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Profitability of Financing Low-Cost Housing in Kenya

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Laurea University of Applied Sciences   **Abstract**
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This research thesis aims at establishing the profitability of financing low-cost housing by formal financial institutions in Kenya and the existing financing mechanisms for the low-income housing segment through which they can help eradicate the growth of slums (informal settlements) in Kenya.

The research study covers financial institutions in Kenya and also takes into account the coordination between the government and UNHABITAT in their mission to eradicate the growing slums in Kenya. The study also provides more knowledge and information to members of staff of informal financing agencies who do the work that the formal financial institutions have not been able to do effectively.

The study is seeks to identify solutions for the stakeholders in the sector to ways in which they can provide their services in a more cost effective and efficient manner and be able to gain profitably from this endeavor. The study will also investigate the risks involved in investing in low income housing. Research data shall be collected by using qualitative research methods and through that the data will be analyzed to be able to depict the market situation in Kenya. This result is expected to be used by the financial institutions to make crucial decisions on the profitability of financing low-cost housing and to be part of the initiative to eradicating the slums in Kenya and mainly in the urban centers.

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1 Introduction

In this thesis research, the researcher studies the risks that financing institutions in Kenya go through in trying to make profit if they invest in low-cost housing and also it will study the cooperation between the government, financial institutions and non- governmental organizations such as UNHABITAT in trying to help curb poverty in Kenya by eradicating the (slums) informal settlements in Kenya. The UNHABITAT is non-governmental and non-profit making institution that seeks to help the developing countries in the quest to eliminate poverty by providing resources and also managing projects that help in eradicating poverty.

Kenya has one of the biggest slums in the world (Kibera) which acts as home to 1.2 million inhabitants. Kibera slum and other slums are growing at a very rapid rate in the urban centers of Kenya due to the rapid growth of population and also because of rural-urban migration. In other developed countries, it has been observed that financing the housing segment helps to reduce poverty levels and the growth of informal settlements and at the same time offer higher opportunity for profitability and growth for financial institutions that have decided to pursue such projects. However some individual financial institutions in developed countries are inclined more heavily towards high-income mortgage supply and have not taken the idea of low-cost housing finance into consideration, this is the case of most financial institutions in Kenya.

The majority of Kenyan financial institutions however have expanded their credit lines and financial products in financing housing for mortgage to the wealthy only. This has constrained the low-cost mortgage segment the necessary funds to participate in the process effectively. Kenyan cities continuously exhibit a problem of housing and the UN agencies and various multilateral agency offices together with certain ministries in the Kenyan government are trying to find ways of how to try and reduce the slums by encouraging the private sector to play a role in trying to curb the problem of slums in Kenya. (Housing corporation of Kenya webpage 2010)

The government has also placed incentives such as tax relief and preferential treatment for the institutions offering low-cost financing for the development of cheaper housing but has yet to receive substantial support from the financial institutions. These projects require substantial financial resource; this is attributed to the fact that most financial institutions do not approve the support given by the government as sufficient to enter the risky business of financing low-cost housing. (Housing corporation of Kenya webpage 2010)

Due to the perceived insufficient government support in the quest to finance low-cost housing, other organizations such as UNHABITAT have set up projects in conjunction with certain

Institutions that seek to improve the living standards of the poor in the informal settlements in Kenya. The projects such as Kenya slum upgrading programme (KENSUP) and Kenya Slum Upgrading, Low-cost Housing and Infrastructure Trust Fund (KSULCH&IT) have been launched in the Kenya to help in poverty eradication in Kenya. (Housing corporation of Kenya webpage 2010)

This initiative taken by UNHABITAT has also been supported by the Kenyan government by giving the necessary support in different ways that will be enlightened in the research conducted above. The government is represented by the ministry of housing and also the ministry of planning in trying to ensure that growth of informal settlements is reduced considerably in the urban centers of Kenya. (Central Bank of Kenya webpage 2010)

There are forty six financial institutions in Kenya according to Central Bank of Kenya which are registered to provide financing in different fields of interest, however the information received from the Central Bank of Kenya indicate that only three housing finance companies in Kenya namely Housing Finance Company of Kenya (HFCK), Savings and Loan Kenya limited (S and L), and East Africa Building Society of Kenya (EABS) have been active in providing housing finance assistance to the low-income groups in Kenya, controlling a big portion of housing markets in assets and deposits. (Central Bank of Kenya webpage 2010)

The financial institutions providing financing low cost housing finance have been operating under a different regulatory system from other financial systems and that enabled them to keep the interest rates for the low-income groups lower, but the mortgage-able assets in form of new houses was still low and the cost of buying land and building material remained expensive and thus the financial institutions have tried to solve this by providing individual loans to people who are financially stable and are willing to set up low-income settlements to rent them to the low-income groups. The main aim of this was to create real estate development for direct construction of low-cost housing units that that would be subsequently rented to the low-income households in the Kenyan urban areas. (Findarticles 1998)

The Kenya slum upgrading programme (KENSUP) is one of the projects set up by the government of Kenya and UNHABITAT to address the problems affecting majority of the urban population who live in informal settlements. These programmes started as a result of the memorandum of understanding (MOU) between the government and UNHABITAT in 2003. This programme selected slums within the administrative boundaries of Nairobi, Mavoko, Mombasa, and Kisumu to set-up a project base for the development of low-cost structures. The main target of the programme is to improve the lives of people working and living in the informal settlements in all urban areas in Kenya and to contribute to the poverty reduction and ful-

fillment of the millennium development goal, specifically Goal No 7 target 11 to improve the lives of slum dwellers by the year 2020. (Housing corporation of Kenya webpage 2010)

The Kenyan financial system is relatively well developed and serves a big number of clients all over the republic of Kenya. There exist some problems that have hindered it from achieving its full potential. Experience from other country's economies shows detrimental effects due to government ownership of the country's financial system and the positive impact achieved by having foreign investors participating in the banking industry, these are important areas that research should be done on before major decisions can be undertaken. However foreign investors investing in the Kenyan financial system have led to high cost of financial services and also high interest rates in the past, hence the foreign participation should be revised effectively to ensure that it provides benefit to low-income earners in Kenya. (Central bank of Kenya webpage 2010)

The Kenyan financial system is comprised of forty four licensed commercial banks, one mortgage finance institution and several microfinance institutions. The financial system is also comprised of foreign investors who manage several financial institutions in the country, however these institutions undergo high risks in the process of their daily operations, and this has prompted the management to ensure that prudent internal controls to help in containing potential losses to the financial institutions. The central bank of Kenya in its (annual prudential guidelines 2006) has clustered the risk factors into nine categories, namely: strategic risk, credit risk, liquidity risk interest rate risk, price risk, foreign exchange risk, operational risk, reputation risk and regulatory risk. These have been identified to have a great impact on the objectives of delivering profits by various investors in the Kenyan financial market. (Central bank of Kenya webpage 2010)

The Kenya housing sector has been struggling with high shortage in financial investment in the low-cost housing sector; this has been magnified by rapid population growth that has not been matched with equitable financial and economic growth. As a result there has been a rapid growth of slums in urban areas in Kenya. The increasing number of people moving from rural areas to urban areas in search of employment has led to life-threatening slum conditions that have arisen in urban areas. (Findarticles 1998)

The Kenyan government seeks to ensure that it provides a sustainable housing finance system that takes care of all its citizens. Sustainable housing system has been defined as one that is broadly assessable and serves the needs of all consumers at market prices. This can be achieved if the project is funded profitably by agents better able to bear the risk of a mortgage loan. (Lohse, U. UN Habitat-Financing Adequate Shelter for All 2002)

1.1 Choice and Purpose of the Study

The choice of this study is mooted by the need to enlighten the growth of informal settlements that are expanding fast in the urban centers in Kenya. Through this study the risks that financial institutions are prone to when trying to finance low-cost housing will be analyzed and guidelines that would help reduce the risks of failure by institutions that finance low-cost housing shall be provided.

It has also been noted that financial institutions in Kenya have evaded financing low-cost housing due to the perceived risks involved in that process, hence the study shall investigate the major risks that financial institutions have listed as to why they do not undertake financing for low-cost housing segment. This research will also outline the impact of UNHABITAT in helping reduce poverty in Kenya and if the government ministries that are concerned with eradication of poverty in Kenya have given their support to the projects being mooted by non-governmental institutions such as UNHABITAT.

Majority of the financial institutions in Kenya have listed several key reasons why they do not offer financing service for low-cost housing segment, this study will seek to determine whether certain risks such as default risk in financing low-cost housing and lack of profitability contribute a significantly higher amount of risk than in other financing segments. The government of Kenya through the ministry of housing has also mentioned that it has set up programmes that are aimed at helping eradicate poverty and mainly to help in fighting growth of slums in Kenya, hence this study will seek to research the extent of investor understanding of the government incentives for investing in low-income housing sector.

The choice of this study is driven by the fact that the research seeks to contribute in poverty reduction in Kenya and specifically in ensuring that growth of informal settlements has been reduced effectively as these have been hideouts of criminals who have been forced to crime due to poverty. The researcher hopes that the study will give financial institutions a reason to rethink and be more active in financing low-cost housing segment. The research will review the topic of low-cost housing development extensively by investigating and giving examples of countries where low-cost housing has been successfully managed and financial institutions have got profit from the projects. It is evident from the reasons given by opponents of low-cost housing finance that lack of knowledge has contributed a big part in the low number of institutions willing to offer finance for low-cost housing, hence the research will aims at giving correct and valid information that can be analyzed and used by institutions to finance low-cost housing effectively.

The government of Kenya through the ministry of housing and UNHABITAT has recognized the finance difference in the housing market and has put in place strategic plans, policy papers and institutional arrangements such as slum upgrading projects and the slum upgrading fund to address the problem of poverty and continued spread of slum areas in the urban areas of the country. This study will be significant to the private and public investors who would want to invest in low-cost housing finance while at the same time acquire a moral obligation to help the less fortunate members of the society who are struggling to meet the day to day needs due to high levels of poverty in the slums.

The objective of the study is to ensure long-term sustainability for the financing system that will be able to reduce poverty levels in Kenya and also to adapt to changes in the environment. Financial institutions can use the research findings when making strategic decisions to invest in this field of financing low-income housing and also the non-governmental institutions that may want to partner with those other non- governmental organizations such as UNHABITAT that are already providing their support for certain projects involving low-income groups.

The structure of the thesis shows that the research begins with the introduction that explains the background information on the thesis topic and the reason why the topic has been chosen for research. This is a fundamental part of the research because that will be the base of the whole study; secondly the theoretical model explains in general the reasons why the growth of slums has become a major problem in Kenyan urban centers. All the important aspect of financing, government activities and the ministries involved in seeking solutions for low-income households in Kenyan urban centers. It will also enumerate and give examples of countries that have been successful in curbing growth of poverty by integrating programmes whose main goal is to provide financing for low-income housing structures.

Research methodology follows third as indicated in the structure of the study below, as the researcher seeks to find answers to the questions that have arisen and to also explain the reason why investors and financial institutions in Kenya in the business of financing should understand and take into consideration when making decisions on matters that concern low-cost housing projects. Research methodology will be done concurrently in this process and data will then be collected by use of different data collection types. These will then be analyzed to give a conclusive verdict to the main topic. Data analysis techniques such as Ms excel will be used to inspect, clean and transform the data into complete information that can be used to make valid conclusions in the topic above. Qualitative research methods will be used to investigate how and why certain decisions have been reached at while making the final verdict from the respondents.

Data will be collected from the responses in the questionnaires that will be sent to the financial institutions, but the researcher will interview some individuals who have better understanding of the whole topic concerning low-cost housing finance in Kenya so as to get more information directly. This will include managerial staffs in the financing and mortgage industry that have good insight about the topic being researched and this will be through telephone interview. To ensure clarity of the whole concept the study will use self-administered questionnaires that will be sent to the respondents by way of sending email and the responses will be expected back by email. The response received will be analyzed effectively so as to draw the correct conclusions. (Saunders 2007, 356)
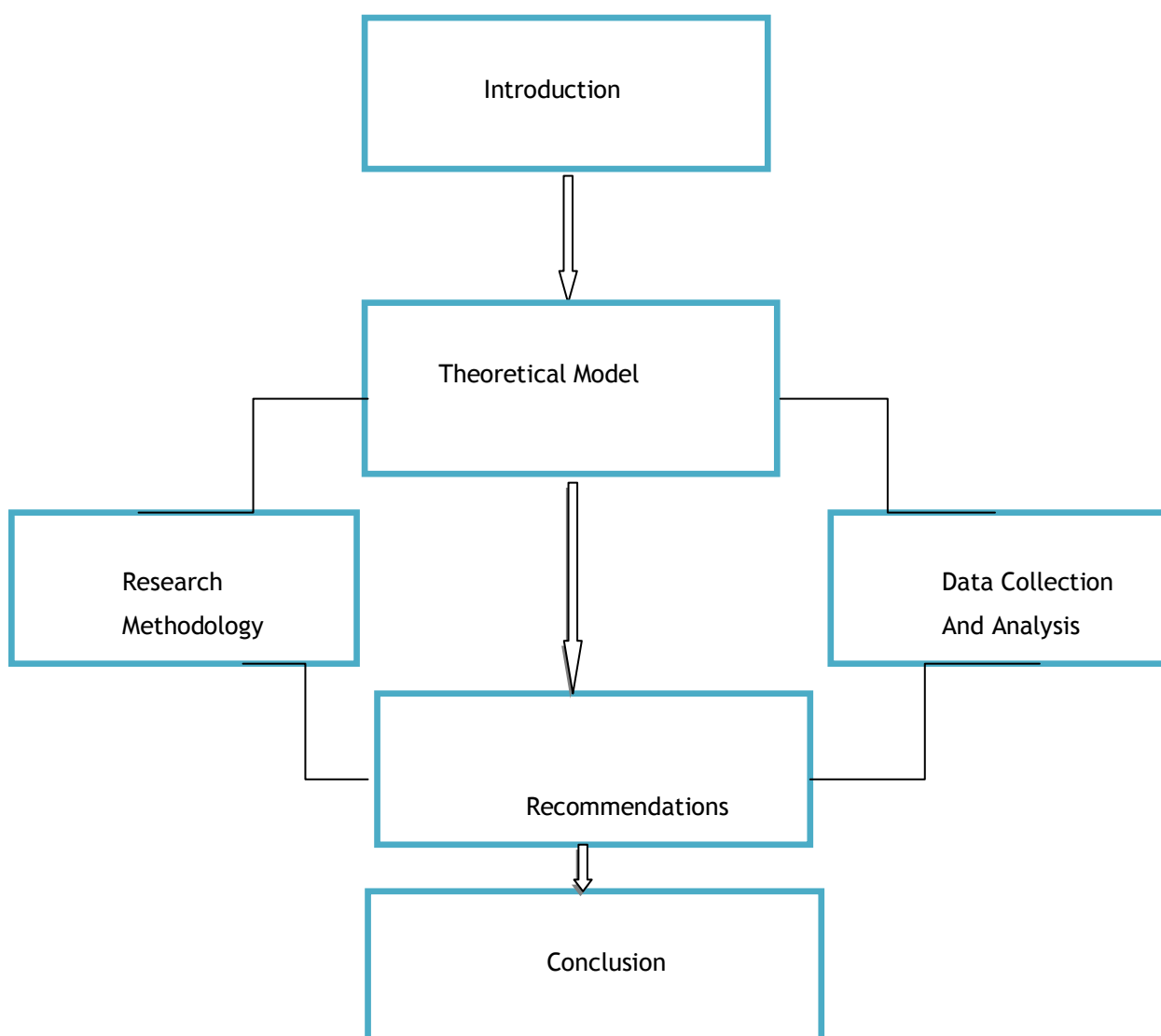
1.2 Structure of the Study

Figure 1: Structure of the study

Secondary data such as online Journals, gathering information from company websites, statistics from previous studies and also online news about financing will also be part of the study because information from these sources will provide the required information needed to get solution to the topic being studied. This will be combined with primary data that will also be collected by the researcher through questionnaires and interviews. The information from these sources also forms a basis in helping to understand the topic well.

Recommendations on this research study will be based purely on the results received during the period of studying the topic. In drawing up the recommendations and conclusions to the study the researcher will give different solutions that can be achieved from the data that has been collected and the information that has been provided. These recommendations reached will be helpful and can be offered to the financing institutions, government ministries and also the non-governmental organizations that are advocating for eradication of the slums In the Kenyan urban areas.

The financial institutions that have not been able to take part in the market segment of financing for low-cost income groups can use the study to make major decisions concerning this endeavor. Some other businesses and the government organs such as the ministry of housing can also be given the information to check if they can involve some technocrats in different ministries to give more options on the recommendations and also if they can adopt the recommendations and share with the institutions that have not been able to start financing for low-cost income households so to help in curbing the problem of poverty in Kenya.

The study will be helpful to the financing institutions because it will take into account some examples of other countries in the world that have successfully undertaken financing for low-income groups and have benefited their economies. Strategies on how to implement this project effectively will be given to the financial institutions by issuing them statistics that will be collected from the interviews and data collected from studies on countries that have undergone the process of financing low-cost housing finance successful.

1.3 Ministry of Housing Strategic Plan

The ministry of housing in Kenya has a target to provide adequate housing in a sustainable human settlement to all citizens who are not fortunate enough to afford better living conditions and to ensure Kenya achieves the "millennium development goal" by improving the lives of the people living and working in the slum areas. The mandate of the ministry of housing in Kenya begins from, formulation, implementation and reviewing the housing policies in Kenya. It is also mandated to promote low-cost housing development by facilitating the ownership of

houses by civil servants and leasing some other housing structures to constitutional office holders. Another task is to develop housing through the national housing corporation and finally the facilitation of housing through proper financing to the borrowers. (Housing ministry of Kenya webpage 2009)

In its mission statement the ministry of housing seeks to ensure adequate, excellent, affordable, and quality housing for all Kenyans. However the mission of the ministry has changed since the private sector is currently providing most of the finance for housing to the citizens of Kenya. According to the planning officer in the ministry of housing, the government through the ministry of housing, Kenya is targeting to ensure that proper guidelines are established to ensure the growth of slums in urban areas is minimized and eventually eradicated, this has taken effect and progress is slowly gaining momentum. (Housing ministry of Kenya webpage 2009)

The government is giving the poor Kenyans living in slums 1500 shillings (15 Euros) per month to help in catering for their daily needs and involving them in activities that will ensure they get proper accommodation that would help them move out of the informal structures that they have built in the urban centers in Kenya. This is one of the projects that the ministry is undertaking in conjunction with the office of the prime minister of Kenya to help eradicate poverty in the slums in Kenya. (Housing ministry of Kenya webpage 2009)

Affordable housing is a term used to describe dwelling units whose total costs are deemed to be affordable to those with median income. In the United States and Canada a commonly accepted guideline is set to ensure housing affordability. The result is to reduce the housing cost and ensure that it does not exceed 30% of a household's gross income; this type of housing can be built in the urban centers of Kenya to replace the growing number of shanties and informal settlements. (Wikipedia 2009)

The term low-income housing for the research has been taken to mean that in which an individual is able to pay Kenya shillings 3000 per month for housing. This is informed by the ministry of housing 2007 survey that provides that 80% of Kenyans are unable to maintain a mortgage of 25,000 Kenya shillings. Saving and loan Kenya limited (S&L) in June 18th 2009 reported that a substantial percentage of its income (Kenya Shillings 422 million to June 2009) originated from demand for loans from individuals earning a net salary of between Kenya shillings 50,000 and 100,000 who were searching for homes. These statistics have clearly shown that a majority of Kenyan adult cannot sustain and pay a mortgage if they are to purchase a house on mortgage and this is the reason why default risk in this sector of finance has become a big problem. Many investors in the financing market in Kenya have termed the financing for low-

cost housing as a failure because of the high rate of default in paying by the borrowers of finance. (Housing Ministry Projects Kenya 2007)

2 Challenges to Low-Cost Housing Finance

Financing low-income housing has been deemed a challenge due to several factors that hinder its proper functioning. Several factors have hindered efficient financing for low-income housing. The most notable aspect of financing for low-income housing is the risk of default by the borrower because the low-income groups do not always have a guarantee of constant financing. These limitations are the main cause of many financial institutions in Kenya avoiding to venture into the business of financing low-cost housing. Research conducted in other countries in the world that have been able to successfully finance low-cost housing such as Angola, Namibia, and South Africa have therefore given an insight in how they have successfully managed to finance the low-cost housing segment and consequently help to reduce the number of informal settlements. (Theeastafrican 2010) The problems identified as major hindrance by the financial institutions in their quest to provide financing for low-income groups has been discussed below in detail.

2.1 Infrastructure

In Kenya low-cost housing has not been successful because the stakeholders who have the duty to undertake the projects have complained that the cost of building materials, land and infrastructure is too expensive to be able to support low-cost housing segment. According to Mr. Joe Mungai, the managing director of the Tamarind property developers, the biggest problem to low-cost housing is the lack of infrastructure. (Theeastafrican 2010)

Although the government has encouraged developers to invest in low-cost housing projects with the promise of providing proper infrastructure this has not been the case and most developers and finance institutions have opted to target wealthy households. The wealthy individuals can finance the mortgages where the infrastructure is good and does not need government involvement because the wealthy individuals in Kenya do not believe that the government will be able to honor its pledge of improving the infrastructure in the urban areas where low-income structures can be built. (Theeastafrican 2010)

Another problem affecting infrastructure is the lack of water in some urban centers. This is a problem that cannot be solved by any financing institutions but the responsibility of the Kenyan government to ensure that supply of water is constant in urban areas; this will in turn attract more investors to put effort to financing low-cost housing. (Theeastafrican 2010)

2.2 Lack of Support by High Income Groups

Lack of support by high income groups is one of the major problems affecting low-cost housing segment. In other parts of the world according to Dr Marc Weiss most high income households do not encourage the growth of low-cost housing buildings in the neighborhoods where they reside because according them that may interfere with the beauty of the neighborhoods by erecting low-cost structures, this is a unique problem that has not been explored by any research in Kenya but has continued to hinder the growth of low-cost housing. (Global Urban Development 2008)

2.3 Fear To Invest Due To High Risk

According to modern portfolio theory an investor will be rewarded via a premium for taking some additional risk, meaning the higher the risk the higher the probability of good profits from an investment. This is a good example that should be emulated by financial institutions when considering if they should invest in low-cost housing. Though the risk involved is high and the history of financing low-cost housing has indicated a poor record mainly in Kenya, the analysis conducted according to portfolio theory shows that such investments have higher probability of giving good profit returns to the investor. (Market portfolio theory 2004)

The financial institutions taking part in the housing market do not have a mechanism to relate the rate of return in the low-cost housing market because little if any study has been conducted to understand this problem; this has led to some financial institutions lacking the ability to forecast returns, hence avoiding investing in the market due to uncertainty. Figure 2 seeks to explain the expected amount of return, taking into account the risk involved in the investment. At the market portfolio level the return on investment may be higher for the investor although the risk is also higher at that level, but when the risk is lower it is clear from the figure that the expected return also may be lower. (Market portfolio theory 2004)

It is also important to note that often losses by financial institutions are a result of imprudent lending decisions, although even in the best regulated systems some losses are inevitable and need to be recognized and built into pricing models, meaning financial institutions should be objective in their approach when dealing with matters related to finance for low-income group financing. (John 1997, 56-57)

The risk return trade-off also explains to the potential investor that potential high returns are associated with the increase in the risk of low returns hence when investing one has to be aware not to be over-expectant in the returns without having an alternative plan, but that should not be a hindrance to the potential investor who has set a target to invest in a poten-

tially risky venture because such investments may lead to higher profits than less risky ventures. It is through this relationship that finance companies in Kenya should be encouraged to invest in low-cost income housing because that has a potential to produce high returns for their business despite the risk level involved. (John 1997, 3)

Market Portfolio

EXPECTED
RETURN

EFFICIENT FRONTIER

RISK FREE ASSET

RISK
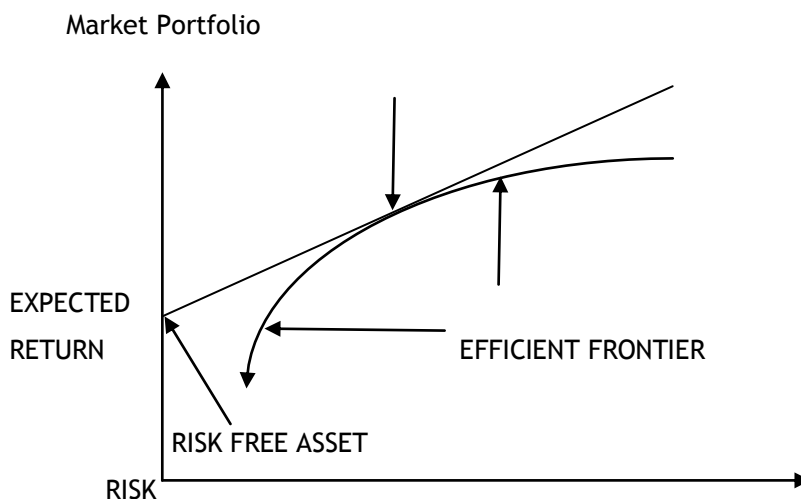
Figure 2: Modern portfolio theory

2.4 Land

The ministry of public works and housing in Kenya has outlined that the major problems to low-cost housing finance in Kenya, these are land, finance, building materials and proper regulatory framework for the projects to be undertaken effectively. Land is a big problem because it is highly valued mainly in urban areas where slums are growing rapidly and mainly it is always the responsibility of the central government and the local authorities in any urban area. Due to these problems land has become a major hindrance to growth of low-cost housing structures that would help solve the problems of low-income households. (Wafula nabutola 1998)

2.5 Finance

The financial institutions in Kenya offer funds in the hope of making profit and declare dividends for its shareholders because that is the reason why the institutions are in business. The high desire to earn quick profits has led to increase in interest rates for borrowers of finance in the institutions and hence it has prevented low-income groups who cannot afford the high interest rates set by the institutions. The local government has the duty to help the poor people who cannot manage to pay the high amounts of interest requested by financial institu-

tions by providing them with better housing at affordable prices but unfortunately the income collected by institutions in terms of taxes and service charges has not been sufficient to completely solve the housing problem in the urban centers. (Wafula nabutola 1998)

2.6 Government Regulations

The government of Kenya has created a ministry of roads, housing and planning to try and solve the problems of housing and infrastructure in Kenya. Unfortunately the ministry has not been very active in the provision for housing solutions to the less fortunate. The government bureaucratic process of achieving results has not helped either as decisions take a very long time in the ministries. This department of housing also has not shown its seriousness in solving key issues of how to identify solutions to the problem of low-income housing finance. (Wafula nabutola 1998)

2.7 Greedy Investors

Greedy investors have created a barrier in financing for low-cost housing because most investors want to invest in projects that will yield immediate return and this has prevented the investors from investing in low-income housing projects due to the popular belief that these are projects that are non-profit making or do not yield profit as fast as they would wish. (Wafula nabutola 1998)

3 Banking Risks Experienced by Financing Institutions

Commercial banks are in the business of providing financial services to the bank clients; this exposes the commercial banks to a number of risks. Commercial bank risks are uncertainties resulting in either problems with the balance sheet of the bank or its lending and borrowing activities. The banks undergo many challenges on how to manage the risk involved in banking effectively and the best way to reduce this is to identify the source of the uncertainty and magnitude of its potential adverse effect on profitability to the institution by identifying proper measures that ensure the bank is protected effectively from such risks. (Joel 2002, 19)

Credit risk in business is commercial because it is business-driven and is a major source of loss to commercial banks. This occurs when a customer defaults in payment of the loan given to him or her. This risk is very severe because a small number of clients can cause very big damage to the profitability of a bank and potentially lead to insolvency of the lender who is the commercial bank. (Joel 2002, 18)

There are three main banking risks namely; Interest rate risk, Market risk and Credit risk but commercial banks and financial institutions are prone to more risks that can cause extreme problems to the financial stability of the institution. These risks have been highlighted in the figure below. (Joel 2002, 11)

Interest rate risk is the risk that occurs due to the decline in the movement and shift of interest rates in any financial market. This can be dangerous to commercial banks because commercial banks mostly generate revenues through interest rates and interest rates tend to be unstable. This means that when commercial banks lend money they are subject to interest rate risk, and when interest rates decline the banks tend to be exposed to interest rate losses. (Joel 2002, 18)

Banking Risks	→	Credit Risk
	→	Interest Rate Risk
	→	Market Risk
	→	Liquidity Risk
	→	Operational Risk
	→	Foreign Exchange Risk
	→	Other Risks: Country Risk, Settlement, Performance

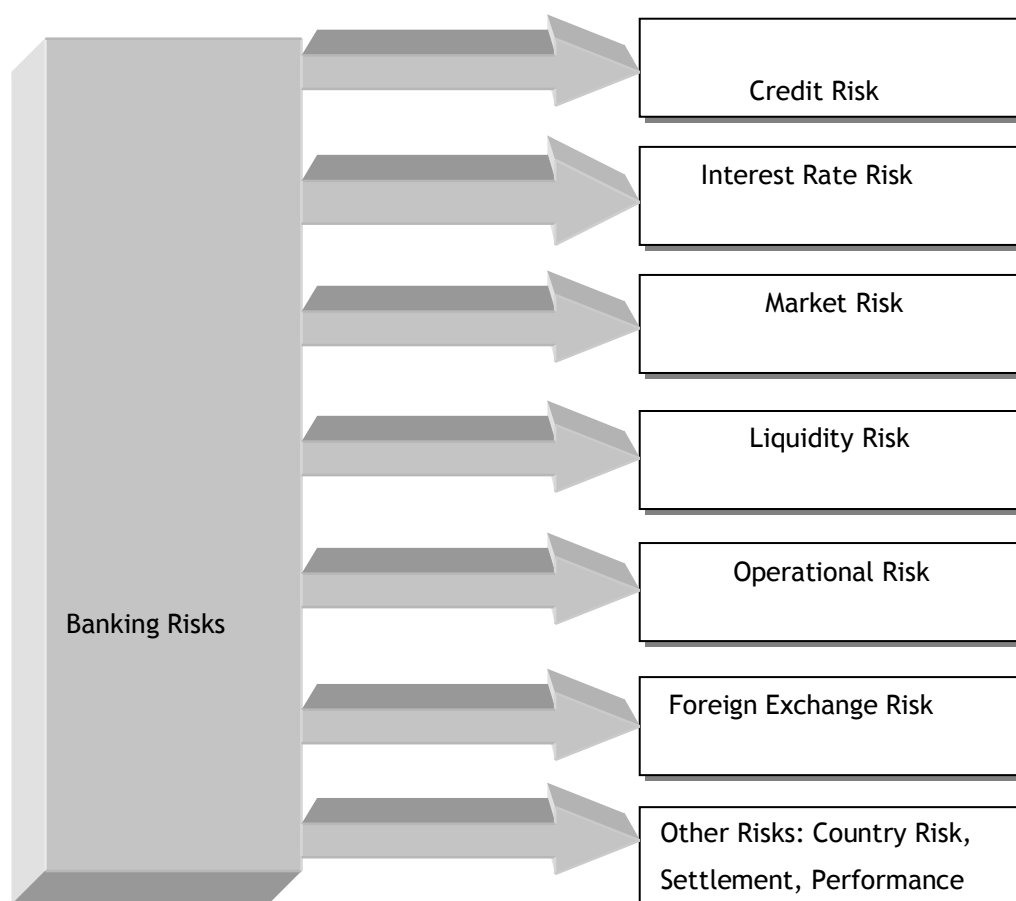Figure 3: Main banking risks (Joel 2002, 12)

Market risk is the risk that affects commercial banks due to market movements. During hard financial times such as liquidation periods, any decline in the value of transactions for commercial banks leads to market loss. Market risk is also referred to as systematic risk because it is a risk that occurs more frequently and all businesses undergo through this type of risk

because assets tend to change in value due to economic factors. Commercial banks and other micro-finance institutions tend to estimate the impact of this type of risk in the performance of the financing activities that they have undertaken. (Anthony 1996)

Default risk is the risk that occurs in the event that a borrower is unable to pay the amount borrowed as promised and signed when being given the loan. Default in payment of loans has risen due to recession; this is caused by several factors such as loss of employment by borrowers, death of the borrower, or even bankruptcy by the borrower of finance. Default risk is a major risk that most financial institutions undergo but the financial institutions have been protecting themselves from losing much by acquiring insurance for the loans they offer to their clients. This then enables them to recover the money they loaned incase a default in payment occurs. (thefreedictionary.com 2010)

4   Risk Management

Management of financial risk involves identifying the risk, assessing it and finally planning how to manage the risk in question. In any organization risk management should involve all the levels of management so that the risk can be managed effectively. This ensures that the risk is understood by all staff members concerned and prudent decisions are reached by consensus. This will reduce the disagreements that may arise in case an organization may suffer losses due to a risky venture that was decided by a minority group in the organization without consultation with the whole management. (Tony & Faisal 2008, 2)

Financing institutions in Kenya have avoided investing in low-cost housing due to the amount of risk involved but some study has to be done to find a way of managing risks involved. According to Chapman & Ward, all projects involve risks and any project with very small risk is not worth pursuing and hence it should be a clear indication to the financial industry participants that risky venture should be able to generate a good amount of income if it is managed well. Low-cost housing finance gives good returns should it be managed properly and critical studies have been conducted to identify issues that may plunge an organization in problems due to venturing in various risky businesses without consulting widely. (Chapman & Ward 1997)

Finance institutions that provide mortgage financing also provides more some insight to the types of risks that they are prone to when undertaking their duties of financing. These risks include prepayment risks, warehousing risk and other risks such as credit risk. Although mortgage loans are long-term loans the financial institution does not have a limitation on the amount of principal the lender can pay as prepayment of the mortgage payment, hence when the lender chooses to pay higher prepayment on the mortgage, the finance institutions losses

the amount of interest that they were expecting to gain from the long period of paying the mortgage. This is also a major risk in mortgage financing. The prepayment risk is not unique in any financial institution, and some institutions have devised means to ensure that they do not accrue losses due to prepayment risk. (Choudhry 2002)

4.1 Mortgage-Backed Securities

Mortgage-backed securities are used by financial institutions to gain capital markets for funds from housing and to improve the accessibility and affordability of housing to allow lenders to better manage the complex risk of housing finance default. Mortgage-backed securities can make a major contribution to housing finance in the Kenyan market where finance institutions have avoided the task of financing for low-income groups due to the high risks they are exposed to. (Loic, Oliver, & Michael, 2004)

Mortgage-backed securities provide a large amount of debt securities on the balance sheet of most finance companies, and it is evident that some non-banking institutions are the major stakeholders in the mortgage industry hence creating unfair advantage for other financial institutions in the business who have not entrenched the mortgage securities in their daily business life. (Paul & Michael, 2004) Mortgage securities represent an ownership interest for mortgage loans made by financial institutions to finance the borrower's purchase of a home. They are secured by a mortgage on real estate or other long-term assets of the borrower. This ensures that the financial institution can recover the money it financed from the asset of the borrower or the mortgage itself. This is a clear means of reducing the risk of default by borrowers of finance. (Ross, Westerfield, Jaffe, 2002).

The most basic mortgage-backed securities, also known as pass-through securities or participation certificates represent a direct ownership interest in mortgage loans (Gitman and Joehnk, 2002). As an investor in such securities, one holds an undivided interest in mortgages, implying that when a home-owner makes a monthly mortgage payment, the payment is passed through to the investor. Although these securities give the borrower some relief, the interest is paid monthly rather than semi-annually. In essence, the monthly payments received by bondholders are the mortgage payments comprising both the principal and the interest. These securities are self-liquidating, since a portion of the monthly cash flow to the investor is repayment of principal (Broadhurts 1996). Therefore at maturity of the securities there is no big principal payment because the investor is always receives back part of the original investment capital.

 Loan repayment was a problem with mortgage-backed securities which led to the creation of Collateralized Mortgage Obligations (CMOs). CMOs are derivate securities created from tradi-

tional mortgage-backed bonds placed in a trust. Participation in this trust is then sold to the investing public in the form of CMOs. Investors are divided into classes called tranches, depending on whether they want a short, intermediate, or long-term investment (Gitman and Joehnk, 2002). In the collateralized mortgage obligation the interest is paid to all bondholders and all the principal payments paid first to the shortest tranche until the principal is fully recovered.

The creation of mortgage-backed securities and CMOs in the mortgage industry has led to the development of a new market technology known as securitization. Securitization is a common way of raising costs effective finance for a wide range of different assets that were previously difficult to finance. It was initially developed in the USA and later introduced in United Kingdom in the mid- 1980s. Securitization then could be introduced to financial institutions in Kenya that have not identified the most effective means of securitization for the finances they lend out.

Choudhry (2002) defined securitization as the creation and issuance of debt securities or bonds, whose payments of principal and interest are derived from cash flow generated by separate amalgamation of assets. Financial institutions that wish to finance low-income groups can use securitization to immediately realize the value of cash-producing assets; this process will effectively gather a group of individual mortgages such that they may be used for funding purposes. As a single entity and made available to prospective investors who want to acquire financing. According to Ross 1999 securitization occurs when the selling company sells its loan to a financial institution. The financial institution then pools together the loan with other loans and issues securities for the financing process. (Choudhry, 2002)

5   Benefits of Securitization to Issuers

Fabbozi and Modigliani (1995) identified several benefits accruing due to securitization of mortgages. Obtaining a lower cost of funds that takes assets and uses them as collateral for a security offering enables lower funding costs to be obtained by the financial institution. By using mortgage loans as collateral and property structuring as security, a financial institution can obtain a credit rating on the security that is higher than its own credit rating, thus resulting in a lower cost of funds hence more profits for the institution.

5.1 More Efficient Use of Capital

For financial institutions that must meet capital requirements to operate effectively, the sale of assets can release capital for the institution. If the assets are then securitized and the securities are sold, the capital required will reflect actual risk associated with the assets,

hence reducing excess capital to offer more financing to its clients. (Fabbozi and Modigliani 1995)

5.2 Managing Rapid Portfolio Growth

Selling assets through securitization provides a means for raising capital quickly while keeping the assets, and hence removes the debts from the balance sheet then release the institution from maintaining high capital requirements. (Fabbozi and Modigliani 1995)

5.3 Better Asset and Liability Management

Mortgage and consumer installments expose financial institutions to prepayment risk. Therefore securitization passes the prepayment risk to the investor. This gives the financial institution a means for funding assets in case the borrower of finance prepays the finance that had been borrowed. (Fabbozi and Modigliani 1995)

5.4 Enhancing Financial Performance

When loans are financed via securitization to a borrower at an expected return lower than the interest rate on the loan, it reflects the fee for servicing the loan and that will partially reflect conversion of the illiquid loan into a liquid security that is more viable for a financial institution growth and performance. (Fabbozi and Modigliani 1995)

5.5 Diversification of Sources

Investors ordinarily could not service mortgage loans or commercial loans can invest in these mortgage-backed securities. This would provide more sources of capital for both financial and non financial entities. (Fabbozi and Modigliani 1995)

6 Benefits of Mortgage Securitization to Investors

Securitization has been discussed above and several benefits have been mentioned to the issuers, but securitization also offers more benefits to the investors because it converts illiquid loans into securities with greater liquidity and reduced credit risk. The credit risk in financial institutions is a major problem but it can be reduced through diversified pool of loans, and credit enhancement (Choudhry 2002).

A securitized loan is a more liquid asset than the loan itself, since it can be sold by the lender if capital is needed. The existence of securitized loans should reduce the difference between

the lending rates and treasury securities. As the market matures, competition among lenders should produce lower lending rates in the market; this gives the borrowers more benefits. (Choudhry 2002)

The market structures, government sponsorship enterprises and the characteristics of the mortgages securitized are all important determinants of mortgage rates in financial markets. Government-sponsored enterprises generally lower the mortgage rates to customers but not always. In many cases when the market is more competitive because the government allows institutions to sell securities without credit enhancements for private sector investors, Mortgage securitization is important for financial institutions so as to remain business in the case of any financial meltdown. (Wayne, Roger & Jamie 2004)

7   Pricing and Marketing in Low-Income Housing

According to Kotler and Armstrong, pricing ensures that a company is paid for the value it creates to its customers and with effective product development, promotion and distribution yields success for an organization. Housing finance companies are in a position to evaluate the financial capability of finance seekers. This enables financial institutions to determine the correct value to be disbursed to a mortgage applicant while considering the interest that will be paid back with the loan. However with the number of low-income households rising, extensive research should be conducted on how to curb this problem. The low-income earners in the society do not have the high income that would be required by the financial institution and this automatically disqualifies them. (Kotler & Armstrong 2008, 633)

The housing finance sector in Kenya is experiencing challenges of a complicated three-tier market that is served by an elaborate financial system. At the top of the hierarchy are households that can afford housing of high quality. In the middle category comprises the middle-income group which is predominantly composed of wage and salaried workers as well as self-employed people. This category is not adequately catered for in the provision of housing and as a result they are relegated to housing targeted for low-income earners. The third category which forms the majority of households is low-income earners. They are the most affected by the housing problems arising from inadequate housing and the displacement caused by insufficient housing facilities for middle-income earners (National housing policy 2004).

The three financial institutions that offer financing and support for the low-income housing segment in Kenya have also to consider certain important issues before setting prices of houses for would-be tenants or those who have the desire to invest in low-cost housing or even in normal mortgage for the wealthy. The customer perception of value, meaning the customer should be able to value the service being offered with the price being paid for low-cost hous-

ing structures. According to the senior relationship manager at the housing finance corpora-tion of Kenya, Mr. Chris Chege, "despite the fact that low-cost housing should be basic hous-ing for the poor living in the slums it should not be of poor quality as this would make the situation same for the people living in the filthy low quality housing to transfer the same problem of the filthy and informal settlements from one place to another". (Chris Chege 2010)

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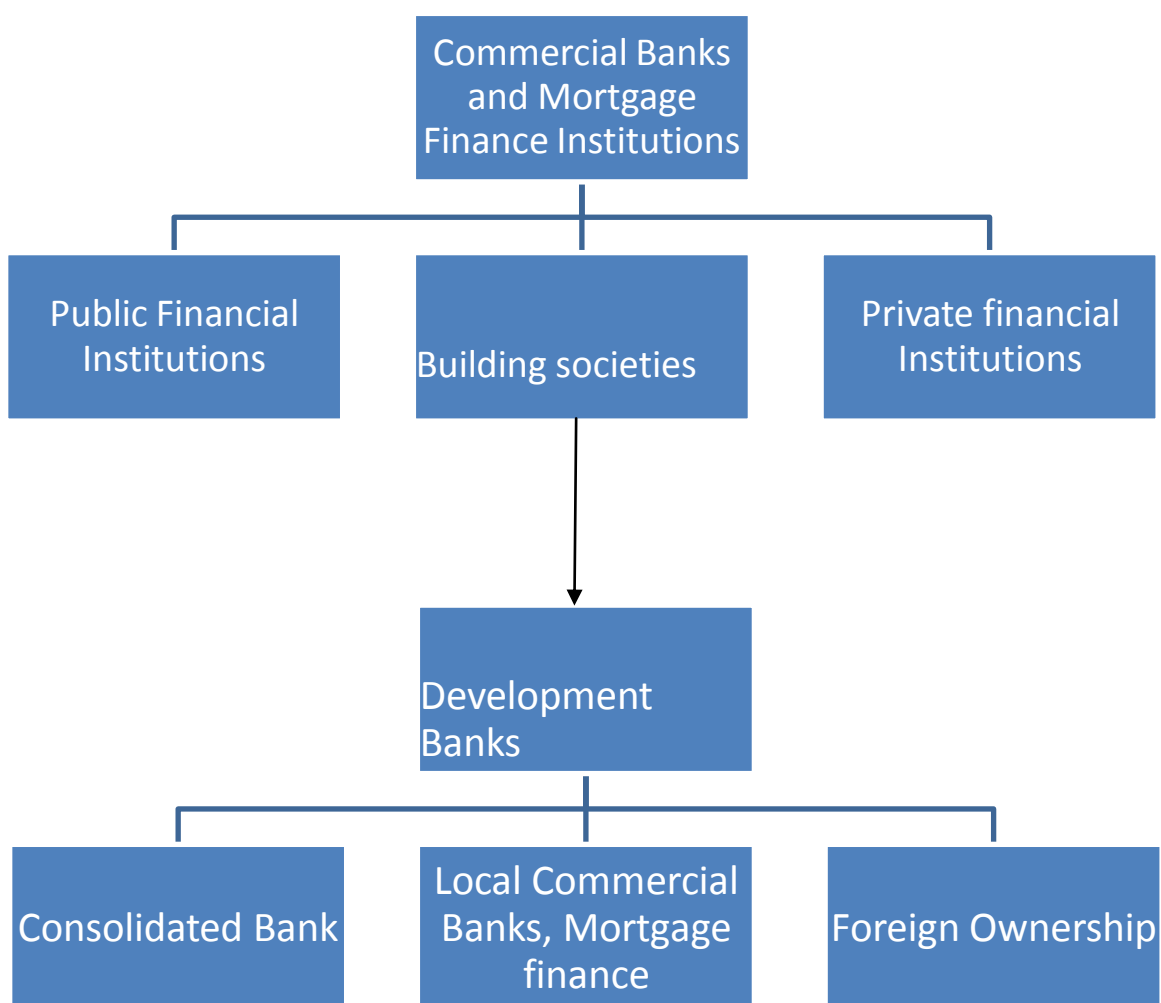
Figure 4: Structure of financial institutions (Central Bank of Kenya)

According to Kotler & Armstrong (2008) value-based pricing should be a key consideration also when offering financing to low-cost beneficiaries, meaning that the financers should be able to offer good value for low-cost housing groups while determining the pricing and not the seller cost as the key to pricing. This is has been disapproved by many because construction

has become an expensive undertaking due to the high cost of building material, land and also for the labor that is involved when undertaking construction.

Most financial and housing companies in Kenya want the cost at different levels of construction in the housing industry to be considered when pricing the houses for low-cost housing segments. However this does complement growth of low-cost housing. Due to this development some of the stakeholders in this field of financing have concluded that low-cost housing is not a wise project to go into and does not offer returns of profit to the investor.

When marketing low-cost housing projects the strategy employed by financing companies should be commensurate with the amount of return expected, meaning that the target market should not be the wealthy and the means used should not be expensive as when marketing for luxurious housing for the rich. Financing companies need to also to remember the exact levels of demand for low-cost housing and ensure that they can provide for the demand and not provide too much or too little, as this would result in shortage or in excess of supply.

The main stakeholders in the field of low-cost housing believe that competitor strategy and prices should be a big factor when offering financing to low-cost housing customers because to be successful in pursuit of service delivery individual finance companies have to remember the strategies that will ensure they are better than their competitors in service delivery and finance options to customers. (Philip Kotler, et al 2008, 639-644)

The mortgage market however has evolved over a period of time due to subprime lending, which has introduced a substantial amount of risk-based pricing into the mortgage market. This is due to lenders imposing prepayment penalties for those who extend the duration of loans and request a larger deposit before they can advance financing. This ensures lower credit exposure from high-risk loans; this is one of the most effective means to reduce the risk of default. (Souphala & Anthony 2006)

According to the senior relationship manager at housing finance Mr. Chris Chege, the mortgage market in Kenya has improved drastically over a period of time. In the 2006/07 budget presented by the minister for finance, Mr. Amos Kimunya, the minister exempted interest earned on deposits of up to Kenya shillings 3 million on home ownership savings plan. Chris Chege (2010), however the mortgage industry has been affected by problems in Kenya because it is an expensive undertaking which requires proper planning by not only gauging the earnings of the country against its daily expenditure and mortgage repayment cost, but it should strive to accommodate hidden charges. Mrs. Caroline Kariuki, the managing director of Kenya commercial bank mortgage subsidiary group of savings and loan (S&L), outlines that the current prices of mortgage are high, meaning potential homeowners should reduce the costs

to understand the impact of the decision they are making. This is in effect a negative campaign against financing for low-cost housing projects as it will outline all the expenses involved when undertaking the project. (Caroline Kariuki 2010)

Financing companies in Kenya are also planning to introduce the civil service housing scheme to ensure that all civil servants can acquire easy and cheap financing to enable them purchase government houses they are residing in. This is expected to help the government reduce the growth of informal settlements because civil servants will have the opportunity to own homes when they retire from government service, (Caroline Kariuki 2010), the civil service housing scheme is part of the strategic plan of the ministry of housing in Kenya to work with other institutions and companies to lower the rates of interest for staff members of these institutions and by doing this they pass the benefit of affordable housing to the market.

The main reason attributed to why only the wealthy can afford mortgage loans in Kenya is because the cost of the deposit demanded by the financing companies is very high and most people cannot afford to pay that. But Mr. Chege of the Housing finance corporation of Kenya notes that interest rates charged by financing companies in Kenya compared to its regional neighbors and other African countries range from between 14 per cent to 20 per cent of the property in question, which is not high as it has been alleged by other pessimistic financers. (Daily Nation 2008)

The economy is currently being funded mainly by industrial output. Industrial capital determines the amount of industrial output that can be produced each year. According to the International monetary fund (IMF) Kenyan poverty levels are at 56% of the whole population, this indicates the total percentage of the Kenyan population living below the poverty level. It is also important to note that the country recorded a negative gross domestic product (GDP) growth of -0.3% in the year 2010. This has been a major setback in the effort to revitalize the Kenyan economy.

According to the central bank of Kenya report for the year 2009 the economy grew by 7.1% in 2007 compared to 6.4% in 2006. However in 2008 the growth decelerated to 1.7% due to post-election violence experienced in most parts of Kenya that led to several investors losing property. This was further compounded by external financial problems including the global financial crisis and high fuel and food prices due to inadequate rainfall in the country that led to the famine of 2008. These factors are the key contributors to the economic hardship being experienced in Kenya currently. However the economy grew in 2009 to 3.9% during the first quarter of 2009 from a decline of 0.6% in the same quarter of 2008, partly showing signs of recovery and also boosting economic activities for the Kenyan investors. (Central Bank of Kenya 2009)
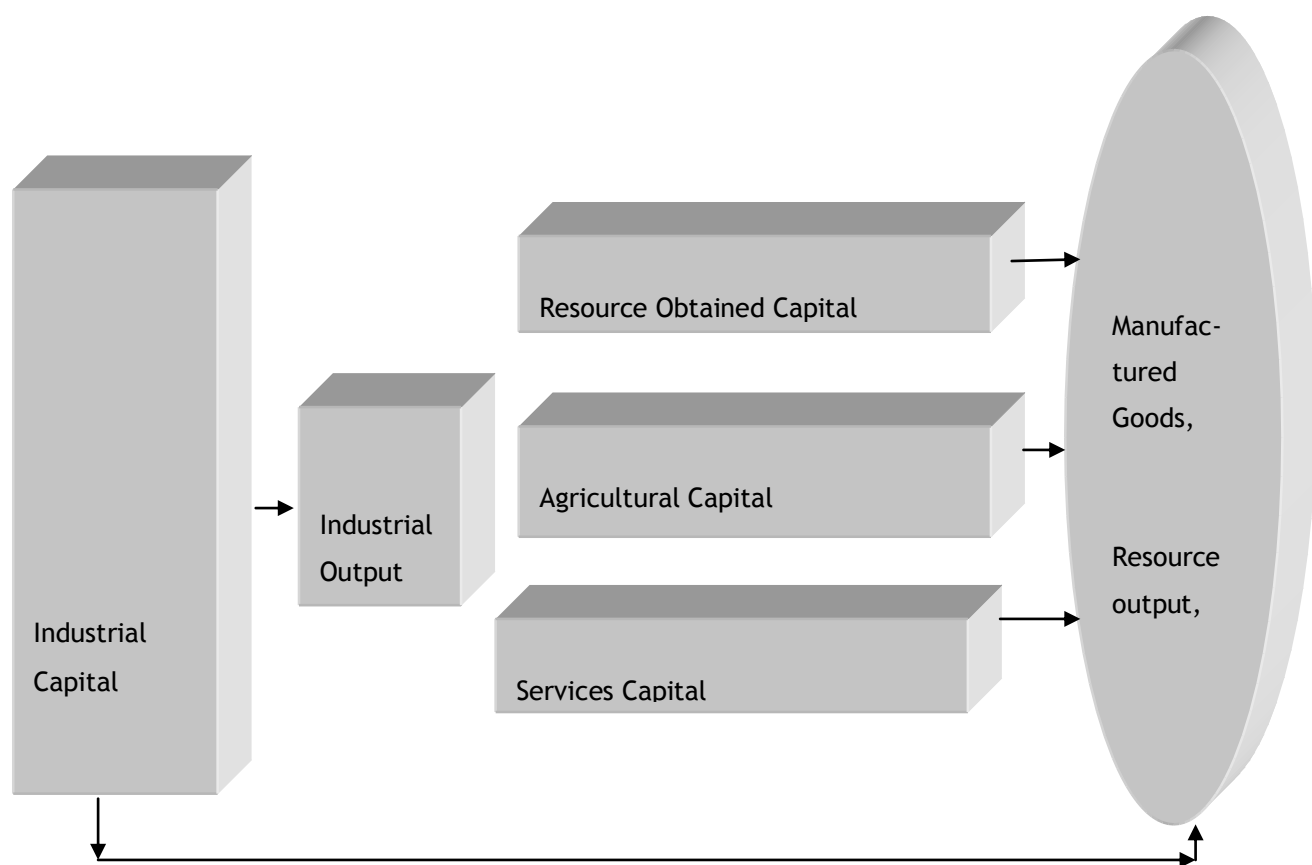
Figure 5: Flows of capital in the economies of the world

Figure 5 above shows the structure of the Kenyan economy. The economy was highly funded by agricultural products and exchange of goods in the early days of independence. However the government has put in place government-run institutions to try and improve the economy further. Agricultural capital is the backbone of the Kenya economy, contributing to a third of the GDP of Kenya; this is through export of mainly tea, coffee, pyrethrum, pineapple among other crops. (Central bank of Kenya)

The per-capita income of Kenya according to the central bank of Kenya in 2009 is Kenya shilling 35,525 (340.7 Euros) and the cost of a low-income housing unit as estimated by the National Housing Corporation (NHC) is 3 million shillings. The ministry of housing in Kenya also noted that 80% of the employed in the formal sector in Kenya cannot afford to service a mortgage. These are indications that a majority of the Kenyan population is living below the poverty level set by the United Nations.

8   International Experiences in Low-Cost Housing

In most urban areas in high income nations good quality housing is very expensive. A big number of expensive settlements have been built by means of acquiring mortgage financing. Middle-income earners and even most upper-income groups in society need a mortgage to be able to construct or purchase good housing facilities. In Africa, Asia and Latin America is different as low-income group of people cannot afford to buy or build good quality housing but can only rent or build in illegal settlement areas. (Marc 2008)

This is due to lack of sufficient income and proper documentation that many housing and finance companies require in order to finance a mortgage. Many financial institutions however have made progress in the last 15 years to try and solve the problem of housing for low-income groups all over the world; this has been done through becoming less concerned with direct provision of housing and more interested in working with financing the whole population to ensure greater choice for the beneficiaries. The examples mentioned below show a few of the countries that have been successful in financing low-income houses effectively and reduced the level of poverty in the respective countries. (Marc 2008)

In Tanzania renters of low-cost housing have helped in financing the construction of housing wit advance rent payment to the landlords, hence they can move into these settlements once they are completed. This enables the renter to pay the rent slowly and at a pace he/she can afford until the whole amount is completely paid, while in Pakistan savings from individuals have been used to finance the development of infrastructure in more than three hundred low-income settlements. This financing takes place within certain non-governmental organizations such as the Orangi pilot project research and the training institute. (Marc 2008)

Another study conducted in South Africa and Namibia showed that benefits of saving programmes have contributed a big amount of finance in building of low-income settlements rather than acquiring loans which may be difficult to repay. In South Africa the Kuyusa Fund set up by the residents of South Africa, offers them loans for improving the shelters they are residing in, but this loan can only be given if one has been saving money with the institution. This has been very successful because 65% of the members use the fund to save money which they use in improving their lives by acquiring better housing facilities. Such programmes have been established in Malawi and Namibia also where self-help groups set up by the people living in slum areas have helped achieve success in improving lives of the people in those settlements by helping them save money. (Marc 2008)

These examples have shown that savings offer many benefits to low-income groups if they invest with credible financial institutions. Studies have shown that individuals with low-incomes go through many problems before they can get bank accounts, hence they have set up their own savings institutes because local banks do not support them as such because

banks always require formal employment or proof of income when opening a bank account, and also have been known to charge high costs for the services they render. These are some of the problems experienced by low-income groups. (Marc 2008)

Microfinance agencies in Angola offer small loans for housing improvements; the loans are given to households who have guarantee of tenure of a certain piece of settlement. These loans are mainly given to individuals to improve the shelters they are currently living in by e.g. adding a room, toilet or bathroom within the shelters they inhabit. These programmes have also been practiced in the Philippines where the institutions have provided loans for housing improvement. This has been through the programme called "Development of poor urban community sector" which supports local authorities for site development and improvement with the housing loan. The loans given are added to the family savings and self-help efforts and the lending has shown great impact in improvement of low-income human settlements. (Marc 2008)

Group lending has also contributed to improving the living conditions of inhabitants in Namibia; it includes loans for fund investments in land and infrastructure. The Namibian housing action group has developed a programme that regulates land purchased from local authorities and extends the infrastructure and construction. This has proved to be very affordable to very low-income groups in Namibia. (Marc 2008)

In the Philippines the community mortgage programme also provides state support for loans given to low-income groups. The mentioned cases are few of the different ways that financial institutions, governments and non-governmental institutions have devised strategies of financing and enabling populations in their countries to have better low-cost housing with little resources that they have at their disposal. (Marc 2008)

These cases from different countries have highlighted very important aspects of Low-income housing that the Kenyan government through non-governmental organizations such as UNHABITAT should take into account and analyze well to see how effective the programmes can be employed in Kenya and how they can be of help to the Kenyan community that is living in informal settlements. (Marc 2008)

9   Research Methodology

As earlier alluded the purpose of this study is to establish the reasons limiting investor participation in the low-cost income housing sector in Kenya and to identify the challenges that constrain the development of an efficient housing market. The research methods used in the study will be inform of interviews, with the stakeholders in the field of housing finance, ques-

tionnaires, newspaper articles that have discussed the topic and journals that have been published on the topic of low-cost housing finance. Qualitative research methods will be used in the research as it has been confirmed that it a diagnostic approach that helps in deeper understanding of the factors that will be studied. Qualitative methods of research are also more subjective and personal because they outline facts and shows real situations that can be used in concluding research. (Peter 2005, 25)

9.1 Population

The target population consists of members of staff from the financial institutions in Kenya, interest groups in the financing of mortgages, and also participants in the programmes associated with low-income housing finance. The target population is expected to provide adequate information that can be used effectively to draw conclusions on the topic.

9.2 Sample Technique

The study used will be probability sampling technique to identify the respondents who were answering the questionnaires sent; this was the chosen means of sampling because it ensured that the researcher was able to identify a random population from a number of employees who work in financial institutions in Kenya without being biased or pre-selecting a group of respondents. Probability sampling design was the most appropriate means to use in the study because this enabled the researcher to provide each person in the total population that was interviewed the opportunity to be included in the final sample. (Pervez & Kjell 2005, 150)

9.3 Research Design

Research design is relating of the research problem to the practical research by providing an environment of data collection and eventually analyzing the data. Research design can be in different forms, namely explorative, descriptive, or causal, but the researcher has opted to use both explorative and descriptive research design to collect the information with respect to the study of the variables or conditions that are involved in the study of low-income housing. (Pervez & Kjell 2005, 56)

This means of research design involves surveying a field that consists of a population of interest to the study. The prime objective of this is to ensure the data collected is not manipulated and is non-intrusive and more importantly the researcher has no control over the results being studied. (Saunders 1997, 194)

The descriptive research design to be used outlines a situation in respect to the variable being investigated. This means of research design makes it possible for data to be collected effectively without any manipulation on the research context. The research design seeks to outlay the goals of the research by stipulating practical issues that are of focus to this study. (Saunders 1997, 194)

In the research design also the relevant literature received during the whole study will be reviewed. This is the beginning of the data collection process. Pilot work, designing the sample, selection of the people to be approached and chosen to do the field work will be the practical part to be undertaken. Finally, the processing of the data, statistical analysis will be finalized and conclusions drawn from the whole study. (Oppenheim 1992)

9.4   Data Collection

Primary data will be used for this study and the data will be collected using open-ended questions during interviews and closed ended questionnaires that will be sent by email. Telephone interviews will be done to enhance the objectives of the study as outlined earlier. The reason for providing the questionnaire is to clarify the answers that have been provided during the interview to improve the credibility of the research. Direct interviews will be performed by way of phone and the open-ended questions will be asked, respondents who have agreed to provide information that may be helpful in the study of the topic being researched on will provide more knowledge on what is required of them. Information collected through the questionnaires form the main part of the qualitative approach in a research, because it explores in depth the research topic and ensures that the major details that are important to the whole study being conducted have been effectively studied. (Tutor2u 2010)

9.5   Research Procedure

Primary data will be collected using the questionnaire appended as appendix 1 and analysis of the results will be performed by the researcher using the appropriate research analysis methods. The interview process is a continuous process during the whole research because certain questions arise every time as the research is progressing and the answers shall be included in the analysis and conclusion of the study.

9.6   Data Analysis

The researcher will use Ms-Excel (computer program) to enter the data collected in the study being carried out. In this case data will be analyzed appropriately and results of different

questions will be entered to provide analysis of the results being investigated. Pie graphs and charts will be used to illustrate the findings of the results.

9.7 Data Cleaning

Data cleaning is the process of identification of the basic causes of errors in the research data, these errors may occur during data entry. Data cleaning is a very important part of information management; the data will be cleaned to improve its accuracy and the questionnaires that have not been answered appropriately shall be omitted from the study. (Chapman 2005)

9.8 Output Presentation

The data collected will be presented in the research depending on the nature of the data analyzed. Graphs, pie charts and histograms may be used where appropriate so as to ensure that the research is clear and easily understandable.

9.9 Ethical Requirements

The respondents to the interviews have been informed that the information they provide will be used to perform a study on financing for low-cost housing. They have also been guaranteed accurate presentation of the information they have provided. The respondents have also been informed that any information they have provided will be divulged to the public but this will be done with full assent from the respondents. It is also ethical and the duty of the researcher to uphold ethics when performing a research on a topic by ensuring that the information is presented correctly and accurately without interfering with the facts as they were presented. (Pervez & Kjell 2005, 20)

9.10 Data Sources

The study will use both secondary and primary data sources, Secondary sources will help the researcher in explaining different conclusions based on previous studies that have been conducted and concluded, while the primary data sources will be information collected by the researcher himself specifically for the study. (Pervez & Kjell 2005, 94,102)

Although data was collected through questionnaires, part of the information that has contributed to the research was received through interviews, journals, archival records of past studies conducted on the topic of low-cost housing. This cannot be tabulated as it is not in

statistic form but has been used to draw up conclusions and proposals in the study of financing low-cost housing.

10   Research Findings

The research objective was to determine the profitability of financing in the low-income housing sector in the Kenyan mortgage industry by investigating the main business activities of the finance institutions and trying to draw appropriate conclusions based on the feedback given by the finance institutions. The research details have been conducted through telephone interviews and also through questionnaires sent to the respondents. The research findings will be used to draw conclusions about the profitability of financing low-cost housing and also what is lacking in implementation. This information acquired from this study will provide proposals to the stakeholders in the field of low-cost housing on how to ensure that they reap profits from investing in low-income housing projects.

The questionnaires were sent to a total population of forty financing institutions but only twenty responses met the required standards to be used in the study. The questionnaires were sent to employees in the financial institutions in Kenya by way of sending emails to them and where the questionnaire had not been answered appropriately the researcher requested more information from the respondents by sending a follow-up email. The number of respondents who responded to the questionnaires constituted 50% of the number expected in the study and this makes the results valid.

 The high number of respondents helps in making conclusions that can be effectively used to make major decisions in the field of low-cost housing. Questionnaires and interviews were used to collect data from the financial institutions and the data has been used to help in finalizing the research topic, Questionnaires that were considered for data analysis were those that were 80% complete while the overall response rate for the research was 50% of the total sample as mentioned above. This was a favorable response rate to be used to make conclusions on the study topic. Data consistency and uniformity is an important aspect of the study and this contributed to proper application of other data analysis techniques such as data classification, tabulation, organization and coding.

Data coding is an important process in the qualitative analysis process, because it involves entering the collected data in the questionnaire, numerical values and the response rate of each respondent category is determined accordingly. Coding is an important aspect of research since it gathers the data collected into small number of classes which have the most important information. This data is easily understood by the reader because it shows how each independent variable affected the dependent variable. (Saunders 1994, 293)

The number of respondents combined with the information acquired from the interviews conducted provided sufficient information that the stakeholders in this field could use as a reference to make major decisions. The population interviewed consisted of employees working in formal and non-formal financial institutions in Kenya. These institutions were identified from the information provided by the central bank of Kenya register and the registrar of companies.
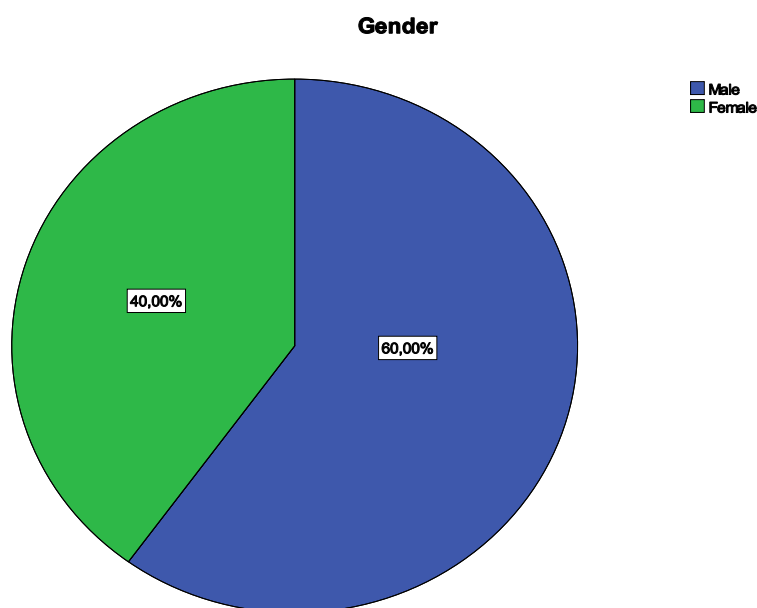
Gender

Figure 6: Population Gender

Figure 6 shows the analysis of the gender of the respondents in a percentage form. The population that was analysed in the study as shown in the figure above consisted of 60% male and 40% female. The target population is not based on one gender because it has accommodated views from both gender groups as each gender group has different ways of thinking and of relating to different situations.

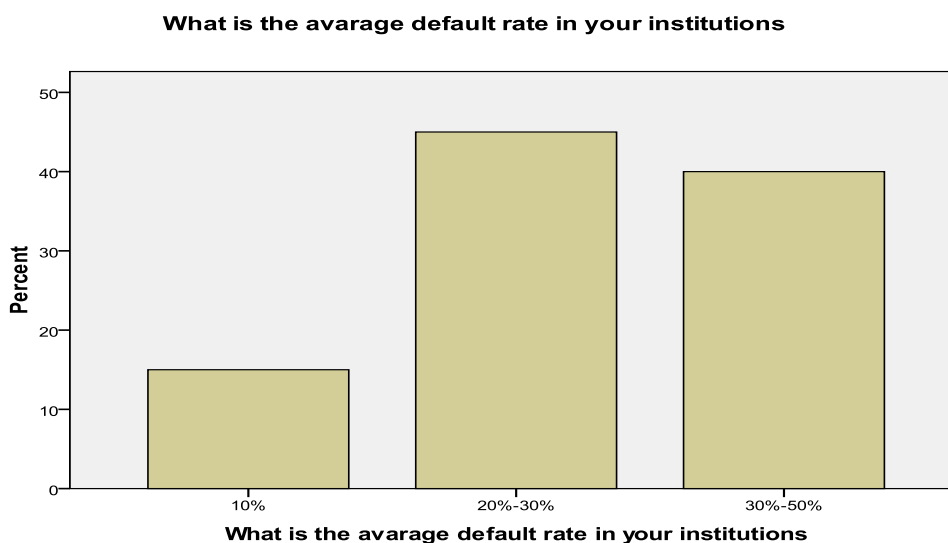**What is the avarage default rate in your institutions**

Figure 7: Default rate

The research investigated the default rate by borrowers of finance from financial institutions and the figure above shows that no institution in Kenya has recorded a default rate of more than 50% at the time of conducting the research, hence the value given when collecting data from the institutions was nil. This is a clear indication that the rate of loan default in Kenya is not high and can be managed. Notably the data collected showed that 45% of the institutions have a default rate of 20% to 30%. From the figure above it is indicated that 40% of the institutions have a default rate of 30% to 50% on the loans they advance to customers; the figure above also shows that institutions that have a default rate of less than 10% are only 15% of the whole population that was involved in the study. The research was interested in establishing the rate of default in the financial institutions so as to determine if default in financial institutions contributes to the losses of financial institutions.
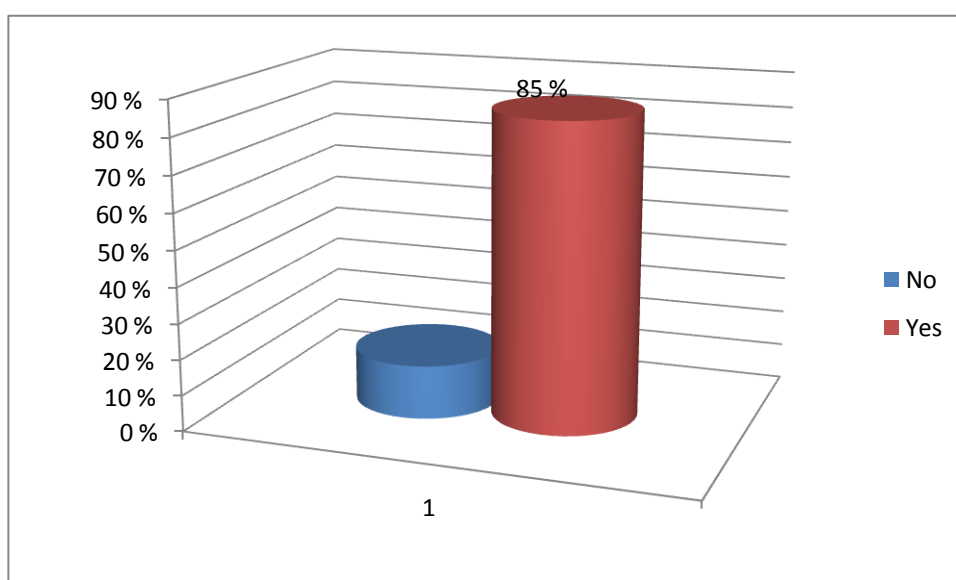
Figure 8: Institutions financing low-cost housing

Figure 8 above explains the number of financial institutions financing low-cost housing, from the financial institutions that were investigated the research findings indicate that only 15% of the institutions that took part in the research provide financing for low-cost housing while 85% do not finance the low-cost housing segment. This shows that a very large number of the financial institutions in Kenya have not started financing low-cost housing as part of their business. The reasons are varied depending on the individual financial institution.

The researcher also investigated the number of institutions that believe financial deregulation by the government has an impact on the interest rates charged for low-income households who want to seek funds from financial institutions.

	Frequency	Percent	Valid Percent	Cumulative Percent
No	15	75,0	75,0	75,0
Yes	5	25,0	25,0	100,0
Total	20	100,0	100,0	

Table 1: Financial deregulation

The response rate was as follows. 75% of the institutions that took part in the study thought that financial deregulation would not improve the interest rates in low-cost housing and also would not encourage them to start financing low-cost housing, while 25% percent thought it would improve the interest rates but some conditions were given on that issue. Several reasons were given as to why a majority of institutions did not think that financial deregulation would help improve the interest rates and these reasons have been explained in the summary of the research findings below.
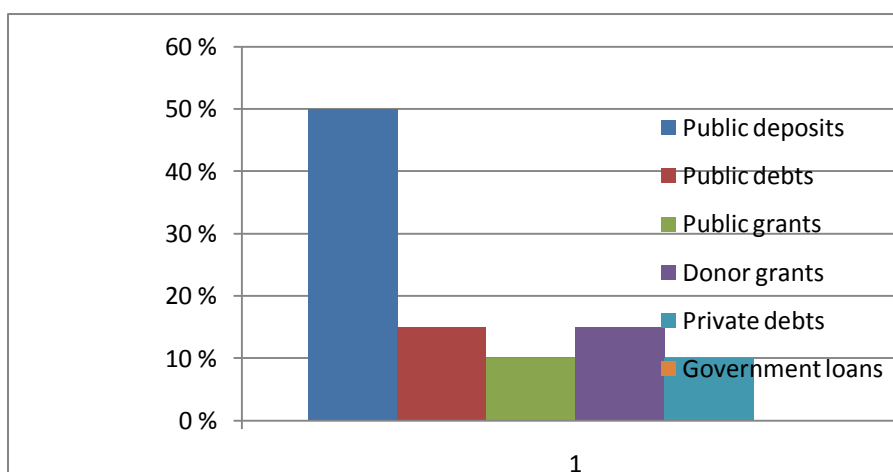
Figure 9: Sources of finance for finance institutions

The research also investigated the sources of financing for financial institutions so as to analyze and see if the institutions rely on deposits and subscriptions from the public. From the figure 9 above it is clear that 50% of institutions derive their financing from public deposits, making it the biggest source of finance for Kenyan financial institutions. Public debts and donor grants contribute for the 15% of the sources of finance for the financial institutions. Public grants and public debts indicate only 10 % of the institutions that took part in the study research. The Kenyan government does not offer any support financially to financial institutions as the table shows zero in the government loan segment.
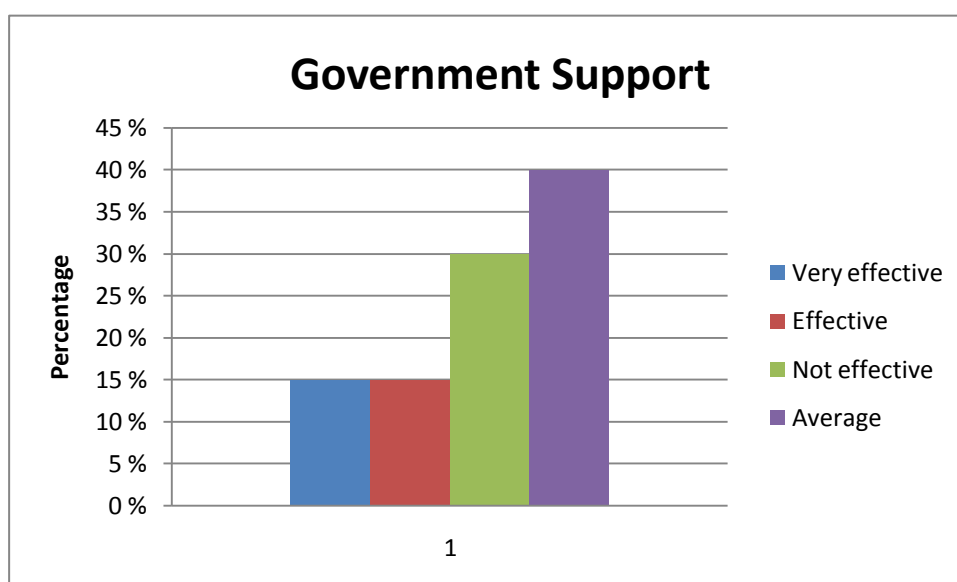

Figure 10: Effects of government incentives

The research also investigated the effects of government incentives. According to financial institutions perspective the results showed that 40% of the respondents indicated that the government incentive to financial institutions to be average, while 30% of the respondents believe that the government is not effective in providing incentives to boost financial institutions that would want to participate in financing low-cost housing. 15% of respondents believe that the government incentive to financial institutions is effective while another 15% of the respondents believe that the government incentive to financial institutions financing low-cost housing is very effective.

Figure 11 below shows how the respondents answered the question of how much the financial institution supported the projects set up by the UNHABITAT in Kenya.
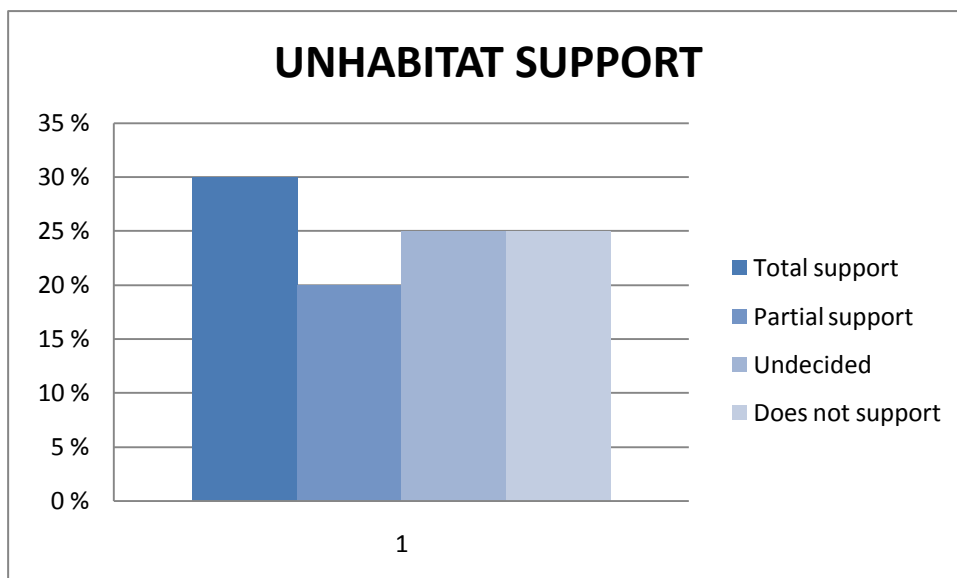
UNHABITAT SUPPORT

Figure 11: Support for UNHABITAT

The graph above shows that 30% of the institutions that took part in the research totally support the programme initiated by UNHABITAT. The graph also shows that 25% of the institutions polled do not support the activities of UNHABITAT and another 25% are undecided if they should support the projects of UNAHABITAT or not.Another 20% of the respondents said they partially support the programmes being carried out by UNHABITAT.

	Frequency	Percent	Valid Percent	Cumulative Percent
Poor	1	5,0	5,0	5,0
Fair	2	10,0	10,0	15,0
Average	8	40,0	40,0	55,0
good	6	30,0	30,0	85,0
Excellent	3	15,0	15,0	100,0
Total	20	100,0	100,0	

Table 2: Impact of UNHABITAT in fighting poverty

The table below and the graph have been used to analyze the impact that UNHABITAT has on the Kenyan people. This information was provided to the members of staff of the financial institutions in Kenya. 15% of the staff gave UNHABITAT an excellent rating in improving the lives of the Kenyan population while 30% of the staff who were involved in the study thought that the organization impact in reducing poverty in Kenya was good. 40% of the staff thought UNHABITAT has been average in helping curb poverty in Kenya, while 10% thought the organization has been fair in its performance in helping Kenyans in reducing poverty and lastly 5%

thought that the organization has not performed well in executing its mandate of trying to help eradicate poverty in Kenya.
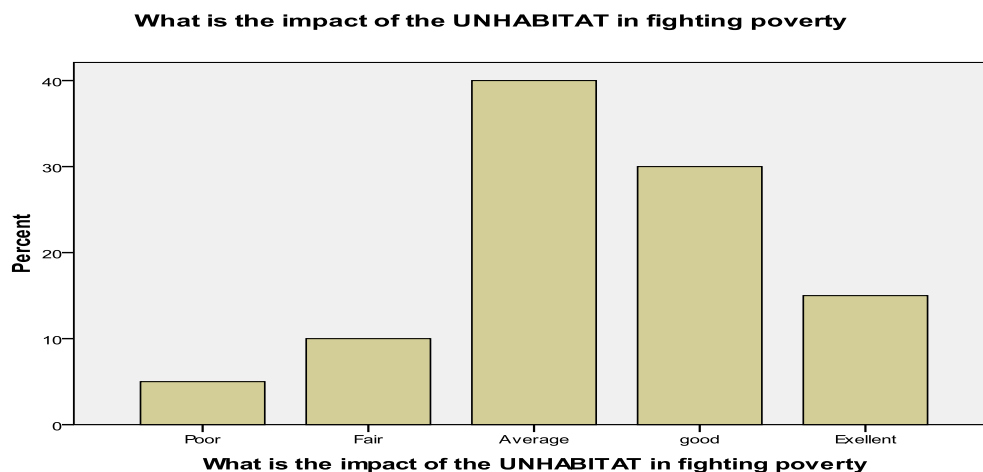

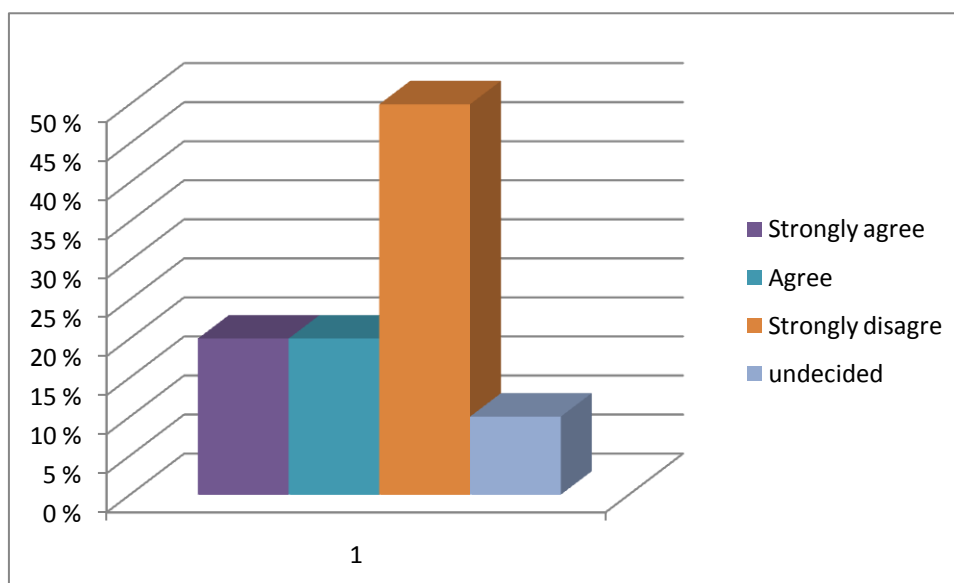Figure 12: Impact of UNHABITAT in Kenya

Figure 13: Profitability of Low-Cost Housing

The research question was to enquire from employees of financial institutions in Kenya if financing low-cost housing was profitable or not. The response received was as follows. Only 20% of the research participants strongly agreed that financial institutions are profitable while another 20% also agreed that financing for low-cost housing was profitable. The higher population of 50% strongly disagree that financing for low-cost housing is not profitable while 10% were undecided or did not know if it is profitable to finance low-cost housing or not. This

result shows how employees in financial institutions perceive financing for low-income housing.

11   Summary of Findings from Questionnaire

Having concluded a comprehensive review where the primary focus was the profitability of financing low-cost housing by financial institutions in Kenya and UNHABITAT, the research has been summarized below by combining different information received from different sources and the result is valuable information that could be used to draw proper conclusions on the topic of low-cost housing. This information is deemed useful in reducing the growth of slums in Kenya as it can provoke some financial institutions to join the field of financing low-cost housing in Kenya to help eradicate the growth of low-cost settlements.

11.1 Improving Private-Sector Participation in Low-Income Housing

To improve private-sector participation in reducing spread of informal settlements and also to eradicate the already large number of informal settlements that have been built in the urban centers of Kenya researches has been conducted. Kenya has a well-developed construction and building industry with very qualified engineers, architectural designers, and the private sector is currently undergoing a major boost from government-initiated projects such as the urban transport infrastructure plan and also due to the high number of human settlements moving from rural to urban centers.

The government of Kenya expects the private sector to play a major role in the financing of low-cost housing in Kenyan urban centers by targeting at least 200,000 units per year to try and meet the high demand for low-cost houses. The government of Kenya has set up projects such as the Athi river project by issuing one hundred hectares of land for the private sector to erect structures that low-income groups can afford. Private investors have been urged to work closely with the National housing corporation to find means of building settlements in the corporation´s large tracts of land that are all over the republic of Kenya. Other projects that the government is initiating for the private sector to be involved in for low-income groups are the pangani projects, starehe projects, packroad and shauri moyo projects, all these projects need private-sector participation to be able to operate efficiently and effectively.

The government has also given the private-sector the opportunity to be involved in slum upgrading and informal settlement programmes by suggesting their own idea on how to solve the problem. These are some of the projects the government has tried to encourage the pri-

vate sector to invest in to help in reducing spread of the slums in urban centers in Kenya. (Tradeinvestkenya, webpage)

11.2 Respondent Willingness to Participate

The total number of respondents who participated in the study and contributed to the data in the research was 50% of the sample population and this showed that the will to participate and find solutions in the process of eradication of slums in Kenya is much welcomed by a majority of Kenyans. A large number of the respondents also were cooperative and were willing to give more information for more studies on the topic being researched.

11.3 Default Rate in Financing Institutions

Defaulting in repaying loans in Kenya is a common phenomenon although research studies show no institution has a default rate of more than 50%.The study includes institutions that finance low-cost housing in Kenya. Although some institutions indicated a default rate of 20% to 50% it is important to note that this was due to varied reasons and not mainly financing for low-cost income groups. It is therefore difficult to say that the financial institutions which have experienced clients defaulting in paying back finances borrowed are due to financing for low-income groups. More studies however have to be conducted to determine the main causes of default by borrowers of finance in financial institutions.

11.4 Institutions Financing Low-Cost Housing

The majority of the financial institutions that took part in the study, 85% have indicated that they do not finance low-cost housing, while only 15% indicated that they finance low-cost housing. This was due to several reasons such as fear of default in payment by the stakeholders in low-income. Negative perception by the management about the returns provided in low-income housing, lack of investor knowledge on government incentives for the low-cost housing financers and finally lack of knowledge on the programmes offered by UNHABITAT.

11.5 Financial Deregulation

Financial deregulation is part of a government initiative to persuade financial institutions to put emphasis on financing low-cost housing. The government had ensured that the financial institutions that finance low-cost housing are able to work under a different financial system from other financial institutions in Kenya but this has not been the case as mortgage-able assets was still low and the cost of buying land is very expensive, forcing the institutions to finance individuals who can repay the mortgages. The results show that government efforts

are not showing positive results in regulating the financial market because the problems that financial institutions undergo are much more than what the government has been able to offer a solution.

11.6 Sources of Finance for Financial Institutions

The data received showed that 50% of financial institutions derive their financing from public deposits. It is therefore the task of the government to ensure the economy is functioning properly as this will ensure that the public is more financially stable. Studies have also showed that private investors want to invest in a stable economy; hence it is the duty of the government to ensure the economy is stable to attract more private investors who will boost financial institutions in the country.

The public invest their money in financial institutions and by doing that the financial institutions can experience growth, which in turn may ensure more financing for the public and finally help in reducing poverty. This is a cycle that starts with the government and comes to a halt with the improvement of living conditions of the Kenyan population. It is also evident from the research that the financial institutions receive no direct financial help from the government but the government help is witnessed in different forms such as tax-cuts and tax reliefs.

11.7 Perception of the Government Incentive by Financial Institutions

The conclusions drawn from the respondents in institutions is that the level of government incentive given to them to finance low-cost housing is mainly average and a number of the institutions believe that the government incentive is not effective and thereby not enough to convince them to invest in low-cost housing. The government support mainly is in tax relief on financial institutions financing low-cost housing and tax-cut for purchasing materials for constructing low-income houses. Information collected from interviews proposed the need to introduce low-cost home ownership plans for civil servants earning low-incomes and should be deductible monthly from the salaries of employees to be paid to the employees when they vacate civil service houses when retiring from employment. This can only be performed by the government since the civil service is run by the government of Kenya.

11.8 UNHABITAT Support

The research also investigated what Kenyan people thought about UNHABITAT and if they supported the activities of the agency. The result showed 30% of the Kenyans working in financial institutions supported fully the programmes performed by the agency. The researcher

also discovered that those who did not support the agency or were undecided due to lack of knowledge of the activities of the UN agency or were yet to see the full impact of the programmes being undertaken by UNHABITAT. It can be concluded from the results of the research on the support received by UNHABITAT that more education needs to be done so as to create awareness of the projects and the benefits that accrue from their activities.

11.9 Profitability of Financing Low-Cost Housing

Profitability of low-cost housing was the main question in the research study and it was answered in different ways through the questionnaires, interviews and also through the responses that were retrieved from the online journals that have in the past discussed the profitability of financing low-cost housing. The results showed that 50% of the respondents who took part in answering the questionnaires totally disagreed that financing for low-cost housing is profitable and they provided reasons such as high cost of land, building material, default by loan borrowers leading to losses for the financial institutions and lack of enough government support for institutions in these programmes. These reasons have clearly discouraged many institutions from taking part in financing low-income groups and by addressing and trying to solve these issues, it is therefore important to conclude that more institutions would be willing to take part in this type of endeavor.

12   General Findings from Interview

The findings from the interview showed that investors in the financing and housing industry are prone to several risks in the process of performing their daily duties of financing. The risks mentioned are risks such as warehousing risk, pipeline risk, default risk and prepayment risk.

The interview also enlightened that most of the financial institutions have not attained mortgage securitization as a tool to ensure security for their finances. The respondents in this research also indicated that the limiting factor to government monetary incentives in low-income housing finance was due to lack of investor knowledge in government incentives coupled with the existence of bureaucratic procedures in the government process that causes delays in accessing the government incentives offered by the government to the institutions that are willing to offer financing for low-income groups. The problem of corr uption in the country has also been identified as a hindrance in effective management of government projects allocated to the low-income groups as money has been misappropriated by the individuals who are in charge of the projects.

The respondent of the questionnaires also enlightened the fact that the domestic financial market has the capacity to absorb the demand for financial capital by private and public-sector agencies involved in low-cost housing; this would help in the development of the projects that have been hindered due to lack of enough finance to complete them.

In considering the most significant risk that the financing industry is prone to, the default risk was mentioned as the most significant according to the research respondents. Other limiting factors identified through the research is the inability to determine the default risk in the provision of finance for the low-cost housing sector due to lack of sufficient information on the performance of debt to the low-cost housing sector.

13   Recommendations

From the findings that were received during the interview the following recommendations have been mentioned to help in solving the problem of slums in the urban centers of Kenya.

13.1 Strong Economic Growth

The research findings show that growth of microfinance institutions in countries that have been successful in low-cost housing is related to the availability of finance for housing to the low-income sector. It is also important to note that private investors are attracted to investing in countries with good economic growth as this was one of the factors related to the market potential. This is due to economic growth increasing the per-capita income, hence increasing the potential of people's ability to repay loans and thereby reducing default risk.

13.2 Availability of Capital for Developers

The research showed that the scarcity of capital is one of the reasons limiting the growth and earnings in the financing of low-income housing. The research results showed that the local market has adequate capacity to provide the required financial capital for the low-income sector; because all the financial agencies interviewed derive their financing from public deposits as a source of finance.

13.3 Availability of End-User Financing

Through the research it is clear that mortgage facilities for low-income housing were difficult to obtain due to management perception of risk in the sector. This is because most of the financial institutions have not directed their financing to the low-income finance sector and have directed their financing to middle-income earners and wealthy individuals in society.

This development explains the possibility of lack of adequate financing for the low-income segment

13.4 Manageable Risk in Low-Income Housing Sector

The research results showed that default risk experienced by the financial institutions was not as high as thought because no financial institution has a default risk of more than 50%.However a large number of the institutions recorded a default rate of 20% to 50%. However other risks that institutions undergo are risks such as prepayment risks, pipeline risks and warehousing risks. These findings imply that the default risk can be underwritten by the financial institutions in Kenya.

13.5 Availability of Industry Returns Information

The research also indicated that the three main financial institutions in Kenya that finance low-cost housing have an average rate of return on capital of 12% compared to institutions which do not offer financing for low-income housing and have an average rate of return of 3.9%. This shows that financing for low-income housing has good returns. Proper risk-return analysis should also be conducted by financial analysts in financial institutions in Kenya so as to properly analyze the returns that the financial institutions can achieve, should they invest in the process of financing low-income housing segments.

13.6 Lack of Investor Knowledge on Government Incentive

The research results showed that most of the management staff in financial institutions had no sufficient knowledge on the monetary incentives provided by the government to promote institutions financing low-cost housing. It is therefore important to educate industry stakeholders on the available government incentives such as tax-cut on building materials, tax relief on financing agencies in low-income housing groups and also the development of secondary mortgage market and establishment of the low-cost home ownership savings plan. Losses to institutions that arise due to imprudent lending decisions should be rectified by the responsible financial officers in the financing institutions so as to properly identify the main cause of loss.

13.7 Bureaucratic Procedures in Government Departments

It is recommended that the bureaucratic procedures that have to been put in place for the financial institutions before they can acquire any assistance should be discarded as this was discouraging potential investors who would wish to participate in financing for low-cost hous-

ing. The financial guidelines by the central bank of Kenya should also be revised to allow financial institutions to share client information with other financial institutions, making it difficult to be able to cooperate in the need to make a decision on the clients' financial credibility.

13.8 Lack of Infrastructure

Lack of infrastructure by government has also been identified as a hindering factor to providing resources such as water in urban centers. It is therefore the duty of the government to put in place correct measures that will ensure the infrastructure is well managed so that financial institutions that would want to engage in low-income housing finance can work in a better environment for business prosperity.

13.9 Land-Buying Companies

Land-buying companies buy and sell land to interested buyers. The government should involve more land-buying companies in its financial system because they offer financing to potential clients to purchase land and offer financing for construction. Other countries practicing effective low-cost housing finance have effectively managed this and have benefited the poor in society. These are institutions that offer services of buying and selling land to the interested buyers by entering into agreements that would benefit the investors who wish to join the housing segment. According to the senior relationship manager of the housing finance cooperation of Kenya (HFCK), substantial amount of low-cost housing is being conducted by the land-buying companies. The land-buying companies also provided limited amount of financing for construction but mainly were concerned with acquisition of land. However this has stopped functioning due to the financial regulations that the government ratified and have come into effect. (Chris Chege 2010)

13.10 Contractor-Based Finance

Another form of housing finance is mutual agreement between a plot owner who may have adequate finance and a construction contractor. This occurs where the contractor provides finance, material and labor to complete an already halfway structure that may have stopped due to lack of finances by the plot owner, and in another scenario the owner may provide building material while the contractor provides labor and completes the building. In both cases a mutual contract between the two implies a loan from the contractor who will then recover his investments in installments either from the rent or other income payment provided by the owner. The contractor is involved only if he is sure of gaining a return on the investment and in most cases he earns profits after recovering the money he invested in the

business. This is a less risky venture because returns are guaranteed from the rent acquired from the property. (Chris Chege 2010)

Contractor-based finance can also be a mutual agreement between plot owner and construction worker to finance a collapsed project due to lack of finances. These are viable recommendations for financing companies to enact as this enables them to recover the money they have invested in a project without fear of default in payment as they enter a mutual agreement to recover the finance invested in the business as soon as the project is complete and functional. This is would help reduce poverty and growth of slums. (Chris Chege 2010)

13.11 Fear of Losses Due to the Amount of Risk Involved

The risk involved in low-income housing has been identified as minor and not as it has been perceived by financial institutions that have not invested in financing low-income housing. Proof of this can be seen as that the financial institutions which have been involved in this type of financing have a higher percentage rate of return as compared to those that have not invested in financing low-cost housing.

14   Conclusions

The main objective of the study was to determine the profitability of financing low-cost housing by indicating the factors that have hindered the institutions from providing financing for low-cost housing projects and what measures can be established to try and influence more institutions into financing low-cost housing in Kenya. The research results of the study show that financial institutions have the capacity to earn profits if they prudently finance low-income groups without the negative perception of incurring losses. The risk involved is not unique because from the research study other types of risks that financial institutions undergo have also been highlighted. This clearly shows that other risks also contribute to the magnitude of losses in financial institutions and it is not only the risk of default as perceived by most opponents of the low-income housing segment. The programme of financing low-income housing has been practiced in other parts of the world successfully with proper guidelines and structures and it can also be practiced in Kenya if it is prudently managed. The proper management of low-income financing projects would then help in reducing the spread of slums in the urban areas of Kenya.

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List of Figures

14.1 Appendix 1: Questionnaire Cover Letter

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Dear Sir, madam,

I am a student in Laurea University Of Applied Sciences and I am conducting a research on the profitability of financing low-cost housing in Kenya and I intend to get information from the financial institutions in Kenya so as to be able to contribute in the fight against growth of slums in Kenya by using the information I receive from the institution. There-fore I request you to kindly fill the questionnaire below on profitability of financing low-cost housing in Kenya carefully. Proper information is important when filling the ques-tionnaire because this information will be used to make conclusions on this sensitive topic.

Please fill the questions by ticking where appropriate as shown in the questionnaire and the respondent is free to omit any question that they chose not to answer. Please return a completed questionnaire to the email provided above to DAN KIDUNDI as soon as possi-ble.

Return of survey serves as consent to use the information provided for the study being carried out, and in case of any questions or uncertainty then you can call the number given above to get clarity of the issue at hand.

Thank you so much in advance for your participation in the survey

APPENDIX 1: QUESTIONNAIRE

1 **Gender**

Male
Female

2 **Is financing for Low-cost housing profitable?**

Strongly agree
Agree
Disagree
Strongly disagree
Undecided

3 **Does your institution finance Low-cost housing?**

Yes
No

Has financial deregulation helped improve your interest rates in
4 **Low-cost housing?**

Yes
No

What projects are being carried out by your institution for the
5 **Low-income households?**

Savings account services

Development financing

Banking with low bank charges

small loan services

Group lending for housing

6 **What is the impact of the UNHABITAT in fighting poverty?**

Excellent

Good

Average

Fair

Poor

7 **What is the average default rate in your institutions?**

Above 50%

30% to 50%

20% to 30%

Less than 10%

8 **Does your institution support the UNHABITAT programme?**

Total support

Partial support

Undecided

Don't support

9 **What are the primary sources of finance in your institution?**

Public deposits

Public debts

Public grants

Donor grants

Private debts

Government loans

        _____

        _____

        _____

**1
0**

What are the effects of government incentives to Low-cost financing institutions?

        _____

Very effective   _____

Effective   _____

Not effective   _____

Average   _____

        _____

        _____

        _____

THANK YOU