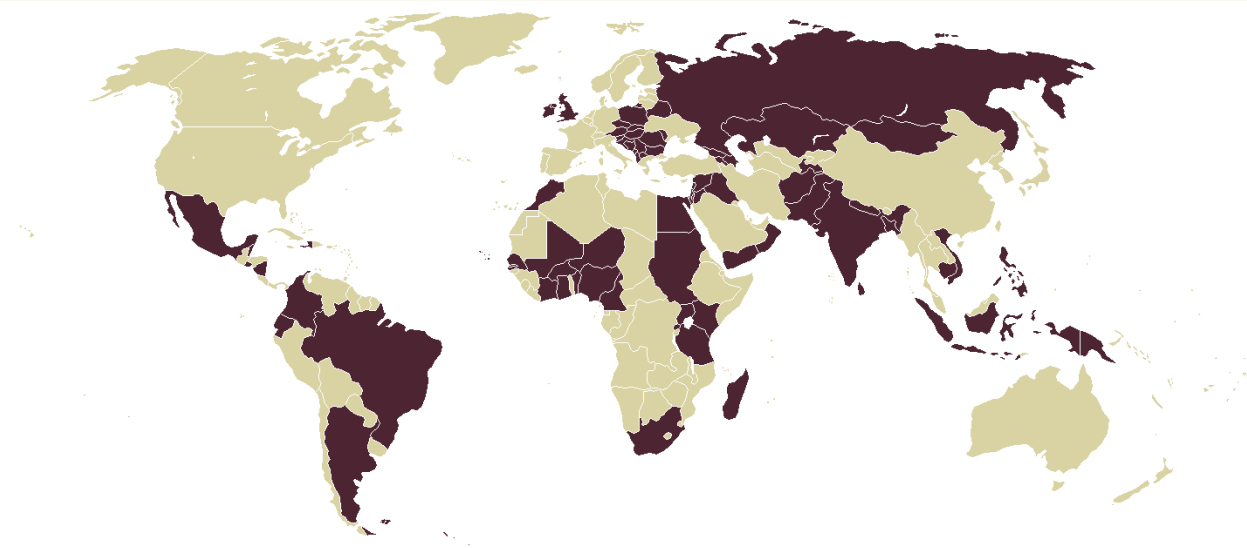

Discussion Paper for an OeEB

Strategy on Housing Finance

*Prepared for OeEB by Shorebank International
Vienna, January 2010*

**DISCUSSION PAPER
FOR AN OEEB STRATEGY IN HOUSING FINANCE**



January 15, 2010

Prepared for



by



SHOREBANK INTERNATIONAL

Table of Contents

PROJECT OVERVIEW	3
EXECUTIVE SUMMARY	4
HOUSING FINANCE MARKET ASSESSMENT	5
THE HOUSING POLICY AND REGULATORY ENVIRONMENT	9
EXISTING HOUSING FINANCE PRODUCT DEVELOPMENT	14
HOUSING FINANCE PROVIDERS OVERVIEW	26
APPENDIX I. PROJECT SOURCES	31

PROJECT OVERVIEW

SBI is the advisory and consulting arm of the parent bank holding company, ShoreBank Corporation, and is charged with applying the lessons and expertise that ShoreBank has accumulated in operating commercial banks and non-bank intermediaries in challenging economic environments. The skills and approaches applied by SBI internationally are rooted in over thirty years of experience of the ShoreBank group of companies in housing finance, commercial and retail banking, and development finance.

Despite a huge demand, investment in housing and the housing finance system as a whole has failed to meet the housing needs of the poor around the world. Innovative housing and housing microfinance solutions have emerged but have yet to reach scale in most parts of the world. Therefore, while there is much to be learned from international best practices and common challenges, there is also a great need and potential for entering the market.

SBI's methodology included desk research, field interviews, and a compilation of field intelligence and project work, over the four month assignment.

SBI wishes to acknowledge the inputs from Ms. Judith Pauritsch, Ms. Kristin Duchâteau and their colleagues at OeEB over the course of this assignment. We would also like to thank Cheryl Young of Bankable Frontier Associates and Dr. Martin Levine for their peer review and substantive edits to the report.

EXECUTIVE SUMMARY

For commercial banks and other primary market housing finance providers, the current economic and investment environment represents particular challenges both for launching new products and maintaining portfolio performance and profitability. Financial institutions globally are facing portfolio performance issues due to the general economic downturn and prior aggressive lending practices. The growth of housing finance markets over the past several years has masked sloppy underwriting and overly ambitious lending among many financial institutions. Despite these challenges, this period represents an opportunity for lenders just entering the market to create sound platforms for future growth by instilling best practice lending approaches, improving technology platforms and risk management systems, and focusing on the fundamentals of lending and financial institution management.

With ever persistent housing shortages combined with the global economic crisis, compounded by more than half of the global population living in cities for the first time in human history, it has become even more difficult for low income households to gain access to affordable housing. The barriers to expanding access to housing finance beyond the upper income groups at the top of the pyramid are in large part due to informality or unpredictability of income and land title. Barriers also exist at the financial institution level due to insufficient capacity to introduce specialized housing finance products and access long-term funding.

In the Housing Finance Market Assessment, SBI introduces the housing finance needs along a continuum of market segments, from housing microfinance at the low end of the market to mortgage finance at the upper end of the market. Perhaps more than any other financial product, the ability to successfully provide housing finance is highly dependent on the local legal, regulatory and market conditions.

The Housing Policy and Regulatory Environment section focuses on regulatory and legal trends and introduces the concept of a checklist of minimum regulatory features that must be in place for housing finance to flourish.

In the discussion on Existing Housing Finance Product Development, the paper provides a comprehensive overview of the types of housing finance products that are currently serving housing needs. We include a discussion of common risks and challenges for developing and providing housing finance products.

Subsequently, the discussion of Housing Finance Providers details the types of organizations that currently provide housing finance and microfinance products, assessing the role housing finance products play in the institutions' portfolio and the opportunities and risks of housing finance programs for institutions.

HOUSING FINANCE MARKET ASSESSMENT

For most people in the world, rich and poor, a house will be the single largest investment they make in their lifetime. This investment is not only important to the family, but has a high multiplier effect which resonates up and down the value chain of the entire economy. Construction, a significant component of GDP calculation, leads to employment generation and industrialization which contribute towards poverty eradication and better quality of life for a country.

The gap between the demand and supply of affordable, adequate housing has reached intolerably high levels. This is exacerbated by the fact that, for the first time in history, more than half of the global population lives in an urban area. This emphasizes the urgent need for a focus on housing finance development and increase in the scale of affordable housing products.

In many markets, the poor and low-income groups have little or no means of financing housing, even improvements and repairs, apart from minor savings, selling assets, Rotating Savings and Credit Associations (ROSCAs), borrowing from relatives and employers, inheritance, loans and savings from Savings and Credit Cooperative Societies (SACCOs), remittances from abroad, or taking exorbitant loans from money lenders. With the growth of microfinance loans for business, education, personal use (salary), agriculture and emergencies, clients have had access to loans which they then divert for housing purposes. In some instances, 80 percent of microfinance loans are being diverted to housing, and many practitioners estimate that 10 to 20 percent of all microfinance loans are used for housing, thus supporting the conclusion that there is a high demand for housing microfinance.¹ Unfortunately, the current microcredit loan products are inappropriate for housing needs as the term is too short and the interest rates charged are too high for non-business use. Some housing experts also strongly believe that housing loans should be accompanied by technical assistance in budgeting, building and/or monitoring.

There is a wide range of housing finance products that provide financing for affordable housing. Many are missing key long-term funding which will allow them to scale and be successfully incorporated into institutions' portfolios. These products will be discussed in this paper as either housing finance or housing microfinance products.

The Affordable Housing Institute (AHI) describes housing finance as an ecosystem, with finance, homeownership, rental housing and affordable housing as four interrelated subsystems that define the overall ecosystem. This term emphasizes the complexity of the issue and its role in contributing to the vitality of a country's overall economy. Housing finance or mortgage lending is defined as the process whereby a financial institution loans funds to finance the purchase, remodeling or construction of real property and individual homes. Housing finance products are defined by relatively large sized loans with long terms for repayment to cover a sizable share of the value of the property that are secured by collateral. Mortgage finance requires regulatory and legal support mechanisms, advanced financial institutions and credit-worthy borrowers who can support large loans with long tenors.

In contrast, the housing microfinance field has a distinct set of products from housing finance. The housing microfinance field has grown drastically since 2000 in response to the desperate situation that typically, less than 20 percent of households, and often less than 10 percent, can qualify for a traditional

¹Habitat for Humanity Report, Public Document, Bankable Frontier Associates, 2009

mortgage to purchase the least expensive commercially built unit.² As Robert Christen describes in his introduction to *Housing Microfinance: A Guide to Practice*, “designing financial products that can more directly respond to the desire for improved shelter represents one of the most interesting challenges we face in the world of development finance.”³

Using typical microfinance lending methodologies and collateral substitutes, housing microfinance provides successive micro and small loans to clients to fund progressive housing improvements and expansions. It provides financial access for housing needs for the poor and low-income brackets in order to improve their housing conditions in slums and rural areas.⁴ These loans are often unsecured and credit assessment is generally based on a combination of financial cash flow analysis and character analysis. The housing microfinance problem 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” as described by Bertrand Renaud.⁵

Serving as a middle ground between housing finance and housing microfinance is a form of low-income mortgage lending, often referred to as micro-mortgage lending or affordable lending. This is served by distinct financial institutions or by conventional mortgage lenders shifting down-market. The financial products are more closely related to traditional mortgages, with similar terms. The loans are structured to allow for lower monthly payments to make the product accessible for lower income populations.

The following diagram depicts the housing market segmentation utilizing the type of employment (formal vs. informal) and whether the borrower possesses a land title. This diagram graphically depicts the underlying reasons for lack of access to finance. Efforts to expand access to finance for affordable housing primarily focus on reaching those with adequate income (formal or informal) and who have secure tenure, but may lack formal title.

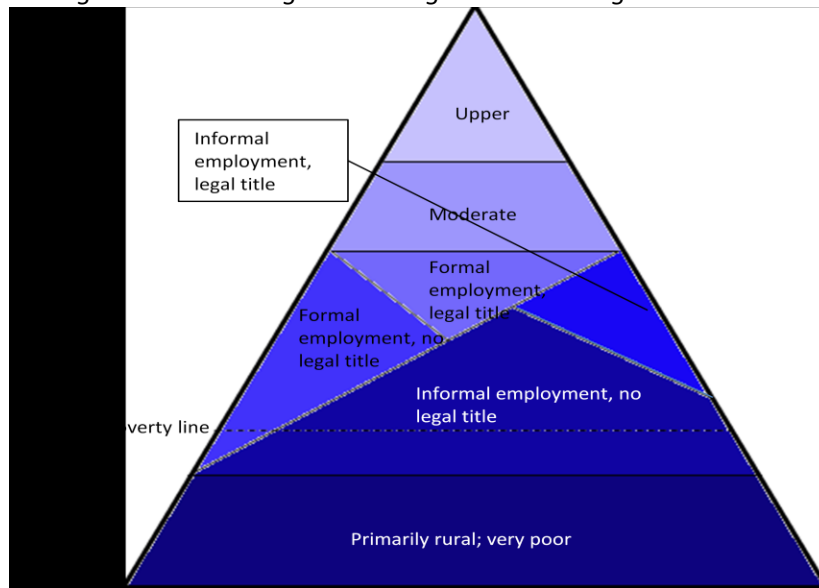
² Daphnis and Ferguson, "Housing Microfinance", Kumarian Press, 2004, p. 16

³ Daphnis and Ferguson, "Housing Microfinance", Kumarian Press, 2004, p. xiv

⁴ Daphnis and Ferguson, "Housing Microfinance", Kumarian Press, 2004, p. 4

⁵ Daphnis and Ferguson, "Housing Microfinance", Kumarian Press, 2004, p. 2

Figure 1 Housing Market Segmentation Diagram⁶



Market Segment Definitions:

1. People with Formal Employment* and Title. This is the upper middle income bracket, which can typically obtain mortgages (if available in the marketplace).
2. People with Formal Employment but No Title. While land title is one form of proof of ownership, there may be other types of proof of land tenure and right of occupancy, which is important for housing microfinance.
3. People with Informal Employment [keep consistent to language in pyramid] and Title to Land. Could be upper/middle and lower income, but less able to access finance due to the informality of their incomes.
4. People with Informal Employment and No title.

*SBI defines “formal employment” as an employee of an institution or organization receiving regular, stable

The middle quadrants would be included in the target group for housing microfinance and the lower end of the micro-mortgage product. Of these categories, those in the “Formal Employment but No Title” would be the group that most MFIs would seek due to the lower risk factor.

Housing finance and microfinance has substantial potential, but is stifled by a dearth of finance. The recent economic crisis has further tightened the supply of financing for housing and construction globally. Many international donors have shied away from riskier types of lending, such as housing, and the cascading effect has forced local financial institutions to limit mortgage finance, which is viewed as a riskier and longer term product. Non-deposit taking mortgage finance companies are particularly constrained as they require a sustainable source of long-term funding to expand their lending activities.

Institutions offering traditional mortgage finance and housing microfinance are both in need of longer-term funding sources to match the longer terms of the underlying housing portfolios, however there are different risks and profiles associated with each type of institution. Institutions offering traditional mortgage finance would largely be commercial banks, specialized non-bank finance companies, or savings and loans or other types of cooperatives. The capital needs for these providers would tend to be larger and for a longer term, given the underlying terms of traditional mortgage loans.

Institutions providing housing microfinance products, on the other hand, are predominantly microfinance institutions that range from for-profit, Tier I institutions to non-profit Tier II and Tier III MFIs, and cooperatives.⁷ In some cases commercial banks and credit unions are offering housing

⁶ Source: Bankable Frontier and ACCION International, Housing Sector Workshop, October 14, 2008, Washington DC

⁷ Many organizations define microfinance institutions on a tiered basis, using a variety of matrices to separate institutions into Tier I, II and III categories. ACCION, for example, adapted the standard bank CAMEL rating into a diagnostic tool for MFIs, measuring: Capital adequacy, Asset quality, Management, Earnings and Liquidity. MicroRate is a private company dedicated to the evaluation of MFIs, and assesses the fiduciary and credit risk to potential investors. Tier I MFIs are often categorized as larger institutions with substantial total assets in multiple geographies or that have emerged as the market leader in their locale, with strong self-financing capacity and multiple capital sources.

microfinance loans as well as mortgage products. However, given the underlying term of housing microfinance loans tends to range from six months to three years on average, with much smaller transaction sizes, the borrowing need for the financial institution would be smaller and for a shorter term than for a bank seeking funding for mortgages.

There is a global need for housing finance products and investment in housing finance, which has grown more acute in the past few years given the global financial crisis. SBI has identified regions that offer market opportunities. Southeast Asia and South Asia have very large urban areas with stunningly high levels of housing shortages. Countries such as India and Cambodia are rapidly developing housing finance and microfinance initiatives that are responding to large market demand at all income levels. Major issues such as the regulatory framework and foreign currency risk will arise but are being addressed by government or private sector initiatives. Parts of Latin America have evolved significantly in recent years, which provide a more supportive regulatory and legal environment for housing finance and have started to incorporate innovative mechanisms such as remittance-backed housing lending. In the more developed markets of Eastern Europe, the financial system is more sophisticated and many countries have already developed a housing finance system but are considering the challenges in funding and developing a secondary mortgage market. In the Caucasus and Central Asia, mortgage markets are emerging. Finally, while there is severe need in many parts of Africa, many of the investment opportunities center on housing development and production and the nascent economies in the majority of the African countries create a difficult investment atmosphere. South Africa is far advanced of the rest of the continent, while banks in East and West Africa are beginning to explore offering mortgage products on a wider scale with technical assistance support from the IFC, World Bank, and other DFIs.

THE HOUSING POLICY AND REGULATORY ENVIRONMENT

The housing finance system relies heavily on the larger enabling environment. While there are minimum regulatory and policy requirements for housing finance to function successfully, it is important to recognize that systems vary and the requirements depend somewhat on whether the country has a nascent economy or an advanced economy. Specific market and regulatory requirements for successful housing finance are discussed below.

The housing finance ecosystem is a term coined by Affordable Housing Institute and emphasizes the importance of the overall environment and market conditions required for housing finance. The housing finance ecosystem is an approach that considers housing finance in the larger environment of the economy, and understands its success as dependent on a range of other factors and elements of the overall system. As described by AHI:

Any nation's housing delivery systems — homeownership, rental, or affordable rental — represent a complex and interconnected ecosystem, with individual elements (rules, capital flows, participants) are as creatures operating within the system for their own goals...Housing finance ecosystems vary in success (how well it addresses housing needs), stability (whether it is rapidly changing), robustness (adaptability to changing circumstances and ability to cope with new introductions), biodiversity (number of diverse elements), and complexity (how many interdependencies among elements).⁸

The ecosystem has four main components: finance, homeownership, rental housing and affordable housing. The success of each component depends on the functionality and success of the other components and of the overall system.

While financial institutions have little control over the legal and regulatory environment for mortgage lending, they are highly impacted by it. There are certain market conditions and legal frameworks that must exist in order for financial institutions to have the confidence to offer housing finance products. The stability of the overall economy is significant for successful mortgage lending in order to assure the lender and borrower that the currency in which the mortgage is denominated will keep its current value. When a bank lacks the confidence in the legal framework behind mortgage lending, as is the case in many emerging market environments, the typical response is for the bank to not engage in mortgage lending at all, or to limit lending to only the wealthiest clients with substantial cash resources.

⁸ "What is an ecosystem", available at http://affordablehousinginstitute.org/what_ecosystem.php

Table 1 Housing Finance System Categorization and Definition

Housing Finance System Categorization and Definition			
	Legal and Regulatory Environment	Housing Stock and Infrastructure	Housing Finance Infrastructure
Nascent	Insecure land tenure, no land titling system Absent or unenforceable legal and judicial system for housing related laws Absent or ineffective lien mechanism No appraisal or property broker sectors	Low quality of construction and construction materials Absent developer financing system Limited or absent infrastructure	Need for long-term funding Minimal financial sector capacity – absent secondary mortgage market No credit information systems Low levels of mortgage as percentage of GDP
Emerging – low	Land titling system, but unenforced, women not included Legal infrastructure and laws in place but largely unenforced, lack of legal professionals with real estate expertise Lien mechanism but timely or costly No appraisal or property broker sectors	Low or unreliable quality of construction and construction materials Developer financing system in place, but largely corrupt or inaccessible Underdeveloped or limited infrastructure in place: water supply, roads and drains, sanitation and solid waste management	Need for long-term funding, selected institutions with ability to absorb funding Limited capacity in financial sector – absent or ineffective secondary mortgage market, limited specialized banking professionals Limited or absent credit information systems Low levels of mortgage as percentage of GDP
Emerging – high	Secured land tenure and titling Effective legal system with key housing finance laws in place and enforced Burgeoning or wide-spread property insurance industry Appraisal and property broker sectors in place	Quality control of construction processes, access to high level quality construction materials Developer financing system in place Infrastructure in place: reliable water supply, maintained and financed roads and drains, developed sanitation and solid waste management	Need for long-term funding and wide-spread ability to adequately absorb funding Capacity in financial sector related to housing finance – beginning secondary mortgage market, limited banking professionals with knowledge of mortgage products Functioning credit information systems Mid-levels of mortgage as percentage of GDP
Developed	Secure land tenure and titling system Enforceable legal system – land registration laws, mortgage laws, asset securitization law, foreclosure laws Cost and time-efficient lien mechanism Capable and qualified property broker and appraisal sectors	High quality construction and construction materials; quality control Accessible developer financing system Infrastructure in place and widespread: reliable water supply, maintained and financed roads and drains, developed sanitation and	Long-term funding available Capacity in financial sector related to housing finance – developed secondary mortgage market, banking professionals versed in mortgage products Comprehensive and searchable credit information systems (credit bureau) High levels of mortgage as

	Judicial training in land and property rights Property and homeowners' insurance industry	solid waste management	percentage of GDP
--	--	------------------------	-------------------

In nascent markets, where credit reporting and credit bureaus are only beginning to take shape, mortgage lenders are particularly reliant on security in the value of the collateralized property over the tenor of the loan. While it is critical to base the lending decision ultimately on the ability of the borrower to repay the loan through an evaluation of income and creditworthiness, the ability to evaluate the underlying real estate collateral and formally register a lien against that property is a basic requirement for traditional mortgage lending. Thus, it is especially important for the country to have the appropriate legal framework securing private land ownership and titling. This allows the financial institution to adequately assess collateral. There must also be an adequate legal system in place that allows the lender to place and enforce liens, enforce its collateral claim and acquire the property if necessary. For collateral valuation, it is essential to have a publicly accessible land registry which backs the titling and private property legal framework. In order to properly value the collateral and loan, public statistics must be available and current, including disaggregated data on household debt, house price data, and data on arrears, defaults and foreclosures.

In addition to a regulatory framework that allows lenders and borrowers to safely and effectively engage in housing finance transactions, there must be a system that provides regulations over housing finance providers. This could include setting market standards in loan officer certification and mortgage training requirements, and a central regulator that oversees the mortgage financing market. There should be a regulation of all real estate appraisers and minimum criteria for licensing. Safety and soundness regulations should adapt international best practices to local requirements, and should include capital adequacy requirements, provisioning rules, annual examinations, regular reporting to the central regulator and permitted classes of loans and investments. National loan underwriting standards must be enforced and include documentation requirements, credit policy, underwriting procedures, and requirements for down payment, loan to unit value and payment to income ratio.

Ultimately, the financial system infrastructure should be supported by public information and systems to access this information. One of the most important organizations for successful housing finance is credit bureaus, which must be independent and credible. Credit bureaus provide a key source of independent information and rating of borrowers for financial institutions, and provide the borrower with a method of proving their strong credit history. While the appearance of functioning credit bureaus greatly enhances the ability of financial institutions to offer consumer loan products, credit reporting typically develops in parallel to the growth of consumer and mortgage lending in an emerging economy.⁹ The demand for reliable credit reports from financial institutions spurs the growth of the credit reporting agency. In the meantime, lenders typically begin collecting data on existing clients and making lending decisions on the financial information available on the borrower.

SBI does not advocate waiting to engage in housing finance until a credit bureau is fully functioning in a specific country, but rather proceeding with international best practice underwriting approaches, combined with advocacy with financial sector stakeholders to push for improvements in the legal and

⁹ The case of the Czech Republic is a good example. In 2001 there was general agreement among the financial sector stakeholders and the government for the establishment of a credit bureau. By 2003 the technical infrastructure was in place to begin to collect credit reporting data from financial institutions. By 2006 the database was robust enough to produce an external credit score for a given borrower.

regulatory framework for housing finance. In general, the development of a primary mortgage market depends on building the capacity of lenders and working through existing government and financial sector stakeholders to remove bottlenecks to efficient mortgage lending.

There is an increased focus on microfinance regulations which impact housing microfinance offerings. This can include regulations that target microfinance institutions generally and bring microfinance institutions under a regulatory body or government statute, or regulations that specifically focus on housing microfinance products. For example, the Housing and Urban Development Coordinating Council (HUDCC) and the Central Bank in the Philippines have passed subsidies and policy related specifically to developing and supporting existing housing microfinance products offered by Philippine MFIs.

Financial inclusion of a broader segment of households into the economy has become a focal point for the international donor community and thought leaders in access to finance issues. Consumer protection is a core element of this focus and specifically relevant for housing finance. A consumer protection framework in mortgage lending is important, as the consumer is entering into a long-term financial agreement for a loan that is a large percentage of the net worth of the individual. CGAP has developed a set of Client Protection Principles in Microfinance that provide an important foundation when considering client protection in mortgage lending. CGAP identifies the following six core principles:¹⁰

- Avoidance of over-indebtedness – This is especially important and relevant when considering housing finance, in which products represent a significant percentage of an individual’s net worth.
- Transparent pricing – It is important for all financial products to clearly state their fees, pricing and terms of conditions. Mortgages are especially complicated financial products, and can include deceptive or complex terms, such as balloon payment arrangements or adjustable rate mortgages, that are not fully understood by the borrower. Pricing deception can have severe repercussions, ultimately leading to foreclosure and the seizing of collateral.
- Appropriate collections practices – Debt collection practices must adhere to legal and regulatory frameworks, especially with regards to seizing collateral, which is often the borrower’s place of residence.
- Ethical staff behavior – CGAP specifies that financial institutions should have adequate safeguards in place to deter and correct corruption or mistreatment of clients.
- Mechanisms for redress of grievances – Problem resolution and client satisfaction are essential when considering mortgage loans.
- Privacy of client data – CGAP explains that client data privacy must be respected, while realizing that financial institutions can assist clients in establishing credit histories.

While no “perfect” environments exist (as demonstrated by the roots of the recent housing and financial crisis in the United States), we would hope to observe efforts by local federal and municipal governments to improve the legal and regulatory environment for housing finance and homeownership. The Cities Alliance, a multi-donor sponsored group dedicated to eradicating slums based out of Washington DC, is working with several governments globally to build capacity at the local level to improve access to affordable housing. They have identified municipal partners willing to take on

¹⁰ “The Client Protection Principles in Microfinance – CGAP and Center for Financial Inclusion at Accion International, available at <http://www.cgap.org/p/site/c/template.rc/1.26.4943>

difficult issues of land tenure and titling to improve access to housing over time. Their work in places such as South Africa, India, Morocco and Thailand, in partnership with local governments and community advocacy groups, has laid the foundation for private sector financial institutions to offer housing finance to a broader population.

EXISTING HOUSING FINANCE PRODUCT DEVELOPMENT

The following section will address the types of products that currently exist in housing finance and housing microfinance markets around the world. While markets vary greatly in terms of level of development, regulatory framework and the sophistication level of financial institutions, there are cross-cutting best practices and challenges that emerge in housing finance practices globally.

In emerging markets, mortgage finance offers many banks a means to enter the broader consumer banking market. Table 2 below highlights the traditional consumer finance products typically offered by commercial banks and specialized consumer finance entities in emerging markets. While mortgage finance is one of the most complex products in terms of servicing platform required and level of loan and collateral documentation, its collateral is more secure in comparison to other types of consumer finance products. Mortgage finance is a basic need of most banks’ customers and provides a means of building a banking relationship over time, often in combination with savings products. Given the larger size of the mortgage loan, banks are able to originate and underwrite the loan through traditional low-tech relationship banking approaches, with the mortgage repayment providing vital customer repayment data to build an internal credit scoring capability in the future. As the borrower proves their ability to service a long-term loan commitment, additional consumer finance products can be offered. Unsecured consumer lending requires a far more robust external credit reporting infrastructure, in addition to a long history of customer repayment information for the internal scorecard. Ultimately automated lending decisions using credit scoring platforms will improve efficiencies, increase lending volumes and lower interest rates for end borrowers. Mortgage finance thus provides a first step for a financial institution in an emerging market context to embark on a broader consumer finance market penetration.

Table 2 Consumer Finance Products Matrix

Item	Mortgage	Motor Vehicle	Debt Consolidation	Consumer Other	Education
Loan Purpose	Utility housing is a core life necessity and may enable borrower to build wealth over the long term	Utility transportation to / from expanded pool of employers and may increase income potential	Financial management reduce monthly debt service requirements and/or lower interest paid	Discretionary purchases may improve quality of life and/or help customer address short term emergencies	Utility career or vocational skills training that will increase employment options and income potential
Loan Frequency	Very infrequent, life event	Periodic, every 5-10 years	Infrequent need (if ever)	Sporadic, unplanned events	Very infrequent, life event
Loan Amounts	Large, \$30,000 and above	Above average	Average-to-above average	Low to average	Average-to-above average
Loan Terms, Range	Longest, 5-20 years	Longer	Average	Short term	longer
Collateral Quality	Strong market, ready buyers and retains value but	Moderate strong market, ready buyers and	Varies depending on collateral type	Varies depending on collateral type	Low (co-borrowers and personal

	longer liquidation time	reasonable liquidation times but rapid depreciation in value			guarantees are important)
Loan to Value Recommendation	50% - 70%	40% - 60%	40% - 60%	40% - 60%	40% - 60%
Product Variations	Fixed vs variable Interest rates Repricing Frequency & indices Fully amortize vs balloon pay Interest only	Fixed vs variable Interest rates New vs used Interest rates Repricing Frequency & indices Purchase vs lease (longer term)	Fixed vs variable Interest rates Repricing Frequency & indices	Fixed vs variable Interest rates Repricing Frequency & indices Multiple draws &/or revolve	Fixed vs variable Interest rates Repricing Frequency & indices Interest only until graduation Multiple draws &/or revolve
Complexity in product/service offering	Highest	Higher	Moderate	Moderate	Moderate

SBI has further defined the housing finance market across three loan product categories as described in the section on Housing Finance Market Assessment, which are roughly differentiated across income levels, repayment capacity, use of funds, and collateral requirements outlined in Table 3.

Table 3 Types of Housing Finance¹¹

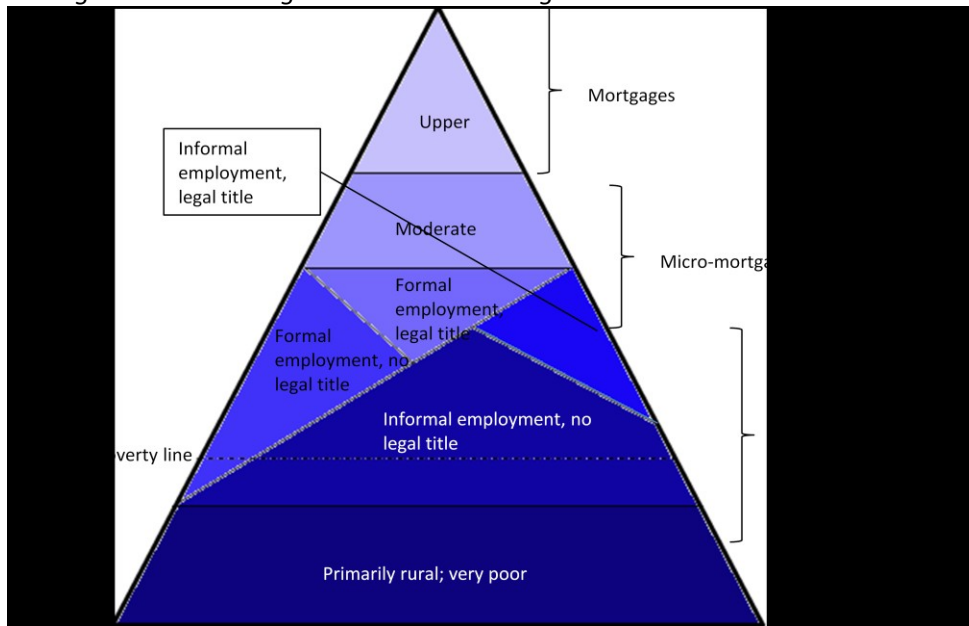
Item	Housing Microfinance (HMF)	Micro Mortgages	Mortgages
Target Market	Poor and low income with or without land title	Low income and lower middle income with land title	Upper middle income and upper income with land title
Type of projects funded	<ul style="list-style-type: none"> ▪ Home improvement (repair, replacement or upgrading) ▪ Expansion (i.e. adding living space) ▪ Completion of existing house ▪ Connection to basic services (electricity, water, sewage) ▪ Rarely: <ul style="list-style-type: none"> ○ construction (new – start up) ○ Purchase land 	<ul style="list-style-type: none"> ▪ All mentioned in HMF <p>PLUS</p> <ul style="list-style-type: none"> ▪ New construction <ul style="list-style-type: none"> ○ New housing project ○ Single residence ▪ Residential existing house ▪ Rental units ▪ Purchase land 	<ul style="list-style-type: none"> ▪ All items from HMF and micro mortgages
Appraisal method	Cash flow based on household income	Cash flow based on household income	Cash flow based on owner and spousal income
Loan size	Small \$50 – 800	Medium \$500 – 10,000	Large > \$10,000
Repayment	12 - 24 months	2 – 5 years	5 – 20 years

¹¹ Micasa: Financing the Progressive Construction of Low-Income Families' Homes in Peru, Cities Alliance, 2002.

period	(group loans up to 12 months only)		
Repayment frequency	Monthly, though some flexibility for certain products	Same	Same
Loan type	Prefer individual (some group loans to very poor)	Individual	Individual
Interest rate	Less than business or personal loans, but covers costs	Same	Same
Savings or down payment required	Savings sometimes used for new clients and individual lending; SACCOs and coops always use savings	10 – 20%	20 – 30%
Collateral required	Savings and collateral substitutes	Land title, savings and collateral substitutes	Land title
% of project funded	90-100%	80-100%	70-80%
# of days for disbursement	< 5 days	1 – 2 weeks	2 weeks – 2 months (can take longer if registration of title is cumbersome)
Income levels	Repayment can equal up to 30% - 40% of the stable household income	Same	Same
Total household debt	Up to 40% of income	Same	Same
Disbursal method	One payment to client or building supplier	Construction: in tranches Existing purchase: one tranche through escrow account at lawyers office	Construction: in tranches Existing purchase: one tranche through escrow account at lawyers office
Technical Assistance to client for building and planning costing	Sometimes	Sometimes	None
Relative Risk Profile	Greatest risk	Medium level of risk	Least risk

Figure 2 illustrates the target market segments for each type of housing finance and housing microfinance product. The figure overlays the housing finance products with the market segmentation, as described in Figure 1.

Figure 2 Housing Finance Product Target Markets¹²



Risks and challenges in housing finance

There are a number of challenges to providing housing finance and housing microfinance products, including insufficient regulatory frameworks, government involvement or apathy with regards to the housing sector, the level of penetration of government subsidized housing which can distort the market or insufficient basic infrastructure and sanitation.¹³ Some of these challenges were addressed in the section on Housing Policy and Regulatory Environment. Additionally, there are challenges specifically related to the institution and institutional capacity that provide barriers for developing and offering housing finance products. The following are examples of the most prevalent challenges from institutional and policy levels:

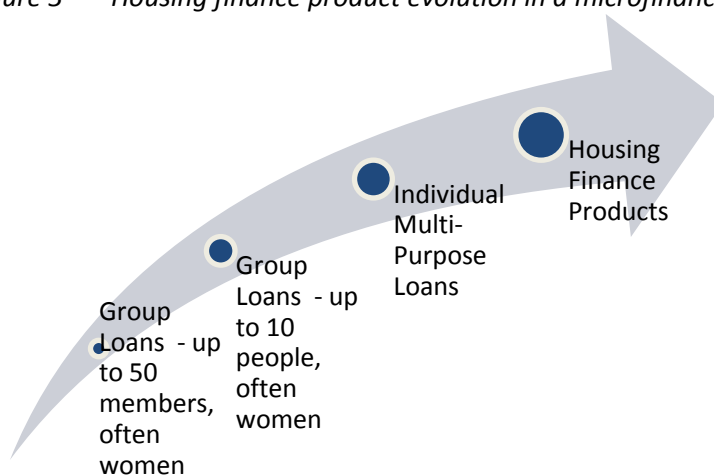
- **Difficulty in identifying and securing long-term funding opportunities:** One of the greatest challenges for banks and MFIs alike is the mismatch of the terms of liabilities and assets when making longer housing finance loans. For MFIs, loans from banks and other wholesalers generally have short maturities because the products are typically designed for enterprise microfinance. Financial institutions can sometimes rely on deposits and savings for additional liquidity and funding, but this is the main barrier for organizations that do not take deposits or do not have a large deposit base. Even highly liquid commercial banks in markets in Africa, for example, are hesitant to launch long-term mortgage finance products because of the maturity mismatch with their core deposit base. An additional challenge to raising long-term funds is the restrictions placed on MFIs in relation to mortgage and asset-backed financing that are often imposed by local governments.
- **Product development and evolution:** Challenges arise as financial institutions transition to new products. For commercial banks and specialized mortgage finance companies, while housing finance may have the allure of new clients and profits, institutions often do not enter the

¹² Bankable Frontier Associates, 2009

¹³ Escobar, Alejandro and Sally Roe Merrill, "Housing Microfinance: The State of Practice" in Housing Microfinance: A Guide to Practice, 2004, 39.

market with a proper strategic framework in place and lack an understanding of their clients' needs. Additionally, if the commercial bank has traditionally offered corporate loans to larger enterprises, entering the mortgage finance market requires new infrastructure, such as more robust IT/MIS systems, especially as it relates to data capture and storage of customer information, more robust risk management systems, and revamped branch and customer service infrastructure. In microfinance, this is especially challenging as institutions shift from group loans to multi-purpose individual loans. Housing finance or microfinance can only be available once institutions have introduced loans structured for individual borrowers. Each step in the evolution of products requires the necessary internal tools (MIS, product experts, leadership and clear strategic vision) to successfully launch and manage this new product.

Figure 3 Housing finance product evolution in a microfinance institution



- **Institutional capacity:** In addition to identifying a source of long-term funding, commercial banks and MFIs face institutional capacity challenges when introducing mortgage or housing lending. For commercial banks, introducing mortgage finance requires additional knowledge in a number of areas, from properly underwriting a long-term loan and documenting income, to effectively appraising the value of the underlying collateral. Housing finance companies and commercial banks can face challenges in product development when trying to go down market, often because of a lack of familiarity with the client segment and the appropriate methods of underwriting and assessing the borrowers' capacity to repay. We mention the infrastructure challenges for commercial banks and NBFCs above. In addition, mortgage collections require a more robust servicing platform, including hardware and software purchases. Especially problematic for MFIs that are upscaling to housing finance is the level of institutional capacity required to develop these products. One challenge is limited MIS capacity as IT systems may have to shift from a one-product based MIS to a complex multi-product system or funders may require synchronization to their IT system for reporting purposes. MFIs often have limited financial knowledge in managing longer term loans, required for a successful transition and greater financial product sophistication. The financial management also has a direct impact on an institution's ability to raise funds and ensure a consistent plan for future product development.
- **Access to technical assistance:** For commercial banks and mortgage finance companies in developing markets, SBI has found that capacity building is essential to the successful launch and expansion of mortgage lending. Technical assistance is required on a number of levels. As mentioned above, banks and NBFCs require the underwriting techniques, IT/MIS and risk

management, and collection processes to effectively launch the mortgage lending product. The IFC Mortgage Toolkit has been one tool to reach the proper level of standardization of lending approaches across mortgage lenders. However manuals are typically not sufficient to introduce the mortgage product, which requires a suite of capacity building activities around strategic planning, underwriting and risk management, and collections. On the side of MFIs, construction and home improvement lending require specific technical skills and knowledge for the borrowers, who are often the ones building or contracting out home improvement work. Though many institutions see value in technical assistance, few have a comprehensive understanding of the different types of TA to the borrowers and how to include such assistance within a housing finance product. The main challenge is the uncertainty of how to price the product with TA and how to implement the program (internally or through an external provider). One approach is to rely on donors to fund or develop TA programs.

- **Foreign currency risk:** Given the longer terms of housing finance transactions, financial institutions are often reluctant to take on long-term funding from IFIs in Euros or USD. Although this was identified in a number of interviews as one of the most difficult investment challenges to overcome, there are a number of organizations and solutions that focus on mitigating some of the foreign currency risk. Organizations that are willing to mitigate a portion of the foreign currency risk may present another venue for partnership in investment.
 - **MFX Solutions** has created tools and products to mitigate currency risk for the microfinance industry. As described on their website: “Our mission is to give microfinance lenders modern tools to analyze and manage their currency risk, enabling them to provide more funding, more safely, to poor entrepreneurs in the developing world. MFX has a specific focus on high risk markets such as Sub-Saharan Africa where mitigating currency risk can generate new lending to traditionally underserved populations. “Their products include cross currency swaps and forward contracts, assistance with documentation and processing to simplify and reduce the costs of hedging and decision-support tools and advice on currency risk decision-making.¹⁴
 - **TCX Fund** is a special purpose fund providing market risk management products to investors active in emerging markets, focusing on currencies and maturities which are not covered by regular market providers. The Fund provides long-term local currency and interest rate derivatives. As of August 2009, the Fund was well-diversified by holding 32 currencies. TCX requires investors to invest equity amounts of a minimum of \$5 million to participate.¹⁵
 - **Guarantee funds:** Grameen Foundation has recently announced a fund that leverages the guarantees of high net individuals to leverage funding by local banks for microfinance institutions. USAID’s Office of Development Credit Authority (DCA) provides partial credit guarantees to cover 50% of defaults on loans made by private financial institutions.¹⁶ USAID’s DCA office has recently partnered with Grameen to co-guarantee local microfinance investment transactions. This type of structure could be further explored for housing microfinance.
 - **Availability of subsidies:** In some countries, governments or donors have implemented subsidy programs that can have a positive effect on the affordability for clients of housing finance products, but disrupt the market by creating unsustainable low price expectations on the part of the client and the lender for accessing funds.

¹⁴ MFX Solutions website

¹⁵ TCX Fund website

¹⁶ USAID DCA Guarantee Summary

The Case of Angkor Mikroheranhvatho (Kampuchea) Co. Ltd (AMK), Cambodia

AMK is an exciting prospect for housing microfinance in Cambodia, and is considering the sector as a way of expanding its offerings to existing clients, recruiting new clients and growing its overall portfolio and geographic reach.

AMK is an emerging MFI dedicated to the provision of financial services to the Cambodian poor, particularly in underserved rural areas. AMK's priorities are centered on its operational and financial sustainability, while maintaining its social objectives. Within the last two years, AMK has tripled its number of clients, offices and staff while quadrupling its loan portfolio. It is the first MFI in Cambodia to establish nationwide coverage and now AMK reaches now 71% of all districts and 34% of all villages in Cambodia. AMK has international investors, a high degree of transparency and disclosure on financial and social indicators, independent board members, strong internal controls and excellent financial performance. AMK has ambitions to expand into new domestic markets and neighboring countries. The future challenges for AMK are related to its ability to mobilize adequate debt and wholesale financing and to further develop its institutional capacity. AMK is currently considering housing finance products as a major venue for development, in terms of product offerings and geography, as it considers expanding into neighboring Nepal.

We define housing microfinance as the riskiest of the three types of housing finance, partly because of the absence of collateral. Mortgages are secured by collateral, which will not necessarily provide a valuable commodity for the bank, but will safely tie the borrower to the loan and prevent them from borrowing against that same property at another bank. There is a high level of psychological value to the home and placing it under collateral, which is a feature missing in housing microfinance. However, for housing microfinance, there are ways of mitigating the risk of the loans; we would argue that the debt service coverage ratio is a more important risk measure than collateralized loans. This allows the bank to safely define the risk of each borrower for the loan, and can also provide an alternative when mortgages or traditional housing finance are not supported by the market. For example, IFC believes HMF is a product that they can do in the face of the crisis because it is not reliant on fully functioning capital markets.

Broadly, housing microfinance practices can be divided into two types of services: **stand-alone**, in which housing loans are not based on prior loan history with the lender but are based on the lender's current financial status, and **linked**, which uses prior lending history with other loan products as an indicator for lender's reliability with housing finance products. With linked services, borrowers can often access loans at lower interest rates than what they pay for enterprise loans and the repayment period can be longer than for stand-alone products.¹⁷ Financial institutions offer the products through an **open market approach**, in which products are available to new and existing customers, or a **closed market approach**. Most housing microfinance is offered through the closed market approach, offering HMF products to clients with a savings or credit track record. The institutions will often prequalify the loan based on reliable savings and repayment history, using the client's savings as a source of down payment and as a guarantee. Often, clients have to successfully "graduate" from less risky products with smaller loans and an excellent repayment rate before accessing a HMF product.

¹⁷ Daphnis and Ferguson, "Housing Microfinance", Kumarian Press, 2004, p. 11

Incremental housing, also known as progressive housing, has been identified as a successful approach to extending longer and larger housing loans to low-income populations. Progressive housing “is housing that evolves over time in tandem with a household’s resources (mostly savings and labor), life cycles and needs”, providing households with greater control over the building process.¹⁸ In this approach, housing microfinance loans are disbursed for discreet improvement or building tasks and the subsequent loan is not disbursed until the prior loan has been fully repaid. While this often slows the pace of the building, it prevents borrowers from becoming over-indebted and mitigates the risk for the institution. However, institutions must be fully versed in construction best practices and the borrower’s level of construction expertise to ensure successful housing development.

The Case of Ujjivan Financial Services, India

Ujjivan is a case study of an Indian MFI successfully engaged in housing microfinance. It illustrates some of the key institutional developments an MFI must attain to provide HMF and the growth potential in the range and reach of these products.

Ujjivan Financial Services was established in 2005 as a finance company and later converted into a non-bank finance company (NBFC). It is a Bangalore based microfinance institution focusing on serving the urban and semi-urban poor. It now operates in eight Indian states with over 165,000 customers served by more than 100 branches, has disbursed \$40 million of loans and enjoys a repayment rate of 99.5%. Ujjivan is a partner of the Grameen Bank of Bangladesh.

Ujjivan offers “family” loans that enable low-income women to finance a range of family needs, from children’s school expenses and business loans to home improvement loans. Ujjivan’s housing loans are used to pay for rental deposits, lease amounts or home improvements. The loan amounts range from Rs.10,000 (\$250) to Rs. 30,000 (\$750) with a rate of 1.1% flat monthly (or 24.0% per annum, declining). From March 2008 to March 2009, Ujjivan’s housing loans grew 2,951% from Rs. 386,770 (\$10,000) to Rs. 11,415,038 (almost \$300,000). However, its housing loans comprise approximately 0.6% of its entire portfolio.

Ujjivan, the only MFI in India to start operations without any grants or donations, will be the fourth highest capitalized MFI in India, having successfully completed its fourth round of equity infusion of \$19.6 million. The housing growth is fueled by capital from HDFC and Unitus’ equity fund, Elevar. The capital will be used for the Company’s major expansion plans over the next year and to meet the enhanced capital adequacy regulations set by the Reserve Bank of India. Ujjivan has ambitious growth plans to cover one million customers over the next 15 months with a national presence.

International Best Practices

Successful delivery of mortgage finance products is dependent on instilling international best practices in origination, underwriting and loan collections. Some of the key features of best practices include:

- **Standardized lending approaches applied to all customers.** Each customer is evaluated and processed in the same way with the same documentation. The standardization of these underwriting and documentation approaches across a mortgage portfolio provides a level of

¹⁸ Bankable Frontier Associates, 2009

confidence from the capital markets to allow the mortgage originator to ultimately securitize that portfolio of loans and raise further liquidity to lend at scale.

- **Key underwriting approaches** include:
 - Borrower down payment of at least 20% of the purchase price of the home. It is important to document the source of the down payment and that this amount is not borrowed from a money lender or other commercial source.
 - Loan against appraised collateral value of 50% to 70% of the total loan amount (Loan to Value, or LTV)
 - Housing debt to total income of 25% to 30%
 - Total debt to total income of 35% to 40%
 - Evaluation of informal income: Given the prevalence of informal income in emerging markets, alternative forms of documenting income should be employed to demonstrate capacity to repay. These include documentation of payment history on utilities, rents, and evaluation of business cash flow in case of a self-employed individual or entrepreneur.
- **Savings:** Borrowers that do not meet the general lending criteria outlined above should be encouraged to save for a down payment over time. Encouraging further transparency on the part of the borrower in use of savings and disclosure of income will improve their ability to access a mortgage over time.
- **Customer disclosures:** Transparency on the part of the financial institution in terms of rates, fees, and interest rate adjustments is best practice. Ensuring the consumer understands the full extent of their liability prevents delinquencies down the road.
- **Funding match:** financial institutions should match the currency and term of the mortgage loans with the source of their own funding. Variable rate funding would entail the need to re-price the rates of the mortgage loans.
- **Evaluation of capacity to repay of adjustable rate mortgages:** Should a mortgage lender offer an adjustable rate mortgage (ARM) to its borrowers, the underwriter should assess the borrower's ability to repay at the highest lending rates envisioned after the variable rate adjustments.

Housing microfinance has developed with certain definitive characteristics that highlight best practices and key challenges around the world.

- **Differentiate housing as a separate loan product from microcredit products.** Housing loan products can include home improvement, upgrading and incremental loans (rather than home purchase or new construction loans), progressive loans (repeat lending of additional small loans, common for extremely poor clients)
- **Small, short-term loans:** Up to 70% of populations in developing countries build houses incrementally which is the only affordable method for low-income populations, and thus HMF loans match the financing needs of the way the poor build and improve their homes. Housing microfinance loans are still generally longer than traditional microfinance loans
- **Fixed rates:** Exact knowledge of repayment responsibilities is important to ensure repayment and is a transparent method of lending, given lower financial literacy rates.
- **Individual loans:** Individual lending has proved more successful in ensuring repayment and aids in the assessment of cash flow; in some cases in working with extremely poor households, group lending has been successful.

- **Nontraditional collateral and underwriting features** have expanded the ability of MFIs to fund individual lenders. The use of alternative collateral mechanisms is a defining feature of the distinction between housing microfinance and traditional mortgage loans. A mortgage loan is collateralized by the property and land title; in housing microfinance, savings and collateral substitutes are used, which are often used as supplements to the property and land title collateral in micro-mortgages. Developing underwriting and collateral criteria are significant challenges in developing housing microfinance products that are profitable and moderate in risk for the lending institution. Examining best practices among housing microfinance institutions in Asia, Africa and South America, the following are common collateral and underwriting alternatives:
 - Mandatory savings
 - Fixed assets
 - Deposits
 - Pension guarantee
 - Personal guarantee
 - Group guarantee
 - Employer guarantee
 - Cosigner(s)
 - Microenterprise loan history
- **Client education:** Supplementary education can include trainings on loan terms and repayment, housing design and construction techniques. Loans are offered with varying levels of technical assistance, from extensive construction assistance to little or no technical assistance. Both strategies have resulted in successful financial repayments.¹⁹
- **Women borrowers:** Predominantly in Asia, microfinance institutions have found that women are more reliable and are better credit risks

Emerging Trends in Housing Finance Product Development

SBI has identified remittance-backed lending and energy efficiency improvements as key emerging products in the housing finance field. These products have received additional attention from international donors as exciting approaches to housing and microfinance and may open additional venues for sustainable housing finance practices.

Energy efficiency

Recent focus on energy efficiency products in small business and commercial lending has also resulted in heightened attention on the potential for energy efficiency products in housing finance. Financial institutions are a crucial link in addressing the limited accessibility of sustainable and reliable energy. Linkages between the microfinance and energy sectors provide the opportunity to expand on an important business opportunity for microfinance institutions while providing much-needed resources for local energy producers. As explained by the Small Enterprise Education and Promotion (SEEP) Network in their 2007 report on *Using Microfinance to Expand Access to Energy Services*, “If appropriately designed, loans offered by MFIs can provide clients with access to high quality modern energy services by closely matching loan payments to existing energy expenditures or income flows.”²⁰

¹⁹ Daphnis and Ferguson, "Housing Microfinance", Kumarian Press, 2004, p. 11

²⁰ Morris, Ellen, Jacob Winiecki, Sonali Chowdhary and Kristen Cortiglia. Using Microfinance to Expand Access to Energy Services. The SEEP Network, 2007, 9.

This has attracted significant attention from donors, such as FMO, IFC and KfW. For some, it has provided an alternative and innovative venue for approaching housing finance, though often the energy efficiency housing products are grouped with the individual and small business energy efficiency loans. The types of product vary widely, according to the environment, level of housing and housing finance development, and energy efficiency needs and sophistication. In general, energy efficiency housing products can include energy efficiency mortgages for new homes or home improvement loans. In Hungary, IFC funded an energy efficiency loan program for blockhouses. Three Hungarian banks developed a new product financing energy efficiency upgrades, which was supported by partial risk and portfolio guarantees from IFC and DIGH.²¹ IFC's first energy efficiency credit line was in 2006 to a major regional bank in Bosnia and Herzegovina, Kosovo and Serbia. The credit line provided long-term funding and product development support for new energy efficiency products for small businesses and consumers.²² Some products are based on the successful US examples of energy efficient mortgages which are subsidized by federally insured mortgage programs and the secondary mortgage market. An EEM is a mortgage that credits a home's energy efficiency in the mortgage itself by financing energy saving measures as part of a single mortgage.²³

The Case of XacBank, Mongolia

This case study focuses on the formation and development of the Eco Products Unit at XacBank, which provides an example of current innovations in energy efficiency housing finance.

Formed in 2001, XacBank is a microfinance bank in Mongolia that focuses on low-income and remote rural households. XacBank offers a full range of products and services including current accounts, savings, loans, credit cards, money transfer services and mobile banking through its 77 branches and outlets. In September 2009, XacBank launched its Eco Products Program, offering low interest loans for energy products to poor households in Mongolia. Two of the main household energy efficient products developed by XacBank are loans for an energy efficient stove and insulated ger blanket, which provide families with a more efficient way of heating their homes and reduces the emissions of greenhouse gases through reduced dependence on fuels such as coal, wood and kerosene. These products target residents of the ger districts in and around the capital, Ulaanbaatar, where air pollution has become an increasingly serious problem and families spend large percentages of their monthly income on heating. This product was developed in partnership with a grant and loan from FMO, and more recently, through a partnership with Micro Energy Credits (MEC), which allowed XacBank to become the first micro-finance bank in the Northern Hemisphere to sell its carbon offsets and access financing through the carbon markets.

Remittance-backed lending

In countries throughout Latin America, South Asia and Southeast Asia, international remittances comprise a large percentage of GDP, and therefore, provide one of the largest sources of funding for housing improvements and construction. A study on remittance-backed improvements to housing in El Salvador showed that in one village, which is representative of many parts of the country, 76% of

²¹ GreenMax Capital website

²² IFC press release, 2006

²³ Energy Star website

remittance-receiving households made housing improvements or engaged in housing construction, compared to 35% of non-remittance households. The housing process funded by remittances also has a larger multiplier effect; often, a non-remittance funded housing improvement will be led by the head of the household, while the study in El Salvador showed that in remittance-backed improvements the recipients are twice as likely to hire paid labor, are more likely to purchase land (31% of remittance households versus 13% of non-remittance households) and are more likely to build new homes (30% of remittance receiving households versus 10% of non-remittance households).²⁴ In Colombia, banks are developing remittance-backed loans that are guaranteed or paid with remittances, and the loans are structured with repayment schedules that match remittance payments. Organizations such as Mutualista Pichincha and its partner Union Andina base housing finance and housing development on activities remittance-backed payments to Latin America.

In general, there are certain requirements for successful remittance programs, whether funding housing loans, consumer loans or small business loans. Remittance flows are often conducted through informal systems, rather than through financial institutions. However, as remittances emerge as increasingly important elements of GDP and in-country financing, many banks, MFIs and other financial institutions are developing targeted remittance products and services. In Bangladesh, BRAC Bank, which targets small business owners, offers a specific product for accepting and distributing remittance flows. BRAC NGO signed a distribution agreement with Citi Bangladesh, the first arrangement of its kind, to distribute workers' remittances deposited at Citi through BRAC's extensive Bangladeshi network.²⁵ Rather than highlighting remittances as a separate type of housing finance product, we indicate its importance for funding housing improvements and mortgages.

The Case of Mutualista Pichincha, Ecuador

Mutualista Pichincha is a major player in the mortgage finance market in Ecuador and has emerged as the leader in the country's transnational mortgage loan market.

Mutualista Pichincha (MUPI), the second largest financial institution in Ecuador in terms of mortgage loan originations, uses its deposit base to offer mortgage loans and construct and sell homes. MUPI sells houses in Ecuador to Ecuadorian migrants which are financed through mortgage loans and repaid with the migrants' earnings from their country of residence. Starting in 1997 selling houses only to migrants in the U.S., MUPI expanded its services in 2004 to reach migrants in Spain and Italy. Through a partnership with Union Andina, which provides sales and customer interface services to MUPI through its sales offices in New York, Miami, and several locations in Spain, MUPI has grown its business steadily to over \$25MM in loans to over 800 clients. Factors of success include the sales channels in Ecuador (to migrants' families) and the United States and Spain, the understanding of the migrants preferences for home purchases, their successful vetting of clients through efficient client in-take procedures, and the building of a successful brand.

²⁴ McBride, Brendan. "Building Capital: the Role of Migrant Remittances in Housing Improvement and Construction in El Salvador", presentation at IDB, Washington DC, May 15, 2009.

²⁵ Micro Capital press release

HOUSING FINANCE PROVIDERS OVERVIEW

A variety of types of organizations currently provide housing finance and housing microfinance, including banks, nonbanks, mortgage finance companies and construction companies. Organizations enter the housing finance market for a number of reasons and offer different products, depending on the role housing finance plays in the portfolio of the financial institution, the capacity of the organization and the economic environment.

Table 4 below summarizes key features and product offerings from housing finance providers. The organizations may vary depending on the country and regulations, and there are many additional non-financial institutions that offer housing or construction loans, such as hardware stores and insurance companies.

Table 4 Financial Institution Landscape

Item	Organizational features	Products offered	Client demographic and requirements
Commercial Banks	Regulated, fund lending with deposits and other funding sources	Wide range of products – mortgages, home equity loans, home improvement loans	Wide base of clients, do not reach low-income populations because of traditional collateral and credit history requirements, and a lack of knowledge of this market segment and product type
Rural/Thrift Banks	Regulated, fund lending with deposits and other funding sources	Wide range of products – can accept savings and deposits, mortgages and housing loans; focus on agricultural products and agricultural value chain	Focus on rural communities, rural poor, farmers
Savings and Credit Cooperative Organizations (SACCOs) , Credit Unions	Often unregulated, though varies by country; owned and controlled by members, typically smaller than banks though size varies	Similar range of products to banks and formal financial institutions, can accept savings, can often offer products at lower rate than MFIs	Only a member of the credit union or SACCO can deposit money or borrow money
Non Bank Financial Companies (NBFCs), Mortgage Finance Companies	Regulation varies by country, does not meet the legal definition of a bank, cannot rely on deposits or savings for lending funding	Restricted to loan products, some focus on certain types of loans, such as housing and mortgages or leasing	Reaches down-market and low-income clients
MFIs	Varied ownership structure, regulated if a financial institution	Group and individual loans, deposits and savings; very few offer housing loans	Serves very poor clients that are not served by formal financial institutions
Government programs (not financial institutions per	Funded by government, regulated	Affordable mortgages and housing finance products, highly subsidized	Targets low-income that are not banked by formal financial institutions often at a subsidized rate

Opportunities for Financial Institutions in Housing Finance

There are a number of reasons that financial institutions enter into housing finance or housing microfinance. Among other reasons explored below, one common motivating factor is market demand that drives institutions into housing finance product development. In order to evaluate an institution's housing finance product development and organizational motivations, it is important to consider how the products fit into the larger strategy, profitability and product mix of the institution.

Housing finance plays a key role in the overall lending activity of financial institutions. In several emerging markets SBI has observed commercial banks utilizing mortgage finance products as a lead into the retail consumer finance market. Mortgage finance is often used as a path into consumer finance and lending, allowing financial institutions to gather information about key customers and target markets. Through mortgage finance, institutions learn about customers' credit history and credit worthiness with the security of a collateralized, secure loan. It allows institutions to focus on relationship banking rather than a large number of loans, as the large deal size does not require automation or scale to make a profit. Domenia Credit, headquartered in Bucharest, Romania, was founded in 2003 as a mortgage finance institution, funded under a USAID project as a potential engine of growth for the local economy. It currently provides access to home acquisition, land acquisition, and home improvement and construction loans in Romania. These activities led into consumer and personal loans, and micro, small and medium size enterprise lending.

The Case of Erste, Czech Republic

The mortgage products offered by Erste Bank were used as a way of entering into consumer lending, and show the opportunities provided to many financial institutions by way of mortgage financing products.

Erste Group acquired Česká spořitelna (CS), originally founded as a savings bank 180 years ago, in 1999. CS has many mortgage loan products which have helped the institution gain recognition as one of the top mortgage institutions in the country. The Bank serves mainly retail clients, small and medium-sized companies and municipalities; it also plays a key role in financing large companies and is a major participant in the local capital market. The Bank has 5.3 million customers and holds leading market shares in the key retail segment, e.g. 31% in retail deposits and 29% in retail loans.

In 2001, they motivated tens of thousands of clients to obtain new homes through *Top bydlení ČS*. With the Top Bydlení ČS product, which the Bank used to stir up the mortgage market in 2001, clients got a preferential interest rate for one-half of their mortgage, of up to CZK 1 mil., for an apartment, and CZK 1.5 million for a family house. CS guaranteed a fixed interest rate for 5 years from the signing of the agreement to provide a mortgage. The overall amount that the Bank allocated was CZK 3.3 billion. In that programme, it provided 15,013 mortgages in the volume of CZK 15,107 mil. The *Ideal Mortgage* product is designed for individual clients for financing of residential real estate. It introduced a new service to go with its Ideal Mortgage: it will give its clients a one-percent discount from the interest rate on one-half of their mortgage of up to CZK 3 mil.

Several factors commonly motivate institutions to offer housing finance products:

- **Disaster response:** Natural disasters impact infrastructure services and the existing housing supply, often exacerbating severe housing and infrastructure needs. CALPIA in El Salvador and Caja Arequipa in Peru both entered the housing finance markets when there was an urgent need after disasters caused destruction and greatly damaged the existing housing supply.²⁶
- **Product diversification:** Typically commercial banks or special purpose consumer finance lenders enter the mortgage finance business as a core offering within a broader consumer finance portfolio. Housing finance provides a form of loan portfolio diversification, and is a method of spreading portfolio risk. Additionally, low-cost deposits from housing finance products can subsidize and fund other products in financial institutions' portfolios, bolstering the institutions' overall financial stability. For example, Planter's Development Bank in the Philippines offers contract-to-sell products and the deposits and profitability from this product help fund other products, such as small business loans.
- **Increased competition and client retention:** Institutions are often driven to offer housing finance products to retain their current clients who may otherwise migrate to institutions that can offer larger and longer term loans. Housing finance can provide a channel to guarantee longer relationships with existing and new clients. Microfinance institutions offer home improvement loans as a response to customer demand for a basic household need.
- **Opportunistic:** Especially over the last decade, before the recent crisis, real estate and construction were seen as highly profitable sectors that could provide high financial returns for institutions that successfully engaged in construction and housing financing.

²⁶ Escobar, Alejandro and Sally Roe Merrill, "Housing Microfinance: The State of Practice" in Housing Microfinance: A Guide to Practice, 2004, 36.

The Case of MiBanco, Peru

MiBanco is one of the largest and most well-known housing finance providers in Latin America. It developed housing loans in order to expand its portfolio and client service opportunities and has successfully developed, piloted and launched various types of housing finance products.

MiBanco, a commercial bank in Peru is focused exclusively on serving the “emerging sectors” and is one of the largest MFIs in Latin America with more than 90,000 active borrowers. MiBanco grew from the nongovernment organization Acción Comunitaria del Perú (ACP), started in January 1969 by a group of business people with assistance from ACCION International.

MiBanco expanded its scope of operations over time. In October 2000, in its search for potential new growth areas and ways to better serve its target clients, MiBanco developed an innovative housing improvement loan product known as *Micasa* (“my home”). Less than 12 months after piloting and launching the new product, 3,000 clients were being served with a portfolio of \$2.6 million. By end of September 2002, the total number of active clients increased to 6,954 and the active portfolio to \$8.1 million, accounting for about 9% of the total active loan portfolio of the Bank. The *Micasa* portfolio had a portfolio at risk greater than 30 days of just 1%.

With *Micasa*, MiBanco is reaching a poorer set of clients than it does with its microenterprise loans. *Micasa* also demonstrated that subsidized interest rates are not necessary to support the housing strategies of the poor. Its experiences are of interest for a number of reasons:

- Use of progressive build lending versus traditional mortgage lending;
- Application of "best practice" microenterprise methodology to housing finance;
- "Minimalist" approach to construction assistance;
- Rapid, profitable early growth.

MiBanco expects that these loans will account for as much as 50% of the Bank’s total portfolio within a few years.

Risks for Financial Institutions in Housing Finance

Financial institutions are often cautious about entering the housing finance field because of low confidence in the market or lack of knowledge of the sector. Institutions that SBI has seen struggle with or ineffectively introduce housing finance products generally do not emerge as market leaders, not because of institutional failings or inadequacies in relation to housing finance, but because of an inability to scale the product offerings. Canadia Bank in Cambodia, with whom SBI worked in 2003-2004, initially limited their housing finance products to high-income borrowers that were moving into a development financed by an affiliated developer, limiting their risk exposure but also limiting their client pool. In addition, housing finance product offerings are often stunted because of the absence of an enabling and supportive environment. Housing finance institutions in Egypt, for example, could not scale their product offerings because of the length of time and money required to receive land titles, greatly limiting their ability to serve clients.

It is also important for institutions to recognize the different strategies and underwriting criteria that are required for housing and consumer finance, as opposed to small business lending. This is an important

part of preparing the institution to offer any new loan products. For example, in Vietnam, many banks started offering unsecured consumer lending products without the appropriate underwriting criteria which resulted in high levels of delinquencies. Today, they are cautiously proceeding with mortgage or vehicle loans to customers with letters from their employers documenting their current level of income. Without a reliable source of customer information and repayment history, or the underpinnings of best practice underwriting approaches, banks in markets like Vietnam are forced to move slowly with the highest income customers.

APPENDIX I. PROJECT SOURCES

ACCION CAMEL Summary, available at http://www.microfinanceregulationcenter.org/resource_centers/reg_sup/reference_library/_tools/_action

ACCION InSight 2004, available at resources.centerforfinancialinclusion.org/insight/IS16en.pdf

Affordable Housing Institute, "What is an ecosystem", available at http://affordablehousinginstitute.org/what_ecosystem.php

Asian Development Bank, *Affordable Housing Brochure*, available at <http://www.fmo.nl/FMO/documents/Brochures/Housing%20Folder.pdf>

Bankable Frontier Associates, *Capitalizing Housing for the Poor: Findings from Five Focus Countries*, Commissioned by Habitat for Humanity, 2009

The Center for Urban Development Studies, Harvard University Graduate School of Design. *Housing Microfinance Initiatives: Asia, Latin America, and Sub-Saharan Africa with Selected Case Studies*. Development Alternatives Inc. And USAID Microenterprise Best Practices, May 2000

CGAP, "The Client Protection Principles in Microfinance – CGAP and Center for Financial Inclusion at Accion International, available at <http://www.cgap.org/p/site/c/template.rc/1.26.4943>

Chiquier, Hassler and Lea, *Mortgage Securities in Emerging Markets*, World Bank Policy Research Paper 3370, 2004.

CLIFF Annual Review 2008, available at www.homeless-international.org

Daphnis, Franck and Bruce Ferguson. *Housing Microfinance: A Guide to Practice*. Kumarian Press, 2004

Energy Star, *What is an Energy Efficient Mortgage?*, available at www.energystar.gov/index.cfm?c=bldrs_lenders_raters.energy_efficient_mortgage

Ferguson, Bruce and Peer Smets, *Finance for Incremental Housing: Current Status and Prospects for Expansion*, in Habitat International xxx (2009) 1-11, available at www.elsevier.com/locate/habitatint

The Global Development Research Center, *MicroRate Summary*, available at <http://www.gdrc.org/icm/rating/rate-4.html>

GreenMax Capital Advisors, available at www.greenmaxcap.org

IFC, *IFC to Boost Raiffeisen International's Housing and Energy Efficiency Financing in Southeastern Europe*, July 2006, available at <http://www.ifc.org/ifcext/pressroom/ifcpressroom.nsf/PressRelease?openform&0EAFCA4B3F212DC7852571A900462CCA>

IFC Housing Finance – Opportunities in Financial Markets (2008), available at [http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/HF-Trifolds/\\$FILE/HF-Trifolds.pdf](http://www.ifc.org/ifcext/gfm.nsf/AttachmentsByTitle/HF-Trifolds/$FILE/HF-Trifolds.pdf)

Llanto, Gilberto. *Shelter Finance Strategies for the Poor: Philippines*. In *Environment & Urbanization*, Vol 19(2): 409-423, 2007.

Martin, Carlos, Development Innovations Group, DAI. *Going to Scale with Housing Microfinance: The Role of Commercial Banks*. Produced for review by USAID, March 2008.

McBride, Brendan. “Building Capital: the Role of Migrant Remittances in Housing Improvement and Construction in El Salvador”, presentation at IDB, Washington DC, May 15, 2009.

Mesarina, Nino and Christy Stickney. *Getting to Scale in Housing Microfinance: A Study of ACCION Partners in Latin America*. In *InSight*, Number 21, May 2007.

MicroRating International Report 2007, Basix, available at <http://www.m-cril.com/BackEnd/ModulesFiles/Publication/Annual-Report-2007-08.pdf>

Morris, Ellen, Jacob Winiacki, Sonali Chowdhary and Kristen Cortiglia. Using Microfinance to Expand Access to Energy Services. The SEEP Network, 2007, 9.

OPIC, *OPIC Provides \$200 million for Housing and SME Lending in Central America*, May 4, 2009, available at <http://www.opic.gov/news/press-releases/2009/pr050409>

UN Habitat Synthesis Report, *Housing for all: The Challenges of Affordability, Accessibility and Sustainability*, 2008, available at <http://www.unhabitat.org/list.asp?typeid=15&catid=292&start=21&page=3>

USAID, Development Credit Authority, available at http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/

Vietnam Mortgage Lending Toolkit, developed by SBI for the IFC, 2009

Institution - Specific Sources

Apoyo Integral, available at www.accion.org, www.integral.org.sv

Asian Development Bank, available <http://www.adb.org/PrivateSector/Finance/housing.asp>

Bank of Africa, available at www.bank-of-africa.net

BRAC Bank, available at <http://www.microcapital.org/news-wire-brac-citi-bangladesh-launch-remittance-partnership/>

CARD Bank, available at <http://www.cardbankph.com/>

DEG, available at http://www.deginvest.de/EN_Home/Projects/Financial_Sector/index.jsp

Fincomun, available at www.fincomun.mx

First Valley Annual Report, available at 1stvalley.com

Inecobank, available at www.inecobank.am

International Finance Corporation, available at
<http://www.ifc.org/ifcext/gfm.nsf/Content/HousingFinance>

MFX Solutions, available at <http://www.mfxsolutions.com/>

MIX Market, available at www.mixmarket.org

Select Africa, available at www.selectafrica.net

TBC Kredit, available at www.tbckredit.az

Ujjivan, available at www.ujjivan.com

XacBank, available at www.xacbank.mn



Oesterreichische Entwicklungsbank AG

1011 Vienna, Austria
Strauchgasse 3
Tel. +43 1 533 12 00-0
Fax +43 1 533 12 00-5252
office@oe-eb.at
www.oe-eb.at

