Monic now has an improved home in Uganda, thanks to housing microfinance assistance.

JENNIFER AGUTI/ HABITAT FOR HUMANITY UGANDA

ARTICLE 3:

Housing Microfinance Product Development: Key Factors for Success

January 2013

The steady rise in housing microfinance providers and portfolios over the past decade heralds the vast, unmet demand for shelter finance among the poor. Even while earlier reports from microfinance practitioners revealed that loans intended for business ventures were frequently diverted to home improvements, many were not prepared to offer loans for nonproductive assets. However, as microfinance has evolved and diversified its offerings, microfinance institutions are increasingly finding housing microfinance to be an attractive option for building client loyalty, strengthening portfolios and improving social returns.

As microfinance institutions attempt to add products that intentionally address this evident demand, many are asking what key steps and considerations are helpful in designing and launching a successful housing microfinance product. A frequent assumption is that housing microfinance is simply a form of consumer lending, or that it can be grouped within a more broadly defined housing loan product (which often includes mortgages). Therefore, why undertake a more

Housing microfinance refers to nonmortgage loans that are intended to finance home improvements, repairs and incremental building and are characterized by common elements of microfinance, such as:

- **Small loan amounts:** Financing a single improvement or step in a gradual construction process.
- **Short terms:** Generally between 12 and 36 months.
- **Market-based pricing:** Typically on par with other microfinance products.
- **Nonmortgage guarantees:** Such as co-guarantors or promissory notes, and accepting alternative proofs of land ownership from legal titles, such as purchase agreements or utility bills.

structured and potentially costly process to design a distinct housing microfinance product? Interestingly, experiences from the field demonstrate unique possibilities for housing microfinance to generate significant business benefits and increase social outcomes, suggesting that a well-designed process is indeed justified. Conversely, when products were developed without following a clear, intentional process, outcomes were notably diminished.

The following report analyzes the experiences of 10 microfinance institutions from around the world that partnered with Habitat for Humanity to develop housing microfinance products. These cases were selected to represent a diverse range of approaches to housing microfinance within a variety of contexts. They serve as a basis for studying what processes were undertaken and the impact these had on product performance. Finally, lessons and key factors of success are highlighted.

Why do microfinance institutions seek housing microfinance product differentiation?

The microfinance institutions studied were all engaged in lending to microentrepreneurs, whether via individual loans, some form of group lending (e.g., the Grameen model, village banking) or a combination of these. More than half of the microfinance institutions had already ventured into other types of financial products and services, such as agricultural loans, fixed asset loans, savings and insurance products. Analysis of the 10 microfinance institutions revealed a variety of motivations for seeking carefully designed housing microfinance products that are differentiated from the other types of loans offered by the institution. Their two primary concerns were:

1. **Ensuring client-focused, successful products**: A compelling concern among microfinance institutions undertaking housing microfinance is ensuring that their new product responds to the needs and interests of their target population. In two of the cases studied, a clear product development process was not undertaken, and product uptake was notably slow. One of these cases was in Brazil, where clients were not consulted before product design. Consequently, the microfinance institution discovered that clients did not value the mandatory construction support provided with housing loans, or at least not enough to pay the associated fees. Moreover, the target group was restricted to a small pool of existing clients, thereby compromising product growth.

   Housing microfinance practitioners recognize that loans invested in housing tend to result in high repayments, which highlights the importance of ensuring proper loan use. The assumption is that loans tied to a family's most valued asset are likewise assigned top repayment priority.[1] Similarly, microfinance institutions have noted that when improvement projects are completed well, this helps to motivate timely repayment. Thus, housing microfinance product design features that contribute to the successful completion of construction projects on the ground are frequently viewed as improving the product's risk profile. One such example is in the Philippines, where the microfinance institution decided to disburse loans directly to materials suppliers and laborers, ensuring that loans are fully used for their intended construction purposes.

2. **Seeking social objectives**: Socially oriented microfinance institutions are commonly attracted to housing microfinance because of the potential social impact of housing loans. Therefore, a top priority is ensuring that loans designated for home improvements are actually being used for their intended purpose. A revealing study undertaken by one of the largest microfinance institutions in Latin America discovered that as few as 30 percent of their housing microfinance loans were being invested fully in housing, highlighting the challenge potentially faced by conscientious housing microfinance providers[2]. Proper loan use takes on added importance in the case of microfinance

1. See "Getting to Scale in Housing Microfinance," page 7, Nino Mesarina and Christy Stickney, ACCION Insight #21, May 2007.
2. "Status Report: HMF in Latin America", Habitat for Humanity International's Center for Innovation in Shelter and Finance – Latin America and the Caribbean, November 2011. habitat.org/lc/lac_eng/pdf/Informe_Estado_MFV_en_AL_eng.pdf

> institutions that offer housing microfinance at lower interest rates than other products, risking potential cannibalization[3].
>
> Furthermore, housing microfinance providers are frequently concerned that home improvements result in safe, durable, cost-effective solutions for clients and their families. These microfinance institutions tend to include services that assist clients in preparing improvement plans and budgets, which are both valuable to the client and also validate their housing microfinance loan request. Microfinance institutions may offer additional nonfinancial services[4], either directly or in partnership with other providers, assisting clients with tasks related to home construction projects, such as drawing up technical plans, selecting materials suppliers, and hiring and overseeing laborers.

It's also important to note that a microfinance institution may decide to undertake an intentional product development process when seeking to redesign a low-performing housing microfinance product, or when adding a new housing microfinance product targeting a specific clientele. Two of the microfinance institutions studied, Tajikistan and the Dominican Republic, had sought to strengthen their existing housing microfinance products through such a process, and the resulting products achieved increased growth and improved repayments. In Peru, the microfinance institution used a similar development process to design a new housing microfinance product that could reach lower-income families, initially perceived as risky because of their informal wages. This process also involved the incorporation of housing support services, which were especially valuable to this target group.

Other microfinance institutions employed a product development process to design specialty or focused products. For example, the microfinance institution in Peru developed a loan product to finance water and sanitation connections in one municipality of Lima. In the Philippines, special housing microfinance products were designed to finance septic tank installations and electricity connections. In Bosnia, the microfinance institution affirmed clients' intentions to undertake energy-saving home improvements by creating a distinct loan product to finance projects that result in increased energy efficiency for families, such as changing doors or windows or installing thermal insulation.

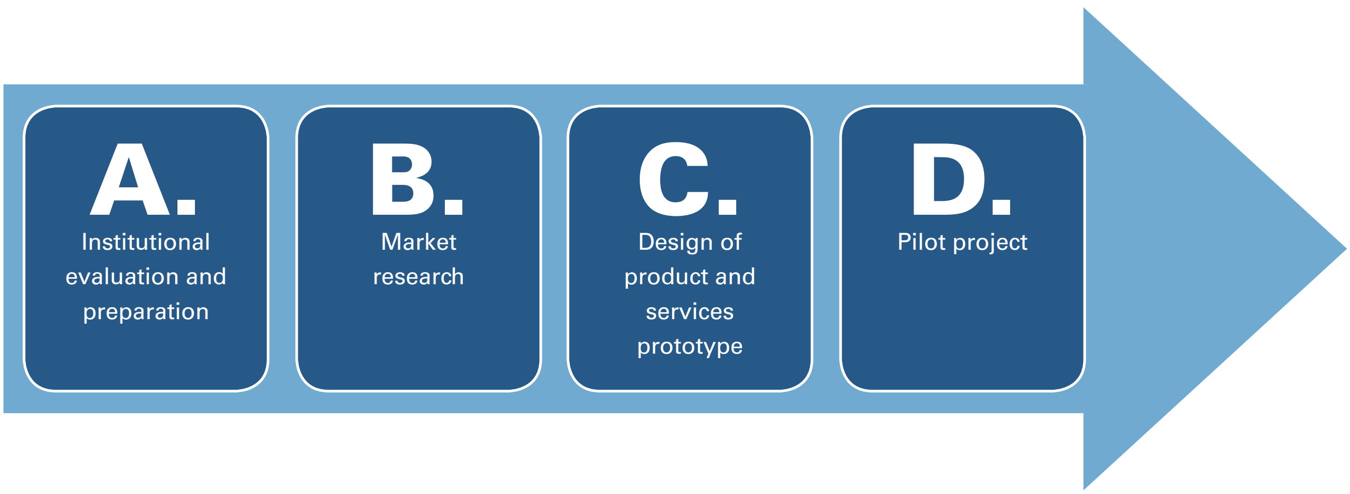
Finally, a well-developed housing microfinance product was viewed by several of the microfinance institutions as integral to responsible lending. A product development process should ensure that loans are adapted to the target group's needs and possibilities, and that loan approvals take into consideration the real costs of the home improvements sought.

3. Cannibalization refers to nonproductive competition between products of the same institution.
4. Commonly referred to as "housing support services" and defined as nonfinancial, demand-driven products or services designed to help low-income households reach adequate housing quality standards or make essential health, safety or livelihood-related housing improvements in affordable stages.

Housing microfinance product development: Process and outcomes

Housing microfinance product development may involve a variety of approaches. However, the majority of the cases studied followed a similar process, based on the practices and methodological approach promoted by Habitat for Humanity's Center for Innovation in Shelter and Finance[5].

The CISF's four-stage process was originally adapted from MicroSave's methodology and then refined over the past five years through worldwide field testing. The four stages are found below, in Figure 1:



Stage A: Institutional evaluation and preparation

This stage helps a microfinance institution assess its institutional readiness for undertaking successful housing microfinance and helps it prepare the needed resources to engage in product development.

Stage B: Market research

This stage involves defining the microfinance institution's target group for this product and determining their current needs, preferences and capacities to improve their homes. It also includes identifying other suppliers of products and services to the low-income housing sector.

Stage C: Design of product and services prototype

At this stage, the microfinance institution seeks to define attractive and competitive housing microfinance products, backed by quantitative projections of loan volumes, associated costs, revenues and the break-even period. The microfinance institution also assesses its institutional capacity to offer these products and services, and determines how best to adapt systems and equip staff before pilot testing.

Stage D: Pilot project

The pilot project stage involves testing clients' response to the new products and services, which are offered within a specific geographic area for a set period. Performance is monitored closely, and observations inform product adaptations and further testing. This stage concludes with an evaluation and appraisal of the institutional adjustments needed to scale up the housing microfinance product and services.

5. See "Housing Microfinance: Product Development Tool Kit," Habitat for Humanity International's Center for Innovation in Shelter and Finance, May 2012. habitat.org/cisf/publications/toolkits.aspx

"We took these steps very literally; it was a very helpful framework."

— Melnisa Begovic, marketing manager of LOK microfinance institution, Bosnia

Product development outcomes

Of the 10 microfinance institutions studied, eight engaged in intentional processes of housing microfinance product development. The other two relied on secondary sources of information and their existing knowledge of markets to inform product design. Of the eight that underwent systematic product development, the majority undertook all four of the stages listed above with some form of technical assistance from Habitat for Humanity. In cases where the microfinance institution already had its own product development methodology, Habitat served in more of a consulting role. In other cases, Habitat directly engaged in product development alongside the microfinance institution. Where housing microfinance was being redesigned, the process was modified according to the microfinance institution's specific objectives and needs. For example, in Tajikistan, the product development process focused heavily on training staff and improving systems to support housing microfinance and add housing support services.

Portfolio growth: Seven of the 10 microfinance institutions studied reported strong growth in their housing portfolios. The 10 microfinance institutions and their total housing microfinance loans are listed in Table 1 below. Also included are the total number of housing microfinance loans disbursed per institution and the average number of housing microfinance loans disbursed per year, as indicators of product growth. Two of these microfinance institutions, in the Philippines and Tajikistan, have already begun scaling up their products, and five others are poised to do so. On the other hand, the two microfinance institutions that engaged in minimal product development before launching housing microfinance, in Brazil and Bulgaria, presented the lowest performance in reaching pilot project objectives, suggesting the importance of a thoughtful development process in ensuring a successful product. Notably, the microfinance institution from India did not engage in an institutional assessment before undertaking housing microfinance product development, and thus failed to identify critical barriers to launching the product, ultimately constraining its outreach.

Table 1: Housing microfinance loans by microfinance institution

Country	Microfinance institution	Housing microfinance loans disbursed[6]	Over period (years)	Average loans per year
Uganda	UGAFODE	1,629	3.6	455
Peru	EDYFICAR	1,138	2.3	506
Bolivia	CRECER	196	0.9	214
Dominican Republic	ADOPEM	465	2.0	233
Brazil	Santander	4	0.5	8
Tajikistan	IMON	4,419	1.4	3,119
Bosnia	LOK	1,985	1.7	1,191
Bulgaria	Mikrofond	355	4.2	85
Philippines	TSPI	11,000	5.7	1,941
India	GO Finance	171	1.9	89

6. Dates figures were reported are as follows: EDYFICAR, ADOPEM, LOK, Mikrofond, and GO Finance – September 2012; UGAFODE – June 2012;TSPI – July 2012; IMON – August 2012; Santander – February 2012; CRECER – October 2012.

Portfolio quality: Of the eight microfinance institutions that undertook intentional product development, all declared high-quality housing portfolios, with PARs[7] reported between 0.0 and 2.6 percent. In general, housing microfinance loans were performing as well as or better than their overall portfolios, which is consistent with industry trends in housing microfinance.[8]

Loan use: All 10 of the cases also reported high loan use for intended purposes among their clients. For example, the microfinance institution in India conducted a study confirming that 78 percent of its housing microfinance loans resulted in completed home improvement projects among its clients.

Client satisfaction and retention: Nine of the microfinance institutions reported high client satisfaction with the housing microfinance product. Four of these cited clients' specific appreciation of the housing support services received. Most of the microfinance institutions also claimed that clients' favorable responses to housing microfinance have contributed to increased client retention for the institution. As Naimjon Masaidov, credit manager for IMON in Tajikistan, notes, "This product helps us reach out to new clients and serve existing clients better. As a result, our clients stay with us longer."

Also noteworthy is that the product redesigns in Tajikistan, the Dominican Republic and Peru resulted in products that experienced steady growth and gave the microfinance institutions the ability to extend services to previously unreached, lower-income sectors. Furthermore, the product development process used to design the housing microfinance product in Uganda was subsequently adapted by the microfinance institution to create a micromortgage product, offering slightly larger housing loans to a distinct population.

7. PAR means portfolio at risk over 30 days.
8. See "Getting to Scale in Housing Microfinance" for earlier figures, or the more recent "Status Report: Housing Microfinance in Latin America", Habitat for Humanity International Center for Innovation in Shelter and Finance, Nov. 9, 2011.

Lessons in housing microfinance product development

A series of lessons emerged from the 10 cases studied, which are listed below, under the related stage of product development.

Stage A: Institutional evaluation and assessment

The institutional assessment stage proved to be critical in confirming the readiness of seven of the microfinance institutions to undertake housing microfinance, and it paved the way for them to engage in well-structured product development processes. Analysis of the cases suggests that microfinance institutions that are both aware of and willing to assign the staff and capital resources that this process entails are well-positioned for success.

The importance of this stage in determining institutional readiness to undertake housing microfinance was further highlighted by two examples from the 10 cases studied. In the case from Brazil, where the housing microfinance product was ultimately unsuccessful, the microfinance institution had not undertaken an institutional assessment before launching the product. Thus, the level of institutional willingness to assume needed internal practices to support the new product was left undetected. As the product launch neared, the staff discovered, for example, that the institution's policies restricted assigning specific targets and incentives for housing microfinance, thereby compromising the product's growth.

As mentioned earlier, the microfinance institution in India did not undertake an institutional assessment before embarking on product development, and thus failed to evaluate how important transitions in leadership and other institutional challenges might later make it difficult to allocate sufficient resources to the housing microfinance product's development. Not surprisingly, pilot project outputs reached only 34 percent of projected goals.

Stages B and C: Market research and prototype design

The market research stage was of particular importance in determining the roles of other actors and the particularities of certain client groups, guiding microfinance institutions in the identification of potential strategic partnerships, unique niches and noteworthy competitors. Examples of each are included below:

- **Strategic partnerships**: The microfinance institution in Peru identified the opportunity to provide financing for water and sanitation connections by working in conjunction with the municipality of Huachipa.
- **Unique niches**: The microfinance institution in the Philippines designed "specialty products," such as loans for septic tanks or water connections, which were especially suitable for particular improvements. In Tajikistan, the microfinance institution identified a unique opportunity to leverage a government subsidy program that had granted 50,000 plots to families. Loans were made available to assist families in financing the completion of their new homes on these plots, ultimately comprising 60 percent of the microfinance institution's total housing microfinance loans.
- **Noteworthy competitors**: In the highly competitive microfinance markets of Peru and Bolivia, the microfinance institutions astutely determined that a housing microfinance product that is bundled with housing support services would have a unique appeal, particularly among the very poor.

Market research also proved critical to hearing clients' needs and preferences related to housing support services. In Tajikistan, the incorporation of housing support services was of particular importance, given the country's labor context. Home improvements were frequently overseen by women, as men were away, working in Russia. Thus, the support provided in planning and undertaking construction projects was highly valued by a clientele that felt less qualified in this area. In India, research revealed that 90 percent of housing microfinance clients could not correctly calculate project budgets or needed financing, so valuable services were developed to assist with these steps. In Brazil, where market research was not undertaken, the product suffered from limited demand as clients did not seem to value housing support services and were unwilling to pay the associated fees.

An important step in prototype design is determining whether a sufficient market exists for the housing microfinance product to generate volumes needed to reach sustainability. The microfinance institution in the Philippines employed a "branch profiling tool" to calculate potential demand before launching the product in new regions. (See box below). It also increased product efficiencies by batching clients into groups of 10. Conversely, in Brazil, the product's growth was overly confined to a limited pool of existing clients, compromising potential growth.

Housing microfinance product development in the Philippines: TSPI's branch profiling tool

As TSPI prepared to expand its housing microfinance product to new branches, it developed a "profiling tool" to assist branch managers in determining whether the product could be financially viable. The tool, which involves a simple market study and the creation of a client profile, projects potential demand for the resulting product. TSPI has calculated that a branch must be serving at least 500 housing microfinance clients in order for the product to reach viability within two years, which is an institutional target.

The profiling tool puts product design in the hands of local managers and provides them with a blueprint for ensuring the product's success. This field-oriented process has also contributed to the design of what TSPI calls "specialty products," referring to housing microfinance products that are tailor-made to specific improvements such as septic tank installation, toilet construction and connections for water and electricity.

Stage D: Pilot test

The microfinance institutions studied highlighted several components of pilot testing that were of critical importance:

- **Staff preparation and training**: Before launching the new housing microfinance product, all staff members involved in supporting the product received training. Particularly in the case of loan officers charged with selling the new product, this training was vital to ensuring that housing microfinance distinctions would not be perceived as burdensome complications or barriers to promoting sales. The microfinance institution in Uganda mentioned the value of training a broad pool of loan officers in housing microfinance product delivery and support to mitigate against potential setbacks due to staff turnover during product launch.

- **Setting outreach goals and staff incentives**: Several microfinance institutions mentioned the importance of setting specific institutional targets for housing microfinance, particularly at the outset. At least three microfinance institutions implemented loan officer incentives specifically for housing microfinance, and insisted that these were critical to overcoming initial hurdles associated with marketing the new product. The Philippines was a unique case, where the microfinance institution decided to promote housing microfinance through loan officers dedicated exclusively to this product. Not only has this assured them of a committed work force in promoting housing microfinance, but it also has allowed the microfinance institution to develop greater specialization among its team in housing finance and support services.

- **Pilot project location**: Most of the microfinance institutions pilot tested their new housing microfinance product in communities near their central office, frequently within the metropolitan area of the capital city. This allowed for close monitoring, and facilitated agile decision-making as the product's delivery was being fine-tuned. Clearly, the selected communities also needed to meet other important criteria, such as sufficient market demand for the new product and services, and a high enough population density to ensure efficient delivery.

- **Marketing strategy:** Before launching housing microfinance, each institution designed a marketing strategy for its new product. Interestingly, the most effective strategy proved to be word-of-mouth promotion via the microfinance institutions' existing clients, particularly those who were considered well-networked.

- **Reporting and monitoring**: During the pilot test, close tracking of housing microfinance uptake and clients' responses were critical to microfinance institutions' ability to make opportune modifications to the new product. They highlighted the importance of making needed adjustments to their loan tracking systems to ensure timely and accurate reports on the housing microfinance portfolio, and the value of outside support received from Habitat during this period (see Point 3 on page 3-9).

Prevailing lessons in product development

In addition to specific lessons that emerged within each of the stages of the product development process, microfinance institutions identified the following three critical factors that contributed significantly to the success of their housing microfinance products:

1. **Product champion**: Each microfinance institution was encouraged to select a product "champion" or internal project leader to oversee and guide the housing microfinance product's design and pilot testing. Study of the cases revealed that microfinance institutions that had assigned capable and respected champions in the central office also experienced great success with their products. In Peru, the microfinance institution's wise selection of a leader who believed in the product and had sufficient determination and influence led to the housing microfinance product being quickly accepted and appropriated throughout the institution.

2. **Partnership support**: Several microfinance institutions attested to the value of partnerships — specifically with Habitat for Humanity in these cases — in helping them navigate initial hurdles in the design and launch of housing microfinance products. To be accompanied by a well-established organization that specializes in low-income housing was a comfort to microfinance institution leadership, often reducing their perception of risk. Lyn Onessa, director of product development at TSPI, stated: "We would have had to spend a lot more time in the research stage before launching the product if it wasn't for partnership. We did not have internal specialization when we started." Moreover, three microfinance institutions specifically mentioned the value of monitoring and support received during the pilot testing stage, keeping them focused on agreed-upon goals and well advised in overcoming obstacles.

3. **Institutional learning culture**: Institutions with strong learning cultures were quick to develop successful housing microfinance products, because they kept a close read on their clients' responses and were swift in making needed adaptations and improvements. For example, the microfinance institution in the Philippines maintained a continuous cycle of product evaluation and innovation, even as it expanded housing microfinance to new branches. By creating mechanisms to receive feedback from clients and field staff, the microfinance institution was able to design and test new innovations, such as products specially suited to improvements in highest demand.

Conclusion

As housing microfinance continues to rise as an attractive option for microfinance institutions seeking business opportunities and social returns, evidence suggests that well-structured product development is a wise investment. Notably, the intricacies of housing microfinance are more nuanced than many financial institutions initially assume. The cases studied suggest that intentional product development is likely to have contributed to more robust products, resulting in strong performance (loan uptake) and increased client satisfaction and retention. Moreover, they equipped microfinance institutions to successfully design niche products, reaching new markets or financing specific products.

Microfinance institutions venturing into housing microfinance are encouraged to consider the four stages of product development outlined in this report. The study findings also highlight that a key to product development success is identifying an appropriate "product champion" with the necessary dedication and influence to lead the process within the microfinance institution. Furthermore, pursuing qualified technical guidance and support during product development, whether from consultants or strategic partners, is a worthy consideration. Finally, microfinance institutions would do well to transform product development into a continuous cycle of improvement, supporting expansion of housing microfinance to new areas and keeping their products and services relevant to the changing housing needs and priorities of their clients.