

# Towards A Better Functioning Housing Market



## **A qualitative housing assessment for Kabul city** [DRAFT]

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June 2012

## Acknowledgments

This research has been prepared for World Bank's South Asia Sustainable Development Unit (SASDU).

Many thanks to the staff of the Ministry of Urban Development Affairs and the Kabul Municipality for the time and assistance they offered for this research. In particular, sincere thanks to Mr. Neemat and Mr. Abad for facilitating meetings with their various departments at short notice, and for engaging their staff in intensive discussions and knowledge sharing events.

Sincere thanks to Deepali Tewari, TTL for this study and Lead Urban Specialist (SASDU), who made this work happen – and for ensuring that everything ran smoothly and efficiently, which maximized the outputs from this short mission amidst security limitations.

And finally, special thanks to the World Bank ACS staff, the drivers, the Guest House staff, and to the numerous individuals who volunteered their time to share their housing stories and provide feedback on this research.



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## EXECUTIVE SUMMARY

The current formal housing sector of Kabul city caters only to the top end of market demand, i.e. households earning more than \$3,500 per month. In general, formal housing in Kabul is in short supply, expensive, and offers ‘too little for too much’ money – both in terms of purchase or rental. This, combined with the lack of housing finance – which is partially due to banks being unwilling to lend in what they perceive as an ‘over-valued’ real estate market environment, and partially the ineligibility of the borrowers to qualify for a housing loan (due to informal sector employment, or simply low income levels), has resulted in situation where the vast majority of the population lives in informal or unplanned settlements.

There are several constraints in the housing sector that directly impact cost, reduce affordability, and limit the ability of the housing market to deliver products adequately in a highly heterogeneous market with very diverse demands. Some of these constraints are discussed below:

- **Cost of construction.** All basic construction materials (steel, glass, cement, pipes) used in conventional building systems in Afghanistan are imported; this makes construction very expensive (\$400-500/m<sup>2</sup>).
- **Cost of land.** Building within the city is about 20-30 percent more expensive than building in the outskirts, not least of all because of the higher cost of land, which can take up to 50-60 percent of the project cost in a good location within the city.
- **House design and configuration.** The typical developer-built units coming into the housing market range between 100-200m<sup>2</sup>, and are occupied by households earning more than \$3,500 per month. In a situation where the base-cost of construction is already quite high, a large house size exponentially increases the house price and reduces affordability.
- **Developers’ capacity.** There appears to be little evidence of developers’ skills to assess and respond to market demand. This may be attributed to either simply limited technical capacity, or more likely, a limited appetite for risk associated with moving down-market (anything less than units priced at \$100,000) in the current political, economic, and security climate. Another issue for developers is the lack of finance: in the absence of construction loans, developers typically raise funds through cash advances from potential customers. This, coupled with the absence of housing finance for buyers, has resulted in a situation where the target market for formal housing production includes only those who have enough savings to pay upfront.

There are also several constraints facing the housing finance industry, as follows:

- **Income levels:** Given the low level of incomes and a weak track-record of ‘banked’ savings of the general population, households generally do not qualify for sufficiently large loans that correspond to the high cost of housing.
- **Asset-Liability ratio:** Housing loans currently being offered have short durations – 3 to 5 years. Reportedly, this is due to lack of long-term funding (deposits, or other financing), without which banks are not able to provide longer term loans.
- **Mortgage Law:** The recent passing of the Mortgage Law, which gives foreclosure rights to the banks, was expected to boost mortgage lending, but that has not happened. Several reasons are cited for this: one, at a fundamental level, an interest-based mortgage product contradicts the Sharia Law; so, in effect, this means that the Mortgage Law contradicts Islamic Law. Two, there exist in Afghanistan today several forms of land/ property ownership, of which only *Shari* – which covers mapped areas, and constitutes only about 10 percent of all properties nationwide – can be challenged in a court of law. The other forms of title namely, *Urfi* and *Community titles*,

cannot be challenged in court, and hence not accepted by banks as collateral.<sup>1</sup> This effectively limits the scope of the Mortgage Law.

- **Market conditions:** The unstable security and economic situation in Kabul is contributing to extreme price volatility in the real estate market and in the housing sector. House prices have reportedly tripled in the past 3 years: for example, a 2-bedroom unit which could be purchased in 2008 for \$30,000 is now priced at \$100,000. Bankers expressed fear that loans based on currently 'over-valued' properties might go 'under-water' once the economy stabilizes and the property bubble bursts. In such an event, it is possible that the market value of the property falls below the loan amount, and leads to mass non-payments. Mortgage lending in such an environment, according to the bankers, could be viewed as another version of the US sub-prime crisis.

In a market that appears to be inconducive for conventional mortgage lending, Housing Microfinance (HMF) is gaining traction as a viable alternative. According to MISFA, the apex institution for microfinance in Afghanistan, HMF as their strategic area of focus, while recognizing that the technical capacity of microfinance institutions in Afghanistan is still very limited. Also, the current security situation and cultural issues pertaining to the concept of 'loans' and 'interest' are constant challenges that the microfinance sector has to overcome. First Microfinance Bank (FMFB) is a member of MISFA, the only licensed MFI in Afghanistan, and the only one offering housing microfinance loans at present. These are essentially housing improvement loans of amounts ranging between \$1,000 and \$5,000 for up to 2 years. HMF constitutes 17 percent of the FMFB portfolio, with a loan default rate less than 2 percent.

Below are three key steps necessary to enable the delivery of affordable housing in Kabul's market:

- **Reduce house costs**
  - Explore **cheaper (alternative/ local) materials and technologies** (local mud technology, for example)
  - **More efficient house design:** Compact (smaller unit size), and socially and economically appropriate for lower income households. In this regard, explore and compare benefits of: (i) high density low-rise, versus (ii) sites-and-services schemes with small serviced plots, versus (iii) high density walk-ups apartment and medium rise buildings (of a reasonable size, and with efficient and compact common spaces).
- **Facilitate private sector delivery of market-based housing targeted to middle and lower income households** (those earning \$300-\$3,500 per month)
  - **Build capacity of developers** in market assessment, alternative technologies, design, financing (training modules implemented through the Afghanistan Builders' Association; Study tours to share the experience of India in lower income housing market development)
  - **Provide incentives** (financial, others) to developers to move down-market, such as tax breaks, cheap land (as in a PPP)
- **Deliver housing finance through more appropriate mechanisms**
  - **Housing microfinance** for home construction and home improvement. Consider working with FMFB as a potential partner in developing a housing microfinance product that is perhaps larger in size and with a longer loan duration.

<sup>1</sup> Only First Microfinance Bank (FMFB) accepts *Urfi* and *Community Titles* as collateral for housing microfinance loans.

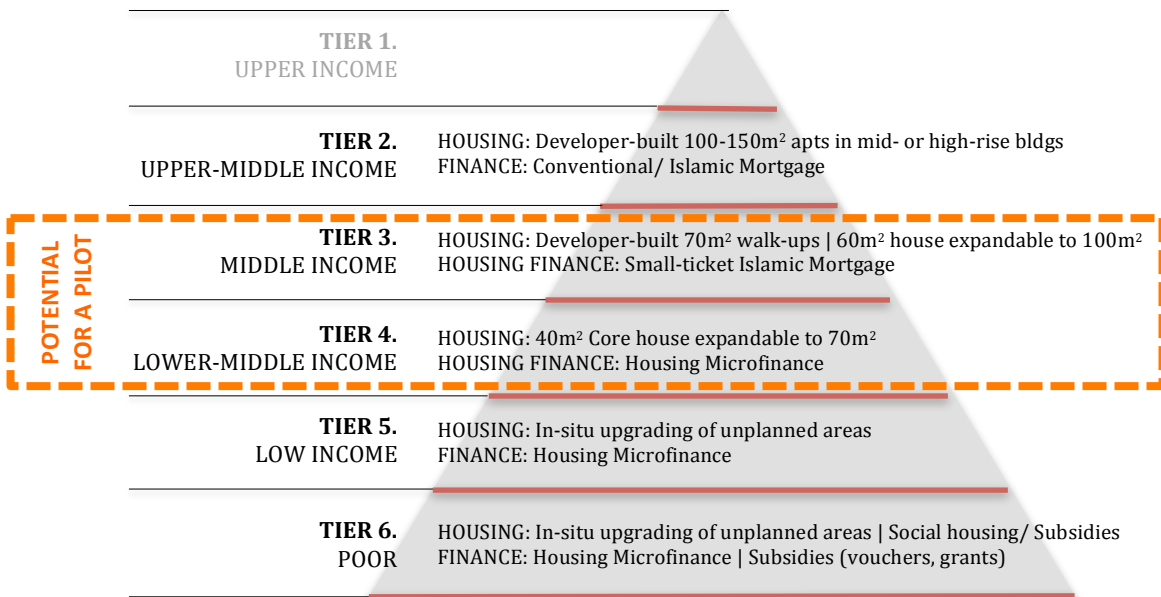
- Explore the possibility of **expanding the reach of conventional mortgage instruments** through guarantee schemes etc., and **small mortgages targeted** at (qualified) lower income households
- **Islamic banking**

➤ **Implement a pilot housing/ housing finance project**

A complex housing market such as Kabul’s requires a range of housing options that cater to the needs of all income groups in terms of ‘housing’ as well as ‘housing finance’ products. The figure below illustrates the sorts of housing and finance interventions/ products that may be explored. As shown, Income Tiers 3 and 4 (monthly household income \$300-1,500) present the highest potential for a pilot demonstration project, where market-based solutions can be tested for housing (e.g. core housing – with a basic room with a toilet and kitchen; sites and services projects; small format apartments), and housing finance (small mortgages and housing microfinance for home improvement/ construction/ expansion).

A pilot intervention should be undertaken to test delivery of an appropriate targeted housing intervention in Kabul. The principles that underpin the design of the pilot would have broad applicability to other cities in Afghanistan.

**Housing and Finance Options to be explored**



## I. INTRODUCTION

### A. About this Paper

The World Bank is currently preparing Afghanistan’s second urban project. In the course of preliminary discussions, there has been a demand from the Mayor of Kabul for “low cost housing”. The research for this report followed from these discussions between the Bank and the Government of Afghanistan (GoA).

This paper is one part of a two-part document based on a 2-week field mission to Kabul in April-May 2012. The mission included two consultants, with complementary objectives:

- **Zaki Ghiacy** (Urban designer, Director-McBains Cooper, UK), responsible for identifying areas of intervention for a WB urban regeneration program in Kabul city; and
- **Ashna Mathema** (Urban Planner/ Housing Specialist), responsible for conducting a qualitative assessment of the housing market in Kabul city.

This paper focuses on the latter, i.e. the housing sector in Kabul. It is an attempt to piece together the various components of the housing ‘story’ – from the perspective of supply (housing availability, associated costs) and demand (prevailing income levels, housing affordability, and house financing options)—and identify the ‘gaps’ in the market for further analysis and intervention.

### B. Methodology

A brief desktop study was conducted prior to the field mission in May 2012. This included a review of recent World Bank reports of on-going or planned work in Afghanistan’s financial sector, which largely focus on banking reform (regulations, supervision etc.).<sup>2</sup> The desktop review also covered recent housing sector reports in the country.<sup>3</sup> However, as the field work subsequently revealed, much of the cost- and affordability-related information, even in documents as recent as 2008-09 is out-dated: for example, housing prices, in many cases, have tripled over the past 3 years in what appears to be a highly volatile and distorted housing market environment.

In the absence of up-to-date quantitative data on income or housing cost for Kabul, group discussions and interviews were conducted with a range of end-users—people working in the public as well as the private sector, and NGOs/international development organizations at various

<sup>2</sup> List of reports reviewed:

- Afghanistan Financial Sector Strengthening Study – Project Appraisal Document (World Bank, 2009) – The objective of this study is to help build the capacity of Da Afghanistan Bank in banking supervision, and to develop financial infrastructure including a Public Credit Registry, Collateral Registry, Afghanistan Institute of Banking and Finance.
- Afghanistan Mortgage Law
- Afghanistan Financial Sector Rapid Response Project - Emergency Project Paper (World Bank, 2011): The focus is on (i) Audits of ten commercial banks; (ii) Modernization of the national payment system to facilitate payments within the country; (iii) Support to the development of the Afghanistan Institute of Banking and Finance (AIBF); and (iv) Technical assistance and training for project implementation.

<sup>3</sup> List of reports reviewed:

- The Housing Sector in Afghanistan: Challenges and Opportunities, World Bank/ IFC, June 2008.
- Housing and Housing Finance of Afghanistan”, Chapter for a WB report on the financial sector by Zaigham Rizvi (December 2009)
- Afghanistan Housing Sector Assessment: Final Report, ShoreBank International/ CHF, prepared for World Bank/ IFC (March 2007).



levels of seniority—to establish an income pyramid. This pyramid is purely ‘purposive’, and illustrates the prevailing housing conditions associated with each segment of the pyramid.

Meetings were also held with the Afghanistan Builders’ Association – with several developers and building contractors—to understand the types of housing products coming into the market, the costs and profit margins involved, the technical capacity of developers, and the constraints they face in terms of access to capital/ financing, land and infrastructure. This helped identify the demand-supply ‘gaps’ currently existing in the formal sector housing market.

In parallel, the team met the Afghanistan Bankers’ Association, with CEOs of all the major banks in Kabul, to get an understanding of the sorts of housing finance products—including housing microfinance—being offered, and their views and perceptions on the potential for expanding housing finance in Afghanistan.

Finally, several rounds of discussions were held with various departments in the Ministry of Urban Development Affairs as well as Kabul Municipality to gather an understanding of the government’s current thinking and direction on urban development and housing in Kabul, and also the two Kabul masterplans currently being considered for implementation.

### **C. Limitations**

This document should be seen as **a first step towards a more comprehensive and detailed housing sector analysis**. It is important to make clear that the findings presented in this paper are largely qualitative, based on, as mentioned above, interviews and field visits that were limited due to the security situation in Kabul during the mission. That said, the findings presented here have been shared with various audiences to vet the underlying assumptions and solicit feedback; the feedback received from these interactions provides sufficient comfort to arrive at the options for intervention presented in the Section IV of this paper.

### **D. Outline of the Paper**

Section II presents a broad analysis of the housing market in Kabul, including discussions on the prevailing income levels, housing supply, house prices and affordability, and the barriers to supply of housing in the formal sector.

Section III is a discussion on housing finance, focusing on access, and issues of ‘acceptability’ of conventional loans, and some constraints to mortgage lending, and alternatives such as housing microfinance (HMF).

Section IV briefly outlines some options to explore as a means to a better functioning housing market in Kabul city.

## II. SITUATION ANALYSIS

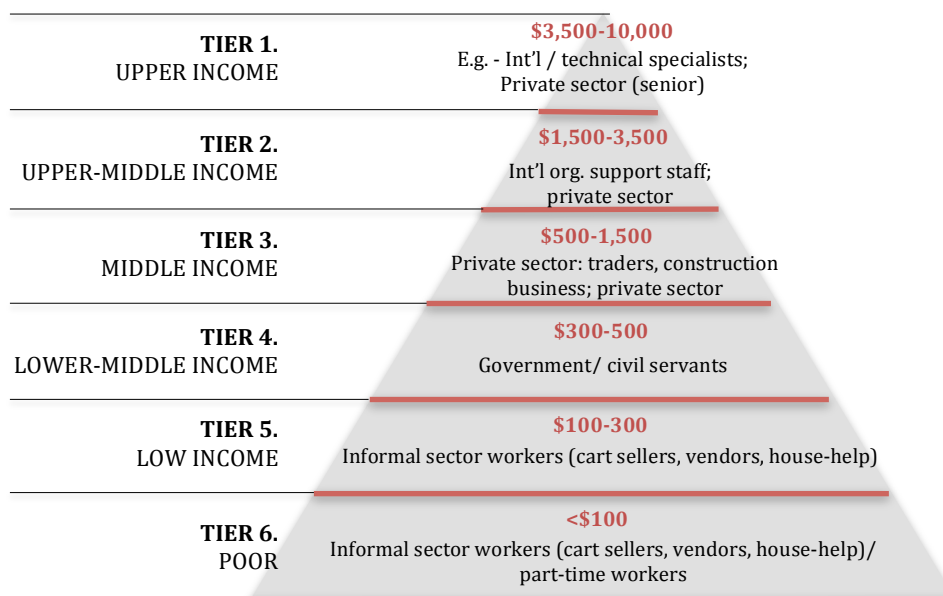
### A. Income Stratification

Income data in Afghanistan is not disaggregated in a way that is meaningful to this housing assessment. As a proxy, therefore, it was necessary to establish a 'purposive' income pyramid that represents the various income categories in Kabul.

As illustrated in Figure 1, the income grouping ranges from 'poor' households earning less than \$100 per month at the bottom of the pyramid (Tier 6, which includes informal sector workers such as cart-sellers, vendors, etc.), to 'upper income' households earning between \$3,500 and \$10,000 per month at the top of the pyramid (Tier 1, which includes the more senior/ specialist workforce employed in international organizations). Tiers 2, 3, and 4 in the pyramid represent upper-middle income (\$1,500-3,500 per month), middle income (\$500-1,500 per month), and lower-middle income (\$300-500 per month) households.<sup>4</sup>

The percentage of population in each segment of the income pyramid is difficult to ascertain; hence, rather than representing *how many people earn how much?*, this figure indicates *who earns how much?*

Figure 1. 'Purposive' Income Pyramid – Household Income per month (Illustrative)



<sup>4</sup> Needless to mention, there are also those earning more than \$10,000 per month; however, since they constitute a relatively small percentage of the population, and not the under-served or unserved segment of the housing market, they are not necessarily relevant for this analysis.

## B. Housing Stock

The bulk of the housing stock of Kabul is 'informal'.<sup>5</sup> The predominant players in the formal housing sector include: (i) Government (planning to build subsidized housing for public servants), (ii) private developers building mostly condominiums or apartment housing targeted to the upper end of the market, and (iii) self-built homes by individuals households, through builders or contractors.

### Private development

The most common type of housing being built by private developers for sale is the apartment, or condominium. These are typically 2-3 bedroom units, approximately 100-120m<sup>2</sup> in area, in 5-6 story buildings. The units are priced in the \$120,000 range, plus or minus 20 percent, depending on the location and public amenities provided on the premises. This translates into a per square meter price of \$1,000-1,500/m<sup>2</sup>. The developments are 'gated',<sup>6</sup> and in most cases, construction is financed with advance payments from the buyers.



*Two private housing developments in Kabul city, with 2-3 bedroom apartments priced at \$100,000-\$125,000.*

These newer apartments are a variance—and improvement—on the Macrorayan model. The Macrorayan are apartment buildings built during the Russian occupation, with 2-3 bedroom flats. When first introduced in the 1970s-80s, most Afghans considered them unsuitable. However, they are now a popular – and even preferred – housing type. One reason cited for their favored status is the higher level of security such apartment complexes offer in comparison to a single family home. These units were priced at \$5,000-6,000 in the 19780s-80s; today they can fetch up to \$150,000, which translates into a price of \$1,500/m<sup>2</sup>.

<sup>5</sup> To use the vocabulary of Ministry of Urban Development Affairs, this includes houses built by 'squatters' (i.e. people who are squatting on public or private land), 'land-grabbers' (i.e. informally developed lands without the necessary legal permits), old part of the city which may be underserved but 'historic', and more generally, those houses located in unplanned areas without adequate basic infrastructure.

<sup>6</sup> A gated community may be defined as a "residential community or housing estate containing strictly-controlled entrances for pedestrians, bicycles, and automobiles, and often characterized by a closed perimeter of walls and fences. Gated communities usually consist of small residential streets and include various shared amenities." (Source: Wikipedia)



*Macrorayan, Kabul city, with 2-3 bedroom apartments renting for \$500-600 per month*

There are also some developments with smaller format units, e.g. 1-bedroom apartments (approximately 50m<sup>2</sup>) in central locations targeted to expatriates, selling for about \$100,000, which translates into a unit cost of about \$2,000/m<sup>2</sup>; the rent for these units is in the \$1,000-1,500 range. The other type of housing targeted for expatriates, diaspora, and the wealthiest Afghans, are the 4-8 bedroom villas, with areas in the 250-350m<sup>2</sup> range, priced at \$0.5-1.0 million and higher, which translates into a unit cost of about \$2,500-3,000/m<sup>2</sup>. These are beyond the scope of this study, hence not discussed in this paper.

Traditionally, the more common practice has been for people to build their own homes. For example,<sup>7</sup>

**Nafiz** lives in a 5-bedroom house (approximately 150m<sup>2</sup>) on a 600m<sup>2</sup> plot in a planned area of Kabul city. With a salary of about \$3,500 per month, he supports his family (wife and 4 children) and ageing parents. Nafiz bought this land 10 years ago for \$55,000. He used his savings, supplemented with some money that he borrowed from family and friends, to construct his house in 2005, which cost about \$80,000 at the time.

**Abdul** is a driver with a salaried job, earning some \$1,400 per month. He lives with his wife and 3 children in a 4-bedroom (approximately 100m<sup>2</sup>) house in the outskirts of Kabul. Abdul bought this house 8 years ago for \$28,000. Today, he estimates the value is \$120,000, despite being quite far from the city center.

This is the preferred option even today, However, given the growing scarcity of land, and the escalating construction costs, access to 'formal' or 'planned' housing, is becoming more difficult – in particular for migrants or young couples who do not already own a property in the city.

**Nasir** is a salaried worker with an income of about \$1,200. He is married, with two young children. He has been unable to find a house for his family that they can afford, so he lives with his parents and two siblings in the parents' apartment. The apartment is in a Macrorayan building, and has 3 rooms (about 100m<sup>2</sup>). His father, who owns a carpet shop, purchased this unit in 1980 for \$6,000; today, it is valued at \$150,000.

## Rental Housing

Rental housing developments, i.e. a development with only rental units or a large number of rental units that are owned and managed by the developer – public or private, do not appear to be popular

<sup>7</sup> Note: All names of people interviewed in this report have been changed to retain the confidentiality of the individuals.

in Kabul. The only rental units available in the market are those that are rented out by individuals. A 2-3 bedroom apartment of 100-120m<sup>2</sup> in a Macrorayan<sup>8</sup> or a newer apartment building can be rented for \$500-600 per month, which translates into \$5/m<sup>2</sup>. (For comparison, the purchase price of these homes is in the \$1,000-1,500/m<sup>2</sup> range.) These are typically occupied households in the second Tier of the Income Pyramid, see Figure 1, i.e. upper-middle income households earning between \$1,500-3,500 per month. A lease agreement is usually for at least one year, with 3-6 months' rent paid in advance.<sup>9</sup> Reportedly, the majority of units—as many as 80 percent of total units—in the Macrorayan buildings are rented out.

**Nadia** rents a 3-bedroom apartment in a Macrorayan building for \$500 per month. Her monthly income from a regular salaried job is about \$2,500, and her husband earns about \$4,000 per month (and possibly more) working in the international security forces. They have two small children. Nadia signed a 1-year lease for this rental unit, and paid 6 months' rent in advance.

At the top end of the rental market are villas and bungalows in walled compounds, which can fetch \$2,000-3,000 (and more) per month. Rents for very large houses (>500m<sup>2</sup>) in prominent locations can fetch a rent of up to \$30,000-\$40,000 per month (\$60-80/m<sup>2</sup>), and are largely rented to the international organizations for both office and residential purposes. Again, these are beyond the scope of this study, hence will not be covered here.

In the middle of the market – between the large bungalows and the 2-3 bedroom apartments – are single family houses for rent, individual single family homes in both planned and unplanned areas, renting for \$500-600 per month. For example,

**Naeem** rents a 6-room (approximately 200m<sup>2</sup>) single-family two-storey house, with his wife and 4 children. The road to the house is unpaved, and they use a well for water – there is no municipality water connection to the property. Naeem pays a rent of \$600 per month. His household income is \$3,500. He says the property would cost about \$250,000 if he were to buy it. He would like to buy a house some day, but he says he can only afford to spend \$40,000-60,000, and based on his family needs, he would like a house or flat with at least 4 bedrooms. In this respect, the 2-3 bedroom apartments being soled in the market are too small, and more importantly, not affordable with their \$100,000+ price tags.

### Informality in Kabul

With Kabul's formal housing market catering to only the wealthiest segments of the population, 70 percent of Kabul's total population of 4.5-5.0 million lives in unplanned or informal settlements. The informal market provides the affordability and flexibility that is absent in the formal market, albeit with the trade-off of poor quality infrastructure (water, sanitation, road access).<sup>10</sup>

<sup>8</sup> As mentioned on page 4-5, Macrorayan is the local term used to typify apartment buildings built during the Russian occupation, with 2-3 bedroom flats.

<sup>9</sup> Real estate agents charge 1 month's rent as fee.

<sup>10</sup> A detailed assessment of housing conditions in informal settlements was not carried out due to the security situation on Kabul during the mission, and restricted movement around the city. Some photos are from a trip to Kabul in 2003 by the author.



*Left: Informal development on a hillside, characteristic of Kabul's landscape. Some of these are very steep slopes, and raise concerns regarding structural stability in the event of an earthquake. Middle: A house on one of the hills, made of stone and mud blocks. Right: Donkeys used to cart water up the slopes since many of these areas do not have water connections, and do not have access roads on which water can be transported on vehicles.*

It is not just the poor (those households earning less than \$100 per month) or lower middle income households (earning \$100-300 per month) who live in informal or unplanned areas. Even lower-middle and middle income households (earning between \$300-\$1,500 per month) cannot, for the most part, afford any formal sector housing. Many of them share accommodation with extended family - parents, siblings and their families. For example,

**Alam** earns a salary of \$4,000 per month with which he supports his family (wife and their 8 children), his two younger siblings, and his parents. This 14-member household lives in a 150m<sup>2</sup> house in an unplanned area of Kabul. Alam bought this house a few years ago, using the proceeds of the sale of an old mud house that he built some 16 years ago. He says that financing is hard to come by, despite his full-time salaried job in an international institution. After paying for his children's education expenses, there is little left in terms of savings that he could invest in buying or building a house in a planned area.

**Abadi**, a chemical engineer by training, works as a driver for a private contractor, and earns about \$1,200 per month. His family—wife and 7 children—live in a large extended family, with a total of 28 members. This 9-room house located in one of Kabul's unplanned settlements was built some 22 years ago by his parents. Abadi would like to get his own house some day, but he says: the minimum rent is \$300 per month, and the cheapest house on the market costs \$100,000, both of which are unaffordable, given his large family.

For those who do not own a home in the city, the informal sector also offers more flexible and affordable rental options.

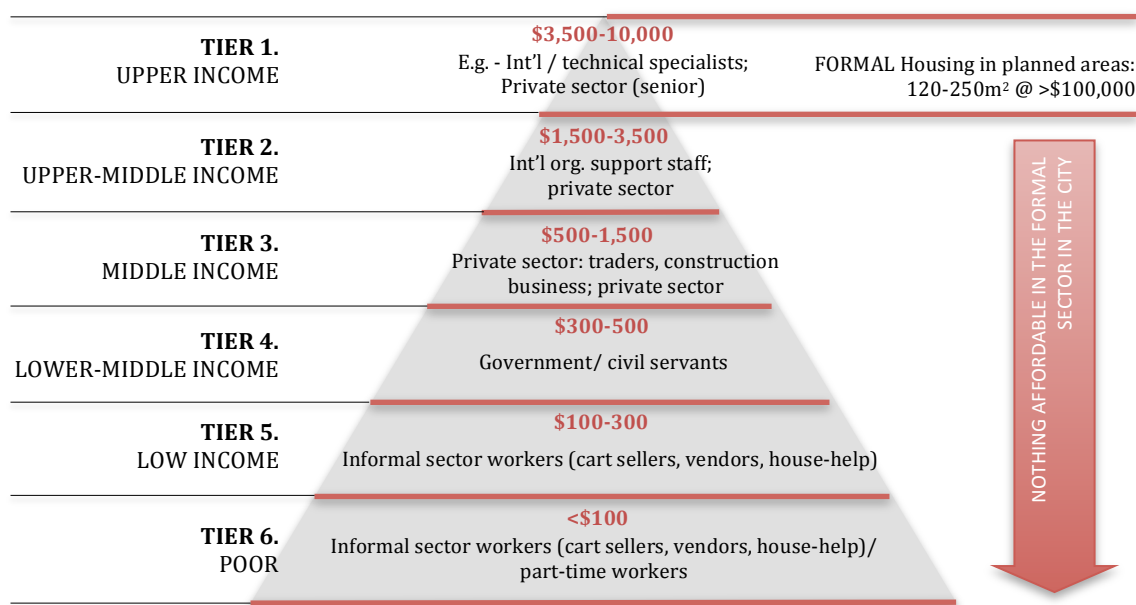
**Humayoun** rents a 2-room house in an unplanned area, where he lives with his wife and 3 children. His income is about \$1,000 per month. The house is constructed of mud, and has poor road access. Humayoun pays a rent of for \$200 per month, and had to pay six months' rent in advance before moving in.

## C. House Prices and Affordability

### Market Demand

As mentioned in the previous section, the formal housing sector is catering only to the top end of market demand, i.e. households earning more than \$3,500 per month. There is little, if anything, affordable in the city for households in the middle or low income segments, i.e. Income Tiers 2, 3, 4, 5 and 6, which includes everyone earning less than \$3,500 per month (see Figure 2). The scale of unplanned settlements in Kabul is indicative of how few households earn \$3,500 or more a month.

Figure 2. Unaffordability of the 'Formal' Housing Sector



### Home Ownership: Cost and Affordability

Clearly, there is a 'gap' in the market, which applies to everyone below the top income tier. But what constitutes this gap, i.e. what are the types of housing options that these various income categories could realistically afford (under certain assumptions of loan financing and construction costs, etc.), but which are not being produced in the market? Tables 1 and 2 illustrate one way to answer this question.

**Table 1:**

This assumes developer-built housing, and the availability of bank financing for households @15% annual interest for 15 years, and 30% down payment, loan-to-value ratio of 70:30, and monthly loan repayment not exceeding 25% of gross HH income. (The multiplier ratio, i.e. house price to annual income, comes to about 1.65.)

HH monthly income	Monthly payment (25% of HH Income)	House price (with LTV of 70:30, and monthly repayment = 25% HH income)	Including down payment of:	Construction cost <sup>11</sup> (@60% of project cost)	Area of house (@ \$500/m <sup>2</sup> )
\$	\$	\$	\$	\$	m <sup>2</sup>
10,000	2,500	197,802	59,341	128,571	257
3,500	875	69,231	20,769	45,000	90
1,500	375	29,670	8,901	19,286	39
500	125	9,890	2,967	6,429	13
300	75	5,934	1,780	3,857	8
100	25	1,978	593	1,286	3

<sup>11</sup> Based on interviews with the Afghanistan Builders' Association, the following two assumptions have been made to calculate the size (area) of the house that is affordable: (i) construction cost is 60% of total project cost, excluding the land cost and profit margin of the developer, (ii) construction cost is \$500/m<sup>2</sup>.

Table 1 highlights households with an income of \$3,500 could afford a house of 90m<sup>2</sup> at a price of about \$69,000 (which would include a down payment of \$20,000, and monthly loan repayment of \$875). Similarly, households with income in the \$1,500 range can afford something in the \$30,000 range, i.e. a unit of about 40m<sup>2</sup>. **However, no such housing—priced at \$69,000 or less—is currently available for sale within reasonable distance from the city center** (say, less than a one-hour drive by car or public transport).

**Table 2:**

Affordability here is derived from an international rule-of-thumb factor for loan eligibility - at 3 times annual income, which seems a reasonable ballpark, given Afghanistan's interest rates and income levels.<sup>12</sup>

HH monthly income	Affordability: House price @3 x annual income	Construction cost (60% project cost)	House area (@\$500/m <sup>2</sup> )
\$	\$	\$	m <sup>2</sup>
10,000	360,000	234,000	468
3,500	126,000	81,900	164
<b>1,500</b>	<b>54,000</b>	35,100	<b>70</b>
500	18,000	11,700	23
300	10,800	7,020	14
100	3,600	2,340	5

Table 2 pushes the envelope in terms of 'affordability', using a factor of 3 times annual income as the eligibility for loan size (compare this with 1.65 in Table 1). According to this, a household earning \$3,500 per month can afford a house priced at \$126,000 (i.e. approximately \$770/m<sup>2</sup>). However, a **'gap' exists for those households earning \$1,500 (or less) per month – who could afford housing in the price range of \$50,000-55,000 (or less), i.e. a unit of about 70m<sup>2</sup> (or less).**

In both Table 1 and 2, for households earning less than \$500 per month, market-based solutions might not be viable; therefore, other options such as upgrading, subsidies etc. will need to be considered.

[Note: Depending on the underlying assumptions, there are many ways to solve for affordability (or loan eligibility). In the above Tables, the following assumptions have been used:

- Developer-built construction is considered, with a construction cost of \$500/m<sup>2</sup>. In a self-built house, however, the construction cost might be significantly lower (no profits, cost savings etc.).
- The cost of construction is assumed to be 60 percent of the total project cost; the remaining 40 percent covers the cost of land and profits for the developer. This is a fair assumption, but this figure could vary drastically depending on the cost of land, which according to some developers, could constitute as much as 60 percent of the total project cost. In such a case, the size of unit (in the right-most column) would decrease further.
- Calculations are based on the assumption that housing finance *is* available – a 15-year mortgage loan at 15 percent annual interest. If, however, the house is self-financed, there will no interest accrued, which could be a significant saving (if the annual return for that money over a 15-year loan period is not considered).

<sup>12</sup> The international standard for such a multiplier ranges roughly between 3 and 4; generally, the higher the interest rate or the shorter the loan terms, the lower the affordability, and hence, a lower multiplier. In Afghanistan's context, where interest rates vary between 15 and 20 percent per annum and the loan term is 15-20 years, a multiplier of 3 may be considered reasonable.



## Rental Housing: Cost and Affordability

As mentioned earlier, rental housing in the formal sector largely constitutes apartment units in multi-story buildings: 2-3 bedroom units of 100-120m<sup>2</sup> area, with rents ranging from \$400 to \$600, depending on the location and the amenities available on-site. These are typically occupied by the top two Income Tiers, i.e. those HHs earning between \$3,500-10,000 or more per month - see Table 3.

**Table 3:**

INCOME TIER	HH monthly income (Lower extreme of range)	Rent for FORMAL SECTOR housing, assuming it is available	Type of unit	Rent, as % of HH income (x)	Could ideally afford <sup>13</sup> (y)	Differential between current rents and the 'ideal' (y-x)
	\$	\$		%	%	
1	10000	600	3BR apartment	6.0	30	+24%: Rent too low compared to income
2	3500	500	2-3BR apartment	14.3	25	+10%: Rent low compared to income
3	1500	400	2BR apartment	26.7	25	-2%: Able to afford rental housing, but limited rental stock captured by the wealthier groups
4	500	400	2BR apartment	80.0	20	-60%: Formal rentals not affordable
5	300	400	2BR apartment	133.3	15	-118%: Formal rentals not affordable
6	100	400	2BR apartment	400.0	15	-385%: Formal rentals not affordable

In the prevailing formal rental market, the top two Income Tiers spend between 6 and 15 percent of their income on rent – much lower than what they can actually afford (which is 25-30 percent). In contrast, households in the bottom three Income Tiers, i.e. those earning less than \$500 per month cannot afford any of the rental options currently on offer in the formal housing market. This highlights two issues:

- One, Tiers 1 and 2 could afford to pay more for housing that is of better quality, but no such options are currently available in the market; and
- Two, given the limited supply of “planned” or “formal” housing, the rental units that would otherwise be affordable to households in Income Tiers 3 and 4 (HH Income: \$500-\$3,500 per month) are occupied by those in Tiers 1 and 2 (HH income: >3,500).

## Property Price Volatility

Prices of real estate appear to be very volatile and unpredictable in Kabul, and the same reportedly applies to the rest of Afghanistan. As one individual, whose side profession is buying and selling real estate, put it:

*“I bought a property in the province last year for \$13,000. Within a month, the value appreciated to \$30,000. And one year later, today, the same land is valued at \$150,000...”*

*I bought a house in a planned area in Jalalabad 6 years ago for \$60,000. Four years after I bought it, someone offered me \$500,000 for it. My wife told me, ‘Sell that house – the property is not worth the money that the buyer is offering.’ But I didn’t listen to her, I didn’t sell – I thought the prices would go up further. But unfortunately, that didn’t happen. Today, the highest offer I am getting for that property is \$180,000.*

<sup>13</sup> This is a rule of thumb in accordance with international standards. As one moves down the income spectrum, the amount of disposable housing for housing decreases because the expense on basic goods such as food increase as a percentage of HH income.

*This is a temporary market, a very volatile market, which can collapse anytime. Prices now seem to be coming down – likely due to the uncertainty associated with the withdrawal of US troops in 2014.”*

## D. Barriers to Affordable Formal Sector Housing

There are several constraints in the housing sector that directly impact cost, reduce affordability, and limit the ability of the housing market to deliver products adequately in a highly heterogeneous market with very diverse demands. Some of these constraints are discussed below.

### Cost of Construction

**Imported materials.** All basic construction materials (steel, glass, pipes) used in conventional building methods in Afghanistan are imported; this makes construction very expensive. Compare the cost of *basic* construction in Kabul at \$400-500/m<sup>2</sup> to, say, India (Delhi, Bangalore, Mumbai) at \$200-300/m<sup>2</sup>.<sup>14</sup> Members of the Afghanistan Builders’ Association attribute the systematic breakdown of the construction-related manufacturing industry over the past 3-4 decades for the country’s total reliance on imports. They claim, for example, that the raw material for cement is readily available in the country, but there is no manufacturing plant. As a result, Afghanistan spends some \$700M per year on cement imported from Pakistan.

*“The political situation in Afghanistan does not allow for local manufacturing of cement or other building materials..... Besides, there are many people who stand to gain from the current situation (misuse of power, corruption).”*

**In-city land and construction costs.** Building within the city is about 20-30 percent more expensive than building in the outskirts, not least of all because of the higher cost of land, which can cost up to 50-60 percent of the project in a good location within the city. Also, within the city, heavy duty equipment used to transport materials can only be used at night due to traffic guidelines; this costs more in terms of labor, further escalating the construction cost. In other words, both the cost of land and construction are higher in the city than in the outskirts.

**Design and configuration.** As discussed earlier, the typical units coming into the housing market range between 100-200m<sup>2</sup>, and are occupied by households earning more than \$3,500 per month. In a situation where the base-cost of construction is already quite high, a large house size exponentially increases the house price and further reduces affordability. A common argument used by policymakers and end-users to justify this large size is that households in Afghanistan are relatively large (with many children and extended families), and hence need more living space. This is true, but a counter-argument in this context could be that the households are—at least partly—so large because they are forced to ‘share’ housing (e.g. young families living with their parents) which is *due to* lack of availability of housing options in the market that are affordable.

### Developers’ capacity

There appears to be little evidence of developers’ skills to assess and respond to market demand. This may be attributed to either simply limited technical capacity, or more likely, a limited appetite for risk associated with moving down-market (anything less than units priced at \$100,000) in the current political, economic, and security climate.

<sup>14</sup> The cost of labor appears to be at par with India: a skilled laborer costs \$20 per day (plus meals), and an unskilled laborer costs \$10 per day (plus meals); this indicates that the extra cost is attributed to construction materials.

According to the Afghanistan Developers' Association<sup>15</sup>, the lack of construction finance for most smaller developers means that they have to raise funds through cash advances from potential customers; and the absence of housing finance for buyers makes moving down-market an even riskier proposition.

The target market for formal housing production thus has been—and remains to be—those who have enough savings to pay upfront, i.e. the wealthy or upper-middle income households. It excludes the vast majority of the population who could otherwise present a massive market opportunity for developers.

### Planning and urban development: Policy and Enforcement

According to official sources, 60 percent of multi-story buildings in Kabul are 'illegal'.<sup>16</sup> Building permits for construction within Kabul city fall under the purview of the Municipality, but lack of enforcement is a major problem. This is reportedly a result of overlap of jurisdiction of the city between the Municipality and the national government, which blurs the line of authority for oversight,<sup>17</sup> and opens up channels for patronage and corruption. To quote an official who was interviewed for this study,

*"Those who have 'individual' power, not 'statutory' power, misuse it. For a builder who has the 'means', they will approve at will a 6-story building in a zone where only 3 stories are allowed. The builder without the right connections, on the other hand, will be harassed: despite a permit from the Municipality, the police and regional authorities demand money for clearance to build."<sup>18</sup>*

There appears to be a fine line between the incentive to abide by the law versus the ability and/or power to defy it. Needless to say, some level of illegality exists in most developing country cities. However, the proliferation of illegally-constructed large multi-story buildings in a seismic zone raises critical questions pertaining to structural stability and public safety in the event of an earthquake. Seismic safety of buildings is one aspect that is quite objective from the perspective of issuing building permits; however, the lack of technical and/or managerial oversight to enforce building codes creates incentives for non-compliance for all concerned.

There also appears to be a sense of apathy with government interventions in urban development. For example, there are allegations that the recent 'lottery-based' allocation of a government-funded housing project in Kasaba<sup>19</sup> was non-transparent, and mired in corruption. As one long-term resident of the city pointed out,

*"[Those who had the power] grabbed the best houses, and often several, not just one - there are some individuals owning 5-6 houses each. The people for whom this development was intended were largely excluded ..."*

<sup>15</sup> The Afghanistan Builders' Association was established in 2004, and have on-going training programs for members in the fields of safety, scheduling, quality management, proposal writing, and vocational training (carpentry, plumbing, electricals etc.).

<sup>16</sup> Source: Interviews with officials from Ministry of Urban Development Affairs and Kabul Municipality (April 2012).

<sup>17</sup> For example, roads come under the jurisdiction of the Kabul Municipality, but transportation in the city falls under the purview of the national government.

<sup>18</sup> Interview with the Afghanistan Builders' Association (April 2012).

<sup>19</sup> It involved the development of 5-bedroom units priced at \$60,000-65,000.

Another issue that came up repeatedly during the interviews is that while the government's upgrading efforts in unplanned areas are praiseworthy, there are no improvements being undertaken in 'planned' areas.

*"...This, in effect, penalizes those who did things the right way, and at the same time, serves as a perverse incentive for others to grab or squat on public land rather than work through the legal channels to build or buy a 'formal' house."*

### III. HOUSING FINANCE

Generally, little or no financing is available for housing in Afghanistan: there are a few banks that currently offer longer term mortgage or other housing-related financial products. Among them,

- Azizi Bank, Afghanistan International bank, Banki-Mili: Targeting households in the >\$2,000 monthly income range; housing loan size: ~\$80,000
- First Microfinance Bank: Housing microfinance - Loan size \$1,000-\$5,000 for 6-24 months.

#### A. Housing Loans: Access and Acceptability

As mentioned earlier, in the absence of bank financing, only those households who can pay cash down are able to buy a house on the market. In most cases, this money comes from a combination of some savings, and some money borrowed from friends or family – *without* interest. For example,

**Faizal**, an engineer, lives with his wife and 8 children in a recently purchased 2-room house in an unplanned area of Kabul. He is the sole bread-winner and earns about \$1,300 per month (including overtime), working as a driver. Faizal heard the house was on sale for \$16,000, and wanted to buy it, but did not have enough money. His friends helped him with small contributions (on loan), with which he was able to make the purchase in a timely manner.

**Sulaiman** is a junior level salaried worker in an international organization, earning about \$1,200 per month. He lives with his young family (wife and two little children), his parents and four younger brothers in an unplanned area of Kabul. Sulaiman's house has 3 rooms, approximately 70m<sup>2</sup>, on a plot of 100m<sup>2</sup>. He bought the land a few years ago for \$20,000 with his savings. To construct the house, he borrowed \$30,000 from friends.

Another constraint to housing finance cited by several residents is the unwillingness of people to take interest-based loans, which contradicts the tenets of Islam.<sup>20</sup> Along the same lines, they only operate current (or checking) accounts in banks, not savings accounts that accrue interest.

**Abadi** is a middle-aged driver, earning \$1,200 per month. His family, comprising a wife and 8 children, live in a joint family, with a total of 28 members sharing a 9-room house. Abadi would like to get his own place some day, he says, but a house is impossible to acquire without financing (given the high prices). At the same time, he is unwilling to borrow money from a regular bank because it is interest-based, and according to him, such a loan is '*haraam*'.

**Akbar**, employed as a driver in a development agency, lives with his wife and four children in a 4-room house, approximately 150m<sup>2</sup>. The plot is 300m<sup>2</sup>. Akbar inherited the property from his parents. He is interested in investing in another house for his children, for which he will need bank financing – but he is only willing to take an Islamic loan.

The need for more Islamic banking products, particularly in the housing sector, requires a more careful consideration. Azizi bank offers an Islamic loan for housing: a 5-year loan with interest factored into the price (the title is given to the bank until full repayment of the loan). But given the short duration of the loan, and hence relatively high monthly repayments, most households even in the middle Income Tiers are unlikely to qualify for such a loan.

<sup>20</sup> Interest in any form is considered "*haraam*" or sinful. However, the fact the MFIs and banks do have regular interest-based lending products implies that people do borrow, and more so in urban areas. However, there appears to be some hesitation to pay interest or openly acknowledge such activity within social circles.

## B. Constraints to Mortgage Lending

According to the Afghanistan Bankers' Association, there are several constraints facing the housing finance industry. Key among them,

- **Income levels:** Given the low level of incomes<sup>21</sup> and a weak track-record of 'banked' savings<sup>22</sup> of the general population, households generally do not qualify for sufficiently large loans that correspond to the high cost of housing.
- **Asset-Liability ratio:** Housing loans currently being offered have short durations – 3 to 5 years. Reportedly, this is due to lack of long-term funding (deposits, or other financing), without which banks are not able to provide longer term loans.
- **Mortgage Law:** The recent passing of the Mortgage Law, which gives foreclosure rights to the banks, was expected to boost mortgage lending, but that has not happened. Several reasons are cited for this: one, at a fundamental level, an interest-based mortgage product contradicts the Sharia Law; so, in effect, this means that the Mortgage Law contradicts Islamic Law. Two, there exist in Afghanistan today several forms of land/ property ownership, of which only *Shari* – which covers mapped areas, and constitutes only about 10 percent of all properties nationwide – can be challenged in a court of law. The other forms of title namely, *Urfi* and *Community titles*, cannot be challenged in court, and hence not accepted by banks as collateral.<sup>23</sup> This effectively limits the scope of the Mortgage Law.
- **Market conditions:** The unstable security and economic situation in Kabul is contributing to extreme price volatility in the real estate market and in the housing sector.<sup>24</sup> Bankers expressed fear that loans based on currently 'over-valued' properties might go 'under-water' once the economy stabilizes and the property 'bubble' bursts. In such an event, it is possible that the market value of the property falls below the loan amount, and leads to mass non-payments. Mortgage lending in such an environment, according to the bankers, could be viewed as another version of the US sub-prime crisis.<sup>25</sup>

## C. Housing Microfinance

MISFA (Microfinance Investment Support Facility for Afghanistan) is the apex institution for microfinance, and provides funds (loans, grants) to its member MFIs. Owned by the GoA/ Ministry of Finance, it was created by the World Bank in 2003 as a not-for-profit LLC. It is now funded by USAID, SIDA and DIDA. Some highlights of MISFA's operations include:

- Lending rate (to member MFIs): 5 percent per annum
- Interest rate charged by member MFIs to their borrowers: 1.25-2.0 percent per month + 1 percent upfront annual fee

<sup>21</sup> For example, a senior government job (deputy minister level) pays \$500 per month.

<sup>22</sup> This belies a deeper issue – people's lack of faith in the banking system in Afghanistan, which was exacerbated by a recent scandal in Afghanistan's largest bank, Kabul Bank. The bank nearly collapsed in 2010 as a result of a scandal that has been described as a "virtual Ponzi scheme": \$1 billion went 'missing', allegedly in the form of 'loans' that were given out without any paperwork. More than a year after the government seized control of the bank, officials have recovered less than 10 percent of the 'missing' money, and the government has yet to prosecute anyone for the widespread fraud that took place. (Sources: *Washington Post* - October 2011; *New York Times* - April 2012).

<sup>23</sup> Only First Microfinance Bank (FMFB) accepts *Urfi* and *Community Titles* as collateral for housing microfinance loans.

<sup>24</sup> House prices have reportedly tripled in the past 3 years. A 2-bedroom which could be purchased in 2008 for \$30,000 is now priced at \$100,000.

<sup>25</sup> 'Subprime' lending in the US in the 2000s involved a large number of loans being to people who had difficulty maintaining the repayment schedule – these were 'non-conforming' loans, or loans offered at teaser rates. But when the price bubble burst, it caused mass defaults in loan repayments: in most cases, this was because the market value of the property became lower than the loan amount. This was the starting point the global financial crisis in 2008.

MISFA has 7 member MFIs,<sup>26</sup> which offer:

- Group loans: \$300-700 for 6-12 months
- Individual loans: typically \$300-500 upto \$7,000, for <3 years
- 66 percent of their borrowers are women
- Portfolio at risk (30 days): 13 percent
- Total 230,000 current borrowers, and 330,000 clients
- Total outstanding loan portfolio: \$105 million
- Loan outstanding per borrower: \$455

First Microfinance Bank (FMFB) is a member of MISFA, and the only licensed MFI in Afghanistan.

Key highlights of FMFB include:

- Portfolio has tripled over the past 6 years.
- Seventy percent of FMFB's loan portfolio constitutes SME loans (\$10,000-\$100,000 in size), with a guarantee provided by GIZ.
- FMFB is the currently the only MFI offering HMF – housing improvement loans of \$1,000-5,000 for up to 2 years. HMF constitutes 17 percent of the FMFB portfolio.
- Loan default rate less than 2 percent.

According to a senior MISFA official, Housing Microfinance (HMF) is now a strategic area for the Facility. That said, the technical capacity of MFIs is still very limited. Also, the current security situation and cultural issues pertaining to the concept of 'loans' and 'interest' are constant challenges that the microfinance sector has to overcome.

*"In the face of so many grants, people do not treat loans like loans. Plus, the security situation limits movement, which restricts the MFIs' reach as well as their ability to collect repayments. Further, interest is still considered 'haraam', especially by people in the provinces and rural areas. Hence, 80 percent of the MFIs' loan portfolio is in urban areas."*

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<sup>26</sup> Recently, five previously-underperforming MFIs under MISFA were consolidated.

## IV. A WAY FORWARD

This section summarizes the three key steps necessary to enable the delivery of affordable housing in Kabul's market:

- (i) Reduce house costs;
- (ii) Facilitate private sector delivery of housing targeted to middle and lower income households;
- (iii) Deliver housing finance through more appropriate mechanisms;
- (iv) Implement a housing/ finance pilot project to test the delivery of an appropriate targeted housing intervention in Kabul. The principles that underpin the design of the pilot would have broad applicability to other cities in Afghanistan.

### A. Reduce house costs

- Explore **cheaper (alternative/ local) materials and technologies** (local mud technology, for example)
- **More efficient house design:** Compact (smaller unit size), and socially and economically appropriate for lower income households. In this regard, explore and compare benefits of: (i) high density low-rise, versus (ii) sites-and-services schemes with small serviced plots, versus (iii) high density walk-ups apartment and medium rise buildings (of a reasonable size, and with efficient and compact common spaces)

### B. Facilitate private sector delivery of market-based housing

- **Build capacity of developers** in market assessment, alternative technologies, design, financing: training modules implemented through the Afghanistan Builders' Association; Study tours to share the experience of India in lower income housing market development. This is to help them move down-market to address the demand of the middle and lower income segments (those earning \$300-\$3,500/m). This will allow the government to focus its scarce resources on subsidy programs for the low income (HHs earning less than \$300/m) and the poor (HHs earning less than \$100/m).
- **Provide incentives** (financial, others) to developers to move down-market, such as tax breaks, cheap land (as in a public-private partnership).

### C. Deliver housing finance through more appropriate mechanisms

- **Housing microfinance** for home construction and home improvement. Consider working with FMFB as a potential partner in developing a housing microfinance product that is perhaps larger in size with a longer loan duration.
- Explore the possibility of **expanding the reach of conventional mortgage instruments** through guarantee schemes etc., and **small mortgages targeted** at (qualified) lower income households
- **Islamic banking**

### D. Implement a pilot housing/ finance project

A complex housing market such as Kabul's requires a range of housing options that cater to the needs of all income groups in terms of 'housing' as well as 'housing finance' products. Figure 3



illustrates the sorts of housing and finance interventions/ products that may be explored. As shown, Income Tiers 3 and 4 (monthly household income \$300-1,500) present the highest potential for a pilot demonstration project, where market-based solutions can be tested for housing (e.g. Core housing – sites and services projects; small format apartments), and housing finance (small-ticket mortgages, and housing microfinance).

**Figure 3. Housing and Finance Options to be explored**

