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## Subsidies and Housing Finance for the Poor

A “Framing the Debate” Brief for the  
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CGAP Working Group on Housing Finance for the Poor

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### Background and Relevance to Working Group

Public housing subsidies, in concept, are in direct conflict with microfinance’s explicit goal of increasing the poor’s access to the private financial services sector (and private finance’s implicit goal, in general). In more instances than we might care to note, we have seen subsidies being ineffectively used to alleviate short-term poverty conditions while further excluding the poor from formal finance and perpetuating the long-term cycle of poverty. In these instances, the poor continue to rely on informal financing while living in settlements or substandard housing. For the blossoming community of financial services for the poor, microfinance’s “hand up” is certainly preferable to subsidy’s “hand out.”

Governments, too, might appear to be reluctant to work with private-sector parties of all kinds to provide housing funds to the poor. Such collaborations would certainly involve putting money in the pockets of financial institutions rather than giving that money directly to a nation’s needy. Worse, it could give the appearance of collusion with commercial banks and other organizations already viewed suspiciously by the poor. It would also decrease opportunities to demonstrate political noblesse.

So, why would the microfinance community in particular and the private financial services sector in general work together with governmental housing officials? To further understand how the poor have access to, receive, and implement funds for housing, this brief explore how subsidies provide and conflict with access to private financing through the following questions:

- 1) Should governments and private financial service providers agree to use housing microfinance as a particular vehicle for delivering subsidies?
- 2) What problems might be equalized or worsened?
- 3) How do they—or, could they—team up without compromising missions?

## Issues

Aside from the enormous logistical problems associated with intermingling governmental subsidies with private sector financing, it would seem that the answer to the first question is a qualified “yes” for a variety of reasons, the first of which is that the common purpose of both efforts is to alleviate poverty and poverty conditions in the long-term. There are underserved households that could immediately benefit from public assistance provided in a privately-operated way that helps them individually and society with short-term social needs (i.e., shelter and all of its benefits) while insuring their long-term economic development (from the inclusion in formal financial services and benefits of homeownership).

There is also a more practical reality that should be faced in that neither effort has yet to fully serve the most poor in the most countries. As the primary and possibly only private, formal housing finance vehicle for the poor, microfinance would seem a likely channel. The commercial banking sector has generally not been interested in working down-market unless required to by law or unless they have discovered that tapping this market could lead to high returns. Traditional microfinance lenders (that have only begun offering explicit housing and home improvement products in the last decade) and housing micro-lenders tend to service the working poor of salaried individuals and entrepreneurs—that is, the lower middle-income and higher lower-income populations—but not necessarily the poorer or poorest segments of the population. This is a well-documented limitation of microfinance but, it so happens, is also the key purported focus of public subsidies. The fact that governments and private financial institutions already work together in a variety of ways that serve whole nations in general, and the wealthy and middle class in particular, should provide further reason for banks and microfinance lenders to explore the effective and efficient incorporation of subsidies in their attempts to include the poor in the formal sector.

Of course, subsidies carry much more baggage than housing microfinance; this complicates such a union pragmatically and conceptually. Subsidies are often linked to political campaigns and administrations as much as any other platform issue but are further complicated by the fact that housing has been historically defined as a fundamental human need and, in turn, a human right in many societies; housing subsidies are then required components of a nation’s domestic policies. Asking leaders to expend political capital on changing legacy subsidies, expecting them to change overnight, or, correspondingly, assuming that new subsidies will outlast administrations are all difficult propositions at best. There are also numerous instances of corruption and abuse in housing subsidies, as well, thereby making the private sector wary of alliances in some countries.

Subsidies’ inefficiency and ineffectiveness are perhaps less publicized but just as insidious. Governmental programs are notoriously inefficient when it comes to delivering social services. They are also often more ineffective in serving the poorest segments of the population than microfinance; they usually directly benefit middle income or upper lower-income groups and, in some lamentable instances, indirectly benefit these groups even when they have been targeted towards the poorest segments. For example, the poor sell or rent out publicly constructed housing that is physically better than middle class housing, or are “outbid” by the middle class in unaffordable neighborhoods. Because so many subsidies are poorly structured, they are socially ineffective due to their many indirect—and ironic—effects: they often increase income disparity; they perpetuate informal housing; and, they result in new declining communities, all the while allowing the private finance and production industry to leave the poor population underserved.

The biggest criticism from the microfinance sector, of course, would be that subsidies encourage bad behavior; they are “charity” rather than inclusion even when structured in ways other than direct, lump-sum grants. Government loans, interest rate subsidies, and public credit programs have historically resulted in mass defaults or loan forgiveness. Both of these results cost public coffers dearly, exaggerate opinions of the government and financial sector, and further keep the poor out of the formal financial world. Ultimately, many claim, subsidies are so wrought with operational problems that the resources could be used for other public purposes rather than further distortion of an already problematic market.

By definition, of course, all subsidies distort markets, and many of the other criticisms of subsidies are well-founded. But, if we assume that a specific minimal standard of living or for an individual household or person (in this case, adequate housing) is necessary for social wellbeing (individual health, public sanitation, community development, urban growth planning, etc.) then they are necessary. In fact, there are few countries in the world that do not have some kind of housing subsidy, especially in the developed world. As listed above, there are numerous problems encountered in both governmental subsidies and private-sector financial inclusion. Neither effort is perfect, but both provide enough benefit to make them essential. The trick is determining which form of subsidies is most appropriate, how they can be efficiently integrated into a microfinance institution’s operations, and how they can be effective jointly.

## Examples

Despite their being numerous examples of successful housing microfinance products and a few examples of successful housing subsidy programs, there remain virtually no examples (good or bad) of subsidized housing microfinance.<sup>1</sup> Of the few that exist, two are worthy of mention here.

The most famous involves local subsidies in the form urban infrastructure provision being tied to individual resident savings accounts, specifically in the city of Ahmedabad. SEWA, SEWA Bank, and the Mahila Housing SEWA Trust partnered in with the city of Ahmedabad and other community organizations in a slum upgrading program titled Parivartan (or, “transformation”) in which the city provided subsidies in the forms of land title and partial infrastructure (water, sewage, and roads) provision to match residents savings and, in turn, purchase of a package of internal plumbing and drainage connections for their homes. Some preliminary results have shown tremendous success on a variety of counts: residents who participated in the program have seen increased wages and productivity, while the community as a whole has dramatically reduced its level of health problems and exposure to illness. While some anecdotal evidence suggests that the city has been less than forthcoming with many of its promised improvements, the overall structure of the relationship could easily be a model for microfinance collaboration with governmental subsidies: the program involves a separate subsidy being provided to residents who availed themselves of formal financial services.

The collaboration, of course, is more complicated when the subsidy and microfinance credit are for the same purpose. Such is the case with the range of recent subsidy programs in Peru, which include three significant programs: Mi Vivienda (“My Housing,” a mortgage guarantee offered through private financial institutions that “rewards” clients with good

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<sup>1</sup> For the former, see Daphnis and Ferguson (2004), and see Hoek-Smit and Diamond (2003) for the latter.

repayment histories with a subsidy), Techo Propio (“Own Roof,” a mortgage guarantee offered through private financial institutions with a larger, direct subsidy for a poorer market segment), and Banco de Materiales (“Materials Bank,” a heavily subsidized credit for the purchase of construction materials for the poorest segments). Together, the performance of these programs best demonstrates the failings and potential of linking housing subsidies to private financial services and, in particular, microfinance.

Mi Vivienda reaches slightly down-market than traditional private mortgage clients because of its subsidy. Because it is a mortgage (that is, a high value asset loan requiring title security), though, its primary client base is the lower middle-class. So, though successfully integrated into the private financial sector and demonstrating a potential new market, it has not had much relative impact on housing demand. Techo Propio was designed to reach an even poorer market segment with a larger, upfront subsidy has been less successful likely due to the inability of offering mortgages to this segment (due in turn to the lack of titled homes valued at those lower-market prices), and to the increased perception of governmental assistance from the direct subsidy. Banco de Materiales, in contrast to the other two, did not offer subsidies through the private financial services sector at all (though construction material retailers accepted BanMat debit-like cards). Because of the direct subsidies, defaulting has been the norm, with many other debts being publicly forgiven in highly publicized political ceremonies.<sup>2</sup>

From these two sets of examples, we can speculate on a couple of patterns. First, the increased perception of governmental involvement (especially, the more direct the subsidy) and the decreased immediacy of the government (that is, the federal government or a foreign agent versus the local authorities) both add to ineffective implementation of subsidies within microfinance. This both wastes the public money and damages the reputation of the financial institution. Secondly, title (and the demographic group’s housing associated with it) appears to be a barrier to providing housing funds where there is either a requirement for it or no trigger for title to be granted. In the SEWA Parivartan example, the granting of title with loosened requirements was viewed as a direct benefit for the clients while in Peru, the inability to demonstrate title partially kept mortgages out of reach of the most needy. Overriding both of these, though, is the fact that the financial institution involved must be in a position to still profit from the selected product (regardless of the subsidy) and that political leaders must still be perceived as delivering services to the population (regardless of the vehicle). While politics and perceptions are likely to play a role in all subsidy-linked private finance access, there are many other areas for exploration and potential practices to be developed.

## Research Areas & Practice Exploration

There are numerous ways in which governments can combine subsidies with private financial services that either minimize the appearance of governmental intervention or separate that intervention from the actual service. On the private sector side, indeed, this paper has focused on formal microfinance only, though other private financing vehicles could potentially be integrated with subsidies. On the public side, the Parivartan model of infrastructure provision is just one case, with there being a variety of other infrastructure “subsidies” that a local government can provide (from utility access, to improved roads and

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<sup>2</sup> It should be noted that the Peruvian Ministry of Housing, Construction, and Sanitation which oversees these programs has launched a significant review and restructuring in the last year.

sidewalks, to even public transit routes and city planning programs). National governments would do well to coordinate such funding with municipal and state authorities in order to support local development. Nationally subsidized financial literacy training offered through both private financial institution and non-governmental organizations, offerings of public land for restricted development, or subsidizing construction loans all separate direct associations between public and private offerings, too. Change in housing regulations beyond financial ones of all kinds also a form of “subsidy” because they decrease the costs of both producing homes and maintaining ownership; even beyond improved property rights and registration process, there are mortgage, consumer protection, foreclosure, credit information laws along with building and zoning codes, to name just a few of the additional government housing restrictions that keep the poor from entering the formal sector (not just financially).

Closer relationships might involve indirect government subsidies of operational costs for financial institutions by providing comprehensive and accessible market research, providing technical assistance on how to reach into these markets, and even basic security for those institutions willing to offer products to new markets. Directly, governmental subsidies could be use to provide liquidity funding for housing microfinance providers with requirements for the kinds of products and clients desired. Direct subsidies to those products’ clients could be provided with loosened restrictions in ways that encourage their inclusion in formal finance, with the most income-restricted populations (such as the elderly or physically challenged) receiving subsidized housing through non-governmental organizations or private developers rather than directly from the authorities. Where direct subsidies for housing improvements or purchase appear necessary, a detailed analysis of the kinds of home transactions (purchases versus improvements), their potential titling, the sequencing of the subsidy with the microfinance credit, and the marketing of the financial product, and a keen and realistic survey of the context are critical.

This also poses numerous areas for additional research; despite having few examples of integrated subsidy-microfinance products, we do have instances where subsidies and microfinance have been in direct competition or conflict (the Banco de Materiales and Peruvian home improvement microfinance products being one case in point). An assessment of the effectiveness and efficiency of these competing services is certainly a starting point not only to gauge the negative aspects of specific programs but also to determine ways for potentially beneficial integration. As new integrated examples, new effectiveness and efficiency evaluations should be performed as well. Constitutional and legal frameworks must be studied to better understand whether, how, and when subsidies can be restructured. Corollary or complementary regulations in housing should also be examined to identify other governmental institutions that might be restructured and, in turn, new indirect subsidies.

Less empirically, a better understanding of the effect of local conditions on housing finance with regard to political, financial, and community organizations and the perceptions of them needs to be performed both for research and practice purposes. As we have seen, there are very different precedents established between governments, financial institutions, and the poor in each country. Ultimately, the best examples in both housing subsidies and private housing finance are those that take the realities of the poor—whether they be rural or urban, land squatters or renters—and of institutions—be they governmental, private, or community-based—into account. Subsidy-linked housing microfinance will certainly follow the same. So, while the case can be made for integration, we are all still waiting for more evidence.

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