InSight

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# Developing Housing Microfinance Products in Central America

In most developing countries, the need for more and improved housing for low-income families is tremendous. In Nicaragua, 800,000 of the 1.3 million existing homes fall below minimum housing standards. In El Salvador, the need for housing is estimated at 200,000 new homes and 400,000 home improvements. Despite the great need, housing finance markets in Central America have not responded with products that work for low-income people. Among the many challenges are the following:

- *Affordability:* The cost of the simplest, most basic new housing unit (including land, services and a 36 $m^2$ structure) is generally more than \$5,000,[1] exceeding the means of most microentrepreneurs. This factor is acute in Nicaragua and El Salvador, the second and fourth poorest countries of the region.
- *Limited availability of titles:* Most poor households in Latin America do not have legal title to their land. Consequently, these households cannot use their homes as collateral. Land title in Nicaragua is particularly uncertain. Government land grants to poor people are often contested by the original owners.
- *Traditional mortgages unavailable or inappropriate for microentrepreneurs:* Mortgage markets in Latin America are very limited. In Nicaragua, for example, there are just 1,500 outstanding mortgages. When mortgages are available, microentrepreneurs rarely qualify. Their undocumented or variable income, lack of title and inability to commit to long-term repayments all but eliminate their access to these loans.

Recognizing the gap, governments and some non-governmental organizations (NGOs) have put forward three main solutions:

- *Subsidized mortgage loans*: Government programs and other organizations provide poor households with low-interest (subsidized) mortgage finance.
- *Low-income housing developments:* Projects develop complete new communities for low-income households utilizing low-cost building and "sweat equity" from beneficiaries.
- *Direct-demand subsidies:* A recent approach uses direct government grants to stimulate private sector provision of housing loans. The subsidy combines with household savings and a housing loan.

[1] All figures throughout this InSight are in U.S. dollars.

Experience shows three drawbacks to these approaches. First, subsidy funds are limited, so only a few of the families and enterprises in need actually receive funding. In Colombia, the government, with support from the Inter-American Development Bank, has budgeted $255.4 million to provide subsidies for 61,000 new houses and 10,000 improvements, for an average cost of $3,600 per house. To cover Colombia's shortage of 1.5 million homes in need of subsidies would cost approximately $5.4 billion. Second, households receiving subsidies often are less inclined to repay loans. Third, in the case of mortgage/ loan programs, the loans are typically mortgages targeted at wage earners, and are thus not accessible by microentrepreneurs. Finally, due to funding limitations, none of these programs are able to reach significant scale and are, by definition, not self-sustaining.

ACCION and other microfinance organizations have taken a different approach and have developed techniques that are coming to be known as *housing microfinance.* Housing microfinance is a non-subsidized, sustainable approach tailored to the needs of the low-income market. Such products apply the best practices developed over the years for microenterprise finance to the housing needs of micro and small entrepreneurs. These loans finance progressive upgrades to poor families' homes – which include improving existing rooms, adding a room, or installing water or electricity. A complete home is built step by step over time. In fact, *progressive build* is the way most poor and self-employed people acquire homes, largely because it makes the process affordable. In the pilots conducted by ACCION, loan amounts to support the progressive-build process average $1,000 to $1,500 with average loan terms of 18 to 24 months, slightly larger and longer term than typical microenterprise business loans, but far smaller and shorter term than traditional 15 to 20 year mortgages. Lenders do not require title to guarantee the loan. They are willing to accept less formal types of collateral, making the financing more accessible to poor borrowers. The housing finance program of ACCION's Peruvian partner, Mibanco, is described in *InSight 4: Building the Homes of the Poor – One Brick at a Time* (available at www.accion.org/insight).

On the supply side, microfinance is becoming more competitive as institutions become stronger and clients more sophisticated. Institutions must become more responsive to their clients and expand product offerings beyond enterprise lending to satisfy more of a household's financial demands, particularly investing in housing. Institutional stakeholders, such as donors and private investors, are increasing pressure on microfinance institutions (MFIs) to achieve better, sustained financial performance. Because housing microfinance loans are often larger and longer than enterprise loans and have lower delinquency rates, they provide an opportunity to increase MFI profitability if costs can be kept under control.

## ACCION's Response to Housing Market Limitations

ACCION is assisting several of its affiliates and partners to develop housing microfinance products.[2] This paper reports on the pilots in ACCION affiliates in Central America: FAMA in Nicaragua and Integral in El Salvador. These pilots tested six major hypotheses regarding the ability of MFIs to implement successful housing microfinance products:

[2] ACCION received funding from the Enterprise Development Innovation Fund (EDIF) of the United Kingdom Department for International Development (DFID) for this project.

1. Housing microfinance is a more appropriate lending methodology than traditional mortgage lending for serving the housing finance needs of microentrepreneurs.

2. A housing microfinance program can be integrated into an MFI's existing microenterprise finance operations without any adverse effects on the quality or growth of the existing microenterprise portfolio.

3. An MFI's existing loan officers can be trained to offer housing loans without negatively affecting their productivity.

4. Microentrepreneurs' need for technical construction assistance, such as drawing plans, estimating construction costs or supervising construction labor, varies from person to person. Therefore, the construction assistance component of an MFI's housing loan product (if any) should be customized to the unique situation of each borrower.

5. A housing microfinance program including an optional construction assistance component can both ensure a high standard of quality in the constructions financed and achieve sustainability (profitability) for the MFI within two years.

6. Housing microfinance portfolios, when designed to incorporate best practices in microenterprise finance, can achieve a similar scale to existing microenterprise finance portfolios.

The housing loan products were developed by a team from ACCION, working closely with FAMA and Integral, using ACCION's proven product development methodology. Findings from each institution will be considered individually, and conclusions drawn in the final section.

## Findings: Nicaragua

### *Context*

Nicaragua is the second poorest country in the Western Hemisphere, with a per capita GDP of $480.[3] The 1995 census estimated Nicaragua's population at 4.35 million living in 1.26 million dwellings. Nicaragua has one of the world's highest rates of ownership. Eighty-one percent of families own their homes, compared to 67 percent in the United States.[4] However, according to the 1995 census, only 53 percent of homes have full legal title.

Nicaragua has a shortage of between 400,000 and 500,000 houses and at least 800,000 homes are of poor quality.[5] NGOs are the main providers of low-cost housing, covering about 1,500 units per year, but cannot meet demand. Bank financing is focused exclusively on the higher end of the market. Poor quality housing, high rates of ownership, and lack of legal titles imply a high demand for home improvement financing, backed by collateral other than traditional mortgages.

*Fundación para el Apoyo a la Microempresa* (FAMA) was established in 1991. It is a nonprofit civil association providing microenterprise loans to microentrepreneurs, as well as consumer

[3] Republic of Nicaragua, "A Poverty Reduction Strategy," August 2000
[4] Nicaraguan Statistics and Census Institute, National Living Standards Survey, 2001.
[5] Nicaraguan Statistics and Census Institute, National Living Standards Survey, 2001.

credit to salaried workers. FAMA's twenty branches are in cities and larger towns in every department in the country, except the Atlantic Region. The regional office in Managua serves the six branches in the capital. At the end of June 2003, the institution had 23,093 clients, 74 percent of whom were women, and an outstanding portfolio of $9.2 million. Before offering housing loans, FAMA had five credit products: microenterprise (65 percent of portfolio value), small business (25 percent), consumer lending (five percent), agriculture (four percent) and rural (one percent). Loan terms range from six to eight months for microenterprise, to 18 months for consumer and 24 months for small business.

### *Housing Finance Pilot*

In 2002, FAMA was looking for new market-responsive products within an increasingly competitive microfinance industry in Nicaragua. The institution's successful individual lending methodology was in place in all branches. A pilot in consumer lending, working through agreements with selected private employers, had proven efficient with low default rates. Previous internal market research found the most requested new products from FAMA clients were loans for housing.

The family of a FAMA client in Granada, with loan officer Freddy Azcevedo. This structure, in the back yard of the main house, is being built in stages. The first loan, $750 in ten months, paid for one bedroom and a new bathroom. Once the first loan is paid off, a second loan will be used to finish the second bedroom (note lack of roof in the top right).

Detailed market research found high interest in loans being offered for housing at the time, mainly for improvements. The average loan size and term demanded was $800 over eighteen months. This led to an estimated monthly payment of $60. Given that 65 percent of clients said their households earned less than $160 per month, a significant minority of families would appear to lack the capacity to pay for their loans. For such families, the typical loan payment, $60, would be 37 percent of monthly income. FAMA therefore placed special emphasis on analyzing client capacity to pay, training loan officers in negotiating with clients, and on progressive housing loans to make the product more affordable.

FAMA also performed a detailed analysis of the competition, with special attention to loan documentation requirements, amounts, terms, collateral requirements and down payments. FAMA's main competitor, the regulated microfinance institution CONFIA, had a reputation for quick disbursements and larger loan sizes, but its interest rates are much higher than those of FAMA.[6] FAMA decided to compete on service as well as price. FAMA aimed to disburse a housing loan within four days, compared to six for CONFIA. During FAMA's market research, 70 percent of clients said they had written proof of home ownership, but this is not necessarily

[6] Under Nicaraguan law, unregulated credit institutions such as FAMA face interest rate ceilings, which do not apply to regulated, financial companies such as CONFIA.

full legal title. Therefore, FAMA accepts household goods such as appliances and furniture as collateral for housing loans, unlike CONFIA.

FAMA and ACCION designed a housing product based on FAMA's existing individual microenterprise lending product. One major change was made to the loan evaluation: the addition of an assessment of the housing project budget. This assessment was developed to ensure loan amounts covered the cost of a client's proposed construction. FAMA decided not to give engineering assistance in construction techniques. The institution does not give training or advice for its other products, and management was concerned that it would be too difficult to hire and train the required staff.

Housing loans characteristics vary, depending on the loan's purpose, as described below:

**Table 1: Summary of FAMA's Housing Loan Products**

| | Improvements | House purchase | House construction |
|---|---|---|---|
| Minimum | $67 | $2,667 | $1,333 |
| Maximum | $4,000 | $6,667 | $9,667 |
| Maximum term | 36 months | 120 months | 72 months |
| Amount financed | 100% | 80% | 80% |
| Interest rate[7] | 15% | 15% | 15% |
| Hazard insurance | None | Required | Required |
| Collateral | Guarantor required; Household goods or mortgage | Mortgage | Mortgage or household goods |
| Collateral coverage ratio – current clients | 100% | 100% | 100% |
| Collateral coverage ratio – new clients | 125% (100% if amount less than $1,333 or term less than 18 months) | 125% | 125% |

Because housing terms are longer, the interest rate on housing loans (15 percent) is lower than that for businesses loans (16.7 percent). The policies and procedures for evaluating, processing and disbursing loans are based on those already in use for business loans, with a few minor changes. FAMA allows a client to have a housing loan and a business loan at the same time, provided the client has the ability to pay and the collateral to cover both credits. Collateral requirements appear to be a more limiting factor than the ability to pay for clients who want two concurrent loans.

FAMA's first housing loans were made in one pilot branch in Managua in November 2002. The pilot was considered a success, so the roll out to other branches began in May 2003. By September 2003, all twenty of FAMA's retail outlets offered housing loans.

FAMA realized that existing loan officers would find the new loans burdensome at the beginning because credit evaluations would take longer. To encourage loan officers to sell the product, FAMA changed its incentive system. For the first three months, loan officers received a flat amount, higher than a normal incentive, for each housing loan made. Once loans were active,

7 The maximum interest rate varies on a monthly basis, according to the ceiling set by the Central Bank of Nicaragua. FAMA decided to charge a maximum annual interest rate of 15% on housing loans.

credit staff earned more incentives because housing loans were less delinquent than others, and their traditional incentive system rewards low delinquency levels.

Two main issues emerged during the pilot. First, the original technical evaluation required loan officers to visit clients up to four times, compared to an ideal of once. As a result of the pilot, the assessment of construction costs was streamlined to focus on the most important categories of a budget, and to be easier for loan officers to use. The new tool still enabled FAMA to verify the costs of proposed improvements to make loans that fit client needs, but allowed them to do so more efficiently. Second, although the initial product design contemplated loans for whole-house construction as well as home improvement, FAMA made only home improvement loans because of concerns that its existing funding liability structure would not support terms of up to seven to ten years.

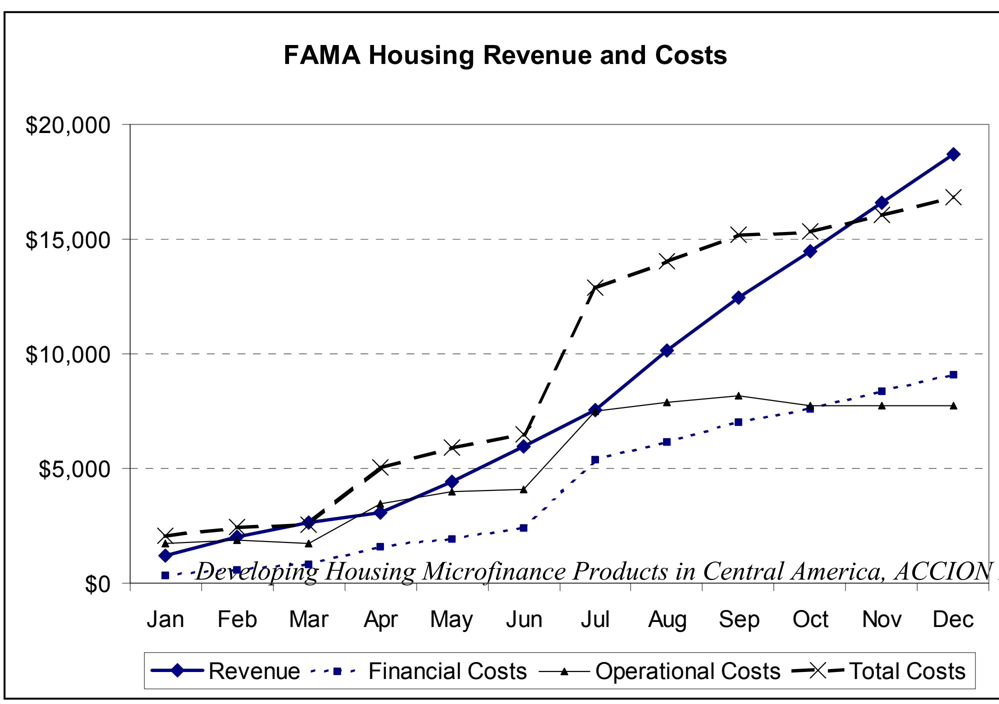
*Pilot Results: Growth and Financial Performance*

**Table 2: Quarterly Loan Statistics: FAMA**

| | March 2003 | June 2003 | Sept 2003 | Dec 2003 | March 2004 |
|---|---|---|---|---|---|
| Clients | 72 | 198 | 404 | 631 | 873 |
| Portfolio (US$) | $121,172 | $276,890 | $585,615 | $883,460 | $1,203,778 |
| PAR > 30 days | 0.00% | 0.14% | 1.86% | 2.20% | 0.73% |
| Average outstanding balance | $1,683 | $1,398 | $1,450 | $1,400 | $1,379 |
| Growth per quarter (# of loans) | – | 175% | 104% | 56% | 38% |

FAMA had hoped to have a housing portfolio of $1 million by the end of 2003, but it met this target slightly later, in February 2004. The main reasons for slightly slower growth were the suspension of whole house finance loans, and a seasonal dip in demand. After one year, housing makes up eight percent of FAMA's total loan portfolio and is on a growth path that will make it an increasing share of the portfolio for at least the near term if not beyond.

**Figure 1: FAMA Housing Loans: Revenue and Costs, 2003**

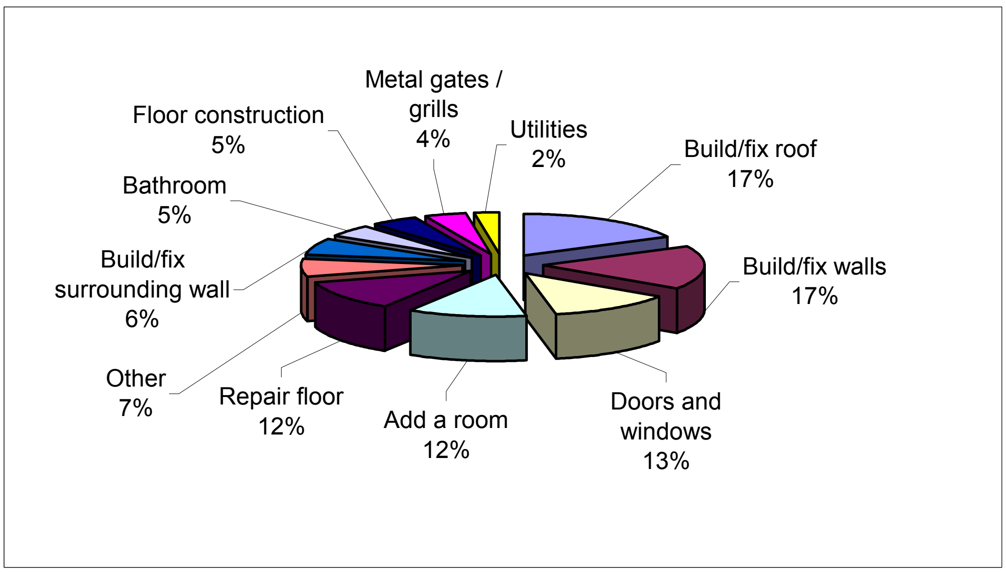


Costing estimates for housing finance at FAMA show that during 2003, the product covered 86 percent of its costs. These figures were derived by estimating product revenue, provisions, average staff costs, and other operational costs related to branch functioning. Loan officers were assumed to spend 10 percent of their time on the product. However, looking at progress by quarter, housing broke even in the final quarter, once the roll-out to all branches had been completed. Extending housing finance to new branches reduces the product's profitability in the short-term, as staff and branch costs are assigned to housing before many loans are disbursed and revenue comes in. As shown in Figure 1, operational costs remained stable once the roll out was completed in July 2003. In the first nine months of 2003, FAMA's operational revenue was 114 percent of its costs. Housing does not yet appear to be as profitable as FAMA's other products, but is near or slightly above the break-even point.

*Pilot Results: Improvements Financed*

To better understand the use of housing loans, FAMA tracked the repairs or construction undertaken by clients in 2003. As detailed in Figure 2, the most common use of loan funds were to make repairs or to build roofs, walls, door and windows. Roof repairs are most popular at the beginning of the year, when people are preparing for the rainy season.

**Figure 2: Types of Home Improvements Financed by FAMA, 2003**




## Findings: El Salvador

### *Context*

El Salvador has an estimated 6.5 million people. According to the World Bank, poverty levels fell during the 1990s, from 60 to 41 percent of the population.[8] A key factor in this economic

[8] World Bank, El Salvador Country Assistance Strategy, 2001

performance has been remittances from overseas, estimated at $1.8 billion per year, more than 60% of exports and almost 15 percent of GDP.[9]

The 1998 Multi Purpose Household Survey[10] estimated there were 1.4 million houses in El Salvador. Forty percent of these, or 570,000, needed at least one major improvement to their walls, roof, floor or water supply. In 1999, a government survey estimated that El Salvador had a shortage of 40,505 houses. The housing situation worsened after earthquakes in early 2001 left nearly a quarter of the country's homes either destroyed or damaged.

Alba Magda Miranda, an Integral client, near Zacatelocua, El Salvador, in front of her new 48m2 home. She built the house with a $1,740 loan from Integral, plus $750 of her savings. Note the horizontal cement reinforcement to protect against earthquakes.

Although the government is active in creating opportunities aimed at extremely poor households to improve their well-being, these do not meet demand. Furthermore, they exclude the self-employed, and focus on households in limited geographic areas. Therefore, there remains a need for private initiatives to move forward with programs that meet the needs of low-income families.

"El Salvador – A Country of Owners" is a government program to reform the country's land tenure system. About 95 percent of the land in El Salvador is registered, but many registrations are not up-to-date. In 1996, the World Bank estimated that less than a third of registered properties had full property information that could be used in a mortgage.[11] Although more land is becoming fully titled, high transaction costs limit poor families' access to mortgages.

Integral began as the financing arm of a Salvadoran NGO, the Salvadoran *Fundación Salvadoreña de Apoyo Integral* (FUSAI), which was founded to support community development in post-war reconstruction. FUSAI made its first housing loans in the mid-1990s, as part of its mission to support low-income populations, and to meet a pressing need in El Salvador. In 2002, Integral was spun off into a separate, for-profit, private company. Today, FUSAI remains Integral's principal shareholder and has a strong presence on the board of directors.

As of July 2003, Integral had 16,547 active clients and a loan portfolio of more than $10 million. Its staff of 140 includes 33 loan officers in 11 branches. Nine of its branches are in medium sized

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[9] *Ibid*.
[10] Ministerio de Economía, Dirección General de Estadísticas y Censos (DIGESTYC), de Hogares de Propósitos Múltiples 1998.
[11] Staff Appraisal Report, No. 15085, El Salvador Land Administration Project, January 31, 1996.

towns outside of greater San Salvador. Enterprise loans made up 37 percent of the value of the portfolio, followed by solidarity groups (29 percent), individual housing (15 percent) community housing (14 percent) and consumption (four percent).

Integral provides two types of housing loans: community and individual. Community loans are focused on New Organized Establishments (NAOs) where a group of up to 50 families receives either a serviced lot (a plot with access to water and electricity) or a basic housing unit. Each family is responsible for repaying its loan. Integral also offers individual loans for clients who are not necessarily part of a NAOS. In December 2003, Integral had 3,259 housing clients and a portfolio of over $3.1 million. The portfolio was evenly split between individual and community loans, but there were more community clients (1,983) than individual ones (1,276).

### *Pilot Product: Individual Loans with Technical Assistance*

By late 2001, Integral started thinking about a creating new housing product – individual loans with technical assistance, in response to three issues surrounding its existing product:

- The loans were often financing projects of poor construction quality, especially in materials used, limited ventilation and drainage.
- Clients sometimes found their loan amounts did not cover the cost of their desired improvement, resulting in half-completed projects
- Loan officers had to pay close attention to a family's existing repayment capacity and debts to make sure they could afford the housing loan. Clients with too much debt, or an incomplete improvement, were less likely to pay their loans on time.

**Table 2: Summary of Integral's New Housing Loan Products**

| | Improvements | Lot purchase | House purchase | House construction |
|---|---|---|---|---|
| Minimum | $114 current clients, $500 new clients | $114 current clients, $500 new clients | $114 current clients, $500 new clients | $114 current clients, $500 new clients |
| Maximum | $3,500 | $3,500 | $9,150 | $5,700 |
| Maximum term | 36 months | 60 months | 84 months | 84 months |
| Amount financed | 100% | 90% | 95% | 100% |
| Interest rate | 23% | 23% | 23% | 23% |
| Collateral | Household goods, guarantor, mortgage or combination | Mortgage required, add household goods or guarantor if needed | | |
| Collateral coverage ratio – current clients | 50% with good credit history, 100% otherwise | 50% with good credit history, 111% otherwise | 50% with good credit history, 106% otherwise | 50% with good credit history, 100% otherwise |
| Collateral coverage ratio – new clients | 100% | 111% | 106% | 100% |

Integral decided to experiment with providing technical assistance for clients to improve construction quality, ensure loan amounts covered the needed improvements, and to strengthen customer service. Individual attention to clients was expected to bring them closer to Integral and would also separate the institution from its competition. To provide the extra construction assistance, Integral used two types of loan officers: construction specialists, who had existing training in construction and would be trained as loan officers and fully dedicated to the housing product, and generalists, existing microenterprise loan officers who were to be trained in construction.

Integral and ACCION conducted market research near four branches: Sonsonate, Santa Ana, Soyapango and Zacatecoluca. Of the 407 people interviewed, more than half said they were interested in a housing loan. Fifty-three percent of those surveyed said they owned their homes. Half of those interviewed were existing clients of Integral.

The market research also highlighted the need to keep loan repayments affordable. Integral took clients' desired amounts and terms for construction, purchase loans and home improvement loans, estimated the payment sizes, and compared these to incomes. For 59 percent of clients demanding improvement loans, loan payments would be less than 30 percent of their income, a benchmark for affordability. Only 17 percent would pay more than 45 percent of their income. For purchase loans, the picture did not look as good: only 16 percent of clients would pay less than 30 percent of their incomes. Requested purchase loan size was, on average, four times greater than the home improvement loan, leading to much higher payments.

The market research showed the need for products to finance improvements, as well as new houses. In defining the product attributes, Integral paid close attention to its other products. For example, the interest rate, 23 percent per year, was set to be one percent per year below the individual microenterprise product of a similar size, with the same commission and insurance rates. Although Integral knew the housing product would be more costly than its individual microenterprise loan – due mainly to costs of providing construction advice to clients and staff training – the cost could be absorbed through longer loan terms. Housing loan terms were up to three years for improvements, five years for land purchases, and seven years for whole house purchase or construction. The collateral coverage ratios for individual housing was set at 100 percent, or 50 percent for existing clients with good repayment histories, compared to 150 percent for individual enterprise loans. Integral accepted a combination of household goods, guarantors and mortgages as collateral, although mortgages were required for loans above $4,000. Loan amounts varied from $114 to $9,150.

Integral began the pilot of individual housing with technical assistance in two branches. The original individual housing loan, without technical assistance, continued to be offered in Integral's remaining branches. Based on the results of the pilot, Integral planned to roll out the new product to replace the original one.

The pilot started slowly in Integral, as the construction specialists took longer than expected to master the financial evaluation, promotion and other techniques required of a loan officer. Generalist loan officers also took longer than expected to master the technical evaluation, particularly sketching the proposed improvements on paper. However, it became clear that it is easier to train a loan officer in the rudiments of construction than it is to turn a construction graduate into a loan officer. Generalist loan officers have solid financial analysis skills, as well as a profile that allows them to sell loans, advise clients, and ensure prompt repayment. All but one of the six construction specialists have been reassigned to the community housing product (NAOS). Integral will use only generalist loan officers in this product during the roll out.

*Pilot Results*

The pilot product, individual housing with technical assistance, was implemented in two pilot branches. The older individual housing product continued at the same time. At the end of 2004, Integral had 3,187 housing clients and a portfolio of $3.0 million.

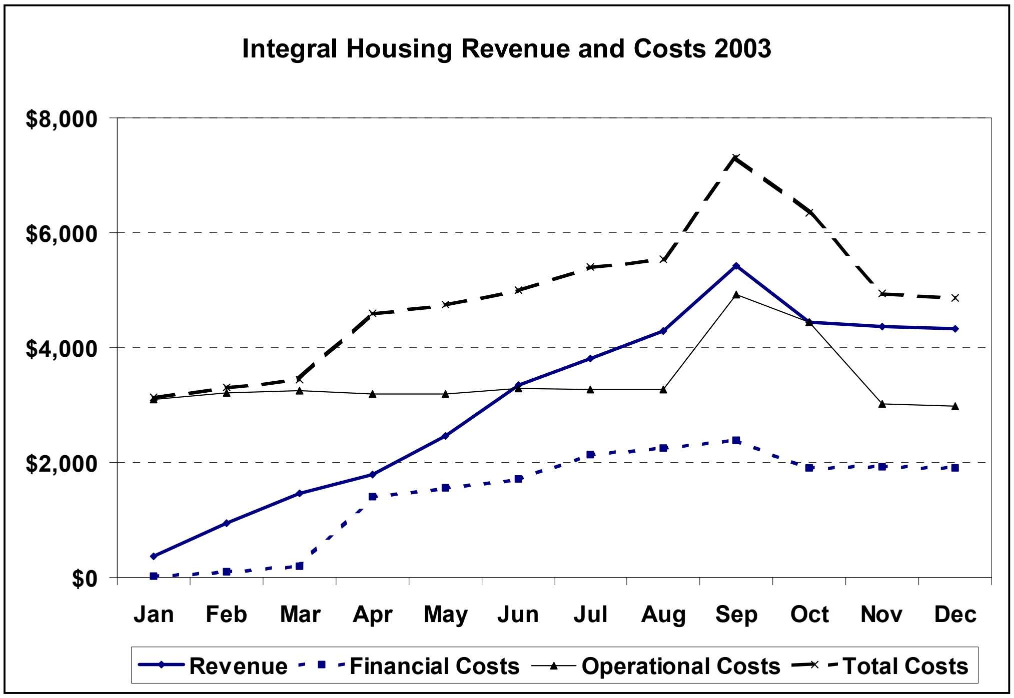
**Table 3: Quarterly Loan Statistics: Integral Individual Housing Loans**

| | March 2003 | June 2003 | Sept 2003 | Dec 2003 | March 2004 |
|---|---|---|---|---|---|
| Pilot Clients | 42 | 123 | 182 | 189 | 218 |
| Original Product | 1,242 | 1,200 | 1,195 | 1,334 | 1,309 |
| Total individual clients | 1,284 | 1,323 | 1,377 | 1,523 | 1,527 |
| Pilot Portfolio | $50,817 | $134,967 | $205,589 | $199,105 | $211,206 |
| Original Product Portfolio | $1,470,284 | $1,391,220 | $1,378,601 | $1,426,955 | $1,405,912 |
| Total individual portfolio | $1,521,101 | $1,526,187 | $1,584,190 | $1,626,060 | $1,617,118 |
| Pilot PAR > 30 days | 0.00% | 2.44% | 3.65% | 5.07% | 7.65% |
| Original product PAR > 30 days | 7.50% | 9.59% | 9.52% | 6.37% | 7.93% |
| Combined PAR > 30 days | 7.25% | 8.96% | 8.76% | 6.21% | 7.89% |
| Pilot Average outstanding balance | $1,210 | $1,097 | $1,130 | $1,053 | $972 |
| Original Product average outstanding balance | $1,184 | $1,159 | $1,154 | $1,070 | $1,075 |
| Combined averaged outstanding balance | $1,185 | $1,154 | 41,151 | $1,068 | $1,059 |

During the first three quarters of 2003, Integral's pilot housing loans with technical assistance grew steadily, as shown. The pilot product accounted for most of the growth in individual housing clients. The largest number of disbursements in the third quarter coincided with the start of the roll-out. This pace did not continue in the final quarter of the year. First, specialized loan officers, who had been working on individual housing since the start of the year, were transferred to the community housing product, reducing the number of loan officers from eight to five. Furthermore, clients demanded more microenterprise loans, at the expense of housing, for the busy holiday period. Also, Integral experimented with several promotional strategies in late 2003. Integral's management has responded to the slow growth in housing loans by placing more emphasis on promoting the product in 2004.

In Integral during 2003, the pilot housing product covered 81 percent of its costs. However, revenue declined in the last quarter because few new loans were made, the value of the portfolio declined slightly and delinquency increased. Operational costs also declined in the last quarter, but that was mainly because the specialist loan officers were transferred to the community housing product. This more than made up for extra branch costs resulting from the roll-out to four branches in September, so overall costs declined.

**Figure 3: Integral Pilot Housing Loans: Revenue and Costs, 2003**




Integral's pilot individual loan product tested our fifth hypothesis in housing microfinance – that a program with an optional construction assistance component can both ensure a high standard of quality in the construction financed and achieve profitability within two years. Evidence from the first year shows intensive construction assistance has no impact on construction quality while greatly increasing the product's costs.

Providing detailed construction advice is proving to be a challenge in Integral. Specialized loan officers' housing portfolios do not generate enough revenue to cover their personnel costs. Integral will use generalist loan officers during the roll out to keep the housing product's costs low. Microenterprise loan officers are taking more time than expected to master the construction advice, so housing loan evaluations take more time than business loans. Both of these factors increase the costs of providing housing loans with technical assistance in Integral, and limit portfolio growth.

ACCION and Integral contracted an independent professor of architecture, Stefano Anzellini, from the University of the Andes in Colombia, to conduct a survey on housing quality in El Salvador. The survey's objective was to document the impact that housing loans had in improving client housing, in terms of quality of life, reduction of vulnerability (particularly to earthquakes), and client satisfaction. A nation-wide sample of 56 recent home improvements covered three categories: improvements financed by Integral with construction assistance; improvements financed by Integral without construction assistance, and improvements not financed by Integral.

A key conclusion from the survey was that there was no significant difference in construction quality among the three categories. In other words, construction assistance provided by Integral did not make houses more livable or reduce their vulnerability to natural disasters. Home improvements financed met minimum standards for earthquake resistance, whether or not clients had received construction advice from Integral. The budget portion of the technical evaluation did help clients by predicting the actual costs of home improvements, allowing borrowers to control their construction budgets and complete their projects with loan funds.

These findings are important. Integral embarked upon a program of intensive construction assistance to respond to quality concerns and to control costs. The program has not met the first objective, but has achieved the second. There are two hypotheses to explain why construction advice may not have an impact on housing quality. First, clients may not be willing to pay for higher quality construction, even when they have funds, particularly if they are accustomed to relatively poor building standards. Second, implementing the advice may be beyond the technical capacity of clients.

In light of these findings, Integral is refocusing the technical assistance to focus more on controlling costs. It is seeking other ways to provide construction advice more efficiently. Integral has developed a series of seven construction pamphlets covering all aspects of home construction. These guides are used by clients to better understand and supervise their builders. As the product is rolled out to more branches, Integral will train existing microenterprise loan officers in construction assistance. Specialized loan officers will focus more on supporting the generalists by reinforcing their training on construction costs, and advising on specific cases.

Microfinance institutions have four main options in providing technical assistance to their clients: providing none, assessing construction costs, providing advice on construction techniques, or a combination thereof. Providing some advice implies higher upfront costs for MFIs, with construction advice the most expensive. Intensive construction assistance involves costs of training, whether the MFI hires construction experts and trains them as loan officers, or trains loan officers in construction. Few people meet the profile required to do both. If the assistance is provided but has little impact on construction quality, then MFIs should not provide technical help.

MFIs may also need to find other ways to improve construction quality in areas where they work. The construction pamphlets prepared by Integral and ACCION cover needs before starting construction, foundations, columns, building brick walls, building cement walls, metal roofing and wooden roofing. These pamphlets can be shared with clients without needing specialized staff or training. They are also permanent references for clients and builders. If an MFI believes it must provide construction advice to its clients, it could consider outsourcing this function to a specialized agency.

## Conclusions

The key lessons emerging from these two product introductions are grouped in response to our six hypotheses:

1. Housing microfinance is a more appropriate lending methodology than traditional mortgage lending for serving the housing finance needs of microentrepreneurs.

Microentrepreneurs and the working poor demand housing finance, and these needs can be reached without using mortgage financing. Enterprise microfinance has reached millions of clients who lack traditional collateral by focusing on repayment capacity and taking guarantees, such as household goods, guarantors, and inventory, that other financial institutions would not accept. Housing microfinance operates in a similar fashion. Institutions pay more attention to repayment capacity and tenure security, rather than requiring a mortgage. Few clients have the documentation required for mortgages, and institutions can more easily take collateral similar to their microenterprise loans. FAMA and Integral made more than 1,400 housing loans in their first year without requiring mortgages, and with strong repayment, showing housing microfinance is an appropriate response to their clients' needs.

2. A housing microfinance program can be integrated into an MFI's existing microenterprise finance operations without any adverse effects on the quality or growth of the existing microenterprise portfolio.

FAMA's experience supports this hypothesis with one caveat: loan officers in the pilot phase became slightly less efficient as they mastered housing finance, particularly the technical evaluation. This dip in efficiency lasted less than three months. It is likely to be shorter the simpler the technical evaluation format is. FAMA met its goals for the microenterprise portfolio in 2003, reaching $11 million, even as it introduced and rolled out its housing product. FAMA's portfolio grew by 25 percent in 2003, compared to 26 percent in 2002. In Integral, it proved more difficult to incorporate specialized loan officers into to MFI than to train existing generalists. During the pilot, Integral's portfolio increased as expected by 10.4 percent, so adding individual housing with technical assistance did not limit overall institutional growth. In both institutions, treating housing as an extension of existing working capital products made it an easy product to include. Housing loans have consistently lower delinquency rates than business loans.

3. An MFI's existing loan officers can be trained to offer housing loans without negatively affecting their productivity.

This hypothesis is validated, if the technical component is limited to controlling costs and adapted to local conditions and profiles. Once training had been completed, FAMA found no difference in productivity between loan officers working on both housing and enterprise, and those working only on enterprise. One factor is lower delinquency in housing loans, which means loan officers with larger housing portfolios spend less time on delinquency than their colleagues. Another factor is to closely monitor any technical evaluation during the pilot phase, to ensure credit staff can use it efficiently. If there are difficulties, the institution may need to simplify the evaluation, or reassess its use.

4. Microentrepreneurs' need for technical construction assistance, such as drawing plans, estimating construction costs or supervising construction labor, varies from person to person. Therefore, the construction assistance component of an MFI's housing loan product should be customized to the unique situation of each borrower.

Results so far do not reject this hypothesis per se, but it is difficult and costly for an institution to provide a wide range of customized assistance to each borrower. There is no evidence that failure to provide such advice limits effective housing finance.

Integral and FAMA took different approaches to construction assistance. Integral provided more detailed advice, using specialized loan officers, while FAMA limited itself to basic budget evaluations. This approach allowed FAMA to use its existing staff and processes, making more housing loans than Integral (632 vs. 192) during the first year, reaching a higher percentage of total portfolio by years' end (eight percent vs. two percent), and ensuring the product was more profitable.

5. A housing microfinance program including an optional construction assistance component can both ensure a high standard of quality in the constructions financed and achieve sustainability (profitability) for the MFI within two years.

This hypothesis has been tested in Integral. The construction quality survey found construction assistance had no visible impact on construction quality. The costs of such assistance, particularly hiring extra staff, more time training existing loan officers, and lower staff efficiency were substantial, lowering the product's profitability. The costs of construction assistance did not provide benefits in terms of construction quality. It may, however, provide value added to the clients, and could give an MFI an advantage over its competitors in customers' eyes. However, market research revealed the main demand attributes in competitive markets to be adequate loan amounts and terms, simple procedures, and low costs. Technical assistance, especially if it results in higher costs to the institution, is not likely to be a main advantage. Therefore, intensive technical assistance components are not justified by the available evidence. Integral is simplifying its construction assistance component as it rolls out the new housing product.

6. Housing microfinance portfolios, when designed to incorporate best practices in microenterprise finance, can achieve a similar scale to existing microenterprise finance portfolios.

Because both products are relatively young, it is too soon to draw a conclusion about this hypothesis. Results so far indicate that housing products have the potential to achieve scale, but this needs to be measured over years. The housing portfolio grew from zero to eight percent of the total in FAMA in a year and growth continues to be strong. In Integral, the share of individual housing in the portfolio declined slightly, from 15 percent at the end of 2002 to 14.4 percent. The pilot product did not grow as quickly as expected because implementing the construction assistance component of its product made it harder to grow. Besides providing this help more efficiently, Integral will also develop strategic alliances with companies to provide their employees with housing loans, and work more closely with hardware stores to attract more clients. The product will be rolled out to more branches in mid-2004, when the MFI's new management information system is fully implemented.

## Applying Lessons Learned

Across the ACCION Network, housing microfinance is rapidly becoming a core product. Several lessons learned from Integral and FAMA have been used to inform the design of new housing loan products within the ACCION Network. FINAMERICA in Colombia wanted a product that could be easily adapted to its staff and systems. Based on the ease of the pilot and roll out in FAMA, FINAMERICA used existing microenterprise loan officers. Technical evaluation would be required only for loans above $1,000, and then would be basic, focusing only on construction budget. FINAMERICA is only financing home improvements for the time being, but will consider financing house purchase and construction in 2004, depending on pilot results, market conditions and the regulatory environment.

Banco Solidario in Ecuador already has a whole house financing product, but introduced home improvements in February 2004. As in FINAMERICA, Banco Solidario is using existing loan officers, and will provide some construction budget verification only to clients with larger loans. During market research with Uganda Microfinance Union, clients asked for help in verifying builder's budgets, so the institution will provide cost control to all housing clients in its pilot, which began in March 2004. ACCION will monitor progress in Colombia, Ecuador and Uganda to deepen our experience in housing microfinance. These lessons will be used in new launches in Haiti, Paraguay, Ecuador and Africa in 2005. They will also be disseminated to the wider microfinance and housing communities.

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