Informal Sector Housing Finance in Africa

by Niels O Jørgensen

Informal settlements are an ever growing part of the housing environment in Africa. Housing policy-makers must face up to this situation and facilitate improvements in both the physical and social conditions of these settlements.

Availability of finance is basic to the success of all housing policies, and an understanding of how resources are mobilised and allocated in the informal housing sector is basic to the effective use of finance. In contrast to the formal sectors, public as well as private, where the flow of funds is regulated by governmental intervention, the informal sector is, by definition, left to its own devices. It is here the free market forces operate most directly to determine the prices of production factors, including the price of money. Only when formal sector institutions understand how much - and on what terms - the informal sector is willing to pay for shelter and services, will they be able to help those most in need of housing.

To make a fundamental distinction between formal and informal housing is misleading, because the line between them is diffuse to the point of being misleading. I shall not try to lend precision to their differences. The article is mainly concerned with why access to formal sector housing finance is possible for some structures and not for others, or for some individuals and not for others, and why some houses, originally financed by formal sector institutions, cannot be extended with finance from the same sources. In short, I propose to show that the problem with housing finance is not affordability but accessibility.

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The data used to illustrate how the informal housing sector operates were collected recently in two typical informal settlements just outside large urban areas in Africa. The names of the settlements have been changed for this presentation. *Bravo Estate* is a fairly new (post 1970) and rapidly growing settlement of relatively expensive structures built in permanent materials, whereas *Hope Estate* is a traditional type or old settlement, with houses built in local materials at a much lower cost.

In both settlements, services are at a minimum and mainly self-provided. The focus of the comparative study is on an analysis of the income generating capacity of housing and of the extent to which this income is recycled into housing. By capturing the flow of these funds, now mainly outside the reach of formal sector institutions, the housing finance sector can mobilise significant additional resources for the benefit of the inhabitants of informal settlements.

In both settlements, houses typically have 5-10 rooms all on the ground floor and with separate entrances from a courtyard, because they serve as residences for the owners as well as tenant families. This pattern has developed out of necessity, as plot owners need the income from lodgers to help repay the cost of their own accommodation. Owing to the high demand for habitable space, income from rented space can repay construction cost within a "manageable" time frame. Repayment time obviously varies with the terms on which funds are obtained and with how many rooms are provided. Because tenants prefer to rent in houses with few rooms, the rent per room tends to be reduced in big houses. However, many owners build to the maximal coverage of their plot, because the marginal cost is favourable. Being informal, the houses do not conform to existing planning and building codes, except with regard to room size. The minimal bedroom space of 3m x 3m is also the optimal size, because it is the smallest room where three beds - or six "double deckers" - fit conveniently.

The first example is a typical unit in Bravo Estate. Here, the original owners had acquired their plots as members of a co-operative which had bought some marginal land from a local farmer, shortly after the country's independence when prices were depressed. Each member of the co-operative got four plots, and most members sold off one or more plots to generate funds for a house. Later, settlers who bought plots from original owners had difficulty getting a structure started, but the survey gives an indication of the sources the new owners drew on, which are:

- Savings and Credit Unions;

- Welfare (Burial) Societies;
- Employers;
- Relatives and friends;
- Loans on other assets; and
- Regular and seasonal income.

No housing finance institution, including Building Societies would lend on the structures, first, because no title deeds exist for the individual plots (the area is still zoned agricultural, and the houses have been built illegally, although curiously, all houses are built in stone with permanent roofs and are much more substantial than the houses in a publicly financed "City Council Estate" nearby) and, secondly, because none of the owners would qualify for a loan on the grounds of "affordability" (present income = 3x repayment).

In most cases, security for a loan was not required but, when it was, it was either in the form of guarantors (Savings and Credit Unions) or, in the case of some loans from friends and relatives, the lender was authorised to collect part of the rent until the loan was paid off.

Interest was charged on some loans, but the rate varied greatly from nothing charged by friends and relatives to 19% from a finance company. Savings and Credit Unions incorporated interest at 12% per annum in the monthly repayments, but individual lenders simply collected extra rent for a couple of months after the loan was paid off. As far as could be ascertained, no one paid interest which, in the local context, could be termed exorbitant. Private moneylenders did not appear on this scene, presumably because the amounts involved and the durations of the loans were not interesting for them. In any case, their rates of interest would have been out of reach of the borrowers.

ECONOMIC VIABILITY

Inhabitants of informal settlements may be ignorant of many aspects of urban life, but economic viability of housing is not one of them. In *Bravo* and *Hope,* owners as well as tenants know about up-to-date construction costs and what kind of rental income can be expected from different kinds of accommodation. Even awareness of annual escalation in both of these factors is widespread in both settlements.

Cost and income figures relating to the houses in Bravo Estate are embodied in the calculations in Figure 1, as they would be carried out by a prospective owner. It is common to use one's own savings to acquire the plot and then to start looking for finance for the house.

For the average low-income person earning $100 per month, the shortfall is affordable. If the owner's income is less than $100 per month or if the money to purchase the land also has to be borrowed, a few rooms would be completed initially, and the rest would be added when funds became available. However, a delay is obviously to nobody's advantage. An income of $22 per room per month would repay a loan of $1,125 over six years at 12% (the interest rate of Credit Unions). This amount is higher than the cost of an extra room and is, therefore, an excellent investment. Actually, it would take less than six years to amortise the loan, because rents go up by about 10% a year.

There are several variations to this example. Interest charges could be higher or lower and the repayment terms could be longer or shorter. However, the example serves as a contrast to what ought to be possible: namely, $10,000 to be raised on formal sector terms at 16% over 20 years, which works out at $139 per month for the whole project. The investor would then have a profit of about $70 per month and be able to live free of charge. This is ideal from the investor's point of view - and would even

Figure 1 : Cost and Income Figures fo Bravo Estate

Plot (Unserviced)	$ 1,250
House with 10 rooms	$ 10,000
Total	$ 11,250
Less own funds	$ 1,250
Amount to be financed	$ 10,000

It is common to use one's own savings to acquire the plot and then to start looking for finance for the house.

Monthly Income and Expenditure :

Repayment of loan of $10,000 over 72 months	$ 139
Plus interest on some loans	$ 60
Maintenance cost	$ 20
Total Expenditure	$ 219
Income from 9 rooms, $22 each	$ 198
Shortfall = own rent	$ 22

house the no-income family ! But looking a it from the point of view of the over-a housing environment, it might not be th optimal solution, given the lack of infra structure and contravention of buildin codes.

If physical planning standards were to b enforced in informal settlements, the cost c housing would increase to the point of mak ing it unaffordable for the low income famil and, hence, a non-viable investment unde the informal finance system. Howeve finance terms from the formal / public secto could be offered on such terms to chang this situation, in short, converting the are from an informal to a formal settlemen This may not reduce another serious prob lem in these areas - over-crowding in rooms

Over-crowding is a function of demand an supply of units. So, if funds on formal secto terms are directed towards these settle ments, more and better houses will be built, and the housing environment will improve.

Before we leave the subject of economic viability, there are a few observations which are worth making. The owners did not include in their calculations such items as - On the cost side:

- cost of their own funds, that is interest earned or forfeited;
- cost escalations due to delays in construction;
- interest during construction;
- opportunity cost of land;
- escalation of maintenance cost; or

On the income side:

- escalation in rental income;
- letting rooms for business at a higher rent than bedrooms;
- capital gains on property as area develops.

These items all have some effect on the ex post calculations of return on investment, but local experience shows that the effects are more positive than negative.

CASH FLOWS

Just as important as being able to raise funds are the terms on which finance is available. No one in the survey thought that the standard terms of Savings and Credit Unions of 1% per month over three years (renewable) for 2-3 times the amount already saved, were unreasonable. However, knowing that the terms of finance companies, which specialise in hire-purchase finance, are 19% per year over three years, kept owners away from these sources of funds. Instead, employers, relatives and friends were approached. Curiously enough, one finance company eventually did get involved in this type of housing finance, offering seven to nine years to pay, but still at 19%. The reason many owners were interested in this was that it made sense to take as much as they could get from other sources first and, then, the remainder from the finance company in order to get their cash-flow going. The security requirement from this one formal sector institution was a "plot owner's certificate" issued by the land owning company to each plot owner and registered in the company's books. The certificate was held by the lender, and the charge was noted in the company's register.

The survey established that the main problem with loan repayment is not the interest rate but cash flows. If finance terms can be changed to make repayment schedules compatible with income generation, the old concept of *affordability,* based on present income, becomes obsolete. A realistic concept would be *payability* or *willingness to pay.* Likewise, the term *low cost housing* becomes less relevant than *low income housing,* when it comes to financing shelter for the poor. Two significant facts support these views:

Investment in informal housing has a capital / output ratio of between 2 and 3, that is, it returns investments in 2-3 years - higher than in most other sectors of the economy.

Income generated from this type of investment does not flow uniformly over the period of its lifetime - the same as for investments in industry, agriculture and other sectors.

The first fact argues for more money to be invested in this area or, put differently, for obstacles in the way of more money being invested in this area to be removed. It highlights the paradox of the present situation, where there is plenty of finance available for cars but not for houses (costing about the same but for very different lifespans, capital / output ratios, social benefits, foreign exchange demands etc.). This is because *affordability* has been replaced with *willingness to pay.* Few investments would be financed at all, if present incomes were used as a criterion.

The other point argues for a loan form different from the fixed annuity type prevailing at the moment. There is no reason why various forms of graduated or variable repayments should not be acceptable, along with grace periods and no-deposit loans. A premium for these sought-after *qualities* of finance could be asked and would be paid. It must also be in the lenders' interest to make loan terms compatible with borrowers' ability to pay, instead of using inflexible repayment methods for administrative reasons. So-called *normal* loans rarely comply with the prescribed repayment schedule anyway.

SECURITY

The overriding concern with security on the part of the formal sector lenders is understandable. However, to insist on having life insurance to cover repayments in addition to security in the house itself ("we are protecting the borrowers' own interest") indicates the existence of an unhealthy sellers' market in formal housing finance. To insist on unrealistically high standards points in the same direction and is not the way to accommodate low income housing. The security of any house is solely the use it can be put to. If no one wants it, it is worthless, but in most informal areas, even the cheapest shack has value, because someone wants it and will pay a price to own or rent it.

Another curious way of dealing with security was uncovered during the survey. Realising that the *plot owner's certificate* referred to before had little or no legal standing in case of default, lenders made the borrowers sign an agreement to sell his property at the amount outstanding in the event of default (defined precisely in the agreement). There is, however, little risk that the lender will ever have to call up this agreement, because any owner / borrower is keenly aware of the profit which can be made by disposing of the house before the forced sale takes effect. We found no case of default on housing loans.

Lenders involved in these two areas only considered future income a criterion for affordability. In this respect they are, of course, in line with commercial banks. They do not want to extend the term of the loans, as their own money comes from short term deposits, but normally, they are willing to reschedule loans in case of genuine hardship. In spite of their illegal nature, neither of the two settlements were in danger of being demolished; thus economic viability of the housing investment was the only kind of security required.

Much more could be said about what constitutes security on housing investment in an informal area. Suffice it to say here that, by definition, informality in this respect means unauthorised if not unplanned. One settlement was self-planned whereas the other was unplanned but subject to what can be called benign neglect from the authorities. As this topic touches directly on the present and future environment of informal settlements, that matter deserves separate treatment.

PHYSICAL ENVIRONMENT

When the urban population overflows into informal settlements it is not the residents' fault. It is because there is no formal accommodation available. The reasons for this are well known. Financing is one of them but, probably, not the most important. At a minimum, land has to be available, and a plan prepared - even if it is only marked by a few pegs in the ground. Water can be brought in and refuse taken out, and these services can be paid for by users. Almost everything can - and will - be organised and paid for by those who live there, but the issue is the environment that is created and whether it improves or deteriorates. To enhance the physical environment, investment in infrastructure and superstructures is necessary. We have dealt with houses - what about infrastructure ?

The most important element of infrastructure is development planning. If there is political will to give high priority to human settlements planning might be all the public sector needs to do. Money is hardly an obstacle at this point. In fact, more sins are committed by setting standards too high than too low. Once areas are designated (zoned) for residential purposes, private developers are usually the first to find out what the market is like. They will acquire land and service it to the standards they think will sell and for which long term finance is available. If central and local authorities feel obliged to provide infrastructure, for reasons of social commitment and political expediency, this is usually welcomed by low income groups and occupants of informal settlements, because they expect it to be cheaper than if left to private developers. Perhaps so, but there is no reason why it should be. All project costs should be recovered for reasons of replicability. Subsidies result not only in "selling below cost", but also in not charging what users are willing to pay. Whatever cost is written off or not charged is lost for further improvements in the physical environment. This is particularly true for provision of water: commercial charges discourage misuse, and they are also among the easiest charges to manage.

Rates are often used as a charge on each plot to cover public expenditure on provision and maintenance of infrastructure, although they seldom do. Actually, it is impractical and unfair to relate income from rates in one area to the cost of providing services in the same area, or, for that matter, to tie tax from one source to expenditure to the maintenance of that same source. The argument for applying rates according to an area's tax propensity is that all settlements are entitled to a sound and improving environment, whether the residents can afford it or not, just as any person is entitled to police protection whether he/she pays taxes or not. The cost of these services has to be raised through taxes, no matter from where. A surplus from one area must consequently be used to cover a deficit in another area.

In regard to public services, it is of interest to see what our survey revealed about residents' priorities. Contrary to what we had expected, security of tenure was not on top of the list. It appeared that residents all felt that the settlements were so well established that it was no longer physically or politically feasible to remove them. There was some concern over having to give up certain plots if the local authorities were to adopt the settlement as a residential area and provide services. This problem could be handled through compensation plots. Highest on the list of priorities was proper roads. During the rainy seasons, practically no vehicles could get through, and pedestrians had to take off shoes and socks when wading through puddles. This type of complaint implied the need for surface-water drains. However, apart from lack of schools and no refuse collection, there were few complaints over lack of services. In Bravo Estate, water had been brought on-site a long time ago by the landowner's company - illegally - but with individual metering and payment via the company to the authorities through the account of the pre-existing farm house. The authorities know what is going on but have decided to ignore it. Electricity and telephone lines are also in, because these are provided by private companies.

There were complaints by tenants in Bravo Estate that density of structures is too high but little can be done about it now. There were no such complaints by owners. Knowing how dense yet attractive some of the old settlements in European and Arab countries are, there is no reason why this problem cannot be tackled over time. Again, cost will not be the obstacle, because any environment and, therefore, user-value will be enhanced, and rents will go up. Finance might be a problem, because private formal institutions are reluctant to get involved where public authorities are still wavering.

Assuming that the environment improves, property values are enhanced and rents go up etc., will present tenants still be able to afford to live there ? Possibly, because their incomes will have risen as well, but it is a normal phenomenon that residents change as neighbourhoods do. It is also conceivable that room occupancy rates will increase, in order to pay for higher rents, but this is a process which cannot be and should not be interfered with.

SOCIAL ENVIRONMENT

It is somewhat misleading to speak about social environment as separate from the economics of housing and services, but, for lack of a better term, it can be used to refer to the significance of human relationships and of community participation which was quite evident in both settlements, although more so in the unplanned and older of the two.

For the purpose of the article, the most interesting aspect of the social environment is the extent to which self-help and neighbour support is involved in the construction of houses. The contractors are local and so are many of those who manufacture windows, doors, roofs, furniture etc. Local labour, skilled and unskilled, is used extensively. The multiplier effect of construction, therefore, benefits the local community.

Existing tenants tend to recommend new tenants to their own landlord or to the one next door, because they like to have friends or relatives living nearby. This, in itself, creates a social coherence not often found in public, low-income housing schemes, and it is a part of the social environment which can hardly be overestimated. It shows itself in the help people can get when in need, for example tending children, doing shopping, washing, cooking and borrowing money. Money lending is facilitated by being able to see what the money lent is used for. Repayment is enforced by social pressure, also known as "proximity control", but those in genuine trouble with a payment will be treated with the compassion so well developed in close communities in Africa.

As pointed out earlier, the kind of multi-tenements which economic realities have promoted in these two settlements are not ideal from an environmental point of view - either physically or socially. Nevertheless, in the absence of a clear commitment by local authorities to recognising and accepting responsibility for these settlements, it is difficult to see how it can be different. The "capital shortage" excuse is no longer valid, because the public sector, in particular, can always raise funds for economically viable projects which benefit the poor.

CONCLUSION

It is easy for some authorities to turn their back on informal settlements and leave them to their own devices; in some respects it could be argued that these settlements do better without interference from the authorities, but only in some respects. Those responsible for physical planning and the environment in general must deal with these unplanned and unrecognised human settlements. The longer they wait, the more difficult it becomes and the more it will cost. What can be done? The survey results which are much more extensive than described here give some encouraging pointers.

Physical planning of even the most rudimentary kind, is essential and must be assisted when new settlements start to form or existing ones expand. Assistance can come from sources other than the local or state authorities, for example voluntary organisations or, if formal approval of plans requires professionals to prepare them, from private consultants. Space provisions for physical infrastructure, including social services, recreational facilities etc. are essential. If such plans are prepared and clearly explained to the community, it will be less difficult to enforce basic regulations, because they will be, and will be seen to be, in everybody's interest.

Many surveys have shown that the only thing poor people need is money! That is to say: if only money could be made available for them to get started on a house, the demographic and economic realities are such that home-builders are prepared to pay a realistic price for what they want. If they can get both the house they want and money on terms that fit their income profile over time, they will even pay a premium price for finance. They need not pay a premium because of the high risk factor, but there is a valid case for charging to cover high unit costs of processing small loans. It is a myth that low income groups are most likely to default on loans: investigations show no such correlation - if anything, a negative correlation exists with respect to defaults and size of loan.

However, the poor are like the rich, in the sense that the economics of the housing situation will tempt them to exploit their land to the full. This exploitation harms the environment, but it can be counter-acted by planning and by a rationing of the finance provided, so that the amount offered will be commensurate with the space available and the densities required. In practical terms this means money enough to complete the approved type of house in one operation and on terms in keeping with the owner's income after completion. This will make loan repayment possible at commercial rates of interest and, in turn, make it easier to mobilise more funds for low income housing. ■