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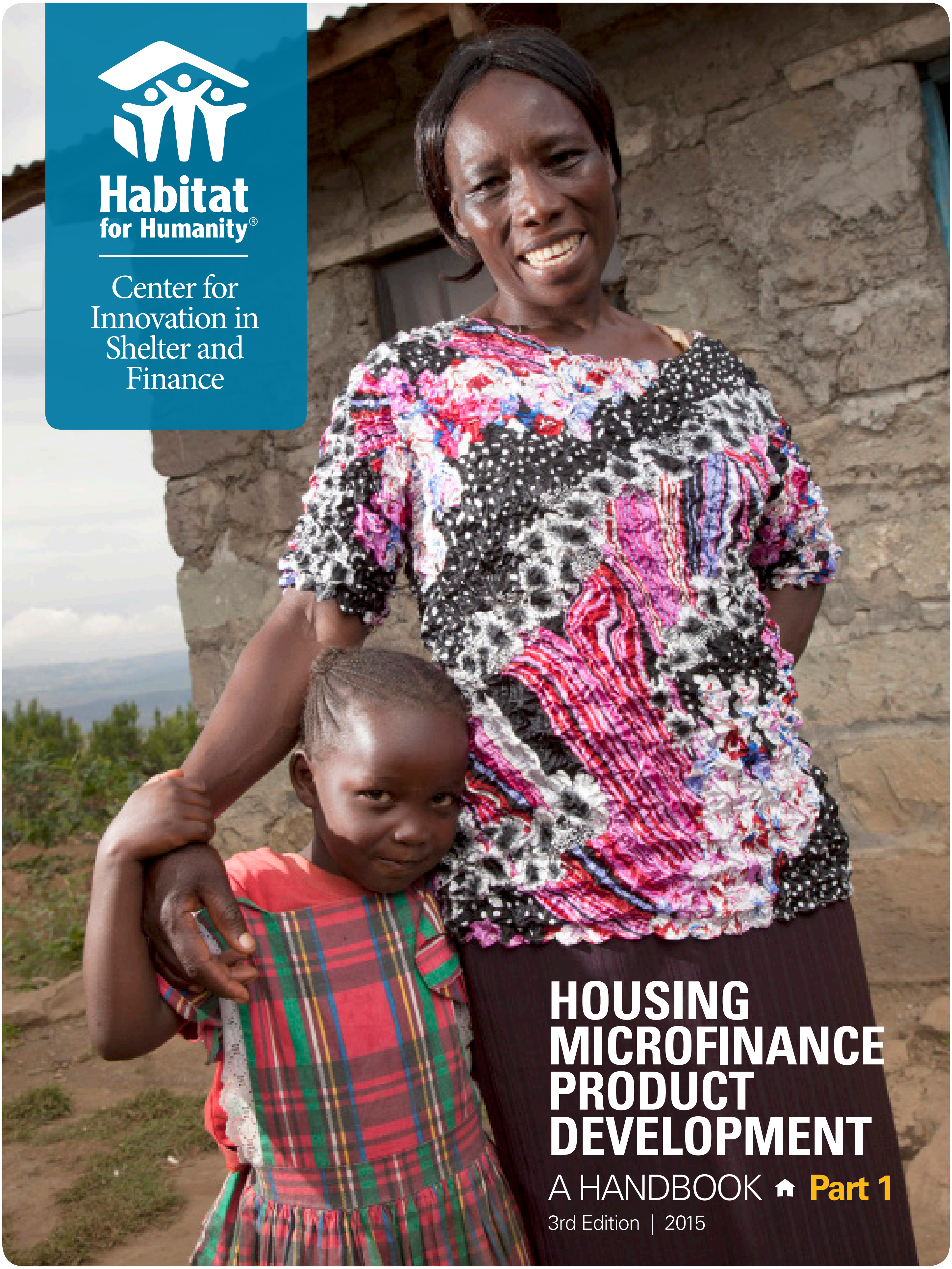
Center for Innovation in Shelter and Finance

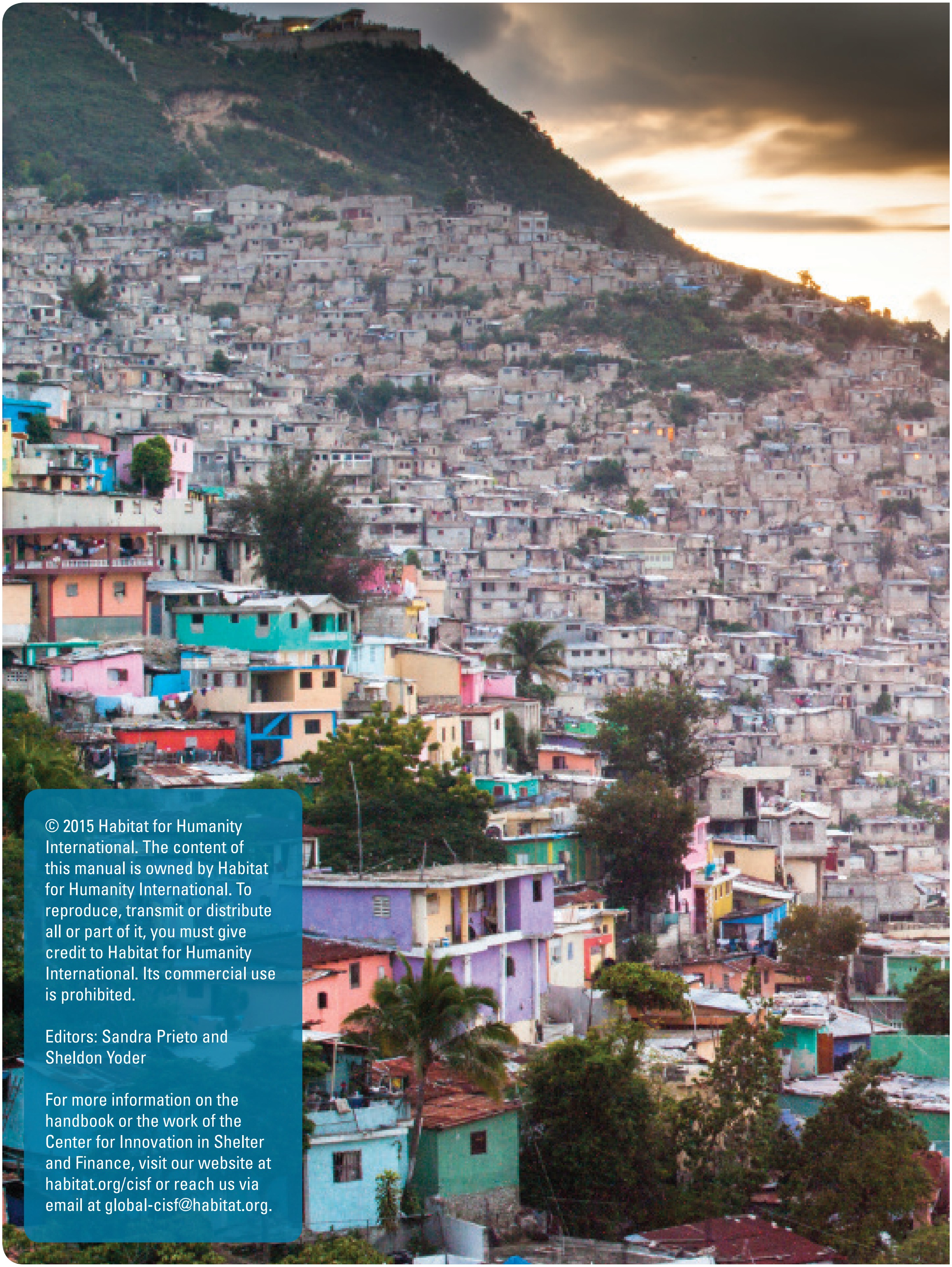


STEFFAN HACKER

HOUSING MICROFINANCE PRODUCT DEVELOPMENT

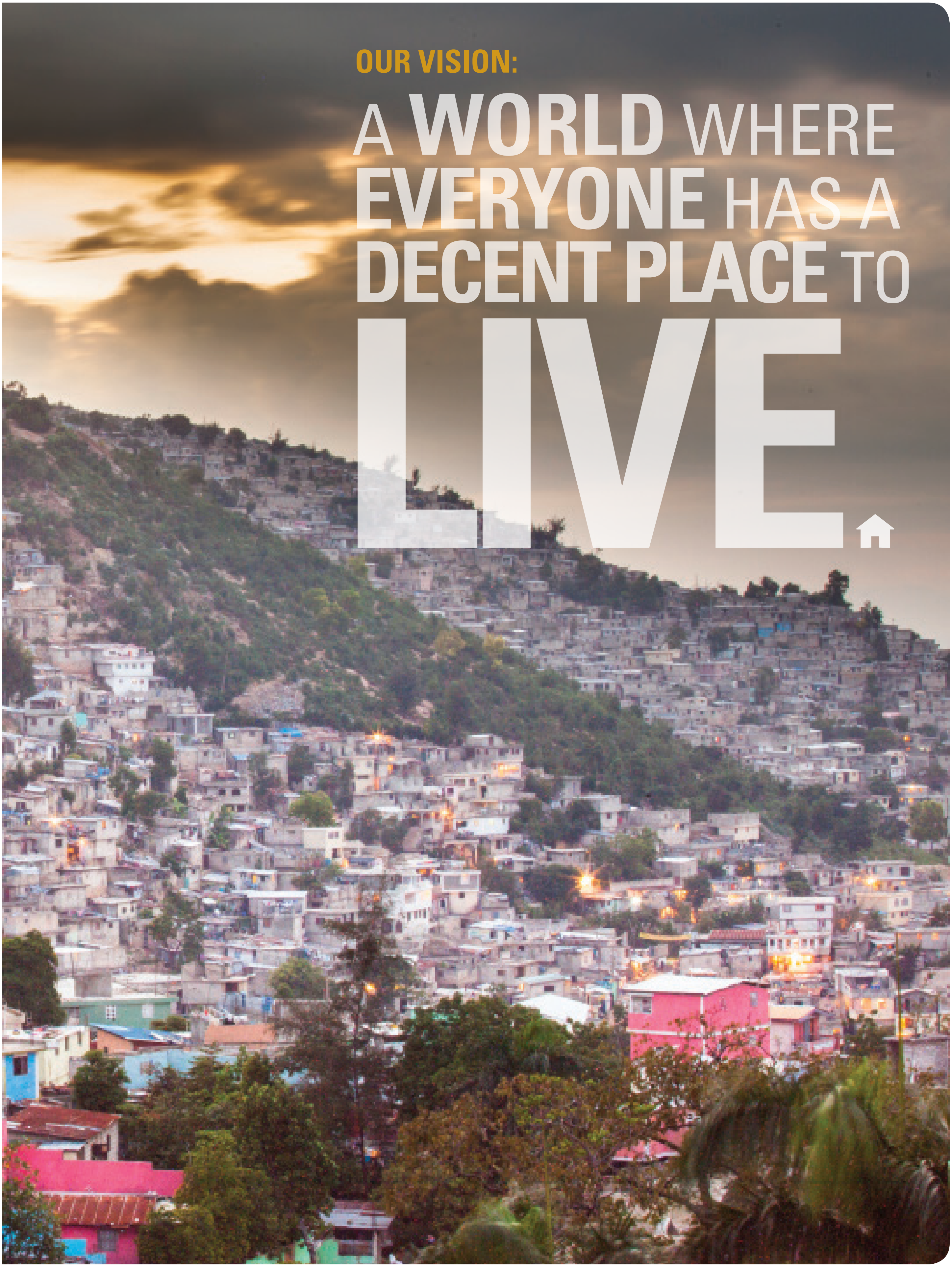
A HANDBOOK Part 1

3rd Edition | 2015



Editors: Sandra Prieto and Sheldon Yoder

For more information on the handbook or the work of the Center for Innovation in Shelter and Finance, visit our website at habitat.org/cisf or reach us via email at global-cisf@habitat.org.



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Seeking to put God's love into action, Habitat for Humanity brings people together to build homes, communities and hope.

Acknowledgments

We are indebted to people from communities around the world who have shared their experiences and ideas on home improvement. We are especially thankful for the institutions in various countries that have received consulting services from the Center for Innovation in Shelter and Finance to design or improve their housing microfinance products; their efforts inform this handbook. We thank them for allowing us to learn with them.

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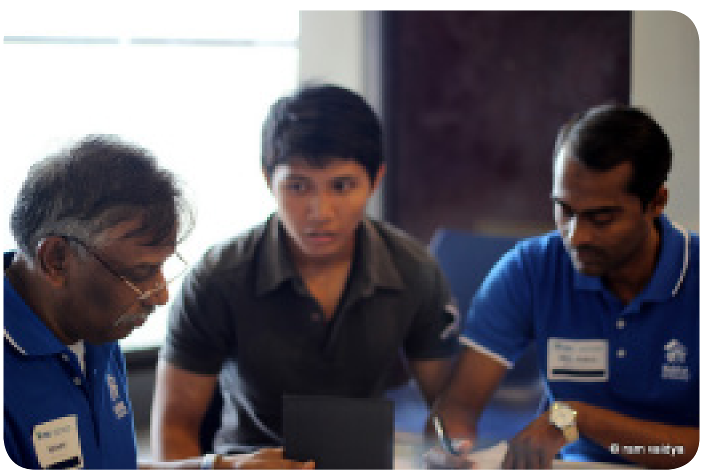

RAM VAIDYA

STEFFAN HACKER

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The Center for Innovation in Shelter and Finance's vision is "To serve as a place of knowledge, expertise, advice and innovation, enabling low- and very-low-income households to acquire adequate housing."

Habitat for Humanity and housing microfinance

Habitat for Humanity International's vision is a world where everyone has a decent place to live. Since its establishment in 1976, Habitat for Humanity International has served over 5 million people around the world through the provision of better housing solutions. Habitat is working in more than 70 countries as of 2015. Habitat's focus on adequate housing is rooted in the belief that housing plays a central role in well-being. Currently, 1 in every 4 people live in conditions that harm their health, safety, prosperity and opportunities. In addition to having benefits in these areas, adequate housing has been linked to increased stability and a sense of dignity for the home's inhabitants. Habitat is always developing new and innovative ways to expand the influence and impact of its work in housing around the world.

Habitat for Humanity International established the Center for Innovation in Shelter and Finance, or CISF, in 2009 to support diverse market development interventions focused on various components of the housing value chain, with the goal of increasing access to adequate housing. The center's vision is "To serve as a place of knowledge, expertise, advice and innovation, enabling low- and very-low-income households to acquire adequate housing."

The center focuses on facilitating collaboration among public, private and nonprofit actors in the market and provides consulting services to market actors to develop sustainable housing-related products and services for the millions of families without adequate housing. Through its consultative role, the center assists the private sector in the development of housing products and services that are both profitable and accessible to the poor. By serving as a facilitator instead of a direct provider, the center can develop programs that can reach greater scale and will continue to be available on the open market after Habitat's role is complete.

An important area of practice for the center is the emerging housing microfinance field, a sector in which the center has established itself as an innovative leader, having trained over 500 practitioners and supported more than 48 financial institutions as of 2014 to develop and roll out housing microfinance products. Its cross-cutting approaches include the design of financial products for home improvement and incremental building, the design of nonfinancial construction assistance models, and the linking of different housing market actors to support the expansion of affordable housing.

JASON ASTEROS

Although the housing microfinance sector shows much promise, the supply of such services still lags far below the natural client demand. Housing microfinance is gaining popularity and earning legitimacy as part of microfinance institutions' business, helped in part by the institutions' desire to not only serve the needs of microentrepreneurs but also focus on health, education and housing — the big three priorities of low-income households around the world.[1] However, housing microfinance's potential for growth is bumping up against the original purpose of these organizations, many of which were designed to support the development of small businesses by providing loans.

A key objective of the CISF is to accelerate the growth of this sector. To accomplish this, the center offers institutional technical assistance to financial institutions and other organizations interested in designing housing microfinance products for low-income households, along with nonfinancial housing technical assistance that is affordable to households and financially sustainable for the provider.

The center offers the following housing microfinance services:

- **Market systems analysis:** The center's team helps institutions understand opportunities and constraints within the housing market system. Key market actors and their roles in the housing value chain are identified, a gap analysis is conducted, and recommendations are provided on potential market-oriented interventions.

1 Jan Maes and Larry Reed. "State of the Microcredit Summit Campaign Report." Microcredit Summit Campaign, 2012.

- **Product development:** Through this service, the center's team of consultants helps institutions design housing finance products or develop housing-related funding mechanisms that allow households to build, renovate and extend housing progressively (in stages). This includes institutional assessments and evaluations of existing products for taking these products to scale.
- **Housing support services design:** This nonfinancial housing technical assistance includes off-site services such as providing informational pamphlets and training to households on shelter-related issues; offering advice and training related to a specific construction project; and providing on-site construction technical assistance for households who are actively improving their homes.
- **Planning, implementation and monitoring of pilot tests:** The center supports pilot tests of prototypes, along with the design and implementation of monitoring and evaluation systems that will measure the performance of these prototypes and make adjustments to them during the pilot phase to increase the chance of success when the product is expanded.
- **Advice and assistance in obtaining adequate funding** for testing and taking the products to scale.
- Other activities include:
  - Advisory services on:
    - Financial modeling and projections.
    - Internal processes and systems adaptations.
    - Marketing and promotion strategies.
  - Peer learning opportunities, facilitating practitioner interactions in virtual forums and regional workshops.

Currently,
1 out of 4 people

live in conditions that harm their health, safety, prosperity and opportunities.

ORGANIZATION OF THE HANDBOOK

We urge practitioners to read the bits of this handbook that are interesting, take what is relevant for the task at hand, and skim what is not relevant.

For ease of use, the handbook has been divided into two parts:

1. **A Primer on Housing Microfinance: Part 1** provides generalists with an accessible overview of housing microfinance and the product development cycle, along with the related topics of housing support services and secure tenure. This section is intended to equip executive directors and managers with the information necessary for deciding whether to add housing microfinance to an institution's portfolio.
   - The first chapter defines and introduces housing microfinance.
   - Chapter 2 covers the market opportunity for housing microfinance.
   - Chapter 3 describes the main stages of product development, providing enough detail to readers wishing to understand the requirements for product design.

- Chapter 4 offers a description of housing support services, the nonfinancial technical assistance to low-income households that financial institutions can bundle with the loan product as part of their due diligence and follow-up processes.
- Chapter 5 covers secure tenure considerations, a subject that deserves special attention because of the impact it has on housing microfinance.
- Chapter 6 details lessons learned by the center and its financial institution advisees over the years.

2. **A Practitioner's Guide to Housing Microfinance: Part 2** is a resource for staff members and consultants who will be part of the product design team. It includes detailed information, illustrations and tools for the steps typically taken to design, test and expand housing microfinance products.
   - Chapters 7-11 cover the five stages of housing microfinance product development. Included in these chapters are detailed instructions on how to assess an institution's readiness, prepare for product development, conduct the market research, design the prototype, and test it. Tools and templates for each of these steps are referenced and included as annexes to the practitioner's guide.
   - Chapter 12 pairs with Chapter 4 on housing support services and offers practical advice on designing nonfinancial services.
   - Chapter 13 provides instructions on monitoring and evaluating the housing microfinance pilot test and product expansion.
   - Chapter 14 offers guidelines to practitioners on incorporating secure tenure considerations into the housing microfinance product.

DEVELOPMENT OF THE HANDBOOK

Habitat for Humanity International, through the Center for Innovation in Shelter and Finance, supports institutions interested in entering the housing microfinance market by providing technical assistance in the design and testing of housing microfinance products and services. This is done through a systematic approach that emphasizes the financial and housing needs, preferences and capacities of low-income borrowers and the capacity of the financial institution to design, pilot and scale up housing microfinance products. The center helps institutions establish themselves in the market for the first time and advises those with housing products on expanding their outreach and refining their existing products.

This handbook is based on the collective experience of the center in providing housing microfinance consulting services globally. Its primary audience is managers and staff members of financial and housing institutions, along with consultants, practitioners and generalists in the housing space who are interested in developing or refining housing microfinance products and services that respond to the needs, capacities and preferences of their clients.

This handbook aids practitioners by:

- Offering an overview and business case for housing microfinance focused on low-income populations.
- Defining some of the drivers of success for a housing microfinance portfolio.
- Describing a structured process for developing housing microfinance products and services that attempt to fill the gap between existing supply and demand.
- Providing field-tested tools for staff members and consultants who are implementing this process.
- Sharing lessons learned from each stage of the process.

In addition to the financial aspect of a housing microfinance product, this handbook discusses nonfinancial technical assistance for low-income homebuilders — called "housing support services" by Habitat — as part of the product development methodology. Habitat's experience has shown that these services can be an important part of improving housing quality and reducing construction costs, besides creating a powerful marketing tool through which loan officers can promote the product. This topic is included throughout the handbook, and two chapters are dedicated to making the case for sustainable and effective housing support services.

The first version of the center's methodology for housing microfinance product development in 2009 was based on the MicroSave product development methodology, which was devised in Africa for business microfinance products. The center honed its methods, tools and housing-focused approach, and added them to the first version, resulting in the second edition of the handbook in 2012.

This third edition updates the housing microfinance product design chapters and adds practical advice based on recent engagements with financial institutions. Additional tools, included as annexes, and mini case studies illustrate the work. This edition also expands the discussion of housing support services and adds chapters on secure tenure and monitoring and evaluation of housing microfinance products. It also adds material for a generalist audience, in particular senior managers who want to understand enough about housing microfinance and its market opportunity to decide whether to add it to their portfolio.

The handbook uses the following principles, all of which have focused the center's technical assistance efforts:

- Listen to the needs, preferences and capacities of clients.
- Adapt an organization's operations to meet its clients' needs in a financially sustainable manner.
- Be aware of the external, contextual changes that affect housing microfinance.
- Develop products and services through the participation of the front-line staff.

This handbook is a work in progress. We welcome your comments and suggestions for enhancing it. Please direct your correspondence to global-cisf@habitat.org.

1

A PRIMER ON HOUSING MICROFINANCE

HABITAT FOR HUMANITY INTERNATIONAL'S EUROPE, MIDDLE EAST AND AFRICA

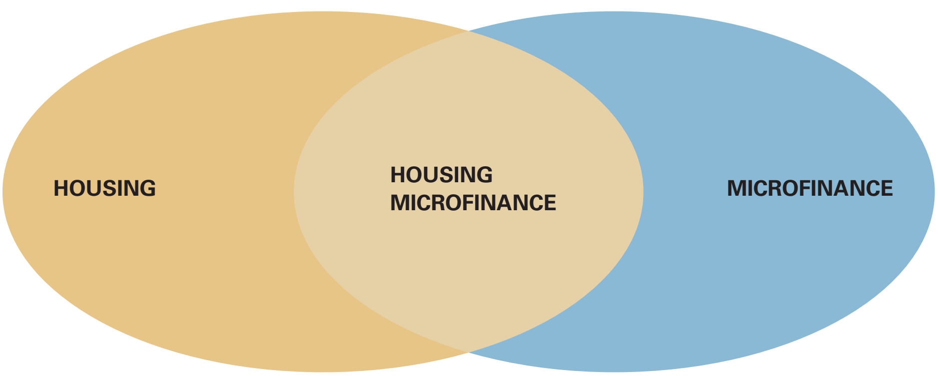
Housing micro-finance is a subset of microfinance designed to meet the housing needs, preferences and capacities of low-income groups.

Chapter 1: Overview of housing microfinance

Housing microfinance is a subset of microfinance designed to meet the housing needs, preferences and capacities of low-income groups, especially those without access to the banking sector or formal mortgage loans. The target population of housing microfinance products is low-income households who wish to expand or improve their dwellings or to build a home progressively.[1]

Housing microfinance takes the same principles applied to other microfinance products and combines them with the progressive, or incremental, housing process that the majority of the developing world uses to build, expand and repair their houses, as shown in Figure 1.

FIGURE 1: Conceptualizing housing microfinance



HOUSING MICROFINANCE IN FOCUS

Housing microfinance refers to a type of microfinance product that consists of small, non-mortgage-backed loans offered in succession to support the existing incremental building practices of low-income populations. It can include a range of financial services that support informal shelter improvements such as home repair and expansions, the addition of water and sanitation services, and energy efficiency upgrades. Housing microfinance can often work where lien-based mortgages do not, and where the improvements are undertaken in a series of small, incremental steps.

1 Merril and Mesarina. "Expanding Microfinance for Housing," Micronote #26. Online USAID publication. 2007. Available at microlinks.org.

Housing microfinance consists of small, non-mortgage-backed loans offered in succession to support the existing incremental building practices of low-income populations.

Within the category of housing microfinance loans there exists a range of potentially differentiated and diversified offerings, such as loans tailored for common improvements (flooring, roofing) or distinct products (water cistern purchases, septic tank installations).[2] Table 1 shows various housing microfinance examples, including loans for home improvements and community loans whereby a group of people borrow together to complete larger-scale projects, such as utility work, that will benefit the community.

TABLE 1: Housing microfinance product profiles

Product	Loan amount	Term	Pricing	Use of funds
Home improvement loan	$500 - $3,000	6 months - 2 years	28%*	Repairs; weatherproofing; upgrades; extensions; connections to utilities such as water, sewage, electricity or solar power.
Home completion loan	$1,000 - $4,000	12 months - 3 years	28%*	Finishing a partially completed home, adding a room.
Home build loan	$3,000 - $10,000	2 years - 5 years	22%*	Building a completely new dwelling.
Group loans	$500 - $3,000	6 months - 3 years	28%*	Group loans for sites and services projects (e.g., roads or utilities).

*Indicative pricing for Uganda, declining balance loan.

Source: 2014 Shelter Report, "Step by Step: Supporting Incremental Construction through Housing Microfinance," Habitat for Humanity International

Generally, housing microfinance lending methodologies follow the principles listed below:[3]

1. **Progressive building, expansion, renovation and repair** of housing are more appropriate activities to finance than the purchase of land or existing or new houses.
2. **Loan amounts should remain small**, generally less than micromortgages but larger than microenterprise credit.
3. **Financing is determined based on clients' repayment capacities**, which can include other household members' contribution to the loan repayment, pre-established loan terms, and the costs of an improvement "step."
4. **Mortgages are generally not suitable instruments** for housing microfinance. In many developing countries, mortgage laws are either nonexistent or weak, the fees associated with taking mortgages are often prohibitive for clients, and liens do not offer added security to the loan because foreclosure procedures are lengthy and difficult. Standard approaches based on the principles of microfinance for soft collateral and guarantees suffice in most cases. Guarantees are tied to alternatives that are within clients' reach (e.g., co-guarantors and promissory notes).

2 In the 2014 CISF survey of institutions around the world offering housing microfinance, basic home repair or improvement (plastering, roofing, ceiling, wall painting, floor finishes such as tiling, etc.), and incremental housing (added rooms, latrines, solar panels, etc.) were the main home improvements selected by clients. The full report from the Housing Microfinance Survey (2015) can be found at habitat.org/cisf.

3 These principles are adapted from Frank Daphnis, "Housing Microfinance: Toward a Definition." Available at housingfinanceforthepoor.com/data/files/housing microfinance%20towards%20a%20definition,%20by%20franck%20daphnis.pdf.

5. **Land title issues require a flexible approach.** Land title is unclear or nonexistent in many countries, but this should not be a barrier to accessing housing finance as long as the client has sufficient land security (e.g., he or she has resided on the land for several years) and is not living on high-value land that may be seized by governments or developers. Tenure security is confirmed via informal documentation (e.g., purchase agreements or utility bills), as opposed to legal title.
6. **Loan terms should remain shorter than mortgage or micromortgage loans but longer than microenterprise credit.** They also should consider the sources and seasonality of incomes of those repaying the loan.
7. **Housing finance products typically leverage client savings.** (This principle is also discussed later in this chapter). Additionally, if the provider is a microfinance institution, credit services for housing can be linked to prior participation in savings or more traditional microenterprise loan services.
8. **Revolving loans** can allow for progressive home improvements.
9. **Loans can be extended to small neighborhood groups** or cooperative housing schemes for simple infrastructure projects such as collective water and sanitation systems or other shared resources.
10. **The loan value should cover the full costs of offering the financial service.**

Housing microfinance success in Peru

Low-income households in Peru grapple with a serious housing deficit of more than 1.8 million homes. In this context, housing microfinance has high potential to reduce this number.

When EDYFICAR, currently the largest microlending entity in Peru, started working with the CISF, it already had a housing product that targeted low- and middle-income populations. Through the market research conducted by the center's staff as part of the product development process, EDYFICAR considered the possibility that it could offer housing loans to a segment of the population it hadn't reached before: the lowest income group, which earns only one to two times the national minimum wage.

The center worked with EDYFICAR to design and implement a financial product for housing with nonfinancial housing support services that reached this highly vulnerable sector of the market. The purpose of the product was to provide microloans to finance progressive home improvements aimed at microbusiness entrepreneurs and salaried employees from the lowest income segments, with the added value of construction technical assistance.

During the pilot, EDYFICAR disbursed 504 loans, with a total portfolio of US$323,579, an average loan size of US$1,840, and a product delinquency of 2.3 percent. Sixty-two percent of the clients were new. As of the end of 2014, Edyficar had disbursed 230,595 loans, with a total portfolio of US$326,100,844 and a product delinquency of 2.7 percent.

Through the project, EDYFICAR found that housing is a long-term project as well as a household project, where income from children and other household members can be included in the calculation used by banks to evaluate creditworthiness. Housing also represents a different type of risk than the typical microloan; housing loans experience less delinquency because they are directly linked to the place where a household lives.

But perhaps most importantly, EDYFICAR found that improved housing leads directly to a dramatic transformation in the lives of its most vulnerable clients. This is a lesson that it is putting into practice as it continues the massive expansion of its housing microfinance product Edyvivienda PASO A PASO (Step by Step).

Common collateral alternatives in housing microfinance

An examination of collateral and underwriting best practices in housing microfinance institutions through Asia, Africa and South America reveals the following common collateral alternatives: mandatory savings, fixed assets, deposits, pension guarantee, group guarantee, employer guarantee, co-signers and microenterprise loan history. Additionally, the 2014 CISF survey of institutions around the world offering housing microfinance found that the main requirement for their loans is a co-guarantor. Ninety percent require the client to have regular income, and 58 percent require the client to be a salaried worker. In addition, 63 percent require a budget for completing the project as a prerequisite to extending a loan.

11. **Institutions often require a life insurance component for housing finance clients**, in part because of the longer maturities and the importance of the loan for the well-being of the household. In addition, this could be combined with a construction completion scheme that would ensure that the project is completed even if the head of the household dies; it could, for example, provide additional funds to hire workers to complete the project.
12. **Housing microfinance products can be combined with nonfinancial housing support services to increase quality and lower construction costs.** Support services can include technical assistance during the construction phase, group training workshops, distribution of printed informational materials, and discounts at hardware and home improvement supply stores. Further details on this point are discussed below.

Institutions that provide housing microfinance loans are typically lending organizations, such as microfinance institutions, banks and credit cooperatives. There are also examples of supplier-led financing, in which housing microfinance products are offered by building materials suppliers or service providers. These suppliers have the option to hire lending institutions to facilitate the process. This strategy can also be useful for finance institutions that offer housing microfinance as a secondary product but do not want to commit the resources needed to expand the offering to a larger market. This "supplier credit" technique has been quite successful for companies such as CEMEX and La Farge (both concrete suppliers) because of their broader reach throughout the building community.

HOUSING MICROFINANCE, MICROENTERPRISE AND MORTGAGE LENDING

A discussion of housing microfinance is not complete without considering the similarities and differences among housing microfinance, mortgage and microenterprise lending.

As mentioned previously, though both housing microfinance and mortgage lending focus on housing, housing microfinance loans are usually not collateralized by the property. This is typically the result of the informal nature of clients' income or lack of land title, making alternative forms of collateral necessary in most cases. Additionally, housing microfinance loans are smaller and for shorter periods than mortgage loans.

Housing microfinance also has similarities with traditional microenterprise lending, such as the loan approval process, which is generally based on an assessment of the applicant's ability to pay (cash flow) and assumed willingness to pay (character assessment). However, unlike in microenterprise lending, the other household members are usually contributors to the repayment of the loan, in addition to the client. Since the customers for these incremental finance products generally participate in the informal economy and do not have steady and verifiable income, additional analysis is used to evaluate the creditworthiness of a borrower.

Housing microfinance also differs from microenterprise lending in that it typically involves larger investment amounts and therefore requires longer terms and a closer association with a savings requirement. Adding to that complexity are the implications of land tenure and safe and durable construction methods. Housing microfinance can be tailored to the construction practices and land formalization of the poor, who usually acquire property and shelter incrementally.

TABLE 2: Comparison of lending models

Characteristics	Traditional mortgages	Microenterprise loans	Housing microfinance
Purpose	Purchase home	Entrepreneurship	Home improvement, incremental building
Target borrower	Middle to high income, salaried	Low income, self-employed	Low income, self-employed
Impact for borrower	Asset-building (productive only when linked to livelihood out of home).	Income generation	Asset-building (productive only when linked to livelihood out of home).
Loan term	Long term (>5 years)	3 – 12 months	6 – 36 months
Loan amount	Large amount	Small amount	Small to medium amount
Collateral	Land and structure	Income from business venture	Guarantor
Interest rate	Less than microenterprise and housing microfinance	Equal to or higher than housing microcredit	Equal to or lower than microenterprise loans
Scale	Global, large-scale	Regional, limited scale	Regional, very limited scale

PROMISING PRACTICES IN HOUSING MICROFINANCE

Although there is great market potential in offering housing microfinance products, financial institutions face some hurdles.[4] Best practices have evolved to mitigate many of these challenges, including:

- Asset liability matching: There is very high demand for longer-term funding to match the longer terms of housing finance products. Although deposits and savings can sometimes cover the funding needed for these products, guarantees also can be helpful.
- Fixed rates: From the borrower's perspective, it is important to know the exact amount they will be responsible for repaying. This transparency promotes a healthy lender-borrower relationship that helps to ensure repayment, especially given lower financial literacy rates.
- Individual loans: Generally, there are higher repayment rates among individual housing lending than in group housing lending. Individual lending also helps simplify the analysis of cash flow (an important element of lending to informally paid workers). However, in some cases with extremely poor households or where group lending is the core methodology for the institution, collective loans have been successful, especially in small communities where community peer pressure helps ensure repayment.
- Client education: Technical construction training, housing design training and financial literacy training have all proved successful as supplementary education programs by increasing the rate of financial repayment.[5]
- Women borrowers: Women have been found to be more reliable borrowers and significantly better credit risks globally.[6]

4 For an in-depth description of housing microfinance, see Habitat for Humanity International's 2014 Shelter Report, "Step by Step: Supporting Incremental Building through Housing Microfinance." Available online at habitat.org/advocate/publications-resources/shelter-report-2014.

5 Daphnis and Ferguson. "Housing Microfinance," Kumarian Press, 2004. p. 11.

6 Chemonics International Inc. "Development Credit Authority Design and Utilization Task Order" WO 043 Low Income Housing Borrower Sector Assessment, p. 18.

Additional discussions around best practices are included in Chapter 3: An Introduction to Housing Microfinance Product Development and Chapter 6: Lessons Learned in Housing Microfinance.

HOUSING SUPPORT SERVICES

A defining characteristic of some microfinance products is the provision of nonfinancial services that enhance the capacity of clients to invest their loan wisely. Similarly, housing microfinance products should ideally be linked to nonfinancial services to help the clients make decisions about labor, materials and the process for improving their homes. Habitat for Humanity refers to this assistance as housing support services and defines it as nonfinancial products and services that enable a household to improve their housing on their own. Some institutions view this form of support to the client — in particular, helping with basic construction design, budgeting, and guidance on materials and labor procurement — as an important part of their housing microfinance products. Some institutions use it as a promotional tool to position the product, others as a means to verify the use of the loan, reducing the risk of diversion of the loan. Other institutions do not place great emphasis on this technical assistance.

As Frank Daphnis points out in "Housing Microfinance: Towards a Definition," if housing support services are not offered, then housing microfinance is essentially a

Housing microfinance success in Tajikistan

About 40 percent of Tajikistan's population lives at or below the poverty line, and about 70 percent lives in substandard housing. Because of limited job opportunities, more than 1 million Tajik citizens work abroad, most of them in Russia. Among those who must find work in Russia are the three adult sons of Mamarahimova Nazokat, 59, a widow who lives with her five adult daughters and her five grandsons in a six-room house made of mud bricks.

In early 2011, IMON International LLC, a commercial microlending organization that had made more than 98,000 loans for more than US$72 million, approached Habitat for Humanity Tajikistan to form a partnership. Together, they set up a pilot program to improve IMON's housing microloans and add a technical assistance component.

With so many men working away from home, women are often in charge of the household tasks, including repairs and renovations. The technical assistance component was designed to help clients manage their own construction and improvement projects by providing access to Habitat's expert advice. The clients said the construction technical assistance improved their knowledge and helped save them time and money.

Nazokat's family saw their lives improved after they received construction assistance and a microloan to repair her home. "It all starts in the family," she said. "Children, their upbringing, learning, love, happiness, extension of the family, etc. The family is the small society where people live and share their sorrow, happiness, success, etc., together, and they work all together to achieve their objectives."

The pilot project was judged a success, and IMON prepared to offer bigger loans over longer terms. Habitat Tajikistan and IMON secured an additional US$2 million from Habitat for Humanity's MicroBuild Fund, and by the close of 2014 had US$12.4 million in its housing microfinance portfolio, with 5,791 clients.

From Habitat for Humanity International's 2014 Shelter Report, "Step by Step: Supporting Incremental Building through Housing Microfinance."

Construction technical assistance in Nicaragua

In Nicaragua, PRODEL has been a pioneer in housing microfinance and housing support services since the early 1990s. As in much of the developing world, many lower-income Nicaraguan households who build their homes incrementally use materials that are rudimentary or of poor quality. PRODEL found that this piecemeal construction process is often carried out without technical construction knowledge. As a result, houses are often built in an unorganized way, resulting in awkward use of space and poor ventilation. These factors can jeopardize a household's safety and well-being, especially in a country that experiences frequent natural disasters.

A core part of PRODEL's housing strategy is to introduce technical assistance in construction by working with microfinance institutions, clients, architects, engineers and master builders who are employed to carry out the building work. PRODEL's advice to households focuses on ensuring safety, appropriate use of space, adequate ventilation and illumination, and use of quality materials. It also provides guidelines on how to optimize the building process to make it cost-effective. For smaller improvements, the technical advice focuses on sound building practices and the choice of good-quality building materials.

From Habitat for Humanity International's 2014 Shelter Report, "Step by Step: Supporting Incremental Building through Housing Microfinance."

consumer loan whose purpose is housing but whose ultimate use cannot be determined with certainty. In this case, the proposed construction allows the institution to assess the required loan amount, and repayment performance determines the client's future with the institution. On the other hand, if housing support services are coupled with the credit, they become part of the preloan due diligence and post-loan follow-up that financial institutions often use with other loan products.

The Center for Innovation in Shelter and Finance's experience sheds light on other compelling reasons for considering adding housing support services to a housing microfinance product. The time between acquiring the materials and starting construction can result in a deterioration of the quality of materials (e.g., cement being stored in wet conditions, causing it to solidify). Households with limited resources, few opportunities to obtain adequate and affordable financing, and inadequate access to quality products and trained service providers typically rely on informally trained builders and laborers, who often over- or underbuild. This can lead to problems such as material deterioration, inappropriate investment in costly improvements, and critical structural deficiencies, especially in disaster-prone environments. The potential losses associated with incremental building practices can be mitigated through appropriate housing support services. Chapter 4 discusses these services in greater detail.

SAVINGS IN INCREMENTAL HOUSING

Developing more effective ways for people and communities to save their own funds allows them not only to have more access to their own money, but also to be seen as less risky by potential financers. Low-income populations working in the informal economy have been financially excluded because of their perceived high risk. This sector of the population is denied not only credit, but also other types of financial services such as savings.

Because of this, slum dwellers are forced to look for alternative saving mechanisms.

Incremental building has an effective built-in saving mechanism: When people accumulate construction materials until they have enough for their construction project, the materials are a form of savings. This saving mechanism could be formalized through a home improvement savings account, with the following benefits:

- Measuring savings capacity is a good tool to assess a household's cash flow, and thus its payment capacity. This is particularly valuable for people with informal incomes who want to borrow but have no collateral or track record.
- Saving aligns the interests of borrowers and lenders. Requiring a down payment from the borrower (using his or her savings) to qualify for a housing loan ensures the borrower has a financial stake in the incremental housing project. This helps ensure the loan is repaid on time.
- Savings organizations (village savings and loan associations, or VSLAs; rotating savings and credit associations, or ROSCAs; and savings and credit cooperative organizations, or SACCOs) are effective tools that assist households in loan repayment. Many microfinance institutions are familiar with these types of group loan mechanisms, which can add a level of comfort to the lender. Other savings schemes, such as locally managed savings groups, may have a strategic importance as a vehicle for community building and the nurturing of solidarity, particularly among women engaged in the incremental building of their home.

WHEN IS HOUSING MICROFINANCE INAPPROPRIATE?

Housing microfinance aims to develop longer-term solutions or solutions that fit between relief shelter and the developed mortgage markets of the West. For institutions considering adding a housing microfinance product to their portfolio, however, it is important to keep in mind the contexts in which housing microfinance is not appropriate and subsidized assistance may be preferable. Examples include:

- Crisis or war zones, or areas at risk from natural disasters, where affected populations might need significant housing subsidies or relocation.
- In areas of extreme poverty, where very low-income households are too poor to pay the required amounts for progressive housing because of overindebtedness or failing to meet basic eligibility criteria. These households might need partial or total subsidies to improve their housing.
- In areas lacking basic community infrastructure, such as drinking water, electricity and sewage.

Chapter 2: The market opportunity for housing microfinance

Housing is often proclaimed to be one of the "big three" priorities for low-income households around the world, along with food and primary education.[1] A comprehensive report on the global housing crisis from McKinsey estimates that 330 million urban households around the world live in substandard housing and more than 200 million households in the developing world live in slums.[2]

The majority of this deficit exists in the developing world among low-income populations, where for many reasons new and formally financed units are unattainable for all but a minority of the population. As a result, there is great demand for improvements and repairs to existing shelters, which are often deemed inadequate. Indeed, in much of the world, the predominant pattern for building and upgrading homes is progressive — by means of small, incremental stages in accordance with a household's priorities and financing abilities.

Many households work on the improvement and extension of their homes first to obtain the minimum standards in size and quality, and later to accommodate changes in household size or to obtain income from their investment in the house.[3] Incremental housing can be described as an inverted version of the traditional, formal process of building and financing a house. For example, in the traditional process, the complete features of the house are available to the owners from the first day of occupancy. In the incremental construction process, households begin residing in a home with the most basic features and build at the pace their financing capacities allow. However, many of these households do not have access to conventional mortgages, and government-financed housing programs are usually constrained by limited resources.

Meanwhile, microfinance has become an effective tool to increase access to capital for low-income populations, often the same populations lacking adequate shelter. Though originally thought of mainly as credit for microenterprises, the microfinance industry has begun to examine other needs and preferences of its clients and has started to design appropriate financial products to serve those clients better.

For those institutions serving the "base of the pyramid" and committed to positive financial and social results, housing microfinance is emerging as a nimble tool to address substandard housing, being a viable financial product while helping achieve a social mission. Housing microfinance has emerged organically out of the realization that microloans could be a useful method for helping the millions of people living in the world's slums

Microfinance has become an effective tool to increase access to capital for low-income populations, often the same populations lacking adequate shelter.

330 million

Urban households around the world live in substandard housing.

200 million

Households in the developing world live in slums.

1 Jan Maes and Larry Reed. "State of the Microcredit Summit Campaign Report," Microcredit Summit Campaign, 2012.

2 McKinsey "Report on Adequate Housing," 2014.

3 Green, M. and Rojas E. "Incremental Construction: a Strategy to Facilitate Access to Housing," Environment and Urbanization, Vol. 20, No. 1, pp. 89-108, 2008.

Housing microfinance is emerging as a nimble tool to address substandard housing, being a viable financial product while helping achieve a social mission.

to incrementally improve their conditions. This understanding is strengthened by the realization that between 20 and 30 percent of microenterprise loans are diverted into housing, which in turn has led some lending institutions to offer microloans for housing (though because some of these products were repurposed consumer loans, they were not always well-suited to housing).

Providing products and services aimed at mitigating the deficiencies and challenges that arise from the incremental housing process can be an opportunity to both fill a market gap and create immense social impact. This chapter explains how housing microfinance offers significant financial and social justification for entering the market, both as a strategy for addressing substandard housing and as a viable product diversification opportunity for financial institutions and entrepreneurs serving low-income populations.

FINANCIAL JUSTIFICATION

Microfinance institutions were born in the 1970s as a viable market opportunity to provide unsubsidized financial services to poor people, relying on their capacity to repay their loans. Today the World Bank estimates that more than 16 million people are served by some 7,000 microfinance institutions all over the world.

Some of the lessons that have emerged include the understanding that many of the households benefiting from microenterprise loans conduct their microbusinesses in whole or in part from home, and that part of these loans are being used for home improvements. Despite evidence that up to 30 percent of microenterprise loans are diverted to shelter needs, housing microfinance remains a nascent product in an industry that emphasizes working capital loans, or loans for home improvements that are consumer loans without any housing product differentiation. There is a huge potential for financial institutions to expand the affordable housing market that, according to at least one study, surpasses that reached by the microenterprise market by up to four times.[4]

As housing microfinance continues to grow and expand as a practice, lessons are emerging on the market opportunity for financial institutions designing products and services clearly targeted toward housing. These include:

- Housing microfinance can be seen as a product to increase client retention and satisfaction, an improvement that can translate into a sustainable boost in demand for an institution's products in the long term. The 2014 Housing Microfinance Survey from the CISF was administered to 48 financial institutions and found that 73 percent selected "Response to client demand" as a reason for adding housing microfinance, and 60 percent chose "Retain loyal clients." One respondent wrote, "The majority of our clients use their savings to improve their homes, health and education. This is why we saw the housing microfinance loan as an opportunity to meet their needs."
- Housing microfinance lending can increase stability by diversifying the loan portfolio and attracting new customers beyond microentrepreneurs. Often, people divert microenterprise loans into housing projects, so building a housing microfinance lending program is a way of responding to a household's implicit demand for shelter and housing solutions while reducing the misuse of loan funds by existing clients.

Testing the market in Kenya

Kenya Commercial Bank, the Kenyan mortgage market leader with a 30 percent market share and approximately 6,000 mortgage loans, felt the need to include housing microfinance as a market opportunity to serve new, potential clients. The bank, with technical assistance from the CISF, started pilot testing the housing microfinance product in 2015 with the aim of expanding it nationally and regionally.

4 JP Morgan. "Impact Investments: An Emerging Asset Class," p.12, November 2010.

Housing microfinance, then, provides a valuable opportunity for the lending institutions to diversify their portfolio and attract new clients.

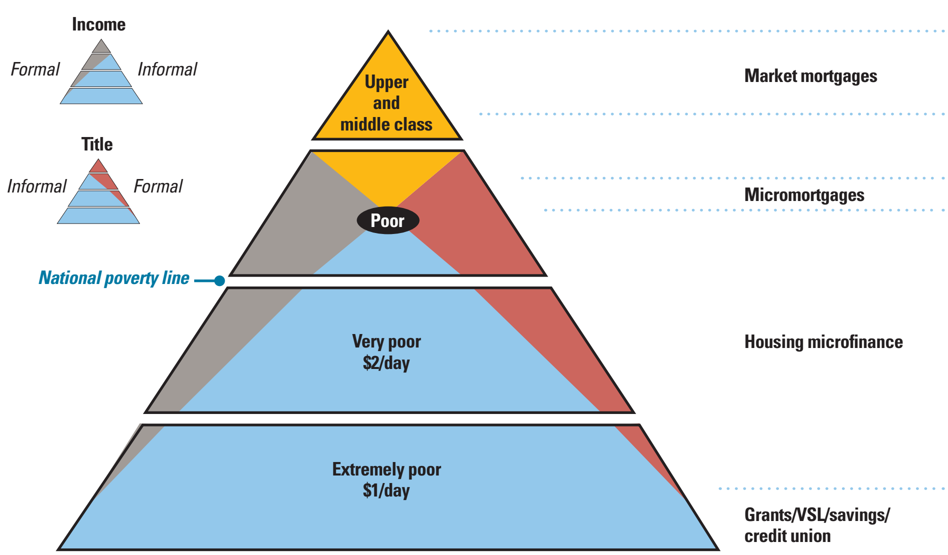
Figure 2 shows that low-income housing finance users are typically salaried workers with documentable income or, in more developing economies, self-employed. Informal workers are generally excluded from access to commercial housing finance because of a lack of verifiable, stable, official income or land title.

The segments in Figure 2 break up the market not only by income type and land situation, but also by most probable type of finance supply. Globally, it is estimated that no more than 3 percent of the population in developing economies has an outstanding mortgage, and in many countries that number drops to 1 percent.[5] Typically, only the upper and middle classes and some low-income households have access to commercial housing finance. This leaves a huge market gap to be filled through housing microfinance products.

Housing microfinance products are readily offered to this segment through microfinance institutions or other nonbank financial institutions that are comfortable with elevated risk and are used to offering noncollateralized loan products. However, banks that are downscaling their operations to cater to a new niche not served by their traditional products and services are also increasingly exploring the inclusion of new products such as housing microfinance.

Providing products and services aimed at mitigating the deficiencies and challenges that arise from the incremental housing process can be an opportunity to both fill a market gap and create immense social impact.

FIGURE 2: Financial product segmentation



Sample developing economy country profile

Note that the brown-shaded area of the pyramid represents the population with documentable income, and the red-shaded area represents the population with formal title to their property.

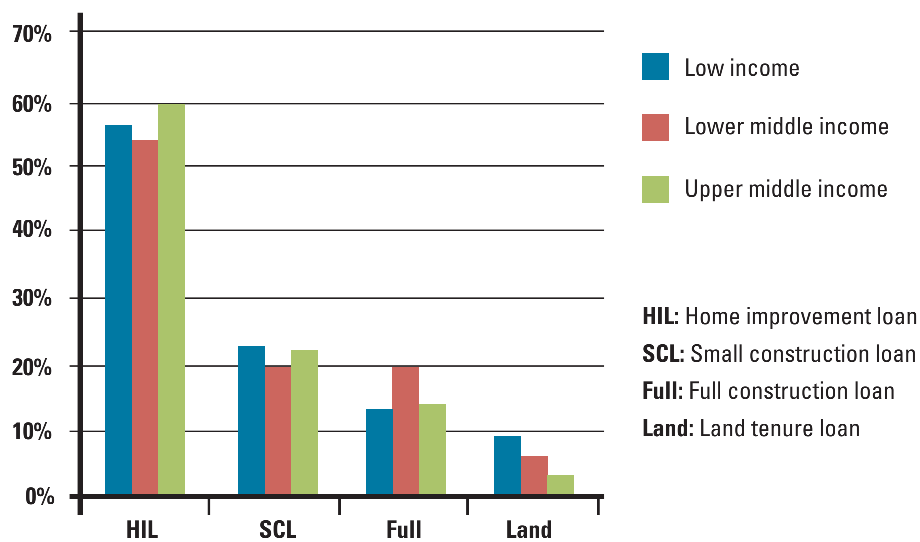
5 Demirguc-Kunt and Klapper. "Measuring Financial Inclusion," The World Bank Development Research Group, April 2012.

60%

of housing loans are used for home improvement.

- Housing microfinance can become one "product line" with several subproducts that reach different segments of the low-income population. The previously mentioned CISF survey found that the majority of housing loans (60 percent) are used for home improvements (see Figure 3). It also found that 75 percent of respondents offer more than one housing microfinance product, with the plurality (40 percent) offering two products, and 35 percent offering three or more. Common examples of housing microfinance products and their wide range of purposes include:
    - Home improvement/repairs.
    - Expansion (addition of room).
    - Improving or purchasing better appliances (sanitation facility).
    - Weatherproofing.
    - Upgrades (solar panels, energy-efficient appliances, installation of connection to public facilities).
    - Construction of new home.
    - Purchase of new home.
    - Land (acquiring title, security of tenure).

FIGURE 3: Use of housing microfinance loan by country income level



Source: CISF Housing Microfinance Survey

- Lastly, financial institutions that dedicate their efforts to the design and positioning of a differentiated housing microfinance product can experience significant growth and have it become one of their leading products.

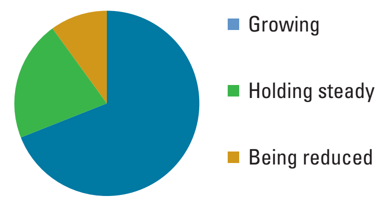
According to the CISF's 2014 Housing Microfinance Survey, housing microfinance loans perform well. The quality of the housing microfinance portfolio also has improved; from 2012 to 2013, the average increase in active loans was 28 percent, and the dollar value of these loans increased by 43 percent. The portfolio at risk, or PAR, also improved from

2.17 percent in 2012 to 2.10 percent in 2013. Additionally, almost all respondents believe their housing microfinance portfolio is growing or holding steady (Figure 4). More importantly, institutions are reporting that housing microfinance is as profitable (48 percent) or more profitable (21 percent) than their other products (Figure 5).

Seventy percent of the institutions that responded to the survey see their product growing as a percentage of their overall portfolios, and given its performance and effects, 80 percent of responding institutions plan to expand their housing microfinance offerings. All but three respondents have housing microfinance in their business plan. These findings are promising in relation to the viability and sustainability of housing microfinance portfolios, confirming the potential of a vibrant, untapped market for lending institutions.

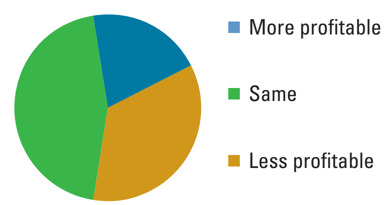
Despite the great business opportunity housing microfinance represents for financial institutions, access to capital is an issue that can prevent institutions from scaling up their products. Additional issues include having a real commitment toward the inclusion of this product as part of the overall institutional strategy and allocating the requisite time and human capital toward the design of this product.

FIGURE 4: Housing microfinance portfolio growth



Source: CISF Housing Microfinance Survey

FIGURE 5: Housing microfinance profitability vs. other products



Source: CISF Housing Microfinance Survey

SOCIAL JUSTIFICATION

By leveraging the vibrancy of informal markets, incremental shelter practices have great potential to create larger numbers of safe and secure dwellings than conventional approaches. By coupling housing microfinance with tenure and basic services such as water and sanitation, households are able to invest in their homes and future. This reduces the financial burden on governments to subsidize housing, and taking small steps to formalize parts of the incremental process creates the potential to have well-planned communities.

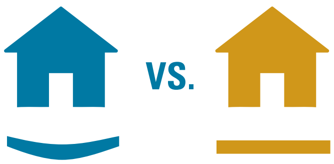
Shelter is a basic human need. Yet unlike the "small doses" of food or clothing that one can take, housing is a major investment and is needed constantly. Providing adequate housing is an effective means of alleviating poverty because shelter is usually the most expensive item for households. It is also a prerequisite for better health and provides savings on medical expenses related to poor-quality shelter. Housing also can be a source of income, either through home-based businesses or renting.

The need for adequate financing for low- and very-low-income populations is made apparent when one considers the rapid urbanization of most developing countries. By 2050, 70 percent of the world's population is projected to be living in urban areas, according to the U.N.'s Department of Economic and Social Affairs. In this rapidly urbanizing world, decent living conditions are becoming scarce, especially in developing countries, where many cities do not have the capacity to support this influx of new inhabitants.

At the same time, traditional mortgage loans are not accessible to the lowest-income populations because of the lack of steady, formal incomes and titles. Because of the lack of formality, financial institutions see these borrowers as much higher risks, and thus charge them higher interest. The high interest rates (in Brazil, for example, rates range from 77 to 257 percent)[6] make financing highly unattractive to potential borrowers. Additionally, borrowers simply lack the information to manage their finances and determine what financial product is appropriate.

6 Bill Drayton and Ashoka. "Transforming Urban Markets for the Poor Through Collective Entrepreneurship," Global Urban Development Magazine, 2008. Available online at globalurban.org/GUDMag08Vol4Iss2/Ashoka.htm#Volume_1.

Slum households



Improved **Unimproved**

Adults in upgraded homes were substantially happier and experienced lower rates of depression and stress.

Low-income populations instead rely on their savings to finance their housing projects. When savings are nonexistent, these populations are forced to turn to informal sources such as selling assets, borrowing from relatives and employers, getting remittances from abroad, or taking exorbitant loans from money lenders.

Housing microfinance has the ability to support low-income households in their incremental building process by allowing them to purchase enough labor and building materials to complete an element of their home that will not degrade while they wait for the next phase of construction, therefore decreasing the loss of savings. Building incrementally often represents what the United Nations Human Settlements Programme calls a "delicate expression of poor people's gradual capacity to climb out of poverty. Like the houses they build, it's not something that happens all at once. But in cases where housing finance and secure tenure are made available to people, the quality of owner-built housing — even at the bottom end of the economic ladder — can improve dramatically."[7]

In the 2014 CISF Housing Microfinance Survey, the perceived impact of housing microfinance was overwhelmingly judged to be "Improved quality of life/happiness," followed by "Improved health/sanitation." These findings correlate with research conducted by the Center for Effective Global Action at the University of California, Berkeley; Washington University in St. Louis, Missouri; the World Bank; and the Mexican government. The research rigorously evaluated *Piso Firme*,[8] a program created by the Mexican government in 2000 to improve the health and well-being of the urban poor. The program replaced slum dwellers' dirt floors with concrete flooring, which was more hygienic and prevented the transmission of parasitic infections, particularly in children. Additionally, it compared improved slum households with those left unimproved and found that adults in upgraded homes were substantially happier (as measured by their degree of satisfaction with their housing and quality of life) and experienced lower rates of depression and stress.

"Improved security of tenure" was the third-highest-rated impact of housing microfinance. Evidence shows that recognizing informal tenure makes housing markets more inclusive for marginalized populations while enabling financial institutions to grow robust housing portfolios. (For more on this topic, see Chapter 5).

7 UN-HABITAT and Asian Coalition for Housing Rights. "Quick Guides for Policy Makers 5, Housing Finance," p. 3, 2008.

8 Cattaneo, Matias, D. Galiani, Sebastian, Gertler, Paul, J, Martinez, Sebastian and Titiunik, Rocio. "Housing, Health, and Happiness." American Economic Journal: Economic Policy, 1:1, 75-1, 2009.

As housing microfinance continues to rise as an attractive option for lending institutions seeking business opportunities and social returns, evidence suggests that thoughtful product development is a wise investment.

Chapter 3: Housing microfinance product development

Organizations that have gone through a comprehensive product development process know that it can be a complex, resource-consuming activity that should not be entered into lightly. But as housing microfinance continues to rise as an attractive option for lending institutions seeking business opportunities and social returns, evidence suggests that thoughtful product development is a wise investment.

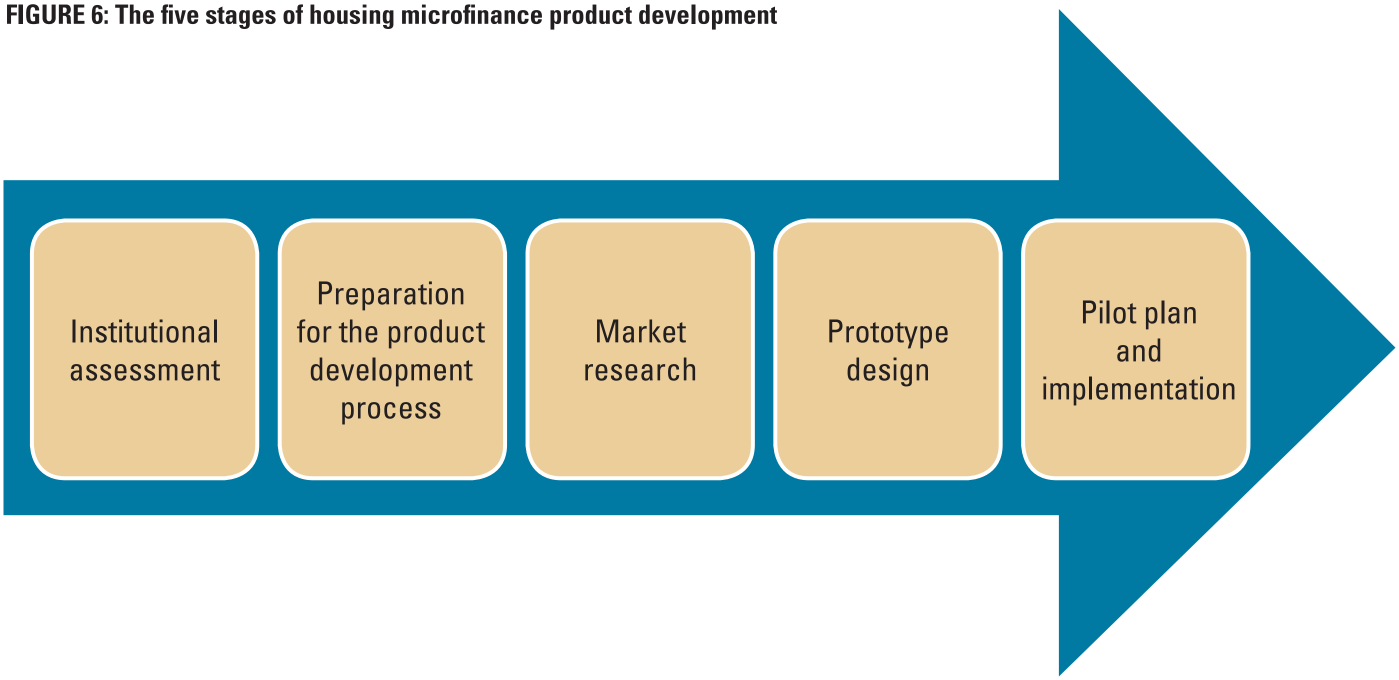
This chapter provides an introduction to the product development methodology employed by the Center for Innovation in Shelter and Finance and is organized into two parts:

1. An overview of the product development process, covering the five stages typically used by the center and key considerations for an institution's management during this process.
2. Product development success factors, covering the lessons learned from the experience of 10 financial institutions the center has advised.

INTRODUCTION TO PRODUCT DEVELOPMENT

The product development process employed by the Center for Innovation in Shelter and Finance is a systematic, step-by-step approach to developing new products or refining existing ones. It was originally based on MicroSave's approach to product development and subsequently adapted and enhanced for housing products over the course of the past seven years of the center's work. In this approach, the interested institution begins by assessing its commitment and preparedness for adding a housing microfinance product to its portfolio. This is followed by analysis of secondary data and the development of a qualitative market research plan that uses a variety of investigative techniques, including focus group discussions and individual interviews with potential clients and other relevant parties. The research findings allow the product development team to design a product concept that is refined through feedback from stakeholders and costing analysis, resulting in a prototype. To provide a final check of the marketability of the prototype before pilot testing, the prototype is subjected to quantitative and qualitative validation. (The practitioner's guide, included as the second section of this handbook, describes in detail these five stages of housing microfinance product development).

FIGURE 6: The five stages of housing microfinance product development



Stage 1: Institutional assessment

This stage helps an institution systematically assess its readiness and commitment to undertaking housing microfinance product development.

Stage 2: Preparation for the product development process

This stage helps an institution prepare the needed resources to engage in market research, product design, pilot testing and wide-scale rollout.

Stage 3: Market research

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

Stage 4: Prototype design

At this stage, the institution seeks to define attractive and competitive housing microfinance products and services, backed by quantitative projections of loan volumes, associated costs, revenues and the break-even period. To provide a final check of the levels of acceptance of the prototype and its marketability before pilot testing, the prototype is subjected to quantitative and qualitative validation.

Stage 5: Pilot plan and implementation

The pilot stage involves the preparation for and implementation of the pilot test of the prototype. Before testing, the institution assesses its capacity for offering the product and services, and determines how best to adapt systems, processes and procedures and equip the staff. This is followed by testing clients' response to the prototype, which is offered within a specific zone for a set period. Performance is monitored closely, and observations inform adaptations and further testing. This stage concludes with an evaluation and appraisal of the adjustments needed to scale up the housing microfinance product. (Please see Chapter 12 for further explanation of the monitoring and evaluation process).

Before an institution begins the housing microfinance product design process, its management must decide on a clear objective and reason for developing the product; commit the requisite time, personnel and capital to design and roll out the product; and establish a well-defined beginning and end to the process. The ultimate goal should be to design client-responsive products and services that meet the needs, preferences and capacities of the target market and the institution serving it. This convergence will guarantee the sustainability and affordability of the products and services.

Housing microfinance product development is meant to be implemented as a complete "project" divided into stages. One stage leads to and informs the next and provides the institution with an opportunity to respond to minor issues before they become major problems. Problems that can be avoided with a thoughtful product development process include:[1]

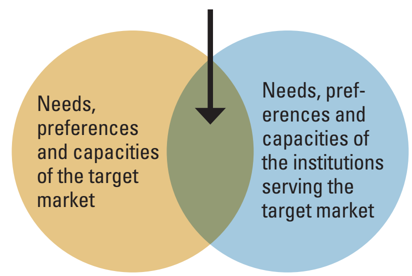
- Limited demand for the new product.
- Diversion of sales from existing products, resulting in no additional revenues for the institution.
- Poor marketing of the new product.
- Management information systems' incompatibility with the new product.
- Staff's inability to deliver the new product.

The two main questions that should be answered during the product development cycle are:

- Which financial products and housing support services fill the gaps between our clients' demands and available supply in the market?
- What changes should our institution make to offer housing microfinance products and housing support services?

Each stage of the process requires the institution and its management to respond to additional questions that guide the product development team. Table 3 highlights the high-level questions.

FIGURE 7: The key to sustainable housing microfinance products and services



1 Wright, Graham A.N., Monica Brand, Zan Northrip, Monique Cohen, Michael McCord, Brigit Helms. "Looking Before You Leap: Key Questions That Should Precede Starting New Product Development." Journal of Microfinance 4(1): 1-15, 2002.

TABLE 3: Key questions for each stage of product development

Stage	Key questions
Institutional assessment	• Is the institution really committed to this? • Why undertake housing microfinance market research and product design?
Preparation for the product development process	• What resources are needed and available, including partnerships with other institutions, and human, financial and technological resources?
Market research	• What housing microfinance products and services are currently in the market, and what external factors affect them? • What is the target market for the new products and services? • What are the needs, preferences and capacities of the target market regarding housing?
Prototype design	• What housing microfinance products and services will the institution offer to satisfy the demand of the target households? What competitive or differentiating advantages will it have over similar products offered by other institutions? • What is the potential demand for the housing microfinance prototype?
Pilot plan and implementation	• Do the housing microfinance products and services satisfy the unmet demands of the target population? • What changes does the institution need to make to scale up the products and services in a sustainable way?

The CISF uses an adaptation of the "Eight P's of Marketing"[2] during the five stages to systematically develop housing microfinance products:

- **Population:** Target market for the product and services.
- **Product:** Amounts, terms, guarantees and payments, among other elements.
- **Price:** Interest rates, commissions, penalties and incentives for clients.
- **Promotion:** Strategies to promote the products and services, including media campaigns and slogans, among others.
- **Place:** Physical location where the product is offered. Appearance of the office, including office furnishings, etc.
- **Positioning:** Perception to be cultivated in the minds of the target population (for example, service delivery speed and low monthly payments).
- **Personnel:** The profile and job description of those offering the product.
- **Process:** The organizational structure and process for delivering the product and related services.

During the institutional evaluation stage, it is important to assess the institution using the eight P's to understand its current practice and offerings. During market research, the data gathered will be compiled and analyzed using the eight P's to ensure there is appropriate information for designing a prototype that includes the key attributes

2 The Eight P's of Marketing grew from an original four "P's." They serve as an excellent launching pad for any strategic marketing plan.

demanded by the target market. Carefully defining these eight P's based on findings from the market research is integral to successful prototype design, pilot testing and wide-scale product rollout.

TABLE 4: Example of a housing microfinance product based on the eight P's

Attribute	Definition
Population	• New and existing clients. In the case of existing clients, they can be individual or group borrowers. During the pilot stage, only existing clients will be targeted. • Clients with homes or plots of land in rural and peri-urban areas, who are self-employed and salaried workers. During the pilot stage, only self-employed workers will be targeted. • Age: 18 and above. • Target incomes: US$200-$600 per month.
Product	Credit for all types of home improvements, offered to families at their homes, and discounts to buy building materials in partner hardware stores. Three types of technical assistance are to be offered depending on the complexity of the construction work: 1) Brief visit to calculate budget. Used when the planned repair is to replace roof and ceiling, plaster walls, install doors and windows, and paint. 2) Initial visit to draw up a plan of improvements and budget, with follow-up supervision visit during construction. Used for floor installations and the construction of latrines, bathrooms and corridors. 3) Same as 2, with an additional supervision visit during construction work. Applies to construction of bedrooms, kitchens and load-bearing walls.
Price	Loan amount: US$500-$2,000. Term: 12-36 months. Payments: Monthly or biweekly; acceptance of anticipated payment. Guarantee: Guarantor. Interest rate: 19-22 percent. Commission: 3 percent, to cover construction assistance.
Place	Peri-urban branch offices.
Promotion	• Fliers in branch offices and affiliated hardware stores. • Phone calls or visits to current microenterprise loan clients. • Workshops on financial education for home improvements.
Personnel	In each branch, two additional staff members will be hired, one construction technician and one loan officer. Customized, in-person training on the product will be provided.
Process	See Annex 27: Example Process Flow Diagram – Loan with Housing Support Services
Positioning	Based on the institution's current competitive advantage, focus on approving and disbursing loans quickly.

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.

2 primary concerns:

Ensuring client-focused, successful products.

Seeking social objectives.

PRODUCT DEVELOPMENT SUCCESS FACTORS

The following lessons are based on the experiences of 10 microfinance institutions from around the world that partnered with the Center for Innovation in Shelter and Finance to develop housing microfinance products. They serve as a basis for studying what processes were undertaken, the impact these had on product performance, and lessons learned from the product development cycle.

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.

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 ensuring client-focused, successful products and seeking social objectives.

Furthermore, housing microfinance providers are frequently concerned that home improvements result in safe, durable, cost-effective solutions for clients and their households. These microfinance institutions tend to include services that assist clients in preparing improvement plans and budgets, which are valuable to the client and also validate their housing microfinance loan request. Microfinance institutions may offer additional nonfinancial services, 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 an institution may decide to undertake an intentional product development process when seeking to redesign a low-performing housing microfinance product or when targeting a new segment of the population for its product. Two of the microfinance institutions studied — in 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 households, initially perceived as risky because of those households' informal wages. This process

3 For the original case studies, see "Housing Microfinance Case Studies of 11 Habitat Partnerships" (2013). For a detailed discussion of best practices, see "Lessons from 11 Partnerships of Habitat for Humanity" (2013), available online at habitat.org/cisf.

also involved the incorporation of nonfinancial housing support services, which were especially valuable to this target group.

Other 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 households, 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.

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 the market to inform product design. Of the eight that underwent systematic product development, the majority undertook all five of the stages listed above with some form of technical assistance from the CISF. Where housing microfinance was being redesigned, the process was modified according to the microfinance institution's specific objectives and needs (determined during the institutional assessment stage). For example, in Tajikistan, the product development process focused heavily on training staff members and improving systems to support housing microfinance and add nonfinancial housing support services.

Portfolio growth: Seventy percent of the institutions that responded to the 2014 housing microfinance survey by the CISF saw their product growing as a percentage of their overall portfolios. Given its performance and impacts, 80 percent of responding institutions plan to expand their housing microfinance offerings, and all but three respondents have it in their business plan. These findings are promising when talking about the viability and sustainability of housing microfinance portfolios, confirming the potential of a vibrant, untapped market for lending institutions.

Portfolio quality: Of the eight microfinance institutions that undertook intentional product development, all showed high-quality housing portfolios, with reported portfolio at risk over 30 days, or PAR 30s, 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. This was confirmed by a survey of 48 financial institutions that found that their housing microfinance portfolio had an average PAR 30 of 1.97 percent in 2013.[4]

4 The full report from the Housing Microfinance Survey (2015) can be found at habitat.org/cisf.

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.

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, stationed at the head office, to oversee and guide the housing microfinance product's design and pilot testing. It was also important to establish a process to make changes during the pilot stage. A 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 the Center for Innovation in Shelter and Finance — 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 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 the 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 the field staff, the microfinance institution was able to design and test new innovations, such as products especially suited to improvements in highest demand.

Housing microfinance success lessons from CRECER in Bolivia

Leadership

Having a highly committed leader is vital. The efficient and effective level of leadership of the project leader at CRECER, who served as the national business director, was vital to the success of the housing microfinance product development process and pilot test. The leader took control of the project, motivating and providing timely advice to all those involved. The process was well-managed to position the product and take it to the level of growth that it has experienced to date.

Institutional capacity

CRECER's institutional capacity and commitment to its clients has helped strengthen, promote and extend the home improvement product. CRECER clearly understood the project's focus and how it contributes to the reduction of the qualitative housing deficit for low-income populations.

Monitoring of the housing microfinance product

A monitoring strategy defined and implemented by the team of CRECER, the CISF and Habitat Bolivia has contributed to the success of the initiative. The timely and adequate follow-up throughout the project minimized cannibalization of existing products, helped control the monthly payments, and identified the needs that arose during the pilot.

Selection and training of construction technical managers

Because CRECER provided housing support services with its product, the selection and training process for the staff was crucial. The selection focused on skills, not just educational background and work experience. This was followed by a very hands-on training in which the construction technical managers understood not only the housing support services model and how to implement it, but also the importance of inserting it as part of the whole housing microfinance product.

The Center for Innovation in Shelter and Finance uses the term "housing support services" when referring to nonfinancial products and services that enable households to improve their housing on their own.

Chapter 4: Housing support services

The growing pool of housing microfinance practitioners is evidence of how housing microfinance is becoming an increasingly attractive proposition to institutions seeking to open new business opportunities and retain clients or to achieve greater social impact. As housing microfinance providers increase in number, more are asking about the relevance of tying nonfinancial housing-oriented services to the financial product.

The Center for Innovation in Shelter and Finance uses the term "housing support services" when referring to nonfinancial products and services that enable households to improve their housing on their own. These services aim to help households acquire the basic knowledge to undertake or supervise their home improvements and to make the right decisions in the process.

The role of housing support services can be thought of as similar to that of nonfinancial services such as training and technical advice in the microenterprise lending market. These services are a tangible expression of the desire to pursue deeper, lasting results among microfinance clients and their households. When housing support services are coupled with a housing microfinance credit, they become part of the preloan due diligence and post-loan follow-up used by many financial institutions. The CISF believes housing support services can also extend beyond what financial institutions themselves can bundle on their own, to include market linkages that borrowers can opt into our out of on their own.

This chapter describes the basic elements of the incremental housing process and common housing deficiencies in self-managed construction. It also explains the value that housing support services can provide in the construction process, as well as to the financial product and institution. And finally it lists the various types of housing support services, how they are provided, and the options for financing their provision.

INCREMENTAL HOUSING AND OUTCOMES

A comprehensive report on the global housing crisis from McKinsey estimates that 330 million urban households around the world live in substandard housing and that more than 200 million households in the developing world live in slums.[1] The authors estimate that by 2025, 1.6 billion people will occupy crowded, inadequate and unsafe housing. It is clear that housing supply has not kept up with the immense growth of demand. Because of this, house construction for most people around the developing world is progressive and informal.

The housing process differs greatly between developing and developed economies. In developed countries and more affluent segments of lower-income countries, the usual process is complete construction of homes by a private construction company,

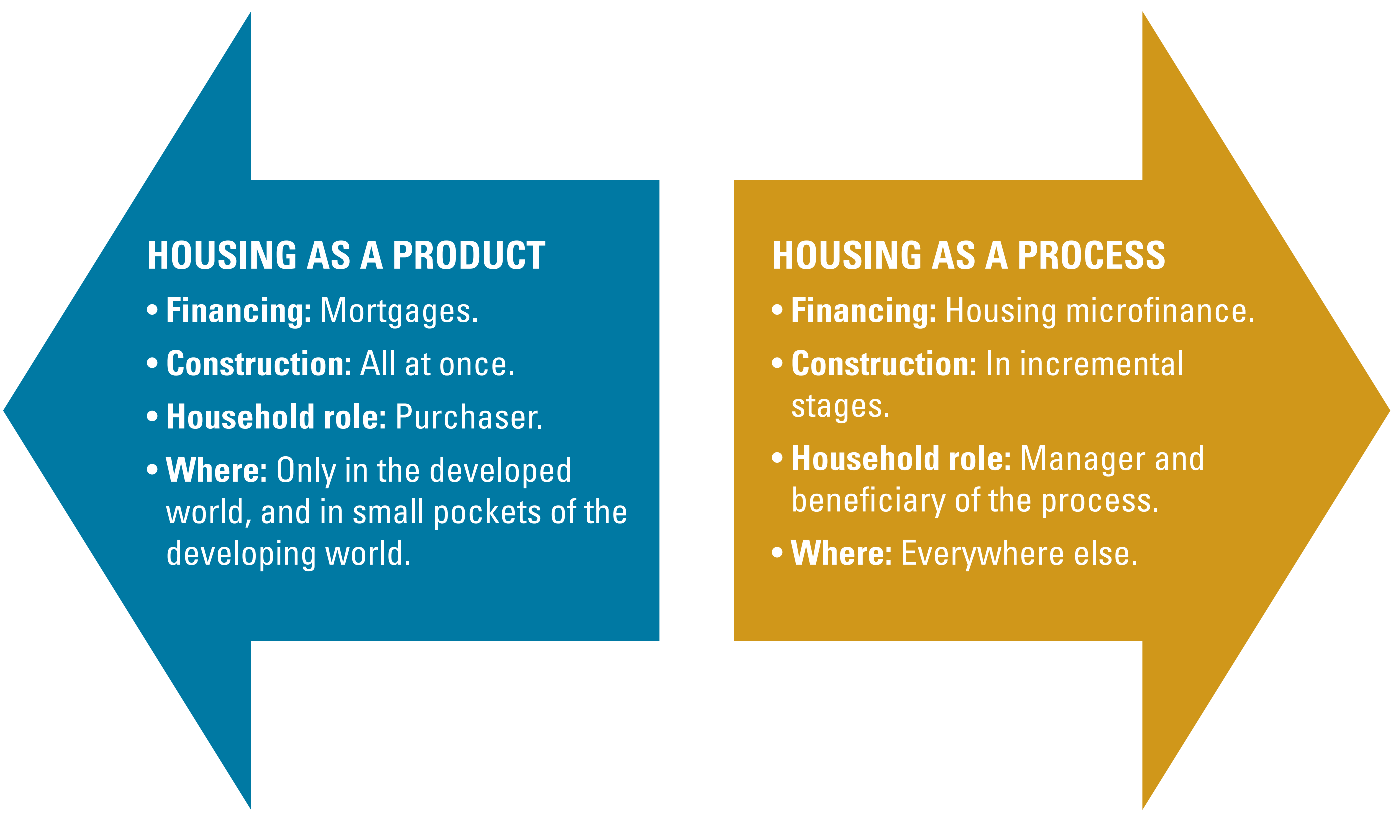
1 McKinsey, "Report on Adequate Housing." 2014.

followed by the purchase of the completed home with the assistance of a mortgage from a commercial financial service provider. In less-developed countries, the process can be substantially informal. The predominant pattern for building and improving homes is progressive, by means of small, incremental stages, in accordance with the household's priorities and financing availabilities.[2] Families take residence on available land, often without legal possession, and begin to build. Accordingly, households begin with core components, such as a bedroom and living space, and continue to build as they are able. Many households work on the improvement and extension of their homes first to obtain the minimum standards in size and quality, and later to accommodate changes in household size or to get income from their investment in the house.[3]

Incremental housing can be described as an inverted version of the traditional, formal process of building and financing a house. For example, in the traditional process, the complete features of the house are available to the owners from the first day of occupancy. In the incremental construction process, families begin residing in a home with the most basic features and build at the pace their financing capacities allow.

In part because of the lack of instutional support for this process, households often replace work that was already completed or upgrade to better and safer materials only when they have the opportunity. This can lead to inefficiency and poor outcomes.

FIGURE 8: Housing as product vs. process



2 UN-HABITAT, "Financing Urban Shelter," p. 99. 2005.

3 Green, M. and Rojas E. "Incremental Construction: a Strategy to Facilitate Access to Housing," Environment and Urbanization, Vol. 20, No. 1, pp. 89-108. 2008.

TABLE 5: Adequate housing definition from U.N.

Adequate housing according to the U.N. Committee on Economic, Social and Cultural Rights

- **Security of tenure**: Housing is not adequate if its occupants do not have a degree of tenure security that guarantees legal protection against forced evictions, harassment and other threats. (For more information on secure tenure, please see Chapter 5).
- **Availability of services, materials, facilities and infrastructure:** Housing is not adequate if its occupants do not have safe drinking water; adequate sanitation; energy for cooking, heating and lighting; food storage; and refuse disposal.
- **Affordability:** Housing is not adequate if its cost threatens or compromises the occupants' enjoyment of other human rights.
- **Habitability:** Housing is not adequate if it does not guarantee physical safety or provide adequate space, as well as protection against the cold, damp, heat, rain, wind, other threats to health, and structural hazards.
- **Accessibility:** Housing is not adequate if the specific needs of disadvantaged and marginalized groups are not taken into account.
- **Location:** Housing is not adequate if it is cut off from employment opportunities, health care services, schools, childcare centers and other social facilities, or if it is located in polluted or dangerous areas.
- **Cultural adequacy:** Housing is not adequate if it does not respect and take into account the expression of cultural identity.

COMMON DEFICIENCIES IN INCREMENTAL HOUSING

Incremental housing is a natural response to the constraints faced by low-income households in the formal housing market. But with limited financial resources, households often make compromises on materials and construction quality in order to solve the urgent need to lodge all household members. This allows them to reside in the core house while they accumulate savings, materials, tools and skilled labor to begin improving the home. However, during this initial period, in which the households get limited services from their shelter, there can be a misalignment of interests. For example, tenure security or sanitation services might have the most impact, but the household members mostly value protection against the elements and some privacy.[4]

Immediately after taking possession of the core house, households expand it using the materials from their previous dwelling or other recycled materials that are easy to install but of questionable quality.[5] (The most prominent example may be poor roofing materials, which are starkly visible in most informal communities).

4 Cities Alliance. "The Case for Incremental Housing," Cities Alliance Policy Research and Working Papers Series No. 1. 2011.

5 Green, M. and Rojas E. "Incremental Construction: a Strategy to Facilitate Access to Housing." Environment and Urbanization, Vol. 20, No. 1, pp. 89-108, 2008.

Another issue arises from the time between acquiring and using the construction materials, which can have a significant impact on the improvement process. Poor construction outcomes can result from a deterioration of the quality of materials, under- or overestimating material needs, or improper storage of cement and wood. This leads to costly improvements and potential structural deficiencies.

Additional challenges are found in the design and location of homes. The design of the house determines its expansion options, and the location defines the overall options for using the property. When the house is not properly designed or thought out beforehand, it limits the growth potential and the ease of extension and upgrading in later phases. In many cases, houses are built in an unorganized way, resulting in higher costs, awkward use of space and poor ventilation. These factors can jeopardize a household's safety and well-being, especially in a country that experiences frequent natural disasters.

In summary, a significant opportunity exists to strengthen and bolster the progressive, incremental process undertaken by low-income households with support that understands this process and its goals. Providing products and services aimed at mitigating the deficiencies and challenges that arise from the incremental housing process can be an opportunity both to fill a market gap and to create immense social impact.

Providing products and services aimed at mitigating the deficiencies and challenges that arise from the incremental housing process can be an opportunity both to fill a market gap and to create immense social impact.

TABLE 6: Common deficiencies found in incremental housing

In Habitat for Humanity International's experience, common construction issues from incremental housing processes include:

- Lack of design or planning in initial construction to support future improvements.
- Poor drainage undermining the foundation.
- Improper building materials that are not resilient.
- Lack of lintels or headers or ring beams above windows and doors.
- Nonsquare columns or walls leading to decay or dilapidation.
- Lack of insulation, poor ventilation and lack of screens.
- Lack of disaster resilience, such as hurricane clips or earthquake-resistant structures.
- Mix issues for mortar and plastering, leading to cracks in walls, floors and foundations.
- Unsecure doors and windows creating safety issues.
- Improper specifications for stairs.
- Toilets that are too close to water sources.
- Poorly designed pit latrine toilets that are unsanitary.

See photos on page 52 for a visual guide to common construction issues.

RATIONALE FOR HOUSING SUPPORT SERVICES

Housing support services represent an exciting business opportunity that offers value to both the financial provider and its clients. Linking the housing microfinance product with a nonfinancial housing service is an opportunity to offer critical support right when a household is making the investment. As a result, it can be a mechanism to provide responsible financing, cultivate new markets for "base of the pyramid" services, and further strengthen the homes and communities where housing microfinance clients reside.

VALUE FOR THE FINANCIAL INSTITUTIONS

Housing microfinance lenders find that the inclusion of training, technical advice and other support can be a tangible expression of their dedication to pursuing deeper, lasting results among microfinance clients and their families. In addition to increasing the loan's value, these nonfinancial housing support services allow institutions to show clients how to properly use the loan through budgeting, financial literacy and education on the end use of the loan. Thus, these services can be advantageous to the financial institutions, especially when the added services increase the client's ability to repay.

In the experience of the center, lenders who incorporate housing support services into their financial products do it for five broad reasons:

1. **Risk management and due diligence:** Housing support services can manage risk in two areas: first, the risk associated with repayment fatigue and default, and second, the risk associated with poor construction and the possibility that the housing investment is not as durable as the loan term and value suggest. When housing support services are coupled with the credit, they can become part of the preloan due diligence and post-loan follow-up that financial institutions often use with other loan products (before the loan to ensure the amount meets the housing need and after the loan to determine whether it was used for its intended purpose, reducing loan diversion). Alternatively, when housing support services are declined, the housing microfinance credit becomes a consumer loan whose purpose is housing but whose ultimate use may be difficult to verify.[6]
2. **Marketing, positioning and differentiation:** Housing support services can offer a useful tool to lenders for articulating the housing aspect of their loan and for marketing this as something that makes their offering distinct from that of their competitors — in other words, a competitive advantage.
3. **Social impact:** Like their investors, many lenders are interested in offering products that create a positive social impact aligned with their mission. Within the overall framework of their commercial objectives, they are intent on offering sustainable solutions to their clients. In the CISF's experience, housing support services can provide customers with better housing outcomes — in terms of construction quality and time or cost reduction — than can financing alone.

6 Frank Daphnis. "Housing Microfinance: Towards a Definition."

4. **Customer satisfaction:** Customers of these services may demonstrate more confidence in their investment and feel that the lending institution is concerned about more than just loan repayment.
5. **Ongoing relationship with clients:** Incremental building projects are by their nature long-term, and the relationship need not be confined only to the term of the loan; it can extend across many loans. Housing support services can help the clients visualize their complete housing project and realize it in stages according to their needs and capacity. These services can be powerful tools to maintain an ongoing relationship, with the clients "buying" not just a loan but the dream of completing their home.

The type of nonfinancial service an institution provides may depend on various considerations: the target clients and their average income, local housing standards, competitors' products, overall institutional structure, strategy, capacity, current risk levels for the institution's portfolios, and the implications for the institution's current processes and procedures. The exact suite of housing support services selected by the financial institution is based on the priority the institution places on each consideration. For example, if maximizing social return is valued most, the institution might choose a more robust and intensive set of housing support services. If marketing and differentiation are prioritized, along with adding local partners, exclusive discounts with a material's provider could work well.

Global microfinance institution experiments in housing support services[7]

A microfinance institution in the Philippines that has worked with the CISF has scaled up its housing microfinance product to 128 branches around the country, achieving a cumulative disbursement of more than 11,000 housing microfinance loans since November 2006. Its housing support services were of relatively high intensity, involving project-based foremen who oversee construction progress, and direct disbursements to materials suppliers and construction laborers. Although these represented significant costs to the institution, management felt that these services helped ensure a low-risk portfolio. Notably, the institution's housing microfinance portfolio was extremely sound, boasting only 1.6 percent PAR (July 2012), compared with its overall portfolio PAR of 4.4 percent (September 2012).

An Indian microfinance institution illustrated that housing support services were contributing to responsible lending, assisting clients in segmenting desired improvements into small steps and manageable loan sizes. Research undertaken by the microfinance institution revealed that up to 90 percent of clients were unable to correctly estimate needed loan amounts because they were unable to properly calculate project costs. The microfinance institution also appreciated that the follow-up visits to clients helped to both confirm and encourage appropriate loan use, thereby reducing lending risk.

In the Dominican Republic, a microfinance institution valued the benefit that delivering housing support services had on its field staff. Loan officers expressed satisfaction in being able to assist their clients with basic construction advice and budgeting support, in addition to the loans. Providing housing support services also strengthened relationships between loan officers and their clients, contributing to both staff effectiveness and client loyalty.

7 Christy Stickney, "Lessons from 11 Partnerships of Habitat for Humanity." Available online at habitat.org/cisf.

90% of **financial institutions**

that responded to the CISF's 2014 Housing Microfinance Survey

note that they **offer housing support services** and other forms of technical assistance.

The 2014 CISF survey of 48 financial institutions offering housing microfinance found that the institutions recognize the value of nonfinancial construction technical assistance in helping households find the right building materials, budget properly and repay in a timely fashion. It also attracted new clients and improved the institutions' competitiveness.[8]

Ninety percent of financial institutions that responded to the survey note that they offer housing support services and other forms of technical assistance. It is important to highlight that 91 percent of the institutions providing construction technical assistance are actively monitoring the use of the loan. Many acknowledged the value of nonfinancial construction technical assistance in helping families find the right building materials, budget properly and repay in a timely fashion. It also can attract new clients and improve the institution's competitiveness.[9]

VALUE FOR THE CLIENTS

Loans intended for home improvements, or those that are diverted for home use, are frequently disbursed to clients who have little construction experience or knowledge and, seeking to minimize costs, undertake projects without a proper design or qualified oversight. Lacking sufficient preparation to adequately oversee construction work, low-income households — sometimes headed by single mothers — find themselves at the mercy of their hired builders, unable to ensure construction quality or validate pricing. Appropriate housing support services can provide advice, information, illustrations, supervision and monitoring activities to minimize quality deficiencies and save money and time.

Benefits of housing support services to clients include:

- Helping clients clearly define their housing goals and create a plan to achieve them.
- Improving housing quality in terms of security and functionality.
- Reducing construction time and costs.
- Increasing a household's satisfaction with the improvement.
- Increasing a household's capacity to carry out additional progressive improvements to their housing.

Of the benefits listed above, assistance in defining housing goals and creating a plan to achieve them might be one of the most powerful. A clear plan helps clients appropriately sequence construction, make efficient purchases, conserve materials, and make better choices when choosing products because they have an understanding of price and quality. Additionally, having a comprehensive, long-term plan can help clients assess their building priorities.

In the CISF's experience, clients frequently affirm the value of assistance in preparing construction plans, materials lists and budgets. Guidance in selecting materials and laborers and cutting costs was also highly valued. In certain cases, clients said access to qualified technical advice is critical, especially when construction is being overseen by

8 The full report from the Housing Microfinance Survey can be found at habitat.org/cisf.

9 Ibid.

women, who might feel less confident in preparing plans, selecting materials or laborers, or overseeing progress.

The financial institutions responding to the 2014 CISF Housing Microfinance Survey mentioned that the top three nonfinancial services provided to their housing microfinance clients are personal finance education for repaying the loan, construction advice, and budgeting for home improvement. One survey respondent wrote that "Most clients [feel satisfied] with this service, they get the consultation and experiences of successful construction, budget estimation, better material supply sources, other construction technical assistance and also with affordable fees." Another respondent succinctly noted, "It's a competitive advantage for the institution and a useful tool for the borrower."

The value of nonfinancial housing support services can extend beyond the basics of the loan and construction. One respondent noted the benefits and impact to the client and community, including low-cost earthquake-resistant construction, and improved understanding of sanitation and health.

Given the ongoing nature of incremental construction, housing support services can have continuous impact on a household. When clients are properly equipped to manage contractors, gain maintenance skills and knowledge, and better understand components of the house that lead to health outcomes or make their home disaster-resilient, they carry those lessons into future construction projects.

HOUSING SUPPORT SERVICES ACTIVITIES AND PROVIDERS

Housing support services generally fall into two categories: preconstruction and construction activities. Financial institutions often think of activities in the preconstruction phase as "pre-disbursement due diligence." These could include budget verification, guidance on materials and labor procurement for building, and assistance with permits and other legal requirements. Construction activities, also considered "post-disbursement" services, are often focused on providing on-site construction advice, usually from a technical professional. Housing support service activities should relate to the local housing market and needs of local communities, uncovered during market research (see Chapter 9).

PRECONSTRUCTION

Preconstruction activities provide the necessary planning and guidance to ensure affordable and secure outcomes for a client. As noted in the section on common deficiencies in the incremental housing process, clients can improperly prioritize improvements, choose materials that are low-cost but will need to be replaced, and design the core house in a way that frustrates future growth and improvement. Preconstruction activities help clients avoid these common pitfalls and enable a household to prioritize impactful, disaster-resilient construction options and health-related improvements.

Customer satisfaction from housing support services

In evaluating products the CISF has helped design, evidence suggests that clients place a high value on training and technical services that inform and guide them in planning and carrying out their intended home improvement projects, such as:

- Segmenting and sequencing desired improvements into financially feasible steps.
- Creating a basic plan for improvements, including an estimate of materials and costs.
- Receiving guidance in avoiding common errors associated with the type of improvement.
- Receiving guidance in how to select materials and construction laborers.

Clients also appreciated having access to more qualified technical services when needed, and in many cases they are willing to pay for these, provided they are not mandatory.

Prominent examples of preconstruction housing support services include:

- Construction design from professionals.
- Planning the sequence of improvements.
- Budget development.
- Client education on the impacts of housing, construction quality, disaster resilience strategies, etc.
- Visiting prospective loan applicants to review the proposed home improvements.
- Evaluating the technical feasibility of proposed home improvements.
- Preparing cost estimates, lists of required construction materials, and timetables for proposed home improvements.
- Verifying cost estimates with the approved loan amount.
- Verifying the land title (or land security status) of the applicant.
- Construction skills training.
- Negotiating discounts on materials from providers.

One of the most important preconstruction housing support services is sequencing advice, eliminating waste in future upgrading. Analyzing the implications of each building step with clients, including approximate costs, the design, and the time to complete the construction project can have tremendous long-term impact. The long-term vision for these improvements should be seen as a story the institution is helping the household create. It begins with learning about their home's current state and identifying the final goal. The technical expertise could help provide for the steps in between and transfer ownership of that story to the household.

Preconstruction housing support services are powerful tools for risk management. Additionally, they can ensure long-term relationships with clients through preapproved loans for stages after the first improvement. Training in planning improvements, offered as group workshops or individual sessions, can be a low-cost method to support clients in this process. These workshops often cover the following themes: prioritization of the improvements, adequate budgeting, finding lending options, and criteria to choose a good builder and construction materials supplier. Training in these topics can encourage the target households to obtain successive loans to carry out progressive improvements instead of a single large loan they may struggle to repay. (Annex 21 contains a summary of topics covered during these trainings).

Construction trainings are courses given by a construction technician. The objective is to improve the households' knowledge of home improvements. Training also can teach construction workers about new building technologies and show loan officers how to assist their clients. This service can be provided by a financial institution or building material suppliers in coordination with a financial institution.

Printed information brochures, distributed as teaching materials, can provide advice for households who will carry out home improvements. These information sheets can help the client in negotiating, planning and supervising the works undertaken by a foreman or builder.

Negotiating with building material suppliers to obtain good prices, guarantee the quality of the materials, and secure deals on transport and delivery to the households can be an attractive market strategy for both a financial institution and a materials provider. One example that shows promise is having a private-sector partner take responsibility for providing these services. LaFarge, the multinational cement company, has seen an increase in sales by its local distributors when it provides these services to microfinance institution clients. Private sellers of materials, therefore, may have the best incentives to provide households with this advice.

Similarly, there is value in negotiating with the local municipality to speed up building permits and reduce their cost. A financial institution also might lobby the municipality to build community works to help mitigate the risk from natural disasters and improve basic services for the target market.

A unique example of housing support services comes from EDYFICAR, the largest microfinance institution in Peru. EDYFICAR has a mason referral program through which masons refer clients to the institution for financing to improve their homes and EDYFICAR refers housing microfinance clients to trusted masons. As part of the program, EDYFICAR also offers lectures and training to masons to improve their technical skills.

CONSTRUCTION

Housing support services in the construction phase are usually characterized by direct consultation with a household but usually do not involve direct construction management on the household's behalf.

Examples of construction or post-loan disbursement activities include:

- Assisting in materials procurement and delivery.
- Providing technical assistance as needed in home improvement design and construction.
- Monitoring and supervising the construction.
- Authorizing any further loan disbursements.
- Providing oversight to ensure appropriate use of the loan funds.

It is always good practice for institutions considering housing support services to look at local laws regarding liability. Typically, financial institutions do not have any civil liability for the construction process; it is the clients themselves who must decide to apply any recommendations. The clients should be ultimately responsible for contracting and following up on the builder carrying out the improvements.

Activities in this phase could be more expensive if heavy staff involvement on site is required. One common activity is construction technical assistance, in which an engineer or architect travels to the home and oversees parts of the construction process. This can be critical for clients who have minimal experience in construction and are doing a major structural home improvement. On-site construction technical assistance can provide the client with recommendations on how to best use resources to carry out home improvements and can identify problems before they become costly.

Housing support services can be a multistep process, from the initial contact with a household to creating a plan and budget and providing oversight. Examples of these processes are illustrated in the Practitioner's Guide to Housing Support Services (Chapter 12).

PROVIDERS OF HOUSING SUPPORT SERVICES

There is no rule for who should provide the housing support services. Providers should be linked to the chosen activities and be appropriate for the local environment. In some cases, this might demand a technical professional, such as an engineer or architect. In others, it may call for a promotion specialist or a financial professional.

Preconstruction activities have the most diversity of providers. For example, architects and engineers are needed for proper household design. When training clients or providing information, a range of specialists can be employed or linked to the financial institution, including loan officers, community leaders, volunteers or NGO staff members.

Construction advice often demands a staff with technical capacity. Beyond architects and engineers, construction contractors or laborers can be used for training or oversight. However, if the on-site construction monitoring is less technical, specialists can be trained to monitor the progress and materials being used.

Creative thought should be given to the housing support services provider candidates based on the activities and needs of the clients and how they can be financed. New avenues to providing housing support services can further differentiate an institution's brand and provide clients with services that were previously not accessible.

The decision whether to outsource or to have an in-house person handle the preconstruction activities and construction advice requires the institution to consider its structure, strategy and capacity. Some financial institutions hire personnel dedicated to these activities, and others choose to outsource the services.[10]

Partnering with other market actors

Three classifications of providers have emerged in the CISF's experience:

- **In-house:** Housing support services are delivered by the staff of the institution providing the housing microfinance loan, whether via loan officers or construction specialists.
- **Linked:** Housing support services are delivered by the staff of another organization operating in partnership with the institution.
- **Embedded:** Housing support services are delivered by staff members of another organization who are placed within the offices of the lending institution.

A financial institution providing housing microfinance loans with housing support services should identify key actors within the housing market system to make links that can enhance the product offering, such as materials suppliers, masons or the local municipality.

Partnerships with materials providers are a particularly prominent linkage. These partnerships can help ensure the quality of purchased materials, negotiate discounts for low-income clients, and make delivery of materials more efficient. Furthermore, upon delivery of materials, a construction professional linked to the materials provider can provide on-site technical assistance.

Housing support services that extend beyond the realm of loan officer responsibilities are increasingly being conceived as a social enterprise, whether managed within the microfinance institution or by a separate partner. A case study in the Practitioner's Guide (Chapter 12) highlights the story of CEMEX, a cement provider, and its use of housing support services to grow its market share and revenue. This business-oriented dynamic implies that even costly and technical types of housing support services are demanded and scalable under the right conditions.

10 See the case study of EDYFICAR at the end of Chapter 12 for an example of an institution that experimented with both options.

Microfinance institutions in the Dominican Republic and Peru offer alliances with hardware stores

Home improvement initiatives may find natural allies among construction materials suppliers such as hardware stores. In the Dominican Republic, two microfinance institutions reached favorable negotiations with hardware stores operating in the same areas where they were extending housing microfinance loans. FIME, a member of Vision Fund International, negotiated with hardware stores in the south of the country and also in the province of El Seibo, obtaining discounts for its clients. These stores also assisted in pricing materials for clients, producing an actual budget based on the improvement being proposed, which then supported clients' loan applications. Some of the hardware stores offered free transport of materials to the construction site. Moreover, the hardware stores helped promote FIME's housing microfinance product by displaying marketing materials and banners in strategic locations. ADEMI Bank, a member of ACCION network, negotiated with hardware stores in the communities surrounding Santiago, where they were extending housing microfinance loans. The alliance allowed the bank to directly deposit to hardware stores the portion of clients' loans that were to be used for construction materials. This spared clients from having to handle cash to buy materials, thereby reducing the risk of robbery or loan diversion. The stores also helped ADEMI market its housing microfinance loans by distributing promotional fliers.

In Peru, EDYFICAR provides loans for clients to improve their housing. It established a partnership with major materials provider Hatun Sol. When EDYFICAR disburses a loan, some customers have the option to send part of the payment directly to Hatun Sol for materials. Once payment is received, a Hatun Sol engineer visits the EDYFICAR client at his or her home during the delivery of construction materials. The engineer can provide training on how to best use the product and give feedback on work accomplished, among other oversight. The relationship has great value for both institutions, as EDYFICAR can provide clients with services from a construction specialist, and Hatun Sol receives client referrals from one of the largest microfinance institutions in the country. Moreover, research from Habitat for Humanity suggests that this program was more influential in construction outcomes than the basic loan officer preconstruction housing support services provided by EDYFICAR.

FINANCING HOUSING SUPPORT SERVICES

The practices in financing housing support services vary widely. Global experience and research suggest that although there is demand for housing support services, it is very price-sensitive. Experience demonstrates that housing support service costs that are incorporated into the loan will be accepted only if the cost/benefit ratio to clients is favorable.[11]

Sixty-four percent of surveyed financial institutions in the 2014 CISF survey on global housing microfinance practice are responsible for the housing support service costs, and the remaining 36 percent require the borrower to pay for it. In some circumstances, another private sector actor has found benefit in covering some or all of the costs.

The cost recovery mechanism used for these services is a critical decision. Generally, there are three types of financing mechanisms for housing support services used by financial institutions: fee for service, selling services as a percentage of the loan or including their cost in the interest rate, and recovering the cost of services with subsidies.

11 Daphnis, F. and Ferguson, B., eds. "Housing Microfinance: A Guide to Practice." 1st ed. Bloomfield USA: Kumarin Press. 2004.

Example of housing support services paid with a subsidy

Until IMON, a microfinance institution in Tajikistan, changed its housing support services model in 2015, it reached significant scale in its housing microfinance portfolio while offering on-site construction technical assistance. IMON's model had engineers employed by Habitat for Humanity Tajikistan sit in their branch offices and meet with clients both in the branch and at their homes. IMON paid half of the engineer's salary and travel though lending revenues, while Habitat Tajikistan paid for the rest. It was a mutually beneficial relationship through which IMON could keep the cost of its service down while offering a comprehensive and attractive service to clients.

FEE FOR SERVICE

Fee for service is the option that provides the most diversity in the delivery of the services. Providers can structure a menu of services or products for a client to choose from to meet his or her needs. In this scenario, the housing support services are completely demand-driven because customers have a choice of the services they will pay for. The advantage of having transparent options and letting the client make the decision is immediate feedback. If a service is not needed or desired, lack of sales will quickly tell the provider a design change is necessary.

However, providers also can make a standardized package of services mandatory. In this scenario, the fee needs to be acceptable to both the client and the institution. One implication to consider when services are mandatory is that lower-income clients may find it costly, potentially driving their business to a different housing microfinance provider.

INTEREST RATES OR SALES PRICE

One mechanism for marketing the services differently is to include the housing support service cost in the interest rate or sales price as a percentage of the loan. In this scenario, the housing support service represents a value addition inherent to the product rather than a separate activity. Institutions can use this to differentiate a product from those of competitors that do not offer the extra service. During focus groups that have been conducted as part of market research, clients have mentioned their desire to receive technical support and have stated they are willing to pay for it, but they also indicated that they prefer the cost to be added to the interest rate rather than having a separate fee.

The potential disadvantage of this strategy is a product that appears to be more expensive. If the perceived value of the housing support service is not justified by the additional costs, customers will seek cheaper options. Understanding the demand for the service is therefore paramount when the pricing of the service is less explicit or transparent.

SUBSIDY

Subsidizing housing support services, either by having the financial provider pay for the service or by finding a donor, is an option when social outcomes are the primary goal. This is especially true when the target market is households with very low incomes. It is uncommon for financial self-sufficiency to be achieved when the target market is the very poor or the cost of housing support services is high.

Mechanisms to address this range from fundraising, whereby funds are sought from donors or other socially minded partners to provide housing support services to the poorest customers, to a cross-subsidization model, whereby a fee for service charged to higher-income earners is used to subsidize the costs of providing the same service to low-income consumers.

Partnerships can be crucial in this model, and there may be private-sector actors for whom the benefit to marketing or brand awareness is enough to justify providing these services to households. Financial institutions also can work with NGOs or local government authorities to provide the subsidized activities. In this scenario, the NGO does not have to be concerned with finding clients or funds for clients and can focus on social outcomes, and the financial institutions receive added value to their products at no cost.

HABITAT FOR HUMANITY PHILIPPINES

CONCLUSION

Housing support services, or nonfinancial products and services that enable a household to improve their housing on their own, can be a viable component of and complement to housing microfinance products. These services offer value for both financial institutions and their clients and represent a means to both strengthen a housing microfinance portfolio and show a commitment to the community that the financial institution resides within.

There are many choices in what types of housing support services to deliver, who should provide them, partnerships to strengthen the services, and how to finance them. The market research undertaken to inform the product also should provide direction to a financial institution looking to make the right choice for its business strategy and clients. Chapter 12 provides advice on this topic for practitioners seeking to explore housing support services for their own institution.

Visual guide to common construction issues

Poor roofing material and ventilation; cracks caused by poor mix.

Foundation weakened from erosion; no header or lintel in window.

Sanitation too close to water; poor materials; poor construction leading to a failing wall.

Socially minded lenders are becoming increasingly convinced that tenure security is intricately linked with improving housing and is a social goal worth pursuing.

Chapter 5: Secure tenure and housing microfinance

Housing microfinance is intimately tied to the tenure status of a client's residence. Land tenure has a direct bearing on several important aspects of housing microfinance, including:

- Whether or to what degree a household is willing to invest in home construction, in relation to the perceived level of secure permanence or rights over the land.
- The physical permanence or likelihood that a client will be allowed to remain at a particular location, which directly affects his or her creditworthiness.
- The capacity of a household to use the home as collateral or as some type of informal or psychological guarantee on loans.

In addition to these considerations, socially minded lenders are becoming increasingly convinced that tenure security is intricately linked with improving housing and is a social goal worth pursuing.

Access to land is a critical component of the housing process of low-income people. Rising land costs make legal purchase or use of desirable properties unaffordable to poorer populations, obliging them to seek residence in distant, marginal and often informal neighborhoods where infrastructure and services are lacking and tenure is uncertain. A household's tenure security is fundamental to their economic and social stability, and it enables households to invest in improving their homes without fear of losing their most valuable asset.

Land issues of the poor

Property rights are essential to a nation's development, contributing to households' economic growth and stability, access to valuable goods and services, and greater civic participation. Access to land and tenure security are central to the well-being of all households, but the poor are often deprived of these basic rights. Approximately 5 million people worldwide suffer from forced evictions every year,[1] resulting in significant physical and social loss for vulnerable populations. According to Hernando de Soto, a world-renowned economist, the lack of formal land rights among the majority of the world's poor is one of the fundamental underpinnings of continued systems of exploitation and poverty in developing countries.

1 UN-HABITAT. "Secure Land Rights for All." 2008.

Land tenure terms

- **Access to land** refers to the temporary or permanent right to use land for shelter, production or other purposes.
- **Land tenure** refers to the way in which land is held or owned by individuals or groups. It may involve individual or collective ownership, rental agreements, leases, or temporary rights.
- **Land tenure security** is the degree of certainty that an individual's rights to land will not be forcibly or arbitrarily taken from them.
- **Adverse possession** is the occupation of land owned by another with the intention of gaining its possession.
- **Customary land tenure** refers to land owned and occupied based on local customs, frequently defined by indigenous practices, and often involving common or communal ownership rights.
- **Eviction** is the forcible expulsion from one's place of residence.
- **A registered freehold title** secures full legal entitlement over land to its owner, allowing for uses such as construction, sales or rental, or as collateral.

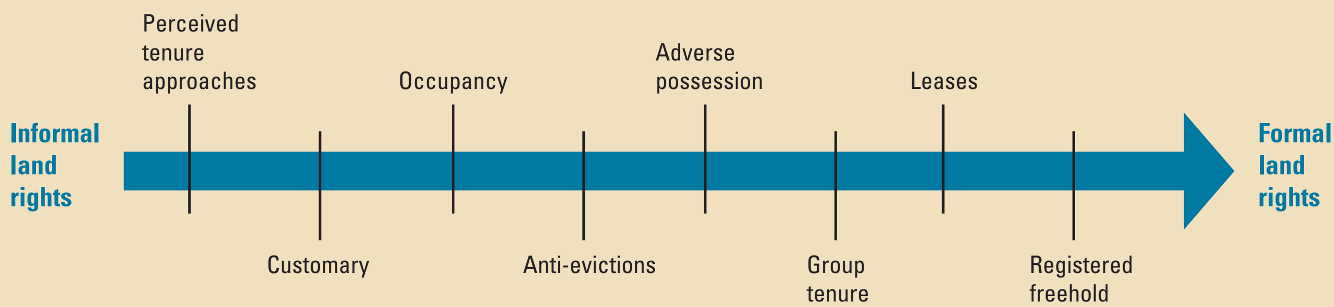
Population growth and economic development are global forces that drive up land costs, making land less affordable for the poor and increasing their obligation to resolve housing needs informally, exposing them to greater risk and potential exploitation. Specifically, urbanization and the migration of rural populations to cities of the developing world place great stress on urban land supplies, resulting in the formation of informal settlements, often on the urban periphery. Marginal neighborhoods frequently arise from land invasions, where public or privately owned property is informally inhabited by low-income dwellers. Informal settlements or slums tend to be characterized by poor infrastructure, a lack of basic services, high-risk locations (vulnerable to natural disasters) and informal constructions. In 2005, almost 1 billion residents of these informal settlements (approximately 934 million people) were estimated to inhabit shelter without secure tenure.[2]

Classification of tenure types

While the developed world classifies tenure primarily in terms of ownership and rental, tenure status in the developing world tends to fall within a range of options, with formal freehold title on one extreme and highly informal and precarious tenure at the other. This "continuum" of tenure is highly contextual, defined by a mix of local legal regulations regarding land ownership, customary norms and practices, religious norms (in some cases), and recognized informal or extra-legal practices. By assessing the status of a household's residential land, various organizations, including UN-HABITAT, visualize tenure security within a continuum of locally available options. This "Continuum of Tenure Types" is presented in Graphic 1.

2 UN-HABITAT. "Secure Land Rights for All." 2008.

GRAPHIC 1: Continuum of tenure types



Source: UN-HABITAT

According to UN-HABITAT, most developing countries have less than 30 percent cadastral coverage, where the cadastre is a public registry of properties based on location, size, ownership and value. A recently launched U.N. initiative known as the Social Tenure Domain Model, or STDM, seeks to create a "pro-poor land information management system" to support land administration among low-income urban and rural areas and will ultimately be linked to existing national cadastral systems. Another encouraging development is the rise of private-sector initiatives such as Medeem's ParcelCert documentation package and Mercy Corp.'s Suyo enterprise. These offer examples of innovative social business strategies that assist households with concrete steps in formalizing their land ownership.

As highlighted in the box above, land rights and tenure security are fundamental to a household's well-being. Increasing land tenure security results in a direct boost in the value of a household's primary asset, as housing and land account for approximately 60 percent of the assets of low-income households worldwide.[3] When tenure is strengthened, land values rise and households become more inclined to invest in home improvements, thereby increasing the value of their shelter as well.

Low-income households also are likely to have home-based enterprises or to use their home for other income-generating purposes, such as renting rooms.[4] Therefore, improved tenure also may increase a household's income, as greater security enables households to invest in the productive use of their home.

3 Center for Urban Development Studies, "Housing Microfinance Initiatives," Harvard University. May 2000.

4 For example, an estimated 30 to 60 percent of housing microfinance clients engage in some form of home-based enterprise. See "Housing Microfinance Initiatives" (Ibid.), p. 133.

ASSESSING ALTERNATIVE FORMS OF TENURE

These opportunities underscore the importance of understanding the various forms of land tenure within a given context and pursuing strategies to legitimize alternative forms of tenure while helping households take incremental steps toward greater formalization. Increasingly, housing microfinance practitioners are seeking to classify households' land tenure status within a continuum of options that present varying degrees of security and opportunities for tenure improvement. Evidence shows that recognizing informal tenure makes housing markets more inclusive for marginalized populations while enabling financial institutions to grow robust housing portfolios.

Because land tenure and property rights are frequently interwoven with cultural norms, informal practices and changing legal frameworks, interpreting their strength is often complex and subject to personal perceptions. Therefore, it is important that institutions supporting housing and land-related improvements be equipped to appropriately assess tenure conditions in order to both understand a household's current reality and, when possible, contribute to strengthening their tenure security.

TAKING STEPS TO STRENGTHEN TENURE SECURITY

An encouraging sign among housing microfinance lenders is the growing recognition of the need to work in partnership with land documentation authorities and service providers to offer greater value to their housing customers. Emerging private-sector initiatives to improve land access and tenure security for poor households are linking with financial institutions to open distribution channels to targeted groups and offer tailored financing for tenure-related services. These collaborative efforts reveal that market-based land documentation services are typically best undertaken in an incremental fashion, as the steps involved may be lengthy, complex and costly. Private-sector solutions are still rather scattered and small-scale, signaling the importance of supporting greater innovation and learning to foster successful business models that have substantial outreach while producing value for households in need of greater tenure security.

Chapter 14 in the Practitioner's Guide continues the discussion by offering guidelines for incorporating tenure security considerations into a lending institution's practice generally and housing microfinance portfolio specifically.

The growing pool of practitioners is evidence of how **housing microfinance is becoming an increasingly attractive proposition** to institutions seeking to open new business opportunities to retain good clients or achieve greater social returns.

Chapter 6: Lessons learned in housing microfinance

As the microfinance industry continues to diversify its offerings and applies increased efforts to responding to clients' needs and priorities, housing microfinance is assuming a more strategic place within lending institutions' portfolios. The growing pool of practitioners is evidence of how housing microfinance is becoming an increasingly attractive proposition to institutions seeking to open new business opportunities to retain good clients or achieve greater social returns. But when microfinance practitioners consider entering housing markets, they will likely ask: What factors favor robust, high-performing housing microfinance portfolios? What factors constrain successful housing microfinance? What is required to scale up our housing microfinance portfolios?

This chapter offers some responses to questions financial institutions ask before entering or expanding their housing microfinance operations. These are based on the Center for Innovation in Shelter and Finance's experience over nearly a decade of providing housing microfinance technical assistance to institutions.[1] These lessons are grouped into two categories: opportunities and constraints to housing microfinance, and taking housing microfinance products to scale.

OPPORTUNITIES AND CONSTRAINTS

Housing microfinance tends to thrive in contexts where microfinance is generally prospering, but certain factors that are particular to housing microfinance lending, organized into the following five categories, should be considered.

1. **Land and location**
   - A favorable condition for housing microfinance is a setting in which land tenure is secure and households feel confident of their property rights, even if they are not formally registered and titled. These factors feed vibrant housing markets and stimulate investment in improving homes, infrastructure and public services. (More detailed discussion of this topic is included in Chapter 5 of this handbook).

     Contexts plagued by insecure tenure, land repossessions and government-sponsored relocations are less suitable for housing microfinance. Households are notably more reluctant to invest in tenuous housing circumstances, and lending risks are also heightened by clients' unreliable residence. Similarly, marginalized neighborhoods lacking basic infrastructure (e.g., roads and public services)

1 For the original case studies that this chapter is based on, see "Housing Microfinance Case Studies of 11 Habitat Partnerships." For a detailed discussion of best practices, see "Lessons from 11 Partnerships of Habitat for Humanity." Both are available at habitat.org/cisf.

Global urbanization presents a vast opportunity for housing microfinance, because urban areas experiencing significant growth and migration are often hosts to vibrant housing markets.

tend to suffer from lower investment in private housing, as residents are forced to divert precious resources to purchase costly services from private suppliers, and property values often stagnate.

- Zones at high risk of natural disasters (e.g., hurricanes, earthquakes, landslides, flooding) are also difficult contexts for housing microfinance, given the associated lending risks. Nevertheless, the effects of natural disasters often present unique opportunities for housing microfinance, particularly in areas where people are settling after a disaster.

  When housing microfinance is offered in contexts that are particularly vulnerable to natural disasters, financial institutions must give priority to pursuing qualified technical guidance and doing a feasibility study of the geographic area to approve of (or disqualify) specific zones for housing finance, based on the perceived level of risk.

2. Sociopolitical factors

Global urbanization presents a vast opportunity for housing microfinance, because urban areas experiencing significant growth and migration are often hosts to vibrant housing markets where demand for financing far outstrips supply.

Another setting favoring housing microfinance is areas facing reconstruction after wars have caused significant destruction to physical property.

Notably, areas that are facing substantial negative migration (e.g., war zones, or Mexican towns near the U.S. border) or that are highly populated by temporary residents (e.g., refugee communities) are considered less appropriate for housing microfinance. Although these contexts present definite challenges for housing microfinance lending, specific product design features may be employed to partially mitigate obstacles.

3. Economic environments

Contexts experiencing stable economic growth and reasonable rates of inflation — and where investment is considered relatively secure — are generally considered favorable for housing microfinance.

High-risk markets, in which capital is constrained and costly, are difficult contexts for growing housing microfinance, as loan capital can become extremely expensive and the price increase of construction materials can outpace the clients' borrowing capabilities.

A related challenge is the noted effect of struggling economies on clients' income, which compromises their borrowing capacity. In this case, the housing microfinance product design needs to be well-targeted, financing only small, incremental improvements and keeping the cost of housing support services low. In cases where the clients of microfinance institutions have the ability to plan and budget for home improvements, the inclusion of appropriate housing support services seems to be essential for properly determining needed loan amounts.

4. Microfinance markets and regulation

The state of local microfinance markets also can have a significant impact on the performance of housing microfinance portfolios. Where microfinance institutions are relatively mature, the banking business is more sophisticated and product diversification is commonplace, housing microfinance appears to be growing and diversifying in its offerings.

In countries where banking regulators have recognized housing microfinance as a distinct product, this recognition will likely serve to encourage product differentiation among lenders. Housing microfinance product differentiation, in turn, enables microfinance institutions to direct specialized services to clients, undertake well-informed loan analysis and verify loan usage. It also allows the microfinance institution to sell housing microfinance as a distinct product to specific target markets. Furthermore, the product's segregation within a microfinance institution's portfolio management system facilitates housing microfinance performance assessment.

Where microfinance markets (or credit markets in general) are saturated or burdened by overindebtedness, predatory lending and other irresponsible lending practices, housing microfinance faces challenging prospects. Because housing microfinance loans are frequently repaid with existing income streams, when these are already overcommitted, repayments are likely to suffer. These types of environments signal the need for well-designed and highly targeted housing microfinance products.

In cases where banking regulators have yet to recognize housing microfinance as a distinct product, regulated institutions find less reason to differentiate housing microfinance from existing products. Consequently, housing microfinance loans are often found embedded in the portfolios of consumer loans, fixed-asset loans, or more broadly classified housing loans (possibly including mortgages). This presents a variety of challenges. For example, classifying housing microfinance as a consumer loan may result in excessive provisioning requirements, given consumer lending's higher risk profile. In certain cases where housing microfinance is included within mortgage portfolios, specific regulations such as legal land title requirements or overly restrictive interest rate caps may stunt its potential. Furthermore, overly regulated microfinance markets may impose restrictions that constrain housing microfinance's success. Major shifts in microfinance regulatory bodies and their leadership can dampen microfinance institutions' readiness to engage in further innovation and diversification.

5. Government housing programs

Government programs targeting improved housing also may be perceived as opportunities or constraints to housing microfinance portfolios. Microfinance institutions have sometimes found that government-sponsored programs stimulate housing markets by helping households acquire land or build a portion of their homes. Consequently, households who have benefited frequently seek financing to continue with or complete their home-building aspirations.

In some cases, an actual partnership may form between government entities and local microfinance institutions, whereby the latter offers financing to increase access to public services. Unfortunately, in certain contexts, government housing programs — particularly subsidy-based initiatives — are perceived as having a negative effect on the housing finance markets of low-income sectors.

TAKING HOUSING MICROFINANCE PRODUCTS TO SCALE: INSTITUTIONAL COMMITMENT AND CAPACITY

Some lessons on scaling up housing microfinance products have emerged out of the work of the Center for Innovation in Shelter and Finance.

Access to capital

As institutions seek to grow their housing microfinance portfolios, capital is needed at conditions that match their products. Most important is that financing accommodates housing microfinance terms, which are generally longer than working capital loans, in some cases extending three to five years.

In the 2014 CISF survey of financial institutions with housing microfinance portfolios, the main issue preventing them from scaling their products was lack of capital. This finding demonstrates the need for identifying funding sources, such as the MicroBuild Fund, an investment fund that provides loans to microfinance institutions for housing microfinance products. A good portion of financial institutions have also mentioned the unavailability of land title as a challenge facing housing microfinance expansion. (Chapter 5 covers this topic in more depth).

Factors that facilitate scale

Housing microfinance products appeared to flourish in institutions that were characterized by the factors listed below. These may be considered criteria for determining where housing microfinance has the best potential for reaching scale.

- **Microfinance institution's existing outreach and growth trajectory:** Microfinance institutions with a national presence and a history of strong growth seem to be better poised to scale up housing products through their existing operational structure. Furthermore, microfinance institutions with a strong commitment to growth are generally more open to venturing into new products and markets with the necessary dedication (and related experience) to overcome initial hurdles.
- **Microfinance institution's legal figure facilitates access to capital:** Although specific funds for housing microfinance are uncommon, regulated microfinance institutions with access to savings and other sources of domestic and foreign capital seem to be better equipped to fund housing microfinance portfolio growth within their existing range of resources.
- **Housing's "fit" within the microfinance institution's mission:** Microfinance institutions that embrace broad social missions and actively seek to pursue these are most eager to engage in housing microfinance and integrate housing as a core product. These institutions' mandates tend to incorporate a more extensive target group than microentrepreneurs and their households, and support engagement in a wide range of financial products and services.

- **Microfinance institution's culture embraces learning, innovation and credit-plus:** Microfinance institutions that could be characterized as "learning organizations" — placing a high value on training staff, listening intently to their clients and welcoming innovation — are particularly ripe environments for scaling up robust housing microfinance products. As microfinance institutions venture further into housing finance, they often seek greater diversification, whether in response to business opportunities or clients' demands. This leads to the development of specialized housing products for distinct market segments that are not being served, or products uniquely tailored to specific types of improvements.

In addition to microfinance institution characteristics that facilitate scale, the following specific practices support housing microfinance growth:

- **High level of appropriation of housing microfinance throughout the organization:** The microfinance institutions with institutional commitment to the new product at all levels, from the board to the loan officers, are keenest to successfully continue expanding their housing microfinance products and services. The social outcomes resulting from housing loans and the increased contact with clients that is entailed by housing support services can contribute significantly to the field staff 's commitment to the product.
- **Housing microfinance growth incorporated into institutional growth plans:** Housing microfinance has a much greater chance of receiving needed attention and support to reach scale when its growth is tied into the broader plans of the microfinance institution. Important aspects to be included in the plan are:
  a) Criteria for determining and prioritizing branches for housing microfinance product expansion.
  b) Staff training in housing microfinance product delivery and support.
  c) The role of the central office in supporting product rollout.
- **Staff incentive schemes promote housing microfinance rollout:** Of critical importance to housing microfinance growth, particularly during product rollout, is the incorporation of supportive incentive policies among field staff to promote product uptake in new locations. These frequently include setting product benchmarks in terms of number of housing loan clients, loan amounts and repayment rates, and may be applied to individual staff members or to entire branches.
- **Extending housing microfinance to new client groups:** Openness to new market segments allows for further diversification of portfolios. Clearly, more competitive lending environments will push financial institutions to venture further in this direction.
- **Financial reporting tracks housing microfinance performance:** The ability to separately track loan products' performance, both in terms of portfolio data and relative to sustainability calculations, is critical to scaling housing microfinance. This latter requirement is constrained by microfinance institutions' capacities to provide cost-accounting figures along product lines, particularly when the field staff is engaged in selling multiple products, thereby complicating an accurate assessment of product-specific operating costs.

Microfinance institutions that embrace broad social missions and actively seek to pursue these are most eager to engage in housing microfinance and integrate housing as a core product.

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