



## SHOREBANK INTERNATIONAL

### **Framing the Debate: *Private Sector Involvement/Mainstreaming* – How can the private sector become more engaged in housing finance solutions for the poor? March 1<sup>st</sup>, 2007**

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This paper seeks to provide a framework to the *CGAP Working Group on Housing Finance for the Poor* for exploring how to leverage the private sector in developing and funding housing finance solutions for the poor. This paper reviews the importance of leveraging the private sector for this market segment and provides some examples of best practices private sector involvement and key elements for success. Finally, it poses additional areas for research and outlines possible approaches to developing scalable projects, which could be explored by the Working Group.

#### ***I. Why should we engage the private sector in developing housing finance solutions for the poor?***

##### **Additional financial resources:**

With a rapidly rising slum population globally, it will be necessary to significantly scale up slum improvement and other low income housing solutions to achieve the U.N. Millennium Development Goal: “*Achieve a significant improvement in the lives of at least 100 million slum dwellers, by 2020.*” Scaling up improvements for low income housing will require substantial financial resources beyond the capacities of local and central governments. ***Only by mobilizing private capital and enabling low income housing residents to improve their lives on a financially sustainable basis can we reach the scale to begin to tackle this global problem.***

##### **Source of innovative, disciplined approaches:**

Private sector approaches not only provide additional sources of capital but are a potential source of innovative, disciplined, and sustainable approaches. Private sector entities will review the strategic importance and operational efficiencies of a proposed new venture. If goals are not achieved a new product or approach may be scrapped.

##### **Potential for replication and scale in private sector:**

These disciplined, sustainable approaches provide a foundation for scale and replication. There are several other components to reaching scale to be explored as outlined under **Section III: Additional areas for research.**

#### ***II. What are best practices and promising trends in private sector engagement?***

SBI performed an inventory of best practices for leveraging the private sector for slum improvement as part of its Global Financial Innovations Partnership, a Global Development Alliance (GDA) with USAID. These are presented in the paper, [Scaling Up Slum Improvement: Engaging Slum Dwellers and the Private Sector to](#)

Finance a Better Future at the World Urban Forum in Vancouver in June 2006, jointly written by The Communities Group International and SBI. Other sources for lessons learned are highlighted under **Section IV: Resources**.

Some of the key questions we explored through our research and work under our GDA program included:

***Q: What is out there? Which approaches are working and which are not for large scale improvement of livelihoods of the urban poor?***

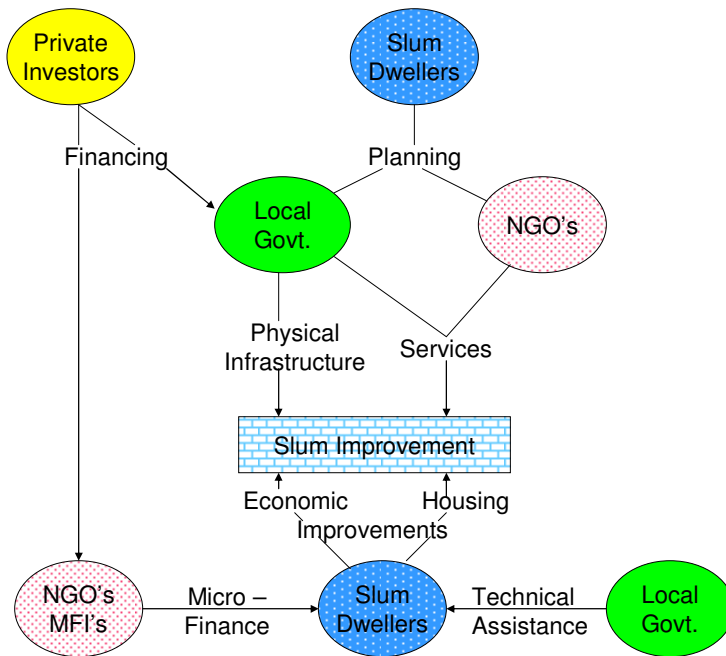
Our research identified many programs, which were efficient and operating in a self-sustaining manner, but rarely had they reached scale. SBI identified the elements in common among the cases and financial models qualified as successful by experts interviewed in the course of our research. Examples of financial models chosen as “best practices” include:

- (a) The Kuyasa Fund in South Africa, a non-profit housing microfinance provider based outside of Capetown;
- (b) Patrimonio Hoy, a subsidiary of CEMEX, Mexico, a supplier financing scheme for self-constructed housing units;
- (c) The FIRE-D program in India, a municipal bond program developed with USAID funding which has reached scale across the country. The bonds under this program were primarily privately subscribed and represented the first municipal transactions not backed by a state guarantee.

Although these examples are best practices in terms of methodology and sustainability, whether Kuyasa and Patrimonio Hoy will be able to reach the level of scale and volume needed to tackle low income housing problems on a country-wide basis is a matter for future research. FIRE-D on the other hand has leveraged billions of dollars thus far through municipal finance transactions. Regardless of their potential for future scale, all successful programs such as FIRE-D, the Kuyasa Fund, the Community Led Infrastructure Finance Facility (CLIFF, Homeless International – India and Kenya), ***rely on the funding and/or active participation and commitment of multiple entities and thrive on the alignment of interests across private, public, and community organizations.***

The diagram presented below illustrates the interactions among the private, community and local governments in achieving impact in low income housing projects (in this case slum upgrading).

The Roles of Key Participants in the Slum Improvement Process (Source, Painter, Campa, Moser: *Scaling Up Slum Improvement*)



“It should be noted that this schematic does not show the role of the national government or international development agencies / banks in the process. That is because their role is to facilitate any or all of the roles played by the other participants. If the slum improvement process is to be sustainable on a large scale, neither national governments nor international development agencies can adequately substitute for the key participants. However, they can play a crucial role in strengthening, coaching, providing start-up assistance, and mitigating risks across the board.

Slum improvement has to be approached from both the “top-down” and the “bottom-up” as indicated in the schematic diagram. Most of the key participants in the process have a role in both levels.”

*Painter, Campa, Moser: Scaling Up Slum Improvement, p. 8*

***Q: What is the universe of private sector that could potentially engage in improvements to low income housing?***

The universe of potential participants and stakeholders in low income housing finance is quite diverse. We have indicated some of the primary potential actors below:

## **Financial Institutions:**

**Commercial banks -- fully regulated for profit, deposit taking institutions), includes:**

- √ Multi-National Corporations (MNCs) such as Citibank, working across multiple geographies with strongest presence in high income and middle income countries. Primary interest in primary mortgages to middle and upper income populations
- √ Large domestic banks: HDFC in India, BMCE in Morocco

**Non-bank financial institutions – regulated finance companies which do not take deposits.**

- √ Mexican SOFOLES – Su Casita: 2nd largest in Mexico (of 58 sofoles); \$3 billion portfolio; 105,000 clients; 130 offices in US & Mexico
- √ Domenia Kredit in Romania, SOA Kredit in Azerbaijan. Domenia Credit is the largest specialized mortgage finance provider in Romania. GE Money recently acquired a 60% stake in the company. SOA Kredit in Azerbaijan is the largest mortgage finance provider in that country and is in the process of leveraging an additional \$7.5 million in loans from OPIC and strategic equity investors. Both SOA Kredit and Domenia Credit were launched with USAID grant funding for technical assistance leveraged with private loan capital.

**Microfinance institutions (both for-profit and non-profit)**

- √ Former NGOs – turned microfinance banks. MiBanco (Peru, Accion affiliate) has developed several products, including Micasa (home improvement) and Mihipoteca (mortgage)
- √ Kuyasa Fund (South Africa) – a housing microfinance provider (exclusively housing, non-profit).

## **Developers/Landlords**

**For-profit developers** which build mixed-use housing on behalf of a particular government. The developers operating as part of the Villes Sans Bidonvilles program in Morocco are examples.

**Double bottom line developers** include both non-profit and for-profit developers, such as SOHCO, in South Africa, which both develops and then manages affordable rental units.

**Double bottom line landlords**, which manage mixed use properties. The Trafalgar Group, South Africa, is a family owned business with 80 000 units under management countrywide, focusing mainly on the middle-upper market, which subsidizes low income segments (mixed income approach).

## **Corporations**

**Examples include: CEMEX – Patrimonio Hoy**, the savings to credit for building materials on 72 week program, which has reached 100 000 households; **Home Depot**, which is developing remittance product around cement. Families purchase cement in U.S. for consumption in Mexico. Other construction materials suppliers could be explored.

## **Foundations**

These include the Home Depot Foundation, Enterprise Foundation, and Ashoka, and others. In a slightly different space is the Acumen Fund, a non-profit venture philanthropy, which funds promising grass roots initiatives and entrepreneurs.

## **Non-profits and Community organizations**

There is quite a lot of low income housing activity being implemented by CHF International, Habitat for Humanity, Homeless International, among others.

All of these private sector entities have a potential role to play in developing sustainable housing finance solutions for the poor. An exciting area for future exploration is identifying potential partnerships among NGOs, private sector financial institutions/developers, and local governments. The linking private, public and community organizations can serve to more effectively reach low income populations.

### ***Q: What are common elements of best practice approaches?***

From our work under the Global Financial Innovations Partnership, which undertook pilots in Morocco and South Africa with commercial banks and microfinance institutions, as well as our additional research into best practices models, SBI has identified the following common themes among best practices programs:

### **Twelve Main Findings Across the Best Practices:**

1. Small and Sequential Loan Schemes
2. Alternative Collateral to Mortgage Lien
3. Market Rates
4. Facilitated Loan Repayment
5. Savings schemes to build up initial capital and to back a loan
6. Land Tenure Not Always Provided
7. Provision of Construction Elements
8. Maintenance and Follow-up
9. Community Involvement
10. Strong Relationship Management
11. Challenging Long Term Customer Retention
12. Municipal Bonds Provide a Promising Alternative for Financing Urban Infrastructure

### ***Q: What are the main challenges to engaging the private sector?***

Our work with commercial banks and other private sector entities in creating products for low income finance presented the following challenges:

- Banks and corporations are focused on the upper and middle class
- Banks and corporations are reluctant to change focus to low income markets – perception as weak and risky market

- Many regulatory and legal constraints exist in emerging markets – governments can create disincentives despite the best of intentions...
- There is a lack of hard data to prove the existence of a market at the bottom of the pyramid to the banks and corporations
- We observed management and operational challenges, such as:
  - Weak MIS systems and IT staff
  - Banks’ systems are designed exclusively to serve the upper and middle income customers
  - NGOs need more rigorous systems and internal controls

**III. Additional areas for research**

***Q: How should the Working Group best approach and harness the private sector? What types of interventions, programs or research could the Working Group sponsor or promote?***

The lessons learned from the work of SBI and others raise the following additional questions related to engaging and leveraging the private sector:

<b>Research Question</b>	<b>Possible Approach</b>	<b>Desired Outcome</b>
How do we define scale for the private sector? What is the interplay between optimal return and impact?	Analysis of best practice low income housing finance case, such as Patrimonio Hoy, in which we explore the revenue/profit/number of clients reached. How many years did it take to reach break-even? What is the acceptable risk-adjusted level of return for a private sector entity? What would it take to grow beyond current levels of activity (100,000 clients in the case of PH)	Further understanding of revenue and profit motivations needed to incentivize the private sector to engage in low income housing finance
What would be an acceptable level of scale at the donor level for impact in a particular country (e.g. India vs. Mexico vs. Morocco)?	Interview Working Group donor members (and other donors outside of the working group); hold facilitated donor workshop on the subject to tease out conclusions	Definition of scale which is acceptable to the donors in the field of low income housing finance and help to set priorities for funding future research, programs, pilot projects
What are preconditions for starting a housing finance pilot with a private sector participant? What are preconditions for scale?	Further research on common elements among pilots and programs to tease out these necessary preconditions for scale	Identification of preconditions will further assist donors and private sector players in prioritizing their resources (both manpower and funding) to projects that “have legs”
Further research of individual topics presented below related to elements of preconditions for scale	To be determined	See above

SBI has observed the following preconditions for starting a pilot based on its experience, which could serve as a starting point for research. These lay the foundation for scale, but in each case there is much more we need to know.

- √ ***Sufficiently trained trusted party to help secure the basis for potential partnerships:*** The work of SBI, CHF, Acumen, Habitat for Humanity demonstrates that a trusted third party can help stimulate partnerships where they might not have occurred previously. What are key characteristics of those trusted parties? (e.g. mission, resources, knowledge and interest)
- √ ***Quality of management.*** What are key characteristics of management in low income housing finance programs? What are some critical areas of capacity building for managers?
- √ ***Cohesion of vision among participants*** – How much time is required to build this cohesion and how do we know when we have it? What are lessons learned in building of alliances to achieve cohesion of vision? How critical is local government in this picture?
- √ ***Set of aligned incentives to motivate participants.*** What are critical elements of incentives? (e.g. profit, expansion into new market segment in increasingly competitive environment, social mission). Acceptance of the market by the participants as a true market opportunity and not charity
- √ ***Sufficient demand for the product (market need).*** Demand studies among target populations will help to further refine the exact product needs – whether it is rental housing, microfinance for housing, or a commercial bank or finance product to fund large scale developments, infrastructure, etc.
- √ ***Efficient model that can be readily transported and translated across geographies and cultures.*** Further study of models currently being undertaken by USAID and others, along with dissemination of results to the field, including the deeper exploration of relationship between profit motivation and scale as described above would be particularly useful.

The presence of these elements in pilots are preconditions to getting to scale...

***Question: How can pilots be developed, replicated and brought to scale at a faster pace than currently? Should the Working Group sponsors create grant windows for piloting and scaling up of models?***

The experience of SBI and others points to the dearth of funding to structure and test private sector models. Many private sector actors need incentives and proof of future profitability before they will undertake a new product, particularly in a sector which they view as high-risk. What is needed is more grant funding to encourage the private sector to test products.

While loans guarantees such as the USAID DCA program are part of the picture, additional funding is needed for market research (surveys), new product development and testing, staff training, and technology transfer. The Retail Advisory Services (RAS) program at CGAP provides grants up to \$250,000 to develop and pilot innovative retail products at commercial banks. A similar approach could be undertaken by the Working Group to facilitate the creation of such a grant pool (funded by a broader set of donors), which could operate on a couple of levels:

1. Funding of costs to explore potential partnerships in priority countries (as identified among the Working Group participants). Grant funding could cover the expenses of trusted third parties such as CHF, Habitat, SBI and others to convene workshops, interview potential stakeholders, to identify promising partnerships among private sector, local government, NGOs, etc. The results of these trips and exploratory missions would be concept papers to be presented to the Working Group.
2. A grant competition with submission of concept papers to carry out pilots in specific locations. This process should be efficient and not heavily bureaucratic. Review and selection criteria would be determined by the Working Group leadership.

The process should emphasize entrepreneurial approaches relying on private sector players with funding commitments (such as loan capital, investments, etc.) as well as in-kind commitment of staff resources, office spaces, materials and know-how.

#### ***IV. Resources***

The following articles and studies provide an overview of approaches which have worked to leverage the private sector in the low income housing sector.

CLIFF Annual Report: [http://www.homeless-international.org/doc\\_docs/CLIFFAR\\_2006.pdf](http://www.homeless-international.org/doc_docs/CLIFFAR_2006.pdf)

Housing the Poor by Engaging the Private and Citizens' Sectors: Social Innovations and "Hybrid Value Chains": Stephanie Schmidt with Valeria Budinich, Ashoka, International Housing Coalition website ([www.intlhc.org](http://www.intlhc.org))

*Inventory of Finance Models/Case Studies*, ShoreBank International, 2005

*The Fortune at the Bottom of the Pyramid. Eradicating Poverty Through Profits.* Prahalad, C.K. (2005), Wharton School Publishing.

The Role of the Private Sector in Delivering Low Income Housing in Developed and Developing Countries, David S. Olinger, International Housing Coalition website ([www.intlhc.org](http://www.intlhc.org))

Scaling up Housing Microfinance: a guide to practice, Housing Finance International (feature). Fergusson, Bruce. International Union for Housing Finance, Vol. 19, Issue 1, p3-13, September, 2004.

Scaling Up Slum Improvement: Engaging Slum Dwellers and the Private Sector to Finance a Better Future David Painter, TCGI, Regina Campa Sole, SBI, Lauren Moser, SBI, International Housing Coalition website ([www.intlhc.org](http://www.intlhc.org))

U.N Human Settlements Program, Facts and Figures about Financing Urban Shelter, September 2005