

POLICY FRAMEWORK FOR HOUSING FINANCE IN RWANDA

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ABSTRACT

The provision of housing as per the Housing policy in Rwanda does not effectively address the needs of low-income earners. The purpose of this study is to identify whether there an evidence-informed policy framework can be developed to better cope with the demands and expectations of low-income earners regarding housing finance in Rwanda. The information gathered in this research was mainly through an international literature review coupled with key-informant interviews. Two senior officials were interviewed: one from the Housing Bank of Rwanda; and the other from the National Bank. One influential Housing developer was also interviewed for the research.

The research outlines the changing pattern of housing provision and policy in Rwanda over the last 10-20 years and considers some manifestations of housing systems in the international arena. It then goes on to consider the models of access that have dominated housing policy debates and how these have influenced the approaches taken in the search for remedies in housing provision policy before drawing conclusions about the challenges for housing the targeted group.

DECLARATION

I declare that this research report is my own, unaided work. It is being submitted in partial fulfillment of the degree of Master of Management in the field of Public and Development Management in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in any other University.

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TABLE OF CONTENTS

CHAPTER 1	1
INTRODUCTION.....	1
1.1 BACKGROUND	1
1.2 PROBLEM STATEMENT	3
1.3 PURPOSE STATEMENT	4
1.4 DATA COLLECTION TECHNIQUES	4
1.5 DEPLOYMENT OF STUDY	5
CHAPTER 2	7
LITERATURE REVIEW.....	7
2.1 PRACTICES ELSEWHERE IN THE CONTINENT	14
2.1.1 <i>Kenya's Housing System</i>	<i>14</i>
2.1.2 <i>South Africa Housing System</i>	<i>17</i>
2.2 INTERNATIONAL LESSONS.....	18
2.3 INFORMED POLICY PRACTICE	23
2.4 CREDIT RISK MANAGEMENT	30
2.5 HOUSING POLICY DISCUSSIONS	36
2.6 SUMMARY	47
CHAPTER 3	49
RESEARCH FINDINGS	49
3.1 ECONOMIC JUSTIFICATIONS FOR HOUSING SUBSIDIES	49
3.2 EVOLUTION OF RWANDAN HOUSING POLICY	51
3.3 THE NEED FOR POLICY REFORMS	58
3.3.1 <i>Housing Policy Orientation.....</i>	<i>58</i>
3.3.2 <i>Challenges and Strategies of Housing.....</i>	<i>61</i>
3.4 BANKING AND FINANCIAL SYSTEMS IN RWANDA	65
3.5 CONCLUSION.....	74
CHAPTER 4	76
ANALYSIS AND INTERPRETATION.....	76
4.1 EFFECTS OF THE ECONOMIC CONDITIONS	76
4.2 DEVELOPING A COMPREHENSIVE HOUSING POLICY	80
4.2.1 <i>Stringent and excessive housing loan conditionality.....</i>	<i>80</i>
4.2.2 <i>Participation in basket funding and sector-wide projects (SWAPs).....</i>	<i>81</i>
4.2.3 <i>Rigid procurement rules and procedures</i>	<i>82</i>
4.2.4 <i>Legal constraints</i>	<i>82</i>
4.2.5 <i>Information, communication and marketing</i>	<i>83</i>
4.2.6 <i>Poverty and inequality.....</i>	<i>83</i>
4.2.7 <i>Vulnerability to shocks</i>	<i>84</i>
4.2.8 <i>Globalization and economic integration</i>	<i>84</i>
4.2.9 <i>Private sector growth</i>	<i>85</i>
4.3 HOUSING FINANCING SYSTEM ANALYSIS	85
4.4 RISK MANAGEMENT REGULATIONS	89

CHAPTER 5	92
CONCLUSION AND RECOMMENDATIONS	92
5.1 CONCLUSION.....	92
5.2 RECOMMENDATIONS	94
<i>Income security and employment.....</i>	<i>98</i>
<i>Credit risk management.....</i>	<i>98</i>
REFERENCES.....	101

CHAPTER 1

INTRODUCTION

This research explores how housing finance institutions can expand their criteria of Credit Risk Management without segregating any group of people, especially the low-income earners in Rwanda. The housing “crisis” has become all too familiar to the people of Rwanda. Since the early 1990’s, this country of 8 million residents has been locked in political and economic turmoil. One crisis after another has kept the national agenda preoccupied with fundamental political reforms and macroeconomic stabilization, and hence inattentive to the growing social concerns rising from rapid urbanization.

Micro Finance Institutions (MFIs) in Rwanda, offer the poor a path to traverse out of poverty. However, this way out from poverty has proved very long and tedious due to the limited nature of MFIs’ existing operations, which is confined to disbursement of credit for micro businesses and at the most, accepting deposits of their members. Commercial Banks draw lines as to who is creditworthy and who is not by looking at several factors like jobs, salaries, collateral and even the ability not to default as part of good Credit Risk Management (CRM) practice, and hence discriminating against low-income earners by default.

1.1 BACKGROUND

Rwanda, a developing country is located in the Western Centre of Africa. Rwanda has an estimated population of 8 million. This country is divided into ten prefectures. The principal cities are Kigali, the capital, with a population (1999 estimate) of 369,000. Most of these people use financial institutions which mostly prevailing with housing.

Rwanda is recovering from tragic human and economic destruction that has few, if any, parallels. The genocide of 1994 resulted in the destruction of the country's social fabric, its human resource base, institutional capacity, and economic and social infrastructure. At least 1 million people were killed, about 2 million fled to camps in neighbouring countries, and another 1.5 million were displaced

internally. The economy declined by 50%. The Government of National Unity, a coalition of the Rwanda Patriotic Front (RPF) and four other political parties, assumed office in July 1994.

The new government has a bold vision for the future and is determined to re-establish peace and put effective governance on a sustainable path. Peace has been restored in most of the country, and 3.8 million persons, including internally displaced and returned old- and new-caseload refugees, are being resettled and reintegrated into society. In 1997, the government adopted a transition program to consolidate the fragile socioeconomic recovery attained during 1995-96 and lay the basis for national reconciliation, sustainable growth, participatory decision-making, and poverty reduction.

Poverty levels have worsened significantly since the 1980s. The ability of a typical household to afford necessities, such as food, shelter, clothing, medical care, and educational services, has declined sharply in the 1990s. The proportion of households below the poverty line has increased from 40 percent in 1985 to 53 percent in 1993; with the sharp decline in income that followed the genocide, it has dramatically increased to 70 percent.

Social indicators, particularly survival rates have worsened considerably. Owing to the genocide, female and minor-headed households, which now account for over 34 percent of the population, are the most vulnerable groups among the poor. Structural reforms and investments in social and economic services are needed urgently to generate high and sustainable growth that, in turn, will create employment, reduce poverty, and improve social conditions according to the International Monetary Fund report 1999-2001.

Provision of Housing was part of poverty reduction, which was extremely difficult most especially after the war (1990 to 1994), yet extremely important function, affecting the quality of life of every citizen. Adequate housing is the cornerstone of a well-developed social order.

In Rwanda, there were three groups of people. There are those that had survived the genocide that had long settled that occupied their own houses although some were at the verge of dilapidating. The second group were the thirty year exiles who were returning back home that were occupying houses of those who had gone into exile or had suffered the genocide. The third group comprised those who had gone into exile after the war of 1997.

Government then came in with a campaign through the Diaspora that those in exile should come back home for reconciliation purposes. Therefore most of the second group that had occupied houses had to vacate them. This brought in discrepancies where the low- incomes earners could not afford renting and yet could not afford building there own houses. They did not have any collateral or security of stable job to get loans from the Banking and Housing Finance institutions hence building sharks that culminated into slums.

The RPF government has a task of insuring security of the person, social stability, better health and crime reduction that are all proven to result from better housing, and are very good reasons to strive for housing excellence. The housing objective for countries in transition is talked about regularly and international and foreign institutions have written many reports. Rwanda in transition would like to pursue such an objective. However, the political and institutional processes to reach the goal are complex and challenging.

1.2 PROBLEM STATEMENT

This research is concerned with the fact that access to housing finance is undermined by the different criteria institutions put in place that often discriminate against low-income earners. Most people in Rwanda believe in purchasing a home as soon as they can afford to do so (Rwanda Housing Bank Housing Conference Report 2002). Often, home-ownership is believed to strengthen the family bond, to enable good citizenship and provide persons with more control to exercise greater authority over their environment. It helps to stabilize neighbourhoods and it creates important individual incentives for maintaining private properties and public spaces.

Home ownership is seen as an indicator of status and success while influencing the self-esteem, control, and self- efficacy of the homeowner. However, it lowers real monthly payments over time. It also protects against unanticipated changes in rental costs. Families borrow money and receive credit from Housing Finance Institutions to be able to attain their dream homes. The long-term payment of the loan creates a risk of interest rates, whereby the cost of the borrowers' funds rise, while the income may be locked at a low level.

1.3 PURPOSE STATEMENT

The mission of this research is to investigate whether there is any evidence informed policies for low-income earners for housing finance in Rwanda through self-governing communities of interest. Policy makers are key potential clients of evidence on the effectiveness of housing finance policies.

There are major gaps in evidence of the effectiveness of developing and implementing tools for accessing housing finance for low-income earners. Nevertheless, for coherent pragmatic policies to be developed, the gaps must be filled with more rigorous levels of evidence. Evidence-based policy approach will be employed in this study to answer three questions:

- i. What is the public policy process on low-income housing finance in Rwanda at present?
- ii. How can the existing process be improved based on evidence gathered by the research?

1.4 DATA COLLECTION TECHNIQUES

The study is a desk study that looked at the new emerging field of evidence-based policy to try to develop a policy framework that would adequately cater for low-income earners in need of housing finance in Rwanda. Leedy (1997: 59) points out “the researcher can be easily beguiled by discovering interesting information that lies beyond the precincts of the problem being investigated.” To ensure that a

framework is set to assist the researcher not to fall into this trap, it is necessary to set limitations and delimitations of a piece of proposed research.

Whether research drives policy or policy drives research, an evidence-based approach has its limitations. Public policy in most African countries are usually conceived, debated, and evaluated through the lenses of politics and ideology. The fundamental question of whether the policy will work often gets a short shrift or is ignored altogether. Knowing how and where to apply even the most incontrovertible evidence is tricky, too.

Evidence can be ambiguous or even contradictory, and it can be complex or difficult to interpret. In addition, the path from research to sound policy can be long and winding. Often, as in the cases of counting the uninsured or the homeless, research findings only gradually turn into conventional wisdom and then, much later, help shape good policy.

1.5 DEPLOYMENT OF STUDY

Chapter 1: Introduction

This chapter constitutes the Problem statement, purpose statement. It introduces the policy framework along the lines of the emerging trend of evidence-based policies on low-income housing financing in Rwanda.

Chapter 2: Literature Review

This chapter will dwell on International lessons and evidence based practices on housing finance for low-income earners, as well as credit risk management.

Chapter 3: Research Findings

This chapter will highlight the history of Rwanda, the economic out look and how it impacts on the low income earners, the banking systems in relation to housing, housing affordability and accessibility, credit risk management, housing challenges encountered by Rwandan housing holds. An issue that figures into all

public policy decisions is about political and social values the proposed options reflect. This is because hard evidence and analysis can bound the political battlefield, help build consensus, and identify the social and economic costs of different policy choices.

Chapter 4: Analysis and Interpretation of Research Findings

This chapter will constitute discussions and debates, which would assist Rwanda to design and develop a policy framework that integrates and consolidates International evidence based policies, and best practices.

Chapter 5: Conclusion and Recommendations

Finally, conclusion and recommendation will wind up the report.

CHAPTER 2

LITERATURE REVIEW

This chapter reviews literature on international lessons and evidence based practices on housing finance for low-income earners, as well as credit risk management. These lessons will help us examine the low-income housing finance in Rwanda. The best practices are those from Kenya and South Africa.

Together with food and clothing, shelter is one of the basic needs for human survival. For any developing country, the provision of shelter is of paramount importance, especially low and moderate- income households. Ferguson (2000) notes that surveys of low-income households in developing countries typically show that housing has a higher priority than education and healthcare. However, finance for housing has received very little attention over the years.

With the increase in population and the migration of people from rural to urban areas in search for often non-existence greener pastures, it has become more pertinent that governments find ways of providing housing either directly or through support to others to do so. Derban et al. (2002) argue that one of the main reasons why finance for housing has received little attention is the large capital that is needed to buy or rent a house.

The provision of housing is subject to the performance of macro-economies within which the various housing finance systems are located. Derban et al report and classify main trends of housing finance systems in four different countries in Africa: Nigeria, Ghana, Tanzania, and South Africa. Each of these shows some unique activity in the housing finance system.

According to Lewis (1992), Customer Credit is understood broadly to mean any forms of commerce under which an individual obtains money or goods or services on condition of a promise to repay the money or goods or services, along with a fee (interest rate) at some specific future date or dates. Credit is the need for funds for investment-- or to cover a temporary shortage of cash. In relation to credit

processes, formulations have been put in place for which Financial Institutions can effectively carry out the credit scheme.

The formulations made among others in Housing Finance are Credit Scoring and Credit Rating. Scoring is the method by which data are used to predict a particular outcome of interest, which also represents an estimate of the probability or odds of an event occurring. Credit Scoring is a process whereby some Information about a Credit applicant or a Credit Account is converted into numbers that are then combined to form a score. This score is then measured to determine creditworthiness (Herning, 2000). Creditworthiness is a character of an individual that makes him or her a suitable candidate for the extension of credit.

Data on variables most likely to measure willingness and ability of low-income customers to pay are excluded from standard loan application forms. The present scoring system is effective in making decisions about more affluent consumers. A 1972 report of the national commission on customer finance stated that despite bad debt losses in the range of 10 to 20 % for sales for low-income customers, 80 to 90 % of debts, were eventually collected. Although this number of bad debts involved higher than average collection costs, the report concluded that some creditors could profit while providing relatively low cost credit if more sophisticated credit-screening techniques were available (Lewis, 1992).

Until credit scoring made it possible to assign a numerical measure of risk to each application of credit, management had no way of expressing a corporate policy. As a result, each individual credit evaluator decided for himself what level of risk the applicant had. In a nationwide loan company that had about 1000 offices, there could have been as many as two to three thousand people defining overall corporate policy.

Development of more suitable screening techniques would enable institutions to grant credit to low income customers formerly excluded from credit granting policies. Once an individual starts approaching certain debt thresholds, they are viewed as a risky proposition. The high-risk poor might not have any security to show for but might have to pay these institutions in due course. These are people

whose income does not come regularly. They may not have a stable job but would want to buy a house and they know that after three to four jobs consecutively they might earn the deposit needed for a decent house but are denied credit finance because of their low-income levels.

Whenever a bank acquires an earning asset, it assumes the risk that the borrower will default –that is, not repay the principal and interest on a timely basis. Credit risk is the potential variation in net income and market value of equity resulting from the non-payment or delay of payment (Herning, 2000). Different types of assets have default probabilities. Loans typically exhibit the greatest credit risk.

Changes in general economic conditions and a firms' environment alter the cash flow available for debt service. These conditions are difficult to predict. Similarly, an individual's ability to repay debts varies with changes in employment and personal net worth. For this reason, banks perform a credit analysis on loan request to assess borrowers' capacity to repay. Unfortunately, loans tend to deteriorate long before accounting information reveals any problems.

The classical conception views risk as “the chance of injury, damage, or loss.” It distinguishes between risk— defined as the probability that a particular adverse event occurs during a stated period of time, or results from a particular challenge— and detriment— defined as a numerical measure of the expected harm or loss associated with an adverse event.

The probabilities and consequences of adverse events are assumed to be produced by physical and natural processes in ways that can be objectively quantified by risk assessment. One way to describe risks and uncertainty is to construct an exceedance probability (EP) curve. An EP curve specifies the probabilities that a certain level of losses will be exceeded. A critical issue in constructing an EP curve is the degree of uncertainty regarding both probability and outcomes (see, for instance, Swift, 1999; Adams, 1995; Kunreuther and Slovic, 1996; Kunreuther, 2002).

Such a view of risk rests upon an agreed objective nature of risk. There is general agreement among those who hold such a view of risk that progress lies in refining the methods of measurement and collecting more data on both the probabilities of adverse events and their magnitudes. A report by Britain's Royal Society called "Risk Assessment" concluded that there was a need for better estimates of actual risk based on direct observation of what happens in society (Adams, 1995).

During the past quarter-century, the term "risk" has been a subject of intensive conceptual and empirical research. The field of risk analysis has grown rapidly, focusing on issues of risk assessment and risk management. The former involves the identification, quantification, and characterization of threats to human health and the environment. The latter; risk management, centres around processes of communication, mitigation, and decision-making (Slovic and Weber, 2002).

It is stated often that the poorer segments of the population are more exposed to disaster risks. With increasingly greater concentration of settlements and buildings in hazard-prone areas, this statement needs to be qualified somewhat. In the Bhuj earthquake (2001) in India, the high- and middle-income groups lost more of their asset value. Most of the people who died in collapse of mid-rise apartment buildings in Ahmedabad and Bhuj belonged to the middle class (Vatsa, 2002).

In the Marmara earthquake (1999) in Turkey, 90 percent of casualties took place in mid-rise reinforced concrete apartment blocks, owned by urban upper middle classes (Erdik, 2001). In Germany, 2002 floods in River Elbe inundated the city of Dresden, did not spare any segment of the population, as it caused inundation of all the residential and commercial properties, and damaged many historical buildings in the city centre (Toothill, 2002).

In the United States, when an earthquake strikes California hillsides or a hurricane strikes the coastal areas of Florida, absolute disaster losses in dollar terms are higher for upper and middle classes than for the poor. This is in spite of the fact that in relative terms the poor generally lose a larger percentage of their material assets and suffer more lasting effects (Bolin and Stanford, 1999).

While the distribution of disaster impacts has become more complicated across social classes, it is also true that stable employment, insurance, credit and assets help upper and middle classes to recover faster from a disaster. The low-income group, on the other hand, has fewer options than the wealthy for coping with a disaster. They have fewer assets, almost no insurance, and less diversified sources of income, and a disaster can push them into destitution (World Bank, 2001).

Economic liberals maintain that the state should not tamper with natural relationships of individual customers to individual suppliers and producers. Individuals operating as 'homo economicus' would ultimately better themselves and achieve parity through private markets and *laissez-faire* economic activity. The policy proposals emanating from this constituency emphasize the role of the housing market and technical and financial instruments in resolving accommodation problems (see, for instance, Mhone and Edigheji, 2003; Bond, 2001).

Neo-Marxists perceive class conflict as the major process shaping urban life. They criticize both state as well as economic liberal policies, arguing that the social geography of the townships is a direct outcome of the conflicts waged over the distribution of the costs of reproducing labour power. They maintain that increasing state intervention in 'everyday life' (for instance, as supplier of housing and subsidiaries of transportation, i.e. the collective means of consumption) and the ensuring prioritization of consumption issues created a structural link with underlying capitalist production relations, on which urban movements might have a transformative impact. The implication is that a transition to a socialist society is the only guaranteed long-term solution to the housing crisis (Cf. Shubane and others, 1991:101).

Today, the housing vision includes values of sustainability, viability, integration, equality, reconstruction, holistic develop and good governance. This requires that we think broadly in terms of our approach to fulfilling our housing needs, and also acknowledge and accommodate general economic growth and employment. We need to support the efforts and contributions of individuals in seeking to meet their housing needs themselves.

Mahanga (2000) says that most of the housing finance institution in the world that have collapsed have done so not because of their failure to mobilize funds, but rather because of their failure to manage risks associated with housing finance, particularly credit (default) risk and liquidity risk. Although there are about six risks associated with housing finance (credit, liquidity, and cash flow, agency, systematic and political) credit or default risk present the most serious concern to the financial institution offering housing loans.

Default (credit) risk is usually a result of difficulties lenders to enforce mortgage contracts. Credit (default) risk is the principle and interest will not be paid on timely basis. The problem of default in repaying is a characteristic not only in housing finance but also in all other lending institutions including commercial banks.

According to various studies, banks in many developing countries, particularly Brazil, Cote d'Ivoire, Benin, Liberia, Mali, Portugal, India and even Tanzania, hold alarming volumes of non-performing assets in the form of loan arrears. It is believed that delinquency (default rate) is high in developing countries because of cultural factors including the fact that the concept of loan repayment in these countries is unfamiliar- people fail to distinguish between loans and grants! A study by UNCHS (Habitat) in 1987 showed that the main financial institutions in Tanzania and long-standing arrears amounting to half their portfolios, and implies losses were nearly 10% of GNP.

The US Housing Finance system is characterized by the predominant role of the market, particularly the mortgage-backed securities market, and a critical role played by government-initiation and supported conduits in guaranteeing securities. The mortgage lien is enforced in the country, making mortgages real collateral. Interest rates for housing loans are set by the market. Loan origination, underwriting and servicing have emerged as core business functions carried out by specialized business agencies (Hendler and Pillay, 2002).

Scholars of housing generally agree that the government cannot solve the problem on its own. We fully endorse the need for a full and meaningful partnership of government, the private sector, and homeless communities. The very specific challenge that Africa faces is that of poverty; quite simply, most of our people are too poor for a pure market solution to the housing problem. It has been determined that housing in Rwanda has historically been a responsibility taken on by the public sector. The dramatic decrease in public sector housing has shifted the responsibility of housing to the private sector, and has thereby forced the private sector to take on a larger share of the risks previously absorbed by the government.

The fact that private sector housing development has not increased with the dramatic decrease in public sector housing suggests that there are risks involved that the private sector will not readily accept. The previous section identified two potential inadequacies faced by the private housing finance system: a lack of savings by potential homeowners and a lack of available credit to enable them to leverage their savings into homeownership.

According to Hernando de Soto (1989) the major stumbling block that keeps the rest of the world from benefiting from capitalism is its inability to produce capital.” De Soto’s claims are not due to a lack of capital, but an inability to hold capital in such a way that it may be leveraged within capital markets as collateral to be used towards greater accumulation of wealth.

Most African people have capital resources, but they hold these resources in defective forms: houses built on land whose ownership rights are not adequately recorded, unincorporated businesses with undefined liability, industries located where financiers and investors cannot see them. Because the rights to these possessions are not adequately documented, these assets cannot readily be turned into capital, cannot be traded outside of narrow local circles where people know and trust each other, cannot be used as collateral for a loan, and cannot be used as a share against an investment.

The lack of clear documentation on landownership and title, as well as the lack of a documented history of landownership and title has forged a disconnection between the real estate markets and the economy in general. In short, banks refuse to lend to someone who does not have registered ownership of the land. In addition, national policy is attempting to address both issues of title and issues of land redistribution to the poor in a single program, which has decreased private property rights in order to increase equity of land occupancy. Combined, these are the largest risks for lending and housing finance in Rwanda and will be further examined in this research.

2.1 PRACTICES ELSEWHERE IN THE CONTINENT

In Kenya and South Africa effective modes of financing low-cost housing remain elusive. The key source of housing finance in South Africa is government funding through the housing subsidy program, though it was expected the private sector would participate in partnership with the government and communities (Tomlinson, 1999; Rust, 2002). The South African National Department of Housing is still trying to make this public/private partnership work for lowest income groups, with little success. The reason why I chose these two countries is because Kenya has tried ways to encourage low cost housing in the region whereas South Africa has done tremendously well, providing housing to low income earners in the African context.

2.1.1 Kenya's Housing System

The housing market in Kenya has evolved considerably since independence in 1963. The 1968/1976 National Housing Policy promoted a predominant role for the government in providing affordable housing for the citizens of the country through its parastatal or quasi-government institution, the National Housing Corporation (NHC), through municipal councils, and through civil service housing.

For more than two decades, the NHC was the market leader in the housing industry, responsible for the development of government-run and -managed public housing. Housing finance in Kenya is best understood within the context of the

wider national financial services industry. Between the 1980s and 1990s, there were over 20 housing finance providers in Kenya. Kenya is committed to progressive realization of the right to adequate housing for all its citizens (Chris William, 2005:23).

The government (Republic of Kenya, 2003:19) has recognized inaccessibility to housing finance for the low-income groups. However, there is still a conviction that the private sector can provide the finance, as reflected in the current housing policy framework. It was expected initially that the USA based company Overseas Private Investment Corporation (OPIC) would fund 150,000 housing units annually. This did not take off because of the government and the company could not reach an agreement.

The policy recommends amendments of Retirement Benefits Authority Act, to allow 10% statutory and pensions funds held by the National Hospital Insurance Fund (NHIF) and the National Social Security Fund (NSSF) to be lent for housing. It further recommends that new legislation be made to compel banks to lend 5% of their funds for housing. Currently, commercial banks and non-banking financial institutions are restricted from investing in housing by the provisions of the Banking Act (Republic of Kenya, 2003: 19).

Other mechanisms for increasing investment in housing include recommendations for tax relief on interest from home ownership; waiver of stamp duty for first time homeowners; housing development bonds; employers to facilitate loan acquisition by employees; and offshore borrowing by the government to reduce local interest rates on loans. It is also suggested that the state sets up a Mortgage Guarantee Scheme to be administered by the National Housing Corporation (Republic of Kenya, 2003: 20/21).

The central problem with most of these mechanisms for housing finance is that they are all indirect, aimed at enabling markets work. They require a lot of legislation, which we doubt the current government has the capacity, let alone the commitment, to enact. Besides, housing is not a right in Kenya, due to an

incomplete constitution making process, making any commitments by the state to deliver housing difficult to claim.

The introduction of a right to “accessible and adequate housing” in Chapter Six, Section 63, of the draft constitution (Republic of Kenya, 2004b) is still caught up in the drawn out constitution making process. Funding mechanisms are clearly in favour of middle and upper income groups, particularly those in formal employment. The token offer to the poor is the Slum and Low-Cost Housing Infrastructure Development Fund, which is yet to be capitalized.

According to the housing policy (Republic of Kenya, 2003), finance is expensive, because the financiers source the money in the open market or through housing development bonds for mortgage, which are subject to taxation. However, the solutions the policy envisages are far from being adequate. For example the biggest slum upgrading initiative in the history of Kenya, the Kenya National Slum Upgrading Programme, is to be funded 80% by donors (Kusienya, 2004). Despite the initiative having been started in 2000, there have not been any committed funds from government to fund it. The government has since pledged to fund 20% of the KENSUP programme (Kusienya, 2004: 6).

In Kenya, there is no government subsidy for low-income housing, and even the new housing policy seems to have ignored the issue. The role of micro-finance and individual investment in low-cost housing does not seem to be appreciated adequately in both countries, hence their potential remain largely un-explored. However, there are isolated cases of success amongst individual savings groups, but these are yet to influence policy meaningfully. (Omenya 2000: 2). There are lessons that could be learnt from the South African situation as well as the International scene, with strong government participation in low-cost housing, and where plethora of bargained structures have been put in place to enable the private sector participation, with limited success.

2.1.2 South Africa Housing System

Prior to the 1980s, land tenure for black South Africans was essentially restricted to rural areas. Housing thus emerged as a central plank in the struggle, as black South Africans now refer to the decades-long fight to end apartheid and establish democracy. In 1994, the new democratic government inherited an environment in which there was not only a large and growing housing backlog in spatially dysfunctional urban areas, but also private sector finance was largely pro-white (Porteous, 2005: 34).

In 1994, the new democratic government of South Africa inherited an environment in which there was not only a large and growing housing backlog in spatially dysfunctional urban areas, but also private sector finance was largely unavailable in the areas corresponding to the affordability of the majority of the population. Nevertheless, the new government set the ambitious goal of building a million new houses for new homeowners (Swilling, 1991:21).

This goal was achieved largely through the introduction of an individual capital subsidy scheme. At low-income levels, the subsidy was intended to cover the cost of a small house with basic services. At intermediate levels, it was intended that the subsidy would be blended with private credit to produce larger, better housing outcomes

In practice, the scheme ended up as a means of mass delivery of small (so-called Reconstruction and Development Programme, RDP) houses to households, often with little or no income, by developers-at first private sector companies. Nevertheless, as inflation limited the value of the subsidies, increasingly local authorities were serving as developers. The numbers were nonetheless impressive: 1.6m houses were completed or under construction as a result of the Programme within ten years, with a peak delivery rate of some 300,000 units p.a. in 1997/8 and more recently around 190,000 units p.a. being delivered.¹

¹ <http://www.housing.gov.za/Stats/200403/20040324.gif>.

However, the average size of a subsidized house (20-60 m² on a 200m² lot) was small, which attracted popular attention; and very few of the subsidies were linked to credit in any form. In addition to new housing, 500,000 previously state owned housing units were transferred to their occupants (Porteous, 2005: 42).

While there is little evidence of either credit linked housing or a primary mortgage market in the R20, 000 to R60, 000-price range, there is a well functioning, established mortgage market in home loans for the remaining 34% of market (i.e. the middle income and affluent segments). Recently, micro-loans have increasingly emerged as a form of housing credit for incremental housing upgrade. The big banks outreach is mainly to high and middle-income individuals. Smaller banks have developed good relationships with low to medium income clients and have sound loan servicing systems in place.

Non-bank, micro-leaders, provincial department institutions, and non-government organisation (NGO's), the relationship tends to lack the discipline and systems of the private sector. Their capacity to expand their business as well as conduct it effectively and efficiently is in doubt. This is perhaps the reason behind their relatively low volumes of housing finance business to date (Housing Conference Cape Town, 2002:13).

It is in this regard that international lessons could give more hint on best practice elsewhere to enhance a more evidence based policy framework for housing finance as elaborated below.

2.2 INTERNATIONAL LESSONS

International interest in guarantee systems in housing finance markets is growing. Today, several countries all over the world have set up, or are in the process of developing, guarantee systems, which are structured mostly by government support. The structure of guarantee funds varies across countries with both government 'owned' institutions and privatised organizations being apparent.

The assessment procedures, which are followed by all guarantee funds in the study, state that borrowers have to meet a number of criteria of which the home purchase cost-to-income ratio, loan-to-value ratio, and the earnings conditions are the principal ones. Through their economies of scales, guarantee funds can obviously manage credit risks better and more efficiently than individual lenders.

Mexico faces significant challenges in its future housing requirements. Like any nation, Mexico's housing needs derive from its demographic age structure, reflected in its household formation rate, which will see its most significant growth rate in the next 30 years. With such an impressive household growth outlook, housing and the related land, urban development, infrastructure investment, and services availability represent crucial challenges for Mexico at this point of its development. Mexico's housing problems mostly derive from a historical lack of focus on housing development.

The Government of Mexico is responding for the first time to the challenge by giving housing the highest federal priority. The commitment of the current administration to housing has given this sector an unprecedented relevance. Here are some measures taken by the Government to address the housing problems: 1. Consolidate a national housing policy and institutional framework. 2. Increase and homogenize housing subsidies. 3. Modernize property registries and rights (Mulas , 2005:12).

In India, according to Suresh (2002:18) in her paper presented to the UNHABITAT in Nairobi, the National Housing and Habitat Policy (NHHP) of the government call for a housing revolution. The policy, in continuation to the National Housing Policy of 1994, focuses on the change in the roles off stakeholder in the Housing development process. In an effort to persuade the private and cooperative sectors to take greater initiatives in meeting the challenge of housing provision, this policy proposed to put in place a facilitating

environment through fiscal concessions and other incentives. The policy has been developed as an outcome of work and experiences of construction in the post-economic liberalisation period.

Building sustainable housing finance markets is the central topic of the Roundtable, which was aimed at being a forum of discussions on a wide range of issues relevant to both primary and secondary mortgage markets, housing finance policies, and the infrastructure required to support housing finance systems. In the implementation of the Roundtable, the World Bank Group worked closely with two major institutions. It was also greatly involved in the development of mortgage markets through funding and other incentives in one case, and through technical co-operation and expertise in the other: Fondo Mivivienda, the leading publicly owned, second-tier mortgage bank in Peru.

The Inter American Housing Union (UNIAPRAVI), an international organization headquartered in Lima, which performs as a trade association for housing finance and other sectoral institutions in the Americas. The Roundtable, held in Lima, in April 2004, was attended by 172 participants (including senior governmental officers, top private sector executives, and experts) from 17 countries and four international organizations (Gonzalez, 2005: 23).

Discussions emphasized the overall idea that a public-private partnership and a stable macroeconomic scenario must support the creation of sustainable housing finance markets. Two major challenges were identified: on one hand, the need to enhance affordability of housing finance alternatives for lower-income segments; and on the other hand, the need to foster long-term funding for housing finance. In order to overcome these Challenges, the Roundtable highlighted policy practices intended to enlarge primary mortgage markets making them accessible to a previously underserved population.

In addition, the Roundtable focused on principles and practices to stimulate linkages between mortgage markets and capital markets and, particularly, to develop secondary mortgage markets. The Roundtable put a special emphasis in

experiences seeking to achieve an improved risk management as a pillar to make mortgage lenders less vulnerable to credit and market risks (Gonzalez, 2005:20).

Lamoreaux points out that, it is estimated that personal residences account for 75-90% of household wealth worldwide, which amounts to three to six times their annual income, and housing represents 40% of the monthly expenditure of households worldwide. From an economic development standpoint, investment in housing accounts for 15-35% of aggregate investment worldwide, and residential construction accounts for 5% of the labour force worldwide, while real estate services (including finance) constitutes 4% of the labour force worldwide (Gonzalez, 2005:20).

However, to a greater or a lesser extent, all Latin American and Caribbean countries face huge housing deficits for a number of selected Andean countries. In Colombia, the quantitative deficit in the urban sector affects 15.4% of total urban households and, if existing dwelling units, which need any kind of improvement, are added, total deficit impacts on 28.7% of total urban households. In Peru, 26% of total housing deficit is explained by lacking dwelling units and, in addition, there is a new demand for housing of about 90,000 units yearly. In Venezuela, the housing deficit is explained by the qualitative deficit, which accounts for 89% of the total deficit.

This adverse situation highlights not only the magnitude of the housing deficit but also the ineffectiveness of housing and housing finance policies implemented in the past. The review of a number of Latin American experiences in this respect leads to the overall conclusion that these huge and growing housing deficits are a combined result of wrong policies and a number of barriers. On one hand, the State has been seen traditionally as having an active role both as a direct housing builder and as lender.

The instruments used to perform this role have prevented the private sector from being an active participant in the housing sector. For instance, the use of subsidized interest rates or ceilings to the interest rates in the mortgage market has impeded the expansion of a sustainable housing finance market. Within

inflationary contexts, the real value of mortgages has tended to vanish, thereby heavily constraining the long-term sustainability of the housing finance market.

When the State has performed a role as a direct lender for housing, this lending has been heavily associated with hidden subsidies and high rates of arrears, even after governmental intervention with repeated debt relief mechanisms. For example, in Chile the role of the State as a low-income housing lender has been rated quite unsatisfactory by some authors who, in turn, assert that this policy practice has enlarged an already large moral hazard.

In addition to wrong policies, the poor record in meeting housing needs can also be explained by the impact of a number of barriers. One of these is the low purchasing power of an important share of population, which has become a limiting factor for accessibility to market-oriented mortgages and housing. The typical response has been to set administrative controls over the cost of housing finance, which, as has been noted, did not favour mortgage market development. Another barrier emerges from the macroeconomic arena and it is related to inflation - and some times, hyperinflation - as well as domestic currency depreciation, which have posed serious difficulties to the availability of long-term finance as, required for housing acquisition purposes.

The typical response has been the creation of a wide range of alternatives - from floating rate to single- or double-indexed mortgages - seeking to protect the profitability and viability of mortgage lenders. While this might be true to a limited extent, within the context of highly volatile economies because of high inflation and devaluation rates and growing interest rates - these mortgage schemes have adversely affected the capacity of borrowers to pay. In fact, there are cases in which market risks - i.e., macroeconomic shocks - have given rise to credit risks in the housing finance systems, leading them - in the extreme case - to their collapse.

For example, the default rate of mortgages soared, banks abandoned mortgage lending, and costly governmental intervention took place because of the so-called Tequila crisis in Mexico in 1994-95. Therefore, there should be a well-informed

and evident policy that has been researched for a conducive policy in most developing countries.

2.3 INFORMED POLICY PRACTICE

Evidence-Based policy has been defined as an approach the “helps people make well informed decisions about policies, programs, and projects by putting the best available evidence from research at the heart of policy development and implementation” (Davies, 1999). This approach stands in contrast to opinion-based policy, which relies heavily on either the collective use of evidence (e.g. on single studies irrespective of quality) or on the untested views of individuals or groups, often inspired by ideological standpoints, prejudices, or speculative conjecture.

Gray (1997) has suggested that there is a new dynamic to decision making in health care and other areas of public policy whereby the speculation of opinions based policy is being replaced by a more rigorous approach that gathers, critically appraises and uses high quality research evidence to inform policy making and professional practice (Jerry, 2004).

The repeated inability of mainstream development to address adequately the above contradictions urgently demands that we challenge development’s body of knowledge and system of practices. Development policies are the bridge between experience, discourse, and institutional practice. New policies will not yield anything new unless the discourse from which they are drawn is fundamentally rethought. Knowledge and politics are companion dimensions of the same process of transformation and change. We will not be able to achieve progressive social change unless we are willing to recognize the central place of politics in the realm of knowledge production and shaping popular consciousness (Guttal, 2004).

From 1996 in the World Bank, and from 2000 in some other bilateral and multilateral agencies, the focus was on mechanisms for sharing and synthesizing the huge amounts of operational knowledge that was already held by staff members of agencies. A series of more or less formal knowledge sharing networks

was encouraged, as were advisory services and websites, to facilitate the spreading, first round the World Bank, and then other agencies, of just-in-time development knowledge.

These exercises were hugely helped by new information and communication technologies. There are now some 80 of these Thematic Groups in the World Bank alone, down from over 120 in the late 1990s. There are smaller numbers in some of the other agencies (Kenneth, 2004).

Taken as a whole, these new approaches demand much greater ownership of the policy process than heretofore. They are almost certainly an improvement upon the myriad of uncoordinated projects, when they are adopted by a government, which however poor, has elaborated a strongly focused development policy. But, the challenge is precisely that in so many of the poorer countries which are the very candidates for these new approaches, the national policy terrain has been eroded by a combination of low salaries, brain drain, and decades of orientation to external donor priorities.

In these circumstances, the very complexity and co-ordination requirements of the new ways of doing aid almost certainly end up being more invasive than the older project approaches, and allow donors to come closer to the heart of governments' financial planning and decision-making. In this sense, these mechanisms may now be substituting for national planning processes, since they have indeed become synonymous with the national planning activity (Kenneth, 2004).

In the policy sciences, the attempt to separate facts and values has facilitated a technocratic form of policy analysis that emphasizes the efficiency and effectiveness of means to achieve politically established goals. Much of policy analysis, in this respect, has sought to translate inherently normative political and social issues into technically defined ends to be pursued through administrative means.

In an effort to sidestep goal-value conflicts typically associated with policy issues, economic and social problems are interpreted as issues need of improved

management and program design; their solutions are to be found in the technical applications of the policy sciences (Amy, 1987). Often associated with this orientation has been a belief in the superiority of scientific decision-making. Reflecting a subtle antipathy toward democratic processes, terms such as "pressures" and "expedient adjustments" are used to denigrate pluralistic policymaking. If politics does not fit into the methodological scheme, then politics is the problem. Some have even argued that the political system itself must be changed to better accommodate policy analysis (Heineman et al. 1990 in Fische, 1998).

In the face of limited empirical successes, neo-positivists have had to give some ground. Although they continue to stress rigorous empirical research as the long-run solution to their failures, they have retreated from their more ambitious efforts. Today their goal is to aim for propositions that are at least theoretically provable at some future point in time. An argument propped up by the promise of computer advances; it serves to keep the original epistemology in tack.

However, the modification misses the point, as post positivists are quick to point out. The problem is more fundamentally rooted in the empirical social scientist's misunderstanding of the nature of the social. As we shall see, it is a misunderstanding lodged in the very concept of a generalizable, value-free objectivity that neo-positivists seek to reaffirm and more intensively apply. (Ibid)

In an effort to establish a new basis for the determination of truth, which could serve as a new foundation for social stability, Descartes and his followers sought to anchor knowledge to the confirmation of empirical experience, revealing the interplay of these social and technical concerns. Such research shows the ways in which what we call knowledge is conditioned historically. It also shows how other periods have defined knowledge in quite different ways.

Having emerged to address problems in a specific socio-historical context, positivist epistemology, in short, is not necessarily relevant to all other contexts. That is, it should not be taken as a universal grounding for scientific practice as a whole. Its historical role in the development of modern industrial society and its

contemporary technocratic variant, post-industrial society, in no way offsets the point. Rather, it demonstrates how a particular conception of knowledge can condition or mediate the very shape of a society (Fischer, 1998).

Beyond the historical dimension, sociological investigation has shown the elements of empirical inquiry--from observation and hypothesis formation through data collection and explanation--to be grounded in the theoretical assumptions of the socio-cultural practices through which they are developed (Rouse, 1987). Detailed scrutiny of research practices turns up something quite at odds with the conventional view of the lone, disinterested scientist in the laboratory struggling to uncover the objective laws of nature (Latour and Woolgar, 1979; Knorr- Cetina and Mulkay, 1983). Repeatedly sociological research has documented the extent to which science is as much a socio-cultural activity as a technical enterprise. Indeed, full understanding of scientific findings is incomprehensible apart from the socio-cultural settings which give them purpose and meaning.

From Woolgar (1979) and Collins (1985) to Foucault (1980) and Latour (1987), scientific inquiry is recognized as a social practice contextually mediated through symbolic means. Its knowledge emerges as a socio-technical construction set in ongoing specific historical and linguistic contexts of conjecture and refutation (Gottweis, 1997). Scientific accounts have to be understood as explanations proffered by a specific community of inquirers situated in particular places and times. (Frank Fischer 1998)

From such investigations, we have come to see the degree to which the application of scientific methods to particular problems involves social and practical judgments. The model form of the experiment, for example, proves to be more than a matter of applying a causal research design to a given reality. As often as not, as Latour has shown, reality discovered to be fitted to the empirical instrument. In some cases, scientists get their results by identifying and organizing those parts of reality that are amenable to the research design.

In other cases, they go beyond such selection processes to restructure the social context (Rouse, 1987). Given such considerations, a proper assessment of research results has to go beyond an appraisal of empirical data to an examination of the practical judgments that shape both the instrument and the object. Although such judgments structure and guide the research process, they are almost never part of the research paper. The formal write-up of the results is organized to conform to the official judgment-free logic of science (Rouse, 1987).

In response to persistent pressure from social movements and independent researchers, the World Bank—one of the largest institutional backers of physical infrastructure projects—has formulated a wide-ranging set of Operational Directives (ODs) and research requirements to ensure rigorous scientific support for Bank funded infrastructure projects. These include studies on the social, cultural, environmental, financial, and economic dimensions of the proposed project, and often entail financing for additional project components for the mitigation of negative impacts.

Although the principle aim of this activity is to establish the Bank's legitimacy in the eyes of an increasingly visible, influential and critical global civil society, it has also provided the World Bank with the opportunity to re-invent itself as an institution committed to environmentalism and sustainable development, backed by scientific research and practice (Kenneth, 2004).

In order for the project to be successfully field-tested, it must have institutional, administrative and policy support. This in turn has triggered a series of policy reforms in sectors such as forestry, the judiciary, and commerce. The Bank and Northern aid agencies have financed numerous “capacity building” initiatives among state agencies on subjects such as Environmental-Impact Assessments (EIA), Social Impact Assessments (SIA), Cost-Benefit Analysis (CBA), biodiversity conservation, Participatory Rural Assessment (PRA), public consultation and participation, etc. This research and training has two main dimensions. First, it lays the ground for institutional and popular acceptance of the Bank's “green science” (who after all would argue against the findings of scientific research?). Second, it re-produces the Lao PDR and its people as social and environmental

“facts” in the Bank’s regime of green science, through a programme of largely extractive research (Guttal, 2004).

Some international public institutions have wanted to be intellectual actors, rather than just investors in the production of knowledge. In the field of economic and social development, perhaps the foremost contemporary repository of this ambition is the World Bank. The Bank advances the economic justification that only by producing knowledge in-house can its benefits for the institutions’ functional operations be secured.

It is argued that this is a matter of being able to ensure that outside researchers undertake the research agenda that the institution in question wants them to undertake. It is also argued that in the absence of in-house champions of specific pieces of research, potentially useful research will not be noticed and will not in fact be used. While there is doubtless some merit in these arguments, they look only to the advantages of doing research in-house, and these advantages always need to be balanced against the potential difficulties (Toyo, 2004).

What then are the drawbacks? For the answer to this, one must turn from the economics of public goods to the sociology of bureaucracy. Max Weber argued that modern bureaucratic organizations would increasingly replace patrimonial ones. He claimed that they are formally the most rational means of exercising control over human beings, because their goals are set by their sponsors and are implemented by bureaucrats who remain politically neutral. In making this claim for the efficiency of modern bureaucracy, Weber simply assumed that bureaucrats’ assigned formal roles are always congruent with their actual motives and orientations. However, this is not necessarily so; officials may don their organizational masks, but they do not easily or frequently become them.

Weber’s ideal type needs to be modified to take account of the fact that people inside bureaucracies can rebel against the machine-like expectations of formal rationality. Experience forces us to confront the fact that ‘defiant bureaucrats’ exist, and that they do ‘engage in behaviour that is from the perspective of organizational goals and procedures irrational and dysfunctional’ (Toyo, 2004).

There can be no complete "factual" description entirely independent of the social circumstances under which it is made. Science measures an interpretation of the object rather than the object (Natter et al, 1995).

Practical deliberation thus seeks to bring a wider range of evidence and arguments to bear on the particular problem or position under investigation. As Worth (1988) explains, "The reasons offered in support of alternatives marshal evidence, organize data, apply various criteria of explanation, address multiple levels of analysis with varying degrees of abstraction, and employ divergent strategies of argument." (Pg 13) However, the reasons given to support "the rejection of one theory does not constitute absolute proof of the validity of an alternative theory."

Through the processes of deliberation and debate, a consensus emerges among particular researchers concerning what will be taken as valid explanation. Although the choice is sustained by reasons that can be articulated and advanced as support for the inadequacy of alternative interpretations, it is the practical judgment of the community of researchers and not the data themselves that establishes the accepted explanation. Such practical judgments, rather than supposed reliance on proof unto itself, provide the mechanism for not only identifying the incompetent charlatan, but also investigating the more subtle errors in our sophisticated approximations of reality.

To be sure, the informal logic of practical reason cannot guarantee the eternal verity of particular conclusions, but the social rationality of the process is far from haphazard or illogical. Most important, it supplies us with a way of probing the much-neglected contextual dependence of most forms of argumentation (Scriven 1987 in Fischer 1998).

As part of implementing more evidence base policy framework on housing finance for low income earners there should be a more critical link to credit risk management since low income leads to non payment or default as banks or the lenders call it. That is why credit risk management lessons should be a central point of when dealing with Housing Finance since there is a scene of loans and defaults in the relation between the borrower and the lender.

2.4 CREDIT RISK MANAGEMENT

Since World War II, there has been a steady increase in instalment debt and the ratio of instalment debt to disposal personal income. During this same period, many stores switched from a cash-and-carry policy to an instalment buying approach. The pervasiveness of credit, or, if credit is granted, it is often cannot obtain credit, or if credit is granted, it is often from the ghetto merchants, neighbourhood finance companies or loan sharks(Tabor et al, 1986:43).

To obtain credit, a customer must possess certain characteristics that convince the lender the loan will be repaid. The likelihood of repayment must be forecast accurately when a loan request is received. Such forecasting is often based on a credit rating scale where customer characteristics such as ownership of a home are given point scores. These characteristics are weighted and a series of point scores are then added together in order to produce a single index of risk (Tabor et al, 1986:43).

Grantors of credit use indices or other methods to determine the point at which probable losses are so great that costs—operative costs, bad debt losses and an adequate return on capital are not covered. Unless good risks and poor risks are identified benefits are lost to both borrowers and lenders and losses mount. The question then is how accurate or relevant are the scoring systems in distinguishing between good and poor credit risk (Tabor et al, 1986:44).

One of the most important contributions to social theories of risk came from the European sociologists Ulrich Beck and Anthony Giddens. In the globalized modern world, which Beck characterized as a “risk society,” the future has become uncertain. Possible events which technology unintentionally generates cannot be insured against because they have unimaginable implications. Beck, citing the example of the Chernobyl nuclear explosion in 1986, associates nuclear power with suspension of “the principle of insurance not only in the economic, but also in the medical, psychological, cultural, and religious sense. The residual

risk society has become an uninsured society” (Beck, 1992: 101 in Krishna, 2004: 6).

The concept of “risks” as discussed by Beck and Giddens derives its context from the developed world. Such a notion of “risk” is inherent in the pursuit of energy-intensive economic growth and affluence, an inescapable condition of the post-industrial society. These risks are qualitatively different from those faced by households with limited resources in both developed and developing countries. Most of the households are exposed to “risks,” which arise from an economy based on lack of resources and limited options. In the field of development, the “risk” is closely related to poverty, deprivation, and lack of insurance.

A great deal of research has taken place on the subject of household risks, but most of it deal with agricultural and pastoral societies trying to cope with individual risks such as illness and unemployment or collective risks such as droughts and scarcities (Udry, 1994; Morduch, 1995; Dercon; 1999, Sinha and Lipton, 1999; Fafchamps, 1999; Krishna, 2004: 7).

Households cope with these losses by withdrawing their savings, borrowing, reducing their expenditures, and selling their assets. Their capacity to insure against these losses is enhanced by the availability of public-funded and market-based mechanisms of risk management. A household’s vulnerability is ascertained because of its asset endowment, likely welfare losses, and risk management strategy. The household is thus said to be vulnerable to suffering an undesirable outcome, and this vulnerability comes from exposure to risk (Alwang, Siegel, and Jørgensen, 2001). (Krishna 2004: 8)

If the principle on all financial claims held by Financial Institutions was paid in full on maturity and interest payments were made on their promised dates, financial institutions would always receive back the original principle lent plus an interest return. That is, they would face no credit risk. Should a borrower default, both the principle loaned and the interest payments expected to be received are at risk. As a result, many financial claims issued by corporations and held by FIs promise a limited or fixed upside return.

This takes the form of interest payments to the investor with a high probability and a large downside risk (loss of loan principal and promise interest) with a much smaller probability. Good examples of financial claims issued with these return risk trade-offs are fixed-income coupon bonds issued by corporations and bank loans. In both cases, an FI investing in these claims earns the coupon on the bond or the interest promised on the loan if no borrower default occurs. On default, the FI earns zero interest on the asset and may lose all or part of the principal lent depending on its ability to access some of the borrower's assets through bankruptcy and insolvency proceedings (Krishna 2004: 10).

Crouhy et al (2001) said that risk management tools, which ensure that the bank's position remains on the efficient frontier of the risk reward relationship, are required. Ensuring that a portfolio remains on the efficient frontier is a commonly accepted truism of modern portfolio theory, when applied to trade instruments. Brodie, Kane, and Marcus (1999) defined the efficient frontier as the lowest possible portfolio expected return. Banks portfolios as rigorously as their market portfolio maybe have not attained this type of applications.

Crouhy et al (2001), Haubensstock and Aggarwal (1997) and Holton (1998) called risk management to be seen, not as risk avoidance, but rather the optimization of the risk that must be taken in order to generate returns. In simple terms, Crouhy et al 2001 called for higher returns for high-risk exposures not only for market risk but for credit risk too.

Measurement of risk is important, without it then management of the very same risk would be impossible. The methodology used to measure risk must provide output in a format that is useful to manage risk, be sufficient and accurate. Risk types are divided in three categories. Market risk exposure is due to price fluctuations of the banks assets on the worlds market, credit risk exposure is due to counter parties defaulting on debt and operational risk, which is the result of accidental or deliberate errors on the part of people.

Financial risks are inherent in financial markets and their management represents one of the main tasks in the business of financial institutions. Firstly, in this entire process the crucial risk types a certain institution faces have to be identified and defined firm wide. In the second step, the possible extents of these risks have to be quantified. As this involves high uncertainties, Alexander and P´ezier use the term risk assessment rather than risk measurement. Along with monitoring and reporting of the results comes the risk controlling function through trading and management action.

As identified by the Basel Committee on Banking Supervision the main risk sources faced by banks are market, credit, and operational risk. In the following section, we introduce the key risk factors that we also incorporate into our model, which is described later (Alexander et al, 2003). In general, market risk arises through adverse movements in the market prices of financial instruments. There exist a number of subcategories depending on the considered market factor, for instance interest rate, equity or foreign currency risk.

A prevalent method to measure market risk is Value-at-Risk (VaR). The formal definition by Frey and McNeil which is pursuant to Artzner et al. is as follows: Given a loss L with probability distribution P , the Value-at-Risk of a portfolio at the given confidence level $\alpha \in]0, 1[$ is represented by the smallest number l such that the probability that the loss L exceeds l is no larger than $(1 - \alpha)$. Formally,

$$VaR_{\alpha} = \inf \{ l \in \mathbf{R}, P(L > l) \leq 1 - \alpha \}.$$

For example, given a Value-at-Risk of Rand 1m for a sample bank portfolio with respect to a risk horizon of 1 day and a confidence level of 99% the following conclusion may be drawn for instance: Within the next 100 days there should occur a maximum of one day with the loss on the current portfolio positions exceeding USD 1m. (Frey et al 2002)

In this case, credit risk is more important in the Housing scenario. Credit risk unlike other risks requires capital allocation for both unexpected and expected

losses. As seen above credit rating systems have been the traditional method for the measurement of risk associated with loans. Credit risk has however, become increasingly complex with the advent of traded bonds and credit derivatives. This has led to the development of more quantitative methods of measuring credit risk.

Commercial credit scoring models are the basis for the second commonly used method of quantifying ratings. Scoring models produce estimated default probabilities (or other risk measures) for individual borrowers, typically using borrower financial ratios and other characteristics as predictors. Where a model can produce fitted default probabilities for a representative sample of borrowers in each internal grade, averages of the fitted values may be used as estimates of average default probabilities for each grade.

In universality accounting based credit-scoring systems, the FI (Financial Institutions) decision-maker compares various key accounting ratios of potential borrowers with industry or group norms. When using multivariate models, the key accounting variables are combined and weighted to produce either a credit risk score or a probability of default measure. If the credit risk score, or probability, attains a value above a critical benchmark, a loan applicant is either rejected or subjected to increased scrutiny. In terms of sheer number of articles, developments and tests of models in this area have dominated the credit risk measurement literature. In addition to a significant number of individual articles on the subject, there are at least four methodological approaches to developing multivariate credit-scoring systems: (i) the linear probability model, (ii) the logit model, (iii) the probit model, and (iv) the discriminate analysis model. In the inaugural issue (JBF, June 1977), Altman et al (1977) developed the now commonly used and referenced ZETA, discriminate model. Stripped to its essentials, the most common form of discriminate analysis seeks to end a linear function of accounting and market variables that best distinguishes between two loan borrower classification groups' repayment and non-repayment.

This requires an analysis of a set of variables to maximize the between group variance while minimizing the within group variance among these variables.

Similarly, logic analysis uses a set of accounting variables to predict the probability of borrower default, assuming that the probability of default is logistically distributed, that is, the cumulative probability of default takes a logistic functional form and is, by definition, constrained to fall between 0 and 1.

Lawrence et al (1992) use the logit model to predict the probability of default on mobile home loans. They find that payment history is by far the most important predictor of default. Smith and Lawrence (1995) use a logit model to find the variables that are the best prediction of a loan moving into a default state (calculated from a Markov model of default probabilities) (Edward and Anthony, 1998).

Such models have the potential to be extended to an analysis of the default/mortality of loans. However, they have been hampered by the lack of a loan default database of sufficient size. For example, McAllister and Mingo (1994) estimate that to develop very stable estimates of default probabilities, an FI would need some 20,000 to 30,000 "names" in its database. Very few FI's worldwide come even remotely close to approaching this number of potential borrowers. This may explain a number of current initiatives in the USA, among the larger banks, to develop a shared national database of historic mortality loss rates on loans (a current project of Robert Morris Associates, Philadelphia, PA).

Finally, as noted earlier, by far the largest number of multivariate accounting based credit-scoring models have been based on discriminate analysis models. Altman et al (1977) investigate the predictive performance of a seven variable discriminate analysis model (that includes the market value of equity as one variable). A private version of this model also exists. In general, the seven variable model the so-called "Zeta model" is shown to improve upon Altman's (Altman, 1968) earlier variable model. In addition, Scott (1981) compares a number of these empirical models with a theoretically sound approach. He concludes that the ZETA model most closely approximates his theoretical bankruptcy construct (Edward and Anthony, 1998).

2.5 HOUSING POLICY DISCUSSIONS

Policy focuses on what Dewey (1927) once expressed as the public and its problems. It is constructed and how they are placed on the political and policy agenda. But it's also the study of how, why and what effects governments pursue particular courses of action in action (Heidenheimer et al. 1990:3) or as Dye puts it, with 'what governments do why they do it, and what difference it makes' (Dye, 1976:1). This study of the nature causes and effects of public and draw on variety of approached and disciplines.

Policy Analysis therefore is an applied subfield whose contents cannot be determined by disciplinary boundaries but by whatever appears appropriate to the circumstances of the time and nature of the problem (Wildavsky, 1979:15). Policy and problems provide a common focus for social science. They also provide areas of scientific activity and research, which have become more aware of the political context with in which they operate (Parsons, 1995:29).

Policy analysis does not stop with the use of multiple methods to produce and transform information. Although information production and transformation are essential to policy analysis, equally important are the creation of critical assessment of knowledge claims based on this information. Knowledge claims, advanced as the conclusions of policy arguments, reflect the reasons why different stakeholders disagreed about alternative policies (Dunn, 1994).

The acceptable approach for assessing the nature of a policy would probably be a descriptive approach, i.e. to investigate the prevalence of this activity in government empirically. An alternative approach would be a prescriptive one, i.e. to provide a framework for classifying the requirements for producing information that is relevant for policy while engaging in the activities associated with the policy process (Cloete et al, 2006).

During recent years, the attention of housing policy and practitioners at all tiers of government has shifted to the provision of finance. Housing Finance is arguably more than simply an aspect of the overall housing delivery system: It is a key

factor enabling the effective and efficient delivery of housing products. However, the provision of housing finance is subject to the macro-economies within which the various housing finance systems are located. It is useful to housing finance systems in various countries in order to establish guidelines for the effective and efficient delivery of housing.

The Kenyan government (Republic of Kenya, 2003:19) has recognized inaccessibility to housing finance for the low-income groups. However, there is still conviction that the private sector can provide the finance, as reflected in the current housing policy framework. It was expected initially that the USA based company Overseas Private Investment Corporation (OPIC) would fund 150,000 housing units annually. Nevertheless, this did not take off because of the government and the company could not reach an agreement.

The policy recommends amendments of Retirement Benefits Authority Act, to allow 10% statutory and pensions funds held by the National Hospital Insurance Fund (NHIF) and the National Social Security Fund (NSSF) to be lent for housing. It further recommends that new legislation be made to compel banks to lend 5% of their funds for housing. Currently, commercial banks and non-banking financial institutions are restricted from investing in housing by the provisions of the Banking Act (Republic of Kenya, 2003: 19).

Other mechanisms for increasing investment in housing include recommendations for tax relief on interest from home ownership; waiver of stamp duty for first time home owners; housing development bonds; employers to facilitate loan acquisition by employees; and off-shore borrowing by the government to reduce local interest rates on loans. It is also suggested that the state sets up a Mortgage Guarantee Scheme to be administered by the National Housing Corporation (Republic of Kenya, 2003: 20/21).

Inadequate housing, George M (2000:13) especially for the low-income group, in most cities of developing countries results from rapid urban growth, which is mainly caused by rural-urban migration and institutional inadequacies approaching the problem of housing shortage. There is therefore a need to

formulate policies that mitigate the effects of the above problems in the cities of developing countries.

Regarding rapid urban growth, there must be appropriate policies that reduce the influx of rural –urban migration. These include providing better opportunities in rural areas and small towns, so that capital cities are not the only centres of attraction in a country. Currently in most, the institutional framework for urban development in most developing countries is inadequate, resulting in a haphazard growth of urban areas.

With regard to institutional inadequacies in urban policies must integrate housing programmes with multiple problems of society. It has been noted that generally there is lack of co-ordination and integration of economic planning with physical and social planning. Thus, housing strategies must take into cognizance the socioeconomic needs of the beneficiaries. As already noted the provision of housing must not be oppressive of the needs of the beneficiaries. It is suggested that governments and urban local authorities adopt the low-income settlement upgrading programmes to solve their housing projects.

This approach has the advantages of incorporating the needs of the poor and encouraging community participation, which is a necessary ingredient in all development projects. Above all low-income settlement upgrading programmes are a cheaper method of providing housing to the poor. Given the bankruptcy of most governments of developing countries, this approach seems to be the best solution (George, 2000:13).

According to Cornwall and Brock (2004:6) “Participation” has been part of mainstream development discourse since the colonial era. It is a well-worn way of neutralising political opposition (Vengroff 1974; Cornia et al. 1987), taxing the poorest (Chambers 1974; Salole 1981) as well as of providing opportunities for the exercise of citizenship and voice for poor people and those otherwise excluded from decision-making.² “Empowerment” has a more curious history, having gained the most expansive semantic range of all, with meanings pouring into

² See ILO, 1978; Pearse and Stiefel, 1979, in Stiefel and Wolfe, 1994; Rahman, 1995; Gaventa, 2002.

development from an enormous diversity of sources, which include the Christian right, New Age self-help manuals and business management (Moore 2001; Henkel and Stirrat, 2001).

However “Participation” and “Poverty reduction,” does not seem to have caught on much beyond the World Bank - beyond its prominent use in documents relating to “gender” and “women” - where its rise and rise is a story that is embedded in the harnessing of a range of relational buzzwords by a particular actor-network to create bureaucratic and policy space (Bebbington et al, 2004). Indeed to ‘strike a positive chord with those “progressive” groups on whom the very existence of international aid agencies and programmes increasingly depends’ (Moore, 2001:322-3).

To address the housing problem of the medium and low-income people the Chinese government has put into force preferential policies for the construction of affordable shelter. During the reconstruction period after the earthquake, they expanded policy support in this respect with an expectation of 37 taxable items such as the pre-construction tax and tax for supporting infrastructure facilities. This resulted in a decrease in the construction cost by one-third. They adopted a flexible land use policy for the construction of such shelter.

To people who had to move for urban face lifting, they offered free use of allotted land; to people who applied for new construction land, transferred the land use right at low price to give people a real taste of the preferential policy. Baotou put into practice on the development of affordable human housing, which aims to establish a compliance with the state seven- factor cost accounting standards and to control the sales price and developers’ profit in favour of the low and middle-income people (International Conference Finance Social Housing, 2004: 38).

The management of the housing in Rwanda is in the hands of the authorities and households. Intermediate, private and cooperative structures have little intervention. Concerning the urban housing, all stages of management are almost exclusively under public authorities. Urban planning, land management, the supervision of construction are all under the public administration, the Minitraco

is responsible for urban studies and the follow-up of the development, and the Miniterre is responsible for land matters and the promotion of the habitat. Since the coming into force of law on decentralization, most operations have been transferred to the urban communities.

This decentralization, integrating local authorities up to the cells, requires a new division of responsibilities and an increased involvement of the local communities in the development and the management of the urban habitat. Yet the financing of the housing must cover the costs of the construction of houses as well as the costs of infrastructures and facilities. The public authorities are practically the only planners. The state budget that should provide the necessary resources for infrastructures and facilities is limited. Banks give short-term credits, household saving capabilities are low and the country does not yet have an efficient specialized institution in the financing of the habitat.

The state did not put in place appropriate mechanisms for the recovery of costs invested in planning. The recovery must include expenses incurred in planning operations: costs of studies, of road construction, of electricity, of conveyance of water and other handling costs on land issues (National Housing Policy, 2004).

The housing conditions of most of Zhivago's contemporaries in pre-Revolutionary Russia were dismal. A 1912 census of St. Petersburg and Moscow had eight occupants per apartment; the comparable figure for Paris was 2.7 (Alexeev, Baker and Westfall, 1991). The average living space per urban dweller was estimated at seven square meters. For workers housing was often a bunk in a rough dormitory attached to a factory. These substandard conditions are no longer the case for the majority of the Russian population.

A massive, post-Stalin construction project—one of the largest government-sponsored investment programs ever undertaken—built nearly 20 million apartments in eight years (Morton 1980). Between the end of World War II and the late 1970s, the average living space per capita more than doubled, reaching 16.1 square meters in 1992 (World Bank– Goskomstat, 1993).

Despite this enormous investment, the housing shortage was by no means resolved. In 1992, almost 10 percent of households lived in overcrowded communal flats. Others lived in dormitories --with less than eleven square meters of floor space for each household member. More than 20 percent of the residents of St. Petersburg and 17 percent of those in Moscow lived communally. For comparison, in 1974 almost 30 percent of Moscow's residents lived communally, and in 1960, 40 percent of Soviet citizens did so (Morton 1980).

The World Bank's response to these challenges has been to create new disciplines of social and environmental expertise, which also means new business opportunities for "green experts." Sociologists, anthropologists and environmental technicians hired by the Bank and donors transform the impending social and ecological destruction of what are sold as beneficial development projects into new "sustainable development" activities such as resettlement action plans, environmental action management plans and sustainable livelihoods projects.

Only through such transformations can developers cope with the fact that their projects are too often imposed on a reluctant society that would have to be made over to accommodate them (Lohmann, 1998). Green science then turns out to be useful to the development establishment on several fronts: it helps to sell large infrastructure projects as sustainable development; it helps to quell unrest among project-affected communities and deflect criticism from civil society.

It provides employment to the development establishment's loyal professionals. According to Goldman, over the past 10 years, the Bank has carved out a "green agenda," produced policies, financing, tools and data for an applied global environmental science and trained thousands of professionals in borrowing countries to conduct "green science" for development (Guttal, 2004:8).

In addition, World Bank policy research indicates that strengthening poor people's land rights and easing barriers to land transactions can set in motion a range of social and economic benefits including improved governance, empowerment of women and other marginalized people, increased private investment, and more

rapid economic growth. Household income analysis must be based on official wage statistics, according to Buckley and Gurenko (1995) in a World Bank observation: Zihivago's Legacy.

Buckley and Gurenko (1995) argue that information by including the amount that would otherwise be spent on housing; we can link the notion of income to household wealth. Housing is the largest component of non-cash income received by households, and it is one that the United Nations recommended be included in household income statistics.

The approach used here to impute the value of housing follows the United Nations (1968, p. 6.22) definition: "The total of owner-occupied dwellings which is to be included in gross output should, in principle, be valued at rent on the market of the same facilities. It may be necessary to approximate the market rent by an estimate, which should cover items such as operating, maintenance and repair outlays. Depreciation and mortgage interest in addition to interest on the owner's investment in the dwelling."

Thus, we must first measure how much rent a household would have to pay to enjoy the same housing services provided by the state or enterprise. One way to make this notion concrete is to consider an individual who sells financial assets to buy a house with cash. Apart from such considerations as risk, liquidity, and administrative costs, if the person were as "well off" after buying the house as he was before, the imputed income (rent that the owner of the house no longer pays) would be equal to the annual interest that would have accrued on the financial assets. In terms of either the United Nations or the Hicks definition, this imputed value must be included as income if income is to be measured correctly (Buckley and Gurenko, 1995:24).

The most commonly used approach to measuring imputed housing income is to assume it is equal to the market rental value of the housing. This estimate takes the value of imputed income to be equal to the market value of an analogous good. Although a rental housing market did not exist in Russia in 1992, it did exist in industrial nations and several developing countries.

Horioka's (1994) careful analysis of household consumption and expenditure patterns in members of the Organization for Economic Cooperation and Development in 1989 found that the average household's expenditure on housing was 18.5 percent of household income, and the median was 19.2 percent. Those averages varied little from country to country (Buckley and Gurenko, 1995:26).

The World Bank Housing Indicators survey (Mayo and Angel, 1993) for 1991 yielded similar results. Covering housing characteristics in fifty-two cities in industrial and developing countries, this survey provides a comprehensive set of data on the housing sector, including the cost and availability of key inputs such as land, infrastructure, building materials; the regulatory environment; demographic variables; finance and subsidies; and the qualitative and quantitative features of the housing stock.

These data were used to infer the median value of housing services received by a median-income household in countries whose per capita gross domestic product (GDP) was similar to Russia's. This figure was computed in the form of a rent-to-income ratio and was drawn from a regression of rent-to-income ratios on per capita GDP in terms of purchasing power parity (World Bank Observer, 1997). There are numerous ramifications to this rapid growth of urban poverty – from the individual level to the global. Densely populated urban settlements with poor sanitation, vermin and poor shelter from the rain are ripe breeding grounds for illness and disease.

An Emory University research study on Habitat for Humanity's work in Malawi provided evidence of the impact of improved housing on social indicators. Children under five living in Habitat for Humanity houses showed a 44 percent reduction in malaria, respiratory or gastrointestinal diseases compared to children living in traditional houses. The researchers concluded that the effect of improved housing on the health of young children was as high as that of water and sanitation programs (CUDS, 2000). The lack of secure tenure also contributes to the inhabitants' inability to invest privately, in their own home or in public infrastructure.

Thus, the potential for social stabilization and wealth creation is absent. For the United States, helping the world's poor develop has become a national security issue as well. As is stated in the 2002 National Security Strategy and reinforced in the 2006 strategy, "A world where some live in comfort and plenty, while half of the human race lives on less than \$2 a day, is neither just nor stable. Including all of the world's poor in an expanding circle of development and opportunity is a moral imperative and one of the top priorities of U.S. international policy." (World Bank Observer, 1997)

Then Rwanda ought to adopt a system of housing that focuses on solving the various problems of land tenure systems. This involves solving tribal conflicts, creating land tribunals and sensitizing the local communities. Yet housing - a stabilizing force in its own right - remains an underserved and often ignored area in the field of international aid and development. While education, health, the environment, good governance and economic growth--all sectors that are connected critically to and dependent on adequate housing - are addressed in bilateral, multilateral and nongovernmental organization strategies for development, housing is not.

What does poverty look like in the cities? Every African has witnessed it. For the most part, the urban poor are left outside of the progress in the cities. In the few cases that land is provided by the governments for the masses of people entering the city each day, it is poorly located, out of the range of social services and employment and too expensive for the poor to acquire.

The majority of people who need housing in urban areas in Africa, therefore, settle in informal settlements that are closer to possible employment and public transportation, but often unsuitable for human habitation. They do not have legal property rights. They do not have basic services. They usually do not even have proper building materials. They build shelters using the materials they can obtain.

The Rwanda National Policy on the Housing (2002) objective 5 is to develop the sector of building and production of construction materials. Strategy 2 specifically

looks at promoting the small building enterprises and organizing the production and the marketing of building materials. This strategy can be operationalized to make sure that all the people access housing services that are adequate and complete. It is reported that low-income households allocate 10-15 percent of their incomes to shelter (whether it is a tent, hut or collection of discarded materials or an abandoned car). They settle wherever they can find space; on pavements, ravines, garbage dumps or drainage channels – as long as the site is marginal enough to deter displacement and close enough to transportation and employment opportunities.

Even if their incomes rise, they will not increase their allocation to shelter above 15 percent unless they have some security of occupancy as owners or tenants (Handorf, 1998). Handorf (1998) adds that these informal settlements soon became established communities - communities of families living in poorly constructed houses, in overcrowded conditions, and with inadequate infrastructure services. Moreover, the number of these communities continues to grow each day.

The Polish housing Fund has been used as a case study for providing lessons for housing finance in our discussions. In Poland, the main operators and borrowers for housing finance are non-profit associations championed by municipalities, and some rental cooperatives and even private developers (in total about 450 institutions by the end of 2004). The applied rents must cover the credit repayment. In addition, not all maintenance and renovation costs should exceed 4% of the replacement investment value. The housing finance institutions also finance infrastructure loans directly to municipalities, but this activity is still relatively marginal in size.

The program however does not target particularly low-income tenants. The institutions do not control the declared incomes, as this responsibility is delegated to specialist brokers and the sponsoring municipality according to its own local housing policy but anecdotal evidence suggests little follow-up monitoring and evaluation.

A rigorous assessment of the large subsidies for construction companies (through below-market interest rates) is needed, as some subsidies may be inefficient and regressively allocated, when put in perspective with the evolution of private rental markets and mortgage markets. The rental associations or construction cooperatives are required to provide 30% equity, the Fund financing up to 70% of the project. This down payment may derive from the tenants, who as a result consider themselves as quasi owners and are selected through this qualification. This situation may end up running against targeting goals and create problems for housing allocations.

According to the data compiled by the PBA (representing in 2004 88% of the individual housing loans extended by all banks), the net outstanding stock of individual housing loans increased by 61% in 2002, by 45% in 2003 (26% for all real estate loans), by 27% in 2004 and by 41% in 2005. About 40% of these housing loans are reported by banks to finance transactions in existing housing units.

Although most housing finance institutions in Africa may compete with housing loans, production remains concentrated at the top (most outstanding national housing lenders. Despite gradual erosion, commercial banks usually remain the largest housing lender with about a one third-market share. Yet, this relative market concentration has had no visible adverse effect on increased competition observed through declining mortgage credit rates and lower bank margins. Nevertheless, this situation enhances the need for stronger consumer information and protection in the housing finance area.

Between 2002 and 2004, the share of individual housing loans within all loans to the private sector increased from 9-12 percent (all real estate loans representing 22% of all loans to the private sector). At this pace, mortgage loans will represent about a quarter of all bank loans to the private sector in three or four years time. This evidence-based example could be a very positive element of stability and profitability for the banking sector in Rwanda, *as long as* the additional risks related to this expansion are well managed.

2.6 SUMMARY

In this chapter, we have sought to accomplish four objectives. In first instance, we traced the development of policy on housing in African countries like Kenya and overseas, such as Poland. The movement towards housing finance products and the decline of interest rates on government have continued to invest in government paper. They are averse to the risks of lending, for example, South Africa where there is evidence of either credit linked to housing or a primary mortgage market in the R20, 000 to R60, 000-price range. There is a well functioning, established mortgage market in home loans for the remaining 34% of the market (i.e. the middle income and affluent segments) to suit their situation. Concerning the international lessons housing systems in developing countries like India, Thailand that are more like African countries are state driven and highly regulated.

In these countries, loans are secured through mortgages and the legal system is effective in ensuring the enforcement of the lien. In other words the state drives, highly regulated housing finance systems. More so with the help of evidence policy practices by different scholars good policy practices would be established. However a broad conception of evidence is used by most governments than academics, who are the main gatherers of information to back up these governments.

Most governments require adequate evidence on the effectiveness of outcomes, implementation and delivery of policies, programs and projects such that right decisions can be made when applied to housing provision. While government provides housing through policies, programs and projects there should be a consideration of credit risk management. Housing comes with borrowing and lending from financial institutions mainly alongside government subsidies with default when payments are not made. Measurement techniques over the past 20 years showed how many of these developments have been mirrored in published articles.

In this chapter, a new approach to measuring the return risk showed that it added much promise to the complex problem of estimating the optimal composition of loan/bond portfolios. It can foresee significant improvements in databases on historical default rates and loan returns.

CHAPTER 3

RESEARCH FINDINGS

This chapter looks at the challenges low-income earners face in financing housing. It examines the banking systems in relation to housing affordability and accessibility, credit risk management and the general housing challenges encountered by Rwandese households.

Rwanda has just come out of a serious political crisis and still faces enormous problems regarding a coherent and sustainable development programme. The country lost more than 1 million people in the 1994 genocide with more than 2 million people in refugee camps in the neighbouring countries, 700.000 old case refugees of 1959 had returned home without any international assistance. They occupied houses left behind by refugees residing in camps in the neighbouring countries.

There was not sufficient security in the country to undertake important housing programmes. About 400.000 housing units had been destroyed and an unknown number needed rehabilitation to make them habitable. More than 180.000 families belonged to the vulnerable groups. Families of genocide survivors did not have houses; a large number of these survivors had been subjected to physical abuse and suffered from various infirmities. In view of a difficult security situation, economic production was non-existent (<http://www.imf.org>).

3.1 ECONOMIC JUSTIFICATIONS FOR HOUSING SUBSIDIES

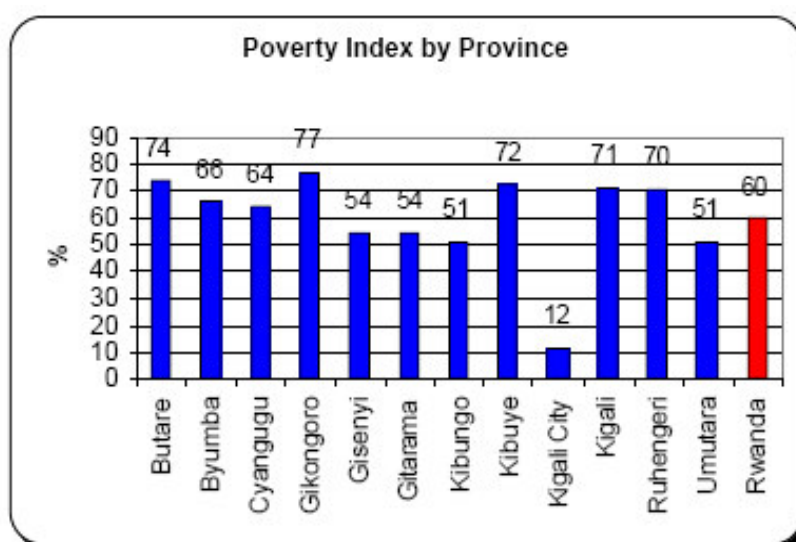
After the war in 1994, widows, mostly because of the genocide, headed 34% of all households. Everywhere in the poor world, women-headed households are the most vulnerable to poverty as are child-headed households. Households headed by a person of less than 20 years constituted 0.7% of the Rwandan population in 2001. Those who are landless are estimated to be at 11.5%. Most of the groups in these categories are susceptible to poverty, especially if they are living in rural areas. Other categories of vulnerability in Rwanda are uneducated young people,

large households with only one adult and more than three children, households headed by old people who are above 60 years (estimated at about 0.4%), orphans, street children and prisoners (Kagaba et al , 2003:15).

The EICV (Household Living Conditions Survey 2003) established that 60% of the adult equivalent population in Rwanda lived below the poverty line and 42% in extreme poverty. Using households as the unit, 57% live below the poverty line. When one considers gender disparities, 62% of female-headed households lie below the poverty line as opposed to 54% of male-headed households. Poverty rates in Rwanda were increasing in the late 1980s and early 1990s and stood at 47.5%⁴ in 1990.

Because of the 1994 genocide, the poverty rate rose dramatically in that year peaking at 78%. Since then, the rate has been falling steadily every year but remains much higher than it was before the genocide. The incidence of poverty is much higher in the rural areas (66%) than in urban areas, 12% in Kigali, and 19% in other urban areas. The EICV survey shows that the provinces with the highest poverty rates are Gikongoro (77%), Butare (74%), Kibuye (72%), Kigali Rural (71%), and Ruhengeri (70%). Kagaba et al (2003:5)

Fig. 1: Poverty Index by Province (% of population below the poverty line)



Source: Kagaba S, Straton N, Edison M (2003)

The share of the poorest quintile (poorest 20% of the population) in national consumption is only 4% and the poorest 40% account for just 10% of national consumption. The Gini coefficient for consumption is 0.451. This shows that there is great inequality in Rwanda. 2003 surveys and living experience show that Rwanda has a large number of vulnerable groups and the character of vulnerability take on many forms. A number of policy interventions, especially those related to social protection are being enacted to reduce vulnerability of the Rwandan population to poverty.

3.2 EVOLUTION OF RWANDAN HOUSING POLICY

This evolution covers the major stages of the country's history: the colonial period, after independence and finally, after the 1994 genocide. It integrates the general aspects of the country's urban development. There have been important changes in human settlements after 1994 especially in their spatial distribution, the management, and modalities of implementation in urbanisation.

The urban housing in Rwanda is a colonial phenomenon. The colonial authorities decided on the creation of towns, determine sites, define urban areas, which are zones that are "urban in nature" and even approve sites for the creation of religious missions. Urban constructions were in the first place reserved to the European and other expatriates. Natives were not admitted to reside in urban areas. For the administration of the country, the colonial authorities needed the presence of native assistants near-by.

They opened up quarters reserved for "native elites" on different sites from European quarters, which demarcated zones between European quarters and centres of activities on one side, and indigenous quarters on the other. This was the beginning of urbanization; the colonial power introduced a new type of habitat for low-income populations. The administration traced road/street networks, delimited plots without putting boundary-marks, indicated the distance from the road to be traced, types of facade to construct and left initiatives to the populations concerned. (National Housing Policy paper 2002: 8)

By the end of the colonial era, four types of housing could be clearly identified: The European type residential housing in a low-density zone. A house is built inside a well-demarcated plot on a site that has been officially approved. The size of plots is generally over 1500 m². Native assistants occupied the middle-income residential habitat. Plots are of medium size between 400 and 600 m². The popular housing located in zones opened to urbanization. The houses are by the people themselves. The rural type of dispersed habitat is dominant in the peripheral zone of the urban areas (National Housing Policy paper 2002: 8).

The Rural housing in pre-colonial Rwanda depended on systems of production based on agriculture and animal rearing. The country had a system of grouped habitat based on the family. This structure still exists in the North West of the country in Gisenyi province. The country was covered by small villages, which were constituted by family units. Colonization and evangelism brought about the disruption of this system of housing. The new religious followers came from the family unit. The dispersed habitat became generalized throughout the country. The high population density necessitated a new reorganization of the rural housing, notably the grouped type of housing. Experimental grouped housing was tried: grouped farming villages in the early fifties in Bugarama area, grouped habitat along the roads in Byumba area and linear habitat in farming villages in Mayaga region (National Housing Policy paper 2002: 11).

Rural housing known as Imidugudu.



Source: www.rwandagateway.org

After the colonial era, the Republican authorities accelerated the system of grouped farming communities in thinly populated zones: Bugesera, Kibungo and Byumba East. The linear housing was dominant in these zones. Experimental grouped habitat in farming villages was prepared and tried notably in Gashora and Sake and in pilot villages in Rango in Butare province. Obtaining agricultural land was conditioned to accepting to live in the village.

Attendant infrastructures that were promised, specifically drinking water and electricity, did not materialise. Agriculture that had to be improved by animal traction remained traditional. The local authorities did not organize populations to protect their farms against banditry and wild animals. Rural housing remains dispersed, and this has become a permanent factor in rural Rwanda (National Housing Policy paper 2002: 14).

According to current estimates, rural housing stands at 600.000 inhabitants with a daytime resident population of more than 1, 2 million is doubling the population in less than six years. The secondary urban centres such as Butare, Ruhengeri and Gisenyi have also doubled their population during the last six years. Currently, the town of Butare has a population of 70.000 people. Ruhengeri has 80.000, while that of Gisenyi is approaching 60.000 people. The rapid growth of these three towns makes them centres of regional balance and development; they will have to play an important role in the global scheme of regional planning (Housing Conference 2003: 21).

The other urban centres had an average growth. Gitarama, Cyangugu and Byumba to some extent have a steady growth sustained by economic activity. There is a new spirit and new dynamics in urbanization around agglomerated centres that are often of recent creation, For example, those found in the regions of Umutara and Kibungo. The development of such agglomerations has led some categories of people to prefer towns to rural centres. In addition to these developed zones, Kigali City is developing a « TTP »³ programme. Zones that are not fully developed are given to the people, who build temporary structures on their plots

³ TTP: Tent, Temporary, and Permanent.

with an objective of building a permanent house. Private associations, organised as enterprises, build housing units for other people (Housing Conference 2003: 21).

A map to show the areas talked about above.



Source: <http://geography.about.com/library/cia/blcrwanda.htm>

In order to understand and have an in depth informed situation in Rwanda an interview with a Senior Official from the Rwanda Housing Finance Institution, senior officer from the National Bank of Rwanda and a Housing developer.

Question: Give a brief background of what your Organization does?

Senior Official: Well, this is the Rwanda Housing Bank, we mobilize resources we give loans for housing and make sure that these loans recovered. That is the core Business of we as the bank.

Question: What is your target group as Housing Bank and in terms of loans for Housing?

Answer: Well for the time being we are operating three windows the General window that deals with anybody that is our client, but of course we concentrate on low and medium income earners. Like we put a limit on the loans we give and

that is a maximum of 20 million FRW (exchange rate is 565 = 1\$) and we already have a certain house in mind that would suite that amount.

Therefore, we finance people who build houses for home ownership occupation. You will find out that in Rwanda high-income earners invest in housing for renting, but our philosophy is for people to have their own homes. We therefore deal with people who have a regular income in other wards those who are employed. Of course if you are self-employed you can apply but we you must give a cast of your income and there must be sustainability of that income.



These are the kind of houses that the Housing Bank has put up for the civil servants and mid-income earners.

Interviewer: Am more interested in the low-income earners could you please shade more light on what you have in stock for them. There is a special window for Civil servants we have an allocation from government as an employer that would assist their employee to get access to housing. Then we have another window for the Diaspora for Rwandese leaving outside Rwanda. Now when it comes to low income earners or social housing we try to promote housing cooperatives, people come together to help each other or stay together and give sometime to each other for individual access of housing.

We also work hand in hand with the Micro- finance institutions who can lend small amounts of money to people who want to build their houses progressively or who wants to improve or rehabilitate their current houses.

Question: What criteria have you put in place as a financial institution in the allocation of loans?

Senior Official: “Assessing individual allocation, one is that we look at the capacity to pay back the loan this is key factor most important is the income and the sustainability of that income, two the age the younger you are the more likely you can pay back. Secondly the Institution can not finance 100% so you must meet us half way by your own contribution of minimum 20-30% the institution finances up to 70% but a civil servant we can go up to 80%. This is where people who want to buy a house for, say, 30 million RFW, we (the institution) tell him to put in 10 million and borrow 20 million. This 10 million should not come over night because you would never know where the borrower got the money, could be by a shady deal or he could have borrowed it from another financial institution.

We want to see his contribution coming in progressively. This is the second major condition and the third of course like in any other bank is guarantee or collateral but usually for us that are not a big thing, for us because that same house being built or bought is used as collateral. Of course, there are other insurances like credit protection insurance, but the main insurances are three. Therefore, for some specific windows like the civil servants window, we only finance the first house but if you happen to own another then you do not qualify.

Question: What is the Key evaluation of Housing since houses keep depreciating?

Senior Official: “Evaluation of houses, value of houses in Rwanda keeps appreciating as of today because of the demand which is increasing high than the offer. So the prices of houses keeps increasing mainly because there is an element of increasing materials which are imported and then of course if you look at the cost of steel as a building material the price has been going up for the last I don’t know how many years.

So all these elements, which are imported actually their cost keeps on increasing, look at the small things like cement, Rwanda is importing Cement. We have one cement plant in Rwanda (in Kamembe Southern Rwanda) and the production is not enough compared to the demand. So Rwanda imports from Uganda, Zambia, Tanzania, and Kenya where every other month the price of cement increases. We could even talk about the depreciation of our currency although it has stabilised.

In the end if you look at the demand of houses and supply, the demand is 40-50 times than the supply. Therefore, the price of houses or the value of houses keeps increasing in this regard. Of course this does not mean the same situation will keep going on like this, it will stop some where so that is why people need to be careful when dealing with their investment.

Question: What are the major challenges as a housing developer in Rwanda for low-income earners?

Housing Developer: For starters, there are no cheap sources of funds. Rwanda does not have long-term development banks for property developers. Most of the sources are short term and from commercial banks, hence borrowing for housing development comes with very high interest rate. Hence very few housing developers and of course with these high interest rates building houses becomes so expensive that these expenses are trickled down to the beneficiary, meaning that the house becomes very expensive.

Secondly, Rwanda is a landlocked country and yet most of its industries (like the tiles and the steel) have just been established hence most of the constructions are imported from abroad or neighbouring countries. Almost 90% of construction materials are bought out of Rwanda and the taxes are very high. For example you will buy building materials like sewage pipes, basically plumbing materials say for U \$ 4000 but when you put the transport and tax charges it is double or triple the amount you bought the materials in the first place. Unless the governments develops chains of transportation like the railway line from Kigali to the port say Dar es salaam, which is expensive to construction but would be a cheaper means of transporting construction materials and other goods for the economy.

Now talking about the basic materials like burnt bricks and wooden panels that are cheap to come by in any normal circumstance, this in Rwanda is very expensive since the government has put an environmental policy in place saying that for environmental conservation there shouldn't be any cutting of trees any reason. Usually when constructing houses we need wood to burn the bricks, which is a

cheaper method of making them strong, and sustainable, also wooden panels for roofing or interior works.

But this now has been changed the option is to use a brick compressor to make bricks out of cement, sand and soil, already cement is expensive since some of it is even imported from Zambia, Malawi, Uganda, Kenya to mention but a few. Our small plant in Kamembe cannot handle the supply. Therefore, considering how much cost you have out in to make this house a perfect home for them, you charge accordingly, of course the house ends up being very expensive. That is why the market is very low because only a few can afford.

3.3 THE NEED FOR POLICY REFORMS

Human settlements must be considered part of the essential physical infrastructure part for the overall development of the country. The mechanisms of this policy management, maintenance, and transformation must be clearly defined. Populations live in these human settlements and the latter ensure economic and social functions at local and regional level and sustain economic dynamics. The implementation of the policy is to be integrated in the general environment. This general environment is dominated by two major factors:

- An unfavourable economic situation that weighs against all policy proposals. Consequently, the housing policy must integrate aspects of national economic stimulation and transformation and must become a component of the country's economic policy, which deals with poverty alleviation hence the provision of housing for vulnerable and low-income earners.
- A society in crisis, affected by the 1994 genocide; Effects of this tragedy are still noticeable and some actions should be considered as emergencies, notably the provision of shelter to families that are still living in precarious conditions, the stimulation and transformation of the agricultural sector to generate income thereby breaking the cycle of poverty in rural areas.

3.3.1 Housing Policy Orientation

The population was internally displaced, majority fled to neighbouring countries especially the DRC (Democratic Republic of Congo) and Tanzania and there was

an influx of old case returnees from different parts of the world. The settlement crisis intensified in 1996 at the return of over 1.5 million refugees from the DRC. In 1994, the government had an uphill task to resettle the old case and recent returnees under a fragile security situation.

Subsequently government announced the undertaking of the villagisation kind of settlement. MINITRAPE issued guidelines and procedures to be followed in the construction of Imidugudu. UNHCR provided most of the funding for the shelter construction programme. Both these guidelines came out in January 1997, to coincide with the massive return of the 1994 refugees from the Congo and Tanzania camps. By this time however, a good number of Imidugudu had been constructed, some as far back as 1995, and construction was still going on. Little wonder then if the guidelines were hardly followed in implementing the policy.

Since then factors including access to land, distance between home and farmland and availability of grazing land has caused concern according to the RISR paper presented in the Land and Villagization workshop September 1999. It was widely acknowledged that Imidugudu were, largely constructed in a hurry and therefore, in a rather disorderly manner. The major factor to which this is attributed is the urgent need to find shelter for all those who did not have a home of their own and those whose homes had been destroyed.

Land is the backbone of society; it is the principle source of livelihood and security. Making changes in how it is owned, used, and sold, without people's inputs is an issue of great concern. As **Pottier** according to his study, Larbi says,

Before the war and genocide many aspects of land ownership were not regulated by statute. Where regulations did exist, there was confusion either because of the provisional character of the law or because of non-implementation (Pottier 1997:5).

Land occupied by natives is governed by custom: As Gasasira (1996:9), "According to custom, land is owned by the person who was the first to occupy

it.” However, “lands acquisition through occupation has now been relegated to history as vacant lands belong to the state.”

Customary ownership has undergone significant change: originally ownership was collective. The family owned Land but to date individuals can possess land and use it as they want. The decree of 4th March 1976 acknowledges customary rights or land occupation rights and the rightful transfer of those rights to the land by sale. One can only sell the rights to the land/assets/property on the land but not the land. It is against this background that in case of expropriation by state approval, the holder of land occupation rights is indemnified for the property situated on the land. It follows that, “Except in case of state-approved expropriation, the holder of customary land ownership rights cannot be forced to abandon them.”(Gasasira ,1996:9)

The Rwandan government introduced the national human settlement policy, which came to be known as Imidugudu, which roughly translated, “agglomeration” in English, in December 1996. The government considered the Imidugudu most suitable for people in rural areas because the returnees would be able to mobilize self-defence units against gangs of militiamen that still roamed the countryside. The militias, known as Interahamwe, have largely been accused of perpetrating the genocide. Since the policy focuses on group settlement the government hoped to solve the problem of land scarcity at the same time. This policy targeted the establishment of specific residential areas in each village in efforts to enhance proper land utilization and the provision of basic services. (Gasasira ,1996:9)

However, although more than one million people had been placed in the Imidugudu settlements, a national survey conducted in September 1999 by the Information Management Unit of the UN Development Programme (UNDP) found that there were some 370,000 vulnerable families living under plastic sheeting in damaged shelters and others were temporarily occupying other people's homes.

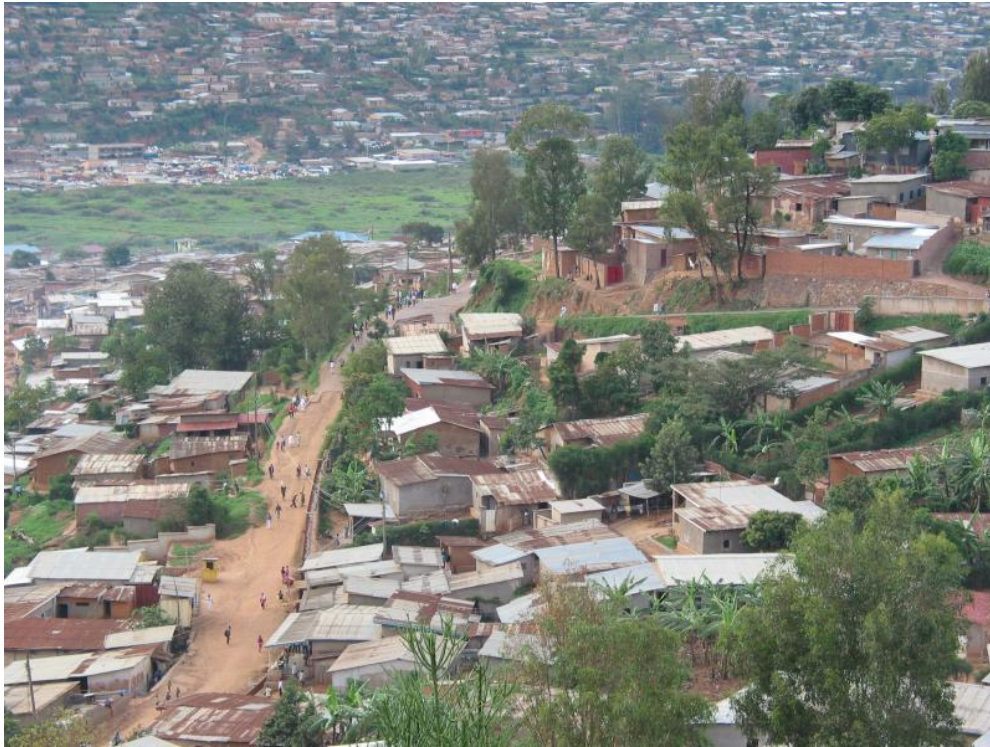
The figure of those living under these conditions currently is 180,000, according to government statistics. Although the Imidugudu scheme is in its eighth year, many donors remain sceptical about the programme; citing reports of "coerced" relocations, the lack of popular participation in the process of home design, plot-size, decision-making and other aspects of planning and resettlement-policy implementation.

"The government did not seek the opinion of the local population before embarking on this project and as a result, many of the present occupants were forced into these group settlements," a diplomat in Kigali, who requested anonymity, told IRIN news. "The result was a lack of ownership for some people who are expected to live in the Imidugudu," Cassien Ngaboyisonga, the director of housing in the Ministry of Infrastructure, said.

3.3.2 Challenges and Strategies of Housing

The main objective of the housing policy in both rural and urban areas is the improvement of the present system of the human settlements for a lasting socio-economic development. This objective implies the integration of the sector of the housing. The economic components that must support the government's general middle and long-term development policies are notably the policies of the fight against poverty and the policy of regional development as well as the programme of re-capitalization of the rural areas. This general objective also implies the rejection of urban development at the expense of the rural areas. This major orientation defines thus a progressive approach to production and the improvement of the housing.

The urban population increased from 7% in 1993 to 12% in 2000. The realistic hypothesis estimates that the country's urban population will be 30% in the year 2020. This 30% increase assumes three axes of development: (i) the development of provincial capitals by creating a balance between the Capital and secondary towns; (ii) creating new towns in every province within the framework of the regional development plan; (iii) developing the existing agglomeration nuclei into tertiary towns with an economic and social interest.



Source: Personal snap short. A snap short of what half of Kigali city (capital city) looks like in which the low income earners leave.

The annual urban needs will be considerable. New houses will have to be built to accommodate new migrants. Needs in infrastructures and in facilities will be in the same proportions and extra efforts must be made to meet such needs. The present choice of settlements in villages subtends short and medium-term urban explosion in the country and the growth of needs in housing in the urban centres. Housing Policy paper (2000: 25)

An expansion of spontaneous quarters is rampant. More than 80% of structures in the urban centres are located in the spontaneous quarters. They result from the inadequacy between the demand and the supply in urban building land and thus represent an alternative solution. The housing becomes decent only when it has good quality infrastructures and neighbourhood facilities. Tared urban road networks are rare, un-tared road networks do not have rainwater evacuation structures; water supply is insufficient, power cuts are frequent, drainage networks are non-existent. The system of public transportation is not organized. Distances between home and workplaces are long and transport costs are high.

At the same time, qualified human resources are very limited in the country: architects, planners, and other town planning specialists. The country does not have any specialized training centre for such people. Ministry departments, local communities do not have enough qualified staff for the studies and the follow-up of actions of planning and promotion of the habitat. Housing Policy paper (2000: 30)

Regarding the urban population increase, controlling the growth of urban agglomerations would be a strategy. The rhythm and the form of urban development have an impact on the implementation of the housing policy. Two strategic orientations are identified: The first Strategy being, Integrating the housing policy into a perspective of regional development and the second being developing urban planning systems such that implantations of structures are defined in a plan. These two orientations permit to take into account complementary nature between urban and rural areas and the creation of a dynamic continuum between them.

The city will thus be able to become an outlet for rural production and a means to increase the income of the peasantry thereby preventing that urban development is achieved at the detriment of the rural areas. This planning must indicate and fix conditions of land occupancy, the distribution of facilities in the urban territory and to define specific short, medium, and long-term investment programmes (National Housing Policy Rwanda, 2004).

However the planning process has a short-coming where y urban plans are all outdated. The other implementation plans, notably the local and specific development plans, plans of plot location are not available. The absence of planning documents in the face of the potential urban explosion represents a challenge in the adequate implementation of the housing policy. There is a big space-customer residential housing. The type of residential housing remains the reference model and requires high norms and standards. It is based on the one-plot-one-house model. The house is built in an area bound by four markers. This overshadows the possibility of thinking of a model of housing adapted to the Rwandan society whose income is low.

Ideally, balancing demand and supply for building land in the urban centres would deal with this problem. The importance of spontaneous quarters, the low capacities of the public and decentralized administration to satisfy demands for building land result in the insufficiency of building plots and this constitutes a bottleneck in urban planning. The strategic orientations would be five in number.

First, they would be need to develop mechanisms of production of building plots in both quantity and quality. Second, they would be need to service and equip districts to be built with basic infrastructures as a prerequisite to the development of the housing. Third, they would need to apply the principle of the recovery of urban planning costs. Fourth, they would need to carry out operations of restructuring spontaneous quarters to integrate the “de facto” city into the urban whole. Fifth, they would need to reviewing principles of expropriation in public interest (National Housing Policy Rwanda, 2004).

The grouped housing does not cover the whole country. In the long term, grouped housing must become the mode of settlement and exploitation throughout the national territory. Villages should not be reserved to refugees, in such case grouped settlements risk becoming ghettos and a source of division. Houses built in the « imidugudu » seem to lack durability. There still exist people without shelter.

Even the houses that have been built still look uncompleted. Structures have been built, but finishing work has not yet been done. The village’s internal infrastructures are poorly or not at all maintained. The plot allocated to each household is not totally laid out and often has an emergency look. The fence in quick set hedge, and garden or house plants are not there as recommended and animal breeding practices do not take into account the constraints imposed by proximity and neighbourhood. National Housing Policy (2002: 13)

Housing finance for many households in emerging markets, often reflect the lack of an appropriate infrastructure and preconditions for lending. The reasons are many lower income households may not be able to afford housing at market rates

of interest and house price, their incomes may not be stable or documented, or their past credit histories may be poor. Despite these obstacles, there is increased interest in and funding for lower income housing markets in many countries.

Equity capital is an extremely important component of finance of rental housing. It is often the most important vehicle for providing affordable housing. Government plays a critical role in creating the legal infrastructure for mortgage lending and security market development for low-moderate income earners. Non-profit institutions and charitable foundations can play a role in providing affordable housing finance through equity investment and credit enhancement of securitization transactions (Michael Lea, 2005).

Systems should be organized to finance both urban and rural housing. Mechanisms of financing the housing must enable families to have access to financial resources so that they may build, improve their home in a setting that allows them to contribute to the national economy. The housing must no longer remain the only domain that consumes the family savings. Through mobilizing the financial resources that can be invested in the sector of the housing, Creating and reinforcing institutions that finance the housing, Create an institution for financing urban and rural infrastructures and facilities for the benefit of local communities.

Understanding the risks and how they are assessed and mitigated within the housing finance system will help us assess the system and the potential for private sector housing finance in Rwanda.

3.4 BANKING AND FINANCIAL SYSTEMS IN RWANDA

It has been determined that housing in Rwanda has historically been a responsibility taken on by the public sector. The dramatic decrease in public sector housing has shifted the responsibility of housing to the private sector. It has forced the private sector to take on a larger share of the risks previously absorbed by the government. The fact that private sector housing development has not increased with the dramatic decrease in public sector housing suggests that there are risks involved that the private sector will not readily accept. The previous

section identified two potential inadequacies faced by the private housing finance system: a lack of savings by potential homeowners and a lack of available credit to enable them to leverage their savings into homeownership.

The business of banking is about buying and selling of money. Put in another way, it is about borrowing and lending of money. The exact manner in which this is carried out is what differs from one institution to another and makes the exact risk exposures vary somewhat.

While the above statement holds truth, it is appreciated that banking business has evolved from the traditional approach of taking deposits and giving loans, and today it portrays technological complexities and advancement. This has tended to bring about similarly complicated risks in the market.

This brings the Central Bank to do supervisions to development, commercial and housing institution as a guidance and protection of citizen's money Kanimba F, personal communication 10 August 2005. Supervision activities were carried out according to the existing generally used procedures: document based inspection and on-site inspection. The regulatory and accounting framework was also strengthened through the establishment of a new accounting system for commercial banks and new guidelines.

Within the framework of the restructuring of the banking system, the banks have pursued the implementation of the action plan jointly agreed with BNR in 2004 and whose objective was to ensure that all the banks comply with the prudential regulations put in place. BNR conducted several on-site checks at the level of the banks and the relative fall in the volume of non-performing loans is continuing. Monetary Policy Statement (2005:10)

Like in 2002 financial year, document-based inspection continued to be used through the processing and analysis of banks' reports with a view to detecting on time risks, which are inherent in some banks' activities. Production of quarterly banks' analysis notes concerning the financial structure, the quality of the loans, profitability, solvency and liquidity, as well as prudential mechanisms, Production

of ad hoc reports on specific subjects such as banking operations. Meeting with banks management to discuss the most important risks identified during document-based inspection. Standardization of the quarterly analysis notes on the entire banking sector, including some financial institutions. Preparation of a report on non-performing debtors of the banking system. (Rwanda national Bank Report 2005)

Rwanda Housing Bank, while incorporated as a full bank under the relevant law, is a specialized institution engaged in mobilizing resources for the purpose of lending long term towards housing. Commercial banks lend short to medium term for commercial activities. The inherent risk in what the Housing Bank does differ in degree from those undertaken by the commercial banks. Given Rwanda Housing Bank's position in the market the identifiable risks that the bank is exposed to are listed as follows: Liquidity Risk, Credit Risk, Operational Risk, IT Risk, Interest Rate Risk, Reputation Risk, and Exchange Rate Risk. The list is not exhaustive neither will it remain static. Risks in banking are dynamic and regular reviews of the bank's risk situation will be undertaken.

The assets of Rwanda Housing Bank are mainly long term. These are funded largely by short- term liabilities. This is a disastrous situation in terms of liquidity risk. Now the disaster may not be about to occur. This is because of the long-term government funds that are held by the bank, being sale proceeds of the government houses that were handed over to RHB for sale.

These funds have been substantially eroded through issuance of mortgage loans to borrowers. In the days to come this asset/liability mismatch will become more and more pronounced. The risk will become critical and will call for stringent control measures. This paper will attempt to outline some of the measures that RHB will put in place to control this risk (Risk Management Strategy Document, 2005).

Credit Risk is defined as a chance that a debtor to the bank will fail to repay the principal he has borrowed from the bank and also the interest that accrues on that amount. RHB lends long term: it is therefore more exposed to this type of risk. Credit and liquidity risks are the major headaches that RHB will face in its

business as time goes by. These are also classified as financial risks. This reality is fully appreciated and, as this document, attempts to show below, the Board of Directors, and senior management have taken steps to ensure that they are put under effective control.

Operational Risk is defined by industry as the risk of direct or indirect loss resulting from inadequate or failed internal processes, people, and systems or from external events. This arises from the way the bank is organized, the equipment or computer systems it uses, the people it employs, and external happenings that occur. Some of these are preventable while others may be beyond the control of the management of the bank. This document will attempt to show the preparedness of Rwanda Housing Bank in dealing with these events as and when they occur, expected or unexpected.

For all the identified risks above Rwanda Housing Bank has put in place clear policies and procedures that are stringently enforced by senior management. The objectives of these policies are, to keep under control these risks, and to minimize their impact on the profits of the bank. In cognizance of the fact that lending is the critical part of the core business of RHB, an elaborate policy on lending has been put in place. In addition, strict procedures have been instituted to control the inherent risk that credit has.

The main components of the lending (credit) policy are as follows: no single individual may borrow more than Frw 20 million at a time. Every individual must raise at least 30% of the cost of the house being purchased. Every borrower for construction must put into the project not less than 40% worth of work before drawing on the 60% loan. This work is done upfront. Corporate borrowers, like the estate developers, must also do at least 40% worth of work before taking the 60% construction loan.

Rwanda Housing Bank will always lend against the tangible security (guarantee) of the property being constructed. Additional security can also be taken if necessary. Loans are only for buying, improving, or constructing real estate especially residential, and for nothing else. In the event of default by the borrower

there is always available a tangible property the bank can sell to recover its money. The only exception to this is the temporary overdrafts that may be occasionally allowed on salaried individuals who could find themselves in need such facilities are cleared from salary within the same month. The maximum a person can borrow under this facility is 50% of his/her salary.

The current funding mechanisms mean that the state is likely to remain the main supplier of wholesale finance and guarantor of loans towards housing (see also Khan, 2003: 80). The only other major organization that availed credit for housing in Rwanda has been the state founded and funded Rwanda Housing Finance. As an institution specializing in Housing finance, it offers loans to Individuals that are into home construction and home purchase, home improvements and home completion, loans to corporate bodies, institutions or employers, loans to property developers, special window of housing loans to civil servants and Diaspora loans. However, because it was conceived as a private sector organization, there has been pressure that it operates as one.

The legal and regulatory infrastructure for real estate finance is adequate in Rwanda although there are several weaknesses and land ownership and registration that so far have prevented the practice of mortgage lending are being addressed. A legal framework protects property rights, which should be secure for both owners and holders of property liens where it applies. However, the land administration system is weakened by the limited scope of the cadastre and land registries.

Cadastre and land registries incorporate only about 20% of the land in the capital. They lead to serious operational shortcomings that hamper the capacity of the land department to meet demand and that jeopardize the integrity of records and a legal provision that links full title to the near completion of construction. These weaknesses are currently being addressed. Furthermore, an overhaul of the Kigali land administration is under way, which will expand the scope of registered properties, create a computerized land information system, and improve the collection of taxes and duties. The new system is expected to be ready within two years.

In response to the increasing need for effective risk management processes in the financial institutions' sector, the Central Bank of Rwanda has set out to promote the establishment of clearly defined risk management frameworks in individual institutions. Due to the fact that banks play the important role of financial intermediation and are key to national and international financial stability, they need to operate in a safe and sound manner and hold capital and reserves sufficient to protect against the risk that arise in their business. As a pre-requisite there is need to identify the extent to which Rwanda has dealt with risk management as a practice in financial institutions.

Rwanda has five commercial banks, one development bank (Rwandan Development Bank) and one credit union system (Rwandan Union of Popular Banks) and one housing bank (Rwanda Housing/ Habitat Bank). Most of the commercial banks are profitable and paying shareholder dividends. The majority of commercial bank loans are short-term credits related to trade. Eight Respondents that were interviewed in five institutions active in Home loans gave a clear background of the risk management guidelines, which were the foundation of the risk management unit in their institution. The quality and comprehensiveness of policies (which were communicated in all institutions with the help of the National Bank supervision) was the level to which priority was given to risk management.

In one institution (Rwanda Housing/Habitat Bank) the respondent reported having clearly defined risk management policies and procedures, the documents were in early draft stage and had not been presented to the Board for consideration and approval; some institutions consider the various reports produced for monitoring risks as sufficient to constitute "clearly defined risk management policies and procedures." Some institutions, Central Bank Rwanda's on site reports indicated that the guidelines available are not adequate comprehensive for effective risk management, particularly for non-credit risks.

In regard to credit risk management, housing provision and affordability a short discussion with one of the senior official of Rwanda National Bank was held and this is what she had to say;

“The way it works is that they should be housing, for instance now if you want to get a loan for a house, the houses aren’t there. So there should be real estate development that should be once you get the loan there are no houses to buy. As long as there is no real estate development then it becomes very difficult. For example you give a person a loan and they start building, that makes the routine very difficult but if you get a loan for an already finished house then it is much easier. For example if you look at the Gachuriro project, that is what it should be.

You should be able to get a loan and have a house to buy considering how much money you have which also depends what price the house is at. Because there is no market, it is not easy to price the assets and the loaners both to the individuals and to the housing people; you give them money to buy houses that are probably not of good quality. For example you buy a house in Gikondo (which is an urban suburb for the medium income earners) that is very difficult to price your asset because the housing market doesn’t price it is almost individual.”

“Also the valuers, if you look at places like Nairobi or South Africa for instance; you can be able to tell the house. Let us say in places like Remera, Kiyovu and other places. You would know that houses in Kiyovu are a high quality area because of the infrastructure. Now here it is a matter of option, so the risk to the housing Bank is that if I resist a mortgage against evaluation, it does not reflect the market value then in case you fail to pay and the bank wants to action they cannot because they fail to get fee value for it.

Therefore, it is a very big problem because there is no national pricing for the real estate. It is quite a challenge of course there are other challenges, which are general in the banking sector that the weight of default is very high in Rwanda. Reason being one, credit culture isn’t very good people are not used to pay back.”

“Secondly the legal institutions follow institutions. If say for instance the bank wants to take you to courts to sell your property, now make it five years before because the courts are clogged up with cases. We do not have a separate corporate commercial court, and because we do not have a separate commercial court. It goes through the whole line of criminal and genocide court everything is mixed up. So it takes forever.”

“There is also a problem of registration of property in the mayor’s office it takes long to get title of property. Now that is a very big challenge to the housing market because the banks should be lending against titles of property now if there are no land titles or if the land titles or if the land title is a problem then it becomes difficult to the borrower and also difficult for banks as well as the land owner.”

Interviewer: Considering the fact that land in Rwanda belongs to the church and the government, could you comment on that in line with the landowner or land title or lease? “Truth is that the land law it’s self that gives power to the Mayor to be the custodian of land titles. You can imagine the Mayor is a political and solicited for everything that has to be open almost all new infrastructure, attend socio-political meetings and at the same time manage other things patterning to his or her province or district. So it becomes very difficult to combine.

There is also the process of getting the land title you need to evaluate, you need to demarcate it. They don’t have demarcated land. Every time you need land they need to go through the valuation, then there is the process of Tax Certificate, which is a tedious process, and they (Mayor’s office) have a lot of work. It takes a long time to register, to remove the mortgage from the title to realize the guarantee by auctioning so all those processes make housing very expensive.

What happens is that the Bank is going to factor in all those possibilities. For instance if I give you a loan and I know that 30% of the time you are not going to pay then am going to cancel with the credit rate it’s partly why the interest rate is very high because the banks make provisions for it if you don’t pay in time. It make it very expensive and in accessible. So the e bank has to get a land title

before hand to be sure that you have collateral or security to pay back before the give you a loan and it takes long to get all that, so you can see how many loans it gives out in a year. These are some of the challenges. However on the positive side, the capital is there, big enough for housing that means there is a big market.

We have competition. What we do now you can have your mortgage financed by the Housing bank/ Habitat Bank or any commercial Bank.

Interviewer: I thought the Interest rate in the Housing Bank is lower than that of any commercial Bank in terms of housing. They should be lower in principle but it depends on the cost of funding. Now the cost of funding is lower for commercial banks than housing bank because they do not have the pool of resources or cheap resources like the commercial banks. Both of them certainly do not have long-term resources but for the short-term resources, the commercial banks have much more because they have three deposits (savings, fixed and current accounts) which they use to lend.

Now the housing bank for it to compete with the commercial banks, they need to have resources of long term and cheap funding. They can also encourage saving or mortgage savings (you save money on your account up to a certain amount then the housing bank tops-up and gives you a loan. Because it's longer term it should be cheaper and it can only be cheaper if their cost of funding is cheap, the key is in how do they fund. They can also lend long term, but they need a good marker in pricing or the source of funds as to how much they should be able to lend.

Question: Is the Gachuriro project in Kigali a long term or short term? Yes it is a long term project. It was actually financed by National Social Security Fund in conjunction with Housing Finance Bank. Two things, the Gacuriro project is built by Housing Bank and NSSF, which are long term that means all our pension is there. In terms of financing people, partly the funds we have are both long term and cheap. Because you have a loan from government in the plan of government housing, government gave them a loan of 605 for more than 20 years as subsidies.

The reason for it was that it was supposed to give priority to the civil servants that had been vacated from the government houses that were sold. That is why they were able to have cheaper funds and long-term funds. Short of that, they do not have a lot of sources of funds but what they are encouraging which is very positive is to encourage people to save long-term. Therefore, they get a pool of resources where they would be beneficiaries of the housing loan.

3.5 CONCLUSION

In conclusion, Rwanda was faced with a settlement crisis after the 1994 war and genocide. The population was internally displaced, majority fled to neighbouring countries and there was an influx of old case returnees from different parts of the world. The government had, in 1994, a task to resettle the old case and recent returnees under a fragile security situation and a fragile economic base, severely impoverished the population with no resources at the time. However, Rwanda has made significant progress in stabilizing and rehabilitating its economy. Subsequently government announced the undertaking of the villagisation kind of settlement.

In accordance to these principles, the economy plays a big role to deal with projects for vulnerable groups directly. It is responsible for disbursing funds to the Provinces and consequently to the Districts which are then responsible for allocating the funds among associations. Individual projects must be under the umbrella of an association so as to ensure better management of the project and its funds.

The Rwanda Housing policy targets a certain group of people and that is the civil servants, those individuals who can afford to pay say 20 million and above houses in ten years, which is the medial class. The other houses both in urban and rural areas were built with money from individual savings. Only a small proportion of the population benefited from these actions. Therefore without researched details which are evident and aliened with Rwanda's situation then policies put in place will have a dead end while implementation.

When we talk about Housing, it goes hand in hand with land, Bank loans and how the bank can retrieve its money from the borrower. This then brings in the question of banking system and the credit risk management in Rwanda. As borrowers move to different homes, they pre-pay the mortgages. This effect occurs even if interest rates do not change. It is dependent on interest rate changes to the extent that real estate purchases depend on the availability of “affordable mortgages.”

When interest rates decline, many homeowners refinance their mortgages. Conversely, when interest rates rise, refinancing becomes less frequent. Therefore Rwanda needs to look at the International lessons in line with an evident and researched housing attitude to be able to adopt a suitable policy framework as outlined below.

CHAPTER 4

ANALYSIS AND INTERPRETATION

This chapter will analyse and interpret the research material on the Rwandese Housing situation as seen in chapter 3 and concerning the international best practices and reflect on Rwanda's policy framework on low-income housing financing.

In Rwanda, the land belongs to the government and the church. It is allocated to people who pay levy to the government. Only a small proportion of the population benefited from these actions as per the policy layout. The other houses both in urban and rural areas were built with money from individual savings. Because of low incomes, this approach contributed to the extension of spontaneous and unsanitary quarters in the urban centres and to the reinforcement of the dispersed habitat. It did not have support of public structures and incentives.

In most cases, the low-income earners were category not considered in the policy. Yet these are the people whom we employ as our tea girls, office messengers, drivers, carpenters, and small informal businesses, to mention but a few. In general these are the low-income earners. They then build shacks or slum-like houses in the city centre where they could have access to transportation and work. In this scene the government does not have a way of preventing the outbreak of disease epidemics in these slums.

4.1 EFFECTS OF THE ECONOMIC CONDITIONS

In most developing countries, state failure is related politically to the creation of a weak, hegemonic state laid on colonial administrative structures and institutions. Another notion of development relates to the economy of a particular country. A nation can only be considered to be developed when the economic management of that particular country is on the right track. In a number of developing countries, the management of the economy has been disappointing. It is no surprise that poverty levels are still so prevalent in the majority of the population. To escape from poverty, people in rural areas flock the cities in search of work and a better welfare, because they cannot afford rent, they then build small informal houses or

shacks, which then become a problem. Then government has to look at trends to eradicate this problem.

Most cities in developing countries are characterised by a multitude of problems, including poverty between residence and inability to provide sufficient housing and related infrastructure. These problems have emanated from the rapid growth of urban population amid staggering economies and inappropriate urban policies. Rapid population growths in the cities of developing countries result from both natural increase and high rates of rural-urban migration. Otherwise, both economic and political instability, have created an influx of refugees from neighbouring countries leading to rapid urban growth. This has happened in Pakistan where Indian refugees have fled to cities of neighbouring Pakistan (Rukanuddin, 1990). African cities, which have world's fastest growth rates, have experienced rapid growth rates during the past four decades, leading to continually deteriorating urban conditions (Obudho and Mhlanga 1987).

In the past, the trend of housing programs in developing countries mainly consisted of government-sponsored initiatives to design, build and sell houses using loans with subsidized interest rates. These policies were generally limited in scale, not affordable by or clearly focused on poor families, and often-inefficient policies (Mayo 1999). Cognizant of these problems, international development organizations in the mid-1970s started to direct their loans and advice to developing countries based on the new "basic needs" strategy, which consisted of providing sites and services, slum upgrading and core housing (Kimm, 1986).

It is the responsibility of every government to provide decent shelter capable of meeting diverse physical, social and psychological needs of the population. However, due to lack of funds most governments and local authorities in the developing countries have failed to provide adequate and affordable houses to urban dwellers. Traditionally, housing has also been viewed as a consumer good, which must be given a very low priority in development issues (Obudho and Mhlanga 1988). However, this view undermines the contribution of the housing sector to economic development through the provision of employment, rental

income and other economic benefits, all of which can lead to higher national productivity.

According to Rasumus (2005:2), cities in developing countries are facing ever-increasing shortages of housing affordable to low-income households. Policies aimed at providing housing to low-income households in developing countries, either directly through the public sector or through promotion of private investment into housing, have not been able to meet the growing demand. Most Developing Country governments, influenced by policy recommendations from International Organizations, have gone through the same approaches to low-income housing. Until the 1960s, slums and squatters have been cleared in an attempt to re-house residents in public housing projects, either in rental units or in dwellings that they had to purchase.

Socially and economically unviable, this approach was abandoned in favour of sites-and-services projects implemented throughout the 1960s and 1970s. Often combined with infrastructure-based settlement upgrading projects, the approach was capital-intensive and implemented in a top-down manner which led to lack of ownership, and, as a consequence, to lack of maintenance. Improvements were not sustainable and insufficient in number. Since the 1990s, participatory or community-based settlement upgrading has been the new paradigm World Bank (2002).

Developing countries like Chile started several reforms in the financial sector and in social housing programs, among which was the creation of the first program to subsidize the demand to buy housing (Gilbert 2004). The Chilean model was established ten years before the “enabling markets housing approach” promoted by international organizations such as the U.S. Agency for International Development (Kimm 1986), the Inter-American Development Bank and the World Bank (World Bank, 1993). Under this enabling policy, governments generate incentives and act as a facilitator so the private sector will produce and finance the housing that the country needs.

The Chilean model (enabling model) of housing has influenced housing policy in many countries of Latin American, and even those of other continents.

Nevertheless, it has not been widely recognized as the first program in which the government plays the role of enabling the market. Rwanda could “fit into” the enabling model, but the study shows that, more than only fitting in, the suggested housing model should be the precursor of the policy. The main characteristics of the program (one-time cash payments of a fixed amount) correspond “unquestionably to the type of subsidy (for housing) that is less problematic than others” (Kimm 1986)

The Rwandan government, through the Ministry of Housing and Planning is a key actor in the success of the housing model. During the first 3 years of implementing the policy (until 2001), the Ministry not only funded and managed the subsidy programs, but it also was the largest real estate firm and the second largest mortgage bank in the country, in terms of the number of houses built and the number of mortgage loans issued.

Gilbert (2002) raises an important question: What have been the instruments and the amounts of public and private resources that were allocated to the construction and improvement of social housing in for instance Chile? If this question is raised in the situation of Rwanda, then the answers lie in the planning authorities and various stakeholders/housing institutions. The solutions to this puzzle can be proper planning firstly for resource allocation, competent technocrats and quality housing services.

To improve the focus of its resource allocation, families do not receive another housing subsidy for the expansion, but since they do not have to pay a mortgage, they can save to finance the materials and labour required. The new program is flexible and accepts projects that involve the purchase of existing houses or construction on existing open space within a lot to increase housing density.

The selection mechanism for housing beneficiaries should benefit people who buy used houses over those who build new houses. The goal is to open a new market for the very low-income sector by making it possible for them to purchase the houses that had been constructed by the government or other private institutions over the previous years. Nevertheless, since most of these houses were destroyed

during the 1994 genocide, it is important that a newer approach be taken into consideration.

4.2 DEVELOPING A COMPREHENSIVE HOUSING POLICY

Despite the government's increased attention to the evolving development needs of Rwanda over the last ten years, there is still considerable opportunity for improvement in the effectiveness of the development assistance efforts in the social sector.

The main challenges and related opportunities for improvements emanate from:

- (a) Changes in the development assistance environment, including people's limited access to other sources of financing;
- (b) Internal challenges in housing institutions, such as policy or procedural constraints within Rwanda;
- (c) The changing needs and preferences of the ruling governments. Notwithstanding these challenges, there are also significant new financing opportunities, which clearly require a much wider menu of assistance packages and partnerships, which the Bank should put itself in a position to provide.

In effect, some common housing challenges overlap across the country. Some of the key challenges that policy makers must face are detailed below.

4.2.1 Stringent and excessive housing loan conditionality

The conditionality placed on housing loans is often perceived by banks as being too stringent. The most frequently raised conditions include those related to the Bank Group's Involuntary Resettlement Policy (IRP), sector policy reforms and environmental assessment impact studies. Several countries have been critical of the inflexible conditions in the Bank's IRP, which causes delays by increasing the bulk of evidence they are required to submit before a project is deemed effective.

This is particularly problematic for Rwanda, which is already advancing to advanced legislation and practices that ensure adequate resettlement of its citizens. A review of housing finance projects is necessary to reduce the requirements imposed on countries that are deemed to have systems in place for adequate resettlement (Angel, 2000). Very often, such projects will require sector reforms and related conditions that require government and parliamentary approval. In a country like Rwanda where such decision-making is lengthy, timely fulfilment of housing-loan conditions is often affected. Conditionality should therefore not include sector reform-related conditions unless the success of the project or program depends on such reforms.

More so, Rwanda needs to adopt good sector policies and sound macroeconomic performance. This will imply that housing finance companies are subjected to fewer conditions for individual projects and programs. Instead, the housing companies should use the government policy dialogue forums, policy-based lending in order to address sector policy concerns.

4.2.2 Participation in basket funding and sector-wide projects (SWAPs)

Although the country put in place SWAP guidelines, these did not address the legal obstacles to the housing company's full involvement in SWAPs. The key obstacles are related to the policies on procurement, taxation and sanctions. The sector's participation in basket funding is hampered by insistence on rules of origin, prevention of the payment of tax components in project costs and the right to impose sanctions on members in arrears. These factors have a significant impact on private sector participation in SWAPs. In some cases, they would necessitate formal interpretations and, where required, an amendment of the relevant provisions of the Agreement Establishing the Fund.

This in turn means that the private sector is enabled to contribute directly or indirectly to the housing finance campaign. It may also have better bargaining power with the local community and technocrats (ADB, 2005). The challenge in this relationship however is that there is likelihood of exclusion of certain key stakeholders like foreign funding agencies, local entrepreneurs and socially

excluded groups. In so doing, the SWAP approach may not apply as the established relationship lacks viable dialogue.

4.2.3 Rigid procurement rules and procedures

Any housing intervention may require procurement to be from suppliers registered by the government or public authorities. This may reduce the competitiveness of housing institutions, vis-à-vis other donors, such as the World Bank and the ADB, which have removed such restrictions. In addition, the rules and procedures are perceived as being lengthy, cumbersome and restrictive. People who may need housing finance also cite the lack of sufficient delegation of authority to facilitate the procurement process, over-involvement of the corporations in procurement activities at the country level and the lack of a mechanism for authorizing the use of national procurement systems (Mayo, 1999).

Rwanda can enhance country ownership and project sustainability, and facilitate harmonization and simplification. This may call for government working more directly with the competent institutions and systems that local communities already have in place and supporting of efforts to strengthen them. For instance, most middle-income countries (MICs) like Egypt have strong and functional institutions, which enable the use of national procurement systems instead of private-lengthy procurement systems. The means to assess the capacity of national systems should be made available to appraisal mission leaders, as proposed under the national legal documents.

4.2.4 Legal constraints

These have been extensively discussed in preceding chapter. There are two broad types of legal constraints: those exogenous to the housing institutions mainly find within Rwanda and those endogenous to the institutions and can manifest themselves during loan negotiations, loan documentation and housing project implementation. These constraints may include delays in fulfilment of loan conditions, stringent policy requirements imposed by the housing company, inefficient mechanism for approval of projects and amendments in housing projects. They negatively affect the housing institutions in their transactions with

the clientele and impede speedy and efficient implementation of housing finance projects.

Angel's (2000) experience in the private sector operations shows that increased involvement of the legal department from the early stages of the project cycle can positively contribute to a smooth delivery of the institutional assistance in the housing field.

4.2.5 Information, communication and marketing

Compared to other development partners, the interventions offered in terms of field presence as well as participation in seminars, conferences and sponsoring events. Overall, Bank Group communication in MICs is poor and special efforts need to be made to effectively improve perceptions of the Bank and raise awareness of its attractive financial products.

While this will require a full review of Bank communication tools and re-orientation of its outreach approach in MICs in the medium term, there ought to be, in the short term, an effective and efficient use of existing communication opportunities (e.g. staff members in the field, Bank website, media coverage of events, and publications). Within the same context, the positive visibility and communication impact of Bank-sponsored training seminars and workshops in MICs should not be ignored. The role of the Bank's Training Department and the Joint African Institute (JAI) in supporting Bank communication efforts through their training events for selected Bank staff and MIC officials should be recognized and institutionalized.

4.2.6 Poverty and inequality

In spite of their relatively higher per capita income levels, poverty persists in Rwanda (51 percent of total population). Gauging poverty is difficult due to inconsistency in statistical methods. However, the 2004 UNDP Human Development Report provides a number of different poverty measures. Based on the country's national poverty line, middle-income countries (MICs) with relatively high poverty rates include Swaziland (40%), Egypt (16.1%) and Algeria (12.2%). Based on the one US\$ per day measure, MICs with relatively high

poverty rates include Nigeria (70.2%), Zimbabwe (36.0%), Namibia (34.9%) and Botswana (23.5%).

A key related problem is skewed revenue distribution, which can be measured by a country's GINI coefficient where zero represents equal revenue distribution and 100 represents perfectly unequal distribution. The average GINI coefficient for MICs is over 51, indicating serious inequalities. This is higher than the overall African average of 46 and the Latin American average of 50. High unemployment rates fuelled by a rapidly growing labour force constitute another constraint. If not addressed this problem could lead to worsening poverty levels especially in urban areas and increased pressure on housing and other social infrastructure.

4.2.7 Vulnerability to shocks

Vulnerability limits the ability of economies and households to deal with external shocks. Changes in international commodity prices leading to abrupt terms of trade shocks can be destabilizing. This can be exacerbated if the country lacks export diversification or is overly dependent on a narrow range of key imports. Shocks can also be the result of natural disasters (including droughts and earthquakes), conflicts or disease.

The problem of HIV/AIDS, especially in the Southern African MICs, merits special attention where the rates are the highest in the world. These countries currently face a growing crisis in delivering vital public services that are crucial to coping with AIDS. The reasons underlying this include migration of key staff from public to private sectors and abroad, in addition to the impact of the disease itself (Mayo, 1999).

4.2.8 Globalization and economic integration

Most MICs are engaged in regional cooperation and integration arrangements, for example within the SADC, COMESA, ECOWAS, UMA, and Maghreb initiatives. They are also engaged in global integration arrangements such as the Economic Partnership Agreements (EPAs) with the European Union (EU), expected to be concluded by 2007, and the SACU/USA Free Trade Area negotiation aimed at providing increased market access for exports from SACU member countries.

These global arrangements require MICs to improve the quality of their products and the competitiveness of their economies. The North African MICs, for example, are currently undertaking reforms aimed at upgrading and modernizing their industrial and physical infrastructure, progressively reducing customs tariffs and gradually embracing commercial and financial liberalization.

These reforms aim at improving the competitiveness of domestic firms and reducing their vulnerability to external shocks. MICs such as Morocco and Tunisia are engaged in the process of upgrading all standards (industrial, services and financial) to the level of EU countries under the MEDA program. This modernization process requires considerable financial resources.

4.2.9 Private sector growth

Over the past quarter century, the private sector business climate has improved in most African MICs. This has also been accompanied by privatization of public enterprises and the development of domestic capital markets. The private sector has responded positively to economic and structural reforms in these countries and is increasingly becoming the driving force for economic growth. Public-Private-Partnership (PPP) arrangements, especially for infrastructure provision, are also becoming a key feature of middle-income countries. Promoting private sector development will be an on-going challenge for Rwanda as it needs to realise better housing.

4.3 HOUSING FINANCING SYSTEM ANALYSIS

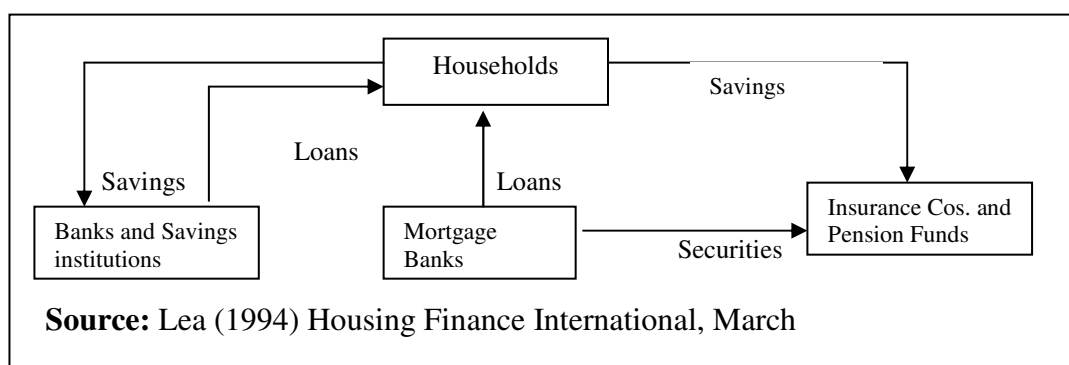
According to Lea (1994), the aim of a housing finance system is to provide the funds, which homebuyers need to purchase their homes. This simple description has spawned a broad array of institutional arrangements, ranging from contractual savings schemes, to depository institutions specialising in mortgage finance to the issuance, sale and trading of mortgage-backed securities (MBS). All of these arrangements have been created with the same purpose in mind, to channel funds from savers to borrowers.

A sign of financial sector development is the funding of owner-occupied housing by formal financial institutions (as contrasted with informal savings clubs, relatives or property owners). These institutes can be shareholder owned, mutual organizations, or special circuits (i.e., government-backing institutions operating apart from the boarder financial markets). As economies develop, provision of housing finance often moves away from extension of housing finance often moves away from extensive reliance on special circuits towards integration of housing finance into the broader financial markets (Lea, 1994).

The traditional model of formal financial sector finance of housing is the deposit taking system. In this model, an institution gathers savings from households and enterprises and makes loans to homebuyers. Thus, it originates services and funds the loan. There are several types of deposit taking institutions, including commercial banks, which offer a complete range of banking services, savings banks that deal largely with the household sector, and specialist housing finance institutions (building societies or savings and loan associations) which focus their leading primarily on housing.

The United Kingdom is an example of a country, which realise largely on depository institutions for housing finance. In Asia, primarily depository institutions provide housing in both Malaysia and Thailand. Depository institutions are prominent in Latin America housing finance (Lea, 1994). An alternative to the depository institution model is the Mortgage Bank System (Figure 1).

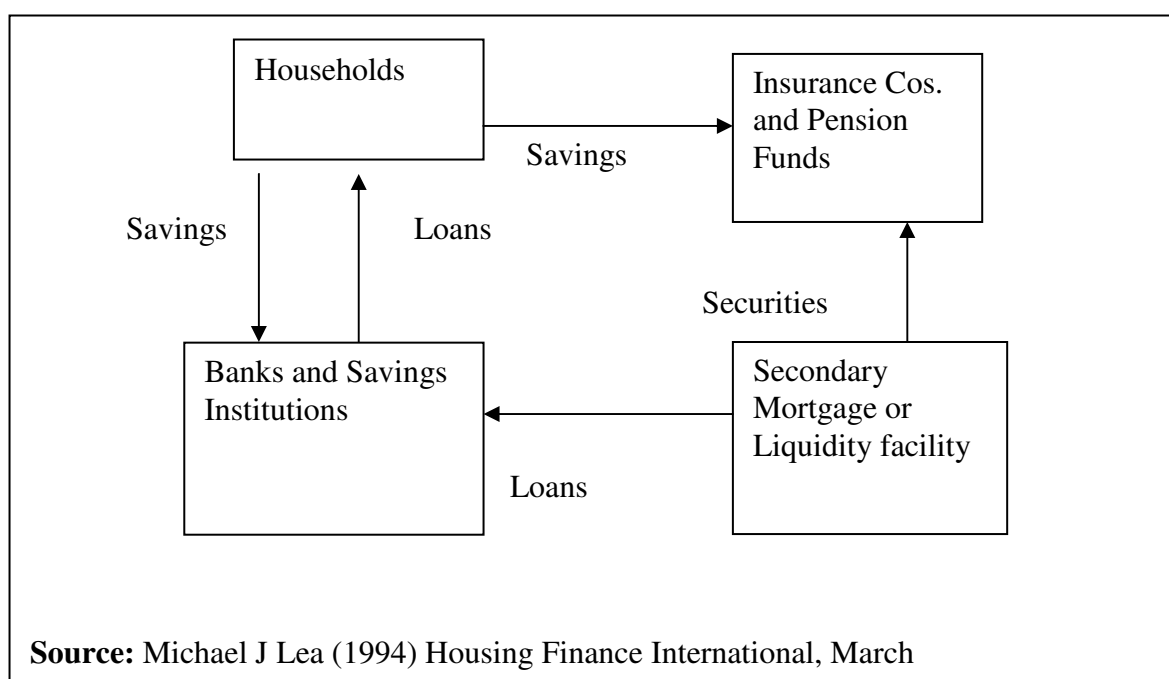
Figure 1: Mortgage Bank System



As shown in Figure 1, social sector lending accounts for a relatively small portion of mortgage in such systems, specialized institutions (mortgage banks) originate and service portfolios of mortgage loans, which are funded by securities they issue. The securities are general obligations of the mortgage bank and are purchased typically by institutions with long-term sources of funds (e.g., pension funds and insurance companies). The Mortgage Bank system is a combination of retail and combination of retail and a wholesale approach. Its wholesale character comes from the funds raising side wherein funds are obtained primarily from institutional sources through the broader capital market rather than directly from the public (Lea, 1994).

In many countries, purely wholesale institutions exist to facilitate the flow of funds to the primary mortgage market (Figure 2). These institutions, referred to as liquidity, rediscounting or secondary mortgage facilities, are typically government owned or supported. They issue general obligation bonds in the capital markets and use the proceeds to refinance the portfolios of primary market lenders (Lea, 1994).

Figure 2: Secondary Mortgage Facility



The use of one or more of these systems depends on the stage of development of a country's financial markets as well as government policies. As housing finance involves lending to individuals, it usually emerges as a retail activity. This is largely a function of the cost of the Bank's resources, which is considered too expensive by the Bank's management, and thus, not appropriate for social sector development. Nonetheless, serious social development issues do exist in developing countries for instance, the rising unemployment among the youth, income inequality and corruption. This results partially from the lack of appropriate skills required on the job market. A possible niche for the bank could therefore be in the area of housing finance reform, which needs to be linked increasingly with the private sector.

The Bank's energies should be focused on co-financing opportunities with either bilateral donors or UN agencies to bring down the cost of the Bank's resources. The Bank could also use its private sector window to finance private initiatives in the social sector. Indeed most developing countries are experiencing an upsurge in private educational and health care institutions, especially of the tertiary kind. This might contribute to freeing up valuable public resources, which could be more profitably dedicated to the needs of the poor in those countries. However, social sector should be given more focus by banks and by implications; this includes the housing sector as the greatest priority.

A principal current challenge to empirical work is the absence of data on internal rating assignments and associated borrower characteristics and defaults. The bank sidesteps this problem by simulating internal ratings. We estimate logit models of default probability for a large sample of U.S. bond issuers, assigning each borrower in each year to a simulated internal grade based on its fitted default probability.

Because our goal is not to produce the best scoring model but rather to evaluate methods of rating quantification, we deliberately use very simple models and are careful not to over fit the data. We examine the out-of-sample accuracy of estimated average default rates by both simulated grade and Moody's grade as produced by both the scoring model and the mapping method. Our results indicate

that properties of different quantification methods can vary with details of the internal rating system to be quantified and of any scoring model that is used. Thus, empirical analysis of actual internal rating data, when it becomes available, is very desirable.

Our evidence represents a first step toward understanding and reliable practice. In addition to limitations associated with simulated internal ratings, other data limitations cause us to analyze only default risk, not risk associated with changes in spreads or changes in borrower credit quality short of default. Rating transition matrices are a common basis for modelling the latter, and Krahnen and Weber (2000) present evidence that transition rates are much higher for point-in-time internal rating systems than for agency ratings. Our simulated point-in-time internal grades also have higher transition rates.

In order to create credit enhancement and risk management operations, the Central Bank of Rwanda can assist sovereign and non-sovereign banks/housing institutions by offering credit enhancement products such as guarantees. Such a product would provide them with lower borrowing costs, because of the Bank's triple-A rating, and help them extend loan and bond maturities. At the same time, issuers would retain the other non-monetary advantages of borrowing from the capital markets. The Mortgaging Bank can also offer risk management products to help banks hedge against financial risks. In turn, credit risk on the side of borrowers is reduced to a significant extent.

Some portfolio models require as inputs measures of the volatility of default rates (Gordy, 2000b) and such volatility is commonly measured using rating agency default rate histories, which might have different volatility properties than internal ratings. Although our evidence is only indicative, we find annual default rate volatility to be rather similar for agency grades and our simulated internal grades.

4.4 RISK MANAGEMENT REGULATIONS

In order to maintain quality of the mortgage portfolio, the average quality of bank housing loans should remain satisfactory to customers when compared to other loans to the private sector (which have an average 17.2% delinquency ratio).

According to the ADB (2005), 4.7% of housing loans are delinquent out of which 3.6% for individuals and 3.1% have late payments above 3 months. This latter indicator should be carefully watched as a possible area of concern, as the low rates of the variable-rate mortgage portfolio may further increase, and foreclosure remains untested.

In most countries, professional mortgage lenders pro-actively recover debt after 3 months of delinquent payments, notably as margins are not large in competitive markets. For example, the average proportion of delinquencies above 90 days for individual mortgages in the US is only 0.49%. The reasons of higher ratios observed in Poland should be studied by the NBP.

The level of net losses after foreclosure is unknown and cannot be accurately estimated without meaningful data. The practice of unregistered statutory liens for public creditors has been revisited, but interviewed banks report the foreclosure process to be still generally long, untested or hazardous. More information is needed in that area. The court system's land and mortgage books need to be gradually modernized (with electronic database implemented in offices) thus reducing costs and delays, and enhancing the collateral security of mortgage lenders. This too can be applied given technical support and government commitment.

The Ministry of Infrastructure has also mentioned its willingness to design a new system of up-front housing vouchers for targeted (low-income) households, as a form of down-payment support, separated from market-based mortgage finance. Such schemes should be carefully designed, targeted and monitored to avoid abuses or undue fiscal pressure. They may become unnecessary and/or redundant with the new program of interest buy down. The alternative option of supporting credit guarantee schemes may also be analyzed.

Some housing institutions may tighten their underwriting mortgage policy and adjust their legal contracts. Nevertheless, there was no banking regulation, nor consumer information rule that deals with this serious issue given the longevity of the housing loans versus foreign exchange rate fluctuations. Banks look more driven by commercial considerations than prudential risk management. More

attention should be paid towards groups that are more vulnerable as mortgage markets expand. One bank in Sweden declared that it might have to revert in 2005 its former decision not to lend hard currency mortgage loans, in order to preserve its eroding market share and avoid a refinancing run of its borrowers.

The credit risk of the poor cannot be easily estimated through a published comparative effective interest rate. Thus, relevant consumer information may have to include other tools of transparency and education, such as providing on a mandatory base to prospective clients a simulated amortization table according to one common devaluation case (as periodically published just as a worse case scenario). The mission could observe that several banks legally bypass the difficulty through a credit contract including an article whereby the borrower plainly acknowledges having been duly informed, but this is clearly insufficient.

Banking institutions should be required to demonstrate how their credit underwriting and pricing policy has been adjusted in order to cope with the devaluation impact on credit risks (through stress tests, adjusted scoring instruments). As a result, some banks should be assigned specific lending limits and/or additional capital requirements (or general loan-loss provisioning depending on whether this additional risk is considered as exceptional or cyclical). The drastic option of a unilateral ban can be rejected as hostile to the needed market competition and consumer's free choice.

Finally, there is a possibility that credit risk can be reduced if the explicit consent of borrowers to allow the sale of their mortgage loans to third parties is a requirement that can be perfected only for new contracts. The requirement does not apply to existing housing loans originated in a period prior to the disbursement of the housing loan. Anyway, this is not a major problem as other technical factors prevent the securitization of mortgage loans before a couple of years at best.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS

5.1 CONCLUSION

This report has shown that Rwanda faces challenges in low-income housing financing, leading to homelessness and deepening poverty. Among the problems that Rwanda has faced as a developing country, the housing policy has changes focus several time simply because the land policy is very controversial and limited in discussion because of the long term Rwandese returnees as well as the Rwandese that were there before the genocide.

None of the eight Millennium Development Goals (MDGs), adopted by a majority of the world's countries at the UN Conference in 2001, and all of the leading development institutions, directly address the critical issue of lack of affordable housing. Goal 7 Target 11 of the MDGs focuses on improving the living conditions of at least 100 million slum dwellers by 2015. Yet the development of new or improved housing is not suggested as a method to meet that goal.

Housing is not one of the major sectors identified by the African Development Bank (2005), and low-income countries. The ADB and other donors have made no loans or grants in the area of urban development between 2001 and 2003. The focus given to housing by US foreign assistance has dramatically declined in recent years. For many years, USAID has had a housing guaranty program that provided \$100 million or more each year in loans to developing countries and a network of regional offices that provided assistance in housing policies and programs with particular attention to the needs of lower income groups. These programs have essentially been eliminated.

With the increasing needs, both in Africa and globally for improved housing and the specific challenges faced with the rapidly increasing population of urban poor, an increased focus on housing is a critical need. The inhabitants of most informal settlements possess focus, talent and enthusiasm. The rise in the large informal sectors in urban areas of the developing world, including Rwanda, is evidence of the abundant entrepreneurial capacity of those who reside in these areas.

Moreover, they have an astonishing ability to wring a profit out of very little. It is surprising that the focus of most development projects is on commercial buildings even in areas that are demarcated typically as residential areas.

Housing presents a key instrument for generating wealth and stability in Africa in general and Rwanda in particular and thereby alleviating urban poverty. For example:

- Housing provides a fundamental precondition to personal wealth creation. It provides the collateral necessary for credit and the development of local and national financial institutions.
- Housing provides a nexus for economic development by providing access to an array of construction jobs, which enables recent migrants' entrance to the urban economy. It also provides a stimulus to the production of construction materials, construction services and housing related to enterprise development.
- Finally, housing is the locus of individual, familial and community stability. In addition, it can be the catalyst for social and democratic development.

Further technical assistance and project funding (loans and grants) may be solicited by the Government of Rwanda or from international funders like the World Bank, in order to support the expansion of housing finance markets in a sustainable and affordable way. Further discussions should be held to prioritize the areas of further cooperation among those presented in this policy note.

This study examined the Rwandan housing policy since 1997, to understand better how it became possible to incorporate the participation of the private sector and improve the focus in allocating resources to the poorest sector. The study explored both good and bad decisions that were made over the past 10 years, and particularly in the past three years.

The outcomes of the study could help identify the roles of different social and economic actors in the process. The early results are encouraging. Using the same budget for subsidies in each of the last three years, the Rwandan government increased by 57 percent the number of families from the poorest three income deciles who have benefited from government housing subsidies.

Despite the great breakthrough in social housing in Rwanda, many tasks remain. A report by Rwanda's Ministry of Lands, Human Resettlement and Environmental Protection (2002) estimates a housing deficit of 43,000 units in 2000 and suggests that 96,000 new units of housing are needed each year just to accommodate new family demand.

The effects in terms of land use are also remarkable. Until 2001 all, the housing units built for low-income families in the Greater Santiago area were developed by MINVU in new infill projects on the periphery of the city. The Funding for Cooperative Housing program established in 2003 encouraged acquisition of existing houses and increased density of housing within already urbanized areas. As a result, the percentage of these types of housing began to shift dramatically, from zero in 2001 to 23 percent in 2003 and up to 63 percent in 2004, with a corresponding decrease in the percentage of new infill units being developed on the periphery.

It took countries like Chile more than 28 years to implement fully the enabling markets housing policy. There is hope this study can help Rwanda to formulate their housing policies so that all citizens, without regard to their socioeconomic condition, can have access to opportunities to own a decent home.

5.2 RECOMMENDATIONS

The findings and Habitat for Humanity's experience in Africa leads to point out three critical changes that can influence urban poverty housing:

- First, we must improve land tenure and property rights systems for the poor so they have security of occupancy and the ability to collateralize these assets to obtain loans for education, enterprise creation and other life-enhancing pursuits.
- Second, local governments must provide services and infrastructure to poor communities in informal settlements and slums.
- Third, it is critical to secure affordable urban land in appropriate settings so Habitat for Humanity and organizations like ours can build communities of low-income housing that allow people to become healthy, contributing members of society.

With these broad goals in mind, Habitat for Humanity recommends the following two significant actions this committee can take to address the issue of poverty housing in Africa.

- Re-establish housing and shelter issues as a major priority of the foreign aid package by allocating more funding to developing countries and other international agencies (NGOs) for programs that address affordable housing, city planning, service delivery, financing – especially micro-financing for the poor, and local economic development.
- Creating a special commission to study the critical issues of affordable housing, especially urban poverty and slums, and seek ways to improve the lives of the millions of people worldwide in need of adequate and affordable shelter. With funding support, Habitat for Humanity is prepared to lead both this comprehensive study of the impact of housing on poverty reduction and a monitoring process to support policies that encourage increased access to affordable shelter. Thus, research consultants and development agents can be contracted.

We recommend that a stronger pillar be considered for policy initiative-the market based rental housing, which requires a number of facilitating regulations putting it at the level playing field with homeownership production. This would allow the government to develop a comprehensive rental housing policy for promotion of housing choice and labour mobility in three rental sub-sectors: market-based, non-profit, and social or municipal.

Banks and other housing credit providers must adopt a simple and transparent regulatory framework that is relatively easy to satisfy. Effective debt recovery and enforcement are particularly important. Effective debt recovery procedures would assist credit providers by reducing bad debt write-offs, and assist consumers by ensuring that high bad debts of a minority of consumers do not feed through into higher interest rates for the rest. Effective enforcement would similarly be of value to both credit providers and consumers by ensuring that reckless credit providers do not increase the risk and cost to all parties.

We further recommend:

The government of Rwanda should continue to play a leading role in assisting local communities and housing institutions to address the present housing development challenges. This is not only critical for private institutions only, but also for the rest of the stakeholders since, as economic hubs, they have the potential to lead the country towards global socio-economic development.

A sound housing portfolio in turn will enable the stakeholders to maintain a presence in local development contribution. The government therefore faces important internal challenges that should be addressed in order to capitalize on the opportunities that exist. The report has identified a number of constraints and areas requiring improvement, such as loan conditions, technical assistance, procurement, disbursement, legal restrictions and communication.

Four specific areas of concern deserve focus:

1. Housing for the poor must be viewed as more than mere shelter. In addition to the physical, it has psychological and social significance, which should be taken into account. To release the poor from dependence and despair, national housing policies should pursue the following goals:

- Helping the poor to continue living in their own homes as long as possible, provision being made for restoration and development and, where feasible and appropriate, the remodelling and improvement of homes and their adaptation to match the ability of the poor to get to and from them and use the facilities.
- Planning and introducing under a housing policy that also provides for public financing and agreements with the private sector. Housing for the poor of various types should suit the status and degree of self-sufficiency of the people themselves, in accordance with local traditional and customs.
- Coordinating policies on housing with those concerned, with community services (social, health, cultural, leisure, communications) to secure, whenever possible, an especially favourable position for housing the poor vis-à-vis dwellings for the population at large. It is very common that housing

interventions are done with little or no consideration of other social amenities like hospitals, schools and recreation centres among others.

- Such a policy should then form part of the broader policy of support for the least well-off sectors of the population.

2. Urban rebuilding and development planning and law should pay special attention to the problems of the disadvantaged groups assisting in securing their social integration.

National Governments should be encouraged to adopt housing policies that take into account the needs of the special populations like the children, OVCs, chronically poor, disabled, elderly, and socially disadvantaged. A living environment designed to support the functional capacities of these groups should be an integral part of national guidelines for human settlements policies and action.

3. Special attention should be paid to environmental problems and to designing a living environment that would take into account the functional capacity of the population and facilitate mobility and communication through the provision of adequate means of transport. The living environment should be designed, with support from Governments, local authorities and non-governmental organizations, so as to enable elderly people to continue to live, if they so wish, in locations that are familiar to them, where their involvement in the community may be of long standing and where they will have the opportunity to lead a rich, normal and secure life.

4. Whenever possible, the local communities should be involved in housing policies and programs. Social welfare services can be instruments of national policy and should have as their goal the maximizing of the socio-economic functioning of the population. They should be community-based and provide a broad range of preventive, remedial and developmental services for the people, to enable them to lead as independent a life as possible in their own home and in their community, remaining active and useful citizens.

In many countries where resources are scarce, there is a general lack of organized social welfare services, particularly in the rural areas. Although the role of

Governments in providing such services is paramount, the contribution of non-governmental organizations is also of great importance.

Income security and employment

The Rwanda government should take appropriate action to ensure to all persons an appropriate minimum income, and should develop their economies to benefit all the population. To this end, they should:

- Create or develop social security schemes based on the principle of universal coverage for all income categories. Where this is not feasible, other approaches should be tried such as payment of benefits in kind, or directs assistance to families and local cooperative institutions. This can enable all income groups attain means for proper housing and all basic household needs.

- Ensure that the minimum benefits will be enough to meet other essential needs of the poor and guarantee their independence. Whether or not social security payments are calculated taking into account previous income, efforts should be made to maintain their purchasing power. Ways should be explored to protect the savings of the elderly against the effects of inflation. In determining the age at which pensions are payable, due account should be taken of the age of retirement, changes in the national demographic structure and of the national economic capacity. At the same time, efforts should be made to achieve continuous economic growth;

Credit risk management

In order to reduce credit risk for the poor, there is need to revise the housing institution's commitment fee structure. This can be done through elimination of the commitment fee for all new sovereign-guaranteed housing loans or expanding the range of the commitment fees for non-sovereign guaranteed operations.

Another alternative strategy in housing finance can be to simplify loan pricing for sovereign borrowers.

Eliminate the market risk premium for all new fixed rate sovereign and non-sovereign loans.

Reduce requirements for the publication of Environmental Impact Assessment for private sector projects in Rwanda. In addition, the government needs to undertake

the following principal actions and present them to the Board for approval or information, as appropriate. There is need to define the eligibility criteria for performing housing finance institutions, using various tools including the Community Risk Profile (CRP) and country ratings, Country Portfolio Review (CPR) and Country Governance Profile (CGP) among other tools. These tools can help ensure that there is quality assurance in the setting of projects for public housing.

There is need to for the government to ensure that the policies in place adequately address involuntary resettlement of people caused by a housing finance institution-financed project, no additional requirement under the country's Involuntary Resettlement Policy (IRP) is applied as long as the Rwanda's policies are fully in line with the Involuntary Resettlement Policy.

(ii) Introduce a more flexible approach to facilitate the housing institutions involvement in basket funding and SWAPs.

Expand the scope of housing sector activities in rural and urban areas although this requires a critical analysis of the credit risk of the rural areas. This is important because people in rural areas have differing characteristics from urban dwellers. The government therefore needs to accelerate the revision of the Rural Housing Development Policy.

Need for promotion of the use of national procurement systems:

(a) Introduce systematic assessment and benchmarking of procurement systems by the concerned line ministries. An alternative to this is the creation of a special commission for settling of procurement delays for housing companies.

(b) There is also need to define a baseline for authorizing the use of country national procurement systems.

Accelerate the development of new instruments that respond to borrowers' needs, including enhanced use of local currency lending.

Alternatively, there is need for creation of a five-year housing project pipeline as a planning tool and monitor it systematically.

Enhancement of partnerships with other housing development institutions is important. This can come with a view to strengthen the effectiveness of country assistance and to blend grants with loans/grants from development partners. Focus should be put on incorporating the new housing needs in the country development programmes or Millennium Development Goals (MDGs).

Enhance customer understanding of existing products / instruments, including guarantees, risk management products and budget support loans.

Simplify and streamline disbursement processes, requirements and rules.

- (a) Design and implement a control-adjusted approach that places reliance on government systems.
- (b) Enhance harmonization of disbursement procedures with sister institutions.
- (c) Improve communication between various stakeholders in the housing loan administration process.

Increase the legal department's participation in all phases of the project cycle for public sector projects. This also requires that the government or legal departments enhance legal support to the poor and homeless in the country

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