



**Terwilliger Center for  
Innovation in Shelter**

# **Pahal Financial Services Building Community Resilience through Housing Microfinance**



# An Overview of India's Housing Market

Access to adequate housing is a fundamental human right for global economic and social development. Beyond providing safety and security, housing unlocks various socio-economic benefits for families, contributing to their overall well-being.

Investing in quality housing, especially in informal settlements in the least developed countries, could significantly<sup>1</sup>:

Boost  
GDP by  
**10.5%**

Increase years  
of schooling by  
**28%**

Extend life  
expectancy by  
**4%**

The **housing and real estate sectors in India** are key economic drivers. They support over 250 ancillary industries and are the second largest employers after agriculture.



# 1. India's Evolving Housing Landscape and Challenges

India's housing market is rapidly evolving due to urbanization, demographic shifts, and economic changes. As the second most populous country with a fast-growing economy, the housing demand has surged. However, access to quality housing has not kept pace, resulting in a significant housing gap.

The development of the housing sector has far-reaching implications for the country's economic trajectory, social fabric, and citizens' overall well-being.

## The reality:

275 million people (22% of the population) lack adequate housing



The rural housing shortage is twice that of urban areas<sup>2</sup>



By 2022, India needed 110 million housing units to meet the burgeoning demand<sup>3</sup>



## The affordability crisis

Addressing the challenge of adequate housing is critical, especially since 96% of the urban shortage affects India's Economically Weaker Section (EWS) and Low-Income Sector (LIS)<sup>4</sup>. This shortfall primarily arises from overcrowded, dilapidated houses, unlivable kutchha homes, and homelessness. Although the majority (approximately 94%) of households own a housing unit in rural areas, the condition of most of these units is inferior compared to urban areas<sup>5</sup>. **The need gap for adequate housing in India is 11% of the world's housing needs** in terms of the population living in substandard housing.

2 <https://pressroom.ifc.org/all/pages/PressDetail.aspx?ID=27360>

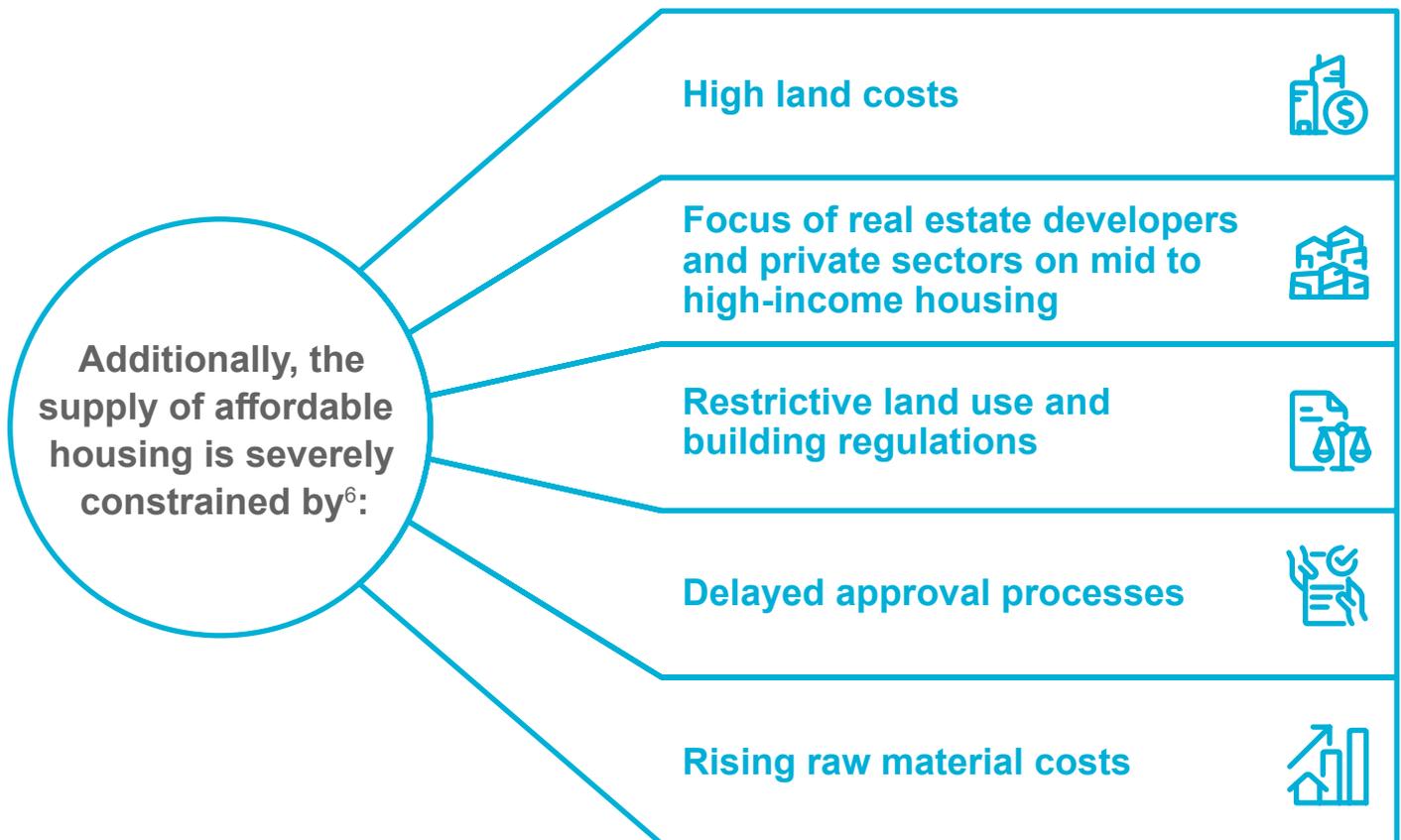
3 [https://www.business-standard.com/article/economy-policy/affordable-housing-market-to-reach-100-billion-over-5-7-years-report-116101600140\\_1.html](https://www.business-standard.com/article/economy-policy/affordable-housing-market-to-reach-100-billion-over-5-7-years-report-116101600140_1.html)

4 EWS- Economically Weaker Section, defined as households having an annual income up to INR 3,00,000 (Rupees Three Lakh) and LIS-Low Income Segment, defined as households having an annual income from INR 3,00,001 (Rupees Three Lakhs One) up to INR 6,00,000 (Rupees Six Lakhs)

5 [https://assets.publishing.service.gov.uk/media/5ede0180d3bf7f45fb3214d0/Final\\_Report-KF-DFID-c1.pdf](https://assets.publishing.service.gov.uk/media/5ede0180d3bf7f45fb3214d0/Final_Report-KF-DFID-c1.pdf)

## The Affordability Crisis Aggravated

India's housing market is grappling with an affordability crisis, exacerbated by steadily increasing housing prices that significantly outpace income growth, pushing homeownership out of reach for many, especially those in the EWS and LIS. Factors such as **rising land costs, escalating construction expenses, and speculative market dynamics** contribute to this trend.



## Government Initiatives and Limitations

In response to the acute housing shortage, the Indian government has launched significant initiatives, notably the Pradhan Mantri Awas Yojana (PMAY), to provide affordable housing to the urban and rural poor. While these efforts mark a crucial step towards addressing the housing crisis, the government's role predominantly as a facilitator (includes policymaking, offering subsidies, and incentivizing private sector participation) underscores the inherent limitations in directly meeting the vast needs of the population.

The affordability crisis in India's housing market poses a significant challenge, affecting the most vulnerable sections of society. Addressing this issue requires a multifaceted approach, involving collaborative efforts from the government, private sector, and other stakeholders to increase the supply of affordable housing units and ensure access to quality housing for all.

6 [https://assets.publishing.service.gov.uk/media/5ede0180d3bf7f45fb3214d0/Final\\_Report-KF-DFID-c1.pdf](https://assets.publishing.service.gov.uk/media/5ede0180d3bf7f45fb3214d0/Final_Report-KF-DFID-c1.pdf)

## 2. Role of Affordable Housing Finance

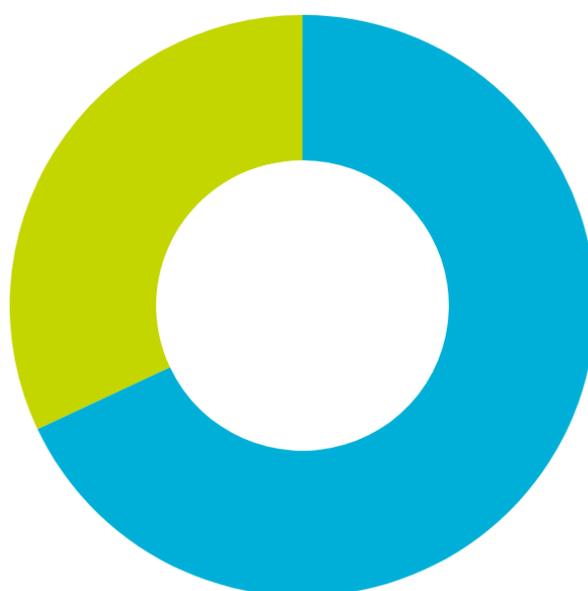
Access to adequate housing finance is crucial for **bridging the gap** between affordable housing demand and availability. By offering financial solutions for lower-income households, housing finance institutions can significantly expand housing accessibility. **India's low mortgage-to-GDP ratio (around 11%) compared to other Asian economies (20-30%) highlights the sector's untapped potential.** Without affordable housing finance, low-income households may take up to 30 years to complete their homes<sup>7</sup>.

### The Housing Finance Landscape

The housing finance market in the country is dominated by Scheduled Commercial Banks (SCBs) and Housing Finance Companies (HFCs), with a market share of 68% and 32%, respectively. As of September 30, 2023, SCBs and HFCs had a total outstanding individual housing loan portfolio of INR 26,03,650 crore (US\$ 310 billion), with an annual growth rate of 16.59%<sup>8</sup>.

### Housing Finance Companies (HFCs)

32%



Scheduled  
Commercial Banks  
(SCBs)

68%

### Barriers to Access

Typically, these institutions adopt stringent lending criteria to minimize credit risk, often requiring:

- Proof of stable and verifiable income.
- Clear property titles.
- Focus on urban areas.

These criteria effectively exclude a significant portion of the population, including the Economically Weaker Section and Low-Income Groups, often engaged in informal work sectors, who constitute 80.9% of India's workforce, according to a 2018 ILO report. Additionally, low-income households' lack of financial literacy exacerbates their inability to meet these strict financial standards, limiting their access to formal housing finance.

7 <https://www.findevgateway.org/blog/2021/11/how-long-should-it-take-build-home>

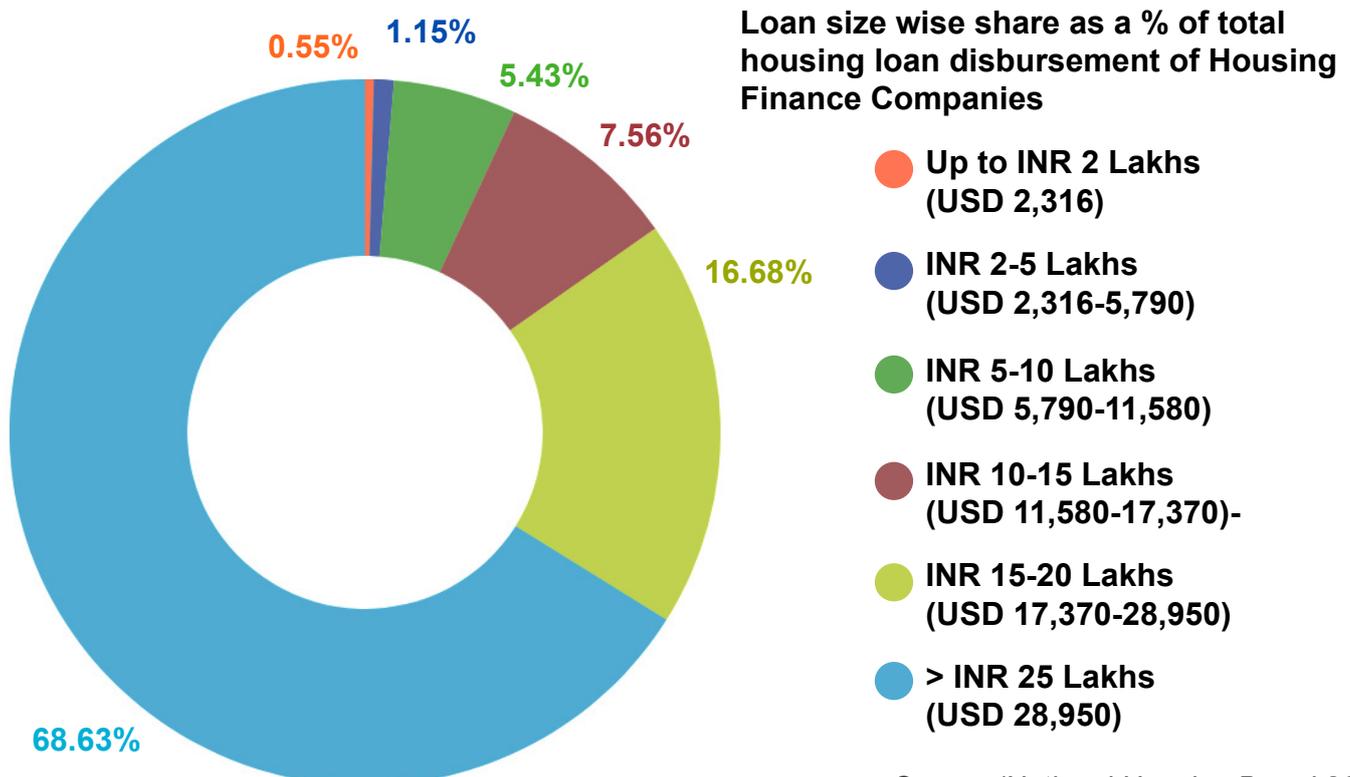
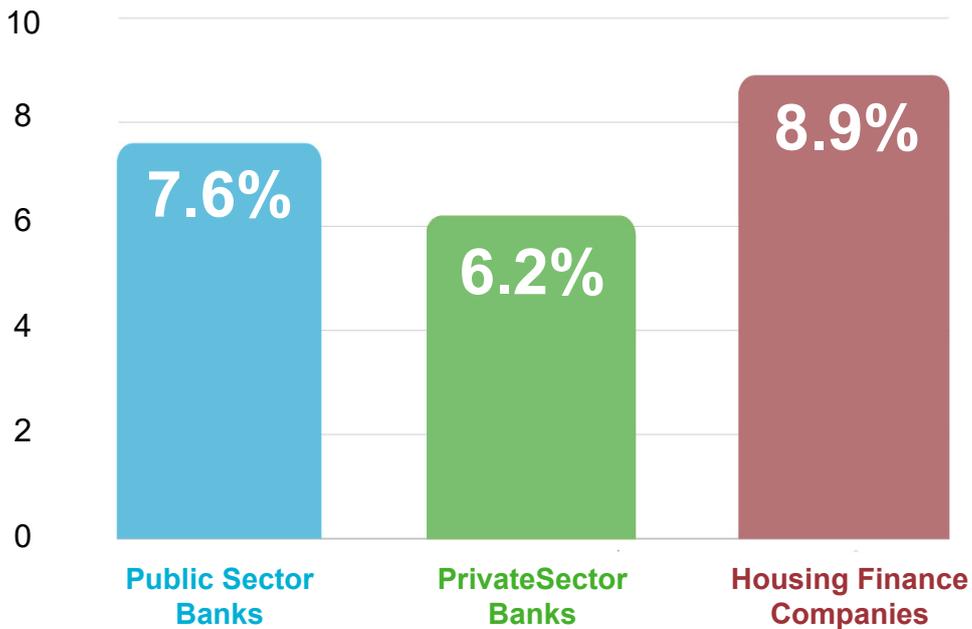
8 NHB 2022, Trends and Progress in Housing Finance

## The Rise of Affordable Housing Finance Companies

Given the enormous unmet demand for housing finance among low-income households, a new category of Housing Finance Companies (HFCs), called Affordable Housing Finance Companies (AHFCs), has emerged in the last decade. Of the total housing loans to the EWS and LIG segments, AHFCs contribute 68%, and 45% of their overall portfolio is within the LIG segment.

As of June 30, 2023, their on-book loan portfolio stood at over INR 92,000 crores (US\$10.96 billion), and their share in the overall HFCs' loan book stood at 6% as of March 31, 2023<sup>9</sup>.

### Percentage share of rural housing loans to total outstanding loans



Source (National Housing Board 2023)

## Challenges and Opportunities

Despite the progress made by AHFCs in serving low-income groups, the industry is in its early stages. The penetration of housing finance in rural areas is still low. Data as of September 30, 2022, shows that rural housing loans account for only 7.73% of the total Individual Housing Loan (IHL) outstanding, with HFCs having the highest penetration. Loan sizes below INR 5 lakhs (US\$5,955) are around 1.3% of the total loans disbursed.

The segment of less than INR 5 Lakhs (US\$5,955) is underserved, and Housing Microfinance (HMF) has significant potential to address the substantial unmet demand, especially among the EWS segment. Mirroring the features of traditional microfinance products, HMF provides smaller, short-term loans (INR 50,000-3,00,000) (US\$ 595.5-USD3,573) for 2-3 years with flexible repayments designed to fund incremental construction – the process by which a low-income family gradually builds their home.



## Innovations in Housing Microfinance

This approach aligns with the realities of low-income households, for whom large, long-term financial commitments are often infeasible. HMF loans cater to various housing needs, from basic repairs and renovations to home extensions.

As of March 2023, housing/home improvement loans account for 1.2% of the country's total assets under management of the Non-Banking Finance Companies-MFIs<sup>10</sup>; this area has a clear scope for growth and expansion.

Within the realm of housing microfinance, MFIs are innovating and offering micro-mortgages. Between affordable mortgages and HMF products, micro-mortgages offer extended tenors and higher loan amounts, expediting clients' housing journey. With the increased use of technology for client sourcing and credit underwriting, many MFIs have been able to offer customer-centric products with high portfolio quality.

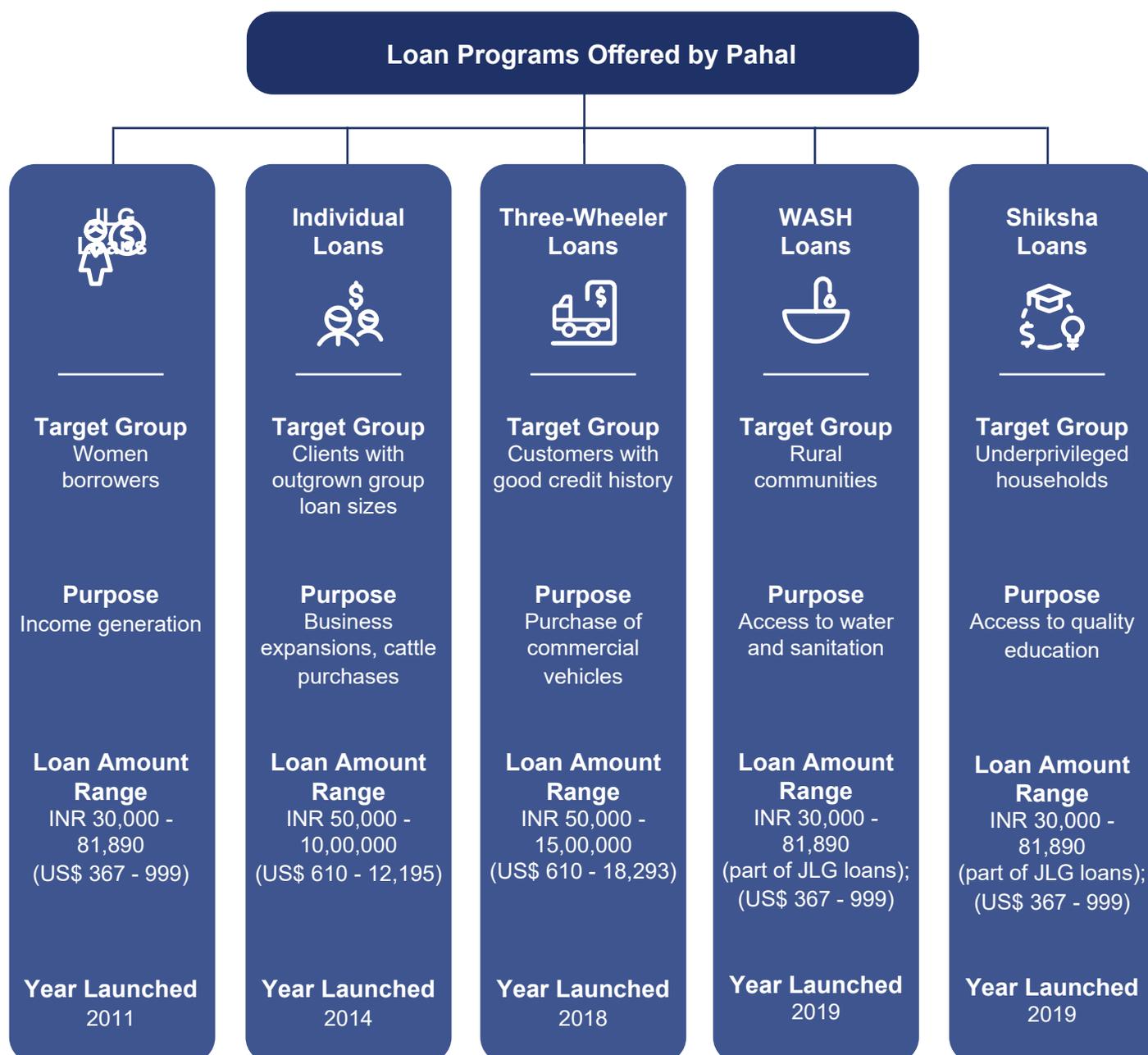
For the HMF sector to scale up, affordable and long-term capital, investment in risk management capabilities, and staff capacity building are needed. With the proper support mechanisms, the sector can grow significantly, making safe and affordable housing solutions accessible to those who need them most and contributing to the country's broader economic and social development.



# Pahal's Journey Into Microfinance

Pahal, a Non-Banking Financial Services Company recognized by the Reserve Bank of India as an NBFC-MFI, is dedicated to uplifting marginalized communities. Commencing operations in 2011, Pahal has positively impacted the lives of over a million low-income households by providing credit for income-generating activities, fostering economic self-sufficiency, and elevating their living standards. As one of India's fastest-growing MFIs, Pahal has a **Gross Loan Portfolio (GLP)** of INR 1,897.48 Crores (US\$219.7 Million), operates across **11 states** with **363 branches**, and employs over **3,160 staff members**. Committed to its mission and vision, Pahal offers a range of financial and non-financial products and services tailored to meet the evolving needs of its clients and enhance their quality of life.

Pahal provides a diverse range of microfinance loans tailored to meet the specific needs of various customer segments within rural communities. These offerings include loans under the Joint Liability Group (JLG) model primarily for women, alongside secured and unsecured individual loans designed for business expansion and other income-generating activities. Additionally, Pahal has extended its financial services to include loans for commercial vehicle purchases and educational purposes, further supporting its clients' economic and social upliftment.



## Pahal's foray into housing microfinance

Pahal aimed to become a holistic MFI by offering various financial services, including a housing-focused credit product. The Asian Development Bank, in partnership with Habitat's Terwilliger Center for Innovation in Shelter, is supporting the pilot testing and scaling up of housing microfinance for low-income rural and semi-urban households in ADB's developing member countries. Pahal was engaged as one of the partners from India.

An institutional assessment exercise was conducted to outline the MFI's preparedness to foray into housing microfinance and develop the requisite planning to strengthen the institutional capacity.

Initial discussions with Pahal's senior management helped assess the MFI's strengths, capabilities, future strategy, and alignment with housing-related financial products. This was followed by detailed desk research into Pahal's product offerings, portfolio distribution, and business performance to evaluate operational stability and the requirements for delivering credit services that enable low-income households to achieve the goal of building and living in decent, resilient housing.



### Habitat's Technical Assistance Services

The collaborative technical assistance project provides expert advisory services to microfinance institutions across five countries. The initiative supports the refinement or development of housing microfinance products tailored to the needs, preferences, and financial capabilities of low-income households.

By deploying a comprehensive, tried-and-tested approach, the Terwilliger Center guides financial institutions through the entire product development cycle. This includes market research to understand the aspirations and requirements of target population, housing quality and resilience evaluation, and incorporating gender-specific factors in housing decisions. The approach builds the capacity of financial service providers, guides them through risk mitigation techniques and positions them to scale a sustainable, impactful product.

#### Technical assistance packages may include the following:



## 1. Market Research

The first step consisted of a detailed market assessment to understand the housing-related challenges of low-income households, which helped outline the type of finance appropriate to support low-income families in their construction endeavors. The emphasis was laid on understanding low-income households' characteristics, including their housing needs, motivations, dreams, pain points, and financial behavior.

The market research was undertaken in two sample states: Rajasthan and Gujarat, where Pahal operates. A total of 249 households were surveyed across the two states.

**Some of the significant findings from the market research are as follows:**



### **Land ownership**

In 75% of the cases, the land ownership was in the name of the male household member.



### **Different construction materials in various regions**

Most respondents were found to be living in Pucca houses. Brick construction was common in Gujarat, whereas stone construction was popular in Rajasthan.



### **Housing vulnerabilities**

Gujarat was more prone to cyclones, strong winds, and natural calamities.



### **Demand for home improvement loans**

90% of the respondents surveyed mentioned that they would require financial assistance to undertake repairs/extensions and renovation work soon. The addition of new rooms, followed by roof construction, was found to be the primary reason households required loan money.



### **Challenges in accessing formal loan products for housing**

Most respondents belonged to the informal segment; hence, accessing formal financial services was a significant challenge. Moreover, during the survey, it was brought to light that financial service providers also did not have adequate loan products to suit their repair, renovation, or home extension-related works. Also, around 15% of the clients felt that not having proper land title documents may hinder their prospects of securing loans from formal institutions.



### **Factors influencing loan requirements**

The housing construction needs and requirements varied geographically. This was because of the different climatic conditions, availability of various local raw materials, and, to some extent, the socio-economic context of the other geographies. Construction costs in states like Rajasthan were higher than in Gujarat. Also, households in Rajasthan built larger houses than those in Gujarat; hence, the demand for loan amounts from this region was also more significant.

## 2. Product Design

The insights from the market research formed the core of the formal design of the product prototype. This stage involved brainstorming sessions between Pahal and the Terwilliger Center for Innovation in Shelter to ensure the product features suit the needs of the end clients and align with Pahal’s overall business strategy and feasibility. Moreover, discussion sessions were held to align the product based on the revised Reserve Bank of India guidelines for microfinance in 2022. The prototype and the product process were developed and discussed several times before finalization.

A higher ticket-size, unsecured product was developed to meet clients’ construction needs. This product, coupled with stringent credit underwriting norms, could meet the loan needs of clients who may not have very clear land title documents. However, the loan would be backed by higher tenure security. A higher repayment tenure was also adjusted to meet the client’s needs.

This product was also designed to cater to the needs of “open market” clients. These families are not “new to credit” but did not have any borrowing history directly with Pahal.



The product provides enough flexibility for clients to access credit per their requirements. However, to control credit risk, the credit limits were fixed for “open market clients” and clients with land tenure security but unclear land title documents.

### 3. Pilot roll-out

Once the necessary approvals were in place from Pahal's management side, the plan to roll out the pilot testing of the product was finalized. Further, to clarify the product features, process, and overall impact, a training session for the branch staff (responsible for disbursement and management of loans) was also conducted before the launch of the pilot. A cross-functional team from Pahal's head office regional offices and the branch offices, such as branch managers and loan officers, attended the capacity building workshop in person at Pahal's head office.

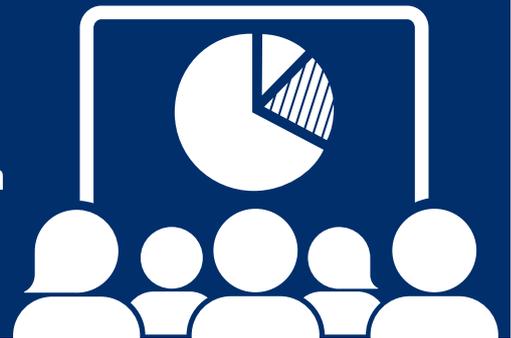
#### Pilot statistics Nov 2023 - Sep 2024

Loans disbursed: **700**

Capital mobilized: **INR 92,495,000 (US\$ 1 Million)**

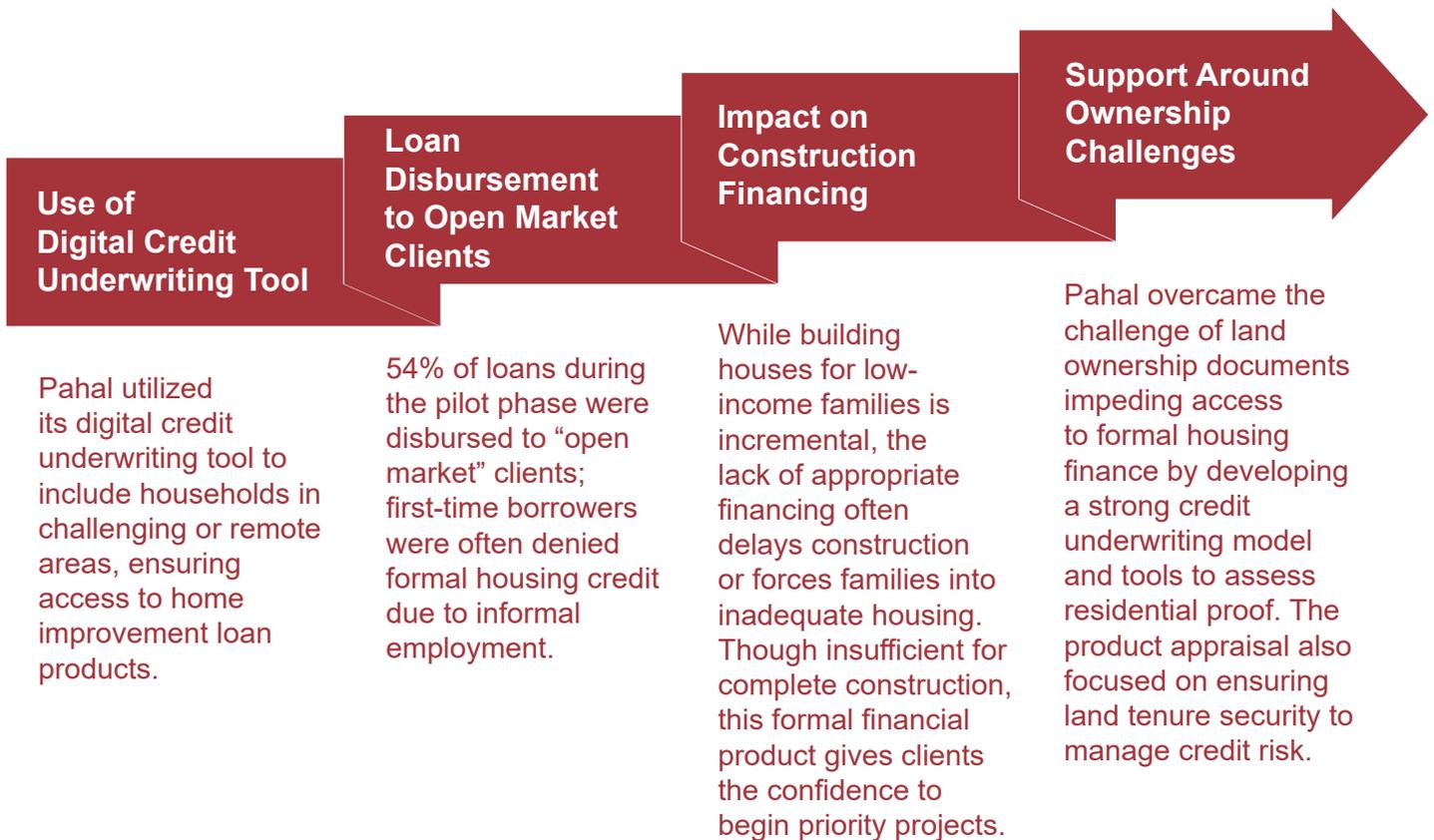
Average ticket size: **INR 132,135 (US\$1,532)**

Pilot states: **Gujarat, Rajasthan, Madhya Pradesh**



# Impact

The technical assistance journey successfully developed an individual housing finance product for low-income households in Pahal's operating areas. Detailed impact and uptake studies will follow once the loan cycle is completed. Key milestones during product development include:



These achievements were made despite external challenges that impacted the technical assistance journey. The COVID-19 pandemic shifted MFIs' focus to business stability and portfolio quality, delaying project progress. However, the Terwilliger Center teams held regular discussions to align the technical assistance journey with the macro context and MFI priorities, starting off-site activities when restrictions eased.

As MFIs, including Pahal, were recovering from the pandemic, regulatory changes in the Indian microfinance sector affected operational priorities. The RBI revised the definition of microfinance loans, setting a standard income limit of INR 300,000 (US\$3,573) and eliminating the rural-urban distinction—entities needed at least 75% of their portfolio to follow the above criteria to qualify for NBFC-MFI license. The new regulations removed the restriction on borrowing from more than two NBFC MFIs but capped total loan repayment obligations at 50% of monthly household income.

These guidelines had long-term implications, including digitizing workflows due to stringent household cash flow assessments. This pushed MFIs, including Pahal, to expedite technology integration. Consequently, the development of new products and digital Loan Origination Systems (LOS) was affected. However, Pahal, and the Terwilliger Center navigated these challenges through regular coordination, planning, and management strategies.



## Building safe places for living and working

Gungun is from Manipur (a far flung Northe Eastern state in India). She is an educated woman who works as a makeup artist in Jodhpur, Rajasthan (one of the western most states in India). She married Ramesh, a professional electrician, from the same city. Once married, Gungun shifted from living in a hostel in Jodhpur to Ramesh's parents' home, in a village approximately 30 kilometres from Jodhpur city. She continued her work as a makeup artist. However, the couple decided to build a separate house on land adjacent to his parents' home.



Ramesh's parents helped with the initial funding for the couple to develop a basic dwelling unit consisting of a room, toilet, and an open space for a kitchen. This initial construction helped Gungun and Ramesh to move into their "new" house. They lived in it for a year, and Gungun gave birth to a baby in 2022.

With the growing personal requirement for a safe dwelling unit and space for the child, Gungun decided to improve the house by expanding the bedroom to allow the child to play and constructing the kitchen with requisite functionalities. While Gungun was looking for financial resources to start the construction work, one of her family members living in the same locality knew about Pahal's housing loan product. He shared Gungun's phone number with the relationship manager.



Gungun and Ramesh had never borrowed earlier, so they were hesitant; however, the relationship manager explained everything to them and helped them with seamless onboarding. Their estimations for the construction work were around INR 2 lakhs (US\$2,382), done with the help of a local mason. However, Pahal could only offer a loan of INR 1 lakh (US\$1,191) for the construction work as Gungun was a "new to credit" client. Based on the family needs and the available loan amount, she decided to go forward and take the loan amount to complete part of the construction.

She decided to repay the loan in two years and apply for a second cycle with a higher loan amount. With the loan money, Gungun and Ramesh could expand their bedroom and do some repair work for the kitchen. They bought the materials for gradually renovate their kitchen and living area. This credit is also an opportunity for Gungun and Ramesh to build their credit history records for future credit needs.

Gungun is a strong, independent woman. She plans to focus on building her home in the next five years using loans from agencies like Pahal. Her goal is to open a small makeup studio at her house so that she can manage her commitment to her profession and take care of the needs of her growing daughter. She believes Pahal would be a partner in her journey to build a decent home with enough space to enable her to work.

# Pahal's Strategic Pathway for Scaling Housing Microfinance

Though it is very early to comment on the success of the pilot test that Pahal has conducted within the housing microfinance sector, there are encouraging signs that this product could become a mainstream lending product for Pahal. This product has the potential to not only help the institution meet its strategic and business goals but also make a social impact by improving the climate resilience of low-income households through better-quality housing.

Based on how the product uptake and performance unfold in the coming months, The Terwilliger Center has contemplated a few strategic pathways with Pahal. These pathways can be placed on a continuum, each potentially following the other:

- 1. Integrate the housing microfinance product into Pahal's business plan and expand organically by gradually rolling out the product in all branches.** The product should be incorporated into the business plan with a dedicated strategy to expand the portfolio organically. The institution could aim for 5% to 10% of the overall outstanding portfolio to be allocated to this product. To achieve this, several guiding principles need to be implemented:



## **Iterative product journey**

Product design should be treated as an iterative process, requiring a culture and mindset within the product management team that encourages ongoing evolution of product features and delivery systems.



## **Dedicated product manager**

Having a full-time product manager dedicated to this product is essential for achieving strategic outcomes. This individual can take ownership of the product within Pahal, overseeing its end-to-end design and delivery. The person will need to work closely with the management team to secure necessary approvals and decisions while coordinating with all support functions related to the product, such as MIS, IT, HR, finance, and risk management.



## **Capacity-building for front-end staff**

Training and upskilling front-line staff, including branch managers, loan officers, and credit officers, must be prioritized, as these staff members are crucial for successful product origination.



## **Regular monitoring**

To ensure that housing microfinance remains client-centric and affordable, the product should undergo regular review to address changing client needs. Implementing product-specific recording, analysis, projection, and evaluation systems can provide better insights into housing microfinance's status, viability, and contribution to the MFI.

**2. Product innovations:** The project's second phase could involve augmenting the existing product with several key features. Depending on the market context and overall landscape, these enhancements could be offered as bundles or individual offerings:



### Climate resiliency

The existing product may be further fine-tuned to respond to low-income families' climate mitigation and adaptation needs. For example, use cases such as promoting green building materials that help reduce carbon footprint or providing non-financial services to help families make the right decisions related to their construction projects and improve their climate adaptation. It is important to note that the Terwilliger Center has already initiated work with Pahal to add a consumer education element to the existing housing microfinance product. This will allow these families to become aware of standard construction practices and dos and don'ts related to material and labor selection, enabling them to make informed decisions for resilient structures.



### Gender considerations

The product may further evolve and be customized for women-only customer segments. This will involve understanding the needs of the women's segments and redesigning the product and its delivery for greater client-centricity. Overall, gender-focused solutions could be delivered with the end outcome of achieving women's empowerment and agency.



### Embedded finance

Another product innovation that can occur involves partnering with material providers and offering a bundled solution that combines access to materials with financing.

**3. Higher ticket size solution or affordable mortgages:** The third phase of expansion could involve launching affordable mortgages for graduated clients of Pahal to help them achieve their goals related to new construction, land purchase, or purchasing new housing units. Such a product would help Pahal address the quantitative housing deficit. It is important to note that this kind of product would require significant operational and business model calibration. It involves establishing a new unit that handles higher ticket-size loans with longer tenors. This expansion must also consider regulatory considerations around product exposure limits and capital adequacy. Access to longer-term funds would also be a prerequisite for launching such a product.

In the coming months, as we thoroughly evaluate the product's performance, the Terwilliger Center will collaborate with Pahal's management team and board to finalize the strategic options as outlined above and support operational modalities.

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