

## SEWA Bank: Housing Finance in India

### Series Introduction

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 finance 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 largely 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 and sustainability. This is the framework applied to five case studies examined under this Series: Mibanco in Peru, SEWA in India, FUNHAVI in Mexico; a wholesale fund facility in Ecuador, and the enabling environment for shelter finance in Kenya. A synthesis paper identifies emerging policy recommendations on taking housing finance for the poor to scale.

The objective of the Series is to look at shelter financing in practice through the prism of scale, sustainability, and outreach to the poor, and learn about best ways to encourage and promote this emerging practice.

## Introduction

SEWA Bank was registered as a cooperative bank under the dual control of the Reserve Bank of India (RBI) and the State Government of Gujarat in May 1974. The Bank's initial capital came from the contributions of approximately 4,000 members, the vast majority of whom are very poor women belonging to the Self Employed Women's Association (SEWA), a Gujarat-based registered trade union established in 1972. The bulk of SEWA Bank's capital comes from its members' savings. For the past few years, SEWA Bank also has received financing for its housing portfolio from the Housing and Urban Development Corporation (HUDCO) and the Housing Development Finance Company (HDFC). As of January 31,

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2002, SEWA Bank’s total outstanding portfolio was \$2,274,866, of which, \$913,086 (40 percent) was housing loans. The number of active loans stood at 9,129, of which 3,677 (40 percent) were housing loans. With the exception of 2001 when financial self-sufficiency fell to 96 percent, SEWA Bank has experienced operating profits since 1998.

Perhaps the most salient aspect of SEWA Bank’s operations is that there isn’t a strict delineation between housing and non-housing loans. In fact, most of SEWA Bank’s loans can be used for housing purposes. The Parivartan scheme (an alliance between SEWA Bank, the Ahmedabad Municipal Corporation, and other local nongovernmental organizations (NGOs) also deserves particular mention as an innovative partnership model for slum-upgrading. The objective of that program is to provide basic infrastructure (road, electricity, water) to people living in the hundreds of informal settlements that dot the Ahmedabad landscape. The Ahmedabad Municipal Corporation contributes approximately 80 percent of the funds needed for the upgrading work. Beneficiary households are expected to contribute the remaining 20 percent – an amount they save with, or can borrow from SEWA Bank. SEWA Bank has used the Parivartan program to expand its client base beyond existing SEWA union members and sees it as an important part of future growth.

## Background

With a population approaching six million, Ahmedabad is the sixth-largest city in India, and has experienced fast-paced growth during the last few

decades, with its population increasing by about 22 percent between 1991 and 2001. Ahmedabad’s economy has suffered from earthquakes, social unrest, and droughts, and as a result its poverty rate is above the national average. Residents there earn an average of \$409 annually, and 34 percent of the population—as compared with just 21 percent for India as a whole—live below the poverty line. Given the rapid population growth, a stagnant economy, and the paucity of housing and basic services, the city has experienced the swift development of new slums, in which about two-fifths of the population now live.

The demand for shelter financing from slum dwellers is outstripping the supply of loans. Though they are numerous and varied, housing finance programs in Ahmedabad have not had a major impact on low-income households employed in the informal sector. Most banks do offer housing loans, but most do not offer it to the informally employed poor, even though the government requires that 10 percent of all lending go toward the “weaker sections” of the economy (i.e., the poor). Loans for this group can still be tens of thousands of dollars, with loan terms approaching 20 years—not the sort of loans that are likely to be the most effective in improving the living conditions of the area’s poor. As a result, the economically active poor who work in the informal sector remain underserved, having to rely on savings and informal moneylenders for financing.

The bank of the Self Employed Women’s Association (SEWA), created in 1974 by the members of the SEWA trade union, is the largest microfinance provider in Gujarat. SEWA Bank is also one of only two nongovernmental institutions

offering housing finance to economically active poor people in Gujarat. But with a current loan portfolio under \$3 million, even SEWA Bank's impact has been limited, and the unmet demand for housing finance remains quite large. Given reliable estimates that more than 90 percent of Indian women work in the informal economy and 41 percent reside in communities classified as slums, the potential female housing microfinance market is conservatively estimated at one million women in Ahmedabad.

## How SEWA Bank Works

### Target Market

With the motto, "A Bank of Our Own," the members of the SEWA Trade Union originally created SEWA Bank as a financial institution dedicated to self-employed women in Gujarat. As such, its immediate potential clientele includes the approximately 400,000 women who belong to the SEWA Union. It is serving economically active poor women in Ahmedabad that cannot access the formal financial sector, a market conservatively estimated at one million.

### The Product

SEWA Bank's main housing microfinance products do not significantly diverge from its microenterprise loans. The main difference consists in the fact that the client has up to 60 months to repay the loan amount, as opposed to 35

months for a microenterprise loan. SEWA Bank offers one major housing loan, the Paki Bhit (its principal housing loan). Other specific housing products such as the equitable mortgage loans for new home purchases, and infrastructure loans under the Parivartan slum-upgrading program represent only 4 percent of SEWA's housing loan portfolio. In reality, however, most of the other loans SEWA Bank offers may also be used for housing purposes. A SEWA Bank report to the Reserve Bank of India (RBI) estimates that fully half of all loans the Bank disburses are used for housing.

The maximum loan amount for an unsecured Paki Bhit loan is Rs. 25,000 (approximately \$532) with an average loan size of Rs. 24,823 or \$528 (based on 2002 data). In principle, SEWA will lend more than Rs. 25,000 for secured Paki Bhit loans based on the value of the pledged asset; however, in practice it has not lent more than this amount. Approximately half of the Paki Bhit loans are used for basic improvements such as wall, floor, or roof repair, and half are used for room additions including kitchen or bathroom additions. SEWA Bank does not require the loan amount to completely cover the cost of an improvement.

The nominal interest rate on Paki Bhit loans depends on the loan fund source. Paki Bhit unsecured loans are financed with funds from the Housing Development Finance Corporation (HUDCO) and have an interest rate of 14.5 percent, as mandated by HUDCO. Paki Bhit secured loans are financed with SEWA's own funds and

carry an interest rate of 17 percent for loans of Rs. 25,000 (\$532) or less and 18 percent for loans of more than Rs. 25,000.

Through the Parivartan scheme, which provides for the installation of roads, electricity, and water, the Ahmedabad Municipal Corporation provides Rs. 8,000 (\$170) per participating household for slum upgrading. Participating households must provide a counterpart contribution of Rs. 2,000 (\$42) for a total investment of Rs. 10,000 (\$212). The participating families may borrow their counterpart contribution from SEWA Bank or use SEWA Bank's facilities to save the required amount. Given the time it takes to bring a particular project from the planning phase to the construction phase, most clients are able to save the required amount instead of taking a loan. SEWA Bank has used the Parivartan program to expand its client base beyond existing SEWA Union members and sees it as an important source of future growth.

SEWA also differentiates between its secured and unsecured housing loans. Secured loans are backed by assets, such as jewelry or a lien on the client's fixed deposits held at SEWA Bank. Unsecured loans are backed by a lien on the client's demand deposits with the Bank and guarantors. Once a loan is approved, the client must provide a guarantee. The guarantor typically comes in at the time of the signing of the loan documents. The guarantor must provide a copy of his or her identification card and a proof of income. The loan officer reviews the guarantor and may seek additional approval from the accountant or

managing director. SEWA encourages and prefers women to have their name added to the property title or stamp paper.

### Delivery Methodology

The average amount of time between a loan application and its disbursement is five days, and is as little as one to two days for repeat clients (unless the applicant's previous loan was for business or consumer purposes, in which case SEWA will undertake a more formal evaluation).

Typically, unless a loan is secured, clients must establish a savings record with SEWA before taking a loan. In rare cases, clients can obtain a loan without prior participation in a savings program if they are members of the Bank and can produce adequate collateral. A client can make savings deposits through a variety of methods. She may go directly to SEWA Bank, pay the mobile collection unit (which travels to the communities SEWA serves once a week), or pay at one of six satellite offices. Most clients save at least four to six months to be eligible for a loan.

### Follow-up Methodology

Approximately one month after the loan is disbursed, a loan officer conducts a site visit to verify loan use. If a client is found to be using a HUDCO-financed Paki Bhit loan for another purpose, her interest rate is increased to 17 percent. On the other hand, if a client decides to use a business loan for housing purposes, the interest rate is not reduced to 14.5 percent.

Payments are considered late if the full

monthly payment is not made. SEWA accepts partial payments. However, the partial payment is considered as a late payment and tracked as such. If a client misses a payment, the bank officials visit the client. After two missed payments, a late notice listing the amount due is sent to the client and her guarantor(s). After three missed payments, a second notice is sent to the client and her guarantor(s). Often, SEWA will telephone the guarantor instead of sending a notice. Once the loan exceeds the 60-month repayment period, a third notice is sent by registered mail to the client and the guarantor informing them that if loan is not paid, legal action will be taken. SEWA Bank has only taken approximately 200 clients to court.

## Sustainability and Outlook

### Financial Analysis

A financial analysis of SEWA Bank reveals a mature organization that has reached full financial self-sufficiency, but one whose outstanding portfolio does not match its formidable potential. Highlights of the financial findings are as follows: Please note that the following figures apply to the totality of SEWA's portfolio, and not to its housing portfolio. SEWA does not disaggregate its financial statements based on loan products.

- ▲ **Arrears:** Based on SEWA's calculation of arrears, 12 percent of the total portfolio is past due and 8 percent of the housing portfolio is past due.
- ▲ **Return on Assets (ROA):** At year-end 2001, SEWA Bank's return

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on assets, which expresses the organization's net operational income as a function of its total assets, stood at 10 percent, compared with 13 percent for the three prior years.

▲ **Portfolio Yield:** Portfolio yield was 16 percent. This ratio describes the organization's annual financial income (interest payments from clients, commissions, and arrears penalties) as a percentage of its annual average outstanding portfolio. The yield is therefore a function of the effective rate clients pay, adjusted upwards by penalties and downwards by annual losses.

▲ **Profitability:** SEWA has experienced net operating profits since 1998, with the exception of 2001, when operating losses amounted to just over \$28,000. In the five years up to 2001, SEWA Bank's level of operational self-sufficiency had been 250 percent to 300 percent. A similar level of sufficiency is expected for the year ending 2002. In terms of financial self-sufficiency, SEWA Bank has been consistently above 100 percent, with the exception of 2001, when the ratio was 96 percent. Financial self-sufficiency occurs when portfolio yield is able to cover total operating costs, including the cost of capital.

▲ **Efficiency:** SEWA Bank's administrative and operational efficiency indicators are excellent. Administrative efficiency (the sum of

administrative costs as a percentage of the average adjusted loan portfolio) in 2001 was 15 percent, up only 1 percent per year over the previous two years. Likewise, its operational efficiency was very good, registering 44 percent in 2001. The operational efficiency ratio, it should be noted, has been steadily declining over the past five years, perhaps because of increased follow-up on delinquent payments.

▲ **Capitalization:** The recommended capital adequacy ratio for cooperative banks in India is 7.5 percent. By comparison, SEWA Bank's capital adequacy ratio for 2000 and 2001 was around 27 percent. This implies that SEWA is overcapitalized and is poised for growth. A second indicator of SEWA Bank's financial capacity is its credit-to-deposit ratio, which stood at 43 percent and 33 percent at year-end of 2000 and 2001, respectively. This indicates that SEWA already possesses the capital to significantly expand its loan portfolio.

## Outstanding Issues and Conclusion

This assessment brings to light several additional findings that may be useful to the future stewardship of SEWA Bank's housing microfinance initiatives.

First, SEWA Bank's available financial reports describe an institution that is financially sound. However, when

evaluators did a performance analysis, they found the process of sifting through financial information unduly cumbersome. More orthodox methods for calculating loan interest rate, arrears, and for setting loan repayment period would lead to greater accountability and simplify financial reporting. Writing off loans on a regular schedule (or, alternatively, preparing a set of adjusted financial statements reflecting a "cleaned-up" portfolio) would help external analysts understand SEWA Bank in the context of other well-known microfinance institutions worldwide.

Second, SEWA Bank is well positioned to increase the size of its outstanding portfolio. Management is well aware of this situation and is planning a major growth drive over the next five years. SEWA can grow its portfolio not only by expanding the current client base, but also through better marketing of SEWA Bank's full product range to its existing clientele. As the institution grows, it will need to further modernize its back-office operations and automate several key financial tracking and monitoring functions.

Third, SEWA's housing loan amounts are not based on the cost of the proposed home improvement. Rather, clients receive a preset amount that may exceed or fall short of the amount needed to complete the improvement. This practice is contrary to what many institutions that offer housing microfinance services believe to be an acceptable practice. Assuming client affordability, SEWA Bank should evaluate whether

it makes more sense to peg the loan amount to the client's request.

Fourth, although the relationship between the Bank and HUDCO may be useful from a political perspective, the cost of capital on HUDCO-financed loans is higher than what SEWA Bank pays for client deposits, and the interest rate is lower than what it charges clients for non-HUDCO housing loans. Given SEWA Bank's low credit-to-savings ratio, it should assess whether its relationship with HUDCO is altogether positive.

Fifth, SEWA Bank needs to track its arrears in a more systematic manner. For instance, tracking portfolio at risk (and not just the actual amount in arrears) might provide management with a more complete picture of future losses and help the Bank take remedial action.

Sixth, the Parivartan scheme—an alliance of SEWA Bank, the Ahmedabad Municipal Corporation, the Mahila Housing Trust (MHT), and other local

NGOs—deserves particular mention for its innovation and its potential contribution to strategies for slum upgrading worldwide. Having established a relationship with participating families, SEWA Bank management believes that these families will be good candidates for future home improvement loans—especially if these families are able to pay for the Parivartan-related improvement through the savings program.

Hopefully, by taking these observations into account, SEWA Bank's operations may continue to improve the lives of India's poorest, providing affordable financing for one of the most basic human needs.

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