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microNOTE 26
Expanding Microfinance for Housing

This microNOTE offers a brief introduction to microfinance for housing: the institutions involved, typical loan products, the constraints on its expansion to more meaningful scale, and the greater role it could play in relieving the shelter problems of the poor.[1]

March 2007

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U.S. Agency for International Development
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WHAT IS MICROFINANCE FOR HOUSING?

Microfinance for housing (MFH) is a subset of microfinance, designed to meet the housing needs of the poor and very poor, especially those without access to the banking sector or formal mortgage loans. MFH is designed for low-income households who wish to expand or improve their dwellings, or to build a home in incremental steps relying on sequential small loans. MFH differs from formal mortgage lending in a few key ways: the loans are smaller, and they are for shorter terms; most important, they are usually not collateralized by the property. MFH clients generally cannot qualify for formal mortgage loans for a variety of reasons, including low income, informal sources of income, lack of land title, and inability to meet formal building standards. In many ways MFH loans are similar to microenterprise loans. Underwriting is generally based on assessment of the applicant's ability to pay (cash flow) and assumed willingness to pay (character assessment). However, MFH loans are generally larger and of longer duration. In some cases, housing and microenterprise loans may be indistinguishable. Many microbusinesses are conducted in whole or in part from the home, and many microlenders have learned that some portion of their loans are being used for housing improvement.

[1] The microNOTE draws from *Housing Microfinance: A Guide to Practice* (Bloomfield, Connecticut: Kumarian Press, 2004), edited by Franck Daphnis and Bruce Ferguson, particularly from Chapter 3 by Alejandro Escobar and Sally Merrill, "Housing Microfinance: The State of the Practice." To update this information, we have carried out brief surveys of selected institutions involved in MFH. All dollar figures are in U.S. dollars.

Who Offers MFH?

MFH is offered by a wide variety of institutions, including microfinance institutions (MFIs), banks, non-bank financial institutions (NBFIs), cooperatives, credit unions, and nongovernmental organizations (NGOs). A major distinction can be made between financial institutions (MFIs, banks, and NBFIs) that offer MFH as part of their primary mission to provide financial services and institutions that offer MFH as part of their primary mission to improve the shelter situation of the poor.

Microfinance Institutions

Microfinance institutions enter the housing lending market for a variety of reasons: to meet client demand, to diversify their product line, or to benefit from government or donor incentives for slum upgrading or shelter provision programs. MFIs that have already developed a strong capital base and a history with individual lending products are well placed to succeed this market. The MFIs interviewed for this microNOTE include BRI (the Bank Rakyat Indonesia), Grameen Bank, SEWA (Self-Employed Women's Association in India), the ACCION network in Latin America, UML (Uganda Microfinance Limited), CARD (the Center for Agriculture and Rural Development in the Phillipines), K-Rep (Kenya), and Jamii Bora (Kenya).

Micro Housing Lenders. The second group of institutions, whose primary focus is improving shelter, are often NGOs or NBFIs that have developed to conduct the savings and lending operations for housing NGOs. In our survey, this group includes Kuyasa Fund, SPARC, and NACHU.

There are also several network NGOs providing low-income housing solutions, including Habitat for Humanity (HFH) and CHF International. These groups offer affordable pricing while partnering with experienced microlenders and commercial banks. For example, CHF International is entering the Ghanaian market by partnering with a local mortgage lender to service microfinance and home improvement loans to low-income clients. By capitalizing on CHF's experience with microfinance and housing, the bank was able to expand into new markets with a new operating model without risking their existing lines of business.

How Does MFH Work?

Loan Products. MFH loans can be used for home improvement, incremental building, new construction, at-home production and storage, or home purchase. As shown in Annex Table 3, there is great variability in loan amount, terms and conditions. Home improvement loans are typically short- to mid-term loans ranging from three to 36 months, with some institutions offering up to 60 months. Although SEWA and Grameen do offer loans of up to 10 years, their average loan is of shorter duration.

Underwriting. Underwriting for MFH products currently uses traditional microfinance models to evaluate ability to repay (cash flow and character assessment). MFIs also use a variety of approaches to reduce credit risk on their MFH portfolio. Lenders may rely on mandatory savings over a specified period, membership in savings groups, co-signers, or previous success with microenterprise loans as increasing the likelihood of repayment.

Funding. Many MFIs that provide housing products have access to commercial financing or deposits. These institutions demonstrate strong middle management and solid internal controls, and can compensate for the costs of introducing a new product. Mibanco in Peru and BancoSol in Bolivia are deposit-taking institutions with a return on assets of 6.74 percent and 1.42 percent, respectively, that have successfully introduced multiple housing products (see Annex Tables 2 and 4). However, not all institutions introducing housing finance are fully sustainable. Many shelter-focused institutions receive donor aid in order to provide more affordable products to a target population. SPARC, a housing NGO in India, used donor funds from CLIFF[2] to provide critical bridge financing for a construction finance loan from ICICI bank in India (see text box).

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[2] The Community-Led Infrastructure Finance Facility, which depends on donor and foundation funds.

MFH: DEMAND AND SUPPLY

Customer Demand for Microfinance for Housing

MFI customer surveys have shown strong demand for housing microfinance, and this demand is reflected in the growth of housing portfolios when they are introduced by strong institutions. ACCION's network in Latin America has achieved notable growth over the past three years, as the housing portfolio jumped from US$38 million in December 2002 to US$117 million in December 2005, an annual compounded growth rate of 49 percent. ACCION affiliates that offer MFH report 18.7 percent of their total portfolios in housing products. Home improvement loans, versus new construction or mortgage loans, represent 62 percent of this portfolio. Yet, across the entire ACCION network, the housing portfolio is only 5.7 percent of the total. Such figures suggest that MFH is a growth opportunity for MFIs.

Institutions like Mibanco and BancoSol have also demonstrated the popularity of the product among clients. The housing portfolio of BancoSol in 2005 reached 35 percent of the total portfolio, and Mibanco's MFH portfolio reached more than 15 percent of its total. SEWA Bank, in India, increased its housing lending by 55 percent in 2005. SEWA notes that they maintain a special focus on housing loans, as many low-income clients use their homes to conduct their businesses. In Indonesia, although MFH represents only 1 percent of BRI's total portfolio, the magnitude is very large ($85.6 million). UML, in Kenya, introduced a pilot housing loan project in 2004, and launched the product in 2005. It has already grown to represent 10.6 percent of UML's portfolio. UML feels that its housing lending is limited by lack of medium-term funds. Similarly, in South Africa**,** Kuyasa Fund reports that demand for MFH is very high, although a lack of access to long-term capital prevents faster growth. Kuyasa's new housing lending was over $1 million in 2005, and expectations for 2006 are $1.7 million. Annex Table 4 offers figures on a sample of MFH portfolios.

Tentatively, we offer three conclusions:

- There has been ***significant growth in customer demand for MFH*** for the institutions which offer these products
- There has been ***steady growth in the number of institutions*** now offering MFH
- ***Housing microfinance remains a small portion of total microfinance industry lending*** and is still far from reaching scale.

Lines of Credit and Loan Guarantees

Lines of credit from commercial banks and other financial institutions are increasingly important for MFH. PRIDE Tanzania receives commercial lines of credit from the National Microfinance Bank and Azania Bankcorp, both in Tanzania. In other cases, commercial borrowing is facilitated by credit guarantees. SPARC used USAID's credit enhancement mechanism, the Development Credit Authority (DCA), as a partial guarantee for a large construction loan from ICICI Bank. The guarantee reduced the risk for the bank to enter this new market, increasing competition and expanding the availability of housing finance for the poor.

Institutional Supply of Microfinance for Housing

The major suppliers of MFH offer the products for a variety of reasons:

- Responding to customer demand and building customer loyalty
- Supporting dwellings that serve a dual purpose as a home and base for an enterprise
- Providing access to longer-term financing

From the perspective of the microfinance industry, the goal of MFH may be primarily to strengthen the institution's business, both by expanding its customer base and by fostering higher customer loyalty through diversified products. Grameen Bank in Bangladesh recognized customer demand for MFH some years ago and began offering housing loans as "rewards" for successful completion of microenterprise loans. Grameen recognized the emotional attachment that customers have to their homes as both the family's shelter and their key asset. Thus, MFH can strengthen ties between the customer and the lending institution, which reinforces customer loyalty and lifetime value to the institution.

For housing-focused lenders, the key aim of MFH is to provide affordable housing. The Kuyasa Fund in South Africa and the housing coop members of NACHU in Kenya pursue this objective. NACHU's loan products seek to address various aspects of housing: home improvement, new house construction, investment, resettlement, and infrastructure. Investment loans tend to go to coops wanting to add commercial building to provide rental housing and income generation, while resettlement loans are typically targeted to help squatters obtain their own land. These products may not be as profitable as the basic home improvement loan, but they can significantly improve the asset base of a household.

Funding for low-income housing may be part of a broader effort to improve the lives of slum dwellers. Increasingly, both donors and governments are seeking solutions that consider holistic slum upgrading. Jamii Bora in Kenya is now introducing housing development into its efforts to improve the livelihoods of slum dwellers, contending that land purchase and greenfield construction may offer long-term solutions. SPARC in India undertakes broad-based efforts to ensure basic infrastructure, provide multifamily housing, upgrade slums, and regularize informal settlements.

Finally, there is ample new action in MFH. In Mexico, Compartamos has a pilot project, and El Comercio in Paraguay plans to increase MFH following its successful pilot of a home improvement product. Sogesol in Haiti has launched its housing product, but continues to experiment with marketing strategies to increase uptake.

BARRIERS TO EXPANDING THE SUPPLY OF MFH

Has MFH been over-hyped? Can MFH become a large-scale product or will it remain relatively "boutique"? What are the issues in increasing scale? Constraints on the growth of MFH are noted below, including barriers at the institutional level, at the financial sector level, and at the shelter policy level.

Barriers to MFH for Individual Institutions

- MFIs lack knowledge of how to design and roll out housing loan products.
- MFH loans are viewed as risky compared with microfinance loans.
- Both MFIs and shelter-focused institutions need more long-term financing.
- Shelter-focused MFIs, many of which rely on grants and donor assistance, need help designing financially sustainable models.
- Shelter-focused NGOs without an effective financial arm are too often relegated to a grant-funded approach and thus fail to achieve scale.

Some Solutions to These Barriers

- Provide technical assistance to help institutions develop housing loan products.
- Demonstrate to MFIs that housing loans can be profitable (ACCION finds lower default rates for MFH than for its average portfolio).
- Help housing NGOs build financial management skills or partner with MFIs.
- Develop MFI-friendly regulatory frameworks and savings products to increase access to long term finance.
- Help MFIs train loan officers, add multiproduct specialists, and improve efficiency to allow loan officers more time for the credit evaluation process needed in housing.

Barriers to MFH in the Financial Sector

Major obstacles to scaling up housing finance include:

- Developing countries tend to have weak financial sectors and very limited mortgage finance sectors.

- MFIs have difficulty accessing longer-term funds, especially at fixed rates, causing an asset-liability mismatch.
- MFIs lack linkages to commercial banks, mortgage lenders, and capital market institutions, such as pensions and insurance companies.
- There is often no conducive regulatory framework that allows for sustainable interest rates, enables MFIs to collect savings, and facilitates access to lines of credit.

Some Solutions to These Barriers

- Increasing competition among mortgage lenders has led some to look downmarket for portfolio expansion and market share. Numerous formal financial institutions are partnering with MFIs to service loans to a low-income market.
- Some commercial banks now securitize MFI portfolios, such as ICICI Bank in India.
- Ensure that regulation of MFIs allows qualified institutions to capture savings.
- Use loan guarantees to reduce risk in the new product line and encourage lending by commercial banks, MFIs, NBFIs and NGOs.

Barriers to MFH at the Shelter Policy Level

Demand and supply for MFH are inextricably intertwined in the shelter policy context. MFH cannot thrive without a shelter policy that effectively addresses numerous challenges, including lack of access to urban land, scarcity of infrastructure, government failure to provide timely planning and zoning, and inadequate land titling and registration.

Tenure security is particularly important for the meaningful expansion of MFH. Households will spend to improve their housing if they have land with a sound title, or at least some documents supporting the case for tenure security; this phenomenon is recognized worldwide. Yet lack of title and ineffective title registration systems are serious problems in almost all emerging markets. These barriers inhibit the growth of formal sector mortgage finance, and in many cases limit the supply of MFH. Some MFIs will not lend for housing unless the borrower has adequate title (Annex Table 3). Demand for MFH is inhibited if a household fears being bulldozed or forcibly relocated, even if the title is not required as collateral.

MFH POTENTIAL IN SLUM UPGRADING AND SHELTER PROVISION

How Can MFH Make a Difference?

The United Nations Human Settlements Programme (UN-HABITAT) has estimated that one-sixth of humanity—1 billion people—now live in slums. Slum upgrading has become the focus of many national governments, megacities, donors, and international organizations, with major efforts being made by Cities Alliance; USAID; UN-HABITAT, via its Slum Upgrading Facility (SUF); and many others. Slum upgrading, however, has its own pitfalls, especially when there are severe shortages of both housing and serviced land. So-called rent-seeking behavior results in higher-income households simply buying out the lower-income groups that the slum upgrading program was designed to assist, while the targeted households often move and once again begin the squatting and slum-building process.

What role can MFH play in this difficult environment? It is now widely accepted that the financial sector and the microfinance industry should play a bigger role in housing. However, MFH is hardly a panacea for lower-income groups, especially given the problem of reaching meaningful scale. MFH needs to be developed in a context where it can be most effective. Major synergies can emerge when MFH is combined with secure land title and infrastructure provision to maximize household incentives to save and to borrow. Where feasible, government subsidies can be very helpful, but only if provided in a way that does not undermine householders' financial incentives.

If the problems of land supply, land title, and infrastructure are being addressed with government help, MFH can potentially play a meaningful role in supporting housing. Next, the question should be placed in the context of effective demand: what type of dwelling is involved, and what can the would-be borrowers afford? If the stated goal is a modest dwelling, MFH's ability to help address the affordability gap could be meaningful for modest and low-income households. However, MFH is not always suitable for the poorest of the poor, unless there is an infusion of public or donor funds as a supplement.

Broad-Based Shelter Programs with Private, Public, and/or Donor Involvement

The majority of MFIs provide housing loans as a stand-alone product, not necessarily connected to slum upgrading or greenfields housing programs. However, there are MFH lenders that focus on the supply side by working with developers, providing multifamily low-income housing, construction finance, and infrastructure. These projects generally have a mixture of private, public and donor involvement. SPARC has led the way in introducing new partnerships between developers, banks, donors, and slum dwellers. SPARC's goal is to address land and infrastructure barriers to low-cost housing through advocacy and practical action. K-Rep in Kenya focuses on construction finance. Jamii Bora plans to provide very modest housing outside the slums of Nairobi, for which members can invest sweat equity and ultimately purchase or rent.

ACCION notes that part of the growth in MFH lending has been fueled by government programs channeled through the microfinance industry. The "Techo Propio" program of the Peruvian government's Mivivienda fund targets lower-income families and complements the original Mivivienda product, which tended to reach somewhat higher-income segments. Techo Propio showed potential for success in mortgage loans for affordable houses, lending to 10,000 customers.

However, many microfinance institutions prefer not to rely on government programs, mostly due to the risk that the customers will assume the loans need not be repaid. For example, when residents learned that funds for the Hanna Nassif slum upgrading effort in Tanzania had been provided by the Ford Foundation, there was massive default. It is also costly for MFIs to comply with the additional bureaucratic procedures associated with these programs.

WHAT CAN POLICY MAKERS AND DONORS DO TO REDUCE CONSTRAINTS ON MFH?

Expanding the Number of Microfinance Institutions Offering MFH. Pilot projects, toolkit materials, training, and technical assistance can help bring more MFIs into this field.

Improving Formal Sector Markets. A first step is to link formal sector mortgage lenders with MFIs. Improving the primary mortgage market and increasing competition will assist in incentives for these linkages. Second, help the formal sector mortgage lenders increase their own access to liquidity and longer-term funds by developing secondary market funding capacity. At the simplest level, this involves establishing the legal framework for mortgage-backed debt, such as mortgage bonds, and permitting capital market institutions to hold a portion of their assets in this form. Alternatively, or in addition, strong microfinance institutions can be assisted in obtaining funds directly from domestic capital markets, either by issuing bonds or increasing their access to credit.

Improving Microfinance Regulation. Central banks in a number of emerging markets are establishing regulatory regimes tailor-made for microfinance. For MFIs to be properly regulated and supervised, they must have a sound, prudently managed capital base as well as transparent reporting and auditing procedures. Both should enhance an MFI's ability to raise funds. For example, PRIDE in Tanzania is soon to be registered under the Central Bank's new guidelines for micro institutions. PRIDE Tanzania already borrows from commercial banks and capital market institutions and will use the new regulatory environment to increase its ability to borrow and/or to take savings deposits. PRIDE plans to initiate MFH in 2007.

Comprehensive Shelter Policies. It is important to place MFH in the context of a comprehensive shelter policy. For example, the central objective of the UN-HABITAT SUF is to facilitate links among local actors and to package the financial, technical, and political elements of slum upgrading and low-income housing development so they can attract domestic commercial finance. SUF's partners include national and municipal governments, domestic and international NGOs, banks, mortgage lenders, MFIs, and capital market institutions. MFH can play a role in this context if the land title and infrastructure issues can also be addressed. SUF is now being piloted in Ghana, Kenya, Tanzania, Sri Lanka, and Indonesia.

Credit Guarantees. Credit guarantees—from commercial banks, formal sector mortgage lenders, and pension and insurance funds—can be used in many ways to leverage funding for both middle-market and low income-MFIs. USAID, the International Finance Corporation (IFC), the Overseas Private Investment Corporation, and others all use guarantees to leverage funds and provide financial sector incentives to catalyze increased MFH. USAID's DCA has been widely used to leverage funds, including for the mortgage market. IFC may introduce a secondary mortgage market development scheme—the Mortgage Funding Trust—in a number of African countries to kick-start the capital market funding process for local institutions. Guarantees could also facilitate interest rate swaps to mitigate interest rate or foreign exchange risk in order to address the issues involved in fixed vs. variable-rate lending and borrowing in foreign currency.

Viable Structures for More Complex MFH. Finally, it should be noted that projects which build multifamily housing, such as those of SPARC and UN-HABITAT, require more complicated processes and legal frameworks relative to single-family housing. Construction finance must first be secured, and then a number of issues may arise concerning the legal framework of ownership, condominium and coop law, and whether the units are for purchase, rent, or rent-to-purchase. The role for MFH is less clear within these large projects, and policy makers can be of assistance in helping to design viable structures.

Key Policy Implications

- Private sector actors, including banks and regulated microfinance institutions, have demonstrated their ability to deliver tailored housing products for economically active poor households if the regulatory framework allows free decision making about product pricing and loan product terms and conditions.
- Housing microfinance based on incremental building fills a critical need for the non-indigent poor and is commercially viable. Examples of successful housing finance programs that do not rely on any government subsidy and originate from private sector innovation are growing in number.
- Government subsidies can play a critical role in making affordable housing available for the lowest market segments (very poor economically active and the non-economically active).
- The most successful government initiatives in low-income housing are those that strategically use subsidies to encourage participation by the private sector—including land developers and financial institutions.
- Land titling is a crucial issue. Although not all micro lenders require title, studies are now showing that households are reluctant to invest without secure tenure.

DISCLAMER

The views expressed in this publication do not necessarily reflect the views of the U.S. Agency for International Development or the U.S. Government.

ANNEX

Table 1: Institutions Contacted for this microNOTE

Latin America and Central America		Asia and Africa	
Mibanco (Peru)	Bank	SEWA Bank (India)	Cooperative bank
Banco Solidario (Ecuador)	Bank	SPARC (India)	NGO
Integral (El Salvador)	Bank	Grameen (Bangladesh)	Specialized bank
BancoSol (Bolivia)	Bank	PRIDE (Tanzania)	MFI
Finamerica (Colombia)	NBFI	BRI (Indonesia)	Large MFI
Sogesol (Haiti)	Pilot phase	UML (Uganda)	MFI
FAMA (Nicaragua)	Transforming to a bank	Kuyasa (South Africa)	NBFI
		CARD (Philippines)	Bank
El Comercio (Paraguay)	Financial institution	Jamiibora (Kenya)	Foundation
Fundación (Santo Domingo)	MFI	NACHU (Kenya)	Apex for housing coops
Compartamos (Mexico)	Pilot phase	K-Rep – Kenya	Bank

Table 2: Sources of Funds

Type of funding	Banco Sol	SEWA Bank	SPARC	CARD Bank	BRI	Grameen Bank	Mibanco	NACHU	Kuyasa	FAMA
Mandatory Savings		X	X	X		X			X	
Deposits	X			X	X	X	X	X		X
Commercial Credit	X		X				X		X	
Donor Funds		X	X	X		X			X	X
Foundation Funds		X	X	X		X			X	X
Public Funds		X	X							
International Finance Corporation						X				
Credit Enhancement			X						X	

Table 3: Loan Features and Underwriting Requirements

Loan Feature /Institution	SEWA Bank	Grameen Bank	CARD	ADEMI	FUNHAVI	Kuyasa Fund	ACCION Latin America
Loan Size	$333 average; $4,444 max	$100–$600	$359	$4,000	$3,000	$700	$300 to $3,500
Maximum Term	120 months	120 months	12 months	36 months	20 months	24 months	120 months
Security	1 yr savings; 2 co-signers	5 co-signers	5 co-signers	Collateralized	2 co-signors	6 months savings	Mostly co-signer
Savings Required?	Yes	Yes	Yes	No	No	Yes	No
Linked or Stand Alone	Linked	Linked	Linked	Stand alone	Stand alone	Stand alone	Stand alone
Time with Organization	1 year minimum	2 years minimum	1.5 years	Not required		Not required	Not required
Gender-based?	Women only	Mostly women	Mostly women	No	No	Mostly women	No
Land Ownership	Not required	Required	Required	Not required	Not required	Required	Mostly not
Housing Technical Assistance	Assistance for illiteracy	No	No	No	Yes	No	Mostly not

Table 4: MFI Portfolios and Micro Housing Loans 2005

Institution	Total Portfolio	Total Housing Portfolio	Housing loans as percentage of total portfolio	Home improvement loans as percentage of total housing portfolio
ACCION Network offering housing loans	$624,324,129	$116,784,223	18.7%	62%
ACCION total Network	$ 1,340,000,000	$116,784,223	8.7%	60%
Mibanco	$206,729,374	$30,864,706	20%	50%
BancoSol	$130,106,032	$45,083,923	35%	50%
SEWA	$5,415,555	$1,638,812	27%	80%
BRI	$8,572,000,000	$85,300,000	1%	N/A
UML	$11,325,566	$1,223,204	10.8%	N/A
Kuyasa Fund	$2,970,000	$2,970,000	100%	50%