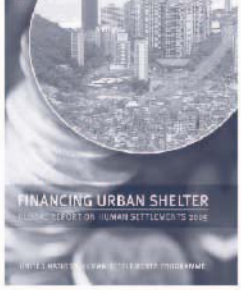

UN-HABITAT
Financing Urban Shelter

UN-HABITAT

Embargoed until 12 Sept. 2005
GRHS/05/F5

SMALL LOANS FOR SHETLER: THE RISE AND RISE OF MICROFINANCE

Poor urban households are rarely able to access formal loan and mortgage facilities. Though many poor people living in urban areas are increasingly treating shelter as a commodity, they only want small loans for incremental investments in upgrading their homes. These loans have to be commensurate with the incomes of people working in the informal economy. Therefore, low-income households seeking to invest in their shelter (land, infrastructure and housing) are forced to use their own limited income, seek additional resources from family and friends, and borrow on informal credit markets or, in some cases, from groups such as credit unions.

In the recent past, there have been several institutional efforts to assist these households in obtaining secure access to some kind of loan finance. In particular, shelter microfinance and community finance mechanisms have grown considerably during recent decades. Based predominantly in Asia and Latin America, there have been multiple explorations and innovations over the last 20 years.

What is characteristic of these initiatives is that they involve small-scale lending for shelter improvements. In many cases, they aim to establish a close working relationship with the community in order to encourage savings and also to help reduce the risk of default.

The growth of microfinance agencies since their inception during the 1980s has been considerable and there are now many such organizations. To illustrate one situation, in India the number of such grassroots-level organizations engaged in mobilizing savings and providing micro-loan services to the poor is estimated to be in the range of 400 to 500 organizations. However, some 60 million families in India (approximately 36% of the country's population) are in need of financial services, while the outreach by microfinance agencies is in no more than 1.5 million households (2.5%).

The growing interest in such programmes is reflected in the launch by the Cities Alliance of the Shelter Finance for the Poor Initiative in 2001, which focuses on emerging practices of providing housing finance to poor clients on commercially viable terms.

There are a considerable number of NGOs that have been working with housing issues, generally for lower income groups, and that have been drawn into loan financing. Shelter NGOs looked to the examples of microfinance agencies who brought finances to those who traditionally had been excluded from opportunities for savings and credit. In addition to NGO initiatives, there has been considerable interest in housing lending shown by the microfinance sector. It appears that the growth of microfinance agencies into small shelter lending is significant. For example, three significant microfinance agencies were profiled in a 1996 study when none of them were working in housing. Four years later, two of the three were working in this area.

One reason for the diversification of microfinance agencies into housing is commercial advantage. Another advantage is that the longer repayment period associated with housing loans helps to draw the borrowers into a longer-term relationship with the lending agency and increases the likelihood that further loans will be retaken. Thus, lending for land and housing has commercial benefits for a microfinance industry seeking to extend its niche and strengthen performance.

A further potential role for shelter microfinance is within slum upgrading programmes. There appears to be a growing interest in using microfinance agencies to provide specialist financial services within more comprehensive neighborhood improvement and poverty reduction programmes. Although most slum upgrading initiatives have been led by the state, an alternative approach is that developed from an Indian alliance of SPARC (an NGO), the National Slum Dwellers Federation (NSDF) and Mahila Milan (a network of women's collectives). Their strategy is to develop the capacity of local communities to manage a comprehensive upgrading and redevelopment process that is financed primarily by the state, with additional monies through loans taken by communities and repaid by individual members. Through a not-for-profit company, communities draw down the funds they need to pre-finance land, infrastructure and housing development.

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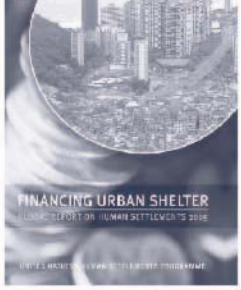

While it might be argued that any household able to afford a loan is not going to be the very poorest, shelter microfinance programmes inherently struggles to reach down to those with lower incomes. The group that is being reached by these programmes is clearly benefiting from the assistance. Shelter microfinance appears to be effective in improving the housing conditions of a group eager to invest in its own dwellings.

SANITATION REVOLVING FUND IN KITALE, KENYA

The sanitation revolving fund has been initiated by the Intermediate Technology Development Group in two settlements in Kitale (Tuwani and Shimo la Tewa).The first phase has included loans, all to plot owners, some of whom rent rooms within their plots. Many plot owners wished to take loans and the successful applicants were selected on the basis of their willingness to accept the loan in the form of materials, as well as according to their capacity to contribute towards the cost. The loans are to be repaid over two to three years.The amounts loaned are between 27,000 and 60,000 Kenyan shillings, and the interest rate charged is 12 per cent (if the repayment period is two to three years), or 11 per cent for a one-year repayment. A one-month grace period on repayments is offered. To assist in securing repayments, an affidavit has to be signed by each recipient. A further incentive for repayment may be that people have bigger dreams (better housing) and seek further opportunities to borrow. A remaining question is whether they see the additional facilities as an opportunity to raise rents. The Catholic Diocese of Kitale has agreed to manage the sanitation revolving fund on behalf of Intermediate Technology Development Group. The diocese already has some expertise in microfinance. A board of trustees oversees the loans and includes three members from the diocese, along with community members. *Source:* L. Stevens, pers comm, 2004.

SEWA HOUSING SCHEME, INDIA

When the Self-employed Women's Association (SEWA) first started lending for housing in India, it did not differentiate between housing and enterprise loans (in practice, the housing loans were bigger and were often the third or fourth loan that was taken). However, due to the size of housing loans (and the fact that they did not necessarily generate an instant higher income flow), they have been differentiated as a separate loan product from 1999, since which time they attract a lower interest rate of 14.5 per cent. Income generation loans – which typically account for 50 per cent of SEWA Bank's total loan portfolio and are usually of a lower loan amount and generate faster returns, charge interest at 17 per cent, thus partially cross-subsidizing the housing loan portfolio. SEWA's average cost of capital is 8 per cent and this primarily reflects the interest that it pays on members' savings. To secure housing loans, clients must have a regular savings record of at least one year. SEWA's experience is that a strong savings record correlates to good repayments and the regularity of payments is more important than the amount. *Source:* Biswas, 2003.

LEARNING HOW TO OFFER SHELTER LOANS, BOLIVIA

When the non-governmental organization (NGO) Proa in Bolivia moved into housing finance in 1991, its original strategy was small loans for home improvements using solidarity groups to guarantee repayments. For this and subsequent strategies, it secured funding from Mutual La Paz, a mutual savings association.This first strategy failed and Proa was forced to cover some of the losses with Mutual La Paz; however, there was an enthusiasm to carry on. The second strategy was to use some form of individual guarantee using landownership.The costs (and time) of registering a mortgage with the Office of Property Rights were considered too high; but even without this measure some claim over the property could be secured. In addition, procedures to follow up repayments were strengthened.This system worked relatively well and a refined, but broadly similar, strategy was introduced in 1993. Most loans are for housing improvements including access to water and sanitation services. However, some are for the regularization of properties and new construction by small contractors. One measure of success has been that foreclosure and late payment rates are now below those for Mutual La Paz's overall mortgage lending and are low for Bolivia. Repayments that are more than 90 days late account for 1.09 per cent of the portfolio compared to 4.1 per cent for Mutual La Paz's middle- to higher income mortgage lending. *Source:* Ferguson, 1999, p193.

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