



*Step by Step: Supporting Incremental Building Through Housing Microfinance*



**SHELTER  
REPORT 20  
14**

**On the cover:**

As schoolteacher George Phiri builds his house in Lilongwe, Malawi, he is receiving training and expert advice on building techniques through Habitat for Humanity Malawi's construction technical assistance program. Phiri, 25, also received a microloan from a partner organization called Select, which allowed him to purchase the materials and labor needed to complete the house.

# Shelter Report 2014

**STEP BY STEP:**

SUPPORTING INCREMENTAL BUILDING THROUGH  
HOUSING MICROFINANCE

**HABITAT FOR HUMANITY  
INTERNATIONAL**

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Habitat for Humanity International is a nonprofit, ecumenical Christian housing ministry that seeks to eliminate poverty housing and homelessness from the world and to make decent shelter a matter of conscience and action.

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Levent Edipov (right) works on renovating the home in Veles, Macedonia, that he, his wife and three children will soon share with his in-laws. The Roma family participates in Habitat Macedonia's Home Improvement Fund, a microfinance program operated in partnership with Opportunity International.



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## Foreword

Housing in the developing world is a process. Families might replace a dirt floor with a clean, hard surface. They might reinforce the walls or the roof to prevent water from seeping through the cracks when it rains. They might build an additional room after welcoming a new child into the world. This method of improving housing one step at a time is called “incremental” or “progressive building” and accounts for up to 90 percent of residential construction in the developing world. Families build their homes bit by bit as needs change and resources become available.

Although this model for building simple, durable shelter takes time, having access to appropriate financial products and construction advice enables families living in poverty to dramatically improve their living conditions.

With 1 billion people living in slums — a number still rising — the task of significantly affecting the problem of substandard housing will not be easy. But by facilitating incremental housing efforts, Habitat for Humanity and other organizations can help create more safe and secure dwellings and can reduce the financial burden on governments that subsidize housing. By improving the incremental process, we can help create better planned communities rather than ad hoc solutions.

Access to financing that low-income families can afford is a crucial element for the success of incremental building. Research indicates that only 2 percent of traditional microfinance loans are designed to improve shelter, but up to 20 percent of microenterprise loan funds intended for businesses are used for housing.

Recognizing the need for greater access to housing finance among low-income people, Habitat has been working in many countries to spark innovation and scale housing microfinance. Two important global initiatives that complement this work are the MicroBuild Fund, a \$100 million impact capital fund for housing microfinance, and the Center for Innovation in Shelter and Finance, our advisory service arm that provides training and technical assistance to help local institutions develop appropriate shelter products for their context.

Recently, I saw firsthand how incremental housing has changed the lives of families in Kenya. I participated in a local savings group meeting in a tea-farming community. Members contribute to a fund, and individuals take out loans for specific home improvement projects. In addition to building floors and walls, many families have purchased cisterns in which to collect rainwater for the dry season. Each individual negotiates a loan amount with Habitat, but the entire group is collectively responsible for total repayment. Loans vary in size and duration and are secured with alternative collateral such as livestock.

Efforts to provide new housing in the developing world are limited, and existing lenders rarely serve lower-income people. We need to encourage market solutions such as housing microfinance to support high-quality incremental building. If these are bundled with basic housing support services, we can create scalable, replicable and sustainable solutions.

A handwritten signature in dark ink, reading "Jonathan Reckford".

Jonathan T.M. Reckford  
CEO, Habitat for Humanity International

# 1

## From microfinance to housing microfinance

Wilfredo Cohelo lives in Cerro Camote, a mountainous area of Peru whose name translates as “Sweet Potato Hill,” with his wife and three children.

“My home was made with mats and plastic and was very dusty,” he recalled. “When it rained, the moisture would come through, and the winds are strong on this part of the hill. This is why my children got sick a lot.”

Cohelo applied for and received two small housing loans from Financiera Edyficar, the second-largest microfinance institution in Peru, and made improvements on his home, including a new roof to keep it drier during the rains. His family is healthier now because of the upgrades, and his neighbors tease him that it looks like he won the lottery.

Cohelo and his family benefited from an alliance between Financiera Edyficar and Habitat for Humanity International’s Center for Innovation in Shelter and Finance. Edyficar’s loan product, Edyvivienda Paso a Paso (Step by Step), offers construction technical assistance to low-income borrowers like Cohelo. It’s just one of many housing microfinance programs around the world that are enabling people to take out small loans to repair or add on to their homes, greatly improving their health and standard of living.

### The emergence of microfinance

When microfinance emerged as a means of alleviating poverty by increasing access to capital for low-income populations, many saw it as the new frontier in international development. Traditional banks

refused to lend such small amounts for the simple reason that it was far less profitable. The bank would have to spend the same amount of time and money to process a tiny loan as a large loan (sometimes more, especially if the borrower has informal income) and would receive far less in return. Microfinance provided an alternative financing avenue for millions of people who lacked access to traditional banking, giving them a chance to invest in their small business or income-generating project.

Microfinance worked because it responded to the needs of those in the informal economy. Informal-sector cash flows are generally characterized by small sums of money and a quick turnover rate, a cycle that does not adapt well to the formal banking system. Muhammad Yunus, a Bangladeshi economist, saw this pattern and developed the concept of microcredit to support the practices of informal-sector microbusiness cycles.

Yunus demonstrated that people living in poverty, especially women, have surprisingly high rates of loan repayment. The microfinance movement led to more than 200 million people gaining access to previously unavailable financial services. As a result, innovative institutions sustainably provide these services to millions of the world’s poor. Services now reach beyond just small-business credit to include savings, remittances, insurance and education finance.

As the need for housing swells and urban migration accelerates, the lessons of microfinance may be helpful. Housing microfinance emerged organically out of the realization that microloans could

be a useful tool for helping the millions of people living in the world’s slums to incrementally improve their conditions. The goal was to design a financially sustainable product that could support low-income populations as they build their homes safely and incrementally. Research indicates that up to 20 percent of microenterprise loan funds (i.e., those intended for business purposes) are already diverted for housing. The continual challenge faced by housing microfinance as described by Bertrand Renaud, former senior housing finance adviser for the World Bank, is “the need to reconcile three particularly conflicting objectives: affordability for the households, viability for the financial institutions, and resource mobilization for the expansion of the sector.”<sup>1</sup>

### Microfinance for incremental shelter

Housing microfinance consists of small,

#### Alternative collateral

An examination of collateral and underwriting best practices in housing microfinance institutions throughout Asia, Africa and South America reveals the following common collateral alternatives:

- Mandatory savings
- Fixed assets
- Deposits
- Pension guarantee
- Personal guarantee
- Group guarantee
- Employer guarantee
- Co-signer(s)
- Microenterprise loan history





Jackson Ssemakula, a professional builder in Kigege, Uganda, dreamed of building a large house for his growing family. After struggling for years on the project, he received his first microfinance loan from Habitat Uganda in November 2009, allowing him to raise the walls. A second loan let him finish the roof.



Habitat for Humanity Kenya field officer Eddah Chepkurui updates the loan repayment records of a microfinance beneficiary at Habitat's regional office in Bomet.

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**“By leveraging the incremental building practices of the developing world, housing microfinance is an economical and efficient tool to address substandard housing as well as a viable opportunity for financial institutions serving low-income populations”**

**Elizabeth Littlefield,  
president and CEO of Overseas  
Private Investment Corporation**

nonmortgage-backed microfinance loans offered in succession to support the existing incremental building practices of low-income populations. While similar to the microenterprise loan, housing microfinance typically has some important distinctions. Housing microfinance involves larger investment amounts and therefore requires longer terms and a closer association with a need for savings. Adding to that complexity are the implications of land tenure and safe and durable construction methodologies. Housing microfinance, though, can be closely tailored to the construction practices and land formalization of the poor, who usually acquire property and shelter in incremental stages. And housing microfinance can be accompanied by housing support

services such as budgeting, construction assistance, or guidance on good building practices.

Since the target customers for these incremental finance products generally participate in the informal economy and do not have steady and verifiable income, additional analysis is used to evaluate the creditworthiness of a potential borrower.<sup>2</sup> Housing microfinance products also allow for alternative collateral, thus breaking the barrier established by mortgage loans, which require land title as collateral.

Housing microfinance shows promise, both as a nimble tool to address substandard housing and as a viable product-diversification opportunity for financial

institutions serving low-income populations.

This Shelter Report makes the case for applying the principles that made enterprise microfinance successful to housing. Given that efforts to provide new housing in the developing world are limited, and that existing bankers and lenders rarely serve lower-income people, we need to encourage market solutions such as housing microfinance to support high-quality incremental building. Housing microfinance (including savings, credit, remittances and insurance services), bundled with basic housing support services, can lead to scalable, replicable and sustainable solutions to the problem of poverty housing.



Subsistence farmer Edward Bly meets with Habitat for Humanity Kenya field officer Nancy Pere at Habitat's Bomet regional office. Bly is partnering with Habitat Kenya's microfinance program to upgrade his family's home.

## 2

## A need for housing

The need for adequate housing is growing, and developing countries are searching for innovative approaches to address the growth of informal settlements. As the center of economic gravity shifts to cities, microfinance has an opportunity to adapt to the evolving needs of the poor and give them the tools they need to improve their living conditions.

In 2007, for the first time, more people were living in cities and towns than in rural areas. By 2050, 70 percent of the world's population is projected to be living in urban areas, according to the U.N.'s Department of Economic and Social Affairs. Urban areas have grown exponentially, particularly in the developing world, as people flock to cities in search of economic opportunity, better health care, education and the promise of a better life. Subsequently, demand for housing remains extraordinarily high. Asia, for example, is urbanizing most rapidly and will need to absorb 120,000 new residents every day into its cities. This trans-

lates into at least 20,000 housing units per day, according to UN-HABITAT.

As urban populations expand, so do slums. Most new city dwellers reside in informal settlements and are experiencing overcrowded, unsafe and unsanitary living conditions. Roughly 1 billion people now live in slums. Women and girls are disproportionately affected by slum life, since the burden of maintaining the home and caring for the family most often falls upon them. They face health and safety risks beyond what their male counterparts experience because of rampant gender-based violence.

The world's slums and informal settlements have developed as a result of the lack of supportive regulations (such as land acquisition policy); extension of services to new settlements (such as roads, water, sanitation and energy); and financial services to help the people who live there access better-quality materials and amenities, which result in safer and

healthier homes. Acquiring these kinds of shelters is an almost insurmountable challenge without access to formal financing, and only 3 percent of adults in developing economies report having an outstanding loan to purchase a home or apartment.<sup>3</sup>

Although the number of people living in urban areas is projected to increase dramatically in the next 45 years (see box on Page 11), especially in developing countries, global urbanization is occurring at different rates in different regions. Urban populations in Africa and Asia, for example, are growing at more than three times the rate of those in Latin America.<sup>4</sup> It is expected that Asia's urban population will increase by 1.4 billion, Africa's by 0.9 billion, and Latin America and the Caribbean's by 0.2 billion by 2025. Since countries in Asia, Africa and Latin America will be the fastest growing, they will present the greatest development challenge — and the greatest demand for housing. The combination of these demographic shifts, poor or nonexistent land ownership policies, and insufficient resources has resulted in an explosion of slum creation and further deterioration of living conditions. These numbers will continue to rise without intervention from communities, policymakers and the private sector.

### Slums

UN-HABITAT defines slum households as a group of individuals living under the same roof in urban areas who lack one or more of the following:

- Durable housing of a permanent nature that protects against extreme climate conditions.
- Sufficient living space, which means no more than three people sharing the same room.
- Easy access to safe water in sufficient amounts at an affordable price.
- Access to adequate sanitation in the form of a private or public toilet shared by a reasonable number of people.
- Security of tenure that prevents forced evictions.

Not all slums are homogenous, and not all slum dwellers suffer from the same degree of deprivation. The degree of deprivation depends on how many of the five conditions are lacking in a given household.



Slums cover the hillside of Soacha, Colombia, where Habitat for Humanity Build Louder volunteers conducted a housing survey before the Latin America and the Caribbean region's first Regional Forum on Adequate Housing in Bogota, which took place in September 2012.



The Kibera community in Kenya's capital, Nairobi, has an estimated population of more than 1 million people, making it the largest slum in all of Africa.

## Trends and the future

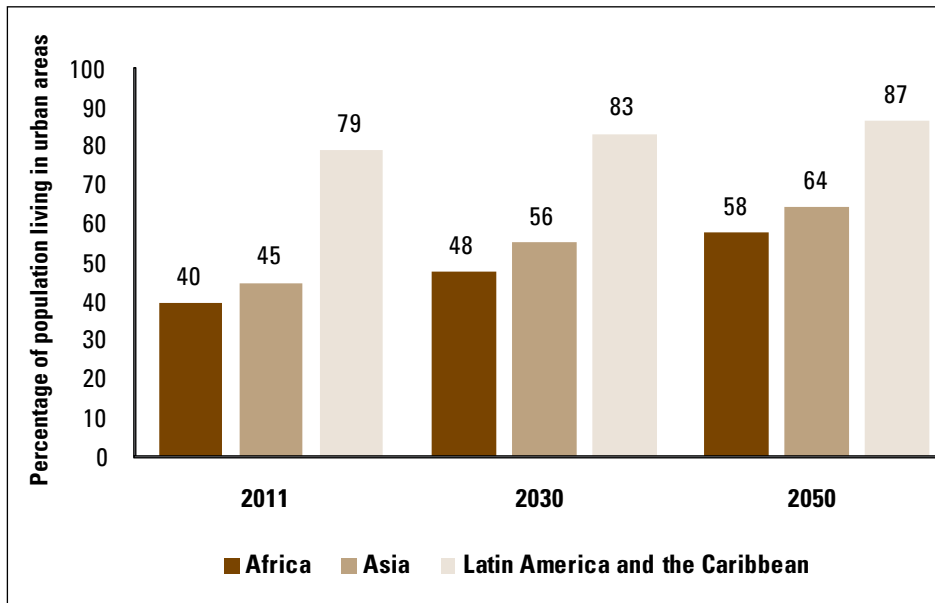
The growing gap between the number of available housing units and the demand for housing units has greatly affected

urban development in the developing world. The cost of land and building materials throughout Africa, Asia, and Latin America and the Caribbean is too high to make it profitable for developers and

private construction companies to build affordable housing. Without financial incentives to encourage production of affordable housing in these rapidly urbanizing regions, the gap between housing supply and demand will continue to widen, resulting in the continued proliferation of unplanned urban settlements. Below are snapshots of the housing situation by region.

### Population trends

- Urban population is projected to increase by 2.6 billion from 2011 (3.6 billion) to 2050 (6.3 billion)<sup>6</sup>
- Sixty percent of the global population in 2030 will be living in towns and cities (and 60 percent of them are projected to be younger than 18).<sup>7</sup>
- Today, about 61 percent of urban inhabitants are in smaller cities (with populations of 1 million or less), but the population trend is rapidly shifting toward megacities (metropolitan areas with more than 10 million inhabitants).<sup>8</sup>
- Currently, 61.7 percent of urban dwellers in Sub-Saharan Africa and 35 percent in South Asia live in slums.<sup>9</sup>



### Africa

In Africa, the prices of housing inputs such as land and housing finance are far too high to make affordable housing an attractive market segment for developers and builders. A deficit of safe and buildable land for new housing makes the cost of land extremely high. That high cost is compounded by the lack of utilities and services outside of urban centers. An interested developer will often have to not only purchase the plot of land to be developed, but also pay for an access road and extension of utilities. All of these costs are then passed on to the homebuyer. Compounding these issues, housing finance in Africa is poorly developed, generally inflexible and aimed almost exclusively at high-income households. Microfinance and community-based savings group initiatives such as Rotating Savings and Credit Associations, or ROSCAs; Savings and Credit Cooperative Societies, or SACCOs; and Village Savings and Loans Associations, or VSLAAs, are active in Africa but are “constrained by unsupportive institutional and regulatory frameworks.”<sup>10</sup>

### Asia and Latin America and the Caribbean

Access to affordable land is also a road-

block to the expansion of affordable housing in Asia. High economic growth in the region has resulted in rapidly increasing prices for urban land. Asia also lacks appropriate low-income housing finance projects. The inflexible housing finance that does exist is not amenable to incremental self-build practices. The Latin America and Caribbean region is slightly more developed than Africa or Asia, but land prices are similarly high, and construction inputs are expensive. A number of relatively successful land formalization strategies — title regularization, municipal land banking and land value recapture — have increased access to affordable and secure land. Even with these and other successes, an alarming number of homes in the LAC region are still in substandard condition and lack access to basic utilities and transportation.<sup>11</sup>

### North America and Europe

North America and Europe do not face the same rate of urban population growth as developing regions, nor do they have a real housing supply deficit or large unserved slums. However, urban gentrification and the growing socioeconomic divide within cities is rendering existing housing unaffordable for low-income households. The market for rental housing, an important tenure option for low-income households, has been negatively affected by the strong desire for homeownership in this region. Most of the substandard housing stock in the region exists as a result of rural-to-urban migration and an influx of refugees in war-torn countries or in those that recently made the transition to a free-market economy. These transition countries have growing numbers of unsafe housing conditions

because of decades of neglect and lack of investment, resulting in about 10 percent of the urban population living in slum conditions without access to basic utilities.<sup>12</sup>

### The cost of unplanned settlement

The extreme need for adequate housing is exacerbated by poor or nonexistent planning. When settlements are not planned, they lack the critical elements required to function properly, which can lead to health problems, safety concerns, increased poverty and overall environmental deterioration.

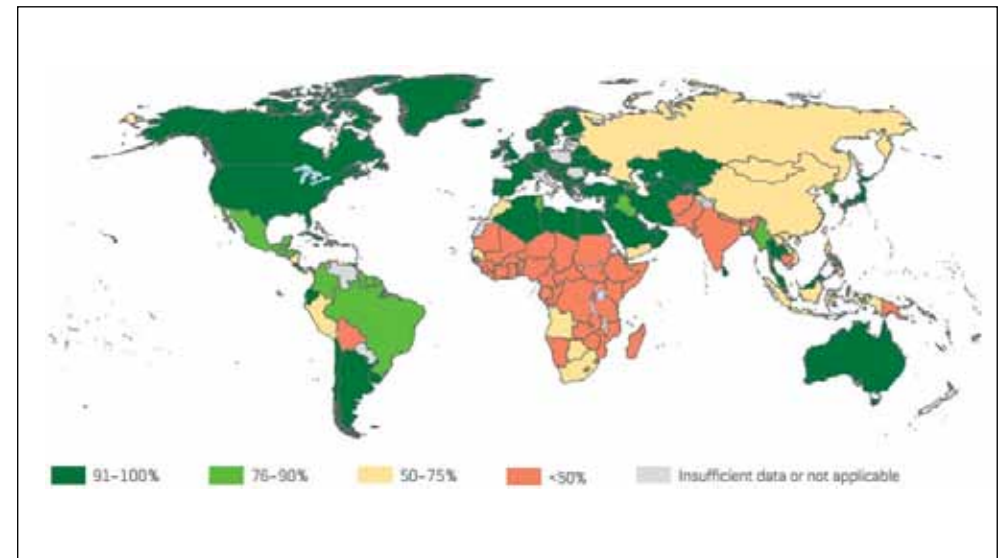
### Health problems

In addition to dirt floors and leaky roofs,

safe drinking water and clean sanitation are closely tied to the quality of living conditions. Unplanned settlements are typically not connected to municipal water supplies, nor do they have adequate sewerage, drainage or waste disposal services. As a result, slums and informal settlements generally lack even basic levels of sanitation. Poor disposal of excreta, poor personal and domestic hygiene, unsafe drinking water, and even a lack of face washing cause disease to spread, and many die from the resulting illnesses. More than 783 million people lack access to safe drinking water, and approximately 35 percent do not have access to basic sanitation services.

### Safety issues

Supporting urban poverty reduction and



Proportion of the population using improved sanitation in 2011<sup>13</sup>



creating sustainable urbanization through city planning are considered essential to fighting urban crime and violence. UN-HABITAT's "Strategic Plan for Safer Cities" explicitly mentions slum upgrades as an integral element for promoting urban safety.<sup>7</sup> The main safety issue in slums stems from the lack of physical access to the communities. It is extremely difficult for emergency vehicles and law enforcement to navigate tightly woven pathways with few signs or distinguishing landmarks, making inhabitants particularly vulnerable to crime and violence.

Poor construction also poses safety risks. Slum dwellers typically construct their homes out of whatever materials are available to them, even if those materials do not make for structurally sound construction. Poor community planning and poor building construction create hazards for inhabitants, and these hazards are exacerbated by the floods, fires and landslides that many unplanned settlements are subjected to.

### **Perpetuating poverty**

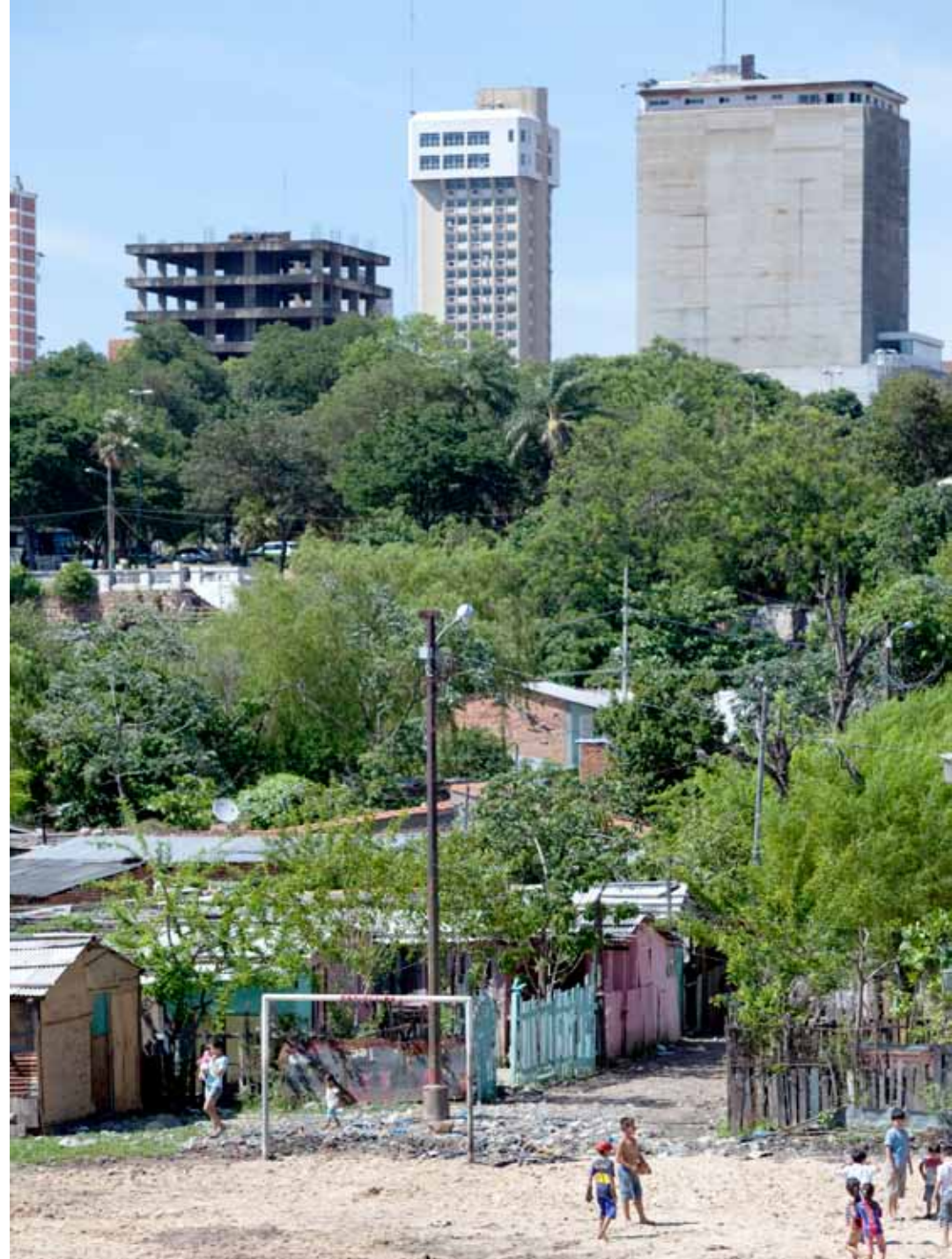
Slums perpetuate the poverty of their inhabitants. The lack of a formal address can be an obstacle to gaining formal employment. Workers are further inconvenienced by the amount of time and resources required to travel to and from work, since there is no efficient transport system in cities' peripheries. Finally, health and safety issues associated with unplanned settlements increase the number of hours that people spend at home, either because they are unable to work or because they need to take care of injured or sick family members (a task that generally falls on the women). Employment and educational opportunities are often

sacrificed out of necessity, perpetuating the financial problems that landed people in the slums to begin with.

### **Environmental effects**

When the priority is to have a roof over your family's head, protecting the environment often takes a back seat. The immediate need for shelter and a lack of resources to attain it sustainably (both financially and environmentally) can lead to ecological destruction. By damaging what could be a great asset, inhabitants end up with poorly constructed shelters and lose a way out of poverty. The World Bank also sees increasing the availability of appropriate, affordable housing to slum dwellers (including access to potable water and sanitation) as the most important and potentially impactful form of adapting cities to climate change.<sup>15</sup>

Sustainable urbanization should thus be considered an overarching goal, reframing these challenges as an opportunity to leverage cities as engines of economic growth. Sustainable urbanization can be thought of as the process through which cities and regions provide citizens with adequate services, security and employment opportunities while limiting their ecological footprints. Sustainable urbanization can be the mesh that links broader development goals together.



Dilapidated slums have grown in the shadow of the historic downtown of Asuncion, Paraguay.

# 3

## Roadblocks to successful housing

The affordable housing sector is particularly complex because of the many stakeholders involved. Such complexity poses challenges for planning support schemes for incremental housing, since there are many different interests that need to be aligned (see the box below). Major roadblocks fall into three categories: lack of a supportive regulatory environment, lack of affordable units, and lack of access to different housing finance options. Each roadblock is examined below.

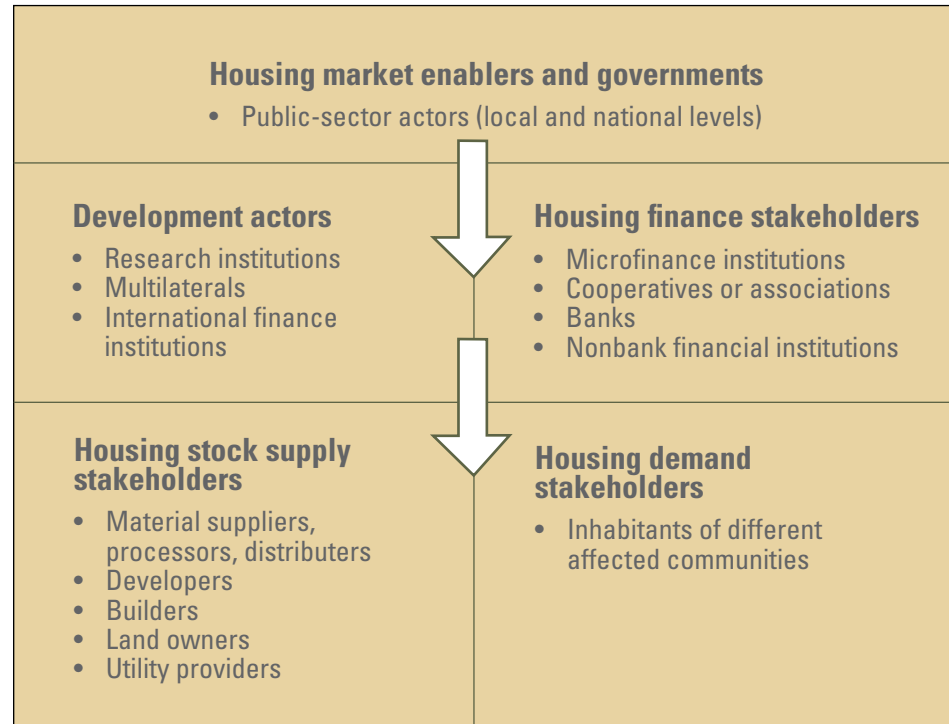
### Roadblock 1:

#### Lack of a supportive regulatory environment

A successful housing sector needs land formalization measures, sufficient supply of affordable housing units to answer the demand, government involvement in community planning and development, and sufficient access to adequate housing finance products. Each of these elements is critical for the success of the entire system.

There are four main market conditions that make up a successful and supportive enabling environment for housing sector development: a stable economy, lien laws, a statutory and regulatory scheme, and a legal and institutional infrastructure that allows for titling.

- Without a sufficiently stable economy, potential housing finance lenders are not confident in the stability of the currency and might be reluctant to lend to either borrowers or other market players for fear that their investments won't retain value.
- Without lien laws that allow financial institutions to enter into a contractual agreement with borrowers that establishes the right to place a lien on collateral, financial institutions would be taking on too much risk to make the transaction attractive.
- Without a regulatory scheme that establishes safety and soundness standards, borrowers have no assurance of protection through the transparency of financial product terms and building standards. These schemes should also ensure the financial stability of institutions.
- Without the legal and institutional infrastructure allowing for titling, low-income populations cannot use their homes or land as collateral to take out a loan. These schemes must be in place to support private ownership of individual residences and to establish a system for recording the ownership of property through a publicly accessible title registry. The more extensive the reach of an informal settlement, the more difficult it is for policymakers to collect



information. With little information about the status, financial activities or financial needs of people living in informal settlements, it is difficult to create and implement appropriate policies to support them.

## Roadblock 2:

### Lack of affordable units

The supply of housing units in most markets is concentrated in the upper-middle- and high-income segments because of the high costs of land and construction. Among lower-income people, alternative housing schemes such as incremental housing are the only available options for improving their living conditions. With nearly 2 billion people lacking adequate housing, the need for housing units is extremely high.

Sub-Saharan Africa, for example, is experiencing a tremendous lack of affordable housing units. The deficit of units in Zambia has reached 1.3 million;<sup>16</sup> in Angola it was estimated at 700,000 in 2000; and Ethiopia experiences a supply gap of between 73,000 and 151,000 units annually. Similar shortfalls can be seen in North Africa. Morocco's government estimates its supply gap at 1 million units, and in Egypt, Cairo alone will require at least 2 million new units to satisfy demand by 2020.<sup>17</sup>

South Asia currently needs 38 million housing units,<sup>18</sup> and India alone will need 11.8 million units by 2016.<sup>19</sup>

The Economic Commission for Latin America and the Caribbean estimates the current housing deficit in that region to be between 42 million and 51 million units.<sup>20</sup>

This lack of affordable housing stems from

obstacles and challenges that exist at nearly every point in the housing process. Some of these issues will require changes at the macro level by governments and policymakers, while others can be addressed by the actions of private-sector stakeholders. Though the housing sector is complex and certainly not without problems, creating access to affordable housing is not an insurmountable task and can begin on the micro level by expanding access to housing finance. Appropriately designed housing microfinance products used in conjunction with strategic market-sector interventions can help bridge the gaps that prevent increased access to affordable housing options for low-income populations.

## Roadblock 3:

### Lack of financing options

Worldwide, half of the adult population does not have an account at a formal financial institution, and 75 percent of poor people are "unbanked."<sup>21</sup> Far fewer can get financing to purchase a home or an apartment. On average, only 3 percent of the population in developing economies has an outstanding mortgage.<sup>22</sup> In many countries, that number drops to 1 percent, according to the World Bank.

As a share of gross domestic product, the mortgage finance numbers are telling. In the United States, mortgage finance accounts for roughly 80 percent of GDP, while in Indonesia and Mexico, it comprises less than 10 percent.<sup>23</sup>

Low-income borrowers have few alternatives. Traditional mortgage loans are not accessible to the lowest-income populations, and standard consumer microfinance loans are not structured to meet home construc-

tion needs. They instead must rely on their savings to finance their housing projects. When savings are nonexistent, they are forced to turn to informal sources such as selling assets, saving through Rotating Savings and Credit Associations (especially in Africa, Asia and Latin America), borrowing from relatives and employers, getting remittances from abroad, or taking exorbitant loans from money lenders with potentially dire consequences.

This is compounded by the informal economy that poor people use. If the borrower has only informal income, whether through a seasonal job (such as agriculture) or selling tortillas on the street, these incomes are generally not tracked and are very difficult to prove to financial institutions. Financial institutions are looking for proof of steady income when vetting potential borrowers so they can rely on receiving regular payments. Because of the lack of formality, financial institutions see these borrowers as much higher risks, and thus charge higher interest. The high interest rates (rates in Brazil, for example, range from 77 to 257 percent)<sup>24</sup> make financing highly unattractive to potential borrowers. Additionally, borrowers simply lack the information to manage their finances and determine what financial product is appropriate.

Given the millions of people moving to cities in the developing world, how can these roadblocks be addressed? While chapters 2 and 3 have outlined considerable challenges, chapters 4 and 5 will discuss how incremental housing can be an innovative solution and how a sector can be established to expand incremental housing through microfinance.

## 4

## Incremental housing: Unlocking solutions

Building a home in progressive or incremental stages is a common practice in much of the developing world, constituting 50 to 90 percent of residential construction. These improvements can be substantial, such as adding a second story, or more modest, such as fixing a roof or resurfacing a mud floor. Even small upgrades can have an enormous impact, particularly on health outcomes.

Respiratory diseases are exacerbated by substandard housing with an excess of dust, mold and smoke in the air. Children from households with no piped water are three to five times more likely to die of diarrhea than those from households with access to sanitation.<sup>25</sup> Very low-cost upgrades to concrete flooring in Mexico through the Piso Firme program resulted in statistically significant improvement in cognitive development and reductions in parasitic infection and diarrhea in children.<sup>26</sup>

Small upgrades can have an economic impact too. A room to rent, a sales kiosk counter, a warehouse or a production space can bolster household income and economic standing.

By leveraging the vibrancy of informal markets, incremental shelter practices have great potential to create larger numbers of safe and secure dwellings than conventional approaches. Coupled with tenure and basic services such as water and sanitation, households are able to invest in their homes and future through housing microfinance. This, in turn, reduces the financial burden on governments to subsidize housing. And taking small steps to formalize parts of the incremental process creates the potential

to have well-planned communities.

Building incrementally often represents what the United Nations Human Settlements Programme calls a “delicate expression of poor people’s gradual capacity to climb out of poverty. Like the houses they build, it’s not something that hap-

pens all at once. But in cases where housing finance and secure tenure are made available to people, the quality of owner-built housing — even at the bottom-end of the economic ladder — can improve dramatically.”<sup>27</sup>

### Habitat for Humanity Bulgaria and Mikrofond EAD

Nearly 19 percent of the Bulgarian population suffers from severe housing deprivation; that’s three times higher than the European average. Many of the Bulgarians in that category are forced to spend more than 40 percent of their disposable incomes for housing. About 17 percent do not have basic facilities in their homes, such as a bath or shower, hot running water, or central heating.

In 2008, Habitat for Humanity International created a Joint Housing Fund in partnership with Mikrofond EAD, a Bulgarian microfinance organization that focuses on underserved regions and communities. Together, Habitat and Mikrofond EAD have run a joint project to deliver housing microfinance services to clients in housing poverty throughout the country. Before the partnership, Mikrofond offered only business loans, but it saw an opportunity to introduce consumer loans that would help spur housing improvements for people like Sylvia Atanasov, who took out a microloan to repair her roof in 2011.

Habitat for Humanity Bulgaria and Mikrofond jointly provide financial education programs to their clients. Staff members are trained to provide financial education on topics such as budgeting, saving, wise borrowing, debt management and financial planning, along with raising clients’ awareness about the benefits and risks of using credit.

#### Habitat and Mikrofond

- Number of loans: 355
- Average loan size: €1,750 (US\$2,365)
- Average loan term: 31 months
- APR: 13.39 percent
- Average loan repayment: €80 (US\$108) per month



Through Habitat's housing microfinance partnership with Mikrofond EAD, along with Roma outreach with the local Club of Non-Governmental Organizations, Sylvia Atanasov and her family were able to take out a small loan to patch her damaged roof in Targovishte, Bulgaria.

## Financing incremental shelter with housing microfinance

Pairing the quickly expanding microfinance movement with the incremental building process presents an enormous opportunity. Housing microfinance is a subset of microfinance services designed to meet the housing needs of low-income families, especially those with little or no access to the banking sector and formal mortgage loans. This type of microfinance is designed for low-income households who wish to build, improve or expand their dwellings in progressive steps, relying on consecutive small loans. It includes a range of financial services — loans, savings and insurance products — that support informal shelter improvements and work where lien-based mortgages do not function.

Housing microfinance differs from formal mortgage loans in that loans are smaller and for shorter periods. Unlike formal mortgages, housing microfinance loans are usually not collateralized by the property. As mentioned in Chapter 1, the informal nature of housing microfinance clients' income or lack of land title makes alternative forms of collateral needed in most cases.

Housing microfinance helps speed up the construction of adequate housing, fitting in with the population's incremental approach. Despite evidence that up to 20 percent of microenterprise loans are diverted to shelter needs, housing microfinance remains a nascent product in an industry that emerged by emphasizing working capital loans.

Ten principles can help guide housing microfinance lending:

1. Financing expansion, renovation and repair of housing is better than purchasing land or existing or new houses.
2. Loan amounts should remain small.
3. Mortgages are usually not suitable for housing microfinance because laws can be nonexistent or weak in developing countries, fees are too high, and liens do not mitigate risk because foreclosure procedures are lengthy and difficult.
4. Land title should not be a barrier to accessing housing finance as long as the client has sufficient tenure security.
5. Loan terms should remain short but can be adjusted to the families' ability to repay.
6. Housing microfinance should leverage client savings, and saving done before the disbursement of the housing loan should simulate post-loan cash flow.
7. Revolving loans can allow for progressive building.
8. Loans can be extended to small neighborhood groups or cooperative housing schemes for simple infrastructure projects such as collective water and sanitation systems or other shared resources.
9. The loan value should cover the costs of offering the service.
10. Housing microfinance products should be combined with housing support services to increase quality

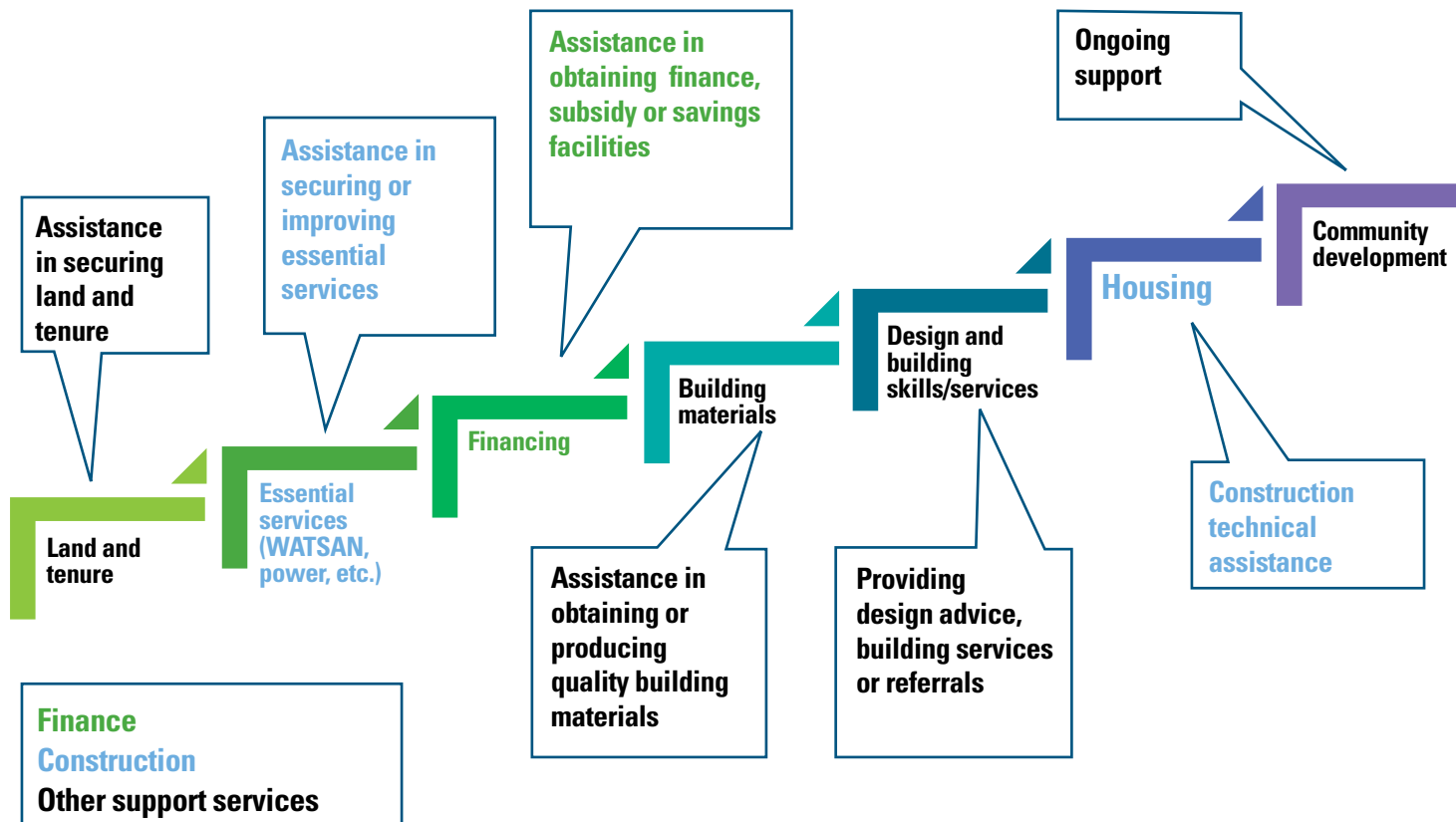
and lower construction costs. Support services can include construction technical assistance, group training workshops, distribution of printed informational materials, and discounts at hardware and home improvement supply stores.

## Maximizing housing microfinance through support services

Although the benefits can be substantial, housing microfinance and incremental housing are not without their challenges. The time between acquiring the materials and starting construction can result in a deterioration of the quality of materials (e.g., cement being stored in wet conditions, causing it to solidify). Homeowners with limited resources, few opportunities to obtain adequate and affordable financing, and inadequate access to quality products and trained service providers typically rely on informally trained builders and laborers, who often over- or underbuild. This can lead to problems such as material deterioration, inappropriate investment in costly improvements, and critical structural deficiencies, especially in disaster-prone environments.

These potential losses associated with incremental building practices can be mitigated through appropriate housing microfinance products coupled with technical assistance. The chart below illustrates this tiered support services model.

Housing support services and construction technical assistance are instrumental in helping housing microfinance clients achieve the best results. In Nicaragua, for



example, PRODEL has been a pioneer in housing microfinance and technical assistance since the early 1990s. As in much of the developing world, many lower-income Nicaraguan families who build their homes incrementally use materials that are rudimentary or poor-quality. PRODEL found that this piecemeal construction process is often carried out without technical construction knowledge. As a result, houses are often built in an unorganized way, resulting in awk-

ward use of space and poor ventilation. These factors can jeopardize a family's safety and well-being, especially in a country that experiences frequent natural disasters.

A core part of PRODEL's housing strategy is to introduce technical assistance in construction by working with microfinance institutions, clients, architects, engineers and master builders who are employed to carry out the building work.

PRODEL's advice to families focuses on ensuring safety, appropriate use of space, adequate ventilation and illumination, and use of quality materials. It also provides guidelines on how to optimize the building process to make it cost-effective. For smaller improvements, the technical advice focuses on sound building practices and the choice of good-quality building materials.

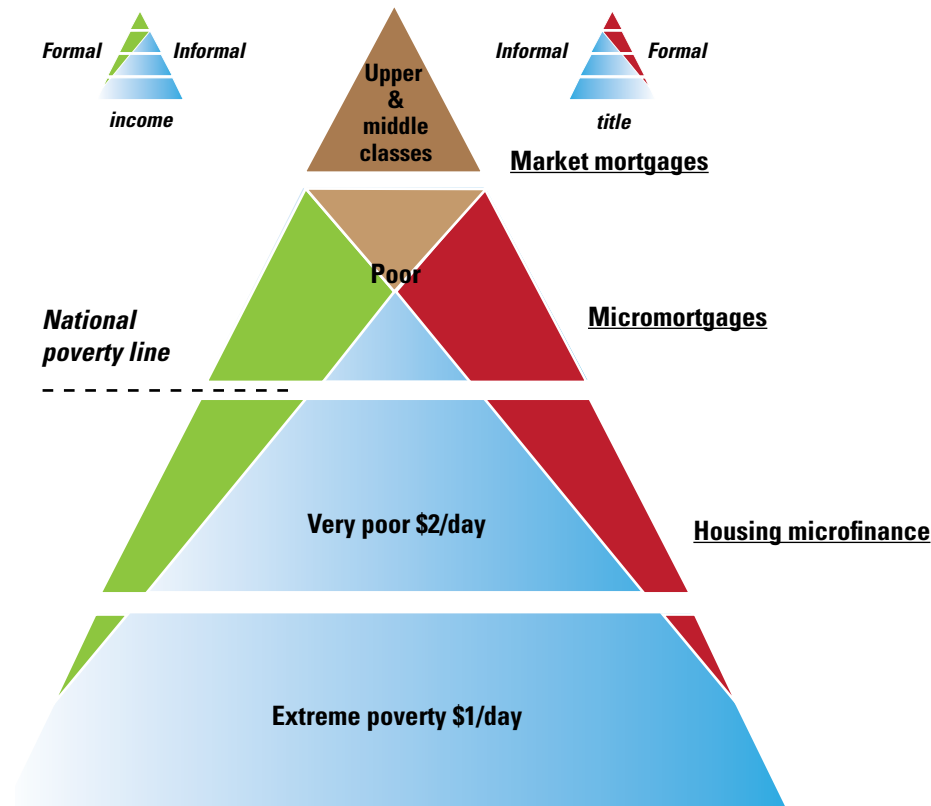
## Expanding housing microfinance

Habitat for Humanity International created the MicroBuild Fund, the first social investment fund dedicated to expanding the market of incremental construction loans through housing microfinance. The objective of the fund is to demonstrate the viability and sustainability of housing as a product. The fund's goal is to invest \$100 million in housing microfinance products to begin a push for scale and learning

around housing products for those living in extreme poverty — what is known as “the base of the pyramid.”

Low-income housing finance users are typically salaried workers with documentable income or, in more developing economies, the self-employed. Although informal workers are generally excluded from access to commercial housing finance (because of a lack of verifiable, stable and official income), housing microfinance products are more readily

offered for this segment through micro-finance institutions or other nonbank financial institutions. The segments shown in the pyramid above break up the target market not only by income type and land situation, but also by most probable type of finance supply. Where the divide line hits each emerging market will depend on local income strata, housing supply type and available financial institutions.<sup>28</sup>



## Mitigating risk

Although there is great market potential in offering housing microfinance products, financial institutions still face some hurdles. It is critical that the financial institution determine whether it has the commitment to add the needed capacity to develop and deliver the housing micro-finance product. In addition, the inclusion of housing microfinance products must be seen as needing the investment of resources for market research, product design and pilot implementation. Housing microfinance products also require adequate capital funds to support the expansion of housing microfinance as a core product within the financial institutions. Best practices have evolved to mitigate many of these risks, including:

- **Asset liability matching:** There is very high demand for longer-term funding to match the longer terms of housing finance products. Although deposits and savings can sometimes cover the funding needed for these products, guarantees can also be helpful.
- **Fixed rates:** From the borrower's perspective, it is important to know the exact amount they will be responsible for repaying. This transparency promotes a healthy



lender-borrower relationship that helps to ensure repayment, especially given lower financial literacy rates.

- **Individual loans:** Generally, there are higher repayment rates among individual housing lending than in group housing lending. Individual lending also helps simplify the analysis of cash flow (an important element of lending to informally paid workers). However, in some cases with extremely poor households, group lending has been successful, especially in small communities where community peer pressure helps ensure repayment.
- **Client education:** Technical construction training, housing design training and financial literacy training have all proved successful as supplementary education programs by increasing the rate of financial repayment.<sup>29</sup>
- **Women borrowers:** Women have been found to be more reliable borrowers and significantly better credit risks globally.<sup>30</sup>

By finding ways to coordinate with various players in the housing sector, financial institutions can open their housing finance offerings to broader-scale markets while limiting the risk of losing their investments. For example, combining existing government housing subsidies with tailored supplier and developer credit products (perhaps using vouchers and direct payment extraction mechanisms such as CEMEX's Patrimonio Hoy in Mexico) can act as a safeguard against risks associated with the clients' willingness to pay. A combination of government guarantee

programs, employer guarantor schemes and direct salary extraction techniques has successfully reduced risks when lending to new, untested markets. Creative combinations of finance products and urban system links have very high potential for bringing housing microfinance to scale.

A stable macroeconomic environment that encourages business investment and growth is critical to the success of any type of microfinance, housing microfinance included. These environments offer reasonable inflation rates, stable economic growth and the peace of mind that accompanies secure business conditions. On the other hand, high-risk markets present considerable constraints to the housing microfinance sector, including costly short-term capital, high inflation rates (leading to higher costs for construction materials and land), and negative effects on low-income clients' income, compromising their borrowing capacity. Well-designed, targeted housing microfinance products can help alleviate the negative effects of an unstable economy. Microfinance institutions that are successful in these conditions generally help mitigate risk and limit their exposure to loss by financing only small home improvement projects and ensuring that housing support service costs are kept low.

Specific housing microfinance products can include energy-efficiency loans that help lower household energy costs and therefore increase the borrower's capacity to repay the loan. This kind of loan serves the household beyond the term of the loan.

The state of a country's microfinance market can have an impact on a housing

microfinance portfolio. Where microfinance markets and institutions are relatively mature, regulations may either constrain or assist housing microfinance. For example, regulators in a few countries (e.g., Philippines and Bolivia) have recognized housing microfinance as a distinct product that can serve to encourage product differentiation among lenders. This differentiation enables microfinance institutions to direct specialized services to housing microfinance clients, undertake well-informed loan analysis, and monitor the use of funds (including project progress). Isolating housing microfinance within the microfinance institution's portfolio management system allows for more accurate performance assessment, encouraging product improvement over time. However, in markets where housing microfinance is not recognized as a distinct product, the opposite can happen. When housing microfinance is lumped in with higher-risk consumer loans, fixed-asset loans or a broader housing loan portfolio (possibly including mortgages), a variety of challenges can arise. Housing microfinance loans analyzed as consumer loans can result in excessive provisioning requirements, given consumer lending's higher-risk profile. For housing microfinance loans analyzed with mortgages, specific regulations such as legal land title requirements or overly restrictive interest rate caps can stunt housing microfinance potential.

## Savings in incremental housing

Developing more effective ways for people and communities to save their own funds will allow them not only to have more access to their own money, but also to be seen as less risky by potential financiers.



A Habitat for Humanity Philippines staff member meets with families as they make their mortgage payment in Karisma Ville, Malabon. Habitat Philippines focuses on an incremental building housing microfinance model, helping families by building core houses. Once the initial mortgage is paid, families can get a second mortgage to add rooms or facilities.

Low-income populations working in the informal economy are systematically ignored by the traditional commercial banks because of their perceived high risk. This sector of the population is denied not only credit, but also other types of financial services such as savings. Because of this, slum dwellers are forced to look for alternative saving mechanisms.

Incremental building has an effective built-in saving mechanism: When people accumulate construction materials until they have enough for their construction project, the materials are a form of savings. This saving mechanism could be formalized through a home improvement savings account, with the following benefits:

- Measuring savings capacity is a good tool to assess a household's cash flow, and thus its payment capacity. This is particularly valuable for people with informal incomes who want to borrow but have no collateral or track record.
- Savings aligns the interests of borrowers and lenders. Requiring a down payment from the borrower (using his or her savings) to qualify for a housing loan ensures the borrower has a financial stake in the incremental housing project. This helps ensure the loan is repaid on time.
- Savings organizations (VSLAs, ROCSOs and SACCOs) are effective tools that assist families in loan repayment. Many microfinance institutions are familiar with these types of group loan mechanisms, which can add a level of comfort to the lender.

Other savings schemes, such as locally

managed savings groups, may have a strategic importance as a vehicle for community building and the nurturing of solidarity, particularly among women engaged in the incremental building of their home. The regular savings of very small amounts of money can generate significant capital funds for borrowing, but the process of collecting, banking, lending and recovering loans is a powerful means of community building and the development of grassroots collective management capacities.

### The role of lenders

Lending institutions that provide housing microfinance loans are primarily microfinance institutions, ranging from for-profits to cooperatives. To be successful, lending institutions must carefully assess the associated risks and expenses that accompany a housing microfinance lending program and should build upon existing strengths where possible. Benefits of housing microfinance lending include an increase in client retention and satisfaction, an improvement that can translate into a sustainable demand increase in the long term. Housing microfinance lending can also increase stability by diversifying the loan portfolio and attracting new customers beyond microentrepreneurs. Often, people divert microenterprise loans into housing projects, so building a housing microfinance lending program can even reduce the misuse of loan funds. Housing microfinance, then, provides a valuable opportunity not only for the clients, but also for the lending institutions.

On Page 23 is a table of housing microfinance examples, including loans for home improvements and community loans whereby a group of people can borrow

## Housing microfinance product profiles<sup>31</sup>

Product	Loan amount	Term	Pricing	Use of funds
Home improvement loan	\$500 - \$3,000	6 months - 2 years	28%*	Repairs; weatherproofing; upgrades; extensions; connections to utilities such as water, sewage, electricity or solar power.
Home completion loan	\$1,000 - \$4,000	12 months - 3 years	28%*	Finishing a partially completed home, adding a room.
Home build loan	\$3,000 - \$10,000	2 years - 5 years	22%*	Building a completely new dwelling.
Group loans	\$500 - \$3,000	6 months - 3 years	28%*	Group loans for sites and services projects (e.g., roads or utilities).

*\*Indicative pricing for Uganda, declining balance loan.*

together to complete larger-scale projects such as roads or utility work that will benefit the community as a whole.

Housing microfinance loans are better equipped to match low-income borrowers' financing needs and ability to repay. A main challenge for creating successful housing microfinance products is developing a set of underwriting and collateral criteria that are relevant to the population the product is designed for. In general, this population is inherently higher-risk, necessitating the careful design and constant modification of products marketed specifically for it. To ensure that the housing microfinance is adequately designed and will respond to the housing and financial needs, preferences and capacities of low-income borrowers, it is necessary to

provide technical assistance to the lending institutions. Several institutions have product development experience but little or no experience in housing finance products.

For example, Habitat for Humanity International, through its Center for Innovation in Shelter and Finance, supports lending institutions interested in entering the housing microfinance market by providing them technical assistance in the design and testing of housing microfinance products and services. This is done through a systematic, methodological approach that emphasizes the financial and housing needs, preferences and capacities of low-income borrowers. The center also considers the capacity of the financial institution to design, pilot and scale up housing microfinance products. The center

has helped institutions enter the housing microfinance market for the first time and has advised those with current housing products on how to expand their outreach and refine the features of current housing microfinance products.

Many commercial banks looked to microfinance as a profitable means of improving their corporate social responsibility credentials, but failed to adopt the responsible lending practices necessary for sustainability and growth. Creating products specific to housing finance is one way to increase the responsible lending practices of financial institutions. By reducing cases of misuse of loan funds, financial institutions can better determine the rates, terms and amounts that are appropriate for buyers.

**The Habitat for Humanity Center for Innovation in Shelter and Finance facilitates collaboration among public-, private- and third-sector actors to develop sustainable and innovative housing solutions for the 1.6 billion people worldwide who lack adequate housing.**

**Our vision:**

To serve as a place of knowledge, expertise, advice and innovation, enabling low- and very low-income families to acquire adequate housing.

**Areas of practice:**

- Affordable housing finance.
- Water and sanitation, other basic services.
- Disaster risk reduction and mitigation.
- Sustainable housing and human settlements.

**Our team:**

Team members are located at Habitat's U.S. headquarters and regional offices. Our consultants are based throughout the world.

**Some current projects**

<p><b>Building Assets, Unlocking Access</b> Duration: August 2012-September 2017 Funded by: The MasterCard Foundation</p>	<p>Expand access to housing financial services to underserved populations in Ghana, Kenya and Uganda by building capacity in nine financial service providers as they diversify their product offerings to include housing microfinance.</p>
<p><b>Citi-Habitat Home Improvement Micro savings Pilot Program</b> Duration: August 2011-July 2014 Funded by: Citi Foundation</p>	<p>An innovative three-year pilot project in disaster-prone regions of Vietnam, the Philippines and Thailand that aims to mobilize 3,000 low-income homeowners to save US\$2 million to improve their homes.</p>
<p><b>IFC Housing Microfinance Toolkit for India</b> Duration: March 2012-March 2013 Funded by: IFC/World Bank</p>	<p>Supported financial institutions interested in entering the housing microfinance market.</p>

## Women and housing microfinance

Women generally feel the negative effects of slum life more than men. This is partly because traditional gender roles require women to handle the bulk of home maintenance and family care responsibilities. Health care infrastructure is typically nonexistent, adding further to the burden of family care. Maternal health is also sacrificed in slum conditions, resulting in high rates of both maternal and infant mortality.<sup>32</sup>

Beyond caring for the sick, women must keep up with the regular housekeeping work. Fetching water, for example, can require a very long walk to a public water source. All of these responsibilities consume women's time and limit the opportunities they have to get an education, look for work or start a business. Women are also subject to widespread gender-based violence, both random and domestic. Shared toilet facilities can put women at risk of rape and sexual assault. Domestic violence occurs at higher rates in slums as well. One study of slums in Dhaka found that 76 percent of surveyed women had endured physical or sexual abuse during the past 12 months, and 85 percent reported that their husbands restricted their access to health care.<sup>33</sup>

Despite the terrible conditions in slums, a home can be an important asset for women who have little else. Self-employment and microenterprises are usually based in the home. A workplace where there are poor or cramped conditions, and where home maintenance requires large amounts of time, is likely to be unproductive. In contrast, a decent house with protection from the elements and adequate space can

be an enormous advantage as a starting point for people who want to pull themselves out of poverty.

Because of the greater difficulty that women face in finding opportunities or even time to leave the home, housing issues are of paramount importance to improving their livelihoods, and they are poised to take a leading role in housing microfinance opportunities.<sup>34</sup> Self-employed women who are able to improve the quality of their homes can increase productivity in their home businesses in a number of ways:

- Getting running water for a couple of hours a day to avoid the long walks to fetch it at the shared pump.
- Improving the ceiling to allow for work to continue during monsoon season without stock getting wet.
- Connecting to electricity to allow for more work hours during the day.
- Improving the look of the home to attract more customers.

Women who work outside the home also may use their house as a storage or processing location for their products. In all of these cases, the home is a productive asset, making a home improvement a productive investment.<sup>35</sup>

Home improvement does, however, require the upfront investment of capital, which many women do not have access to. This is where housing microfinance can play a crucial role. Small housing loans can give women an opportunity to improve their situation, and microfinance institutions have found that female clients generally pose less of a credit risk and produce higher repayment rates overall.



### Partnering with IMON to improve micro loans

About 40 percent of the Tajikistan population lives at or below the poverty line, and about 70 percent lives in substandard housing. Because of limited job opportunities, more than 1 million Tajik citizens work abroad, most of them in Russia.

Among those who must find work in Russia are the three adult sons of Mamarahimova Nazokat, 59, a widow who lives with her five adult daughters and her five grandsons in a six-room house made of mud bricks.

In early 2011, IMON International LLC, a commercial microlending organization that has made more than 98,000 loans for more than US\$72 million, approached Habitat for Humanity Tajikistan to form a partnership. They set up a pilot program to improve IMON's housing microloans and add a technical assistance component.

With so many men working away from home, women are often in charge of the household tasks, including repairs and renovations. The technical assistance

component was designed to help clients manage their own construction and improvement projects by providing access to Habitat's expert advice. The clients said the construction technical assistance improved their knowledge and helped save them time and money.

Nazokat's family saw their lives improved after they received construction assistance and a microloan to repair her home.

"It all starts in the family," she said. "Children, their upbringing, learning, love, happiness, extension of the family, etc. The family is the small society where people live and share their sorrow, happiness, success, etc., together, and they work all together to achieve their objectives."

The pilot project was judged a success, and IMON is now preparing to offer bigger loans over longer terms. Habitat Tajikistan and IMON have secured an additional US\$2 million from Habitat for Humanity's MicroBuild, and plan to reach out to 2,000-4,000 more clients a year.

## Land tenure is essential

For the success of a housing ecosystem and of housing microfinance, there must be a supportive regulatory environment that allows for the formalization of land. Land tenure refers to the right of an individual or group to occupy or use a piece of land without fear of eviction. A formal land title is one proof of ownership, but it is often too cumbersome or costly to obtain. This is particularly true for women. Formal land titles also presume a functioning cadastre and a system to adjudicate claims. In many developing countries, land tenure takes the form of a de facto recognition rather than an official legal status. Without collateral or land title, access to traditional mortgages is limited, and there is less desire to invest in home or community improvements. Microfinance can increase access to land title through titling loans, but more importantly, it can rely on softer forms of collateral to facilitate broad access to housing. Helping people gain legal ownership of their property can lead to other housing finance and development opportunities.

Governments have critical roles to play as funders, facilitators and regulators of housing microfinance and secure tenure. Formalization of land tenure should be coupled with an effort to increase the collection and reporting of information in a functional registration system. A large database of demographic and housing-related information will not only improve the ability of financial institutions to provide the correct services, but also assist policymakers in designing appropriate responses to housing issues.



In La Guardia, Bolivia, Habitat is helping 45 families to buy land, extending two- or four-year loans that cover the cost of a plot of land and the necessary paperwork to prove ownership. Once the families have paid 70 percent of the land loan, they will be eligible to begin constructing their Habitat houses. The families regularly gather to clear the land they are purchasing in preparation for the creation for their future Habitat neighborhood.

© Habitat for Humanity International/Mikel Flamm

Gathering information in informal settlements is notoriously difficult, however, and some governments have developed innovative approaches such as participatory enumeration. This method uses the residents themselves in gathering

information, improving both the reach of the data gathering and, in some cases, the level of trust between residents and authorities. More innovative solutions to the continuum of land tenure are discussed in Chapter 5.



Pho and his wife bought land in Battambang, Cambodia, only to discover later that it was government property. Seeking secure tenure, Pho and 230 other Battambang residents received their land certificates after 21 years of perseverance.

# 5

## Industry building: Innovations in housing microfinance

Supporting the low-income housing industry is just as important as encouraging financial institutions to offer housing microfinance products. How, then, can housing microfinance be brought to scale? There are many examples of innovative, industry-building initiatives. Linking industry, creative tenure schemes and technology with housing support services and basic financing, the housing sector

and incremental building can expand and improve the lives of 1.6 billion people in need of a decent place to live. The following are a few ideas.

### Impact investing and housing microfinance

Impact investing aims to generate both social and financial returns on invest-

ment. The terms “blended value” or “double bottom line” have also been used to describe impact investing. By some estimates, impact investments represent a potential investment opportunity between \$400 billion and \$1 trillion in the next decade. This initiative has the potential to play a major role in the success of housing microfinance in increasing access to affordable, safe housing. Impact investors

## OPENING DOORS WITH MICROBUILD

Habitat for Humanity International launched the MicroBuild Fund to mobilize impact capital to demonstrate the viability of housing microfinance to households and the institutions that serve them. Because housing microfinance is a nascent product, HFHI has committed to a technical assistance facility to help institutions design appropriate financial products and linkages to housing support services.

The fund launched at \$50 million and is expected to double its size of commitments to \$100 million in 2014. The fund is managed by a third-party social investment fund manager, Triple Jump, based in the Netherlands.

## SCALING ACCESS TO HOUSING MICROFINANCE

- Provide a source of longer-term social investment capital for financial service retailers who target the poor to begin or expand their housing microfinance portfolios.
- Demonstrate to the microfinance sector (microfinance institutions, their networks, and the donor and investor communities) the viability and scale opportunity of incremental housing and housing microfinance products.
- Provide leading technical assistance in the design and refinement of housing products, and steward and share best practices with the sector as they emerge.

### WHERE WE HAVE STARTED

- Armenia
- Azerbaijan
- Bolivia
- Cambodia
- El Salvador
- Ghana
- Kenya
- Lebanon
- Mexico
- Philippines
- Tajikistan
- Uganda



whose primary goal is to make a positive impact may accept lower expected returns or higher risk in their investments. These impact investors are therefore in a unique, more risk-neutral position to invest in innovative housing microfinance products that create learning and best practices to expand the sector and reach greater scale.

To begin to demonstrate the viability of

housing microfinance to the sector and to impact investors, Habitat for Humanity International created the MicroBuild Fund. MicroBuild is the first impact investment fund dedicated to expanding the market of incremental construction loans through housing microfinance. Since housing microfinance remains an emerging market, MicroBuild accompanies investments with a package of technical

assistance to help design products that are client-responsive and meet their needs, preferences and capacities.

### Technology and linkages

Technology and linkages play an essential role, including:

- Pay-as-you-go utilities — electricity, water, solid waste collection,

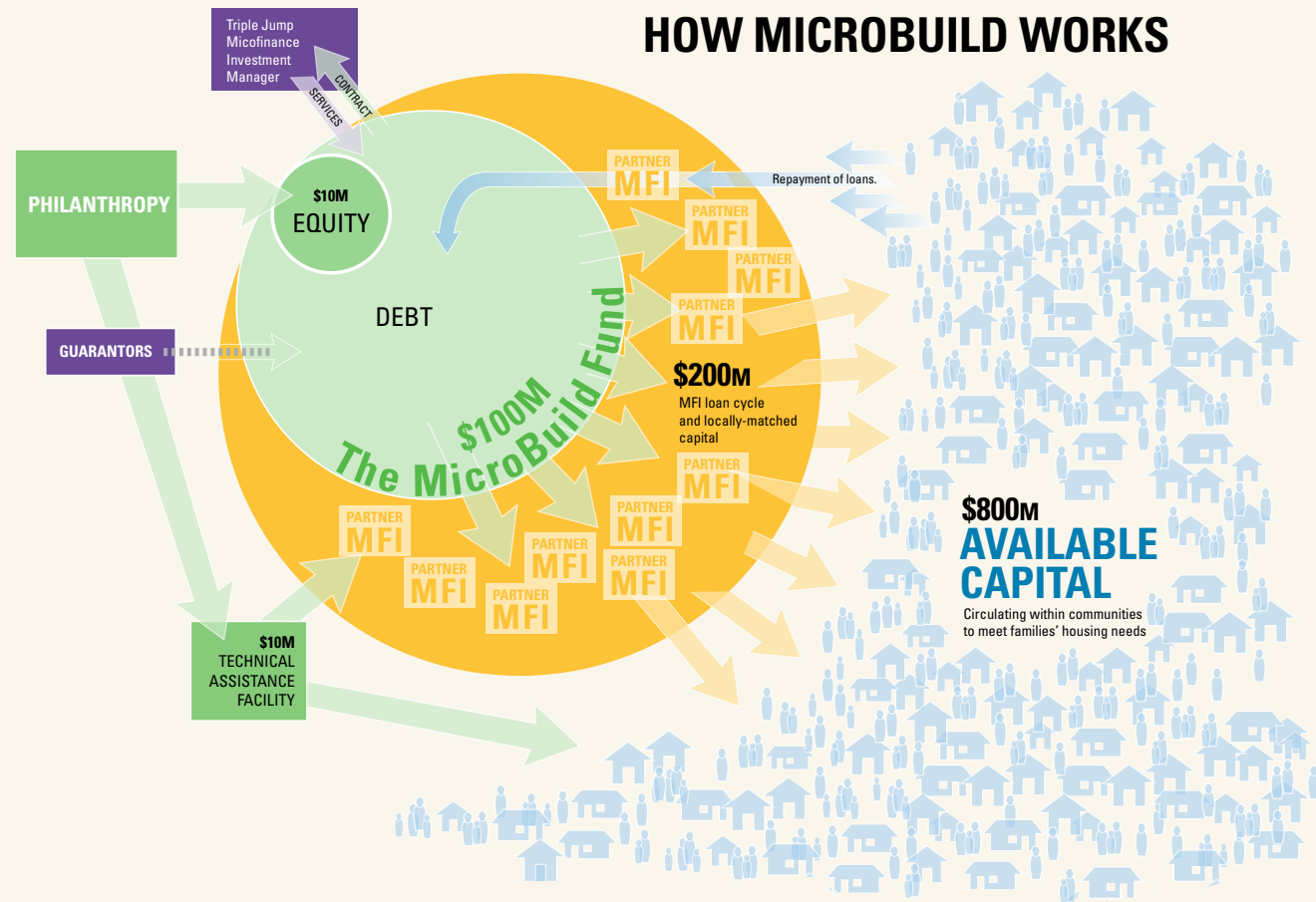
### INSTITUTION SELECTION CRITERIA

- Institutional commitment to housing microfinance.
- Operationally sustainable or in positive trend.
- Strong management and good corporate governance.
- Good portfolio quality.
- Leverage within reasonable limits.
- Commitment to fair lending practices.
- MIX Transparency rating of three diamonds or higher (preferred).
- Audited financial statements of more than three years.

### LOAN TERMS

- Loan size: US\$500,000 to US\$5 million.
- Tenor: Three to seven years.
- Type of investment: Mostly senior debt.
- Currency: U.S. dollars and local currency.
- Interest rates: Competitive with current market rates of international funders.

### HOW MICROBUILD WORKS



sanitation, etc. — through SIM card payments that activate the release of a set amount of a product.

- Increasing access to housing finance by linking financial institutions with mobile network operators to help provide new kinds of financial behavior records.
- Packages of financial and nonfinancial services that link various players into the progressive housing process. The development of appropriate packages requires business partnerships among finance institutions, building materials retailers, manufacturers, banks, homebuilders, community organizations, service practitioners (architects, engineers, etc.), and governments.

### Community-led solutions

Open defecation affects a third of Africa's population. The Sanitation Hackathon is a contest to design an application to help collect data addressing this problem. The app will use the Community-Led Total Sanitation methodology to mobilize communities to eliminate open defecation by reporting cases on sight via SMS or calls to a hotline. The data collected from the app would be connected to GPS data from the call and would allow municipalities to map those points and determine hot spots in need of urgent support. This method could revolutionize data collection within slums or other hard-to-reach populations, giving policy-makers relevant data to direct their decision making while encouraging excluded communities to make their voices heard.<sup>36</sup>

### Supplier-led financing

Housing microfinance products such as

savings, deposits and credit can be offered by building materials suppliers or service providers. These suppliers could then hire finance institutions to facilitate the process. This strategy is especially useful for finance institutions that offer housing microfinance as a secondary product but do not want to spend the resources needed to expand the offering to a larger scale. This “supplier credit” technique has been quite successful for companies such as CEMEX and La Farge (both concrete suppliers) because of their broader reach throughout building communities. Studies also suggest that using microfinance institutions in this way would be successful in Asia (such as Monitor Group in 2007).<sup>37</sup>

### Expanding the scope of housing microfinance

Housing microfinance has become misunderstood in recent years as exclusively small home improvement loans, mostly because of the ease of transition into the market for the microfinance institutions. With the rapid growth of housing in emerging markets such as Peru, Mexico, Brazil, India and Indonesia and the increased wealth of those populations, new opportunities are developing for housing microfinance products. As Bruce Ferguson, a consultant and former senior housing and urban economist at the World Bank,<sup>38</sup> points out, the following housing microfinance adaptation opportunities exist:

- In Brazil, housing microfinance products could be used to expand or complete “government-assisted shell units” and for highly skilled professional labor instead of exclusively building materials.
- In Latin America and the Caribbean,

where rental units currently make up less than 20 percent of housing, housing microfinance products could be used for remodeling or building accessory spaces to be used as rental units.

- In East Asia, governments build out apartment shell units for low-income housing blocks. Housing microfinance products could be made available to assist owners with incremental home improvements.
  - In a “sites and services” model where subdivision plots have minimal utilities (maybe communal water and dirt roads, usually without title), such as in Pakistan, housing microfinance can be used to improve living conditions on these plots, especially when linked with other housing-sector players.
  - In sub-Saharan Africa, most low- to moderate-income households do not have legal title to the land they occupy. Microfinance institutions have begun accepting evidence of security of individual tenure (such as land leases) as collateral for housing microfinance rather than title. Housing microfinance can play a pivotal role in the development of these kinds of plots, especially when the financial institution takes the time to understand the populations they target for these products and the constraints they face.<sup>39</sup>
- Governments around the world have come up with innovative land formalization models for low-income populations along the land rights continuum.
- In India, the use of online administration and management of land records has dramatically improved the efficiency of these processes, increased

transparency, and reduced the need for lengthy bureaucratic procedures (all making the process more efficient and affordable). Local computer kiosks have been installed in remote areas, increasing access to land registry services for low-income populations in Karnataka who would normally be excluded.<sup>41</sup>

- In Kenya, the creation of Community Land Trusts has allowed for a reduction of speculation and ambiguity of land demarcation.

A group retains ownership of the land through the trust and distributes individual leases to group members. This reduces the cost of land acquisition by eliminating the need for surveys of individual plots, and Kenya's Land Department has agreed to waive the initial land premium. This arrangement also encourages the population to improve and develop the land while giving them a key element for accessing the financing to do so.<sup>42</sup>

### Government subsidy integration

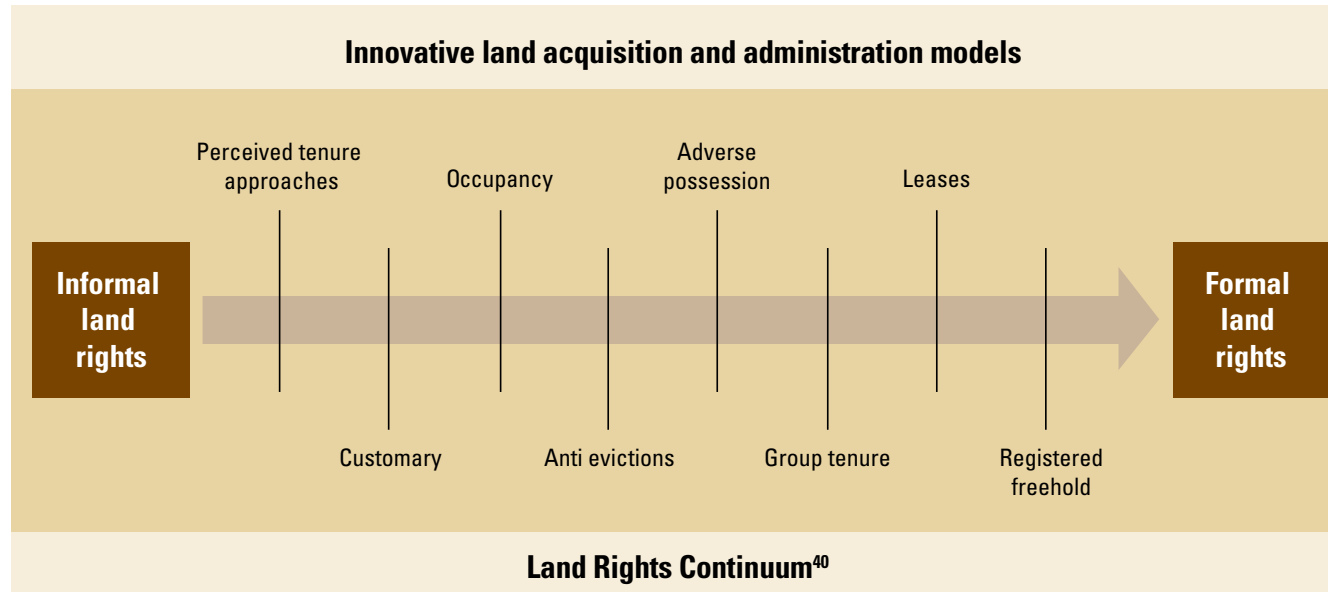
Public-private partnerships have great promise for increasing access to decent housing for excluded people around the globe. However, there is much skepticism on the part of the private-sector players to engage with government agencies for fear of diluting the borrower's willingness to

pay. A combination of government housing subsidies and housing microfinance loans can be used to incentivize developers to participate in the low-income housing market. This has been effective in the United States since the housing crisis of 2008; in Mexico through SHF/Financiers Independencia; and in Cape Town, South Africa, through the Kuyasa Fund, through which low-income borrowers were allowed to expand their residences from an average of 23 square meters to 54 square meters.<sup>43</sup>

### Product suites including savings, insurance and customer education

Educating customers in the areas of saving, wise borrowing, debt management and financial planning, along with raising clients' awareness about the benefits and risks of us-

ing credits, has the potential to improve the housing and financial sectors tremendously. This education can encourage potential borrowers to use available savings products to protect (and earn) on their money while saving up for either a down payment or the first installment of building materials for an addition. By combining an insurance and savings product, there is a built-in deterrent for clients to withdraw their money to use for consumer purposes. This safeguards the money and helps to develop responsible client behavior while giving those clients access to the added protection that insurance has to offer.



## 6

## Conclusion and recommendations

In our rapidly urbanizing world, decent living conditions are becoming scarce, especially in developing countries. The lack of economic opportunities in rural communities is encouraging a global urban migration, but many of the world's cities do not have the capacity to support this influx of new inhabitants. This trend, combined with unsupportive regulatory environments, the lack of adequate housing units, and the lack of access to financing for these poor populations, has led to the creation of informal settlements in and around many of the world's growing cities.

Incremental construction is the way that these informally settled populations have adapted to the constraints of their situation. By slowly saving money under mattresses or in jars, people collect building materials to gradually expand and improve their homes. These homes are usually not constructed by trained builders, and therefore they generally are not structurally sound. Building materials may be damaged, stolen or spoiled while in storage, resulting in an effective loss of savings that could be avoided through a more formalized savings system or access to financing.

Housing microfinance has the ability to support these households in this incremental building process by allowing them to purchase enough labor and building materials to complete an element of their home that will not degrade while waiting for the next phase of construction, there-

fore decreasing the loss of savings.

The advent of microfinance enabled large-scale access to finance — and consequently economic growth — in informal sectors around the world. Similarly, housing microfinance has the ability to unlock the potential of progressive informal housing practices to increase access to safer, healthier and less impoverished living conditions for the world's poor.

By applying the principles that made enterprise microfinance successful to housing, policymakers, impact investors, developers, material suppliers and microfinance institutions have the ability to reshape inadequate living conditions around the world. We need to encourage market solutions such as housing microfinance for high-quality incremental building. When bundled with basic housing support services, housing microfinance, including savings, credit, remittances and insurance services, can lead to scalable, replicable and sustainable solutions.

### Recommendations

- **Housing microfinance should be recognized as an effective way to finance housing for low-income populations in the developing world.** Government efforts to develop housing solutions in the formal sector have fallen short. Habitat encourages policies that strengthen

what low-income people are already doing in the informal sector as a way to serve greater numbers of people more equitably.

- **Secure land tenure is essential for successful housing microfinance.** Though full titles are not necessary in every context, national and local laws must create a framework for granting sufficient tenure security, including an accessible, transparent and accountable land administration system.
- **Incremental housing and housing microfinance should be approached as sources of developmental and financial returns.** Government aid accounts for less than 20 percent of the developed world's economic dealings with developing countries. Habitat therefore encourages private-sector and social entrepreneurship opportunities that advance access to better housing in sustainable and even profitable ways. Housing microfinance shows promise as a product that offers financial service providers both social impact and financial returns.
- **To function best, housing microfinance needs to be coupled with financial education and construction technical assistance.** Purchasing or improving a home is often the largest investment a family will make. Appropriate financial educa-

tion and housing support services can improve the likelihood of a successful outcome.

- **Market actors must prioritize the consumer.** Market actors serving low-income segments of the population must design appropriate products and services, prevent overindebtedness, provide transparent information, use responsible pricing, and protect clients' privacy.
- **Governments should catalyze, facilitate and regulate housing microfinance.** Governments can nurture the growth of the housing microfinance sector by ensuring that housing is not restricted or restrained by being classified as a consumer loan. Housing plays a nuanced and often economically productive role in the lives of people working in the informal sector. Likewise, local building codes should not prohibit methodologies that allow households to safely build their homes incrementally.
- **Multilateral development institutions should provide capital and capacity building to spur innovation and expansion of housing finance products.** In addition to funding, multilateral institutions are well-positioned to provide capacity building and technical assistance — critical resources that are often overlooked.

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- 38 Bruce Ferguson is also a member of the advisory board of Global Urban Development. He previously served as an urban development and housing project officer at the Inter-American Development Bank, and he has published widely on housing and urban development in developing countries and the U.S.
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Habitat for Humanity International is a global nonprofit Christian housing organization that seeks to put God's love into action by bringing people together to build homes, communities and hope. Since 1976, Habitat has served more than 600,000 families by welcoming people of all races, religions and nationalities to construct, rehabilitate or preserve homes; by advocating for fair and just housing policies; and by providing training and access to resources to help families improve their shelter conditions.

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