Habitat for Humanity®

Terwilliger Center for Innovation in Shelter

The 2016-17 State of Housing Microfinance:

Understanding the Business Case for Housing Microfinance

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Habitat for Humanity's Terwilliger Center for Innovation in Shelter has been honored to work with numerous financial institutions in developing housing microfinance products. Through these engagements, we have gleaned a deeper understanding of both the challenges and the potential of housing microfinance portfolios to enable low-income households to obtain adequate and affordable shelter. This publication was made possible by the contributions of these financial institutions with whom the Terwilliger Center has worked, and also through the input and participation of many other financial institutions that have embraced the opportunity and taken on the challenge to provide these products. We extend to each of them our deepest gratitude for contributing their data and insights to further the expansion of housing products within the microfinance sector. We hope the findings of this report serve to further strengthen your efforts as we work toward a world where everyone has decent shelter.

We would also like to acknowledge the contributions of experts in the housing and finance sectors who contributed their expertise as reviewers of the survey or the report, namely: Ruth Dueck-Mbeba (senior program manager, Mastercard Foundation), Christy Stickney (independent consultant) and Patrick Kelley (vice president, Terwilliger Center). Our gratitude also goes out to many current and former members of the Terwilliger Center for their support in the implementation of the 2016-17 survey. Without them, this edition would not have been possible: Jitendra Balani, Jonathan Chelang'a, Giselle Espinoza, Belinda Florez, Dzenita Kicic, Adriana Llorca, Elena Milanovska, Enrique Montero, Mario Moran, George Mugweru, Ruth Odera, Naeem Razwani, Rosie Savio, Gema Stratico, Stephen Wanjala and Joanna Zuniga.

About Habitat's Terwilliger Center for Innovation in Shelter

Habitat for Humanity formally launched the Terwilliger Center for Innovation in Shelter at the historic Habitat III conference, which took place in Quito, Ecuador, in October 2016. The Terwilliger Center is one of Habitat's key commitments toward the implementation of the United Nations member states' New Urban Agenda.

Families partner with Habitat to build strength, stability and independence through safe, sustainable and affordable shelter. Yet, with more than 1.6 billion people around the globe still lacking adequate and decent shelter, local markets prove critical in addressing this challenge. To that end, Habitat established the Terwilliger Center to work with housing market systems by supporting local firms and expanding innovative and client-responsive services, products and financing so that households can improve their shelter more effectively and efficiently. The Terwilliger Center's approach stays true to Habitat's original principles of self-reliance and sustainability by focusing on improving systems that enable families to achieve safe and affordable shelter without needing ongoing direct support.

The Terwilliger Center consolidates more than a decade of experience in developing market-based solutions for housing and the body of work resulting from these early efforts, formerly referred to as the Center for Innovation in Shelter and Finance. The Terwilliger Center works to enhance the inclusivity of housing market systems for low-income households on both the supply and demand sides. The center does so by mobilizing the flow of capital to the housing sector and serving as a facilitator and adviser to market actors on strategies to more effectively engage low-income households. In addition, the center advances knowledge around housing markets by conducting research studies on the impact of these strategies, compiling sector insights and best practices in flagship publications, developing tool kits for practitioners, and presenting and educating at key industry events to foster increased impact in the sector.

If you are interested in learning more about the work of the Terwilliger Center for Innovation in Shelter, please check out our website, **habitat.org/TCIS**, or email us at **TCIS@habitat.org**.

Abstract

The 2016-17 State of Housing Microfinance, based upon a survey of 101 housing microfinance practitioners, is composed of insights and findings regarding practitioners' perceptions of the challenges and opportunities facing housing microfinance, successful implementation strategies, and the performance of housing microfinance portfolios. Using a simple framework to analyze these responses at the regional and global levels, we explore the market-level, institutional-level, product-segmentation-level, and profitability drivers that make differentiated housing microfinance products a viable and attractive option for financial service providers. Findings include:

- **At the market level,** competitiveness has contributed to the expansion of housing microfinance products. Yet growth of these products faces constraints on the demand side – from unavailability of land or formal title documentation and high demand coupled with low eligibility of potential clients – and on the supply side – from restrictive policies and practices within capital markets. Through careful assessment, institutions can understand the implications of these constraints for their housing microfinance products and develop strategies and processes that enable sufficient growth, such as by defining an array of acceptable land tenure documentation or by adapting housing microfinance products to varying affordability levels.
- **At the institutional level,** housing microfinance aligns with the social mission of many microfinance providers while enabling the expansion and deepening of market reach. Key challenges, however, include a lack of adequate capital and of knowledge and institutional capacity to add or expand such portfolios. Housing microfinance providers are addressing the knowledge gap by investing in staff and hiring experts to provide technical assistance. Capital constraints, meanwhile, pose an opportunity for investors seeking a double bottom line to engage with financial service providers ready to scale their housing microfinance products.
- **At a product level,** housing microfinance currently represents an array of product offerings that are being adapted for differing housing-related purposes and client affordability levels, even extending to customer segments beyond the microentrepreneurial focus of traditional microfinance products. There appears to be an opportunity to increase inclusivity and open new markets for financial service providers.
- **Regarding profitability drivers,** considerations include the cost increase of shifting to an individual lending methodology and of offering nonfinancial housing support services to clients, along with concerns regarding the inconsistent income of potential clients. Practitioners are addressing these cost factors by streamlining processes and integrating support services within the loan origination process. Portfolio performance mitigated concerns over client income risks as housing microfinance portfolios demonstrate lower portfolio at risk over 30 days, or PAR30, and lower write-off ratios than general portfolios. Though differentiated housing microfinance products appear to remain nascent, initial evidence points to the potential profitability.

With these considerations in mind, the survey reveals that housing microfinance continues to emerge as a differentiated product that has the potential to provide financial institutions with double bottom line returns and to become a relevant subsector within the microfinance industry. In highlighting the challenges and opportunities and the practical approaches taken to address them, we hope that more financial service providers will be better informed to respond to this apparent opportunity for such products within their own markets and will be better able to serve the millions of additional low-income households seeking to acquire safe and affordable shelter.

The 2016-17 State of Housing Microfinance

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Introduction to the report

Habitat for Humanity's Terwilliger Center for Innovation in Shelter is pleased to present *The 2016-17 State of Housing Microfinance*, the third edition of our housing microfinance sector report. As advisers to financial service providers on the development and expansion of housing microfinance products and as sponsors of the first housing microfinance investment vehicle, the MicroBuild Fund, we have had a privileged view from which to gather insights on the trends and developments within the housing microfinance sector. From these insights, we continue to compile and contribute back to the sector best practices and key lessons learned. In 2014, we conducted the first survey of housing microfinance practitioners, to which 39 financial institutions contributed their data. The brief survey confirmed the practices, operational standards and challenges our field staff had observed in case-by-case research to be broadly characteristic of the market at large. The data provided a baseline against which we continue to explore sectorwide trends.

In 2015-16, we conducted our second survey, and the number of participating institutions increased to 83. The insights gathered from this survey confirmed trends identified in the 2014 edition and further explored key topics. Highlights of that report include the following insights:

- Housing microfinance products were introduced primarily in response to client demand, to achieve social impact, and/or for portfolio diversification.
- In practice, tenure security is viewed as a continuum of land rights, rather than a binary of formal versus informal, which enables financial institutions to serve clients who may lack formal tenure but are able to produce either a formal alternative or an informal proxy.
- Housing microfinance portfolios generally outperform traditional microfinance portfolios in both returns and lower delinquency ratios.

For the 2016-17 edition, the survey and subsequent report focus on the drivers of the business case for housing microfinance, specifically the market-level, institutional-level, product-segmentation-level, and profitability drivers that make housing microfinance a viable and attractive option for financial service providers. Throughout the report, we also explore emerging opportunities in the sector. It is our hope that in sharing both the trends observed in housing microfinance portfolios and the analysis of the drivers of the business case, more financial service providers will be able to identify the opportunity for such products within their own markets and develop or expand housing microfinance products that will enable millions of additional low-income households to acquire safe and affordable shelter. Relevant examples and additional information obtained through ongoing research by the Terwilliger Center contributed to the understanding of the trends and performance of housing microfinance portfolios.

About the 2016-17 State of Housing Microfinance Survey

Methodology

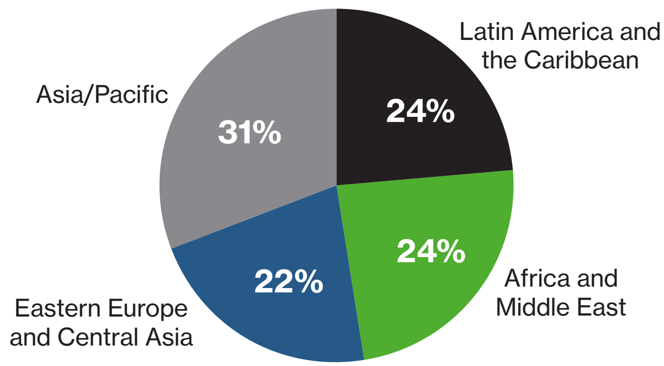
The 2016-17 State of Housing Microfinance Survey was implemented using the SurveyGizmo platform and disseminated directly to financial service providers with whom Habitat's Terwilliger Center has worked, and through various networks of influence in the field of microfinance. The survey was released Jan. 24, 2017, and officially closed May 17, 2017. The extended survey period allowed institutions to verify their end-of-2016 numbers before reporting. We received 101 unique responses. This is an increase in participation of 22 percent over the 2015-16 survey and 120 percent over the 2014-15 survey.

The 2016-17 State of Housing Microfinance Survey saw some restructuring and reframing of questions from prior versions. Questions around the cost and sources of capital, capital adequacy ratios, market position and other factors were added to deepen analysis of the drivers of the business case for housing microfinance products. The survey consisted of 45 base questions with additional logic-based questions designed to collect information on capital constraints, market development and technical assistance as relevant. The survey also provided opportunity for institutions to share qualitative information.

Regional representation

This year we were particularly pleased to find that responses represented a fairly even regional distribution. In general analysis, we will group responses from Africa and the Middle East as one region and the responses from Eastern Europe and Central Asia as a separate region, as seen below; however, we have separated out the subregions where relevant for the analysis conducted.

Figure 1: Regional representation in survey



Survey responses per region

Latin America and the Caribbean	24
Africa and the Middle East	24
Africa	*22*
Middle East	*2*
Eastern Europe and Central Asia	22
Eastern Europe	*18*
Central Asia	*4*
Asia/Pacific	31
Total	**101**

Regional segmentation reveals common trends specific to a geographical cluster, along with challenges and opportunities unique to specific regions. It should be noted that while this clustering may be indicative of wider regional trends, its application is limited to the countries represented in the survey. A full list of the countries represented and their frequency is provided in Appendix 1.

Institutional profiles of survey respondents

In the survey, institutions were asked to report their legal structure based on nine commonly observed types of legal entities in the microfinance sector. The largest of the reporting groups, comprising 30 percent of the responses, were nonbanking financial companies or institutions, or NBFC/NBFIs, with nongovernmental organizations, or NGOs, and microfinance banks comprising the second and third largest groups, respectively.

Based on our findings in the previous two editions of this survey, we do not expect housing microfinance to be the primary or exclusive offering of many financial institutions. Out of 101 responses, 93 institutions represent a broad array of offerings; however, it should be noted that eight participating institutions have an exclusive focus on housing. The following graph provides a general summary of the other products institutions frequently offer. Business loans are the most common offerings, with 92 percent of respondents offering short-term working capital loans, 84 percent offering other business loans, and 60 percent offering loans for longer-term fixed-asset investments. Sixteen percent report offering a loan product specifically developed for the agricultural sector. These products all fall within the traditional concept of microfinance for income-generating purposes. Non-income-generating products were not absent from product reports; however 67 percent of institutions offer consumption loans,

Figure 2: Survey participation by institutional type

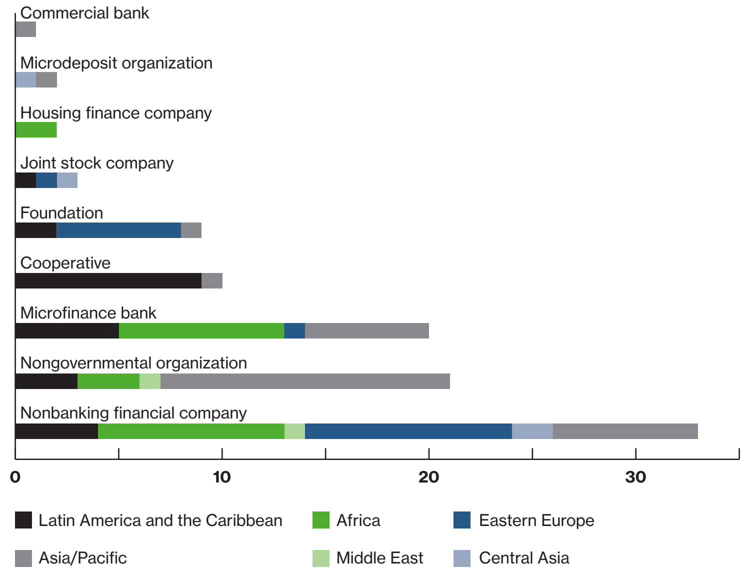
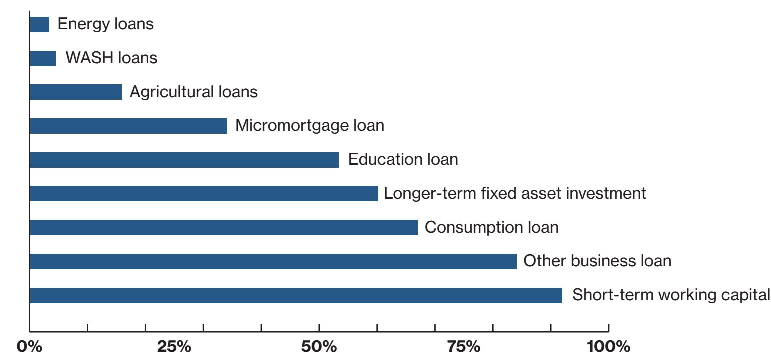


Figure 3: Other microfinance products offered



and slightly over half of respondents offer education loans. Micromortgages, WASH (water, sanitation and hygiene) loans, and loans for energy-related purposes all fall under the umbrella of housing-related products, but it is worth noting their presence as distinct products.

Our dataset represents not only a wide array of institutional types, but also a wide array of institutional sizes. Of the institutions that participated in the survey, 59 percent reported total assets (in US$) of under $25 million, and about a quarter of these (14 percent of all participants) reported total assets under $5 million. On the opposite end of the spectrum, 28 percent of respondents reported greater than $75 million, and 4 percent reported over $500 million in total assets.

While total assets represented a wide range, housing microfinance portfolios were consistently small across the range of reporting institutions. In the second edition of the survey (2015-16), we found housing microfinance portfolios on average represented 16 percent of institutions' overall portfolios, though 5 percent was the most frequently reported amount. In the 2016-17 survey, we reframed the question to provide better distinction among portfolios and asked institutions to report the size range of their housing microfinance portfolios, their general microfinance portfolios, and their gross loan portfolios. We found that as a percent of gross loan portfolios, housing microfinance portfolios account for 5 percent or less in at least 30 percent of institutions, with the number likely even higher. Close to half of the institutions reported housing microfinance portfolios of less than US$1 million, with 70 percent falling under US$5 million (Figure 5).

Figure 4: Total assets in millions of US$

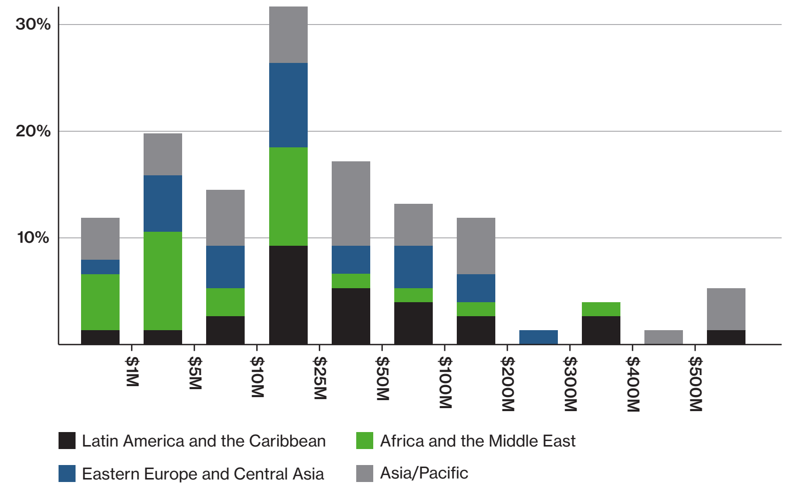
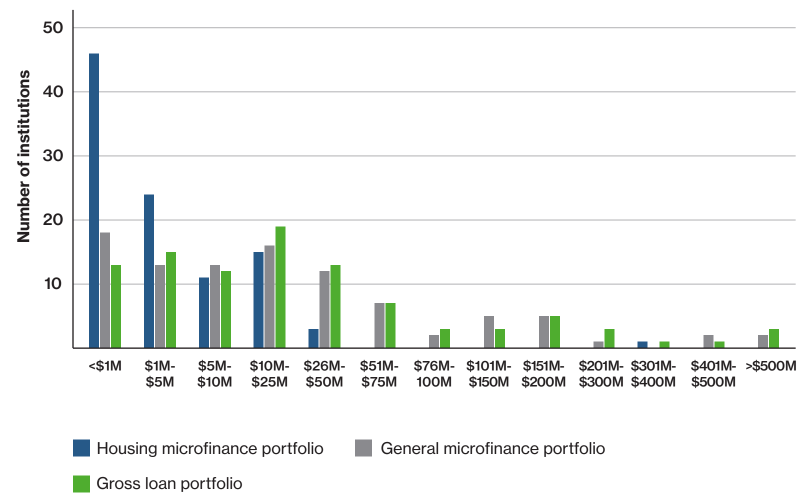
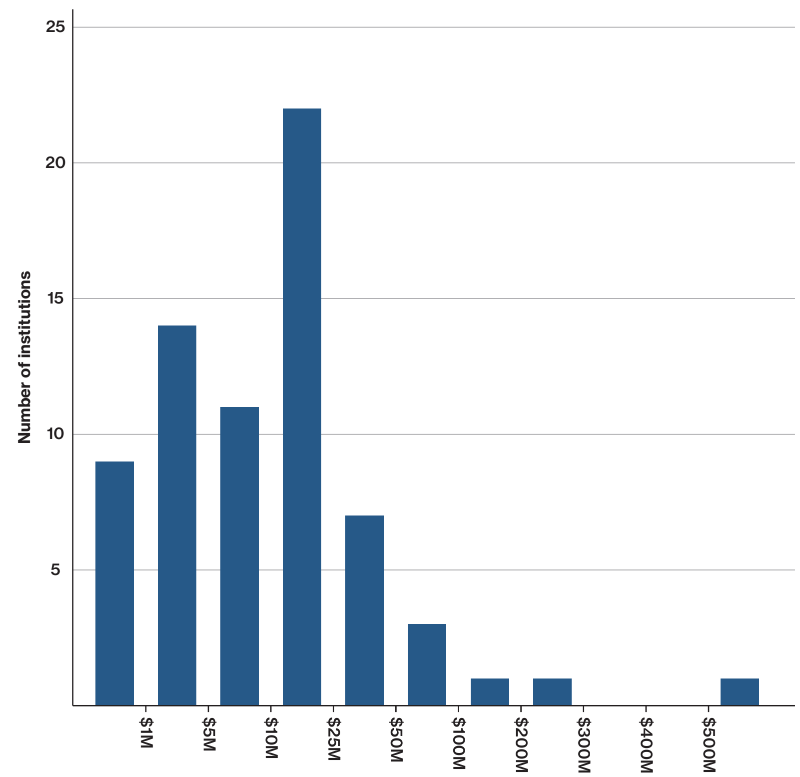


Figure 5: Portfolio size in millions of US$



Further segmenting this out, we looked at the size (in terms of total assets) of the institutions that reported housing microfinance portfolios of less than US$5 million. The institutional size of this segment ranges from less than US$1 million to greater than US$500 million (see Figure 6). Ninety-four percent of these institutions fall under US$75 million in size, while the most frequently observed institutional size was between US$10 million and US$25 million, followed by between US$1 million and US$5 million. These figures indicate that outside of a few well-known success stories, housing microfinance remains nascent.

Figure 6: Total assets of institutions with housing portfolios under US$5 million



What does the opportunity for housing microfinance look like?

The global affordable housing gap is estimated to swell to 1.6 billion people by 2025, largely driven by rapid urbanization (McKinsey Global Institute, 2014). The markets where this rapid urban expansion is happening are faced with lacking regulatory environments, an inadequate supply of affordable units, and a dearth in financing options available to support the incremental building process used by the majority of the developing world to build a home. A report from World Bank on housing finance across countries shows that mortgage depth and housing loan penetration is very low in low-income countries, suggesting that housing finance is a "luxury" segment of the financial sector.[1] Low and often unsteady incomes, coupled with lack of tenure security or limited land rights, raise the risk profile of low-income households such that most are excluded from traditional mortgage markets.

This failure of the formal housing market, evidenced by only 3 percent (on average) of the global population having an outstanding mortgage, demonstrates the need for other financing options that consider not only the incremental building patterns of low-income households but also their borrowing capacity and the other roadblocks that prevent them from building shelter and improving their housing conditions.[2] Shorter-term, unsecured financial products, characteristic of many traditional microfinance products, seem well-poised as a solution to this market constraint. For this reason, though institutional types surveyed may vary, we have in most cases specified that institutions report performance metrics on both their housing products and their general microfinance portfolio. By comparing against relatively familiar products, we hope to relate the viability and potential opportunity dedicated housing microfinance products may have as part of the gross loan portfolio of financial institutions.

Growth of the housing microfinance sector

Globally, the microfinance sector continues to display growth. Mix Market estimated that the number of borrowers worldwide grew by 15 percent to 130 million in 2014-15. This figure represents only 20 percent of the population that could benefit from a microfinance product, indicating continued demand and potential for strong growth. This trend is important in the discussion around the place of housing microfinance in portfolios because of the diversion observed in the microfinance sector of traditional microfinance loans into housing. In fact, housing is mentioned, along with education; health; and business formation, operation and expansion, as one of the main motives in developing countries for taking out a new loan from any financial institution.[3] This provides evidence that a current need is not being met by the existing supply of financial products. An opportunity then exists for more financial institutions to provide dedicated loans toward housing for low-income households.

Indeed, the Terwilliger Center has observed the microfinance sector increasingly pursue the introduction of dedicated housing microfinance products. The results of the 2016-17 housing microfinance sector survey indicate that 35 percent of housing microfinance offerings began within the past five years, 68 percent within the past decade, and 85 percent within the past 15 years. This trend reveals an initial sluggishness in the introduction of housing microfinance products yet highlights the potential relevance of such portfolios as demonstrated by more frequent introduction of housing microfinance products beginning around 2005.

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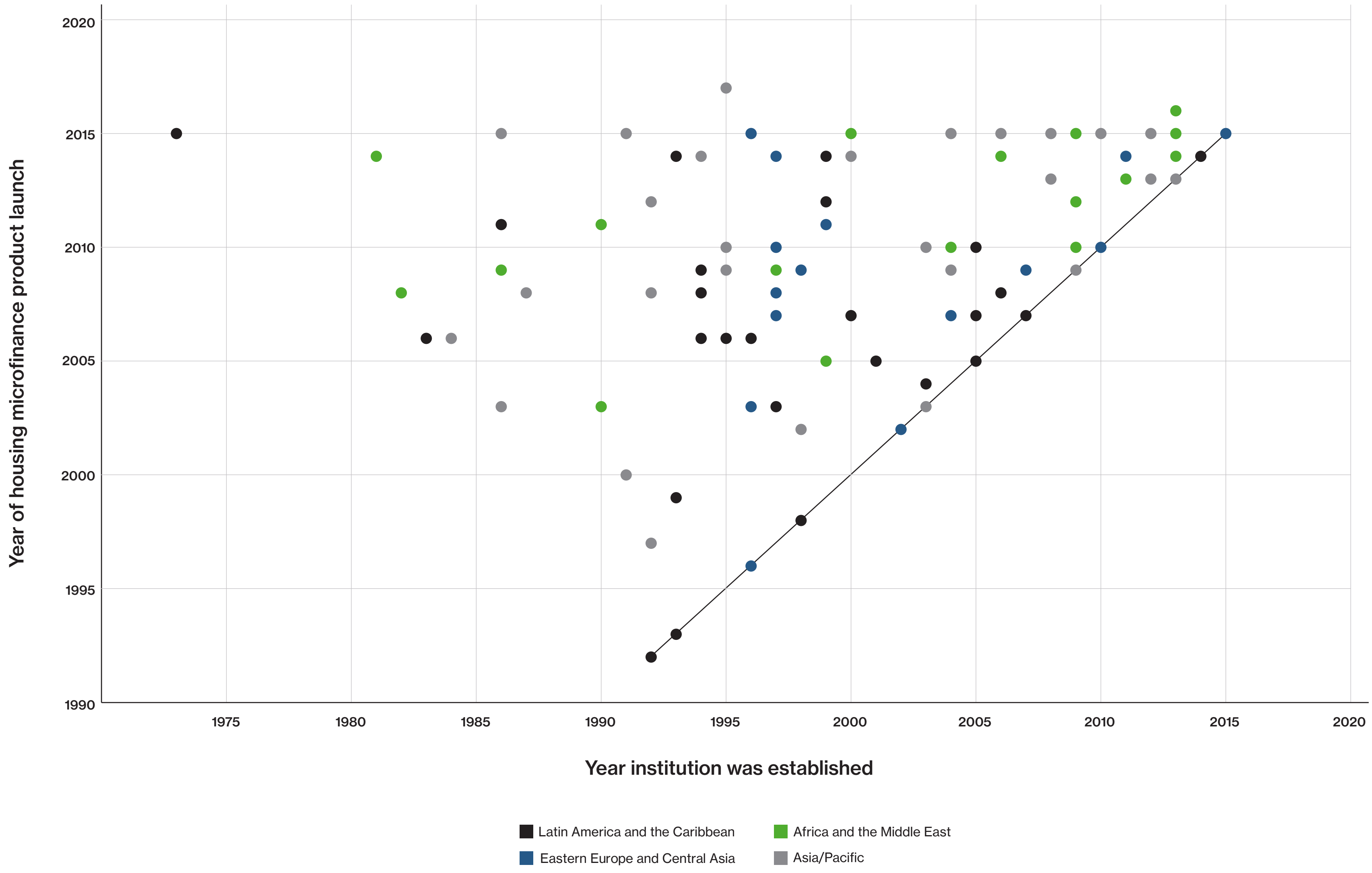
1. Badev, Anton; Thorsten Beck; Ligia Vado; and Simon Walley. "Housing Finance Across Countries: New Data and Analysis." The World Bank Development Research Group, January 2014.
2. Demirguc-Kunt, Asli, and Leora Klapper. "Measuring Financial Inclusion." The World Bank Development Research Group, April 2012.
3. ResponsAbility Investments AG *Microfinance Market Outlook,* 2016.

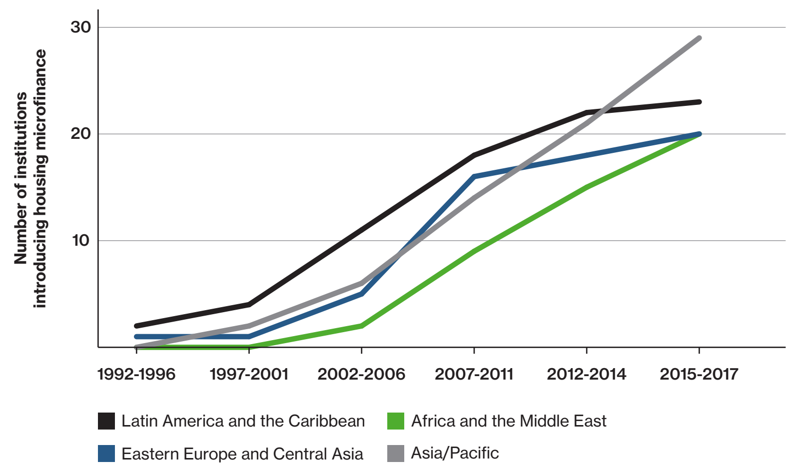
Figure 7: Introduction of housing microfinance product versus year of organization's founding



Based on our dataset, financial service providers in Latin America and the Caribbean were early adopters of housing microfinance products; the oldest offering in our dataset was introduced in 1992 in El Salvador. Latin America and the Caribbean led introduction of housing microfinance products in nominal terms, peaking around 2012, but the introduction of housing microfinance in Asia and the Pacific quickly followed. The solid line in the chart on the facing page reflects institutions that introduced housing microfinance products in the same year the institution launched, about 16 percent of total reporting institutions. The farther left on the horizontal axis, the greater the time gap between the institution's formation and the introduction of housing microfinance products. Roughly 41 percent introduced housing finance products within the first five years of the organization's founding.

Responses from Eastern Europe and Central Asia revealed an interesting trend of rapid growth between 2001 and 2011 and a notable tapering off after 2011. Globally, the number of financial institutions offering housing microfinance products nearly doubled between 2006 and 2011. Though growth was slow in the earlier periods, both the Asia/Pacific region and the Africa and the Middle East region have experienced steady growth since 2002. At present, growth appears to be strongest in the Asia/Pacific region, and within our dataset Cambodia and the Philippines seem to be driving this uptake. This pattern is in sync with the 2017 growth estimates for micro-, small and medium enterprise, or MSME, microfinance markets, which also put Asia/Pacific at the lead with estimated growth between 20 and 30 percent.[4]

Figure 8: Introduction of housing microfinance products



4. ResponsAbility. *Micro and SME Finance Market Outlook 2017.* 2016. Page 17.

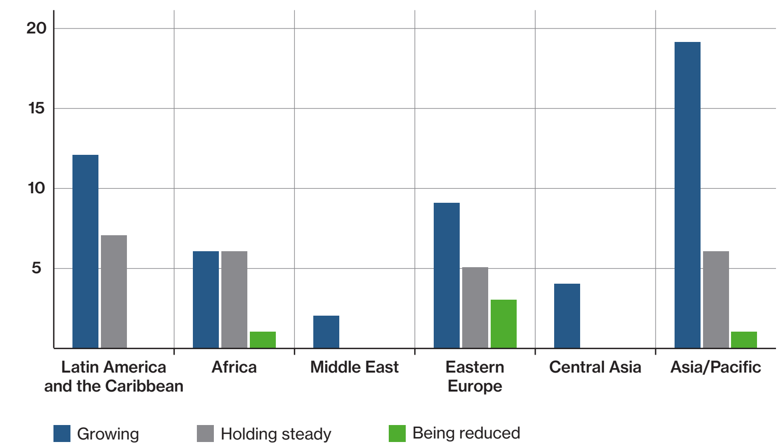
Although the timeline of product introduction provides some insights into the business case for housing microfinance products, it must be noted that the introduction of housing microfinance does not necessarily mean that every institution has introduced a dedicated housing product. In an attempt to foster inclusivity and thereby collect a greater amount of data on the availability of housing microfinance products, the questions in the 2016-17 survey were intentionally vague about this aspect. However, to drill in more specifically on the adoption of dedicated housing microfinance products, we asked our respondents what microfinance products they offered. Ninety-two percent confirmed that they offer a housing-related microfinance product. In addition, one institution indicated offering micromortgage loans exclusively. For the rest, we can assume that they do indeed provide financing for housing-related needs based upon answers to additional questions in the survey; however, they may extend this financing through asset-based loans, consumption loans or another category of loan product. Anecdotal evidence from the fieldwork of the Terwilliger Center's staff has revealed that, in some countries, financial institutions are restricted from listing housing microfinance products as such and must instead report them as asset-based products.

Additionally, it should be noted that the broadest description of housing microfinance incorporates a wide range of housing-related loan uses, including purchase of a home, additions or renovations, and minor construction, in addition to complementary goods such as electrical connections, solar power or the addition of water tanks. Crossover, therefore, may exist between housing microfinance and water, sanitation and hygiene or energy products. Some institutions distinguish between these, while others do not. The 2016-17 survey included questions to distinguish between these products and offerings where necessary.

Demonstrated viability of housing microfinance products

One indicator of the viability and market opportunity for housing microfinance products is their growth relative to the growth of the overall portfolio. About 10 percent of survey respondents indicated an exclusive focus on housing, so excluding these from the analysis, we find around 64 percent of institutions report their housing microfinance product to be growing relative to their overall microfinance portfolio. An additional 30 percent reported their housing microfinance products to be holding steady relative to the overall microfinance portfolio, while the final 6 percent reported their housing microfinance products were declining as a percentage of their overall microfinance portfolio. To understand this trend further, we broke the information out by region (Figure 9).

Figure 9: Growth of housing microfinance as percentage of overall microfinance portfolio



Segmented by region, the data indicate that growth is strongest in Asia/Pacific; this growth is attributed mostly to growth in Cambodia (28 percent), the Philippines (28 percent) and India (22 percent). Most of the institutions reporting growth in Cambodia are microfinance banks, while NGOs are the leading institutions reporting growth in the Philippines. The responses from India were split evenly between NGOs and NBFCs. In Latin America and the Caribbean, the strong growth is reported from numerous countries, but Peru stands out.

If we segment by type of legal entity, nonbanking financial institutions, microfinance banks and NGOs reflect higher levels of growth, with around 68-69 percent indicating housing microfinance portfolios to be growing versus the global average of 64 percent of institutions reporting housing microfinance portfolios to be growing. In contrast, only 56 percent of cooperatives and 50 percent of foundations report growth relative to overall microfinance portfolios. This lower percentage of institutions indicating growth is likely related to the capital funding structure, the lending methods used, and the fit of housing microfinance products within the institutions' overall mission; all of these are factors that the Terwilliger Center, based upon its work in the field, has identified as relevant contributors to the growth of housing microfinance portfolios.

Averaged globally,

64%

of housing microfinance providers report their housing microfinance portfolios are growing as a percentage of their overall portfolio.

Defining the business case for housing microfinance

The information in the previous section indicates that on a global level housing microfinance is increasingly recognized by financial service providers as a valuable addition to their portfolios. Initially, however, the incorporation of a dedicated housing finance product may be perceived as daunting and unfamiliar – requiring expertise in housing construction, building codes and mortgage markets – and therefore outside the scope of the financial institutions' traditional microfinance product offerings. However, for many institutions, housing microfinance loans represent only a moderate adaptation of existing lending products and practices, tailoring these to the incremental building process. In fact, most financial institutions, before launching a housing microfinance product, recognize that their clients frequently use or divert funds borrowed through existing product lines to finance housing construction. A greater challenge lies in how housing microfinance is perceived and communicated to clients by the staff members who sell the product. The success of a housing microfinance product relies on establishing a clear business case for developing and growing a dedicated housing microfinance product or portfolios of housing microfinance products, rather than continuing to allow diversion of traditional microfinance loans to meet clients' housing needs.

A compelling business case must answer the following questions:

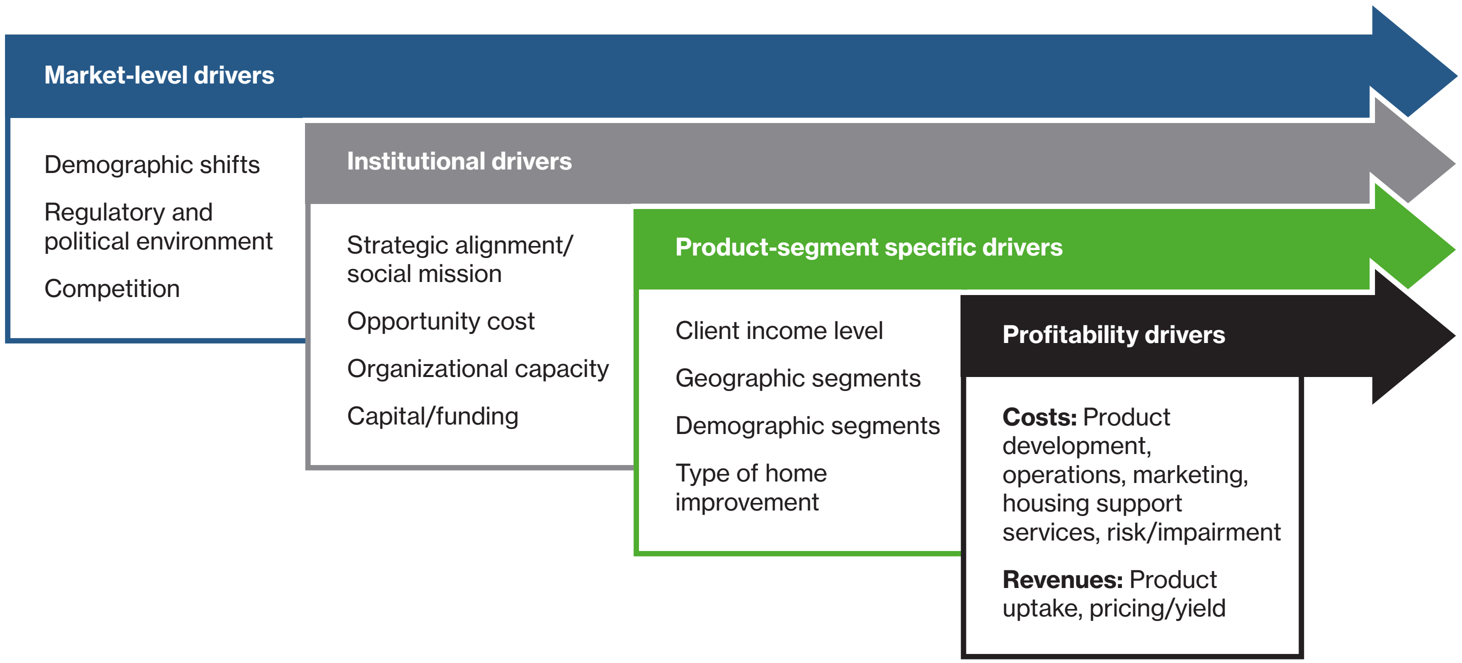
1. Why should the financial institution offer a housing microfinance product? More specifically, does this product make good business sense for the financial institution, and if so, how?
2. What are the differentiating features of a housing microfinance product that make it a winning product both within the institution and within the broader housing finance market?

To address these key questions, the business case must take into account market conditions, institutional realities and the financial institution's financial goals. It is also important to clearly identify which low-income market segments will be or are currently served by the housing microfinance product and the changes or adaptations to existing lending practices that might need to be considered to increase the potential success of such products.

The following framework was adapted to guide financial institutions in building a robust business case for their housing portfolios.[5] The Terwilliger Center applied this framework in recent analysis of the business case for the housing microfinance products of two African financial institutions.[6] This framework will be used to guide the analysis of the 2016-17 survey findings. The following sections cover each of the main categories of drivers and present a review of the data provided by financial institutions as it relates to these various components. Our hope is that the information in the following sections will not only provide insights valuable to financial institutions in the launch and expansion of housing microfinance products, but also compel investors and other housing and finance sector stakeholders to continue expanding housing microfinance portfolios that enable low-income groups to improve their housing conditions.

5. The framework was adapted from drivers highlighted in *The Business Case for Youth Savings.* 2014. CGAP. Note 96.
6. A report on this analysis is forthcoming and expected to be released in late 2017.

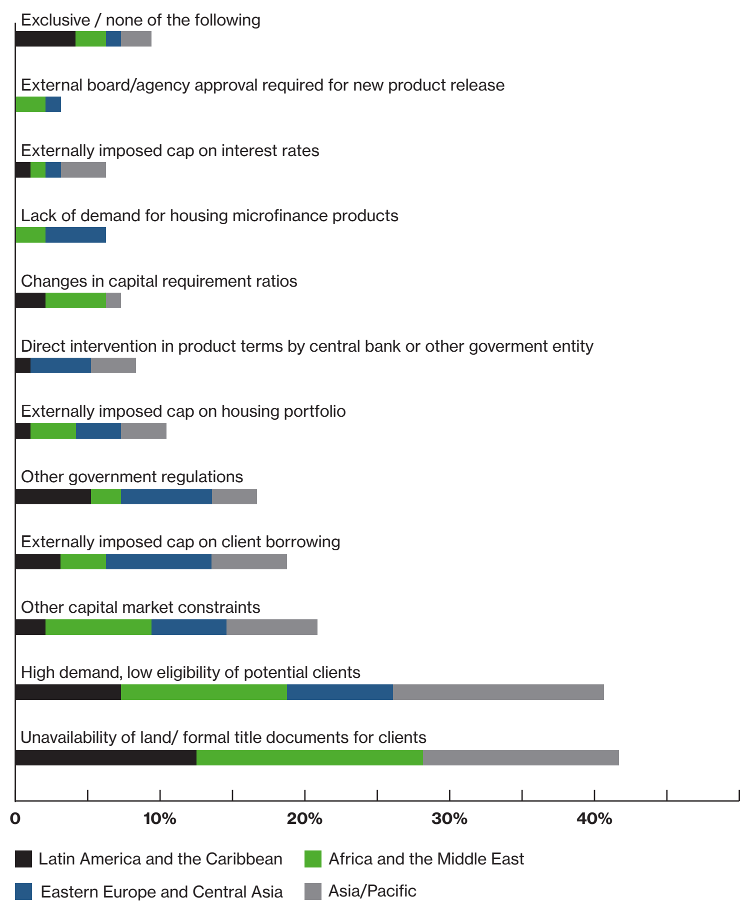
Figure 10: Framework for understanding the business case for housing microfinance



Market-level drivers of the business case for housing microfinance

A key determinant of the success of a housing microfinance product is an institution's understanding of the market opportunity for the product and the competitive environment within which the institution operates. A variety of macroenvironmental factors can affect the feasibility of introducing and scaling up a housing microfinance product, including demographic changes and consumer demand, global and national economic trends, regional and political stability, and policies and regulations that can favor or constrain the addition of housing microfinance portfolios. In this section, we will explore key demographic shifts, regulatory concerns and the competitive landscape for housing microfinance products. The following graph provides a brief snapshot of the market constraints identified by the institutions that participated in the 2016-17 housing microfinance sector survey.

Figure 11: Market constraints to scaling housing microfinance portfolios



Demographic shifts

The United Nations estimates that by 2030, almost 60 percent of the world's population will live in urban areas, and 95 percent of urban expansions will take place in the developing world.[7] It is expected that by 2025, Asia's urban population will increase by 1.4 billion, Africa's by 0.9 billion, and Latin America and the Caribbean's by 0.2 billion. Since countries in Asia, Africa and Latin America will experience the fastest growth in urban populations, they will also pose the greatest development challenge in terms of demand for housing. The combination of this demographic shift, poor or nonexistent land ownership policies, and insufficient resources has resulted in an explosion of slum creation and further deterioration of living conditions.[8]

7. United Nations. "Goal 11: Make Cities Inclusive, Safe, Resilient and Sustainable" 2017. http://www.un.org/sustainabledevelopment/cities
8. Habitat for Humanity. "The Shelter Report: Step by Step Supporting Building through Housing Microfinance." 2014. p 8.

While these estimates are staggering, financial service providers should take note of the phenomenal opportunity this presents for those prepared to address the challenge through provision of housing microfinance products and services designed for this low-income, urban population. A 2014 study by the McKinsey Global Institute estimates that meeting the increasing global demand for urban housing from low-income households would cost a total of US$2.3 trillion by 2025, representing additional revenues of approximately US$200 billion-250 billion annually for the construction industry.[9] Estimates for the financial services sector have not been made, but would reasonably be considered to represent a significant portion of the US$2.3 trillion.

Regulatory and policy environment

Another critical element in understanding the market opportunity for housing microfinance products is the regulatory and policy environment shaping the housing finance market in a country. Regulatory considerations include constraints on institutional lending, the rule of law and enforceability of land tenure documentation, and housing quality standards, which can affect the incentives for financial institutions to introduce a housing microfinance product. For the purposes of this analysis, we will divide our assessment between the demand-side constraints and the supply-side constraints.

Demand-side constraints

Demand-side constraints represent the two most frequently reported market constraints to the scalability of housing microfinance products (see Figure 11): unavailability of land or formal title documentation and low eligibility of potential clients despite high demand. Unavailability of land or formal title documents is seen as a constraint to scaling up a housing microfinance product by over 40 percent of the institutions in the study. Inability to demonstrate tenure security limits the resident's options for home improvements, can de-incentivize investment in shelter, and can exclude the resident from financial markets. The issue is reported by institutions in all regions except for Eastern Europe or Central Asia, likely because of the land redistribution policies that many former Soviet states implemented after World War II.

For the regions where this is a prevailing issue, institutions are addressing it by defining a range of acceptable formal/informal tenure documentation. This is no simple solution, as the types of tenure documentation available and recognized by the local legal system can vary widely by country. This is illustrated in Figure 12, which reflects the percentage of housing microfinance clients whom institutions estimated to be able to produce a formal title, formal title alternative or informal proxy documents as their highest form of documentation, or who could produce none of these. Thirty percent of institutions estimated that most of their housing microfinance clients (76-100 percent) would be able to provide a formal land title or formal title alternative. On the opposite end of the spectrum, only 3 percent of institutions reported that more than half of their clients would not be able to produce any of the documentation types about which the survey inquired. The institutions in between, however, demonstrate a mix of formal/informal documentation options producible by housing microfinance clients.

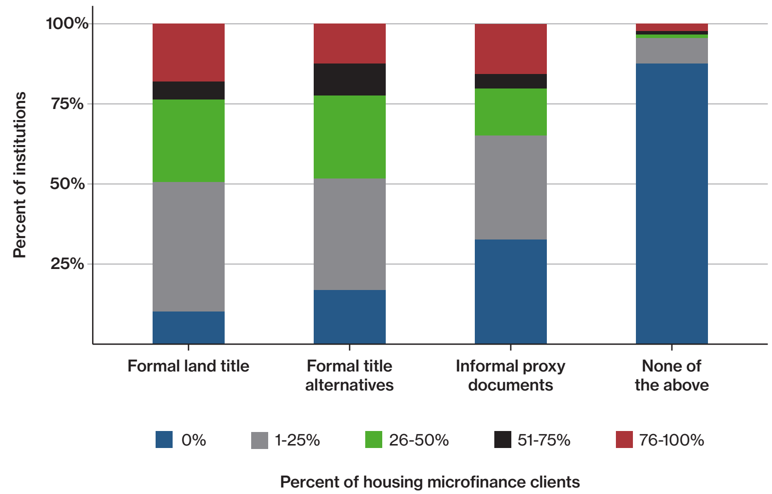
Financial service providers considering offering a housing microfinance product must be familiar with the local standards, and the low-income households' ability to meet these, in order to adequately price in risk. How this factors into product design will be discussed later in this report. For this

Woetzel, Jonathan; Sangeeth Ram; Jan Mischke; Nicklas Garemo; and Sirish Sankhe. "A Blueprint for Addressing the Global Affordable Housing Challenges." McKinsey Global Institute. McKinsey & Company. 2014.

section, we emphasize rather the importance of understanding tenure security of low-income households in the institution's country or region of focus. Some financial service providers will find that this is not an issue in their respective countries or region (as observed for Eastern Europe and Central Asia previously), but for others, this can significantly affect the feasibility and expansion potential for a housing microfinance product. Understanding whether formal titles or other formal documentation signifying tenure security are commonly available to low-income households, what informal alternative documentation exists, how commonly available they are, and the extent to which they are used within the housing sector are critical elements in assessing the market opportunity for housing microfinance products. Legislative reform seeking to improve the availability of recognized tenure documentation is under way in several countries, though the stage of reform varies widely.

Low eligibility of potential clients (but high demand) should also be carefully considered by financial institutions planning to add or expand housing microfinance product offerings. Housing affordability is a function of the price of a house and/or housing materials, the terms of the loan, and household income; in order to mitigate low eligibility, affordability must be considered if thinking about extending housing loans to low-income households. Affordability also needs to be considered from context to context and from household to household, and institutions may consider designing a menu of housing-related products that can meet the diverse housing needs of the differing affordability levels.[10]

Figure 12: Estimate of highest secure tenure documentation by percentage of housing microfinance clients



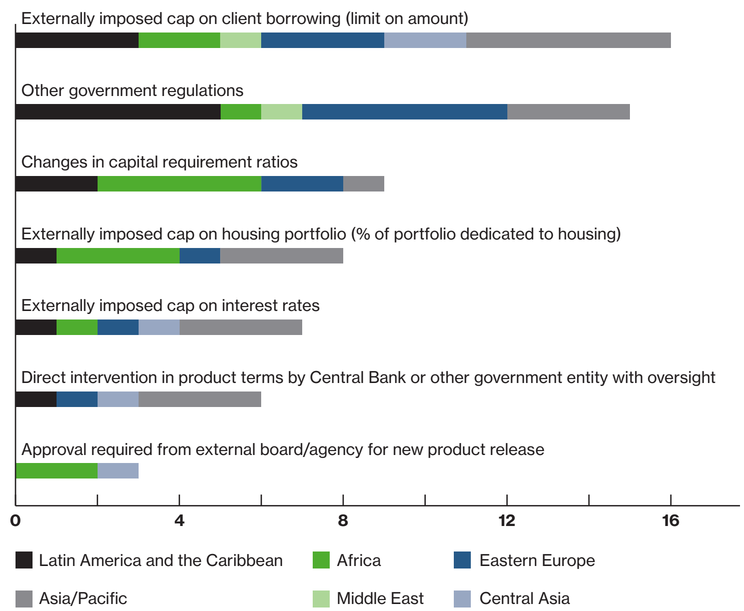
10. Center for Affordable Housing Finance. *Housing Finance in Africa: A Review of Some of Africa's Housing Finance Markets.* 2017.

Supply-side constraints

Constraints on the supply side of the market relate primarily to financial regulations and interventions from external agencies, whether originating from central banks or another organization with industry or sector oversight. Limitations here include caps on the size of a housing portfolio (as a percent of an institution's overall portfolio); caps on interest rates; prohibitive capital adequacy requirement ratios, or CAR; direct intervention by an external agency in the specific terms of a housing microfinance product; and any external approval required to release the product. While these regulatory requirements may not inherently be negative, they do bear consideration because of their ability to draw out the timeline for launch of a product, to reduce the profitability of the product, and to pose potential limitations on the scalability of the product, which then affects the growth strategy and prioritization of the product. Supply-side constraints are highlighted in Figure 13.

Two of the top three constraints are broad indicators and imply that capital market constraints and other government regulations not already specified pose a concern for a significant percentage of responding institutions. In terms of specific constraints, an externally imposed cap on client borrowing is the leading factor reported, posing a challenge for nearly 20 percent of responding institutions. We note this constraint is particularly high in Asia/Pacific and Eastern Europe. Externally imposed caps on percent of the portfolio that can be dedicated to housing are the second most commonly reported specific constraint, affecting 10 percent of reporting institutions. The subsequent constraints affect less than 10 percent of reporting institutions, but this is not to say that they are insignificant issues; rather the significance of these issues is evident in only certain markets. To illustrate this point, Figure 14 depicts the minimum capital adequacy ratios, or CARs, reported by 23 of the surveyed institutions.

Figure 13: Regulatory constraints facing housing microfinance providers



Most of the reporting institutions were cooperatives and microfinance banks, with a couple of NGOs, a couple of nonbanking financial institutions, one microdeposit organization, and one commercial bank reporting. Minimum CARs ranged from 4 percent to 150 percent. The majority of respondents reported minimum CARs of less than 20 percent, with the exception of the commercial bank, which reported a minimum CAR of 70 percent, and cooperatives in Mexico, which reported minimum CARs ranging from 20 to 150 percent. Excluding these exceptions, a simple, unweighted average results in a minimum CAR of 13 percent. When asked how the minimum CAR for the institution had changed over the past year, 25 institutions responded, with slightly over half indicating that CARs were increasing. Twenty-eight percent said CARs stayed the same, and the remaining 16 percent said they declined.

With only 23 percent of all survey respondents reporting these figures, however, and only a select few reporting a minimum CAR that varied significantly from other regions, the key takeaway is that for most institutions the minimum CAR is not a driving concern in considering adding or expanding a housing microfinance product. However, for certain institutional types and in certain countries, the minimum CAR may play a larger than ordinary role in defining the opportunity for a housing microfinance product.

Competitive landscape for housing microfinance

Before introducing a new product, firms must also consider the competitive landscape for the product or service they would like to offer. This includes the depth of financial inclusion, the development stage of the housing microfinance market, the respective institution's relative market position, and the array of products already on the market.

Figure 14: Minimum capital adequacy ratios (CAR)

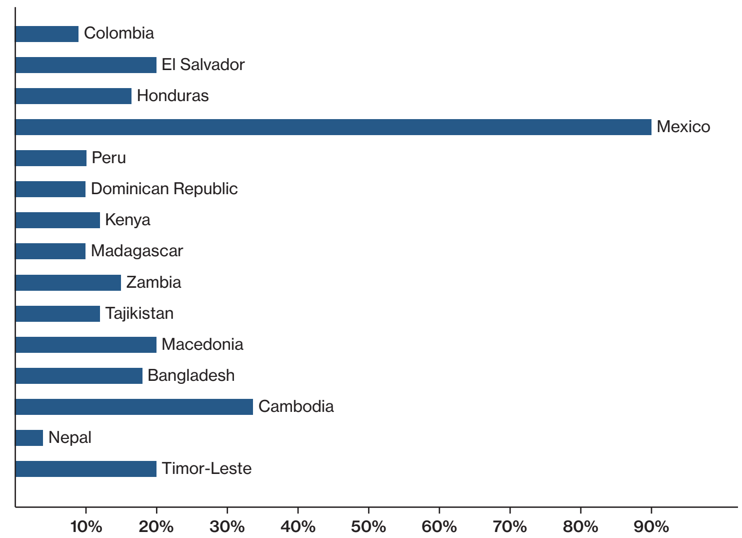
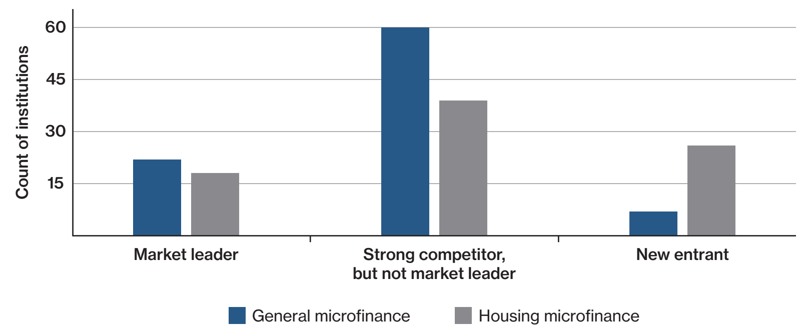


Figure 15: Market positions of global housing microfinance actors



Many financial service providers will already be familiar with the depth and breadth of financial inclusion for their market. Indicators to consider in determining the depth of inclusivity of the housing finance market include percent of population who are homeowners (particularly percent of lowest-income quintile who are homeowners); percent of low-income population who withdrew a loan for the purpose of buying a home, apartment or land; and percent of population holding a mortgage. As the availability of these indicators varies by country, proxy indicators may be necessary. Recommended proxy indicators include improved sanitation figures for both urban and rural populations and access to water and electricity, which are reported within the World Bank's Global Development Indicators. Any other statistics available on the national or local levels regarding construction purchases as a percentage of overall GDP or housing adequacy levels, particularly as they relate to the lowest two income quintiles, would also be useful in establishing a baseline for assessing the potential market for a housing microfinance product and the variation of the product that may present the greatest opportunity (e.g., a product supporting increased energy efficiency in heating solutions may be the best fit for some markets, while a construction-oriented product may be more appropriate for other markets).

Understanding the development stage of the local housing microfinance market is then a logical next step. Is the market in its infancy or firmly established? Are adaptations already present in the local market? Is the local housing microfinance market already saturated? Who is the market leader? And perhaps most unique to the introduction of a housing microfinance product, are there any other noncompeting market players that would become competitors if the institution entered the housing microfinance space (for example, a commercial bank versus a housing nonprofit)?

Figure 16: Market position of housing microfinance providers

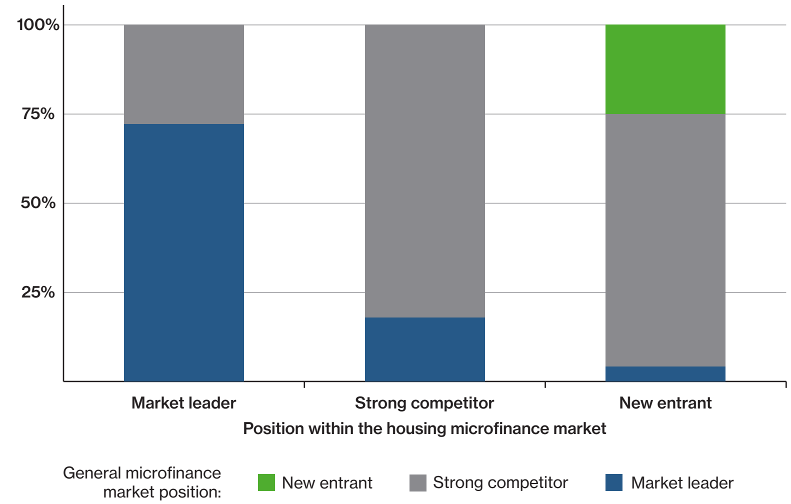
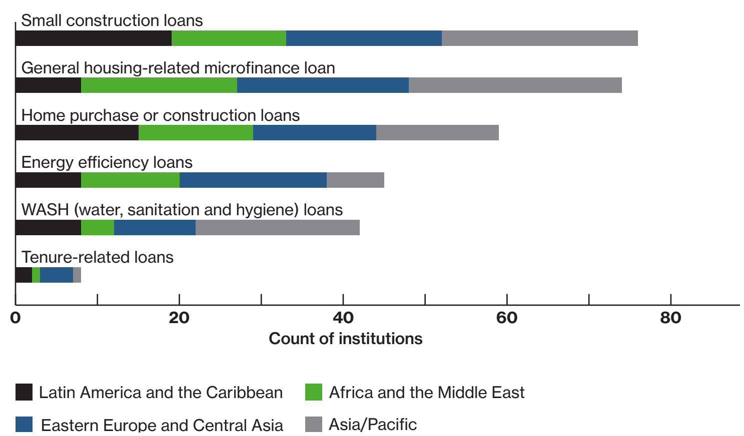


Figure 17: Commonly available housing microfinance products



In this year's survey, we asked institutions what they considered their market position to be within both the general and housing microfinance markets in their respective regions. About a quarter of the institutions reported themselves to be market leaders in the general microfinance market. An additional two-thirds reported that they were strong competitors, though not the market leader for their region, and the rest (about 8 percent) were new entrants to the general microfinance sector. For the housing microfinance sector, we find 22 percent reported themselves to be market leaders, along with 47 percent strong competitors and 31 percent new entrants. Regional breakdowns of the preceding data are provided in Appendix 2.

Comparing against self-reported positions within the housing microfinance market, we find that 72 percent of housing microfinance market leaders were also market leaders in the general microfinance market, while 28 percent were strong competitors, and no housing microfinance market leaders were new entrants to the microfinance market.

It is not surprising that market leaders in the general microfinance market most frequently assumed the market leader position in housing microfinance, as their size, market position, and organizational and institutional capacity can prove advantageous in venturing into new products or services that may pose higher risk levels. We will explore these institutional-level drivers in further detail later in the report. Financial institutions with an established position within the market could be better positioned to innovate with new products. These market leaders incentivize the expansion of housing microfinance products as late adopters follow their lead, thereby contributing to the expansion of the housing market at large.

Once a baseline market opportunity has been established and an assessment of competitors and relative market position has been conducted, an institution should consider the range and variety of housing microfinance products cur 75 percent of institutions confirmed general housing microfinance products to be commonly offered in their region, 77 percent confirmed that small construction loans are commonly available, and 60 percent confirmed home purchase or construction loans to be commonly available. While energy-efficiency loan products and loan products for water, sanitation and hygiene, or WASH, do not reflect the same levels of adoption, they do appear to be increasing in prevalence. Energy-efficiency loan products appear to be particularly competitive in Africa and the Middle East and in Eastern Europe and Central Asia. In Asia/Pacific, WASH loan products surpass products for home purchase/construction. Loan products for addressing tenure security are an emerging product segment, primarily in Eastern Europe and Central Asia, but also in Latin America and the Caribbean.

As mentioned before, a whole range of housing finance products can be developed while taking into consideration the affordability levels and the markets within which financial institutions operate. For instance, the Center for Affordable Housing in Africa is examining residential rental markets in five countries across Africa and found that in many cities the majority of households rent. Preliminary findings of the center's study also report that though the majority of rental housing is made of permanent materials, a significant proportion of renting households live in overcrowded conditions with poor access to water and sanitation.[11] These findings reveal a potential market opportunity for financial institutions well positioned within the markets to introduce housing microfinance offerings that can address the realities of urbanization and an evident market gap.

11. Center for Affordable Housing Finance. *Housing Finance in Africa: A Review of Some of Africa's Housing Finance Markets*. 2017.

Institutional drivers of the business case for housing microfinance

Identification of a market opportunity is fundamental for the introduction of housing microfinance, but the ability of a financial service provider to capture this market opportunity is determined by its strategic fit with the financial institution's mission and vision, and by the resources and capacity upon which the institution can draw. Introducing a housing microfinance product that can be scaled in a sustainable manner hinges on product alignment with the institutional mission and business strategy, opportunity cost considerations, organizational capacity to implement the product, and access to adequate capital sources.

Strategic fit for institutions

With evident growth of housing microfinance products within institutional portfolios, what is driving financial service providers to offer these products? Introduction of a new product requires assessing its alignment with the mission and business strategy of the institution. When asked to provide their top three reasons for offering housing microfinance products, 90 percent of respondents listed social impact, and 56 percent responded that they introduced the products in response to demand from loyal clients. Pursuit of portfolio diversification and attempt to tap into a new market or grow clientele bases were also top answers, at 40 percent and 39 percent, respectively (Figure 18). Institutions are validating missional alignment (social impact) and considering how the product contributes to the business strategy of the institution (retain clients or expand market).

The distinction between social mission and profits becomes a bit clearer if we segment by institutional types. Figure 19 summarizes the four main categories (for clarity, we have excluded the limited responses from the corporate bank, housing finance companies, joint stock companies and microdeposit organizations). For some motives, the contrasts are striking, while others are a

Figure 18: Top three reasons for offering housing microfinance

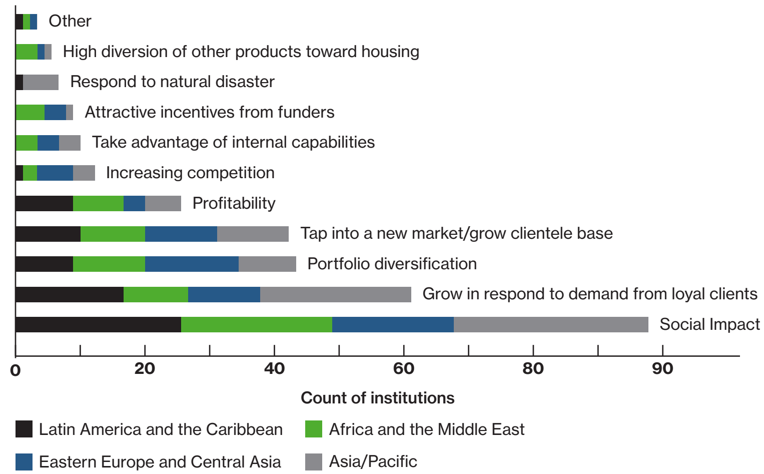
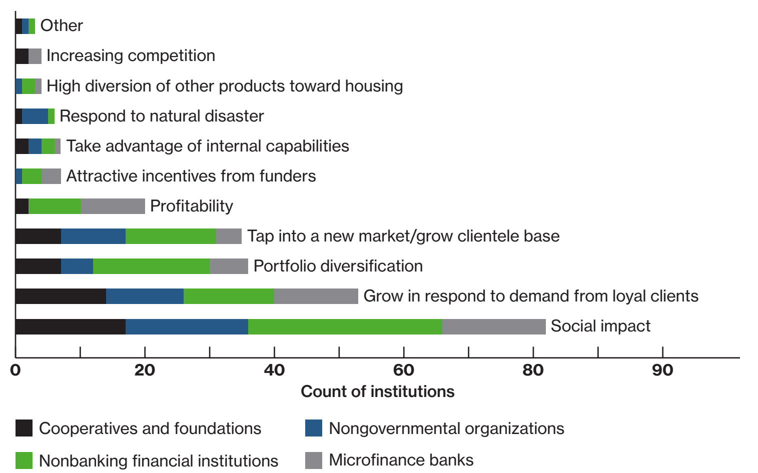


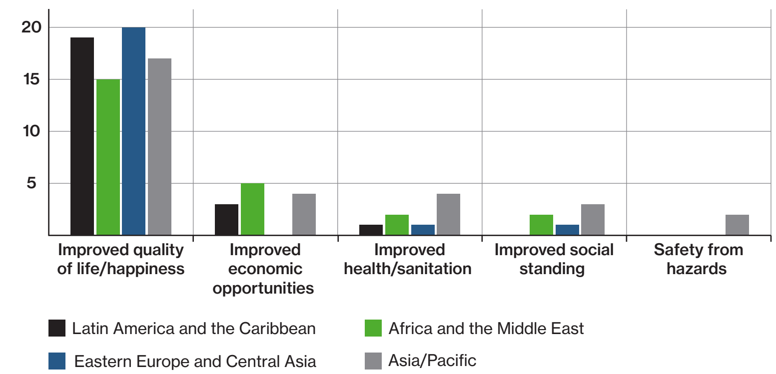
Figure 19: Top three reasons for offering housing microfinance



bit less clear. "Social impact" was the most frequently listed motivator across all institutional types in the chart (representing 84-95 percent of responses from each organizational type). For cooperatives and foundations, NGOs and microfinance banks, "growth in response to demand from loyal clients" was the second most frequently cited motivator. For NBFCs, however, the second most common motivator was portfolio diversification. "Growth in response to demand" tied with "tap into a new market" for third place among NBFCs and was very similarly ranked by NGOs, but in that case slightly surpassed "tap into a new market." For cooperatives and foundations, "portfolio diversification" and "tap into a new market" tied for third most frequently cited motivator. These may seem like subtle variations, and to some extent they are. However, a striking distinction is seen in the type of institutions and frequency with which profitability has been cited as a leading motivator. As would be expected, no NGOs cited profitability, while 53 percent of microfinance banks indicated profitability was a top motivator. In fact, profitability ranks third for microfinance banks. About a quarter of NBFCs and 11 percent of cooperatives and foundations cited profitability as a top three motivator.

Numbers fall off sharply after these five motivators, but there are a few additional distinctions to note. First, microfinance banks report "attractive incentives from funders" with greater frequency than any of the other institutional types; foundations and cooperatives are the only category, in fact, not to have at least one institution list this as a motivator. Additionally, NGOs account for 67 percent of institutions reporting "respond to a natural disaster" as a top three motivator.

Figure 20: Expected primary social impact of housing microfinance products



Alignment with mission

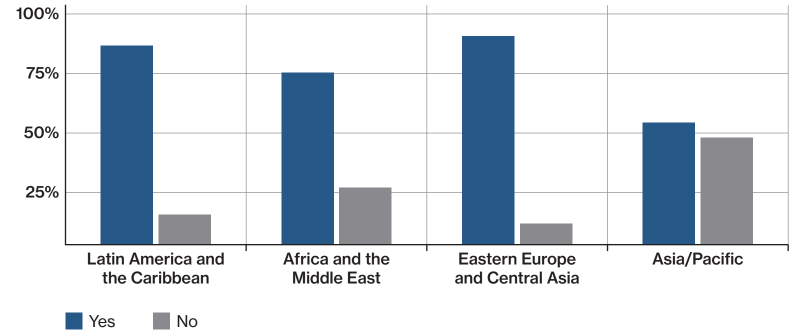
The dominance of social impact as a primary driver across the board is not particularly surprising. It is expected that most institutions serving the "base of the pyramid" would cite this, as they are characteristically driven by a compelling social need. Housing microfinance has, however, been touted as a conduit for profound social impact, largely based on the ancillary benefits of improved living conditions: reductions in illness based on a healthier environment, enhanced capacity for self-employed homeowners to expand their businesses, and more stable environments leading to improved educational attainments in children. To parse out whether any one of these reasons was driving the social impact alignment, we asked institutions what they expected the primary social impact of their housing microfinance products to be. The responses revealed a dramatic lean toward improved quality of life/happiness as the primary expected social impact.

Housing as a fundamental human right and its role in overall quality of life is increasingly being recognized on the global stage (Figure 20). As research on housing microfinance has accumulated, the aforementioned ancillary benefits are being validated. In a recent study in South India, commissioned by Habitat's Terwilliger Center, a sampling of clients from two financial institutions revealed increased sense of security and increased feelings of self-worth and pride as the main impacts of having accessed housing microfinance products, yet the breadth of these impacts depends widely on the region and each homeowner's situation.[12] Although the secondary outcomes are undeniably important, we hope that financial service providers, in their consideration of housing microfinance products, also recognize that these benefits enhance rather than validate the potential impact of safe and secure housing for low-income households.

Alignment with business strategy

Additional "top motivators" vary somewhat by region, but demonstrate on a broad level the various perspectives financial service providers hold on how housing microfinance products support their respective business strategies. Globally, the most commonly accepted driver appears to be retaining loyal clients, though the prioritization of this strategy versus others varies somewhat by region. In Africa and the Middle East, and in Europe and Central Asia, responding to client demand fell secondary to portfolio diversification. In Latin America and the Caribbean and Asia/Pacific, developing new markets surpassed portfolio diversification. Other notable motivators specific to a region include increasing competition in Europe and Central Asia, attractive incentives from funders in Africa and the Middle East, and responding to natural disasters in Asia/Pacific.

Figure 21: Availability of housing microfinance products to new clients



Over half of surveyed institutions (56 percent) indicated that retaining loyal clients was an important driver in their decisions to introduce housing microfinance products, while 39 percent were driven by pursuit of a new market/clientele base (Figure 18). Cross-analyzing these responses revealed that only 15 institutions selected both drivers. In trying to understand the implications of these drivers, a natural question is whether housing microfinance products are more often offered exclusively to current clients (supporting the idea of retaining loyal clients) or whether they are offered to new clients as well (supporting the development of a new market/clientele base).

Globally, we find that 75 percent of institutions offer housing microfinance products to new clients. We see some variance regionally, with Eastern Europe and Central Asia having the highest percentage of institutions offering housing microfinance products to new clients, while Asia/Pacific represents the highest percentage of institutions reporting restrictions in offering housing

12. Habitat for Humanity's Terwilliger Center for Innovation in Shelter. *The Impact of Housing Microfinance: An Independent Institutional and Social Impact Evaluation of Two Housing Microfinance Products in South India.* 2017.

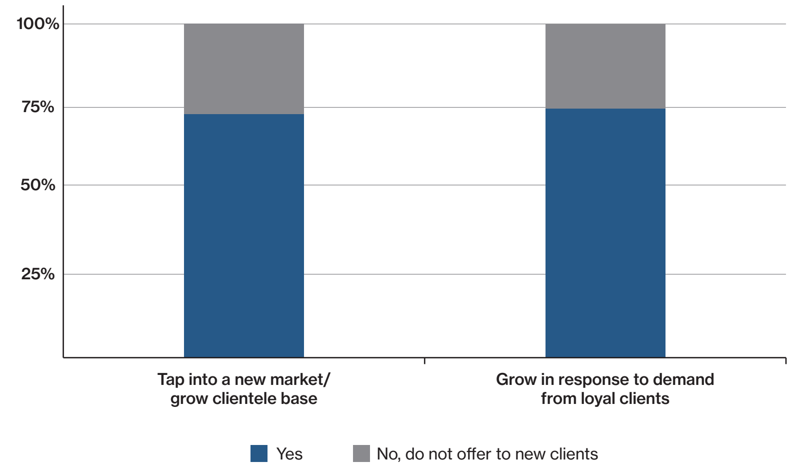
microfinance products to new clients. Most of the institutions restricting housing microfinance products to current clients are NGOs, with nonbanking financial institutions and microfinance banks accounting for the rest of this segment (one foundation reported this exclusion as well).

Restricting responses to only the institutions indicating either client retention or new market development as one of their top three drivers, we find the percentage of institutions offering products to new clients is roughly the same: 75 percent for client retention and 73 percent for market development. Interestingly, it appears that 10 of the institutions (or 27 percent) introducing the product for the purpose of tapping into a new market or growing the clientele base do not offer housing microfinance products to new clients. This implies that institutions may not be looking at client retention solely or even primarily as a way to offset risk, but rather as a strategic business development opportunity.

While only a quarter of the institutions in the survey cited profitability explicitly as a top three driver for housing microfinance product introduction, nearly all institutions indicated that some form of financial return was indeed expected. Financial return is most frequently attributed to interest rate margins, though about 30 percent attribute it primarily to cross-selling. We will explore this in greater depth in the later section on profitability drivers.

Of the 11 institutions in our survey that indicated that increasing competition was a top reason for introducing housing microfinance products, 36 percent were market leaders in the general microfinance market, and the rest were strong competitors. Though Eastern Europe and Central Asia had the most institutions per region that selected this driver, the only country in which we observe multiple institutions noting this driver is Cambodia. Housing microfinance appears to be a key strategy for maintaining market share and competitiveness.

Figure 22: Alignment of market growth objectives with outreach to new clients



This indicates that although housing microfinance products were initially thought of within the industry as a tool for retaining clients, the business case for housing microfinance as a differentiated product has moved the sector to consider the strategic value they add for portfolio diversification, new market development, and stronger competitiveness within markets.

Opportunity cost

A housing microfinance product can exhibit high potential for social and financial returns, but pursuit of this return does not come without some opportunity cost. Numerous considerations must be taken around the allocation of institutional resources for the development and implementation of a housing microfinance product. The trade-offs that must be made, or rather the opportunities forgone in the decision to proceed with the development of a housing microfinance product, are known collectively as the opportunity cost.

Box 1: Reducing opportunity costs in the Kenyan market

When Kenya Women Microfinance Bank, or KWFT, considered introducing a housing microfinance product, the Nyumba Smart Loan, it realized this product was potentially more complicated than its core business loan products and pushing it could result in lower issuance of more cost-effective products. To reduce this opportunity cost, it determined to streamline loan processes and limit the scope of nonfinancial construction technical assistance, thereby bringing the cost-effectiveness of the housing loan product into closer alignment with the institutions' other products. By charging similar rates and fees for the housing microfinance product relative to the institution's other microfinance products, KWFT was able to avoid diminished yields or internal competition with its other loan products. The Nyumba Smart Loan portfolio currently comprises just over 5 percent of the total loan portfolio, and the bank intends to grow the housing portfolio to at least 10 percent.

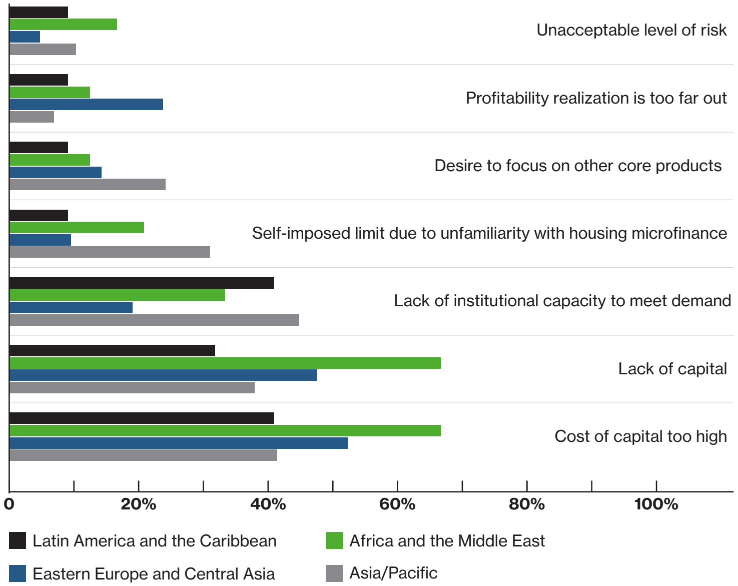
The severity of the opportunity cost may vary from institution to institution based on market context, but it generally originates in the same aspects across institutions: forgone financial returns and excessive administration or processing time. Regarding financial returns, a financial service provider considering introducing a housing microfinance product should consider how housing microfinance portfolio returns in the institution's market will compare with the returns of the financial institution's other products or with other products the institution could introduce. Second, and particularly if the potential portfolio returns are similar across products, the financial service provider should consider whether the staff time required for implementing a housing microfinance product exceeds the time required for implementing the organization's other products and how this difference may affect potential returns across the whole portfolio. Particular care should be given to the question of whether either of these two factors could lead to unhealthy competition with other products the financial institution is offering, whether directly through clients selecting a housing product over other products or because of a reduction in the time available for loan officers to implement more profitable products. The severity of these issues should be assessed early on so that they can be mitigated in the product design phase.

Organizational capacity and resources

To successfully introduce a housing microfinance product, a financial institution must take a critical look at its own capacity for implementation. The insights gleaned from the initial assessment of the market environment should confirm whether housing microfinance is appropriate given the institution's macroeconomic and regulatory environment and in line with the institution's strategy. However, a financial institution must have a minimum level of resources available, along with some aptitude for the nuances of housing, in order to successfully market, implement and monitor a housing microfinance product.

To provide practical insights from the field, we asked housing microfinance providers to indicate their perceptions as to the biggest constraints on their capacity to extend housing microfinance products. The responses are not mutually exclusive, so multiple constraints may hinder an institution's ability to scale up housing microfinance products. The responses reveal that close to half of all financial service providers faced capital constraints, whether due to lack of capital or a prohibitory cost of capital. In Africa and the Middle East and in Eastern Europe and Central Asia, capital constraints are the prevailing hindrance to the expansion of housing microfinance products. In Asia/Pacific, however, lack of institutional capacity is the most frequently reported limitation;

Figure 23: Operational constraints to scaling housing microfinance



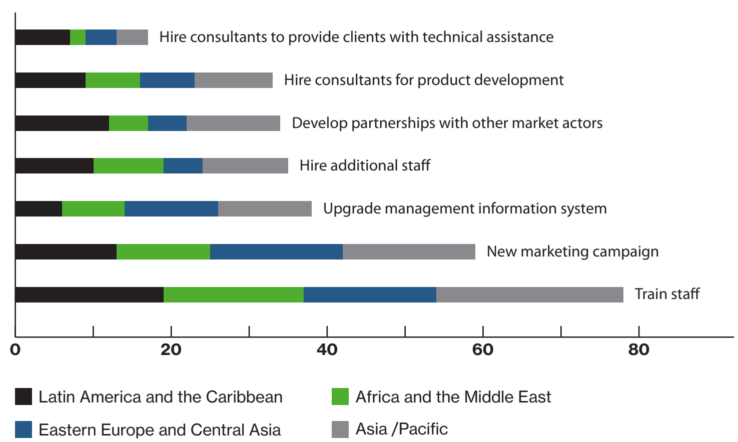
and in Latin America and the Caribbean, capital constraints and lack of institutional capacity were evenly ranked. Unfamiliarity with housing microfinance, along with the strategic choice to focus on core products, is observed most frequently in the Asia/Pacific region. These figures confirm findings from early research that presents lack of adequate capital and knowledge as the main constraints to implementing housing microfinance portfolios. This also reinforces the value of investment funds targeted at housing products for low-income groups, accompanied by a technical assistance component to support financial institutions in streamlining their processes and overcoming the barriers of offering a product with which they are unfamiliar. This type of strategic funding can enable an institution to fully realize the potential of housing microfinance for its portfolio and its local housing market.

Assessing institutional capacity

In order to better identify institutional capacity gaps specifically related to the introduction and implementation of housing microfinance products, we asked financial service providers what steps were necessary to prepare for the launch of their housing microfinance products. The findings reiterate one of the operational constraints already identified: lack of institutional capacity to meet demand.

Staffing concerns dominated the responses, with close to 80 percent of participating institutions indicating training staff as a key step to product launch, 37 percent having hired additional staff, and 36 percent having hired consultants for assistance in product development. This builds upon an earlier finding that the vast majority of financial service providers do not have staff dedicated specifically to housing, but rather use a multiproduct loan officer model for product implementation. The experience of the Terwilliger Center also supports these findings, as our own work in advisory services had

Figure 24: Steps to prepare for housing microfinance product launch



revealed common prioritization given to training staff. Some institutions, with whom the Terwilliger Center has worked, have incorporated “product champions” within their business model. These highly committed team members, convinced of the benefits of the products, are then used as performance benchmarks for other staff members in charge of selling the product. By internally positioning the housing product in this way, institutions are able to support loan officers in overcoming the challenges of selling an unfamiliar product that may require additional steps from promotion to loan origination versus more familiar loan products.

In addition to training staff, nearly 60 percent of respondents reported “launch of a new marketing campaign” as a key step. Other considerations included upgrading the institution’s management information system, developing partnerships with other market actors (such as architects, masons/*fundis*, construction materials suppliers, etc.), and hiring consultants to provide clients with construction-focused technical assistance.

Assessing capital resources

Findings at the market level have already indicated that capital resources are a key constraint for many financial service providers considering offering a housing microfinance product. In this section, we will explore further what this means on the institutional level, specifically in terms of the capital funding decisions made in regard to housing microfinance products.

The following chart displays the difference in the capital funding sources institutions have used for their housing microfinance products relative to their general microfinance portfolios. It should be noted that this graph looks specifically at the frequency at which these capital funding sources are reported versus their use for general microfinance portfolios, but does not attempt to weight this by composition of portfolios.

Figure 25: Capital sources – general microfinance portfolio vs. housing microfinance portfolio

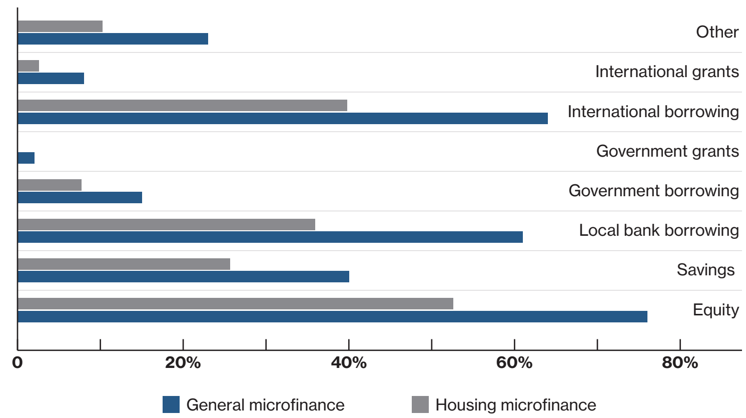
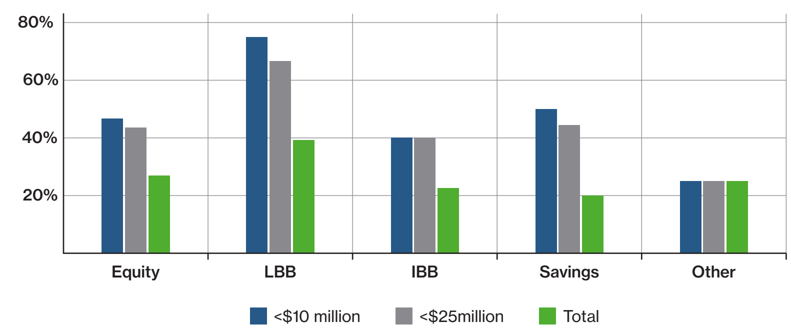


Figure 26: Use of singular capital funding type



We note that for the most part, the relative use of capital sources follows the same pattern for housing microfinance as it does for general microfinance portfolios. Equity is the most broadly used source, followed by international borrowing. Local borrowing follows in the ranking, and then savings. Government borrowing is used infrequently. One interesting point of variance, however, is the limited use of grants, whether international or government, for housing microfinance products.

While this perspective can make it appear that funding sources are used less for housing microfinance portfolios than for general microfinance portfolios, this is not exactly the case. Rather, the graph suggests that there is less diversity in the funding sources of housing microfinance portfolios than for general microfinance portfolios. That is to say housing microfinance portfolios are more likely to have a single type of capital funding as opposed to the myriad capital types seen in the capital structures of general microfinance portfolios.

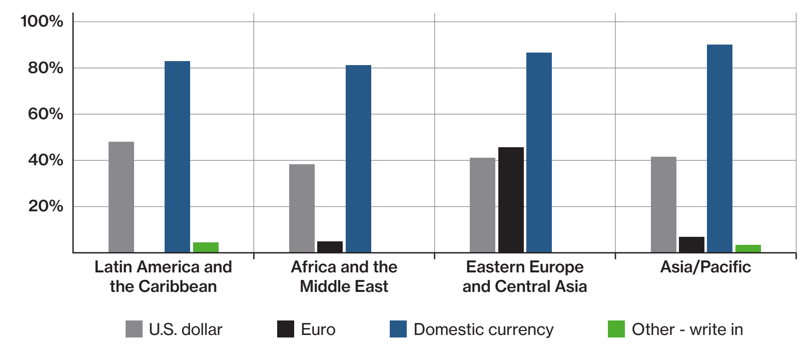
In fact, if we look at single-source funding, we observe more than three times as many housing microfinance portfolios funded with only one capital type versus general microfinance portfolios. Smaller institutions (in terms of total assets) are more likely to make this capital funding decision (see Figure 25). Looking at those institutions using equity to fund their housing microfinance products, we find that 27 percent have funded it exclusively with equity. This percentage increases if we segment the pool by institutional size: 43 percent of institutions under $25 million in total assets funded their housing microfinance product solely from equity, as did 47 percent of institutions under $10 million in total assets. The trend is even more dramatic for local borrowing, though it should be noted that this is not equalized by equity type (n = 41, 28, 31, 20, 8 for equity, local bank borrowing, international borrowing, savings and other, respectively). This makes sense when one considers that the process of introducing any new product typically involves a design phase and a piloting phase prior to scaling up the product, which an institution would likely fund with a single capital type or a rather limited mix. When product testing is completed and the focus turns to scaling the product, additional funding sources may be required. Exploring funding use by institutional type provided a few additional insights. Five out of eight cooperatives, which were almost exclusively located in Latin America and the Caribbean, funded their housing microfinance products with 90-100 percent savings. Eight out of nine foundations, which were prevalent in Eastern Europe, used equity to finance 50 percent or more of their housing microfinance portfolios. Where this represented a change in capital funding ratios, it was usually away from local or international borrowing. Microfinance banks demonstrated the most variety in funding ratio. A consistent funding pattern was not visible across the institutional types, but further segmenting by region revealed slight trends in some regions. For Africa, no pattern was visible, but microfinance banks in Asia/Pacific tended to shift funding from savings or equity toward increased levels of borrowing, whether local or international. For Latin America, only one institution reported a change in capital funding ratios. The other four institutions maintained the same balance as their general microfinance portfolio.

Looking next at NBFIs, which reported from across Africa, Asia/Pacific and Eastern Europe, we also observe a mix in strategies. The funding structure was commonly a mix of equity, local borrowing and international borrowing, but shifts between funding sources for general microfinance portfolios and housing microfinance portfolios were inconsistent. NGOs, which were concentrated in Asia/Pacific but also reported from Africa, Latin America and the Caribbean, and the Middle East, demonstrated a variety of funding sources, yet over half of the institutions fund their housing microfinance portfolios from a single source. Financial institutions from Asia/Pacific, which accounted for two-thirds of participating NGOs, demonstrated a remarkable trend toward local bank borrowing in both the Philippines and India. Around half of the institutions in Asia/Pacific financed their housing microfinance portfolios primarily through local bank borrowing, which comprised an average of 65 percent of their general microfinance portfolio, but 97 percent on average of their housing microfinance portfolios. This increase usually resulted in a decrease in borrowing against equity or savings. The rest of the NGOs generally trend toward reliance upon equity, though a few still use savings as well. This result is not surprising given that several exclusively housing-focused institutions fall into this category (including a few Habitat offices). Figures from Africa and the Middle East and from Latin America and the Caribbean were too few to extract any key regional trends.

Based on this data, it appears that institutions primarily rely upon a mix of equity, local borrowing and international borrowing. This mix may vary based on institutional type (cooperatives more likely to draw upon savings) or availability of preferable rates for institutional borrowing, whether local or foreign. Smaller institutions, however, tend to use only one type of capital source, which indicates potential opportunities for impact investors as institutions seek to diversify funding in scaling up their housing microfinance products.

Financial service providers also demonstrated a willingness to leverage growth of their housing portfolios through multiple currencies. Currency risk does not appear to be a widespread concern, as over 80 percent of institutions across all regions reported capital funding to be available in local currency. Around 38-48 percent of institutions in each region also report capital funding in U.S. dollars. Eastern Europe and Central Asia also show a significant intake of capital in euros, which is to be expected.

Figure 27: Currency of capital funding



Product segmentation levers that drive the business case for housing microfinance

Client segmentation

In order to understand market appetite for housing microfinance products, it is necessary to understand the target markets in greater depth than simply labeling the target population as "low-income." Based on the target market selected, an institution will face different risks, challenges and opportunities in developing a successful housing microfinance product. High-level segmentation common in the affordable housing sector includes rural versus urban households, female versus male borrowers, and salaried versus self-employed borrowers, among others. As the social norms, perceptions, needs and affordability levels of these segments vary, they are key factors to consider in the design of the product, the choice of marketing approach and distribution channels, and the expansion possibilities.

One aspect of this behavioral understanding that should not be overlooked is the intrahousehold decision process. This process reflects the fact that it is not only the voice of the client accessing the loan that matters, but also those of other household members who will influence how the loan will be used and what home improvements are prioritized. Another example of behavioral factors to consider is the variance observed in some countries between the building practices and preferred types of materials for urban households in contrast to rural households. The components that go into the home improvements and the processes and standards followed during construction or renovation are major determinants of housing quality standards. Regional differences in the standards and norms between urban and rural areas, and from country to country, can greatly affect the quality of the home.

Observations regarding the macroeconomic and regulatory environment are also important to consider here in terms of their relative effects on the various market segments. Some countries have systemic barriers to specific demographic segments of the population, which can severely impair the expansion of a housing microfinance product if overlooked or can pose a significant opportunity for growth if identified and addressed through innovative means. In some countries, for example, women face greater obstacles to obtaining tenure security. An opportunistic institution might decide to support clients in obtaining increased land security by offering a variation of technical assistance that focuses on these legal matters.

Understanding client income levels and sources

One crucial aspect to consider in developing any microfinance product is the average income of potential borrowers in the target market. National poverty lines and global poverty offer a variety of ways to define target markets based on income. For the purposes of this analysis, we chose to focus on whether the income level of housing microfinance borrowers differs dramatically from general microfinance borrowers. We want to understand whether financial service providers feel targeting a higher-income segment to be necessary or whether any have demonstrated an ability to serve a lower-income segment than they could through traditional microfinance products. Seventy-eight percent of financial service providers reported that their housing microfinance product targets clients with equal or similar income levels to their general microfinance clients. An additional 9.5 percent reported targeting clients with higher income levels (6.8 percent represented institutions in Asia/Pacific, and the other 2.7 percent in Africa), while 13 percent of financial service providers target clients with lower incomes for their housing microfinance products. This variance may relate to the varying size of housing microfinance products based upon use of loan, but for the most part we observe that client income segments remain on par with those of general microfinance products.

Traditionally microfinance has targeted microenterprises or self-employed individuals by offering an array of products designed for income-generating activities. Housing microfinance joins health and education products as part of a new wave of microfinance products that have been developed with a primary focus on the improvement of overall wellness. This focus may have a positive secondary effect on income-generating activities, but the financial model for

Figure 28: Income of housing microfinance clients relative to other clients

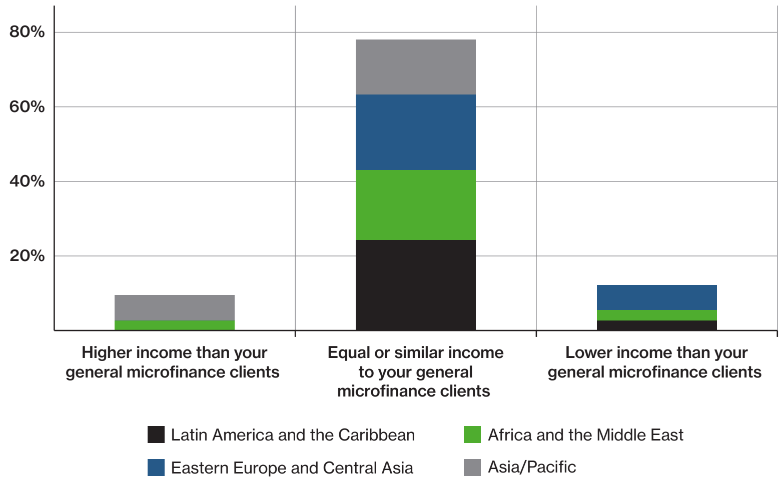
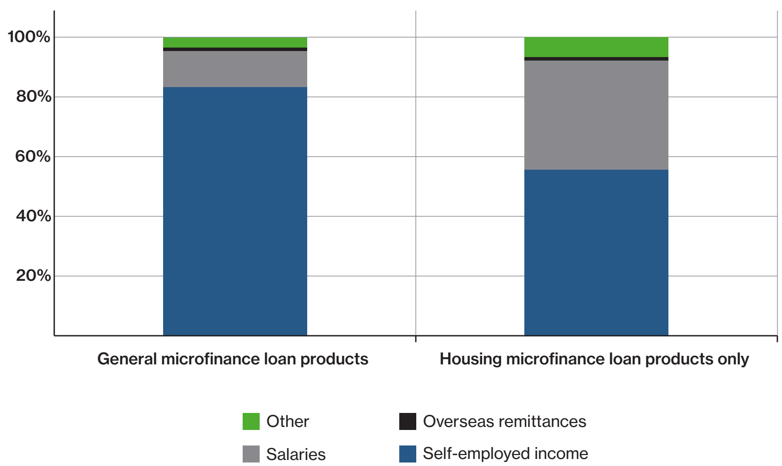


Figure 29: Source of client repayment



Box 2: Housing microfinance market niche – public-sector employees

Select Africa is a retail financial services group that operates in four countries of Sub-Saharan Africa – Kenya, Malawi, Lesotho and Swaziland – and is primarily dedicated to extending housing microfinance loans to unbanked public-sector employees. Select began lending in 1999, having identified low-earning civil employees as a stable, underserved market, and began securing loan repayments through direct payroll deductions. The institution soon discovered that clients were frequently using personal loans to finance housing. It addressed this diversion by developing a product tailored to support incremental housing construction, which entails larger loans (an average of US$200 in Malawi and US$750 in Kenya) over longer tenures (an average of five years). Select currently serves approximately 55,000 borrowers, and over 60 percent of its portfolio is invested in housing.

the product itself is not contingent on the success of an income-generating activity. In this way, housing microfinance presents an opportunity for institutions to expand their target markets to include nontraditional microfinance clients, such as low-income salaried workers (public officials are a good example of this) who face exclusion from traditional housing finance markets. However, the relatively stable income of this population segment proves attractive to financial institutions looking to offset the risk posed by self-employed borrowers. Figure 29 highlights the dramatic shift seen between traditional microfinance products and housing microfinance products by the opening of the market to low-income salaried workers.

Rural vs. urban implications

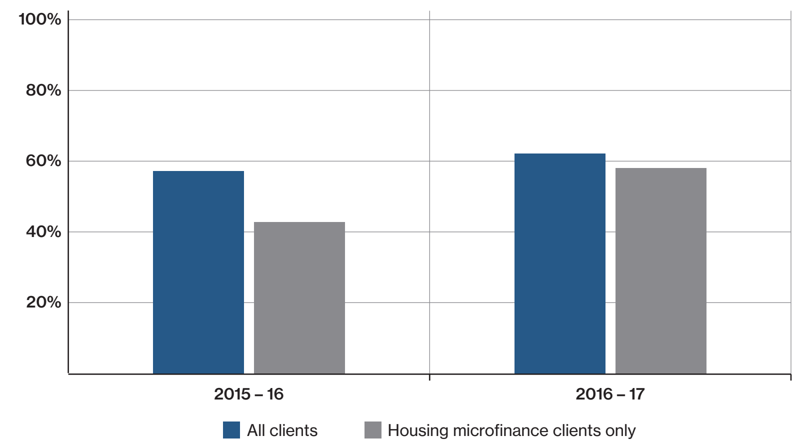
Figure 30 compares the average percent of the portfolio composed of rural clients as reported by institutions in the 2015-16 survey versus the 2016-17 survey. We observe an upward trend in the percentage of the portfolio composed of rural clients both for general microfinance portfolios and for housing-specific products. The housing microfinance portfolios, however, demonstrated a much stronger shift toward rural clients. This is somewhat surprising, given the aforementioned trend of rising urbanization and the increased demand for affordable housing it is expected to create.

Although rapid urbanization may be the indicator of future market demand, the data from the institutions who participated in the 2016-17 survey indicate that demand from rural markets should not be overlooked. Regional data regarding the percentage of housing microfinance portfolios represented by rural clients highlights the importance of the rural market segment for Asia/Pacific in particular. Over half of responding institutions in Asia/Pacific reported that rural clients comprised 81-100 percent of their housing microfinance portfolios, while an additional third of institutions in Asia/Pacific reported rural clients comprised 61-80 percent of their portfolios. Africa, the Middle East, Eastern Europe and Central Asia display a relative mix of institutions focused on rural versus urban clients. Similar to recognized trends across the microfinance sector more broadly, housing microfinance institutions reporting from Latin America and the Caribbean demonstrate a strong trend toward urban versus rural.

Segmentation of housing microfinance by gender

In certain markets, housing microfinance products can prove a pivotal tool in addressing gender inequality and empowerment of women. As the development community at large continues to shift toward sectorwide adoption of an intentional approach to the empowerment of women, some microfinance practitioners are already demonstrating the impact that housing microfinance can have in enabling women to secure safe and affordable shelter. However, intra-

Figure 30: Average percentage of clients who are rural



household decision-making processes, even at financial institutions focused on lending to women, should not be overlooked. The Terwilliger Center has realized the relevance of understanding the household dynamics that can impact loan use and prioritization of home improvements. In some cases, in fact, market research conducted before the design of a product has included group interviews with males in order to understand building practices and priorities for home improvement, even though the loans were to be received by women. Enabling women through housing microfinance products should remain a priority, but financial service providers also should bear in mind that housing often involves multiple family members. The implications of this should be considered in determining the market orientation of housing microfinance products.

Year-over-year survey data demonstrate a sizeable increase in the average percentage of housing microfinance portfolios composed of female clients from 2015-16 to 2016-17, but the data also indicate that this percentage continues to diverge from the average seen for general microfinance portfolios (participants in the 2016-17 survey report an average 66 percent, while the average reported by Microfinance Barometer for 2016 was even higher, at around 81 percent). Our regional analysis again suggests that the highest concentration of female clients both in terms of general loan portfolio and the housing microfinance portfolios is found in Asia/Pacific (Figure 32). Financial service providers in Africa follow, with females making up an average of 72 percent of general microfinance portfolios. For housing microfinance portfolios, however, Central Asia leads, with a slightly higher average of 50 percent versus 45 percent in both Africa and the Middle East.[15] Only three institutions from Latin America and the Caribbean provided data on female borrowers for both housing and general portfolios, but these all reported percentages of less than 30 percent for their housing portfolios, resulting in the lowest regional average at 10 percent.

Figure 31: Average percentage of borrowers who are female

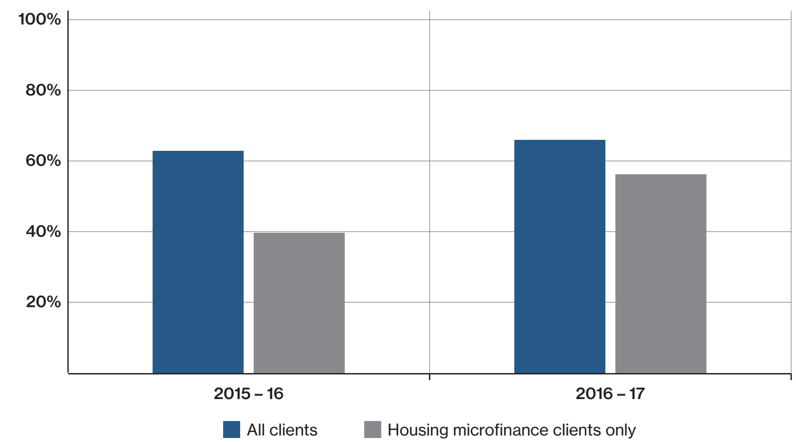
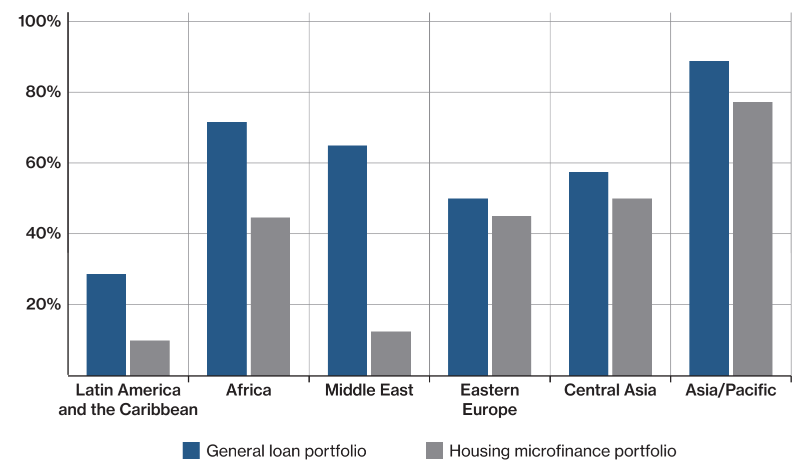


Figure 32: Average percentage of female borrowers by region



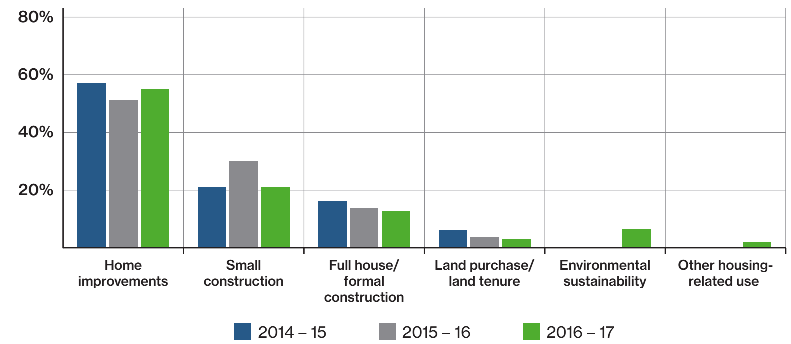
15. It should be noted that only two institutions reported in from the Middle East.

Product segmentation by use

Given that housing microfinance is an umbrella term for a broad array of housing-related products and services, we continue to inquire as to the intended purpose or use of these products. The distinctions are notable both for understanding the underlying risk and for identifying emerging trends that could signal opportunities for additional products. In the 2016-17 survey, we asked institutions to indicate use of housing microfinance loans both as a percentage of the total number of housing microfinance loans and as a percentage of total housing microfinance portfolio value. We maintained the categories used in the previous year's survey: home improvement (basic repairs, including plastering, roofing, ceiling, finishing floors, etc.), small construction loans (incremental construction to include expansion of a home or addition of a latrine), full house purchase or construction, and land purchase or use in acquiring increased tenure security. Based on a trend observed through Habitat's Terwilliger Center advisory services engagements toward use of loans for energy-efficiency applications, we chose to include environmental sustainability as a separate category.

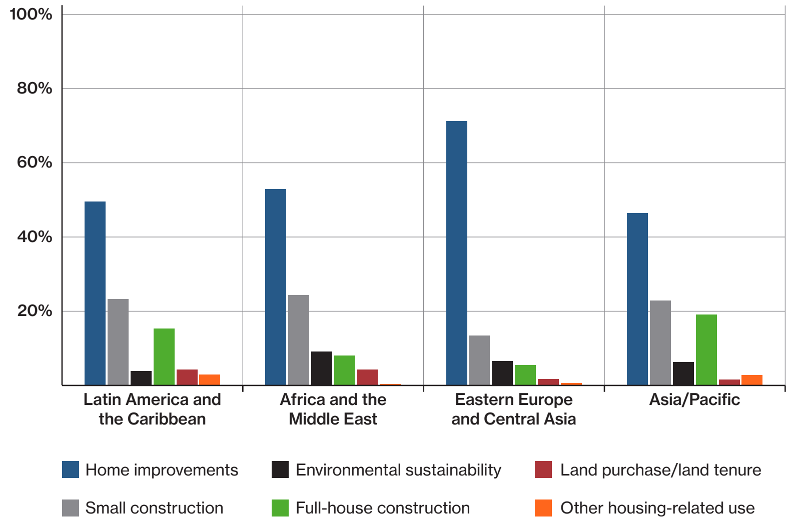
Looking at the average percentage of loans issued for each use, the findings indicate that 2016-17 figures are in line with trends observed in previous years' surveys (see Figure 33). The decline in small construction loans in 2016-17 versus 2015-16 is likely due to the introduction of the environmental sustainability category, which was previously included in small construction (at least for solar panel additions). It should be noted that the number of participating institutions has increased each year, so the decline observed in allocation toward full house/formal construction and land purchase/land tenure should

Figure 33: Global use of housing microfinance loans (average percentage of loans)



not be interpreted as a decline in those uses across the sector, but rather a refinement of our understanding of the global outlay for these products. Based on the increased number of respondents in 2016-17, we further analyzed loan use by region. Home improvements prevail as the most common use of loans across all regions, though we note that this category comprises a higher percentage of portfolios in Eastern Europe and Central Asia than in other regions. Other distinctions include the more prominent use of housing microfinance loans for full house construction in Asia/Pacific and Latin America and the Caribbean, and the relatively higher purposing of housing microfinance loans for environmental sustainability in Africa, the Middle East, Eastern Europe and Central Asia.

Figure 34: Uses of housing microfinance loans as average percentages of all housing microfinance loans



To further refine our understanding of the use data reported in previous iterations of the survey, we introduced a new question in the 2016-17 survey to clarify the relative value of the portfolio that each use represents. Comparing these responses to the earlier analysis revealed that loans for the construction of a whole house, land purchase or improvement of tenure security accounted for a slightly higher value of the housing microfinance portfolio than count indicated (4.2 percent higher if the average is taken only of those indicating this type of use). This is reasonable, given that these loans are likely larger than loans intended for small construction or housing improvements. In contrast, loans for environmental sustainability purposes accounted, on average, for 5.2 percent less of the portfolio value than conveyed by count, indicating higher frequency of use but lower average loan size.

Box 3: Examples of loans for specific housing solutions

- **Kenya Women Microfinance Bank, or KWFT**, offers its clients loans for the purchase of rainwater catchment systems (including large tanks), water filters, energy-efficient cook stoves, and solar panels. Each of these intended uses corresponds to a specific product, which in turn is serviced by the relevant vendor. Such loans do not face any risk of fund diversion, as no cash is disbursed. This direct connection with a specific product requires a tight alliance between the bank and the vendor to ensure timely delivery and high-quality products and support services. KWFT staff state that when these alliances break down, loan repayments may be jeopardized.
- **Centenary Bank** provides loans specifically for water, sanitation and electrical power connections. The bank has also recently launched CenteSolar to finance the purchase and installation of solar energy systems. These loans are disbursed in cash to the borrower and supported by a supplier invoice. Centenary Bank does not engage with specific vendors but allows customers to make their own selections.

These trends reaffirm the opportunity for products targeted to specific subsegments and how these fit within the umbrella of housing microfinance. A financial institution seeking to maintain or increase its competitive position within a market should explore this sort of differentiation in order to identify the most appropriate product both for the institution and for the market. Box 3 provides two examples of financial institutions that offer housing-related products to support specific, targeted housing needs.

Profitability drivers: Key cost and revenue considerations

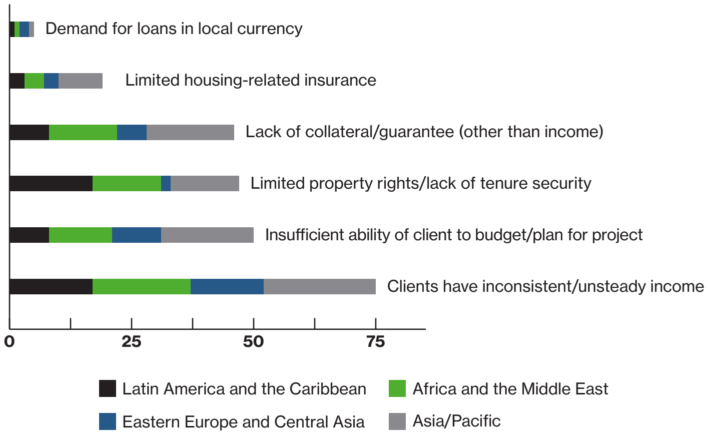
As discussed previously, only a quarter of the institutions in our survey cited profitability as a top three driver for the introduction of a housing microfinance product, but 88 institutions – nearly all – indicated that some form of financial return was indeed expected. Regardless of whether an institution is aiming primarily for a social goal with financial returns intended only to supply additional loan capital or whether financial targets are the driving motivation, the profit potential of housing microfinance products is a critical component in a thorough analysis of the business case. In the following section, we will explore the risks and costs that factor into pricing housing microfinance products, along with expected versus realized returns.

What are key risk considerations?

Numerous risk and cost considerations should be made when developing a housing microfinance loan, but the most frequently cited risk, listed by 79 percent of institutions, is the inconsistent and unsteady nature of client income. This is a factor in most microfinance loans and something that financial institutions serving microentrepreneurs should know how to factor into their pricing model. As noted in an earlier section, some institutions are offsetting the typical risk inherent with microfinance clients by extending loans to low-income salaried workers.

Roughly 53 percent of respondents indicated clients' insufficient ability to budget or plan for the project as a risk. This is a constraint that may be mitigated through the inclusion of a technical assistance component, which we at the Terwilliger Center often refer to as housing support services. However, providing these services requires additional staff resources, poses an added cost in the delivery of housing microfinance products and services, and has proved to be unsustainable once housing microfinance products are taken to scale. The issue of lack of collateral can be exacerbated by limited property rights or lack of tenure security – risks cited by roughly half of respondents.

Figure 35: Perceived risks in issuing housing microfinance loans



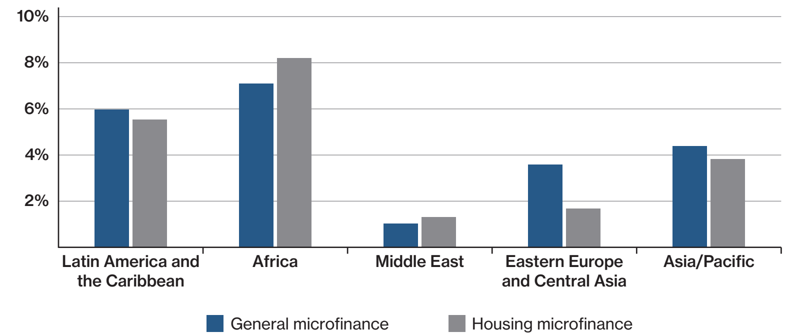
Finally, we observe limited housing-related insurance as a perceived risk for 20 percent of financial service providers, notably more so in Asia/Pacific than in other regions. This is not surprising, given the relatively frequent natural disasters the region weathers. Demand for loans in local currency may be a risk for institutions operating in unstable economic environments or experiencing swift or frequent changes in currency valuations, but overall it appears to affect only 5 percent of responding institutions.

Client repayment considerations

The leading risk cited by financial service providers is the inconsistent income of potential clients. Inconsistent or even unpredictable income is a common concern throughout the microfinance sector and generally goes hand-in-hand when targeting the low-income sector with financial services. The primary way this risk would be manifested in a portfolio is through late payments and delinquent accounts. We asked institutions to provide their portfolio at risk greater than 30 days, or PAR30, in order to understand whether this risk is heightened for housing microfinance portfolios versus general microfinance portfolios. The 2016-17 data, echoing our findings in the 2015-16 survey, indicate that globally housing microfinance portfolios have continued to outperform general microfinance portfolios in terms of PAR30. Excluding institutions that are solely focused on housing, 62 percent reported PAR30 for housing microfinance products to be lower than PAR30 for the general microfinance portfolio. This is an important distinction for financial service providers to acknowledge, particularly as they pursue sources of capital funding. Eleven percent of financial service providers reported PAR30 for their housing microfinance portfolios to be equal to that of their general microfinance portfolios, while 25 percent report housing microfinance portfolios with higher PAR30 than that of their general microfinance portfolios.

The global average PAR30 for housing microfinance portfolios was 5.6 percent, while the global average PAR30 for general microfinance portfolios was 6.39 percent. However, the average calculations included six institutions (out of 97) that reported PAR30 greater than 15 percent for general microfinance portfolios. Excluding one of these outlying institutions that reported a staggering PAR30 of 98.4 percent, the global average PAR30 for housing microfinance is 4.6 percent, while the average global PAR30 for general microfinance portfolios is 5.34 percent. Of the institutions considered in these calculations, 5 percent reported PAR30 for their general microfinance portfolios to be greater than 15 percent. PAR30 of housing microfinance portfolios averaged 85 basis points lower than general microfinance portfolios. This consistently favorable performance of housing microfinance loans over the three years of the housing microfinance sector survey should assuage doubts as to whether non-incoming-generating loans can perform on par with income-generating products.

Figure 36: Average PAR30



In Figure 36, we have excluded the aforementioned extreme outlier from the dataset for a more equivalent comparison. Regional comparisons reveal that the greatest variance between the average PAR30 for the general microfinance portfolio and the housing microfinance portfolio is in Eastern Europe and Central Asia, while Africa and the Middle East are the only regions in which we observe the average PAR30 for housing microfinance portfolios to be higher than that of general microfinance portfolios. Institutions in the Middle East report the lowest PAR30 across regions for both portfolios – though we recall that only two institutions participated from the Middle East.

Another important measure of performance is the write-off ratio. Our findings from the survey regarding write-off ratios complement the findings regarding PAR30. The average global write-off ratio for housing microfinance portfolios is less than that of general microfinance portfolios (2.91 percent versus 3.45 percent). This relationship is consistent across regions, even in Latin America and the Caribbean, where we observe the highest write-off ratios.

Interestingly, if we compare only the write-off ratios that are greater than 0, this relationship between housing microfinance and general microfinance write-off ratios reverses. Write-off ratios for housing microfinance portfolios average 6.67 percent, while write-off ratios for general microfinance portfolios average 5.07 percent. The data were inconclusive as to drivers of this reversal, but one might consider that housing portfolios are more concentrated in one industry while a general microfinance portfolio may encompass multiple types of products and extend across industries. However, housing is a substantial part of life, and for many borrowers, paying for their house is a priority when facing economic hardships.

Nonfinancial constraints

The second most commonly reported risk was an insufficient ability of housing microfinance clients to budget or plan for the project. A primary way to address this concern is through the provision of technical assistance or housing support services. These services may include construction guidance, assistance in budgeting for the project, legal assistance in securing formal recognition of land tenure, and even home maintenance skills. We found slightly less than 50 percent of institutions surveyed provide technical assistance or housing support services to their housing microfinance clients. Of these, the majority provide technical assistance for a number of products, evidencing that this may correspond to a cross-cutting practice within the financial institution rather than being specifically linked to the housing microfinance products. Roughly 20 percent of respondents provide

Figure 37: Average write-off ratios

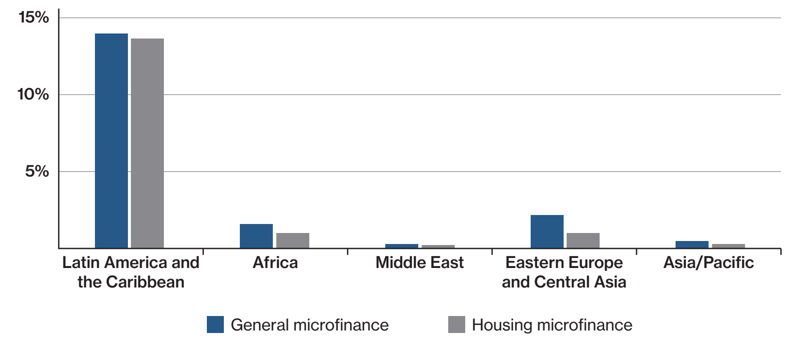
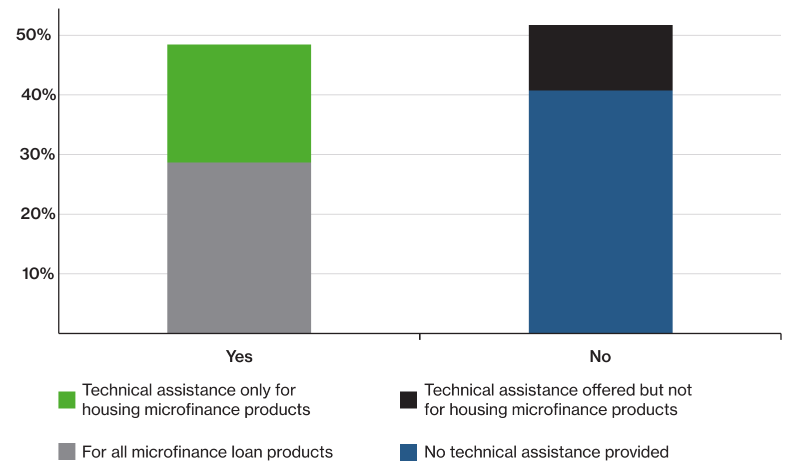


Figure 38: Provision of technical assistance



housing support services only for housing microfinance products (two of these are institutions exclusively focused on housing). Perhaps more intriguing is that only 11 percent provide technical assistance for other products, but not for housing microfinance products. This could indicate that the constraints around offering technical assistance for housing microfinance clients may be less dependent upon unique housing-related issues, and instead due to constraints preventing institutions from offering technical assistance for any product, whether housing-related or not.

This theory seems to be confirmed by the responses to our follow-up question. When we asked institutions why they do not provide technical assistance to housing microfinance borrowers, the most common answer was "insufficient capacity" to do so. Many also cited costs of providing technical assistance, while others simply found it unnecessary or felt client demand was too low.

Segmenting these constraints by region revealed substantial variance in their impact. Insufficient internal capacity was the top constraint in all regions, except for Latin American and the Caribbean, where cost was the leading constraint. Financial service providers in Africa and the Middle East also stated cost as a leading constraint. Institutions in Asia/Pacific and Eastern Europe and Central Asia, however, indicated that insufficient demand presented a more severe constraint than costs. Other constraints reflect institutions that are either developing a technical assistance component, have a unique approach to technical assistance, or simply do not see technical assistance as necessary. Institutions that affirmed that they do offer housing support services to housing microfinance clients were presented with additional questions to assist in building our understanding of what technical assistance looks like across regions and whether a specific component might be deemed most valuable. Questions focused on whether technical assistance was mandatory or optional, types of technical assistance offered, and how costs are allocated.

Figure 39: Why don't you provide technical assistance to your housing microfinance clients?

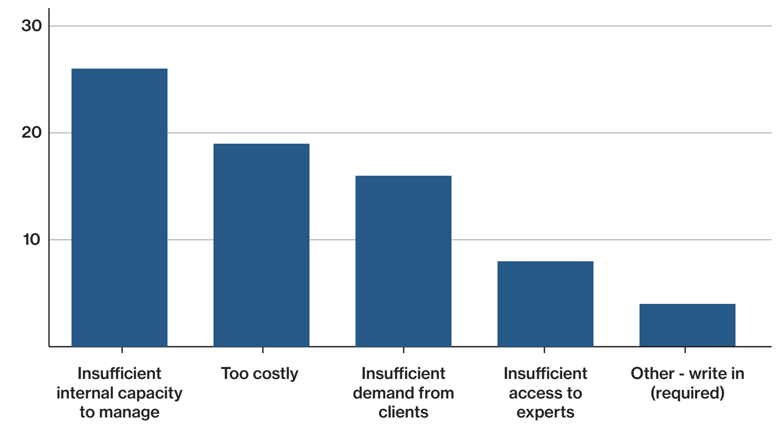


Figure 40: Why don't you offer technical assistance to your housing microfinance clients (by region)?

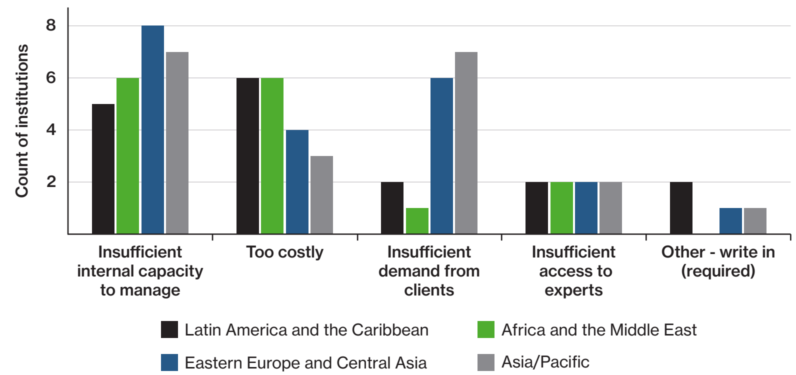


Figure 41: Technical assistance requirement for housing microfinance clients

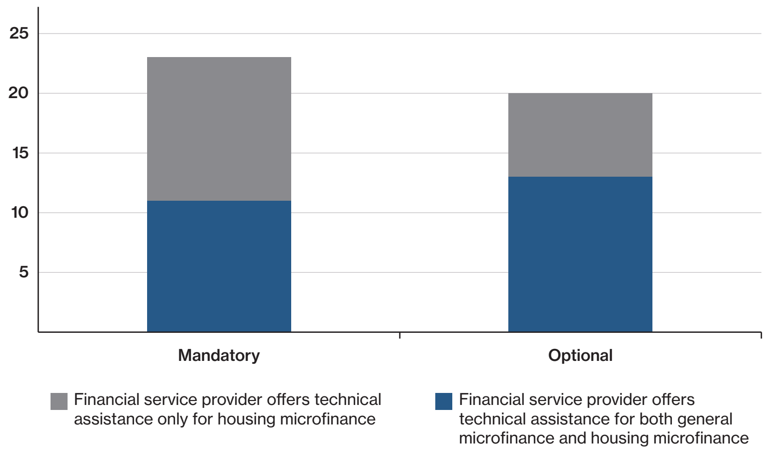
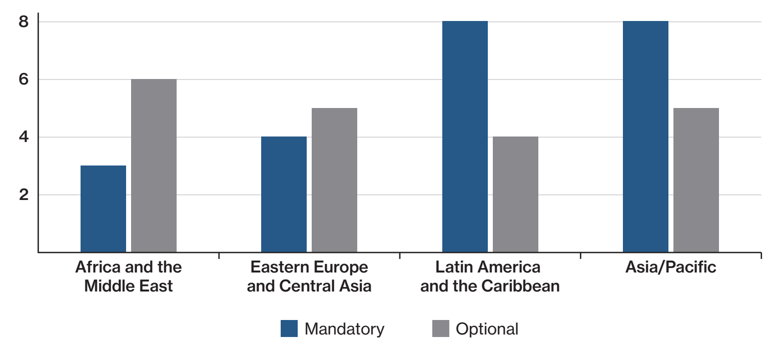


Figure 42: Technical assistance for housing microfinance clients is...



Nearly 30 percent of our respondents offer technical assistance for both general microfinance products and housing microfinance products. When asked whether technical assistance was mandatory or optional for their general microfinance products and then for their housing microfinance products, "optional" was the prevailing response in both cases. However, financial service providers showed a higher inclination to require technical assistance for housing microfinance products versus general products. This supports the notion that technical assistance is considered relevant, particularly in the case of housing-related products, likely because of the technical construction aspect involved in housing. However, lack of capacity and cost of delivery seem to be keeping more financial institutions from offering technical assistance, especially when they consider taking a housing microfinance product to scale.

Including the exclusively housing-focused institutions back into the analysis expands the pool of responses to 43 institutions. This analysis confirms that technical assistance for housing microfinance products is more likely to be mandatory than optional, particularly among financial service providers that offer technical assistance exclusively to housing microfinance clients. For those institutions that offer technical assistance for an array of products, the tendency is to make technical assistance optional or mandatory in line with the institution's approach to technical assistance for other products. The determination as to whether technical assistance is mandatory or optional varied between housing microfinance products and general microfinance products for nearly a quarter of institutions offering technical assistance for all products.

Construction advice, budgeting for home improvement, and general financial education (whether personal financial education based on repaying the loan or on budgeting for specific home improvements) are the most commonly observed forms of technical assistance overall. However, certain variations of technical assistance are more common in some regions than in others. For example, blueprint drafting is particularly common in Latin America and the

Figure 43: Types of technical assistance offered

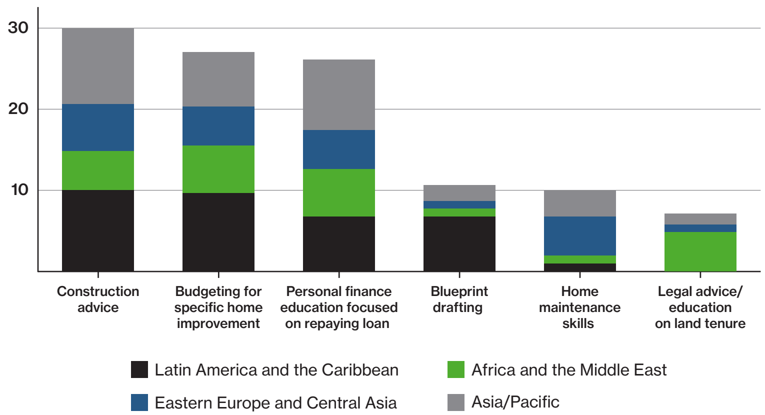
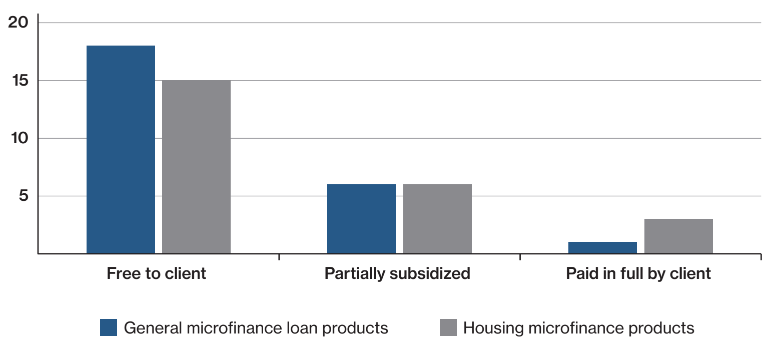


Figure 44: Technical assistance cost attribution in financial service providers offering technical assistance to all clients



Caribbean; home maintenance skills are more commonly seen as a focus of technical assistance in Eastern Europe and Central Asia; and technical advice regarding land tenure and security is most frequently offered in Africa and the Middle East – all well in sync with the particular market dynamics and housing challenges present in each context.

For a more complete assessment of the technical assistance offerings, it is important to understand how costs are attributed. In institutions offering technical assistance across a range of products, most technical assistance is offered for free to clients. We observe, though, a slight increase in the tendency to attribute technical assistance costs to clients when it relates to a housing microfinance product rather than a more traditional microfinance product offering (see Figure 44).

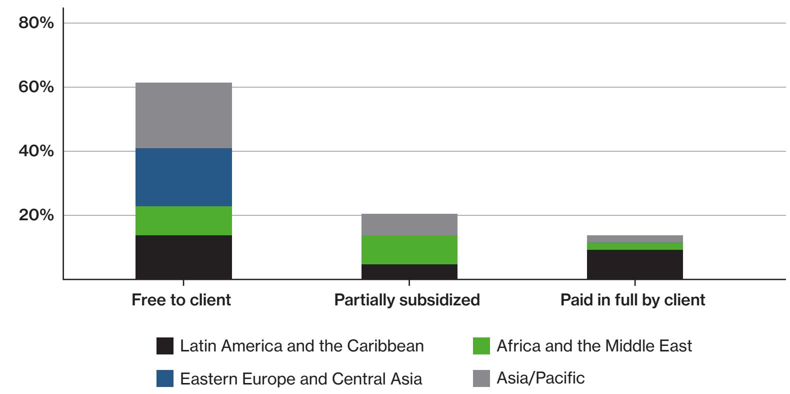
If we look specifically at the cost allocation of technical assistance provided to housing microfinance clients (again, 48 percent of institutions offer technical assistance to their housing microfinance clients), we can distinguish some interesting regional trends. All responses from financial service providers in Eastern Europe and Central Asia indicated that if they offer technical assistance to their housing microfinance clients, it is free. Offering technical assistance for free is common to most other regions as well, though not to the same extent. In Africa and the Middle East, we observe a strong disposition toward subsidizing costs, while full cost attribution to clients is more prominent in Latin America and the Caribbean than in any other region. In Africa and the Middle East, institutions seem fairly divided between partial subsidies and free provision of technical assistance to clients.

An interregional comparison of technical assistance models used by financial institutions reveals key differences in approaches taken by those institutions to shared constraints. As noted previously, financial service providers in both Africa and the Middle East and Latin America and the Caribbean indicate insufficient capacity and costs as the reasons that offering technical assistance is prohibitive. As in most regions, the key forms of technical assistance include construction advice, personal financial education for loan repayment, and budgeting assistance specific to home improvements. Legal advice, specifically related to land security, is an offering we see mostly in Africa and the Middle East, while blueprint drafting is more commonly offered in Latin America. From here, the divergence in the regional approaches to technical assistance becomes more distinct.

Institutions in Africa and the Middle East most commonly offer technical assistance as an option with housing microfinance products, and about half of the financial service providers in this region indicated that they offer technical assistance for free, while the other half subsidize technical assistance in part. This approach of optional technical assistance at little to no cost to the client may be due at least in part to the varying need for legal assistance related to tenure security. For financial service providers to ensure sufficient market demand for product viability, they must address the constraint imposed by lacking tenure security. Technical assistance in the form of legal assistance seems to be a common tool for these financial service providers.

By contrast, in Latin America and the Caribbean, technical assistance is more commonly included as a mandatory component of housing microfinance products, and costs are more frequently attributed to clients than in any other region. The focus is heavily on construction-related technical assistance, including budgeting for home improvements. This approach could derive from a strong institutional understanding of the value of sound technical advice in reducing client risk profiles and increasing assurance that the loan is applied in the most efficient manner. In this way, institutions may be using technical assistance as a means to increase the quality of their loan portfolio and ensure the well-being of their clients.

Figure 45: Cost attribution of technical assistance for housing microfinance clients



Box 4 includes examples of models commonly used by financial service providers, and is complemented by conclusions from a study conducted by the Terwilliger Center of 34 financial service providers that offer some sort of non-financial housing support services to their clients.

Box 4: Housing support services – research findings

In February 2017, Habitat for Humanity's Terwilliger Center for Innovation in Shelter concluded a study of 34 financial service providers from around the globe with the intent of assessing the current status of and trends in providing housing support services alongside housing microfinance products. Three types of housing support service strategies emerged from the surveyed institutions:

Market linkages
Financial service providers formed partnerships with other private-sector actors to strengthen the value chain of goods and services offered to families undertaking incremental housing construction. These tended to result in added benefits for borrowers, such as favorable prices from construction material suppliers or lists of recommended masons. Institutions also supplied printed materials to equip their customer base with basic project know-how and construction tips to enable them to make more informed decisions as consumers of shelter-related goods and services.

Key finding:
Financial service providers found that **market linkages were difficult to maintain,** and **clients tended to value these less than was expected.** The only sustainable, large-scale partnership identified was an alliance between MiBanco and HatunSol (a division of Cementos Sol), which serves primarily as a sales channel for capturing new borrowers.

Loan-related services
Financial service providers assisted borrowers in determining how to segment and prioritize their home improvement goals, and ensured that the costs of the proposed project were consistent with the client's current borrowing capacity. These steps contributed to housing microfinance sales and appraisals, and tended to be streamlined and standardized such that loan officers could deliver them as part of housing microfinance loan processing.

Key finding:
Financial service providers with growing housing microfinance portfolios tended to concentrate their housing support services on loan-related processes, such as home improvement project planning and budgeting, which could be carried out by their existing sales force.

Qualified technical assistance
In a few cases, borrowers were offered advice or direct assistance from a qualified construction professional (typically an architect or engineer). These services tended to be offered by a third party, such as a local Habitat for Humanity program, although in a few cases they were provided in-house by the financial service provider.

Key finding:
The sustainable provision of qualified technical assistance **in conjunction with housing microfinance remains an unresolved challenge** for financial service providers with growing portfolios. The few that had attempted to offer this service had either discontinued it or were reducing supply.

Considering the findings from the survey and other research conducted by Habitat's Terwilliger Center, we have found that the provision of nonfinancial housing support services or technical assistance can be used as an additional service to support an institution's social mission or as a risk-reduction measure to ensure that loans are indeed used to improve clients' shelter condition, but the costs should be offset.

Tenure security

As mentioned earlier in the discussion regarding regulatory environments, tenure security can prove to be a major factor in the success of a housing microfinance product. In regions that lack sufficient regulation, homeowners might not be able to validate their ownership, meaning that if the client defaulted, the institution would have extremely limited recourse on the property. It can also mean that an external party could lay claim to the property and pry it from the residents' control, implicitly increasing the risk and subjecting the institution to potential write-offs. Given the nature of this tenure security gap, it is crucial for any institution considering the development of a housing microfinance product to understand the parameters for the region in which it operates and to adequately price this risk into the product terms. Key parameters to understand are what types of documents are acceptable and what potential clients in the target market segment are able to produce. As identified in the 2015-16 survey, tenure security often exists on a range from formal to informal, rather than a binary scale.

When asked how they assess the tenure security of potential housing microfinance clients, close to 80 percent of financial service providers indicated that they include some form of assessment within the loan application process. Cross-analysis did not reveal any clear reasons as to why some institutions elect not to assess tenure security. One might assume this would not be necessary because of the regulatory restrictions that already exist within the contexts in which they operate, or might not be necessary

Figure 46: Method for assessing tenure security of housing microfinance clients

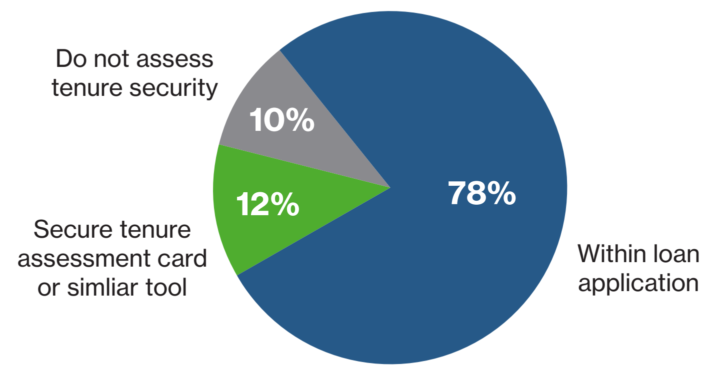


Figure 47: Estimated highest tenure documentation of housing microfinance clients by percent of housing microfinance clients

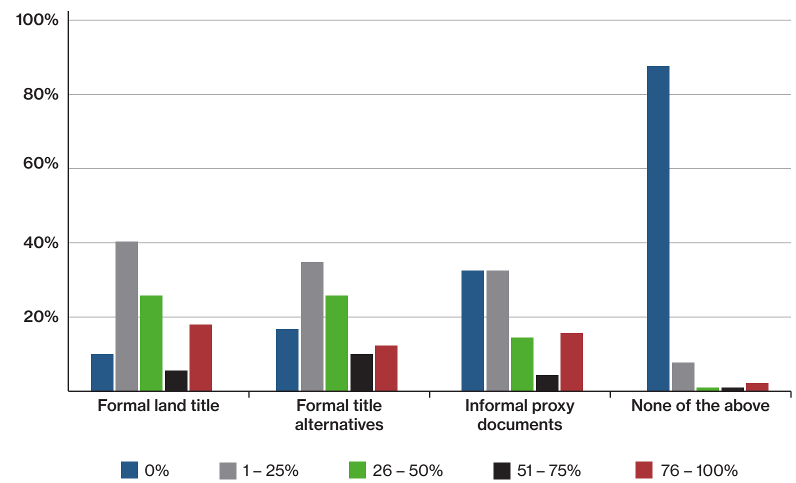
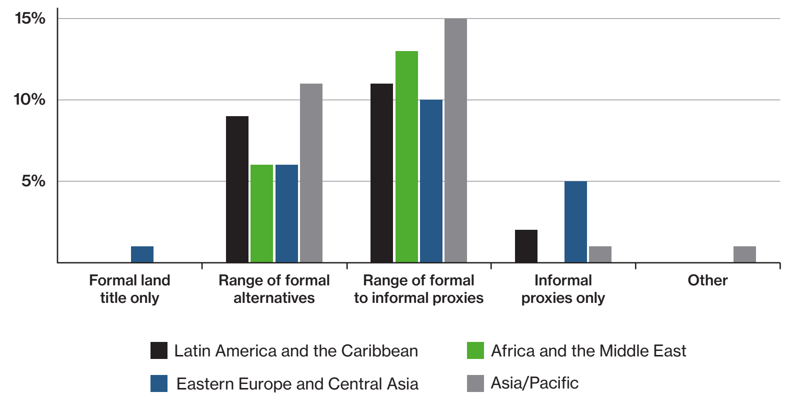


Figure 48: Accepted tenure security documentation



Box 5: Example from Centenary Bank – Kibanja mortgage

Motivated by the vast unmet demand for housing finance, Centenary Bank realized an opportunity to extend smaller, unsecured loans, and engaged a local legal instrument, known as the "Kibanja mortgage," to increase the security of housing loans above a set threshold. Opening access to clients with customary land ownership is one of the strategies the institution is using to progressively increase market share throughout Uganda.

based on the types of home improvements conducted or offered. The remaining 12 percent of institutions use special tools developed specifically for assessing tenure security.

We polled institutions as to the highest level of documentation they believed their clients would be able to produce. The most striking bar in Figure 47, the first column in the category "none of the above," denotes that 88 percent of financial service providers estimate their housing microfinance clients would be able to provide some form of tenure documentation, whether a formal title, formal title alternative (such as a land purchase agreement, inheritance document, registration certificate, municipal use document or cadastral plot certificate), or an informal proxy document (utility or other bills, tax payment records, or references from neighbors). Globally, 76 percent of institutions said fewer than half of their clients would be able to produce a formal title, and 78 percent said fewer than half would be able to produce formal title alternatives. We observe, in fact, that estimates as to the percent of clients who could provide a formal title vary only slightly from estimates of the percentage of clients who could produce a formal title alternative. Only two institutions indicated that their clients would likely be unable to produce any of the suggested documents.

In terms of documentation accepted to demonstrate tenure security, most institutions accept a range of formal to informal proxies. Fifty percent of institutions accept a range of formal to informal tenure documentation, while 33 percent accept documentation only within the range of formal alternatives (the majority of which is composed of institutions in Asia/Pacific and Latin America and the Caribbean). A mere 8 percent of institutions accept only informal proxy documentation, and only one institution accepted only formal land titles. The wide ranges depicted here suggest that many institutions have found ways to work within the constraints of their local markets, but that this often requires flexibility and a keen understanding of local tenure standards.

One way institutions can mitigate risk is by requiring a formal land title for housing microfinance loans of or beyond a certain size. In our dataset, about 43 percent of institutions implement some type of threshold beyond which a formal title is required, with thresholds ranging from US$1,000 to more than US$15,000. The other 57 percent do not base tenure requirements on the size of the loan. However, as mentioned before, knowing the local land tenure laws is necessary for adapting the lending processes and requirements to the realities of the markets in which the financial institutions, and the low-income households they intend to serve, exist.

What operational costs should be considered?

In addition to the costs that must be considered in relation to market risks, numerous operational costs also must be considered. Training and hiring staff members, developing new marketing campaigns, and updating management information systems were already mentioned in the review of institutional drivers and represent expenses related to initial product development and launch. Other administrative and operational aspects that relate to ongoing implementation and scaling up of the housing microfinance product also must be considered. These include loan size and duration; the loan application process and analysis of the type of home improvement; budgeting for the home improvement; and, finally, assessment of client debt burden.

To help gauge whether these screening costs are similar to or more costly than those of traditional microfinance products, we compared the rejection rate for housing microfinance clients with that of general microfinance clients, since a higher rejection rate equates to time lost to unqualified borrowers. It appears that most institutions find the rejection rate to be about the same as for general microfinance loans. A remarkable 37 percent of institutions report that the rejection rate is actually lower (this could be due to limiting housing microfinance products to known clients versus new clients).

Figure 49: Rejection rate for housing microfinance clients vs. general microfinance clients

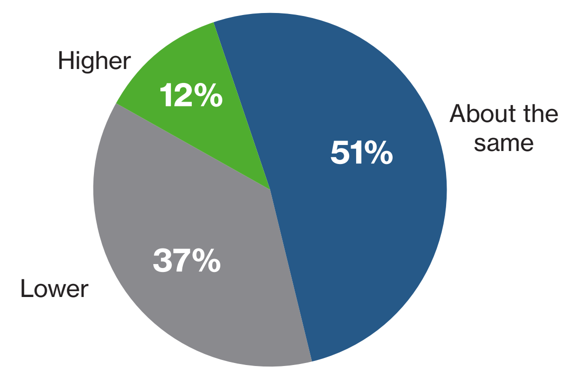
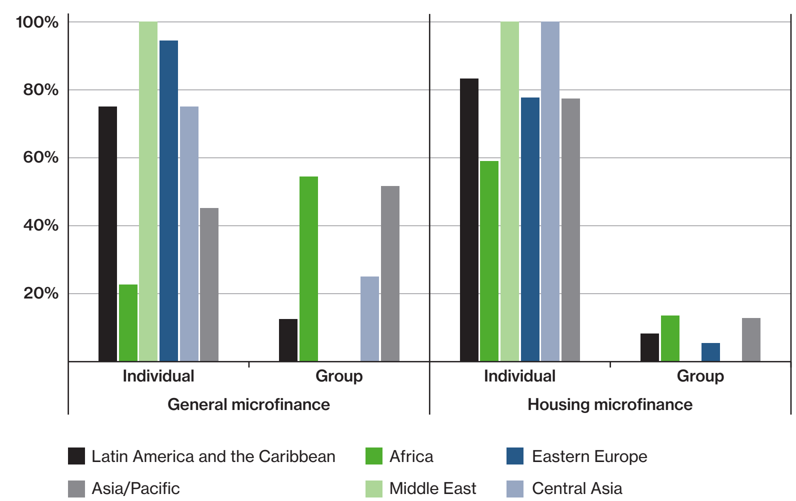


Figure 50: Primary lending methodology



Although we do not have a clear indication of why the rate is lower, this figure speaks to the potential cost savings that may be achieved through housing microfinance products. Further research must be conducted before a definitive conclusion can be made.

In addition to these, other operational costs that should be considered include lending methodology to implement the housing microfinance product (particularly if an institution uses a group lending methodology to implement its overall microfinance portfolio); costs and implications for monitoring use of the loan (these may be direct or indirect); and, in some cases, provision of technical assistance regarding the construction or improvement made to the house.

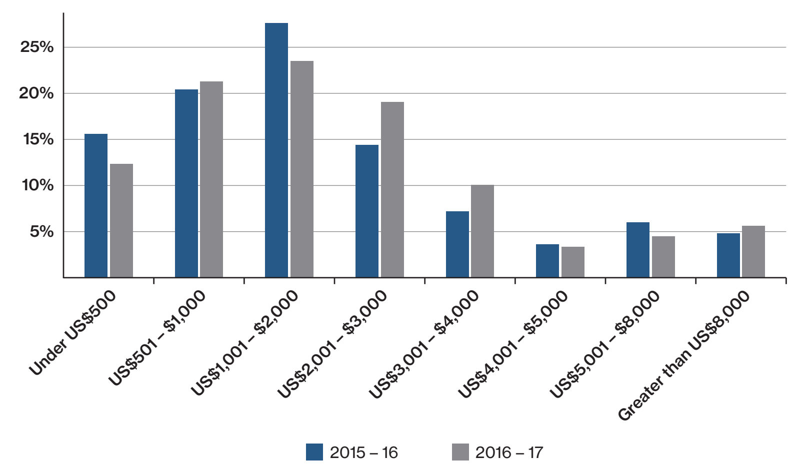
Group lending versus individual borrowing

One risk reported by survey participants was a lack of guarantees and collateral for housing microfinance. One of the ways in which financial service providers have addressed this risk for traditional microfinance products is by using a group lending model. For traditional income-generating microfinance products, group lending is a common methodology, as the community-focused method establishes guarantors with a vested interest in repayment of each group member's loan, thereby reducing risk. For housing microfinance, however, group lending is less common. The survey data confirmed individual borrowing as the primary lending methodology in housing microfinance. Based on our data, group lending is most prevalent in Africa and Asia/Pacific, with 52-55 percent of institutions reporting group lending as their primary lending methodology for general microfinance. This figure drops to less than 15 percent for each region when looking at housing microfinance products. The longer duration and larger loan size of housing microfinance products make individual borrowing a much more common methodology. Where group lending is the primary methodology used for the rest of the microfinance portfolio, the financial service provider should consider the additional costs of implementing housing microfinance products through an individual lending methodology, including building the capacity of loan officers used to selling group lending products versus individual lending products. This is a risk not easily offset by a complementary service and should rather be priced into the product terms. Adapting and streamlining the loan origination process and monitoring are important steps in reducing the impact on the pricing and yield of the product.

Average loan size and duration

When looking at housing microfinance product features, the average loan size and duration should be examined along with interest rates to define the optimal range for the market conditions and target market. Based on survey feedback, it appears that housing microfinance loans, on average, range in size from US$1,000 to US$2,000. Survey data indicate that 2016-17 saw a slight increase in the average size of loans relative to 2015-16 data.

Figure 51: Average size of housing microfinance loans



Comparing the average loan size of housing microfinance products to the average loan sizes of other microfinance products, we find that housing microfinance loans on average are larger than 51.4 percent of other loans, relatively equal to about 21.7 percent of other products, and smaller than the remaining 26.9 percent of products. Of course, this aggregate provides only limited insights. A better understanding is provided again through a product-to-product comparison. We observe that the average loan size for housing microfinance products is generally less than that of long-term fixed assets and micromortgages, but generally larger than short-term working capital loans, education loans, other business loans and consumption loans.

We find housing microfinance loan tenor to be, on average, 32.7 months. This figure remains largely consistent with prior years' figures of 31.5 months in 2014-15 and 28.8 months in 2015-16. In the 2015-16 survey, we asked institutions the duration of general microfinance products. However, we know that the duration of general microfinance products can vary significantly based on the underlying loan products. In order to conduct a more thorough assessment, we asked the average size and average loan duration of several common microfinance products, including short-term working capital loans, longer-term fixed-asset investments, consumption loans, other business loans and education loans.

Comparing against these products, we find the average loan tenor of housing microfinance products is roughly double the average duration of consumption loans (16.1 months) and 2.3 times the average duration for short-term working capital loans (13.9). The loan tenor of housing microfinance products is most comparable to the loan tenor reported for both long-term fixed-asset investments (33.2 months) and micromortgages (32.7 months). This suggests that the longer-term nature of housing loans is not something completely unfamiliar to many financial service providers, but is rather unique in the combination of midrange loan size with a similar duration to fixed assets and micromortgage products.

Figure 52: Average loan size – housing microfinance loans vs. other microfinance products

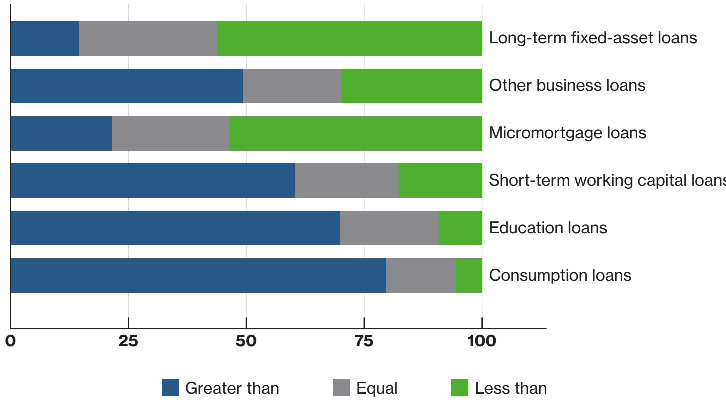
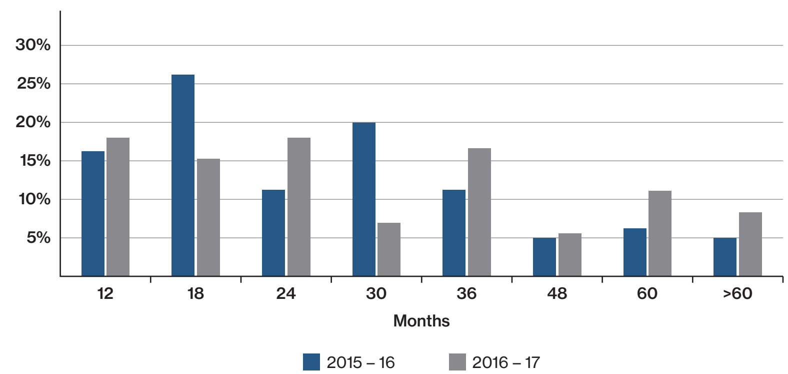


Figure 53: Average housing microfinance loan tenor as percent of responding institutions



Interest rates

With the high loan sizes (relative to short-term working capital loans and consumption loans) and longer-term duration of housing microfinance products, an important consideration is how to prevent or limit cannibalism of other loan products caused by the introduction of a housing microfinance product. A wide variance in the interest rates of different products would provide natural incentive toward poaching. For this reason, we did not expect a wide variance among average interest rates reported.

With the exception of short-term working capital loans and consumption loans (which we recall are much smaller and generally of a shorter duration), the interest rates for housing microfinance loans are generally quite similar to the interest rates for other loan products. These results are in line with our findings regarding average loan size and duration: As housing microfinance loans are close in duration to long-term fixed-asset loans and micromortgages, and somewhat smaller, we would expect to see rather comparative interest rates. Indeed, the interest rates for housing microfinance products are closely in line with the fixed-asset products and micromortgages. Similarly, it should come as no surprise that the average interest rates of housing microfinance products are generally lower than the short-term working capital rates and consumption loans.

Table 1: Interest rates of housing microfinance loans compared with those of other loan products (by percentage of financial service providers with housing microfinance product interest rates as indicated)

	Short-term working capital	Long-term fixed-asset	Other business loans	Consumption loans	Micromortgage loans	Education loans
Greater than	10.7%	22.2%	14.5%	6.4%	18.8%	15.6%
Equal	39.3%	57.8%	45.5%	40.4%	65.6%	57.8%
Less than	50.0%	20.0%	40.0%	53.2%	15.6%	26.7%
Number of responses	*56*	*45*	*55*	*47*	*32*	*45*

Monitoring housing microfinance loans

Monitoring microfinance loans is common practice within the microfinance sector and serves as a crucial step for financial service providers to verify loan use and identify any signs that may indicate a client is potentially overindebted or likely to face repayment challenges. For housing microfinance loans, monitoring is also an important way to identify and mitigate potential issues with the construction project. Because of the technical nature of construction projects, there is potential for monitoring housing microfinance products to be more burdensome than monitoring traditional microfinance products.

For the most part, institutions have reported that the operational burden for monitoring housing microfinance products is equivalent to that of general microfinance products. In Africa and the Middle East, however, institutions reported the operational burden of housing microfinance products to be greater than that of general microfinance products, highlighting a somewhat dramatic variance from other regions. If we examine types of monitoring conducted, we can further consider what is leading to the variance in the operational burden for Africa and the Middle East.

Figure 54: The operational burden for monitoring housing microfinance loans compared with general microfinance loans is...

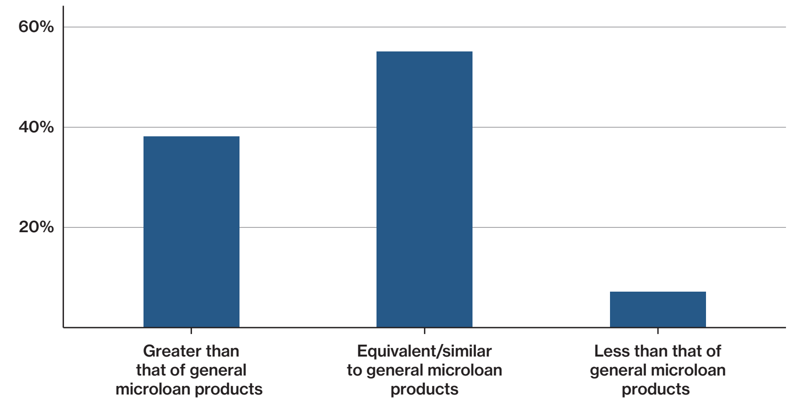
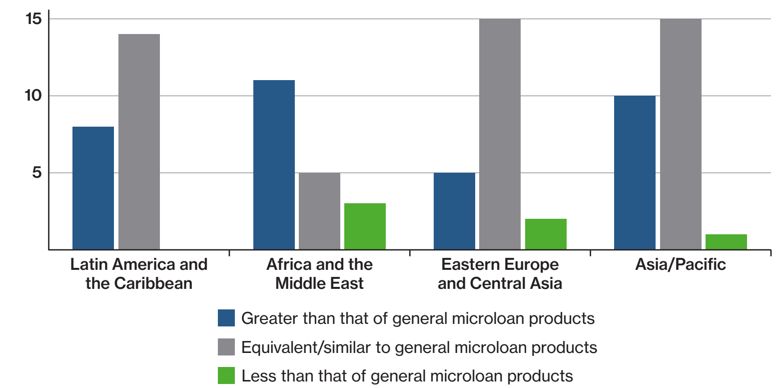


Figure 55: The operational burden for monitoring housing microfinance loans is....



Site visits are the primary method of verifying and monitoring loan use, used by over 90 percent of the 89 institutions that reported having a loan verification method. Regular in-person meetings with the borrower are a close second globally, but use of this and the other three methods varies widely by region.

Institutions in Africa and the Middle East reflect the highest usage of material supplier verification, and of physical meetings, site visits and phone calls. This high-touch approach seems a likely driver of the region's indication of a higher operational burden for monitoring housing microfinance loans. Institutions in Asia/Pacific show a similar tendency toward high-touch monitoring, though at a lower intensity. The actual number of institutions in Asia/Pacific indicating a heavier burden for monitoring housing microfinance loans is similar to that of institutions in Africa and the Middle East, though this number represents a smaller percentage of institutions in Asia/Pacific than in Africa and the Middle East.

Having a monitoring method may be perceived and in fact imply an additional operational burden to financial service providers. However, this operational burden is not excessive when one considers its importance to ensuring appropriate loan use and its utility in promoting adoption of the product by other clients. In the early stages of product launch and expansion, monitoring can actually promote buy-in of loan officers, particularly multiproduct loan officers, as they begin to see the opportunity for cross-selling. These initial findings suggest that more rigorous studies on the cost benefit of different monitoring methods and their respective impact on portfolio quality should be conducted to draw further conclusions.

Figure 56: Loan verification and monitoring methods

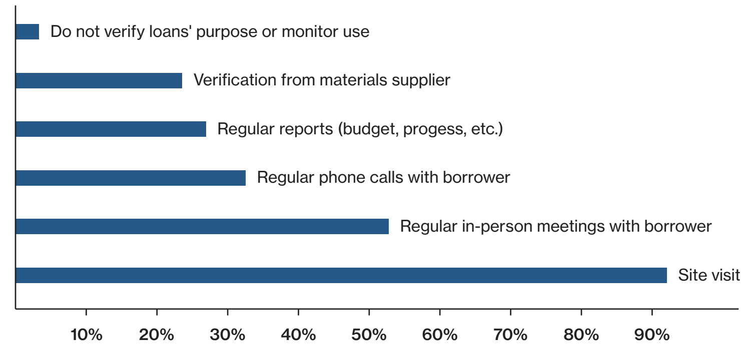
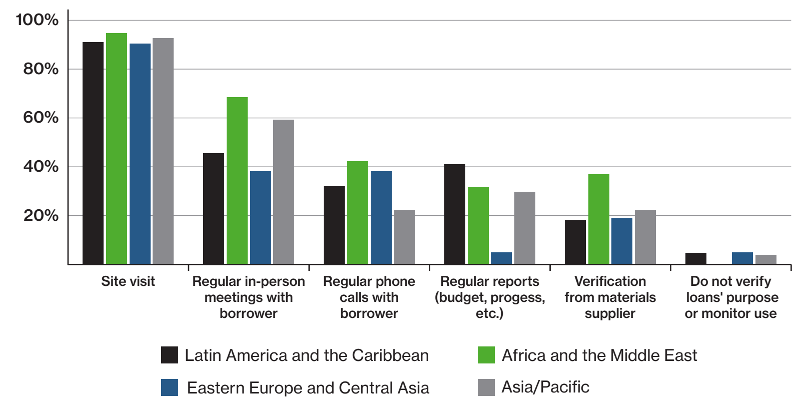


Figure 57: Loan verification and monitoring methods by region



What does the expected return profile look like?

Nearly 90 percent of institutions indicated that some form of financial return was expected, but it is important to understand how these returns are derived. As noted earlier, financial return is most frequently attributed to interest rate margins, though about 30 percent of institutions attribute it instead to cross-selling. To understand whether cross-selling indeed was where these expected returns might be realized, we asked institutions the percent of new housing microfinance clients who had taken out another loan product with the institution, whether housing-related or not.

After repaying their first loan, new housing microfinance clients seem slightly more inclined to take out another housing loan than to take out a loan product that is not housing-related (40 percent versus 38 percent). This is in line with what we would expect given that incremental building patterns typically result in sequential loans. On average, about a quarter of new housing microfinance borrowers do not take out another loan.

When looking at regional averages, it must be noted that these figures reflect an unweighted average across institutions. Financial service providers in Africa and the Middle East seem to lead in terms of new housing clients taking out additional loans, but we note that institutions with the largest housing portfolios (in terms of number of loans) report lower percentages of new clients (15 percent for institutions with over 15,000 housing loans, and 10 percent for institutions with over 55,000 housing loans). The largest portfolios are observed in Eastern Europe and Latin America, possibly contributing to their seemingly lower rates of cross-selling.

Another important consideration in gauging profitability is the expected return horizon. As seen in Figure 60, slightly over half of the institutions (51 percent) indicated that the expected return horizon for housing micro-finance products was short-term, or rather they expected profits to be

Figure 58: Expected primary source of financial returns on housing microfinance products

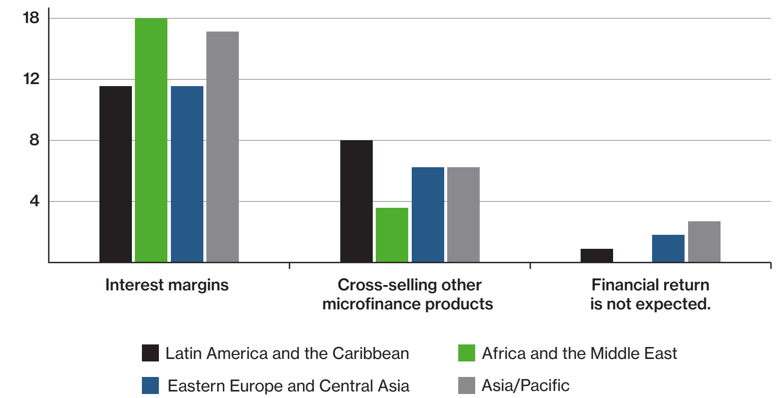


Figure 59: Average percentage of new housing microfinance clients

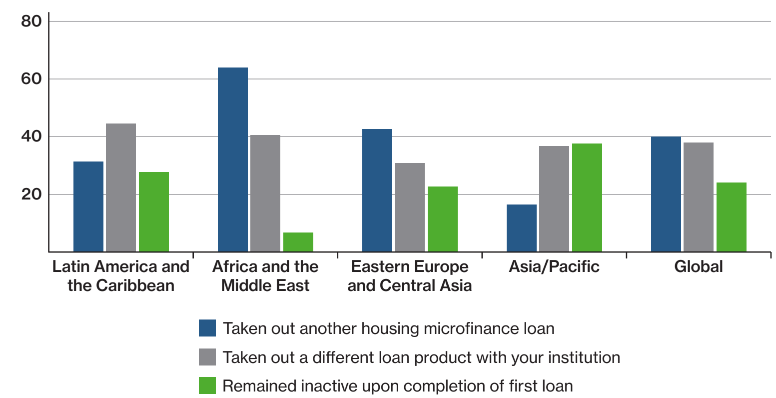


Figure 60: Expected return horizon

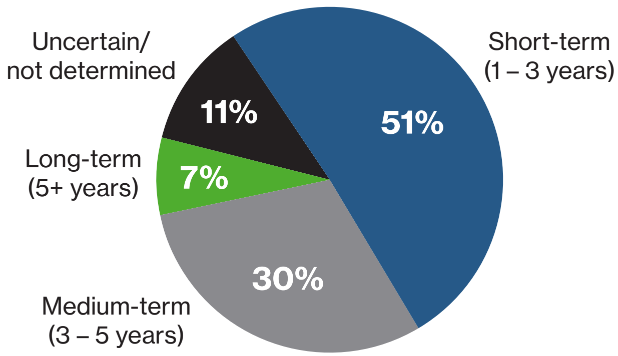
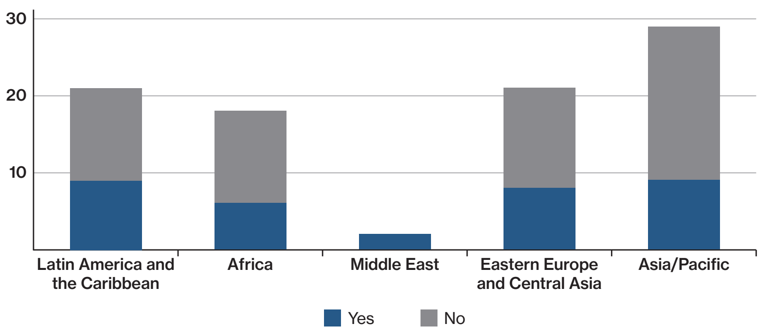


Figure 61: Did you conduct a profitability analysis in the last 12 months?



realized within one to three years of the product's launch. An additional 30 percent expected to realize profits in the medium-term (three to five years), and only 7 percent of institutions indicated returns were expected only in the long term (five or more years).

What does the actual return profile look like?

Thirty-seven percent of institutions that participated in the 2016-17 survey conducted a profitability analysis within the 12 months prior to the survey. We asked these institutions additional questions regarding the profitability of their housing microfinance portfolios versus their general microfinance portfolios, including identifying the most profitable products, return on assets, and contribution to profits.

Data collected on average contribution to profits provide us with some insight as to the significance of housing microfinance regarding the profitability of financial institutions. The responses indicate that the contributions of housing microfinance products to profitability, which average 14.5 percent, are comparable to those of consumption loans (12 percent) and other business loans (17 percent). Short-term working capital products still appear to dominate most institutions' portfolios, and contribute on average 43 percent to profits.

These figures suggest that financial service providers, even those currently offering housing microfinance products, have not yet fully realized the potential for these products. Housing microfinance products do not appear to be driving the profitability of financial institutions, perhaps affirming that though a contributor to the financial profitability of the institution, its inclusion within the range of product offerings is truly a blend of profitability incentives and social objectives. To better understand the potential of housing microfinance products within the overall portfolio of financial institutions, we look at the reported profitability relative to that of other products and at average return on assets, or ROA.

Starting with the qualitative information, 47 percent – nearly half – of the institutions reported their housing microfinance products to have relatively the same profitability as their other products. An additional 35 percent stated their housing product to be less profitable, while 18 percent said it was more profitable. When asked which product was the most profitable, the majority of institutions (55 percent) said that short-term, working capital loans were the most profitable, followed by business loans (26 percent). Housing microfinance loans came in third on the ranking, with only 10 percent listing this product as their most profitable (which includes a couple of housing-exclusive institutions).

The quantitative data, however, tell a slightly more positive story when it comes to housing microfinance products. Eight institutions out of 23 reported the return on assets for their housing microfinance loan product to be higher than the ROA for their general microfinance products. The highest average returns were reported in Africa and the Middle East, while the lowest average ROAs for both general and housing portfolios were in Eastern Europe and Central Asia. Yet housing portfolio ROAs outperformed the ROAs of general portfolios in both these regions. The housing portfolio ROAs for Asia/Pacific and Latin America and the Caribbean, however, both came in lower than the ROAs for general microfinance portfolios in their regions.

It must be noted that the data sets for these two indicators, ROA and profitability, were too small to extrapolate sectorwide conclusions, but these findings do provide a baseline upon which to build future studies that it is hoped will lend more certain conclusions. Figures on ROA and profitability suggest that housing microfinance could play an important role both in the lives of low-income households and in the profitability objectives of financial service providers.

Figure 62: Average contribution to profit

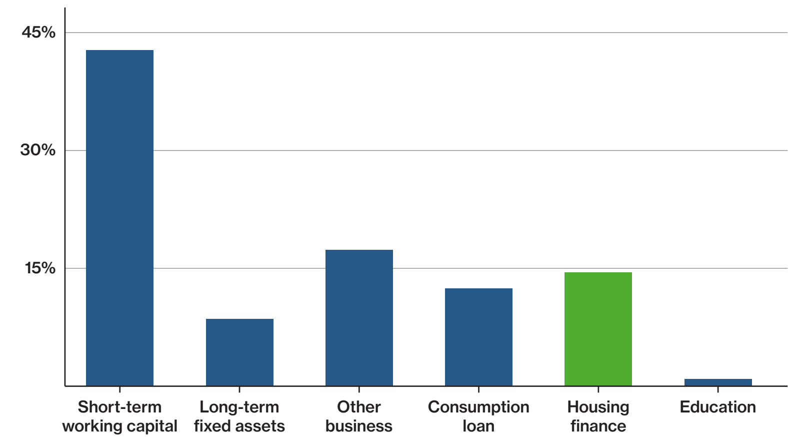


Figure 63: Housing microfinance profitability relative to other microfinance products

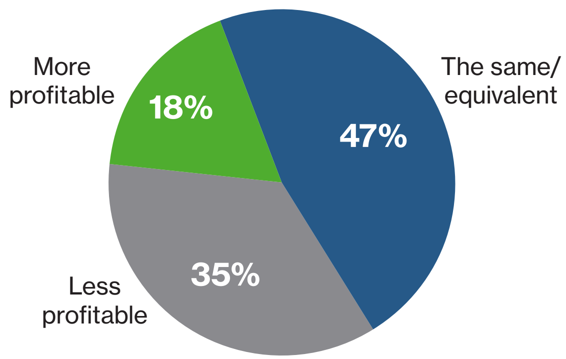


Figure 64: Most profitable product

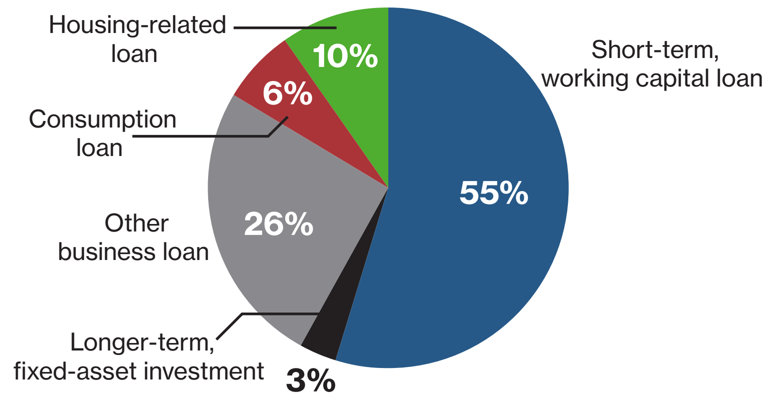


Table 2: Average return on assets

	Latin America and the Caribbean	Africa and the Middle East	Eastern Europe and Central Asia	Asia/Pacific
General microfinance	9.82%	21%	2.1%	4.7%
Housing microfinance	5.59%	40%	3.50%	3.6%

Conclusions

Housing microfinance has emerged as a powerful tool to overcome some of the most pressing challenges faced by low-income households in securing safe and affordable shelter – low affordability levels and the prevalence of unsecure land tenure – while aligning with the incremental building approach used by many low-income families as they seek to improve their shelter and overall living conditions. The 2016-17 State of Housing Microfinance Survey has reinforced trends observed in the first two editions of the survey and highlights new findings regarding profit origination and provision of technical assistance.

The question that persisted after the 2014 and 2015-16 surveys was whether there is a business case for differentiated housing microfinance products. In this latest edition of the survey, we sought to understand whether housing microfinance products make good business sense for financial institutions, and if so, how. In addition, we hoped to discover whether there are differentiating features of a housing microfinance product that make it a winning product both within the institution and within the broader housing finance market. Insights resulting from the responses of financial service providers indicate that housing microfinance, though still a nascent product, is increasingly gaining recognition as a strategic opportunity for financial service providers to maintain or strengthen competitiveness, diversify their portfolios, and tap into new markets. Housing microfinance has the potential to become a mainstream microfinance product.

To understand what is driving this, we adapted a simple framework to guide our analysis of the business case for housing microfinance, looking first at market-level drivers, then institutional drivers, product segment-specific drivers, and finally profitability drivers. Following are some of the key findings that support the business case for housing microfinance products.

Market-level drivers

Demand-side constraints: Unavailability of land or formal title documentation and high demand coupled with low eligibility of potential clients can be overcome by defining an array of acceptable land tenure documentation and through adapting housing microfinance products to varying affordability levels.

The main market constraints facing financial institutions in expanding housing microfinance products come from both the demand and supply sides. The primary demand-side constraints are unavailability of land or formal title documentation and high demand coupled with low eligibility of potential clients. Financial institutions can address the first constraint by becoming familiar with the land laws and regulations in their market so that they adapt loan requirements to include an array of formal land title alternatives and informal proxies as deemed appropriate for the institution's market context and risk appetite. In addition, a financial institution can address the low eligibility of potential housing clients by adapting product offerings to the different affordability levels within the low-income population. This approach requires a financial institution to move beyond a "one-size-fits-all" model to consider developing a menu of product offerings that acknowledges the variety of housing needs and improvements for which loan products may be used, integrates with the typical incremental building process, recognizes local behavioral norms and preferences, and offers terms that are inclusive and affordable for the variety of subsegments within the institution's target market.

Supply-side constraints: Regulatory policies and practices affecting capital markets can undermine potential growth of housing microfinance portfolios and should be carefully evaluated in developing the housing microfinance product strategy.

The main constraints on the supply side are related to capital markets. Regulatory policies and practices such as caps on the size of a housing portfolio (as a percentage of an institution's overall portfolio); caps on interest rates; prohibitive capital adequacy requirement ratios, or CAR; direct intervention by an external agency in the specific terms of a housing microfinance product; and any external approval required to release the product can undermine the potential growth of a housing microfinance portfolio. The implications of the local regulatory and policy environment must be carefully observed in order to expand housing microfinance products.

Competitiveness within markets contributes to expansion of housing microfinance products.
Looking at the competitive landscape for housing microfinance products, there is a huge market opportunity for these products, as evidenced by the growth of the portfolio size of housing microfinance products once they are launched. We observe that financial institutions with an established position in the microfinance market, particularly market leaders, often seem to be better positioned to introduce new products and innovate upon them for their local context. As these institutions demonstrate the feasibility of implementation, highly competitive institutions will follow their lead and may introduce other adaptations to housing microfinance products. In this way, the competitive market can actually drive the expansion of housing microfinance at large.

Institutional-level drivers

Housing microfinance adheres to social mission but also enables expansion of market reach.
Housing microfinance, as a concept, aligns with the social mission of the majority of microfinance institutions, and as a differentiated product it offers a means through which financial service providers can better support clients in their efforts to improve their shelter and overall quality of life. Indeed, 90 percent of survey respondents listed social mission as one of the top three reasons for introducing a housing microfinance product. However, the potential of the product has gone beyond this and proves of strategic value to financial institutions in expanding their market reach in two ways: deepening market reach through the design of products that meet previously unaddressed housing demand/needs of current clients and broadening market reach by enabling the institution to reach new market niches. Lack of adequate capital impedes housing microfinance growth but poses an opportunity for impact investors seeking a double bottom line.The data indicate that the growth of the housing portfolio and potential returns are impeded by the duration mismatch in capital funding and a knowledge gap regarding housing. Financial service providers require patient capital to grow and expand the portfolio, along with more support in learning the nuances of housing. Financial institutions still in the early stages of launching a housing microfinance product often rely on only one source of capital funding for the new product, but as they expand, a greater mix in capital sources is observed. The funding sources used (and their relative proportions) did appear to vary somewhat based on institutional type and the availability of preferable rates for institutional borrowing, whether local or foreign.

The funding dilemma highlights a potential opportunity for impact investors to address this need as financial institutions seek to diversify funding when scaling up a housing microfinance product. To better understand the investor perspective on funding housing microfinance products, the Terwilliger Center commissioned a consultant to conduct a one-time survey on the state of investment in affordable housing in emerging and frontier markets with a particular focus on (1) investors' current activities in housing, (2) plans for investments in the sector, and (3) opportunities and perceived risks from an investor perspective. The findings of this survey are consolidated in a separate report titled *State of Investment in Affordable Housing*.

Lack of knowledge and institutional capacity are leading constraints to housing microfinance product growth, but financial service providers are addressing this by investing in staff and hiring expertise.
Though lack of knowledge and institutional capacity was cited as a leading constraint on housing microfinance growth, financial service providers also shared their approaches to successfully implementing a housing microfinance product. Many indicated that they invested in training staff, hired consultants, or developed new marketing strategies to better incentivize loan officers and to address the knowledge gap on both the organizational side and the client side. Approaches include offering tips for clients and incorporating an educational component in the loan origination process.

Product segmentation drivers

Adaptation of housing microfinance products for differing housing-related purposes and client affordability levels can increase inclusivity and open new markets for financial service providers.
Though originally seen as a means to fulfill a social mission or retain clients, today housing microfinance appears to be increasingly recognized for its potential to unlock new markets for financial service providers. The variety of housing needs, ranging from physical improvements such as adding on a room, sealing a floor or strengthening the roof, to solar power installation and other energy-related improvements, to WASH-related uses, along with varying affordability levels within target markets, present an opportunity for financial institutions to diversify their portfolios with an array of housing-related loan products.

In addition, the realities of urbanization and the failure within the formal housing finance market to address the global housing shortfall present further opportunities for financial institutions to address the needs of low-income households even beyond the homeowner-focused model. Financial institutions are tapping into new markets by designing targeted products such as environmental loans or WASH loans and even entering into rental housing markets. Each market segment presents different risks, challenges and opportunities that should be considered, along with the social norms, perceptions, needs and affordability levels of these segments. Successful implementation of a housing microfinance product depends on allowing this analysis to inform the design of the product, the choice of marketing approaches, the distribution channels and the expansion possibilities.

Profitability drivers

Inconsistent income of potential clients – the most widely cited risk – provides limited demonstration of real risk, yet profitability indicators demonstrate housing microfinance as a still nascent product.
If the risk of inconsistent and unsteady client income were to be realized, it would be manifested in a portfolio as late payments and delinquent accounts. However, based on the data collected in the 2016-17 Housing Microfinance Sector Survey and the prior two editions of the survey, housing microfinance products have outperformed general microfinance portfolios in terms of both PAR30 and the write-off ratio. Additional risks and cost considerations beyond inconsistent client income must factor into product design and implementation; these include nonfinancial support services or technical assistance provided to clients, difference in lending methodologies between housing products and traditional microfinance products, and the monitoring process. Although initial figures indicate positive returns for housing microfinance products, the data also indicated that many financial service providers have yet to fully realize the potential returns for these products.

The cost structure of nonfinancial housing support services doesn't seem to support their expansion as an add-on service, but rather as embedded within the loan origination process and implemented by the staff in charge of selling and assessing loan eligibility.
Nonfinancial support services and housing support services are intended to support and educate housing microfinance clients in developing positive financial behaviors and ensuring sound construction/installation through the loan product. Just under half of surveyed housing microfinance service providers offer some form of support services to their housing microfinance clients. These services ranged from advice on budgeting for a construction project to actual construction technical assistance. The structure and content of these services should be based upon local market constraints and factored into the cost structure of the product (e.g., should legal supports in securing land tenure be offered, and if so, should the costs of this service be borne by the financial institution, the client or both?).

Individual lending methodology – the most common approach in housing microfinance – increases implementation costs, which must be considered while analyzing the profitability levels.
The longer duration and larger loan size of housing microfinance products make individual borrowing a much more common methodology. For financial service providers that typically offer their microfinance products via a group lending methodology, the additional costs of implementing this product through an individual lending methodology must also be considered. Loan officers used to implementing group loan products will require support to develop their capacity to sell the housing microfinance products. In addition, the depth of loan monitoring deemed necessary to ensure appropriate use of each loan can also pose an operational burden. One way to reduce the impact of these costs on the pricing and yield of the housing microfinance product is to adapt and streamline the loan origination and monitoring process. These risks are not easily offset by a complementary service and should rather be priced into the product terms.

With these considerations in mind, we find that housing microfinance as a differentiated product has the potential to provide financial institutions with double bottom-line returns (generating profit while helping to improve quality of life of low-income households) and to become a relevant subsector within the microfinance industry to support the housing finance needs of low-income households. The adaptability of housing microfinance products to respond to the differing needs of low-income households, the potential to deepen existing markets and unlock new markets, and the financial performance of housing microfinance products to date are all positive signs of the potential for housing microfinance as a differentiated product to soon represent a greater percentage of the overall portfolios of financial institutions.

Lastly, challenges due to the nature of housing microfinance products and market factors continue to constrain the introduction and expansion of housing microfinance, with inadequate capital, in particular, being the most often mentioned constraint. However, the positive performance of housing microfinance portfolios and their growth trajectory as part of the overall portfolios of financial institutions, despite the challenges and market constraints, should be seen as positive signs by investors to further analyze and explore the opportunity to initiate or expand investment in housing microfinance portfolios. As demand for housing microfinance persists, we hope that both financial service providers and investors consider their role in addressing the shelter needs of the 1.6 billion and the opportunity presented by housing microfinance.

Appendix 1: Survey count by country of financial service provider

Latin America and the Caribbean

Colombia	2
Costa Rica	2
Dominican Republic	3
El Salvador	2
Haiti	1
Honduras	2
Mexico	5
Nicaragua	1
Panama	1
Peru	5
Total	**24**

Africa

Kenya	8
Madagascar	1
Democratic Republic of the Congo	1
Tanzania	5
Uganda	4
Zambia	2
Zimbabwe	1
Total	**22**

Middle East

Lebanon	1
Palestine	1
Total	**2**

Eastern Europe

Armenia	1
Azerbaijan	1
Bosnia and Herzegovina	7
Georgia	2
Macedonia	2
Republic of Moldova	2
Romania	1
Serbia	1
Ukraine	1
Total	**18**

Central Asia

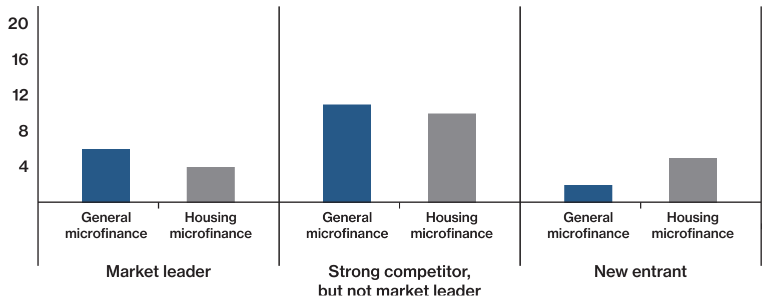
Kazakhstan	1
Kyrgyzstan	2
Tajikistan	1
Total	**4**

Asia/Pacific

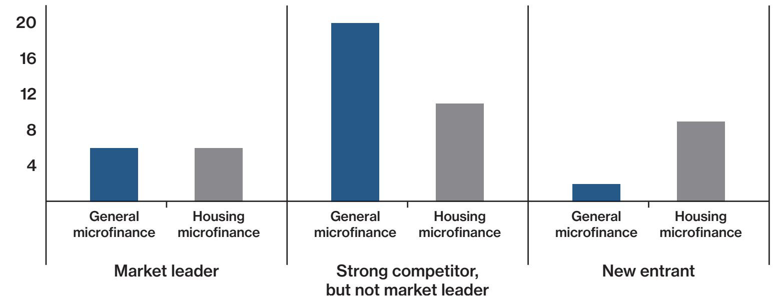
Bangladesh	2
Cambodia	8
India	7
Nepal	2
Philippines	10
Sri Lanka	1
Timor-Leste	1
Total	**31**

Appendix 2: Market position of housing microfinance actors by region

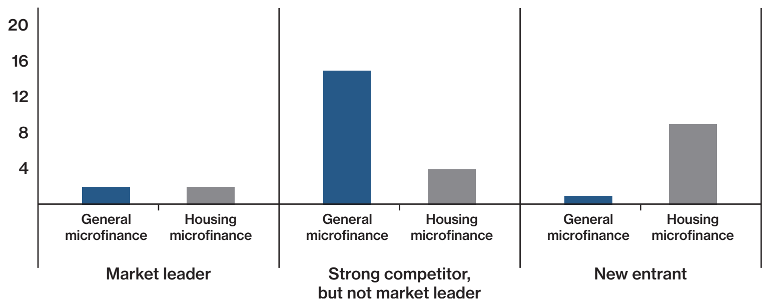
Latin America and the Caribbean



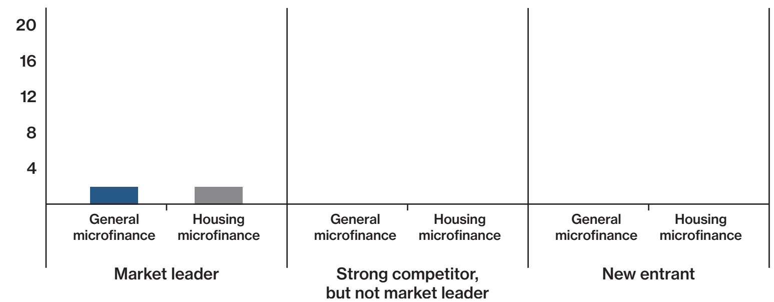
Asia/Pacific



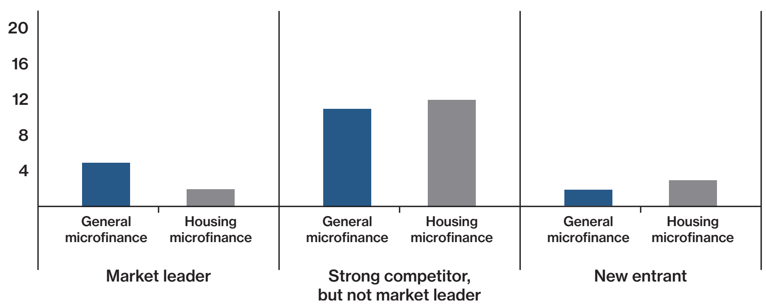
Africa



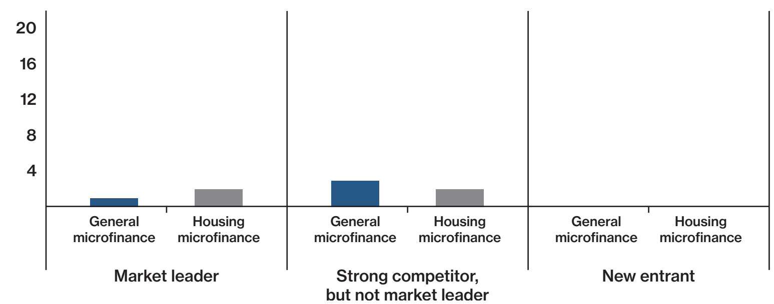
Middle East



Eastern Europe



Central Asia



Appendix 3: Technical assistance by region

Region	Constraint	Offering	Requirement	Cost allocation
Africa and the Middle East	Insufficient capacity Cost	Budgeting/personal finance Legal advice Construction advice	Mostly optional	Free Partially subsidized Paid by client
Eastern Europe and Central Asia	Insufficient capacity Insufficient demand	Construction advice Budgeting/personal finance Home maintenance	Slightly leans to optional	Free
Asia/Pacific	Insufficient capacity Insufficient demand	Budgeting/personal finance Construction advice	Mostly mandatory	Free Partially subsidized Paid by client
Latin America and the Caribbean	Cost Insufficient capacity	Construction advice Budgeting/personal finance Blueprint drafting	Mostly mandatory	Free Partially subsidized Paid by client

Appendix 4: Average interest rates for housing microfinance products by region

Average interest rates for housing microfinance products	Average	Numerator
Global average	25.8%	71
Latin America and the Caribbean	26.5%	20
Africa	33.4%	14
Middle East	10%	1
Eastern Europe	25%	12
Central Asia	27%	4
Asia/Pacific	20.88%	20

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