FACTORS AFFECTING GROWTH OF MORTGAGE INDUSTRIES IN KENYA: A CASE STUDY OF NATIONAL HOUSING CORPORATION

Mores Mwirigi Njiru

Masters Student, Jomo Kenyatta University of Agriculture and Technology, Kenya

Dr. Makori Moronge

Lecturer, Jomo Kenyatta University of Agriculture and Technology, Kenya

CITATION: Njiru, M. M. & Moronge, M. (2013). Factors affecting growth of mortgage industries in Kenya: A case study of National Housing Corporation. *International Journal of Social Sciences and Entrepreneurship, 1* (7), 26-35.

ABSTRACT

The overall demand for housing in Kenya according to a UN Habitat survey is 150,000 housing units compared to 35,000 housing units being delivered in the market per year. These include those by the mortgage industry. The survey argued that housing problem can't be solved starting at the bottom because the poor will still be overshadowed. Houses meant for the lower end could still be snapped up by individuals in the higher income class thereby distorting prices and displacing the target market. Mortgage industry in Kenya is still underdeveloped despite the high demand for houses. Therefore, the general objective for this study was to establish the factors affecting growth of mortgage industry in Kenya. The study applied descriptive research design and adopted stratified random sampling technique. The study found out that the factor that affect growth of mortgage industry in Kenya were; interest rate volatility and mortgage loans accessibility to low income earners which affected to great extent compared to credit risk which was found to have lesser effect. It also found out that the Kenya government had not put up sufficient incentives & regulations that could encourage greater uptake of the mortgage. The study recommends that to improve on mortgage industry growth government should put up in place rules & regulations to prevent the customers from being exploited through high interest rates and other charges. Also it should review property registration system work towards a one stop shop with unified data base. It further recommends that players in mortgage industry to work towards product range diversity. This will in turn capture the needs of low income earners.

Key Words: *growth of mortgage industries, Kenya, National Housing Corporation*

Introduction

Housing plays a huge role in revitalizing economic growth in any country, with shelter being among key indicators of development (Ireri, 2010). For most people, the money needed to buy a house is not something they get from their savings. The large sums involved mean that a loan has to be taken out to buy the property - a loan for the purchase of a property is called a mortgage (Crowley, 2000).

Global Perspective of Mortgage Industry

All over the world, the mortgage industry has faced numerous challenges. This has not spared countries in Sub-Saharan Africa (SSA) since they face formidable housing problems. Almost without exception they have poorly developed housing institutions and markets, stocks which are in poor condition, a huge backlog of housing need and weak policy responses. In fact the housing boom of the mid-eighties eventually led to a collapse in house prices and misery for thousands of house owners (Greenlaw, Hatzius, Kashyap & Shin, 2008). This is even believed to be the inception of global economic crises which arose in the United States of America (Acharya, Philippon, Richardson & Roubini, 2009; Morgan, 2009).

Kenyan Perspective of Mortgage Industry

Kenya has recognized the right to housing in her constitution which is the supreme law of the land (Section 43(1) (b)) (RoK, 2010). “That every person has the right to accessible and adequate housing and reasonable standard of sanitation”. Yet, housing remains a major problem especially in urban areas. Millions of the citizenry are living in the sprawling slums and also in other informal settlements around Nairobi (UN-HABITAT, 2008). The informal settlements are sometimes referred to as “unplanned” or “spontaneous” settlements, which are misleading, since many informal settlements are planned, albeit not in a conventional way, and are not spontaneous (WB, 2003).

On other hand, the political violence of 2008 interfered with the mortgage industry whereby economy came to a standstill which affected the interest rates and also the prices of real property which is a major concern with the mortgage industry (NABUTOLA, 2004). Up to this day prices of real property and interest rates of mortgages have been on the raise. This has made it difficult for most people to access decent housing as they cannot afford the mortgage due to its cost (WB, 2011).

Though there is an attempt to achieve decent housing for Kenyans, Kenya has, on the whole, failed to address the housing needs of her population. The situation has been partially alleviated through the activities of the private sector housing developers, who have been a key supplier of housing, particularly in Nairobi (Hassanali, 2009). But the attempt has been slowed down as the Government expenditure for housing has been on a consistent decline, stemming from activities on price controls, inappropriate building regulations and codes as well as lack of basic planning and provision of services (Otiso, 2003). This in turn frustrates mortgage dealers eventually hampering the goal of decent house provision.

On the other hand, there has been a great appreciation of property prices & volatility across the different property markets in Kenya since the year 2006. According to Hass property consultants, in their first property index in Kenya, the prices for high end residential properties doubled between the years 2005 and 2009 (Hass property index, 2009).

Statement of the Problem

According to Pittman (2008), obtaining a mortgage in today’s mortgage market is a complicated process as it involves many procedures like identifying the best service provider with the best interest rates. This in turn hinders accessibility to mortgage funding. This supported by statistics that show; in May 2011 the mortgage holders stood at 15,049, in December 2011 they were 16,135 mortgage holders (CBK, 2011), while by end of 2012 there

were 17,000 holders (Hass Consult, 2013). This shows low uptake of mortgage in the country. World Bank (2010), attributes this to fact that mortgage is accessible to only a small majority of the Kenyan population. Further Loutskina and Strahan (2007), points to securitization, cost and availability of mortgage as discriminating factors on those intending to take up the mortgage.
WB also found that only 11 per cent of Kenyans can afford an average mortgage loan. An average mortgage loan in Kenya is Sh6.6 million, and demands a monthly repayment of about Sh90, 000 for a period of 20 years (CBK, 2011). More so, there is a continuing upward surge in the prices of construction materials hence the selling prices of houses move up too (Bonyo 2010). The prices in Nairobi for instance up surged by 7.4% between April and September 2010 (Business Post Statistics, 2010). There is very little that has been done to address these challenges in Kenya hence the minimal growth in the mortgage Industry. Therefore the study sought to identify factors affecting growth of mortgage industry in Kenya.

General Objective

The general objective of this study was to explore the factors affecting growth of the Mortgage Industry in Kenya with reference to NHC.

Specific Objectives

1. To investigate the effects of interest rate volatility in relation to growth of mortgage industry in Kenya
2. To establish the effects of regulations and incentives by the government in relation to growth of mortgage industry in Kenya
3. To determine the effects of accessibility of mortgage loans to Low Income Earners in relation to the growth of mortgage industry in Kenya
4. To establish the effects of Credit Risk (lack of credit histories, documented income) in relation to growth of mortgage industry in Kenya

Research Hypothesis

H_0: Interest rate volatility may not reduce the growth of mortgage industry in Kenya
H_1: Interest rate volatility may reduce the growth of mortgage industry in Kenya
H_0: Incentives and regulations by the government may not have effect on the growth of the mortgage industry
H_1: Incentives and regulations by the government may have effect on the growth of the mortgage industry
H_0: Lack of accessibility of mortgage loans to Low Income Earners may not reduce growth of the mortgage industry
H_1: Lack of accessibility of mortgage loans to Low Income Earners may reduce growth of the mortgage industry
H_0: Credit risk (lack of credit histories, documented income) may not affect growth of mortgage industry in Kenya
H_1: Credit risk (lack of credit histories, documented income) may affect growth of mortgage industry in Kenya

Review of Critical Literature

Interest Rate volatility on mortgage loan

According to Crowley (2004), prior to the 1980s, mortgages were supplied primarily by building societies. The de-regulation of the financial services industry in the 1980s meant that many building societies now had to compete with banks and other financial groups who were offering mortgage services. Some of these mutual societies de-metalized (became PLCs) and effectively became banks. This had the effect of increasing competition in the mortgage industry. Firms now offered mortgages more freely and as a result the demand for owner occupied property increased. What this meant was a significant change to the housing market. As the demand for housing grew, prices rose. As prices rose, the newly formed PLC's-Banks were able to take advantage of its freedoms by offering house owners the opportunity of making use of the equity in their homes to borrow for other purposes like holidays, cars and so on.

By the fact that the interest rates oscillate between certain ranges (14%-17% in Kenya) these firms can give varying rates for similar levels of loans depending on the market forces of demand and supply and also depending on the level of market risk at that particular time. Crowley (2004), argued that it is not by surprise that one can negotiate for a two million loan at a subsidized rate, and another person gets the same amount of loan from the same firm at a higher rate but at different times. This makes planning for mortgages hard due to various uncertainties.

According to Merriam (2002), Interest-rate movements are based on the simple concept of supply and demand. A major factor driving interest rates is inflation (Dennis & Pennington-Cross 2008). Higher inflation is associated with a growing economy. When the economy grows too strongly, the Federal Reserve-Central Bank increases interest rates to slow the economy down and reduce inflation. A strong economy therefore results in higher real-estate prices, higher rents on apartments and higher mortgage rates.

Regulations and Incentives

According to Livingstone (2008), the government of the UK was more concerned with the effects of the financial crisis of 2007/2008. One of the most affected parts of the economy was the mortgage industry. In order to support the Industry, the government implemented the following: More technical specialists, so the players will more often be able to have their queries and questions resolved on first call. This involved improving communication channels between the two and the government put more emphasis on helping the Industry with principles-based regulation questions. In line with this it piloted this approach with questions about the new high-level ICOBS rules for general insurance intermediaries and they have done well.

According to development analyst Simons (2006), government owned or sponsored mutual fund driven housing schemes and the pseudo-mortgage arrangements that allow public sector employees to own their own property have proven to be relevant. "Housing schemes and mortgages tend to be inseparable in Africa, particularly as the secondary market is effectively vacant," he says.

Mortgage Accessibility to Low Income Earners

The scenario resonates throughout sub-Saharan Africa where the mortgage market remains undeveloped against the background of a growing middle class in need of affordable homes. Demand for residential housing aimed at the middle class, and also catering to specialized niche markets such as provision of housing and office space to the expatriate and business communities, is witnessing a surge across cities in Africa. The challenge with provision of housing has not been building or lack of demand, but access to financing to buy homes. What are missing are lenders willing to take the risk (Vusumuzi, 2009).

According to McCann (2009), for young people and low paid workers, the price of property is proving prohibitive to their entry into the market. This due to a number of costs associated with acquiring a mortgage (Knight, 2005). These costs include: survey costs, arrangement fees, booking fees, telegraphic transfer fees, deeds release fee on final repayment, broker fee, and the solicitor's charge for his involvement with the mortgage. Knight advices that since these costs are met by the mortgagee thereby increasing the load to the mortgagee they could be waived of such costs or more so these cost are reduced to such a level that they do not over-burden the mortgagee.

Credit Risk

Credit risk is one of the oldest and most important forms of risk faced by financial intermediaries (Broll, Pausch & Welzel, 2002). Since this risk carries the potential of wiping out enough of a financiers capital to force it into bankruptcy, managing this kind of risk has always been one of the predominant challenges in running a financial intermediaries (Broll, et al, 2002). Banks play a crucial role in the financing of real estate through mortgage financing. They lend for the purchase of land for development and existing buildings; they finance construction projects; they lend to non-bank and they finance companies that may finance real estate; and they lend to non-financial firms based on real estate collateral (David & Zhu, 2004).

Research Methodology

Research Design

Research design is the plan and structure of investigation so conceived as to obtain answers to the research questions. It includes an expression of both the structure of the research problem and the plan of investigation used to obtain empirical evidence on the relationships between the variables of a study (Cooper et al, 2006). The researcher applied a descriptive research design. The study aimed to give more information on a given variable and show relationship between variables. Descriptive study design helps the researcher to understand the root cause of the research problem (Chordiaet, 1997).

Population, Sample and Sampling Techniques

According to Thomas, Nelson, and Silverman (2010), a population refers to a universal set of all elements in which the characteristics under consideration are present. The target population of the study was employees of National Housing Corporation. Cooper and Schinder (2003) defines sampling as a selection of few items (a sample) from a bigger group (population) to become the basis for estimating or predicting prevalence of an unknown piece of information, situation or outcome regarding the bigger group. The research adopted stratified random sampling technique. The sampling technique within the strata was random sampling among employees in each stratum. Mugenda and Mugenda (2003) indicate that for descriptive studies as this one, a sample size of 10% of the accessible population will be adequate. This study utilized a sample size of 30% taking into consideration that most of the questionnaires were administered through interview mode hence expected high success rate. The researcher used self-administered open and closed ended questionnaires due to their convenience (Thomas, Nelson, & Silverman, 2010). They were delivered to the respondents, the researcher then administered them through interview mode.

Data Analysis Technique

Data entry and management was done using Statistical Package of Social Sciences (SPSS) version 19.0. Then analyzed using both descriptive and inferential statistics. In this study, measures of central tendency were used to give expected summary statistics of variables being studied. These included mean, mode and median. The multiple regression analysis was used to correlate the four independent variables.

According to Fraenkel and Wallen (2000) regression is the working out of a statistical relationship between one or more variables. The researcher used multiple regression analysis to show the influence of the independent variables on the dependent variable.

Hence, the hypothesized relationship was;

$$\mathbf{Y = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + e} \quad \textbf{Equation (i)}$$

Where;

Y = Growth of the mortgage industry in Kenya

α = Constant

$\beta_1, \beta_2, \beta_3, \beta_4$=the partial regression coefficients

X_1= Interest volatility on mortgage loan

X_2 = Government regulations and incentives

X_3 = Mortgage accessibility to low income earners

X_4 = Credit risks

e = error term

Summary of Findings

The study was carried out to determine the factors affecting growth of mortgage industries in Kenya with reference to the National Housing Corporation (NHC).

First hypothesis

The study revealed that there was a relationship between the interest rates volatility and the rate at which mortgage grew as indicated by majority (54.5%) of the respondents. Also, the study revealed that NHC was involved in regulating interest rates it charges to customers and that NHC established the procedure for assessing its capital adequacy consistent with its risk profile and providing the strategy to maintain the capital adequacy. Furthermore, the study revealed that NHC report to CBK the bank's capital allocation, self-assessment for the capital adequacy and self-assessment for management and also that the Mortgage account is considered delinquent when payments have not been received after predetermined number of days (i.e. 30, 60, 90 days).

Second hypothesis

On the government regulations and incentives, the study revealed that the effect of government regulations and incentives on the rate of growth in the mortgage industry in Kenya was to a great extent. Also the study revealed that the government had not put in place sufficient regulations and incentives to promote the mortgage industry and further the study revealed that the respondents were neutral on the fact that the government took into account all stake holders views in coming up with regulations and incentives.

Third hypothesis

On the mortgage accessibility to low income earners the research revealed that increase in interest rate and volatility highly decreased the demand for current mortgage top ups (demand) and also that accessibility of mortgage loans to low income earners affected the growth of the mortgage industry in Kenya to a great extent.

Fourth hypothesis

The study also revealed that NHC had a monitoring and control system to reduce mortgage defaults and also that the monitoring system was reviewed for reporting in NHC mainly on quarterly basis. The study also revealed that credit risks affected the growth of the mortgage industry in Kenya to a great extent. On mortgage defaulting, the study revealed that it could be reduced in Kenya and specifically at NHC.

Conclusions

The study revealed that; Interest volatility on mortgage loan, government regulations and incentives, and mortgage accessibility to low income earners was the main factors that influenced the growth of mortgage industries in Kenya. From the study carried out, the researcher learnt that in order to enhance and increase mortgages at the NHC or any other similar institution, then it was necessary to put more effort in addressing issues related to Interest volatility on mortgage loan, government regulations and incentives, and mortgage accessibility to low income earners.

Recommendations

The government should come up with rules and regulations to prevent the customers of mortgage from being exploited through high interests' rates and other charges.

Players in the Mortgage industry to work to diversify product range. Affordability is a key constraint on the future growth of the said industry. One way of tackling affordability is by designing products where cost of the loan is spread out more evenly over the lifetime of the loan. This in turn will capture the low income earners.

The government through Central Bank of Kenya should implement policies that reduce on the interest rates that financial institutions charge on mortgages. Currently, Kenya has high interest rates (average of 15% p.a) for borrowing on mortgages compared to the developed countries like the USA which charges 5% on their mortgages.

The Government should review property registration system work towards a one stop shop with unified database. A simpler, more secure, reliable process which is both cheap and efficient could significantly boost the development of the mortgage industry in Kenya.

References

Acharya, V., Philippon, T., Richardson, M. and Roubini, N. (2009). “The Financial Crisis of 2007-2009: Causes and Remedies.” New York University Salomon Center and Wiley Periodicals, Inc.

Bonyo, J. (2010, July, 22). Business section, Daily Nation

Broll, U, T. Pausch and P. Welzel (2002), Credit Risk and Credit derivatives in Banking. Discussion paper No. 228. Germany University of Augsburg.

Central Bank Of Kenya (2011) Risk Management Survey for Banking Sector.

Crowley, A. (2000). Taming the ferocious outsourcing beast. PC Week, (Feb.):85

Chordiaet (1997), The Handbook of Non-agency Mortgage Backed Securities, 2nd edition.

Cooper, D. R., & Schindler, P. S. (2006). Business Research Methods (9th edition). USA: McGraw-Hill.

Hass Consult survey on property market, (2009)

Hass Consult survey, (2013), Kenyan property market

Hassanalli, F. M. (2009), Understanding reduced private- Sector participation in Low Income Housing delivery in Nairobi

Greenlaw, D., J. Hatzius, A. Kashyap, and H. Shin (2008): “Leveraged Losses: Lessons from the Mortgage Market Meltdown”, US Monetary Policy Forum, Report no. 2, pp. 7-59.

Ireri, F. (2010, July 19). Monday View, Daily Nation, p. 27

Pennington-Cross, A., and Ho, Dennis (2008), Predatory lending laws and the cost of credit. Real Estate Economics, 36(2), 175-211.

Mugenda, O. M., &Mugenda, A.G. (2003), Research Methods Quantitative and Qualitative Approaches. Nairobi: Applied Research and Training Services Press.

Otiso, K. M. (2002), Forced eviction in Kenya cities, Singapore Journal of tropical geography

World Bank (2010), World Development Indictors database

Thomas, J. R., Nelson, J. K., & Silverman, S. (2010), *Research Methods in Physical Activity,* 6th ed. Champaign: Human Kinetics.

Fraenkel, J. R., & Wallen, N. E. (2000). *How to Design and Evaluate Researach in Education,* 4th ed. Boston: McGraw-Hill Higher Education.

McCann, E.J, (2009). City Marketing. In International Encyclopedia of Human Geography ed. R. Kitchin and N. Thrift. Elsevier.

Nabutola, W. (2004) Affordable housing in Kenya.*A case study of policy on informal settlements, Land administration and Housing Issues in Informal environment, 3rd FIG Regional Conference, Jakarta, Indonesia.*

Government of the Republic of Kenya (2010), Kenya Constitution