InSight

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Building the Homes of the Poor – One Brick at a Time
Housing Improvement Lending at Mibanco

The "microfinance of housing" is an emerging and promising practice among microfinance institutions (MFIs). Housing microfinance merges elements from microenterprise finance and traditional housing finance (e.g., mortgages). Rather than financing the purchase or construction of a complete house, these loans are used to help poor families build incrementally, through a process commonly known as *progressive build*. A household's first loan might replace temporary scrap wood walls with cement blocks; a second loan might replace a worn zinc roof with reinforced concrete; and a third might add an additional room[1]. Among ACCION International's Latin American partners, seven[2] organizations have housing loan portfolios with a combined total of more than $30 million in outstanding portfolio and 15,000 active clients. This *InSight* publication summarizes the results of a case study[3] on the largest housing loan program in the ACCION Network, Mibanco's Micasa product in Peru. Initiated just two years ago, Micasa currently serves nearly 7,000 active clients with more than $8 million in outstanding portfolio and is already profitable.

Through its Initiative on Housing Microfinance, ACCION is actively supporting the development and growth of housing finance throughout its network. By 2005, more than 12 partners will be involved in this new area.

Market for Housing Finance in Greater Lima

The majority of Mibanco's branches and clients are located in the poor *barrios* in and around the Peruvian capital, Lima. The market for housing finance in this area is characterized by substantial demand for access to housing finance among the lower-income strata of the population, who represent 82 percent of total households. However, limited supply exists to satisfy this demand.

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[1] The genius of this incremental approach to finance is that it aligns with the processes low-income families around the world already use to improve the quality of their shelters.

[2] Mibanco in Peru, Banco Solidario in Ecuador, Fundación Mario Santo Domingo in Colombia, Génesis in Guatemala, BancoSol in Bolivia, FAMA in Nicaragua and Integral in El Salvador.

[3] ACCION is grateful to the Cities Alliance's Shelter Finance for the Poor Initiative for funding the case study. Readers interested in a more detailed description of the Micasa product should contact ACCION or the Cities Alliance (www.citiesalliance.org) for a copy of the full publication.

Demand for Housing Finance

Key factors affecting the demand for housing finance among low-income families in Greater Lima include:

- *High incidences of land possession, though limited legal title:* Two-thirds of poor households live in dwellings that they call their own, although very few of these actually possess the legal title to their property.
- *Improvements in size and quality of housing correlated with increasing incomes:* Less-poor households are more likely to have homes with additional rooms, constructed out of solid materials such as bricks and cement rather than wood and dirt.
- *Strong desire to improve or expand homes within the next 12 months:* At least half of poor households, and as many as 60 percent of the poorest households, express a strong desire to expand or improve their home within the next 12 months. However only 10 to 15 percent of households are currently borrowing from formal or informal sources.

Supply of Housing Finance

The two formal suppliers of housing finance to poor households in Peru are the government and private sector financial services providers. Government support for or provision of housing finance is limited to two programs, Banco de Materiales and MiVivienda.

- *Banco de Materiales (Banmat):* A state-run development agency providing heavily subsidized loans to poor, titled households for the purchase of construction materials. The program has been subject to political misuse and has been crippled by sky-rocketing non-repayment rates. At the time of writing, Banmat has stopped issuing new loans.

- *MiVivienda:* A government subsidy program designed to improve poorer households' access to mortgage loans, MiVivienda provides a capital subsidy of up to 20 percent of the loan amount for borrowers that obtain an approved mortgage loan from a private bank and maintain an excellent repayment record. Organizational and administrative difficulties have limited the expansion of this program. Few banks have more than a few hundred loans financed through the MiVivienda program.

With the exception of Micasa and a few other targeted programs, private sector supply of housing finance to the poor is limited to microenterprise or consumer loans that are diverted to housing investments. Examples of some of the other targeted private sector programs include:

- *Banco de Trabajo:* The sixth largest consumer lender in Peru, Banco de Trabajo, has a consumer lending portfolio to finance housing improvements in the middle- and lower-income segments. Local building supply stores market the loans for the bank and disburse the loan in the form of materials from their stores. Initial estimates suggest that Banco de Trabajo's housing-related active portfolio may reach several million dollars.

- *EDYFICAR:* A microenterprise lender like Mibanco, EDYFICAR has a small housing improvement loan portfolio of 160 loans that are disbursed with a significant construction assistance component.

The combined government and private sector supply of housing finance pales in comparison to the substantial need. This untapped potential market is the target of Mibanco's Micasa product.

Mibanco's Micasa Product

Product Description

Mibanco, a commercial bank focused exclusively on serving the "emerging sectors," is one of the largest MFIs in Latin America with more than 90,000 active borrowers. In mid-2000, Mibanco expanded its product offering to include Micasa, a housing improvement loan product. The loans are designed to help households finance projects to improve, expand, sub-divide, re-build or replace elements of their homes, rather than to purchase or build a new home, as is typically the case with mortgage lending.

The Micasa loan program is very similar to Mibanco's successful microenterprise lending methodology with four important differences:

- *Lower Interest Rates:* Micasa loans carry a lower interest rate (up to one-fifth less) than Mibanco's microenterprise interest rates. Micasa rates range from 50 to 70 percent annual interest[4] depending on the loan size, while working capital rates for similar amounts range from 60 to 85 percent per annum. These interest rates are market rates. They incorporate no subsidy and, as is demonstrated in the Institutional Impact section below, are sufficient to cover Mibanco's full cost of providing the Micasa loans. There are no additional commissions or charges – the full amount paid by clients is reflected in the interest rate.

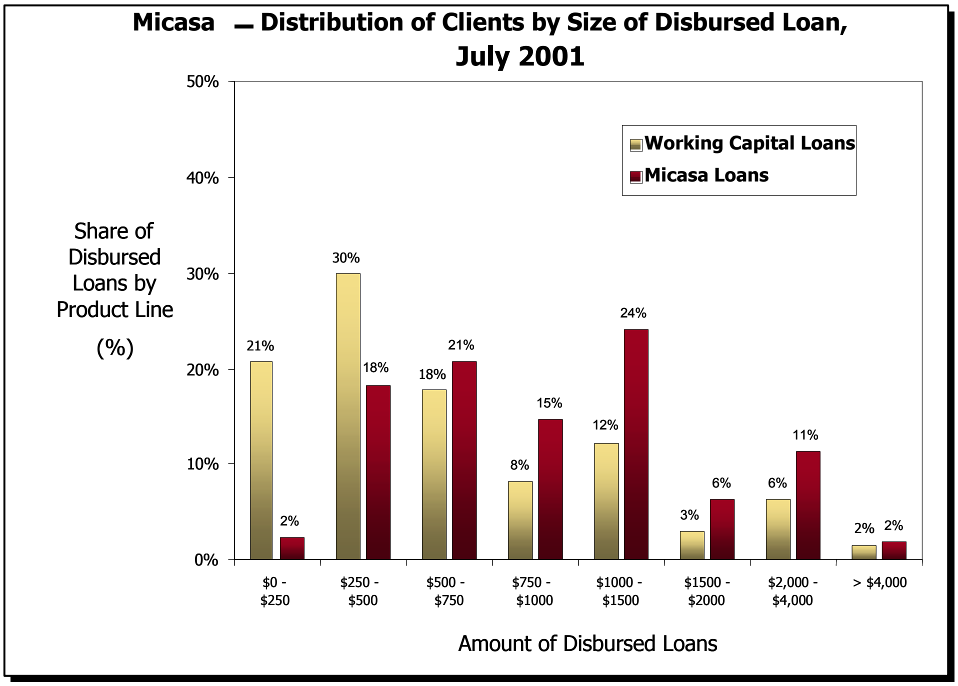
- *Slightly Longer Loan Terms:* Micasa borrowers can finance their improvement up to a maximum of 36 months. However, Mibanco's early experience suggests that most clients choose to finance their loans over much shorter terms (see Figure 1). The average term of a Micasa loan is 11 months, while Mibanco's working capital loans average less than six months.

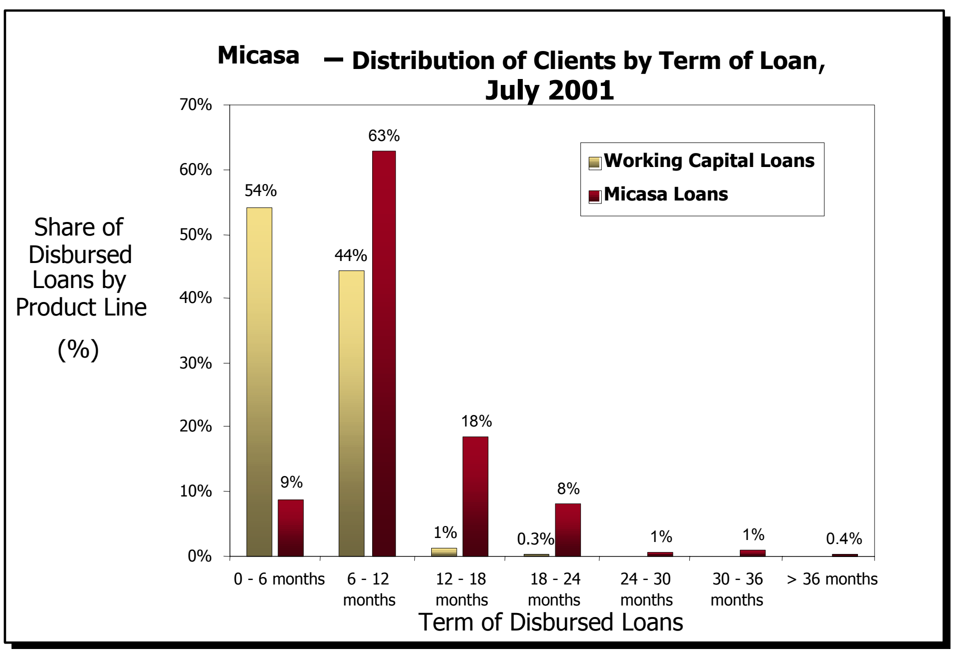
- *Slightly Larger Loan Amounts:* Although there are no limits on the size of Micasa loans, borrowers have tended to apply for amounts slightly larger than the average working capital loans. Average loan size for Micasa is $916 versus $655 for working capital loans.

- *Available to microentrepreneurs and salaried employees:* Micasa loans are helping Mibanco expand into a new market segment, low-income salaried employees. Existing Mibanco clients, new microentrepreneurs and new low-income salaried employees can all obtain Micasa loans. Roughly one-third of Micasa's clients in the first year were low-income employees.

[4] On declining balances.

Figure 1:


Micasa – Distribution of Clients by Size of Disbursed Loan, July 2001
Share of Disbursed Loans by Product Line (%)
50%
40%
30%
20%
10%
0%
Working Capital Loans
Micasa Loans
21%
2%
30%
18%
18%
21%
8%
15%
12%
24%
3%
6%
6%
11%
2%
2%
$0 - $250
$250 - $500
$500 - $750
$750 - $1000
$1000 - $1500
$1500 - $2000
$2,000 - $4,000
> $4,000
Amount of Disbursed Loans


Micasa – Distribution of Clients by Term of Loan, July 2001
Share of Disbursed Loans by Product Line (%)
70%
60%
50%
40%
30%
20%
10%
0%
Working Capital Loans
Micasa Loans
54%
9%
44%
63%
1%
18%
0.3%
8%
1%
1%
0.4%
0 - 6 months
6 - 12 months
12 - 18 months
18 - 24 months
24 - 30 months
30 - 36 months
> 36 months
Term of Disbursed Loans

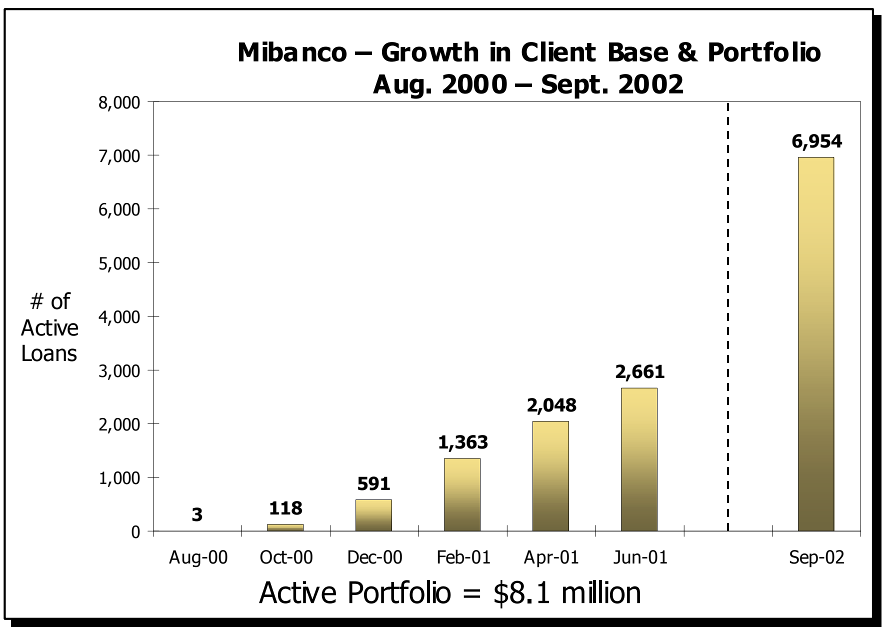
Micasa borrowers are not required to have legal title in order to obtain a loan and the guarantees used are predominantly not titles, but rather more traditional microenterprise guarantees such as co-signors or household assets.

The lending process is the same as that used for microenterprise loans. Mibanco uses the same *asesores* ("loan officers") for microenterprise and Micasa to identify prospective clients, evaluate loan applications and make approvals according to seniority levels. Loan turn around time averages three days for new clients and one day for repeat borrowers.

Institutional Impact of Micasa

To date, the institutional impact of adding Micasa has been unequivocally positive. Although the systems changes required to add salaried borrowers required greater time and budget than expected, Mibanco is already profiting from its investment. After 24 months of operations, Mibanco has almost 7,000 Micasa clients and portfolio at risk greater than 30 days on its Micasa portfolio of just one percent.

Figure 2:



Preliminary estimates suggest that Micasa broke even on a free-cash-flow basis, including the initial systems investment, within nine months. If it continues at current levels, Micasa will generate a return on loan portfolio between seven and nine percent – significantly higher than Mibanco's overall return on loan portfolio of 3.4 percent.

The only potential institutional risk uncovered in the analysis is the growing potential term risk in Mibanco's liabilities structure. Forty-six percent of the outstanding Micasa portfolio has a term longer than 12 months. As the Micasa portfolio grows relative to total portfolio – it currently represents 10 percent – Mibanco will need more access to medium-term funding sources. Currently, it covers this term risk through a five-year credit line with the government second-tier lender, COFIDE.

Client Impact of Micasa

The anecdotal evidence collected in this research through two focus groups and visits to 10 households suggests the following with respect to the client impact of Micasa:

- *Client satisfaction is high:* All of the clients interviewed were very satisfied with their loans and most expressed a desire to finish repaying their current loan in order to take another one to continue building.

- *Type of project is highly variable:* Projects financed ranged from the relatively simple (e.g., replacing doors and windows) to the more complicated (e.g., replacing foundations and building second floors above clients' businesses).

- *Many projects have an income-generation component:* Although not the majority, a substantial number of the projects financed were intended to or did generate additional income for the borrowers. One borrower used his Micasa loan to move his five-person family into two new rooms, leaving the previous two rooms (totaling 30 square meters) available for expansion of his bicycle repair shop. Another borrower added an open patio and modified her kitchen allowing her to sell hot meals to patrons at the nearby market. In both cases, the Micasa loan generated incremental income for the family.

- *Few projects are completed with a first loan:* Virtually all of the clients interviewed had not completed their construction project with their first loan. In some cases their loan amount had been limited because of insufficient capacity to repay or limits set by Mibanco on the amount first-time borrowers can receive; in others the estimation of the construction budget was inaccurate; and in others, the client had decided to increase the scope of the project during the construction.

- *Risk of diversion of housing loan funds seems small:* Loan officers consistently report that few, if any, of their clients have attempted to use their Micasa loans for other purposes, despite the lower interest rates.

- *Construction assistance may or may not be beneficial:* Mibanco does not provide any construction assistance to Micasa borrowers as part of the lending process. Borrowers are responsible for hiring their own help in designing, budgeting and building the desired improvement. None of the improvements visited suffered from serious structural deficiencies, although several had problems with the accuracy of the construction budget. Client interest in receiving construction assistance from Mibanco varied: some were very interested, while others were not at all.

If the trends identified from this anecdotal evidence can be more broadly applied, they highlight some of the added complexities of housing improvement lending relative to microenterprise lending. Borrowers counting on additional income generated by the construction may have difficulty repaying the loan if they are unable to complete the project. Similarly, borrowers that complement a Micasa loan with other loans in order to complete a project may have difficulties repaying both loans. In both cases, the loan officers' ability to analyze the repayment capacity and to determine the true project cost is crucial in managing these risks.

Implications and Conclusions

This emerging experience at Mibanco corroborates experiences at other ACCION affiliates. In synthesis, these emerging experiences with housing microfinance challenge many of the paradigms that have historically dominated thinking about low-income housing finance (see Table 1). Providing finance for progressive construction projects rather than complete constructions fits with low-income households' existing method of construction. It also reduces the total cost to the household over the life of the loans, relative to a single, larger loan over a longer term. At the same time, loan terms and conditions for progressive-housing improvement loans more closely resemble microenterprise than mortgage loans. Loans average \$1,000 to \$2,000 with terms of less than 24 months, while mortgages are seldom used as guarantees. Taking a formal mortgage is generally too expensive for the lender and too time-consuming for the borrower for loan amounts less than approximately \$4,000 or \$5,000, which leads lenders to rely on traditional microenterprise guarantees of household assets and co-signors.

Table 1: Challenges to Traditional Housing Finance Paradigms

Traditional Housing Finance Paradigm	Emerging Experience: Housing Microfinance
▪ Finance must be for a complete housing solution. ▪ Loans large enough for a complete housing solution (greater than \$5,000), must be long-term and subsidized to be affordable for low-income households.	▪ Low-income households are accustomed to a "progressive build" process. ▪ "Progressive build" loans with market rates of interest can more easily be customized to households' capacity to repay. ▪ Financing "stages" of a project with multiple, shorter-term loans rather than one larger, longer-term loan reduces interest paid by the household and risk for the lender.
▪ Design, planning and construction must be done by outside, technical experts to reduce the cost of the project and ensure the quality of construction.	▪ Households can manage portions of the technical process on their own and still achieve an acceptable level of quality. ▪ Households have a strong preference to make their own design decisions. ▪ Role for external technical expertise likely varies depending on the project and the household. Role is as a consultant. ▪ Primary role for outside expertise is in the design and costing phase.

Traditional Housing Finance Paradigm	Emerging Experience: Housing Microfinance
▪ Low-income "housing" finance follows a paradigm similar to the mortgage finance industry in North America.	▪ Low-income "housing" finance follows a paradigm similar to the microfinance industry in many countries.
▪ The interest rate is the key factor in households' decision to borrow.	▪ Access to capital for housing investment, simplicity, flexibility and speed of disbursal are the primary factors in households' decision to borrow. Interest rates are important, but secondary.
▪ Investment in housing is "non-productive."	▪ In many, though not all cases housing investments directly generate additional income (e.g., rentals, additional space for home-based microenterprise).

The early success of Mibanco also strongly suggests that many of the principles and "best practices" developed in microenterprise lending are highly appropriate to the provision of housing microfinance to the same families. Moreover, the process of integrating a progressive-housing improvement lending program into an existing microenterprise lender may not be as difficult as one might expect, particularly given that many housing investments do generate additional family income as rent or additional space for a microenterprise.

This is not to say that all MFIs can or should immediately expand their portfolios to offer progressive-build housing loans. Much of Mibanco's early success relies on its well-trained loan officers, smoothly functioning processes and procedures, and an advanced management information system (MIS). MFIs whose lending methodologies do not accurately determine borrowers' capacity to repay may have difficulty setting the terms and conditions of the loans without the cushion of the additional income generated by most working capital loans. In some cases this could lead to client over-indebtedness. Housing microfinance loans, when they do not generate any additional income for the borrower, leave less margin for error in an MFI's lending methodologies. MFIs considering the addition of a housing lending product to their portfolios should first be confident in the quality of the information from their loan officer's evaluations and comfortable that their microenterprise lending program is operating smoothly and efficiently.

Outstanding Issues

Several key questions remain for MFIs or other financial service providers with existing or developing low-income housing portfolios. In particular, the question of whether and how to provide construction assistance as an integrated part of lending to low-income households remains unanswered. Génesis in Guatemala, Fundación Mario Santo Domingo in Colombia and several organizations working with the Cooperative Housing Foundation argue strongly that additional construction assistance, particularly in the design and planning phase, is required to ensure that construction budgets are reasonable and projects meet minimum quality standards. However, Mibanco and several other MFIs in the ACCION Network have had some success without providing this assistance. At a minimum, the experience collected to-date suggests that i) loan officers need to be trained in how to evaluate construction budgets and simple aspects of design; and ii) further experimentation and documentation of the existing evidence is needed to better understand the costs and benefits of providing additional construction assistance.

Additional outstanding questions highlighted by the experiences documented in this study include:

- *Where will the medium-term sources of funds needed to finance the growth of low-income housing finance portfolios come from?* Most MFIs have limited access to commercial sources of funds with terms greater than one year. Yet progressive housing improvement loan terms can be as long as five years and average 12 to 18 months. Mibanco is currently able to fund its medium-term Micasa loans in part thanks to access to a five-year government loan. However, as the portfolio grows, additional sources of longer-term capital will be required to avoid liquidity problems. If Micasa and other housing microfinance programs continue to grow rapidly, reliable access to medium-term funding sources will be a requirement in the not-too-distant future.

- *Can sustainable progressive-build lending be designed or adapted to effectively reach the "extremely" poor?* Mibanco's lending primarily targets "very poor" and "poor" households and serves few of the poorest households due to concerns that these households may not have the means to repay a loan. Other programs both in Peru and elsewhere are generally similar. It remains to be seen whether sustainable housing lending programs can or should try to reach substantial portions of the "extremely poor" or whether these households are best served by subsidized government programs.

To follow up on these issues and increase the growth of housing microfinance within the ACCION Network, ACCION's Initiative on Housing Microfinance supports our partners in Latin America and Africa to design, pilot test and roll-out housing microfinance products. In 2002, ACCION worked with FAMA in Nicaragua to launch a new housing microfinance product and Integral in El Salvador to test the benefits of adding a stronger construction assistance component to its microfinance of housing loans. In 2003 and 2004, ACCION will be working on similar issues elsewhere in Latin America and Africa. Our goal is to increase the number of active housing borrowers within the ACCION Network from 15,000 today to more than 50,000 by the end of 2005 (see Table 2).

Table 2: Housing Microfinance & Traditional Housing Finance within the ACCION Network, September 2002[5]

	Product	Active Portfolio $000's	# of active clients
Mibanco (PERU)	Housing Microfinance	$8,123	6,954
	Traditional Housing	$461	20
BancoSol (BOLIVIA)	Traditional Housing	$15,596	3,183
Banco Solidario (ECUADOR)	Community Development	$2,400	1,098
Integral (EL SALVADOR)	Housing Microfinance	$1,511	1,233
	Community Development	$1,598	2,072
Génesis (GUATEMALA)	Housing Microfinance	$210	868
Fundación Mario Santo Domingo (COLOMBIA)	Housing Microfinance	$394	216
FAMA (NICARAGUA)	Housing Microfinance	Launched in November, 2002	
TOTAL		**$30,293**	**15,644**

[5] Génesis data as at June 2001.

This paper was written by Warren Brown, senior director of Research & Development at ACCION International. Special thanks to the staff of Mibanco for sharing their knowledge about the microfinance of housing and their Micasa program.

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