Shelter Finance for the Poor

Access to credit for the poor is a global policy challenge, which has a direct impact on incremental shelter delivery as well as local economic development. Innovations in providing sustainable financial and other services to poor people for shelter are emerging from different quarters, particularly in micro-finance. Several organisations have focused on gaining tenure and property rights for the poor and are also innovating with financial services for communities. To date, many of these experiences have not been documented, or at least analysed according to a common framework. Many commercial financial institutions, including those that started as micro-finance institutions (MFIs), are interested in learning from other experiences in order to improve their own product offerings to poor clientele. Governments and their funding partners are also interested in learning from successful and efficient housing finance schemes to improve their own models of support.

The Cities Alliance has launched a primary analysis on this topic, initially through assessing innovations from field programmes. The Alliance has partnered with Accion International, the Cooperative Housing Foundation and Frontier Finance, each of which is a network of financial institutions with a long history of commitment to and experience and success in delivering sustainable financial services to the poor. This will be a learning exercise, with the different institutions working together to learn from each other's models and experiences and applying these lessons throughout their networks. The three networks of financial institutions engaged as partners in this exercise collectively represent over 100 of the leading financial institutions involved in micro- and shelter finance provision to the urban poor. Over 60 per cent of their clients are women.

The three networks are selecting best practice cases from among their member institutions for field analysis and documentation on innovations. Lessons from this initiative will be widely disseminated to inspire replication, adaptation and further entry into this area by commercial financial institutions. In addition to the three implementing partners, the Consultative Group to Assist the Poorest, the International Finance Corporation, the World Bank, the Inter-American Development Bank, Plan International, the US Agency for International Development and the Urban Management Programme for Latin America and the Caribbean are co-sponsors and participants in this initiative.

Current MFI experience in shelter finance, analysed in the case studies, probes the conventional parameters and wisdom about housing and provides an interesting lens through which to explore this field. The early success of shelter finance products questions the mortgage-backed loan paradigm. It also questions whether the interest rate is the prominent factor in a low-income household's decision to borrow. Early experience suggests that access to capital for housing investment and simplicity, flexibility and speed of disbursal play a larger role in a household's decision to borrow.

The concept of shelter finance values 'progressive-build', meaning incremental improvements to existing housing rather than construction of new housing. It recognises that incremental construction is a way of opening up credit markets to low-income households. Progressive-build allows low-income households to borrow what they can afford rather than the total cost of the construction project, which often times would preclude them for borrowing at all.

Because shelter finance is a relatively new product being offered by financial institutions to poor clients, many questions remain. Early experience shows, however, that MFIs can profit from offering a shelter finance product. By serving more of their existing customers' needs, customer loyalty may be strengthened. Furthermore, by adding low-income salaried employees to their micro-entrepreneur clientele, MFIs can broaden their customer base. A shelter finance product can also help MFIs control fungible monies, as microenterprise loans are redirected to housing.

As mentioned above, MFI experiences with shelter finance products for the poor are young, and, thus, numerous questions remain to be answered. Some points for future discussion and analysis are:

- *Understanding the institutional and macroeconomic factors that enable MFIs to successfully introduce shelter finance.* Even though it has been possible, to some extent, to apply microfinance methodologies and products across regions and countries, when it comes to housing, a significantly larger set of issues and factors makes replication more challenging. Some of these issues and factors which vary by country include:
  - The restrictions and regulations on financial institutions and MFIs in relation to mortgage and asset-backed financing;
  - The extent of government involvement in the housing sector. Housing is still a political issue in some countries and while many governments have scaled back their presence in the local financial markets, some are still quite active in the housing sectors as direct providers of services;
  - The level of penetration of government subsidised housing in the housing microfinance market;
  - The presence of other private and quasi-public mechanisms currently providing housing finance;
  - The level of access to basic infrastructure for housing development, which is more advanced in some countries than others.

- *Identifying the level of construction assistance, if any, that should be provided by the MFI and how it should be priced remains an outstanding issue.* Among those MFIs providing shelter finance, there is no consensus on the utility and appropriateness of providing construction assistance. Some MFIs provide a substantial degree of technical oversight, with on-staff engineers and architects working with borrowers throughout the design and construction of the project. This construction assistance is built into the loan process. In contrast, some MFIs view such technical assistance as moving too far from their core competency and thus provide little to no construction assistance.

- *Locating sources of medium-term capital.* As the average loan term of an MFI's portfolio extends, with the introduction of longer term shelter finance loans, the MFI will face a mismatch between assets and liabilities. The availability of medium-term capital, term risk and, potentially, exchange risk, depending on the currency of the medium-term capital, pose significant future constraints to scaling-up shelter finance for the poor.

- *Exploring in greater depth the relationship between land tenure and shelter finance.* The MFIs that have been studied do not price shelter finance loans differently when guaranteed by a mortgage as opposed to a collateral/co-signer guarantee. Nor do they require land tenure as a condition of eligibility. Land security has been found to be sufficient. It would be worth exploring the potential long-term implications for the shelter finance market if the issue of land tenure is sidestepped.

While the field of shelter finance may be new, the poor's need for access to credit is not, nor is their desire to improve their living conditions. The investigation into microfinance products for housing improvements could not be more timely. The Cities Alliance and those engaged in its Shelter Finance for the Poor initiative are analysing and documenting both the innovations and the constraints in providing shelter finance for the poor. It is hoped that these findings, which will be disseminated widely, will advance best practices, inspire replication and adaptation, and increase the availability and affordability of shelter finance for the world's poorest households.

All of the case studies and information produced through this initiative will be available on www.citiesalliance.org.