THE EXTENT TO WHICH THE NATURE OF EMPLOYMENT DETERMINES THE USE OF MORTGAGE AS A SOURCE OF FINANCE IN NANDI SOUTH DISTRICT

Dr. Joseph Okumu Otsyulah, PhD & Carolyne Kerubo Gesimba

The Strategic JOURNAL of Business & Change MANAGEMENT
ISSN: 2312-9492 www.strategicjournals.com
Vol. 10, Iss.2, pp 1397 – 1407. June 20, 2023. www.strategicjournals.com, ©Strategic Journals

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[1] Otsyulah, J. O., & [2] Kerubo, C. G.

[1] Senior Lecturer, Kaimosi Friends University College, Kenya
[2] MSc, Part time Lecturer, Kaimosi Friends University College, Kenya

Accepted: June 3, 2023

ABSTRACT

Owning a standard house is one ambition that most Kenyans share. Every Kenyan, formally or informally employed strive to have a place to call home. The Kenyan Government established a National Housing Cooperation to perform duties and have the powers conferred on it by the 'The Housing Act' (The Housing Act, Chapter 117, section 3). The roles of the cooperation include the development of decent and affordable housing and facilitation rural housing development. The vision of NHC is "A decently housed Nation". The objective of this study was to determine the extent to which the type of employment influences the use of mortgage as an option for financing housing projects in Nandi South District. The study was conducted in Nandi South, Kenya. The target population was the current home owners. The study adopted a descriptive approach. Data presentation was done in tables after using questionnaires to collect the data. The analysis was done with the aid of SPSS. From the data collected and analyzed, it was observed that mortgage financing has not explored the rural market. The mortgage market should reduce their interest rate, increase the repayment period to reduce the monthly repayments and provide low-cost housing in order to compete with other methods of financing like SACCOSs.

***Key Words:** House Ownership, Housing Finance, Housing Development, Affordable Housing, Employment, Mortgage*

CITATION: Otsyulah, J. O., & Kerubo, C. G. (2023). The extent to which the nature of employment determines the use of mortgage as a source of finance in Nandi South District**.** *The Strategic Journal of Business & Change Management,* 10 (2), 1397 – 1407.

INTRODUCTION

The Kenyan Government established a National Housing Cooperation to perform duties and have the powers conferred on it by The Housing Act. Among the roles of the cooperation include the development of decent and affordable housing and to facilitate rural housing development (NHC, 2010). The vision of NHC says it all, "A decently housed Nation".

Owning a home is a long-term commitment that one should be careful when getting into. There are several factors that are considered in acquiring a mortgage.

The amount borrowed is determined in part by the down payment required by the lender. The minimum down payment is based on the lenders desired loan-to- value ratio which is calculated by dividing the maximum amount the lender will loan on a piece of property by the property purchase price. The lender limits the amount that it will risk on a mortgage to ensure that it will recover the debt if the loan goes into default (German, 2000). The lack of affordability is a combination of factors which includes the low levels of income, especially in rural area and the high and volatile level of inflation and relatively high margins charged by banks. Issues of the supply side also create a price barrier for many, where the cost of even the most basic new house is out of reach for the vast majority (World Bank, 2011).

The Interest rates impact on the monthly payments and hence the borrowers need to shop for a mortgage that has a low interest rate. The lower the interest rates on the mortgage the smaller the monthly mortgage payments. The Interest rates impact on the monthly payments and hence the borrower needs to shop for a mortgage that has a low interest rate. The lower the interest rates on the mortgage the smaller the monthly mortgage payments. Even a slight increase (such as 0.5 percent) in the interest rate increases the monthly mortgage payment (Madura, 2004). Home owners may find it advantageous to refinance a mortgage when interest rates decline. In mortgage refinancing, a new mortgage is obtained to pay off and replace an existing mortgage (German, 2000).

Interests rates are a key determinant of losing affordability, changes in interest rates can play have on the ability of families to afford the house of their dreams or even one that only make inroads towards a dream. When a young family is stretching to get into a first house, even a relatively small increase in interest rates can cause the house to be less affordable and may even result in rejection of the couple's loan application. (Harold, Vickie & Karrol, 2000).

A Central Bank of Kenya report (2011) highlighted that the potential mortgage market in Kenya is worth around Sb. 1.1 billion. However, the survey said the market was crippled by among other factors, high interest rates. This, the report noted, had made Kenya's total mortgage debt to stand at only 2.4 percent of gross domestic product compared to South Africa's 30 percent. High interest rates are not only bad for borrowers, but also for the whole market. For instance, as a result of high interest rates in the 1990's a large number of loan recipients defaulted, leading to repossessions of their properties which were eventually auctioned (CBK, 2011). There is no need for mortgage lenders to fear going for the "mass market". With reasonably low interest rates banks can be sure for attract more mortgage takers. They can still make smart profit that would not only come from a few privileged Kenyans but from the volumes they would steadily grow as a result of low mortgage rates. It still makes good sense, doesn't it? (Ayieko, 2011).

Interest rates can be classified into Fixed Rate and Adjustable Rate Mortgages. The attractiveness of these two different types of lending instruments depends greatly on economic condition and buyer perceptions regarding the direction of future interest rates changes and price appreciation. Since the prediction of future interest rates in difficult for even most informed financial experts, a prospective buyer needs to determine which mortgage type is better given individual financial circumstances and personal risk tolerances (Harold, Hampton & Kin, 2000). Fixed mortgage rates are suitable for those who need stability and fear that any increase will make the house unaffordable.

Those who can be flexible will choose ARM since the initial low interest rates is a motivator during the first few years of their home purchase. Due to added risks inherent in ARMs, the buyer needs to fully understand just how high and how fast his interest rates can rise. This is why it is important to read the contract thoroughly and choose an ARM that has competitively low caps on annual and overall interest rate increases. Part of the interest rate is transferred from the lender to the borrower (Mbugua, 2004).

The repayment period will also affect the monthly payment. For loans with the same interest rate, a longer term of repayment results in smaller payments. Ironically, more total interest is paid over the longer repayment time period despite the lower monthly payments. Some mortgage borrowers opt for a mortgage loan with comparatively short maturity like 15 years. Its advantage includes a faster build up on equity, lower total interest and a quicker pay off of the loan.

Statement of the Problem

According to the National census of 2009, the housing standards in Nandi South District are low. There is no viable market in the rural areas given the low levels of income together with the high costs of distribution network. The potential size of the mortgage market is around Ksh. 800 billion, around 13 times the current level.

Despite the available mortgage products, residents of Nandi South District have continued to live in houses whose standards are poor. According to GoK sub-standard houses lack dignity, security and privacy to the individual, the family, and community as a whole. On the other, adequate shelter prevents social unrest occasioned by depravity and frustrations of people living in slums and informal settlements. Besides these social functions, housing is also an investment good contributing both directly and indirectly towards poverty eradication through employment generation, raising of incomes, improved health and increased productivity of the labor force.

While much has been said about non-viability of the mortgage market in rural areas, none of these factors had been verified empirically from the rural residents of Nandi South District who may have wanted to own houses for residential and commercial purposes. This constituted a gap which this study sought to bridge by establishing the determinants of acquisition of mortgage financing in housing projects among the middle-income home owners in Nandi South District.

Objective of the Study

To establish the extent to which the nature of employment determines the use of mortgage as a source of finance in Nandi South District.

LITERATURE REVIEW

Perfect Capital Market Theory

The theory of perfect capital markets is the starting point of understanding investment decisions and how they should be made (Dixon, 2000). The perfect market is an economic model based on a set of assumptions, the objective of which is to help explain how businesses make their decisions. The major assumptions are that an individual can borrow or lend as much money as he wants at a common rate of interest which does not vary over time, there are no transaction costs associated with raising finance for investment and the market does not experience inflation or taxation. The implication of this form of capital market is that any investment opportunity which is deemed to be profitable should be undertaken since the firm has to access to as much capital as it requires.

In reality capital markets are not of course perfect nor could such market could ever exist in the real world. The chief objection to the perfect model is not that taxation and inflation do not exist. These assumptions are made to simplify reality; they do not challenge the validity of the model, for the model could be redesigned to allow for these variables. It would merely make it more complex. The real objections are that interest rates are not available at uniform rates and that loans are not available in limitless amounts. It was in response to these objections that the imperfect capital market theory was formulated.

The Imperfect Capital Market Theory

This refines the capital market theory by stating that there is no single market rate of interest. Interest rates are likely to be available at a range of levels. In practice, this will mean that the finds available to business for investments purposes will be limited. The corollary of this is that the investment managers will have to be more discerning; that is they will have to decide which investment opportunity is most profitable over its whole life. Investment opportunities will have to be graded in terms of their desirability. The timing of cash flows as well as the total sum of cash returns will have to be considered. Thus the imperfect capital market model is a starting point for the realization that investment decisions are made on the consideration of a number of factors (Pandey, 2010).

The Capital Structure Theory

The capital structure of a firm is an area of great debate among academics. The battle lines arc drawn between those who take what is known as "traditional approach" and those who follow the arguments of MM. traditionalists argue that the cost of capital is dependent upon the capital structure of the firm, and that there will therefore be some optimal capital structure which will minimize the cost of capital. Consequently, they argue, the financial manager should try to identity and aim for the best possible mix of different types of equity and debt finance. M&M supporters on the other hand maintain that the cost of capital is independent of capital structure so that there is no point in trying to identify an optimal capital mix because such a thing does not exist.

This study will be based on the imperfect capital market theory which confirms that investment decisions will have to be made in consideration of a number of factors. Among the factors to consider when investing in housing project include: the interest rate, the repayment period and the regularity of income. This study will particularly, consider mortgage financing as a method of financing housing projects.

Mortgage Financing

A mortgage loan is a loan to purchase real estate in which the real estate itself serves as collateral. (German, 2000) A mortgage is a transfer of a legal or equitable interest in a specific immovable property for the payment of a debt. In case of mortgage, the possession of the property may remain with the borrower, with the lender getting the full legal title. The transferor of interest (borrower) is called the mortgagor, the transferee (lender) is called the mortgagee and the instrument of transfer is called the mortgage deed, (Pandey, 2010). Through a mortgage broker and for a fee, one is able to shop and finance a home purchase. In exchange for the loan, the mortgagee has a lien on the property in the event that the mortgagor defaults the loan. This happens after a foreclosure (German 2000). A mortgage loan is paid off gradually through a amortization. The larger the mortgage amount, the larger the monthly payments (Madura, 2004). Each monthly mortgage repayments represent a partial equity payment that pays a portion of the principal of the loan and an interest payment. There is also a tax components and insurance.

The prevailing interest rates could be a determinant in choosing mortgage financing as an option for housing projects. Interest rates refer to money charged by a lender for the use of borrowed hinds as a percentage of the borrowed amount. The rates in Kenya vary from 12.2% to 14.1%. The rates in Kenya are either fixed or Adjustable.

The Repayment period is another factor to be investigated. This refers to the period a mortgage takes to completely pay off a mortgage loan. According to the Housing Act of Kenya, the maximum Repayment period is 40 years, though most banks take 5 years to 25 years.

The type of employment will also be a factor to be considered in the study, the type of employment can be formal or informal. This study targets the middle-income earners. Formal employment here refers to a type of employment where the wage or salary is regular and can be predicted. For informal employees, the income could be irregular and not easily predicted accurately.

METHODOLOGY

The research design was descriptive in nature. A descriptive design is concerned primarily with addressing the particular characteristic of a specific population of subjects either at a fixed time or at varying times for comparative purposes (Gill and Johnson, 2010). This study sought to collect facts and information on the determinants of acquisition of mortgage finance in housing projects among the middle-income home owners in Nandi South District which is a rural area. The result was then used to compare urban and rural mortgage financing. According to (Hartley 2004) descriptive research often goes beyond 'fact gathering' and may be used either as a diagnostic device prior to change or to facilitate changes through the feedback of findings and the monitoring of progress towards particular strategic goals. It should be thought of as a means to an end rather than an end itself (Saunders, Lewis and Thornhill, 2003). The main characteristic of this design is that the researcher has no control over the variables but is only able to report what has happened or what is happening.

Selection of site is essential since it influences the usefulness of the information produced (Kombo & Tromp, 2011). This study was carried out in Nandi South District in Kenya. This is because Nandi South is a rural area and has middle income earners who are formally / informally employed. There are teachers and other civil servants in the area. This is also an area with many prominent farmers, businessmen and athletes who are capable of financing housing projects using mortgage financing, yet they stay in sub-standard houses (Census, 2009). The local was ideal since it is where the researcher resided.

A population is a complete set of individual cases or objects with some common observable characteristics (Mugenda & Mugenda, 2003). The people a researcher selects as respondents in the study are vital in achieving the set objectives, (Kombo & Tromp, 2011).

The target population in this study consisted of 30,643 house owners in Nandi South District, which is the number of households according to the census of 2009. This population was handy in achieving the objectives of the study since it is a rural area that has not benefited from mortgage financing (World Bank, 2011). The district has residents who are formally/informally employed and have middle income earning. The housing standards in the area are also low as per the national census us of 2009.

A sample design is a definite plan for obtaining a sample from a given population (Kothari, 2011). The respondents selected should be as representative of the total population as possible in order to produce a miniature cross section. This study adopted a stratified sampling technique. The target population was divided into households that are; permanent (stone, block/brick), semi-permanent (mud/cement, mud/wood) and temporary (wood, corrugated iron sheets, grass/reeds, tin, others). This information was used in stratified sampling.

According to Kothari (2011), proportional allocations were used to determine the sizes of the samples from each stratum.

Table 1: Population

Stratum	No. of households in each stratum	Proportion of the population in the strata	Percentage population in the strata
Permanent buildings	2,562	0.084	8.4%
Semi-permanent buildings	27691	0.904	90.4%
Temporary buildings	390	0.012	1.2%
Total	**30,643**	**1**	**100%**

Since the household population was more than 10,000, Mugenda and Mugenda (1999) states that 384 sample is enough. The sample size per stratum was determined by the following formulae

n i = n.pi

where i = 1,2,3

pi = proportion of population included in stratum i

n = total sample size desired by researcher (384)

Table 2: Sample Size

Stratum	Proportion of population in strata i (p_i)	Sample size ($n.p_i$)
Permanent buildings	0.084	32
Semi-permanent buildings	0.904	347
Temporary buildings	0.012	5
Total	**1**	**384**

Questionnaires were used to collect data. Questionnaires have an advantage of covering a large area hence saving on time (Kothari, 2004). Since they are presented in paper format, there is no opportunity for interviewer bias (Kombo & Tromp, 2011). This implied that all information received was a true picture of the situation in Nandi South District.

Internal validity in relation to questionnaires refers to the ability of the questionnaire to measure what it is intended to measure (Saunders, Lewis & Thornhill, 2009). Often, when discussing the validity of a questionnaire, researchers refer to content validity, criterion related validity and construct validity (Cooper & Schindler, 2008). Content validity refers to the extent to which the measurement questions in the questionnaire provide adequate coverage of the investigative questions. Criterion related validity is concerned with the ability of the questions to make accurate predictions. Construct validity on the other hand, refers to the extent to which the measurements questions actually measure the presence of those construct they are intended to measure.

Validity of the questionnaires was done with the help of a pilot study that was conducted on five per cent of the population. This pilot study enabled the researcher to establish the questions that were not necessary in the study. The questionnaire was further improved by a panel of expert lecturers during defense. Reliability of the study addresses similarity of the results through repeated trials, (Mugenda, 2003). A pre-test was done to assess clarity and effectiveness of the questions. Critical analysis of the responses from the questionnaire in terms of the consistency were made, making judgments on their degree of reliability, after which, necessary changes were made to improve on the quality of the questionnaire and improve its reliability.

The questionnaires were administered by the researcher and her assistants to the respondents. The researcher went personally to the target homes and administered the questionnaires to the home owners. This accorded the data collector the opportunity to introduce the research topic and to motivate the respondents to offer their answers frankly. Where respondents were illiterate, the data collector assisted the respondents in filling the same. The questionnaires were then picked on the same day.

After data collection, coding of the data was done for easy analysis. Quantitative techniques, mean, standard deviation and variance were used. For presentable, elaborate and accurate analysis, the researcher employed descriptive statistics with the aid of Statistical Package for Social Sciences (SPSS). The software is complete and designed to solve statistical problems to analyze quantitative data of studies. The data is presented in tables. The SPSS package was useful in generating figures that are used in portraying the results.

RESULTS

Financing Method Used in Housing Project

In this section the researcher sought to find out the method that was used to finance the housing projects. It was important to determine whether the home owner had approached any financial institution for a mortgage loan. It was also crucial that the reasons behind the preferred method be exposed.

Type of Houses owned

The researcher wanted to find out the type of houses that were owned by the respondents. The results were as shown in the table below.

Table 3: Type of Houses owned

Type of house	Frequency (N)	Percentage (%)
Permanent	56	22.7
Semi-permanent	156	63.2
Temporary structure	35	14.1
Total	**247**	**100.0**

Most middle-class home owners had semi-permanent buildings63.2%. Those with permanent buildings and temporary structures were 22.7% and 14.1% respectively. Clearly, there is need of financial support in Nandi South District when it comes to housing projects.

Respondents who used acquired mortgages in their projects

The researcher wanted to know the home owners who had used mortgage in their projects. The results were as shown under.

Table 4: Home Owners Who Had Used Mortgage

Used mortgage finance	Frequency (N)	Percentage (%)
Yes	15	6.1
No	231	93.5
Missing	1	0.4
Total	**247**	**100.0**

A very small percentage, only 6.1% had used mortgage financing in their projects. A higher percentage, 93.5% had used other methods in financing their projects. A mean of 1.9797 confirms this. This is further corroborated by the standard deviation of 0.31879 and a variance of 0.102 from the table above. This is a clear indication that mortgage financing is not utilized fully in Nandi South District. There is a combination of factors attributed to this:

According to World Bank (2011) survey report, there is no viable market in rural areas given the low level of income together with high costs of distribution network.

Home owners who approached financial institutions for mortgage loans

The researcher sought to find out the number of respondents who approached any financial institution for a mortgage loan. The following were the findings.

Table 5: Home owners who approached financial institutions

Used mortgage finance	Frequency (N)	Percentage (%)
Yes	37	15.0
No	205	83.0
Missing	4	1.6
Total	**247**	**100.0**

From the findings in the table above, majority of the home owners, 83% did not approach any financial institution for a mortgage loan, only 15% of the respondents had approached a financial institution for a mortgage loan. This is a clear indication that the mortgage industry has not moved downstream and is not popular among the rural residents.

Preferred Financing Method by Home Owners

The researcher sought to find out the financing method that respondents preferred in their housing projects. The findings were as shown below.

Table 6: Preferred Financing Method

Preferred financing method	Frequency (N)	Percentage (%)
Mortgage	17	6.9
Sacco Loan	62	25.1
Own Saving	125	50.6
Bank Loan	24	9.7
Micro Finance	19	7.7
Total	**247**	**100.0**

From the table above most home owners 50.6% preferred using their own savings to finance their housing projects. This was followed by those who preferred SACCO loans. Bank loans, Microfinance loans and Mortgage Loans at 25.1%, 9.7%, 7.7% and 6.9% respectively. Clearly, mortgage loans are the least popular in Nandi South District. Increasing accessibility and introducing innovative ways of marketing can easily improve the popularity mortgage preference by the rural community. This is also confirmed by the (Republic of Kenya, 2004), which asserts that at the institutional level, the rural community dependence on informal credit mechanisms. This will be achieved by encouraging rural-based non-governmental organizations to work closely with community based-organizations.

Reasons for preferred Method

The respondents were asked to give their main reasons of preferring the methods of financing. The responses were as the table below:

Table 7: Reasons for preferred Method

Reason for preferred method	Frequency (N)	Percentage (%)
Other	9	11.7
Lower Interest	78	31.6
Friendly repayment period	34	13.8
Fewer requirements	47	19.0
Easier accessibility	55	22.3
Friendly monthly installments	4	1.6
Total	**247**	**100.0**

From table above, findings indicate that majority of respondents 31.6% prefer low interest rates followed by easiest accessibility at 22.3%, fewer requirements at 47(19.0%), friendly repayment period at 13.8% and others at 11.7%. This implies that there is need for institutions offering mortgages to lower their interest rates to compete with other institutions. Easy accessibility should also be ensured. The mortgage institutions should also flex the requirements for mortgage loans.

Nature of Employment

The researcher sought to determine the nature of employment of the middle-income home owners in Nandi South District. The findings were as under.

Table 8: Nature of Employment

Nature of Employment	Frequency (N)	Percentage (%)
Missing	12	4.9
Formal	143	57.9
Informal	92	37.2
Total	**247**	**100.0**

From the above findings 5 7.9% of the respondents are in formal employment while 3 7.2% are in the informal sector. This is an indication that both sectors are conscious about investing in housing stock and are therefore a potential mortgage market.

Monthly income of the Respondents in €

The researcher sought to find out the amount of income earned by the respondents and table below shows the findings.

Table 9: Monthly income

Monthly income	Frequency (N)	Percentage (%)
0-15000	81	32.8
16000-30000	71	28.7
31000-45000	59	23.9
46000 and above	34	13.8
Missing	2	0.8
Total	**247**	**100.0**

The findings indicate that 32.8% are in the income bracket of O-15,000, 28.7% are in income bracket of 16,000- 30,000, 23.9% are in the income bracket 31000 - 45,000 and 13.8%. Cumulatively, 66.4% of the respondents are in the income bracket of 16,000 and above. From table, the mean monthly income is 2.19 indicates that the income of most respondents ranges between 31000 and 45000.The standard deviation of 1.47 and the variance of 1.096 implies that a reasonable number falls outside the bracket. This is a pointer to the fact that that majority of respondents can afford a mortgage for home ownership.

Monthly Installments Comfortably Payable

The researcher wanted to find out the monthly installments that the respondents could easily pay in case they were to access a mortgage loan. The results were as shown below.

Table 10: Monthly Installments Comfortably Payable

Monthly installments	Frequency (N)	Percentage (%)
0-15000	156	63.2
16000-30000	35	14.2
31000-45000	35	14.2
46000 and above	12	4.9
Missing	9	3.6
Total	**247**	**100.0**

From the above findings, majority of the home owners (63.2%) were comfortable with installments below 15000 KES. A small percentage (4.9%) felt that they were comfortable with repaying 46000 KES and above. This is a pointer to the fact that mortgage institutions can sell well if they offer low-cost housing or stretch the repayment period. This is in harmony with the World Bank Report, 2011 where the non-viability of the mortgages in rural areas was attributed to low income.

Problems in Loan Acquisition

The researcher sought to find out whether the respondents had experienced problems in loan acquisition or application because of nature of employment. The results were as follows;

Table 11: Problems in Loan Acquisition

Response given	Frequency (N)	Percentage (%)
Yes	118	47.8
No	129	52.2
Total	**247**	**100.0**

Majority of the respondents (52.2%) had never experienced any problem related to their nature of employment when applying for a loan. However, 47.8% of the respondents had experienced a few problems. This clearly indicates that the nature of employment has no major role with regards to mortgage loans applications. However, it cannot be totally ignored. Those in the informal sector had to pass through a hard time since their credit history proved to be a controversial issue.

SUMMARY

Most of middle-class income earners were in the informal sector. These informal workers had sufficient income to enable them acquire mortgages. As compared to their formal counterparts, they were doing well financially but were not utilizing mortgage financing. This is a market that is yet to be tapped by the mortgage industries. The potential market, according to the World Bank is 13 times the current market.

CONCLUSION AND RECOMMENDATIONS

The mortgage markets as not hit its full potential in Kenya. Nandi South District, in particular has not utilized this method of financing. Those who acquire mortgages are very few and located in the urban areas.

On employment status, the informal sector is doing well in terms of income generation. This implies that the informal sector should be considered seriously by mortgage industries. There should be credit bureaus to establish the credit history of those informal employees if this is a threat to be concerned about. Those in the formal employment were the home owners at forty-one to fifty years. This implies that the home ownership aspect did not ring in their minds in their early years of employment.

To ensure that National Housing Corporation is in line with its vision, ‘A decently housed nation’, it should move its services downstream to the rural areas like Nandi South District. It should partner with other mortgages providers to ensure that mortgage financing do not only benefit to urban dwellers only but also the rural residents.

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