

FSD AFFORDABLE HOUSING STRATEGY

RATIONALE FOR AN AFFORDABLE HOUSING WORKING GROUP FOR KENYA

04 February 2021



Framing the approach

FSD Kenya supports the development of inclusive financial markets in Kenya.

FSD Africa works to reduce poverty by strengthening Africa's financial markets. In support of this objective, FSDA provided support to the **Centre for Affordable Housing Finance in Africa** for its first six years of operation, with the intention of making Africa's housing finance markets work, and to see an increase of investment in affordable housing and housing finance throughout Africa.

FSD Africa Investments provides early-stage, risk-bearing capital to selected breakthrough firms that can strengthen financial markets in Africa.

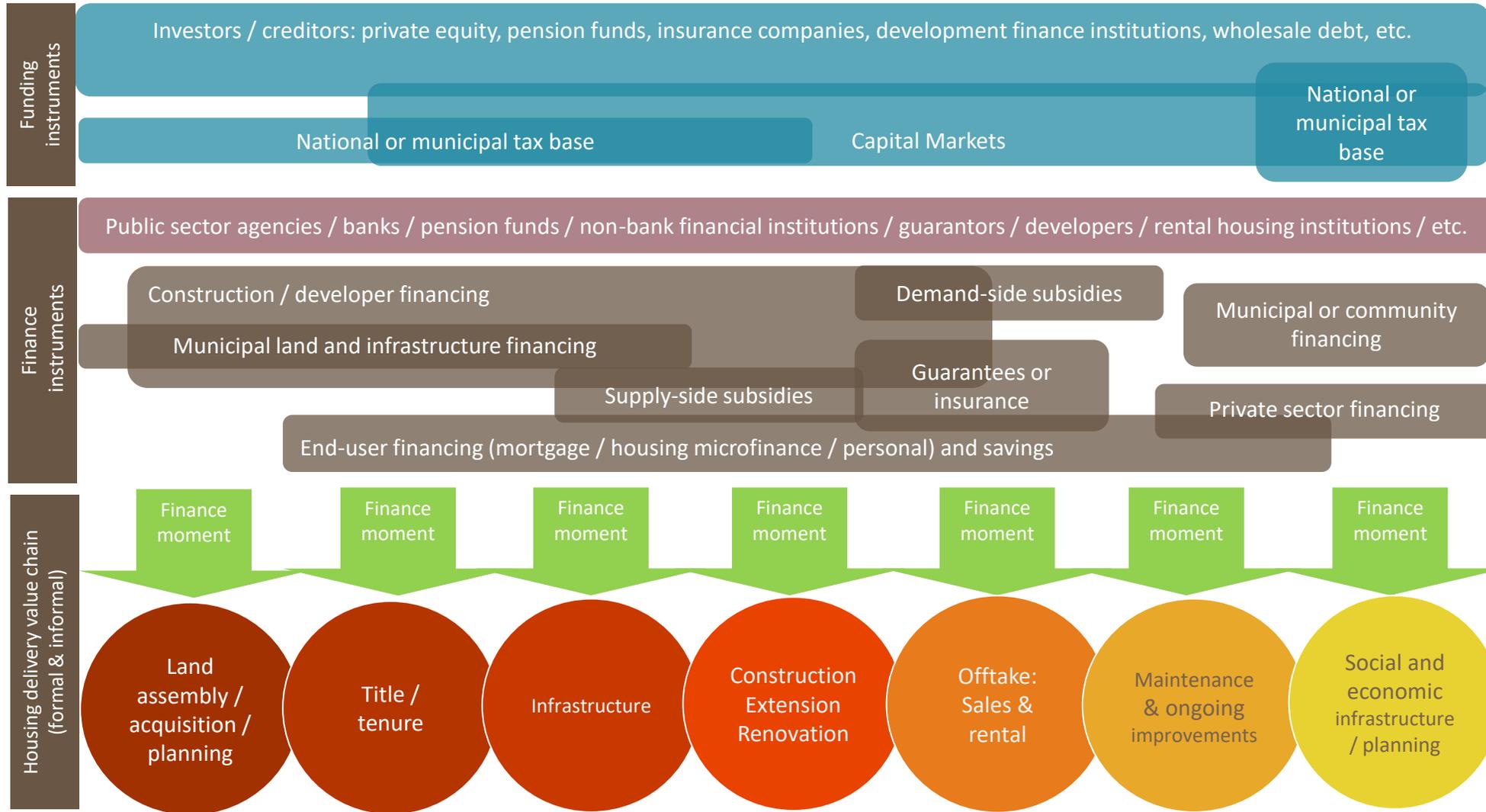
In late 2020, the FSD Network agreed to incorporate affordable housing as part of their overall strategy for financial sector deepening in Kenya.

See www.fsdkenya.org | www.fsdafrica.org | www.housingfinanceafrica.org | www.fsdafrica.org/about-us/fsd-africa-investments/



“Housing Value chain is long and complex”

* Note: different market segments will engage in different housing processes involving different value chains and different finance moments – this diagram is purely illustrative.



Therefore, requires

- Appropriate regulatory support and finance at each step
- Shift in focus away from delivering units, to supporting the transformation of the ecosystem.

Source: CAHF's Housing Finance Value Chain



Many stakeholders have examined the overall constraints within Kenya's affordable housing market

Complex value chain constraints are expressed differently in different sub-markets

Engaging with the four key Kenyan sub-markets:

Incremental
Rural
Peri-urban



Informal Settlements
Urban



Small landlord
Urban



Formal
Urban



Key Features:

Incremental:
Estimated size: 9 million households
Typical HH Income range: < KES 50,000/month
Typical tenure: Ownership

Informal Settlements:
Estimated size: 1,6 million households
Typical HH Income range: <KES 30,000/month
Typical tenure: rental, absentee landlordism

Small landlord:
Estimated size: 1,1 million HH
Typical Income range: KES 30,000 - 75,000
Typical tenure: Rental

Formal:
Estimated size: 360 000 households
Typical Income range: >KES 75,000
Typical tenure: Owner (30%), Rental (70% - and enters rental pool inefficiently)

Key failures which limit access to finance and undermine sub-market performance:

Incremental:

- Poor quality, long time to deliver
- Poor, disjointed, supply value chains
- Poor land title rights for securitization

Informal settlements:

- Extremely poor quality
- Contested land rights
- Government / DFI initiatives to date often lead to displacement or take very long to deliver

Small landlord:

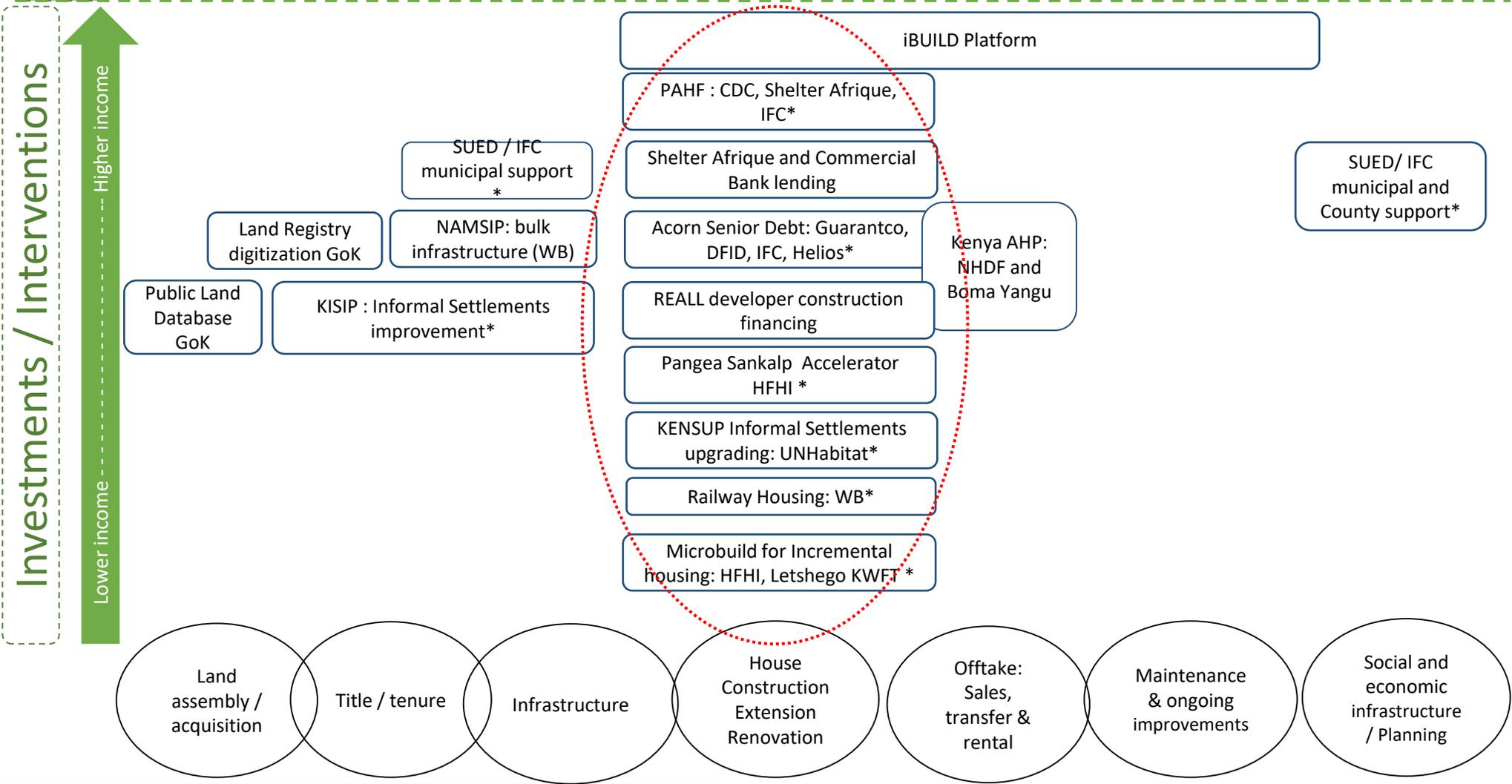
- Lack of scale, limited amenities
- Variable compliance
- Pressures on municipality infrastructure

Formal:

- Long time to deliver and high costs
- Difficulty exit due to land registry challenges
- Mortgage / Rent x 2
- Limited long term in design and management

CAHF Knowledge Platforms with support from World Bank, REALL, FSDA, TCIS, others: Kenya-specific data including data Audit for Kenya, Housing Economic Value Chain, Landscape of Housing Investment, Case Studies

KPDA Affordable Housing Taskforce supported by KEPSA



There are so many stakeholders working in different segments of the housing value chain, at different income levels..

However, the focus is largely on the 'delivery of units' and more knowledge sharing is required to develop the ecosystem

We recognise that capital alone is not the limiting factor

There is a lot to do: Kenya needs \$45 - \$90 billion over next 20 years

A (very) rough calculation:

| | |
|----------------------------------|--|
| Existing deficit | 2 000 000 housing units |
| Annual requirement over 20 years | + 7 000 000 housing units (350 000 units pa) |
| Total housing need over 20 years | = 9 000 000 housing units |

| | | | |
|----------------------------|---------------------------|----|---------------------------|
| Assume average house cost: | \$ 5 000 | or | \$ 10 000 |
| Total investment required | USD 45 000 000 000 | | USD 90 000 000 000 |

This scale of investment is more than the capacity of any group of players.

Therefore, what housing needs from the finance sector is:

1. Patient blended finance products
2. Deep regulatory support
3. Mechanisms for local currency capital
4. Market development and investment support

Kenya is seen as a highly promising country to enable housing transformation due to

- Priority national program
- Deep demand
- Availability of land, building materials, developer experience
- Strong regulatory environment
- Deep capital markets
- Technological and innovation hub

The FSD Network Strategy: underlying principles

1. **Investment as action learning:** the FSD Network is taking an investment-focused, local intervention approach to generate market development learnings which can then be leveraged to support market transformation.
2. Expanded effort to share information, using the investment experience as the basis for identifying market blockages, and then using the collective capacity of investors to motivate and drive policy, regulatory and market change. Promoting a culture of **Open Source to leverage stakeholders existing resources and experiences.**
3. Notwithstanding an emphasis on the B40, a recognition that we must **work across the spectrum of housing sub-markets** to leverage capacity in support of market transformation.

FSDAi will make data sharing, and market collaboration a condition of its investments into housing initiatives

FSDAi and FSDKenya have appointed CAHF to develop an approach to “Open Source”

Recognition that impact in one sub-market can influence others positively. Commitment to share lessons learned and research widely.

FSD Network Strategy: Lead with investment in two grouped sub-markets.

Money invested provides the basis for Open Source dissemination of experience.

Engaging with the four key Kenyan sub-markets:

Incremental
Rural
Peri-urban
Ownership



Informal Settlement
Urban
Primarily rental



Small landlord
Urban
Rental



Formal
Urban
Rental (70%)
Own (30%)



Incremental

- **Invest** in pilot of selected ABT project (housing + infrastructure) of 25 units
- Structure demand side finance products
- Land Title Regularization

1.

Informal Settlements

- **Invest** in pilot of selected ABT project (housing + infrastructure) of 25 units
- Structure supply side financial product (better rental)
- Land Title Regularization

Small landlord

- Distill learnings from formal sector to improve quality, long term resilience
- Structure supply side financial product for scale (better landlord)

2.

Formal

- **Invest** in formal supply (delivery or offtaker) to promote greener, more resilient buildings at lower cost due to scale and positioning
- Demand side finance products to support offtake

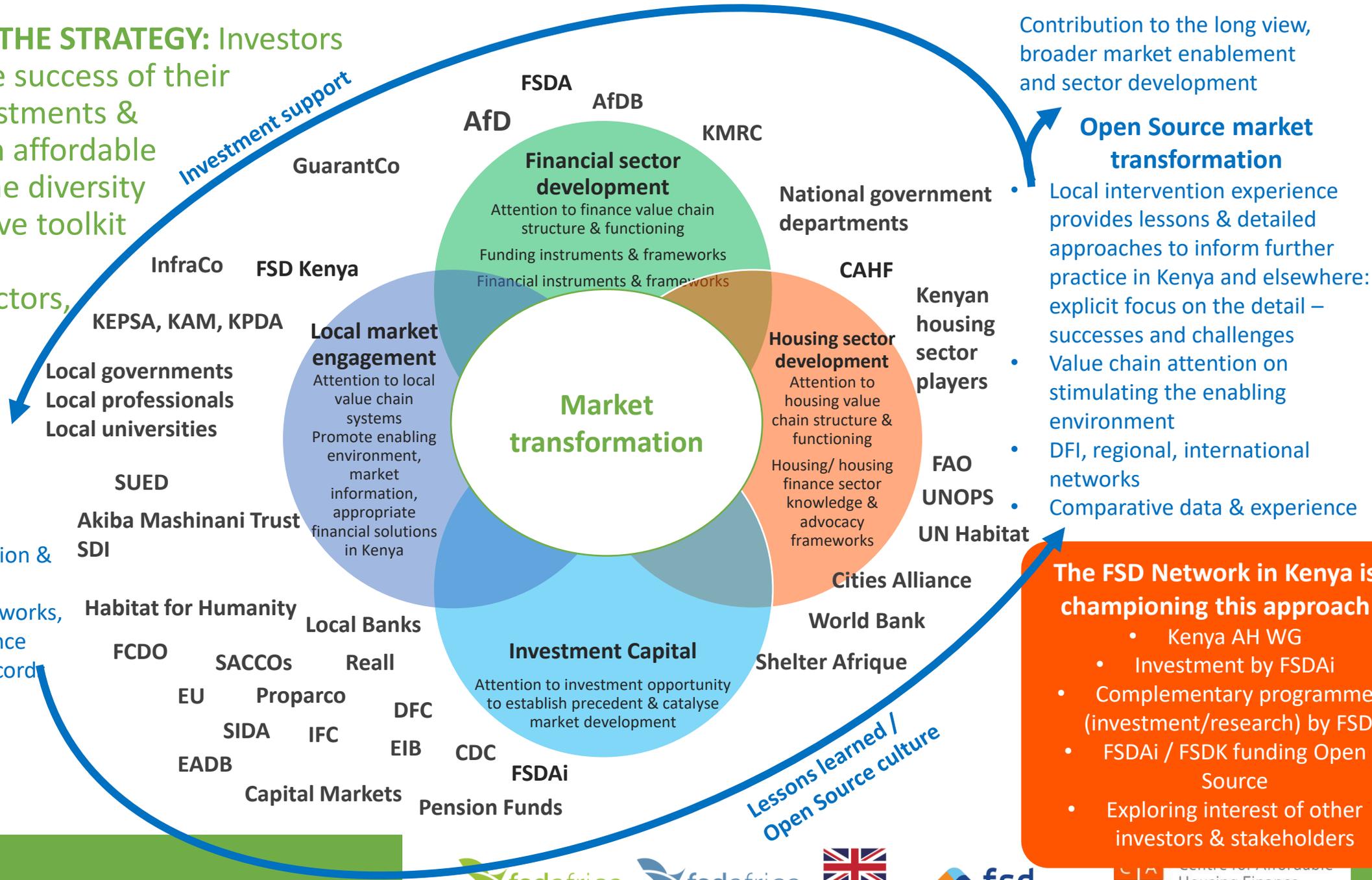
Targeted Output: **Market transformation**

- By investing in two ABT pilots of 25 units, the **Network will assist with objective evaluation** of the dozens of available technologies
 - **Network will champion design of demand & supply side financial products for suitable technologies to overcome market challenges**
 - By addressing the value chain blockages the pilots will face, **Network will identify systemic issues for wider reform**
 - Potential to leverage other long term, patient and blended finance sources to allow scale
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- By investing in formal sector, **Network will shift focus from 'build to sell' to 'build for resilience'** incorporating green technologies and 'life cycle cost evaluation.'
 - By addressing value chain blockages, the **Network will identify systemic issues for wider reform**
 - 'Life cycle cost focus', economies of scale and supply incentives promote affordability
 - **Network will support investee to exit to capital markets**, bringing in local capital into affordable housing sector
 - Potential to leverage other long term, patient and blended finance sources to allow scale

SUMMARY OF THE STRATEGY: Investors can support the success of their respective investments & interventions in affordable housing with the diversity of their collective toolkit across finance and housing sectors, domestically and regionally, working in concert

Local, practical intervention

- Creating demonstration & precedent
- Drawing on local networks, local data & experience
- Establishing track records



Contribution to the long view, broader market enablement and sector development

Open Source market transformation

- Local intervention experience provides lessons & detailed approaches to inform further practice in Kenya and elsewhere: explicit focus on the detail – successes and challenges
- Value chain attention on stimulating the enabling environment
- DFI, regional, international networks
- Comparative data & experience

The FSD Network in Kenya is championing this approach

- Kenya AH WG
- Investment by FSDAi
- Complementary programme (investment/research) by FSDK
- FSDAi / FSDK funding Open Source
- Exploring interest of other investors & stakeholders

FSD ENTITY PRIORITIES

04 FEBRUARY 2021



FSD Kenya: three components of affordable

Building an enabling ecosystem and promoting coordinated and evidence-based investment making

- Digitization of Land Information Management Systems
 - Land as collateral
 - Reduce transaction cost /time
 - Effective revenue streams
- Affordable Housing Investment Alliance
 - Data driven advocacy
 - Bring providers and users of capital

Create Demand Side and Supply Side Financial products for both rental and owner occupation options

- Deeper demand segmentation and rental surveys
- Alternative Credit Scoring for Informal income
- Demand and supply side financial products
 - Microfinance
 - Transfer pension assets
 - Partial credit guarantees

Demonstrating and Promoting Greener and more affordable housing and infrastructure technologies

- ABT technologies AND off-grid infrastructure evaluation
- 2 x pilots of 25 units
 - Target delivery price KShs 500,000 to KShs 1,000,000 including land

FSDAi rationale for investment in institutional off-taker

Housing as a financial sector deepening strategy

- **Housing is an asset** with real & diverse investment potential
- Good housing addresses many of the SDGs, **enabling active & broad based participation in the economy & financial sector**
- Working housing markets **improve efficiencies of resource allocation** in meeting housing needs – especially important in a post Covid19 context
- Housing must be paid for. The **intersection of the housing and finance value chains** offer opportunities for intervention.

An institutional off-taker will stimulate supply and support demand

- Opportunity to develop Kenya's **institutional infrastructure for private sector housing delivery**
- Explicit attention on **building developer capacity and life cycle costing and management for a relatively new class of residential property delivery**
- Demand side attention to **extend down-market**, leveraging the FSD Network's credit-market skills

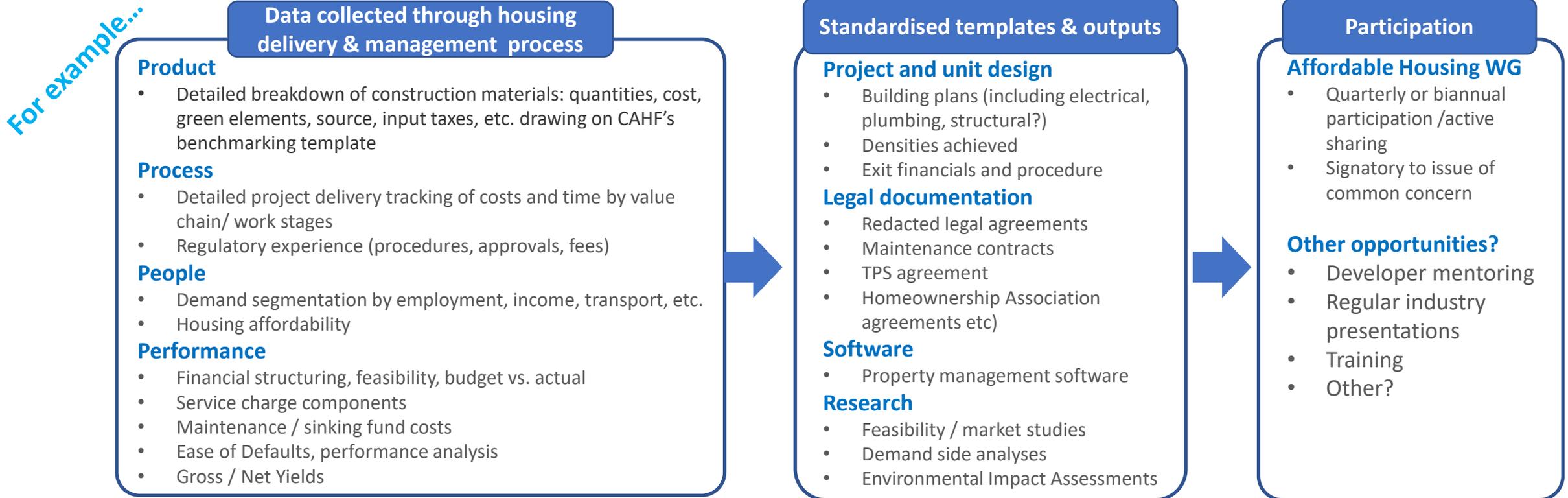
Opportunities to leverage capital and crowd in new investment

- Targeted placement of development capital can **leverage local market participation in housing**
- **Precedent-setting investment**, tracked and shared over time, can stimulate investor interest and build market trust
- Market transformation outcome **de-risks opportunities for a wider array of institutional and private investors.**

Market transformation impact depends on the notion of Open Source

Initial thoughts: elements of the Open Source concept

With such great investment need, the real competitive edge is found in the implementation capability, much more than it is in the reports, data, and other information that get collected towards delivery. 'Housing units' delivered through an investment are a means to an end, not an end in itself. Investor + Investee work together to overcome value chain failures and build knowledge base to transform ecosystem



Overall philosophy of Open Source: when practitioners compete in how they *access* data, rather than in how they *use* it, we are wasting resources

FSD Africa Priorities and partnership with FSD Kenya

Credit Markets

- Product development
 - micro-mortgages
 - insurance
 - Leasing
- Capacity development for value chain actors

Capital Markets

- Exit through REIT markets
- Syndicated blended finance
- Bonds: Green, municipal, development impact
- Technical Assistance

Policy and regulatory reform

- Tax policies
- Pension transfer
- Urban planning and infrastructure