

Helping to Improve Donor Effectiveness in Microfinance

HOUSING MICROFINANCE

Inadequate sanitation and housing threaten the lives and health of some 600 million urban dwellers worldwide. Traditional housing finance has not offered products adapted to low-income people, but new providers are developing creative approaches to the problem. A range of financial institutions are applying good microfinance practice to housing finance, and are successfully delivering much-needed services to poor customers.

What is housing microfinance?

Housing microfinance consists mainly of loans to low-income people for renovation or expansion of an existing home, construction of a new home, land acquisition, and basic infrastructure (e.g., hooking up to city sewage lines). To date, most of the successes in this new field have been with home improvement loans. Land acquisition and new housing construction are still dominated by subsidies, rather than financial services.

Why is housing microfinance important?

The demand for housing microfinance is high. Indeed, microfinance institutions (MFIs) say that clients already channel a good portion of microenterprise loans to home improvement.

- Shelter is a **basic human need** that helps ensure personal safety and health. Housing microfinance offers small, incremental loans that fit with the way poor people build: progressively and over time.
- The home is a **personal asset** that usually appreciates in value over time. Thus, home improvement not only enhances living conditions, it is an investment.
- Microentrepreneurs often use their homes as **productive assets** in generating income. The home can be a place to produce goods, store inventory, and conduct business.

Who offers housing microfinance?

Housing microfinance comes in many forms and brings together a variety of actors, including urban developers, regulated financial institutions, government agencies, credit cooperatives, NGOs with an urban poverty focus, and MFIs. Traditionally, housing finance for low income people has been part of a slum upgrade or urban development strategy, with the financial service accompanied by construction assistance or land rights advocacy. Increasingly, housing microfinance is a loan product offered by an established MFI. Some MFIs offer construction advice or supervision, but many more do not. Construction assistance in the context of housing microfinance does not appear to be a predictor of financial performance.

What are the key features of housing micro loans?

Size	Varies, but generally 2–4 times larger than average working capital loans
Term	Usually 2–24 months for home improvements, and 2–5 years for land purchase or construction
Interest	Same as standard working capital loans or slightly lower
Delivery Method	Almost always provided to individuals, rather than to groups
Collateral	Mostly unsecured; co-signers often used; real guarantees may be used; formal ownership of dwelling or land may be required; savings sometimes used as a guarantee (may be compulsory)
Target Clientele	Low-income salaried workers; microentrepreneurs primarily in urban areas; poor people
Other Services	Sometimes accompanied by land acquisition, land registration, and construction (including self-help building techniques)

What are the challenges for expanding housing microfinance?

Limited access to medium- and long-term capital. Housing loans should be funded with capital that matches their longer term structure. Yet much MFI funding tends to be short-term—a year or less. And while some housing microfinance providers capture savings, they rarely collect enough to cover the demand for housing loans. Adequate funding instruments would allow institutions to expand their portfolios and avoid a mismatch between the source and use of funds.

Insufficient understanding of the appropriate relationship between subsidies and financial services. There are good reasons for governments to subsidize low-income housing. Housing microfinance can complement subsidies, but financial services should be kept distinct from the subsidy element. For example, in a slum improvement program, loans to individual slum-dwellers should be managed separately from state subsidies for infrastructure and sanitation. Most MFIs' comparative advantage lies in providing financial services, not administering subsidies. MFIs usually weaken themselves when they try to do both.

Insecure land tenure. In most developing countries, poor families do not possess formal proof of land ownership. While formal land titles are not necessary in housing microfinance, *land security* is essential. Households are more likely to invest in their homes when they know they will not be evicted. This security is also important for financial institutions' risk management.

What can donors do to expand sustainable housing finance?

- **Use appropriate technical expertise.** Donors working on urban development or housing projects with a finance component should bring financial service experts in from the beginning of project design.
- **Provide flexible funding mechanisms.** The donor community should offer diverse funding options (grants, loans, guarantees, or a mix of all three) that provide medium-term capital to institutions with a track record for providing housing microfinance. Where possible, donors should support links with domestic funding sources, rather than displacing local capital.
- **Fund product development for strong financial institutions.** Donors' funding agreements should be flexible enough to allow institutions to develop a variety of products beyond working capital loans. Though product development is not a donor activity, donors can help sustainable institutions introduce housing finance by funding market research, product design and pilot tests.

Following Hurricane Mitch, the Swedish development agency, Sida, gave FUSAI, a private non-profit organization in El Salvador, a revolving loan fund for construction and improvement of low-income housing. Sida's funds also supported strengthening of administrative systems, training, and loan marketing. Although FUSAI's mission is to provide integrated housing solutions, it separates its lending activities from its construction assistance and disbursement of state subsidies. In partnership with Duenas-Herrera Foundation, ACCIÓN International, and the Inter-American Development Bank, FUSAI established a new financial institution in 2002 to manage its loan portfolio: *Apoyo Integral, S.A. de C.V.*

- **Support research, innovation and dissemination of experiences.** Donors can fund new efforts to marry low-cost building technologies and financial services. They should distill lessons learned from pilot programs and disseminate them broadly. For example, the Cities Alliance, composed of bilateral and multilateral development agencies, sponsored a series of case studies—Shelter Finance for the Poor—to study and publicize housing microfinance techniques.

Authors: Bonnie Brusky with inputs from CGAP staff. **Sources:** Interviews with Kristina Boman, Warren Brown, Juan Buchenau, Karin Dahlstrom, Franck Daphnis, Ruth McLeod, Diana Mitlin, and Mohini Moholtra. See also Franck Daphnis and Bruce Ferguson, eds., *Housing Microfinance: A Guide to Practice*, (Bloomfield, Conn: Kumarian Press, 2004). **Where to go to learn more:** Center for Urban Development Studies, Harvard University Graduate School of Design, "Housing Microfinance Initiatives: Synthesis and Regional Summary" (paper for Microfinance Best Practices project, Development Alternatives, Inc., Bethesda, Md., May 2000). W. Brown, "Building the Homes of the Poor, One Brick at a Time: Housing Improvement Lending at Mibanco," *Small Enterprise Development Journal* 14, no. 1 (March 2003).

Web sites: www.chfhq.org; www.citiesalliance.org; http://www.iied.org/urban/pubs/hifi_news.html; www.theinclusivecity.org; <http://www.worldbank.org/urban/poverty/land.html#finance>.