Housing Microfinance:  
Towards A Definition

By Franck Daphnis

Housing microfinance has come into its own.

Filling a void created by the limitations of traditional housing finance and building on the lessons of the recent microfinance revolution, housing microfinance has come of age as a discrete area of practice that intersects housing finance and microfinance. The emerging practice holds an ambitious promise for microfinance institutions, housing finance providers and commercial banks the world over: It shows how the shelter needs of the poor can be financed in a way that is economically viable, affordable, and consistent with tested methods of delivering microfinance services to the poor. The situation in the United States is somewhat different, as we shall see later in this chapter, but there are applicable lessons from developing country experience.

Developing Economies

In developing countries, historic constraints in the supply of traditional housing finance and recent demand opportunities revealed by the successes of microfinance underlie the recent rise of housing microfinance.

From a supply perspective, traditional housing finance has not succeeded in addressing the needs of poor people around the world. Bertrand Renaud defines the housing finance problem as “the need to reconcile three partially conflicting objectives: affordability for the households, viability for the financial institutions, and resource mobilization for the expansion of the sector and the national economy” (Renaud 1984). Until recently, housing finance providers, governments and donors understood that problem as the need to finance a complete dwelling under terms that are affordable to poor families, attractive to the commercial sector, and on a scale large enough to register an impact on national housing shortages. More often than not, in poor and very poor countries, this simply proved an impossible proposition. Mortgage lending and a supporting secondary mortgage market never materialized as financially viable options in addressing the housing needs of the poor. Poor people could not afford to borrow enough money at real interest rates to finance a completed home, unless repayments were stretched over long periods of time. This created two problems: (1) few sources of funds existed that could match repayment periods spanning 10 to 30 years, creating a severe asset/liability mismatch for commercial institutions interested in housing finance; and (2) when these sources were found (government pension funds for example) poor borrowers could not sustain repayments over long periods of time. Understandably, outside investors did not place their money in securities backed by such loans. Currently, no reliable secondary mortgage markets for housing loans targeting poor people exist outside the Western World. Mortgage lending, while a part of commercial lending in middle income and poor countries, generally focuses on rich and near rich clients. Housing banks created with the help of donor agencies over the past thirty years have gone bankrupt or moribund,
evolved into full-fledged commercial banks (such as Capital Bank in Haiti) or become real estate banks with few poor clients (the Housing Bank of Jordan).

To be sure, many governments in poor countries have developed non-commercial schemes to help poor people finance a completed basic home. These schemes include, for instance, mortgage loans financed by the country’s national social security fund (RAP in Honduras and Infonavit in Mexico), even group-based national subsidy programs (in South Africa). These programs, while sometime useful in a specific national context, tend to be excessively bureaucratized and have never come close to offering a promise for worldwide replication.

Although mortgage lending has not supplied low-income earning families with viable means of financing their housing needs, promising developments in microfinance suggest that demand does exist for alternative forms of housing finance. In many parts of the world, the home is the most important asset poor people will ever own. Sometimes, it can be a productive asset, for instance in the case of home-based microentrepreneurs. Even in cases where the home in not systematically used as a place of business, MFIs have long observed that clients use loan proceeds to improve their living conditions. Microfinance clients make the economically rational choice of subverting the use of business loans in response to the lack of widespread access to housing finance (or of more flexible consumer finance, for that matter). A microenterprise loan offers much better repayment terms than do informal sources of money lending (loan sharks), and such a loan can be a supplement or alternative to saving towards habitat improvements. This suggests that a fundamental expectation of microfinance—that economically active poor people can finance their needs in a manner that is incremental and affordable, and under conditions that allow the financing provider to cover all associated costs—has potential beyond income generating (enterprise) uses and can apply to personal asset building (housing).

Indeed, organizations as diverse in size, client focus and service offerings as the Grameen bank in Bangladesh, CARD in the Philippines, SEWA Bank in India, Banco ADEMI in the Dominican Republic, Financiera Calpia in El Salvador, as well as several institutions affiliated with Accion, CHF and IPC, currently offer financial services purporting to fit under the housing microfinance tent. In addition, providers include commercial banks and suppliers of construction materials who offer up to twelve-month worth of credit for home improvements to low-income customers throughout Asia Africa, and Latin America. Reflecting the diversity of these organizations, the housing services they offer elude easy classification. In Mexico, CHF and FUNHAVI have developed a home improvement loan that features an average loan amount of $1,800, a repayment period of 18 months for first time borrowers, and a 54% effective annual interest rate. The Grameen Bank’s housing loans typically are repaid over ten years, they are offered at an interest rate that is 10 percent below rates assessed for microenterprise loans, and first time clients are not eligible for such loans. If microfinance in its own right defies precise categorization, the intersecting housing dimension does not render the task any easier.
Still, a discussion of the range of services covered under housing microfinance is a necessary prelude to any serious analysis of this growing it. In the interest of inclusion rather than selectivity at this early stage in the research, a useful definition should allow for a reasonable range of ongoing initiatives to rise to scrutiny. A subsequent phase in the analysis would consist in sifting the useful from the less useful and, ultimately, in suggesting key elements of best practice that define successful housing microfinance services. For this to happen, a reasonably inclusive attitude should serve as context for the question at hand: What is housing microfinance?

Current practice and a survey of the emerging literature suggest two paths towards a preliminary answer: a microfinance product-centered definition, and a provider-centered definition of housing microfinance.

From a microfinance product perspective, housing microfinance encompasses financial services that allow poor and low-income earning clients to finance their habitat needs with methodologies adapted from the microfinance revolution. These methodologies rest most notably on the following principles: (1) Loans are for relatively small amounts and are based on clients’ capacity to repay; (2) Repayment periods are relatively short (especially in comparison to mortgage lending) and are on par with mid- to high-end microfinance individual loans; (3) Loan pricing is expected to cover the real, long run costs--operational and financial--of providing the service; (4) Loans are not heavily collateralized, if at all, and collateral substitutes are often used; (5) Loans tend to finance habitat needs in an incremental manner, a function of the purchasing power of loans with short repayment periods and relatively low monthly payments; and (6) If the provider is an MFI, credit services for housing can be linked to prior participation in savings or more traditional microenterprise loan services. In summary, from a product-based perspective, housing microfinance is the “microfinancing” of housing needs: the application of a microfinance-based approach to housing finance.

An alternative way to proceed is to define housing microfinance from a provider-based, rather than a product-based, perspective. Housing microfinance, according to this viewpoint, would include all explicitly recognized housing-focused financial services microfinance institutions offer—even when the conditions under which these services are offered appear to deviate from microfinance orthodoxy. This is a literal, rather than a methodological interpretation: Housing microfinance services are housing services offered by microfinance institutions. This definition, seemingly less rigorous than a methodological or product-based definition, is nevertheless useful given the desire for inclusion. It allows a range of services that would otherwise not fit within a recognized microfinance spectrum to come to scrutiny and to guide our emerging understanding of housing microfinance. It also helps bring to light an important issue in housing microfinance: MFIs sometimes find it compelling to offer their clients housing products that deviate from key characteristics of their traditional product offerings.

The product-based and provider-based filters complement one another--albeit with ample areas of overlap. The product-based approach reaches outside the realm of microenterprise-centered organizations by focusing on the distinguishing characteristics
of the financial services rater than on the types of institution that offer these services. It brings to the fore housing finance providers, NGOs and commercial institutions that have developed innovative housing-related financial services based on microfinance best practices. The provider-based filter allows for the consideration of housing innovations that do not, a priori, appear to fit within the expected confines of traditional microenterprise lending products—but nevertheless constitute an important part of current housing portfolios for MFIs throughout the world. Together, the two approaches define the current universe of activities classified under housing microfinance. They also provide a point of departure for more refined analyses.

If the two-pronged approach towards a preliminary definition helps to define an inclusive universe of current housing microfinance services, what to make of that resulting universe? Specifically, what are there basic clusters of products that—allowing for expected variations—demonstrate some level of consistency in how MFIs and other providers offer housing microfinance services to their clients?

A survey of current housing microfinance initiatives suggests that one answer to this question lies in analyzing the distinguishing characteristics of financial services (principally loan amounts, repayment period and pricing strategy) in relation to the client’s history with the service provider. Using this framework, housing microfinance providers fall into two clear categories: (1) those that make housing financing available on a stand-alone basis to all eligible clients, including first-time clients and (2) and those that extend such financing on a linked basis and only to clients who have a prior history with the provider.

A. **Stand Alone Housing Microfinance Services**

MFIs, banks and NGOs currently deliver housing microfinance services on a stand-alone basis alongside other microfinance or housing finance products, but independently of them. Some organizations, such as FUNHAVI in Mexico, have built their entire organizations around a single housing microfinance loan. As the qualifier suggests, stand-alone housing microfinance products do not rely on a prior history with the provider as a proxy for capacity to pay. The eligibility criteria, loan term and loan uses are designed to qualify potential borrowers on the merits of their current financial profile and habitat needs, independently of their existing relationship with the provider. Loans are extended to individuals (rather than to groups of individuals), they tend to be for relatively small amounts ($1,000-$5,000), and they carry a relatively short repayment period when compared to traditional housing loans (1½ to 4 years). Consequently, loans typically—thought not in all cases—allow borrowers to finance their home in an incremental manner.

Table I.I illustrates basic features of stand-alone housing microfinance services for three organizations that have developed such services.
**Table I.1. Examples of Stand Alone Housing Microfinance Products**

<table>
<thead>
<tr>
<th>Organization</th>
<th>Average Loan Size</th>
<th>Maximum Repayment Period</th>
<th>Security Collateral</th>
<th>Required Time with Program</th>
<th>Savings Required</th>
<th>Solution Type</th>
<th>TA to Clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADEMI</td>
<td>$4,000</td>
<td>36 Months</td>
<td>Collateralized</td>
<td>None</td>
<td>No</td>
<td>Variable</td>
<td>No</td>
</tr>
<tr>
<td>FUNHAVI</td>
<td>$1,500</td>
<td>20 Months</td>
<td>2 co-signers</td>
<td>None</td>
<td>No</td>
<td>Variable</td>
<td>Yes</td>
</tr>
<tr>
<td>Mi Banco</td>
<td>$916</td>
<td>36 Months</td>
<td>Collateralized</td>
<td>None</td>
<td>No</td>
<td>Variable</td>
<td>No</td>
</tr>
</tbody>
</table>

ADEMI, Calpia, FUNHAVI, Bancosol in Bolivia, MiBanco in Peru, Genesis Empressarial in Guatemala, CHF International (in Central America and the Middle East) are among the dozens of organizations that deliver stand-alone microfinance services to their clients. CHF provides the following rationale for its own version of housing microfinance (the Home Improvement Lending Program, or HILP):

CHF’s approach is rooted in the observation that the working poor in developing countries build and improve their homes incrementally. As mortgages are typically not available, low- and moderate-income earning individuals rely on their disposable income and savings or borrow money from informal sources to finance their home improvements. Traditionally they begin with a basic core house and gradually improve the structure by increasing its size and adding amenities such as sanitation connections as funding becomes available. The [housing microfinance service] provides access to credit based on how people build, their building needs and what they can afford.

For MFIs offering stand-alone housing microfinance services, the benefits are multiple. Stand-alone products can help MFIs diversify their client base beyond microentrepreneurs, assuming salaried employees who do not operate a microenterprise can become eligible for financing. Housing microfinance products can also help MFIs manage default risks by spreading these risks over an increased number of financial services. Finally, housing microfinance services offered on a stand-alone basis should help with client satisfaction (and retention) by providing clients with a fuller range of financing options within one roof.

Stand-alone housing microfinance products make sense for organizations looking to respond to a perceived demand for housing finance services that is independent of other credit or saving services they offer. Future clients, whether they are microentrepreneurs or not, will have the financial capability of taking on a new loan, given current income and debt circumstances. For instance, CHF International, as a rule of thumb, will allow clients to use only 25% of their disposable monthly income towards loan repayment. CHF will not accept a monthly debt burden (including housing loan repayment) that exceeds 40% of monthly disposable income. The repayment period for housing microfinance loans is relatively short as providers attempt to mitigate the risks of repayment fatigue, uncertainty over future income, asset liability term mismatch, and the absence of a repayment history as proxy for repayment capacity.
B. Linked Housing Microfinance Services

Many MFIs, especially in Asia, have developed housing microfinance services that are linked to prior participation in microenterprise or savings services. The Grameen Bank, SEWA Bank, and CARD are among the best known MFIs linking housing microfinance to other products they offer. A survey of these MFIs shows that client’s access linked loans at interest rates that are often lower than what they would have to pay for microenterprise loans. The repayment periods for of these loans appear, on average, to be longer than for stand-alone products.

Linking the eligibility for housing loans to clients’ performance on prior services seems to accomplish several objectives. Housing microfinance loans, especially for organizations involved with poorer clients and with solidarity or other group-based lending, do not constitute business as usual. Housing loans are usually provided on an individual basis; they tend to be for higher amounts than group-based loans or individual loans targeting the very poor; and, as a result, they require longer repayments periods than these more established loans. MFIs offering linked housing loans use their credit or savings services as a performance filter, a form of internal credit bureau that allows faithful and reliable clients to rise and become eligible for the different, seemingly riskier, loan.

Table 1.2 illustrates some basic characteristics of linked housing microfinance services as offered by three well-known MFIs.

<table>
<thead>
<tr>
<th>Organization</th>
<th>Average Loan Size</th>
<th>Maximum Repayment Period</th>
<th>Security/ Collateral</th>
<th>Required time with Program</th>
<th>Savings Required</th>
<th>Solution Type</th>
<th>TA to Clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>Grameen Bank</td>
<td>$100-$600</td>
<td>120 months</td>
<td>5 co-signers + Center guarantee</td>
<td>Two years minimum</td>
<td>Yes</td>
<td>Fixed (incl. Latrine)</td>
<td>No</td>
</tr>
<tr>
<td>SEWA Bank</td>
<td>$300</td>
<td>60 months</td>
<td>One year savings as lien; 2 co-signers</td>
<td>One year minimum</td>
<td>Yes</td>
<td>Variable</td>
<td>No</td>
</tr>
<tr>
<td>CARD</td>
<td>$359</td>
<td>12 months</td>
<td>Five co-signers</td>
<td>One and a half year</td>
<td>Yes ($39)</td>
<td>Variable</td>
<td>No</td>
</tr>
</tbody>
</table>

MFIs that link housing microfinance to more traditional microfinance services subordinate housing finance to their other products. From a risk standpoint, this suggest a much more cautious approach than that of MFIs following the stand-alone approach—perhaps a function of the targeted clientele. Indeed, many among the MFIs currently offering housing microfinance as linked services have clients at or near the poverty level. Assuming that microentrepreneurs have financing needs beyond their business needs, the promise of a housing loan is a powerful incentive to perform on first-tier loan and savings...
programs. As a consequence, housing microfinance, when tied to other MFI services, has the potential of enhancing the MFI’s overall financial performance and client retention rate.

Linked housing microfinance services, to the extent that they only benefit current MFI clients, do not necessarily lead to an expansion of the client base. If, however, housing loans are linked to a savings program open to non-traditional clients, client diversification is a possibility.

Many MFIs offer linked housing loans at an interest rate that is lower than what they charge for microenterprise loans. A possible explanation is that these MFIs price housing products to account for a reduced default risk from clients with whom they already have a relationship. Another explanation is that MFIs view housing loans more as a reward to faithful clients than a profit center. As such, housing loans would not be expected to generate the returns anticipated for other loans. It is tempting to compare this discrepancy in pricing with the fact that commercial mortgages loans typically carry annual interest rates that are usually lower than business or consumer loans. This is not, however, a useful comparison. Mortgage loans usually are priced lower than other loans because the risk to the financing provider is lower. Mortgages are usually highly collateralized by the resale value of the home being financed. In the case of linked housing microloans, the house does not always serve as collateral for the loan. In many countries where MFIs operate, housing resale value is often doubtful and the possibility that the MFI might be able to repossess the home in the first place may be even more problematic. Uncertainty surrounding land tenure in these countries can also prevent large segments of the housing stock from becoming transferable assets--especially when owners are poor people building in marginal areas. Whatever the reason for the differences in interest rates, it does appear that many MFIs linking housing products to other services engage in some form of cross-subsidization. MFIs will only be able to sustain this practice in the long run if the benefits of running housing microfinance operations outweigh the opportunity costs from the unearned income.

C. Construction Assistance

A defining characteristic of some housing microfinance programs is the provision of construction advice or supervision to clients. Some institutions view this form of technical assistance to the client as an important part of any housing microfinance loan. Others do not perceive any particular value-added in providing construction assistance services.

One way to approach construction assistance is to view it in the context of institutional attitudes towards the concepts of “due diligence” and “follow up”. To the extent that institutions believe that pre-loan due diligence on a business microenterprise loan is necessary --to assess whether a client’s desired loan amount is appropriate to and can be used for the purpose declared on the loan application-- they may want to extend the practice to housing microfinance. This could entail helping with basic construction
design, budgeting, and guidance on materials and labor procurement. Similarly, if an institution’s practice is to follow up, post-loan, to ensure that the loan was used for the intended purpose, construction oversight may make sense.

If construction assistance is not an option, than housing microfinance becomes, in effect, a consumer loan whose declared purpose is housing but whose ultimate use cannot be determined with certainty. The proposed construction project provides a rationale for assessing the required loan amount; repayment performance determines the client future standing with the institution.

If housing microfinance includes construction assistance, responsible providers with no outside subsidies should include that service into the pricing of the loan. This suggests that the product line will be viable in the long run only if rational clients determine that the cost/benefit ratio to them—including the value added of technical assistance-- is favorable. If the pricing is prohibitively high, clients will look elsewhere for alternative sources of housing financing. They may, as a consequence, choose to access microenterprise or other loans for that purpose.

If a housing microfinance loan is a flexible consumer loan using housing for marketing appeal or as a gauge for the loan amount, the possibility does exist that the loan will compete with other products the organization offers. Clients will shop around for the loan terms that best suit their various needs. They may access a housing loan for enterprise and other purposes, depending on the level of flexibility the housing loan offers.

Construction assistance in the context of housing microfinance does not appear to be a predictor of financial performance. FUNHAVI and ADEMI, for instance, have developed housing microfinance programs that are polar opposites in their attitude towards such assistance, but are similar in many other ways. Both report repayments rates approaching 100%. FUNHAVI sees its non-financial services to clients as a cornerstone of its mission. ADEMI managers have publicly stated that such assistance is contrary to their operating philosophy; clients, they believe, must decide for themselves how best to use their own money. There is currently no empirical evidence suggesting that one approach is correct and that the other is not.

D. Conclusion

1. The Product.
A survey of current practice in developing economies shows that housing microfinance loans are extended to low-income-earning individuals or households, under terms that reflect the lessons learned from microenterprise lending.
- **Loan Use.** Loans can be for minor home improvements (such as a paint job, a door or windows); or major home improvements (a room addition, a new roof). Less typically, a loan can finance a new home.
- **Target Clientele.** Housing microfinance loans are typically extended to a single party, rather than to a group. Clients can be individuals or households, salaried workers or self-employed entrepreneurs.
- **Pricing.** Interest rates for housing microfinance loans should reflect the long run operational and financial costs of providing the service. This often means that interest rates should be close to those a given organization would charge on individual microenterprise loans with comparable loan maturity.
- **Maturity.** Repayment periods usually range from one year to five years—although some institutions find ways to reduce the risk associated with longer repayment periods by linking eligibility for housing loans to prior participation in other lending or in savings programs.

- **Construction Assistance.** Some organizations include construction assistance as part of the total housing microfinance package; many more do not. If construction assistance is provided, the cost of providing the service must be included in the pricing of the loan.
- **Security Requirement.** Co-signers provide the most common form of loan guarantee. Some organizations do use hard collateral, including, in a few cases, the property being financed.

2. **The Institutions**

Organizations currently offering housing microfinance loans include non-regulated MFIs (FADES); regulated MFIs (Mi Banco, SEWA Bank, Grameen Bank); NGOs (FUNHAVI); commercial banks (Arab Bank, Credit Libanais). The list should also include suppliers of construction materials who offer up to twelve-month worth of credit for home improvements to low-income earning customers throughout Asia, Africa and Latin America.

3. **The Market**

The market for housing microfinance is very similar to the market for microenterprise lending, with one important difference. Housing microfinance clients include low-income earners throughout the world, especially in places throughout Latin America, Asia, Africa, and Central and Eastern Europe where the formal financial sector systems does not systematically cater to the economically active poor. Unlike microenterprise lending, however, housing microfinance explicitly includes among its targeted clientele salaried workers, in addition to self-employed entrepreneurs.

A survey of current practice shows that housing microfinance can be offered on a stand-alone or on a linked basis. Organizations that offer housing microfinance on a stand-alone basis may be able to increase their client base; better manage default risks through
the diversification of product offerings; and provide a fuller range of financial services to the poor and lower income earning families. Organizations that offer housing microfinance on a linked basis can reduce default risk by using client history as an indicator for future capacity to pay; create an incentive for clients to enhance their performance on pre-existing services; and improve client retention rates.

1 Documented most notably in Harvard University 2002; Ferguson and Haider 2000; and Daphnis and Tilock 2001.
2 As much as 20 percent of MFI business lending goes “de facto” for housing, according to Ferguson and Heider 2000, 9.
3 See Daphnis and Tilock 2001 for a more detailed discussion of these principles.