase loans have been made using HCF resources, but as of September 1985, 20 applications for loans had been received.

The government of Barbados has decided to make the HCF a revolving fund, in effect capitalizing it with US\$10 million which can be relent for similar programs benefitting low and moderate income households through private sector type institutions. In addition to the US\$5.6 million remaining of the original loan, as of August 1985 the HCF had accumulated reflows totalling US\$1.6 million consisting of loan repayments and interest earned on deposits of undisbursed funds and reflows.

With the Housing Guaranty loan, USAID also provided a US\$320,000 grant for technical assistance activities designed to improve the managerial and administrative capabilities of the MOHL and public and private lenders participating in the program, and to assist in development of a national housing plan.

Project Evaluation

The Project can clearly be characterized as successful in meeting its objectives, although at a slower pace than expected. The project has as its underlying assumption the belief that the availability of funds would be sufficient to draw private institutions - banks, credit unions, developers, and builders - into providing homes, home improvement, and land ownership opportunities for low income people. The project to date has demonstrated that, while financing is certainly necessary to that activity, it is not necessarily sufficient.

Private Sector Financial Institutions

- Commercial Banks are making loans to lower income persons for housing improvements. These institutions had not previously lent in any significant way to this group. Loan repayment experience has been good and loans profitable to the institutions. These commercial banks indicate they would be willing to continue to lend to this group as long as resources are available and the government interest rate and other credit controls allow sufficient margins to lend profitably. Loans

using HCF resources are slowing as commercial banks are experiencing a period of excess liquidity. The cost of savings to banks is lower than HCF funds, and thus, commercial banks are choosing to lend savings deposit funds rather than borrow from the HCF for on-lending. Thus, in a sense, the private sector in this instance has already taken on the role of lending to lower income individuals.

- Credit Unions are participating in a limited way because many members of the larger, more organized credit unions which are able to administer housing loans, have incomes which make them ineligible for these loan funds. Smaller credit unions do not have the management capacity to administer these loans. Also, the margin between the cost of HCF funds and the lending rate credit unions believed was reasonable for members was not initially sufficient. As a result, the HCF decided to lower its on-lending rate to provide adequate margins to the credit unions. Thus, the government absorbs the difference between the cost of the housing guaranty loan and the HCF on-lending rate.

In the instance where existing financial institutions are experienced in dealing with a program element, in this case, home improvement loans, there is a good likelihood that the infusion of additional funds will result in the hoped for outcome, although considerable effort will be required to market the program. Obviously, if the funds are only available under conditions which are unacceptable to the institutions (as was sometimes the case with Barbados' credit unions), the institutions will not participate. Familiarity with local lending priorities is essential to determining effective ways of dealing with them.

- Trust Companies in the private sector have not participated significantly in the project. The BMFC, a government-owned trust company, has made an effort to adapt policies and procedures, such as agreeing to provide mortgages on timber houses and finance insurance in the loan, as well as counselling potential homeowners on how to go about obtaining the necessary legal documentation and regulatory approvals. Other trust companies have been less interested in changing their standard lending procedures to serve this market.

Housing Production

The main reasons why so few mortgage loans have been made under the project are not due to financial institution unwillingness to participate, but rather to the builders not producing housing affordable to the target group, and the high "front end" costs and time needed to process mortgage loan applications. Legal and processing costs add up to about 8% to the cost of a house necessitating substantial cash payments in addition to the minimum 10% downpayment required by HCF guidelines. The project initially underestimated these costs and how this would limit eligible participants.

Few subdivision houses have been purchased with financing provided by the project. While builders appear to be willing to participate, they have not yet provided any significant number of houses that are affordable to the target group. Uncertainties as to what are acceptable Town Planning standards, particularly lot size, have affected the costs and have discouraged creative housing solutions as well as the provision of affordable lots. The builders continue to believe that this is a government-run program, where the government sets the rules and makes decisions as to what should be built and by whom. Additional direct communication with developers is needed to help define the real limits and opportunities of the program so that they take certain risks but will also be allowed to develop their own solutions to meet the market demands of low income households.

Efforts are being made to solve these problems. The HCF staff has been working with builders and regulatory officials to develop affordable housing solutions, the possibility of providing construction loans is being discussed and, on an experimental basis, projects with reduced lot sizes are proposed. The NHC is currently planning joint ventures with builders where NHC provides serviced sites for construction of low income housing by developers who will market the houses to households eligible for the HCF mortgage loans.

In the home mortgage element of this project, the availability of mortgage money was sufficient to promote the purchase of new homes by a small group of relatively skilled low income households who managed to get approval and build their own houses. It was not sufficient to encourage the private development community to alter the kinds of housing it was delivering to the market, nor to force the planning and regulatory community to address its role in inhibiting the emergence of alternate, affordable solutions. Housing provision is a process which includes many participants. Its successful completion requires understanding by all parties of the goal that is being sought and an agreement by each that the goal is a worthy undertaking.

In this project, this latter understanding is now emerging, but it has taken many months. Had project planning and early implementation addressed the consensus building process as a whole, it may have progressed more rapidly.

Finally, when a project represents a substantial departure from the status quo it is necessary to examine the legal and structural relationships which underpin the original arrangement. In the case of the tenancies purchase aspect of the project, the mechanics of transferring title for the plantation tenancies required a massive legal and surveying task. For urban tenancies legal and survey work is even more complex. The need for infrastructure upgrading and for negotiating sale prices for tenantry plots will require even more implementation time. Had the underlying administrative issues been understood more clearly at the outset, the project implementation plan would have reflected the front-end work required and proposed a different

KENYA: EXPANDING PRIVATE SECTOR LOW INCOME HOUSING ACTIVITIES

Two projects in Kenya involving both the public and the private sectors are described in this case study. The first involves public provision of serviced sites with housing construction by the private individuals using primarily informal sector financing and building mechanisms. The second involves public sector provision of construction finance for private sector built low income housing with private sector financing of long-term mortgages to low income household purchasers. The first can basically be characterized as an informal public/private partnership where government facilitates construction of housing by private individuals. The second is a formal project specific public/private partnership where private institutions in effect take the role formerly assumed by the government in building low income housing, and provide a formal sector alternative to informal sector building and financing of housing. The objective of the sites and services project is to facilitate orderly extension of an already existing system of housing construction and financing in the formal sector. The private sector building and finance project aims rather at involving institutions in the low income market where they had previously not participated and bringing to the project both financial resources and expertise greater than the public sector could provide at this time. Expectations are that after gaining experience in this market, these private sector institutions will continue to serve the low income market without the same level of government assistance. A substantial portion of the funding for government activities to date in low income housing has been provided by international donors. Private sector substitution of funding is needed as neither the government nor international donors will be able to supply sufficient funds to meet future needs.

Background

Kenya has a population of about 19.4 million (1985 estimate) which is growing at about 4% per year. The urban population, now about 17%, is expanding rapidly at a rate of 7% per year. The total gross fixed capital formation in dwellings is 3.4% of GDP, and about 2.0-3.5% of the government budget has in recent years been allocated to housing, of which about one-half has been from external sources. The economic system is mixed with government participating as both majority and minority shareholder in commercial and industrial enterprises.

Finance

Of the three parastatals in the housing sector, the most important is the National Housing Corporation. It develops housing on behalf of Local Authorities, and on-lends money for low-cost housing to both individuals in the rural areas, and local authorities. It also develops higher cost housing, for which the long-term finance is provided by a parastatal building society, the Housing Finance Company of Kenya (HFCK). The third parastatal is also a building society, Savings and Loans Kenya Ltd.

In the financial sector, 22 banks operate including two state-owned banks which compete with two well-established international banks and a number of private Kenyan banks. Thirty-one building society savings and loan type institutions operate, with five being prominent, including the two parastatals previously mentioned.

The government has recently taken an active role in controlling the interest rate and charges levied by the finance houses of all types, as it was found that there was a tendency to make excessive charges for loans. In early July 1985 the government announced new measures to control the sector. These have now been incorporated in the Banking (Amendment) Bill, which is expected to be made law by the end of 1985. It lays down strict levels of capitalization, measures to control asset quality, liquidity levels, penalties for the abuse of interest rate ceilings, a mandatory deposit insurance scheme and many other more minor matters.

The trend is for government expenditure for housing to be reduced relative to the demand. This is due to two factors: first, the demand is increasing as urbanization increases; second, the demands of recurrent expenditure on the government (paying especially for education, health and defense) have been increasing very rapidly without corresponding revenue increases, resulting in government having less to spend on capital projects.

The private sector has raised considerable sums on the local market for housing development, from insurance companies, pension funds, building societies, etc. So far these funds have only been applied to the medium and upper income sectors; in fact, they have funded these sectors virtually in toto. In some towns the upper income housing market is now saturated.

The private sector has hesitated to become involved with the low income market. First, with limited resources, it has tended to concentrate its lending on the larger loans which have comparatively low overheads, and may have lower default rates. Second, the standards required by the local authorities for private housing development have been such as to make it very difficult to build housing that is affordable by low income groups. Other factors, such as land availability, interest rates, availability of developers willing and able to take risks, and competitive activity by government agencies directly serving the low income market have reinforced the tendency of private sector institutions to continue to serve this same market.

Housing

The total production of housing units by the formal sector is meeting about 7% of demand. Only about one in five new urban households is being housed by the formal sector. Informal sector solutions predominate. These are typically not squatter settlements, but are developed by the land owner to low, but affordable standards. The housing usually takes the form of rows of single rooms, each of which is let to a single family, with

shared, rudimentary sanitary accommodation.

Upper income housing is mostly developed by individuals or in small scale speculative developments. Middle income housing is very rarely developed by the owner; purchasers rely on estate developers to provide a solution appropriate to their needs.

The National Housing Corporation (NHC) is the agency responsible for low income housing in Kenya, in association with the local authorities. Housing developed by the NHC has not exceeded about 3000 units per year in the last five years. It has been operating in two distinct sectors of the low cost market. The first is the site and service system which is intended to provide for the very low income groups. In practice it has not done so because building a house with the small loans available was impossible without additional private capital. The second has been rental and tenant purchase units which serve the income groups just below and just above the median income.

Squatter and informal settlement upgrading has been conducted on a small scale. The largest, and most successful, projects have been implemented under the World Bank/IDA Second Urban Project, and some modest upgrading is included in both the Third Urban Project and the USAID Small Towns Project. One of the features of low income housing in Kenya has been the dominance of external finance. Virtually all the low cost housing in the large towns of Kenya in the last decade has been externally financed. In the 1985-86 financial year, government funds allocated to the NHC are sufficient to build only about 300 units at the NHC's present standards.

Sites and Services Case - Support for the Informal Sector

In the past six years over 12,000 sites and services units have been erected. Government-funded infrastructure costs about Sh16,000 per plot. Government loans (financed with World Bank and other resources) contributed Sh7,000 of the total self-help housing unit cost of about Sh34,000 with informal sector lenders and the individual borrower providing the balance. In other words, the government contributed about Sh47 million per year for the serviced site program, and the private sector spent about Sh56 million yearly, of which about one-third went to labor (small and very small contractors) and two-thirds to materials costs.

One example of this approach is the Dandora project started in 1977, funded partially with World Bank resources, which consisted of 6,000 plots with sanitary facilities, all infrastructure and community facilities. Plots were allotted to low income households earning Sh280-650 per month. Loans for building materials to be used in self help construction were provided with the local authority making and servicing the loans through a special Housing Development Department (HDD) which had finance, technical, community development, and management sections located at the site. Beneficiaries were expected to mobilize labor and to build the minimum required one or two rooms using the loan for

materials. If more than the minimum unit was to be built, the beneficiary was expected to find other resources. In fact, after six years in phase one of the project, 225% more than the minimum number of rooms had been built by 90% of the beneficiaries.

Funding for building came primarily from savings (48%) and loans (45%), and only 7% represented gifts. Savings included wage income and family business income, and importantly rental income from renting one or more rooms. Of the loans 17% were informal (friends, relatives, employers), and 10% from quasi-formal sources such as co-operatives, building groups and the Welfare Revolving Fund. Formal loans represented only 18% of financing, but 28% of the number of loans made. Most of these were small project loans from the Nairobi City Council made for a thirty year term at 8% with the plot title used as security for the loan. These loans only covered an average of 15% of costs.

Based on sample data, about one half of the homeowners decided to maximize the economic benefit of plot ownership by renting the housing unit and living elsewhere, presumably in lower quality accommodations. It appears that the tenant households in Dandora have similar income characteristics to owners. Therefore, the project continues to serve the target low income group.

Project Evaluation

The Dandora project can be considered successful in that low income individuals were able to improve their housing situation and/or their economic situation as a result of the participation. Formal sector finance in the form of seed loans for room construction was successfully used as a catalyst for mobilizing additional money from quasi-formal and informal sources in order to complete and expand houses beyond the project minimum. In fact, formal resources represented less than 20% of total investment. The project shows that low income groups have the capacity and willingness to pay back loans, as repayment experience has been satisfactory, although deteriorating somewhat as economic conditions have worsened. In addition, the project created employment in small scale construction as artisans, masons, and laborers were able to find work and many small businesses were formed. It can be assumed that many people acquired new skills which were transferable to later phases of this project and other projects.

The Nairobi City Council through the HDD has successfully operated as a housing loan institution although as the volume of loans increased, the capacity for collections has declined. The project results suggest that housing finance could form a useful part of the municipal financial base, if administrative costs can be paid out of income. Another option would be to change the form of legal title in some way so that plots could be used as security for loans from other formal and quasi-formal institutions providing beneficiaries with greater access to financing and possibly lower the administrative burden on the local authority.

The case of Dandora is a good example of a functioning public/private partnership involving the informal sector and is similar to sites and services projects in many parts of the world. It shows clearly that given the opportunity through access to a plot and starter money, low income individuals have the capacity and desire to save, repay loans, and mobilize other funds to improve their housing situation. This represents a vastly lower cost solution to government than direct public sector construction and allows beneficiaries to choose the housing solutions that they can afford which meets their needs.

Mortgage Finance Case - Stimulating Formal Sector to Serve Low Income Housing Market

The objectives of this program, funded by a USAID US\$20 million Housing Guaranty loan, are to involve the private sector in Kenya for the first time in the formal production and financing of low cost housing. The infusion of funds is designed to demonstrate that low cost housing can be a profitable venture for housing finance institutions, as well as for private builders and developers, and that the private sector is an efficient vehicle for the provision of such housing. 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 replication of the project concepts. This project is similar to the case in Barbados described in another section of this paper.

Specific results expected include private developers in Kenya planning and completing approximately 2,500 housing units for below median income urban households, and the National Cooperative Housing Union (NACHU) demonstrating the capacity to plan, develop, and contract out the construction of approximately 500 housing units for several member cooperatives. Also, private housing finance institutions will have provided approximately 3,000 mortgages to below median income families.

Since the external funds will produce only a fraction of the units needed to satisfy demand, other means need to 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. To tap the insurance, pension and other formal funds market, as part of the project, a secondary mortgage market system will be explored, and if found viable, a secondary mortgage market system will be developed.

The project will operate by any private developer, in collaboration with a housing finance institution, making application to the funding agency (probably the National Housing Corporation), for inclusion in the project, provided that it can prove that the land will be available, and that it is meeting a real demand. The National Housing Corporation will enter into sub-agreements with the housing finance institutions. These subagreements will spell out the eligibility criteria. The housing finance institutions will conduct technical and financial

feasibility studies. One of the housing finance institutions will provide a letter of commitment for the mortgage financing; the developer will acquire the land, attain the necessary municipal approvals, build and finally sell the houses. The developer will use the letter of commitment as the basis for obtaining the construction financing from a commercial bank.

The National Housing Corporation will be the borrower from the US investor, and the loans to the housing finance institutions will be repaid to the Corporation, which in turn repays the investor. As of July, 1984, 17 developer, 2 NACHU and 3 co-op projects had been proposed. Four major and three smaller financial institutions, as well as one co-op have agreed to provide term mortgage financing.

Beyond the initial allocation of projects, USAID and the National Housing Corporation will not intervene in the decision-making process of the financial institutions or developers. If any project should overshoot the cost ceilings, then the developer will have to deal with the consequences, either by cutting profit margins or by selling the units on the open market. In the latter case, buyers would be responsible for finding their own long-term finance.

The advantage of this process is that developers are not constrained by multiple approvals by the public sector, but have an assured source of long term finance for the units that they are selling. The public sector's main role will be to ensure that local authorities, where necessary, reduce the standards required for the housing and the infrastructure. Without this reduction developers may be unable to meet the cost targets.

The development of the co-operative projects is not expected to move as rapidly as those of the private developers. USAID will provide technical assistance to these co-operatives and the NACHU to help develop their capacity to execute such projects.

Since the concept of private sector involvement in low income housing is very new, it has taken time for the details to be finalized, but it is hoped that the project is near to realization. The project has received widespread support from the private sector, which is well aware of the largely unmet demand in that price range.

Project Evaluation

As this project is just beginning, obviously it is not possible to evaluate it. However, the operating project in Barbados provides an example of a similar project that can be considered successful. It also illustrates some problems that could be encountered in Kenya. In order for builders to participate in this new market, government imposed standards must be clear and, if necessary, adjusted to make profitable, affordable production of low income housing possible. Barbados demonstrated that, unless standards clearly allow for producing this type of housing,

ZIMBABWE: EXPANDING PRIVATE SECTOR INVESTMENT IN HOUSING

Three separate examples of public/private partnerships are included in this case study. Zimbabwe has an operating guaranty system where the public sector provides a guaranty for a portion of the repayment risk associated with mortgage loans made by private sector financial institutions. The objective is to facilitate financial institution mortgage lending with small downpayments from borrowers, by guarantying the repayment of the loan for the difference between a normal and a small downpayment. This is an example of a public/private partnership where government action allows the private sector to provide housing finance where it would not normally. It can be likened in some respects to the FHA guaranty program in the US.

The second case presented is a USAID, UNCHS supported sites and services project in which government and international donor resources fund site development and materials loan, informal private sector efforts are mobilized for construction and private sector financial institutions provide long-term mortgage loans. Thus, this project involves not only the public and private sectors but also both the informal and formal sectors outside government. In effect, this pilot program attempts to mobilize resources from several sources in order to meet the objective of providing low income housing, substituting for the more expensive direct government provision of shelter for this group.

The third case is a World Bank financed project that is in its formative stage. This project resembles the previously mentioned case, except that the building society extends construction finance to beneficiaries who use self-help methods of building. This is another example of mobilizing resources outside government to meet housing needs of low income populations.

Background

Zimbabwe has a population of about 7.5 million people of which approximately 22% live in urban areas. The overall population is growing at about 3.5% per year and the urban population is increasing at a 7% rate. Zimbabwe's urban housing stock is in sound condition albeit very over crowded. Because of government policies against the development of squatter settlements, improvised housing is not a significant share of the total stock.

At Independence, the government of Zimbabwe declared itself set on a course of economic transformation from a capitalist to a socialist state in an effort to overcome the social, economic, and technological forms of dualism created under the former regime. This implied some direct forms of state intervention in the economy. To date, this intervention has taken the following forms: (1) a widening and intensification of regulatory practices such as those affecting labor, prices, foreign exchange, or investment decisions; (2) rapid growth of public spending pushing up the public expenditure/GDP ratio from 35% to 45% in five years; (3) the establishment of a range of new parastatals, e.g. oil

procurement, reinsurance, housing (not yet operational); and (4) a policy of state capitalism in the form of joint ventures and government equity participation in what were previously privately controlled companies.

In the housing sector, local authorities seeking financial assistance from central government were prohibited from engaging private sector contractors for house construction. Instead they were required to establish their own direct labor construction teams called building brigades. This was intended to eliminate the profit element in the investment with consequent lower costs to the consumers. Government has also expressed a commitment to establish a national housing corporation which is seen as a developer of housing units for all but the lowest income groups.

Despite the increased role assumed by the public sector, government has realized that the task of providing shelter to the nation is far larger than can be tackled by the public sector alone and attempts are being made to develop mechanisms for joint public/private ventures in housing for all income groups.

Finance

The country has a sophisticated financial sector which, until 1980, mainly served the interests of the private (individual, commercial, and corporate) sector. Since independence in 1980, government has introduced several operational controls on assets and interest rates designed to direct capital into the public sector for purposes of national development through deficit financing. Government competition for private sector financial resources appears likely to continue for the foreseeable future.

For the past three years, the nation's five commercial banks have held the largest share of the mortgage bond market providing just over 30% of the total value of both residential and non-residential mortgage lending during the period. Traditionally, the building societies have been the main providers of mortgage finance but since 1981, their share of the total market has fallen to slightly less than 30%. Zimbabwe's three building societies, governed by Building Societies Act (1965), accept deposits and make loans mainly for residential construction. Interest rates are regulated by government fiat. Deposits have stagnated since 1980 and assets have only increased by 9% owing to less attractive investment return vis a vis the Post Office Savings Bank. Other regulatory activities have reduced the capacity of the societies to expand, i.e. restrictions on the use of non-resident funds, increases in deposit and lending rates inducing reductions in margins, increases in lending rates creating higher arrears rates with concomitant increases in collection and legal costs.

In the four years ending June 30, 1985, the government disbursed Z\$185.4 million for the development of housing by local authorities. More than 99% of these disbursements were for urban housing. These units, not all of which are complete, were

developed for households on the local authority waiting lists who earn less than Z\$600 per month, i.e. below the 70th percentile. This housing takes the form of single family detached four-room core houses on fully serviced plots of a minimum 300 m² in area for an average unit cost of Z\$6,000 including services. Construction is carried out either by municipal building brigades or by self-help methods. Some local authorities are reverting to the method of hiring labor on a piece work basis, which was one of the dominant modes of construction used in smaller towns before Independence that was subsequently replaced by the new government in favor of the building brigade direct-labor method.

Of the total of Z\$184 million being spent on projects, Z\$92 million and Z\$45 million are being provided by international aid agencies and the Zimbabwe private sector respectively. The balance of Z\$47 million is funded by government. The projects involving the private sector taking the business risk (IBRD/CDC) are only just getting under way in 1985. The share of donor funding for housing has increased over the years and has represented more than half of actual expenditure in the public sector investment program since July 1984.

Guaranty Program Case

The objective of the Government Guaranty program is to permit households unable to make the conventional 25% downpayment on the purchase price of a house to achieve homeownership by guarantying to the lender (building society) the repayment of 20% of the purchase price, thus permitting the deposit to be as little as 10%. Non-public servants may obtain a loan guaranty if they are able to make a deposit equal to 10% of the purchase price of a house. The government then guaranties the top 20% of the loan with the lender taking the remaining 70% risk. The maximum purchase price is Z\$24,000 with a maximum loan of Z\$21,600 (90%). Monthly payments may not exceed 22.5% of the purchaser's salary. Families with incomes up to Z\$475 per month qualify for this guaranty scheme. The purchaser must arrange for the loan and pay all front end costs of the purchase as well as a commission to the Housing and Guaranty Fund (HGF) of one-half of 1% of the loan amount. Civil servants enjoy a similar scheme which provides for a 30% guaranty resulting in no need for a deposit. The Ministry of Public Construction and National Housing (MPCNH) manages the program as custodian of the HGF established under the Housing and Building Act of 1979.

The Building Societies provide long-term finance at prevailing interest rates, now 12.5% over 25 years, to purchasers of existing housing or developers of new housing under the terms of the Building Societies Act.

The only income accruing to the HGF is from commissions charged to purchasers. In fiscal year 1984, this totalled Z\$65,523 which exceeded annual expenditure for the period. This excess was applied to previous years' losses, leaving a net deficit of Z\$56,551.

Since Independence, a total of 10,712 guaranties have been issued for a total value of Z\$38,400,285. Of this total, 52% were given to non-public servants. The government's liability for a guaranty is withdrawn once the purchaser has amortized 20% of the loan principle. Between 1979 and 1984, only 69 loans were foreclosed. The price the HGF paid to building societies for these units roughly equaled the appraised value of the properties. The administration of the guaranty scheme is paid for through an annual appropriation to MPCNH and is not borne by the HGF.

This is a clear case where government has facilitated home ownership to middle income households and civil servants with little direct cost to the government. The program appears to be well managed as evidenced by the modest loan foreclosure rate and adequate security value on those foreclosures to recover guarantied amounts. As long as this type of scheme is well managed, beneficiaries can maintain incomes and housing values are stable or rising, this type of program can be a useful tool to promote homeownership.

Kwekwe Pilot Low Income Self-Help Private Sector Finance Case

The objectives of this UNCHS-USAID financed project are to (1) provide serviced plots and technical and financial assistance to Kwekwe's low income urban households for shelter; (2) demonstrate the ability of private sector building societies to participate in low income shelter projects; and (3) demonstrate the ability of low income plot developers to mobilize additional housing finance through the informal sector.

This is a pilot scheme implemented under the aegis of the MPCNH with technical assistance from UNCHS and financial assistance from USAID. The scheme has provided 1,045 serviced plots to households earning less than Z\$175 per month (1982). Beneficiaries obtain loans in the form of materials to build approved four-room core houses with toilets and indoor plumbing. They also receive technical assistance from the project site team fielded by UNDP on selection of house plans, setting out, construction techniques, inspections, etc. MPCNH provides construction finance from the National Housing Fund (NHF). As and when houses are completed and upon the beneficiary meeting the eligibility criteria of Beverly Building Society (BBS), householders enter into long-term mortgage agreements for the home and BBS pays out MPCNH. Cost recovery for infrastructure services is the responsibility of Kwekwe Municipality which collects from beneficiaries and repays the MPCNH.

The estimated total project cost is Z\$5,200,000 of which 50% is provided through USAID and the balance from the NHF's normal government sources. The BBS is expected to provide Z\$3,800,000 in long-term finance through mortgages funds which will flow to the NHF. Households are eligible for material loans in amounts governed by affordability criteria whereby total expenditure on shelter is not to exceed 27.5% of household income. Loans range in size from Z\$200 to 3,500. In most cases, loans have not been

big enough to cover the cost of a complete four-room core, including labor costs. Therefore, beneficiaries have had to find additional sources of funds with which to complete the house. In some cases, through administrative error, plot developers over-borrowed. These cases were regularized by reassessing current household incomes and revising upwards the associated loan entitlement.

The BBS is offering purchasers the option of repaying on the basis of graduated repayment schedules, rather than on the basis of fixed annuities. Payments in year 1 are set at 75% of the 'normal' fixed level and increased 5% per annum thereafter. This has allowed the lowest income group to participate without paying more than 30% of income for shelter.

Project Evaluation

While the Kwekwe project shows early signs of success, potential problems exist regarding financial complexity and the delay in capital recovery associated with the project. An arrangement whereby mortgage payments are adjusted every year and under which the borrowers indebtedness actually increases for the first twelve years or so of a 25 year amortization period creates a complex system which is difficult to explain to borrowers. These difficulties can lead to administrative complexities, more especially if the interest rate changes as well, as is permitted under conventional lending practices. The graduated repayment system makes the risky assumption that purchasers' incomes will rise at 5% per annum over 25 years. Neither historical evidence nor current economic predictions support this assumption.

The graduated repayment system does appear attractive to project planners who are keen to see the project launched but who may not be involved in later years to assist with the problems. This approach may simply postpone the problem of arrearages and defaults. The approach also delays capital recovery with deleterious effects on the purchasing power of any revolving fund into which repayments are directed.

Low Income Self-Help Private Sector Construction Finance Case

The objectives of this World Bank financed program, which is in the planning stage, is to focus the efforts of the local authorities on servicing residential land and providing community facilities using public funds and to develop a mechanism whereby the private sector (primarily building societies) can, in liaison with local authorities, provide loans to low income borrowers to develop their own shelter on publicly serviced land. The program also has components designed to assist local and central governments in expanding urban development capabilities.

The project is designed to provide 11,324 serviced plots and associated community facilities in the four towns of Harare, Bulawayo, Mutare, and Masvingo at a total cost of Z\$106 million. An additional Z\$11 million is provided for institutional

CHINA: CREATING A MARKET-ORIENTED SOCIALISM

The case of China illustrates the formulation of a national strategy supporting the development of a private sector within the context of a planned economy. This national strategy, aimed at a socialist market-oriented economy, moves the role of government from total state planning to guideline planning which allows state-owned enterprises to respond to economic market conditions and encourages joint ventures with private sector and foreign companies. Decision making is being decentralized and individual incentives and markets are being stressed in the framework of a loose central government plan.

The People's Republic of China has reached a stage in its development process in which urbanization, in general, and the growth of a vigorous urban economy, in particular, is assuming paramount importance in the social and economic life of the nation. The pace and direction of change has been given renewed impetus by the recent decision of the Central Committee of the Chinese Communist Party on the reform of the economic structure, giving special emphasis to fostering the modernization and development of cities along with the growth of urban enterprises.

Since the death of Chairman Mao Tse Tung, China has begun a huge program of cultural and economic liberalization accompanied by increased friendly ties with the United States, Japan, and parts of Western Europe. Investment funds from capitalist countries and from capitalist business firms have been eagerly sought to help advance the country's modernization program. China has made the political decision to support and encourage the development of the private sector within the framework of a planned economy.

In 1978, China's leadership announced the "Four Modernizations" program, an economic development strategy that would provide the country with a "powerful socialist economy" by the year 2000. (Burns, 1985) The modernization was to focus on agriculture, industry, national defense, and science and technology. That same year, a dramatic enlargement of China's trade policies began in February and expanded throughout 1978 and 1979 with announced normalization of relations with various countries, including the United States. At the same time, greater emphasis was given to raising living standards for a population that had tolerated virtually no improvement in living conditions for two decades. Domestic consumer markets and housing were to be enhanced. Heavy industry was deemphasized in favor of agriculture and light industry. China has begun to emphasize major roles for foreign trade, investment, and technology in its future development.

In an effort to achieve such major changes in a socialist system, China has had to make major changes in the state planning process while maintaining controls associated with state planning policy. State planning tends to produce a vertically organized economy in which the Party sets the targets and the government ministries attempt to formulate them as detailed plans and impose them on the industrial and rural sectors. In this system, the producers

receive their orders from above, do their work, and turn their products over to the state. In the case of industrial consumer goods, factories sell items at fixed prices to retail outlets. Wages are paid either out of the price obtained or from funds supplied by the ministry. To work in such an industry conveys a feeling similar to that of people working in a government ministry in any country. In such a system, profit and loss are unimportant, serving the state is priority, and market pressures are nonexistent. Until recently, industries turned all their profits over to the state after deductions had been made for welfare funds and improvements in workers' housing. The individual, state-owned enterprise had to apply to the higher authorities if it wanted new equipment or more factory buildings which would be supplied by the state. No link exists between profitability of an enterprise, the wage level for workers and administrative staff, and the funds available for expansion or modernization. Under the new reforms, state-owned enterprises are now required to deal with economic realities. Government is promoting the growth of private businesses and entrepreneurial opportunities for citizens and increased foreign private sector joint ventures. China has, under Chairman Deng Xiaoping's "open door" policy, begun a modernization program larger than has ever been undertaken. China is decentralizing decision making and stressing individual incentives and markets within the framework of a loose central government plan.

China began its recent modernization program in the rural areas where the vast majority of the population lives and works. Only 20.6% of the people live in cities compared with 79.2% in the United States. Incentives were created for rural villagers and peasants to increase production and to expand the number and kinds of food and other products. Peasant incomes were increased by the raising of procurement prices for products. Free markets were restored and peasants were welcome to sell surplus commodities for profit. Rural agriculture quickly moved from state-run collectives to entrepreneurial, family-run businesses where private production and trade have stimulated the rural economy and created relative wealth among the peasants. (Burns, 1985)

In 1984, the central government initiated a series of urban economic reforms that specifically called for the separation of government and urban enterprises. Private businesses were to be actively encouraged and foreign private sector investment was to be aggressively solicited under a new "open door" policy.

China's goal is to remove the obstacles to the establishment of a "socialist market-oriented economy." Its new economic model is to focus on promoting enterprise vitality and on correctly controlling the relation between the state and the enterprises and between the enterprises and employees. Systematic reforms are underway in the planning system, pricing system, labor and wage system, and the role of state organization in managing the economy. The development of this socialist market-oriented economy demands closer economic ties between enterprises and potential expanded markets, both within the country and with

foreigners. It has been proposed that, with the development of a unified socialist market system, the scope of mandatory planning will be gradually reduced and that guideline planning will be enlarged. Enterprise management will change from direct state control to indirect control. Enterprises are gradually being granted greater individual powers and are being encouraged to seek direct foreign investment and joint venture partnerships.

Foreign investment and partnerships are seen as ways of bringing to China's modernization a high level of technology, enterprise, and managerial skills, in addition to needed investment capital. From practically nothing six years ago, foreign investment in China gradually grew to about US\$4 billion by the end of 1984. Since the inception of the open door policy a little more than five years ago, a series of measures have been promulgated by central government to provide a favorable climate for private, foreign investors to join with public enterprises to form new partnerships. In the first half of 1985, Chinese business representatives signed more than 1,700 agreements and contracts for foreign joint ventures. The foreign funds involved in these agreements and contracts totalled US\$3.1 billion, of which US\$2.06 billion was direct foreign investment, a fourfold increase over the total during the first half of the prior year. During the last five years, growth of construction and foreign trade, especially in the special economic zones and the 14 coastal cities designated for foreign investment, has been remarkable. In its efforts to emphasize its wish to open itself to the outside, China is the only country which has written into its Constitution that foreigners are allowed to invest in joint venture enterprises.

As noted, China has not only stressed the need for foreign private participation in its economic reform, the central government has also stimulated the privatization of many domestic businesses and enterprises. More than 16 million Chinese people are now employed in private industrial and commercial business. They are engaged in 11 million licensed private businesses with a combined working capital exceeding US\$4.5 billion in the first half of 1985. More than 70 percent of these private entrepreneurs are in industrial or commercial businesses in the countryside and rural areas.

Although implementing these reforms has not been without problems, the government has maintained and is reinforcing levels of control necessary to avoid corruption and minimize inequities which might otherwise result from shifts in control, responsibilities, and decentralization of decision making. "The modernization of China will produce a new model for growth in the developing world, somewhere between unrestrained private enterprise, of which many new nations are afraid, and Soviet-style economics, which cannot work." (Kissinger, 1986).

China's Housing Program

For much of the past thirty-five years, state investment in urban housing was relatively low, averaging 9.7% of total investment in fixed assets. But over the past five years, the rate of

investment has increased dramatically, averaging over 25% in 1981 and 1982. This level of investment puts China on a par with many developed countries. The investment is made by constructing new, high-rise apartment buildings and by upgrading conditions in existing housing stock. In large cities where land shortage is acute, the apartment buildings may be ten to twenty stories high; in small cities they are generally four and five stories high; and in the countryside they are generally one and two stories high.

The government's goal for the year 2000 is to create a separate dwelling unit for each household averaging 8 m² of living area. To meet this goal, some 1.411 billion m² of building area will have to be constructed at a cost of 19.24 billion yuan (US\$8.86 billion) per year. This figure is almost double the annual investment in housing for the period 1979-1983 when enormous increases in the housing stock were created. (McQuillan, 1984)

The central government will not assume total responsibility for meeting this goal but will encourage other agencies to become active in creating housing. Already the central government's share in housing activity has declined: from 1980 to 1982 the government's share in housing investment dropped from 32.4% to 19.3%. Responsibility for new housing will be borne by state-owned and collectively owned enterprises who will create housing, not only for their own members and employees but also for the general market. The enterprises have increased their share of the housing supply market from 62.7% in 1980 to 71% in 1982.

China is seeking new and innovative solutions to meet the acute housing shortage. Pilot reforms are being tested in various cities and the potential for public/private partnerships in housing are being explored with the development and sale of condominiums to private individuals. Since 1979, various government leaders have stressed the importance of allowing people to purchase and build housing and that rents should be raised to make buying a house more attractive. In 1979 and 1980, Nanning, Guilin, Xian, Shenyang, and 50 other cities pioneered the idea of selling housing to individuals.

In 1982, the China Housing Development Corporation was established as the largest company in this industry. It has in turn established 102 companies in 99 cities across the country. These companies are encouraged to seek out private investors to produce joint venture housing projects. In the past three years, the Corporation has begun construction of 25 million square meters. About 1.8 million families have already moved into completed housing.

The price of an apartment building usually includes: land use fees which incorporate compensation for seized cropland and relocation costs of residents; construction fees; and the cost of utility hook-ups, roads, schools and administration offices.

The state has decided to experiment in the sale of housing to individuals. But an individual pays only one-third of the

ZANZIBAR: IMPLEMENTING AN URBAN REDEVELOPMENT STRATEGY

The government of Zanzibar has undertaken specific actions in a targeted area, the historic Stone Town quarter of the City, to create the conditions conducive to economic revitalization of an overcrowded and badly deteriorated urban neighborhood. Zanzibar has chosen to emphasize housing, in particular rehabilitation of older residential buildings combined with transfer of ownership from government to individual households, as a means to promote a revitalization of economic activity in the area. A new development authority was created to focus attention on the problems and programs were formulated to attract private investment. The Zanzibar case study illustrates how establishing special focus institutions and programs can be an effective strategy to improve shelter conditions in a targeted area and shows the range of problems which must be tackled to successfully implement such a strategy.

In Zanzibar, one of the most cosmopolitan centers on the east coast of Africa, four broad cultural streams converge, the Arab, the Indian, the European, and the local Swahili tradition, to produce a richly variegated society. The Stone Town section of Zanzibar city is an architectural expression of this complex heritage. Although the Arab tradition predominates in urban design and architecture, there are also powerful infusions of Indian and European, mainly British, influence while the stone buildings of this old urban core contrast sharply with the single story Swahili type house in the Ngambo area, which encircles the town on its eastern flank.

The city of Zanzibar has a population of approximately 120,000, or about 40 percent of the island's total inhabitants. Slightly more than 15,000 people live in the old Stone Town.

Evolution of the Physical Form

The urban structure of the Stone Town, as indicated by the street plan, suggests haphazard development where the streets create a maze of narrow winding alleys among the large Arab houses. The labyrinthian street plan has its origins in the Arab traditions of land distribution and urban development. Families and kinship groups often received plots on which they built a cluster of dwellings, or perhaps a single large house with a central courtyard. The intervening spaces between the plots became alleys, rights-of-way and streets.

Although large Arab houses tend to dominate the Town, there are many smaller structures similar to the Swahili houses found in Lamu and Pate on the Kenyan coast. These long narrow buildings front directly on the street, usually without a central courtyard. Similar two-story structures are found along the bazaar streets which combine retail space on the ground floor with the family residence upstairs.

The cultural heritage contained within the Stone Town represents

the accumulation of several centuries and includes a number of notable historic structures. These buildings are now protected by law, although funds for their restoration are not available. The majority of buildings in the Town, while not remarkable individually, when taken together represent a unique cultural heritage and a substantial capital asset which should not be allowed to deteriorate. (McQuillan and LaNier, 1984)

Social Change and Physical Decay

Dramatic social and economic upheavals in the Stone Town occurred following the 1964 Revolution, which overthrew the Arab ascendancy and gave the African majority a socialist state. Many of the wealthiest merchants and craftsmen fled to the mainland, abandoning their fine old houses and bazaar shops. The Government subsequently confiscated the abandoned buildings and placed in them low-income residents from the Ngambo section of the city and newly arrived immigrants from rural areas. Many of these families were assigned to large Arab houses which had once been single family residencies but now were subdivided into small units by the government. The dramatic increase in tenancy in the Stone Town coincided with a sharp decline in the physical condition of buildings and in economic life.

Presently, three-quarters of the households in the Stone Town are tenants, who pay rent for their accommodation. Only 17% of the householders own the buildings which they occupy. The remaining 9% neither own their homes nor pay rent. These include squatters, relatives of the (often absentee) owners, and displaced residents from one of the government clearance projects who were granted rent-free accommodation in government buildings.

Tenancy is linked with low living standards in the Stone Town. Rented accommodations are smaller in size, with more people per room, than in owner-occupied homes. The pattern is repeated for sanitary facilities. Almost 90% of the owner-occupied homes have private toilet facilities. Only 55% of rented home have private facilities; 33% have shared facilities, and 1% have no toilets at all (LaNier, et.al., 1983).

Although the extended family is still widespread, there is a tendency toward smaller household units including the nuclear family and an increasing number of single-member households. A universal problem with social atomization of this kind is a diminished sense of communal responsibility and Zanzibar's Stone Town appears to be no exception. Cast-off junk and refuse clutter the corridors, stairways, and courtyards of buildings. As residential density increases, the problems are exacerbated. From a social point of view, a high residential density within an extended family is tolerable to a degree. But when unrelated individuals are crowded together, disagreement and conflict frequently occur over responsibilities for the upkeep of shared facilities. The conflicts cannot be defused by familial pressures. Consequently, in designing and planning the redevelopment of housing in the Stone Town, accommodation should

be made available for smaller households, with increased privacy and clearly demarcated areas of responsibility for maintenance of the building fabric.

As a general rule, tenancy and poor maintenance go hand in hand; renters often perceive no long-term advantage in upgrading their accommodation. The government, which is the largest landlord in the Stone Town, faces a herculean task in managing the properties it has confiscated since the Revolution. Records of who live in government-owned houses are incomplete and the rent collection system is inadequate. Tenants pay extremely low rents. In terms of the weekly budget, families spend four to six times as much money on discretionary items, such as entertainment, as they do on rent. Government income from rents comes nowhere near covering the costs of basic maintenance, and consequently the properties have become a recurring financial drain.

The difficulties associated with rehabilitation of the Stone Town may be thought of in terms of social stabilization, economic revitalization, rationalization of land use, and physical upgrading of buildings and infrastructure. These issues and the constraints of implementing an integrated redevelopment plan are addressed in this case study.

A Strategy for Urban Rehabilitation

The essential sequences and inter-relationships of an implementation program aimed at redevelopment of the Stone Town were outlined in 1983 as part of a study commissioned by the UN Centre for Human Settlements (UNCHS). The study was intended to serve as a guide for the Ministry of Land Construction and Housing (MLCH) of Zanzibar by identifying the actions required to implement policies and achieve objectives. Realization of this ambitious program required the commitment of government at the highest levels, and the cooperation of many different ministries, agencies, and parastatal organizations. Broad community support was also needed to mobilize the human resources to carry out such a program. In addition, significant capital investments were needed; and government had to determine the extent to which these resources would come from current revenues or from external grants and loans; from private capital generated through foreign investment or from domestic savings. The government eventually determined it would be required to draw upon all of these sources.

In order to initiate the implementation program, basic policy decisions were required by government in a number of key areas. Specific recommendations for policy changes were proposed in the areas of land use, land tenure, and housing. These specific recommendations included:

- o a rational system of lot allocation and limitation of individual holdings;
- o registry of land allotments, mortgages, and title to buildings;
- o land leases for specific terms and of sufficient length to allow lessors to secure mortgages on improvements;

- o clear rules governing revocation of land grants;
- o clear rules governing compensation to owners for improvements of land 'set apart' for public projects;
- o land grants or leases for nonresidential purposes;
- o rating and property tax on granted lands and on privately-owned building;
- o ground rents on leased land;
- o revised residential rental rates to allow recovery of maintenance costs and amortization of construction costs;
- o sale of government-owned buildings to private parties.

Assuming official approval of these essential changes, specific requirements for new legislation or for modification to existing laws and statutes were outlined. The responsible institutions, either existing or newly created, were then identified, followed by the programs or activities with which each would be charged and their anticipated benefits to government and to individual residents.

The planning policies and legal actions proposed were those required to implement the recommendations of the UNCHS study. Once government accepted the concept of integrated development planning, a planning authority was to be appointed for the Stone Town and certain modifications made to the "Town and Country Planning Decree" and other statutes to reflect this broader concept of planning. Other policy recommendations related to planning controls and incentives for conservation and rehabilitation.

In other economic development sectors, recommendations were more general than those affecting planning or land ownership and housing. For the most part, such recommendations were presented as ideas or alternatives intended to stimulate a dialogue which would eventually lead to official government policies and priorities in these sectors. Based upon such policies, the sequence required for implementation would be similar to those required in housing and planning.

Creation of the Stone Town Conservation and Development Authority

In 1983, policy changes were formally adopted after considerable debate within government. These policies affected land ownership, planning and housing, and set the stage for legal and administrative reforms which followed. In 1984, the strategy for Integrated Development of the Stone Town was formally adopted. The strategy included privatization of housing and upgrading of housing conditions as the focal point of a lead sector approach to economic revitalization. In early 1985, a new institution, the Stone Town Conservation and Development Authority, was established to implement the strategy and to focus attention and target public and private sector resources on the problem of redevelopment.

To date, the achievements of the authority have been modest due to limited resources, but efforts are underway to implement several

of the programs outlined in the strategy. A pilot program has been initiated begin selling the one-third of the housing stock which is publicly-owned to tenants who presently occupy the units. As no loan funds are available to assist with upgrading or with purchase, the program has been limited to only a few structures and to families who have sufficient savings to make the necessary investment. However, the pilot program has provided the authority with the experience needed to formulate policies and institute the regulatory and administrative reforms needed to institutionalize such a program on a broader basis once loan funds are available. Cost estimates and requests for financial assistance have been prepared for each of the major infrastructure and public service improvements recommended in the UNCHS study. The limited public funds available have been used for emergency repairs, in life threatening situations. The development authority has also initiated discussions with domestic and foreign investors on several potential public/private joint venture projects and is working with individuals, governments and international assistance agencies to secure resources to implement its program.

The principal elements of the program strategy include resolution of land use conflicts, upgrading of urban infrastructure and housing rehabilitation. The principal objective is economic revitalization. While all three components are essential to the success of the program, this case study will omit discussion of specific efforts to resolve land use conflicts and upgrade urban infrastructure and services, which are perceived as areas for governmental action. The former is to be accomplished primarily through regulatory authority, and the latter primarily through public investment. However, it is in the area of housing rehabilitation that the Government of Zanzibar sees the need for a public/private partnership.

Housing Rehabilitation

Traditionally, maintenance of the house was a part of family life, but many Stone Town residents are newcomers with little or no experience in maintaining stone buildings, and few have capital resources to carry our repairs. Vigorous government action and leadership will be necessary to halt this process of deterioration, but government does not have the resources to tackle the problem alone. A program has been recommended which would provide the residents with basic instruction on building maintenance, create an emergency loan fund for repairs, and stockpile necessary repair materials. The actual repair work would be carried out by the residents themselves. Qualified inspectors would be required to examine work in progress. While emergency repair work may be possible using this approach, sustained maintenance will only be possible as a part of a broader program.

An essential step in the strategy of rehabilitation of the Stone Town is for the government to convert as many tenants as possible to owners. A source of long-term housing finance will be

necessary in order for most families to purchase their residences. Home improvement loans may also be required in order to encourage rehabilitation of many of the structures. In the case of larger buildings housing a number of households, assistance will be needed in forming housing cooperatives or other communal organizations. These buildings in the poorest condition may require even bolder action, such as introducing a program similar to the urban homestead plan used in inner city revitalization in the US during the past decade. In such a program, new owners receive deteriorated property for a nominal sum on the condition that substantial improvements be made to the property within a specified time period - usually five years. The government often augments such programs with low-cost loans to the purchasers, but the objective is to stimulate investment of private sector resources in housing rehabilitation. It is a truism that owners take better care of their homes than tenants. By embarking on such a program, the government can achieve an upgrading of shelter conditions, improve building maintenance, and rid itself of an annual drain on its limited budget resources. A revolving fund is to be established with the proceeds from the sale of housing units currently owned by the government. These funds can serve as a capital base for the development authority and should be used to further leverage private investment in rehabilitation activities.

In implementing this program, the development authority will be expected to take a lead role but should seek cooperation from other institutions. For example, the home improvement loan program might best be administered by the Bank of Zanzibar and the commercial banks with the development authority providing funds for on-lending, perhaps on a matching basis with funds provided by the financial institution. Implementing a full scale program to sell houses or residential units to individual families will require activating a mortgage lending program. This might be accomplished by using the revolving fund to buy mortgages originated by the two building societies which currently exist or by the commercial banks.

Economic Revitalization

Rehabilitation of the housing stock in the Stone Town is intended to serve as the lead sector in an effort to initiate a process of redevelopment that will create jobs and generate private investment. Economic revitalization of the Stone Town and preservation of its historic character cannot be achieved without rebuilding a diverse economic base. In order to assure not only upgrading and repair of existing buildings, but also their maintenance in the future, the residents will require an adequate income and secure jobs. With current unemployment levels estimated at around 25%, the need to create new jobs is very great. In addition to the construction trades, the principal areas in which employment may be expanded include tourism, manufacturing, retail sales, port activities, and fisheries.

A program of tourism development has been launched. A master plan

has been prepared, the largest of the three government-owned hotels has been upgraded and turned over to private management. Tourism may be further developed by providing new recreational facilities for visitors, by upgrading existing and developing new accommodation. The opportunities for joint venture projects with foreign investors are considerable and there are indications of domestic private investment interest in tourism as well.

Growth in tourism can be expected to stimulate development of the handicrafts industry in the Stone Town. The new enterprises could be organized as cottage industries but on a cooperative basis. The cooperative could be responsible for obtaining materials, organizing training programs to upgrade skills, and marketing final products, particularly those made for export. In some cases, such as embroidery and tailoring, production itself would be carried on in the workers' homes, thereby allowing flexibility in worktime and keeping disruptions in family schedules to a minimum. Through the revival of handicrafts, vacant retail areas of the bazaar streets may be redeveloped and brought back to life.

Retailing has always been an important activity in the Stone Town. The principal foci are the bazaar streets and the Markets area. One of the most striking features of the bazaar streets today is the large number of vacant shops, the result of economic decline during the past two decades. Surveys estimate that over 30% of the retail space is vacant, or perhaps much higher because former retail space is now being used for general storage purposes.

An important element in the economic revitalization of the Stone Town is the rehabilitation of this vacant retail space. Training programs will be organized to revive the tradition of handcrafted articles for personal and household use, as well as architectural components to be used in building renovation. Buying and marketing cooperatives will also be established to assist the new enterprises and vacant retail space will be made available at modest rents. These new enterprises should be located along the principal bazaar axis through the center of the Town. By concentrating redevelopment in a specific area, the initial impetus will not be dissipated but will gather momentum and trigger further redevelopment in adjacent areas.

Expansion and upgrading of port facilities is also an area with considerable economic potential. The port of Zanzibar is one of only three major natural harbors on the east coast of Africa. Trade has been the key to the island's past prosperity and may offer potential for the future. Since 1985, plans have been developed for major harbor improvements and the concept of creating a free trade zone is being seriously explored as a way of encouraging the location of new manufacturing facilities on the island. Support for the initial phase of this program has been obtained from international assistance agencies.

Conclusions

Redevelopment of the Stone Town represents a major challenge for

the Government of Zanzibar and encompasses a broad spectrum of responsibilities. The redevelopment strategy involved policy decisions by several government ministries which covered land ownership, private sector development, repair of historically valuable and architecturally distinguished buildings, rehabilitation of hundreds of residential units, upgrading of infrastructure services, resolution of land-use conflicts, and generation of new employment opportunities in areas such as manufacturing, trade, fishing, and tourism. Revitalization of the Stone Town will require very considerable coordination among the various government ministries and agencies and significant investment by the private sector. The establishment of a development authority charged with the task of implementing the redevelopment strategy and the rationalization of legal and administrative procedures represents substantial progress toward achieving the objectives.

The effectiveness of public and private investment in housing rehabilitation as a lead sector in an integrated strategy of economic revitalization has not yet been tested. The program of selling government-owned residential units to the tenants and providing assistance to encourage self-help home improvement has only begun on a pilot basis. The lack of financial resources to establish a loan program is a critical obstacle to testing the effectiveness of the approach.

(Prepared from published literature as cited and the authors' field experience.)

UNITED STATES: REDEFINING THE ROLE OF GOVERNMENT IN HOUSING

The United States Federal Government has moved from direct intervention in building housing and providing subsidies to a less direct role of providing funds to local communities which in turn develop their own programs primarily involving public/private sector partnerships and joint ventures. The US experience illustrates that housing for lower income households in need of assistance can be provided more effectively and at less cost by eliciting the involvement of the private sector and directing resources to the local government level than was possible through more direct central government involvement. This approach has required rethinking of the roles of federal and local government agencies as well as private enterprise. The successful partnership programs have incorporated the concepts of power sharing between participants, leveraging public funds and targeting programs to specific disadvantaged households or to specific declining or unstable neighborhoods. In addition, joint public/private efforts have been made to change regulations in order to effect cost savings. The following discussion traces the evolution of the US experience in redefining the role of government in housing and describes several examples of successful public/private partnerships. These examples show the myriad of possibilities for structuring public/private partnerships and the value of tailoring programs to meet the particular needs of a community.

The US approach to the development of housing and community facilities has changed dramatically over the last thirty years. The federal government's role has gone from one of extensive involvement in large scale urban renewal projects in the 1950s to one of massive subsidies through numerous categorical grant programs in the 1960s and 1970s to today where the federal role is less dominant and where the emphasis is on the creation of new opportunities for private initiatives and for public/private partnerships and joint ventures. The federal government was once the dominant force both in providing the majority of funds and technical assistance for subsidized housing and at the same time regulating all aspects of federal aid through extensive controls and documentation requirements. Today, because of changes in government policy and a recognition of the limits of public resources, the federal government has become an advocate for the multi-player concept of public/private partnerships and now focuses its efforts on stimulating an array of new cooperative initiatives to address the problems of housing primarily in areas of economic distress.

A public/private partnership is a collaborative effort between government agencies (primarily at the local level) and private enterprises in which each of the partners shares in the planning of projects that meet a public need, and in which each contributes a portion of the financial, managerial, and technical resources needed to implement the project. Although the concept has been applied to other sectors, the general field of housing and community development has had the most experience in formation of

public/private partnerships. Large scale community development partnerships have operated for some time in a number of US cities, in part as a response to opportunities presented by the federal funded urban renewal program but primarily because of a unique civic spirit and business climate which existed in those cities. The Committee for Economic Development (CED, 1982; Foster and Berger, 1983) documented partnership projects and organizations in the early 1960s in Baltimore, Minneapolis, Pittsburgh, and a few other locales. Little, if any, national influence or leadership was involved in forming these early partnerships that focused on downtown revitalization. These locales were unique and progressive in developing what has been termed the first generation of partnerships.

Turnkey Construction

The Housing Act of 1965 gave the federal government, through the Department of Housing and Urban Development (HUD), new options in the development of low rent public housing. This law authorized construction of 240,000 additional units of low rent public housing to be built over a four year period or nearly twice the rate of housing being developed annually under previous public housing programs. The innovative concept contained in this law was the use of private sector contractors to build public housing units. HUD encouraged local housing authorities to have private contractors build housing projects on a turnkey basis, e.g. at a predetermined, fixed price. The law allowed local housing authorities to enter into direct negotiations with private firms for the building, acquisition, or leasing of housing for low income families. HUD's objective in trying the turnkey approach was: (1) to have private enterprise become more deeply involved in the public housing program; (2) to accelerate production of public housing; and (3) to cut costs. In addition, it was believed that a great potential existed for acquiring desirable sites not otherwise available for public housing from private contractors who already had control of sites and who could arrange their own financing. Local authorities were also encouraged to work with interested contractors in helping the contractors learn to develop plans that would meet public housing design and cost criteria.

Procedures were designed for turnkey projects which permitted private developers to deal with local housing authorities (LHA) in the same manner that they would be accustomed to dealing with private clients. Developers hired their own architects, created their own development plans, arranged for construction financing, and negotiated a price under which they could complete the project and make reasonable profits. The public partner, the LHA, helped acquaint the builder with public housing specifications, arranged for HUD approval of the project, and entered into a "letter of intent" by which it agreed to purchase the completed project at a specified price. Because the letters of intent were backed by the bond authority of the LHA and commitments against the US Treasury, they helped the developers obtain the necessary construction financing from commercial sources. In a tight money situation, such as existed through much of the late 1960s, the letter of

intent provision helped make turnkey public housing projects attractive to private developers.

Over the next fifteen years, the turnkey program proved to be a success in stimulating the production of additional new public housing. However, after its initial demonstrations, HUD added new regulations and requirements that undermined the chief advantage turnkey projects had over conventional development, namely speed of processing approvals. The result was that turnkey public housing did not produce cost savings over conventional public housing as had been projected by HUD. A comparison of development, financing, and life cycle costs of housing programs (Urban Systems Research and Engineering, Inc., 1982) showed that turnkey projects averaged \$1,000 more per unit than conventional new public housing construction. Subsequently in the 1980s, the federal government itself began to challenge the costs which government "red tape" and regulations added to housing production.

Federal Support for Local Initiatives

Throughout the 1960s, the federal government had expanded its influence in virtually every aspect of urban and social policy. Numerous categorical direct aid programs were created and with them the federal government expanded its control and regulation of local government programs. The influence of the federal government began to change in the 1970s. During the Ford Administration, passage of the Community Development Block Grant (CDBG) legislation became the foundation for two major changes in government policy: (1) it freed federal funds from the constraints of categorical programs, and (2) it stimulated the concept of public/private partnerships for the development of housing.

During the Carter Administration, local government autonomy was increased through new urban policy initiatives, such as Urban Development Action Grants (UDAG), Neighborhood Self-Help Development Grants, and Innovative Grants. Each of these new programs operated within a partnership framework. The most prominent initiative was the UDAG program which provided entrepreneurial investment for community development projects.

During the period of transition from direct federal intervention to one of federal support for local initiatives, the US also began to see an expansion of private sector leadership in the area of public policy. Organizations such as the the Committee for Economic Development, the Conference Board, the Center for Corporate Public Involvement, and the Public Affairs Council began to provide information and encouragement to their corporate members to participate in public/private partnerships. In addition, several private organizations like the Local Initiatives Support Corporation, the City Venture Corporation, and the Enterprise Foundation were established to provide frameworks for local partnership formation. National organizations such as the National Association of Counties, the National League of Cities, the National Association of Housing and Renewal Officials, and others began major information dissemination programs and held

conferences and seminars on various aspects of public/private partnerships.

During the early 1980s, the Reagan Administration expanded the theme of support for public/private partnerships. Most prominently, the appointment of a Presidential Task Force on Private Sector Initiatives symbolized a commitment by the federal government to full mobilization of the role which the private sector could play in meeting public needs. In addition to numerous efforts by the federal government to stimulate and recognize the potential of such private sector involvement, a major effort has been made to use existing government programs and new government initiatives to leverage private sector involvement in government sponsored programs.

Community Development Used to Stimulate Housing

Within the last several years, cities have been actively encouraged by HUD to utilize their CDBG funds to form and fund public/private partnerships for the creation of housing. Partnership formation has extended to a wide array of housing and commercial rehabilitation and urban revitalization activities as well as for construction of new public housing and housing for low and moderate income families, the elderly and the handicapped.

While some localities receive CDBG funds on a direct entitlement basis from the federal government, others must apply for such assistance. As with the UDAG program, pools of funds are set aside by the federal government and these are applied for on a competitive basis by local governments that are able to demonstrate need and meet certain conditions of inadequate or substandard housing.

Local governments, once freed of the restraints of categorical federal assistance programs, have been creative and entrepreneurial in their use of grant funds for investment in housing and community development programs. In recognition of shrinking annual federal subsidies, cities have been quick to recognize the value of using their funds for loans rather than grants, and today many cities have structured their public/private partnerships to recoup loaned money and to earn interest on loans to private developers.

New Roles for Local Governments

Public/private partnerships have required new orientations on the part of public officials. Local officials have had to assume a leadership role and have had to require new skills from their technical and professional staff. Public officials, themselves, have had to become highly entrepreneurial, seeking out new housing opportunities. Older US cities have increased their marketing programs and special incentives to attract significant private investment in their downtown areas. In combination with traditional incentives, such as infrastructure improvements and zoning concessions, the most important device for stimulating

public/private partnerships in housing has been the massing of dedicated local capital through which low interest, long-term loans or "seed money" grants can be made. City officials have learned that they can have important roles in the distribution of benefits from these partnerships and that it is important to share power with the private sector through direct contractual agreements or by creating community based organizations which serve as the public partner. Local governments have begun to treat public/private partnerships not like other federally initiated programs but like business opportunities where there are risks and rewards for all partners.

The following examples of public/private partnerships in housing demonstrate three concepts that are prevalent in all successful housing program partnerships: (1) power sharing; (2) leveraging; and (3) targeting (US-HUD, Working Partners, 1982 and 1984).

Power Sharing:

Public/private partnerships may be created to redevelop a neighborhood or an older public housing project because of the realization that sufficient resources may not be available for either individual partner to purchase and rehabilitate the entire project or area. If no one group is capable of developing the project alone, then the creation of a public/private partnership will readily recognize the need to share power and responsibilities. In the cases reviewed, two types of power sharing arrangements are found. In one type, a non-profit organization is formed which includes all participating partners, typically residents, city officials, lending institutions, and other private firms. The non-profit organization becomes the instrument for achieving agreements, concessions, and commitments among the various partners. In other cases which are typically short-term loan projects between public agencies and private lending institutions, the specific housing project agreement itself addresses the sharing of responsibilities.

An example of the non-profit partnership vehicle is the Clearwater (Florida) Neighborhood Housing Services, Inc. (NHS) which focused on the South Greenwood neighborhood. In this relatively stable but deteriorating neighborhood, local lenders were worried about protecting their mortgage portfolios, city officials were concerned about health and safety as well as erosion of the tax base, and residents were concerned about the decline of their property value. The obvious solution was to rehabilitate the neighborhood, but no entity had enough money to make such a commitment. The neighborhood services corporation approach was initiated by the president of a local savings and loan who, working with city officials, recognized the need for reinvestment in the area while it was stable.

The non-profit organization NHS was created in 1978 governed by a board composed of residents, local financial institution representatives, and a city official. The city allocated \$250,000 in CDBG funds to establish a revolving loan fund for low income

homeowners unable to qualify for conventional home improvement loans, committed itself to \$2 million in capital improvements, and set out to improve municipal services.

Local financial institutions agreed to provide below-market rate mortgage financing to residents for the purchase and renewal of neighborhood houses. They also agreed to underwrite NHS operating expenses and provide it with management technical assistance, and offered finance counselling to borrowers.

This program is viewed as one of the most successful neighborhood housing programs in the country. It has demonstrated a higher leveraging ratio of private to public dollars than other more limited partnership programs with financial institutions. In its first three years it stimulated investment of nearly \$16 million in neighborhood housing. The financial institutions had made commitments totalling \$10.4 million, including \$9.4 million in mortgage loans, \$820,000 in home improvement loans, and \$180,000 in support for operations. The residents themselves have invested over \$3 million. The city responded to the strong private commitment and provided \$2 million in CDBG funds to make neighborhood improvements in the area.

The South Bend (Indiana) Home Improvement Loan Program set out to enlist private financial institutions in its efforts to preserve and improve the city's housing stock. In particular, the city wanted to help low and moderate income homeowners who did not meet conventional lending standards because of insufficient income or because they had had credit problems in the past.

In this program, a lending consortium was formed which included the city and five area banks. The city provided \$100,000 of CDBG funds to be used as a non-interest generating loan guaranty reserve fund for below market loans to homeowners. The program quickly built a sound track record with only one default in 100 loans. As the bankers' confidence in the program grew, they increased their loan commitment at each biennial renegotiation with the original private pool jumping from \$200,000 to \$600,000 in the first few years. The program has led to new public/private partnerships with the financial community. These include an interest subsidy program in which a savings and loan makes home repair loans with a city subsidy from CDBG funds reducing the interest rate to the borrower and the Neighborhood Housing Services Program which provides rehabilitation loans through a public/private loan pool.

In virtually all public/private loan pools, the private sector has taken the responsibility for the loan terms, while the public sector either guaranteed the loans or subsidized the interest rate. On eligibility, the private sector generally held final loan approval jurisdiction while the public sector established target groups, advertised the program, and screened the applicants. On matters of administrative management, the public sector generally inspected the property to see if rehabilitation jobs were completed while the private sector limited itself to the

management of the loan itself. In all cases, the public sector wanted access to increased private investment in housing, the private sector wanted new markets, and homeowners wanted loans. It is the effective meeting of these interests that has led to successful public/private partnerships.

Private lending institutions in the US and elsewhere are generally skeptical of public agencies as partners primarily because they doubt their ability to perform in a timely fashion and to make sound business decisions. They are also skeptical of the intentions of public agencies and of their administrative capacities. These examples of successful power sharing within public/private partnerships are important models because they illustrate that the public sector can work effectively with the private sector.

Leveraging:

Leveraging is a concept that has been associated with the UDAG program from its inception, a concept adopted over the years by the majority of cities in the US who converted their CDBG funds from grant programs to revolving loan pools. The primary technique for leveraging funds for housing has been the commitment of CDBG funds to attract pools of loan capital from private lending institutions that become part of a public/private partnership. There are four different ways in which this financial leveraging is accomplished: (1) buydowns; (2) blending; (3) guaranties; and (4) grants.

* In the buydown technique, public funds are used to subsidize the interest rate on loans made to investors and property owners in rehabilitation areas. The city pledges CDBG money to cover an agreed upon rate reduction on a capital pool pledged by a bank or other lending institution. In a blending situation, CDBG or other public funds are used to make a partial loan to the consumer or investor at a reduced interest rate. The blending or averaging of the public and commercial loans makes the final market rate loan affordable and creditworthy. Loan guaranties require the public agency to pledge a certain amount of money against any possible default. Depending on the perceived risk, the lending institution pledges a pool of seed capital commensurate with the size of the public guaranty fund. Grants to investors and purchasers reduces the amount of money that needs to be financed by private lending institutions and improves the creditworthiness and affordability of the private loan. Public/private partnerships for rehabilitation usually combine financial leveraging with infrastructure improvements as part of an overall redevelopment plan.

Atlanta (Georgia) has initiated a very effective program of mortgage loans to low income minority families. Their program, the Tri-Party Partnership, illustrates the utilization of the buydown technique. The CDBG funds supplied by the City are used to buydown or reduce interest rates to levels affordable by low and moderate income homebuyers while providing market rates of

return to the other two participating partners, local lenders and the Federal National Mortgage Association (FNMA). The City receives little or no interest on its part of the participation, but receives invested principal as the loans are amortized or paid in full. The low or zero interest rate on the city's portion of the participation permits the borrower to receive a substantially lower than market interest rate. Today, the program is in operation in several cities around the country and has been actively marketed by FNMA. In most Tri-Party Partnerships, approximately 60% of the funds are provided by FNMA, 30% by the city, and 10% by private lending institutions.

An example of blending is found in the Participation Loan Program (PLP) of New York City. In this program organized by the city government, CDBG money is lent at 1% as a complement to commercial loans lent at market interest rates. The resulting interest rate is the average between the two separate loans. The goal of this program is to make rehabilitation financing available for large, multi-family, residential properties in transitional areas of the city that show signs of deterioration and disinvestment.

The PLP emphasizes moderate rehabilitation without displacing the tenants. A typical project involves repair or replacement of electrical, plumbing, and heating systems and installation of a new roof and new windows. On completion, the city removes the building from rent control and restructures rents so that they are still affordable to the tenants who are usually low and moderate income families, but high enough to ensure debt service and continued maintenance.

By 1982, the PLP program had made 105 loans resulting in the rehabilitation of 13,000 apartment units. The public cost, all of which was directly recoverable, was \$70 million; this in turn has generated \$86 million in loans from financial institutions and another \$26 million in borrowers' equity. In addition, the program strengthened neighborhood tax bases and provided hundreds of thousands of hours of work for men and women in the construction trades.

The South Bend (Indiana) example described earlier is also a good example of a guaranty program. This program was established as a conservative low risk program in which \$100,000 of CDBG money was deposited in a non-interest bearing account with a consortium of five private lending institutions to guaranty home improvement loans made by the consortium. As the program proved successful and working relationships of the partnership improved, the same \$100,000 was used to leverage additional capital from the private sector.

In Revere, Massachusetts, interest rates were effectively reduced through a combination of a CDBG program grant and a 2% interest reduction on loans from a commercial bank. The purpose of this combined program was to make affordable loans for low and moderate income homeowners and businesses in targeted areas of the city. The grant program provided 25% payment on the principal of the

loan which effectively bought down the interest payment to 3% for home rehabilitation and 5% for businesses. Out of a loan pool of \$800,000, approximately 100 loans were made. The city found that combining home rehabilitation with commercial improvements made the program more acceptable to the private lending institutions. Overall, the program ended in higher leveraging ratios because of the lesser risk associated with business loans.

Targeting:

Targeting in community development partnerships refers principally to the degree to which program benefits are directed to disadvantaged groups, such as low income people, minorities, or the handicapped; or to declining or unstable neighborhoods. In the housing field, targeting usually involves the provision of homeownership opportunities, the prevention of displacement, and the rehabilitation of multi-family housing stock that houses the poor.

The Mount Winans area in Baltimore is an example of targeting a specific neighborhood for improvement. Mount Winans was a neighborhood of predominantly low income, black families which had never had sanitary sewers or storm drains, some of its streets were unpaved, and not even a local market existed. Despite this, most residents were homeowners with a fierce pride in their neighborhood. The Mount Winans Civic Interest Group did what it could and patiently asked the city for help.

In 1969, with the proceeds from a bond issue, Baltimore renovated 130 long vacant rowhouses as rental units, demolished 67 frame houses that were beyond repair, and made extensive public improvements, including street construction and a playground. It was hoped that this public investment would attract a private developer, but none materialized until 1980.

That year, private entrepreneurs put together a housing development corporation which laid out its plans to the city. Baltimore enthusiastically joined in the venture. Under the arrangement, the city conveyed title to 131 lots at \$1 each to the developer, who then used \$4.5 million from conventional loan sources to build 131 Baltimore-style, three bedroom townhouses, each with 1,152 square feet of living space.

The developer marketed the homes to the community \$41,215 (later \$45,000). Under the "Baltimore Plan," buyers have been able to purchase homes for as little as \$500 down, with the purchase price effectively reduced through a unique city-held second mortgage to as little as \$32,000. Under the "Baltimore Plan" buyers repay the second mortgage only when they sell a house. The amount to be repaid is lowered the longer the house is owned.

Once completed, the new homes sold quickly, and Baltimore has realized \$110,000 annually in new property taxes. The undertaking was accomplished at a cost of \$1.1 million in CDBG monies for improvement and points on interest, \$1.8 million in other public

funds, and a private investment of \$4.5 million. Similar projects are now in progress elsewhere in the city using the same procedures.

Housing rehabilitation has been the largest single CDBG supported activity for the last several years. In FY 1983, for example, approximately \$921 million or 36% of all CDBG funding went for housing rehabilitation. Today, the public partner (the city) has become sophisticated in financing deals and in many cases has become entrepreneurial in forming joint venture deals. Participation in the partnership financing through deferred interest loans provides attractive incentives for the private sector partner and allows the city to recover its investment and later to assist another valid project.

Cities have become very knowledgeable about development financing and recognize the extent of their limited resources and therefore pursue a variety of financing options. Today, many US cities are taking an equity position in the deal rather than simply acting as a lender. In projects where a positive cash flow and long-term appreciation are projected, the public agency is very likely to negotiate a deal with the partnership to allow the city to participate in future benefits.

Current Federal Initiatives in Public/Private Partnerships

The current Federal (Reagan) Administration continues to stress the potential of public/private partnerships for rebuilding America's local economy (Urban Policy Report, HUD, 1984). Federal agencies including HUD have placed a high priority on partnerships and increased private participation.

According to Administration statistics (HUD, 1984), over 3 million families were receiving housing assistance through HUD-supported low income housing programs in 1981 and that increased to almost 4 million in 1985.

Rental Rehabilitation:

Rental Rehabilitation is a new program initiated by the administration to bring together public and private resources in cities with established need for additional low income housing stock. Cities use rental rehabilitation grants to leverage private investment for rehabilitation. These grants may provide up to 50% of the project costs but no more than \$5,000 per unit, except where adjusted for high cost areas. The Rental Rehabilitation program provided \$150 million to localities in both FY 1984 and 1985 to refurbish 30,000 housing units in each year.

The design of the Rental Rehabilitation program is as follows:

- o The Federal Government provides grants to state and local governments on a formula basis.
- o State and local governments design their own program to meet locally determined goals. They can make either loans or grants

to developers.

- o State and local governments may choose to supplement their federal rehabilitation funds with other money - for example, CDBG funds. In any case, leveraging is assured since the rental rehabilitation subsidies will not exceed half the cost of renovating the units.
- o Rehabilitation assistance is targeted to low income neighborhoods where at least 80% of the rehabilitated units will be affordable and available for very low income families.
- o HUD provides 10,000 vouchers from the voucher demonstration program and as many as 20,000 Section 8 certificates as an additional resource to help communities meet their rehabilitation needs. These vouchers and certificates, which are both federal rent subsidy vehicles, can either support tenants in the renovated units or be used to aid tenants displaced by rehabilitation.

Deregulation to Create Affordable Housing:

The Joint Venture for Affordable Housing Program is an effort of the administration to effect deregulation in the area of housing production. This HUD-initiated program combines federal technical assistance and state and local cooperation with private developers to attack overregulation of the building industry. HUD's program unites public and private sector groups who share a commitment to creating more affordable housing through coordinated projects and activities. These include: (1) identifying innovations in site planning, site development, building, and processing which can reduce the cost of housing; (2) demonstrating these innovative techniques throughout the country in developments carried out by local builders, officials, and community organization; (3) identifying federal, state, and local regulations such as building codes, zoning regulations, and processing procedures, which discourage or prevent use of innovations; (4) providing information to builders and government officials on workable improvements and the resultant cost savings; and (5) supporting local coalitions of private citizens, businesses, civic organizations, housing and real estate professionals, and government officials to bring about changes at the community level (Affordable Housing, HUD, 1984).

In its first 18 months, the program had significant accomplishments in three main areas:

- o By the end of 1983, more than 30 states had demonstration project sites. Early sales figures show that the demonstration units are selling at prices \$5,000-\$10,000 below those of comparable units in the local market. Administration statistics indicate that nationally, housing can be built at as much as 20% below current costs.
- o The message that regulatory reform can indeed cut costs has been spread through numerous conferences and publications.
- o The program has proven successes "in infill" projects built on vacant land in developed areas as well as new subdivisions.
- o Building on the interest in regulatory reform developed through

the Joint Venture program, the National Association of Home Builders has created its own Regulatory Reform Task Force to bring the influence of its 800,000 local members to bear on the problems of regulatory reform in their own communities.

Unlike other HUD programs, no special federal funding is used. The builders may, but are not required to, use FHA or VA financing; if they do, HUD field offices can waive Minimum Property Standards (MPS) or procedures to achieve the objectives of the program.

(Prepared from published literature as cited, including HUD publications cited in the Bibliography, and the authors' own experience.)

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