Micasa: Financing the Progressive Construction of Low-Income Families' Homes in Peru

SHELTER FINANCE FOR THE POOR SERIES

Cities Alliance
Cities Without Slums

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Mohini Malhotra
Series Editor

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ACRONYMS/ABBREVIATIONS

COFIDE	Corporación Financiera de Desarrollo S.A. (Financial Corporation for Development)
COFOPRI	Commission for the Formalization of Informal Property
EDPYME	Entities for the Development of Small- and Medium-sized Businesses
hh	Household
NGO	Nongovernmental organization
MFI	Microfinance Institution
RPU	Registro Predial Urbano (Urban Property Registry)

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INTRODUCTION: SHELTER FINANCE FOR THE POOR

From shacks in the shantytowns of Lima, Peru, to tin-roofed mud huts in the slums of Gujarat, India, insecurity of tenure and uneven income streams force the poor to build their homes tentatively, one wall at a time.

Yet the poor lack access to financial institutions and financial products tailored to the way they build. This, 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 Cities Alliance launched the Shelter Finance for the Poor Initiative to focus on the still 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 date, few of these experiences had been viewed through the prism of scale, outreach and sustainability. This is the framework applied to the five case studies examined under this initiative. The cases include Mibanco in Peru, SEWA in India, FUNHAVI in Mexico; a wholesale fund facility in Ecuador, and the policy, legal, and regulatory environments in Kenya. A synthesis paper identifies emerging policy recommendations on taking housing finance for the poor to scale. All are accessible on www.citiesalliance.org.

This research initiative is a lateral learning partnership with five networks of finance and housing institutions: ACCION International, Cooperative Housing Foundation (CHF), Frontier Finance, Plan International, and the Mennonite Economic Development Agency. Additionally, the initiative has six development agency partners: Inter-American Development Bank, U.S. Agency for International Development (USAID), The World Bank, the International Finance Corporation (IFC), the Urban Management Programme (UMP), and the Consultative Group to Assist the Poorest (CGAP). The Shelter Finance for the Poor initiative is funded by Cities Alliance, CGAP, IFC, and USAID.

The intention is that these findings will advance best practices, inspire replication and adaptation, and increase the availability and affordability of shelter finance for poor households.

This case study tells a compelling story of how Mibanco, one of the largest regulated microfinance institutions in Latin America, added a progressive-build loan product called Micasa. Within its first 12 months, Micasa had almost 3,000 active clients, an outstanding portfolio of $2.6 million, and was profitable. Mibanco's experience with Micasa provides lessons to financial institutions on adding a housing loan product, as well as to policymakers in government and donor agencies about ways to assist institutions such as Mibanco attain greater scale and sustainability. This report also speaks to emerging lessons drawn from seven ACCION-affiliated institutions providing progressive housing loans in Latin America.

EXECUTIVE SUMMARY

Introduction

In mid-2000, Mibanco, Latin America's second largest regulated microfinance institution, with 70,000 active borrowers, launched Micasa ("my home")—its housing product. Within a short period of 12 months, Micasa achieved impressive results in terms of scale—3,000 active clients and a $2.6 million portfolio. This scale, combined with low incremental costs have ensured Micasa's profitability; as of June 2001, Micasa was generating approximately $15,561 a month in incremental net income. Moreover, Micasa is actually reaching a poorer set of clients with its housing loans than Mibanco does with its microenterprise loans.

Unlike traditional housing finance, Micasa is an adaptation of Mibanco's successful microenterprise lending methodology that provides the finance needed to complement the poor's progressive process of housing construction. Micasa has achieved rapid and profitable growth because its product was developed and launched within Mibanco's existing branch and lending infrastructure—there was no need to develop new offices or hire new loan officers. Micasa does not provide its borrowers any specific assistance in designing or supervising their constructions. Thus far, anecdotal results suggest that the quality of constructions financed is, at a minimum, acceptable. Micasa's emerging experience in housing finance indicates that adapting microenterprise techniques to housing lending may be less difficult than previously imagined.

Background

Lima, the capital city of Peru, is a sprawling metropolis of roughly 8 million people, four-fifths of whom live in households classified as "poor," earning less than $340 per month. These poor residents live in substandard housing with dirt floors and without running water. Although few households have legal title to their property, 80 to 90 percent of poor households claim *de facto* ownership of the place where they live. Half or more of the poor households plan to improve or expand their homes every year.

In this context, evidence of robust demand for housing finance abounds. However, supply has lagged far behind. Heretofore, most private financing of housing improvement for low-income clients has come from diversion of microenterprise loans, or from consumer loans wherein lenders allow borrowers to use the funds for housing. The fact that the poor have unstable income sources and lack legal titles to their property has dissuaded private-sector mortgage lenders from supplying more options. What is more, government programs have been slow to fill the gap, despite a relatively effective titling program for the property of the poor.

Mibanco and ACP—its NGO predecessor and essentially the same organization under a different legal structure—developed a successful, efficient microenterprise lending methodology and customer-focused organization through several decades of learning by doing, and have consequently grown to become the second-largest microfinance institution in Latin America. In searching for new growth areas and ways to better serve their clients' financial services needs, Mibanco looked to their early experiences rebuilding earthquake-devastated homes in Northern Peru, and to later market research showing that Mibanco's microenterprise clients also had a substantial need for housing finance. Making small adjustments to its microenterprise lending methodology, Mibanco launched Micasa in mid-2000.

Since its initial launch, Micasa has experienced very rapid growth, reaching almost 3,000 clients and $2.6 million in outstanding portfolio in just 12 months, and has grown to represent almost 6 percent of Mibanco's total portfolio. Management predicts that it may grow to make up as much as half of the bank's total portfolio within a few years.

How Micasa Works

Target Market

There are two target markets for Micasa loans: 1) Mibanco's traditional customer base of micro-entrepreneurs, and 2) low-income, salaried workers living in the same communities. Not surprisingly, the profile of Micasa clients during the first 12 months closely matches the profile of Mibanco's microenterprise borrowers. By adding low-income workers to its target market, however, Mibanco has ended up serving poorer households. Although many loan officers initially rejected the idea of working with low-income, salaried workers, feeling that they were "too risky" as clients, this group now accounts for one-third of Micasa's loans. As with Mibanco's microenterprise borrowers, half of Micasa clients are women, and 80 percent are between 25 and 55 years of age.

The Product

"Progressive-build" lending: Micasa supports the existing housing strategies of low-income households—building and improving their home in progressive stages. Micasa loans finance on-going investments in upgrades and improvement projects such as converting wooden walls to brick, replacing zinc roofs or dirt floors with cement, or adding additional rooms, one at a time. In terms of loan guaranties, Mibanco has taken a page from its microenterprise lending practices, securing most most of its Micasa loans with household assets rather than mortgages.

Terms and conditions: Though similar to Mibanco's microenterprise loans, Micasa's housing loans are larger, have longer terms, and lower interest rates. This reflects the tendency for housing loans—in contrast to microenterprise loans—not to be income-generating, meaning that housing borrowers are less able than microfinance borrowers to repay the loans out of increased income. It should be noted, however, that this is not always the case. Sometimes housing loans do generate additional income for the borrower in the form of additional rental income, or expansion of a home-based microenterprise.

Relative to Mibanco's microenterprise loans, Micasa's **interest rates** are approximately 4/5 the microenterprise rate for smaller loans and 9/10 for larger amounts. These rates contain no subsidy, and are sufficient to cover the full cost of providing the loan. Though **loan term** limits on Micasa loans (36 months) are broader than microenterprise loans (24 months), clients do not automatically take the maximum term—63 percent of existing Micasa clients opt for loans with a 6- to 12-month term. **Loan amounts** must be greater than $200 and no more than 90 percent of the cost of the project to be financed. Overall, these amounts tend to be larger than the loans Mibanco disburses for microenterprise; median loan size for Mibanco's working capital loans is $500, while the comparable figure for Micasa loans is $1,000.

Construction Assistance: Micasa does not provide its borrowers with any technical assistance in the planning, supervision, or implementation of their construction projects. While they require clients to submit a construction budget as part of their loan application, Micasa has no formal process for evaluating this budget. Through experience, loan officers have learned to evaluate whether a given construction budget is reasonable, but to date they have not been given formal training in any aspect of construction.

Delivery Methodology

The evaluation and disbursement of Micasa loans is essentially identical to that of Mibanco's traditional microenterprise loan. Loan applications for new clients typically take three days from the time the application is submitted to the time the loan is disbursed. However, repeat loans (for the same purpose) are generally processed in one day. Mibanco achieves such rapid processing times by decentralizing the loan approval decision as much as possible, giving its loan officers—who typically manage over 300 clients at a time—much discretion. An average prospective client requires anywhere from 50 to 80 minutes to complete the entire application process.

Follow-up Methodology

To encourage good repayment, loan officers will often pay a visit to first-time clients the week prior to their scheduled loan payment, encouraging them to make their payments on time. Additionally, since most clients build progressively, they expect to take out successive loans, once they have finished repaying their first. This serial borrowing provides an additional incentive for clients to make their payments on time, since rapid approval of subsequent loans will depend on clients' repayment history on previous loans.

Late repayment rates for Micasa are low, with just 0.6 percent of outstanding balances past due more than 30 days. These low figures in part reflect the youth of the Micasa product. By comparison, the portfolio at risk greater than 30 days in Mibanco's overall portfolio averaged just 2.7 percent at the end of June 2001.

Sustainability and Outlook

In the first 12 months, Mibanco amassed nearly 3,000 Micasa clients. At the same time, product profitability estimates suggest that Micasa is sufficiently profitable to allow Mibanco to continue growing the portfolio. However, such strong growth and early profitability should not suggest that all MFIs expand their portfolios to offer progressive-build housing loans will automatically achieve similar results. Much of Mibanco's early success relies on its well-trained loan officers, smooth functioning processes and procedures, and advanced management information systems. Housing loans, when they do not generate any additional income for the borrower, leave less margin for error in estimating clients' available income. Thus, two preconditions should be applied to MFIs considering adding housing improvement lending to their portfolios. First, MFI's must be confident in the quality of the capacity-to-repay analysis conducted by their loan officer's. Second, procedures and processes for an MFI's existing microenterprise lending program should be operating smoothly and efficiently.

One of the challenges for Mibanco in the future (and one of the challenges for many microfinance institutions looking to get into the housing market) is how to fund its Micasa portfolio as it grows. As the longer-term Micasa loans take on a more substantial share of the total portfolio, Mibanco will need to identify more medium-term liabilities to keep the term of its liabilities in line with its assets.

Most microfinance institutions have limited access to commercial sources of funds with terms greater than one year, yet progressive housing-improvement loan terms can be as long as five years and average 12 to 18 months. Mibanco is currently able to fund its medium-term Micasa loans because of a five-year government loan; however, as the portfolio grows, additional sources of longer-term capital will be required to avoid liquidity problems. If housing finance programs in Peru and other countries are to continue to grow, reliable access to medium-term funding sources will need to be available in the not-too-distant future.

Lessons Learned

Progressive-build financing vs. traditional mortgage lending: Micasa matches the progressive, one-step-at-a-time construction that poor clients usually use to build their homes, with successive short-to-medium term loans. This challenges the traditional belief that housing finance for the poor requires large loan amounts over long-terms with government subsidies to keep the payments affordable. Micasa's loans average $1,000 to $2,000 with terms of less than 24 months, and mortgages are seldom used as guarantees because taking a formal mortgage is generally too expensive for the lender and too time-consuming for the borrower. In short, loan terms and conditions for progressive-housing improvement loans more closely resemble microenterprise loans than mortgage loans.

Construction assistance may not be necessary: Most housing finance for low-income borrowers is coupled with design, planning, and construction assistance by technical experts. Traditionally, it has been believed that such assistance reduces the cost of projects, and ensures the quality of construction. However, Mibanco's innovative approach holds that households can manage portions of the technical process on their own and still achieve an acceptable level of quality, and that households have a strong preference to make their own design decisions. Indeed, a small study made up of 10 client interviews and a focus group of 20 clients indicated that clients were generally satisfied with the quality of their constructions and that none of the structures investigated were sub-standard.

The importance of interest rates: Traditionally, the low-income borrowers have been thought to be particularly interest-rate sensitive. However, Mibanco's experience shows that other factors may be more important—simplicity, flexibility, and speed of disbursal are likely the primary factors in households' decisions to borrow.

Housing investment may be income-generating: Whereas housing investments are generally considered as consumption spending, housing improvements often generate income for the borrower through rentals or by providing additional space for home-based microenterprise.

Outstanding Issues and Conclusions

Several key questions remain for financial service providers with existing or emerging low-income housing portfolios.

Whether and how to provide construction assistance as an integrated part of lending to low-income households? At a minimum, the experience collected to date suggests that loan officers need to be trained in how to evaluate construction budgets and simple aspects of design. However, further experimentation and documentation of the existing evidence is needed to better understand the costs and benefits of providing construction assistance.

How effectively can housing improvement finance reach the extremely poor? Mibanco's lending primarily targets poor households—those at or just below the poverty line. Other programs in Peru and elsewhere are generally similar. It remains to be seen whether sustainable housing lending programs can or should try to reach substantial portions of the "extremely poor" or whether these households are best served by subsidized or partially subsidized services.

Looking forward, the challenges faced by Mibanco's management will include: managing and sustaining the early growth, accessing medium-term capital, maintaining portfolio quality and administrative efficiency as fewer Micasa clients come from the existing base of microenterprise borrowers, and determining whether and how to provide some form of construction assistance to borrowers.

Mibanco's early success strongly suggests that many of the principles and "best practices" developed in microenterprise lending are highly appropriate to the provision of housing finance to the same families. Moreover, the process of integrating a progressive housing loan program into an existing microenterprise lender may not be as difficult as previously thought, particularly given that many housing investments do often generate additional family income, such as rent or additional space for a microenterprise.

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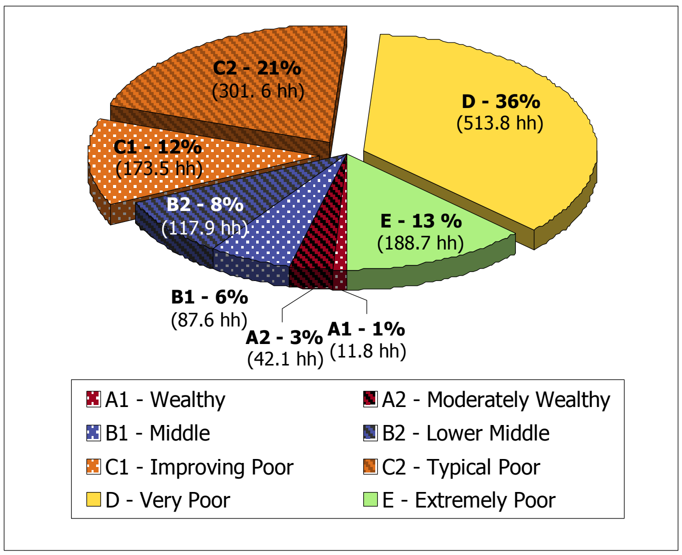
1 THE HOUSING CONTEXT IN PERU

1.1 Demand for Housing Finance in Low-Income Households

1.1.1 DEFINITION OF LOW-INCOME HOUSEHOLDS

The population of Peru is estimated at 25.6 million, of which approximately 8 million live in the metropolitan area of Lima. The wealth and poverty of these households are measured on a scale from level A1 (Wealthy) to E (Extremely Poor).[1] The majority (82 percent) of households is classified as "poor" (see Chart 1), and is the target market for Mibanco. Take note that hereafter, "low income" will be defined as levels C through E.

CHART 1. SOCIOECONOMIC LEVELS IN GREATER LIMA



1.1.2 PROFILE OF "LOW-INCOME" HOUSEHOLDS

Median family income level for the "improving poor" (sub-group C1) is $340 per month, while the majority of "extremely poor" households (group E) earn less than $110 (see Table 2). By way of comparison, the World Bank has drawn the poverty line at $175 per month, placing levels D and E clearly below and level C just above this benchmark.

[1] Information in this section is drawn from population and socioeconomic studies conducted by the marketing research firm, Apoyo Opinion y Mercado S.A., in January and July 2000.

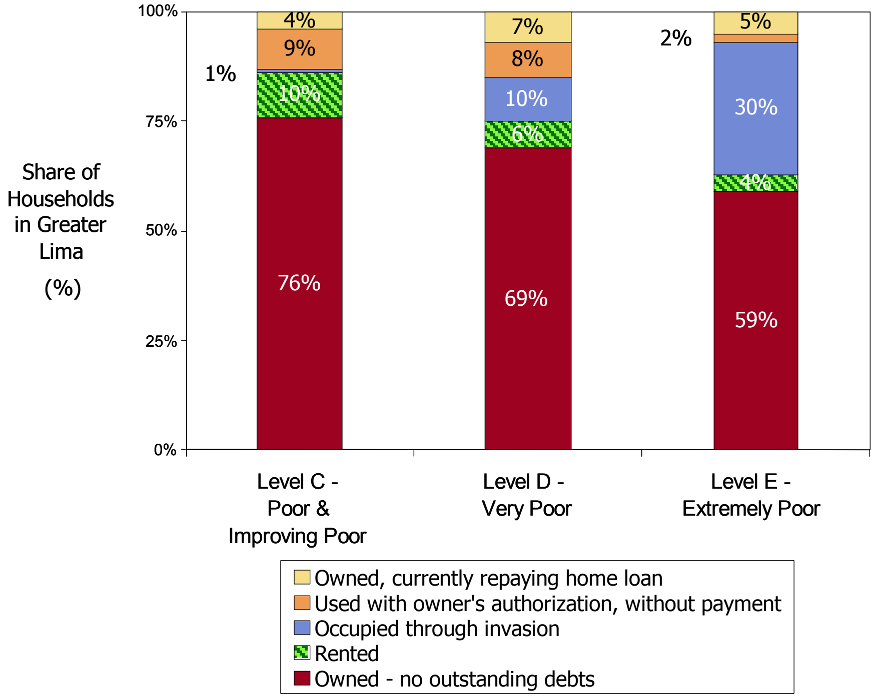
TABLE 2. PROFILE OF LOW-INCOME HOUSEHOLDS IN GREATER LIMA

	"Improving Poor" C1	"Poor" C2	"Very Poor" D	"Extremely Poor" E
Percent of households in greater Lima	12 %	21 %	36 %	13 %
Average family size	4.9		4.9	4.4
Primary source of income	Self-employed: 44 % Employee: 33 %		Self-employed: 57 % Employee: 32 %	Self-employed: 46 % Employee: 25 %
Median monthly family income	$340	$260	$165	$110
Average monthly food expenditures	$165	$151	$128	$103
Average education (# of years)	13.5 years	11.3 years	9.3 years	7.3 years
Existing bank account	44 %	27 %	13 %	5 %

1.1.3 HOUSING SITUATION OF LOW-INCOME HOUSEHOLDS

For households in levels C and D, 80 to 90 percent have a standalone house, and 70 to 75 percent claim to have "land security" (see Chart 2). In contrast, the housing arrangements of the extremely poor are less stable with nearly half living—often squatting—in improvised shelters. However, a surprising 51 percent of these households do have a standalone house, and 59 percent claim to own the property where they live. In interpreting these claims of ownership, one should differentiate between land tenure and land security. Land tenure is "legal" ownership—documented, legal evidence of registered land ownership. By contrast, land security is "effective" ownership—possession of a plot of land without formal, legal documentation. Most households claiming to "own their own property" have land security but do not have the legal, registered title that would give them land tenure.

CHART 2. HOME OWNERSHIP STATUS OF LOW-INCOME HOUSEHOLDS



The size and materials used to build these homes varies significantly between the poor and the extremely poor.

TABLE 3. PROFILE OF HOUSING CONDITIONS OF LOW-INCOME HOUSEHOLDS

	Poor & Improving Poor C	Very Poor D	Extremely Poor E
Average # of rooms:	5.3	3.7	2.3
Wall material:			
Bricks or cement	95 %	73 %	22 %
Wood	2 %	16 %	47 %
Woven mat	0 %	3 %	22 %
Roof material:			
Reinforced concrete	95 %	73 %	22 %
Calamine sheets	2 %	16 %	47 %
Woven mat	0 %	3 %	22 %
Floor material:			
Bare cement	70 %	64 %	25 %
dirt	0 %	29 %	74 %
Access to water:			
In-house	94 %	71 %	22 %
Via truck or community tank	3 %	23 %	57 %
Access to electricity:			
Yes	100 %	95 %	80 %
No	0 %	5 %	20 %

However, in contrast to this static representation, the actual housing situation of any given family is constantly changing. After all, 50 to 60 percent of all low-income households plan to improve their existing home in some way within the next year. To finance these expansions and improvements, 10 to 15 percent of low-income households have taken on debt.

TABLE 4. HOME IMPROVEMENT PLANS OF LOW-INCOME HOUSEHOLDS

In the next 12 months, will you…[2]	Poor & Improving Poor C	Very Poor D	Extremely Poor E
Expand the size of your house:			
Yes	27 %	40 %	52 %
No	69 %	55 %	43 %
Improve your existing house:			
Yes	49 %	57 %	58 %
No	47 %	39 %	36 %

1.1.4 IMPLICATIONS FOR THE LOW-INCOME HOUSING FINANCE MARKET

Such strong demand represents an opportunity for low-income financing. If the Apoyo figures are accurate and households are able to realize their plans, then each year, households in Mibanco's target market—levels C and D in metropolitan Lima—undertake more than 500,000 home construction projects. By including E, this increases by another 110,000 projects annually.

The apparently high rate of land security among low-income households suggests that most households already have a foundation on which to build, though it is unlikely that these homes can be used as mortgage collateral. The results of a World Bank study (COFOPRI 2000) indicate that 60 percent of urban property owners in Peru lack the formally recognized proof of ownership that would be necessary to secure a mortgage guarantee.

1.2 Supply of Low-Income Housing Finance in Peru

1.2.1 Government Involvement in Low-Income Housing Finance

The Peruvian national government has been involved in the low-income housing finance sector in recent years through two main initiatives: the Banco de Materiales—a state-run development agency—and, more recently, through a second-tier mortgage-lending program named Mivivienda.

Banco de Materiales

Since 1980, the Banco de Materiales ("Bank of Supplies" or Banmat) has operated as a state-run development agency providing heavily subsidized loans for the purchase of construction materials to households with legal title. Although official statistics report a large number of disbursements,

[2] Responses do not total to 100 percent because 4-6 percent of respondents replied "no comment."

the process was highly politicized. As a consequence of political turmoil and skyrocketing non-repayment rates—many Banmat clients have joined debtors' clubs and are refusing to repay their loans—Banmat has stopped issuing new loans, committing all resources to collecting on loans already made. Table 5 describes Banmat's product offering in more detail.

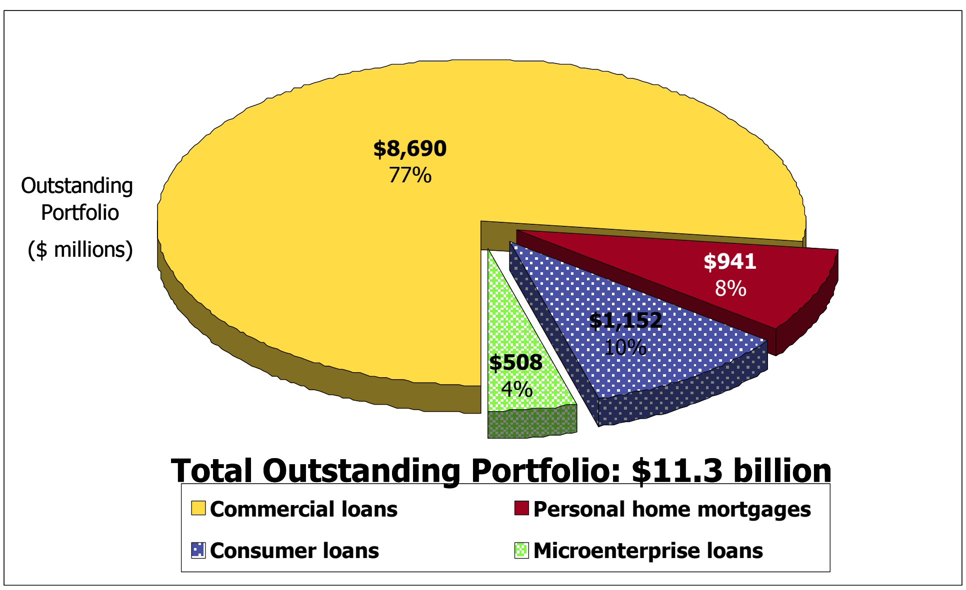
Mivivienda

Literally "My housing," Mivivienda is funded through a "solidarity tax" of 5 percent of employees' salaries, and bolsters a market for subsidized mortgage loans. The government's COFIDE (Financial Corporation for Development) acts as a second-tier lender providing long-term loans to banks at 8.5 percent to be re-lent as mortgage loans whose terms and conditions are mandated by COFIDE. Interest rates to end-borrowers are between 12 percent and 13.5 percent with loan terms of up to 15 years. The loans are made more attractive to potential borrowers through the inclusion of a good-repayment bonus (*bono de buen pagador*). Every six months, COFIDE rewards borrowers who have made their repayments on time by paying down a portion of their outstanding capital. Over the course of the loan, borrowers can have up to 20 percent of their loan subsidized in this manner.

1.2.2 Private-sector Involvement in Low-Income Housing Finance

As outlined above, informal incomes and lack of legal title prevent most low-income households from accessing the $941 million in personal mortgage loans issued annually by Peruvian banks (see Chart 3). Instead, the low-income housing finance that does occur in the formal sector tends either to be microenterprise loans diverted to housing or consumer loans where lenders allow borrowers to use the funds for housing.

CHART 3. OUTSTANDING PORTFOLIO OF FORMAL SECTOR FINANCIAL INSTITUTIONS, JUNE 2001



Although the formal supply of low-income housing finance in Peru is small and hidden in official statistics, there are a wide variety of institutions that make loans to low-income households for other purposes. In addition to Mibanco, which focuses exclusively on the low-income market, several other private banks, such as the Banco de Credito and Banco del Trabajo, have important microenterprise portfolios (see Chart 4). The Cajas Rurales and Cajas Municipales—a collection of state-sponsored community banks that primarily serve markets outside of metropolitan Lima—are responsible for 26 percent of the total microfinance market. Moreover, the entry in recent years of new firms into microenterprise lending has quickly increased competition.

Rounding out the regulated providers of low-income finance in Peru are the EDPYMEs (Entities for the Development of Small- and Medium-sized Businesses), a special category of finance companies with lower capital requirements and limitations on their deposit-taking capabilities. Ten former NGO lending programs have used the EDPYME structure to formalize their operations, five of which have operations in Lima. In addition to these formal institutions, many NGOs continue to operate small-scale lending programs in various cities. In total, more than 30 different institutions provide loans to low-income Peruvians. The rapid growth of these institutions in recent years highlights the limited but growing degree of access to formal financial service available to low-income households.

CHART 4. SHARE OF PERUVIAN MICROENTERPRISE MARKET BY TYPE OF PROVIDER

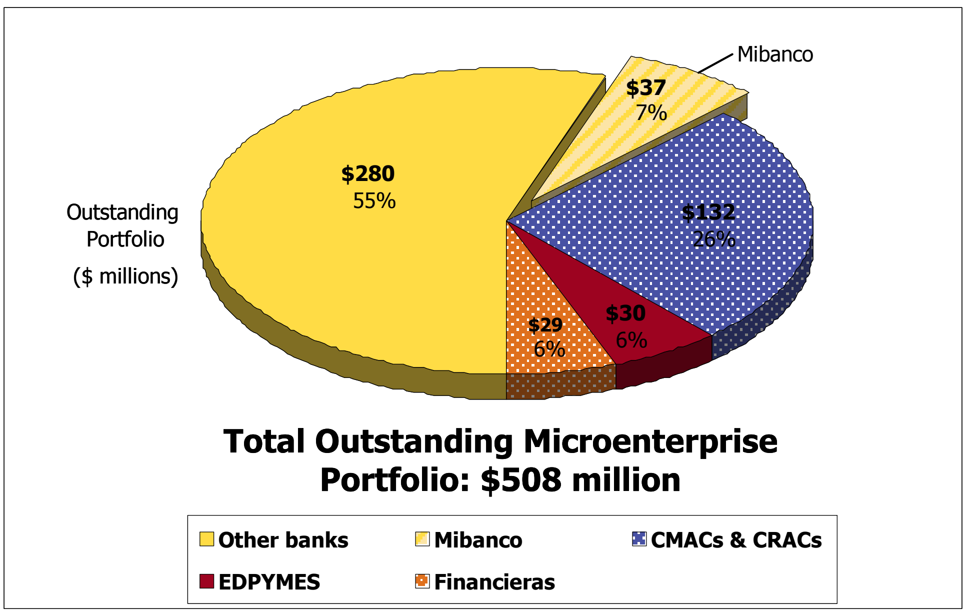


TABLE 5. COMPARISON OF MICASA & OTHER HOUSING FINANCE PROGRAMS IN PERU

	Target Market	Use of Funds	Amount	Term	Effective Annual Interest Rates	Guarantees	Application Process	Construction Assistance	Length/ Status of Program
Micasa	All low-income households with established tenancy and capacity to repay	- Client determines type of project to be financed - All types of projects accepted	Greater than $200, upper limit determined by capacity to repay Median = $750 - $1,000	3 to 36 months	45 – 70 %	- Household assets - Guarantors - Mortgages (for larger amounts)	< 5 days	None	- Launched in 1999, ongoing
BANMAT (State-run development agency)	Low- and moderate-income households that self-organize in groups of 20 or 30 and that live in communities pre-selected by Banmat	- Banmat official selects standardized project most appropriate for each client - Loan funds for materials only, no labor	- Determined by Banmat standardized construction budgets -Median = < $1,000	6 months to 15 years Repayment begins 60 days after delivery of materials	12 – 14 %	Guarantor	Unknown	- Plans and materials are predetermined. - Banmat approved technical advisor supervises construction	- Has stopped issuing new loans as a result of high non-payment rates - Many Banmat clients have joined debtors' clubs
KARPA (Consumer finance company)	All low-income households with legal land title and capacity to repay	- Client determines type of project to be financed - Loan funds are for materials only, no labor - All types of projects accepted	- Determined by capacity to repay - Median = $500 - $1,000	12 months	100 – 150 %	- Land title - Guarantor - Household assets - Informal mortgage	< 5 days	- Advice in construction techniques, registering land titles, obtaining municipal construction techniques - Standardized plans available	- Although KARPA was financially stable, it folded in 1997 when its parent, Banco ORION, collapsed
EDYFICAR (EDPYMEs)	Households earning $250 - $400 monthly and living in northern suburbs of Lima (75 % of clients must be Plan International families)	- Client suggests project to be financed. Project is reviewed and refined by Technical Advisor	$100 - $800	2 to 24 months	50 – 55 %	- Submission of land title or other comparable documents - Guarantor	10 to 18 business days	- Technical advisor on staff involved in all phases of construction from planning to budgeting to supervision and inspection of construction	- As of 8/01, 160 "progressive-build" housing improvement loans in portfolio - Support from Plan Int'l concludes in 5/02, growth of program unclear

Given the difficulty in separating out low-income housing loans from institutions' overall portfolios, it is difficult to arrive at estimates of the cost of these loans for low-income households. In Nuevos Soles in 2001, interest rates on consumer and microenterprise loans—the loans most accessible by low-income households and most likely to be used for housing purposes—averaged 65 to 80 percent, respectively. As detailed in Section 2, interest rates on Micasa loans in Soles range from 50 to 70 percent. In the overall market, interest rates in dollars and Nuevos Soles have trended downwards since 1998. With the growing number of competitors serving low-income households, it seems likely that this trend will also apply to the low-income segment of the market.

1.2.3 Implications for the Low-Income Housing Finance Market

The private sector's involvement in low-income housing finance is limited, and the lending that does occur tends to be microenterprise or consumer lending. The wide-range of organizations—banks, *Cajas,* EDPYMEs, and NGOs—that are reaching low-income households with loans for other purposes is, however, an encouraging sign. Several of these institutions, including Mibanco, Banco de Trabajo and EDYFICAR—one of the largest EDPYMEs—have, within the past two years, launched lending programs to target the housing-finance needs of low-income families. If these experiments prove successful, it is likely that other players in the microenterprise segment will follow suit.

The potential impact of government programs on the market for low-income housing finance in Peru remains unclear until the new administration makes decisions on how and whether to continue operating Banmat and Mivivienda. However, during Micasa's initial 12 months, neither Banmat nor Mivivienda posed a significant competitive threat. If they are able to deal with their significant repayment problems and begin disbursing new loans again, Banmat could represent future competition for Micasa and other private housing finance initiatives, particularly given its subsidized interest rates of approximately 12 percent per year. Even if Banmat does not restart loan disbursals, the organization of debtors' clubs could set a dangerous precedent of organized non-payment in the market.

However, if the comments of clients interviewed for this study are representative of the broader market, this seems unlikely. The Banmat clients interviewed are generally dissatisfied with the terms and conditions of Banmat lending. They clearly differentiate Banmat from the banks, EDPYMEs, and others offering market-rate loans, suggesting that dissatisfaction and non-repayment of Banmat loans is unlikely to cross over to private-sector programs such as Micasa.

1.3 External Influences on the Low-Income Housing-Finance Market

1.3.1 Political and Macroeconomic Trends

The 12 months between the initial launch of Micasa and the field visit for this study were uncertain times for Peruvians. During 2000 and 2001, Peru lived through a series of political crises and scandals that sent the economy into a downturn throughout much of 2000 and the first half of 2001.

However, the swearing in of new President, Dr. Alejandro Toledo—in July 2001 on a platform of prudent, growth-focused monetary and fiscal policies—returned a sense of stability both within Peru and internationally.

Macroeconomic stability is generally cited as an important precondition for the development of microenterprise finance, and this likely holds true for low-income housing finance as well. Although macroeconomic trends do not necessarily translate directly into the micro-economies in which Mibanco's clients and potential clients operate, the general consensus—based on interviews with clients, branch staff, and senior management—is that low-income households were increasingly concerned about the political and economic uncertainty during 2000 and the first half of 2001. As a result, many were delaying decisions on borrowing, investments, and spending until it was clear who would win the elections.

1.3.2 Land Tenure, Property Rights, and Registration

In addition to political and macroeconomic trends, the Peruvian government's efforts to address the issue of property rights and property registration also affect the low-income housing-finance market. An estimated 60 percent of Peruvian households live on land without possessing formal ownership documents, and are thus unable to use their land as a guarantee to obtain access to loans. They are also at greater risk of eviction and may be less likely to invest in improving their home.

As Hernando de Soto (2000) has documented, the process for obtaining and registering a land title in Peru used to require visits to 14 different government agencies over as many as 15 years and cost an estimated $2,000. Since 1992, the combined efforts of de Soto, a team of World Bank consultants, and the Peruvian government began to change this through the creation of two institutions: COFOPRI and the Urban Property Registry (Registro Predial Urbano, or RPU).

Created in 1996, COFOPRI (Commission for the Formalization of Informal Property) is the national government's titling agency. COFOPRI's role is to "convert informal property rights into formal ones, keeping the costs of formalization as low as possible while at the same time creating mechanisms to ensure that formalized property remains in the formal system." According to the most recent statistics, COFOPRI has granted approximately one million titles to poor households living in urban areas around the country (El Peruano 23/6/2000; World Bank, 2000).

The Urban Property Registry was created in an effort to bypass the confusion and morass of Peru's 17 existing public registries by creating a single, national institution for the registration of property titles, property transfers, mortgages, liens, and land use permits. Unlike its predecessors, the RPU's databases are maintained electronically and centralized with access available in every office. The registration process in the RPU is straightforward, requiring the household or institution to fill out a single form and have it verified by an approved lawyer, engineer, or architect. There is a one-time cost of $10.28 for completing the RPU registration process. Registration of a property title takes a maximum of seven days if the document is error-free.

The low-income housing finance market is expected to significantly expand as a consequence of this work. However, anecdotal evidence collected as part of this study suggests that the immediate impact of these changes has been somewhat limited by families' reluctance to "give up" their newly obtained titles in a mortgage, the skepticism with which several commercial banks view the "new" COFOPRI and RPU documents, and the fact that the costs of establishing a mortgage are still higher than the costs of using the traditional guarantees employed by micro-lenders. Mibanco, for instance, only accepts the new titles as a guarantee for loans larger than $4000 or $5000. Otherwise it considers the cost of establishing a mortgage guarantee too high for small loans.

1.3.3 National Building Code

The national building code should encourage the building of high-quality constructions, however, difficulties in enforcement and the high cost of permits for low-income households result in a substantial number of construction projects being completed without reference to the building code. Obtaining a permit typically costs $60 to $90 and requires a formal plan of the project. Legally, these regulations apply to all homes built out of "substantial materials"—shelters built of cartons, for example, are excluded. However, based on interviews with households in several communities, enforcement of these regulations varies from municipality to municipality.

2 HOUSING FINANCE AT MIBANCO

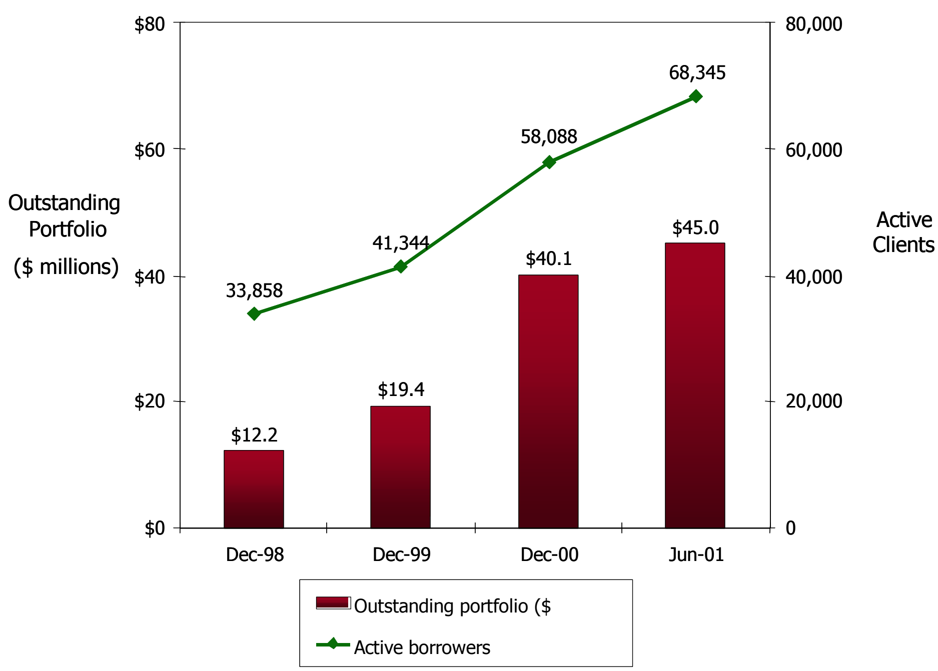
2.1 Mibanco Profile

> *"We are a private bank committed to the development of micro and small enterprises. We are leaders in providing innovative services and products that help them achieve success."*
>
> – Mibanco Mission Statement

Mibanco ("My Bank") was formally launched in 1998 as a licensed bank when it assumed the loan portfolio of Acción Comunitária del Peru (ACP), a nonprofit NGO operating in Lima. At the time of the transfer, ACP had built up a loan portfolio of $14 million dollars and 32,000 clients, all of whom were micro-entrepreneurs borrowing to build up the working capital in their microenterprises. Today, Mibanco has more than 22 offices blanketing Lima and its suburbs, and has recently expanded to open offices in the cities of Chiclayo, Huancayo, and Chincha. In the three years since the transformation, Mibanco has more than doubled the portfolio and client base it inherited, reaching 68,345 borrowers by June 2001 with $45 million in outstanding portfolio and more than $2.5 million in individual deposit accounts (see Chart 5 for the historical growth of Mibanco's portfolio since the transformation and Appendix 1 for Mibanco's financial statements).

This impressive growth has been achieved against a backdrop of growing competition from commercial banks, consumer finance companies, EDPYMEs, and NGOs. Despite the competition, profits and portfolio quality have remained strong, with a December 2000 net income of $1.2 million.

CHART 5. HISTORICAL GROWTH IN MIBANCO PORTFOLIO



2.1.1 Background

Through its development as the lending program of ACP and in the three years since transformation, Mibanco has developed a clear set of principles that underlie its operations:

- *"Focus on doing one thing, and doing it well":* As described by Manuel Montoya, Director and General Manager of Mibanco today and long-time director of ACP before the transformation, "ACP started by trying to work in all areas of development—health, education, income-generation, etc.—but gradually realized that in order to have a significant impact, we had to choose one area, and focus on doing it very well."

- *Grow carefully and maintain a strong capital base:* In 1988, ACP's lending program contracted from a portfolio of $5.8 million to less than $100,000 in a little more than a year due to a macroeconomic crisis in Peru. Although the program subsequently recovered, this crisis firmly established one of the hallmarks of ACP/Mibanco's management—grow carefully and cautiously, and maintain a strong capital base at all times.

- *Products and services should be flexible and customer-responsive:* One of the most salient features that came across through all of the interviews and site visits conducted for this study is the intense "commitment to the customer" evident in the actions of staff at all levels of the organization. Long-time staff claim that this has been one of the keys to success since the early days.

These principles are clearly visible in the development, design, and launch of Micasa.

2.1.2 Entry into Housing Finance—Micasa

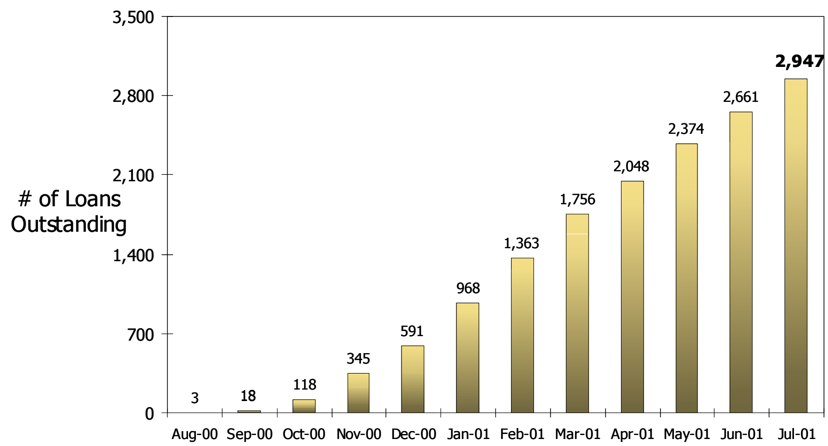
Though Micasa was not launched until August 2000, the impetus for Mibanco's entry into housing finance traces back to senior management's construction and finance experiences while at ACP. Manuel Montoya recalls experiencing first-hand the housing difficulties of poor households as early as 1970, when ACP helped to finance and rebuild houses in Northern Peru destroyed or damaged in a recent earthquake. Later, as part of ACP's "Programa Progreso" lending program in the 1980s, Montoya and ACP management began offering loans for housing and infrastructure improvements. While the program was very popular, Montoya recalled, "We just didn't have the funds to meet the demand. Although we shut down the program, we remembered the strong demand for the product and retained the desire to satisfy that need."

The transformation of ACP into Mibanco in 1998 gave management the access to sources of capital necessary to design and offer a wider range of products. From a single product—working capital loans—at the time of the transformation, Mibanco has added new lending and savings products each year in accordance with the demand expressed by clients in market research. The importance of housing as an investment priority for the micro-entrepreneurs and households in ACP/Mibanco's target market was further reinforced by market research—which suggested that many of Mibanco's existing businesses were already using loan proceeds for housing construction, and others wanted to borrow for the same purpose.

In 1999, Mibanco launched new loan products for the purchase of fixed assets and for the expansion of market stalls. Then in August 2000, Montoya and the rest of Mibanco management were finally able to respond to the need they had seen as early as 1970. Micasa was born.

Since its initial launch, Micasa has experienced very rapid growth, reaching almost 3,000 clients and $2.6 million in outstanding portfolio in just 12 months (see Chart 6), and has grown to represent almost six percent of Mibanco's total portfolio. Management predicts that it may grow to make up as much as half of the bank's total portfolio within a few years.

CHART 6. MICASA—PORTFOLIO AND CLIENT GROWTH OCT. 2000—JUNE 2001



Active Portfolio ($000s)	$5	$31	$173	$437	$664	$1,020	$1,381	$1,728	$1,915	$2,166	$2,430	$2,676

2.2 Micasa—Product Description

Micasa is a "progressive-build" housing loan product. That is, the loans are designed to help households finance projects to improve, expand, sub-divide, re-build, or replace elements of their homes, rather than to purchase or build a new home. Projects range from simple, such as adding doors, to more complex constructions, such as the addition of a bathroom. The following paragraphs describe the details of the Micasa product, including how it was developed.

2.2.1 Process of Product Development

The basic terms and conditions for Micasa lending were developed through a series of "development meetings" among senior management from all areas of the bank. According to Jesus Ferreyra, director of business operations and a 16-year ACP/Mibanco veteran, "we fairly quickly agreed that housing improvement loans would have to allow for larger amounts, longer terms, and lower interest rates than Mibanco's traditional working capital product to reflect the fact that there is no immediate increase in income from an investment in housing."

It was clear to Mibanco management from the beginning that the Micasa loans would be offered through the same branch network and the same business consultants (*asesores de negocios*) as their other loan products.[3] Given the investment already made in developing an efficient credit approval process with well-trained *asesores*, creating a separate channel or separate processes for Micasa was viewed as adding costs with no appreciable benefit. The core part of the credit process—the evaluation of a client's capacity to repay—would be essentially the same no matter the intended use of the loan. As a consequence, the institutional preparations necessary to offer the product were primarily related to training. The details of the changes made in these two areas are discussed in the "Institutional Impact" section (2.3) below.

Although only 21 loans had passed through the system during the two-month pilot, management felt confident enough to extend the product to all the branches. The managers of the pilot-test branches gathered up the experiences of their loan officers in group-discussion sessions and transferred the lessons learned to the other branch managers in a meeting at the bank's head office. Following a presentation of the product to the *asesores* in the new branches, Micasa was launched in October 2000 throughout Mibanco's entire branch network.

2.2.2 Target Market

There are two target markets for Micasa loans: Mibanco's traditional customer base of micro-entrepreneurs, and low-income, salaried workers living in the same communities. Not surprisingly, the profile of Micasa clients during the first 12 months closely matches the profile of Mibanco's microenterprise borrowers. By adding low-income workers to its target market, however, Mibanco has ended up serving poorer households. As with Mibanco's microenterprise borrowers, half of Micasa clients are women, and 80 percent are between 25 and 55 years of age.

2.2.3 Terms and Conditions

Though similar, the terms and conditions of Micasa loans differ from Mibanco's microenterprise loans in taking into account the fact that houses do not generate revenue.

With a typical microenterprise loan, the principal and interest can generally be repaid out of the profits from the investment over the course of a few months. By contrast, the proceeds from a "progressive-build" housing loan are less likely to generate an increase in income for the borrower. Households using a microenterprise loan for a housing project, run a greater risk of having repayment difficulties because their loan conditions were set assuming that they would have additional household income as a result of investing the loan in their business. Micasa's terms and

[3] The use of the name "business consultants" rather than "loan officers" at Mibanco is quite intentional. The role of *asesores* is not simply to "sell" or collect on loans, but rather to develop relationships with clients where the *asesor* acts as a trusted advisor in helping the client determine their borrowing needs.

conditions—with lower interest rates and longer terms—help households and Mibanco avoid this risk by reducing the monthly payment required for a given loan size.

Interest Rates

Micasa interest rates on loans in Peruvian Soles range from 70 percent per annum for loans less than $857 to 50 percent per annum for loans larger than $2,858.[4] Relative to Mibanco's microenterprise rates, these represent a 20 to 25 percent discount for smaller loans and a 10 to 15 percent reduction for larger amounts. The loans contain no subsidy and are sufficient to cover Mibanco's full cost of providing the Micasa loans. There are no additional commissions or charges—the full amount paid by clients is reflected in the interest rate, except in the case of mortgage-guaranteed loans, which require additional fees to cover the cost of evaluating the property and registering the mortgage.

To protect against clients using the home improvement loans as a lower-priced replacement for their business borrowing, Micasa loan contracts include a provision that the interest rate increases to microenterprise rates if Mibanco discovers that the loan proceeds have not been invested in housing. Based on follow-up visits conducted by the *asesores,* very few clients have attempted to direct Micasa loans towards other purposes in order to take advantage of the lower interest rate.

Loan Term

The term limits on Micasa loans (36 months) are broader than for microenterprise loans (24 months). The actual term of a given loan is negotiated between the client and their *asesor,* based on the client's preferred term and the size of the monthly payment relative to the client's calculated capacity to repay. Interestingly, when given the choice, Mibanco's clients have not automatically opted to take full advantage of the extended term. In fact, 63 percent of existing Micasa clients have opted for loans with a 6- to 12-month term.

Loan Amount

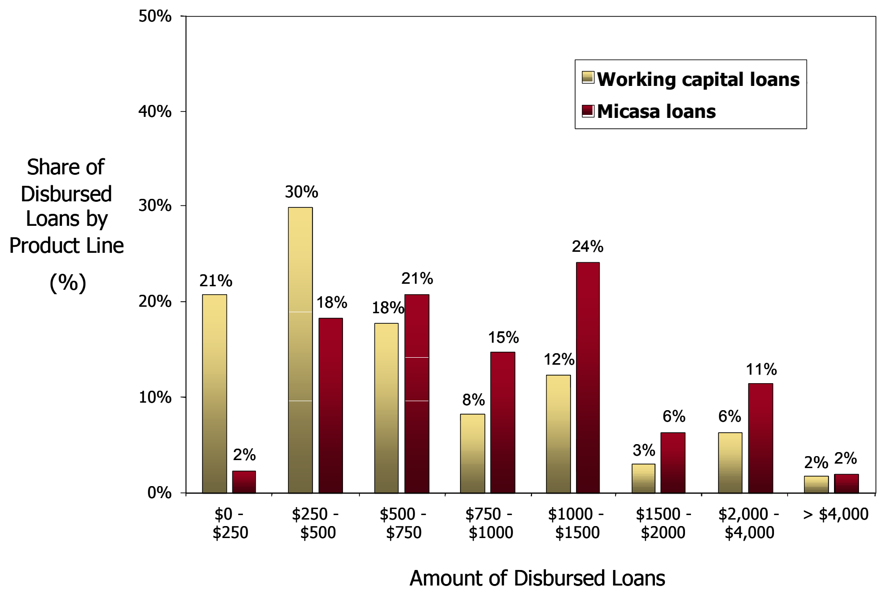
The size of Micasa loans are determined by the cost of the project clients want to build, balanced against the analysis of their capacity to repay (see section 2.2.4 on processes for more detail on this calculation). Loan amounts must be greater than $200 and less than or equal to 90 percent of the cost of the project to be financed. When the requested amount exceeds a client's capacity to repay, their *asesor* will work with them to either increase the term of the loan (thereby reducing the monthly payments, but increasing the total interest paid) or, more commonly, reduce the amount of the loan (thereby reducing the monthly payments and the total interest paid). When the amount of the loan is reduced, clients typically no longer complete their project as originally planned, and complete their projects in stages as successive loans are repaid.

On average, Micasa loans tend to be larger than the loans Mibanco disburses for microenterprise. Fifty-one percent of Mibanco's outstanding working capital loans are for less than $500, while only 20 percent of Micasa loans are below that amount (see Chart 7). The majority of Micasa disbursals range from $500 to $1,500. However, these larger loan amounts are not an indication that Mibanco

[4] 95 percent of Micasa loans are disbursed in the Peruvian currency Soles. The remaining 5 percent are disbursed in dollars at interest rates of 25 to 40 percent.

is serving higher-income clients with its Micasa program since Micasa's lower interest rates can sustain larger loans amounts.

CHART 7. DISTRIBUTION OF MICASA LOANS BY LOAN AMOUNT, JULY 2001



To control the risk of over-lending to unproven clients, Mibanco has limited loan amounts to a maximum of $897 for first-time borrowers. Clients who have borrowed with the bank previously for other purposes are not subject to this condition.

Guarantees

Micasa's guarantee requirements are the same as those applied to Mibanco's working capital loans. Micasa borrowers use household assets to secure most of their loans. A sworn declaration over assets valued at a minimum of 30 percent of the value of a loan is sufficient to guarantee a Micasa loan. Mibanco relies mainly on the quality of their up-front analysis of capacity, the willingness of clients to repay, and a rapid, sympathetic collections process to minimize the risk of defaults and losses. For clients with poor credit histories or who present a higher credit risk, more tangible physical assets or one to three guarantors can be required. All Micasa loans are individual loans. Although Mibanco does offer microenterprise loans secured by group guarantees, it does not allow group guarantees for Micasa loans.

For loans larger than about $4,000, assuming the client has clear and legal title to the property, mortgages are sometimes used. Despite the efforts of COFOPRI and the Urban Property Registry, the cost of establishing a mortgage is still prohibitively high for smaller loans (see Table 6). Establishing a mortgage guarantee at Mibanco takes 17-18 working days and requires the client to pay $68 to $200 in fees. In contrast, the household assets used to guarantee most Micasa loans are evaluated during the *asesor's* visit at no additional cost. Moreover, Mibanco does not provide any benefits, such as lower interest rates, to borrowers providing a mortgage guarantee; they are treated the same as clients with other guarantees. As of June 30, 2001, only seven percent of the Micasa portfolio was backed by a mortgage guarantee. Nevertheless, with portfolio losses at zero, it appears that Mibanco's guarantee policies are increasing Micasa's accessibility to poorer households without increasing its risk.

TABLE 6. ESTABLISHING A MORTGAGE AT MIBANCO

Process	Average Days	Client Cost
Step 1: Client prepares initial documentation - Registry report of 'clean' title - Copy of ID - Municipal valuation	—	$8.57
Step 2: Submission to local branch of Mibanco	—	—
Step 3: Mortgage documents sent to Mibanco head office for revision	Same day as submission	—
Step 4: Review documents in head office - Legal department verifies documents - Approved files returned to local branch	1—2 days	—
Step 5: Conduct independent valuation - Contracted out among 2 –3 local firms - Includes valuation report, photographs	3 days	Percent of value of home (varies with value of home) Avg. $39 - $150
Step 6: Develop loan/mortgage contract - Conducted in central office	4 days	—
Step 7: Client meeting / payment of fees - Cost of valuation - Registration fee - Notary fee - Establish temporary lien until registration completed	2 days	$21 if registered in RPU $42 if registered in Public Registry
Step 8: Establish temporary lien on property	—	—
Step 9: Sign contracts, submit to urban property registry - Signatures verified by Notary Public	7 days	—
Step 10: Loan disbursed		
Totals:	**17—18 working days**	**$68 - $200**

Other Terms, Conditions, and Requirements

If required, Micasa clients can also receive a grace period of up to two months before they begin to repay. Interest is charged during this time and is added to the regular monthly payments. Grace periods, though not common, are generally given if the construction is likely to occur over several months or if the client has an expense (such as repayments on another loan) due to end within the allowed period (see Table 7).

The minimum requirements for potential Micasa borrowers are as follows:

TABLE 7. MINIMUM REQUIREMENTS OF MICASA LOANS

Requirements	Micro-Entrepreneurs	Employees
Age	18—70	18—70
Employment experience	At least six months in business	At least 12 months working for the same company Company has strong Credit Bureau record Copies of most recent payment stubs
Identifying documents	Proof of citizenship or other formal ID; Documentation of business	Proof of citizenship or other formal ID
Proof of residence	Title, rental contract, other evidence of residence	Title, rental contract, other evidence of residence
Evidence of good repayment	Receipts from payment of telephone, water or electricity bills	Receipts from payment of telephone, water or electricity bills
Evidence of construction project	Detailed construction budget including materials and labor	Detailed construction budget including materials and labor

Other than the construction budget and the allowances for employees, these are the same requirements that apply for Mibanco's microenterprise loans.

Technical Assistance with Construction

Mibanco does not provide Micasa clients with any technical assistance in the planning, supervision or implementation of their construction projects. In the words of Jesus Ferreyra, "If we believe a client has the capability to manage and repay the loan we are providing, why wouldn't we believe in their capability to design and manage their own construction projects?"

Micasa clients are required to submit a construction budget as part of their loan application. However, there is no formal process for evaluating this budget. Individual *asesores* have learned to validate the prices and quantities of materials and labor required for different types of projects as they process more applications and by consulting local building supply yards, but there has been no formal training of *asesores* in any aspect of construction.

In sum, Micasa's loan terms and conditions are largely based on Mibanco's successful microenterprise lending methodology, with slight modifications in interest rates, loan terms, loan size, and minimum requirements (see Table 8). In fact, the biggest change for Mibanco in adding Micasa to its portfolio has been the incorporation of low-income workers into the bank's target market.

TABLE 8. SUMMARY OF MICASA TERMS AND CONDITIONS

	Micasa
Loan Amounts:	Average[5]: $916
Minimum:	$200
Maximum:	Determined by capacity to repay
Limits:	90 % of the cost of the project
Interest Rates:	< $857: 70 % $858 - $2,857: 60 % $2,858 - $14,285: 50 %
Loan Term:	Average: 11 months
Minimum:	3 months
Maximum:	36 months
Guarantees:	▪ Sworn declaration on household goods valued at >30 % of the loan amount ▪ Pledge of additional assets or guarantors (for larger amounts or riskier situations ▪ Mortgage (only for larger loan size and longer terms)
Grace Periods:	Up to 2 months (with interest)
Minimum Requirements:	▪ 18 –70 years of age ▪ Proof of employment/business experience (6 or 12 months) ▪ Proof of identity ▪ Proof of residence ▪ Evidence of good bill repayment record ▪ Detailed construction budget

2.2.4 Processes

Mibanco has, over time, invested a great deal of time and money in improving its processes for microenterprise lending to make them more efficient and responsive to clients' needs. These same processes have been applied to the promotion, evaluation, disbursement and collection of Micasa loans and are outlined in the paragraphs that follow.

Processes of Marketing

During the first 12 months, *asesores* have reported that little promotion of the Micasa product has been necessary, because many existing clients have been asking for this type of loan for years and new clients have quickly learned about the program through word-of-mouth.

Mibanco's receptionists are perhaps better described as front-line sale representatives. Although they have a variety of administrative functions, they are responsible for informing potential clients about the bank's products, receiving and verifying the information in new loan applications and providing existing customers with information on their accounts. After speaking with the receptionist, a potential client walks away with a clear explanation of the application process, a written list of the simple requirements necessary to apply and a printout of a simulated repayment calendar customized for the loan they are interested in.

[5] Average outstanding balance as at June 30, 2001.

Mibanco's *asesores* are trained to promote Micasa in a similar fashion while they are in the field. Mibanco also has developed a variety of mechanisms to encourage word-of-mouth recommendations. These generally focus on providing prizes—kitchen appliances, for instance—to clients who refer two or three new clients to the Bank.

Process of Loan Evaluation and Disbursal

The process of evaluating and disbursing Micasa loans is essentially identical to that used by Mibanco for its microenterprise lending. Loan applications from new Micasa clients typically take three days from the time the application is submitted to the time the loan is disbursed to the client. Repeat loans (for the same purpose) are generally processed in one day, unless there have been significant changes in the client's situation or in the intended use of the funds.

Mibanco accomplishes these rapid processing times by decentralizing the loan approval decision as much as possible, eliminating any extraneous information requests in the process and empowering all employees to ensure that applications do not get unnecessarily delayed.

After an applicant leaves her application with the receptionist, the *asesor* assigned to the applicant's neighborhood assumes responsibility for the application. Within a day or two, the *asesor* will conduct an evaluation visit with the applicant in her home. The evaluation visit takes 20 to 30 minutes, during which the *asesor* collects the necessary information to calculate the applicant's available income and assess her capacity and willingness to repay. At the same time, the *asesor* negotiates the term and amount of the loan with the applicant. Based on their own experience and their growing knowledge of the cost of construction materials, the *asesores* validate the construction budget supplied by the client.

When all of the information has been collected and analyzed—usually within a day or two—the application moves to the approval phase.

An average prospective client requires anywhere from 50 to 80 minutes (plus the time required for two trips to the branch) to complete the entire application process.

Process of Loan Repayment/Collections

To encourage good repayment, Mibanco's *asesores* will often pay a brief visit to first-time clients the week prior to their scheduled loan payment to check in on them and remind them to make their repayment on time. Fast turn-around times on subsequent loans to clients with good repayment records (most are processed in less than one day if there have been no significant changes) are also a strong incentive for clients to repay on time. And to encourage on-time payment, repayments can be made at any Mibanco branch.

For the few Micasa clients who, in the first 12 months, have not repaid on time, Mibanco applies the same collections process as with its microenterprise lending. The *asesor* visits clients within a day or two of their past-due payment and highlight the benefits of on-time repayment. Clients who remain delinquent after this first visit receive notification letters, subsequent visits from groups of *asesores*, and ultimately the branch manager. The emphasis of these visits is to look for an amicable arrangement that establishes a clear plan for how the loan will be repaid.

As one branch manager described, “Most delinquent clients are not intentionally delinquent.…It costs us more to lose a client for good than to show them a little understanding in collections.” Whereas this approach to collections is a departure from the hard line taken in the past, it is not a lackadaisical one. *Asesores* still have a strong incentive to prevent clients from reaching this point because they are financially penalized for all clients transferred to collections.

Late repayment rates for Micasa are well below our expectations with just 0.6 percent of outstanding balances past due more than 30 days. These low figures may reflect the youth of the Micasa product. By comparison, the portfolio at risk greater than 30 days in Mibanco’s overall portfolio averaged just 2.7 percent at the end of June 2001.

In sum, the process focuses on understanding clients’ needs and negotiating flexible solutions quickly, while controlling the risk exposure of the institution. Decisionmaking is decentralized to increase customer responsiveness and reduce processing times. At the same time, the decision makers are held responsible for their decisions through incentive plans and random visits. The end results are *asesores* who are responsible for all aspects of the lending, loan disbursals that occur in less than a week, and loyal clients.

2.3 Institutional Impact on Mibanco of Adding Micasa

2.3.1 Systems and Processes

Mibanco invested more than one year and approximately $100,000 in developing, testing and installing changes to their existing systems to handle personal loan products. They ranged from relatively minor adaptations—such as adding product and accounting codes for the new products—to more substantial revisions—such as creating new data categories for clients who are employees rather than micro-entrepreneurs.

To avoid confusion, Micasa explicitly intended to follow the same processes used for Mibanco’s working capital loans. Every department, from branch staff through collections, finance, accounting, and operations reported that little additional effort—other than the systems changes—had been required to adapt existing processes for use with Micasa.

2.3.2 Personnel

The most difficult change was altering the mindset and updating the abilities of the *asesores*. Many *asesores* initially rejected the idea of working with low-income, salaried workers, feeling that they were “too risky” as clients. Part of the difficulty in lending to employees is simply finding them at home. *Asesores* typically work during the day during the regular workweek, but low-income, salaried workers are not generally at home at these times. Serving employees has required *asesores* to work longer hours and on weekends.

With time, and training in how to identify forged payment stubs (a practice common in Peru), the *asesores* have become more comfortable working with their new target market—comfortable enough to make one-third of their Micasa loans to this group.

In contrast, the change to lending for housing improvements was almost universally greeted with a sense of relief. As one loan officer described: "For a long time, clients—many of them my best clients—have been coming to me asking for loans to fix or expand their houses. In the past, I had to say 'no,' or look the other way when they used some of their business loans for their house. With Micasa, it works better for both of us."

However, it has been a challenge adapting to the evaluation of construction projects rather than business opportunities. Mibanco has not provided *asesores* with any technical training and does not expect them to provide technical advice to clients on construction issues. As a result, *asesores* have attempted to learn how to evaluate the cost of proposed projects by sharing information among themselves. Both the *asesores* and the clients interviewed report that further support in this area would be helpful. As one client described: "I have borrowed from Mibanco for several years for my business and took a loan for my house a few months ago. When we discussed how much the loan was going to be for, I didn't know if the contractor's estimate was accurate or not—and neither did my *asesor*. So she said 2,000 Soles [$571] and we went ahead. Turns out that it was more expensive. Now I have a half-finished room and have to wait until I repay this loan before I can finish."

Mibanco management is currently considering how to strengthen their *asesores'* capabilities in this area.

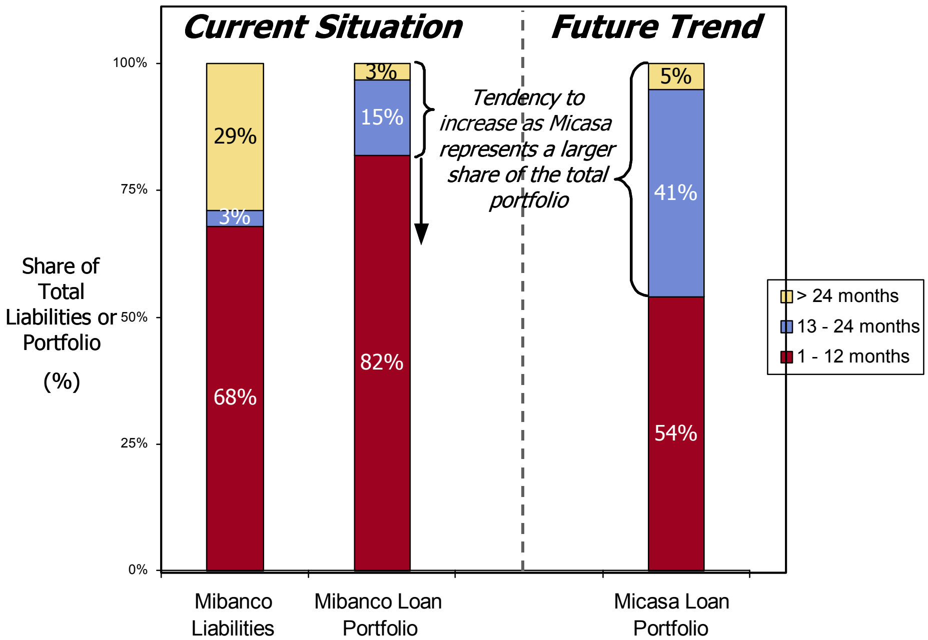
2.3.3 Financial and Operating Results

Term Risk

Part of the overall financial risk of a firm is the difference in the term of its liabilities and assets, called *term risk*.

Mibanco's traditional portfolio of working capital loans has an average loan term of five months. With its portfolio turning over in less than half a year, Mibanco could easily fund these loans with short-term (less than one year) liabilities without fear of facing a liquidity crisis. Adding Micasa brings the potential risk of extending the average term of Mibanco's loan portfolio beyond that of its liabilities. However, Mibanco is not currently exposed to significant term risk (see Chart 8) thanks to a five-year line of credit signed with COFIDE. Mibanco currently has almost twice the amount of long-term (greater than 12 months) liabilities as long-term loans. However as the Micasa portfolio grows, the share of long-term loans in its portfolio will continue to rise, creating potential exposure to term risk. Given that Micasa is not the only new product in Mibanco's portfolio increasing the average term of its loan portfolio, Mibanco is actively interested in developing additional sources of long-term funding to meet this future need.

CHART 8. MIBANCO—TERM STRUCTURE OF ASSETS AND LIABILITIES, JUNE 2001



Product Profitability

Although Mibanco does not track its products as separate profit centers, all indications suggest that Micasa has quickly become a profitable addition to Mibanco's suite of products. In 2000, Mibanco's overall operations earned $1.2 million in net income, representing a return on loan portfolio of 3.4 percent. (See Appendix 1 for Mibanco's full financial statements from 2000.) Micasa's impact on these results can be considered in two ways: comparative product profitability and return on investment.

1. Comparative Product Profitability: This approach compares the profits generated by Micasa against Mibanco's overall portfolio. Using a conservative set of assumptions, one can generate an approximate income statement for Micasa during its first twelve months. (See Table 9 and Appendix 3.) By December 2000, just five months after its launch, Micasa was generating positive net income. As of June 2001, Micasa was generating approximately $15,561 a month in incremental net income.

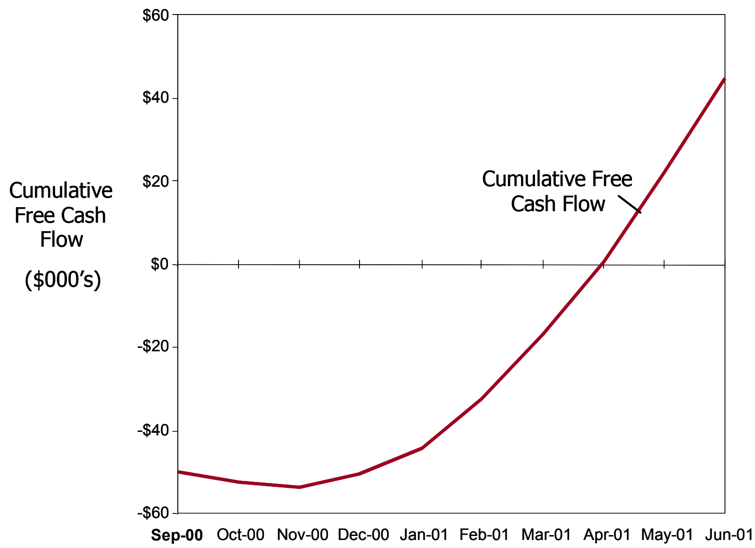
TABLE 9. ESTIMATED MICASA INCOME STATEMENT, OCT. 2000—JUNE 2001

in $000's	Oct-00	Dec-00	Mar-01	Jun-01
Average Monthly Portfolio	$71,223	$590,556	$1,515,786	$2,240,919
Interest income	$2,801	$22,290	$58,326	$85,522
Interest expense	$958	$7,169	$17,392	$26,500
Gross Financial Margin	$1,844	$15,121	$40,934	$59,022
Operating expenses	$4,355	$11,569	$20,091	$27,137
Depreciation & provisions	$1,062	$2,902	$7,723	$6,951
Total Expenses	$5,416	$14,471	$27,815	$34,088
Net income before tax	($3,573)	$650	$13,119	$24,935
Estimated taxes	$0	$244	$4,932	$9,373
Net Income After Tax	**($3,573)**	**$406**	**$8,188**	**$15,561**

These monthly net income results can then be divided by Micasa's average outstanding portfolio and compared against the 3.4 percent return achieved against Mibanco's overall portfolio. Estimates of the return generated by Micasa over its average portfolio range between 7 and 9 percent, depending on the assumptions used. While these are estimated figures, the fact that they are significantly above the overall return on loan portfolio figure suggests strongly that Micasa is not only generating a profit, but that it is also increasing the relative profitability of Mibanco.

2. Return on Investment: This approach compares the cumulative free cash flow generated by Micasa against the initial investment incurred in developing and launching the product. Mibanco estimates that development costs for the launch of Micasa and Mifacilidad (its personal loan product) were approximately $100,000. Assuming that half of this amount is relevant to Micasa, Mibanco is estimated to have reached a break-even point on its investment in Micasa in approximately April 2001, nine months after the pilot launch. Chart 9 depicts the estimated cumulative free cash flow generated by Micasa, including the initial investment.

CHART 9. ESTIMATED MICASA CASH FLOW, SEP. 2000 – JUNE 2001



Efficiency and Portfolio Quality

This analysis considers the operational impact of Micasa by looking at key indicators of operational efficiency and portfolio quality. After only 12 months, it may be premature to accurately judge, but the initial trends are positive. Exact figures on changes in loan officer caseloads before and after Micasa are not available. However, the consensus among loan officers and branch managers was that the introduction of Micasa has lead to small increases in the number of clients per *asesor*, but larger increases in outstanding portfolio per *asesor*. Looking ahead, as *asesores* increasingly need to look outside their existing portfolio for new Micasa clients, it will be interesting to monitor how Micasa loans will affect their case-loads.

In terms of portfolio quality, initial indications for Micasa are very positive. It will be several years before a "steady-state" picture of Micasa's portfolio quality emerges; however, with late repayment rates of less than 1 percent, the early results are encouraging (see Table 10).

TABLE 10. MICASA PORTFOLIO QUALITY

Portfolio At Risk > 30 days	Aug. 00	Dec. 00	Mar. 01	Jun. 01
Micasa	0 %	0 %	0.06 %	0.4 %
Total Mibanco	1.7 %	1.7 %	2.3 %	2.7 %

2.4 Client Impact

2.4.1 Use of Funds

Based on discussions with Micasa clients and interviews with the *asesores*, several interesting trends emerge regarding how clients are using Micasa loans:

- *Type of project is highly variable:* Among the clients interviewed, there was no clear trend among the types of projects financed. They ranged from the relatively simple replacement of windows to the more complicated replacement of foundations.

- *Many projects have an income-generation component:* Although not the majority, a substantial number of the projects generated additional income for the borrowers. Income-generating projects include: building extra rooms to accommodate renters, adding a second story to create more space for a microenterprise, and adding rooms or windows to create the space needed to expand or start a new microenterprise.

- *Micasa funds are often combined with additional resources*: Many of the clients interviewed used the Micasa funds in combination with savings or other borrowings (formal and informal) to complete a project. Savings were often in the form of previously purchased construction materials.

- *Few projects are completed with a first loan:* Virtually all of the clients interviewed had not completed their construction project with their first loan. Perhaps their loan amount had been limited because of insufficient capacity to repay, or maybe the estimation of the construction budget was inaccurate. Alternatively, the client may have decided to increase the scope of the project during construction.

- *Risk of diversion of housing loan funds seems small: Asesores* consistently report that few, if any, of their clients have attempted to use their Micasa loans for other purposes, despite the lower interest rates.

BOX 1. IMPACT OF MICASA BORROWING

Maria, a market vendor living in a poor *barrio* south of Lima built on "invaded" land, borrowed 2,000 soles ($571) from Mibanco over 12 months for her home. For more than five years, Maria had been saving what she could out of her monthly income of $150 to buy the bricks needed to convert the walls of her two-room home from particle board and to add rooms on the back of the house for her children. She applied for the Micasa loan so that she could finish buying the materials and pay for the construction labor. In applying for the loan, Maria consulted with friends and neighbors to find a contractor with a good reputation. However, when the contractor started building, he realized that the soil on Maria's lot was unstable and needed significant reinforcement to support the weight of the new walls. To cover the additional construction costs, Maria borrowed from family members and a local moneylender. Seven months after taking her Micasa loan, Maria now has encased her original two rooms and kitchen in brick and has installed a cement floor. The walls of the new rooms are complete, but they still lack a roof and solid flooring. Maria has repaid her family members and the moneylender and has five payments left on her Micasa loan. When she finishes repaying her existing loan, she plans to take another to continue work on the additional rooms and begin replacing the tattered zinc and wood panel roof.

2.4.2 Quality of Construction

Micasa was intentionally designed without any technical advice or construction assistance for borrowers. This has allowed Mibanco to provide loans quickly and profitably, but it also raises questions regarding the quality of the projects being built. Although a more thorough analysis is required to completely address these questions, three distinct trends emerged from the client interviews and visits to clients' homes:

- *Existing constructions are of "acceptable" quality:* None of the projects visited were of substandard quality. In certain cases, less poor clients (level C) had chosen to hire technical help to assist them with the planning or supervision of the project. This additional assistance significantly improved the quality and design of the constructions, but even so, the projects that did not have this assistance were still found to be safe and structurally sound. In addition, several clients had experience as general contractors or had family members with similar experience who provided construction advice for free.

- *Interest in construction assistance is varied, but some minimum level is widespread:* Although clients varied in their desire to receive construction assistance, some minimum level of assistance was almost universally requested, particularly in the initial design and costing phase of the project. Interest in more substantial assistance varied depending on the person and the type of project. Not surprisingly, there was greater interest in advice for larger, more complicated projects.

Implications for Micasa

Among those interviewed, some clients hired technical support on their own, others obtained free consultations from friends or relatives, and still others relied on the technical skills of the contractor that they hired. If these trends are representative of the broader population, they suggest that the housing finance programs may not need to incorporate significant construction assistance.

One of Mibanco's challenges in the coming months and years will be to determine whether and how to accommodate borrowers' varied needs without jeopardizing the speed and simplicity of loan application and disbursal, which was almost universally mentioned as the most important and valuable aspect of the Micasa service.

2.5 Micasa Summary

Micasa has grown to almost 3,000 clients and $2.6 million in outstanding portfolio in the 12 months since its inception. These results have been achieved by making only minor modifications to its microenterprise lending methodology and avoiding the inclusion of construction assistance as part of the core financial services.

Looking forward, the challenges faced by Mibanco's management will include: managing and sustaining the early growth, maintaining portfolio quality and *asesor* efficiency as fewer Micasa clients come from the existing base of microenterprise borrowers, and determining whether and how to provide some form of construction assistance to borrowers without hurting the profitability and efficiency of the product.

3 COMPARATIVE EXPERIENCES IN HOUSING FINANCE

3.1 Description of Other Experiences In Latin America

As part of an emerging "Working Group on Housing Finance" in August 2001, ACCION International brought together housing finance representatives from seven of its network affiliates and partners (including Mibanco) to create a forum for sharing knowledge between institutions in Latin America.

Among the participating institutions, the products offered ranged from straightforward "progressive-build" housing improvement loans to construction of complete communities. There was general agreement that each product can be appropriate depending on the target market, institutional goals, and local context. However, the participants strongly agreed that housing improvement lending was the product most likely to be appropriate for the majority of low-income households and the most similar to MFIs' existing microenterprise loan products.

Among the institutions with experience in housing improvement lending, there was strong consensus on most of the basic terms and conditions of these loans (see Table 11). In general, the idea behind "progressive-build" housing improvement loans is to establish a relationship with the client that, over the course of multiple loans, will allow them to renovate or rebuild their homes.

TABLE 11: PARAMETERS FOR TERMS AND CONDITIONS OF HOUSING IMPROVEMENT LENDING

	Consensus Parameters Established by Latin American MFIs
Target market	▪ All low-income households with established tenancy and capacity to repay (includes microenterprises and low-income, salaried workers)
Use of funds	▪ Client determines type of project to be financed ▪ All types of projects accepted
Amount	▪ Generally less than $5,000
Term	▪ Up to 5 years (average < two years)
Effective annual interest rates	▪ Sufficient to cover full cost of providing the product ▪ Lower than microenterprise rates
Guarantees	▪ Standard guarantees accepted for microenterprise ▪ Mortgages only for loans greater than ~ $4,000
Provision of construction assistance	▪ Minimum training of loan officers required ▪ Additional assistance depends on clients' needs and institutional capacity to provide

As indicated above, the provision of construction assistance to borrowers is varied among these institutions. One El Salvador-based MFI has been lending for more than 10 years without providing any construction assistance and, to date, has not reported difficulties in construction quality or dissatisfied clients. At the same time, a fellow MFI in neighboring Guatemala found that without assistance, many constructions were of dangerously poor quality and materials waste was high, and have since integrated a technical advisor into their program.

The group agreed, however, that the need for a construction assistance component in a low-income housing finance program depends on the type of construction being financed and the goals of the institution providing the loans. For simpler projects, construction assistance likely just represents an unnecessary cost for both the client and the institution. But more complex projects—such as adding a second story—can benefit from some form of construction assistance in many cases. In addition, there were some indications that the need for construction assistance may vary according to household income or geographic location (rural or urban). Currently, those programs that provide construction assistance provide the same assistance to every borrower, and they consequently worry about the sustainability of the assistance when many borrowers may not need it.

3.2 Emerging Lessons from Comparative Experiences

Although the institutions and objectives of the programs discussed above are highly varied, a number of similarities do nevertheless stand out. These similarities suggest emerging lessons in this nascent field with respect to the demand for housing finance and product design.

3.2.1 Emerging Lessons about the Demand for Low-Income Housing Finance

The first and perhaps most significant emerging lesson from these varied experiences is that the largely unmet demand for housing finance identified among low-income Peruvian households is visible in other Latin American countries as well. In Guatemala, the Dominican Republic, El Salvador, Venezuela, Ecuador, and Colombia—just as in Peru—informal incomes, lack of legal titles, and traditional prejudices against low-income households limit access to formal sources of housing finance. Although cooperatives or developer-based finance programs are stronger in some countries, even in these markets the need and the opportunity to increasingly serve the existing demand is substantial.

In addition to this confirmation, the following lessons emerge from the collected experience presented in this study:

- *Progressive-build lending is part of a spectrum of products that can be developed for different market segments:* Although progressive-build housing loans are the most common product among the institutions studied and may have a broad appeal among low-income households, they should not be considered as the only product necessary to serve the housing finance needs of low-income households. For example, in Ecuador, Banco Solidario's "Vivienda Propia" program integrates an up-front savings component and government subsidy into larger, longer-term mortgage-backed loans for new housing construction that can reach "improving poor" households—monthly payments on these loans can be as low as $100. At the same time, there is a sense that progressive-build housing programs may have difficulty targeting the poorest of the poor without sacrificing sustainability.

- *Low-income, salaried workers are viewed, cautiously, as an important new client base:* Although the focus of virtually all of these institutions is on micro-entrepreneurs, all issue a portion of their housing loans to low-income, salaried workers. While these clients are viewed as an important new potential client base that can be served through existing distribution channels (low-income, salaried workers are often the neighbors and friends of such institutions' existing micro-entrepreneur clients), most institutions are cautious about lending to this group. Despite their regular, easy-to-verify income, the participating institutions are proceeding cautiously into this market because of concerns about the risk of job-loss among low-income, salaried workers and their limited ability to find replacement sources of income quickly.

- *Poorly designed subsidy programs can stifle demand and inhibit potential private sources of housing finance:* Although several programs integrate subsidies into their lending, the institutions participating in the ACCION working group universally agreed that government subsidies are not a necessary condition for the development of successful low-income housing finance programs. In fact, many argued that government subsidy programs, particularly those that mandate subsidized interest rates, often undermine and limit the development of commercial programs that serve the low-income market, thereby reducing the poor's access to housing finance. In general, the group argued that institutions are better off without subsidies unless the subsidy is applied to the loan capital, not the interest rate; the rules and regulations regarding eligibility are clearly defined and free of political influence; the availability of subsidies is guaranteed, or at least assured beyond the short-term; the subsidies are designed to motivate positive behaviors by borrowers and institutions rather than cover up inefficiencies and poor repayment;[6] and the subsidy disbursement process is simple and quick.

3.2.2 Emerging Lessons about Product Design

The collected experiences of Mibanco and its peers in other Latin American countries also provide an emerging series of valuable lessons regarding the design of progressive-build housing loan programs, including:

- *Basic terms and conditions of progressive-build housing loans are similar across different markets:* There was strong consensus among ACCION-associated institutions regarding the basic terms and conditions for progressive-build housing loan programs.

- *Progressive-build lending is predominantly individual rather than group-based:* Unlike the origins of microenterprise lending, nearly all of the institutions considered in this report

[6] Participants used the example here of the "good repayment" incentive built into the Mivivienda program in Peru (see section 1.2.1 for further detail). These subsidies reduce the amount owed on individual borrowers' loans only if they continue to repay their loans on time. In this way both the borrower and the lender have incentives to maintain a healthy loan portfolio.

make progressive-build housing loans to individuals only. In part, this reflects an overall trend in Latin America toward individual lending, though early evidence suggests that households are even less willing to consider a group guarantee for a progressive-build loan than for a microenterprise loan.

- *Access to capital, speed of loan disbursal, flexibility, and wider range of guarantees appear to be more important to households than interest rates:* Although many traditional housing finance programs have focused on lowering interest rates to increase accessibility for low-income households, the experiences presented here suggest that lower interest rates may be less important for many households than hassle-free access to flexible terms, amounts, and guarantees. Borrowers at nearly all of the institutions studied in this report have demonstrated a willingness to pay market rates if the loans meet these clients' needs. Clearly, lower interest rates will always be preferred over higher ones all thing being equal. However, these results suggest that interest rates do not have to be heavily subsidized to serve low-income households.

- *Multiple loans for progressive construction projects are an alternative mechanism for making loans more affordable to poorer households:* As described in section 2.2.3, providing a series of smaller, successive loans can be an effective way of reducing the monthly payment on a housing loan, thereby increasing accessibility for poorer families. Although this often delays the completion of construction, it reduces the total interest paid by the family.

- *Lower interest rates for housing may not necessarily lead to abuse:* Early evidence suggests that, at least in the initial stages, few Mibanco borrowers are considering taking advantage of the lower interest rates to use Micasa funds for other purposes. Results in El Salvador have been similar, suggesting that as long as certain controls and incentives are in place, microenterprise lenders may be able to charge lower interest rates on their progressive-build housing lending without experiencing substantial misdirection of funds.

- *Up-front savings may play a role, even in progressive-build lending:* Although down-payments and up-front savings are generally only associated with long-term mortgage lending, some institutions are also finding that integrating an up-front savings option into a progressive-build lending program can be useful. In particular, for clients new to the institution or with highly unstable incomes, up-front savings can be a valuable opportunity for the institution to improve its understanding of the client's repayment potential and for the client to reduce the amount of the loan, thus reducing the monthly repayment. In addition, up-front savings are not, in many cases, so new or unusual to low-income households. Most households are accustomed to saving in some form or another as they slowly build up the money necessary to continue building their homes. An up-front savings component simply converts these savings into a more liquid form.

Clearly there is much more to learn about how to meet the housing finance needs of low-income households as existing programs continue to mature, and new methodologies are developed and tested. However, these emerging lessons can serve as useful guidelines for both existing and new programs as the microfinance of housing moves into the mainstream.

APPENDIXES

Appendix 1: Mibanco Financial Statements

Appendix 2: Sample Micasa Pamphlet

Appendix 3: Assumptions for Product Profitability Calculations

Appendix 1: Mibanco Financial Statements

Mibanco Balance Sheet
as at December 31, 2000
(US$ 000)

ASSETS	
Cash and Temporary Investments	3,257
Net Loan Portfolio	36,289
Total Current Assets	**39,546**
Net Fixed Assets	3,637
Other noncurrent assets	2,307
Total Noncurrent Assets	**5,945**
TOTAL ASSETS	**45,491**
LIABILITIES	
Deposits & Obligations	9,492
Total Current Liabilities	**9,492**
Due to	18,4
Other Liabilities	2,160
Total Noncurrent Liabilities	**20,650**
TOTAL LIABILITIES	**30,142**
EQUITY	
Shareholders Equity	15,349
TOTAL EQUITY	**15,349**
TOTAL EQUITY AND LIABILITIES	**45,491**

Mibanco Income
For the Year Ending December 31,
(US$ 000)

Operating Income	13,810
Financial Expense	2,492
Gross Financial Margin	**11,318**
Loan Loss Provisions	804
Net Financial Margin	**10,514**
Operating Expenses	8,911
Operating Margin	**1,603**
Non-Operating Income	405
Taxes	761
NET INCOME	**1,247**

Appendix 2: Sample of Micasa Pamphlet

Appendix 3: Assumptions for Product Profitability Calculations

The following assumptions were used to generate estimated monthly income statements for the Micasa product.

Income Assumptions

Interest Income	=	Weighted average interest rate on outstanding Micasa loans x average monthly portfolio outstanding

Expense Assumptions

Interest Expense	=	*Weighted* average cost of funds x average funds utilized (average portfolio outstanding x (1 + % of required legal reserves))
Provisioning Expense	=	0.5 % of portfolio in November 2000 rising to 2.5 % in June 2001
Operations Personnel Expenses	=	Full salary cost x (2 x Micasa share of monthly transactions)
Business Personnel Expenses	=	Full salary cost x (2 x Micasa share of outstanding portfolio)
Head Office Personnel Expenses	=	1.5 % of portfolio
Marketing Expenses	=	Total marketing expenses x (2 x Micasa share of outstanding portfolio)
Other Operating Expenses	=	Total other operating expenses x (Micasa share of # of outstanding loans)
Depreciation Expense	=	Monthly depreciation expense x (Micasa share of outstanding portfolio x total loan portfolio / (total loan portfolio + total deposits)

Investment Assumptions

Up-front Capital Expenditure = ½ of $100,000 invested in systems and training

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