Financial Services for the Urban Poor

From shacks on stilts in polluted waters in Brazil to tin-roofed mud shacks in slums in India, the poor are constructing their homes, one wall at a time. Faced with insecurity of tenure, the poor build tentatively and progressively. And even with tenure security, they build incrementally to match their uneven income streams. Yet, despite the fact that in so many developing cities around the world a majority of the population lives in slums – 60 percent of Nairobi's population, 82 percent of Lima's population – and that most housing is built informally and progressively, the poor lack access to financial institutions and to financial products tailored to the way they build.

In response to this problem, the Cities Alliance launched the Shelter Finance for the Poor Initiative to focus on an emerging and still very nascent practice of financial institutions providing housing loans to poor clients on commercially viable terms. These loans are distinct from mortgages in that they are typically not for the purchase or construction of new units, but rather for home improvement and progressive building. They are being offered as a new product line by a generation of financial institutions that built their success on providing working capital loans to the urban poor, and are now looking to expand and diversify their products to meet the needs and demands of their poor clientele.

The Cities Alliance launched this research initiative as a lateral learning partnership with five networks of finance and housing institutions: Accion International, Cooperative Housing Foundation, Frontier Finance, Plan International, and MEDA; and with six development agency partners: Inter-American Development Bank, USAID, The World Bank, the International Finance Corporation (IFC), the Urban Management Programme (UMP), and the Consultative Group to Assist the Poorest (CGAP). The three institutions analysed under this initiative include two banks – SEWA Bank of India and Mibanco of Peru – and FUNHAVI, an NGO in Mexico. Policy and regulatory constraints for housing finance for the poor in Kenya, and a government-supported second-tier finance facility in Ecuador were also analysed. The intent is that these findings, which will be disseminated widely, will advance best practices, inspire replication and adaptation, and increase the availability and affordability of shelter finance for the world's poorest households. For donor agencies looking to increase the access of the poor to credit and to support financial institutions in their efforts to reach out to this market, this initiative will have distilled a set of practices and recommendations. The Shelter Finance for the Poor initiative is funded by Cities Alliance, CGAP, IFC, and USAID.

Initial operational impacts

The Alliance's Shelter Finance Initiative has facilitated an informal network among practitioners and development agencies which is already having operational impacts:

- Accion International is introducing or expanding housing products in an additional five institutions to increase the number of affiliated institutions involved in housing loans from 6 to 11, and to eventually introduce the product line throughout the 21 Latin American and African partner institutions in its network.
- Housing micro-finance loans are being designed drawing directly on these findings in World Bank operations in Indonesia and the Philippines.
- The Alliance and the IFC are exploring the potential of a shelter finance facility extending medium-term local capital loans to financial institutions engaged in housing finance for the poor.
- Sweden's SIDA is reviewing its housing portfolio and is developing guiding principles and policies for its housing micro-finance operations.

Shelter Finance for the Poor: Lessons from Experience

Experiences and case studies analysed have already produced a number of lessons and raised critical questions for further exploration.

Findings to date:

- Shelter finance loans tend to be larger and have longer terms than microenterprise loans;
- MFIs do not rely on land title as a guarantee for progressive housing loans;
- Loans area largely made to individuals;
- Shelter finance loans carry lower interest rates than traditional microenterprise loans.

Outstanding issues for further analysis:

- The institutional and macroeconomic factors that enable MFIs to successfully introduce shelter finance;
- The level of construction assistance, if any, that should be provided by the MFI and how it should be priced;
- Locating sources of medium-term capital;
- Forms of tenure that can be used to increase access to shelter finance;
- Public-private partnerships for shelter finance delivery.

Community-Led Infrastructure Finance Facility

The Community-Led Infrastructure Finance Facility (CLIFF) is a new finance facility designed to increase the access of poor communities to medium-term sources of capital from the private and public sectors; the capital is used for urban shelter and associated infrastructure, such as access to water, energy, and sanitation facilities. CLIFF aims to support the scaling up of community-driven slum development, rehabilitation, and infrastructure initiatives, in partnership with local authorities and the private sector in poor towns and cities.

EMERGING EXPERIENCE CHALLENGES TRADITIONAL HOUSING FINANCE PARADIGMS	
Traditional Housing Finance Paradigm	**Emerging Experience**
▪ Finance must be for a complete housing solution ▪ Loans large enough for a complete housing solution (> $5,000) must be long-term and subsidized to be affordable for low-income households	▪ Low-income households are accustomed to a "progressive building" process ▪ "Progressive build" loans with market rates of interest can more easily be customized to households' capacity to repay ▪ Financing "stages" of a project with multiple, shorter-term loans rather than one larger, longer-term loan reduces interest paid by the household and risk for the lender
▪ The interest rate is the key factor in households' decision to borrow	▪ Access to capital for housing investment, simplicity, flexibility, and speed of disbursal are the primary factors in households' decision to borrow. Interest rates are important, but secondary
▪ Low-income "housing" finance follows a paradigm similar to the mortgage finance industry in North America	▪ Low-income "housing" finance follows a paradigm similar to the micro-finance industry in many countries
▪ Design, planning, and construction must be done by outside, technical experts to reduce the cost of the project and ensure the quality of construction	▪ Households can manage portions of the technical process on their own and still achieve an acceptable level of quality ▪ Households have a strong preference to make their own design decisions ▪ Role for external technical expertise likely varies depending on the project and the household. Role is as a consultant ▪ Primary role for outside expertise is in the design and costing phase
▪ Investment in housing is "non-productive"	▪ In many, though not all, cases housing investments directly generate additional income (e.g., rentals, additional space for home-based microenterprise)
Source: Shelter Finance for the Poor Series: Micasa: Financing the Progressive Construction of Low-Income Families' Homes at Mibanco.	

Micasa clients improve and expand their homes progressively.

The CLIFF will:

- provide bridging loans, guarantees, and technical assistance, both local and international, to initiate medium-scale urban rehabilitation in cities in the developing world;
- work in partnership with CBOs and NGOs who have a track record in delivery of urban rehabilitation;
- seek to attract commercial, local, and public sector finance for further schemes, thus accelerating or scaling up the response to the challenge of urban renewal.

An initial financing contribution of US$10 million equivalent has been pledged by DFID, to be contributed over three years, of which approximately US$7.4 million equivalent will be for capital for a revolving loan facility. The balance will be for technical assistance, operating, and management costs. SIDA is considering becoming a co-financier, and USAID has expressed interest (for 2003) in making local currency guarantee funds available through its country programmes. The World Bank will participate with DFID and other donors in the facility's governance.

CLIFF will initially be introduced in India, where there is considerable relevant experience.

Activities for CLIFF will be implemented by Homeless International (HI), a UK-based NGO, and its Indian partners, Society for the Promotion of Area Resource Centres (SPARC) and the National Slum Dwellers Federation (NSDF). HI will make available

Mibanco, Micasa

With almost 70,000 active borrowers, Mibanco in Peru is one of the largest MFIs in Latin America. In mid-2000, Mibanco expanded its product offering to include Micasa, a "progressive build" housing loan product – that is, the loans are designed to help households finance projects to improve, expand, subdivide, rebuild, or replace elements of their homes, rather than purchase or build a new home.

The Micasa loan programme is very similar to Mibanco's successful microenterprise lending methodology, but with four important distinctions: Micasa loans carry a lower interest rate, allow for longer terms (up to 36 months), tend to be slightly larger in size than Mibanco's typical microenterprise loans, and are available not just to microentrepreneurs, but also to low-income, salaried employees, who are poorer than the microentrepreneur clients. Micasa loans average US$916 over 11 months. Borrowers are not required to have legal title in order to obtain a loan and the guarantees used are generally not mortgages, but more traditional microenterprise guarantees such as co-signers or household assets. Loan turnaround time averages three days for new clients and one day for repeat borrowers.

For Mibanco, the addition of the Micasa product has been very positive. After 12 months of operations, Mibanco has almost 3,000 Micasa clients and portfolio at risk greater than 30 days on the Micasa portfolio of 0.6 percent. Preliminary estimates suggest that Micasa broke even on a free-cash-flow basis, including the initial systems investment, within nine months and, if it continues at current levels, will generate a return on loan portfolio of between 7 and 9 percent, significantly higher than Mibanco's overall return on loan portfolio of 3.4 percent.

SEWA Bank and the Parivartan scheme

India's SEWA Bank was registered as a cooperative bank in May 1974. The bank's initial capital came from the contributions of approximately 4,000 members of the Self Employed Women's Association (SEWA), a Gujarat-based registered trade union of poor women established in 1972. As of January 31, 2002, SEWA Bank's total outstanding portfolio was US$2,274,866, of which US$913,086 (40 percent) was housing loans. The number of active loans stood at 9,129, of which 3,677 (40 percent) were housing loans. SEWA Bank is the only micro-finance provider of scale in Gujarat, and one of two institutions offering housing finance to economically active poor people in Gujarat. The bank offers savings and a wide range of loan products designed to meet the financing needs of its clientele. Secured loans are backed by assets, such as jewellery or a lien on the client's fixed deposits held at SEWA Bank. Unsecured loans are backed by a lien on the client's demand deposits with the bank and guarantors. SEWA Bank estimates that 50 percent of its portfolio is used for housing. SEWA is a profitable bank, and has been profitable over the past five years, with the exception of 2001, when the ratio dipped slightly below 100 percent; however, the ratio is on track to be above 100 percent again in 2002.

SEWA Bank is a key partner in implementing the Parivartan scheme, a slum upgrading programme. Parivartan is an alliance of SEWA Bank, the Ahmedabad Municipal Corporation (AMC), the Mahila Housing Trust, and other local NGOs, and deserves particular mention for its innovation and its potential contribution to strategies for slum upgrading worldwide. Through the Parivartan scheme, which provides for the installation of roads, electricity, and water, AMC provides US$170 per participating household for slum upgrading. Participating households must provide a counterpart contribution of US$43; they can either borrow this amount from SEWA or use SEWA Bank's facilities to save the required amount. SEWA Bank has used the Parivartan programme to expand its client base beyond existing SEWA Union members and sees it as an important source of future growth. Based on its performance, the Parivartan model is being scaled up throughout Ahmedabad, in a linked effort funded by the Cities Alliance.

US$2 million in loan guarantees through its existing community guarantee operation. SPARC, with the assistance of HI, will work with community-based slum dwellers organisations to prepare packages for bridge loans and loan guarantees, to be presented to technical review and investment boards. Projects in India will primarily be for sanitation (e.g., toilet buildings) and housing (slum community resettlement).

Illustrative CLIFF Activity

The Municipality awards contracts to community organisations or individual contractors selected by community organisers to implement sanitation projects in their settlements. Typically the facilities comprise 20 toilets, special facilities for children, a community hall that can be rented out, and accommodation for a resident caretaker. Each facility services 1000 people. The Municipality provides the cost of land and construction, and the community pays to use and maintain the facility. However, contractors are expected to provide a 10 percent bond and to prove that they can cover 10 to 25 percent of the start-up costs. This has proven to be a real constraint on community-based contractors who do not have access to this capital. They do get reimbursed at later stages.

In this case, CLIFF would provide a guarantee to the Municipality which can substitute for the performance bond and may be sufficient to release start-up capital, or cover the performance bond through a guarantee, and provide a bridge loan to the community contractors for the start-up costs, to be repaid when municipal funds get released. Such an approach has already been negotiated in Mumbai with UTI Bank, where a guarantee was provided to the Municipality for the performance bonds and start-up costs for the construction of 220 sanitation facilities in Mumbai by slum dwellers.

The CLIFF model

- A local facility (CLIFF) provides pump-priming loans to a local NGO or CBO undertaking an infrastructure project;
- A commercial bank will loan funds to the NGO/CBO, backed by a guarantee from Homeless International;
- The pump-priming loan is repaid in local currency to CLIFF, and the bank loan is repaid at the end of the community project (when municipal funds for the project are released), allowing the guarantee to be extended to new community projects requiring the same financing vehicles.