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HOUSING FINANCE FOR THE POOR IN MOROCCO: PROGRAMS, POLICIES AND INSTITUTIONS

microREPORT #96

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The authors' views expressed in this publication do not necessarily reflect the views of the United States Agency for International Development or the United States Government.

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EXECUTIVE SUMMARY

In 2004 the government of Morocco embarked on an ambitious program entitled Villes sans Bidonvilles (Cities without Slums) to make home ownership affordable for the urban poor. The government was supported actively by many donors, including the World Bank, the EU, AFD and USAID. This initiative has led to innovations in the field of housing finance, and provided globally transferable lessons. Creative ways have been developed for the government to leverage the role of private banks and developers, for example by providing guarantees to banks which lend for housing to lower income people. In parallel, Morocco’s largest microfinance institutions are playing an increasingly important role in housing finance for the poor.

This microREPORT provides a general overview of the programs initiated by both government and donors in the housing finance sector. The study is qualitative rather than quantitative, and seeks to present housing finance for low-income communities within the overall context of Morocco’s housing policy, programs, and institutions.

Chapter One introduces the government and donor programs and reviews the policy and institutional aspects of housing finance for the poor in Morocco. Chapter Two examines the roles of banks and microfinance institutions. The final chapter analyzes the effectiveness of these programs in reaching their target populations.

Morocco’s experience is of particular interest to the broader industry in three respects. The first is the use of credit enhancements, by both the Government and USAID, to create confidence in a new market: in one case to lend to borrowers in the informal sector to help meet their housing needs; and in the second to establish the credit-worthiness of micro-finance institutions, to increase the amount of loan capital available for housing finance on-lending. The second aspect is the increasing role of microfinance to meet the demand for small loans primarily for progressive improvements or downpayments. MFIs also provide fee-for-service assistance to banks entering this market. The third transferable lesson is the work of ShoreBank International in establishing retail platforms and providing product development and staff training to commercial banks serving slum dwellers.



*Top: A typical house in a bidonville, near Kenitra
Below: Another house in a bidonville in Ennkhil, near Casablanca, one of the few remaining in an area slated for resettlement*



CHAPTER ONE

THE ROLE OF GOVERNMENT AND DONORS

Morocco has long been considered one of the more progressive countries in its management of urban development, and in particular its search for housing solutions that are suitable for the poor. It has implemented a variety of housing policies since independence in 1956, including sites and services schemes, upgrading of informal settlements, mortgage interest rate subsidies, and capital subsidies of new dwellings. In particular, the impetus provided by its program “Cities Without Slums” (*Villes sans Bidonvilles*, or VSB) has stimulated creative thinking regarding housing finance.

While the growth of informal settlements was reduced in the 1970s, it began to accelerate in the 1980s. A major program to address sub-standard housing (*l’habitat insalubre*) was launched in the 1980s, and a special agency was established for that purpose, the National Agency for the Prevention of Sub-standard Housing (ANHI, *Agence Nationale de lutte contre l’Habitat Insalubre*). In 2004, this was followed by the current formal VSB program which reflects the Cities Alliance slogan “Cities without Slums” (*Villes sans Bidonvilles*, or VSB). This program is central to understanding the current housing policy of Morocco.

Two programs use the title “Cities Without Slums”. The first is the government’s slum eradication program; the second is a Cities Alliance grant. Both are described in more detail below. But first we examine the affordability gap that led the government and donors to become heavily involved in subsidizing costs and lowering lending risks to provide increased and improved housing for the poor.

CITIES WITHOUT SLUMS

Currently, the annual urban growth rate in Morocco is between 3 and 4 percent (about 120,000 units). Despite the determination of the government to achieve “cities without slums,” housing production rates are inadequate and new informal settlements continue to develop. As in other countries, these settlements are often located in the most hazardous locations and populated by the poorest households.

Income information from the National Slum Upgrading Program shows that 16.8 percent of the households living in slums are “destitute” and cannot afford any mortgage payments (see Table 1).¹

¹ Data derived from the 2000-2001 Household Consumption and Expenditure Survey, as reworked and analyzed by the World Bank Poverty and Social Impact Analysis of the National Slum Upgrading Program (June 2006). One US dollar (USD) is equivalent to approximately 8 Moroccan Dirhams (MDH).

TABLE 1: HOUSEHOLD INCOME OF SLUM RESIDENTS

Household Income (USD per month)	<177	<251	< 352	<544	>544
Percentage of households	16.8	22.5	23.0	26.8	11.3
Affordable mortgage payment (USD per month)	0	63	88	125	>125

Source: *Enquête Nationale sur la Consommation et des Dépenses des Ménages 2000–2001* (cited from *Morocco National Slum Upgrading Program: Poverty and Social Impact Analysis*, World Bank, 2006). [MDH converted to USD]

Another source of income information is a household survey undertaken by USAID in the slum Nakhil, in Nouaceur, which showed that about 20 percent of heads of households of the slum population earn less than USD 63 per month (see Table 2).²

TABLE 2: INCOME FOR HEADS OF HOUSEHOLD

Income (USD per month) for Heads of HH	None	1-62	63-125	126-251	252-375	>375
Percentage of Households	14	6	19	49	10	2

Source: *Résultats de l'Enquête Ménage du Bidonville NAKHIL*, Near East Foundation, USAID Morocco, October 2006. [MDH converted to USD]

According to CHF's Practical Guide for Housing Finance in Morocco (2005), the poverty line in 2002 was defined as USD 490 per capita per year, or USD 41 per month, in urban areas. At the household level (assuming the average household size to be 5.5), this translates into a poverty line of USD 225 per household per month. The monthly minimum wage of USD 228 allows a single employee to keep a typical family of 5.5 people just above the poverty line. Table 3 shows the monthly income of the various income quartiles, highlighting that three-quarters of the population cannot afford to spend more than USD 150 per month on housing.³ Whether we rely on national level data, or data gathered from a particular slum, it is clear that there is a section of the population which cannot afford formal and regular housing payments.

TABLE 3: INCOME QUANTILES AND HOUSING AFFORDABILITY

Income Quartiles	Q1	Q2	Q3	Q4
Mean Household Income per month (USD)	289	455	601	931
HH Income range (USD)	88-375	376-512	513-687	688-4000
Max housing payment (25% of total income)	72	114	150	234

Source: *Practical Guide for Housing Microfinance in Morocco*, CHF International, prepared for RTI/ USAID, 2005, pp 9-10. [MDH converted into USD]

² For ease of reading, future references will be in USD, using an exchange rate of 8 MDH = 1 USD.

³ Using 25% of household income as an affordable level of housing expenditure.

Three different types of dwelling are classified as slums by the Government.

- There are the truly temporary shacks made out of second-hand materials which only offer the minimum protection from the elements, in the so-called *bidonvilles*. In 2003, these constituted about 9 percent of the total urban population. The government claims to have reduced the percentage of households in bidonvilles to 5 percent in 2007.
- The second, constituting about 18 percent of the housing stock, are the dwellings which are structurally sound, but illegal (*“habitat non réglementaire”*).
- The third—3 percent of the total housing stock—are the buildings in the historic core of the major cities (the medinas).

In 2004, the Government launched its Cities without Slums program (Villes sans Bidonvilles (VSB)) which aims to eliminate all slums by 2010, and has a target of 10-15 towns declaring themselves “slum free” every year. The VSB program was based on the concept of cost recovery but it was recognized that the physical solutions which were proposed—whether resettlement into apartments or relocation onto serviced plots—would be unaffordable to a substantial proportion of the beneficiaries. Accordingly, new measures had to be used to encourage banks and other financial institutions to lend to the target group. A total of 210,000 households in 70 towns are expected to benefit from the program. The total cost was estimated at USD 2.6 billion, of which USD 1 billion would come from government grants.

The VSB program takes a city-wide view, and aims to include the widest possible range of stakeholders in order to achieve its objectives. The management of the program is, therefore, based on the concept of collaboration between central, regional, and local government, public and private developers, and the inhabitants of the slums themselves. This collaboration is symbolized by contracts which are signed by the parties concerned. It also emphasizes the participation of the residents concerned.

The VSB program was based on the concept of cost recovery but it was recognized that the physical solutions which were proposed—whether resettlement into apartments or relocation onto serviced plots—would be unaffordable to a substantial proportion of the beneficiaries. Accordingly, in addition to capital subsidies, two new measures were used to encourage banks and other financial institutions to lend to the target group. The first was a government guarantee, FOGARIM, introduced at the end of 2003 in order to encourage banks to offer housing loans to the lower middle and lower income groups. The second was the elimination, in 2004, of the prohibition on micro-finance institutions making housing loans. The degree to which these measures have been successful is discussed in more depth later in the report.

Main Actors. The VSB program is supervised by a central committee chaired by the Prime Minister, supported by regional coordinating committees and provincial implementation committees. A special unit has been established by the Ministry of Housing and Urban Planning (MHU, *Ministère de l’Habitat et de l’Urbanisme*, and the Directorate of Social Housing and Land Development (DHSAF, *Direction de l’Habitat Sociale et des Affaires Foncières*) to manage the program. The main actors in the delivery of housing for lower income groups and of slum upgrading are as follows:

- *Government.* The Ministry responsible for the VSB program is the MHU, which also manages an off-budget subsidy fund, the *Fonds de Solidarité de l’Habitat* (FSH), a fund which is used to subsidize the cost of social housing units (typically in 4-5 story apartment blocks) which are provided for former

residents of slums subject to resettlement. The FSH obtains its revenue from a 10 percent tax on cement.

The government has also established a central guarantee—the FOGARIM—which is used to guarantee 70 percent of each bank mortgage loan to low-income individuals with irregular incomes who would normally not be eligible for these loans.

- *Donors.* International donors have provided substantial funds to the VSB, including about USD 90 million from the European Investment Bank for off-site infrastructure and VSB operations, and USD 65 million from the Agence Française de Développement (AFD) to the government’s parastatal developer, Holding Al Omrane. The EU has also made a grant of USD 117 million for social infrastructure in connection with the program.
- *Local Government.* All local governments are required to prepare comprehensive plans for the elimination of slums in their jurisdiction. They are also expected to provide sites free of charge to the developers of new social housing apartments. Sometimes central government land or land acquired from private owners is also used.
- *Banks.* With the provision of the 70 percent FOGARIM guarantee, commercial banks are expected to play an increasing role in the provision of loans for low-income housing purchase or construction.
- *Developers.* Private sector developers are encouraged to participate in the social housing market by the provision of tax incentives and serviced land by local governments. The parastatal, Holding Al Omrane, acts as the developer for many of the slum upgrading projects, and undertakes the construction of new housing and even new towns.⁴ Holding Al Omrane was founded in 2004 through an amalgamation of ANHI and about 18 other smaller agencies. Of the VSB projects for which we have data, Al Omrane had 52 percent. The remainder of the work is being implemented by private developers. All these projects are for residents of



Top and below: Apartment blocks in Ennakhil, near Casablanca, where residents from a nearby slum settlement are slated to be resettled.



⁴ Holding Al Omrane is essentially the new ANHI, except that it is a parastatal. Parastatal housing companies have until recently dominated land servicing, the construction of social housing, and the implementation of slum upgrading programs. Holding Al Omrane (HAO) was created in 2004, and charged with the elimination of redundancies and of restructuring the 10 parastatal companies into a single effective group, responsible for the implementation of nearly all of the VSB operations. The government’s goal is for HAO to move increasingly to land servicing and to disengage from the construction of social housing, in which the private sector is expected to get more involved.

Contractors and private developers are called upon to increase their role in the production of social housing, and in particular to build apartment blocks in the context of the VSB program. The government, via HAO, is ready to transfer to them urbanized land below market value, on condition that the subsidy is transferred to the buyers in the form of below-market sale prices of the housing units to make them affordable. [source: *Kingdom of Morocco: Poverty and Social Impact Analysis of the National Slum Upgrading Program*, World Bank. 2006, p24].

existing slums. While specific income data is not available, it is understood that the great majority of beneficiaries are below the median income group, and many are in the lowest quartile.

Developers are required to service the land given to them by the government and construct the apartments. So long as the apartments cost less than USD 25,000, they are eligible under the VSB program, and applicants will receive a purchase subsidy of 30 percent, among other subsidies (discussed below). Developers compete fiercely for this market. As a result, standards have risen and costs have fallen—unlike in many other countries. Not surprisingly, private developers are more interested in new housing than upgrading. Only one private developer is engaged in upgrading.

Microfinance Institutions (MFIs). Three years ago the government permitted MFIs to lend for housing. These loans are mainly used for incremental house construction or improvement, or for downpayments required to reserve a subsidized apartment. The role of MFIs is discussed in more detail in Chapter Two of the MicroReport.

Program components. The VSB program has four components, summarized below. The decision regarding the methodology to be adopted depends on the suitability of the land (in the case of in-situ upgrading), the availability of serviced land, resident incomes and other factors. The planning is undertaken by the local government in collaboration with the Ministry of Housing and Urban Planning, the communities concerned and other state agencies. The results of the planning process are embodied in the town-wide contract.

- ***On-site upgrading of existing settlements.*** This is the least disruptive and the most beneficial component, and more commonly done in areas that are older and more established. It consists of improving the infrastructure while allowing the residents to remain on their plot. This system applies to 29 percent of the participating households or about 70,000 households.
- ***Provision of apartment units.*** This involves the demolition of the existing settlement and resettling the residents in new apartments. These apartments cost USD 25,000, but thanks to a variety of subsidies, the majority only pay about USD 6,875. Currently, about 21 percent of the residents of slums (some 45,000 households) benefit from this program. The capital cost of the units is limited to USD 25,000, and purchasers must make a down-payment of USD 3,750. The government's FOGARIM guarantee provides a 70 percent guarantee to banks for loans up to USD 25,000 offered to low-income individuals to purchase these subsidized apartments. Borrowers typically borrow the USD 3,750 from an MFI to make an advance booking of

BOX 1: VOICES OF THE BENEFICIARIES

"...The architect came to show us his plans. He gave us the specifications, 100 apartments of 36 square meters, and others of 48 and 58.... They are going to construct apartment blocks. But the inhabitants absolutely reject this project. It is incomplete, because there was no consultation with the inhabitants.... What we prefer is that they leave us here and give us titles.... They are going to say to us, you must pay 120,000 MDH, then 50,000 MDH, but we shall be strangled with the bank at 700-800 MDH."

"...Among the new households who have come to live here are those from (a different neighborhood). They heard talk of resettlement under which they will benefit from a new apartment or building lot—that's why they bought here. They bought for 10,000DH or 15,000DH, and they are also owners of another property allocated to them. Inhabitants sell their apartments due to their financial situation. ... But all that is known to the authorities"

"...This type of housing suits rural people who have come to the city perfectly. . . But there are some people who live here and have other dwellings elsewhere. They only want to benefit from a new apartment. We must stop this speculation and corruption."

All quotations translated from French by the authors:

Source: World Bank: *Kingdom of Morocco, Poverty and Social Impact Analysis of the National Slum Upgrading Program, Final Report*, June 2006

the unit, and once the loan is approved from the bank under the FOGARIM guarantee, they pay back the MFI.

- ***Redevelopment and provision of fully serviced plots.***

This system applies to 35 percent of the participating households, some 75,000 of them. It involves the gradual redevelopment of the whole site into regulated and surveyed plots, by resettling families onto nearby land, followed by demolition of their houses and redevelopment of that portion, using the so-called domino approach. In this way, the settlement is totally redeveloped over a period of several years. As densities are reduced in the redevelopment process, the total amount of land occupied is considerably larger than that occupied by the original settlement, and also typically includes larger plots sold at market rate to cross-subsidize the poor (who typically get smaller plots). Under this system, the new plots are offered virtually free to households being resettled/ upgraded, but the occupants must build their own houses. The developer provides standard plans for a 3-storey house which the beneficiary is expected to adhere to: the bottom floor is for commercial use, and the middle and top floors are for residential use.



A focus group meeting with members of a community that are being resettled from a bidonville in Ennakhil, near Casablanca. RTI has been organizing the community and working with them to make the transition easier.

- ***Provision of partially serviced plots.*** This involves the provision of surveyed plots with minimum services and at minimum cost, on which families can build new houses. This system applies to 15 percent of the participating residents (about 20,000 households). The same considerations (as for fully serviced plots land) apply to the new sites, except that water and sanitation is not provided and building controls are typically not strict. It is, therefore, possible to build to lower standards, and hence easier for lower income families to build shelter.

LIMITATIONS

The VSB program is based on the concept of bringing all settlements up to a certain standard in terms of services. When upgrading programs are discussed with the communities, the project manager's task is to sell the concepts and the program to the residents, rather than inviting them to state what they want and what they will be willing to pay for it. There is thus a top-down approach which results in some households being forced into making payments for improvements to their environment for which there is no effective demand. Participation by the communities in plans for upgrading is still a rarity, and given the system of governance, the people for most part, expect to "follow the rules" and "obey orders." For example, we were told by a group of women in Ennakhil that when they protested the proposed resettlement, two of them were arrested for 6 months.

Many beneficiaries of resettlement programs cannot afford to build a formal house. It is not unusual, therefore, for them to enter into a contract either to sell the land when they are legally allowed to do so (after 5 years), or to allow someone else to build and use the house on the condition that they allow the beneficiary family to use the top floor (see Box 2 for an example). Some beneficiaries simply sell the new plot, and move to other areas to squat.

BOX 2: CASE EXAMPLE OF SERVICED PLOTS: OULAD MUBARAK, NEAR KENITRA

Started in 2004, this site is being developed by the parastatal Holding Al Omrane. They are resettling some 3500 slum households onto developed land. 50 hectares of new land have been acquired and serviced with basic infrastructure, and subdivided into plots. This is planned as a mixed income development, where the smaller plots for the poor are cross-subsidized by the larger plots sold at market rate to upper income families. The smallest plot is 63m², which is free for the slum residents, and sold at market rate to the middle-and upper income households. They, however, pay a third of the land servicing cost, about US\$2500. Al Omrane pays a third, and the government pays another third. The project is done in phases, and the land is developed as it gets vacated. There are no forced evictions; people are expected to pay the land development cost and move voluntarily. Most do, and are given house plans and building codes which they need to adhere to. Where people are unwilling to move, there is a due process of negotiation between the developer and the household. Where people are still resistant to moving due to financial reasons, they are sometimes allowed to build incrementally [starting with a basic temporary structure] as their resources permit.

Where households are moved to build a road or other infrastructure, they are given higher subsidy for the land development cost, for example, in this case they pay \$1200 per plot as opposed to \$2500 paid by other low-income households.

Limitations:

Duration: Given the phased approach, this kind of development takes longer periods of time than “greenfield” construction.

Targeting: Another hurdle is that of assisting beneficiaries with financing for house construction. In this case example, the FOGARIM guarantee was not available (since the project began prior to the introduction of FOGARIM). So people have to arrange their own funds for construction. Many have the money, “lots of money”, as the project officer says, to construct. But there are also those who are financially constrained who either sell off their plots to wealthier families and move to another slum, or make an arrangement with a wealthier household to build the house and occupy a part of it (for example, the beneficiary will occupy one floor, and the other household might occupy 2 floors). It is difficult to keep track of who has sold and who has retained the property, as the official title remains in the original beneficiary’s name. And while these records are computerized to avoid multiple allocations in different sites to the same person, which does something to control mismanagement, the extended family structure creates enough loopholes in terms of determining the real head of the household.

Plot size: While the plot size sounds reasonable, beneficiaries complain about being allocated only one plot per dwelling unit which might contain several families.



Left: Part of the slum settlement that remains to be resettled, and cleared/ redeveloped.

Middle and right: New construction by the bidonville residents on freshly allocated serviced plots. Most houses use perforated brick and concrete for construction, and follow the plan given to them by the developer.

If they have the means to do so, they can take a loan for house construction from a bank or MFI, but both categories of institutions are nervous about lending for construction (due to the high risk involved) and in most cases these loans are difficult to obtain. Also, there is a requirement that slum dwellings must first be demolished for the household to qualify for the purchase of the lots and/or to occupy them. This lag makes the transition even more difficult.

THE CITIES ALLIANCE PROGRAM

The Cities Alliance (CA) has made grants totaling one million dollars to provide technical assistance in the development and management of the VSB program. Among the objectives of the grant are the development of the FSH, and encouragement of the banks to enter the low income market. It also aims to work with the USAID's Local Government program to:

- Help residents obtain access to credit
- Obtain funds to invest in land development and bulk infrastructure
- Strengthen capacity of local government to manage local development
- Support local community groups in the design and management of projects

The CA program has a highly detailed framework of activities, including:

- the provision of technical assistance to the implementation of the VSB
- communications and conferences
- participation in pilot projects in two towns
- support for the evaluation of VSB
- the establishment of a research body to be called “study the efforts to improve sub-standard housing”

In addition, the grant provides for the development of training programs in connection with housing finance. One is a three-module training program aimed at bank borrowers to promote better repayment levels. A similar program is aimed at MFI borrowers—about 170,000 households are expected to be in this category.

The Cities Alliance grant has effectively been running for just over a year, so it is too early to analyze its impact on the VSB program. The indications are that it is filling a useful gap, but its activities are not yet mainstreamed.

Based on a survey conducted by CHF International, just over a third of borrowers from the lowest income quartile take loans from banks, as opposed to between 40 and 48 percent of those in the other three income quartiles. In contrast, and as expected, 41 percent of the poorest borrowers take loans from MFIs versus 28 percent in the other income quartiles (see Table 4). In this context, it would be interesting to investigate what percentage of each income quartile actually access loans; unfortunately this data is not available.

TABLE 4: MAIN SOURCE OF LOAN OF BORROWERS BY INCOME QUARTILE

Source of Loan	Income Quartile			
	Q1	Q2	Q3	Q4
Banks	36%	48%	40%	42%
MFI's	41%	28%	28%	28%
Consumer credit companies	19%	20%	26%	24%
NGOs	4%	4%	5%	6%

Source: *Practical Guide for Housing Microfinance in Morocco*, CHF International, prepared for RTI International/ USAID, June 2005, p11.

Mortgages are concentrated among the upper-middle income brackets. Outstanding housing loans are estimated at 13 percent of total bank credits. However, banks finance only 20 percent of all housing construction, leaving the remaining 80 percent to self-financing. We now present in more detail the financing options available.⁵

THE ROLE OF CREDIT ENHANCEMENTS

There are typically three problems in housing finance in developing countries, especially finance for poor households. These include: (i) the reluctance of formal financial institutions to lend to people with low and/or irregular income; (ii) the affordability of the product; and (iii) obtaining sufficient long-term capital in markets which are typically dominated by short-term government paper such as Treasury Bills, and personal savings. Governments and donors have responded to these issues by offering a variety of solutions from guarantees to stimulate lending, subsidies to address affordability, relaxing regulations on MFIs, and grants to cover start-up costs in low/irregular income markets. These solutions are discussed below.

There is more than sufficient liquidity in the markets in Morocco, but lending has traditionally been constrained due to a lack of security which could be offered by the majority of potential borrowers. To give the banks the security that they require in order to lend to lower income families, the government introduced the FOGARIM guarantee.⁶ It is targeted at low-income households with irregular and/or informal incomes. Commercial banks are guaranteed 70 percent of the principal balance in case of default, which comes from a fund managed by the Caisse Centrale de Garantie (CCG), a public agency under the purview of the Ministry of Finance and Privatization. For this purpose, the CCG manages a fund of USD 25M made available by the MUP with resources allocated from the Housing Solidarity Fund (FSH).

As a result of the reduced risk from the FOGARIM guarantee, banks can reduce the rate of interest of the loans. Loans are provided at a low fixed rate of interest (between 5 and 9 percent) for a maximum term of

⁵ Source: Morocco Housing Market: Industry Status, Government Involvement, and Investment Opportunity, Overseas Private Investment Corporation, January 2006.

⁶ It should be noted that banks also require land title for housing lending.

25 years.⁷ The maximum monthly household income for loan eligibility is USD 375, and the maximum loan amount is USD 25,000.

Under the system, banks have the duty to select the client. It is intended solely for people with irregular or low incomes, who do not already own a house and have not previously been the beneficiary of another state guarantee.⁸ Banks can, and do, eliminate people on the basis of bad credit history (though it must be noted that most clients are not banked, and therefore have no history as such), or factors such as extreme instability, bad character etc.⁹ It should, however, be noted that there are strict rules to protect the borrower against eviction by the bank for non-payment, including one that prohibits court action against the borrower until after he/she has missed nine monthly loan repayments.

The guarantee has transformed the market. Banks compete with each other in terms of service—approval speeds for example—and interest rates. They are responsible for assessing the risk, but can call the government’s guarantee only after nine months of default. Currently, the experience of the banks has been very positive, but, as all admit, these are early days. To date, the nine participating banks have made over 24,000 loans, and the guarantee has only been called upon in 24 cases.

Interestingly, a second guarantee by USAID to BMCE on a risk sharing basis of 50 percent was not utilized by BMCE. Banks preferred lending under the FOGARIM guarantee because it lowered their risk liability to only 30 percent. However, this could lead the bank to relax its credit analysis procedures, knowing their risk is far less than a typical loan. Other donors or governments are encouraged to design guarantees that are commercially oriented, requiring the bank to share risk equally.

SUBSIDIES

In addition to the credit guarantee, the government offers three major sources of subsidy to target financing for the poor.

- Land and infrastructure for VSB projects are not charged to the purchaser, i.e., they are free.
- Any developer who completes more than 2,000 “affordable” units in four years can claim exemption from Value Added Tax (VAT), which is currently 14 percent. This allows the price of the units to be reduced by a corresponding amount. Currently, there are discussions to reduce the ceiling to allow smaller developers to benefit.
- The units are subsidized 30 percent by the FSH.¹⁰

The research found that many of these subsidies are not effectively targeted to the poor and have loopholes that have led to extensive “leakage” to higher income groups. These difficulties are created through a combination of weak enforcement, such as inadequate verification of income, units being

⁷ The final loan payment must be scheduled before the borrower turns 60 years old.

⁸ Eligibility criteria for the FOGARIM guarantee include: Moroccan citizenship; proof of income generating activity, even if irregular but excluding public sector employment; proof that the beneficiary does not own other property; the beneficiary must not have previously benefited from a loan for the acquisition of social housing.

⁹ Eligibility criteria for the FOGARIM guarantee also includes: Moroccan citizenship; proof of income generating activity, even if irregular but excluding public sector employment; proof that the beneficiary does not own other property; the beneficiary must not have previously benefited from a loan for the acquisition of social housing.

¹⁰ Fonds de Solidarite de l’Habitat, a fund managed by the Ministry of Housing and Urban Affairs and financed by a ten percent tax on cement.

purchased and left vacant, re-sale by the poor to speculators, and the actual design of the subsidy itself (the size of the subsidies and the ability to serve the target groups). The subsidies have also led to mispricing, as the market value of the products offered are substantially higher than the sale price. This has led to many allegations of corruption and abuse of the allocation systems by which a proportion of the units are sold to people who do not need the subsidy. For the rest, which are occupied initially by the poor, the general prognosis is that before long a substantial proportion of the original beneficiaries will sell out and return to live in unregulated housing.¹¹

Countries with similar programs have avoided these limitations through clauses which require beneficiaries to live in their homes for a minimum number of years. Additionally, other programs sometimes require the community to approve any new tenants or sale of property to ensure the residents are not selling in order to profit from the scheme. In general, subsidies when appropriately designed and targeted can bridge the affordability gap of the poor in escalating real estate markets, such as in Morocco. But strict monitoring and oversight is required to ensure the subsidies reach the intended beneficiaries.

TARGETED DONOR SUPPORT

USAID has had a long relationship with micro-finance institutions (MFIs) in Morocco, having provided seed capital and technical assistance to the largest MFI, Al Amana. However, it soon became clear that unless Al-Amana had access to increased and sustainable sources of funds, they could not meet their clients' demands. Request for financing from banks had not been successful as MFIs were not considered a sufficiently safe investment.

The financial sector was sufficiently liquid, but primarily invested in treasury bonds. USAID used their Development Credit Authority (DCA) to guarantee bank loans to MFIs.¹² Two MFIs, Al-Amana and Zakoura, each received portable loan guarantees, which allowed them to select lenders on a competitive basis. The DCA reduced any perceived risk of MFIs by legally ensuring a 50% repayment of any default by the MFI. The second stage provided loan portfolio guarantees directly to banks, which could then lend guaranteed funds to any qualified MFI.

DCA guaranteed loans to MFIs in 2002 totaled USD 5M. Once the success of this system had been established, lending increased to USD 10M in 2004. Other organizations have also provided guarantees, most notably the AFD. In this way, banks became more comfortable lending to MFIs, and experience showed that MFIs were a good credit risk. Today, MFIs can readily borrow on the commercial market, and representatives of both banks and MFIs report that guarantees are no longer considered necessary.

Thus USAID was able to build upon their earlier work of providing grant funds for start-up costs for Al Amana, by using the DCA mechanism to achieve the essential economies of scale, and to use guarantees as a catalyst to facilitate housing lending to poorer segments of the population. Without these guarantees, it is very likely that the MFIs would have been unable to grow to meet the demands of the market, or that such growth would have been much slower.

¹¹ Personal interview, Leila Akhmiss, Zakoura. See also *La Vie économique*, 8 July 2007.

¹² For a full treatment of this topic see DAI: Review of DCA Credit Guarantees for MFI Access to Commercial Credit in Morocco, Accelerated Microenterprise Advancement Project (AMAP)/USAID, microREPORT#67, Bethesda, 2006.

Donor support has also been provided to assist banks to serve this new market, particularly regarding their loan underwriting procedures and customer service standards. These issues are discussed more fully in the next chapter.

CHAPTER TWO

ROLE OF BANKS AND MFIS

The Moroccan government and international donors have invested significantly in providing incentives to banks and MFIs to bridge the affordability gap in housing finance for the urban poor. This chapter examines the role of the private sector and MFIs in providing finance options to various target markets, and how these financing options are supported or limited by current government programs. We begin with an analysis of the FOGARIM guarantee program offered through the formal banking sector, and then consider products and services offered by MFIs.

ROLE OF BANKS

The FOGARIM program has led to a significant increase in the number of housing loans being made by banks. Banque Marocaine du Commerce Extérieur (BMCE), Morocco's third largest commercial bank, found that the guarantee has resulted in considerable competition on interest rates and service. For example, BMCE tries to give credit approvals within 12 working hours, and by so doing, they clearly hope to get the business of the applicant. They have developed new criteria for loan underwriting for people in this category, but admit that this market has large variations, and that they do not feel very comfortable with certain segments of it. For example, banks consider that residents of slums—as opposed to those with informal sector jobs who reside in formal housing—present a higher risk. Banks face a number of challenges in serving this new market, as discussed below.

Risk assessment. The biggest problem for banks is to assess the risk of lending to people with irregular incomes—a requirement to be eligible for the FOGARIM guarantee. As the usual systems of checking the operation of bank accounts, tax records, salary records etc. do not apply, they must adapt to a totally different environment. One of the banks most active in the market, BMCE, has taken the interesting step of engaging the MFI, Zakoura, to act as its credit screener (see Box 3). Zakoura has the credentials of having worked with the informal sector for many years, and its staff are therefore able, quite quickly, to verify the financial circumstances of its clients.

Zakoura uses indicators such as the appearance of the home, the personal assets, the word of neighbors, and an appraisal of the person's business. The last is, of

BOX 3: CREDIT VERIFICATION FOR FOGARIM LOAN, CARRIED OUT BY MFIS

BMCE sends potential borrowers to Zakoura for screening (for a fee of USD 50 per applicant), which they are better suited to do since their loan officers specialize in serving the poor. The screening includes checking the character of the individual, his or her income level, and residency. They then prepare a dossier for the loan application, which includes the following: declaration acknowledging debts and repayments; ID; residency certificate; non-tax-paying certificate (from the Tax office); copy of the reservation of the apartment; Agreement of Sale from the developer; and the loan application.

A photograph of a loan application form. The form is titled 'ATTESTATION DE NON IMPOSITION A LA TUTE' and includes fields for personal information such as name, address, and profession. It also features a section for 'Déclaration de la Profession' and 'Déclaration de la situation fiscale'. The form is filled out with handwritten text and includes several red circular stamps, likely from the bank or the MFI. The date '2007' is visible at the bottom left.

The photo is an example of the loan application.

course, crucial, and Zakoura has established income norms for a wide variety of enterprises. Zakoura prepares a credit appraisal, and ensures that all the paperwork is complete, before sending the dossier to the bank, at which point the bank takes the final decision about whether or not to approve the loan. The MFI receives a service fee of USD 50 for each screened dossier. If approved by the bank, Zakoura advances a loan to the applicant for the down payment (USD 3750 at 19 percent annual interest for up to 3 years), until the full USD 25,000 loan is approved by the bank (at an interest rate of about 5 percent for 20-30 years). In this way, MFIs are a critical component in extending housing credit to the low-income households.

Client relationship management: Typically, the residents of slums have no relationship with banks: they often view them with fear and suspicion. To overcome this gap is not easy. One measure which has been adopted with technical assistance from ShoreBank International, funded by the Consultative Group to Assist the Poor (CGAP), has been to train credit officers of banks to serve this market. A series of training workshops has been planned (the first of which has been held) for this purpose. The reaction from the banks has been very favorable, and they have requested that the program be extended.

Another problem is that bank branches are often located far from the potential borrower's homes and workplaces, are only open at restricted hours, and appear intimidating to slum dwellers. There is a need for the banks to adjust their style and public face to become more accessible to their new market.

To overcome this problem, ShoreBank pioneered the establishment of "retail platforms"—one-stop shops—at which clients can be assisted in identifying the best deal from banks, and get support in preparing and processing their applications. They also receive education in how the loan system operates and in financial management. For more detail on ShoreBank's work, see Box 4.

To summarize, the banks have shown themselves willing to lend to a lower market segment, and a competitive market has been created. This has surprised many observers, and is evidence of the impact of lowering risk through the Government's FOGARIM guarantee. The guarantee gives banks an opportunity to capture an additional segment of consumers while, at the same time, promoting themselves in terms of corporate social responsibility by offering services to disadvantaged groups.

PROGRAMS OFFERED BY BANKS

The question here is what percentage of the population benefit from these new arrangements. To answer this question, three different types of FOGARIM guaranteed loans are examined below:

- ***Social housing apartments.*** The first category of the population is one that purchases social housing apartments at USD 25,000. With interest rates varying between 5 and 9 percent, as shown in Table 5, monthly repayments will be between USD 165 and USD 225 (assuming a repayment period of 20 years). Considering 25 percent of household income as an affordable level for housing costs, the lower figure of USD 165 would require a monthly income of USD 660. As Tables 1 and 3 showed earlier, the vast majority of the population—close to 70 percent—has a monthly household income less than USD 660. This raises the issue of affordability and effectiveness of subsidy targeting, discussed in more detail in the next section.

BOX 4: SHOREBANK—BRIDGING THE GAP

A problem faced by many financial institutions trying to enlarge their markets by serving the poor is a lack of knowledge, understanding and trust between the two parties. This manifests itself in two ways—the poor are intimidated by the grand buildings, the smartly dressed and aloof staff, and the unfamiliarity with what is expected of them. Also, the remoteness of bank branches and the restricted opening hours make it difficult for the poor to use conventional banking facilities. For their part, the banks are not confident that people whose incomes are low and often irregular can repay loans. Bank staff often have negative stereotypes about the poor, and are resistant to serving in poor neighborhoods and slums.

With support from the USAID Global Financial Innovations Partnership and the Consultative Group to Assist the Poor (CGAP), ShoreBank International has been successful in promoting the low income housing market as a viable market, and in bridging the gap between commercial bank operations and the needs of slum inhabitants eligible to be relocated under the VSB program. SBI has done so in five ways:

Demand Studies

Shorebank conducted housing finance demand studies in Fez and Rabat/Sale. These studies firmly established that there was a wide range of income levels within the slums, and demonstrated the extent of effective demand for housing finance in these communities.

Retail Lending Platforms

SBI assisted commercial banks (initially BMCE (Banque Marocaine du Commerce Extérieur), and subsequently other banks), to develop retail lending platforms in pilot sites, under the aegis of the local government. These facilities are one-stop shops where developers, banks (and in future, micro-finance institutions) and notaries are located at an office near the target clients. Thus slum-dwellers can select the product that they wish to buy, the bank with which they wish to do business, and sign all forms necessary for a loan, all in one location and with coordinated services.

Training

Shorebank provided a combination of classroom training and mentoring for loan officers to appreciate the economic and physical realities of the lives of their new, poor, client base and to appraise their credit-worthiness from a different perspective.

- Three BMCE field staff, including one branch manager, received intensive training on loan underwriting for the new housing product. Due diligence activities, including visits to the client's micro-enterprises, were conducted by BMCE's staff with SBI's support.
- Classroom trainings of 20-25 people including loan officers and branch managers on underwriting have been held. Mentoring activities complement the classroom trainings to ensure that loan officers working on the pilot sites have the necessary skills to serve this target segment in a safe and sound manner.
- BMCE's monitoring and collection policies and procedures based on a review of actual practices at the bank's headquarters and branches were also reviewed.

This training was complemented by a Training of Trainers (ToT) curriculum designed to enable project staff engaged in the social aspects of development on the pilot sites to deliver financial literacy training to slum dwellers through innovative methods designed for illiterate populations.

New Product Development

SBI provided extensive advice to BMCE Bank on the design of a construction loan product tailored to this target market. SBI also offered specific advice to BMCE on tailoring a micro-construction product to the needs of the Cities Without Slums' beneficiaries. The purpose of the provision of this TA is to enable BMCE to serve most of the slum dwellers targeted by the Programme (60 percent of 270,000 households by 2010). (BMCE has not yet launched this product.)

Simpler Paperwork

SBI tailored BMCE's loan documentation and forms to better work with the characteristics of the target market. Furthermore, the bank documentation was modified to incorporate cash flow analysis and character-based lending. BMCE is currently in the process of getting internal approval to use the revised documentation.

- **Subsidized apartments.** The second category is those who are resettled into apartments under slum upgrading programs who receive the apartments at a subsidized rate of about USD 6,250. The monthly repayment will be between USD 41 and USD 56, requiring a monthly income of USD 164 to USD 224. Using the information Table 2 as an estimate of income levels in the slums, approximately half of slum dwellers may have an income that could support these payments.¹³
- **Serviced plots.** The third category is those who build on serviced plots under a slum upgrading program who also require a minimum of about USD 7,500 to complete a habitable dwelling. This means monthly payments of between USD 49 and USD 67, and monthly income between USD 196 and USD 268. Again using the information Table 2 as an estimate of income levels in the slums, approximately half of slum dwellers may have an income that could support these payments.

TABLE 5: MONTHLY PAYMENTS FOR TYPICAL LOANS OFFERED BY BANKS

Type of Housing Option	Total Approx. Cost to Beneficiary (USD)	Monthly Payment for Varying Interest Rates	
		5%	9%
Social housing apartments (purchase)	25,000	165	225
Subsidized apartment units (resettlement)	6,250	41	56
Serviced plot	7,500	49	67

LIMITATIONS

Targeting and affordability. Here, we discuss the housing costs associated with the guarantee in the context of the target income groups. The mean monthly household income for the lowest income quartile is USD 289.¹⁴ The household's net income, which is total income minus all non-discretionary spending, is USD 49. Assuming the expenditure on housing that is "affordable" to be 80 percent of the net income—which is more conservative but more realistic than the conventional assumption of 25 percent of total household income—the household will be able to spend USD 39 per month on housing (see Table 6).

TABLE 6: INCOME AND AFFORDABILITY BY INCOME QUARTILE

Income Quartiles	Q1	Q2	Q3	Q4
Mean Household Income per month (USD)	289	455	601	931
HH Income range (USD)	88-375	376-512	513-687	688-4000
Max payment (25% of total income)	72	114	150	234
Max payment (80% of "net" income)	39	63	88	175

Source: *Practical Guide for Housing Microfinance in Morocco*, CHF International, prepared

¹³ As shown in Table 1, income levels below USD 177 cannot afford any housing expenses given other consumption requirements.

¹⁴ Source: CHF's *Practical Guide for Housing Microfinance in Morocco* (2005).

for RTI/ USAID, 2005, pp 9-10. [MDH converted to USD]

Some examples of loans and monthly repayments at current commercial bank lending terms (loans up to 25 years, and an average fixed-term interest rate of 7.5 percent) are presented in Table 7.

TABLE 7: SAMPLE LOAN AMOUNTS AND MONTHLY PAYMENTS AT CURRENT MARKET RATES

Loan amount (USD)	Maturity (years)	Annual Interest Rate	Monthly payment (USD)
3,750	10	7.8%	45
6,250	10	7.0%	73
12,500	15	7.0%	112
12,500	20	7.0%	97
15,000	20	7.5%	121
15,000	25	7.5%	111
25,000	20	7.0%	194
25,000	25	7.0%	185

Source: Kingdom of Morocco: Poverty and Social Impact Analysis of the National Slum Upgrading Program, World Bank, 2006, p 40.

In other words, the lowest income quartile can afford none of the payment options currently offered by banks. The second and third income quartiles can afford the subsidized units (in case of resettlement mostly), but not the independent purchase of the apartments. Only the highest income quartile can afford the apartment units being sold at market rate. These figures demonstrate that formal sector housing finance can be effective in reaching the poor, but there are, and always will be, a section of the population which it does not serve.

For a household with a monthly income of between USD 500 and 625, the formal sector apartment blocks are clearly an attractive option, provided that the location is appropriate and the accommodation itself is sufficient. However, as discussed earlier, most in the lowest income quartile do not have such incomes, and do not qualify for even the USD 3750 down-payment loans with the MFIs.

Another issue is that the last monthly payment for a FOGARIM guaranteed loan should be made no later than the borrower's 60th birthday. This is a constraint for borrowers 35 years and older, who have to take shorter



Above: Zakoura's branch office in one of the local communities in Casablanca—an apartment converted into a small office—where the loan officer reviews the loan applications.

Below: Clients meeting with the loan officers.



term loans, and thus face higher monthly payments. In addition, there is a cap of USD 188 to the monthly repayment which further limits eligibility for borrowing larger amounts.¹⁵

Leakage of the subsidy. As suggested by Zakoura and several other interviewees, the eligibility requirements for the FOGARIM loan are lax in terms of targeting the subsidy to the needy. An applicant need only provide a “statement of honor” declaring the income, which must be less than USD 375 per month to qualify for the loan guarantee. In other words, there is no real verification of income by the banks. Although there is increasing collaboration between the banks and MFIs to improve due diligence, according to the formal rules of the subsidy, anyone without a regular salaried income (i.e., not paying income tax) but stating that their income is below USD 375 can apply for the FOGARIM loan to buy the apartment. As a result, many of these so-called low-income houses are being bought by wealthy speculators, leaving little housing stock available for the poor.

There are also claims that several members of the same extended family apply for several loans under the FOGARIM guarantee, and buy multiple subsidized units as a form of investment or for future use. Of more concern is the fact that these units typically lie vacant for years, given the pro-tenant regulations which make eviction difficult.¹⁶ Although the phenomenon of poor targeting and subsidy leakage is common in many countries, in Morocco this problem is severely undercutting the government’s attempts to address quantitative shortages of decent, affordable housing, since many of the units remain vacant. According to the World Bank study, there is a risk that banks will be mostly financing the acquisition of apartments priced at USD 25,000 (see Box 5). Unfortunately, this clientele differs significantly from the one originally targeted by the FOGARIM.¹⁷

BOX 5: TARGETING THE POOR?

“...There has been too much speculation in the last few years. The rich are buying up all the so-called ‘low-income’ units that are being sold under the FOGARIM guarantee. Eventually, none of the apartments that are being built for the poor are going to go to be left for the poor. The only option then will be to focus on construction loans....

The same applies to new towns. In Tamasna, for example, the middle class and foreigners are buying up the houses. As a result, the poor are being forced to live in the rural areas and come to town to work. There are no more handicrafters living in the medina anymore... it’s too expensive to live in town.”

- An interview with a senior official from an MFI (September 2007)

To minimize leakage of the subsidy, there is a need for closer scrutiny in the management of the housing stock to control corruption, and a review of eligibility criteria and the percentage of loan being guaranteed. The 70 percent guarantee seems to be a disincentive for banks to conduct adequate due diligence.

Exclusion of lower-middle income groups with irregular incomes. A common problem is that people working in the informal sector do not fit banks’ traditional underwriting practices as they lack the paper-based certifications regarding income. This has excluded many households who have the ability to pay, but whose income does not fit traditional criteria.

¹⁵ Kingdom of Morocco: Poverty and Social Impact Analysis of the National Slum Upgrading Program, World Bank. 2006, p40. Opposition politicians have advocated government provision of free housing.

¹⁶ Home ownership rates increased in Morocco during the 1990s, from 65 percent in 1995 to 74 percent in 2001, reflecting greater urban home ownership, which increased from 53 percent in 1995 to 62 percent in 2001. [source: Royaume du Maroc, Haut Commissariat du Plan, Direction de la Statistique, Indicateurs Sociaux 2002, cited from Practical Guide for Housing Microfinance in Morocco, CHF International, prepared for RTI/ USAID, 2005]. In June 2005 it was estimated to be 78% (Program Document, Housing Sector Development Policy Loan, IBRD, June 1, 2005).

¹⁷ Kingdom of Morocco: Poverty and Social Impact Analysis of the National Slum Upgrading Program, World Bank. 2006, p40.

Take for example, informal sector workers like taxi drivers, who earn enough, approximately USD 500, to make a mortgage payment. Banks, however, are unwilling to lend to them, since their income exceeds the maximum to qualify for the FOGARIM guarantee. MFIs like Zakoura, on the other hand, hesitate to lend to them because they do not fall within their definition of the “poor”. Moreover, even if they did, the cost of housing (of the right size and in the location of choice) is at least 2 or 3 times the amount that the FOGARIM guarantee offers. So, while this group can pay, they have no financial institution or program that can make it possible for them to buy a house.

Need to adapt to the new market. There are many new risks faced by banks in entering this market: limited knowledge of the target population, wariness of placing long term financial assets with economically weak clientele, the high transaction cost of reaching out to an unfamiliar and uninformed public, and the political risk of wide spread defaults encouraged by opposition political leaders.¹⁸

Banks were not ideally positioned to serve this market, either in terms of the location of branches, or in terms of their procedures and culture.¹⁹ Some banks are using donor-funded programs to re-train their credit officers to work in this market and develop more appropriate systems for credit appraisal.

The Retail Platforms (discussed above), are meant to include all stakeholders, including representatives of the developer, bank, MFI, and local government. However, MFIs like Zakoura claim that they have yet to be invited to sit in these discussions. This is unfortunate since this is the critical stage in the overall financing cycle: this is when the MFIs can effectively play the interconnecting role between the formal sector institutions (banks and developers) and the informal sector clientele, and contribute to developing a more efficient housing product in terms of its financing as well as its physical form.

Social and economic implications of resettlement. Resettlement has social and economic implications which affect the poor to a greater degree than higher income groups. The economic challenges include:

- The family is moved to a more remote location. While there are cases where the new housing is very close to the location of the settlement being demolished, there are also those, especially in Casablanca, where convenient sites are not available, and the community is moved to a location many kilometres away. For people with employment this may impose substantial transport costs for the journey to work, and for informal sector workers it may remove them from their marketplace.
- Rules in the new housing—as in all formal sector housing—will not allow residents to trade from their houses and/or use them as workshops. This may mean additional expenses for residents who had previously traded from home.
- The new apartments are smaller than many slum dwellings. This may cause the break-up of the extended family, and consequent additional housing expenses and familial social security.
- The new apartments, affordable though they may be in theory, consume household income that was previously applied to household enterprises or social expenditure such as health or education. For example, water and electricity, which the beneficiaries previously got for “free” in the bidonville, must now be paid for.

¹⁸ Kingdom of Morocco: Poverty and Social Impact Analysis of the National Slum Upgrading Program, World Bank. 2006, p. 26.

¹⁹ The FOGARIM was established in December 2003, but by the end of 2005, it had backed only 2900 loans, of which only 600 went to the beneficiaries of the VSB program. This indicates the hesitation felt by banks initially. This has now been largely overcome through the ShoreBank training initiative and similar measures being undertaken under the Cities Alliance grant.

Although some may resist resettlement; for many it offers a substantial opportunity to upgrade their housing, at a cost which is affordable. Moreover, they realise that the subsidy offers them the potential for future windfall profits if they so choose.

Overall these programs have brought very important and effective changes in the system, which have transformed the financial landscape for lower income groups. Many of these reforms are relatively new, and efforts to address the limitations are underway. The limitations highlighted are intended to help further fine-tune these programs to make them more efficient and effective for the poor.

ROLE OF MICROFINANCE INSTITUTIONS

Microfinance in Morocco has expanded dramatically in the past ten years, and is increasingly being seen as an essential component in providing housing finance for the poor. The industry has been helped substantially by capitalization and technical assistance from donors, including USAID. Microfinance institutions are, by law, established as non-profit organizations. The majority of the micro-finance loans are solidarity group loans for business. Indeed, when the government legislated micro-finance, it was restricted solely to business loans. In 2004, however, the legislation was changed to permit lending for housing—possibly in recognition of the fact that some of the enterprise loans were finding their way into housing. Still, housing remains a comparatively small part of the MFIs portfolio.

Today, the microfinance industry has 1,045,215 loans outstanding, of which the biggest four institutions account for the vast majority (Al Amana—39 percent, Zakoura—35 percent, FBP- 13 percent and Fondep- 7 percent).²⁰ They employ a total of 4,327 personnel, and have a loan book of about USD 435 million. Al Amana ranks 15th in the world in terms of the number of active loans, while Zakoura is 19th in the world. Al Amana holds 4 percent of its loan portfolio in individual housing loans. In the case of Zakoura, housing loans constitute 10 percent of their portfolio.

²⁰ Source: Association Al Amana Pour la Promotion des Microentreprises: Rapport d'Activité 2006, cited from Al Amana Annual Report 2006

TABLE 8: HOUSING LOANS AMONG SELECT MFIS

	Al Amana	Zakoura	FONDEP	AMSSF-MC	FBPMC
Status	Pilot launched July 04, 16 branches Casa	Improvement pilot launched Sep 2004	Launched Mar 2005; 4 branches	-	-
Purpose of loan	Improvements; purchase	Improvements; add utilities; rural construction; social housing purchase	Improvements; purchase	Improvements; purchase	Improvements; purchase
Active loans (April 2005)	876 (2005) 1700 (2006, source: Al Amana annual report)	400 improvements; 1000 utilities; 97 rural; 30 purchase	20 (est.)	Information unavailable	Information unavailable
Portfolio	7.5M MDH (2005) 153M MDH (2006, source: Al Amana annual report)	6M MDH (est): 1.6 M purchase, 800K improvements; 1.3 M rural; 2.3 M utilities	Information unavailable	Information unavailable	Information unavailable
Amounts	3,000-30,000 MDH	2,000-5,000 MDH; utilities up to 10K; purchase up to 30K	3,000-30,000 MDH	3,000-30,000 MDH	3,000-30,000 MDH improvements; up to 50K purchase
Avg. amount	10,500 MDH	4K MDH improvements, 2K utilities; 13K rural; 27K purchase	Information unavailable	Information unavailable	Information unavailable
Term	6-36 mths	Improvements 6-18 mths; utilities up to 36 mths; purchase up to 60 mths	6-24 mths	6-24 mths	Improvements 6-36 mths; purchase up to 60 mths
Repayment frequency	28 days; 14 days	Monthly	monthly	30 days	28 days
Interest rate	29% DB<6000; 27% DB>6000	18% flat improvements and utilities up to 5K; others 12%	24% improvements; 20% extension; 15% purchase	18-24% flat	14.4% flat improvements; 12% purchase
Guarantees	Contract; promissory note; claim on bank account; lien on business or mortgage for entrepreneurs >6K MDH	Contract; promissory note; no guarantor	Guarantor, promissory note; mortgage if purchase	Co-signer spouse or family member; up to 3 guarantors; claim on bank account	Promissory note; letter of engagement
TA to clients	Budget verification; price list	Budget verification; price list	Budget verification; price list	Budget verification; price list	Budget verification; price list
Amount financed	80% if <10K MDH; 70% if >10K MDH	100%	90%	90-95%	80% improvements; 90% purchase

Source: Practical Guide for Housing Microfinance in Morocco, CHF International, prepared for RTI/ USAID, 2005 [Note: loans for "purchase" include downpayment loans]

PRODUCTS OFFERED BY MFIS

Table 8 presents some of the key characteristics of housing loans offered by select MFIs.²¹ In many ways, these MFIs complement each other in terms of their target groups: for example, Zakoura targets the poorest, while Al Amana is a little more upmarket. They report bad debts of less than 0.5 percent of their total portfolio, and are continuously expanding their markets. MFIs provide housing loans to existing customers with whom they have established trusting relationships.

There are three differences between housing loans and enterprise loans which affect the management and financial structuring of an MFI. The first is that the majority of enterprise loans use the group solidarity system as a form of collateral. But for housing, individual loans are preferred and MFIs must find alternative ways to establish repayment capacity and ensure repayment. The second is that enterprise loans are typically short-term, ranging from 6 to 12 months, while housing loan terms range from 18 to 36 months. The third is that enterprise loan sums are fairly small, at least for the vast majority of borrowers, hence the risk as well as the demand for capital from the MFI is lower. MFI housing interest rates range from 12 percent to 29 percent. While microenterprise loan rates may be higher, interest rates can become a bigger challenge to affordability when spread over a longer period of time.

Three different types of loans are offered by the MFIs, which are described below.

Loans for house construction. A very small number of housing construction loans (about 1 percent of the total) are being provided. MFIs are aware of three potential risks—that when the loan is spent, the borrower will not have completed the house due to an underestimation of the costs involved; that the house will be substandard; and that the proceeds of the loan will be diverted to other purposes. In addition they feel neither competent nor willing to monitor construction on a regular basis. USAID's Local Governance program is providing training to MFIs in construction cost estimation, and it is hoped that it will help them gain the confidence they need to expand their lending in this field.

Loans for house purchase. These constitute another small sector, but there are about four times as many as there are construction loans. MFIs are limited by law to a maximum loan amount for housing purposes of USD 6,250. Given that a house costs substantially more, these types of loans are taken by those who have multiple sources of funds, for example when the borrower already has substantial savings or the property is very small or in poor condition.²² In total, these loans above constitute only about 5 percent of housing loans held by the two largest MFIs.

Loans for house improvement. These are the most common loans, and the portfolio is growing rapidly. Loans are for improvements such as plumbing, extra rooms, and finishes. Borrowers typically take a series of loans and achieve progressive improvements over a period of time. The maximum loan amount is USD 2,500. These loans are a niche product for MFIs, especially if the improvements lead to improved incomes as well, for example providing space for business activities or constructing an additional room to rent.

Loans for house down-payments. Social housing units developed through the various government programs can only be secured by paying a deposit of USD 3,750. Most poor people cannot raise such

²¹ This data is cited from a 2005 CHF report [Practical Guide for Housing Microfinance in Morocco, CHF International, prepared for RTI/ USAID, 2005], hence some of the information might be outdated.

²² Typically, a basic unit of 60m² in a formal building will cost in the range of USD 18,750-25,000.

sums (although some obtain funds from family sources) and therefore borrow from MFIs to do so. In such situations, speed is of the essence, as there is considerable competition for the units. As discussed above, MFIs provide loans for the down payment to secure the unit.

Typically these loans are maintained for 2-3 years before the house is actually constructed and the borrower receives approval of the full bank loan. The bank loan, once approved, is typically used to pay the balance of the more expensive MFI loan. The bank loan will only be approved if the MFI loan has been repaid, or is incorporated in the larger house loan. After this period of time, the underlying land value will often have appreciated considerably, so that the two loans together—from the MFIs and the banks—are in aggregate considerably below the house-cum-land value. This result gives borrowers stronger incentives to continue to repay the loan because they have their own wealth at risk.

LIMITATIONS

Affordability. MFI housing loan interest rates are currently typically 19 or 20 percent, thus a person borrowing USD 3,750 over a period of the maximum term of three years will be required to pay about USD 125 per month. As we have seen in the discussion of loan carrying capacity (Table 6), this is not affordable for the lowest quartile, and barely affordable for the second quartile.

As shown in Table 9, a loan of USD 1,250 at a 24% annual interest rate will take about 4 years for someone in the lowest income quartile to pay off and still be affordable. Since the maximum loan term available in the market is 3 years, no one in the lowest income quartile can carry this loan. A loan of USD 3,225 is not affordable to the poorest quartile unless the interest rate is much below the current market rate, or stretched to a much longer repayment period.

Exposure to risk. As mentioned earlier, MFIs like Zakoura only lend for housing once the borrower has established some sort of credit history with them (through a prior enterprise loan etc.). Still, there is no denying that housing loans—given their relatively large size, and limited recourse in case of default—present a real risk to MFIs. Unlike banks, which are protected by the FOGARIM guarantee, and also have the ability to foreclose and acquire the mortgaged property in case of default, the types of loans that MFIs offer have little or no such protection. The MFIs have only a subordinated lien against which to recover their money. This exposes them to a greater risk, which is why they have been hesitant to lend for housing. This is evident from the fact that house purchase down payment loans are still rare, and construction loans very uncommon.

TABLE 9: LOAN REPAYMENT PERIOD (YEARS) AT VARYING INTEREST RATES

	Payment (USD per month) by income quartile	12%	18%	24%	36%
Loan amount: USD 1,250 (MDH 10,000)— average cost of home improvements	39 (Q1)	3.2	3.5	4.2	9
	63 (Q2)	1.85	2.0	2.1	2.5
	88 (Q3)	1.3	1.3	1.4	1.6
	113 (Q4)	1.0	1.0	1.0	1.1
Loan amount: USD 3,225 (MDH 25,799)— average amount of loan desired, according to CHF's survey	39 (Q1)	14.5	*	*	*
	63 (Q2)	6.0	8.0	*	*
	88 (Q3)	3.8	4.4	5.5	*
	113 (Q4)	2.8	3.1	3.6	5.5

Source: Adapted from *Practical Guide for Housing Microfinance in Morocco*, CHF International, RTI/ USAID, 2005, p17. [MDH converted to USD]

Loan size. Microfinance lending may be more sustainable than the FOGARIM guarantee which is vulnerable to political pressures as well as to long term interest rate and financial pressures. The MFIs are increasingly willing to get into the housing market. They are being courted by private developers who see their flexibility and willingness (compared to banks) to take risks, as well as their commitment to serve poor and low-income clients, as important factors in helping them access customers. However, MFIs currently offer only small loan amounts. Despite their success in commercial borrowing, MFIs are still capital constrained, which limits the volume and size of housing lending. MFIs also suggest that the banks are not seeking their participation in the retail platforms, which could potentially lead to larger loans (see Box 6).

BOX 6: USING MFIS TO REACH THE TARGET POPULATION

"...We [the MFIs] need to be there before these apartment buildings are built for the target [low-income] population, and before people book their units. The promoters and financiers of such projects should be consulting with us closely during the initial project planning stages, not at the end of the project when all the decisions are already made. We know the target population well, and we can serve as the link that communicates what the people want and need and what the developers build and deliver.

At the same time, we work for the people, and ethics dictate that we are not in any sort of 'partnership' with the developers... after all, we are not commercial agents of the developers.

But we do have an important role to play, which we should be doing, but are not doing enough yet. As much as the banks claim to be involving us on the Retail Platform, we have yet to be invited even once....."

- An interview with a senior official from an MFI (September 2007)

CHAPTER THREE

HOW EFFECTIVE ARE THE INCENTIVES?

Here we will concentrate on analyzing the impact of the various players in the housing finance market. :

- How well is the policy being translated into housing improvements and delivery of increased number of housing units (housing supply)?
- How well are banks and micro-finance institutions performing in the provision of long-term finance for housing (housing demand)?

HOUSING SUPPLY LIMITATIONS

There is little doubt that thanks to the FOGARIM guarantee, the VSB program, and the existence of a strong microfinance system, housing finance in Morocco is one of the most poor-friendly in the world. However, there are limitations which must be noted from the supply side.

Limited land supply. The government-led system of providing social housing is not producing adequate quantities to meet the demand. In the major centers, and most especially in Casablanca, the supply of land is inadequate and more importantly, the supply of well-located land is very limited. Under the present policies, even if in-situ upgrading is undertaken, there is a tendency to reduce densities.

The reasons include land shortages, bureaucratic delays in relation to land survey and titling, town planning and building controls. This is even more pronounced in redevelopment projects. For example, in an informal settlement of 1,000 households, which has density of 200 dwellings per hectare, only 500 households will be resettled on the same site as plot sizes in the redeveloped scheme are larger. Moreover, only one household per dwelling is re-housed which means that tenants and extended family members (in case of large families) must go elsewhere. Moreover, according to a World Bank report, many of the towns do not have adequate vacant public land to carry out upgrading and/or redevelopment to meet the VSB targets (see Box 7).



A competitive private bank, Wafa Immobilier, offering a lower interest rate to capture a segment of the low-income market. This poster was displayed in the community center for a low-income settlement.

Housing development. Partly due to the lack of suitable land, partly due to ponderous land planning and regulatory systems, and partly due to budgetary constraints for infrastructure development, the construction of new apartments to receive the displaced slum dwellers is falling behind the demand. These are unfortunately common experiences in the case of policies which require resettlement of slum residents into apartments, due to the complexity of the physical development process, as well as the costs.

Affordability. Truly poor residents of slums do not have affordable options, and thus inevitably have to find alternative land where they can build a dwelling that will be labeled a slum in the future. The VSB program and the FOGARIM guarantee are not priced correctly for the target population. On the other hand, even the existing affordability criteria mean that the standard unit is not suitable for large households typical of slum residents. An important minority is unable to meet the minimum monthly payments required either for buying a new apartment or constructing a new house. As discussed in the previous chapter, the situation is exacerbated by the corruption by which subsidies are misdirected to the wealthier and more influential sectors of the population. This suggests that the subsidies are probably insufficient on their own, and need to be complemented with other reforms that address the larger issue of high land and housing costs.

Establishing credit with savings. One prominent gap in the current system is the lack of explicit savings policies, both for their own sake, and as a means of establishing ability to pay. In many societies, savings are used both as an indicator of the potential of families to make financial sacrifices—whether for savings or loan repayments—and as an indicator of financial management and discipline. A housing savings scheme has been under discussion for several years, and was supposed to be introduced in 2006, but to date has not been implemented.

With regard to banks, there is clearly a potential to generate more interest around savings, and make themselves more consumer friendly in that respect. For the MFIs, the fact that micro-lenders are not allowed to take savings does not make the concept unworkable; in many communities, savings and credit organizations use banks to take deposits.

Consumer education. It is very much in the interest of the lender to avoid default through ignorance, and for the borrower to understand the procedure to be followed if he or she is in financial difficulty. This aspect is being covered increasingly in the VSB, where all residents are expected to receive education on financial management and their responsibilities for repayment. However, commercial banks will have to take more responsibility, both to establish a good relationship with their clients and ensure that the clients understand the system. This may be a good role for donors to support as most banks will not be willing to pay to educate consumers to manage their finances.

BOX 7: LIMITED ACCESS TO LAND

“The mobilization of land for the VSB program has been a problem in the past and has hindered the development of housing and slum upgrading operations. To ease the land constraint, the Government implemented two massive transfers of publicly owned land to the Ministry of Housing and Urban Planning, totaling some 8,500 hectares. Of the 70 cities covered under the program, half are concerned by the transfers of land from the public domain: 19 have public land in excess of the slum upgrading needs, and 16 have an amount of public land which is sufficient for only half of the program needs. . . . If public land is insufficient, local governments contribute their own land reserves, and in some cases private land is acquired.”

Source: Kingdom of Morocco: Poverty and Social Impact Analysis of the National Slum Upgrading Program, World Bank. 2006.

LONG-TERM FINANCE USING FOGARIM

The FOGARIM program is still young, and it is therefore not yet possible to clearly measure results and impact. As of September 2007, the number of loans guaranteed was 24,503, with a mean size of USD 18,260. About 95 percent of these were for house purchase, 4 percent for house construction, and 1 percent for purchase of a plot.

By the same token, it is not too early to state that the FOGARIM guarantee has made a huge impact on the willingness of banks to lend to a section of the population which they would never have considered before. Not only that, the interest rates are relatively low.

The guarantee cannot be called until the debtor is nine months in arrears, and the program has effectively been operating for just over three years. During this time period, the number of families whose circumstances have dramatically changed—the main underlying risk for default—is likely to be small. So far only 25 debtors have defaulted, which for a loan duration of 20–25 years, is not unusual. The real test will be in five—ten years.

That said, there are two grounds for concern. The first is that the risk for the banks is so small, that they become less diligent than they would be without the presence of the guarantee. This lack of diligence is reflected in rather cursory loan underwriting, and the time and trouble required to recover their loss in the event of default might be insufficient to force them to pursue the debtors aggressively. Some in the financial community feel that a 70 percent guarantee is market distorting, reducing the burden on banks to make serious efforts to prevent default. As a result, the more “market-oriented” guarantee (at 50 percent) offered by USAID to the commercial bank BMCE has not been utilized, as the bank prefers to access the higher coverage provided by FOGARIM.

The second ground for concern is a political one. The government programs are vulnerable to criticism for two reasons:

- In the case of resettlement, the affected families are given no option regarding the choice and cost of their new dwelling.
- Many families do not have sufficient income to meet their monthly payments.

The major city governments are controlled by the opposition who claim the state should provide the housing free of charge. This is potentially a very dangerous move for the government and the guarantee fund, because there is a very real potential for a mass boycott of payments. In turn this could be catastrophic for the banks: while they can comfortably absorb the occasional default, mass default could trigger a crisis.

While a substantial number of loans have been made, it is too early for the long-term risks of the FOGARIM program to be assessed. There are no published targets against which to evaluate the program, but success may be gauged by the fact that there is substantial competition between the four main banks which together offer about 98% of the guaranteed loans.

CONCLUSION

Apart from the concerns discussed above, our conclusion is that both types of guarantee have been highly effective in expanding markets. For the banks, they now have two additional sectors to lend to: the MFIs and the low-income housing market. It is evident that the USAID guarantees provided sufficient comfort

to the banks to initiate lending to MFIs, and has resulted in on-going lending to MFIs without any guarantee. For the banks, their efforts to bridge the gap between lenders and borrowers in terms of procedures and communications augur well for the future. While it is too early to assess the degree to which the banks will begin to venture down market in retail housing lending without a guarantee, they are now armed with a new understanding of this market and new tools for operating within it.

This study has revealed policies and practices which we consider readily transferable to other countries:

- Subsidies for the poor for urban land and infrastructure are often essential in addressing the affordability issue, especially the provision of partially serviced plots which provides an affordable option to both the state and the occupants. However, targeting subsidies is very difficult, and the greater the subsidy, the greater the likelihood of the eligibility regulations being evaded. Even a generous subsidy regime may not be adequate for the lowest income groups. An unintended consequence of the subsidy system is that the government seems to be creating an artificial demand (or overstating the real demand) for improved housing and consequently driving prices higher.
- The complexity of implementing policies which require resettlement into formal apartments often leads to delays and cost overruns.
- Governments should aim to mobilize private sector finance, but at commercial rates. The provision of government guarantees to banks lending to the poor, especially the informal sector, is preferable to direct government financing. However, a more market oriented approach, requiring the bank to equally share risk (50 percent guarantee) will create more sustainable lending in the long run.
- Donor support through guarantees to enable MFIs to access commercial capital is preferable to donor capital. The relationship between a local MFI and a bank will lead to long-term access to capital, rather than a one-time infusion of funds.
- Demand is high for microfinance in housing, in terms of both short-term bridge loans for downpayments, and incremental housing improvement/extension loans.
- Banks find it difficult to relate to clients in the low income sector, especially those working in the informal sector, and need training and orientation programs to help their staff serve this new market. They also need to extend their services to the areas where low income people live, and use different systems and criteria in their lending practices. Donor support for technical assistance for banks to work with the lower income groups either through community-based organizations or MFIs is highly useful. Additionally, banks can leverage the experience of MFIs in originating and monitoring loans, or in providing bridge financing for purchase.