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**Learning More About Informal Housing:
An Agenda for Policy-Oriented
Research, Documentation, and Demonstrations**

by

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Prepared for
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This agenda describes information needed to fill gaps in the knowledge now available on the informal housing sector in developing countries and how formal sector institutions have worked with them successfully in the past and might work with them in the future. As stated in a number of recent forums, facilitating the workings of the informal sector to provide housing may be the only hope for meeting the housing needs of developing countries. This paper takes as its central premise that the information developed should contribute to answering the question of how PRE/H can structure its activities so as to guide informal activity to produce a high volume of housing which meets minimum acceptable standards.

The paper in turn discusses information needed in housing finance, land, housing construction, and infrastructure. The focus is on what we need to know, not how to design a research strategy for obtaining this information. This second step is more appropriate after the research priorities have been identified.

Housing finance

From studies in several countries we know that lower income households rely very heavily on informal sources of finance for their housing.¹ We also know that they very seldom turn to moneylenders for long term finance; rather it is friends, relatives and sometimes employer loans that supply most of the

funds. This resulting system is one in which credit is available only on a spotty basis and at uncertain cost.² On the other hand, we know very little about the investment in rental housing. In Kenya, where we do know something, a significant share of such investment is financed with commercial bank loans taken on an overdraft basis or from loan proceeds that are supposed to be for other purposes (Struyk and Nankman, 1987); there is no formal lending explicitly for rental housing in the country.

There are two ways in practice for lower income homeowners to be included among those who receive mortgage financing at market rates, if we leave aside the financing that is an integral part of government housing schemes. (a) Formal institutions work with informal ones to identify creditworthy borrowers and to originate and service loans. One of the critical problems among informal institutions is the shortage of funds to be lent for long terms (at reasonable rates). On their side, formal institutions have trouble rating credit risks of non salaried workers and originating small value loans at reasonable cost. This type of arrangement helps solve the problems of both sectors. (b) Formal institutions make loans

1. Korea and the Philippines (Struyk and Turner, 1986); India (Lall, 1985); Jordan (Struyk, Katsura, Mark, 1987).

2. Most funds appear to be lent at low rates by family and friends. However, the full price would include the loss in interest income to the current borrower from having to be a future lender at below market interest rates. On a discounted present value basis the ultimate cost to the borrower is still probably reasonable, but higher than it first appears.

directly to lower income households, a solution which some formal institutions would be more comfortable with and one that is perhaps necessary where the informal institutions are weak.³

We know very little about successful arrangements for either (a) or (b), and the central thrust of the immediate research program should be to document them. To be sure, we should take advantage of any household surveys to continue to add to our knowledge base on how low income households are currently financing their housing, as there may be important differences among countries and within countries between the financially well-served capital and other cities.

With respect to working with informal institutions, (a), a useful division can be made between truly informal institutions and quasi-formal institutions. Among the latter are non or very weakly regulated company-based credit unions, cooperatives, small savings institutions (such as the Thrift and Credit Cooperative Societies in Sri Lanka). The informal institutions can include a neighborhood association or savings clubs which also lend funds. Priority should be given to documenting in detail cases of good working relationships being developed between formal housing finance institutions (HFIs) and these informal entities. It is said that in Colombia HFIs are using neighborhood associations as their agents, when the group places blocked balance deposits with the HFI. The TCCSs in Sri Lanka

3. See the paper by M. Miracle for this conference for a description of some informal financial arrangements.

are acting as loan agents for NHDA in the Million Houses Program in rural areas and may take on a similar role for a HFI (Mumtaz, 1987). Presumably there are cases of cooperatives and credit unions developing such relationships with HFIs.

If good examples cannot be found of some arrangements, a careful analysis of the impediments to them should be developed; and PRE/H might consider experimenting with such agents as part of particular HG loans.

Regarding formal institutions themselves reaching further down into the income distribution, (b), the thrust should again be the full documentation of successful cases. Some examples come readily to mind: HDFC (India) has been making about 17 percent of its individual mortgages to households with incomes below the median; the Grameen Bank in Bangladesh, while not yet making mortgage loans, has apparently been extraordinarily successful in making loans to very low income households (Madeley, 1987); and, building societies in Zimbabwe are reaching lower income households by relaxing their underwriting standards.

There are several distinct types of successful modifications to standard practices that should be sought, some of which are illustrated by the cases listed above. These include: (1) simplified and less restrictive mortgage instruments--those which may make definitive land title less essential and which may help deal with affordability problems; (2) relaxed underwriting standards which accept alternative

indicators of ability-to-repay the loan especially for the self employed, such as the use of loan guarantors, use of past rent payment receipts as an indicator of ability to pay, successful participation in a loan-linked contract savings scheme, or inclusion of anticipated rental receipts from renting out part of the property to be purchased in the borrower's income base; (3) relaxed underwriting standards in terms of the quality of land title possessed by the household (Sri Lanka's Million Houses Program is using less stringent requirements at least in rural areas); (4) use of government default insurance to induce HFIs to take greater but still prudent risks; and, (5) examples of successful outreach and establishing rapport with low income borrowers, ranging from branch office locations to treatment of potential borrowers by branch staff. As suggested above, we have a few scattered examples of such practices, but nothing systematic nor in a form which would serve as serious guidance for either RHUDO staff or other HFIs.

Lastly, we come to rental housing whose financing is particularly opaque. Of greatest interest is the source of financing for those owning and developing rental units for lower income households, who may well turn out to be middle class households with a modest number of properties. A major source may be additions to or subletting of owners' own units. Freestanding rental, though, are often more important as one move up the income scale. Such investments can be extremely lucrative, as demonstrated by data for Kenya. With the

likelihood that rentals will become more important for lower income families as the densities of urban areas continue to rise (Doebele, 1987), paying more attention to the production of this housing is essential. Hence, research on rental housing finance is a high priority.

Urban land

William Doebele's paper prepared for this conference forcefully both states the current level of knowledge about the operation of informal urban land markets and lays out a cogent research agenda. This section restates his agenda and amplifies it in some places.

In general, Doebele points out the key role which small scale brokers are playing in overcoming the inefficiencies in the land market produced by the combination poorly drafted laws, badly run government agencies, and neglected land registration systems. He also documents the little which is known about how these brokers operate and the extent of their role in the land market. I agree with his argument that the key research necessity is to learn more about the workings of these micro-brokers if the operation of urban land markets is to be understood.

Doebele lists five points that should be covered in such studies.

1. Clearly identify the factors that give the current practices of micro-brokers its efficiency.

2. Clearly identify the abuses of current practices. (The first two items are necessary to later devising regulations most likely to eliminate the abuses without damaging the efficiency.)

3. Clearly identify the points of intersection between the private sector and the public bureaucracies that are now occurring.

4. Carefully consider what the private sector is saying about the adequacy and efficiency of existing institutions.

5. Carefully consider what the private market is saying about the geographical directions in which urbanization is moving, so that there can be appropriate public response.

There are some additional questions that might be added to this list which should be answered in such studies.

6. What is the legal standing of the land conveyed by the broker to the purchaser? Is it a clear title, a certificate of occupancy, or other type of arrangement? (Variation among countries is expected.)

7. How are these various instruments treated by financial institutions? How are subdivisions treated by government in terms of service provision?

8. Who are their clients, individual homeowners? petite entrepreneurs who will develop rental housing? larger developers? How often does the micro-broker also develop rental units or land rentals for lower income households?

When several such studies are in hand, a careful cross-country comparison along these various lines would be exceptionally valuable. Key objectives in this analysis would be identification of regular patterns of inefficiency in government land agencies and lessons for how the public agencies could work with the micro-brokers to speed and streamline the land development process and relate land development more closely with the provision and financing of basic infrastructure.

As part of the overall effort to document and analyze the activities and implications of micro-brokers, a high priority should be given to the development of a statement on the methodology to be employed in such studies. Based on the experiences in Kathmandu and Metropolitan Bangkok, it appears that such a document could be produced to guide further analyses. Having such guidelines would both increase the likely productivity of each additional study (like that about to be launched in Indonesia) and help insure some degree of comparability in the information generated.

A final topic of research in the land area should be on the degree of concentration in urban land ownership and development in different countries. There is a common perception in sub Saharan African countries, for example, that Asians--perhaps a few families--own a vastly disproportionate share of the urban land. If such concentration were the case, exercise of oligopolistic power would be possible. No doubt documentation of land holdings would be difficult, given the poor state of cadastral registers in many countries and the ease with which true identity can be masked. If such studies were to go forward, and substantial concentration was documented, an important question would concern the relationship between the activities of the micro-brokers in land development and the process of acquisition by the few principal land owners.

Small-scale residential construction

The paper prepared by Paul Strassman for this conference informs us of the vitality of the small builder in constructing housing in the informal sector. Lower income households do not have difficulty finding small contractors with adequate skills to assist or carry out incremental dwelling construction. The serious problems faced by these contractors in producing housing meeting legal requirements are the unrealistic standards at which they would have to build and the expensive and time consuming process of obtaining building permits (which are often not available for areas of low income housing) and meeting other requirements.

Both Strassman and Tim Campbell identify unrealistic building and subdivision standards as a key impediment to development of legal housing and therefore a disincentive to households investing more heavily in their units. A high priority should be accorded to documenting cases in which lower standards have been made generally applicable (i.e., outside formal site and service cum minimum unit schemes). We should be interested both in the process by which adoption of such sensible standards was achieved and in the impact which these have had on the pace of development, the quality of housing produced, and the profile of the occupants.⁴

4. The technical assistance provided by AID to the Town Planning Department in Jamaica may have this salutary outcomes (Kingsley, 1987).

Lower subdivision standards seem particularly important for producing a high volume of legal housing with at least minimum infrastructure services. A World Bank project under the Urban III program in Kenya, for example, successfully demonstrated the use of very low subdivision standards in Nakuru in an area in which local government provided basic infrastructure for privately owned land and recovered its cost upon sale of the sites; small investors and individual households built units on the sites. But this case is not well documented.

Surely there are other examples which could be compiled which together could have the kind of impact which the monitoring of several early sites and services projects by the World Bank had on the course of housing development in LDCs. Such documentation should include land assembly (and the role of micro-brokers), development financing, the role of the developer in bringing owners together (or buying them out), the marketing of sites, and type of encouragement offered by government, if any, beyond simply setting the lower subdivision standards.

Strassman also identifies limited credit as one of the prime impediments to efficient production by small building contractors and developers and by small materials producers. This limitation has been noted in large number of analyses. For contractors and developers it would seem worthwhile to search for examples of credit being efficiently provided to this group. Several countries have set up programs to do this, but they have not been successful. A government agency in the Philippines,

for example, offered loan insurance for housing development loans perceived to be risky; but the commercial banks used the insurance only for major developments. Similarly, in the Philippines the development bank was to assist small businesses, including residential building contractors; but the red tape was too elaborate for little firms. It may well be that informal and quasi-formal institutions working as agents for formal HFIs, as described earlier, are or could fill this role in some countries.

There have, of course, been many projects sponsored by AID and other donors to provide credit to small firms. These projects could be reviewed to identify those that were taken up by lenders after the demonstration period was over and to assess their applicability to small builders. Again, documentation of successful cases would be an important step in developing programmatic initiatives.

Infrastructure

As Tim Campbell's paper for this conference points out, the informal sector by default is very important in providing water and sanitation services to low income urban households. In water supply, even leaving aside the major role of vendors, the informal sector through illegally tapping into water mains provides extensive services in some cities. In terms of sanitation, pit latrines--often a health hazard because of high housing densities--are typically built by the households

themse ,ves.

Despite the general acceptance of the propositions just stated, there is only very limited information on the existing pattern of services, particularly the extent of "unauthorized" services. Consequently a high priority should be to determine the source of water, and water and solid waste removal services more accurately. Most household surveys inquire about the presence of such infrastructure services, but they fail to ask about the source (do you pay for these services? who do you pay. i.e. is it a government agency? how much, how often?). At the moment we do not really have a good idea of the importance of unauthorized services generally or the degree to which such provision is concentrated in one or two regions. Hence, it is difficult to know how much priority to accord to trying to integrate the unauthorized systems into the broader governmental systems.

Because provision of urban infrastructure services like water supply and removal of waste water, human waste, and solid waste require resources and a degree of organization quite beyond the individual household, their provision is the domain of larger entities. In this aspect the development of such services differs sharply from the development of the actual dwelling unit, which is well within a household's resources. Typically, government has taken it upon itself to provide these services, and in the developing world has failed at the task undertaken.

A key research issue concerns the possibility for useful cooperation between the legal providers of these services-- usually a government agency--and unauthorized providers in a type of public-private partnership. A major benefit of such cooperative arrangements would be an improved financial base for the official water agency, assuming realistic prices are charged.

When public-private partnerships for infrastructure services are discussed, the emphasis is on a private entity taking over full responsibility (both investment and operations) or at least responsibility for all aspects of operations; and the French-based systems in west Africa are the prime examples (Roth, 1987, Chp. 7). But a less comprehensive model may have greater applicability. Under this model, the principal provider contracts for limited services with other entities--including the unauthorized providers already in operation. Such contracts could cover, for example, water distribution in a defined area and/or collection of water charges.

Campbell reports that such licensing arrangements have been tried for delivering water in Bolivia, Sudan, and Liberia. And there are documented cases of public water agencies licensing the sale of water from standpipes at defined rates. Clearly, these examples should be carefully studied for more widespread applicability. Such analyses should include a description of how the unauthorized providers were started, i.e., their capitalization and organization, the extent of maintenance

provided on the systems operated, and rate setting and collection practices. For example, were the services begun by the "developer" of a private subdivision after initial consolidation using "downpayments" received from the area's residents?

It appears that similar opportunities for limited public-private cooperation may exist in many cities for the collection of solid waste. This is not an area in which PRE/H has had an interest in the past, but promotion of such partnerships could be included under a broader conception of its urban management activities.

Summary

The table given below summarizes the "research" areas identified above and then classifies what might be done in the next couple of years to generate the information necessary to overcome our current ignorance. Three distinct approaches to information development are indicated: actual research in the sense of gathering new data to understand processes about which we are not currently very clear; gathering, analyzing, organizing, and documenting examples of on-going activities, such as a housing finance institution making a significant volume of loans to lower income families, which could be used to draw concrete lessons for other institutions and countries; and, areas in which we believe we already know enough to attempt demonstrations that might be undertaken in the process of

implementing HG loan programs to learn more by actually doing. It is difficult to over emphasize the requirement that the demonstrations be carefully documented and evaluated, so that the hard information developed is captured. Quite often both documentation and demonstrations are indicated in the chart. These are areas in which my sense is that we could pull together the essential information quite quickly and move on to the demonstration phase expeditiously.

Carrying out the volume of research suggested in the chart--not just for a single country but for several so that regional differences can be understood and highlighted--is obviously a very large order and one probably beyond the resources of PRE/H. The strategy, then, should be to be opportunistic. One element in such a strategy is building work funded by other donors. In learning about the operation of land markets, for example, the results of the metropolitan Bangkok study, funded by Habitat, complement those uncovered in Nepal in work supported by AID.

But in addition to building on others' research, the Office could take two other actions. First, it can try explicitly to influence the content of projects--both research and programmatic--being undertaken by other donors. For example, when a housing finance sector review is being formulated by the World Bank, the Office could press for documentation of cases in which formal HFIs are working constructively with an informal entity to make medium or long term loans to low income households. More broadly, the Office could work out joint

research agendas for the informal sector, based on the results of this conference.

The other action the Office can take is closer to home. Many projects sponsored by the Office have the potential to provide information needed on key questions about the informal sector. The RHUDOs should have these questions before them in designing everything from household surveys to new HG projects with HFIs. The findings must be carefully written up and transmitted to the central office. Strong encouragement must be given to contributing to expanding the collective corpus of information--possibly with some additional funds being provided from central funds to support the "add-on" portion of some activities which is crucial to developing the new information. Obviously, for the effects of such encouragement to be sustained over a several period, the RHUDOs will have to be informed of the new information gained in simple, action oriented documentation and workshops.

Summary of Information Needs by Type of Activity

topic	Research: how does the market work?	Document good examples	Execute demon- stration*
1. rental housing market	X		
2. informal finance	X		
3. formal HFI lending to low income households		X	X
4. formal HFI working with informal institutions		X	X
5. micro land brokers	X		
6. concentration of land holdings & development	X		
7. realistic subdivision stds on general basis; bldg codes		X	X
8. credit for small contractors		X	
9. unauthorized water services; waste water/sewage removal	X		
10. Pub-prv partnerships in water services/waste removal		X	X

* Including careful evaluation.