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**A Report on
Low Income Housing in India:
Challenges and Opportunities for
Microfinance**

for
Habitat for Humanity India

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Executive Summary

The objective of this report on low-income housing micro finance in India is to explore best practices and models used by organisations already providing housing finance products, with particular emphasis on southern India. The Study will help understand in detail, the challenges in providing low-income housing finance in India, with special attention to housing microfinance, and generate recommendations for product design and implementation. Other related issues are also tracked in the report, such as past achievements in low income housing, demand for current trends in housing finance in India, perceptions of various stakeholders and new potential investments available in the sector.

Although consumer demand for housing remains high, the financing options available for low-income households, especially for those employed in the informal sector, are limited. Moreover, the current financing options, which range from moneylenders to government subsidies, are not tenable in the long run. Fortunately, Micro Finance Institutions (MFIs) provide an innovative channel to finance housing for the poor. However, the ability for microfinance institutions to provide housing continues to be difficult, mired in concerns over scarce funding, legal risks arising from informal land title, lack of collateral and insufficient knowledge about construction. An in-depth look at housing microfinance in India brings to light the variety of products in the market, each with their own advantages and disadvantages. Different experiences and initiatives in this sector call for proper documentation so that they can be analyzed with respect to a common framework of housing microfinance. Governments and funding organisations are also interested in learning from successful and efficient housing finance schemes to improve their own models of support. A sector-wide analysis of housing microfinance is particularly relevant for stakeholders interested in entering this sector and developing cost effective housing finance solutions.

This report has seven sections. The first section identifies the need for low income housing and finance and provides an introduction to the report. The second section examines in detail factors that affect demand for low income housing finance and identifies different providers of finance to the low income sector. This is followed by a detailed discussion of three different models of housing finance. Section 4 specifically discusses the challenges and opportunities for housing microfinance in the sector. The next section lists out some of the successful programmes in India and the reasons behind the same. Section 6 enumerates the steps to be followed in designing and implementing a housing microfinance programme. Section 7 concludes with a discussion on the urgent need to remove roadblocks in this sector through mutually advantageous partnerships between MFIs, financial institutions and international donor agencies and organisations providing technical and construction services.

Glossary of Acronyms

1. AUDA: Ahmedabad Urban Development Authority
2. BPL: Before Poverty Line
3. DFID: Department for International Development
4. DHFL: Dewan Housing Finance Corporation Limited
5. ESAF: Evangelical Social Action Forum
6. GOI: Government of India
7. HMF: Housing Microfinance
8. HUDCO: Housing and Urban Development Corporation (public housing)
9. IASC: Indian Association of Savings and Credit
10. MCHF: Micro-Credit to Housing Finance (approach to housing microfinance)
11. MFI: Microfinance Institutions
12. NABARD: National Bank for Agriculture and Development
13. NBFC: Non Banking Finance Company
14. NGO: Non governmental organisation
15. NHB: National Housing Board (public housing)
16. NURM: National Urban Renewal Mission
17. SAHF: Shelter Advocacy to Housing Finance (approach for housing microfinance)
18. SEWA: Self Employed Woman's Association
19. SIDA: Swedish International Development Cooperation Agency

Low Income Housing in India: Challenges and Opportunities for Microfinance

1. Background: Need for Cost Effective Low Income Housing

Owning an asset, such as, a house protects the poor from the vicissitudes of life. It is one of the basic needs for most poor households and is important to ensure safety and health. For poor people who work out of their homes, such as micro-entrepreneurs, home improvement may have positive implications for income generation. As such, low-income housing is an area of interest for NGOs and financial institutions that serve the poor since not only is this an important need for the well-being of poor people, it is also something for which there is a clear willingness to pay for secure housing or land title.

In India, the right to housing and adequate shelter is guaranteed in the Directive Principles of State Policy¹. Consequently, both central and state governments have an obligation to keep this provision in mind while formulating laws and policies. Until recently, the government had the tendency to view housing as a social problem, rather than as a developmental activity which could have tremendous trickle down effects for the economy. Yet, research shows there is possibility for much lucrative activity, as the consumer demand for housing is very high in the low income housing segment. India's housing shortage is estimated to be as high as 40 million units and demand from the low income segment constitutes a large proportion of this shortage. Other studies indicate that more than 200 million people are living in acutely poor housing conditions or on the streets². Such high demand heralds customized designs of housing finance products and supply mechanisms targeting low-income groups which have traditionally been excluded from the housing market due to land tenure and high investment requirements.

In the recent past, several institutional efforts have been made to improve access to loan financing for these low-income households. In particular, shelter finance and community finance mechanisms have expanded considerably in the recent decades³. Notable examples of housing microfinance include the Self-Employed Women's Association (SEWA) Bank's efforts in Gujarat and the National Slum Dwellers Federation in Mumbai amongst others. These micro finance initiatives, typically comprised of small loans for housing improvements, are bolstered through close relationships with the community to encourage savings and discourage default. This is compatible with the pattern of low-income home building in which there are gradual improvements over time as the poor avail themselves of more opportunities to access finance through family, friends, local money lenders, and, in some cases, credit unions.

¹ These provisions, contained in Part IV of the Constitution of India, are non-justiciable or non-enforceable by any court, but the principles laid down therein are considered to be guidelines to the State in its attempt to establish a just society in India.

² Asia Development Bank web site: <http://www.adb.org/Documents/Profiles/LOAN/30204013.ASP>

³ United Nations Human Settlements Programme. Financing Urban Shelter: Global Report on Human Settlements, 2005. London: UNHABITAT (2005).

It would be pertinent to begin by defining housing microfinance. Housing microfinance delivers housing finance to low-income people based on mechanisms first developed for the delivery of micro-enterprise loans. In other words, housing microfinance consists of small loans to low and lower middle-income households, typically but not necessarily without collateral, specifically intended for housing-related endeavours, including new constructions; repairs, improvements or upgradation of existing structures; purchase of land; and investment in infrastructure. Low-income households tend to build gradually and incrementally, often building only one room at a time. This process of ‘progressive housing’ or ‘progressive build’, as it is referred to in literature, is thought to be compatible with microfinance which comprises small loans of a short tenor⁴.

The table below summarises the basic features of financing housing microfinance loans:

Table 1: What are the key features of housing micro loans?	
Size	Varies, but generally 2–4 times larger than average working capital loans (income generation loans tend to be Rs. 3000-10000)
Term	Usually 2–24 months for home improvements, and 2–5 years for land purchase or construction
Interest	Same as standard working capital loans or slightly lower (~12-18%)
Liability	Almost always provided to individuals, rather than to groups
Collateral	Mostly unsecured; co-signers often used; real guarantees may be used; formal ownership of dwelling or land may be required; savings sometimes used as a guarantee (may be compulsory)
Target Clientele	Low-income salaried workers; microentrepreneurs primarily in urban areas; poor people. Low income housing is usually targeted at people with a monthly income of Rs. 10,000 and below
Other Services	Sometimes accompanied by land acquisition, land registration, and construction (including self-help building techniques)
<i>Source:</i> Adapted from CGAP Donor Brief No. 20, August 2004 “Helping to Improve Donor Effectiveness in Microfinance”	

2. The Low Income Housing Sector

2.1 Demand for Low Income Housing Finance

There is an enormous unmet demand for low-income housing finance. It is believed that the root cause of the shortage is the lack of housing finance options for low-income households which account for over 90 percent of the housing need⁵. In a market study of microfinance in three Mexican cities bordering the US, the effective demand for Housing Micro Finance (\$122 million) amounted to five times that for micro-enterprise loans (\$20 million)⁶. In India, micro-loans made by Micro Finance Institutions (MFIs) for entrepreneurial activities are habitually diverted by clients towards housing needs. Surveys of low-income households conducted in

⁴ Ferguson, Bruce. “Housing Microfinance—A key to improving habitat and the sustainability of microfinance institutions.” *Small Enterprise Development* Vol. 14, No. 1 (2003),

⁵ Asia Development Bank web site: <http://www.adb.org/Documents/Profiles/LOAN/30204013.ASP>

⁶ Capital Advisors Ltd. (1998) ‘Demand for market-based financial services for progressive housing and micro-enterprise development on Mexico’s northern border’, Report prepared for the World Bank.

developing countries indicate that for these households, housing has a higher priority than education and health⁷.

A household's decision to invest in housing is influenced by its perception of housing. Theory leads us to think of low income housing from three vantage points⁸. First, *housing is most commonly thought of as Shelter*: housing is a basic right, necessary for safety, health and dignity. Second, *housing can also be a Commodity*: about 60% of a poor person's assets are represented by her/his home. The investment in housing can thus be a significant gauge of social and economic status for a poor person. Third, *housing is also an investment* as is apparent in the case of home-based micro-enterprises. Home improvements provide the opportunity for higher productivity and thus, higher income. For instance, SEWA reports a 35% average increase in small enterprise weekly earnings as a result of the Parivartan slum upgrading programme⁹.

However, as the Report on Housing Microfinance Initiatives conducted by Harvard University indicates, poor households will not spend more than 15% of their income on housing without some assurance of their ability to exercise authority as owners or renters. Thus, government policies must seek to increase security of land and home tenure if poor households are to be motivated to seek housing loans.

Another aspect of low-income housing is the central importance of the neighbourhood which the beneficiary currently inhabits to her/his life and livelihood. Poor people in rural and urban areas prefer to make improvements to their existing house rather than move to a new unit. This preference ultimately underscores the importance of the economic and social networks which are rooted in their neighbourhood. For instance, in Ahmedabad, 110 beedi workers were allotted houses through a scheme involving SEWA, Ahmedabad Urban Development Authority (AUDA) and the Beedi Welfare Fund in 1993¹⁰. The location of the houses was far from the centre of the city and from the original homes of the allottees. They were also far from the site of their occupations, which raised transportation costs. As a result, it is estimated that close to half of the homes have been rented out or sold by the original allottees¹¹. Even in other AUDA schemes where homes are typically located close to employment opportunities, about 40% of the beneficiaries move back to their original neighbourhoods. These episodes reveal critical importance of neighbourhood ties to low-income livelihoods.

⁷ Ferguson, Bruce and Haider, Elinor (2000). "Mainstreaming Microfinance of Housing" Inter-American Development Bank.

⁸ Serageldin, Mona (1993). Use of Land and Infrastructure in the Self Improvement Strategies of Urban Lower Income Families. Working Paper. Office of Housing and Urban Programs. U.S. Agency for International Development.

⁹ The Center for Urban Development Studies, Harvard University. "Housing Microfinance Initiatives." Microenterprise Best Practices (2000).

¹⁰ Gujarat Manila Housing SEWA Trust Website. <http://www.sewahousing.org>

¹¹ These are the preliminary findings from a CMF project. Please note these results are not final.

2.2 Supply of Finance for Low Income Housing

The supply of low income housing finance is constrained mainly because of banks' inability to accurately assess credit risk associated with low income borrowers, lower profit margins, lack of land titles, and uncertainty of repossession. While the penetration of traditional mortgage finance market in India is already miniscule, the penetration of low income housing is even smaller. In India, the mortgage to GDP ratio is estimated at 2%¹². This mortgage to GDP ratio compares poorly to that of over 51% in USA and between 15-20% in South East Asian countries. The national government has control over legislation and resource allocation for housing finance; however, the enforcement of these rules falls under the jurisdiction of the state government which control suburban development, land-use regulation, and housing. Local governments enjoy a great deal of flexibility in terms of executing affordable housing interventions.

The two main public players in housing finance in India are the Housing and Urban Development Corporation (HUDCO) and the National Housing Board (NHB). HUDCO was created with the goal of servicing low- and middle-income households by financing infrastructure development and increasing credit options. Accordingly, HUDCO also provides loans to housing finance institutions which are then lent to low-income households. NHB is the regulatory body for housing finance institutions and principally promotes housing finance institutions at regional levels. It also provides refinancing to the financial institutions that provide loans for low-income housing. Recently there has been discussion pertaining to the restructuring of state housing boards since funding from HUDCO often proves insufficient. The National Urban Renewal Mission (NURM) is a new initiative from the central government which provides grants to State housing boards to improve living conditions in a holistic manner for the urban poor.

In stark contrast to the burgeoning traditional mortgage finance market, very few commercial banks have entered the low-income housing market and even fewer have dabbled with housing microfinance. Those that do service low-income households tend to offer long-term mortgage loans which extend out to twenty years and require a down payment between 10% and 30% of the home value, payslips, and a legal title to the property. Even in the case of HDFC, one of the largest housing loan providers in India, whose proposed objective is to serve middle- and lower-income clients, they require a legal title to the house and clients to be formally employed or business owners with audited financial statements. As a result, only about 10% of their consumer housing portfolio is directed towards the lower middle and low income groups. However, they tend to lend in bulk to organisations serving the needs of the poor, such as, SEWA and Indian Association of Savings and Credit (IASC). In order to target specifically low-income populations, HDFC and the Aga Khan Fund for Economic Development established GRUH Finance Limited in 1986 to provide home construction and purchase and improvement loans. Dewan Housing Finance Corporation Limited (DHFL) is today considered to be the largest company targeting lower income segments.

Housing Microfinance is one of the more recent avenues for low-income households to access loans for housing. However, it is still at a nascent stage. Even in the four South Indian states,

¹² Karnad, Renu S. "Housing Finance and the Economy: regional Trends, South Asia: Perspectives." Presented at the 25th World Congress, International Union for Housing Finance, Brussels (June 23, 2004).

where MFIs are thought to be extremely active, there are only a handful of organisations which explicitly offer housing loan products.

3. Models of Low Income Housing Finance

This section will provide an overview of the different channels through which low-income housing is currently provided in India. The government, both at the state and central level, continues to be an important player. Its influence in this sector is felt primarily in the form of some combination of grants and loans to various vulnerable sections of the population including but not limited to: Below Poverty Line (BPL) households, Scheduled Caste, and Scheduled Tribe households. Other innovative models for the provision of low-income housing finance include notable examples of MFIs; public-private partnerships involving NGOs, banks and financial institutions; and bottom-up community-based government programmes supporting housing loans for vulnerable sections. This section will focus on programmes for low income housing offered by MFIs.

3.1 Government Programmes

Traditionally government interventions, both in India and abroad, take place through some combination of subsidies and new housing construction. Several commentators have expressed the futility of a policy that rests on these two legs¹³. Substantial subsidies, while fashionable with politicians and even poor households, are susceptible to corruption and nepotism, provide low per-unit coverage relative to demand and ultimately, and are financially unviable. Further, a housing policy that promotes expensive new housing is not in keeping with the realities of low-income housing which, as we saw earlier, is characterised by ‘progressive build.’ Such policy arises not only from influential parties such as home finance institutions and land developers but also from a top-down approach towards low-income housing. This policy may also discount opportunities for micro finance, which unlike the top-down approach, is capable of being scaleable and sustainable if managed properly. In the Indian context, government sponsored programmes seemed poorly targeted and poorly funded relative to the demand. In urban areas alone, current funding covers less than 1 percent of the housing demand¹⁴. Further, Government of India (GOI) urban programmes have been allocated close to \$130 million assistance per year in the Budget¹⁵. Assuming that GOI targets 40 million out of the total slum population of 60 million, every slum dweller receives \$3 of assistance per year, emphasizing Ferguson’s point that subsidies are insufficient to meet housing demand. The problem is even worse in urbanized areas than in rural ones, as Buckley et al. demonstrates. Comparing rural versus urban programmes, the research of Buckley et al. shows that rural subsidies are six times higher than

¹³ Ferguson, Bruce. “Housing Microfinance—A key to improving habitat and the sustainability of microfinance institutions.” *Small Enterprise Development* Vol. 14, No. 1 (2003).

Ferguson, Bruce and Elinor Haider. “Mainstreaming Microfinance of Housing.” *Housing Finance International* Vol. XV, No. 1 (September 2000): 3-17.

¹⁴ According to GOI, current programs create 100,000 new houses, whereas there are about 12 million households in slums (Kalarickal & Singh, 2005)

¹⁵ Buckley, Robert; Kalarickal, Jerry and Singh, Mahavir. “Strategizing Slum Improvement in India: A Method to Monitor and Refocus Slum Development Programs” World Bank Working Paper (2005).

urban subsidies, even though the ratio between rural and urban poor is three to one. Thus, on per capita basis, the rural poor get twice as much funding as the urban poor¹⁶.

Looking at Table 2 below, which describes two major GOI urban programmes in place – Valmiki Ambedkar Awas Yojana and the National Slum Development Programme, subsidy-laden framework of financing of such programmes becomes apparent. Embedded in the statistics, the poor repayment performance is a hidden subsidy and consequently, these programmes incorporate subsidy rates of 80 to 90%. Such high rates of subsidy embodied in the form of grants, free land and loan defaults are present in rural schemes as well. More than anything else, what the government programmes have revealed is that a demand-driven process, informed by community participation, would lead to greater satisfaction with the end product and greater efficiency. Consequently, poor people would be more willing to pay for the product, which would in turn alleviate the appreciable monetary load on the state. The Kudumbashree's Bhavanashree programme in Kerala exemplifies this point¹⁷.

This discussion on government programmes is important because in some sense, it frames the environment within which any financing institution in the low income housing sector would have to function. The culture of subsidies is a challenge for providers of low-income housing finance such as MFIs. Given that they are important political tools to gain votes, they are difficult to do away with. At the same time, it may be possible for MFIs to use the subsidy to better leverage their products. For example, some government housing subsidies insist on the presence of a foundation prior to the disbursement of funds for the superstructure. MFIs could extend loans to build the foundation. Similarly, there exist subsidies to build sanitary toilets. When MFIs lend to beneficiaries, the latter can use home loans in conjunction with the subsidy for toilets, thus making more money available for the home itself.

¹⁶ *ibid.*

¹⁷ See Case Study for details.

Table 2: Comparison of Urban Housing Programmes						
Programme	To State	To Beneficiaries	Loan Element (A)	Loan Default Rate (B)	Effective Grant Due to Default (C) = (A) X (B)	Total Effective Grant 1 - (A)+ (C)
NSDP	70% Loan and 30% Grant For special category states, the amount is given as 90% grant and 10% loan	1) Selection and development of one slum in each city as a "model slum" in the case of Karnataka 2) 10% of NSDP funds can be used for housing construction and/or upgradation (the rest should be used for physical and social infrastructure). 3) Housing provided on loan (Rs. 50,000); amenities free of cost	50%	60%	30%	80%
VAMBAY	50% Central subsidy 50% matching funds from State From GOI routed through HUDCO	1) 80% of total amount received from GOI spent on housing of which: 50% given as subsidy, 50% as loan. 2) 20% to be invested in the provision of water supply and sanitation (toilets) within the assisted slums	70%	80-86%	60%	90%

Source: Buckley, Kalarickal & Singh (2005)

3.2 Slum Upgradation and Re-development Programmes

Increasing urbanization in India has put immense pressure on existing civic amenities, leading to the creation of informal settlements and slums. Slum dwellers live in inadequate conditions that are inimical to health, hygiene and education. Although the majority of India's poor live in rural areas, the rapid scale of urbanization has meant that poverty is also becoming an urban phenomenon. In India, for instance, the 10th Five Year Plan indicates that in eleven states (including states like Haryana, Uttar Pradesh, Andhra Pradesh, Kerala, Maharashtra and Rajasthan), poverty in urban areas is greater than in rural areas¹⁸. While it was earlier believed that slums and other informal settlements in urban areas were temporary and make-shift, there is evidence to show that slum dwellers are not simply newly arrived rural migrants. In Mumbai, as many as a 100,000 of the pavement dwellers are second-generation residents. Nearly 62 million urban people in India live in slums and squatter settlements today, constituting over 21% of the urban population. Though cities are engines of growth and contribute nearly 60% to country's GDP, the urban infrastructure has not developed in accordance with the requirements of time¹⁹.

Many housing programmes in slums begin as rights advocacy movements, which then realize the need for providing financial and technical assistance to their target audience. Typically, MFIs providing financial assistance in urban areas tend to focus on housing upgrades and infrastructure improvements, the most notable example being SEWA Bank's involvement in the Parivarthan slum redevelopment scheme in Ahmedabad. Increasingly, purchase of land has also become an important activity for MFIs, constrained by the high price of land in metropolitan areas. Urban slum HMF programmes tend to follow the partnership model, where usually the MFI, NGOs, community based organisations, the city municipal corporation, the private sector and the government are involved. HMF in slums has had a few high profile successes like the Parivarthan project and the SPARC-NSDF-Mahila Milan slum upgrade efforts in Mumbai. There is currently a pilot project in Bangalore which examines the benefits of offering micro-loans for renting and leasing. In the urban context, this is a significant step in the right direction since renting is an important way of obtaining shelter.

3.3 Housing Microfinance – Different Approaches

Housing microfinance (HMF) is often said to lie at the intersection between traditional mortgage finance and micro-enterprise finance²⁰. For instance, the amount and the tenure of the loan are typically much smaller and shorter in HMF than in traditional mortgage finance. What differentiates housing loans from income generation loans even

¹⁸ Buckley, Robert and Kalarickal, Jerry. "Shelter Strategies for the Urban Poor: Idiosyncratic and Successful, but Hardly Mysterious" World Bank Policy Research Working Paper 3427 (2004).

¹⁹ Buckley, Robert; Kalarickal, Jerry and Singh, Mahavir. "Strategizing Slum Improvement in India: A Method to Monitor and Refocus Slum Development Programs" World Bank Working Paper (2005).

²⁰ Ferguson, Bruce and Haider, Elinor (2000). "Mainstreaming Microfinance of Housing" Inter-American Development Bank.

within MFIs is that while traditional microfinance loans are unsecured, HMF loans generally require some kind of collateral, most typically a title, be it legal or para-legal. Table 3 encapsulates some of the salient differences between micro enterprise loans and HMF.

Table 3: Micro-Enterprise Loans versus Housing Microfinance	
Micro-Enterprise Loans	Housing Micro Finance Loan
Affects borrower's income	Affects borrower's income and asset base
Loans are short, small loan amounts	Loans are relatively longer and larger
May or may not be "fungible" Ex: A loan to buy livestock can be used towards housing activities	Relatively harder to be "fungible" since housing loans are disbursed in a staggered manner and are easily verified
Repayment capacity based on ability to use loan to generate future income	Repayment capacity is based on current income and future income. Housing asset does not directly generate income
Unsecured loan	Can be Secured or Unsecured. Typically requires either legal title or some para-legal document
Tend to be group loans; social collateral said to enforce repayment	Can be individual or group loans; social collateral not as effective for higher loan sizes

Adapted from table in presentation "Housing Microfinance: An Overview" by Franck Daphnis and Bruce Ferguson at the Small Enterprise Education and Promotion (SEEP) Network Annual General Meeting, October 28, 2004

Housing finance for the poor is often categorised under two approaches²¹: Shelter Advocacy to Housing Finance (SAHF), and Micro-Credit to Housing Finance (MCHF). While both approaches offer housing loan products with an emphasis on reaching the "unreached," the respective origin of the two has set distinctive characteristics in the way they deliver housing services to the poor. In case of SAHF, which grew out of slum upgradation efforts, the primary focus is on land rights and shelter advocacy, and credit plays a supplementary role. As a result, when the impact of a SAHF programme is assessed, more emphasis is placed on human development indicators than on financial performance. Moreover, due to its focus on land acquisition and infrastructural services, SAHF tends to have larger loan amount and longer tenure, if there is a loan component in the programme.

On the other hand, MCHF has evolved naturally out of conventional micro-credit programmes as MFIs realized that a sizable portion of their clients had been diverting their micro-enterprise loans towards home improvement. This led to the convention that MFIs tend to use the existing loan disbursement and repayment mechanisms, generally joint liability group, for housing products. This enables MFIs to maintain the transaction costs low while offering an additional product to their product line. In addition, compared to SAHF, the financial performance of the housing product is as important as,

²¹ The Center for Urban Development Studies, Harvard University. "Housing Microfinance Initiatives." *Microenterprise Best Practices* (2000).

if not more important than, achieving the development mission of the MFI. The sector has also observed that HMF has emerged in response to emergencies or disasters. For instance, Evangelical Social Action Forum (ESAF), an MFI in Kerala was involved in house rebuilding efforts in Kanyakumari, Tamil Nadu after the tsunami in 2004.

As it will be discussed in the later sections, however, in order for HMF under the MCHF approach to be successfully implemented, MFIs must make a departure from conventional approach of extending small loans. As Table 3 presents, there are various characteristics in HMF that distinguish itself from micro-enterprise loans, and each of these characteristics poses a new challenge for the MFIs that contemplate pursuing this opportunity.

Nonetheless, despite the challenges, there is strong case to be made for MFIs to introduce housing finance products²². It helps them to lower risk by diversifying their portfolio over multiple products. This can also lead to cross-subsidisation of products. For instance, several MFIs are able to offer lower interest rates on housing loans. Examples range from Banco Sol in Bolivia to SEWA Bank in India. MFIs offering HMF can also retain their existing clients as well as attract new clients in the face of increasing competition in the sector. Housing loans also allow MFIs to develop a longer and deeper relationship with their clients.

4. Provision of Housing Microfinance -- Challenges and Opportunities

There are few examples of successful housing microfinance models in India or abroad. However, there is enough experience and lessons from past and existing attempts at providing finance for low income housing through micro finance or other channels. This section examines some of the challenges that have to be overcome in providing housing microfinance and opportunities for growth.

4.1 Funding

Funding perhaps poses the largest constraint for MFIs in delivering HMF. It is only the last decade or so that MFIs have started offering housing microfinance loans to their graduated clients, that is, clients with a successful repayment record. In the absence of a large number of successful stand-alone housing microfinance examples, loans for housing often tend to be perceived by financial institutions as consumption loans. Financial institutions are unwilling to lend for consumption loans and thus some MFIs find it difficult to meet the housing finance demand with limited resources. That target population of HMF often lacks a legal title, as will be discussed later, makes things even more difficult.

²² Escobar, Alejandro and Merrill, Sally Roe. "Housing Microfinance: The State of Practice" in Daphnis, Franck and Bruce Ferguson, Eds. Housing Microfinance: A Guide to Practice. Bloomfield, CT: Kumarian Press (2004)

One way to resolve this bottleneck in housing microfinance is to enable the securitisation of mortgages. Securitisation is a very new, though very effective, avenue for MFIs to improve their portfolio quality so that they can obtain external commercial funds more easily at cheaper price. However, in order for MFIs to securitise their liabilities, they must be registered as NBFC, and the number of securitisation deals in both India and elsewhere has been limited.

Since securitisation is not yet an option for many MFIs, the most viable alternative is for MFIs to find ways to tap longer term funding. There are international examples where governments, donors and NGOs have worked together to establish liquidity facilities for housing micro finance. In the Dominican Republic, with support from USAID, the NGO FONDOVIP has undertaken groundwork for becoming a secondary HMF liquidity facility. Alternatively, an international liquidity facility could be established to make discounted HMF loans available to MFIs. Such a facility could provide 5-10 year lines of credit to established MFIs that have developed or are developing profitable shelter finance products. A local commercial bank could act as an intermediary and the facility could guarantee the bank's loans for HMF to qualified MFIs²³. An illustrative case would be that of the establishment of the Community Led Infrastructure Finance Facility (CLIFF) used to finance projects in India and Kenya. In India, SPARC, Nirman (the financial and construction arm of SPARC), the National Slum Dwellers Federation and Mahila Milan (known as the 'Alliance') have been working together on infrastructure and housing issues in slum areas for over twenty years. Access to finance emerged as a big obstacle. At this point, CLIFF was set up with funds from DFID (approximately £6.8 million) and SIDA (approximately £1.5 million). In India, CLIFF works closely with the Alliance to implement upgrade programmes in Dharavi slums in Mumbai and in urban Bangalore. By December, 2004, CLIFF had financed 9 community-led housing projects benefiting more than 2,700 families and two sanitation programmes benefiting over 215,000 families²⁴. However, it is important to note that funds from CLIFF are used only as guarantee or as bridge loans. Thus, while CLIFF provides a short-term remedy, funding in the long-term remains an issue.

4.2 Land Title and Collateral²⁵

There are four ways to demonstrate land rights in India²⁶. The first three ways can be used to access bank finance. First, one can gain land rights through a title deed which has the highest legal sanction. Second, one can attain a leasehold, which gives the holder rights to use property for a certain number of years. Third, one can receive a license to cooperative societies, upon which members register with the cooperative to demonstrate

²³ Ferguson, Bruce. "Housing Microfinance—A key to improving habitat and the sustainability of microfinance institutions." *Small Enterprise Development* Vol. 14, No. 1 (March 2003), p. 22.

²⁴ Morris, Ian and Jack, Malcolm. "The Community Led Infrastructure Finance Facility (CLIFF)" International Association of Local and Regional Development Funds in Emerging Markets (2005).

²⁵ This section of the paper is based on work previously done by Cheryl Young at the Centre of Development Finance, Chennai in an untitled working paper.

²⁶ Daphnis, Franck and Kimberly Tilock, et al. "SEWA Bank's Housing Microfinance Program in India." Cities Alliance (2002).

right to the property. The fourth is through stamp paper signifying sale of a property and has no legal validity.

As noted earlier, access to formal sources of housing finance is limited by one's ability to show evidence of legal title and formal employment. Low-income households who inhabit informal settlements seldom have formal legal titles. Their rights to land exist through other forms of land security.

Literature refers to these rights, which may be in the form of property tax receipts or through stamp paper signifying sale of property, as para-legal rights. Para-legal rights in urban areas can also take the form of government-granted security to slum dwellers which protect them against eviction. In rural areas, para-legal rights are typically embodied by *pattas* which are land rights to either ancestral or government-granted land. While ancestral *pattas* are accepted by banks and other financial institutions, *pattas* to government-granted land are not always acceptable. This is because, the latter specifies that the property may not be sold or transferred for a certain period of time. Clearly then, this form of land security would not be acceptable to a bank as collateral. Recognising these rights would incentivise rural households to invest in their dwelling because these rights provide them with land security.

This is an area where governments, both state and central, can play a significant role in ameliorating the housing environment that surrounds the poor. The industry acknowledges the difficulty of formal financial institutions to increase the extent of financial intermediary unless the land title conditions among the poor are improved. For example, the National Housing Bank, in its 2000 report, has commiserated with banks on the difficulty of lending to individuals without clear title, recommending that the state governments must get involved in order to assist the lending process in the absence of full land titles²⁷. In this context, Ferguson and Haider (2000) point out that in order to enable financial institutions to better serve low income clients, governments may direct some of the funds available for subsidies towards the regularisation of land title.

At the same time, as far as housing microfinance is concerned, in spite of these obstacles posed by the lack of title, the existence of a full title has not always been necessary for housing microfinance, as some MFIs have already proven. Most MFIs in India retain legal title from their clients only as a psychological deterrent, without any intention of repossessing the house in the event of default. There are two reasons for this. Firstly, the process of foreclosure is often time-consuming and burdensome for MFIs²⁸. Secondly, MFIs may find it morally problematic to possess a poor person's home or land.

4.3 Construction Services and Technical Assistance

At first glance, providing technical assistance and supervision of the construction process yields many setbacks. It implies increased administrative costs and often, the MFI may

²⁷ National Housing Bank, "Report on Trend and Progress of Housing in India" (June 2000), p. 6

²⁸ Klinkhamer, Madeline. "Microfinance Housing Products and Experience with Land Title as Collateral." Latin American and Caribbean Division, World Bank Paper, 2000

not have the expertise to provide technical assistance regarding construction. As a result, these services would have to be outsourced, the cost of which ultimately get passed on to the consumer, making it more expensive for clients to borrow. However, such assistance has the potential to yield a broad array of benefits including the increased likelihood of completing construction through enhanced efficiency, lowered overall cost of construction through cheaper materials, and more robust construction through good quality materials. These benefits translate into increased likelihood of repayment. For those MFIs that do not possess technical expertise, partnerships with NGOs or private institutions, such as construction companies or material suppliers, provide a viable option. There has been evidence that these partnerships generate some positive outcomes. For example, FUNHAVI in Mexico has close relationships with the materials suppliers from whom it purchases at bulk prices. In turn, FUNHAVI sells these materials to clients at retail prices. In this manner, they ensure that the quality of the materials used is good, and in fact, make 11% of their operating revenue. In addition, it may help the MFI to directly estimate finance requirements of their clients. This form of technical assistance is clearly encouraged in Daphnis (2004):

If the MFI plans to offer no form of construction assistance, the housing microfinance loan is, in effect, a consumer loan whose declared purpose is housing but whose ultimate use is up to the client. The proposed construction project provides a rationale for estimating a required loan amount (pp. 101-103).

For example, the Bhavanashree scheme in Kerala has observed cases where borrowers take a Rs.50,000 loan and attempt to build a house costing Rs.100,000. Not surprisingly, many borrowers are ultimately forced to discontinue the construction due to insufficiency of funds. These examples suggest that partnership with construction material suppliers and technical assistance can benefit both borrowers and MFIs through various channels, such as higher quality of materials used, a potential avenue for MFIs to gain profit, and lower default rate.

It should be noted, however, that there are cases that do not support this view as evidenced by the case of Indian Association of Savings and Credit (IASC), in Tamil Nadu. Here, a course on cost-effective construction methods was offered to its housing loan clients. A survey conducted by IASC revealed that only 5% of clients who attended the class incorporated the course concepts of cost-effective methods into their actual building methods, and thus the class was discontinued²⁹. There is also anecdotal evidence that homeowners who are in control of the home building process and decision making about the design, size and organising the building tend to be most satisfied with the end product and additionally, more willing to pay for it.

It is difficult to reach a decisive conclusion whether technical assistance should be incorporated in the provision of HMF. However, what is clear is that this is one of the areas where viability of the option is less explored by practitioners, and thus, it is crucial that this assistance, if there is at all, is carefully designed to address specific needs of the

²⁹ Shankar, Uday (2006). "A Note on Housing Intervention by IASC"

clients. The MFI must weigh the benefits accrued from providing technical assistance against increased costs to the organisation and clients.

4.4 Awareness Building

Offering HMF would also necessitate some level of awareness-building amongst potential borrowers. The reasons for this are twofold. Firstly, microfinance clients are used to repaying loans on a short term basis for durations up to a year. HMF entails loans that are at least three years long. Thus, MFIs must spend time training their borrowers to develop a long term view of their finances. Secondly, while 'progressive build' that is incremental building characterises low-income housing construction when access to finance is limited, MFIs observe that once barriers for access to housing finance are removed (for example via HMF), clients are keen to build once and for all, rather than over time. This may not be financially possible for them or for the MFI. This reinforces the importance of cost-effective construction assistance, but also underscores the need for awareness building on 'progressive build.'

4.5 Subsidies

Discussion on subsidies is central to housing microfinance. The general perception is that government subsidy programmes and institutional grants for housing tend to cloud prospects for micro finance. They create a culture of expectation amongst the beneficiaries and furthermore perpetuate a culture of non-repayment. A. P. Fernandez, Chairperson of Sanghamithra, an MFI operating in the Mysore district in Karnataka, points out the distinction that the local people make between a '*sala*' (which means loan in the local Kannada language) and a 'loan'³⁰. A loan is seen as something endorsed from the state which *does not* require repayment whereas a *sala* is an amount borrowed locally whose repayment is compulsory.

While there is no doubt about the negative consequences that are entailed in government *direct* subsidy programmes, there are various other ways to make better use of subsidies. Bhavanashree in Kerala provides an illustrative example. The scheme does not involve direct subsidies, in the sense that borrowers do not receive any grants unless it is coupled with other government direct subsidy programs and are required to repay 100 percent of what they borrowed plus interest. Yet, commercial banks involved in this scheme are eligible for refinancing from NABARD, and the spread between the on-lending rate and refinancing rate gives them a comfortable risk-adjusted margin. Without this hidden subsidy component, it would have been difficult, if not impossible, to provide the existing Bhavanashree housing loans as large and long as they are. Given the inherent consequences nurtured by direct subsidies as described above, this is more promising approach to make the best use of subsidies available to MFIs.

There are also ways that direct subsidies can be harnessed in a positive way by innovative MFIs and NGOs. Some MFIs have structured their credit products in such a way that

³⁰ Fernandez, AP. The Myrada Experience: Alternate Management Systems for Savings and Credit of the Rural Poor. Second Edition. Bangalore: MYRADA. (1998)

their clients are able to take advantage of the government subsidies available to the loan beneficiary as well. Borrowers under the 'Parivarthan' slum upgradation project in Ahmedabad were able to access the city's subsidy for building toilets, thus optimising the amount of finance available to them. Similarly, there are various rural housing subsidies which are dependent on prior construction of the house's foundation.

4.6 Interest Rates³¹

If a housing loan is secured by the beneficiary's home, housing loans should be cheaper than micro-enterprise loans. But, as we saw earlier, foreclosure is not a realistic for most MFIs. Furthermore, most banks are not comfortable lending to MFIs for housing purposes since banks are unable assess credit risk of low-income groups. The result, as we saw earlier, is that medium to long-term funding for HMF is not readily available. The funding which is available is priced at prohibitively high interest rates due to these reasons in the absence of subsidies for HMF.

One way that MFIs get around high interest rates is by depositing the legal titles of all HMF loans with their source of finance for making HMF loans. However, this policy is prejudiced against those who do not possess legal title, which we know to be common in rural areas. The solution could be to offer two kinds of HMF loans, one that is collateralised with a clear legal title and one that is not, as is the policy in SEWA. Additionally, in India, where housing loans are offered only by MFIs that are already heavily involved in microfinance, the possibility for cross-subsidisation of products exists.

The other salient point is for policymakers and practitioners to network with financial institutions to arrive at a better risk assessment for HMF loans. Globally, HMF loans have shown up to 97% repayment rates, signifying that the risk is not as high as it is currently calculated.

Offering low-income groups affordable and safe housing, especially when there is demand for it, may be part of the larger social goal of an MFI or of society as a whole. While subsidies are not a financially sustainable solution, innovative subsidy structures may allow MFIs to offer low income housing and attain their social goals while minimising the negative consequences of subsidies. We have seen earlier the example of the Bhavanshree scheme and also the innovative use of government subsidies in the Parivarthan slum upgradation scheme.

4.7 Changes in Lending Methodology in Implementing HMF programmes

³¹ The formula used to calculate interest rate is as follows:

$$R = \frac{AE + LL + CF + K - II}{1 - LL}$$

Where AE is administrative expenses, LL is loan losses, CF is the cost of funds, K is the desired capitalization rate and II is investment income.

Daphnis, Frank. *Elements of Product Design for Housing Microfinance* in Daphnis, Franck and Bruce Ferguson, Eds. "Housing Microfinance: A Guide to Practice". Bloomfield, CT: Kumarian Press (2004).

There are several operational constraints and issues in rolling out housing finance products through the microfinance channel. Three major shifts away from typical microfinance mechanisms and the challenges that this represents will be discussed below.

4.7.1 Delivery mechanisms

For micro-credit loans, MFIs predominantly used joint liability methodology although some large MFIs in the country have started experimenting individual lending. In the context of providing housing microfinance, both methods are currently in use: SEWA, Evangelical Social Action Forum (ESAF) and IASC lend to individuals, while the other MFIs like Sanghamithra use group lending through their SHGs. However, it is important to note that even some of those MFIs, such as IASC, that are using individual lending method utilize existing group structure to select borrowers, disburse loans, and collect repayments. In such a case, each individual is liable to only her own loan but group lending helps to reduce administrative costs.

Although the benefits of joint liability in the context of micro-enterprise loans are widely known, evidence suggests that people become increasingly less willing to be liable for other members' loans as the loan amount becomes larger. Further, in urban areas where the potential of HMF is perceived to be high, joint liability becomes even more questionable as social networks are more fluid, migration is frequent, and incomes are more stable than in rural regions.

4.7.2 Reaching the poorest

Conversations with DHFL, a private sector housing finance company, reveal that while 85% of their low income housing portfolio is in the monthly income level of Rs. 5,000-Rs. 10,000, their challenge lies in reaching the income-threshold of Rs. 5,000. The issues in lending to this group mainly revolve around the volatile income of low-income groups and the vulnerability of these groups to small economic shocks which could adversely affect repayment. Further, those employed in the informal sector have greater problems accessing credit. Complicated land title and collateral issues make the business all the more difficult.

In an attempt to reach the poorest in this difficult environment, MFIs that have existing HMF products often require either savings deposits or successful repayment of previous loans. These practically act as substitutes for physical collateral and reduce risk for the MFI. Offering HMF to "star borrowers," clients with successful previous repayment records, MFIs are also able to retain good clients who have credit disciplines. Despite these options, however, MFIs' options are strictly limited. First, many MFIs are not able to offer savings products. Second, even with star borrowers as potential clients, the loan amount and the tenure required for new construction of a house are much larger than other existing loan products and pose an immense risk to MFIs. Accordingly, a rationale option left with MFIs, as far as reaching the poorest is concerned, is perhaps to focus on house repair and upgradation loans, which are typically as big as or slightly larger than micro-enterprise loans.

4.7.3 Loan amount

Even among those MFIs that target the population moderately above the lowest income bracket, very few offer loans that are able to cover the complete cost of a new housing unit. This is mainly due to funding issues and fear of non-repayment. Since the loan amounts from an MFI are not enough to cover the construction of a house, the beneficiaries then resort to a number of informal sources of credit. Moneylenders tend to charge prohibitively high rates of interest. As the poor tend to pay off their biggest liability first³², the moneylender's loan receives higher priority, which leads to defaults on the MFI loan, at the time of repayment. In other words, the lack of funds leads to a vicious cycle which limits the ability of the MFI to lend.

Two MFIs, ESAF and IASC, active in the area of housing microfinance, offer perhaps the largest amounts in this sector, at Rs. 50,000 and Rs. 75,000 respectively. In spite of these comparatively high amounts, they do not cover the entire cost of building a house. This calls for highlighting the importance of "progressive build" to their clients. Progressive building allows MFIs to reduce the risk of default while borrowers can obtain future inflow of credit till they complete the construction, upon successful repayment in each phase, without relying on money lenders. In addition, technical assistance in the form of providing information regarding low-cost building materials and partnership with material suppliers is an area that is potentially extremely effective in solving this problem but has not received the deserved attention so far.

Since MFIs have only recently entered the housing microfinance market, there remain unanswered questions. MFIs tend to report up to 97% repayment rates on housing products in India, which is comparable to their credit products. But since the tenure of housing loan products is long, it is difficult to conclude whether borrowers are really able to keep up with the repayment for next several years, what effect an external shock may have on repayment, or what credit delivery mechanism yield the most efficient outcomes. For example, the Bhavanashree program in Kudumbashree, Kerala, has just started in 2004 and the loan tenure expands over 10-15 years. This, in addition to the sheer paucity of HMF programmes in the country, makes it difficult to extract general principles which would help achieve scale. However, it seems apparent that innovative approach that diverges from conventional micro-enterprise loans is necessary.

5. Examples of Existing HMF Programmes

One innovative programme is Bhavanashree, which incorporates the micro-housing scheme into the Kerala State government's poverty eradication programme. This poverty eradication programme, known as Kudumbashree, is implemented with community participation and has achieved tremendous success. Kudumbashree is administered in partnership with the Kerala state government, NABARD and various Community Based Organisations. It provides economic interventions, including SHG formation and microfinance, by linking up SHGs with nationalised banks. In 2004, after the failure of a previous housing programme which had utilized subsidies, Kudumbashree implemented

³² CMF Interview with Malcom Harper, chairman of M-CRIL, available at <http://www.microfinancegateway.org/content/article/detail/34911>

Bhavanashree, a subsidy-free HMF programme. Bhavanashree is one example of how state governments, which have a great deal of flexibility in implementing housing policies, can put into practice highly successful housing programmes which are embedded in a larger, holistic poverty alleviation scheme.

Other MFIs that have implemented HMF programmes include ESAF in Kerala and IASC in Tamil Nadu. As we see in the previous section, housing loans from these institutions are dependent on previous credit history and ownership of certain minimum amount of land. Although groups allocate housing loans to its members, housing loans do not carry a group guarantee. ESAF, in addition, has plans to acquire land, build a housing complex and sell to its existing microfinance clients. IASC offers every housing loan client an insurance coverage, which protects against death of client and spouse and also against damage to the superstructure of the house through any disasters, whether natural or man-made.

Sanghamithra from Karnataka demonstrates implementation of HMF while retaining the group lending mechanism. Qualifying groups, which comprise 15-20 women, receive Rs. 1.5 lakhs to be divided so that no housing loan exceeds Rs. 30,000. This is in line with the point made earlier that, generally, housing loans which continue to follow the group guarantee methodology tend to provide smaller loans for shorter periods of time.

While there are only a handful of MFIs that offer HMF as a formal product, one can argue that almost every MFI makes housing repair/upgrade loans without having a product that separately bills it as one. This is because microfinance loans may be fungible and are often used for purposes other than the declared intent at the time of borrowing. As a matter of fact, as it was described earlier, MFIs have observed that a sizable portion of clients divert micro-enterprise loans towards housing. For instance, BSS in Karnataka allows older clients to use half their loans for “Life Quality Improvements,” through which many clients use for housing construction and repair. Since the maximum loan amount is not greater than Rs. 20,000, clients would only be able to execute repairs and upgrades. Evidence like this suggests that not only is latent demand for housing high among microfinance clients, many MFIs are likely to be in the position to start house repair loans for which loan amount is similar to existing micro-enterprise loans.

This, however, does not necessarily mean all MFIs should start HMF. There have been cases, such as Activists for Social Alternatives – Gramma Vidiyal (ASA-GV), an MFI in Tamil Nadu, where the MFI was unable to sustain their housing product due to high levels of default and lack of funding. This underscores the importance of assessing the demand for the product and clients’ loan absorption capacity and procuring funding sources with sufficient time horizon.

While it is difficult to draw generalised principles of providing HMF given the limited number of HMF programmes in India, the programmes that have worked the best are programmes that involve the one or more of the following:

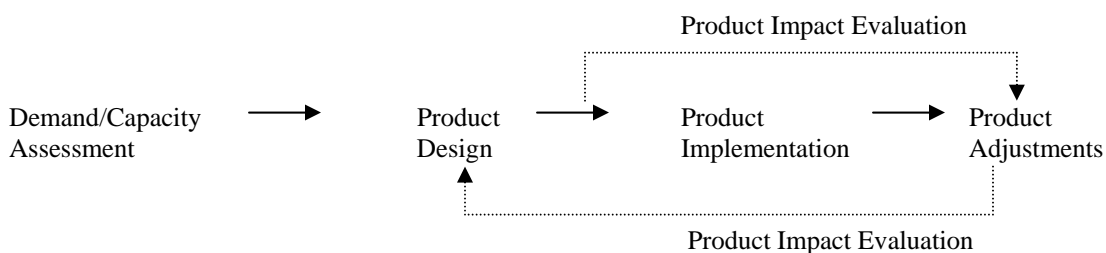
- 1) Partnerships with governments, traditional home lenders, low-income land developers and building materials suppliers, especially in urban areas.

- 2) The perception of a need for housing finance in the community and a commitment by the MFIs to provide housing loans to their clients.
- 3) Sufficient funds, whether grants or commercial debts.
- 4) Experience in micro-credit lending.

6. HMF Product Design and Implementation

It is clear that there is a huge unmet demand for housing microfinance in India. There are several useful lessons from past and current experiences that can be used in developing new products for this sector. Several players are interested in entering the HMF sector – donors, MFIs/NGOs, banks, organisations that provide technical expertise in construction, and government agencies. Efficient partnerships between these players are likely to yield effective results. For example, it would be possible for MFIs to get discounts from building materials suppliers by placing a bulk orders on behalf of their clients as we introduced the FUNHAVI case from Mexico. MFIs can help borrowers to access subsidies from the government in order to enable more construction or MFIs themselves rely on subsidies to lower interest rate. In Ahmedabad, the state toilet subsidy has been linked to the Parivarthan slum upgrade scheme so that service delivery is more organised. In the Bhavanashree scheme in Kerala, a government subsidy was effectively incorporated in the loan component of the scheme.

In order to develop a housing microfinance programme, it is advantageous to follow a sequence of steps involving: (a) Understanding the market potential and clients profile through a demand assessment; (b) Incorporating findings from the demand assessment into product design and pricing; (c) Implementing the product with technical advising services once the operational procedures are streamlined - the product should be offered as a pilot in a small set of locations; (d) Evaluating the impact of the product on the clients' economic and social outcomes to analyze cost effectiveness of the programme, and; (e) Identifying what aspects are successful and which product features need to be adjusted. The programme can then be replicated and scaled across geographic locations. This is illustrated in the following diagram.³³



Each of these stages involves several steps. A demand assessment study conducted through household interviews and focus groups would allow MFIs to understand

³³ This diagram is adapted from Daphnis, Frank. "Elements of Product Design for Housing Microfinance" in Daphnis, Franck and Bruce Ferguson, Eds. *Housing Microfinance: A Guide to Practice*. Bloomfield, CT: Kumarian Press (2004).

preferences of potential borrowers for different characteristics of a housing loan including tenure, repayment period, technical assistance and potential for a linked product. The assessment should also contain a profile of the client base, including socio-economic and demographic characteristics, client sources of income and expenses and an estimate of informal and formal financial contracts which exist in the region. (See Text Box at the end of this Section for an illustration of a demand assessment for *Ankuram Sangamam Poram* (ASP) and how it could inform an organisation's decision to launch a housing microfinance product). In addition, assessing the loan absorption capacity of clients is equally important as demand assessment. This requires analysing income flows of potential clients across different seasons and the extent of borrowing for non-housing products or from local money lenders.

Product design must incorporate results from the demand and capacity assessment in order to design a product for which clients' willingness to pay correspond their capacity to pay while serving the clients' needs. It has been documented in literature that HMF clients invariably desire long-term, high-value loans, irrespective of their capacity to pay. Clients' low loan absorption capacity may prompt an MFI to offer a housing loan product only for minor improvement for which the loan amount is typically much smaller. Experiences from Genesis in Guatemala, BancoSol in Bolivia and SEWA Bank in India, suggest that 20 to 25% of their clients' monthly income should be used to service the housing loan provided they are currently not taking other loans. Product design also involves setting the price for the product. Interest rates are determined by three components: the cost at which the MFI can secure funds, the operational costs involved in running the programme, and the provisions for losses. While the MFI does not have much leeway to control these components of interest rates at least in the short run, the MFI may be able to make an internal arrangement to lower the rate through cross-subsidy if the mission of the MFI justifies it.

MFIs must also consider whether construction and awareness assistance become a part of the product. Construction assistance can become a factor to differentiate the product from other competing MFIs' products. In the face of high interest rates, construction can also reduce the cost of building a home, and thus lowering borrower's liability. In the event that an MFI decides to offer technical assistance, it is advisable for the MFI to partner with another agency specialized in providing such assistance rather than offer the service itself.

Once the demand assessment and the initial product design stage have taken place, the concerned MFI must do a pilot test of the product in order to determine the feasibility and sustainability of the product amongst the clients. The MFI must also put in place systems for implementing the programme. As discussed earlier, although the MFI can utilize existing systems to provide HMF, such as group structure for disbursement, monthly meeting for repayment, etc., the MFI is likely to have to make some changes in operation. Verification of required documents, client eligibility, and loan usage, and collecting provision of additional services such as technical assistance, bulk purchase of raw materials are some of the examples that are required as part of the process and that many MFIs are not often familiar with. Particularly because of the high costs associated with

large loan sizes and longer tenure, it is crucial that the operational procedures are streamlined before rolling out the product. The pilot phase of the product is an opportunity for an MFI to test the take-up rate of the product and the appropriateness for the targeted market and to fine-tune the product in such a way the impact of the product is maximized. Upon successful results from the pilot phase, the product should be expanded to larger areas.

Finally, rigorous impact evaluation of the housing product is a critical part of the process despite the lack of sufficient attention from practitioners and researchers up to date. Introducing a housing microfinance product involves substantial resources and operational costs for the MFI. There are large sums of capital investments or loans provided by donors or other financial institutions. In order to justify and promote such investments, the impact of the product on clients' economic conditions and vulnerabilities, incomes and consumption, risk behaviour, among other factors, must be measured. The results from the impact evaluation could have significant implications for future housing policies and the availability of funding sources for the sector.

Text Box – Demand Assessment

Ankuram Sangamam Poram (ASP) is a relatively new MFI that works primarily with the people who belong to the most poverty stricken part of society – the scheduled caste, scheduled tribe, backward caste, and minority groups. In order to increase the social impact of its activities, ASP is considering an introduction of a housing loan product. The following preliminary demand analysis provides a snapshot of how ASP should go about formulating a housing product that is viable to ASP as well as attractive to its members¹.

Both household and focus group interviews were administered in an attempt to obtain firsthand information about members’ preference for potential housing products, current use of loans, and other factors that surround members which potentially affect their take up of the products. Two tables below show a summary of findings.

Household Interview

- 18% noted their SHG members used a loan for housing purposes
- 79% expressed an interested in dedicated housing loans
- 76% ranked housing as “most important” to them (1-10 scaling)

Focus group interview

Region	Env't and avg monthly income	Cost to Build House	Key Observations
1	Very drought-prone Rs. 2,440	Rs.80-90K	<ul style="list-style-type: none"> • Most villagers had pucca houses and had already used income generation loans for improvements • In outlying villages, government subsidies have been promised and villagers are wary of debt
2	Drought-prone Rs. 2,440	Rs.1 lakh	<ul style="list-style-type: none"> • Some villagers had borrowed from moneylenders or used government subsidies to finance the construction of a new home • Many begin to build but cannot afford to finance the entire project, arresting construction • New concrete roof costs Rs. 25,000
3	Fertile Rs. 3,660	> 1 lakh	<ul style="list-style-type: none"> • Villagers are prepared to take loans or sell cropland to finance construction of a new home • Roofs made of palm fronds must be replaced every 2-3 years, which costs Rs.3,000/- • Very few villagers live in the more primitive mud huts that were prevalent in X and Y

Currently, ASP's loans are supposed to be used specifically for income generation. In the face of such a condition, the finding that 18% of respondents have used a loan for housing purposes is a significant indication of a latent demand for a housing loan. In the table of focus group interviews, in Area X and Y, where income level is relatively low, house construction or improvement are already financed either through a loan from ASP, moneylenders, or government subsidies. In Area Z, there seems to be large demand for maintaining roofs, and government subsidies are not available in this region.

From these findings, it is clear that the demand for housing loans does exist, but regional variation arises based on what types of housing products are needed.

Identifying potential demand is not sufficient to introduce a housing microfinance product. There must also be a demonstrated capacity to repay the loans given. Traditionally, micro-enterprise loans use future income of improved businesses to gauge repayment. In the case of housing loans, since income may not be directly affected by building/repairing a house, current income must be used to gauge the likelihood of repayment. Two tables below shows equated monthly instalments (EMI) for the three regions under various scenarios. Panel *a* represents two scenarios when minor and mid-size improvements are conducted. Interest rate is arbitrarily set at 20% per annum. The costs for new construction for the three regions are displayed in panel *b*, as well as the respective EMIs under the interest rate of 18% per annum². (The interest rates of 20% and 18% were derived from the fact that the current interest rate for the ASP micro enterprise loan is 24%, and as ASP achieve better operational efficiency, interest rates should be lowered to the proposed level)

Panel a. EMIs under minor and mid-size improvements at 20% interest rate

		A: Loan tenure 12 months		B: Loan tenure 36 months	
Improvement	Cost	EMI	Minimum monthly income required	EMI	Minimum monthly income required
Minor	Rs.5,000	463.17	1544	185.82	619
Mid-size	Rs.20,000	1852.69	6176	743.27	2478

Panel b. EMIs for new construction at 18% interest rate

		C: Loan tenure 120 months (10 years)		D: Loan tenure 180 months (15 years)	
Region	Cost	EMI	Minimum monthly income required	EMI	Minimum monthly income required
X [Rs.2,440]	Rs.85,000	1531.57	5105	1368.86	4563
Y [Rs.2,440]	Rs.100,000	1801.85	6006	1610.42	5368
Z [Rs.3,660]	Rs.120,000	2162.22	7207	1932.51	6442

Combining the results from the two analyses, demand and affordability analyses, gives rise to some important messages for ASP. With the current pricing of the product, only the loan for minor improvement (Rs.5000) is within the reach of all members (entries highlighted blue). The loan for mid-sized improvement is affordable only for members in Area Z with the average monthly income of Rs.3,660. The loan for new construction is beyond the reach of all members even if the loan

tenure is 15 years.

This outcome, however, does not necessarily mean that the possibility for ASP for the provision of housing loans is confined to a small-scale loan only for minor improvement. Many MFIs that are new to the field often start with a loan product for improvement. As they gain experiences and expertise, and more importantly, access to public/donor funds, they will gradually be able to lower the interest rates while extending the loan tenure.

1. The purpose of the analysis presented here is *not* to present a comprehensive guideline for a demand analysis for product development, but rather, to offer an illustrative example.
2. Most of MFIs offering housing loans set relatively short loan terms, i.e., 3 months to 2 years for home improvements and 2-5 years for new construction. Longer-term loans of 5 years more are offered in the presence of government-backed loans (Escobar & Merrill, 2004). In this particular analysis, however, for an illustrative purpose, the EMIs for much longer term are shown.

Escobar, A., & Merrill, S.R. (2004). Housing microfinance: The state of the practice. In F. Daphnis & B. Ferguson (ed.), *Housing microfinance – A guide to practice* (pp. 33-68). Bloomfield, CT: Kumarian Press.

This demand assessment is based on an untitled working paper by Cheryl Young at the Centre for Development Finance, IFMR, Chennai.

7. Conclusions

Low- and moderate-income households in India are not able to access traditional housing finance. Government programmes in India, largely in the form of new construction and subsidies, have been unable to satisfy the escalating demand for housing and have rarely been successful. Housing microfinance can be a promising channel to meet some of the demand for low income housing effectively, assuming MFIs can overcome some of the challenges presented in this paper.

There are several operational and financial constraints that MFIs in India face as they decide to offer HMF to their clients. One of the major constraints has been the scarcity of medium to long term funding for this product. Banks are more comfortable lending to MFIs for micro-enterprise or productive loans, rather than for housing which they see as a long-term consumption loan and are often unable to assess the credit risks in the low-income sector for such a product. Second, MFI clients are rarely able to furnish clear land titles as clear titles typically do not exist in areas inhabited by the poor. Land titles are means to verify legal ownership of the land and also serve as collateral for a loan which is much longer and larger than a micro enterprise loan. Thus, lack of land titles does increase risks to MFIs in offering HMF to their clients. Third, since the lack of collateral makes HMF loans riskier, it causes interest rates to be prohibitively high, which adversely impacts affordability for borrowers.

Fourth, MFIs need to make significant changes to their lending methodology to move from group to individual lending. This can be both costly and time-consuming for MFIs. Fifth, these challenges are compounded by the fact that MFIs often operate in areas where significant government subsidies, comprising up to 90% of the unit cost of the

home exist, thus crowding out opportunities for HMF. Sixth, the decision to provide technical assistance, while beneficial for efficient building, inevitably means higher costs for MFIs. All this implies that the high cost of HMF delivery prevalent in the market today actually prevents the poorest of the poor from accessing shelter microfinance. This represents a shift away from the social mission of some MFIs.

In India today, the paucity of housing programmes makes it difficult to obtain any conclusive evidence on the impact, sustainability, and scalability of HMF. Nonetheless, there are lessons to be learned from the limited experiences available presently and in the recent past. The MFIs who have successfully implemented large HMF loans (loans which cover more than 50% of the home value) are usually larger MFIs with a well-diversified range of products. Thus, their HMF programmes appear to be based on a foundation of a long experience with micro-credit lending. These MFIs understand and assess the demand for housing finance and capacity to pay for it within the community of their borrowers well. HMF providers are also able to secure sufficient funding for their programmes, either via commercial debts or donor grants. Finally, successful programmes are likely to involve partnerships between MFIs, governments, traditional home lenders and construction assistance providers amongst others. This is particularly true of urban HMF efforts or slum upgradation efforts where land cost is high and access to civic amenities low.

There are significant gaps in the amount of information available regarding the housing portfolios of current HMF programmes. Reliable data regarding repayment rates and loan performance are not publicly available. Additionally, providing HMF may have a significant impact on a MFI's portfolio of loans, either negative or positive and this would affect the sustainability of the programme and the performance of the organization. Again, there is very little information available regarding portfolio composition and how the organization manages risks.

Ownership of a house not only provides safety and dignity, but also can be an asset for the poor, which reduces their vulnerability to economic shocks. Microfinance has proved itself to be an effective channel for low-income households to access credit. MFI expertise and experience in this sector can be harnessed to improve access to housing finance. Thus, despite the challenges underlying implementing HMF programmes, this sector presents untapped opportunity for greater business and providing a much needed service to their clients. Given the potentially large impact that HMF can have on low-income housing, stakeholders should work together to create an enabling environment where HMF can be both sustainable and scaleable.