Status Report: Housing Microfinance in Latin America

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Between August and October of 2011 the Center for Innovation in Shelter and Finance undertook a brief study to assess the current status of housing microfinance[1] in Latin America, with a specific focus on institutions operating at relative scale (defined as at least 2,500 active housing loans), in order to document current practice, highlight trends, and identify key barriers to growth. A total of eighteen institutions participated via interview or survey:

- Thirteen retail financial institutions (eight of them managing housing loans at relative scale) operating in seven Latin American countries: Mexico, Guatemala, El Salvador, Honduras, Colombia, Bolivia, and Brazil.
- Five second-tiered institutions, providing technical assistance and funding to retail financial institutions in Latin America.

The following report summarizes the primary findings from this study.

A. Institutions involved in Housing Microfinance (HMF)

A wide variety of financial institutions (FIs) are involved in providing HMF; among those included in the study were non-profit organizations (e.g. NGOs) and a variety of regulated financial institutions including microfinance banks, state banks, and savings and loan cooperatives. The 13 FIs included in this study collectively reported over 250,000 active HMF loans (as of mid 2011), and portfolio allocations for HMF fall between 5% and 30% of total institutional portfolios. Institutions operating HMF portfolios at relative scale tended to be, as one interviewee commented, "the same usual suspects". This is to say that many of the larger FIs, predominantly members of the ACCION Network, continue to manage the more significant HMF portfolios in the region[2]. However, two key entrants are making important advances: (1) Non-traditional suppliers of housing finance from among commercial providers of goods and services are stepping in to provide financing for a variety of home improvements. Companies such Promigas (Brilla) and Corona (Viste tu Casa) along with housing finance veteran CEMEX (Patrimonio Hoy) currently represent a combined outreach of approximately 615,000 clients[3] in Colombia and Mexico. (2) Banco Compartamos, which launched its HMF product in only 2006, has by and large the most significant HMF portfolio among FIs in the region, reporting over 163,000 outstanding loans as of March 31st, 2011.

B. Reasons for engaging in HMF

The primary reason cited by FIs for adding housing microfinance loans to their portfolios was to respond to their existing clients' requests, in an effort to build loyalty and increase client retention. Secondary reasons cited were:

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[1] Housing Microfinance (HMF), for the sake of this report, refers to non-mortgage housing loans utilized primarily for home improvements, repairs, and incremental building. Loan terms are generally under three years, and interest rates tend to be within the market range for microfinance loans.

[2] See "Getting to Scale in Housing Microfinance", ACCION Insight #21, for an overview of the status of HMF among ACCION´s Latin American partners in 2006.

[3] It is important to note that while these initiatives target the base of the pyramid, not all of their clients would be classified as "low income".

(1) the clear beneficial impact to their clients and their families that resulted from housing loans; and (2) the perceived business opportunity that housing loans offered the FI, given the large, unmet demand.

C. Characteristics of the HMF loan product

Approximately half of the FI's surveyed manage a **distinct loan product for HMF**, while others include HMF within a broader housing loan product (often including home mortgage loans), or as a type of fixed asset or consumer loan. Bank regulators in most of the countries surveyed have yet to recognize HMF as a distinct housing loan product, apart from mortgage lending, further confusing its classification and thus its performance tracking and analysis.

HMF is still heavily directed, and in many cases still limited, to **existing business loan clients** of the FI. Less than a third of the FIs intentionally market HMF among non-clients and particularly among other types of income earners (e.g. salaried employees, wage earners and retirees).

Loan sizes are typically larger than microenterprise loans, averaging between $1,000 and $2,300.

Interest rates are generally within the range of market microfinance rates, though sometimes a few points below what the FI is charging for commercial or consumer loans. Institutions that have no system for verifying HMF loan use tend to apply the same rate as for other types of loans to discourage "cannibalization"[4] between products.

Loan terms for HMF are generally longer than working capital loans. Institutions cited terms up to five years; however, terms between 12 and 36 months were most common.

Loan repayments are typically monthly, though in a few cases are adjusted to the cash flow patterns of the income-generating activities financing repayments. (e.g. increased frequency for market vendors, reduced frequency for farmers)

Loan guarantees for HMF are most commonly fiduciary (i.e. guarantors), although occasionally are based on promissory notes or physical collateral. In some cases the FI takes legal property titles (if these are available) as a form of guarantee, without actually registering these as a formal mortgage.

Although HMF is typically treated as an **individual loan**, two FIs have **connected HMF to village banking**. In one case, clients are permitted and encouraged to invest their village banking loans in home improvements as well as business activities. In the other, the village bank participates in approving the HMF loans of its own members.

Interestingly, four of the FIs specifically mentioned that they are offering a **micro-insurance policy to cover home damage** during the life of the loan. In some cases this is required, and in others it's optional.

Ensuring proper loan investment was highlighted as one of the key challenges of HMF. One FI had conducted a study revealing that as few as 30% of their HMF loans were being fully invested in housing. Clients often called this FI's housing loan product the "$3,000 loan", referring to its larger loan size, rather than its intended purpose. This challenge has caused FIs to consider options such as loan verification visits, staged disbursements, or rewards for confirmed proper investments, and, in some cases, to even question whether a distinct housing product is necessary, rather than simply increasing existing credit lines to accommodate for potential investments in home improvements.

[4] Cannibalization refers to negative or unproductive competition between products of the same institution.

D. Construction Technical Assistance (CTA)

The provision of construction technical assistance to clients undertaking home improvements was perceived as another of the great challenges of HMF. While many of the FIs recognized potential value and importance in assisting low-income clients with basic budgeting and planning advice, as well as technical oversight of larger and more complex construction projects, only two have integrated these broadly into their HMF product, and only one of these is operating at relative scale. Among the remaining FIs, approximately half are testing or have already incorporated CTA among a small segment of their HMF clients. In each of these cases, the FI is engaged in a partnership with another organization that equips the FI's staff, finances all or a portion of the CTA costs, and/or directly provides more specialized CTA to the FI's clients.

Of those offering CTA, one FI is simply providing basic services through their loan officers, such as reviewing budgets, materials lists, and sketching simple project diagrams, while three have added more specialized, on-sight advising for larger or more complex projects. Approximately four other FIs have completely outsourced these services to a third party (a Habitat for Humanity organization or another local NGO). Also noteworthy is that two of the FIs that do not offer CTA mentioned having negotiated with materials suppliers to provide quality products at favorable prices for their HMF clients.

The primary challenges cited in offering CTA were: (1) the costs involved in offering these services, reducing affordability for clients (or increasing dependency on outside subsides or grants); (2) the potential bottle-neck to rapid loan approval and overall portfolio growth that non-financial services may present; and (3) clients' possible perception of FI responsibility if problems arise during or after the construction project, thereby increasing risk of loan default.

E. HMF product performance

HMF arrears rates matched findings from an earlier study[5], demonstrating that HMF is generally a high performing product, frequently outperforming other loan products including business loans. The FIs reported HMF arrears rates between 0.4% and 4.5% at 30 days with only two exceptions.

Sustainability of the HMF product line remains a topic of speculation, as none of the FIs segregate cost data by product. Nevertheless, within institutions that extend housing loans primarily or exclusively to existing clients there is a perception that HMF increases overall profitability as it generates increased income at minimal additional cost. However, when CTA is provided in conjunction with HMF, this perception is lost; only two of the FIs offering CTA claim to be recovering the costs associated with these added services.

F. HMF portfolio financing

HMF is predominantly financed by the FI's own resources. Although in several cases an external funding source helped encourage the development of a particular HMF product, all programs operating at scale were primarily, if not exclusively, self-financed. Since the majority of the scale programs are implemented by regulated FIs, these also have access to a wide range of financing sources, including clients' deposits.

While access to capital was rarely cited as a barrier to increasing HMF outreach, there remains a perception among a few institutions that longer term financing at lower interest rates would be valuable, if not necessary, to scale up housing finance for the base of the pyramid (BoP). These statements were commonly accompanied by the

[5] See "Getting to Scale in Housing Microfinance", ACCION Insight #21.

sentiment that incremental home construction is a substandard solution, and the perception that low income sectors would ultimately be best served by a form of mortgage lending.

Also noteworthy is that HMF is often utilized to complement government subsidies in financing home improvements. Three FIs claimed to be working in collaboration with government subsidy programs, while two others did so previously, though not at present.

G. Barriers to growth in HMF

Comments emerging throughout the study suggested that HMF portfolios are still growing, but not at the rapid pace that was noted five years ago in the study published jointly with ACCION[6]. This general deceleration was attributed largely to the global financial crisis and increase in clients' over indebtedness, as well as greater attention being given to other products and trends within the industry, such as savings and "green" businesses. New entrants among FIs and non-traditional providers of housing microfinance, as mentioned earlier, are possibly offsetting some of the reduced growth of previous HMF lenders.

The most common barriers cited to growing HMF were imposed by the FIs themselves. Although HMF continues to demonstrate success as a worthy and high performing product, the majority of the FIs were reluctant to increase HMF portfolio shares based on perceived conflicts with their primary focus: microenterprise lending. In general, they seemed content to allow HMF to grow along with the portfolio as a whole, maintaining but not surpassing its current level of participation. This attitude, combined with FIs' preference for extending HMF to existing clients, suggests that HMF growth will be significantly tied to the growth of microfinance institutions themselves.

Other barriers mentioned to increasing HMF portfolios were the following:

- Three institutions reported that loan officers were less likely to promote HMF among clients, often preferring to stick with more familiar core products.
- Three institutions mentioned the lack of access to adequate financing, particularly with longer terms and lower interest rates, as a limiting factor.
- Two institutions referred to restrictions imposed by banking regulators, failing to recognize HMF as a legitimate product, as stunting its proper development and growth.

H. Conclusion: Key Findings

1. HMF continues to grow in the region, but not at the same pace as five years ago, due largely to the effects of the global financial crisis, and other regional and industry-wide priorities and concerns. Key actors picking up some of this deceleration are large FIs now engaging in HMF and corporations responding to BoP housing finance opportunities they've identified.
2. FIs seem most eager to add HMF as a means of responding to existing clients' needs and demands with a product that builds loyalty and increases retention.
3. HMF tends to perform well, resulting in relatively low delinquency rates with respect to other product lines. Nevertheless sustainability remains open to speculation, particularly when CTA is provided. FIs generally perceive that HMF loans add to the organization's overall profitability; however, limitations in cost accounting practices restrict FIs from determining actual returns.

[6] According to the previous study (See "Getting to Scale in Housing Microfinance", ACCION Insight #21), between 2002 and 2005 the number of active HMF loans of institutions surveyed grew at an average of 36% per year. During the following five years (through early 2011), several of these same institutions reported minimal (1.7-2.5%) or even negative average annual growth in HMF clients.

4. The primary barriers to increased growth are supply-driven, as was clearly noted in a previous study with ACCION[7], whether these are explicit caps on portfolio allocations, an intentional subordination of HMF to the core business-focused product, or a more subtle reluctance to sell a less familiar product.
5. A key challenge faced is ensuring that housing loans reach their intended purpose. Loan verification is only conducted among half of the institutions, and is even less common among programs operating at relative scale.
6. In countries where bank regulators have yet to recognize HMF as a legitimate product, loan verification and accurate portfolio tracking are even less likely.
7. CTA remains limited to few institutions, and is not yet provided at scale. Principal barriers mentioned were: (1) the costs associated with providing these services, (2) potential bottle-necks to growth of providing more specialized and/or tailor-made non-financial services, and (3) possible perceptions of FI responsibility for problems emerging during or following construction projects, thereby jeopardizing repayments.
8. HMF portfolios are predominantly financed by the FI's existing resources, particularly among those implementing at scale.
9. One of the more interesting additions within HMF is the provision of home damage micro-insurance, which is being offered on either a required or voluntary basis by at least four of the financial institutions involved in the study. Further study would help to assess products being offered, clients' perceptions, and effects on HMF performance.

[7] See "Getting to Scale in Housing Microfinance", ACCION Insight #21.