Strategies for enabling informal settlers to obtain decent housing: **How can the informal financial resources of the poor be institutionalised for house affordability?**

Presentation to the NGO workshop on Housing for Low-Income Groups at Habitat II by Geoffrey Payne, housing consultant, London
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We have come a long way since Habitat I. Whilst many of the principles advocated then remain valid, the emphasis on the direct role of the state has been exposed as inappropriate and unrealistic. It is now generally agreed that the enabling approach has to be the way forward for state action and that the private sector, NGOs and communities must be in the driving seat.

To a large extent, this has already happened, if only by default. The inability of central and local governments to meet the ever increasing need for shelter, especially by lower-income groups, has created a void which various informal settlement processes have filled. In some towns and cities, these now accommodate the majority of all citizens and by this token, they take a wide range of socially and commercially motivated forms. Whilst these have collectively served to bridge the gap between formal systems of shelter supply and the needs and resources of the population, it is therefore inevitable that not all can be considered worthy of support.

However, there is much to celebrate. Innovations in the field of shelter policy and practice have spawned many examples of success. Initially, many of these examples were individual, local, ad hoc innovations generated by NGOs or imaginative local authorities and finance institutions, often as demonstration projects. During the last part of the two decades since Habitat I, it seems that these are beginning to coalesce into networks and systems operating between cities and even countries. We have never been so aware of the nature of the challenges facing us, **or** of examples of success which can be adopted to resolve these challenges. The pace of change is still accelerating and puts us in a good position to justify optimism. In this presentation, I would like first of all to indicate some of the reasons for such optimism and also to address the concerns of pessimists or cynics. There is still plenty of room for both.

Since this workshop focuses on means by which the informal financial sources of low-income settlers can be institutionalised to enable households to obtain decent housing, I shall focus on issues of shelter finance in this paper.

Progress so far

Interest in this subject is not new and it seems we are not short of good ideas or examples of successful innovation. The case studies in books by John and Bertha Turner (1988) and Johnny Astrand and Bo Johansson (1988), not to mention the numerous submissions to Habitat`s Best Practices programme, have brought welcome attention to groups solving local shelter problems. These ideas deserve greater exposure and, with relevant adaptations, wider application.

A review of shelter community-based finance and innovative credit systems for low-income households was undertaken in ten Asian countries in the late 1980`s by ESCAP (1990) with French government funding.

The report noted that between 40 and 95 percent of all urban households have no possibility of acquiring a dwelling unit produced by the formal sector. It was also acknowledged that very little was known about how informal housing was financed. However, examples were found in every country of attempts to bridge the gap between conventional financing methods and more responsive and sustainable means of improving access to credit by lower income groups. Among these were the Grameen Bank of Bangladesh, SEWA (the Self Employed Women`s Association) of India, the Community Mortgage Programme of the Philippines and the Khuda ki Basti programme of Pakistan.

In other parts of the world, other examples are flourishing. Banco Sol and FIE in Bolivia, together with the Scotia Enterprise Bank in Guyana, have made considerable inroads in offering credit to low-income groups, though mostly for micro-enterprises rather than for shelter.

The financial success of these innovations has refuted all assumptions that the poor cannot afford credit. Despite interest rates which are often significantly higher than those imposed by formal sector institutions, most have achieved loan repayment levels of almost 100 percent, even though little formal collateral is required. They have achieved this remarkable feat by the simple expedient of offering credit on terms and conditions appropriate to the circumstances of their members. Some have concentrated on mechanisms to minimise transaction costs and risk, while others, such as the "vishis" in India, have introduced new ways of offering credit, by auctioning some loans with a `reserve rate' of interest and others by lotteries among members.

Similarly, the Kampung Improvement Programme in Surabaya has resulted in the improvement of most of the city`s informal settlements in a unique collaboration between the urban authorities, a local NGO and the communities.

Gustave Massiah, one of the consultants responsible for the ESCAP study, claims that, even by the end of the 1980`s, these initiatives demonstrated an evolution away from individual actions to alternative systems of shelter finance.

A similar claim has been made more recently by Munjee, (1994) who accepts that informal solutions to pressing problems are the natural consequences of inadequate institutional responses. Munjee argues that inappropriate conditions have increased shelter prices and created pressure for demand side interventions, in the form of subsidies, etc, which have only compounded the problem. Under the emerging paradigm, this process is reversed by removing the constraints to the supply side, to reduce costs and boost entry into construction. He considers that the heart of the concept is that top-down resource flows will not help the problem in the long run and that resources must be generated at the level at which they are applied.

Do all these examples and the new paradigms mean that our problems are solved? Clearly not. Many of the examples cited in the literature cover systems of credit which are not all related to shelter investment. This is true of the Latin American examples cited above. Even the Grameen Bank has only recently introduced a housing loan programme.

Of more concern is the limited scale of these innovations when compared to demand. Many of the examples cited in the ESCAP study were small, with members of many between 75 and 300. Others, such as housing co-operatives in India, are not primarily intended for lower income groups. These contributions are welcome, but they are almost insignificant compared to increases in urban populations since Habitat I. With large conurbations like Cairo, Bombay and Mexico City increasing by more than 1,000 people a day, the vast majority of urban populations continue to live outside the old and new paradigms. This is the nature of the challenge facing us.

In these circumstances, it is perhaps advisable to question why so many of these innovations have not already been adopted more widely or quickly.

Perhaps two examples will suffice to illustrate the problem. In the early 1970`s, the World Bank undertook one of its earliest housing programmes in Kenya. As part of the loan agreement, the government agreed to review its building and planning regulations to ensure that they were appropriate to contemporary needs. The review was duly conducted, but it has taken more than twenty years for the recommendations to be approved by Parliament. Second, the Orangi Pilot Project in Karachi has been internationally acclaimed as a model of participatory development in settlement upgrading and financing, yet the Karachi Development Authority has steadfastly refused to apply the approach in other parts of the city and it is only now being adopted as part of a World Bank programme in other parts of Pakistan, fifteen years after the project started.

In all too many cases, the time span between the initial idea, its local application and its adoption at the larger scale can be considerable, assuming it reaches the last stage at all. Why ?

Constraints to progress

In large part, the answer lies in the constraints imposed by the regulatory framework created and operated by governments and the terms and conditions imposed by formal sector financial institutions.

These collectively and individually impose standards, conditions and costs which the majority of people cannot afford and may not even need. Their impact on access to shelter by the poor is made more serious by the fact that they cover all main aspects of shelter development, namely land, infrastructure, finance and building.

Lee (1994) identifies some of the ways in which regulatory costs are manifested:

- Delays in getting proposals through the bureaucratic maze to obtain planning permissions.
- Even greater time costs incurred by poor households in trying to get permissions, so that they can comply with the law.
- Excessive time taken to get permits can dampen the ability of the private sector to respond to changes in market conditions.
- Difficulties in penetrating the administrative system can discourage new firms from starting up business and preserve inefficient monopolies.
- The bureaucracy in many countries is structured so as to connive at, or even encourage, bribery, either to circumvent the rules or just to get the job done.
- Inappropriate planning regulations, such as those relating to zoning, severely limit the availability of land for new development and thereby contribute to raising its cost.
- Costs incurred as a result of inappropriate land use planning, which may render up to 70 percent of a plot "un-sellable".
- Social, environmental and economic costs imposed on the poor for being unable to comply with the regulations and therefore being forced to live outside the law, excluded from government subsidies and other benefits.

Lee accepts that the principle of regulation has been generally well intentioned, but that in practice it has not worked out as envisaged and "many regulations have served to amplify the more damaging consequences of the market". He notes dryly that few countries have been more active than India in regulating land development, but that this has been as unsatisfactory to the policy makers of, say, Calcutta, as it is to the city residents.

In assessing the impact of standards and regulations on land prices, Lee claims that avoidable costs of development typically increase land prices by 50 percent in Asian cities.

If the constraints on affordable land development are serious, they are no less so in the field of infrastructure provision. In their study of the impact of infrastructure standards, Gakenheimer and Brando (1987) argued that high standards of provision double the cost of service. If these estimates are typical, they represent a hefty barrier to the ability of low income households to obtain decent shelter, whatever innovations are proposed through specific projects.

Building regulations further compound the problems. Floor area ratios, building setbacks and high specifications of acceptable building standards, are often based on inherited or imported models. As such, they serve to distort the relationship between supply an demand and raise land prices - all of which only serves to trap even more households in the illegal world of informality.

The additional impact of procedures can be particularly significant in countries with high inflation rates. If inflation is 10 percent a year and it takes four years to complete all the administrative hurdles costs for a large development costs would increase by more than 50 percent for this reason alone. At 20 percent inflation, project costs would more than double.

De Soto has made a speciality of quantifying the impact of administrative procedures on housing costs and other forms of economic activity. Before recent reforms by the Peruvian government, it routinely required 207 bureaucratic steps and 43 government offices, averaging 43 months at a cost of ten weeks` worth of the official minimum wage, to obtain title to a piece of land (Economist 9.12.95).

Other examples abound. In Tanzania, Walton (1984:191) cites 21 steps being involved in obtaining a building loan and Lee notes that in Malaysia 55 steps are involved in obtaining approval for housing projects, whilst the conversion of rural land to urban use, receiving land subdivision and building approval can take anything from five to seven years. The World Bank has noted that the cost of the time delay alone is sufficient to double the effective cost of land on which a developer intends to build. Farvacque and McAuslan (1992:v) note that in Peru, the adjudication process of state lands takes about 43 months and is the result of 207 bureaucratic steps involving 48 different government offices. In Cameroon, it can take up to seven years to register a plot, which they assert explains why only 6 percent of all plots nationally are registered.

If the additional costs of land development, infrastructure standards and building regulations are included in the equation, it would seem that the total costs of conforming to formal sector requirements could be several times the cost of modest, but acceptable standards. It is only because the numbers of households forced into these categories (there are many of them, not just one), and the proportion of total households are so great, that they have come to enjoy de facto rights without the formal obligations imposed (to varying degrees) upon the more affluent groups living in the formal sector. However, the fact that so many are exempt from payment of taxes and other fees undermines the moral authority of the state to collect dues from even the formal sector.

As if this were not enough, housing finance institutions impose conditions which exclude even more people from obtaining credit to finance their shelter needs. Contrary to common assumptions, it is not the imposition of commercial rates of interest which exclude the poor, since they often pay much higher rates to informal money lenders.

The real barriers are threefold: First, the minimum size of loan which a formal institution is willing to offer in order to cover its transaction costs and risk, and still leave a reasonable profit. Second, the need for substantial collateral to cover such large loans, for which title deeds are the generally adopted means; and third, the perceived risk of applicants living in informal settlements. The last two factors even exclude households in informal settlements who would be financially capable of servicing a larger loan.

The traditional method of reconciling these contradictions was to subsidise the gap between affordability and costs. Yet that has compounded problems by increasing market distortions. Renaud (1984:102) has observed that there is no set of government regulations more extensive than that of financial institutions. This regulatory environment is replete with conflicting objectives and a wary approach to financial innovations by central banks.

<u>The outcome</u>

These are the rocks upon which so many innovative ideas and best practices founder. The wrong emphasis is put into the regulatory framework; government intervenes too much in matters which are essentially private or communal and too little in matters of primary public interest, such as setting a legal and institutional framework appropriate to the needs and priorities of society as a whole.

The relevance of mentioning these constraints at Habitat II is that many of the groups instrumental in formulating or enforcing such barriers to change are attending the conference. This is therefore the ideal opportunity to address the issue!

If the sheer extent of informal settlements provides a measure of protection, the costs of informality may be considerable; the lack of long term security, limited access to credit and services and exclusion.

The factors listed above are instrumental in excluding households in informal settlements from obtaining officially sanctioned shelter. The result is that informal settlements have tended to increase at twice the rate of urban growth in the two decades since Habitat I. The problems are increasing far more rapidly than solutions, even good ones, can anticipate and contain.

<u>Who benefits?</u>

So why has it proved so difficult to expand effective methods of enabling people to afford better housing, especially when their advantages have been so well known to so many for so long?

Strong vested interests in the present system are a large part of the answer. Farvacque and McAuslan (1992) note that the winners in the present system of land management are "politicians, senior civil servant, traditional rulers, existing land-owners, armies of lower and middle civil servants and thousands of persons who make a living by guiding both the poor and the middle class through the mazes, .. all have a substantial stake in the confused, multi-layered and irrational systems that now prevail". They note that "all of these groups will dislike the idea of change, which would threaten their well-being and their way of life. Change could upset powerful vested interests". According to Kitay (1985), some of the most active speculators in land markets would be those holding senior government positions or their family members.

Within the infrastructure sector, Gakenheimer and Brando (op cit) identify a number of groups which combine to reinforce the status quo. These include:

- Local engineers who are keen to do things "right" and who benefit from contracts in which fees are based on a percentage of the contract, giving little incentive to reduce costs. The separation of design, construction and maintenance operations also tends to justify insistence on higher standards of initial provision.
- Within the public sector, they argue that officials are reluctant to take risks, since they are sure to bear the brunt of any criticism of system failure by politicians in search of a scapegoat.
- For many professionals, standards are seen largely as a technical subject, best left to the experts, whilst for
- politicians, the issue may be seen in terms of a technical matter best left to engineers, though "standards are never likely to be an important political issue except when suddenly and visibly lowered, especially if only in a limited area". In addition, many politicians are drawn from an elite which shares the modernist preference for high technologies and they may consider that they have a "social contract" which necessitates the provision of high standards, even if they cannot be provided to everyone. (In practice, this also increases their powers of patronage, an indisputable consideration for any politician).
- Inevitably, suppliers have a vested interest in maintaining high standards of provision, since this is the route to higher profits.
- Finally, Gakenheim and Brando argue that even users, who may be considered to benefit most from reduced standards. Yet they claim that there is little popular demand for lower standards - merely for more connections. For those who can pay, high standards are expected, whilst it is politically unacceptable to consider the application of lower standards for others. Even residents in informal settlements may not advocate lower, and more affordable standards, since they consider (often rightly) that those presently benefiting from high standards did not pay the full capital cost of their services, and therefore expect government to subsidise full provision for them also.

Gakenheimer and Brando define this coalition of interests in favour of the status quo as an unintentional conspiracy in which each group of actors pursues an independent agenda, but ends up sustaining the same unfortunate tendency - increasingly high and unrealistic standards - for urban infrastructure. A similar conclusion could easily be drawn in connection with standards for land development and building.

What is to be done?

The question is not that de-regulation is the answer - the issues are too complex for such a crude approach. The need is to redefine what is to be regulated and how best this can be achieved in the light of intense demand and limited public resources. Even so, it is clear that many of the existing regulations, standards and procedures are counter-productive as they stand. A comprehensive reform of the regulatory framework is therefore a necessary pre-condition to enhancing access to decent shelter by residents of informal settlements.

Fortunately, we are not short of options and each of the analysts referred to above have offered ideas for such reform.

Among the recommendations offered by Farvacque and McAuslan are the following:

- Reforming the institutional framework to define the scope of responsibilities of the public sector and to improve the capacity of government at all levels to enhance the tasks it does best.
- Audit existing administrative institutions.
- Develop incentive-based systems of personnel management to enhance efficiency and business like practices in public agencies.

In terms of land use regulations, they recommend:
- Discarding obstructive and costly regulations and promoting those focusing on essential public health, safety and environmental factors. This would entail releasing all small scale development from the requirement to obtain permission to develop and creating "one-stop shops" for obtaining permissions to develop urban land.

In his assessment of options for land management, Lee advocates:
- engaging the private sector in planning, financing and providing for public needs;
- utilising pricing as a tool of environmental management;
- re-appraising appropriate vehicles for providing subsidies as a part of a poverty alleviation strategy;
- involving NGO`s and CBO`s in interpreting community needs and;
- integrating specialised urban and shelter financial circuits into national and international financial markets.

Gakenheimer and Brando propose the following action in terms of infrastructure provision:
- Link responsibilities for design and operations so that agencies can consider the trade-offs between them (difficult under privatisation policies). Separate them, or pay for design and construction by some measure of effort, rather than a percentage of the contract value. Increase the feasibility of labour-intensive construction methods. These are considered difficult to administer. Prepare and build projects in small contracts.
- Reorganise the budgeting process.
- Revise the "social contract" on infrastructure service toward a concern for welfare and development.
- Show the savings and improvements resulting from more appropriate standards (and methods of delivery - as in Orangi).

The role of government in influencing access to finance for shelter is emphasised in the ESCAP study. Whilst endorsing a `bottom-up' approach, it reiterates the importance of state authorities and the institutional framework in mobilising and directing funds to those in need. Accordingly, it recommends that:
- The priority should be to develop financial markets which are capable of channelling investment funds towards economic development. It is accepted that this implies monetary and financial deregulation, but considers that housing finance can be successfully used as a means to develop and strengthen financial markets.

Munjee develops this approach and emphasises the importance of removing constraints to the supply side. His proposals involve:
- Positive incentives for investment in construction inputs and a gradual expansion of market determined housing finance.
- More efficient regulatory structures for land transfer and development, as well as financial institutions. Within his new paradigm, this is considered the most important intervention that governments can make in the sector.
- Networking between financial institutions active in the shelter sector. The success of the Asian Coalition of Housing Finance Institutions is testament to the benefits of exchanging experiences between cities and even countries. It is presently pursuing four main objectives: facilitating technical assistance in the region, providing training in housing finance, undertaking research and experimenting through action research new ways of linking the formal and informal shelter finance activities.

Renaud (op cit:104) summarises his views in three principles of sound financial regulation:
- Improve competition
- increase efficiency and

- stimulate long-term finance.

Clearly, any progress in reforming the regulatory framework will be dependent upon overcoming the vested interests supporting the status quo. Farvacque and McAuslan have identified a large cast of opponents. However, it is the professionals within the shelter sector, the architects, planners and engineers, who are largely responsible for establishing, monitoring and implementing official standards, regulations and procedures. We therefore have to accept that, collectively, we are as much a part of the problem as the solution. Before we can claim immunity from criticism, it is therefore necessary for us to put our own house in order by accepting the need for change and supporting efforts to achieve it.

Changing attitudes and practices will not be easy. One approach is to build coalitions between innovative groups and agencies, so that the lessons of good practice can be incorporated whenever possible. Another is to confront opposing interests head-on. Inevitably, local conditions will determine the answer in any given case. The main point is that the issue cannot be ducked and this conference is ideally placed to address it, since most of the key interest groups are represented in either the conference or the NGO Forum.

A pre-condition of such change is that central governments recognise the economic, social and cultural contribution being made to national development by urban areas. Cities already generate more than half of GNP in many countries and this is increasing annually. Yet most cities are denied adequate resources to manage their needs and in effect act as agents of central government, collecting property taxes for central treasuries and dependent upon grants to manage their affairs. Such a relationship does not provide a climate for responsible urban governance, since local politicians are impotent to fulfil their electoral promises. Enabling cities to retain a larger proportion of the revenues they generate would strengthen local democracy, increase the resource base and encourage more efficient and transparent administration, without which no reforms will succeed. Curitiba and Surabaya demonstrate what can be achieved through imaginative and committed local government.

Specific proposals

If these two hurdles can be passed, more technical aspects can be addressed. These may include, the following:

Land development:

- Revising regulations on plot sizes, floor area ratios, plot densities, etc, to reflect local conditions
- Replacing land use and other zoning regulations with a system of locally controlled methods of resolving conflicts over incompatible land uses.
- Revising standards for public areas, especially residential roads, to reduce the total areas required.
- Providing security of tenure to residents in informal areas. This could take many forms, such as occupancy certificates. Leases, or even a public statement that settlements will not be removed.
- Encouraging a wide range of groups to contribute to land development. Planning objectives to improve access to housing by lower-income groups could be achieved by formulating site development and design briefs, to which developers would have to conform in order to receive planning permission. The British concept of `planning gain', or the Thai experience of land sharing, are examples of how public sector influence can be extended without a corresponding increase in resources.

Infrastructure provision:

- The examples of Indonesia`s Kampung Improvement Programme and the Orangi Pilot Project in Pakistan demonstrate beyond doubt the value of getting the basics right. By matching forms of provision to local priorities, the standard of living of thousands of households have been improved at marginal cost to public resources. Furthermore, they have been adopted and maintained by the local community. Clean water, narrow roads and efficient drains are the priorities. Anything else is a bonus.

Building regulations:

- These should focus on aspects of public concern, such as safety, structural stability, fire protection and environmental protection. Aspects of private concern should be omitted or made optional rather than mandatory.

Finance:

- Encouraging innovative financial institutions which are willing to offer small loans for house improvements and extensions on terms and conditions acceptable to residents in informal settlements.
- Make access to the formal sector easier by creating a scale of taxes and charges for housing and land development related to the value involved. This would be more equitable and, if related to the actual provision of benefits, would create incentives for the poor to pay.
- Improve access to credit through mechanisms which do not require title deeds as collateral. Not all of these lend for housing; most lend for small businesses, though the financial principles could easily be adapted for small loans to extend or improve an existing house.

Administrative procedures:

- Simplify procedures for processing housing developments. Impediments could be addressed by privatising the agencies concerned or providing incentives to staff from improved efficiency and recovery rates collected and retained by local authorities.
- Increase co-ordination between and within urban development agencies.
- Encourage multi-disciplinary teams to work on shelter issues as close to the local level as possible.

Other recommendations:

- Public/private partnerships can play a large part in improving the efficiency and equity of urban developments. Many examples exist of benefits to developers, land-owners, local authorities and especially lower-income groups of such innovations.
- Public policy should seek to increase the range of supply options. As John Turner (1990:186) has demonstrated so clearly, the most efficient and responsive housing market is one which offers a wide range of options or courses of action.
- Finally, the best way of repeating past mistakes is to ensure that the education system exposes students to present realities and issues in our towns and cities and encourages collaboration between disciplines.

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Attn: Dr Hulya Turgut
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Dear Dr Turgut,

As promised in my fax of 17 May, I am transmitting the title and abstract of my presentation for the workshop on Housing for Low-Income Groups at the Habitat II conference, which I hope is sufficient for your purposes.

I look forward to receiving further details on the workshop in due course.

With best regards,

Geoffrey Payne

`Rules for the level playing field: enabling the poor to obtain decent housing' Abstract of presentation to the workshop on Housing for Low-Income Groups at Habitat II, Istanbul, 12 June 1996

Geoffrey Payne

Informal settlements currently constitute the majority of <u>all</u> housing in many cities and their rate of growth is generally higher than for officially sanctioned housing. They therefore represent a substantial proportion of all investment in housing and urban development. Any assessment of options to enable settlers to afford decent housing must therefore begin with an explanation of why people choose these options in the first place.

This presentation contends that a major factor is the imposition of inappropriate standards, regulations and administrative procedures concerning housing and urban development. The terms and conditions of both public and private financial institutions also make it impossible for low-income households to obtain credit for affordable house improvements or extensions, whilst the intense demand for urban land has frequently forced up prices at a rate even higher than rampant levels of inflation. The reluctance, or inability, of governments to tax land-owners or developers encourages this speculative pressure and reinforces a vicious cycle of exclusion.
Under such conditions, the achievements of informal settlers are considerable. However, most lack long term security, and access to services, facilities or credit.

Strategies to improve access by low-income groups to decent housing need to address these constraints. In particular, they need to build on the considerable experience which already exists in numerous isolated examples. These include new forms of credit which do not require title deeds as collateral and public/private partnerships which require developers to provide some low-income housing, in return for planning permission to realise a site`s commercial potential.

Many of these examples have been around for many years, but few have been adopted at a wider scale. It is contended that a major reason for this is the reluctance of governments, and their servants, to revise the regulatory framework or collect property taxes and the economic costs of public services from middle and higher income groups. Until this issue is addressed, the scope for progress will be limited.