

HOUSING MICROFINANCE: IS THE GLASS HALF EMPTY OR HALF FULL?

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Introduction

Donors, governments, microfinance networks, and foundations have promoted housing microfinance ("HMF") for a decade. Considerable operational experience has accrued on this practice over this time. Meanwhile, many emerging economies have grown rapidly, which has changed housing markets and the context for HMF. The moment, then, is auspicious for a re-examination of housing microfinance and its record.

How have microfinance institutions performed at housing lending? Is HMF still relevant to the enormous challenge of low-income housing and urban development in emerging countries and, if so, how can it be expanded to massive scale?

This paper answers these questions by analyzing recent survey data on housing microfinance, examining the housing economies and HMF practice in three countries that display a wide range of experience (Peru, Mexico, and Brazil), and profiling cutting-edge cases of market-based low-income housing delivery that include HMF. This paper mainly deals with Latin America, where HMF has advanced the most, but also draws on evidence from other regions. A short description of the emergence of HMF prefaces this investigation:

HMF has become "hot" largely for two reasons:

First, HMF has the potential to serve most low and moderate-income households. These families neither want nor can afford a large long-term traditional mortgage to purchase a developer-built complete unit. Instead, these households build progressively, by acquiring and upgrading title to a lot, building a makeshift shelter, replacing this makeshift shelter with permanent materials and expanding it, and lobbying government for services (Ferguson, 2003; Greene and Rojas, 2007). A series of small short-term loans can fund the steps in this progressive housing process with payments affordable to households.

The prototypical HMF loan consists of a small, short-term unsecured credit (US\$500-\$2,500 with a term of two to five years, depending upon context) to a homeowner to expand or remodel their informally-built house. Sometimes, microfinance institutions (MFIs) offer somewhat larger loans (US\$3000-\$7000) at longer terms (five to 15 years) for a family to construct a new home (often on a lot that they already own), occasionally secured by a mortgage. Small home improvement credit, however, is the main market for which microfinance institutions have created a housing microfinance product.

However, small credits could also finance a wide range of other housing investments useful to low and moderate income households. These include lot purchase, title regularization, construction of a floor/joist/roof structure that the homeowner builds out, adding rental units onto the homeowner's property through horizontal or vertical expansion, individual and communal infrastructure, the vertical or horizontal buildout of a developer-built core unit or humid core (a bathroom/kitchen area containing plumbing and electricity) in pre-programmed steps, or the completion (adding fixtures, cabinets, electrical equipment, additional plumbing, painting etc.) of an unfinished condominium shell in a high-rise building. This paper will mainly deal with the supply and demand for small home improvement loans, which has become virtually synonymous with "housing microfinance." However, these other possible applications of housing microcredit will be considered when strategizing how to expand HMF to relevant scale.

Social support programs joined with GDP growth have stimulated a rapid increase in household income of families in the bottom half of the income pyramid in many emerging countries over the last decade -- including Peru, Mexico and Brazil. This paper will also examine how this rise in family income has diversified housing investment of low/moderate income households beyond small home-improvement and the implications for HMF.

Nonetheless, the potential market for small home-improvement loans remains huge and, often, relatively uncontested; 50% to 80% of the population in most emerging countries build their homes progressively. Market studies typically show that one-quarter of these families want and can afford a small home-improvement credit at any one time. Although each individual project is small, the huge numbers result in an impressive total market potentially financed by such credit -- \$331.8 billion worldwide according to the World Resources Institute (see their paper in this issue of GUD magazine). Traditional mortgage finance institutions have typically lacked the low-cost community-based systems necessary to lend to this market. Hence, microfinance institutions have frequently faced little institutional competition in extending HMF to these families.

A second reason that HMF has become a developmental "hit" involves its fit with the microfinance industry. Small home improvement credit offers a useful product that microfinance institutions can add to their core business -- micro-enterprise lending. MFIs can successfully apply their existing loan methods and installations for micro-enterprise loans to small home improvement loans with little or no modification. Roughly 20% of funds nominally borrowed for micro enterprise go to housing improvement in the absence of an explicit housing product.

HMF also fits well with the transformation of many MFIs from NGOs into financial institutions that are regulated because they take deposits from the public. The aspiration to own or build a house has historically proved the main motivation for families to save in developed countries (where "savings and loan" societies have traditionally linked these functions) as well as emerging nations (where savings clubs and housing cooperatives have emerged for the same purpose). Hence, adding a home-improvement credit as well as a savings products makes sense for MFIs seeking to take deposits -- the least-expensive type of funding -- and become regulated financial institutions.

Small serial credits largely for building materials to improve a homeowner unit -- which has come to be called "housing microfinance" -- began expanding a decade ago mainly because of these synergies with the microfinance industry. By this time, roughly 200 microfinance institutions worldwide had become commercially viable (Robinson, 2001). Increasing competition had caused microenterprise loan markets to tighten in some countries (e.g. Bolivia, Bangladesh). Diversifying into home-improvement lending and savings products appeared useful next steps for leading MFIs and their networks. Major figures -- such as Hillary Clinton -- lauded the achievements of the "microfinance revolution", and the concept of "housing microfinance" enjoyed legitimacy by association.

In addition, a series of events, papers, and a book (Daphnis and Ferguson, 2004 -- republished in Spanish in 2006) on housing microfinance during this period disseminated awareness of HMF throughout the international housing community and microfinance networks, and brought these two audiences into communication for the first time.

This conjunction of factors pushed and pulled the microfinance industry into low-income home lending. The next two sections of this paper assess how MFIs have done at this task.

Summary data on the current state of housing microfinance within the microfinance industry

Two recent studies present comprehensive empirical data on the state of housing microfinance. Both focused on Latin America, the region where this practice has advanced the most. The first -- by Accion (presented in Messarina, 2006; and Merrill and Messarina, 2006) -- surveyed 10 of its regional affiliates in Latin America. The second -- by Micro Service Consult GmbH (GmbH, 2005) -- was commissioned by Housing Microfinance Ltd., a financial group planning to issue securities to finance low/moderate income housing in order to assess market

demand from MFIs for funding. The GmbH study surveyed 25 of the top MFIs in Latin America on their housing credit products and plans.

Although conducted independently for different purposes, these two studies arrive at highly-similar conclusions. Discussing each in turn:

From 2002 to 2005, the HMF portfolio of the ten Latin American Accion affiliates surveyed grew from US\$38 million to US\$117 million, and home improvement lending increased from US\$20 million to US\$74 million. Interestingly, almost as many of these Accion affiliates offered home purchase loans (70%) as home improvement loans (80%), indicating that microfinance institutions (“MFIs”) are seeking to serve moderate-income households that buy a new unit as well as low-income households that upgrade a lower-cost housing solution.

The HMF portfolio grew from 12% of the total portfolio of these 10 microfinance institutions to 19%, but still represented only 9% of the total network portfolio of Accion. Repayment rates on the HMF portfolio of the surveyed MFIs were superior to that on microenterprise lending. This datum bears out the impression of many microfinance lenders that households prioritize repayment of housing credit over microenterprise credit.

These 10 MFIs surveyed by Accion stated that HMF loan demand is immense. Most of these MFIs do not market this product, although some competition is beginning to emerge from building materials suppliers and finance companies. This finding jibes with the conclusion of a market study conducted in three Mexican cities (Capital Advisors, 1999) that bordered the US that the effective demand for HMF totaled four times that for micro-enterprise finance in this same geographic area. Fifteen percent of Mexican households surveyed by this study both wanted and could afford a small loan at market rates with short terms for home improvement. The general sense of lenders is that roughly half the households of Latin American countries are interested in improving or adding to their homes, although only about a third of this half of the population can afford market-rate finance in a given moment.

The Accion study concluded that HMF has proved useful to build customer loyalty, but is not a core product of these ten MFIs. The core mission of these MFIs continues to be fostering economic development through micro-business lending. In general, these MFIs do not view housing as an integral part of this core mission.

The GmbH study showed that 17 of the total 25 MFIs surveyed had products for low-income housing, while the remaining eight were seriously considering developing such a product in the short run. These institutions had extended a total \$84.2 million for housing loans. Overall, housing loans represented 8.8% of the total micro loan portfolio of these MFIs. Housing credit accounted for over 15% of the portfolio in only three of these MFIs. Despite this small share, many of these MFIs valued housing credit because it fits well within their overall business strategy. HMF helps to diversify their portfolio, and meets the housing credit need of their existing client base of micro entrepreneurs.

All 17 MFIs with a housing product surveyed by the GmbH study make loans for home improvement, but only nine offered finance for purchase or construction of new homes. Maximum maturities lie between 10 and 20 years for MFIs offering new home loans and between two and five years for MFIs offering home improvement loans. The average loan amount was \$1,925. Almost all institutions funded their housing loans at least partly from their own equity. Eleven of these 17 institutions used credit lines mainly from national public banks and international development banks for refinancing their housing portfolio.

The institutions surveyed by the GmbH study were interested in roughly doubling their housing credit volume over the next three years, although their core mission continued to be micro-enterprise credit. This expansion would raise their housing loan volumes from 8% to 10% of their total loan portfolio to 15% to 20% – a significant increase but hardly a dramatic one relative to the immense demand for this product.

These MFIs surveyed by GmbH said the “lack of availability of appropriate funding” was the most important constraint for the expansion of their housing portfolio. However, donors, investment banks, and others have flooded the microfinance industry with liquidity. Hence, such “lack of funding” statements may sometimes indicate other

problems (such as high costs and inefficient operation that make funding at competitive rates unprofitable for these MFIs) and, therefore, deserve analysis on a case-by-case basis. These MFIs cited lack of institutional capacity and technical know-how as the second most important problem in limiting the expansion of their home lending. Given the multiplicity of sins that “lack of appropriate funding” often indicates, technical assistance to remedy institutional and operational problems appears to be as important as simply more or better funding.

Other recent studies of HMF within MFIs by International Habitat for Humanity (Stickney, 2006) and the Cooperative Housing Foundation (Schumann, 2006) come to findings consistent with these conclusions.

From the perspective of promoting HMF in MFIs, the glass is half full

Hence, these studies show rapid growth of HMF loan volume within MFIs, although from a minuscule base. MFIs have discovered that HMF is profitable and has immense potential for expansion. Thus, HMF – particularly small home improvement loans – is now well established as a recognized niche product for MFIs. From the perspective of many MFIs, their housing product is on track to fulfill its institutional missions: to diversify risk, support development of savings products and the transition to a regulated deposit-taking financial institution, and offer an additional product popular with their core micro-entrepreneur clients.

The “lack of funding” constraint – which MFIs cite as the main bottleneck to expand housing microfinance – is also on its way to solution. For example, Mexico’s second-tier housing development bank, the Sociedad Hipotecaria Federal (“SHF”), which previously offered liquidity only for mortgage loans mainly for middle-income home purchase, has had an HMF window since 2005 and now offers a subsidy that can be joined with the HMF loan (as discussed below). The government of Colombia has also tried to start a secondary market for housing microfinance. Investment groups and capital market institutions are establishing financial vehicles to fund home credit of MFIs. The paper by James Magowan in this issue of *Global Urban Development Magazine* describes the considerable progress in issuing securities on public markets for on-lending to MFIs to finance low/moderate income housing in emerging countries. These major achievements deserve recognition and further support in order to consolidate them.

However, three interrelated factors seriously limit expansion of HMF within MFIs:

First, an explicit housing product typically has a slightly lower interest-rate and longer tenor, and can cannibalize their existing microenterprise loan business. That is, the MFI’s microentrepreneur clients could nominally borrow for housing to fund their business and get better terms than they would under a microenterprise credit. Thus, the end result of developing an explicit housing product might mainly be lower profits, unless marketed to a new clientele or unless the MFI monitors the use of the funds for housing.

Second, the Accion and GmbH studies confirm that microfinance institutions consider housing an adjunct secondary product. From the perspective of most MFIs, housing credit deserves little attention and is unrelated to their core mission of “promoting economic development.” Many studies as well as common experience show that most households build wealth mainly through homeownership and housing investment plays a crucial role in national economies. Nevertheless, microfinance institutions continue to relegate housing to a trivial role in their business strategy aimed, supposedly, at “economic development.” With a few notable exceptions, MFIs lack the interest to make housing a major focus.

Most fundamental, however, the microfinance industry offers far too small an institutional base in most countries for the expansion of housing microfinance to a scale relevant to demand, even if MFIs were interested in this role. The next section explores this fundamental institutional bottleneck in Peru, Mexico, and Brazil.

From the perspective of satisfying household demand and addressing the low-income housing and urban development emergency of the next three decades, the glass is more than half empty

The supply of HMF is still only a minuscule fraction of demand. Even if HMF continues to grow at current rates within MFIs, the total loan volume will be trivial relative to demand in most contexts over the next 20 to 30 years – that is, the peak of the world’s low-income housing/urbanization emergency (see Cohen, 2005).

The following profiles the housing economies and HMF practice in Peru, Mexico, and Brazil in order to illustrate the range of experience in ramping up HMF and to explore alternatives for addressing low-income housing needs on a market basis at massive scale.

Peru

Peru is a country of 27.5 million people, with 54% living below the poverty line. The population of the capitol – Lima – has increased from 1.5 million in 1960 to around 6 million currently. Gross national product grew at 5.35% in the third quarter of 2005, with inflation of 3.65% on average in 2004. As regards housing demand, 57% of the residents of Lima want to improve their house. In the south of Lima, 42% of roofs are of zinc or fiber. In the south and east of Lima, 26% of floors are made of earth. The housing deficit has been calculated at 1.2 million units, and is increasing at 90,000 units annually (Gwinner, 2005a).

Government has a number of housing programs (Gwinner, 2005b). One of these – BanMat – makes “loans” for building materials. However, arrears rates are about 80% on these credits. A second program – MiVivienda - is funded by a 5% tax on salaries. MiVivienda channels these monies through a second-tier finance institution, COFIDE, to first-tier housing lenders that – in turn – extend below market-rate credit to around 14,000 middle-income households per year for the purchase of new developer-built homes costing US\$25,000 to \$50,000. A third program, Techo Propio, operates by joining a direct demand subsidy (i.e. a grant) with the household’s downpayment and – if necessary – a loan for purchase of a new home, construction of a home on a lot owned by the family, or rehabilitation of their existing home. The subsidy amount varies from US\$1,200 for home improvement to US\$3,600 for purchase of a new home. Techo Propio currently delivers around 3,000 subsidies per year to households earning around US\$400-\$500 per month.

Overall, Peru has housing conditions and a set of governmental housing programs that are fairly typical of Latin American countries. The great bulk of the housing subsidy and finance system – the MiVivienda program in the case of Peru – focuses on middle income families and fuels the commercial homebuilding and mortgage industries. These programs contain significant subsidies per unit that limit their scope and production to a small share of the population – mainly middle-income families. The implicit government policy for the low-income majority is for these households to invade land or purchase a lot in a clandestine subdivision or low-income community and to build their home over many years without formal-sector support.

In short, Peru is particularly fertile ground for small serial home credit. A conservative estimate is that pent-up market demand totals US\$1.1 billion for housing microfinance loans from 550,000 existing low income households, and is increasing at \$20 million annually from 9,000 new low-income families.

MiBanco – the largest microfinance institutions in Peru and in Latin America, – has responded by creating one of the largest and fastest-growing housing microfinance businesses in emerging countries. MiBanco was formally launched in 1998 as a licensed bank when it assumed the loan portfolio of Accion Comunitaria del Peru, a nonprofit NGO operating in Lima. Today, MiBanco is the largest microfinance bank in Latin America and one of the largest banks in Peru. MiBanco has recently won an award as one of Latin America's most successful commercial banks.

The impetus for creating a housing product dates back to the experience of senior management in helping to finance and rebuild houses in northern Peru destroyed or damaged by an earthquake in the early 1970s (Brown,

2003). Funding limitations precluded extending credit for housing before the organization became a commercial bank. In 2000, however, management began designing a product for market-rate finance of home improvement, called MiCasa. Management decided that the MiCasa loans would be offered through the same branch network with the same staff as their other loan products. The core part of the credit process – the evaluation of the client's capacity to repay -- would be essentially the same for housing as the bank's micro enterprise loans. There were two targets for MiCasa loans: MiBanco's traditional customer base of micro entrepreneurs, and low-income, salaried workers living in the same communities. By adding low income workers to its target market, however, MiCasa has ended up serving poorer households than the micro-enterprise portfolio of the institution.

Credits – averaging US\$1,600 – are extended for up to five years at interest rates of around 45% in the Peruvian currency (Soles), a somewhat lower rate than that for micro enterprise loans. Borrowers, however, typically pay off ahead of the loan maturity; actual terms average 20 months. MiCasa was envisioned as a microcredit product without technical assistance for construction. Currently, however this program assists households with the construction process through an initial design and budget, one visit at the start of construction to help orient the work, and a technical report on the feasibility of construction. MiCasa serves households, extends credit, and collects repayment through its regular system of loan officers, each of whom manages a portfolio of around 250 loans and gets paid largely on commission based on loan origination and collection performance.

Loans are secured mainly by cosigners, personal collateral, and temporarily taking custody of households' proofs of ownership until credits are paid off, rather than mortgages (only about 10% of MiCasa loans are secured by a mortgage), which are time-consuming and expensive to secure and impractical to execute in low-income areas where home resale markets are thin. Thus, assiduous methods of loan collection and maintaining good credit in order to get access to more finance constitute the main incentives for repayment.

MiCasa has grown rapidly. In 2001 – its first full year of operation – MiCasa made 5,000 loans. In 2006, MiCasa made 13,498 loans. As of April 2007, MiCasa had 20,903 loans outstanding in total, and was making new loans at the rate of US \$2.5 million per month. Arrears exceeding 30 days were 1.81% -- low by Peruvian and international standards. Return on equity was 7% to 9% per annum – which, when leveraged by the institution's capital-to-asset ratio, resulted in profits of over 20% per year. From April 2006 to April 2007, the MiCasa loan portfolio grew at virtually the same rate (42%) as that of the loan portfolio of MiBanco as a whole (40%). MiCasa constituted 12% of the total portfolio of MiBanco.

According to the manager¹¹ of MiCasa, effective demand for these micro housing loans is huge, and far exceeds the supply of loans under the MiCasa program. This manager notes that the first priority of MiBanco as a whole continues to be micro enterprise lending, although the institution also actively markets MiCasa.

Recently, MiCasa has attempted to establish alliances with building materials suppliers, which are still at a beginning stage. For example, MiCasa has opened an office of five people within a building materials supply store associated through overlapping ownership interests with one of the largest cement producers of Peru -- Cimento Lima. This office has extended credit of around US \$300,000 for purchases of building materials. Large international companies - such as Ace Home Center (US based) and Sodimac (Chile based) increasingly dominate the building materials retail sales environment in Peru.

MiCasa also has a pilot urban upgrading loan project. Under this program, loans have been extended for a total of around US\$300,000 for infrastructure provision, including installation of water and electric networks, to six groups of households in various low income communities, which collectively agree to repay the loan. These loans are being repaid on time, and two of the six groups of households have repaid their loans fully.

Although the partnership with the building materials supplier and the urban upgrading loan project are still embryonic, the manager of MiCasa believes that these initiatives hold the future to expansion of housing microcredit in Peru.

With the success of MiCasa, a number of other local financial institutions – particularly cooperative credit societies (Casas Municipales) and other MFIs – have now introduced housing products similar to MiCasa and are beginning

to explore this market. This competition has contributed to forcing down interest rates on housing microfinance loans, from around 70% per annum three years ago to 45% currently.

Of the three countries profiled here, Peru represents the “best case” for the argument that housing microfinance can become relevant to the scale of the urbanization/low-income housing challenge. On a flow basis, Peruvian MFIs appear to be extending roughly the amount in HMF loans – US \$20 to \$30 million per annum -- necessary to cover demand from new families. However, little progress has been made in satisfying the huge pent-up demand from the past. The housing micro credit volume extended by all Peruvian MFIs over the last decade totals less than US \$150 million compared to a pent-up market demand of US\$1.1 billion.

Mexico

With a population of 110 million, Mexico has 30 million households, growing at a rate of 750,000 families per year. Forty percent are low-income, earning up to three minimum salaries – about US\$450 per month.

Mexico has made great progress in traditional mortgage finance over the 15 years since the Tequila Crisis of 1994 virtually destroyed the private housing finance system led, at that time, by commercial banks. An institution funded by pension contributions of private workers mandated by federal law, INFONAVIT, lends at below-market interest rates largely to low-income formally-employed workers and still dominates the Mexican mortgage market, accounting for roughly 60% of mortgage loans.

In 2002, the federal government created a second-tier housing development bank – SHF – to lead the development of private market-rate housing finance. Under its organic law, SHF enjoys the support of the federal treasury necessary to build a private housing finance system, which phases out over a period of 12 years in order for the private sector to assume full responsibility. SHF has been the main funder and de-facto regulator of 17 mortgage banks, called housing “SOFOLAS” (SOFOLAS can lend but not take public deposits for a single asset type – in this case, housing) that filled the gap in mortgage finance left by the exit of commercial banks after the Tequila Crisis.

These housing SOFOLES have innovated successfully in their origination and collection methods, and became the main home lenders to moderate and middle-income families. The success of housing SOFOLES has, since 2004, begun to re-attract commercial banks back into home lending. The largest housing SOFOLES are now turning into commercial banks so that they can take deposits from the public and better compete in a more contested mortgage market. Other housing SOFOLES are branching out into new products – including unsecured lending for home improvement – by converting into a new category of financial institution, called a “SOFOM”, which allows diversification of asset types without taking deposits from the public.

INFONAVIT, SHF/SOFOLAS, a number of other government housing finance institutions, and – recently – commercial banks have joined to increase mortgage lending dramatically in Mexico over the last eight years, which has more than tripled to around 500,000 loans per annum. These mortgages mainly finance the purchase of new homes built by sophisticated commercial housing development companies, which have become some of the most efficient and largest-scale homebuilders in the world. This system is constructing many new residential subdivisions of 10,000 to 20,000 houses with complete infrastructure on the periphery of the major metropolitan areas of Mexico. These new commercially-developed homes mainly consist of core units that the family can expand horizontally and vertically in pre-programmed steps.

Despite these striking successes, roughly 40% of households – who are largely low-income and employed informally – lack access to institutional housing finance and fall outside Mexico's housing system. As a result, a large market exists for small home credits for home improvement. Based on a market study (Capital Advisors, 1998) that shows 15% of Mexican households want and can afford such loans, unsatisfied HMF pent-up demand in Mexico is roughly US\$9 billion, and growing at US\$330 million per annum.

The Mexican MFIs sector is somewhat underdeveloped. The MIX – a microfinance database – lists only 27 institutions versus 40 in Peru, a country of only about one quarter of Mexico's size (Elias, 2008). Seeking to

diversify from its customary middle-income clientele, SHF has established a facility for offering credit for first-tier lenders to fund HMF loans and has recently added a subsidy program that can be joined with these home microcredits. One Mexican MFI – Financiera Independencia – is assertively expanding the HMF market, mainly through joining SHF's HMF credit and subsidy facilities. Box 1 profiles this experience.

Box 1 -- Financiera Independencia in Mexico; leveraging housing micro finance with government subsidies without contaminating credit markets

Joining mortgage finance, government grants, and a household down payment has worked well for assisting middle-income households and stimulating mortgage lending and commercial homebuilding for this segment. Such "direct demand subsidy programs" have a long history in emerging countries, particularly Latin America (Ferguson, 1996).

However, combining housing microfinance with government subsidies has proved elusive for low-income households. MFIs frequently distrust governments and are concerned that the availability of subsidies will dilute borrowers' willingness to pay on microcredit. In turn, government housing bureaucracies frequently emphasize increasing housing production numbers, pay much less attention to cost recovery (e.g. repayment rates on loans), and do not understand the perspective of MFIs. Largely for these reasons, attempts to join HMF with housing subsidies have failed in Columbia, Nicaragua, and elsewhere. A Mexican MFI, Financiera Independencia, and the federal government second-tier housing Bank, SHF, have succeeded in joining these two sources of funding on a large scale for the first time.

Financiera Independencia is an MFI incorporated in Mexico as a Sociedad Financiera de Objeto Multiple ("SOFOM"). Since its inception in 1993, FI has grown to include a network of 128 branches in 30 of the 32 Mexican states. The institution offers four products, including a credit line for home improvement called CrediConstruye.

FI introduced CrediConstruye in 2007 funded by a US \$80 million line of credit from SHF that expires in 2011. FI is the first MFI to use this SHF housing microfinance facility. Borrowing households must have low incomes – below 4 minimum salaries (approximately US\$600 per month). Loans must be used for home improvement and all are extended in the form of a voucher that can be exchanged for construction materials. The average loan size is US\$600. Loan terms are two years with an interest rate of 43% per annum.

Virtually all of these loans are joined with a subsidy, typically of US \$400 per household, under the Esta Es Su Casa program of the Mexican federal government. CONAFOVI – the apex housing policy organization of the Mexican federal government – has delegated the administration of this subsidy to SHF.

As of December 2007 after one year of operation, CrediConstruye had disbursed US \$32.7 million in loans to 20,000 clients. Arrears rates for 90 days were 2.5% – low by both Mexican and international standards. FI anticipates quadrupling loan volume and number of borrowers served by the end of 2008.

The management of FI has found no problem with borrowers confusing subsidy and microcredit, and attributes the smooth operation of the program to the SHF grant process. While housing agencies unfamiliar with banking operate most housing subsidy programs, SHF is a second-tier housing Bank with long experience working with the private sector. SHF has largely succeeded in developing a private housing finance market for middle-income households in Mexico. The institution has now begun to focus on bottom-of-the pyramid housing finance markets.

Sources: interview with management of FI, June 24, 2008; and Elias, 2008.

The CreditConstruye program of FI shows that joining housing microfinance with housing subsidies can, indeed, dramatically increase loan volumes without contaminating credit quality.

Government subsidies, however, are a limited resource. Even if the FI/SHF partnership with accompanying subsidies were to quadruple to \$120 million in loans per annum as planned for 2008, it would satisfy only a miniscule fraction of the US\$9 billion of pent-up demand for small housing credits in Mexico. Other commercially-viable Mexican MFIs have shown little interest in housing. In summary, the relatively underdeveloped Mexican MFI industry lacks the capacity and interest to satisfy a significant fraction of demand for HMF in that country. The efforts of the SHF and FI are highly promising, but have a long way to go to reach a scale relevant to this market.

While small housing credits are a niche secondary product for most MFIs, they are vital to the business of Mexico's enormous building materials manufacturers and retailers, such as CEMEX (the third-largest cement manufacturer in the world) and Home Depot of Mexico. These modern corporations must provide consumer finance for their products to be competitive. The experience of the Patrimonio Hoy program of CEMEX of Mexico illustrates the likely evolution of housing microcredit in large markets, such as that of Mexico – see Box 2 for a description. This case has received wide attention within the building supply and manufacturing corporate sector in Latin America, in particular, but also throughout emerging countries.

In effect, Cemex's Patrimonio Hoy program merges small credits with other components of the low-income housing value chain – including building materials, a savings program, and technical assistance in construction. The integration of these elements greatly expands the market for each one. Typically, no one organization can provide all these elements. Hence, as Patrimonio Hoy demonstrates, this integration comes from alliances among various entities – corporations, citizen-sector organizations, and government.

The expansion of housing microfinance to scale depends fundamentally on the creation of such business alliances. Irene Vance's paper on HMF in Guatemala in this issue of *Global Urban Development Magazine* provides a good second example of creation of a low income housing value chain through business alliances organized by a commercial bank. A third intriguing example is that of a building materials manufacturer, Corona, of Colombia, which provides very small credits (US\$400) to the poorest households for ceramic tile to replace dirt floors, also documented by a paper in this issue of *Global Urban Development Magazine* by Gutierrez.

Home Depot of Mexico – the largest retailer in this country – also provides consumer credit for 12 to 18 months for purchase of its building materials, although without integrating other aspects of the progressive housing process. The consumer credit extended by the Patrimonio Hoy program of Cemex, alone, has exceeded US\$400 million, compared to the US\$120 million in loan volume to which FI aspires by the end of 2008 for its Creditconstruye program.

Thus, consumer credit for the purchase of home construction materials represents, by far, the main source of low-income housing finance in Mexico and has an enormous institutional platform for growth – the world-class Mexican building materials manufacturing/retail industry. In comparison, home improvement lending through microfinance institutions is miniscule and only one commercially-viable MFI is aggressively pursuing this market.

Box 2 - Patrimonio Hoy in Mexico

The *Patrimonio Hoy* Program of CEMEX, the giant Mexican cement maker, serves do-it-yourself homebuilders, who account for 40 percent of the consumption of cement in Mexico. CEMEX research showed that low-income homebuilders in Mexico take four years to complete one room, and 13 years to complete a 4-room house. This slow rate largely reflects the lack of formal-sector support. So, many households join informal savings clubs (*tanda*) in which each family pays US\$10 to a pool and one member is selected each week by lottery until all have received money. However, this informal savings and self-help construction has strong drawbacks when unguided. Building materials dealers often sell these households poor quality materials left over from large customers at high prices. Homebuilders who lack construction skills often waste materials by buying too much or too little. They also hoard these materials, which leads to their deterioration by weather and loss from theft. Home design and construction is often poor quality. Finally, *tanda* savings often end up getting used for festivities rather than invested in construction materials.

The CEMEX *Patrimonio Hoy* program addresses these problems with self-help construction with the business goal of expanding CEMEX sales in this market. It first organizes small groups of families who commit to a 70- to 86-week saving program. As informal *tanda*, each group's members take turns collecting payments and playing the role of enforcer. To ensure that savings get spent on construction materials, however, families receive raw materials rather than cash. Deliveries start after only two weeks, before families have saved much, and subsequent deliveries are made each 10 weeks. Thus, CEMEX is, in effect, advancing microcredit to these families in the form of building materials. CEMEX operates this program through establishing "cells" – four-member offices – located in low-income communities. CEMEX arranges with local building materials suppliers to deliver high-quality product and uses its cells to orient groups of households in the construction process. Rather than use advertising, CEMEX hires local "promoters" – 98 percent of them women – to inform local households about the program. These local women are the key to establishing the relationships and developing the trust necessary for the program to work in the challenging environment of informal communities. The program sponsors parties and other events to celebrate completion of a room or a house.

The average do-it-yourself homebuilder in Mexico spends US\$1,527 and takes four years to build an average size room of 100-square-feet. But participants in *Patrimonio Hoy* can build the same size room, with better quality, in less time – 1.5 years – and at two-thirds the cost (US\$1,038, which includes the cost of materials, technical assistance from an engineer or an architect, and *Patrimonio Hoy* club fees). *Patrimonio Hoy* reached 100,000 people in its first two years of operation, and planned to expand this number to 1,000,000 by 2008. *Patrimonio Hoy* operates without subsidy. SHF – the secondary housing-finance liquidity facility of Mexico charged with leading the development of market-rate home credit – has established a window for housing microfinance that works with *Patrimonio Hoy* and other first-tier lenders. CEMEX has operations in 23 countries, and management are interested in expanding *Patrimonio Hoy* outside Mexico.

Sources: interview with management of *Patrimonio Hoy*; and Prahalad, 2005.

Brazil

In contrast to Peru and Mexico, Brazil has virtually no commercially-viable microfinance institutions. Nonetheless, small credit for housing is a huge industry and finances roughly one-fifth of housing units in the Sao Paulo area, comparable to the number of units funded by Brazilian institutional mortgage finance in this metropolis.

These small housing loans mostly take the form of consumer credit channeled by building materials retailers for the purchase of their products. However, this building-materials consumer credit industry is fragmented, disorganized, and charges relatively high interest rates. An examination of Brazilian housing finance and its building materials

consumer credit industry provides important insights into small serial credit for progressive housing in an environment without microfinance institutions.

One million Brazilian households form each year and enter the market for housing (Ferguson, Cherkezian, and Motta, 2007). Over half of this demand for new housing comes from low and moderate-income households earning below five minimum wages – about US \$650 per month. Self-financed progressive housing accounts for 62% of new Brazilian housing investment. Much of this self-financed progressive housing development occurs in the informal sector.

As in Peru and Mexico, economic growth joined with social support programs have expanded the lower middle-class and decreased the number of households in abject poverty over the last three years, stimulating demand for housing investment. According to *The Economist*, “between 2000 and 2005 the number of Brazilian households with incomes of US\$5,900 to \$22,000 grew by half, from 14.5 million to 25.3 million, while those receiving less than US\$3,000 a year fell sharply to just 1.3 million.”

Although growing at a rapid rate recently, mortgage finance is still small in Brazil, both relative to the share of housing funded and to GDP. Table 1 compares mortgage finance as a share of GDP in Brazil with that of other countries.

Partly because of the low penetration of institutional mortgage finance, many Brazilian households pay for a surprisingly large share of their housing in cash. Downpayments of 30% to 50% are common. A wide variety of “alternative” sources of housing finance have also developed.

The main sources of institutional mortgage finance are the SBPE (Sistema Brasileiro de Poupanca e Emprestimo) (averaging about 20% of mortgages for purchase of new homes) and the CEF using FGTS funds (averaging about 60% of mortgages for purchase of new homes).

Table 1 -- Mortgage Finance As a Share of GDP

Country	Mortgage finance as a share of GDP
Argentina (2001)	4%
Brazil	2%
Bolivia (2001)	8.6%
Chile (2001)	10.8%
Columbia (2001)	7.0%
Indonesia (2007)	3%
Malaysia (2007)	25%
Mexico	2%
Panama (2002)	24.4%
Peru (2001)	2.9%
Uruguay (2001)	7.0%
United States	79.6%
European Union	42.6%

Sources: Galindo and Lora in Inter-American Development Bank 2005; and Unitus/Lehman Brothers, 2007.

The remaining medium and long-term home funding (20%) comes from three “alternative” non-bank sources: direct financing from developers, real estate “consorcios” (federally-regulated savings clubs that pool funds gathered each month and allocate them to one or more members to buy a house), and housing cooperatives (groups formed by groups such as churches that help to organize the process of saving, accessing land, construction, and home purchase of their members).

The SBPE (Sistema Brasileiro de Poupanca e Emprestimo) provides a government guarantee to individual savings deposits, but places limits on the rates paid for these savings that are below market. In turn, banks are required to lend most of these sums in the form of long-term mortgages at below-market rates.

FGTS (Fundo de Tempo de Garantia de Servicos) collects each year about 4.5% of GDP through a levy of 8.5% on formal private-sector wages -- a greater share of the economy than any other housing finance/pension mandatory contribution system in Latin America . These amounts are credited to accounts of individual workers and accrue interest at a low rate. The CEF (Caixa Economica Federal) – a government-owned institution that is the largest retail bank in Brazil – lends the great bulk of FGTS funds in the form of below-market rate credit. CEF offers two programs; one for borrowers acting as individual households, and the other for borrowers acting within the context of a group.

The SBPE has mainly financed middle-class housing, with an average loan amount of R. \$81,503 (2006) – about US\$27,000. The FGTS/CEF has largely funded moderate-income housing, with an average loan amount of R. \$20,021 (2006) – about US\$6,500. In terms of numbers, the SBPE reportedly financed 115,823 housing units in 2006, while FGTS financed 304,882 in this year – a boom year for housing construction and finance that saw volumes and numbers of units financed reportedly increased by over 50% from the averages of 2001 to 2005.

Brazil has begun to build a sizable mortgage finance industry and a modern housing economy with some world-class homebuilders (e.g. Gafisa) modelled on their Mexican counterparts (e.g. Geo, Urbe) that serve these countries' emerging lower middle-class as well as upscale markets. Nonetheless, as new annual household formation in Brazil runs at one million, these two main mortgage sources (SBPE and FGTS) left a gap of more than half of all new households unassisted by mortgage finance even in the boom year of 2006.

In terms of both numbers and volume, the bulk of FGTS finance went to "microcredit" ("microcredito") for a package of building materials, with an average loan size of R. \$4,901 (about US\$1,630). However, these government-funded housing microcredits have a number of serious problems that make their label of "microcredito" misleading. Most fundamental, they occur at highly-subsidized rates of interest. In addition, many households consider such government loans as partly gifts, and do not pay them back. Such unscrupulous competition from the government has almost completely undermined commercially-viable microfinance institutions in Brazil.

The total amount funded under this housing "microcredito" program – R. \$827 million (US\$276 million) – is also insignificant relative to the annual investment in progressive housing – R. \$62 billion (about US\$20 billion), let alone the additional sums needed to improve the inadequacies of the existing housing stock.

As a result, private consumer credit for building materials purchase is big business in Brazil. Brazilian Federal law requires that commercial banks invest 2% percent of their demand deposits in "microcredit" of some sort. The law also regulates the amount, maximum interest rate, and term of this microcredit funded by commercial banks. As regards housing, these banks either offer this housing microcredit directly to their depositors or channel this microcredit through building materials stores.

Two studies have recently examined this industry, one commissioned by Ashoka (Leonardo Letelier and Soares, 2007) and one contracted by Cities Alliance and the municipality of Sao Paulo (principal investigators: Frederico Celentano and Alex Abiko, 2007).

The Ashoka study surveyed 12 local building-materials stores, 237 households and conducted a number of household focus groups in two favelas in Sao Paulo. Virtually all households in these two favelas owned their own home. The municipality has provided basic services in these favelas and 91% of households intended to improve their homes through expansion and/or remodeling. Families prioritized price, financing, store brand, and distance from their house as the main factors in choosing stores to purchase building materials.

Half of all purchases were made in cash. Families financed about a third of purchases mainly using consumer credit but sometimes with a credit card, either their own or of a friend. These stores reported that their sources of

financing typically qualified customers for a maximum of US\$1,500 in credit – the average cost for the building materials to add one room. These building materials stores offered credit of their own by accepting two to three monthly installment payments.

These stores also channeled bank credit for materials purchase at market rates (3.5% to 6% per month) with 12 to 48 monthly installments, and offered negligible amounts of highly subsidized FGTS housing “microcredit” (at 0.5% per month, with up to 96 monthly installments) due to its scarcity (and reported nonpayment rates of 30% on such “microcredit” government programs). These interest rates for consumer credit compared to market-rate mortgage interest rates of around 15% per year at the time, with inflation running around 4% per annum. For many reasons, Brazil has historically had some of the highest real interest rates in the world, which plague economic activity, in general, as well as the housing industry, in particular.

Households accepted the market rates of consumer credit charged for building materials purchase as the cost of doing business. In fact, 40% of households surveyed were unable to remember the interest rate at which they took consumer credit. In comparison, moneylenders typically charge much higher rates – 10% per month in Brazil – while credit card companies charge stiff penalties when debt is carried from month to month, resulting in effective interest rates of as high as 140% per year.

In addition to credit for building materials, the Ashoka study reported that roughly half of households expressed a strong interest in specialized labor for construction. Families had hired qualified workers for roughly a quarter of work conducted in the past, wanted to reduce the amateur level of construction, and – because of increasing household incomes – were willing to pay for more professional help in the future. Prior to the research, Ashoka investigators thought that community members frequently helped each other with construction; e.g. barbecues to pour foundations. In fact, they found little evidence of such mutual self-help.

The Ashoka study concludes by recommending a pilot project in one favela in the greater Sao Paulo metropolitan area that joins consumer credit, discounts on building materials negotiated with local stores, and technical assistance to families in construction. This pilot project is currently in a start-up phase and briefly described in this issue of *Global Urban Development Magazine*.

The Cities Alliance/Municipality of Sao Paulo study conducted focus groups of building materials retailers and low-income households throughout the municipality of Sao Paulo. The locations of household focus groups spanned a wide range of low-income communities, including high-rise government-assisted low-income housing projects, government-assisted subdivisions of core units, shantytowns (“favelas”), and central city rental tenements (“corticos”).

The focus groups confirmed progressive construction as the main method of housing investment for all of these low-income communities. The demand for HMF came not only from informal communities (favelas) but also from government projects – both high-rises and subdivisions of core units. Virtually all residents of these government projects wanted to remodel their apartments or core units, which had been delivered without internal or external finishing. Even 58% of the renters of central-city tenements owned by others wanted to improve the units in which they lived.

A number of factors, however, tended to deter housing consumer credit. Informal employment, the inability to qualify for formal credit, and lack of or credit history registered in a credit bureau were most mentioned. Largely as a result, most low-income households paid for most of their building materials purchases (70%) in cash, and used credit finance for most of the remainder.

Most low-income households used construction contractors much more than their own labor or family or friends, and also wanted credit in order to pay for specialized construction labor. The focus groups showed a strong interest in technical assistance in planning and design of construction.

The Cities Alliance/Municipality of Sao Paulo study also conducted extensive interviews with public and private financial institutions offering credit for building materials purchase and with building materials stores. Private banks typically targeted their credit towards their account holders or the clients of building materials stores with which they had formed business alliances. Public agencies and financial institutions targeted credit to low-income households earning up to three minimum salaries. Maximum amounts financed varied from US\$2,000 to US\$10,000. Interest rates for private-sector institutions ranged from 2% to 6.5% per month, and maximum terms from 12 to 48 months. Not surprisingly, households with no credit record tended to receive smaller loan amounts, higher interest rates, and shorter terms within these ranges.

Virtually all of the financial institutions that extended building materials credit required verification of household income and confirmation of no liens on the property registered in the local cadastre. Commercial banks often insisted that borrowers open an account in that institution, while other programs often demanded that a guarantor cosign the loan.

Profit levels varied dramatically among stores. The stores surveyed sold mostly to homeowners (40% to 60%), then to renters (10% to 30%), and finally to construction contractors (5% to 10%). Small stores purchased most materials very frequently – either weekly or every two weeks. These frequent purchases allowed small stores to save money by maintaining a small stock, but did not permit negotiating better prices through bulk discounts with suppliers. A key bottleneck in their business model is finance to buy larger quantities at one time from suppliers, and the capacity to negotiate better prices through bulk discounts.

These building materials stores lend based on knowledge of their client base and relationships of trust developed over time. Households pay largely in order to maintain their credit with the stores and place in their community. This logic closely parallels that of microfinance institutions. However, these stores' consumer credit lacked the rigorous methods of microfinance institutions, was highly fragmented, and suffered from lack of integration into other aspects of the store's business.

The Cities Alliance/Municipality of Sao Paulo study arrives at a number of key conclusions. Consumer credit finances approximately 20% of housing investment in Sao Paulo and is a huge business involving virtually all the major financial institutions of the country. However, enormous demand for small serial credits for housing remains unsatisfied. The study finds that housing microfinance could be greatly expanded to facilitate progressive housing if current consumer credit practices were revised to adapt to the needs of clients.

In particular, interest rates, terms, and the products and services must better suit customers. The extremely high interest rates charged to households without credit records in Brazil – 4% to 6.5% per month – are clearly unsustainable, and threaten to provoke a consumer debt crisis. Consumer credit should allow the finance of specialized construction labor rather than just building materials. While building materials retailers must offer or channel consumer credit to be competitive, they are not specialists in extending loans to low-income households and conduct this aspect of their business casually without integration into their larger business. Thus, there is a strong need for microfinance expertise, which could be acquired by forming business alliances.

The market for small housing loans goes far beyond construction materials for improvement of homeowner units in informal communities – i.e. prototypical housing microfinance. There is huge market demand in Brazil for small loans to finish, remodel, and improve government-assisted housing projects – both high-rise apartments and core-units subdivision – that essentially deliver an unfinished shell unit. Even most renters of central-city tenements (“corticós”) have expressed interest in credit to fix up their units.

New strategic directions necessary to expand housing microfinance to a scale relevant to demand and need

The evidence examined in this paper suggests that current approaches to HMF will result in miniscule supply relative to market demand, and have little impact in meeting the low-income housing/urbanization challenge of the next two to three decades. HMF requires fundamentally new strategies to achieve massive scale:

Broaden the institutional platform for support of small credits for the low-income housing/upgrading process by using the building materials and supplying industry as the base and employ MFIs as intermediaries. Small home improvement loans have become a niche secondary product useful to many MFIs. In most countries, however, microfinance institutions lack the capacity and the interest to expand low-income housing credit to massive scale.

In contrast, homebuilders and building materials manufacturers and retailers must provide home credit for the bottom of the income pyramid, as a large portion of their sales come from this segment. Modern corporations such as CEMEX of Mexico provide a much broader, powerful, and more robust institutional platform for small home credit than do microfinance institutions, particularly in large countries. Although they recognize they must channel credit to grow their core business, building materials retailers and manufacturers frequently do not want to become lenders to poor families and communities.

In big emerging economies such as Mexico, Brazil, India, and Indonesia, some microfinance institutions may come to specialize as niche lenders for large distribution networks of suppliers of inputs to the progressive housing process or for large commercial banks. Various studies have suggested the use of MFIs as intermediaries for housing microfinance, particularly in Asia (e.g. Monitor Group, 2007). This option has many attractions. It builds on the comparative advantage of MFIs – their ability to keep in close relationship and work with low income households. In comparison, large building materials manufacturers and commercial banks face great difficulties in working directly in low-income communities.

Package HMF with other key inputs to the low-income housing value chain through business partnerships and new business models. The key to creating value and, thus, markets in affordable housing is not only to lower the costs of each step in the value chain but also, more importantly, to innovate and join products and services together into new business models that address larger segments of the problem (Ferguson, 2008). No one corporation or organization contains the range of products and services necessary to support progressive housing comprehensively. Hence, assembling appropriate packages requires business alliances among microfinance institutions, building materials retailers and manufacturers, banks, homebuilders, citizen-sector organizations, and government. Credit is only one of various important pieces of this puzzle.

In large markets dominated by modern building materials retailers and manufacturers, these large corporations are the most likely candidates to organize such business partnerships.

Expand beyond small home improvement loans to extend credit for the enormous variety of low/moderate income housing investment in emerging countries. “Housing microfinance” has come to be synonymous with small home improvement loans for building materials to expand a homeowner’s unit. This is largely because microfinance institutions found that they could apply their existing loan methods and organizations to such loans with virtually no modification.

However, housing markets in emerging countries have evolved rapidly in the last decade. Low-income families earn more and a large new group of households – about 20% of the population of dynamic countries including Peru, Mexico, Brazil, India, and Indonesia – have graduated into the lower middle class. Small serial home loans can fill many of the new market niches created by this dynamism. For example, market assessments of Brazil show large demand for small credits to finish or expand government-assisted shell units – either in high-rises or core units in subdivisions – and for professional labor rather than just building materials. However, Brazilian banks and consumer-credit providers lack products useful for these needs.

The very small share of rental housing (less than 20% of housing stock) creates enormous problems for many low/moderate income families in many Latin America and Caribbean countries. Elsewhere – such as much of sub-Saharan Africa – most urban households rent, but no institutional financing or means of formal support exists for rental housing. Alan Gilbert's seminal study of rental housing in emerging markets has shown that the main rental supply comes from informal low-income communities. In this regard, small credit could be extended to build or remodel accessory spaces and units for rent.

A couple of US comparisons illustrate useful approaches to rental HMF. In the US, prudent lenders and mortgage insurers (e.g. FHA) apply the same favorable underwriting standards for owner-occupied single-family homes to owner-occupied apartment buildings of up to four units. Similarly, microfinance institutions, building materials retailers and manufacturers, banks, citizen-sector organizations and governments could support such small owner-occupied apartment buildings in low and moderate income communities.

South Shore Bank – the premiere community lender in the US – revitalized the south side of Chicago through financing local businesspeople to purchase and rehabilitate run-down rental buildings in this area. Community lending by MFIs, banks, and building materials retail credit programs should also include loans for multi-story rental buildings in low-income areas as well as prototypical housing microfinance – i.e. small home improvement loans to owner-occupants.

The governments of densely-populated dynamic East Asian cities (e.g. those of China) have little choice except to build shell condominium units in high-rises for low-income housing. Small credits could be used to build out the shell so that the unit becomes habitable.

In low-income South Asian countries – such as Pakistan – government has largely opted for the “sites and services” model for low-income housing projects. Typically, this means a plot of raw land in a distant subdivision with, at best, communal water and dirt roads without legal title to the property. The case of Saiban in Karachi (see the paper by Bruce Ferguson on urban land development in this issue of *Global Urban Development Magazine*) demonstrates the many ways that small home credit can improve this dismal reality when joined with other parts of the low-income housing value chain.

In many sub-Saharan African countries (e.g. Rwanda and Kenya), few urban low and moderate-income households individually own the land on which their houses sit, which is often communal tribal property or owned by others. In such contexts, some MFIs have begun to accept evidence of security of individual tenure (rather than ownership rights) – such as land leases – for underwriting small housing credits (Unitus/Lehman Brothers, 2007). HMF can play an important role in financing low-income urban land development – the largest bottleneck to housing the poor (see Ferguson, 2008 in this issue of *Global Urban Development Magazine*; Freire, Ferguson, Cira, Lima, Kessides, and Motta, 2007).

Incorporate HMF into the core mission of MFIs (a recommendation of the Accion study presented by Messina, 2006), in particular, in smaller countries and markets where MFIs may well continue to play a lead role. In this regard, MFI networks must bring to the attention of individual MFIs the crucial importance of housing to their core mission of “giving people the tools they need to work their way out of poverty” (Accion’s stated mission). More frequently than in high-income nations, housing generates income through rental of spaces and accessory units, provision of the location for many micro- businesses, and as the main social security in old age in emerging countries with precarious or no pension systems. Most fundamental, homeownership is the main means used by families to build **wealth**, which many studies show is the main route out of poverty and to upward mobility.

Raising the profile of housing credit in the MFI industry will require more technical know-how on this topic – that is, putting the “housing” back into “housing microfinance.” It will also involve formation of business alliances with other key players in the low-income housing industry including government, an institution that MFIs have long sought to avoid (as discussed directly below).

Channel government housing subsidies through second-tier housing banks experienced in working with developers and financial institutions in the form of small grants that complement housing microcredit. MFIs in Colombia,

Nicaragua, and elsewhere have had trouble joining housing microcredit with government subsidies to help the poor. In essence, these MFIs fear – with good reason – that involving politicized government housing agencies will dilute the willingness to pay of households on microcredit. Historically, the MFI industry has grown out of a rejection of grants and subsidized credit for rural development and a recognition that only market-rate credit can sustainably finance micro-business (Robinson, 2001). Housing, however, is a “merit good” in which the public sector inevitably retains some responsibility. The colossal effort of the US government begun in 2008 to rescue this country’s housing and related finance sector is a vivid case in point.

In this regard, the SHF/Financiera Independencia partnership in Mexico demonstrates how to join effectively housing microcredit with small subsidies. One key is for government to delegate administrative and executive functions for housing subsidy programs to a second-tier housing finance institution with a good track record in extending market-rate credit and in working with developers, first-tier lenders, and others involved in housing supply.

Another approach is that of the Kuyasa fund of Cape Town, South Africa. This organization makes loans to families that have received a government housing subsidy that allows them to increase the size of their unit from an average of 23 square meters to 54 square meters (Unitus/Lehman Brothers, 2007).

Provide technical assistance to financial institutions for HMF along with appropriate funding mainly from domestic sources but also from international groups with experience across countries and regions. The GmbH survey of 25 Latin American MFIs found that appropriate funding is the main factor necessary to increase their housing lending. The paper in this issue of *Global Urban Development Magazine* by James Magowan details the characteristics of such “appropriate funding.” More and better funding can certainly help in many instances.

With some frequency, however, declarations of “lack of appropriate funding” indicate deficits in the know-how, information systems, and business alliances necessary to engage in low-income home lending. Packages of funding and technical assistance from international sources with experience in a range of countries have an important role to play in supporting HMF. Such international support can disseminate important innovations. As capacity develops, this funding and TA best comes mainly from local sources.

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^[1] Interview with Jesus Ferreyra, the senior manager of MiBanco most responsible for developing the MiCasa product, on May 22, 2007.

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