



PART II

SHELTER FINANCE: ASSESSMENT OF TRENDS

MORTGAGE FINANCE: INSTITUTIONS AND MECHANISMS¹

Despite its recognized economic and social importance, housing finance often remains underdeveloped in emerging economies. Residential lending is typically small, poorly accessible and depository based. Lenders remain vulnerable to significant credit, liquidity and interest rate risks. As a result, housing finance is relatively expensive and often rationed. The importance of developing robust systems of housing finance is paramount as emerging economy governments struggle to cope with population growth, rapid urbanization and rising expectations from a growing middle class.²

HIGHLIGHTS

Cost of houses and need for mortgage finance

The cost of a complete dwelling in the North is generally 2.5 to 6 times the average annual salary.³ Indicative costs suggest very similar figures or higher figures for the South. The Housing Indicators Programme suggested the ratio was as high as 12 for Algeria.⁴ For those planning and able to purchase property, it is very difficult to finance such costs without a loan and generally such loans will need to be long term (typically over 10 years and sometimes over 20 years). When the repayment period is to stretch for such a considerable period, a legal framework is required for lenders to be confident about the security of their finance – hence, the significance of mortgage finance in which the loan is secured on property. This is the predominant context in which lending for a complete (or almost complete) dwelling takes place.

The primary emphasis in this chapter is on such mortgage finance. This is generally provided by commercial companies and/or by the state through specialist housing finance organizations. The majority of housing finance agencies only provide finance for completed units that comply with building regulations – Chapters 6 and 7 consider those institutions that are concerned with the provision of small loans. In some countries in the South,

mortgage finance may be available for an ‘almost complete’ dwelling (together with title).⁵

Loans secured on the property only offer realistic collateral for the lender if a claim on the property can be established and the property is sold to cover any remaining monies owing on the loan in the case of default. As a result, there is a requirement for the legal capacity to register property rights, transfer titles and foreclose on loans. There are also systemic requirements for mortgage finance. Sources of funding need to be appropriate, particularly with regard to the long-term nature of the loan commitment. Such financial systems are generally also dependent upon a stable economy, notably to ensure that default rates are minimal (as borrowers maintain real incomes) and because of the multiple impacts of high levels of inflation. However, the experiences discussed in this chapter suggest that, in a number of countries, the systems have been strong enough to recover from the difficult economic situation experienced in parts of the world during the 1990s.

Mortgage finance and poverty

The size of such loans (given the cost of properties) and the requirement for a deposit or down payment to cover a significant part of the cost means that most households accessing mortgage finance are those at the top or in the middle of the income scale. As noted already, low-income households may lack the finance for the down payment and are likely to lack formal legal title deeds; therefore, they are unlikely to be able to offer acceptable collateral. The poor face further problems in their search for housing finance.⁶ Other significant issues discussed in this chapter include the lack of verifiable incomes, the additional costs involved in the process of purchase, and lending policies that impose a minimum loan size.

Despite such difficulties, one emerging global trend is the effort to extend mortgage finance to lower income groups, expanding the market for housing finance and increasing formal homeownership. Such policies are partly commercial and partly state led. The commercial interest is in extending financial services to a new group of people. The last two decades have been ones of financial deregulation, with increasing numbers of financial agencies and growing

Governments have multiple reasons to support homeownership, including the significance of the construction industry for economic growth and prosperity

competition in financial services. In many countries, governments have been behind strategies to extend mortgage finance to those who have traditionally been unable to afford such loans. Governments have multiple reasons to support homeownership, including the significance of the construction industry for economic growth and prosperity, the significance of shelter for well-being (and poverty reduction), and the political popularity of such policies. As discussed later in this chapter, they have followed numerous strategies, including providing financial support. Measures that have focused primarily on reducing the cost of lending (notably through reductions in the interest rate) and support to the system of mortgage finance (such as extending secondary markets and reducing risks) are considered in this chapter.⁷ Other measures have included capital grants (direct demand subsidies), sometimes with access to mortgage finance for additional loans (see Chapter 5). While government support has been widespread, it should also be noted that there is no universal agreement on the appropriateness of encouraging homeownership.⁸

The focus of this chapter is threefold:

- 1 to consider emerging trends in the provision of mortgage finance and to summarize present terms and conditions of such finance;
- 2 in the context of this discussion, to look particularly at the situation with regard to lower income households who might be seeking mortgage finance and the affordability of such options for these households; and
- 3 to look at emerging tensions and opportunities in current mortgage finance and to assess its potential *contribution* to addressing household needs for housing finance.

Box 4.1 Reductions in general subsidies to housing

A survey of the Nordic countries, Western Europe and more highly liberalized systems shows that there are clear tendencies to restrict general subsidies and deregulate financial and housing markets. The greatest impact upon housing investment has come from the reduction in the scale of direct subsidies for housing. In most countries, targeting towards particular types of investment or households has become more significant. Two countries of particular interest are New Zealand and the Netherlands. In New Zealand, the whole range of subsidies and tax relief has been removed to be replaced with market rents and prices, together with an 'accommodation allowance' payable to low-income households of all tenures. In The Netherlands, all existing supply-side subsidies have been rolled up into a single capital grant and replaced with a system of privatized guarantees to assist both the social and owner-occupied sector to raise finance.

There are three potential impacts of these very large reductions in general assistance. In most countries there have been significant falls in output in both social and private sectors. Second, there have been significant increases in risk in the finance market. This was particularly obvious during house price falls during the early 1990s. To counter this trend, there has been some increase in credit insurance and guarantees. Finally, there has been an impact upon prices, although this is hard to assess because of other influences. In social housing, costs have increased as a result of reduced supply-side subsidies.

Source: Turner and Whitehead, 2002, pp 172–173.

RECENT TRENDS

General trends related to providers

In general, governments have sought to encourage homeownership and have, in many cases, provided preferential financing to influence consumer choice. In part, this reflects the multiple benefits of housing, combined with the belief that citizens will take better care of the dwellings if they own them and the knowledge that many households wish to provide for themselves. One further factor motivating housing investment is the financial advantage arising from capital gains, as homeownership is often associated with capital appreciation.⁹

There has been a general shift towards market-based mechanisms for the provision of housing, with attempts to reduce subsidies and deregulate markets (Box 4.1).¹⁰ This is due, in part, to the past ineffectiveness of housing strategies that have depended upon direct provision by the state. This trend is also consistent with the overall direction of macro-economic strategies during recent decades. With limited state funds (in the North and South) and few social providers beyond the state, increasing access to housing means increasing the affordability of housing provided by the market. Governments are (almost universally) seeking to stabilize or reduce state expenditures, and the scale of their support is limited. In this context, many have actively sought to encourage commercial companies to address the needs of lower income households. This fits more generally within policies to liberalize financial services and encourage competition within this service sector. It is anticipated that more providers will reduce the cost of housing finance and therefore contribute to easing affordability constraints.

As noted in the following chapters, this trend towards market provision is significant in how it has influenced strategies for social housing and has included, in at least some countries and some institutions, greater use of small loans. There was a shift towards the market for those at the lower end of the income scale in the North. Such changes are one factor encouraging more homeownership in the North. However, the example of New Zealand also warns against the dangers of generalization as, in this country, the new policy towards market provision has replaced a previous strategy that was considered to be more specifically favourable towards homeownership, while the new policy also encourages private rental markets.¹¹

Traditionally, mortgage agencies have focused on a specific set of users (such as those saving regularly or making payroll contributions). The preferential circumstances favouring these groups (notably lower interest rates) mean that other financial institutions may have been reluctant to enter the market. In other cases, they were simply unable due to government policies. The shift to greater financial deregulation has meant that while mortgage finance used to be the preserve of specialist lenders (commercial mortgage companies and/or state housing banks), other providers, including more conventional financial institutions, have now been drawn into the market. In European Union (EU) countries, non-specialist financial institutions now account for more than 60 per cent of the mortgage market.¹² In some

Number	Category	Description of institution	Products	Examples
1	Wholesale finance institutions			
1.1	Wholesale finance institutions	Providers of wholesale finance facilities that may be used by housing institutions for internal capital needs or for retail lending activities.	Wholesale loans Institutional loans	Mutual banks Banks (e.g. Standard, Nedcor, ABSA)
1.2	Specialist housing finance institutions	Specialist DFIs established with state support in order to increase the number and capacity of housing finance organizations through providing inter alia wholesale finance. Regulated by special statutes.	Wholesale loans Institutional loans	NHFC NURCHA RHLF TUHF
2	Retail finance institutions			
2.1	Banks	Commercial financial institutions regulated by Banks Act and Usury Act.	Mortgage finance	Members of the banking council
2.2	Non-bank lenders	Institutions issuing medium to small loans or exempted for products of below 10,000 rand.	Securitized loans Personal equity-backed loans	NHFC (Makholong product) South Africa home loans
2.3	Microfinance institutions	These are a subsection of non-bank lenders that grant unsecured personal loans which are exempted from the Usury Act (Usury Act Exemption Notice) and regulated by the Microfinance Regulatory Council (MFRC). These include normal microfinance institutions, niche market lenders and NGO lenders.	Unsecured small loans Savings-backed microloans	Members of the Microfinance Regulatory Council
2.4	Housing institutions	Specialist housing institutions providing end-user financing for housing products using innovative tenure arrangements. Regulated by various laws, including Instalment Sale (Alienation of Land Act, 1989).	Instalment sale products Rental tenure co-operatives	Rental housing institutions (e.g. Johannesburg Housing Company) Social housing institutions (e.g. COPE Housing Association) Instalment sale institutions (e.g. Cape Town Housing Company)
3	Savings institutions			
3.1	Savings-linked credit institutions	Housing savings schemes linked to the provision of credit by microfinance institutions.	Savings-linked credit	Instalment sale institutions (e.g. Cape Town Community Housing Company) Finance institutions (e.g. uTshani Fund)
3.2	Specialist savings institutions	Specialist institutions or schemes established to assist low-income households to accrue savings for their 'own contributions' to subsidized housing.	Savings schemes	National Savings Scheme (NURCHA)
4	Guarantors			
4.1	Wholesale housing finance guarantors	Institutions that underwrite or provide guarantees to the providers of wholesale loans for housing purposes.	Housing-specific wholesale finance guarantees 'Hardship cover' guarantees for rental institutions/SHIs	NHFC (specialist guarantees) NURCHA (OPIC bridging finance guarantees; Gauteng Rental Guarantee Fund guarantees for rental institutions) HLGC (hardship cover guarantees on rental income streams for rental institutions)
4.2	End-user housing finance guarantors	Institutions that provide guarantees to the providers of end-user housing finance (mortgage finance) on individual loans.	Loan default guarantees AIDS guarantees	HLGC guarantee products

Note: see pp xviii–xxii for unabbreviated forms of acronyms and abbreviations in this table

countries, providers previously came solely from the government sector. New mortgage providers may be commercial financial institutions or, in some cases, mortgage companies. Many Southern countries now have access to market-rate housing finance, which was not the case 20 years ago.¹³ The section on 'Regional analysis' discusses this trend in more detail.

Table 4.1 illustrates the current range and diversity of providers of housing finance in South Africa. The table looks at all providers of housing finance both for mortgage and smaller loans. However, it does not include the kinds of programmes discussed in Chapter 5, which are significant in South Africa as there is a state-financed capital subsidy scheme to assist the poor in addressing housing need.

However, precise assessments of the extent to which there has been a de-concentration of mortgage providers away from state agencies, or those benefiting from state concessions, remains difficult. For example, while the numbers of financial institutions in India has clearly increased (including those providing housing finance), an estimated 92 per cent of India's banking sector remains under state control.¹⁴ In addition to the state's overall

involvement in the finance sector, the state may be particularly involved in the direct provision of mortgage finance. Even where this is not the case, the state may still seek to influence housing outcomes and make institutional interventions.

The aspirations of government to influence the scale and quality of the housing stock through housing finance are longstanding. Box 4.2 gives an example from Zambia of the complexity of state involvement in housing institutions and the continuing aspirations of the state for involvement. Despite these attempts, the policies have not been successful and housing need was estimated at 846,000 units in 1996.¹⁵ More generally, the performance of state-owned housing finance institutions in the South has been widely criticized. One recent analysis of the performance of such financial institutions concludes that mortgage lending in the South has not emerged as a financially viable housing finance strategy for the poor.¹⁶ It is suggested that 'housing banks created with the help of donor agencies over the past 30 years have gone bankrupt or moribund, evolved into full-fledged commercial banks (such as Capital Bank in Haiti), or become real estate-focused banks with very few poor clients

Table 4.1
The current range and diversity of providers of housing finance in South Africa

Box 4.2 Zambia: a brief history of state involvement in housing finance

During the period of the second and third National Development Plans in Zambia (1971–1983), the government pursued a policy of developing residential and commercial property through the parastatal firms. Among the parastatal companies that were used to increase housing stocks were the National Housing Authority (NHA), the Zambia State Insurance Corporation (ZSIC), the Zambia National Provident Fund (ZNPF) and the Zambia National Building Society (ZNBS). Apart from the National Housing Authority, these companies were supposed to build institutional houses, which their employees would rent. The NHA was allowed to build houses specifically for selling and letting out to the public. This in itself represented a shift in the general policy from encouraging homeownership to allowing renting from parastatal firms.

During the 1970s, the government removed the responsibility of housing financing from the local authorities. The government created the Zambia National Building Society in 1970 to finance property development for both residential and commercial purposes. It offers three types of property financing. First, credit is available for the outright purchase of already developed property to all prospective owners. Second, it manages a construction scheme under which it finances the construction of property on behalf of its clients. Third, it offers smaller loans for renovations, improvements and extension of already owned property. With the ZSIC, it undertakes real estate management (residential and commercial) and rents out from its own stock or on behalf of customers.

Since its inception in 1971, the NHA's core function was property development for the purposes of selling and renting to the general public, with selling being its biggest option. The NHA sought to provide minimum housing standards within the resources of the country. At the same time, it conducted research to lower the costs of low-income housing. The third National Development Plan (1979–1983) gave the NHA the responsibility of 'vetting all housing programmes' prepared by all organizations, including government. Currently, the NHA specializes in building houses for sale through outright purchase and financing of construction. A large segment of the houses built by the NHA are of low-cost type. The NHA also considers itself to be the foremost adviser to government on housing policy. The government also formed the Presidential Housing Initiative (PHI) in 1999 to spearhead the implementation of the National Housing Policy. Among other things, the PHI was expected to rejuvenate the construction of new houses. However, the programme was dissolved in 2002 under accusations of corruption.

Source: Mulenga, 2003.

(the Housing Bank of Jordan).¹⁷ However, it should be recognized that many were only intended for limited groups of workers.

Despite what is generally a pessimistic appraisal of the potential for direct state provision, a popular response to housing problems in the transition countries has been the establishment of national housing funds, in most cases orientated towards the provision of low-income housing.¹⁸ Moreover, in some contexts in other nations during the last decade, government strategies to move away from direct involvement in the housing finance sector have been forced to change due to the scale of economic crisis. For example, the National Housing Bank in Thailand has sought to stabilize a difficult situation for housing finance following the financial crises during the late 1990s, and the bank has, as a

consequence, become an increasingly important provider (see Box 4.3 and Table 4.2).¹⁹ Hence, although state housing banks are perhaps less popular than previously and their role may be smaller, some governments still choose to use them as a provider of housing finance. In Mexico, the problems of the mid 1990s resulted in commercial banks reducing their exposure to mortgage lending.²⁰ One study of Mexico notes that banks issued 54 per cent of mortgage lending in 1994, but only 6 per cent three years later.²¹ In both Thailand and Mexico, government agencies have had some success in supporting the continuation of mortgage lending.

Sources of finance

Access to sufficient sources of finance has long been recognized to be critical for the effective operation of housing finance markets. Mortgage finance involves the commitment of capital for long periods of time. If the only source of finance available to the mortgage lenders is deposits, then even if they can secure sufficient funds, lenders face a risk when committing long-term loans with short-term finance. In general, they minimize such risks by lending a relatively small proportion of these funds. As an alternative to short-term deposits, there are several sources of longer-term finance. One source is the state itself and the direct contributions that it might make. A second source is private funds institutionalized for housing finance, either through specialist saving schemes, such as those in Germany and Austria (and now some transition countries), and/or through the state establishing requirements for payroll deductions to capitalize housing funds. A third source is private commercial investment. Despite these multiple sources, the availability of long-term finance is limited in many countries, including the Philippines, with negative consequences:

In the absence of long-term finance, the large demand for housing is not translated into effective demand. As it is, the banking system has been reluctant to hold long-term mortgages as assets because of the poor match in maturities between mortgages and sources of funds. Banks thus make loans only to the high-income households to minimize risk. The low- to middle-income households, on the other hand, have been largely dependent on government social security funds; but these funds are limited and cater mainly to households in the formal sector.²²

The importance of deposits to the bank system is widely acknowledged.²³ Deposits account for 62 per cent of the funding of all mortgage loans within EU countries and this percentage is even higher in the transition countries.²⁴ As noted in 'Strengthening secondary markets', below, in a number of emerging economies secondary markets have been slow to develop because deposit funding is available to mortgage lenders. With the reduction and restructuring of state involvement, financing has potentially become a more significant issue. In theory, the withdrawal of the state, particularly from providing subsidized interest rate loans,

Table 4.2

Growth of mortgage lending in Thailand: size of the primary mortgage market (million baht)

	1997	1998	1999	2000	2001	2002
Outstanding balances of mortgage loans (A)	793,521	769,379	712,401	688,544	688,884	701,700
New origination of mortgage loans (B)	204,303	103,733	64,301	108,886	111,996	120,000

Source: Kritayanavaj, 2002, pp 18, 20.

should have encouraged additional agencies into a more commercially orientated market. Nevertheless, there are concerns, notably in Asia and Latin America, that a lack of capital will inhibit lending and reduce the effectiveness of housing finance reforms. As a result, there have been a number of efforts to strengthen secondary markets in housing finance.²⁵ The following discussion considers these efforts, the need for them and their success.

While the state has become less significant in some countries, it maintains a high level of involvement in others (see 'Regional analysis', below). Governments may have simply been concerned to ensure sufficient cash flow into the housing sector. In Latin America, for example, strategies to raise the amount of loan finance available include the use of special payroll taxes, taxes on fuel, surcharges on sales tax and state lottery sales.²⁶ A further source is the proceeds of privatization, which have been important in some countries – for example, the Housing Finance Company of Uganda in which such funds formed 50 per cent of the available capital by 2000.²⁷ And, as noted in the case of India, the state may provide capital finance to state-owned housing finance companies for on-lending, notably in the case of the Housing and Urban Development Corporation Ltd (HUDCO).²⁸ Budget allocations to 2001 were responsible for taking HUDCO's total equity to US\$204.1 million.

A notable further source of finance is employer and employee contributions to payroll funds for housing.²⁹ Country-level analyses suggest that they are of significance in countries as diverse as Mexico, Singapore and, now, China. In Nigeria, attempts have been made to extend their significance, and there is now a mandatory contribution of 2.5 per cent for workers with monthly incomes of over 3000 Nigerian naira. Every commercial and merchant bank is mandated to invest 10 per cent of loans and advances in the fund and with further requirements on investment companies; but there is a serious problem of compliance.³⁰ Provident funds have also been used in some cases – with particular effectiveness in Singapore. They are being employed in Bangladesh, Namibia and South Africa as a source of loan guarantees.

Strengthening secondary markets

The secondary market in mortgage finance developed to cope with the risks associated with short-term deposits and longer-term loans. The US has led developments in secondary markets, which have become notably significant from the mid 1980s.³¹ For the last 25 years, there have been significant changes in mortgage finance with the growth of involvement by the capital markets; this began in the US and spread to Europe and, more recently, is being explored in Latin America and Asia.³² In the transition countries, legislation to support the development of secondary markets in housing finance has been introduced, or is being introduced, in the Czech and Slovak republics, Hungary, Poland and Latvia.³³ Such growth, in Europe and beyond, partly reflects the integration of financial markets and the attractiveness of mortgage finance for international investors. European markets now include all three major

Box 4.3 The role of the Government Housing Bank in Thailand

The Government Housing Bank was established in Thailand in 1953. Its major functions were intended to be the mobilization of funds for on-lending, land subdivision and the construction of houses for sale to the public. However, the bank was forced to be a developer due to a lack of alternatives. In 1972, the National Housing Authority was established to take on this role (among other activities) and this enabled the bank to focus on finance.

During the 1990s, the Government Housing Bank expanded its retail lending, and between 1990 and 1994 the number of retail branches grew from 10 to 100. Growth continued during the 1990s, and by mid 2002 the bank had 30 main branches in Bangkok, 30 main branches elsewhere and 43 sub-branches. Between 1987 and 1997, the mortgage market had expanded rapidly. In 1988, annual new home loan origination by all financial institutions in Thailand was 40 million baht; but during the mid 1990s it reached over 200,000 million baht. However, the situation became particularly difficult during the financial disasters of the late 1990s, when there was a crisis of confidence in financial institutions and several collapsed. The housing market went into a slump, in part because there was a significant oversupply as a result of speculative building. In 1994, there were 253,000 new housing units offered in the Bangkok Metropolitan Region; by 1998, this had fallen to 1000, rising to 6000 in 2001.

The total number of home mortgages outstanding in Thailand had risen to a peak of 794,000 in 1997. The consequence of a speculative market and falling prices resulted in a rapid rise in non-performing loans. In 1997, the ratio of non-performing loans reached more than 30 per cent (although by the end of 2001 it had fallen back to about 23 per cent). By June 2002, the Government Housing Bank had a non-performing loan ratio of 17.4 per cent, still considered to be too high.

As a result of the crises of the late 1990s, commercial firms tended to withdraw from the market and reduce their lending. However, the bank sought to stimulate new developments. The mortgage rate was kept low for low- and lower middle-income groups. Its share of the market in outstanding home loans increased from about 20 per cent during the early 1990s to almost 40 per cent by the first years of the new millennium. By the end of March 2002, the bank had outstanding home loans totalling about 280,000 million baht and was servicing 700,000 borrowers.

The Government Housing Bank has sought to offer low interest rates due to efficiency and a desire for growth, and in order to assist entry into homeownership. It offers lower rates on the smallest loans (less than 1 million baht and some 90 per cent of borrowers) with a cross-subsidy between high- and low-value loans. In order to increase affordability after the financial crisis, repayment periods were increased to 30 years and loan-to-value ratios rose to 90–100 per cent. This willingness to lend reflects, in part, the strategy of the government, which is to use housing development as part of its economic policy and to be willing to stimulate the economy through housing. Its strategies include a low interest rate for lower income borrowers, a further interest rate reduction for state employees and the possibility for borrowers to fix interest rates for three to five years (thereby reducing their risk).

Source: Krittayavanaj, 2002, p15.

securities – structured covered bonds, agency bonds and mortgage-backed securities.³⁴ In addition to specific measures to enable the investment of other financial institutions in mortgage lending, there has been the related trend towards specialization. In the US, which is the global leader in this respect, mortgage finance has become increasingly complex with the growing division between aspects of the mortgage lending process: origination, servicing, funding and accepting credit risk. The shift in models is summarized in Figures 4.1 and 4.2.

The significance of the secondary market in the US is considerable, where most US mortgages are now sold – especially fixed rate mortgages, which take up 60 to 90 per cent of the market.³⁵ The government has supported the rise of specific institutions that have supported these financial

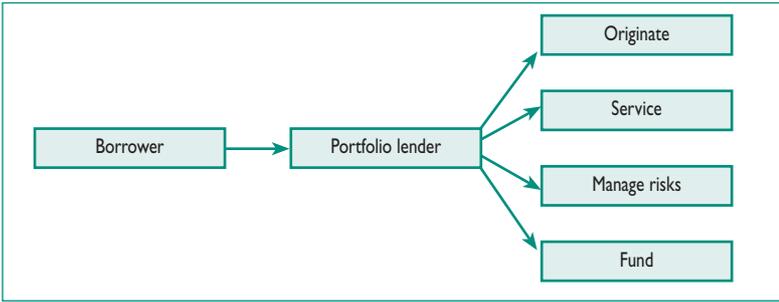


Figure 4.1
The bundled home mortgage delivery system

Source: Lea, 2000, p1.

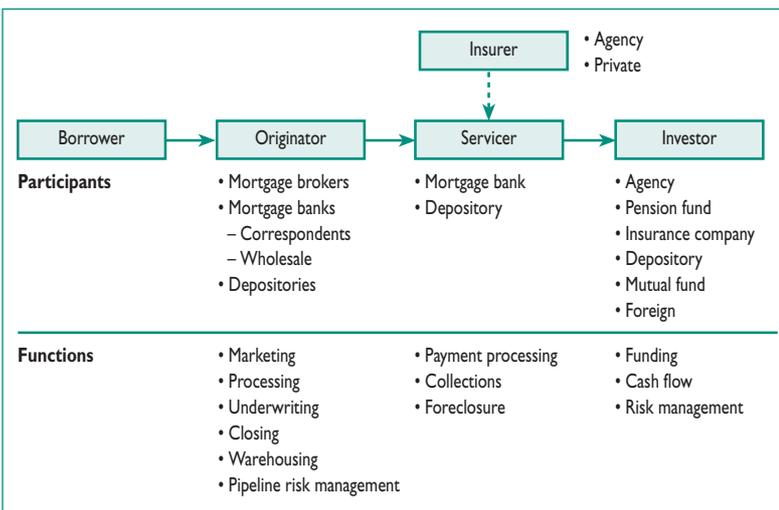
systems (see Box 4.4) and ‘Virtually all government-insured loans become mortgage-backed securities via Ginnie Mae and over 40 per cent of conventional mortgages are now sold to either Fannie Mae or Freddie Mac’.³⁶ The US experience shows that it is possible for the market to make money on single-family mortgages and that mortgage markets can be linked to capital markets with very little subsidy.³⁷ The US Office of Management and Budget argues that the liquidity added to the mortgage markets by these organizations reduces mortgage rates by as much as 0.5 per cent, reducing the interest charges on a loan of US\$100,000 by about US\$12,000 over the life of a 30-year loan.³⁸ The achievement in the US has been an elastic supply of long-run funding from the capital markets for mortgage finance. The major innovation has been the mortgage-backed security (MBS), which works as follows:

*An MBS is a ‘pass-through’ security. The issuer, typically a mortgage bank, passes the payment from a pool of mortgages (both principle and interest net of fee) through to ultimate investors who typically receive pro rata shares of the payments. The issuer also guarantees the payment of interest and principle even if the borrower defaults (the insurer is covered by the government insurance for almost all of the foreclosure costs) and Ginnie Mae guarantees timely payment even if the issuer does not make the payment.*³⁹

Figure 4.2
The unbundled mortgage delivery system

Source: Lea, 2000, p2

Despite the success in the US, there remain risks that have to be managed.⁴⁰ The government in the US appears to have



played an important long-term role and has been instrumental in supporting the formalization of the secondary market.

More fundamentally, it should be recognized that in the US, 80 per cent of the increase in homeownership rates occurred within a deposit-based system prior to the development of the secondary market.⁴¹ Two further issues are relevant to considering the value of these strategies in the South.⁴² First, the use of secondary markets depends upon demand from a market in long-term debt and/or deposits. Second, the efficient operation of secondary markets in the US requires the ability to use the house as an efficient loan security, which means that it is possible to foreclose and minimize losses if necessary.

Mortgage-backed securities are less significant outside of the US, although in some Northern countries there is an emerging market. In Europe, the UK was one of the first countries to have experience with the strategy and the first mortgage-backed security transaction was introduced in 1985.⁴³ Development was slow until 2000–2001 due, in the main, to the decline in the housing market during the late 1980s and early 1990s; and even after the rapid growth of the late 1990s, they still account for less than 5 per cent of total mortgage balances.⁴⁴ Their growth has been particularly linked to lenders in the sub-prime market and to banks’ interest in preparing for diversification of funding sources.⁴⁵ However, mortgage-based securities may have limited potential in the UK for two reasons: first, the market is structured around variable rate mortgages and, hence, interest rate risks are greater; second, the retail lending institutions are not capital constrained and therefore are not looking for new sources of funds.⁴⁶

There has been some interest in secondary market strengthening in the South, particularly in some Asian and Latin American countries. The Inter-American Development Bank (IADB) has sponsored a number of reports and argues that secondary markets are relevant to the expansion of housing finance, and particularly argues for a greater role by the private sector.⁴⁷ In respect of Asia, the International Finance Corporation held a seminar in 1998 to advance an understanding of how the capital markets could provide the required finance for an expansion of mortgage lending.⁴⁸ The World Bank also argues that mortgage securities are relevant to emerging markets to enable an increase in finance for housing investment through the capital markets.⁴⁹

However, a number of detailed studies raise significant questions about the possible relevance of some secondary market strategies. In the case of Mexico, specific problems in relation to the development of secondary markets are macroeconomic instability; the inflation adjustment to the loan and the risks that it poses; poor credit assessment; inadequate services with high levels of default (due, in part, to few branches outside of major urban areas); and foreclosure processes that take several years.⁵⁰ Securitization in Chile began in 1994 and remained at a very low level. In 1999, there were new possibilities for expansion and the market grew to reach US\$1200 million by August 2003.⁵¹ While there are now six companies issuing securitized bonds

in relation to housing, highly variable interest rates have reduced recent interest in this sector.⁵² In Korea, mortgage-based securities became possible in 1997 following housing-sector reforms. Mortgage-based securitization was encouraged in 1999 with appropriate legislation and a regulatory framework. KoMoCo was then set up by the government to play a similar role to Fannie Mae/Freddie Mac in the US; by the end of 2002, it had issued about 80 per cent of all mortgage-backed securities in the Republic of Korea. Despite this encouragement, the MBS market remains small; 'commercial banks ... have dominated the mortgage market and have faced difficulties in investing funds rather than raising them'.⁵³

A number of measures have been taken in Africa to strengthen secondary markets and, specifically, securitization. In Kenya, the draft national housing policy aims to create a secondary market to ensure additional capital from overseas and a reduction in the costs of borrowing.⁵⁴ Generally, mortgage bonds have not been widely used in sub-Saharan Africa, although there have been attempts in Ghana and, more recently, Kenya to raise finance in this way.⁵⁵

A recent overview examines attempts to strengthen secondary markets in over 20 countries and looks in detail at those in Argentina, Colombia, Hong Kong, Hungary, Jordan and Republic of Korea.⁵⁶ Supported by other work,⁵⁷ a number of conclusions emerge:

- Notable successes have been achieved in Malaysia and Colombia, with multiple examples of standardized securities and an increase in funds for housing finance. Both examples are relatively simple bonds rather than more complex securitization models. Success is more likely with more simple forms of secondary market instruments. Other experiences are more limited.
- Macroeconomic stability is important. The experience in Argentina was developing well until the recent and rapid devaluation of the currency.
- Market demand from housing finance providers for wholesale funds is important and, as noted earlier, this has been lacking in the case of South Korea. The significance of this element is also reinforced by the experience in the UK, where the plentiful supply of deposits has constrained the scale of secondary market instruments.
- A demand for longer-term finance from would-be investors is also important, and this is lacking in some countries, such as Hong Kong.

State support for housing finance

A further and remaining source of finance, despite frequent criticisms on the grounds of economic efficiency and ineffectual targeting, is the state. Governments have, over many decades, intervened in housing markets with the intention of widening access to housing finance, and they continue to have a major role in housing finance through the continued use of subsidies. In general, these are designed to improve access to housing finance. This section

Box 4.4 Strategies to strengthen secondary markets in the US

The rise in the secondary market in the US during the 1970s and 1980s came about largely because of standardization of pools of mortgages brought on by three government-sponsored agencies: the Federal Home Loan Mortgage Corporation (Freddie Mac), the Federal National Mortgage Association (Fannie Mae) and for government-insured loans, the Government National Mortgage Association (Ginnie Mae). Annual sales of mortgages to these three institutions have risen from US\$69 billion in 1980 to more than US\$700 billion in 1998; they now own or are responsible for about half of the outstanding stock of single-family mortgages. It is these agencies that purchase mortgages and package them into securities (or fund them with debt), thereby enabling them to be traded easily with minimal risk of default.

Freddie Mac was created in 1970 to be a secondary market for thrifts. At that time it dealt with thrifts and Fannie Mae with mortgage bankers; but now both institutions deal with the same mortgage originators. It initiated the first mortgage-backed securities programme in 1970.

Fannie Mae was established during the 1930s to provide a secondary market for government-insured loans to households. During the 1970s, it switched to providing secondary conventional mortgage loans.

Ginnie Mae was created as a successor to the old Fannie Mae. Its purpose is to handle Fannie Mae policy-related tasks and provide a secondary market for government-insured loans. It also guarantees issuer payments on mortgage-backed securities, providing an extra level of insurance.

Source: Van Order, 2001, pp19–20.

concentrates on measures focusing primarily on assisting those in housing need through the commercialized housing finance market. Other measures, which are more reliant upon the direct state provision of housing (although they may use the commercial construction sector or specialist providers as a conduit) are discussed in Chapter 5. The division between these two strategies is a continuum, rather than a strict and unambiguous divide. Governments have explicitly sought to reach lower income households through mortgage finance, although, as argued below, they have rarely been successful.

In some cases, the scale of state support to higher and middle-income households through measures to extend homeownership (notably, interest rate subsidies) may significantly exceed more direct strategies to support housing improvements for lower income households.⁵⁸ However, whatever the specific outcomes, there is a difference between state policies to enhance housing finance markets and to extend opportunities for the purchase of dwellings, and housing policies directed at addressing the housing needs of low-income citizens.

There are several motivations for state involvement. With regard to the welfare of households, motivations are, notably, to promote homeownership as a whole and to specifically address the needs of those with inadequate housing. The state may also have systemic interests to ensure that the financial markets for housing are stable. As noted above, in some cases state support is directly through state housing companies. However, in general, these have become increasingly commercially orientated in their use of finance. Box 4.5 summarizes the involvement of the state in the Philippines.

Although the emphasis with mortgage finance is on commercial provision, the use of subsidies is still prevalent

There is a difference between policies to enhance housing finance markets and to extend opportunities for the purchase of dwellings

Box 4.5 Government support for mortgage finance in the Philippines

In the Philippines, the government aims to address the needs of the lowest 50 per cent of income earners through the direct production of units by government, through the provision of public funds for private development and through end-user financing to entice the private sector to produce suitable housing. There are several significant state agencies that support housing finance. The Housing Guaranty Corporation provides mortgage insurance and guarantees in order to encourage private banks and financial institutions to grant housing loans on easy terms of payment. The National Home Mortgage Finance Corporation acts as a secondary market for housing mortgages. The National Housing Authority is specifically concerned with social housing. Finally, the Home Development Mutual Fund is a provident savings/pension fund for formal-sector workers. Increasingly, strategies have moved from being highly centralized to being more participatory, with the involvement of communities, local government and private-sector agencies in delivering housing. Measures continue to be taken to improve the supply of funds and the secondary mortgage market.

In housing finance, the government's role in the market remains that of a primary lender. Between 1993 and 2001, approximately 971,000 households gained homeownership through the National Shelter Programme. Fifty-one per cent of these obtained housing through private developers with loan finance provided through government programmes. About 13 per cent benefited from state-financed resettlement programmes, while a further 12 per cent secured dwellings through the community mortgage programme and other community programmes. Ownership through the presidential proclamations of public land for low-income housing accounted for a further 16 per cent. Despite such provision, however, the proportion living in informal settlements continues to rise.

Source: Ballesteros, 2002.

in some contexts. The popularity of attaching subsidies to finance continues, in part to meet the 'social goals and expectations of the middle and lower-middle classes'.⁵⁹ Their scale is often significant, even in countries in which commercial mortgage systems are advanced. In France, for example, during 1990, 23 per cent of mortgages still had a subsidy.⁶⁰ Such programmes are indicative of the support given to housing both for issues of social need and, more likely given the income groups that benefit from such measures, political popularity.

Table 4.3 summarizes common strategies to increase homeownership through the enhanced provision of finance. It draws upon experiences in the North and particularly Western Europe, although such strategies have been widely used in many other countries. One further strategy employed in some countries is the more direct involvement of the state in housing construction, with governments seeking to address housing needs by expanding the supply

Table 4.3

Government measures to widen access to homeownership through finance

Scheme	Comments
Mortgage interest relief	Can be poorly targeted/regressive Can be capitalized into higher prices
Interest subsidies	Often a substitute for poor economic management
Housing savings scheme	Can be poorly targeted May be used as subsidized savings scheme and not used for housing Design can deal with these problems
Guarantees	Form of credit enhancement Provided by market in the UK
Subsidies for 'key' public-sector workers	Can crowd out private-sector workers and inflate prices May be more efficient (though possibly more costly) to vary wages by region
Intermediate tenures	Lower risk method of extending ownership

Source: Stephens, 2004.

of suitable dwellings and/or lowering the price for owner occupiers. In the West European context, this strategy has not been significant, except in Spain, where banks were obliged to invest in housing at sub-market returns, with the cost reduction theoretically passed on to the ultimate occupant.⁶¹ However, in some countries in the South it remains popular, although it has not often been effective at scale.

A more recent shift, discussed in Chapter 5, has been subsidies designed to augment the payment capacity of the poor (direct-demand subsidies). The strategy has been strongly associated with a number of countries, including Chile, where state-subsidized housing is a very significant component of new housing construction, with the government at least partially financing between 58 and 63 per cent of the total housing construction for each year between 1994 and 1997.⁶² Of total construction, about 44 per cent was heavily financed and another 16 per cent had a less significant public contribution, being financed under the Unified Subsidy Programme and produced by the private sector on the open market.⁶³

Direct construction and loans

One of the most far-reaching systems of state intervention through direct construction has been used in the case of Singapore, where 96 per cent of the households are living in homeownership apartments (Box 4.6).⁶⁴ The strategy has been based on the provision of subsidized mortgage finance (primarily through the interest rate), combined with a dedicated supply of funds through already existing provident/pension funds.

The Singapore system appears to be a closed one in which the Housing and Development Board manages the construction (sometimes with subcontracts to the private sector) and the financing. Despite the accomplishments here, there are many other less successful attempts. Singapore was successful in part because it has one of the world's fastest growing economies, in part because the government owned so much land, so that land acquisition was not a problem (although compulsory purchase was used), and in part because there was little in-migration as the rural population was small. Nigeria is an example of how Southern governments have been committed to improving the housing situation in their countries, but have struggled to find effective policies. Between 1971 and 1995, the government actually built only 76,370 dwellings, 13 per cent of the units they intended to construct.⁶⁵ The problems can be explained thus:

Since the attainment of independence in 1960, and the subsequently intensified urban growth, there are some major distinct approaches to housing development and improvement in Nigeria. These include slum clearance and resettlement, public housing schemes, sites-and-services [projects], settlement upgrading and self-help housing. Apart from the last, these housing strategies are essentially public

*provider-orientated policies and made, at best, little impact on the housing programme... Of all the housing strategies, public direct housing was the most elaborately pursued and has cost the country billions of US dollars.*⁶⁶

There are many further examples of failed public housing policies.⁶⁷ One similar problem was the National Housing Corporation in Kenya, whose production was also well below need, with only several thousand units a year.⁶⁸ Two parastatals in Côte d'Ivoire together constructed 41,000 units between 1960 and the 1980s before being wound up.⁶⁹ The public housing schemes generally involved completed units that were sold at a considerable discount. In one example from Nigeria, sale prices in one scheme completed during the mid 1990s were, at best, half the costs of construction and, at worst, 20 per cent of these costs.⁷⁰ Such strategies were a significant transfer of public funds to the few who received the dwellings, and they did little for the many who remained without adequate housing.

There have been further attempts by some governments at more active collaboration in the production and allocation of housing using housing finance – for example, part-equity initiatives or rent to purchase. In the North, there have been a number of targeted assistance programmes for first-time buyers, either as direct subsidy or shared equity arrangements.⁷¹ Some Northern governments have targeted assistance on certain groups. In the UK, the problem of recruiting 'key' public-sector workers became acute in high-demand and high-cost areas, such as London.⁷² This has led the government to introduce schemes to subsidize entry into homeownership for defined groups of public-sector workers. Critics of such schemes suggest (variously) that private-sector workers will be crowded out of the market, and that much greater regional pay variation in the public sector would tackle the root of the problem. However, regional pay variation is also likely to be more expensive than subsidizing housing for new recruits, as higher pay would be paid to existing workers, not just the new recruits. Intermediate tenures, such as 'right of occupancy' housing in Finland and 'shared ownership' in the UK are intended to widen access to some form of (quasi) homeownership without excessive risk to households.

Taxation-related incentives

Northern governments may provide direct subsidies (grants and interest rate concessions) and/or fiscal incentives and/or loan insurance.⁷³ In many West European countries, mortgage interest payments are, to some extent, tax deductible.⁷⁴ Generally, this instrument is seen as being inefficient (indeed, counterproductive as at least some of the relief will have been capitalized into higher house prices) and poorly targeted. In the Netherlands, tax deductibility is unlimited; but other countries have sought to limit the level of tax relief. For example, in Finland the tax treatment of mortgage interest relief has been restructured. Both the UK and France abolished mortgage interest relief during recent decades, a policy shift facilitated by falling nominal interest

Box 4.6 Financing homeownership in Singapore

In Singapore, the public housing programme began prior to self-government in 1959. However, the Singapore Investment Trust (established by the British colonial government) failed to meet the housing needs of the poor. The new government was committed to improving housing, and it began during the early 1960s on a relatively small scale by providing basic rental units for the poor who were living in congested urban shop houses and as squatters. The flats, built by the Housing and Development Board, were let out at monthly rentals of between US\$20–\$40 and were within the paying ability of 75 per cent of the working population. In 1964, homeownership was introduced and flats were sold on 99-year leases. Once the state allowed would-be homeowners to use their savings in the Central Provident Fund to help finance their purchase, the scheme took off. The fund is a state-managed, tax-exempted compulsory social security fund for all citizens to which employees and employers contribute. The prices of the flats are subsidized so that they remain within the affordability of the majority population. The interest rate charged is 0.1 per cent above the rate paid on savings.

Among the mortgage financing policies, the significant point is that purchasers of public housing are allowed to use their provident fund savings to pay for their flats. The 20 per cent down payment may be drawn from their accumulated savings, and monthly repayments may be deducted directly as well. The board provides the mortgages. With this facility, the entire process constitutes an internal fund transfer without involving any conventional banking process. The board receives finance from the government and is charged an interest rate 0.1 per cent below the mortgage rate charged by the board for its loans. As of 31 March 2002, the total mortgage financing loans on the board's books was 63 billion Singapore dollars, of which 51 billion Singapore dollars was lending at concessionary rates. By 2001/2002, an estimated 85 per cent of the 3.3 million population in Singapore were living in Housing and Development Board dwellings (96 per cent of which are owned by their occupants and 4 per cent of which are rented).

Source: Chin Beng, 2002, pp99–114.

rates which reduced the burden of repayments for households. However, they continue in a number of countries, including India.⁷⁵

There are other favourable treatments in the tax regime, with imputed rental incomes being untaxed in most European countries (except Italy) and capital gains on owners' principal house also being untaxed (although not in Japan).⁷⁶

Interest rate subsidies

Interest rate subsidies have been a popular way of enhancing housing finance affordability. Occasionally, this policy has been criticized as acting as a substitute for prudent macro-economic management. Moreover, in the present world of flexible rates, it can look outdated; when market interest rates fell in Spain during the 1990s, they actually fell below the level at which the 'subsidized' loan rate had been set, giving rise to calls for prepayment without penalty.⁷⁷ A similar phenomenon was observed in Japan during 1996.⁷⁸ Interest rate subsidies in some countries in Europe may be associated with savings schemes for housing investments, the best known of which is the German *Bauspar* system. However, in practice, they extend well beyond this system.

Moreover, interest rate subsidies may not be effective in targeting help where it is most needed. While the data in Table 4.4 suggests that in the Philippines there is a programme which at least goes some way to meeting the housing needs of the poor, the main mechanism for reaching

Interest rate subsidies have been a popular way of enhancing housing finance affordability

Programmes	Income group		
	Low (%)	Middle (%)	High (%)
UHLP	38	33	29
EHLP	12	67	21
CMP	39	49	12
GLAD	17	56	27
LTAP	27	54	19

Notes: UHLP: Unified Home Lending Programme, open to members of the Home Development Mutual Fund (HDMF)
 EHLP: Expanded Home Lending Programme, open to members of the Home Development Mutual Fund
 CMP: Community Mortgage Programme (see Chapter 7)
 GLAD: Group Land Acquisition Support Programme (similar to CMP)
 LTAP: Land Tenorial Assistance Programme (similar to CMP for HDMF members)

Source: Llanto and Obera, reproduced in Ballesteros, 2002, p18.

Table 4.4

The distribution of housing subsidies in the Philippines

down to low-income groups is subsidized loans to formal workers through the provident funds. A more detailed analysis highlights the distributional implications of such strategies, and the conclusions of such an analysis are summarized in Table 4.4, which depicts the distribution of housing subsidies within five housing finance programmes. The success of higher income groups in capturing even the community-based housing finance programmes – the Community Mortgage Programme (CMP), the Group Land Acquisition Support Programme (GLAD) and the Land Tenorial Assistance Programme (LTAP) – is notable. An estimated 77 per cent of the country cannot afford a loan from the formal sector even at a subsidized interest rate of 9 per cent.⁷⁹ It is such findings that have resulted in a critical perspective on the provision of interest rate subsidies in housing finance.⁸⁰ However, despite a professional acknowledgement that they are a poor tool for assisting the poor to secure housing finance and improve housing, their popularity remains significant.

The case against interest rate subsidies has been strongly made. It has been argued that direct subsidies are a preferred way of offering assistance with housing costs as they can be more precisely targeted to those in need. Interest rate subsidies inevitably favour those who can afford loans and larger subsidies go to those able to afford larger loans. Although some programmes seek to minimize this problem by offering the lowest rates only to smaller loans (for example, in the Philippines and Thailand), the essence of this critique remains. If one cannot afford a loan, one does not receive a subsidy. A related concern is that where

subsidized rates are offered only by state housing finance enterprises, they prevent the development of a commercial market. Households wait for access to a low-interest loan rather than pay a commercial price, and the commercial housing finance market does not develop because it cannot compete. Governments have tried to minimize this problem by attaching low rates to smaller loans and/or designated categories of workers.

Despite such arguments, interest rate subsidies appear to continue to be widely used.⁸¹ Box 4.7 elaborates upon the example of Mexico where the World Bank estimates implicit subsidies (due to lower interest rates) to be 26 times the value of explicit subsidies.⁸² In Sweden, the government has reduced interest rate subsidies from 36 billion Swedish kronor in 1993 to (a still sizeable) 7 billion Swedish kronor in 1999.⁸³ In the Philippines, four general types of subsidies are used, with interest rate subsidies being overwhelmingly the most significant and accounting for 90 per cent of the value of housing subsidies; other types are land cost subsidies (5.1 per cent), tax exemption (4.5 per cent) and cash subsidies (0.4 per cent).⁸⁴ Ironically, little of this is directed at the poor; the Community Mortgage Programme receives an estimated 3.7 per cent of the total subsidy related to interest rates. In Tunisia, subsidized loans are provided to low-income households (those earning less than three times the minimum wage), with a state-owned bank administering all subsidized loans, which account for 80 per cent of all mortgages.⁸⁵ In this case, the interest rate is between 3 and 5 per cent – about half that of non-subsidized loans.⁸⁶ In India, the mortgage rate of interest was 15 to 15.5 per cent in 1998, while the poor could get access to subsidized rates of 9 to 11 per cent.⁸⁷ In Hungary, the subsidized mortgage rate was 4 to 5 per cent in 2002, while the market rate was 18 per cent, with an estimated cost equal to 2 per cent of the government budget.⁸⁸

Securing stability: insurance and guarantees

In addition to direct assistance to households to increase the affordability of housing finance, governments have sought to ensure the stability of the system and to reduce the risks for lending institutions when they extend services to lower income households. As the greater availability of finance has been reflected in growing levels of ownership occupation, risks have increased.

Mortgage insurance is provided in English-speaking countries in the North through a variety of mechanisms.⁸⁹ Governments may specifically provide guarantees in order to extend mortgage lending.⁹⁰ Within the 15 member states of the EU, private insurance mechanisms are well developed only in the UK, and elsewhere the state takes the lead.⁹¹ For example, in the Dutch system a national insurance scheme, backed by government, has fulfilled a similar function since the mid 1990s: the borrower pays a supplement based on the value of their mortgage, which is paid into an insurance fund that is ultimately backed by the state.⁹² Similar trends to strengthen risk management can be seen in New Zealand where the government, in September 2003, introduced a mortgage insurance scheme to encourage the private sector to extend finance to low-income households that are

Box 4.7 Mexico: interest rate subsidies

The bulk of Mexico's housing subsidies come in the form of below-market interest rates – off-budget subsidies mainly provided by Instituto del Fondo Nacional de la Vivienda para los Trabajadores (INFONAVIT) (a fund financed by a compulsory 5 per cent contribution from all private-sector workers). In 2000, interest rates subsidies from INFONAVIT amounted to an estimated US\$2.2 billion (based on the net present value of the implicit interest rate subsidy for the life of the loans originated in 2000, with the implicit interest rate subsidy being the difference between the actual interest rates and an estimate of the real rate on government funds). The highest subsidies are offered on a per credit basis and increase to US\$9000 per borrower. Although all formally employed households pay into these pension funds in principle, the subsidies go mainly to the moderate-income households who can afford to take mortgages necessary for a commercially produced finished house. These below-market interest rates account for about 75 per cent of all mortgages.

Source: World Bank, 2004a, p5.

'marginally out of reach of homeownership'.⁹³ One consequence is that on loans of up to NZ\$150,000 no deposit is required and on loans between NZ\$150–\$280,000, only 5 per cent deposit is required.⁹⁴ While most loan insurance has been intended to protect lenders (allowing them to make loans to higher risk groups), new products are being developed to enable borrowers to insure against falls in value and loss of income.⁹⁵

In the US and Canada, governments have developed complex systems of insurance that have supported financial flows into a system for housing based around mortgage finance. Hence, for example, the Government National Mortgage Association (Ginnie Mae) established in 1968 guarantees the payments from a number of mortgage providers so that their loans can be securitized and sold on, thereby returning cash to the housing finance system (see Box 4.4)

Mortgage insurance has been generally thought to be too risky in the transition countries, although a self-managing guarantee fund was established in Estonia in 2000.⁹⁶ Loan guarantees are being developed in Estonia, Lithuania and the Slovak Republic.⁹⁷ In the North, the South and transition countries, the role of the government (as opposed to the private sector) has been particularly important in providing support.⁹⁸ Table 4.5 summarizes the situation in a number of countries. Experience suggests that for mortgage insurance to be offered effectively, certain prerequisites are necessary; notably, there must be effective foreclosure procedures, a competitive banking sector and an efficient mortgage lending industry.⁹⁹

In addition to planned subsidies, there are also those that occur when governments move to support commercial lending institutions in danger of collapse. For example, in Colombia:

*... the crisis that threatened to bring down the whole financial system in 1999 was partially resolved by compensating middle-income families in default on their mortgage payments. A financial bail-out in Colombia in 1999 diverted US\$2.5 billion in debt relief to 800,000 middle-class mortgage holders. When it was recalled that the Colombian government was providing housing subsidies to poor families of only US\$75 million per annum, the limited resources devoted to the housing subsidy programme become obvious.*¹⁰⁰

The Colombian government faced considerable problems at that time, with a housing loan system that had been devised during the early 1970s and a group of specialist savings and housing corporations that were struggling with inflation and increasing real interest rates during the 1990s.¹⁰¹ Gross domestic product (GDP) growth was negative during the late 1990s and households struggled to repay rising repayments. Overdue mortgages were about 3 to 4 per cent of total mortgages in 1995; but this rose to over 18 per cent in 1999. Faced by legal as well as financial challenges, the state sought to recreate the sector. At the same time, the mortgage lending

Country	Type of mortgage insurance (MI)	Loan coverage
US: Federal Housing Authority and Veterans Administration (VA); seven private MI companies	Public and private	Public: 100% Private: 20–30%
Canada: Canada Mortgage and Housing Corporation (CMHC); private MI company	Public and private	Public: 100% Private: <100%
Australia: three MI companies	Private: 1 public until 1997	100% or less
New Zealand: three MI companies	Private	20–30%
UK: numerous general insurance companies	Private MI insurers and mortgage indemnity insurance	<100%
France	Public	100%
Italy	Private	20–40%
Spain	Private	20–40%
Netherlands	Public	Public: 100%
Sweden	Public	Varies: less than 100%
South Africa	NGO	20%
Hong Kong, Special Administrative Region of China	Public/private	30% or less
Israel	Private	20–30%
Lithuania	Public	100%
Kazakhstan (expected)	Public	30%
Latvia (expected)	Public	22%
India (expected)	Public/private/international finance corporation (IFC)	Not available
Thailand (expected)	Public	Not available

Source: Merrill and Whiteley, 2003, p12.

institutions had become progressively less specialist, with a group of more diversified lenders. A similar rescue process was undertaken by the Mexico government during the mid 1990s.¹⁰²

Table 4.5

Mortgage default insurance

REGIONAL ANALYSIS

This section assesses trends in provision of housing finance in a number of regions around the world. There do not appear to be any single sources of data about the significance of mortgage finance for homeownership across the world.

Tables 4.6 and 4.7 consider homeowners and the significance of residential debt to GDP, respectively.

Homeownership rates vary considerably, as indicated in Table 4.6. Such differences reflect many factors, one of which is the availability of finance. Interpretation is not straightforward. For example, low rates in Germany reflect, among other things, the difficulties of securing finance and the relatively high proportion of saving that is required. One recent survey provides data for the percentage of owner occupiers with mortgages in countries of the EU; in Greece, only 25 per cent of owner occupiers have mortgages, while in Belgium the figure is 56 per cent and in the Netherlands, 85 per cent.¹⁰³ In Australia and the US, the figure is 45 per cent and 62 per cent, respectively.¹⁰⁴

However, high rates in many Southern countries also reflect the high cost and related lack of opportunities for loan finance. In this case there are few alternatives to informal and, sometimes, illegal forms of incremental development. As noted before, without alternatives many build incrementally in the South using savings and, in some cases, available sources of smaller loans. While mortgage finance as a way of acquiring dwellings is relatively common in the North, it is less common elsewhere in the world.

For mortgage insurance to be offered effectively, certain prerequisites are necessary: effective foreclosure procedures, a competitive banking sector and an efficient mortgage lending industry

Table 4.6

Homeownership rates
(percentage)

Argentina ⁱ	68	1991	India	82	1990
Austria	57	2001	Ireland	77	2002
Australia	71	1998	Italy	80	2002
Belgium	68	2001	Japan	60	1998
Bolivia ⁱ	67	2001	Latvia	74	2002
Brazil ⁱ	70	1991	Luxembourg	67	2002
Canada	65	1998	Mexico	84	1999
Chile ⁱ	63	2002	Netherlands	53	2001
Colombia ⁱ	68	1985	New Zealand ⁱⁱ	68	2001
Costa Rica ⁱ	65	2000	Panama ⁱ	79	2000
Czech Republic	47	2001	Paraguay ⁱ	74	1992
Denmark	51	2002	Peru ⁱ	72	1992
Ecuador ⁱ	68	1990	Poland	55	2002
Finland	58	2002	Portugal	75	2003
France	56	2002	Republic of Korea ⁱⁱⁱ	54	2002
Germany	42	2002	Spain	83	2003
Greece	83	2001	Sweden	61	2000
Guatemala ⁱ	65	1981	UK	70	2002
Honduras ⁱ	80	1988	US	68	2002
Hong Kong, SAR of China ⁱⁱⁱ	52	1998	Uruguay ⁱ	63	1996
Hungary	92	2000	Venezuela ⁱ	78	2001

Source: unless otherwise indicated, Proxenos, 2002, p3, and European Mortgage Federation, 2004. i ECLAC, 2003. ii Stuart et al, 2004. iii Ha, 2002a.

Table 4.6 gives no indication of trends and, despite the state policies noted in the previous subsection, it should not be assumed that homeownership is rising. For example, homeownership levels in New Zealand have been falling despite financial deregulation from the mid 1980s onwards.¹⁰⁵ The trends in Western Europe are less clear (see Table 4.7).¹⁰⁶ During the last decade, demand in some Northern countries has been supported by large-scale lending and relatively low interest rates. Other factors encouraging homeownership in the North have been growing affluence and longer life expectancy.¹⁰⁷ Changing household structure has also had implications for the scale and nature of housing. Such increasing demand for housing has been countered by rising real housing prices (see 'The price of housing', below).

Table 4.7 shows residential debt as a percentage of GDP and offers an assessment of the significance of mortgage loans for national economies. For Northern countries, these figures are high, generally over 25 per cent, notable exceptions being Italy and Greece. For both the transition economies and Latin America, figures are considerably lower, indicative of the much lower incidence of mortgage borrowing.

The North

Homeownership is now the majority tenure across Western Europe, with only a few exceptions – notably in Germany. Nevertheless, levels of owner occupation vary considerably and are highest among some of the Southern European

Argentina ⁱ	4.0	2002	Ireland	45.0	2003
Austria	26.4	2003	Italy	13.3	2003
Belgium	28.5	2003	Latvia	8.3	2003
Bolivia ⁱⁱ	8.5	2004	Luxembourg	33.4	2003
Brazil ⁱ	2.0	2002	Mexico ⁱ	4.0	2002
Chile ⁱ	12.0	2002	Panama ⁱⁱ	24.4	2004
Colombia ⁱ	7.0	2002	Peru ⁱ	2.0	2002
Czech Republic	4.5	2003	Poland	4.7	2003
Denmark	87.5	2003	Portugal	50.6	2003
Estonia	5.0	2001	Slovenia	3.0	2001
Finland	35.6	2003	Slovakia	3.0	2001
France	24.7	2003	South Korea ⁱⁱⁱ	13.4	2001
Germany	54.3	2003	Spain	42.1	2003
Greece	17.4	2003	Sweden	50.0	2003
Hong Kong ^{iv}	31.0	1998	UK	70.4	2003
Hungary	7.8	2003	US	71.0	2003
			Uruguay	7.0	2004

Notes: i Forero, 2004, p32.

ii Rojas, 2004; this is mortgage lending, not residential debt.

iii Mortgage debt to gross national product (GNP); Lee, 2003, p24.

iv Lamoreaux, 1998, p51.

Data for Austria and the Czech Republic includes non-residential mortgage loans and Portugal includes loans to individuals for housing purchase only.

Source: Yasui, 2002b, p18; European Mortgage Federation, 2004, p7.

Table 4.7

Residential debt as a
percentage of GDP

countries (Spain and Italy), where homeownership can be described as being ‘dominant’ (see Table 4.8). Homeownership is relatively high in several other countries, notably the UK, at around 70 per cent. In a cluster of countries, such as France, the Netherlands, Denmark and Sweden, homeownership has been established as the ‘majority’ tenure without being especially high or dominant. Among members of the EU, homeownership in Germany still ‘lags’ behind the other countries (outside the 15 member states of the EU, but within Western Europe, similarly low levels of homeownership exist in Switzerland.)

There is little evidence of convergence in homeownership levels, either in the sense that they are moving in the same *direction*, or that they are converging towards similar *levels*.¹⁰⁸ As a result, since 1980, there has been strong growth in homeownership in Germany and the Netherlands, starting from relatively low bases, but also in Italy, starting from one of the highest bases. Finland exhibited a marked fall in homeownership levels, which is attributable to the coincidence of a very severe property market slump with an extremely severe economic recession partly linked to the loss of trade with the former Soviet Union. Sweden also experienced a severe housing market slump during the early 1990s, which seems to have contributed to a stagnation of homeownership levels. In the four other Organisation for Economic Co-operation and Development (OECD) countries for which data is reported in Table 4.9, levels of homeownership are relatively high and increased significantly in the US, but changed little in the other nations.

It is difficult to detect a consistent trend in mortgage lending despite a convergence in mortgage rates both within the Euro zone and outside it.¹⁰⁹ In general, strong growth in mortgage lending has been experienced; but there is little consistency between these countries. The Netherlands stands out as having experienced a huge rise in mortgage lending, linked to deregulation in the mortgage market during the 1990s; this took place somewhat later than in Scandinavia and the UK, while arguably it has still to occur fully in Germany, France and Italy. Having experienced big rises in mortgage lending during the 1980s, the process was thrown into reverse in Sweden, and between the years selected, it stagnated in Finland.¹¹⁰ In fact, in each of these countries, a slump was followed by renewed and strong growth, so Table 4.10 is slightly misleading in this respect. Table 4.11 summarizes trends in other OECD countries, and they are also positive – although the scale of increase differs considerably.

In 2003, the European market, as a whole, continued to grow with the total value of residential mortgage debt increasing by 7.4 per cent, a little below the ten-year average of 8 per cent.¹¹¹ The total volume of mortgage loans in Europe at the end of 2003 was US\$3.4 trillion.¹¹² This figure has grown rapidly and it now accounts for 42 per cent of the EU’s GDP. This rapid expansion in lending has been encouraged by lower interest rates (both because of currency convergence and low global rates); in particular, this has helped to increase borrowing in countries such as Spain, Greece and Ireland.¹¹³ However, it should be remembered that the rise in the volume of lending is not necessarily associated with increasing access, as one further

Country	circa 1990	circa 2000	Change
Dominant			
Spain	78	82 (1999)	+4
Italy	74 (1993)	80 (2002)	+6
High			
UK	66 (1992)	70 (2002)	+4
Finland	71 (1992)	64 (2001)	-7
Majority			
Netherlands	45	53 (1998)	+8
Sweden	55 (1991)	55 (1997)	0
Denmark	55	53 (1999)	-2
France	54	56 (2002)	+2
Low			
West Germany	37 (1987)	46 (2003)	+9
Germany	–	44 (2003)	not available

Source: Stephens, 2004.

Table 4.8

Levels of owner occupation in Western Europe, circa 1990–2000

trend has been rising house prices, with capital gains for current homeowners and increasing difficulties for those seeking to become homeowners for the first time. The final part of this chapter discusses the rise in house prices during the late 1990s and the early 21st century.

In the US, homeownership grew on average, as did income, throughout the largely prosperous 1990s and now stands at a record high. The homeownership level has, in fact, become a significant measurement of economic health.¹¹⁴ However, data from the US Census Bureau and American Housing Survey’s (AHS) most recent publication indicate that affordability constraints are significant. Box 4.8 shows a measure of success of government policy in reaching down to lower income households with Federal Housing Administration (FHA) support through insurance assistance. Almost 52 per cent of Fannie Mae’s mortgage purchases went to low- and moderate-income (LMI) household mortgages in 2002.¹¹⁵ Likewise, Freddie Mac’s LMI mortgage purchases reached 51.4 per cent of its total 2002 purchases.¹¹⁶ Furthermore, 2 million household units in 2002, or close to 70 per cent of the units that qualified toward Fannie Mae’s LMI performance, served low-income families (those earning 80 per cent or less of area median income). Freddie Mac had similar success, purchasing 1.4 million mortgages from low-income household units, or roughly 69 per cent of its total qualifying LMI mortgage purchases.¹¹⁷

Transition countries

The transition countries face a particular problem in that commercial housing finance markets were previously non-existent. The shift in political systems resulted in considerable and continuing housing problems, with very low levels of housing construction and, in some cases, deliberate attempts to encourage building.

Table 4.9

Levels of owner occupation in four Organisation for Economic Co-operation and Development (OECD) countries

Country	1990	2003	Change
Australia	72	70	-2
Canada	63	65.2	+2.2
Japan	61	62	+1
US	63.95	68.25	+4.3

Source: IMF, 2004, p73.

Country	Mortgage debt (percentage of GDP)		Change
	1990	2003	
Dominant			
Spain	11	42	+31
Italy	4	13	+9
High			
UK	53	64	+11
Finland	32 (1995)	32	0
Majority			
Netherlands	40	100	+60
Sweden	60 (1995)	50	-5
Denmark	59 (1995)	74	+15
France	20	25	+5
Low			
Germany	43	54	+11

Source: Stephens, 2004.

Table 4.10

Trends in mortgage lending in Western Europe, 1990–2003

There has been state support for the development of housing finance systems, with the expectation that the commercial sector will become an increasingly significant provider. Unfortunately, much of this support has been to the benefit of higher income groups who are the only ones able to afford such finance. The Slovak and Czech Republic governments pay 30 to 50 per cent of their 'budget subsidies to the *Bausparkasse* institution supporting ... middle-class savings'.¹¹⁸ Tax incentives have also been used to encourage homeownership in the transition countries.¹¹⁹ In the Czech Republic, Hungary, Poland and Slovakia, the German and Austrian *Bausparkassen* model was used with interest rate subsidies.¹²⁰ However, the scale of support in Hungary and the Czech Republic was estimated to cost 2 per cent or more of GDP.¹²¹ The cost led to concerns and the subsidies were reduced. Special funds, such as the Housing Fund of Slovenia (set up in 1991), have been established to extend subsidized loans both for individual construction and for the construction of social housing by local communities and non-profit organizations.¹²² For example, the Estonian Housing Foundation assists young families to secure housing. In a number of countries, such funds were established with the proceeds of privatization.¹²³ In Poland, direct and indirect subsidies have reached 1.3 per cent of GDP.¹²⁴ The costs of such measures are considerable and the effectiveness is difficult to evaluate at present.

While the scale of home loans is equivalent to 20 to 60 per cent of GDP in many Northern countries (see Table 4.7), volumes of housing loans are low in the transition countries. However, there are indications that housing loan markets are growing rapidly; for example, in Estonia, the scale of housing loans doubled between 1997 and 2000 and in the Czech Republic the scale of loans grew more than sixfold during the same period.¹²⁵ During 2002 and 2003, mortgage lending grew particularly strongly in Hungary,

Table 4.11

Trends in mortgage lending in four OECD countries, 1990–2003

Country	Mortgage debt (percentage of GDP)		Change
	1990	2003	
Australia	19.90	57.30	+37.4
Canada	39.1	42.79	+3.69
Japan	30.26	36.4	+6.14
US	44.59	63.73	+19.14

Source: IMF, 2004, p73.

Poland and Latvia (by more than 85 per cent).¹²⁶ The growth in mortgage lending in Hungary is such that residential mortgage loans as a proportion of GDP increased from 1.3 per cent in 1998 to 6.6 per cent in 2002.¹²⁷ However, these loans have only limited reach as they are generally short term (less than ten years), with high interest rates (sometimes with repayments in hard currencies) and offered for a relatively small proportion of the value of the dwelling.¹²⁸ As such, they only address the needs of the higher income earners.

There have been a number of attempts to address the systemic problems related to the lack of housing finance. A number of the national housing agencies that were established in the transitional countries during the 1990s were, essentially, mechanisms to use donor finance to address urgent housing problems.¹²⁹ It was anticipated that once commercial finance moved in to fill the gap, the role of such agencies could shift to ensure sufficient secondary finance. However, while growth in housing finance is rapid in some countries, general uncertainty, falling house prices, aversion to debt and social expectations that the parents will provide accommodation remain a significant deterrent.¹³⁰

There are two distinct housing finance systems that are developing in the transition countries – one that is similar to Southern European countries and one that shares characteristics with the German system.¹³¹ The first system is associated with high levels of homeownership, with a housing finance system that has yet to develop. Countries in this group include Hungary, Slovenia and Lithuania. The second group includes the Czech Republic, Poland, Slovakia, Estonia and Latvia, all of whom have adopted legislation to support mortgage bonds.

The privatization process that took place resulted in the transfer of significant numbers of dwellings into private hands. However, despite the subsequent increase in homeownership, the financial systems needed for such ownership have not developed. One major reason for delay is that the necessary legal systems and structures to support mortgage finance are not in place. Title registration, for example, can take more than one year.¹³² In some cases, property rights are associated with uncertainty due to property restitution initiatives; even where this only involves a small number of households, the associated uncertainty is still significant.¹³³ There are further problems with regard to land rights faced by the countries formed by the break-up of Yugoslavia, partly associated with the war.¹³⁴

Owner occupation (see Table 4.7) is now close to or above 90 per cent in Hungary, Bulgaria, Estonia and Romania, while in Poland, Slovakia and Slovenia it is above 70 per cent.¹³⁵ However, to some extent this reflects the transfer of housing stock from the state to residents. For example, in Southeastern Europe, some 15 per cent of the total public housing stock was privatized to sitting tenants.¹³⁶ Generally, in the transition countries, there is a relatively large housing stock, but poor construction and, now, poor maintenance.¹³⁷ While the state has pulled out of construction, the private sector has not yet filled the gap, partly because there has been no housing finance for purchase. One indication of the problem is that, while in

most EU countries between four to seven dwellings were completed for every 1000 inhabitants in 1998, in the transition countries the figure was two or less, except for Slovenia (2.5 dwellings).¹³⁸

The South

The problems of affordability in the South are considerable. As noted above, high levels of homeownership can be misleading because while many own their homes, they are illegal and/or informal. The housing price to average income ratio in Southern countries is considerably worse than in the North. While house prices are four times average incomes in the developed world, the ratio is just under six in Latin America and the Caribbean, seven in oriental Asia, almost ten in the rest of Asia and more than ten in Africa. This subsection makes some general comments about problems that are fairly universal before looking in more detail at what is happening in specific regions within the South.

The supply of mortgages in Southern countries has been limited by a large number of factors. First, in general, there is a lack of supply of long-term funding, even in those Southern countries in which financial markets are beginning to 'emerge'.¹³⁹ This is related to many factors, including low incomes that barely cover subsistence needs for a considerable proportion of the population, a lack of formal financial institutions that can capture people's savings, and macroeconomic instability that deters households from holding savings with institutions, such as pension funds that have a particular interest in long-term finance. Low incomes and macroeconomic instability prevent institutions from developing to address problems and to facilitate the flow of long-term funds.¹⁴⁰ The recent financial crises have had negative impacts upon the formal housing finance systems in a number of countries and have particularly deterred commercial provision of mortgage finance. However, there are signs of a recovery in lending in both Asian and Latin American countries. It should also be recognized that (as discussed earlier) secondary markets have not developed to any large extent in a number of countries because there was no shortage of retail funds for mortgage lending.

Second, urban land and property development and urban livelihoods (labour markets) are associated with a high degree of informality that does not fit easily with the requirements of mortgage finance. The property market has not favoured mortgage systems because of uncertain property titles and difficulties in using the property as collateral, and the difficulties with which foreclosure can take place. With respect to the latter point, in some countries, there are multiple barriers to eviction that can be exemplified by political pressures on courts to restrict eviction – for example, in Zimbabwe during the early 1990s.¹⁴¹ For many homeowners in the South, titles are problematic as formal registration systems may be lacking and there may be multiple claims on the land. The relevance of legal property titles to the scale of economic development and, notably, to the development of capitalism has recently been emphasized.¹⁴² The argument is that property titles are essential if assets are to be used as productive wealth. As a consequence of this work, there has been a greater

Box 4.8 The expansion of homeownership in the US

A sample survey of loan originations made in 2002 by the US leading home mortgage lender (Wells Fargo Home Mortgage) provides further clarity on US Federal Housing Administration (FHA) clientele. From a survey size of 173,541 loans, 21 per cent (or 36,474) of originated loans were FHA insured and the remaining 79 per cent were conventional mortgages (uninsured by federal government agencies). Of FHA-insured mortgages, 35 per cent were made to moderate-income borrowers or borrowers who were purchasing a home in a neighbourhood where the median income was below 80 per cent the area median. Another 14 per cent of FHA-insured mortgages were extended to low-income households (those whose income is less than 50 per cent the area median or whose home purchase is in a neighbourhood where the median income was below 50 per cent the area median). Overall, the study implies that just less than half, or 49 per cent, of FHA-insured mortgages reach low- and moderate-income households. The conventional mortgage market only reaches 28 per cent of the population (for example, 9 per cent to low income and 19 per cent to moderate income).

Source: Carolini, 2004, p8.

interest in titling during recent years. Box 4.9 summarizes the findings of research on a state programme that issued land titles in Peru and the relationship of such titles to the release of mortgage finance. The research took place seven years after the introduction of this policy.

The findings from Peru clearly indicate that legal title alone is unlikely to secure large-scale lending. There is growing evidence that titling programmes are only one part of what is needed to improve the definition of property rights; titling is often expensive and may be disputed.¹⁴³ A

Box 4.9 Land titles and mortgage finance in Peru

The policy to legalize property was established by the Peruvian government in 1996 through the Urban Property Rights Programme. A commission to legalize informal property was created and more than 1 million title deeds were distributed by 2000. The assumption was that this would enable the poor to access loans and thereby improve their standard of living. In order to maximize the potential, the commission established an information centre and offered training workshops in the use of credit for microenterprise development (although it should be noted that the government had previously legalized squatter settlements and the commission was speeding up rather than initiating a process).

There are a number of categories of insecure tenure and inadequate titles in the country. Clearly, not everyone was entitled to receive a land title. Generally, owners of unauthorized housing (those in public housing but who have not yet been given title deeds) and those living in low-income settlements which either began life as squatter settlements and which are in the process of regularization, or those which are illegal subdivisions (from agricultural land) are entitled to benefit from this policy. In the case of squatting on private land, the granting of title deeds takes longer because the commission seeks an agreement for the purchase of the land between the squatters and owners.

Taking into account all of those able to claim a land title, between 1996 and 2002, 1,269,194 title deeds were awarded, almost half of which were in metropolitan Lima. However, many of those living in squatter settlements who are in the process of improving their settlements were already reasonably confident of their tenure security. While they did not have effective possession of a title deed, improvements (both self-help and investments from service providers) had not waited on such a legal title. Perhaps as a consequence, there was very little take-up of mortgage finance. Up to 2002, 17,324 families in Peru who had obtained title deeds from the commission had gained access to mortgage loans, some 1.3 per cent of the total title deeds allocated during the process. This evidence suggests that the poor are as scared of borrowing from the banks as the banks are reluctant to lend to the poor.

Source: Calderón, 2004.

Low incomes and macro-economic instability prevent institutions from facilitating the flow of long-term funds

healthy housing market may exist without titling.¹⁴⁴ In relation to housing finance, a critical point (elaborated upon in Box 4.9) is that the granting of title may not necessarily mean that the title can be used to secure loans because, for example, formal employment may be required to obtain credit.¹⁴⁵ Thus, titles are valuable; but they do not necessarily 'unlock' capital.¹⁴⁶

However, it is recognized that problems of titles have made foreclosure difficult and deterred lending. Overlapping customary and Western land tenure systems may further exacerbate the problem in some countries. In addition to improvements in titling, one element of housing policy reform now ongoing in some Latin American countries, including Chile, Costa Rica, Colombia, Ecuador, Guatemala and Peru, are legal changes to facilitate the recovery of collateral.¹⁴⁷ In Latin America, there has been a shift towards land reform and more effective land titling and land registration, which, in turn, enables more land to be used as collateral to secure loans.¹⁴⁸ Limited ownership rights may reduce the ability of the poor to transfer their assets.¹⁴⁹ However, other factors are also important. In South Africa, the ability to secure a mortgage to purchase a property in a low-income settlement may be prevented by factors other than a clear title, such as insufficient income by the purchaser, lack of formal employment and 'red-lining' (the refusal to issue mortgages in specific areas) due to generalized problems of foreclosure.¹⁵⁰ The informality of incomes is not highlighted in the general literature, although it did emerge as significant in research to understand the low take-up of loans in Peru and South Africa, and it also appears to be significant in Panama.¹⁵¹ As discussed in 'Housing finance, affordability and lower income households', this can be a relatively significant barrier preventing mortgage lending to certain households in the North.

A third and further barrier is the low level of income relative to the cost of complete dwellings. There are generally two related problems: households cannot afford the deposits (which are often large as a result of the risk assessment of the financial institutions) because they have not been able to accumulate this quantity of cash, and they cannot afford to repay the loan due to their low incomes. The first problem is, in part, related to attempts by the lending institutions to reduce their risks (see Table 4.16). Lenders can reduce risk by offering to restrict the loan to a smaller proportion of the value of the dwelling. As shown in Chapter 5, a number of countries (notably, in Latin America) have introduced subsidy programmes that offer capital grants to address this problem and enable the would-be homeowner to then take up a loan.

A further indication of the problem of affordability is given by the World Bank, which reports that for Mexico 'about 40 per cent of newly formed households (300,000) earn less than three minimum wages (below US\$327 per month) and cannot afford a finished house in a serviced neighbourhood'.¹⁵² Only 12.6 per cent of the housing stock in Mexico is currently mortgaged and self-built housing accounts for roughly half of all new building in Mexico.¹⁵³ One assessment of the costs involved in borrowing money to purchase contractor-built housing in four Latin American

countries noted that even a modest 40 square metre house on a 100 square metre plot is too expensive for the low-income groups under existing lending terms and conditions.¹⁵⁴ In Colombia, a similar percentage (40 per cent) of families earn less than two minimum salaries (US\$250 each month) and are considered to be too poor to be able to afford loans for housing.¹⁵⁵ Other studies have also reported the lack of mortgage finance in low-income areas. In urban areas of Morocco, where just under 50 per cent of families own their own home, only 6 per cent of all formal housing loans are secured by low- and moderate-income households despite a government subsidy programme offering low-interest loans.¹⁵⁶ In Bangladesh, for example, the construction of a small house is affordable only for those with median incomes and above.¹⁵⁷ When the land costs for Dhaka are added to this cost, it increases significantly, and therefore only high-density medium rise appears affordable for this income group. Rising land prices also appear to have been a problem in some other Asian cities (for example, Manila) due to rapid economic growth and inward flows of finance for speculative property investment. In the context of Mexico, one assessment concludes:

... the least expensive commercially produced unit costs US\$16,000 and is affordable only to families earning about five minimum salaries without subsidies. In contrast, major home improvement and/or expansion costs US\$2000 to US\$40,000 and is affordable to households earning 1.5 to 2.0 minimum salaries. Other relative low-cost housing solutions include construction of a core unit on a lot already owned by the households (US\$6000 to US\$8000) and purchase of an existing unit in a low-income settlement (US\$10,000).¹⁵⁸

The kind of dwelling being referred to in Mexico is a basic unit of 40 square metres designed for further growth on a plot of, perhaps, 60 square metres and on the outskirts of the city. An indication of the scale of those who cannot afford mortgage finance is that 40 per cent of households earn less than three minimum salaries and, hence, cannot afford mortgage finance even when it is subsidized by the government.¹⁵⁹ In Latin America, only the upper-middle and upper-income households have access to mortgage finance. In Bolivia, Colombia, Venezuela and Suriname, low-income households make up, respectively, more than 60 per cent, 78 per cent, 80 per cent and above 70 per cent of the populations.¹⁶⁰ In the Philippines, one commentator concludes that the state is ineffective in targeting low-income households through a homeownership policy and an interest rate subsidy.¹⁶¹ Given indicative loan thresholds, the monthly repayment of a loan of 150,000 pesos for a low-cost house is such that 77 per cent of the country cannot afford to access these loans (54.5 per cent of urban households). In Panama, 34 per cent of urban households earn less than US\$300 a month and cannot afford mortgage finance (a further 43 per cent earn over US\$600 and qualify

without difficulty).¹⁶² The middle group households are in an intermediate zone and may only be able to secure mortgages if they have formal employment since it is common practice in Panama for mortgage payments to be deducted from salaries.¹⁶³ As these figures indicate, even in Southern countries that have experienced rapid growth in household income, few can afford mortgage loans. Many of the attempts to provide mortgage finance to lower income groups have failed due to issues of affordability (even with subsidy support).

In addition to the cost of the property, there are significant additional costs related to the transfer of properties, securing a mortgage and associated title registration costs. Table 4.12 gives indicative costs for mortgage bond registration and the transfer duty in South Africa; legal costs and taxes amount to an average of just under 7 per cent of the purchase price of a typical middle-class home. Transaction costs in Chile are estimated to be considerably lower, at about 2.75 per cent of the cost of a typical dwelling of US\$40,000, with just under half being stamp and registration fees.¹⁶⁴ One estimate suggests such costs equal 10 to 30 per cent of dwelling cost in sub-Saharan Africa, with stamp duty at 4 per cent in Kenya.¹⁶⁵ Such costs rise to 31 per cent of the estimated average transaction in Bangladesh.¹⁶⁶

Informal incomes may not be acceptable to those lending mortgage finance because they cannot be verified. Mortgage companies may refuse to provide finance to those who do not work in the formal sector and/or who cannot prove their incomes. Even if some income is secured through formal labour markets, in many cases, informal employment is a further and significant source of livelihood for the household. Alternative collateral such as provident or pension funds can be used in South Africa, Bangladesh and, more recently, in Namibia; but it does not emerge as an important source of a guarantee elsewhere. A further example about the problems of informal incomes comes from a group of potters, who have legal ownership of land, in the city of Alwar, India.¹⁶⁷ They have saving and land collateral, but no financing institution is ready to support them. This is mainly due to the seasonal nature of their job, which does not provide a regular income throughout the year. As such, the dependence upon the indigenous money lenders remains in the range of 60 to 80 per cent.

The costs of loan services may be too expensive at US\$10 a month in the US.¹⁶⁸ Total repayments on microfinance loans in Latin America are typically US\$20–\$80 a month, illustrating the difficulties that might be faced if high loan servicing costs were added:

... collecting on and processing a mortgage payment costs roughly US\$15 for a typical savings and loan in Latin America, while the total payment on most HMF [housing microfinance] loans usually is only US\$25 to US\$100 per month (for families earning US\$100 to US\$400 per month – i.e. income range of the low-/moderate-income majority in Latin America and the Caribbean).¹⁶⁹

Registration costs of a bond of 300,000 rand					
Initial costs	Valuation costs	Stamp duty	Administration costs per month	Registration	Transfer duty
199.50 rand	Up to 1250 rand ⁱ	600 rand ⁱⁱ	5.70 rand ⁱⁱ	3500 rand ⁱⁱⁱ	15,400 rand ⁱⁱⁱ

Notes: i Maximum permitted by law; around 684 rand would probably be charged.
 ii Defined by law.
 iii Average based on quotations supplied by three banks.
 Source: Hawkins, 2003, cited in Baumann, 2004

Table 4.12

Mortgage bond registration costs in South Africa

Both dimensions of affordability emerge from a more detailed analysis of the situation of the potters in Alwar. One reason why they face difficulties in accessing formal housing loans is described thus: 'Actually, the crux of the issue is that these loans are non-profitable for the banks due to small amount and high administration cost; and according to the bankers, these are high-risk loans.'¹⁷⁰ While a number of self-help groups in the city manage to save and access bank loans for income generation, their incomes are not adequate to access the larger loans for housing investment.¹⁷¹

For those who can afford mortgage loans and who can offer acceptable collateral, there are further barriers. In some settlements, it is difficult for low-income residents to reach the banks during opening hours due to their distance from low-income settlements. As a result, taking loans and making regular repayments is not possible. When the Self-employed Women's Association (SEWA) in India introduced its small loan programme, it sought to overcome these problems through pioneering doorstep banking.¹⁷² This was initiated by SEWA Bank in 1978, when its first mobile van travelled to areas of high customer concentration in order to facilitate cash collection. Today, two mobile vans cover the city daily, with average daily collections of 10,000 to 15,000 rupees each. Further barriers are cultural and skill related. In many societies, including Botswana, women suffer particular difficulties in securing formal housing finance because of their lower labour market participation in formal employment and the fact that they may not be able to prove ownership of assets.¹⁷³ The formal requirements of financial institutions may be difficult for the poor, who may have limited literacy skills and not be familiar with formal processes. These general comments serve as the preface to a more detailed look at the trends in Southern regions.

■ Asia

The financial crisis of the late 1990s resulted in difficulties for a number of Asian countries and housing finance has been struggling to recover. There is evidence from a number of countries that the difficulties have been overcome and mortgage finance is now continuing to grow. Box 4.3 describes the increase in default rates and, hence, poor financial returns in Thailand. The total number of home mortgages outstanding in Thailand had risen to a peak of 794,000 in 1997. Mortgage finance had expanded rapidly between 1985 and 1995, growing annually at 34 per cent in the first five-year period and 33 per cent in the second.¹⁷⁴ As a result of the financial difficulties during the late 1990s, there was a crisis of confidence in financial institutions and several collapsed. Mortgage finance, supported by the Government Housing Bank, has picked up in recent years. In the Republic of Korea, the system has recently been

Box 4.10 Deregulation of housing finance in the Republic of Korea

Prior to the financial difficulties in the Republic of Korea in 1997, the major source of funding was the Korea Housing Bank, renamed the Housing and Commercial Bank in 1997. The state used the bank to support low-income, low-cost housing; in effect, there was a single public supplier of mortgage housing finance, with only the Korea Housing Bank being authorized to give long-term mortgages with terms exceeding ten years. Housing finance was relatively scarce and homeownership in urban areas actually fell between 1960 and 1995 from 62 to 46 per cent.

The government sought to prioritize finance for industrial development and the Housing Bank was heavily dependent upon savings. Demand for housing so exceeded supply that state housing allocations were determined by lottery, the 'winners' of which could join the bank's lending scheme after making 'subscription deposits' for two years. Little additional state resources were directed to housing, and the system was public only in so far as it was structured by the state; people provided their own finance through savings. To further assist the accumulation of resources, a very specific rental finance system developed with capital commitments thereby facilitating the accumulation of funds; in 1997, informal rental deposits were twice the amount of formal housing loans. Mortgage rates benefited from an interest rate subsidy, although the benefits were primarily realized by the middle class who could afford to accumulate sufficient funds for the required deposit and take loans.

Source: Ahn, 2002, pp255–257; Ha, 2002b, p243; Ha cited in La Grange and Nam Jung, 2004, p563.

through major changes. While the financial crisis has encouraged the trend, deregulation began significantly earlier during the late 1980s.¹⁷⁵ Mortgage lending rose steadily throughout the early period of the 1990s and growth was in double figures until 1996.¹⁷⁶ The market was further encouraged by the removal of price controls on housing in 1998.¹⁷⁷ Financial deregulation did not initially result in a large uptake in mortgages because 'the long-term interest rate is very high, there is no tax concession on mortgage loan repayments, and the ratio of mortgage loan to housing price is set very low'.¹⁷⁸ However, the housing market began to recover towards the end of the 1990s, as indicated in Table 4.13. The more active involvement of the private sector in mortgage lending after 1997 was further encouraged by the fact that there was no longer an advantage to the public sector due to lower interest rates. By 2001, the private sector accounted for 42 per cent of mortgage loans.

Strong growth is also reported elsewhere. In Hong Kong, SAR of China, growth rates have been strong during the mid to late 1990s – for example, 26 per cent growth during the first half of 1997.¹⁷⁹

The economic crisis in Japan has been longer lasting than that which affected Asia during the late 1990s. The experience of Japan is particularly important because it highlights some of the risks of deregulation as increasing

financing opportunities encouraged lending for housing and consumer credit.¹⁸⁰ Investments in homeownership were encouraged during the 1960s and the lack of public rental accommodation increased the pressure on households to become homeowners.¹⁸¹ As economic problems increased for the banks' traditional industrial customers, they switched their concentration to potential homeowners. However, rapid rises in land prices caused particular problems during the 1990s – although the initial rise in prices and the associated real capital gains encouraged residential investment.¹⁸² In 1992, prices were so high that the required average loans equalled five times the average incomes of working people.¹⁸³ Prices peaked around 1990–1991 and have fallen since then. The state has sought to offer assistance to those in particular difficulties as a result of redundancy and income falls; but take-up of options such as longer repayment periods has been minimal. Homeownership levels are now similar to the early 1960s. While homeownership was heavily concentrated among men, recent trends and, notably, lower prices and interest rates together with deregulation of lending criteria have resulted in greater access for women.

Mortgage growth has also been notable in lower income Asian countries, such as Indonesia and India. In Indonesia, housing finance grew at annual rates of over 20 per cent between 1993 and 1996.¹⁸⁴ In India, the 1990s were noted for the increase in the number of specialist housing finance institutions. Prior to this, developments had been slow, although the Housing Development and Finance Corporation (HDFC) had been established in 1977.¹⁸⁵ During the 1980s, banks were reluctant to lend for housing as they saw it as too risky. However, during the 1990s, there was a turnaround when industrial growth slowed and banks looked for alternative borrowers. Low interest rates, rising disposable incomes, stable property prices and fiscal incentives all encouraged growth in lending for house purchase.¹⁸⁶ One commentator summarized the situation during the late 1990s thus: 'There are now more than 370 such companies that have housing finance as their principle objective, although the majority of them play an insignificant role'.¹⁸⁷ Reflecting this last conclusion, only 26 of these companies worked with the National Housing Bank.¹⁸⁸ These institutions have been lending to middle- and higher income groups. However, the scale of finance has increased by an estimated annual rate of 30 per cent during the last five years.¹⁸⁹ Nevertheless, the market remains small in India at only 2 per cent of GNP, compared to 13 per cent in the Republic of Korea.¹⁹⁰

This somewhat optimistic picture is not replicated everywhere. Mortgage finance has been slow to emerge in Pakistan, while traditional approaches have also dominated in Bangladesh. Box 4.11 describes the role played by the Bangladesh House Building Finance Corporation and its continuing emphasis on higher income groups.

In the Philippines, the government does appear to have been somewhat successful in extending subsidized loans to middle- and lower middle-income groups employed in the formal sector, principally through government-controlled pension and provident funds.¹⁹¹ There was an

Table 4.13

Growth of mortgage lending in the Republic of Korea: size of the primary mortgage market (trillion Korean won)

	1997	1998	1999	2000	2001
Outstanding balances of mortgage loans (A)	53.0	55.5	61.3	67.6	72.9
New origination of mortgage loans (B)	13.4	12.1	17.1	21.4	29.7
Gross domestic product (C)	453.3	444.4	482.7	522.0	545.0
A/C (percentage)	11.7	12.5	12.7	13.0	13.4
B/C (percentage)	3.0	2.7	3.5	4.1	5.4

Source: Bank of Korea, Kookmin Bank, quoted in Lee, 2003, p24.

increase in private-sector production of low-income housing during the early 1990s, which peaked in 1995 with 55.3 per cent of total residential development, involving the production of units costing less than 375,000 Philippine pesos, followed by a decline to 29 per cent in 2001.¹⁹² This appears to have been encouraged by tax incentives and the provision of mortgage finance for low-income earners through the Unified Home Lending Programme, and discouraged following the Asian financial crisis of the late 1990s.¹⁹³ However, as always, care should be taken when generalizing. In the case of the Philippines, private-sector housing production may have increased; but with regard to housing finance, the government's role in the market remains that of a primary lender. Between 1993 and 2001, about 971,000 households gained homeownership through the National Shelter Programme. Despite such provision, however, the proportion living in informal settlements continues to rise.¹⁹⁴ There have been attempts to reduce the significance of the government housing finance institutions; but the reforms were abandoned in 1999, with a return to an emphasis on subsidized housing.

In China, the system of housing finance has been significantly redeveloped. The previous scheme was one in which dwellings were primarily provided through work units that housed employees in return for a nominal rent.¹⁹⁵ During the 1980s, an alternative system began to emerge in which the state sought to privatize and commercialize housing, shifting responsibility away from work units. Key to such a shift was a significant reduction in state housing subsidies across urban China; they fell from being equal to 18 per cent of household income in 1988 to less than 10 per cent in 1995.¹⁹⁶ In 1995, the government introduced two major programmes to encourage home purchase: the National Comfortable Housing Project and the Housing Provident Fund. It is difficult to assess the significance of these moves with regard to increasing access to mortgage finance and greater homeownership. One study concludes that, in 1997, 80 per cent of the population still remained in some form of state-owned housing.¹⁹⁷ Another assessed that, by the end of 1997, the average percentage of privatized housing in the 36 major Chinese cities was 60 per cent.¹⁹⁸

The Housing Provident Fund programme in China drew on the successful experience of encouragement for homeownership in Singapore and was launched in 1991. One of the objectives was to ensure that employees made a greater contribution of the costs. The first provident fund, established in Shanghai in 1991, required a 5 per cent contribution from both employee and employer.¹⁹⁹ By the end of 1999, all of the 203 large- and medium-sized cities and most of the 465 small Chinese cities had started provident funds, with 69 million participants and 140.9 billion yuan having been raised.²⁰⁰ However, just 10 per cent of this total had been released in mortgage loans. This is partly because of real problems in affordability, as illustrated in Box 4.12.

Box 4.11 Bangladesh House Building Finance Corporation

The Bangladesh House Building Finance Corporation (HBFC) was established in 1952 to stimulate middle-income house construction for civil servants in urban areas, and Bangladesh HBFC was recognized in 1973 after independence. While the majority of its clients are civil servants, its mandate has broadened to include all eligible private citizens and groups. It does not lend to developers or builders. During 1995/1996, the corporation's total assets were 26,218 million Bangladesh taka, of which 22,201 taka were outstanding loans and advances. Authorized capital is 1000 million taka, with 973 million taka being paid up. The main sources of funds are dedicated government bonds issues specifically floated for their programmes. The recent interest rate paid on debentures is 8 per cent, although previous issues had a lower rate. Additional transfers are provided by government on a limited scale. The HBFC is tax exempt. The government decides annually on the scale of funding and on activity. The HBFC disbursed loans of 1306.0 (provisional) million taka during 1999–2000, which was an increase of 42.3 per cent over the preceding year.

The corporation operates commercially, setting interest rates in accordance with the cost of funds and operating costs. Net profits have been increasing and since 1993/1994 have been positive (until 1999). The HBFC has financed 125,000 units since its inception, mostly for higher income households. In 1998, the bank only operated in high-income areas within Dhaka and on a limited scale in Chittagong and Rajshahi. In 1999, the corporation expanded its housing loan programme all over the country.

Recovery performance is poor and the recovery on current loans is 86 per cent, although the cumulative recovery is only 44 per cent. The HBFC recovered 2286.3 (provisional) million taka during 1999–2000, which was 16.9 per cent higher than the preceding year. Various incentive schemes are in place to encourage people to repay on time and to receive interest rate incentives. Mortgages are for 15 years, with interest rates increasing with the loan amount. This may be relaxed to 20 years in the case of small-size apartment schemes for low- and middle-income people. In Dhaka, loans above 1.5 million taka carry a simple interest rate of 15 per cent, and those below 1.5 million taka have a rate of 13 per cent. Outside Dhaka, the rate is 10 per cent. The grace period is one year. The local loan-to-value ratio is 60 per cent except for group loans, which have a loan-to-value ratio of 80 per cent.

In 1998, the institution was reluctant to move down market for fear of high levels of non-repayment. However, new apartment loans in the metropolitan cities of Dhaka and Chittagong and for 'semi-pucca' houses in the district towns, and a loan scheme for small-size flats (550–1000 square feet) for middle- and lower middle-class people have been introduced.

Source: Hoek-Smit, 1998; www.bangladesh.net/article_bangladesh/economic_trends/eco_13_house_building_finance.htm

Box 4.12 The move to homeownership in China: Guangzhou Province

Guangzhou is a city of 8 million people in southern China in an area that has experienced rapid economic growth. In 1998, Guangzhou pioneered a Housing Allowance Scheme to replace in-kind welfare housing and to move away from existing systems of housing provision. The scheme sought to reduce the responsibilities of work units and to encourage homeownership.

Despite the housing allowances, there remain considerable problems of affordability. In 1997, annual incomes for low- and middle-income groups ranged from US\$1150 to US\$1900. The cost of housing at that time was such that a 60 square metre unit cost US\$26,000. In order to address the lack of affordability, the government designed an allowance based on rank and seniority that could be used to pay rent, to build up housing savings or to apply for a government loan that could cover up to 30 per cent of a property price. The loan would be repaid through the housing allowance. Once households have 30 per cent of the property price in their savings account, they can apply for a bank loan. Continuing problems are a lack of affordability, the lack of mortgage finance and low investment in housing.

Source: Chi-Man Hui and Seabrooke, 2000

■ Latin America

In Latin America, less than 30 per cent of dwellings are produced by the formal housing market.²⁰¹ As noted in Table 4.7, residential debt is, in general, a fairly low percentage of GDP, indicating that mortgage lending is not extensive. Significant difficulties of foreclosure, with long foreclosure periods taking over one year, are just one set of the problems that has reduced the attractiveness of mortgage finance in this region.²⁰² Some governments in Latin America established housing banks; but these concentrated on middle- and higher income housing and failed to address issues facing those with lower incomes.²⁰³ During the last decade, the core issues facing governments in Latin America appear to be the longstanding problems of macroeconomic performance and, notably, inflation; the specific economic difficulties of the late 1990s; and the need to extend finance to those with lower incomes (Box 4.14 describes the complexities of mortgage indexing in Mexico, which has been developed to reduce the risks associated with anticipated inflation). The related strategies have been titling, direct-demand subsidies, the use of specially defined units for housing investment and the expansion of capital into the system through strengthening of the secondary market. Direct-demand subsidies have been introduced in a number of Latin American countries (including Chile, Colombia, Costa Rica, Ecuador and Mexico) to improve access and affordability (see Chapter 5).

While there are continuing problems of underdeveloped housing finance systems, in part as a result of the economic difficulties of recent decades, there are some positive trends in Chile, Costa Rica, Panama, Mexico and Peru, with uneven progress in Colombia, Bolivia and Ecuador.²⁰⁴ These improvements include financial-sector reforms to facilitate the expansion of mortgage financing, judiciary reform to facilitate the recovery of collateral and an increase in housing production/finance in the private sector. They also involve attempts to have public housing agencies working more effectively with the treasuries, private banks and developers to address housing needs of beneficiaries.

Box 4.13 Extending housing finance in Mexico

In Mexico, the government has sought to increase access to mortgage finance (with subsidies) for the low- and lower middle-income group with between two to five minimum salaries. The challenge that the government has set itself is to double annual formal housing production to 750,000 dwellings. The newly created Federal Mortgage Bank (Sociedad Hipotecaria Federal, or SHF) provides secondary finance to a group of specialist housing lending agencies, SOFOLES (Sociedad Financiera de Objeto Limitado), which were created in 1994 to serve as intermediaries in the residential mortgage market. SHF provides a guarantee in respect of loan default.

The SOFOLES originated less than 1 per cent of mortgages in 2001. By 2006, it is anticipated they will originate 19 per cent of mortgages in a market that is expected to double the number of loans that are granted. By the end of 2002, 18 SOFOLES had been set up with a total portfolio of 265,000 mortgages. Collection rates have been maintained with an average default of 2.4 per cent on total outstanding mortgage balances. The next challenge for SOFOLES is to move beyond their dependence upon funding from the SHF with the greater use of secondary market instruments.

Source: Dale-Johnson and Towle, 2002; Zaltzman, 2003.

Box 4.13 describes the creation of new housing finance institutions in Mexico and illustrates some of the challenges. In 2001, 69 per cent of mortgage loans in Mexico were given by Fondo de la Vivienda del Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado (FOVISSTE) and Instituto del Fondo Nacional de la Vivienda para los Trabajadores (INFONAVIT), with the institutions receiving compulsory contributions of 5 per cent from public and private works for housing and pension funds. Many of their loans go to those with higher incomes; even with an interest rate subsidy, they are not affordable by the poor. It is estimated that households need to earn three times the minimum salary to be able to afford such subsidized loans.²⁰⁵

To reduce the significance and, hence, the cost of subsidized loans, and to create new possibilities for expanding lending, the government introduced a new set of housing institutions, the SOFOLES (see Box 4.13). SOFOLES, or Sociedad Financiera de Objeto Limitado, are now estimated to be the main source of private home lending, following the withdrawal of the banks from the market after 1995; they can make loans and raise debt on the capital markets, but cannot take deposits from the public.²⁰⁶ Their target market is now those who have more than five minimum salaries (about US\$7500), which is already an increase on the initial target market (more than three minimum salaries) at the time of establishment in 1994.²⁰⁷ SOFOLES appear to be particularly successful in reaching out to informally employed households. They have sought a means of reaching those who do not have access to payroll lending, with the achievement of lower delinquency levels than either INFONAVIT or the banks:

First, they have developed underwriting criteria for self-employed and informal workers: households pay a monthly sum equal to their desired mortgage payment into an account for a designated period of time, demonstrating consistent ability to pay and accumulating funds for a down payment. Second, in-person delivery of statements, acceptance of payments at on-site locations and outside of traditional business hours offer convenience and greater comfort than traditional servicing mechanisms.²⁰⁸

In Chile, household demand for mortgage housing finance has been growing during recent years and, in 2002, loans generally started at about US\$10,000 (compared to US\$6000–\$8000 of finance within the subsidized housing programmes, which may include a component of loan finance). It appears that the non-repayment of loans associated with subsidized housing has reduced the capacity of mortgage finance to reach further down to lower income households.²⁰⁹ In 1976, there was an authorization for banks to offer mortgage-backed bonds and, since then, the banking system has been the main originators of housing loans. Although other types of mortgages have developed, these remain the most significant, with about 75 per cent of lending. An expanding market with new products and greater competition has brought down the price of housing

finance, with a decline in the spread (the difference between the rate paid on the bond and that paid by the borrower) from 3 to 2 per cent between 1988 and 1997.²¹⁰

■ Sub-Saharan Africa

The situation in sub-Saharan Africa divides between South Africa (and, to a lesser extent, Namibia and, until recently, Zimbabwe), where the commercial banking sector is significantly involved in mortgage lending, and the rest of the continent.²¹¹

In South Africa, outstanding credit extended to private households in South Africa was about 360 billion rand (US\$55.8 billion²¹²) in 2002 (see Table 4.14). Of this, 191 billion rand (53 per cent – US\$29.6 billion) was for private mortgages. A further 7 billion rand (US\$1 billion) was for mortgages extended by parastatals and non-bank institutions. South Africa's mortgage market is thus about 198 billion rand (US\$30.7 billion). The South African Microfinance Regulatory Council²¹³ estimates that registered microlenders (including banks) currently hold 5.6 billion rand (US\$868 million) in non-mortgage credit used for housing purposes.

Table 4.14 emphasizes that most housing finance is provided through bank mortgages. Despite this scale of finance, there is evidence to suggest that the lower income households remain excluded from the market. A national survey by the National Housing Finance Corporation in 2000 focused on the 1000 to 8000 rand monthly income bracket of lower to lower middle-income households.²¹⁴ The survey found that, of those seeking to buy, 41 per cent felt that financial institutions would not provide them with credit facilities due to their low income, while nearly a third (31 per cent) were unable to access credit from financial institutions due to being informally or self-employed. Only 38 per cent had applied for finance, with 13 per cent being successful. Three specific problems emerge: informality of tenure and incomes; lack of affordability; and lack of institutional reach. The informality of tenure and of incomes makes it hard for the poor to secure finance. While those who are in formal employment can use their provident funds to guarantee housing loans, many work in the informal sector. Moreover, mortgage finance is unaffordable to many. Approximately 2.28 million households live in South Africa's 'township' areas, 21 per cent of all households in South Africa. Thirty-three per cent of these households own their property (compared to a national average of 53 per cent).²¹⁵ Most lack sufficient income, estimated to be a minimum of 2500 rand, or US\$390, per month, that is needed to afford a mortgage loan. The government census of 1996 estimated that 75 per cent of households have incomes below this level. There are few alternatives; those offering smaller loans charge higher interest rates. Although legislation has eased the provision of such microloans, their size is small and insufficient for housing purchase. As discussed in Chapter 6, many would be refused loans for reasons other than income.

The lack of market development in much of the rest of sub-Saharan Africa is related to similar reasons for excluding many poor South Africans from formal mortgage

Box 4.14 Reducing lender risk in Mexico

One of the historic problems for Mexican borrowers and lenders has been interest rate risk as a result of high inflation. During the early 1990s, escalating payments and falling incomes resulted in up to 80 per cent defaults on loans.

The Dual Index Mortgage (DIM) links the price of the house, or principal of the loan, to Unidades de Inversión (UDIs), which are the Mexican unit of investment introduced after the 1995 financial fiasco. In November 2004, the UDI was worth 3.5 pesos, or approximately US\$0.30. The UDIs are indexed to the cost of living, so the amount that borrowers have to pay rises as the value of the loan rises, while the monthly payment is indexed to the minimum wage level, which also increases (although it often lags somewhat behind both the cost of living and average wage). Differences between the actual and required payments are added to the loan balance. In extreme cases it might be that the lender had a loan that could never be fully amortized. This problem has been reduced by the introduction of insurance against relative declines in the borrower's income. The insurance was originally 11 per cent of the monthly payment, but is now 5 per cent.

Source: Dale-Johnson and Towle, 2002, p23; Lea, 2000, p18.

markets. Incomes are too low and employment is informal. Further problems include macroeconomic instability and problems around tenure insecurity. As a result of such factors, commercial housing markets remain minimal in many African cities.²¹⁶ The housing finance sector is dominated by those institutions which are state owned, receive financial support from the state, often offer subsidized loans and have poor repayment records.²¹⁷

The original conceptualization after political independence was that the private sector would provide for higher income groups; hence, the focus of government should be on the middle- and lower income groups. Many sub-Saharan African governments established national housing agencies to directly develop houses, offer loans and establish financial systems. However, the experiences were not successful. As illustrated in the case of the National Housing Fund in Zimbabwe, there were structural and affordability problems.²¹⁸ In this specific case, the fund loaned at interest rates that were lower than the cost of funds, and had significant arrears from local authorities who managed the dwellings and who were responsible for repayment. Nevertheless, despite a technical agreement that such local authorities would be denied future loans, in practice the political decision was that investments should continue, even in the case of local authorities in arrears.²¹⁹ A further example is the Tanzania Housing Bank established in 1973, which collapsed in 1995. In this case, despite a number of specialist and general funds, relatively few loans were issued, with a total of about 36,000 units, over the 22-year period of its existence and the estimated loan recovery rate was only 22 per cent.²²⁰

Table 4.14

South African housing finance (by total loan book)

Type of credit	US\$ billion	Percentage of housing finance market	Percentage of consumer credit market
Consumer credit	55.8	–	100
Total housing finance, of which:	30.9	100	55.4
bank mortgages	29.6	95.8	53.0
non-bank mortgages	1.01	3.3	10.0
non-mortgage loans for housing	0.87	2.8	1.6

Source: Hawkins, 2003, and Microfinance Regulatory Council (www.mfrc.co.za), both cited in Baumann, 2004.

	Deposits	Bonds	Foreign loans	Equity
Housing Finance Corporation of Kenya (HFCK)	79			14
Housing Development and Finance Corporation (India)	48	15	8	14
Union Homes (Nigeria)	74			7
Banque de l'Habitat du Sénégal (BHS)	63	26	5	6
Home Finance Company (Ghana)	8	80		10

Source: Okonkwo, 2002, p93.

Table 4.15

Source of funds for housing finance institutions (percentage)

Affordability is one of the problems faced by housing finance institutions in Africa. Even in South Africa, 75 per cent of households earn too little to be considered for mortgage loans; this is already considerably higher than the 40 per cent of households who cannot afford mortgage loans in Mexico and Panama. In Zimbabwe, nine out of ten low-income home seekers on the housing waiting list in Harare in 1996 had a monthly income of less than Zimbabwe \$900, which would only qualify them to buy a plot in the Kuwadzana 5 low-income housing project that was being developed at the time.²²¹ Even a plot and wet core was beyond them; but this is what would be required for legal settlement. The emphasis on affordability problems continues elsewhere: 'The average cost of a decent low-income family house in Ghana (about 50 million cedi) is more than ten times the average annual salary of most key works in Ghana.'²²² Similar conclusions about affordability problems are reached for Tanzania, where a two-bedroom low-cost house required, in 2002, a monthly repayment equal to the total of a minimum monthly government salary.²²³

The consequences of such a lack of affordability have been the lack of market development. Hence, in Kenya, it is estimated that during 2004 the banks and mortgage institutions only offered 9000 loans.²²⁴ Few loans have been given by the Housing Finance Company in Uganda; in 2000, they had 724 loans on their books.²²⁵ The very small numbers is indicative of the scale of the problem. Such low levels of lending reflect perceptions of risk, as well as the small numbers who can afford mortgages. An illustration of the cautious nature of lending agencies is given by the Home Finance Company in Ghana, which would like to have monthly repayments in US dollars, despite the difficulties for those being paid in a local (and depreciating) currency.²²⁶ Such lending conditionalities will inevitably result in a very small demand for mortgage loans.

While state housing finance institutions have continued in some cases, the greater emphasis on cost recovery and operating efficiency during the 1990s has given them considerable problems in securing finance. A recent review noted that while housing finance institutions exist in some African countries, in others they are lacking.²²⁷ Generally, those that do exist have been heavily regulated and have also been seen as social instruments, rather than financial mechanisms. More recently, the state has withdrawn from this area, and some housing finance institutions have withdrawn as well. Government institutions that continued have been expected to secure higher levels of cost recovery in an effort to reorientate them to financial agencies, and alternative (commercial)

institutions have been encouraged. One recent analysis of the situation across the continent highlights this process of transition.²²⁸ Structural adjustment reduced the role of building societies and resulted in state-owned development institutions being privatized or wound up. There are a number of new initiatives emerging, notably in the Gambia and Kenya. However, apart from Ghana's Home Finance Company (and excluding South Africa), secondary mortgage finance institutions are limited.²²⁹ Hence, a particular and continuing problem faced in Africa has been 'a lack of effective institutions and instruments to mobilize these savings and channel them into housing investment'.²³⁰ For the most part, housing finance institutions have remained dependent upon deposits and have not been able to secure long-term finance (see Table 4.15).²³¹

Despite the recognized need for additional finance, relatively little concentrated attention has been given to the private sector. In Nigeria, only 1 of 18 broad housing strategies designed to realize housing policy during the early 1990s concerned the private sector.²³² The Federal Mortgage Bank of Nigeria was established to provide additional housing finance; but between 1977 and 1990/1991, it gave only 8874 loans.²³³ As noted above, attempts have been made to replicate payroll funds; however, while the National Housing Fund collected 4 billion naira from households in mandatory savings, only 300 million naira of loans was approved by the Federal Mortgage Bank, with only one third of this total actually being advanced.²³⁴

This regional analysis has highlighted some of the trends (opportunities and difficulties) with regard to housing finance. The following section summarizes information about lending terms and conditions and, in so doing, highlights some of the problems faced by would-be borrowers in the South.

TERMS AND CONDITIONS

Mortgage lending is associated with a standard package of terms and conditions that specify the contribution of deposits, on some occasions the period of savings, the interest rate to be charged on the loan (and if it is fixed or variable), the period of the loan (potentially with penalties for early and late repayment), and loan-to-value ratios (the maximum percentage of the loan against a verified value of the dwelling). A further important factor is the amount that the loan institution is willing to lend in relation to the borrowers' income(s).

Loan periods and loan-to-value ratios (LTVs): Accessing loans

While aspects such as interest rates are likely to be determined by macroeconomic conditions and policies, and borrower income cannot be determined by the lender, other factors make a critical difference to the affordability of the loan and the capacity of lower income households to secure mortgage finance. Longer loan periods reduce monthly repayments and higher loan-to-value ratios (LTVs) reduce the scale of the deposit that has to be saved. Table 4.16 gives

indicative mortgage loan lengths and estimated LTVs for a number of countries.

Table 4.16 demonstrates that there is considerable difference even between countries in the North. Higher loan-to-value ratios may be associated with longer repayment periods if both are responding to high housing prices and the need to borrow larger proportions over longer periods to cover such costs. For example, the terms given in Table 4.16 for Thailand was introduced following the financial crises and the problem of affordability. However, risk is an important factor in addition to affordability, and it is notable that shorter repayment periods prevail in a number of transitional and Southern countries. This issue can be illustrated by Ghana, where mortgage companies want homebuyers to have a high stake in the property and generally require at least a 20 per cent deposit, although, in some cases, the required down payment is 50 per cent.²³⁵

Table 4.17 provides a summary of 'typical' and 'maximum' LTVs in 8 countries drawn from the 15 member states of the EU. Half of these countries' mortgage systems are able to provide LTVs of at least 100 per cent; but maximum LTVs of 90 per cent or less apply in 60 per cent of the EU-15 market.²³⁶ Maximum LTVs may be raised by the use of secondary loans (for example, in Germany); but they may still be a considerable barrier to entry into homeownership. Rising house prices in many Northern countries have increased the pressure on the system and have resulted in increasing efforts to improve borrower affordability. In Japan, loan periods also increased during the 1990s as house prices rose.

Difficulties of foreclosure are often associated with the South, but, as Table 4.18 indicates, the process of foreclosure is often not quick even in the North. Such issues explain the significance given to verifiable incomes and other indicators of borrower reliability, as well as measures to reduce lender risk, such as red-lining. Foreclosure is, in general, a last resort that is difficult to use effectively at scale. Where lenders are under pressure to carry additional risks with longer loan periods and higher loan-to-value ratios, or with extending loan services to new groups of clients, then insurance may be increasingly significant. Table 4.18 provides data for some countries in Latin America; although, in general, periods are longer, this is not the case for every country.

Savings

Typically, mortgage finance is only available for a proportion of the purchase price of the house. As noted in Table 4.15, it is not common for mortgages to be available for the full cost of the property and LTVs are typically below 90 per cent. The remaining costs have to be met by savings or some other form of pre-existing finance. However, traditionally, saving has played a much more important part of access to mortgage finance in specialist institutions aimed at both collecting savings and issuing loans. Savings are believed to be important in preparing households for making regular payments and ensuring that the loan repayments are affordable. The increased diversification of housing loan

Country	Usual contract length (years)	Estimated average LTV ratio (new loans) (percentage)
Australia	25	90–100
Austria	25	60
Bangladesh	up to 15	50–80
Belgium	20	80–85
Canada	25	60
Chile	8–20	up to 75
Czech Republic	less than 20	30–50
Denmark	30	maximum 80
Finland	15–20 (variable)	75–80
France	15–20 (variable)	maximum 60
Germany	20–30, with initially 5–10	70–80
Greece	15	55
Hong Kong, SAR of China	15–30 (mostly 15)	up to 70
Hungary		maximum 70
Iceland	25–40	65–70 from main lender
India	maximum 20	maximum 85
Jordan	up to 20	80–90
Lithuania	20–25	70–95
Mexico	20–30	80–90 (100 from payroll funds with contributions as implicit deposit)
Netherlands	30	87; maximum 125 for first-time buyers
Portugal	25–30	90
Slovenia	10	50
South Africa	10–20	70–100
Republic of Korea		average 41 (maximum is 50–60)
Sweden	30–40	80–90
Tanzania	15	75
Thailand	30	70–80 is typical; maximum 90–100
UK	25	70
US	30	average 76.2

Source: Scanlon and Whitehead, 2004, p18.

Except: India – Karnad, 2004; Tanzania – Mutagwaba, 2002; Mexico – Connolly, 2004b; South Africa – Baumann, 2004; Chile – Pardo, 2000 (for mortgage bonds which are 75 per cent of all mortgage loans); Thailand – Kritayanavaj, 2002; Aphimeteetamrong and Kritayanavaj, 1998, p229; Republic of Korea – Lee, 2003, p28; Jordan – Chiquier et al, 2004, p29; Hong Kong – Lamoreaux, 1998, p70; Bangladesh – Hoek Smit, 1998, pp29–30.

Table 4.16

Indicative mortgage lengths and loan-to-value ratios (LTVs)

suppliers has reduced the general significance of savings activities that are specifically linked to housing; but some form of saving remains essential if mortgage loans are offered for less than the full cost of the property.

A significant refinement of more traditional savings practices that remains important in some countries is contractual savings for housing, or *Bausparkassen*. Contractual savings schemes are dedicated savings activities undertaken by would-be borrowers who may be paid below-market interest rates on their accumulating savings. The savings period is followed by the offer of a housing loan (also at reduced interest) once the deposits have reached a certain level. The institution has been popular in Germany and

Table 4.17

Loan-to-value ratios (LTVs) in eight EU countries

Country	Typical LTV (percentage of property value)	Maximum LTV (percentage of property value)
Denmark	80	80
France	67	100
Germany	67	80
Italy	55	80
Netherlands	90	115
Portugal	83	90
Spain	70	100
UK	69	110

Source: Mercer Oliver Wyman, 2003, cited in Stephens, 2004

Table 4.18

Approximate time to take property into possession

Country	Time (months)
Netherlands ⁱ	4
Denmark ⁱ	6
Spain ⁱ	8
France ⁱ	10
Germany ⁱ	10
UK ⁱ	11
Portugal ⁱ	20
Italy ⁱ	60
Argentina ⁱⁱ	10–18
Chile ⁱⁱ	12–18
Colombia ⁱⁱ	45
Peru ⁱⁱ	31
Uruguay ⁱⁱ	24

Source: i Mercer Oliver Wyman, 2003, cited in Stephens, 2004; ii Rojas, 2004, p14.

Austria and has more recently spread to other countries, particularly the transition countries. Such institutions were introduced in Slovakia (1993), the Czech Republic (approximately 1994), Hungary (1997) and Croatia (2000).²³⁷ The subsidy is often justified on the grounds that long-term savings are encouraged, that the practice of regular payment is established by the early period of saving and that interest rate changes are minimized.²³⁸ However, one necessary precondition is low and stable inflation rates (thereby maintaining the value of the accumulating funds).

There have been concerns about the efficiency of contractual savings schemes. Once committed, the savings are tied up; as a result, such schemes suffer from their inflexibility when the broader financial and economic environment changes. The subsidies required to attract savings may be considerable, leading to the inefficient use of government funds and budgetary pressures. It is for reasons such as these that Poland is moving away from this system.²³⁹ In Slovakia, there is some evidence that they have been used as a transitional instrument, with loan volumes rising while the subsidy burden is falling.²⁴⁰ Such schemes have been poorly targeted in terms of households' incomes. However, they could potentially be limited to certain groups defined by income or age. Some schemes have been criticized for being used to subsidize savings unconnected to house purchase, although this could also be prevented by a more restrictive design.²⁴¹

Interest rates

Interest rates reflect the cost of capital – they are the price that borrowers have to pay to the lender to make use of the funds. If the housing finance market is working effectively, interest rates should be only slightly higher than prime lending or deposit rates in the commercial banking sector.²⁴² However, in practice, rates may be higher and/or lower depending upon market efficiencies, perceptions of risks and state intervention. Despite the comment above that interest rates are often a 'given', set exogenously by macroeconomic trends and monetary policy, in some cases state housing institutions or those receiving subsidies charge interest rates below market rates.

State housing agencies have more flexibility in the use of funds. In Thailand, for example, the National Housing

Bank undercuts commercial interest rates. It also offers differential rates (through a cross-subsidy) to those taking smaller loans in order to 'make borrowing more accessible and more affordable to a large number of home buyers'.²⁴³ Examples of subsidized interest rates have been given in this chapter for Tunisia, India and Hungary. A further example comes from the Philippines mortgage market, where rates are variable; in 1996 the cost of commercial borrowing was 16 per cent (secure for one year), while subsidized loans charged 9 to 12 per cent.²⁴⁴

Alternatively, the way in which financial markets respond may also differ. As a result, the cost of funds may vary to reflect the relatively lower administration costs associated with larger loans. The following figures are those currently prevailing in Chile:²⁴⁵

- For loans from 800 to 1999 UF (Unidades de Fomento, a Chilean-peso denominated unit with daily adjustment to inflation) the rate is 4.8 per cent.
- For those from 1999 to 2999 UF, the rate is 4.4 per cent.
- For 3000 UF and more, the rate is 3.7 per cent.

Interest rates can be particularly problematic for affordability during periods of high inflation. High nominal interest rates tend to worsen the so-called 'front-end loading' problem, where the real burden of interest payments falls very heavily during the early years of the mortgage, which often coincides with stages in the life cycle when financial burdens are high (dependent children) and earnings have not yet been maximized. High interest rates considerably increase the cost of borrowing and make housing investments unaffordable for many families. The problem can be exemplified by Tanzania, where inflation in 2000 was between 18 and 25 per cent.²⁴⁶ A loan equal to three times annual income would require total yearly payments equal to 55 to 75 per cent of annual income. A more detailed report calculates that if the interest rate 'was to drop to 10 per cent per annum, the affordability ratio, though still low, will tremendously improve'.²⁴⁷

In the North, there is discrepancy between fixed and variable rates. In general, there appears to have been a shift to flexible, variable rates, which pass more of the risks from the provider of the loan to the borrower.

Table 4.19 illustrates the situation in South Africa by providing a snapshot of terms and conditions for lenders of small loans (the first two rows) and complete loans (the following four rows). Interest rates are relatively high, reflecting two state policies not unusual in the South: first, the government wishes to encourage capital inflows to strengthen the currency and, second, it wishes to encourage saving. Table 4.19 illustrates the high cost of borrowing for those unable to secure mortgages.

Finally, lenders commonly restrict loan repayments to a maximum percentage of incomes. While a typical percentage is up to 25–30 per cent of income, higher rates have been used to increase loan acceptances as house prices rise. In Hong Kong, the rate rose to 50 per cent, in Thailand it is 30 per cent or higher for big loans and in Ghana it is about 35 per cent.²⁴⁸

Table 4.19

Terms and conditions in the South African housing finance market

Type of intermediary	Cost of funds (percentage)	Average annual charge to client (percentage)	Form of security	Average loan size (rand)	Term of loan
Microloan – NHFC incremental housing	16%	42%	Unsecured	4660 rand	21 months
Pension-backed loan	11% ⁱ	16–17%	Pension fund	20,000 rand	8 years
NHFC mortgages – homeownership	13%	17%	Property; after eight months, risk shifts to NHFC	80,000 rand	15 years
Low-end bank mortgages	11% ⁱⁱ	19–20%	Property	90,000 rand	20 years ⁱⁱⁱ
High-end bank mortgages	11% ⁱⁱ	15–17%	Property	210,000 rand	20 years ⁱⁱⁱ
High-end independent	13.5%	15%	Property	220,000 rand	20 years

Notes: i Opportunity costs of possible deposit rate.
 ii Highest deposit rate; in reality, the average depositor earns far less.
 iii Written for 20 years, but average effective term is 7 years.

Source: Baumann, 2004, p12.

HOUSING FINANCE, AFFORDABILITY AND LOWER INCOME HOUSEHOLDS

Considerable effort has been made to extend opportunities to secure housing finance during recent years. This is the product of two related factors. On the one hand, the housing finance market has become more competitive as new providers have been encouraged to enter the market. Such providers have been seeking new customers to extend their activities. Thus, the extension of mortgage services is a commercial response to market conditions. As noted earlier, this has been partly determined by growing incomes. On the other hand, the state has been looking to the market to address housing need. Faced with considerable housing problems and seeking to reduce public expenditure (see Chapter 5), governments have sought to encourage the market to address needs where possible.

The price of housing

Affordability is not just about access to and the cost of housing finance; it is also critically about the price of housing. The price of housing reflects the costs of production, but also the balance between supply and demand in the market for housing. However, much policy emphasis has been placed on extending financial services, with relatively little attention being given to increasing the quantity of housing.

The relatively high price of housing now appears to be a significant constraint on access to housing in a number of different contexts around the world. One of the most important trends in housing finance in Western Europe has been the widening 'gap' between incomes and house prices, as the latter have risen relative to the former in many countries.²⁴⁹ The increase in housing prices extends beyond Europe. For example, in New Zealand, between December 2001 and December 2003, house prices rose by 27 per cent while consumer price inflation was only 4.3 per cent during the same period.²⁵⁰

This 'gap' can be characterized as the main indicator of 'underlying' affordability that housing finance systems

exist to bridge. Table 4.20 shows changes in (as opposed to absolute levels of) housing affordability in a number of West European countries based on the relationship between house prices and disposable incomes per worker.²⁵¹

Analysing Table 4.20, it is evident that 'underlying' affordability has worsened considerably in four of the seven countries included in the table since 1990, although the deterioration can often be traced as far back as 1970. The largest deteriorations in underlying affordability since 1985 have been experienced in Spain, the Netherlands and Ireland, and to a lesser extent in the UK. More modest deteriorations have occurred in France and Italy since 1985; but these have occurred within a longer-term context of relative stability. Germany stands out as having experienced consistent and marked improvements in underlying affordability since 1970.

House prices have risen particularly since 1997, notably in Australia, Ireland, Spain and the UK.²⁵² In 2003, the European Mortgage Federation noted particularly strong price increases in Latvia, Portugal, Spain, the UK and Ireland.²⁵³ *The Economist* has tracked a slightly larger range of countries and data is given in Table 4.21. It notes that there is evidence of prices falling towards the end of 2004 in some countries; but growth continues in others.

Seeking to explain the rise in house prices, the International Monetary Fund (IMF) suggests that house prices are increasingly synchronized across high-income countries. There is evidence of a long-term trend in rising house prices; but prices are also linked to affordability (and, therefore, to incomes), with particularly high prices at present. One further explanatory variable is interest rates (a significant part of the cost of borrowing), and it is low interest rates that are one explanation behind the current

Table 4.20

Changes in underlying affordability since 1970 in selected West European countries

Country	1970	1980	1990	2003
Germany	129	114	95	80
France	123	125	119	125
Italy	–	135	130	131
Spain	147	127	199	289
Netherlands	137	151	111	243
Ireland	–	136	110	201
UK	97	109	137	156

Note: Change in ratio of house prices to disposable income per worker. 1985 = 100
 Source: IMF, 2004.

Country	2004 ⁱ	2003 ⁱⁱ	1997–2004
Australia	8.2	17.6	112
Belgium	9.3	5.5	50
Canada	6.7	6.5	43
China	9.9	4.1	no data
Denmark	7.3	3.4	50
France	14.7	11.5	76
Germany	-1.7 ⁱⁱⁱ	-4.5	-3
UK	13.8	11	139
Hong Kong, SAR of China	31.2	-13.6	-49
Ireland	10.8	14.8	187
Italy	9.7	10.6	69
Japan	-6.4	-4.8	-24
The Netherlands	3.3	1.9	76
New Zealand	16.4	21.2	56
South Africa	35.1	20.9	227
Spain	17.2	16.5	149
Singapore	nil	-2.3	no data
Sweden	9.8	5.5	81
Switzerland	2.2	2.4	12
United States	13	6	65

Notes: The first two columns show percentage change on a year earlier.
i Third quarter, or 2004 latest. ii Third quarter. iii Second half of 2003.
Source: The Economist, 2004.

Table 4.21

House price changes

global price boom. Overall, global developments, including those specific to housing markets (the performance of the global economy such as real stock prices, per capita output and real interest rates), explain 40 per cent of house price movements during the period of the IMF study (from 1980 to 2004).²⁵⁴ The UK and the US are particularly open to such global markets as such factors explain approximately 70 per cent of house price movements in these countries, while they only explain 3 per cent of house price movements in New Zealand. There is evidence to suggest that the deepening of mortgage markets has been associated with higher global house prices (that is, efforts to expand affordability by increasing access to housing finance have resulted in increasing prices).²⁵⁵

The cost of housing – and the response of supply to increased demand

In a number of countries, housing supply appears to respond only slowly to increases in housing demand expressed through rising prices. This is clearly linked to the many stages involved in the construction process. When 'supply is inelastic, the same increase in demand ... results in a much larger increase in price and a much smaller increase in

Table 4.22

International comparison of price elasticity of supply of new housing in high-income nations

Country	Price elasticity of supply
UK	0.5
Germany	2.1
France	1.1
Netherlands	0.3
Denmark	0.7
US	1.4

Notes: >1 = relatively strong supply response to rising prices.
0–1 = relatively weak supply response to rising prices.
Source: Swank et al, cited in Stephens, 2004

quantity supplied'.²⁵⁶ If supply does not increase, or only increases slowly, there is no reason to believe that a more efficient housing finance market will result in better housing (even in the short or medium term); it will simply result in rising house prices. The increase in the availability of housing finance assumes that more dwellings will be produced and/or marketed in response to increased demand and, hence, that homeownership will rise. But how responsive is supply to demand? Housing elasticity varies considerably between countries and estimates for Western Europe are given in Table 4.22.

A major reason accounting for the lack of responsiveness is regulation. Research has shown that local regulations that prevent housing construction are a significant cause of high house prices in US and UK cities; more evidence shows that in Malaysia and South Korea there is also an unresponsive housing supply due to regulations.²⁵⁷ In Finland, one of the reasons for low housing starts is that local authorities are reluctant to sanction new housing construction because of the associated costs of infrastructure and services.²⁵⁸ Similar problems emerge in Tanzania, where it is noted that in Dar es Salaam the average annual demand for plots between 1990–2001 was 20,000, while average annual supply was under 700.²⁵⁹ Similar concerns emerge in the context of the Philippines:

... the inelastic housing supply aggravates the housing problem. Supply-side constraints arise primarily from problems in the land and financial markets. The land market has been inefficient because land administration and management is weak in various aspects: legal and regulatory framework and administration infrastructure. Land laws in the country are inconsistent... Land administration infrastructure is also poor and inadequate.²⁶⁰

A poor and inadequate regulatory system is not the only reason for a low responsiveness of supply to demand in housing construction. In New Zealand, where prices rose rapidly between 2001 and 2004, the building sector noted that the lack of labour was a major constraint on expanding the supply for housing.²⁶¹

Whatever the causes, the consequence is that homeownership is unaffordable to some groups. Analysing the figures in Table 4.20 and Table 4.22, one factor ensuring the continued affordability of homeownership in Germany may be the responsiveness of construction to changes in price.²⁶² This discussion highlights the interconnected nature of housing finance with other factors, notably land markets and regulations for housing, land development and other urban development processes.

The implications for homeownership for the young

In a context of rising prices, housing is becoming more expensive and housing finance systems have a greater job to do in bridging this gap. Young people have particular

difficulties in purchasing dwellings; they have had less time to save for a down payment (deposit) and earnings are lower for those who have recently entered the labour market. They are particularly affected by rising house prices. Table 4.23 depicts changes in homeownership of young households in selected countries in Western Europe.

In the UK, the decline in homeownership among young households is very striking, with a percentage point decline of 15. Deteriorating housing affordability means that fewer young households can access homeownership, even within the context of a liberalized mortgage market that can provide 100 per cent loan-to-value ratios (LTVs).²⁶³ Before mortgage market deregulation, LTVs were the principal constraint faced by potential first-time buyers in the UK. Although this is no longer the case, many households cannot afford to service 100 per cent mortgages, even with historically low interest rates. So the proportion of first-time buyers in the UK has fallen and their age has risen – from 27 years in the 1980s to 34 years today. A similar picture emerges in some of the other countries that have experienced large house-price rises during recent years, notably in Spain where there has been little expansion in rental alternatives to ownership, with the result that household formation has become severely inhibited. An indication of similar problems is seen in New Zealand where homeownership rates have been falling generally: ‘the greatest drop in homeownership rates [between 1991–2001] was amongst 25- to 44-year-old age cohort, which experienced a 10 per cent drop’.²⁶⁴ Similar consequences have been noted in Japan, even though prices have fallen from their increases during the early 1990s. Homeownership rates have been falling among the young in Japan; ‘in 1978 well over a quarter of those in the aged 25–29 category were homeowners’, while by 1998, the figure had fallen to one in eight.²⁶⁵

More general problems of affordability

US data indicates that there are some 6 million households living in owner-occupied dwellings who fall below the poverty line (and with a median annual household income of US\$6011).²⁶⁶ This is not that much less than the 7.9 million households below the poverty line who are living in rental accommodation. While some are older households whose housing costs have been paid, just over 4 million still have a mortgage outstanding on the property. What is evident is that the numbers of owner occupiers below the poverty line with mortgages have increased significantly. From 1960 to 1985, mortgage originations for this group were below 100,000; since then the numbers with mortgages have risen fairly steadily.²⁶⁷ The government has deliberately sought to reach out to low-income households; one of several programmes is the Targeted Lending Initiative, which was started in 1996 to encourage mortgage institutions to provide loans within specifically designated underserved areas, including inner-city neighbourhoods and Native American lands. Special incentives include reduced guarantee fees and increased servicing fees. Over 100,000 households have secured mortgages within this programme.

Country	circa 1990	circa 2000	Direction
Denmark	23 (1990)	20 (1999)	Down
Finland	41 (1992)	39 (1995)	Down
France	21 (1990)	17 (2002)	Down
Netherlands	43 (1993)	44 (1998)	Stable
Sweden	45 (1991)	46 (1997)	Stable
UK	74 (1994/1995)	59 (2001/2002)	Down

Source: Scanlon and Whitehead, 2004.

Table 4.23

Change in homeownership of young households (percentage)

In the transition countries, there are real problems with affordability due to generally low levels of income. For example, only 10 to 20 per cent of the population in Estonia and Latvia are considered to be eligible for housing loans.²⁶⁸ The transfer of properties from the public sector to private-sector households, together with the switch to a market-based economy, has resulted in considerable poverty and real problems in ensuring adequate housing with associated services. This is indicated by a recent study of Southeastern Europe, which found that for Bulgaria in 2000, the radiators of 50 per cent of those with central heating were cold.²⁶⁹

In the South, the numbers of people able to afford formal housing with the associated financing costs are limited. As discussed earlier, the clear emerging trend in a number of countries is that of the extension of mortgage finance. However, it is very difficult to assess how successful this has been. The high costs associated with large loan finance in a context in which incomes are very low suggest that the potential for down-marketing is limited.²⁷⁰ However, there is little information about how successful specific initiatives have been in reaching lower income groups.

The housing finance market in India expanded during the 1990s, but did not really move down market; in particular, down-marketing was perceived by the managers of housing finance institutions as being very difficult.²⁷¹ Partly due to hesitation within primarily commercialized markets, the state changed strategy and began more systematically to explore options with non-profit lenders (such as credit unions) and the potential role of non-governmental organizations (NGOs). In India, the Asian Development Bank deliberately sought to down-market housing finance with a loan of US\$300 million to create linkages between formal housing finance institutions and NGOs and community-based organizations (CBOs). One assessment has been made of several schemes designed to extend housing finance in India in order to judge their success in reaching the poorer income groups.²⁷² Some of the critical issues raised have also been a concern of other programmes:

- *Institutional bias*: generally, smaller loans are more useful to the poor. The focus on smaller loans aims to put in place self-discriminatory sorting systems as the higher income groups are not interested in smaller loans. However, the high administration costs mean that institutions prefer larger loans and there is an ongoing tension about trying to push down loan size. A similar problem was faced by the Community Mortgage Programme in the Philippines when the low

Affordability is not just about access to and the cost of housing finance; it is also critically about the price of housing

Box 4.15 Private development of affordable housing in India

The Parshwanath Group had developed a niche market in Ahmedabad in providing housing to lower middle-income households – generally those employed as school teachers, police constables, tailors, carpenters, bus and taxi drivers – and had developed over 20,000 units in 125 projects. During the late 1980s, they began a partnership with the government agency, the Housing and Urban Development Corporation (HUDCO). HUDCO's objective was to enable the developer to expand its operations and reach further down market. Together, the two planned to develop Parshwanath township. The group had previously targeted relatively low-income households by reducing costs through the manufacture of its own building materials and constructing minimal units, with the new residents constructing second floors and completing the finishes, such as kitchen counters, plastered walls and staircases.

HUDCO provided the Parshwanath Group with development capital for construction and agreed to offer mortgages to the residential buyers. Only the first two phases were developed. Initially, the Self-employed Women's Association (SEWA), a local NGO, had intended to be involved in targeting low-income households and in supporting repayments, but this component never fully evolved. The Parshwanath Group ran into litigation and financial troubles (when some residents refused to make repayments and challenged the quality of the buildings); the group sold the remainder of the land to developers, who now intend to target higher income groups.

The development proved acceptable to some purchasers; but others subsequently complained about the quality of the units and their size. Some residents filed a lawsuit against the developer due to the poor quality of completion, the lack of services such as street lights and the poor quality of construction. It appears that expectations had changed and that the quality was no longer considered acceptable. At the same time, the link with the public agency meant that the formal planning and regulatory procedures had to be complied with and that 'informal' practices previously used (such as the post-dating of cheques for repayment) were no longer possible.

Source: Mukhija, 2004a.

interest rate meant that the support institution was reluctant to give loans during the mid 1990s as it could make more money investing the funds.

- *Savings-related barriers:* savings-linked schemes are generally thought to require too long a time period before the release of loans.
- *Land title:* lack of clear land title is a continuing problem in India. In many cases, communities are not threatened with eviction and therefore have secure tenure; but without a legal title the land cannot be used for collateral.
- *Payroll deductions:* workers on low wages are not allowed in India to have their repayment deducted at source, and this is a further deterrent to housing finance corporations. Wage deductions are seen as one strategy to reduce risk. As noted earlier in the discussion of Panama, a problem in lower middle-income families working in the informal sector was that they could not have direct deductions and therefore were not accepted by mortgage lenders.
- *Flexible payments:* requirement for regular repayments can also be hard for the poor. This is particularly true for informal workers. It is notable that the success of the SOFOLES in reaching the informal sector in Mexico is linked to acceptance of payments at on-site locations and outside of traditional business hours.

Some of the lowest-cost housing (and, hence, smallest mortgages) have been for incomplete units, which (while being of sufficient quality to be legal dwellings) enable occupiers to finish them as and when incomes increase. The possibilities of such strategies to extend homeownership through mortgage finance in the Indian context are analysed through the experiences of a private developer in Ahmedabad (see Box 4.15).²⁷³ This example involves a partnership between the state and the private sector in which the finance was provided by the national government agency, the Housing and Urban Development Corporation (HUDCO), for a low-cost housing development. Previously, the company had been successful in providing housing for lower middle-income households, and the objective of the development was to use a proven low-cost construction process with state mortgage finance to reach a group that had previously been excluded on the grounds of affordability. However, the experience raises questions about this strategy, with the presence of public agencies reducing the extent of informality in the development and therefore making it less attractive for the developer.²⁷⁴ In particular:

... enabling informal-sector developers can be extremely difficult and tricky because public involvement and support can reduce their flexibility and incentives, as well as impact upon the expectations and opportunities of homebuyers.²⁷⁵

A similar strategy for homeownership via subsidized state loans with minimal investment required for a completed unit has been tried in the Philippines, this time from a private developer that has particularly targeted the lower end of the market for social reasons. Freedom to Build is active in Manila and provides core or starter housing units of 20 square metres to those able to secure government mortgages (generally employed in low-income formal-sector work). The company argues that its model is effective. However, the profit levels are lower than those for developers aiming at the higher end of the market, and for this reason there are relatively few such providers. To date, 7000 units have been completed with a major problem being the identification of suitable land.²⁷⁶ While Freedom to Build is somewhat unusual in being specifically orientated towards low-income housing, there has generally been an increase in private-sector production of low-income housing during the early 1990s.²⁷⁷

More commonly, affordability and loan repayment remain a problem in many Asian contexts. In the Philippines, the recovery rate on programmes provided by the National Housing Authority varies from 23 to 74 per cent.²⁷⁸ Loan programmes that provide only plots have performed better than completed housing loan programmes, and attempts to shift towards self-help have improved loan performance. These low repayment rates have resulted in internal pressures for reform and, as a result of poor loan repayments, the pension funds that have been providing finance for the Unified Home Lending have refused to release further funds.²⁷⁹ Such a situation is indicative of remaining strains in the housing finance system.

Table 4.24

Availability of mortgages to different groups in Western Europe

Country	Young household <30	Older household >50	Low equity	Self-certify income	Previously bankrupt	Credit impaired	Self-employed	Government sponsored
Denmark	A	A	C	C	B	B	A	B
France	B	B	A	C	C	B	B	A
Germany	A	B	B	C	C	C	A	B
Italy	B	B	C	C	C	B	A	B
Netherlands	B	A	B	B	C	B	B	B
Portugal	A	B	B	C	C	C	A	A
Spain	A	B	B	B	C	B	A	B
UK	A	A	A	B	B	A	A	B

Key:
 Readily available A
 Limited availability B
 No availability C

Source: Mercer Oliver Wyman, 2003, cited in Stephens, 2004.

The continuing problem of informality

In several Northern countries such as the UK and New Zealand, it has become cheaper to borrow but harder to get through the admission requirements.²⁸⁰ Despite attempts to extend affordable housing finance to those with lower incomes, many households living in the South, and at least some in the North, are not able to secure such finance. This is not just an issue of affordability, but also of the reluctance of formal-sector financial institutions to lend to those working in the informal sector. Box 4.16 summarizes this context in South Africa. While non-lending to those without formal employment is more commonly associated with the South, Table 4.24 outlines the extent to which households with specific characteristics might find it difficult to get credit in the North. Although self-employment is itself no barrier to securing mortgage finance, those who cannot verify their incomes (for example, through accounts and tax returns) fall into the category of 'self-certified' incomes and in most countries cannot be considered for mortgage finance, or only have limited access. When analysed alongside the earlier discussion of titling and access to mortgage finance, Table 4.24 highlights the fact that informal income is a major barrier. In a context in which many find employment in the informal sector, Southern countries have large numbers of citizens who have to 'self-certify' their incomes.

The authors of one study argue that 'Risk-based pricing should be desirable in mortgage markets as it allows lenders to accurately price the product for the risks and provides access to the mortgage product to a wider range of borrowers.'²⁸¹ Risk-based pricing can take several forms; but where significant differences in prices exist, lending that is termed 'sub-prime' or 'non-conforming' becomes possible. As a result, they suggest that the market can respond to this situation by allowing lenders to charge a premium (higher interest rates) for providing mortgage finance for such borrowers.

The US, since the mid 1990s, has seen the growth of sub-prime lending or lending to those borrowers who have poor credit records or who cannot verify incomes.²⁸² In 2000, there was US\$138 million in sub-prime originations and by 2002 the figure had increased to US\$213 million.²⁸³ The expansion in homeownership rates (up to 68.4 per cent

in 2003) may be partly attributable to this. Such lending now accounts for some 7 per cent of new lending in the UK, which is the only EU-15 country to have developed a substantial sub-prime market.²⁸⁴ Various barriers exist in Europe that have prevented the wider adoption of risk-based pricing. These range from usury laws in Italy, to the difficulty for any one lender in making the first move, thereby risking losing market share.²⁸⁵ Sub-prime products are estimated to be virtually unavailable in 70 per cent of the EU-15, and there may be significant growth in the population served by the mortgage market should risk-based pricing become more widespread.²⁸⁶ This is based on the experience of the UK and the US where customers have been willing to pay additional interest to secure funds. At the same time, there have been allegations of unfair additional charges being made to borrowers in this sub-prime market.²⁸⁷ There is now borrower education about the dangers of predatory prices where lenders offer low-income households favourable terms in the expectation that they will default on the loan and foreclosure will take place.

This section has considered the problems arising from down-marketing of mortgage finance. Such strategies have been one component within government strategies to address housing need. The interest of low-income households in homeownership is directly linked to a lack of alternative options. With respect to social housing, there has been a significant change in policy in many countries with the use of more market-orientated strategies. As the scale of public housing is withdrawn and as the cost of social housing rises, households consider homeownership. In one recent (2003) survey, 35 per cent of renters in the US have tried and failed to become homeowners primarily due to affordability obstacles. There are suggestions that housing inequality is increasing in at least some countries as a result of down-marketing strategies. To take the example of China, 'housing policies (privatization and subsidies combined) accounted for 37 per cent of overall inequality in the distribution of income in urban areas in 1995', while it only accounted for 30 per cent in 1988.²⁸⁸ In this context, it appears that: the 'current trend in housing reform is to privatize public housing as much as possible and demolish all poor-quality welfare housing. It seems that the new emphasis on the market is incompatible with public or welfare housing.'²⁸⁹

Box 4.16 Mortgage finance: problems with down-marketing in South Africa

The preconditions for the mortgage model are that houses have exchange value and are easily traded, so banks can use them as security for a high-value, long-term mortgage, and that borrowers can make regular repayments out of a predictable income stream. These conditions, however, do not hold for South Africa's low-income majority. South African banks are undeniably correct that they cannot extend mortgage finance to the informally employed, low-income majority, most of whom do not even have bank accounts. What is only beginning to be understood is that mortgage lending at the bottom end of a 'developing country' market – which is what South Africa really is – is risky not only for banks, but also for potential low-income borrowers. Even though they can repay small loans (as some South African microfinance institutions have proved), most low-income households cannot maintain the rigid repayment schedule required by a mortgage. Moreover, South Africa's 'township' housing markets are institutionally weak, and it is very difficult to sell a house, either to move up/down the housing ladder, or in execution. To make matters worse, South African formal-sector wage employment has actually declined in absolute terms since 1994, especially in the low middle-income bracket. As a result, when they do manage to get a mortgage, many low-income black South Africans lose their houses due to factors such as income instability and retrenchment.

Source: Baumann, 2004, p.6.

Assessing systemic risks

Considerable efforts have taken place in some countries to extend market reach. The 'market' may be able to extend reach by improving its efficiency; but, ultimately, there is likely to be a trade-off between extending 'reach' and risk arising from the increased likelihood of a borrower with a large loan defaulting.²⁹⁰ The risks with regard to individual borrowers can be reduced through insurance. However, there is also a need to recognize that such risks may be systemic rather than random (for example, they occur because of a general economic recession or rise in interest rates), and therefore can endanger the financial system itself. This, in part, explains the willingness of the state to provide assistance to households who find themselves in financial difficulties at the time of a financial crisis. The market itself may provide ways of mitigating against risk to protect itself, or allow individual borrowers to shift risk to third parties.

In the absence of falling prices assisting in affordability, the mortgage finance industry has to balance its response to consumer demand together with requests by governments to expand lending against pressure from shareholders, members and regulators, and start to lend

prudently. The new lending undertaken by mortgage providers in the North has introduced new risks into the lending process.²⁹¹ Even in high-income countries, the housing market may be volatile partly due to the scale of financial deregulation. A recent IMF survey suggests that strong regulation of the banking sector is necessary to minimize these risks and that a deregulated banking system can encourage speculative investment in property.²⁹² The IMF highlights the specific problems faced by Thailand and (to a lesser extent) Malaysia.

In the US and UK, there have been problems with housing market 'booms and busts'.²⁹³ Policy changes in the UK have shifted risks from institutions to borrowers. Several factors, notably increasing interest rates and very high loan-to-value ratios, resulted in a crisis during the late 1980s, with a significant increase in foreclosures. The 1980 foreclosure rate (as a percentage of outstanding mortgages) was 0.06 per cent, while the rate of 6 to 12 months' arrears was 0.25 per cent and the rate of 12-month-plus arrears was 0.08 per cent.²⁹⁴ By 1989, these figures had risen to 0.17, 0.73 and 0.15, and by 1991 they were 0.77, 1.87 and 0.93 per cent, respectively. A related problem to 'boom-and-bust' house prices combined with high loan-to-value ratios is negative equity – that is when the value of the remaining loan exceeds the price of the house (for example, following a fall in prices). The fall in the Japanese market during the early 1990s offers an illustration of the potential scale of this problem: 'The total amount of negative equity for the whole of the Tokyo area was estimated [1995] to be about UK£7 billion.'²⁹⁵ The consequences are considerable. One immediate problem is less housing mobility, as households simply cannot afford to repay their mortgage and take another because of the additional capital that they have to raise. A second problem is that foreclosure becomes less effective for the lending company since the value of the property will not fully cover the debt. Other problems relate to a lack of confidence in the housing finance system and housing markets in general. The dependence of the Japanese banking system upon real estate collateral resulted in considerable financial instability when land prices fell.²⁹⁶ The message is that in addition to assessing the effectiveness of extending mortgage finance for their poverty reduction goals, governments also need to consider the implications and risks for housing market stability.

NOTES

- 1 This chapter is based on a draft prepared by Diana Mitlin, University of Manchester, UK.
- 2 Chiquier et al, 2004, p.1.
- 3 Yasui, 2002a, p.15.
- 4 Nuri Erbas and Nothaft, 2002, p.15.
- 5 It is only such dwellings that are likely to meet the need for potential repossession and resale. Even if incremental dwellings have a legal land title, they may contravene building and/or zoning regulations.
- 6 Lohse, 2002, p.42.
- 7 Governments have sought to control inflation for many reasons; but success in this area is likely to have particularly beneficial effects on mortgage lending.
- 8 For example, some argue that homeownership limits labour mobility and/or the need is for household savings (with appropriate interest rate policies) to be directed to the benefit of enterprise investment rather than personal assets.
- 9 Stephens, 2003, p.1015. Stephens also notes that this pattern is associated with the housing finance history of Western Europe in recent decades. During the last decade, consistently lower inflation (likely to continue given current macroeconomic policies) means that the real value of the mortgage does not rapidly erode. Hence, consumer preferences may change.
- 10 Renaud, 1999.
- 11 Stuart et al, 2004.
- 12 Yasui, 2002a, p.14.
- 13 Buckley and Kalarickal, 2004, p.2.
- 14 Cities Alliance, 2002, p.2.
- 15 Government of the Republic of Zambia, cited in Mulenga, 2003, p.52.
- 16 Daphnis, 2004a, p.2.
- 17 Daphnis, 2004a, p.2.
- 18 Hegedüs, 2004, p.8.
- 19 See Kritayanavaj, 2002, p.15. Nevertheless, the bank's non-performing loans are at 17.4 per cent (Kritayanavaj, 2002, p.25), and this suggests that the

- weakness referred to by Daphnis (2004a) has not been fully addressed.
- 20 Lea, 2000, p17.
- 21 Joint Center for Housing Studies, 2004, p8.
- 22 Ballesteros, 2002, p3
- 23 Dübél, 2004, p28.
- 24 Yasui, 2002a, p12.
- 25 The primary market is retail lending to households. The secondary market is wholesale lending to retail providers.
- 26 Rubinstein, 2002, p15.
- 27 Okwir, 2002, p94.
- 28 Suresh, 2002, p119.
- 29 These are funds that receive mandatory payments, generally from employers and employees, and from which the employees can draw on for housing finance under particular circumstances.
- 30 Gadzama, 2002, p74.
- 31 Van Order, 2001, p16.
- 32 Dübél, 2004, p28.
- 33 Yasui, 2002a.
- 34 Dübél, 2004, p28.
- 35 Van Order, 2001, p21.
- 36 Van Order, 2001, pp20–21.
- 37 Van Order, 2001, p29.
- 38 Carolini, 2004.
- 39 Van Order, 2001, p20.
- 40 Van Order, 2001, p17.
- 41 Van Order, 2001, p29.
- 42 Van Order, 2001, p19.
- 43 Karley and Whitehead, 2002, p31.
- 44 ODPM, 2003, p1.
- 45 Karley and Whitehead, 2002, p32.
- 46 Karley and Whitehead, 2002, p36.
- 47 Lea, 2000, unnumbered Foreword.
- 48 Watanabe, 1998.
- 49 Chiquier et al, 2004, p2.
- 50 Lea, 2000, pp20–21.
- 51 D'Cruz, 2004a, p19.
- 52 D'Cruz, 2004a.
- 53 Lee, 2003, p26.
- 54 Gitau, 2004, p2.
- 55 Gitau, 2004, p9.
- 56 Chiquier et al, 2004.
- 57 Dübél, 2004, p29; Lea, 2000, pp3–5.
- 58 Connolly, 2004b.
- 59 Hoek-Smit and Diamond, 2003, p7.
- 60 Dymski and Isenburg, 1998.
- 61 Stephens, 2004, p11.
- 62 Pardo, 2000, p3.
- 63 Pardo, 2000, p3
- 64 Chin Beng 2002, p100.
- 65 Ogu and Ogbuozobe, 2001, p476.
- 66 Ogu and Ogbuozobe, 2001, p477.
- 67 Hardoy and Satterthwaite, 1989, pp107–111.
- 68 Stren, cited in Gitau, 2004, p4.
- 69 Mabogunje, cited in Gitau, 2004, p4.
- 70 Ogu and Ogbuozobe, 2001, p478.
- 71 Williams, 2004.
- 72 Stephens, 2004.
- 73 Stephens, 2003, p1020.
- 74 Stephens 2004, p11.
- 75 Suresh, 2002, p120.
- 76 Stephens, 2003, p1020.
- 77 Stephens, 2004.
- 78 Watanabe, 1998, p135.
- 79 Ballesteros, 2002, p18.
- 80 See, for example, Okpala, 1994, and Renaud, 1999.
- 81 As illustrated by Rubinstein (2002, p16) for Brazil, Mexico and Panama.
- 82 Quoted in Connolly, 2004b, p2.
- 83 Turner and Whitehead, 2002, p176.
- 84 Ballesteros, 2002, p18.
- 85 Nuri Erbas and Nothaft, 2002, p22.
- 86 Nuri Erbas and Nothaft 2002, p22.
- 87 Kumar Garg, 1998, p106; Smets, 2002, p138.
- 88 Lea, 2004b, p24.
- 89 Stephens, 2003, p1014.
- 90 Stephens, 2004, p12.
- 91 Scanlon and Whitehead, 2004
- 92 Stephens, 2004, p9.
- 93 Stuart et al, 2004, p9.
- 94 Stuart et al, 2004, p9.
- 95 Scanlon and Whitehead, 2004, p20.
- 96 Kahrlik, cited in Hegedüs, 2004, p7.
- 97 Yasui, 2002b, p27.
- 98 Merrill and Whiteley, 2003, pp11–12.
- 99 Merrill and Whiteley, 2003, p18.
- 100 Gilbert, 2004, p35.
- 101 Forero, 2004, pp34–38.
- 102 Connolly, 2004b.
- 103 Scanlon and Whitehead, 2004, p18.
- 104 Scanlon and Whitehead, 2004, p18.
- 105 Stuart et al, 2004, p3.
- 106 Stephens, 2004.
- 107 Williams, 2004, p20.
- 108 Stephens, 2004, p3.
- 109 Stephens (2004, p4) notes that nominal interest rates fell throughout the advanced economies, a phenomenon linked to the worldwide fall in inflation; however, although the nominal interest rate is the same throughout the Euro zone, different levels of inflation between member countries mean that real interest rates continue to vary.
- 110 Stephens, 2004, p4.
- 111 Earley, 2004b, p4.
- 112 Earley, 2004b; Lambert, 2004.
- 113 Earley, 2004b.
- 114 Pitcoff, cited in Carolini, 2004, p2.
- 115 HUD, 2003, cited in Carolini, 2004.
- 116 Carolini, 2004.
- 117 HUD, cited in Carolini, 2004, p11.
- 118 Hegedüs, 2004, p6.
- 119 Hegedüs, 2004, p6; Yasui, 2002b, p25.
- 120 Lea, 2004b, pp22–24.
- 121 Lea, 2004b, pp22–24.
- 122 Yasui, 2002b pp29–30.
- 123 Yasui, 2002b, p30.
- 124 Hegedüs, 2002, p56.
- 125 Yasui, 2002b, p19.
- 126 Earley, 2004b.
- 127 Chiquier et al, 2004, p28.
- 128 Yasui, 2002b, p19.
- 129 Hegedüs, 2002, p10.
- 130 Hegedüs, 2002, p49.
- 131 Stephens, 2003, p1021.
- 132 Yasui, 2002a, p11. These delays are partly due to the extensive transfer of properties from state to household in many countries (Hegedüs and Teller, 2003).
- 133 Hegedüs and Teller, 2003.
- 134 Hegedüs, 2002, pp18, 23.
- 135 Yasui, 2002b, p22.
- 136 Hegedüs and Teller, 2003.
- 137 Yasui, 2002a, p8.
- 138 Yasui, 2002b, p23.
- 139 Bugie, 2004, pp32–33.
- 140 An example of the scale of the problems is given by Zambia where, between 1985 and 2000, the average mortgage interest rate oscillated between 20 and 90 per cent per annum (Groves, 2004).
- 141 Kamete, 2000, p255.
- 142 De Soto, 2002.
- 143 Buckley and Kalarickal, 2004, pp21–22; Lincoln Institute of Land Policy, 2002.
- 144 Gilbert, 2002b, p16.
- 145 Buckley and Kalarickal, 2004, p22.
- 146 Buckley and Kalarickal, 2004, p23.
- 147 Rojas, 2004.
- 148 Vance, 2004, p127.
- 149 Daphnis, 2004b, p107.
- 150 Nell et al, cited in Baumann, 2004.
- 151 Calderón, 2004.
- 152 World Bank, 2004a, p2.
- 153 Joint Center for Housing Studies, 2004, pp12–14.
- 154 Ferguson, 1999, p186.
- 155 IADB, 2003.
- 156 Davies and Mahony, 2001, p25.
- 157 Hoek-Smit, 1998, p18.
- 158 World Bank, 2004a, p3.
- 159 World Bank, 2004a, pp2–3.
- 160 Ferguson, 1999, pp186–187.
- 161 Ballesteros, 2002, p18.
- 162 Jacobs and Savedoff, 1999, p5.
- 163 Jacobs and Savedoff, 1999, p6.
- 164 Pardo, 2000, pp23–24.
- 165 Gitau, 2004, p13.
- 166 Hoek-Smit, 1998, p18.
- 167 Lall and Lall, 2003, pp15–16.
- 168 Ferguson, 2004a, p22.
- 169 Ferguson, 2003.
- 170 Lall and Lall, 2003, p16.
- 171 Lall and Lall, 2003, pp20–21.
- 172 Biswas, 2003.
- 173 Datta, 1999, pp192–193.
- 174 Aphimeteetamrong and Kritayanavaj, 1998, p227.
- 175 Ahn, 2002.
- 176 Lee and Lee, 1998, p162.
- 177 Ha, 2002b, p245.
- 178 Kim and Ahn, 2002, p224.
- 179 Lamoreaux, 1998, p69.
- 180 Itoh, 2002, p157.
- 181 Oizumi, 2002, p170.
- 182 Oizumi, 2002, p181.
- 183 Itoh, 2002, p166.
- 184 Seki and Watanabe, 1998, pp118–119.
- 185 Karnad, 2004.
- 186 Karnad, 2004, pp8–9.
- 187 Kumar Garg, 1998, p98.
- 188 Kumar Garg, 1998, p99.
- 189 Karnad, 2004, p8.
- 190 Karnad, 2004, p8.
- 191 Gallarado, 1998, p204.
- 192 Ballesteros, 2002, p28.
- 193 Ballesteros, 2002, p28.
- 194 Ballesteros, 2004, pp15–16.
- 195 Zhao and Bourassa, 2003, p722.
- 196 Zhao and Bourassa, 2003, p738.
- 197 Ballesteros, 2002.
- 198 Zhao and Bourassa, 2003, p724.
- 199 Zhao and Bourassa, 2003, p733.
- 200 Zhao and Bourassa, 2003, p733.
- 201 Rojas, 2004.
- 202 Rojas, 2004.
- 203 Rubinstein, 2002, p15; Rojas, 2004.
- 204 Rojas, 2004.
- 205 World Bank, 2004a. Minimum salaries are set in many Latin American countries. However, they have not kept pace with inflation and, hence, the assessment of what is required to afford a mortgage even on a very basic unit.
- 206 World Bank, 2004a, p4.
- 207 Joint Center for Housing Studies, 2004, p35.
- 208 Joint Center for Housing Studies, 2004, p35.
- 209 World Bank, 2004a.
- 210 World Bank, 2004a.
- 211 Coovadia, 2004, pp10–11.
- 212 At the exchange rate of US\$1 = 6.45 rand, as of Thursday, 7 October 2004.
- 213 See www.mfrc.co.za/detail.php?s=91 downloaded on 7 October 2004.
- 214 Moss, 2001, pp33–34.
- 215 Nell et al, cited in Baumann, 2004.
- 216 Groves, 2004.

- 217 Coovadia, 2004, pp10–11.
- 218 Kamete, 2000, p252.
- 219 Kamete, 2000, p254.
- 220 Government of Tanzania and UN-Habitat, 2003, pp44–47.
- 221 Kamete, 2000, pp249–251.
- 222 Kofi Karley, 2002, p27.
- 223 Government of Tanzania and UN-Habitat, 2003, p32.
- 224 *Sunday Nation*, 2004, cited in Gitau, 2004, p2.
- 225 Okwir, 2002, p95.
- 226 Kofi Karley, 2002, p28.
- 227 Shelter Afrique, 2002, pp50–51.
- 228 Baëta Ansah, 2002, pp55–59.
- 229 Okonkwo, 2002, p87.
- 230 Baëta Ansah, 2002, p57.
- 231 Although, as observed earlier, Van Order (2001) argues that, in the US, 80 per cent of the increase in homeownership rates occurred within a deposit-based system and prior to the development of the secondary market.
- 232 Ogu and Ogbuozobe, 2001, p479.
- 233 Ogu and Ogbuozobe, 2001, p480.
- 234 Nubi, cited in Gitau, 2004, p4.
- 235 Kofi Karley, 2002, p28.
- 236 Mercer Oliver Wyman, cited in Stephens, 2004, pp7–8.
- 237 Hegedüs, 2004, p7.
- 238 Yasui, 2002a, p13.
- 239 Yasui, 2002a, p13; Yasui, 2002b, p29.
- 240 Zehnder, 2004.
- 241 Stephens, 2004, p12.
- 242 Arimah, 2000, p2562.
- 243 Kritayanavaj, 2002, p21.
- 244 Gallarado, 1998, p212; Ballesteros, 2002.
- 245 Fernandez, 2004.
- 246 UN-Habitat, 2002, p8.
- 247 Government of Tanzania and UN-Habitat, 2003, p72.
- 248 See, respectively, Lamoreaux, 1998, p51; Aphimeteetamrong and Kritayanavaj, 1998, p229; Kofi Karley, 2002, p27.
- 249 Stephens, 2004, p5.
- 250 Stuart et al, 2004, p3.
- 251 This is not a perfect guide to 'underlying' affordability because the growth of dual-income households in some countries increases the number of incomes that can be called upon to finance house purchase or pay interest charges on mortgages.
- 252 IMF, 2004, p72.
- 253 Earley, 2004b, p11.
- 254 IMF, 2004, p84.
- 255 IMF, 2004, p86.
- 256 Buckley and Kalarickal, 2004, p12.
- 257 Stephens, 2002.
- 258 Buckley and Kalarickal, 2004, p12.
- 259 Government of Tanzania and UN-Habitat, 2003, p26.
- 260 Ballesteros, 2002, p2.
- 261 Stuart et al, 2004, p5.
- 262 Stephens, 2004.
- 263 Stephens, 2004, p5.
- 264 Stuart et al, 2004, p6.
- 265 Forrest et al, 2003, p286.
- 266 Carolini, 2004, p4.
- 267 Carolini, 2004, p4.
- 268 Yasui, 2002b, p31.
- 269 Hegedüs and Teller, 2003.
- 270 Down-marking is a term used to refer to the practice of reaching lower income groups.
- 271 Smets, 2002, p175.
- 272 Smets, 2002, p175.
- 273 Mukhija, 2004a.
- 274 Mukhija, 2004a, p2235.
- 275 Mukhija, 2004a, p2241.
- 276 Freedom to Build, 2004, p77.
- 277 Ballesteros, 2002, p28.
- 278 Ballesteros, 2002, p21.
- 279 Ballesteros 2002, p23.
- 280 Dymiski and Isenburg, 1998; Stuart et al, 2004.
- 281 Mercer Oliver Wyman, 2003, quoted in Stephens, 2004.
- 282 Lea, 2004a, p13.
- 283 Carolini, 2004.
- 284 Stephens, 2004, p10.
- 285 Mercer Oliver Wyman, cited in Stephens, 2004.
- 286 Mercer Oliver Wyman, cited in Stephens, 2004.
- 287 Lea, 2004a, p13.
- 288 Khan, cited in Zhao and Bourassa, 2003, pp738–739.
- 289 Zhao and Bourassa, 2003, p742.
- 290 Stephens, 2004, p1.
- 291 Williams, 2004, pp20–21.
- 292 Collyns and Senhadji, 2002, p73.
- 293 Stephens, 2003, p1014.
- 294 Dymiski and Isenburg, 1998; Stephens, 2003, p1014.
- 295 Forrest et al, 2003, pp285–286.
- 296 Forrest et al, 2003, p282.

FINANCING FOR SOCIAL AND RENTAL HOUSING¹

As already indicated in the discussion of subsidies within Chapter 4, there is a widespread acceptance of the need for subsidies. This does not simply reflect political ideology, nor is it only a populist response by politicians in need of votes. The willingness of governments to consider housing subsidies reflects the significance of shelter and a home to citizens, the recognized importance of this to society, and the importance of residential construction for the economy. More specifically, a number of reasons can be identified to explain the prevalence for state subsidies for shelter (which explicitly includes services and the dwelling):²

- *Improving public health and, more specifically, ensuring that living conditions do not cause outbreaks of diseases.* This relates particularly, but not exclusively, to the provision of water and sanitation services.
- *Improving fairness, justice and social stability.* This set of objectives reflects the poverty orientation of some housing programmes. It is understood that children need places in which to study and to be safe, and equally that social exclusion and poverty may be characterized by living in an inadequately resourced neighbourhood. It may simply be that incomes are too low to afford the basic standard of living that society wishes to provide to its members or that households under-provide from their income – hence the need for subsidies.
- *Providing some aspects of housing considered to be a ‘public good’ that is not adequately coped with by the private market.* For example, the high level of informality in Latin America suggests that ‘It is a public responsibility to devise and implement the legal systems and policies required to bring housing into compliance with land and building regulations.’³ Only such tenure security will encourage private investment in housing.
- *Overcoming market inefficiencies that may result in monopoly profits and undersupply by developers, poor housing quality, or an insufficient volume of construction, particularly low-income housing.* Financial subsidies are only one possible response to such problems; others would include facilitating the

supply of land and reforming the regulatory framework.

- *Reducing housing costs.* This can be achieved, for example, by developing a system for mortgage insurance in primary or secondary markets, or encouraging competition in the building materials sector.
- *Stimulating economic growth.* The construction industry is a very important sector.

The breadth of the appeal of subsidies is illustrated later in this chapter by the government of the Republic of Korea, which, even as it considers how to deregulate the housing finance market, is looking at alternative ways to assist those in housing need. Moreover, as indicated by housing-support strategies in the North, increasing prosperity does not necessarily result in the state doing less in housing markets.

While a narrow definition of housing finance may focus only on the provision of credit, the scale and significance of housing finance subsidies – primarily through rental housing, subsidized loan finance and direct demand (capital) subsidies – makes this component difficult to ignore. An understanding of how the financing of social housing can fit within a broader system of housing financing is needed.⁴ This chapter looks specifically at some strategies that have recently been used to provide financial subsidies. Financial subsidies seek to provide incentives ‘to enable and persuade a certain class of producers or consumers to do something they would not otherwise do by lowering the opportunity cost or otherwise increasing the potential benefit of doing so’.⁵ Some argue that such financial subsidies are best avoided and should ‘be a policy of last resort’.⁶ These concerns focus on the potential distortion of markets and are often accomplished by recommendations on institutional and regulatory reforms, such as those elaborated upon in Box 5.1. As already noted in Chapter 4, such subsidies, especially those offered on interest rates, may have a huge hidden cost.

Although subsidies tend to be criticized by economists seeking to encourage a greater realization of the potential effectiveness of markets, they remain popular with governments. One critical assessment of the potential of subsidies in Latin America is forced to also recognize, in a

Increasing prosperity does not necessarily result in the state doing less in housing markets

Box 5.1 Regulations, policies or subsidies?

Subsidy should be used as a policy of last resort or, more precisely, should only be used in conjunction with other policy steps. The hierarchy of complementary government actions needed to improve the housing conditions for the majority of housing in an economy are as follows:

- Develop or reform institutions and policies to facilitate the role of private and non-profit lenders and developers in expanding the moderate-/low-income housing supply, and provide education and training to consumers and producers to improve the operation of the housing finance industry;
- Improve the regulatory system in the different supply markets (land, finance and infrastructure) to allow more households to acquire authorized and healthful housing;
- Provide subsidies to address well-defined objectives.

Simply put, if government does not do what is necessary to encourage housing construction and finance industries to function efficiently, housing supply cannot respond to price signals, and higher incomes or subsidies will not translate into better housing.

Source: Hoek-Smit and Grigsby, cited in Hoek-Smit and Diamond, 2003, p5.

footnote, that 'it appears that countries at the level of economic development in Latin America allocate from 1 to 5 per cent of government budgets for housing subsidies'.⁷ The interest in subsidies has resulted in multiple approaches to their delivery of subsidies, which notably include direct interest-rates reductions, allowing mortgage interest to be deducted from income taxes; support for housing savings; support for insurance in the primary market; and support for insurance in secondary markets and direct grants.⁸

Nevertheless, concerns remain, notably that such subsidies rarely reach the poor. This concern has been widely recognized and is validated in Chapter 4. As discussed in Chapters 6 and 7, recent housing policy in some countries of the South has been associated with a growing interest in small loans to enhance the process of incremental or progressive housing. Furthermore, as discussed in Chapter 6 (which deals with smaller loans), many of the poor, particularly those living in the South, face highly distorted markets for housing, especially in the markets for credit and land. Further problems arise because of the constraining impact of the regulatory systems. In such a context, governments have made use of finance as a way to address need. This chapter looks specifically at financial subsidies that have particularly sought to reach the poor and provide them with access to a complete dwelling. Governments in the North and the South have primarily used two financing strategies to assist families to obtain housing: assistance for ownership and/or the assistance to afford adequate rental accommodation. Despite this focus on the poor, the limitations of these approaches should be recognized. The Chilean programme, for example, gives a majority of subsidy funds to subsidy streams that include loan components and are for higher income households.⁹

Prior to discussing specific experiences in the provision of subsidized housing finance to low-income families for complete dwellings, several predominant trends should be recognized. As is the case with Chapter 4, there are always exceptions to such trends. Nevertheless, three

specific trends are well established in a number of countries:¹⁰

- 1 There is now less direct provision managed by the state or agencies associated with the state. Governments have shifted away from the direct construction and management of public housing. They have also used several strategies to reduce their stocks with, in some cases, large-scale transfers to occupiers.
- 2 There is increasing assistance for homeownership through direct-demand (capital) subsidies. The scale and costs of interest rate subsidies have already been noted. In an effort to reduce costs and increase the effectiveness of expenditure, several countries have introduced capital subsidies for those with low incomes to assist them in purchasing complete (or almost complete) dwellings. The use of targeted financial benefits for housing presupposes the institutional capacity to identify households in need. This may not exist in all Southern countries.
- 3 Consistent with the two trends above is the greater use of housing allowances (rather than direct provision) to assist low-income families renting accommodation in private or not-for-profit sectors.

All these options involve considerable subsidy finance and therefore their use is limited to a number of countries. No consideration is given in this chapter to loan finance, as interest rate subsidies have been considered in Chapter 4 with regard to larger loans and are considered in Chapters 6 and 7 in the light of smaller loans. However, it should be noted that some of the direct-demand subsidies have loan components. Despite their focus on lower income households, funding for direct subsidies is often smaller in scale than interest rate subsidies when the full costs of the latter over the life of the loan are considered. The different strategies for supporting the housing costs of the poor depend considerably upon state capacity to pay; for this reason, this chapter is divided by world region.

CONDITIONS AND TRENDS

State rental housing in the North

Although the state in the North is generally playing a less direct role in economic intervention, this is not necessarily the case in housing. Despite the shift to income-related support, the social rented sector (defined as housing let at below-market prices and allocated administratively on the basis of housing need, rather than on the ability to pay) remains a significant tenure in several of the 15 European Union (EU-15) member states, including the UK, France, Denmark, Finland, Sweden and the Netherlands. However, there have been significant changes in policy and the nature of housing support has shifted in Western Europe:

The existing support system with large, general interest subsidies for new construction and

*rehabilitation has been phased out. Targeted, income-related, subsidies have become relatively more important, as have subsidies to depressed housing areas.*¹¹

Such changes partly reflect the success of housing systems in addressing housing need.¹² However, what is also evident is that, despite a commonality of trends with regard to more limited funding, considerable diversity continues within Europe and there is no single approach to addressing housing need.¹³

In the US, the direct provision of social housing has not been a popular strategy, with just 1.7 per cent of the population living in public housing.¹⁴ Just over half of the funding to support low-income housing from the Housing and Urban Development Department goes to the Section 8 Housing Choice Voucher Programme, which initially focused on rental housing, but which has now been extended to enable support for ownership occupiers. This scheme is means tested by income and family size. Within this programme, there is evidence of similar trends to those in Europe, with a shift away from designated housing units and towards greater market choice, with the individual selection of accommodation. Public housing also remains an option (see Box 5.2), albeit somewhat limited. There are 1.8 million occupied units across the country owned by public housing authorities. There is also limited assistance, such as tax credits for private-sector developers building rental housing for low- and moderate-income housing. However, public housing is not perceived as the most suitable option for low-income families; rather, it is a route that will lead, in the longer term, 'toward self-sufficiency and homeownership'.¹⁵

There has been a general marked decline in the levels of new housing units in this sector. Subsequent problems include those faced by women in Canada as reductions in state funding in 1993 resulted in the loss of 325,000 subsidized rental units.¹⁶ The decline in new housing units reflects the fulfilment of the mission to remove 'crude' housing shortages (when the number of households exceeded the number of dwellings), although regional shortages have often re-emerged.¹⁷ As noted earlier, the government still plays an important role in housing people who are unable to access housing through market mechanisms, although the emphasis placed on the *safety net* function (assistance to the very poor) and wider *affordability* (assistance to those who are not so poor) objectives varies greatly. In the UK, the emphasis is very much on the safety net function, which has contributed to the concentration of very poor households in the sector. Elsewhere, the tenure is much more mixed, although sometimes the most marginalized households have difficulty in accessing social housing. The incomes of social renters averaged at least 70 per cent of the average in France, Germany, the Netherlands and Sweden, but were less than 50 per cent of the average in the UK.¹⁸

As the numbers of designated social housing and/or public properties fall, there are concerns that the scale of social disadvantage associated with such accommodation will rise. It is feared that the shifts in housing policy in Europe and, notably, a more limited housing stock will result in a

Box 5.2 Public housing in New York

The New York City Housing Authority (NYCHA) is the largest public housing authority in the country, with roughly 181,000 apartments in 2698 residential buildings throughout the city (as of September 2004). The public housing residential population represents roughly 5 per cent of the city's total, and on average pays US\$311 in monthly rent. This same population's average annual income is US\$18,334, and almost 18 per cent of households are on public assistance.

NYCHA has more than 10,000 apartments that are for the elderly alone, and about 33 per cent of NYCHA households are headed by persons over 62 years of age. Working families account for 40 per cent of NYCHA residents; but with an extremely low vacancy rate of only 0.43 per cent of apartments available for all public housing households, it is not very surprising that over 136,000 families are on NYCHA's waiting list.

Source: Information from NYCHA Fact Sheet (revised 2 December 2004) quoted in Carolini, 2004, accessible online at www.nyc.gov/html/nycha/pdf/factsheet.pdf.

high concentration of social disadvantage, thereby exacerbating social exclusion, reducing mobility and creating greater marginalization for tenants.¹⁹ One further concern is that the growth of means-tested housing allowances (also encouraged by use of private finance) has resulted in higher rents.²⁰ However, these are considered to offer better incentives in terms of labour mobility and to enable more effective targeting.

One of the most significant developments in social rented housing has been the increased use made of private finance for social rented housing in much of Western Europe.²¹ Despite this use, there has been limited private-equity investment, although there is some evidence of greater interest in the UK.²² Box 5.3 discusses changes in the financing of social housing in the EU countries. An analysis of margins suggested that despite a degree of sophistication, UK housing associations pay more for finance than their counterparts in the Netherlands, Denmark and Sweden (see Table 5.1). This could be attributable to the absence of a state guarantee system in the UK.

One of the key trends during recent years has been the emergence of surpluses in the social rented sector as a whole in many countries.²³ Declining debt burdens arising from lower levels of construction and the repayment of older debt have coincided with rising rents to create these surpluses. Several countries have attempted to establish 'revolving-door' systems of finance whereby surpluses are reinvested in the sector. This may happen informally (as in the Netherlands where redistribution between landlords occurs through the informal mechanism of merger) and more formally (through the Housing Fund in Finland and the building funds in Denmark). However, it seems that revolving-door finance alone does not stimulate increased construction, either because funds are inadequate or incentives are absent. Without subsidy mechanisms, governments appear to lack the leverage with which to stimulate the social rented sector.

At the same time, the shift from state provision to state financing of a range of providers means that government has reduced its risk. However, the market for social housing is heavily influenced by political choice. Whatever the housing system for lower income households, governments appear to be highly involved; even if they are

One of the most significant developments in social rented housing has been the increased use made of private finance

Box 5.3 Funding social housing in the European Union (EU)

At the highest level of generality, European Union (EU) social providers (particularly not-for-profit providers) typically raise private-sector loans collateralized on the housing stock (although the UK still uses extensive capital grants). The financial basis of the funding is supervised by local authorities or dedicated public agencies and by the financial supervisors who follow lenders' practices. Unlike the constraints facing mortgage markets, there is some evidence of a European-wide market for social housing finance.

The classic model of social housing finance in Western Europe involved significant public commitments to underpin, insure, subsidize or provide public loans (or some combination of the above). This meant that providers could repay loans at below-market terms or have to fund investment on only a proportion of the capital value (rather than the private-sector provider who needs to raise market finance on the entire capital value). The growth in the use of market instruments, buttressed by housing allowances and some subsidy in the form of capital grants, has many important consequences:

- the opening up of the source of social housing funds to the global capital market and to a diverse range of social instruments;
- 'professionalizing' the voluntary housing sector (arguably to the detriment of tenant participation);
- expecting most providers in EU countries to use their own funds (reserves), which can be as large as 33 per cent of funding;
- the fact that, despite the growth in private funding, public funding remains important in the UK, Germany, Belgium, the Netherlands, France and the Nordic countries; and
- the diversity of the sources of private funding, with an increase in risk.

Source: Gibb, 2002, p331.

not significant operationally, they are significant with regard to finance. In such a context, it is important for the private sector to:

*... understand both the current situation in relation to government safety nets for the sector and the extent to which what is on offer is truly open to the usual risks of changing costs and demand ... it is political risk rather than market risk which determines the value of the investment.*²⁴

Table 5.1

The cost of private finance to social landlords

Country	Spread (basis points)	Benchmark rate	Cost of guarantee to landlord	Estimated value of guarantee (basis points)
Denmark	20–30	Government bond	0	20
Finland	30–40	IBOR (inter-bank offered rate)	0	–
Netherlands	20–40	Government bond	Initial membership fee/commission	100
Sweden				
• strong	20–25	Government bond	0	20
• weak	100	Government bond	0	20
• securitization	40	Government bond	0	20
UK				
• VR (variable rate)				
LIBOR (London inter-bank offered rate)	53.4	IBOR	not available	not available
• FR (fixed rate) <7 years	164	5-year government bond	not available	not available
• FR 7–16 years	180	10-year government bond	not available	not available
• FR >20 years	170	20-year government bond	not available	not available
• Bond issues 1998–2001	126.4	Government bond	not available	not available

Source: Stephens et al, 2002, cited in Stephens, 2004.

State rental housing in transition countries

Prior to transition, in most Eastern European countries housing was provided by state institutions (workplace, local government and/or housing co-operatives). Essentially, the system was one in which state-provided social rental systems dominated, with low rents and administrative allocation systems.²⁵ However, there was also considerable diversity with, for example, Albania having 35 per cent of its housing stock in public hands compared to Bulgaria, with only 7 per cent public housing.²⁶

The transition phase included the transfer of some of these dwellings to their occupants under privatization programmes. In some countries, more than 90 per cent of the stock was sold, while in others the percentage was as low as 6 per cent.²⁷ In most cases, the share of the public sector in the housing stock has fallen to 5–10 per cent, with some exceptions such as Poland and the Czech Republic.²⁸ In some countries, this transition began during the 1970s and 1980s when pressure for improved housing increased and experiments were made in market provision.²⁹ However, housing markets were very limited. Even where people owned their dwellings, it appears to have been difficult to trade them. While such transfers of public housing to occupants are particularly associated with the transition countries, the policy is not exclusive to them. Similar transfers are currently taking place in China; and in the UK, the homeownership rate rose from 54 to 65 per cent between May 1979 and November 1990 as a result of the Conservative government's 'right to buy' policy.³⁰ Similar opportunities have now been introduced in Sweden.³¹

By the end of the 1990s, there was some interest in reinvestment in rental housing – for example in Poland, Slovakia, the Czech Republic and Hungary.³² A significant scale is planned – between 10 and 30 per cent of new construction in Poland, Romania and Hungary.³³ However, a considerable problem remains, which is that the institutional strategies for addressing the housing needs of the poorest have 'collapsed', with no alternative being developed. Although there has been much debate, little has come forward to develop solutions at scale. Support for the private sector seems to be politically more acceptable; but it appears to be both expensive and rarely orientated towards the social rental sector.³⁴ Housing allowance systems have been considered, but appear to be too expensive given the scale of need.³⁵ Moreover, a recent assessment of the effectiveness of this approach in Russia is pessimistic and suggests that it is failing to fulfil the safety net function that was intended.³⁶ An alternative used in Hungary sought to provide subsidized capital to entities (such as local government) to set up agencies that provide social housing which would be let under controlled rents to eligible households.³⁷ In the countries of Eastern Europe:

Although there was no absolute shortage in housing, there was a significant need for more housing that was affordable for low-income groups. The low-income social groups will not be able to afford to finance homeownership, thus support to these groups by public housing

*will be needed. As a result of the extreme privatization policy, no substantial public sector remains.*³⁸

Despite such needs, it appears that social housing is becoming a residual category.³⁹

Rental housing in the South

Large-scale public housing has not been that significant in the South despite exceptions such as Hong Kong. While many countries have experimented on a minor scale, in general the scale of provision reflects the limited funds available to invest in public housing initiatives and the high standards that are required. As noted in Chapter 4 vis-à-vis housing for sale, units have been expensive and scarce. Usually, they have not been allocated to the poor, nor would they necessarily have been affordable even if they had been allocated. In some cases, these properties have now been privatized following the increased emphasis on market provision.⁴⁰ As with the transition countries in Europe, China has relatively recently begun a policy to transfer to homeownership dwellings that had previously been rented primarily from state-owned enterprises, but also from other state housing providers. Box 5.4 describes this process in the city of Jinan.

Despite this general trend against direct provision in the South as well as the North, there is some continuing support for rental housing. In Hong Kong, the Housing Authority actually increased its stock by 18,000 units between 1991 and 2001; this is also in spite of the simultaneous sale of public rental housing during this period.⁴¹ The authority continued building and increased the entitlement threshold in real terms, thereby adding to its potential clients. However, a considerable subsidy is required; tenants pay about 9 per cent of their income in rent compared to 29 per cent in the private sector.⁴² In the Republic of Korea, since 1989 there has been a growing interest in a permanent rental dwelling programme for those on low incomes.⁴³ Progress has been slow and, by the end of 1999, public rental units only accounted for 2 per cent of the total housing stock; however, the policy reflects government recognition that homeownership is not a viable solution for all of those on low incomes.⁴⁴ In South Africa, there has also been a policy (albeit as a secondary strategy subsidiary to the main emphasis on homeownership that is discussed in the next section) to support the development of a social housing sector and, more specifically, to encourage the development of housing associations to manage low-income estates and rental accommodation. The government estimates that there are 60 institutions offering 25,000 rental units.⁴⁵ The institutional housing subsidy programme is used to assist with the financing of developments. In this case, a further benefit has been the use of finance to rehabilitate inner-city buildings. There is a recognition within the government that rents should not be more than 25 to 30 per cent of income, and this may make future financing complex. Even more recently, the municipal government in São Paulo, Brazil, introduced further measures in January 2004 to provide benefits to low-income households renting accommodation in the city.

Box 5.4 The right to buy in China

In Jinan, a city of 1.5 million in eastern China, the percentage of work-managed housing was still at 63 per cent in 1998, with 18 per cent living in state-managed housing and 19 per cent in private housing. Nominal rents in public housing rose during the 1990s from an average of 0.11 yuan to about 6.75 yuan per square metre. The Comfortable Housing Programme was aimed at assisting those in particular need, and by 1999, 10,800 (just under half of the 24,500 low-income households with special housing problems) had bought – at cost price – or were renting comfortable housing.

Attempts to sell public housing began in 1994, but did not really take off until conditions were made more favourable; by the end of 1995, only 5 per cent of all units had been sold. The subsidy on sale was further increased until it became almost a free allocation in many cases, and by the end of 1999, 80 per cent of public housing units had been privatized.

Source: Zhao and Bourassa, 2003.

The majority of renters in developing country cities are in the informal housing sector. In some parts of West Africa and Asia, the incidence of renting is very high. It is estimated that 80 per cent of households in Abidjan, Côte d'Ivoire, were tenants in the 1980s and that 88 per cent were tenants in Port Harcourt, Nigeria, in 1984. Comparable percentages in 1981 for Calcutta and Madras, India, were 76 and 68 respectively.⁴⁶ In spite of this reality, most low-income shelter policies, programmes and projects have tended to promote homeownership and have paid little attention to rental housing, either in terms of understanding and addressing the needs of tenants or encouraging the development of this type of housing. However, there is now increasing recognition of the significant role of rental housing in meeting the shelter needs of the many urban poor households who cannot afford homeownership (see Box 9.3).

Social housing and homeownership

In practice, the high costs of constructing rental public housing and the ongoing costs of maintenance, often in a context in which rents remain very low, has resulted in large-scale rental programmes being considered impossible in many Southern countries. Housing budgets in Southern countries can 'seldom carry universal housing subsidy programmes and very few new programmes are created that are structured as an entitlement'.⁴⁷ Despite these problems, there are some governments that have sought to introduce subsidy programmes of a significant scale. There is often widespread popular support for measures to address housing needs. Box 5.5 describes the pressure that social movements in Brazil have been exerting over a number of years in order to increase state commitment to this area. Given the financial constraints, governments have a limited range of choices. In some cases, they have chosen to use limited funds to support small loan programmes that enhance the process of incremental housing development. These strategies are considered in Chapter 6 on shelter microfinance and Chapter 7 on community funds.

In other cases, governments have chosen to subsidize a minimum complete dwelling. The remainder of this chapter considers financing strategies that have incorporated capital grants (direct-demand subsidies), in some cases together with mortgage loans.

Housing budgets in Southern countries can seldom carry universal housing subsidy programmes

Box 5.5 The National Fund for Popular Housing, Brazil

During the early 1990s in Brazil, the popular housing movements acting in the National Forum of Urban Reform presented to the Brazilian Congress a popular initiative subscribed to by 1 million voters,⁴⁸ hoping to create the National Fund of Popular Housing and the National Council of Popular Housing. This project has been a long time in gestation (over 12 years); but was finally passed in the Brazilian Chamber of Deputies in June 2004 and is now awaiting approval of the senate.

The objective is to make access to housing easier for low-income populations in both urban and rural areas through the use of subsidies. Land policies will need to facilitate this programme. The target population are those living in insecure conditions, in slums, collective-renting accommodation, tenement houses and risk areas, or individuals with an income equal to or lower than ten minimum wages. It is proposed that the main resources for the fund will be the national budget, together with the investment resources of the government's Severance Indemnity Fund for Employees (FGTS). These resources will be invested in social programmes such as the production of serviced land; slum improvement; the upgrading of tenement houses and co-operative rental housing; the construction and reform of community and/or institutional facilities connected with housing projects; land regulation; and the purchase of building materials.

It is proposed that a National Council of Popular Housing be established to draft guidelines and design programmes to allocate the fund's resources, to carry out the economic management of these resources and to determine objective

Source: Nelson Saule, pers comm, 2004

criteria for resource distribution. The membership of the council will be drawn from the federal government, the trade unions and legally constituted popular housing organizations. The system, as a whole, must include the Brazilian Urban Ministry and other federal, state and municipal organizations of public administration.

The federal government already manages various social housing programmes of benefit to low-income rural and urban populations, which provide land for housing and smallholdings. These programmes include:

- the efficient production of economical housing and infrastructure improvement (Better Living and Pro-Housing; Residential Leasing);
- regularization of informal settlements; and
- slum upgrading (Habitar Brazil).

These are all subsidized programmes controlled by Programme for Social Housing (PSH), a federal entity. In addition to financing self-help and co-operative construction, they endeavour to give some priority to women who are heads of household, to families with the lowest incomes, and to rural and poor urban populations. There is also a low-cost credit aid programme (Solidarity Credit) directed at family groups organized into formal co-operatives or housing associations where the members' incomes ranges from zero to three times the present minimum wage, with 542 million Brazilian real for 2004.

Occasionally, effective capital subsidies have been given through supposed low-interest loans. The poor performance of state-owned housing finance companies has already been discussed in Chapter 4; but what was not elaborated upon are the reasons for such a poor

performance. The limited resources that exist for housing finance mean that allocations may be made as political favours rather than universal entitlements. Governments have been reluctant to be seen to agree to foreclosure, as noted in the example from Zimbabwe in Chapter 4.⁴⁹ In other cases, state loans may simply be written off (perhaps as part of an election campaign). In such contexts, one reason for low repayment rates on government loans is that borrowers do not expect to be held to their repayment commitments. The dynamics around such lending are illustrated in Box 5.6.⁵⁰ In this case, the scheme sought to assist the poor, identified by the Indian classification system of 'economically weaker sections' (EWS), with additional and explicit criteria specifying inclusion of scheduled castes, scheduled tribes and backward classes. In order to participate in the schemes, beneficiaries had to own land; furthermore, to enable the inclusion of the poorest, land was allocated free to some squatting on public land with plots of less than 85 square metres. A basic permanent structure was provided using funds provided by the Housing and Urban Development Corporation (HUDCO) at a subsidized interest rate of 9 per cent, with the loans to be repaid by beneficiaries and guaranteed by the state government. In one project, in 1994, used for purposes of illustration, the cost of each unit was 13,000 rupees, of which 11,700 rupees comprised a loan. The reason for a recovery rate of less than 15 per cent is explained in Box 5.6.

Box 5.6 The politicization of housing finance in India

By building as many housing units for 'economically weaker sections' (EWS) of the Indian social hierarchy, the Indian government has attempted to demonstrate that it is doing a lot to benefit the poor. However, almost all of the actors involved try to manipulate the creation of policy, the selection of beneficiaries and/or the implementation of housing schemes for personal gain. Almost none of the government officials are really bothered whether or not the target group is helped.

The recovery rate of EWS housing loans is also poor, which implies that the schemes can only be implemented at the expense of the taxpayer. Party-political leaders allocate and sell pattas (land titles) and half-completed houses to people who do not necessarily belong to the target group. For this purpose, beneficiaries have to pay slum leaders.

The leaders in cooperation with political leaders create a vote bank by getting the housing scheme sanctioned. Later on, these politicians try to maintain their vote bank by telling the beneficiaries that they do not need to repay the housing loans provided by the government. The leaders have to bribe bureaucrats and other political leaders to get housing units allocated to people of their choice. Bureaucrats who do not cooperate face being transferred to unpopular districts. Despite payments, which have to be made to (political) leaders and government officials, EWS housing schemes tend to be gift schemes.

Source: Smets, 2002, p150.

Box 5.7 The Chilean approach to housing subsidies

Since the mid 1980s, housing policy in Chile has been orientated towards subsidizing demand for housing. There are now a number of different housing programmes; but the financial principle is the same in each, with finance being based on three components: beneficiaries' savings, government subsidy and loans. The proportion of these three components varies according to the cost of the house and according to each housing programme. The lower the price of the housing, the higher the proportion provided by the subsidy – although the actual subsidy per housing unit could be almost the same amount. One of the most important aspects of Chilean housing policy is its continuity. It has been based on this approach for almost 20 years, and during the last 15 years the average number of subsidies provided has been nearly 100,000 per year.

In most programmes, people apply through the regional office of the Chilean Ministry of Housing or through the local government. Each programme has its own regulations that are primarily related to who can apply, what they will need to submit in order to be eligible for financial support and what they obtain. The process of selection of the applicants is a very important part of the housing process. One of the reasons for the success of the Chilean model is that almost everyone believes that the process is transparent. This process is computerized and, in general terms, people know what the criteria are according to which they will be selected (for example, level of poverty as indicated by a socio-economic survey of each family and the amount of initial saving). The result of this selection is published in a local and/or a national newspaper so that people can be informed.

There are basically two types of programmes:

- 1 *Modalidad SERVIU (SERVIU way)*: the regional government will contract the construction of a housing scheme to a private contractor (usually through a process of tendering) and then sell the units to the applicants who have subsidy certificates.
- 2 *Modalidad privada (private way)*: each applicant manages the construction of the housing themselves or purchases an existing unit in the market. Each person receives the subsidy certificate for a specified amount of money (typically the equivalent of around US\$4500). For those

Source: Fernandez, 2004.

Such programmes demonstrate some of the difficulties of low-interest loans for the poorest households. As already noted, loans may simply be unaffordable, but may be targeted at the poorest groups (as those most in need of housing). The contradiction encourages the type of practices described earlier, whereby such subsidies are diverted to higher income groups and/or loans suffer from high levels of default. In other strategies, there has been a greater emphasis on grant finance, and one alternative has been the direct-demand subsidies that are associated particularly with the Chilean housing subsidy system, but which are now also being used in a number of other countries. As noted in Box 5.7, one aspect of this programme that is considered essential is its clarity of

who are building new units, they will need to hire a building enterprise (it is difficult for those who would like to do self-build to get this funded).

All programmes require the families (even the poorest) to have a certain amount of savings. This is to make people feel that they have made an effort and that they are not wholly dependent upon the state. At the same time, most programmes included a credit system or support for a loan system (private mortgage). This has meant that it is very important to make the terms and conditions of the loan clear. If the government considers that a certain housing programme is orientated towards the poorest families, it may decide that it is better that the programme does not include a loan component.

The Solidarity Fund for Low-income Housing is a programme that has no loan component as it seeks to reach the poorest households. It is based only on family savings and a subsidy that varies regionally. The housing programme generally restricts the proportion of the subsidy that can go on land to below 30 per cent – largely because a certain level of quality for the house is considered necessary (in terms of size, building materials, etc.). Most applicants are families; but people living on their own can apply if they are older than 60 years or if they are disabled (and registered with the National Disabled Register) or are Indigenous people (registered with the National Register of Indigenous Peoples). Single-person households cannot be more than 30 per cent of the families in the whole group. Groups need to be organized in at least ten families. The organization of the group is managed by an external institution that could be the municipality, a non-governmental organization (NGO), the regional housing office, a housing co-operative or a housing foundation, among others; this institution must be registered with the Ministry of Housing. This institution will prepare the housing project as it is requested. Each project needs the approval of the municipality (in terms of urban planning regulations) and the feasibility of urban infrastructure/services (such as water, sewerage and electricity). If the group is buying the land, it will need to show the ownership as a group or the fact that the site is owned by the institution in charge.

Table 5.2

Three nation comparison: Chile, Colombia and South Africa

	Chile	Colombia	South Africa
Housing subsidies as percentage of central government expenditure	5.8	0.6	1.3
Housing subsidy as percentage of GDP	1.25	0.1–0.46	0.38
Number of subsidies per year	91,130	45,000 ⁱ	196,030
Subsidies to population ratio (percentage)	2.2	0.4–0.65	2.4
Subsidies to the housing deficit ratio (percentage) ⁱⁱ	10–12	2–3	7.5
Subsidy value at purchasing power parity PPP (US\$)	10,111	11,776	6904
Subsidy value to GDP per capita ratio (percentage)	86	175	83

Notes:

ⁱ Official estimates range between 37,977–58,755.

ⁱⁱ Figures for 1996, 1993 and 1998, respectively.

Source: Gilbert, 2004, pp21, 25.

Box 5.8 Costa Rica: savings, subsidies and loans

Costa Rica has a population of 3.3 million, with 786,600 housing units of which about 100,000 are informal and an estimated housing deficit of 164,000. A direct-demand subsidy programme was introduced in 1987 which, modelled on the Chilean system, offered access to a subsidy and a mortgage loan in return for a down payment (savings). The lowest-income households up to one minimum salary do not have to make a down payment. The process works largely through 'authorized entities' that support households to acquire a house.

In contrast to Chile and most other countries that have adopted direct-demand subsidies, the programme of Costa Rica has succeeded in reaching low-income groups. The main reason is that a group of sophisticated non-governmental organizations (NGOs), experienced in housing development, have become the main developers under the programme. At first, many for-profit developers were involved; but they have now withdrawn from the programme. Some NGOs have become authorized entities, forming communities, extending credit and building the units. These NGO-authorized entities even issue bonds to raise money on public markets for housing finance. Between 1988 and 1998, the programme delivered just over 93,000 dwellings reaching 13 per cent of households in the country.

Source: Ferguson, 2002, p 169.

conditions and transparency of selection. Previous programmes had been characterized by public-sector provision, inadequate scale and, subsequently, by political favouritism and corruption in their allocation.⁵¹ In general, such programmes are small, although in both Chile and South Africa there have been extensive programmes of grant finance to access homeownership. This has been linked to loans in the case of Chile and, more recently, South Africa. Capital grant subsidies have also been offered in a number of other countries, although at a smaller scale. By 1999, five other Latin American countries had introduced owner-orientated direct-demand subsidies: Costa Rica (1986), Colombia, El Salvador, Paraguay and Uruguay (all in 1991).⁵²

As noted in Box 5.7, the Chilean subsidy programme requires a period of savings, which is then rewarded by access to a subsidy to be used to purchase housing. Families compete for subsidy vouchers, with the funds being allocated on the basis of four criteria: savings, poverty level of the family, family size and geographic location.⁵³ Savings is the variable that they can most easily affect, and savings levels have grown considerably to 1.38 million savings accounts by the end of 1997. Savings contributions are becoming recognized as being more important in South Africa. The South African capital subsidy scheme has recently been amended to require a mandatory upfront savings contribution of 2479 rand for all subsidies, unless the beneficiary chooses the People's Housing Process (self-build) route, in which case they must contribute 'sweat equity', although there are not yet fixed guidelines for what this means in practice.

Despite the initial political commitment, a recent comparative study argues that the Chilean, Colombian or South African governments have not put large-scale funding into this process.⁵⁴ As shown in Table 5.2, the percentage of state expenditure for these three countries does not exceed 1.25 per cent, while 2 per cent has been considered typical in the South. The Chilean state was committed to provide a complete house, rather than support incremental

development, and for that reason gave fewer and larger subsidies.⁵⁵ Colombia concurred with the emphasis on complete housing (except for a period between 1994 and 1998 when upgrading was also included). In South Africa, the emphasis has been on scale, although it is also considered necessary that a complete house be offered; minimum size requirements were introduced during the late 1990s reflecting concerns about the small size of the units.

Arguably, the strong focus on capital subsidies responded to the needs of the construction industry. The construction companies in Chile appear to have favoured higher standards and have been opposed to self-help housing.⁵⁶ In South Africa, while the focus on housing reflected political priorities, the strategy for addressing housing need emerged from the business representatives and consultants who dominated the National Housing Forum between 1992 and 1994.⁵⁷ The forum saw low-income housing finance in terms of a new capital subsidy deployed by private developers in large-scale construction projects. The Costa Rican programme profile in Box 5.8 is particularly interesting because it appears to have avoided these problems, being less concerned with construction volume and more orientated towards addressing the needs of the poor.

The interest in these programmes is highlighted in Box 5.9, which summarizes an analysis by the World Bank of the merits of the approach. As noted earlier, similar programmes have been introduced in a number of countries, including Ecuador and Colombia. In Colombia, a recent Inter-American Development Bank (IADB) loan is to provide additional financing, with an anticipated 10,000 subsidies for housing improvement and 61,000 subsidies for complete housing aimed at the poorest 40 per cent of households with monthly incomes of less than two minimum salaries. A specific component aims to support shelter microfinance.⁵⁸ In Ecuador, the Housing Incentive System (SIV) offers households access to a subsidy if they can provide savings. There is state assistance to purchase a new house and also for housing improvements. In the case of housing improvements that are seen as being appropriate for the lower income groups, the take-up of a loan is optional. Between 1998 (the beginning of the programme) and October 2002, approximately 25,000 families were given support for housing improvement and a further 25,000 higher income families received support for housing purchase.⁵⁹

The influence can also be seen in current discussions in Mexico where the theoretical arguments have increasingly favoured direct subsidies, although, as described in Chapter 4, interest rate subsidies have, in practice, been given much emphasis. The government now intends to put in place a single unified system of housing subsidies linked to savings and loans with (for those with low incomes) *Tu Casa* and, for those with slightly higher incomes, a more market-orientated linked subsidy and loan (such as the special programme for housing loans and subsidies, PROSAVI).⁶⁰ In 2003, just over 13,000 loans were provided through this second programme. Plans for *Tu Casa* highlight

the tension between small subsidies and loans for incremental improvements and more substantial loans for home improvements and purchase. Within this programme, there is a strong emphasis on the 'formal' housing solution, with 92 per cent of these funds being earmarked for the purchase of a completed minimal house (about 60 per cent of the loans).⁶¹ The average subsidy in 2004 was US\$4540 for finished minimum houses and US\$184 for home improvements. At present, high unit subsidies of *Tu Casa* and PROSAVI (which the World Bank estimate to be US\$6000 and US\$5000, respectively) limited the reach of the programmes to about 33,000 in 2002.⁶²

For the most part, such large subsidy programmes have been driven by state agencies and state funds. In some cases, such as in Chile and Ecuador, NGOs may play a role in the programme – for example, to assist groups and individuals to prepare themselves. In Chapter 6, Box 6.6 describes the use of a fund in Ecuador to help applicants acquire their 'savings' so that they can secure their subsidy entitlement. Another approach is illustrated by the People's Dialogue on Land and Shelter in South Africa who pioneered use of the People's Housing Process subsidy stream through the utilization of bridge funding and demonstrated the effectiveness of self-build options. A similar strategy is that used by the Society for the Promotion of Area Resource Centres (SPARC) and the National Slum Dwellers Federation (NSDF), who have raised bridge funds to advance developments in a number of Indian cities with the understanding that once development is fully or partially complete they will be able to draw down the subsidy funds. The funds are sufficient for land, infrastructure and a small but complete dwelling of about 200 square feet. In 2001, the government of India came up with a scheme of subsidy for housing the urban poor in India – the *Valmiki Ambedkar Yojna* (VAMBAY). VAMBAY allocations were initially used by politicians to benefit their supporters and do not involve the participation of the poor in any way. SPARC supported local communities to demonstrate how the subsidy can be used most effectively to address their needs. In several cities they have demonstrated that the communities can do it at much lower costs – for example, 50,000 rupees rather than 70,000 rupees. In the last two years, they have extended this work (see Chapter 6).

Similar loan and subsidy schemes to support low-income housing have been developed in other contexts. While the programmes discussed above have been state programmes, municipal governments have also been interested in innovation. One recently established scheme in Mexico City offers loans and subsidies to those with single incomes below 4.7 minimum wages and joint incomes less than 7 minimum wages.⁶³ Loans are for land acquisition, improvements and new housing. The maximum loan is US\$10,500, with an attached subsidy of US\$2000. An additional subsidy is payable if repayments are made on time. The deposit is 5 per cent and the annual interest is 6 per cent above the annual wage increment. Repayments are tied to a maximum of 20 per cent of the income. More than 5000 families were assisted in 1999 and 2000.

Box 5.9 An assessment of direct-demand subsidies by the World Bank

Direct-demand subsidies have proved the most efficient type of homeownership subvention for moderate- and middle-income households in Latin America. Essentially, direct-demand subsidies are portable vouchers that bridge the gap between the amount that households can afford (by joining an affordable mortgage, a down payment and the subsidy) and a housing solution. This form of subvention most effectively stimulates competition among supply agents (developers and financial institutions) and furthers development of the financial sector. Securitization of accompanying market-rate home credit becomes feasible, although it is generally unviable when subvention takes the form of below-market interest rates. Once subsidy programmes reach a significant size and continuity, they develop important economies of scale necessary for the systemic improvement of housing conditions. However, developers, financial institutions and other formal-sector institutions often find serving low-income groups uneconomic if they have other options, even with families obtaining direct-demand subsidies.

As a result, there is a need to supplement these programmes with other policy changes. Supply bottlenecks, such as a lack of lending institutions and land development standards, need to be addressed.

Source: World Bank, 2004a, p8.

CHALLENGES

Despite the widespread recognition that has been given to the subsidy approaches discussed above, their limitations should also be recognized.

Reaching the poor and the poor quality of developments

Despite intentions, the evidence from Chile and Colombia is that such programmes have struggled to reach the lowest-income households.⁶⁴ As noted in Box 5.7, the government of Chile created new (non-loan) options in 2000 because they recognized that the programmes were not reaching the poorest.⁶⁵ Subsidies of a similar value (with greater financial requirements on the household) have also been offered in programmes aimed at encouraging middle-class households to remain in inner-city areas. One study of the Chilean programme reported that 8.7 and 5.7 per cent of households in the highest-income quintiles were receiving a subsidy.⁶⁶ In part, this was because savings were required.

Other problems include the small size of the housing units and the poor quality of housing construction. The remote location of the land has resulted in isolation and costly access to jobs and services for lower income families. Box 5.10 summarizes some recent concerns about the programme in Chile. One analysis of trends in Europe suggests that where subsidies are tied to the purchase of new housing (presumably in the hope of stimulating construction), significant problems can arise, including the housing being built in unpopular locations to take advantage of lower land costs.⁶⁷ This is similar to the emerging conclusions about the situation in South Africa:

The result of this system is that local authorities and private developers have consistently produced low-quality houses in cheap dormitory suburbs far from higher-cost land in the urban core. This raises long-term public and private non-housing costs (transportation,

Box 5.10 The Chilean housing subsidy and the quality of dwellings

A considerable accomplishment of the Chilean government has been achieving a high rate of housing construction, which has controlled the housing deficit through using public resources to leverage private contributions. However, while significant numbers of dwellings have been constructed, concerns have also been raised. In particular, the policy offers few location options for the urban poor. The construction focuses on new housing developments that have primarily been built in the urban periphery where land costs are lowest. This has promoted a rapid process of urban expansion. Today, social housing is only available in a few very distant areas of the capital city of Metropolitan Santiago.

However, the peripheral setting of these units, together with the size of the complexes (estates), has resulted in serious problems for the residents' well-being, with implications for the quality of life in Santiago. The externalities of building on the periphery have not been fully taken into account and no allowance has been made for the costs of new transportation networks and other urban infrastructure and services. Nor has any consideration been given to the additional transport costs faced by families who often have limited employment possibilities. A further problem is the consequences arising from a high concentration of vulnerable families in remote areas. The result is greater urban and social segregation, an increase in the disparity in access to urban services, a worsening of local living conditions, increased environmental damage, urban security problems, and the deterioration of urban and historic centres.

Source: Jiron and Fadda, 2003.

schooling, etc.) and creates numerous negative externalities, including household- and community-level economic decline, increased crime and so on. This is entirely in keeping with the logic of private-sector housing delivery under a fixed output price (the subsidy), but also reflects a broader failure to see housing delivery in terms of integrated human settlement development rather than the physical production of 'top structures'.⁶⁸

Cost for households

One problem in South Africa is that some households are beginning to abandon their subsidy houses, partly because of their poor quality and location, but also because households are now liable for rates and other service charges. It is not clear that capital subsidies are the way to go for the poorest households. A more effective strategy might be to ensure access to serviced plots in well-located areas where the poor choose to live and then to provide small loans to finance incremental housing.

How much of a problem is affordability in Latin America? There are some indications in Chile that affordability is not a serious problem as service bills are being paid, although the repayment of housing loans received in association with capital subsidies is poor.⁶⁹ However, it should also be recognized that only 17 per cent of subsidies go to the poorest income group.⁷⁰ The financing model in Colombia anticipated that households earning less than two minimum salaries with an average monthly income of US\$117 will be able to save US\$710 and repay US\$35 a month.⁷¹ This seems somewhat unlikely and suggests that affordability may be an issue. In Ecuador, there is also evidence that suggests the lowest-income families find it hard to participate, particularly in the larger towns. The

cheapest dwellings are now priced at around US\$2400 in smaller towns and US\$4500 in the larger cities.

There are those who believe that such programmes are unaffordable to the poor in Latin America, given that there are 18 million indigent poor in the continent and that these families cannot provide themselves with enough to eat, let alone save for housing.⁷² However, solutions can be developed. In Chile, Hogar de Cristo has provided more than 330,000 shelters. One of the key activists behind the Latin American and Asian Low-income Housing Service (SELAVIP), an NGO which has supported many housing initiatives for the poor argues that:

What is required ... is that the poorest of the poor have access to locate themselves on urban property. A bit of their own land permits the families to advance by their own means in the building of a house.⁷³

Costs for the state

The potential scale of such strategies for financing housing appears to be limited by the high and explicit costs: 'few governments can afford to grant ample per-unit subsidies for complete units' and, generally, these strategies lead to small and insignificant programmes.⁷⁴ In some countries, such as Venezuela, this is funded by specific taxes on salaries; however, the Ley de Política Habitacional results in only one in a hundred of the contributors being assisted each year.⁷⁵

In Chile, Colombia and South Africa, the intention was that the commercial banks would be involved in providing credit (small loans) to supplement the subsidies. 'Unfortunately, all three countries have faced major problems in convincing the banks to lend to the poor.'⁷⁶ Clearly, in a financial context in which the ambition is to keep the subsidy to a minimum, the option of supplementary loan finance is attractive. However, it appears that commercial institutions used to mortgage finance find the low-income market difficult due to a lack of conventional collateral and lack of affordability.⁷⁷ In addition, initial attempts to draw in private finance may have failed in Chile because loan recovery on state loans was poor.⁷⁸ One additional factor is that, despite the political situation during the 1980s, it was considered unacceptable to evict people:

... government efforts to recover due payments or collect by exercising its rights through the court system have been minimal. For example, despite arrears in the order of 65–75 per cent, there have been few efforts to repossess properties.⁷⁹

For such reasons, in 1992, the State Bank of Chile (as the private sector had avoided offering loans) had 62 per cent of borrowers in this programme who were more than four payments late.⁸⁰ However, the state has now passed over the loans to the banks, together with a guarantee of repayment, as the banks know that past repayment rates have been low. A similar strategy to persuade the banks to offer loans for housing to low-income households occurred in South Africa,

where it was believed that South Africa's mainline banks would extend the middle-class mortgage model 'downwards'. This was, in part, based on the supposition that finance market behaviour had largely reflected racial discrimination. In this case, there was also opposition to incremental housing on political grounds and a reluctance to accept 'second-best' strategies for the poor (black) majority in housing need.⁸¹

Poor location due to market choice and financial shortage

There are concerns with regard to social housing (including both Northern rental and Southern direct-demand subsidy options) about the concentration of the poor in specific spatial areas. It is recognized that remote location can add to problems of social exclusion, while a high concentration of very poor households can increase some of the problems of poverty. In programmes that place emphasis on market mechanisms, the poor may have relatively little choice about the kind of housing solution that is offered. The locations appear to be a result of greater reliance on the market, which chooses the location according to a range of factors but

which has no particular incentive (in most cases) to maximize locational advantage to the poor. The emphasis placed by government on the adequate standard of the dwelling (as in Chile and South Africa), combined with the wish for contractors to maximize profits, tend to orientate the solution towards lower land costs and greater construction investment.

There are repeated concerns about the lack of finance in these systems except, perhaps, vis-à-vis the North. Even in the North, there are expressed concerns about the quality of provision, which is related to the scale of finance. In the South, there is some evidence of a lack of provision even among those countries that do have programmes, as well as concerns about the quality of the social housing that is provided. Many are not reached by the systems of capital subsidies discussed earlier. Even in the countries in which they are operating, it can be hard to secure subsidies, with numbers considerably below need. In every case, there are many who remain in need. In the South, many low- and low middle-income households build incrementally because this is all that is affordable (see Chapter 6). Much of this building (as is shown in Chapters 6 and 7) is financed by saving and virtually none by the formal financial sector.

With regard to social housing, there are concerns about the concentration of the poor in specific areas

NOTES

- 1 This chapter was prepared by a team of experts led by Diana Mitlin, University of Manchester, UK.
- 2 Mayo, 1999; Hoek-Smit and Diamond, 2003, pp3–5.
- 3 Mayo, 1999, p9.
- 4 Renaud, 1999, p756.
- 5 Hoek-Smit and Diamond, 2003, p5.
- 6 Hoek-Smit and Diamond, 2003, p5.
- 7 Mayo, 1999, p40.
- 8 Hoek-Smit and Diamond, 2003, pp11–12.
- 9 Fernandez, 2004.
- 10 Renaud (1999, p758) argues that the superiority of demand-side subsidies had been shown in the US experience during the 1970s. He argues that there is a strong case for saying income transfers were needed more than expenditure on improved housing.
- 11 Turner and Whitehead, 2002, p171.
- 12 Whitehead, 2003; Stephens, 2004.
- 13 Whitehead, 2003.
- 14 Taylor-Hayford, 2002, p149.
- 15 HUD, cited in Carolini, 2004, p16.
- 16 Farha and Goba, 2003, p22.
- 17 Stephens, 2004.
- 18 Stephens, 2002.
- 19 Priemus and Dieleman, 2002, p198.
- 20 Gibb, 2002, p332.
- 21 Stephens, 2004.
- 22 Whitehead, 2003.
- 23 Stephens, 2004.
- 24 Whitehead, 2003, p6.
- 25 Stephens, 2003, p1021.
- 26 Hegedüs and Teller, 2003.
- 27 Hegedüs et al, cited in Stephens 2003, p1021.
- 28 Hegedüs, 2004, p1.
- 29 Stephens, 2003, p1021.
- 30 Proxenos, 2002, p5.
- 31 Turner and Whitehead 2004, p175.
- 32 Hegedüs, 2004, p4; Yasui 2002b, p25.
- 33 Hegedüs, 2004, p4.
- 34 Hegedüs, 2004, p3.
- 35 Hegedüs, 2004, p3.
- 36 Lykova et al, 2004, p633.
- 37 Hegedüs, 2004, p5.
- 38 Hegedüs, 2002, p24.
- 39 Stephens, 2002, p180.
- 40 See Mulenga, 2003, for an illustrative discussion of this process in Zambia.
- 41 Ho, 2004, p486.
- 42 Lamoureux, 1998, p71.
- 43 Ha, 2002b, p202.
- 44 Ha, 2002b, p200.
- 45 Department of Housing, 2003.
- 46 UN-Habitat, 2003c.
- 47 Hoek-Smit and Diamond, 2003, p6.
- 48 According to the Brazilian constitution, citizens have the right to present bills through the instrument of popular initiative. In the case of national bills, 1 per cent of the national electorate must subscribe to the initiative through signing a petition.
- 49 Kamete, 2000.
- 50 Smets, 2002, p150.
- 51 Gilbert, 2004, p15; Gilbert, 2002b, p310.
- 52 Mayo, 1999, p36.
- 53 Pardo, 2000, p5.
- 54 Gilbert, 2004, p20.
- 55 Gilbert, 2004, p23.
- 56 Gilbert, 2004, p28.
- 57 Baumann, 2004, p6; Huchzermeyer, 2003, p604.
- 58 IADB, 2003, p2.
- 59 Frank, 2004, p173.
- 60 World Bank 2004a, p6.
- 61 Connolly, 2004b, p4.
- 62 World Bank, 2004a, p9.
- 63 Solis and Ortiz, 2002, pp157–158.
- 64 Gilbert, 2004, p27.
- 65 Fernandez, 2004.
- 66 Cummings and Di Pasquale, 1997, p13.
- 67 Bosvieux and Vorms, cited in Scanlon and Whitehead, 2004.
- 68 Baumann, 2004, p17.
- 69 Pardo, 2000, p6.
- 70 Fernandez, 2004.
- 71 IADB, 2003, p3.
- 72 Van der Rest, 2003, p8.
- 73 Van der Rest, 2003, p7.
- 74 Ferguson, 1999, p190.
- 75 Ferguson, 1999.
- 76 Gilbert, 2004, p32.
- 77 Tomlinson, cited in Gilbert, 2004, p33.
- 78 Gilbert, 2002a, p315.
- 79 Pardo, 2000, p6.
- 80 Cummings and Di Pasquale, 1997, p8.
- 81 Baumann, 2004, p6.

SMALL LOANS: SHELTER MICROFINANCE¹

SMALL LOAN CHALLENGES

Shelter has become a commodity for increasing numbers of low-income households, especially those living in urban areas of developing countries. Those who build incrementally (or progressively) are a very significant group in many countries in the South. However, loan finance for shelter-related investments in incremental dwellings made by low-income households whose income comes from the informal economy is rarely available through the formal commercial financial sector. In the vast majority of cases, these households are ineligible for commercial mortgage finance. Households seeking to invest in their shelter (land, infrastructure and housing) have been 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. Sources of longer-term finance are extremely limited and interest rates may be high. Box 6.1 illustrates sources of finance used by low-income households in Hyderabad, India.

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.² Initial activities were developed by non-governmental organizations (NGOs) working in housing and urban development, and by microfinance organizations interested in supporting housing investment. Agencies responsible for these activities now span the voluntary and public sectors. There are now a small number of larger programmes that involve multi-sectoral initiatives, with some also having a role for the private sector. As the effectiveness of small loans has become more evident, some innovative state programmes have sought to secure similar development benefits by replicating such programmes, albeit within different structures and systems. A small number of private-sector initiatives have been launched, generally building on microfinance approaches and seeking to expand into what is perceived to be a potentially profitable market. Urban dwellers in a wide range of different countries may now be offered such

opportunities related to savings and loans for shelter investments.

What is characteristic of these initiatives is that they involve small-scale lending for shelter improvements. In many cases, they also encourage savings (although this may be constrained by the rules and regulations of the financial system). 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.

These initiatives are of particular significance in the urban sphere where land, housing, infrastructure and basic services are all marketed commodities. However, in some cases, lenders have extended into rural areas, notably in Bangladesh, where traditional materials are not sufficient for a secure dwelling. Community funds for utilities such as electricity and water management may also be associated with rural areas.

The programmes share a common perspective in that they work with the realities of urban development in the South (and, in some cases, in transitional economies), rather than the Northern model of urban development in which a house is constructed and then sold (often through a financing package) to a family or individual. Their underlying model of housing investment is one of incremental shelter development. Housing is secured over time as improvements are made when funding is available. The dwelling is gradually consolidated, made more secure and services and infrastructure are obtained. As is the case with micro-enterprise development, there is not a big market for such lending in the North.³ This is partly due to much higher levels of affordability, but also arises because building regulations prevent the extensive use of incremental shelter strategies. In the North, conventional modern housing is complete in one single stage even if later investments expand, renovate and/or modify the dwelling.

Low- and many middle-income urban households in the South use incremental strategies. Underlying incremental housing development is the issue of affordability; as already noted in Chapter 4, many struggle to afford mortgage finance and lack the capital to purchase a completed house outright. In 1991, one study in nine Asian

Shelter microfinance and community finance mechanisms have grown considerably during recent decades

countries concluded that between 40 and 95 per cent of all households had no possibility of living in a dwelling produced by the formal sector.⁴ Estimates of cement producers conclude that 70 per cent of housing investment in Mexico is occurring incrementally.⁵ In Tanzania, it is estimated that 98 per cent of the housing stock in urban areas is constructed on an incremental basis.⁶ This is unchanged from the figures quoted for 1978.⁷ In the Philippines, a similar estimate is that 93 per cent of owner-occupied houses have been built through an incremental building process.⁸ Such figures emphasize the significance of incremental development.

This chapter considers a distinct approach to delivering small loans to low-income households (almost universally in the South): microfinance. Another significant approach – community funds – is discussed in Chapter 7.⁹ Microfinance loans are almost universally to individuals, generally to those with some security of tenure, for investment in housing (construction, improvement and extension). Chapter 7 examines the community fund approach in which lending is typically to communities for land purchase, infrastructure and service investment, and (in some cases) for housing construction. In both cases (although most likely in the first), shelter lending may be accompanied by opportunities to borrow for micro-enterprise development. Prior to considering these lending strategies, the strategy of incremental development of shelter and the strategies used by the poor to secure finance are introduced.

Incremental development

For individuals or households with limited incomes, the only possibility of homeownership (even in an illegal settlement) is through shelter investment made in several stages. Land purchase, service installation and upgrading, as well as housing construction, consolidation and expansion, are all made at separate times. For higher income households, the land purchase may be first, with subsequent investments made as incomes increase and assets accumulate over a period of years. In the lower income families, the first investments may be in shelter on a piece of land with uncertain security. Subsequent investments are made as security increases. Infrastructure may be installed (perhaps with state assistance). A shack may be transformed into a more robust dwelling, with rooms being added, and flooring and roofing improved with the use of permanent materials.

Such incremental shelters, often initially built of temporary materials, frequently require repairs because of damage – for example, from natural forces. In Hyderabad, about one quarter of a sample of 224 households had recently repaired their house.¹⁰ No less than 64 per cent had repaired the roof (essential against monsoon rains). Box 6.15 on the Grameen Bank's loan package highlights the high cost of repeat repairs for houses built of traditional materials; with loan finance, scarce funds can be allocated more effectively.

Box 6.1 describes the strategies that are used in Hyderabad, India. The lack of contact with formal financial

institutions that is illustrated within this example is evident in many parts of the world.

Despite its significance, incremental development may be discouraged by more formal housing finance agencies. The Kenyan Banking and Building Societies Act explicitly forbids financial institutions from lending for plots of land with no or partially constructed housing on it.¹¹ Households allocated land by the state Self-help Housing Agency in Botswana were expected to replace traditional building materials within two years – a very short period of time for those with low incomes to accumulate sufficient funds.¹² One study of housing strategies for the poor in Zimbabwe also highlights the resistance of some politicians and residents to incremental housing.¹³ The lending conditions of the Housing Finance Company of Uganda require land title, together with a number of further conditions: the development must be located in an urban area, have full services, be constructed of permanent materials and have local authority approval for construction.¹⁴

In general, this resistance to incremental housing by formal finance companies is because of the risks associated with the building processes (particularly potential illegality) and because of uncertainty about house value and, hence, problems of mortgage valuation. However, one general policy concern about incremental strategies is that investment is wasteful because small improvements are made that might have to be repeated when a further extension is added.¹⁵ However, the financial implications are also clear. Low-income households cannot afford to pay the high interest charges on a complete loan, but are more likely to be able to cover the relatively small interest charges from repeat borrowings of much smaller amounts of finance.

Access to financial services

What research and practice during the early 1990s emphasized was that the quality of self-help investment could be enhanced by financial institutions that enabled the accumulation of savings and/or offered small loans. However, little finance is available for the poor in the South. Several examples from different countries all point to the high dependency of the poor upon non-mortgage sources of housing finance.

In India, according to the National Statistical Survey's (NSS's) 44th round survey, more than 80 per cent of housing finance comes from private savings, sale of assets and non-formal sources of credit.¹⁶ In a number of households studied in Hyderabad, 45 per cent of those living in 13 low-income settlements were in debt for housing (but less than 2 per cent borrowed from formal financial institutions).¹⁷ This is higher than that reported in low-income settlements in Amritsar, where it was estimated that 10 per cent of the credit taken out by low-income households was for housing.¹⁸ A further example comes from South Africa, a country widely noted for having an extended financial sector. As noted in the discussion of mortgage finance, within one group of low to lower-middle earners in South Africa, only 38 per cent had applied for finance, with 13 per cent being successful.¹⁹ For those unable to secure mortgages, in the non-mortgage

Low- and many middle-income urban households in the South use incremental strategies

Box 6.1 Housing finance for low-income households in Hyderabad, India

What are the strategies of low-income households for obtaining housing finance? This question was studied in detail by Peer Smets in Hyderabad, India. This Indian city was chosen because it is in a state that had moved away from a managed economy towards liberalization. The information was collected between 1993 and 1996 in 13 low-income neighbourhoods, each with between 76 and 530 households. There were no housing schemes by external agencies in the chosen settlements. The focus was on low-income groups, notably the economically weaker sections (which at that time had a monthly income of below 1250 rupees) and the low-income groups (with a monthly income of between 1250 and 2650 rupees).

In 2002, the city population was about 5 million, with considerable numbers of the poor squatting or living in illegal subdivisions. Despite the interest during this period by the national government in exploring the role of innovative savings and lending instruments, both with regard to housing and, more generally, the housing finance systems, practices and outcomes in Hyderabad could only be understood with reference to local land and housing markets. Important factors included how competing elite interest in land development have been reconciled, the presence of ongoing ethnic tensions between Muslims and Hindus, local political interests, and the changes that resulted from Hyderabad being made the capital of the newly formed state of Andhra Pradesh in 1956. By the 1970s, the land market in Hyderabad was uncertain, with an inadequate registration process and many disputes. In 1970, 60 per cent of residents lived in rental accommodation, and by 1981 this percentage had fallen to 55 per cent. In 1981 the population living in illegal settlements was 19.6 per cent; but ten years later it had increased to 29 per cent.

Considering the urban poor in the 13 study settlements, 53 per cent of the households are above the poverty line and 47

Source: Smets, 2002.

per cent below. Some 38 per cent are tenants and 62 per cent are homeowners with no significant differences in income. The physical quality of the shelter can be divided into *kaccha* (traditional materials, corrugated iron, cloth and wood) semi-*kaccha* (partly or completely constructed with concrete or cement-plastered walls, with asbestos or iron sheets or tiles on the roof) and *pucca* (concrete or brick masonry with a concrete roof). Over 80 per cent of tenants and homeowners are living in semi-*kaccha* houses, with only 4 per cent of the sample living in *pucca* houses.

A sample of 242 households has been surveyed in greater detail. These are either homeowners or tenants who have bought elsewhere in the city. Sixty-five per cent of those with land in the low-income settlements (illegal land) have bought their rights. About half made a single payment for the land and the other half paid in instalments. In terms of construction materials, just under 50 per cent have made some use of second-hand materials. Forty-five per cent are in debt because of an investment in housing, of which the majority live close to the poverty line. The biggest single source of funding for the first step of incremental building is savings and the second most significant source is friends/relatives/neighbourhoods. This is closely followed by the third source of finance: chit funds. Chit funds involve a given number of participants who each commit to paying an equal monthly amount. There are a number of different systems for selecting the order according to which members receive the funds. For second investments in incremental housing, savings and money lenders/pawnbrokers are the most important, and for further steps, savings is the source of finance in 75 per cent of cases. Considered across all financing stages, employers are a fourth source of funds. Finance or credit co-operatives and banks are used very rarely, if at all.

housing finance sector 89 per cent of loans by value are personal loans secured by ceding a pension and payroll deduction (only available to formally employed persons). The remaining 11 per cent of housing loans by value are unsecured personal loans. Approximately 60 per cent of South African households fall into income and employment categories that would make them potentially eligible for *only* this kind of loan under current South African conditions.²⁰ And in a further African example, the overwhelming source of housing finance in Tanzania during the 1980s were people's own savings, and this was true for the formal and informal sectors.²¹

The importance given to savings is repeated elsewhere. A study of 198 households in low-income settlements in Pereira, Colombia, found that savings was the most common method of financing land purchase and construction, with only 10 per cent of households using loan finance.²² In Botswana, savings were once more found to be a critical source of funding for housing investment, with few other alternatives being used.²³

This information points fairly clearly to a lack of housing finance. Would more finance increase investment in

low-income areas and assist in a more speedy development of incremental housing? The evidence is somewhat mixed. In one area in Colombia, about one third of these households could secure public-sector loans as they had plots in a sites-and-services project.²⁴ Despite this possibility, these groups did not have a higher incidence of borrowing, and even within these projects those who secured loans did not appear to be faster at consolidating their housing than other households. Another scheme in Mauritania provides land security to the urban poor, together with further assistance for development.²⁵ The assistance programme includes housing finance, technical assistance for enterprise development and literacy and skills-enhancement classes for residents. The housing finance package is divided into three components: room, latrine and perimeter wall. Participants make a deposit of 25 per cent of the cost, the municipality gives a subsidy of 25 per cent and the remainder is repaid over two years at 0 per cent interest. Due to poor uptake, subsidies were increased for the second phase (which started in 2002). During the first 18 months, the programme was successful in increasing housing development. Those who did not obtain shelter finance but who secured land from the

programme invested an average of US\$178 in their housing, while those who secured the loan and subsidy invested an average of US\$349. Clearly, affordability remains an important issue. At the same time, the speed with which some microfinance initiatives for shelter have grown suggests that, in at least some households, there is a considerable demand for loan capital.

What is also notable is that limited access to mortgage finance means that there are few alternatives to incremental development for households wishing to secure housing. The problem is exemplified by the low-income settlements in South Africa where, even if someone wants to sell a house in a low-income settlement (even with legal tenure), it is difficult to secure mortgage finance. There are no financial products in South Africa appropriate for those who wish to purchase housing that has been developed incrementally from a sites-and-services programme, or that has been recently constructed and financed under the capital subsidy programme or formal houses built for Africans between 1948 and 1960.²⁶ Current lenders to low-income households offer secured and unsecured microloans and pension-backed loans of between 5000 and 15,000 rand (US\$775–\$2325). This is not enough to purchase existing houses in any of the housing sub-markets mentioned above: the mean selling price for houses in each is between 13,000 and 52,000 rand (US\$2000–\$8000). The specific problems resulting in mortgage refusal include lack of adequate land title, insufficient income by the purchaser, lack of formal employment and red-lining (the refusal to issue mortgages in specific areas) due to generalized problems of foreclosure.

This is the situation in which low-income householders find themselves. Unable to afford fully developed houses with established legal title, they develop housing incrementally. In the absence of commercial or state finance for complete houses, they invest when and as they are able. To fill this gap, a number of different initiatives have developed. This chapter looks particularly at the provision of small loans for shelter to individual households provided primarily, but not exclusively, by the group of microfinance agencies that emerged during the 1980s and 1990s to supply enterprise finance. It concentrates on the financial sector that works primarily with individuals, while Chapter 7 considers the separate but related tradition of community finance. This chapter focuses largely on microfinance institutions because that is where considerable innovation has taken place, and where there are indicative signs that further value might be added. However, the discussion also considers other small-scale lending through civil society groups, such as credit unions, as well as commercial loans from small commercial lending firms and building material suppliers.²⁷ Chapter 7 then turns to community funds, a further financial strategy developed within socially orientated development agencies working particularly on urban poverty and/or addressing housing need.

Table 6.1 highlights the differences between these two strategies and those of mortgage and microfinance for enterprise development. In essence, community funds seek to address the needs of poorer groups and, thus, use

	Mortgage finance	Microenterprise finance	Shelter microfinance	Community funds
Objective	Provide long-term housing finance	Provide investment finance for enterprise development and enable income growth	Provide housing improvement and improve well-being	Enable the poor to secure shelter assets, particularly land and infrastructure
Borrowers	Upper- and middle-income households	Micro- and small entrepreneurs	Those with land who need to improve the dwelling	Those without secure tenure, basic services and adequate housing
Use of loan funds	Acquisition of property	Development of business	Housing improvement	Land, infrastructure and occasionally housing improvement
Role of savings	Deposit required; savings process not important	May be required	Savings may be required; deposit may be required	Savings generally essential; deposit may be required
Additional support	Irrelevant	Generally not	Possible	Nearly always considered necessary because of complexities of land development
Attitude to the very poor	Avoid	Generally avoid; some specialist programmes	Depends upon orientation; but requirement for land likely to exclude the poorest	Generally seeks to help the very poor if they are residentially stable
Purpose of the collective (community organization)	None	May be used as guarantor	May be used as guarantor; sometimes additional community support is a part of the process	Lending is collective and the role of the group is seen as essential to address the exclusion of the poor
Amount	Generally over US\$10,000	Generally under US\$500	Generally between US\$100–\$5000	Generally under US\$1000
Interest rate	Inflation plus a margin of 8–15%	Inflation plus a margin of 15–45%	Inflation plus a margin to cover costs of 10–20%	Inflation plus administration
Term	15–30 years	Less than 1 year	1–8 years	3–20 years (generally shorter)
Collateral	Mortgage	Personal guarantees, goods, co-signers	Personal guarantees, goods, co-signers, mortgage	Can be title deeds but emphasis placed on collective loan management
Financial sustainability	Generally considered essential, but may be state subsidies	Desired – support for product development	Desired – support for product development; occasionally integrated with subsidies for land development	Seek state support to offer subsidies for land development and services in order to include lower income families
Linking role	None	To other financial institutions	To other financial institutions; may involve the municipality in slum upgrading programme	To state and municipality

Source: adapted from ACHR, 2002, p6, and Ferguson, 2004b, p5.

Table 6.1

Lending strategies for housing development

collective loans both to build the capacity of the poor to act together and because the priorities of secure land tenure and infrastructure cannot be afforded individually. Shelter microfinance responds to the needs of the poor with reasonably secure tenure to upgrade their dwellings using strategies that have developed for lending to small and medium-sized enterprises.

Microfinance: what is it?

As emphasized above, many in the South develop housing incrementally and the need for small loans is considerable. An estimated 70 per cent of housing investment in developing countries occurs through such progressive building.²⁸ Microfinance for shelter addresses a gap that larger-scale mortgage lenders are unwilling to provide for and, arguably, for which they lack the skills and capacities.

Size	Varies, but generally two to four times larger than average working capital loans
Term	Usually 2 to 24 months for home improvements and two to five years for land purchase or construction
Interest	Same as standard working capital loans or slightly lower
Delivery method	Almost always provided to individuals rather than to groups
Collateral	Mostly unsecured; co-signers often used; real guarantees may be used; formal ownership of dwelling or land may be required; savings sometimes used as guarantee (may be compulsory)
Target clientele	Low-income salaried workers; microentrepreneurs primarily in urban areas; poor people
Other services	Sometimes accompanied by land acquisition, land registration and construction (including self-help building techniques)

Source: CGAP, 2004.

Table 6.2

Consultative Group to Assist the Poor (CGAP): typical terms and conditions for shelter microfinance

Shelter microfinance responds to the needs of the poor with reasonably secure tenure to upgrade their dwellings

Microfinance for shelter addresses a gap that larger-scale mortgage lenders are unwilling to provide for

The main issues discussed in this section are the growth of shelter microfinance, including the sources of funding, the terms and conditions of lending and the challenges that this sector faces.

Microfinance for shelter offers small loans suitable for significant housing improvements. Terms and conditions are summarized in Table 6.2. Loan sizes are between US\$1000 and US\$5000, although they may be smaller in some countries where construction costs are lower and/or building standards do not prevent low-cost housing options. Loan terms are generally between one and eight years, although in most cases they are at the shorter end of this range. Hence, although these loans are often given by existing microfinance lenders and are seen as falling within this category of financial services, they are often considerably larger than enterprise loans (especially those taken by new borrowers when entering this market).²⁹

Security conditions vary considerably depending upon local circumstances. In some cases, they are similar to those required for enterprise development (that is, group guarantees and co-signers). In other cases, they involve holding the para-legal documents to the property and other non-mortgage collateral. Some shelter microfinance lenders follow a process similar to that of a conventional mortgage for larger loans. The Consultative Group to Assist the Poor (CGAP) is a consortium of 28 public and private development agencies seeking to expand access to financial services (microfinance) for the poor in the South. In 2004, they recognized the significance of shelter microfinance with a briefing for members.

Loans are generally taken to build additional rooms (often turning space constructed using wood and traditional materials into concrete built structures), improve roofs and floors, and add kitchens and toilets. Investing in improved facilities is very popular and the Self-employed Women's Association (SEWA) in India estimates that 'almost 35 per cent of housing loans from SEWA Bank are utilized for installing infrastructure, such as a private water connection or toilet'.³⁰ The emphasis is very much on improvements for homeowners. The terms and conditions of microfinance lending in the context of incremental development favour those who already have some degree of tenure security and housing structure. For this reason, these loans are often referred to as housing loans, or housing microfinance. In some cases, they are also for land – for example, the Grameen Bank will lend for land purchase if the borrower does not have legal tenure. However, lending for land

purchase is much less likely because of the high costs and other problems with individualized solutions to tenure and infrastructure needs, and because some degree of land security may be a prerequisite for such a loan.

There is a vibrant rental market in many low-income settlements in most Southern cities. Such rental activities are, in general, informal; in addition to the fact that the income is not taxed or declared, the rental agreements are managed outside of the formal legal system. Tenants may be particularly vulnerable and may face difficult terms and conditions, with few alternative affordable options. They generally enjoy restricted access to services.³¹ In some cases, microfinance loans are used by the landlords to construct additional rooms for rent. However, there is not much information about such purposes and it does not appear to be happening at scale. In one housing loan scheme in low-income settlements in Mauritania, two-thirds of households used the home for some kind of enterprise activity, including renting space. The percentage renting space to others among the group who took housing loans is twice the percentage of those who did not take loans – but it still remains low at 6 per cent of households.³² In a few cases, small loan programmes have been orientated towards the landlord sector to improve the living conditions of tenants. However, there are relatively few intentional initiatives of this kind. One difficult issue is that, although the project may be intended to improve living conditions for tenants, in practice, the improvements may be associated with rent increases and the displacement of one (poorer) group of tenants by another (higher income group). Box 6.2 describes a small revolving fund in Kitale, Kenya, which offers loans for improved sanitation to plot owners, many of whom are also renting rooms. The objective is to improve environmental health, although the risk of potential rent increases and the displacement of tenants is recognized.

THE GROWTH OF MICROFINANCE FOR SHELTER

The growth of microfinance agencies since their inception during the 1980s has been considerable and there are now many such organizations. To exemplify the situation in one country, in India the number of such grassroots-level organizations engaged in mobilizing savings and providing microloan services to the poor is estimated to be in the range of 400 to 500 organizations.³³ However, some 60 million families in India (approximately 36 per cent of the country's population) are in need of financial services, while the cumulative outreach by microfinance agencies is no more than 1.5 million households (2.5 per cent).³⁴

The developments in shelter microfinance follow the development of a growing microfinance sector. During the 1980s, several agencies demonstrated success in offering small loans for enterprise development. The underlying and emerging argument was that small entrepreneurs were constrained by a lack of credit. The availability of credit, it was argued, would enable businesses to expand and

development opportunities to emerge from within the small-scale, invariably informal, business sector.

Early and continuing evaluations demonstrated that, whatever the loans were taken for, a proportion as large as 25 per cent could be diverted for shelter investments. For example, *Centro de Fermento a Iniciativas Economicas* (FIE), a Bolivian microfinance agency, estimates that 20 per cent of its enterprise loans are allocated to housing investments.³⁵ An assessment made by the Association for Social Advancement (ASA) in Bangladesh suggests that 15 per cent of borrowers for income generation use these loans for improving housing.³⁶ Findings such as these have encouraged the exploration of microfinance lending specifically for shelter. Box 6.3 describes how one microfinance agency sought to develop a specific product to address the housing needs of borrowers.

Although much emphasis of the early microfinance lending was on enterprise development, shelter has been a possible reason for lending since the mid 1980s, much the same time as enterprise lending was expanding. For example, the Grameen Bank started lending for housing in 1984;³⁷ while in 1985, for example, the US Agency for International Development (USAID) offered finance for the Co-operative Housing Foundation to implement credit programmes in a number of Central American countries.³⁸ The foundation developed its work with local organizations such as CACIEL (a credit union in Honduras) to expand shelter lending. Between 1985 and 1990, US\$11 million was invested in activities with 28 organizations to offer 4653 home improvement loans and a further 2828 construction loans.³⁹ Within the same programme, experimentation also occurred (on a much smaller scale) with community loans for infrastructure improvements (such as water systems).

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 in order to scale up their activities and/or to provide assistance to residents who have been successful in acquiring land. In such cases, NGO loan programmes are part of a more substantive programme to improve housing conditions that may involve the provision of technical assistance; community development training; grants for improving infrastructure and services; building materials production; and support in negotiations with local authorities.⁴⁰ Most of these initiatives emerged from Southern NGOs seeking to address the needs of the poor more effectively. Agencies working with housing, urban poverty and urban development issues were aware that self-builders faced major problems in securing the finance they needed for incremental development, and the NGO professionals were also aware of the long-term cost of short-term temporary improvements.

Shelter NGOs looked to the examples of microfinance agencies seeking to bring financial markets to those who traditionally had been excluded from opportunities for savings and credit. Others concentrated on the individualized lending systems of enterprise microfinance, but orientated the loans towards housing improvements. One example of this heritage is Proa in Bolivia, an NGO that started work in 1988 with a concentration on urban

Box 6.2 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 23 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.

development and which evolved a programme of housing loans (see Box 6.4).⁴¹

Even within the housing NGO sector, there are two distinct groups of such NGOs working in housing finance in Mexico.⁴² The first group is professional urban development NGOs who have primarily been drawn into finance programmes in order to influence state policies and the demands of low-income communities. Such programmes are illustrated in Box 6.6.⁴³ The second group are humanitarian agencies who have worked to improve housing conditions in low-income areas. Recognizing that families are able and willing to invest in their own dwellings, they have directly developed small loan programmes at scale. Their work is illustrated in Box 6.5 (it is estimated that households below five minimum salaries cannot afford a fully completed dwelling paid for with unsubsidized mortgage finance).⁴⁴

Box 6.3 Launching a housing microfinance product: Mibanco, Peru

With 70,000 active borrowers, Mibanco in Peru is one of the largest microfinance institutions (MFIs) in Latin America. The organization started as a non-governmental organization (NGO), but became a commercial bank in 1998. The conversion into a deposit-taking institution gave Mibanco the funding necessary to expand from microenterprise lending into other areas. During mid 2000, Mibanco added a housing product, Micasa, in the form of a loan for improvement, expansion, subdivision, or rebuilding or replacement of existing housing.

After 12 months of operation, Micasa had 3000 clients, with portfolio at risk greater than 30 days of 0.6 per cent and a return on loan portfolio of 7 to 9 per cent. Loan size ranged from US\$250–\$4000, and averaged US\$916. Interest rates were 50 to 70 per cent per annum. These rates are less than those Mibanco charges on microenterprise loans. Loan periods were as much as up to 36 months; but most households preferred loans of 6 to 12 months, and the average loan period was 11 months. Mibanco uses its analysis of repayment potential and household assets to guarantee most loans. Mortgage liens are sometimes taken, but only on larger loans (those above US\$4000) if the client already has clear legal title. In total, mortgage liens secure only 7 per cent of Mibanco's home loans. The housing loan product has strong profitability and demand, and Mibanco expects such loans to represent half of its portfolio within three years.

Source: Ferguson, 2003.

Box 6.4 Proa: learning how to offer shelter loans

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, p.193.

However, it is also important to recognize that not all housing and urban development NGOs have chosen to develop financial services for housing. In Mumbai, for example, at the end of the 1990s there were 18 NGOs addressing issues broadly related to housing and community finance, but only four specifically providing housing loans.⁴⁵ Urban development NGOs in Mexico have tended to develop housing finance initiatives as exemplar projects, not necessarily intending to take them to scale, but seeking to

Box 6.5 Humanitarian housing interventions in Mexico

One of the most significant of the humanitarian housing agencies operating in Mexico is *Habitat para la Humanidad México A.C.*, the Mexican branch of Habitat for Humanity. This agency began operating in Mexico in 1987 and currently works in the federal district and 13 other states, with 20 active affiliate groups. The organization provides credit to previously formed mutual aid groups of selected families, who supply the labour for their own and other group members' house construction on their own land. Until now, it has financed 14,388 houses in 600 communities in both rural and urban areas.

Another non-governmental organization (NGO) which provides home improvements finance for workers in the bonded industries (*maquiladores*) in Ciudad Juárez, on the Mexico-US border, is *Fundación Habitat y Vivienda A.C.* (FUNHAVI). This was set up in 1996 as a branch of Co-operative Housing Foundation International with the help of a Ford Foundation donation as seed capital. It is also sponsored by the Inter American Foundation, from which it received two loans for a total of US\$500,000 last year and donations from local businesses. Its target population comprises homeowners earning between two and eight times the minimum wage, although the average income of beneficiaries was four minimum wages in 2001; 38 per cent were women. The same source quotes that loans ranged from US\$500 to \$2500 (average loans of US\$1623), interest rates were 2.5 to 3 per cent a month, and a 2 per cent commission is charged by the organisation, as well as a US\$20 mandatory technical assistance fee. The technical assistance provider or 'architect' decides what sort of loan is needed. Loan terms vary from 6 to 36 months, with repayments being paid monthly at the local supermarket chain, with which FUNHAVI has a special arrangement. Another special arrangement with construction material distributors enables FUNHAVI to purchase them at wholesale prices, although recipients of the loans have to buy them from FUNHAVI at retail prices; this covers 11 per cent of FUNHAVI's running costs.

Source: Connolly, 2004b.

use the experiences to influence the ways in which housing policy is being developed.⁴⁶ This strategy extends well beyond Mexico, and many other NGOs who are advocating for more successful housing policies and strategies have introduced demonstration projects to show the effectiveness of small loan provision.⁴⁷ Another significant and influential group are the community organizations and their representatives, and NGO-initiated programmes have sought to switch community demands away from clientelist favours and towards effective development interventions that can go to scale. The Step-by-Step programme in Ecuador and Peru is a recent example of such a programme (see Box 6.6).

As illustrated by the Step-by-Step programme, in the case of some NGO programmes the desire to influence policy is combined with a wish to respond to the needs of those seeking to improve their housing and to improve access to loan finance. Despite widespread discussions about the value of microfinance, need remains acute, and in many cases there are few providers. In Ecuador there is a subsidy programme; but as illustrated in Box 6.6, the requirement for a savings contribution means that it cannot be accessed by many low-income households.

A further illustration of the continuing responsiveness of the NGO sector is given by the launch of South Africa's Kuyasa Fund (see Box 6.12). In South Africa, there is considerable state subsidy for housing provision and a commercial banking sector that has been under significant pressure to expand lending to the poor. Hence, the context appears to be one in which there are opportunities for low-income communities to secure both housing improvements and financial services. Despite this apparently favourable context, there is a further need for small housing loans. A Cape Town-based NGO, the Development Action Group, launched the Kuyasa Fund in 2001 after beginning trial housing loans in 1999. It did so because the communities with whom it was working needed finance to upgrade their dwellings, and there were few alternative accessible and affordable sources of finance.

Links to formal financial agencies

During the 1980s, some programmes had the explicit intention of preparing their clients for entry into formal housing finance either in the short or the longer term.⁴⁸ There was an underlying expectation that the poor could borrow from the formal financial systems once appropriate modifications had been identified and implemented. For example, in the case of the Central American programmes supported by the Swedish International Development Agency (SIDA), links have been sought. However, in practice, it has proved difficult to convince such formal financial institutions that they should participate in direct lending; this is due, in part, to the small loan size and associated high administration costs.⁴⁹ Generally, this expectation has changed and there is now greater recognition that it might be preferable to build significant institutions that specialize in small loans. Such institutions might link to the more formal commercial financial institutions to secure capital; but the formal financial institutions would not be expected to interact directly with the poor.

Box 6.6 Step-by-Step programme in Peru and Ecuador

The Step-by-Step programme is located in Peru and Ecuador and is being implemented by Centro de Investigaciones (CIUDAD) and Centro de Estudios y Promoción del Desarrollo (DESCO), with contributions from the European Union (EU), Centre for Ecology and Development (KATE), Instituto de Estudios Políticos para América Latina y África (IEPALA), Alternativas Sostenibles de Desarrollo, España (ASDE) and La Asociación para la Cooperación con el Sur/Las Segovias (ACSUD-Las Segovias). Activities include the establishment of a revolving loan fund with the related construction of safe and affordable housing through incremental development and the promotion of savings among participants. The revolving loan fund for shelter production seeks to establish a credit system that is adaptable to, and appropriate for, the needs of self-building families. Technical assistance in the building of affordable, healthy and safe houses is also being provided. Training programmes for the people involved in the construction of low-income housing are offered, together with the dissemination of good practices on progressive shelter financing schemes through a training and dissemination centre. In addition to the direct benefits, a further intention is to improve housing policies for low-income families through the targeted dissemination of the programme's achievements.

The total budget for the programme is 1.8 million Euros. In Peru, the project is taking place in Villa el Salvador (part of metropolitan Lima), with its 1 million residents. In Ecuador, the project is located in Quito, Riobamba, Alausi and Cotacachi. In total, 0.54 million Euros are allocated to the revolving fund and it is anticipated that just over 2000 loans will be provided.

Source: M. Vasconez, pers comm, 2004.

In Ecuador there is a national housing subsidy system that offers families a grant of US\$1800. However, families have to be able to save 10 per cent of the value of the house to qualify, and experience suggests that it is difficult to save the required amount. Generally, they are not eligible for loans and they do not trust formal credit institutions. As a result, one use of the revolving fund is for the down payment to secure the subsidy. Additional uses are part payment for new houses in existing housing programmes, housing improvement, down payments or deposits for commercial loans and providing community facilities.

Local financial strategies involving the fund can be exemplified through the women's association *Luchando por la Vida*. The 36 families have an average income of US\$185 per month, with 94 per cent of households falling below the official poverty line (US\$360 per month). The housing programme involves the construction of 6 buildings and 36 apartments (of 60 square metres at a unit cost of US\$5100). The total costs are paid thus: 33 per cent by the government housing subsidy and 67 per cent by the families (using a combination of savings, commercial loan and a Step-by-Step deposit to access the housing subsidy).

From 2001 to 2004, Step-by-Step in Ecuador has granted more than 930 loans and 550 families have secured new houses of good quality. In addition, 62 per cent of the users of the loans are women, and 72 per cent of families who have secured houses through the programme have incomes below the poverty line. Step-by-Step's loans (for a total amount of US\$750,000) have already mobilized more than US\$2.5 million from government subsidy (25 per cent) and private bank loans (75 per cent).

There remains the tradition of guarantee funds, although their use is somewhat limited to a few specific examples, and scaling up such examples into regular practice appears difficult.⁵⁰ A number of NGOs have specifically sought to use guarantee fund strategies to release financial capital from the formal (mainly commercial) financial sector. Such guarantee systems have a dual rationale. On the one hand, they are intended to build links between the formal and informal financial systems, encouraging further lending (with no or lower guarantee ratios) once a positive experience has occurred. Second, they are a way of leveraging finance if the guarantee is accepted to be less than 100 per cent. Examples of guarantee funds include the Latin American and Asian Low-income Housing Service (SELAVIP), the Society for the Promotion of Area Resource Centres (SPARC), Homeless International and a number of other Southern NGOs. Such guarantees can be illustrated by SPARC (an Indian NGO), the state-financed Housing and Urban Development Corporation (HUDCO) and a housing co-operative in Dharavi (a large low-income area in Mumbai).⁵¹ In this case, the funding was only released after SPARC guaranteed the repayments (with the financial support of a Northern NGO) and 25 per cent was withheld from the first loan instalment as a contribution to interest payments. More recently, SPARC has had more successful experiences based on the increasing interest of the private

sector to find a way of investing in the development of low-income urban areas.⁵² One experienced commentator concludes that despite difficulties around the release of additional finance for the local development activities of NGOs and community organizations 'it is too early to give up on banks yet'.⁵³

In this context, the more recent interest by commercial financial agencies, such as the Colombian Banco Davivienda, in developing a small loan facility is notable.⁵⁴ However, what is not yet clear is the extent to which the state will have to support such initiatives. What is evident from the following discussion is that the commercial banking sector in some countries is seeking more involvement in what is considered to be a potentially profitable sector.

The microfinance institution (MFI) experience: enterprise to housing loans

In addition to NGO initiatives, there has been considerable interest in housing lending shown by the microfinance sector. It is difficult to assess the significance of the growth of microfinance agencies into small shelter lending, but it appears to be significant. For example, three significant microfinance agencies were profiled in a 1996 study when, at that time, none of them were working in housing.⁵⁵ Four years later, two of the three were working in this area.

Microfinance agencies appear to be diversifying rapidly into housing micro-credit in at least some regions

Box 6.7 Assessing the demand for housing finance

Demand for housing and small-scale lending for housing investment is likely to increase, as is illustrated by the following examples:

- *Peru:* 82 per cent of the 8 million people living in greater Lima are classified as poor. At least half of poor households and 60 per cent of the poorest households express a strong desire to expand or improve their home within the next 12 months. Only 10 to 15 per cent are borrowing from formal or informal sources. The potential market in metropolitan Lima for housing finance loans is estimated at 610,000 home improvements annually.
- *Indonesia:* during 2000, the country's urban population of 85 million already represented 40 per cent of the total. By 2010 it will represent 50 per cent, with 120 million people. Annual projections for housing needs for the next ten years are approximately 735,000 new units and an additional 420,000 in need of improvement. An estimated 70 to 80 per cent of all housing in Indonesia is constructed informally and incrementally, with minimal access to formal financial markets.
- *Morocco:* two surveys found that 88 per cent of households have or are planning a productive activity in the home, and more than 83 per cent of households are willing to take a loan to finance home improvement. Ninety-two per cent of urban and 94 per cent of rural households constructed their own homes without access to formal finance.
- *Mexico:* one market study of microfinance in three Mexican cities (Tijuana, Matamoros and Juarez) bordering the US found that 14 per cent of all households both qualified for and wanted housing microcredit at terms of 35 per cent amortized over three years. The effective demand for shelter microfinance (US\$122 million) amounted to five times that for microenterprise loans (US\$20 million) in these cities.

Source: Malhotra, 2003, pp218–219.

Microfinance agencies appear to be diversifying rapidly into housing microcredit in at least some regions.

Over the last three years, most leading microfinance agencies in Latin America and the Hispanic Caribbean have established a housing product. Cases in point include Banco Sol in Bolivia, Banco Solidario in Ecuador, Mibanco in Peru, Banco Ademi in the Dominican Republic, Calpia in Honduras, and Genesis Empresarial in Guatemala.⁵⁶

One study funded by the International Finance Corporation (IFC) identifies 141 institutions providing shelter-finance loan products to the poor.⁵⁷ Another, focusing on Latin America, identifies 57 microfinance agencies as offering housing loans, just under 30 per cent of the total number of such institutions.⁵⁸ Of these agencies, about 18 per cent of their total loan portfolio is related to housing loans, amounting to about US\$160 million.⁵⁹ Among the 27 financial institutions in the Accion Network, seven have housing portfolios totalling almost 10,000 active clients and US\$20 million in outstanding balances.

The speed with which housing loans have been integrated within such agencies appears to have been facilitated by the similarity of lending practice. For example, in the case of one Peruvian agency, Mibanco, adding a home improvement loan product was easier than originally anticipated.⁶⁰ Traditional microfinance agencies treat housing loans broadly as they treat microenterprise lending, with small repeat loans that are not (in many cases) conditional upon collateral.

Reasons for expansion of MFIs into housing

One reason for the diversification of microfinance agencies into housing is commercial advantage. Such diversification may increase the financial stability of their loan portfolio, enable them to take advantage of opportunities for growth, and avoid losing clients to other microfinance agencies that provide housing loans.⁶¹ A further notable 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 taken (for example, for enterprise development). Thus, lending for land and housing has commercial benefits for a microfinance industry seeking to extend its niche and strengthen performance. The need for diversification may be particularly important in countries such as El Salvador and Bolivia, in which microfinance agencies are facing considerable competition for clients.⁶²

It appears likely that there is significant scope for expansion, at least in most of Latin America and Asia. Given the scale of housing need, microfinance for shelter remains significantly underdeveloped in many countries in which market conditions appear favourable, such as Mexico and Brazil.⁶³ In Central America, the SIDA has been financing a number of market assessment studies to identify what people want, both in terms of demand for housing loans and other financial services beyond credit.⁶⁴ Generally, demand has been diverse and has included infrastructure loans, as well as demand for microinsurance and housing. The market may also be significant in Africa; but it is likely that the income group will be different. In Africa, where many of the middle class may not be able to access formal loans due to land title problems, microfinance may not reach down the income groups so far and scale may be smaller but still valuable. Box 6.7 summarizes a recent analysis of the potential for growth in a number of countries. These assessments are only indicative of potential. However, they illustrate some of the reasoning that lies behind new initiatives in shelter microfinance.

Neighbourhood improvement (slum upgrading)

A further potential role for shelter microfinance is within more comprehensive slum upgrading programmes. There appears to be a growing interest in using microfinance agencies to provide specialist financial services within more comprehensive neighbourhood improvement and poverty reduction programmes. Within this strategy, the development agency, central government and/or municipality finances a process to upgrade the low-income area with components to regularize tenure and provide and/or upgrade infrastructure and services. The upgrading programme then contracts with an organization to offer small-scale housing loans for those who wish to upgrade their homes. At the broadest level, such programmes are similar to best practice elsewhere, involving local government and public-private partnerships to address housing and community development activities.⁶⁵

A further potential role for shelter microfinance is within more comprehensive slum upgrading programmes

Box 6.8 The local development programme (PRODEL) in Nicaragua

In order to address the need to improve the physical environment and the socio-economic conditions of the poor in Nicaragua, Programa de Desarrollo Local (PRODEL), a local development programme, established the following kinds of support:

- infrastructure and community works, including the introduction, expansion, repair and improvement of infrastructure and services through small-scale projects costing up to US\$50,000;
- housing improvement through small loans (of between US\$200–\$1400) targeted at low-income families who can afford to enlarge and improve houses and to repay their loans;
- financial assistance to microenterprises with small short-term loans (of between US\$300–\$1500) for fixed and working capital; these loans are directed, in particular, at microenterprises owned and operated by women; and
- technical assistance and institutional development to strengthen the capacities of local governments and encourage institutionalized financial entities to become involved in non-conventional lending programmes for housing improvements and microenterprise loans.

Between April 1994 and December 1998, 260 infrastructure and community projects were carried out in 155 different neighbourhoods, benefiting more than 38,000 families. Total investment has been US\$4.4 million (an average of US\$16,972 per project). Contributions from municipal governments and the beneficiary communities (in kind, cash, materials, tools, labour,

administration and supervision) totalled 43.1 per cent, with the remaining 56.9 per cent coming from the programme. Thirty-five per cent of the projects were for improving roads, gutters and sidewalks; 10 per cent for improving and expanding potable water and sewage systems; 14 per cent for rainwater and storm water drainage; 18 per cent for electrification (public lighting and/or household connections); and 23 per cent addressed community infrastructure (including construction, improvement, expansion and repair of primary schools, daycare centres, health centres, parks and playgrounds). The communities contributed approximately 132,000 days of work to these 260 projects, both volunteer and paid, using their own resources.

In five years, more than 4168 loans were given for housing improvements (total disbursed funds reached US\$2.7 million). By 2003, the total had grown to over 11,000 loans and annual disbursements during this year exceeded US\$2.5 million. These benefited approximately the same number of families. Families contributed their own resources, construction materials, labour, transportation and project administration to an amount equivalent to at least 15 per cent of the total value of the labour, transport and building materials. Seventy per cent of the families have monthly incomes of US\$200 or less, including many with monthly incomes below US\$100.

More than 12,451 loans to microentrepreneurs were allocated to communities in which PRODEL is active, with almost US\$5.5 million being disbursed, benefiting approximately 2400 existing families. Seventy new microenterprises have been created, giving jobs to some 210 people.

Source: Stein, 2004, pp117–118; PRODEL, 2004.

A number of different variants of this model have developed. Box 6.8 describes the Local Development Programme (Programa de Desarrollo Local, or PRODEL) in Nicaragua that was set up to enhance development in smaller towns and cities with a number of components, including infrastructure improvements, housing loans and loans for microenterprises. The activities received the support of SIDA, who signed an agreement with the Nicaraguan government in 1993 for the implementation of a programme to address basic needs and support development in a number of urban centres. In this case, the programme worked with Banco Crédito Popular, a state commercial bank, and selected two existing NGOs, Asociación de Consultores para el Desarrollo de la Pequeña, Mediana y Microempresa (ACODEP) and Nilapán-FDL, both of whom were already active in lending for microenterprises and who wished to expand their activities.⁶⁶ Although the physical areas for the different components of the programme do not necessarily overlap exactly, the cumulative effects are illustrated by the change in the number of those receiving housing loans who have land titles. In 1994, only 15 per cent of those receiving housing loans had title deeds; in 2002, the figure had increased to 73 per cent as the titling programme expanded.⁶⁷ Although communities do not pay directly for the improvements in

basic services and infrastructure, they contribute self-help estimated at 13 per cent of the costs.

A more focused (and smaller-scale approach) is illustrated in Ahmedabad, India, where the Slum Networking Project (undertaken within the municipality) wished to include a credit component to help households afford to contribute to infrastructure improvements. In establishing this programme, they drew upon the local expertise of SEWA, a local agency lending to the poor. More recently, the Parivartan Programme has been established to upgrade slums in and around Ahmedabad through the joint participation of government entities, NGOs, the private sector and low-income residents themselves. The programme was initiated by the Slum Networking Cell within the Ahmedabad city government. Parivartan means 'transformation' in Gujarati and Hindi. The programme seeks to offer improved infrastructure and better communication between the local residents and the authorities. It provides a water supply to every house, an underground sewerage connection, toilets in the home and an efficient storm water drainage system. Further benefits are street lighting, paved roads and pathways and basic landscaping, together with solid waste management. Costs are divided between the residents (2000 rupees, or US\$42) and the municipality (8000 rupees, or US\$170). SEWA helps the lower income residents with loans.⁶⁸

Box 6.9 Community-led Infrastructure Financing Facility (CLIFF) and bottom-up neighbourhood development

The Community-led Infrastructure Financing Facility (CLIFF) is an urban poor fund capitalized by donors that has been designed to act as a catalyst in slum upgrading through providing strategic support for community-initiated housing and infrastructure projects that have the potential for scaling up. The overall goal is to reduce urban poverty by increasing the access of poor urban communities to commercial and public-sector finance for medium- to large-scale infrastructure and housing initiatives. The first initiative is in India with the Society for the Promotion of Area Resource Centres (SPARC), the National Slum Dwellers Federation (NSDF) and *Mahila Milan*.

Scaling up citywide requires an engagement with the formal development process and the establishment of working relationships with formal-sector institutions. This is usually problematic, largely because public-sector financing is severely constrained and has a proven record of being reluctant to lend to the poor. A further problem is that the formal sector has continued to be unable to adapt their systems to accommodate non-formal investment processes. In December 2002, Cities Alliance approved a proposal to establish CLIFF with a seed capital of US\$10 million from the UK Department for International Development (DFID) and an additional US\$2 million from the Swedish government. Homeless International (a UK NGO) is the implementing agent and works with *Samudaya Nirman Sahayak*. The main function of CLIFF is to:

- provide bridging loans, guarantees and technical assistance;
- initiate medium-scale urban rehabilitation in cities in the South;
- work in partnership with community-based organizations (CBOs)/and non-governmental organizations (NGOs) who have or can be assisted to develop a track record in delivering urban rehabilitation;
- seek to attract commercial, local and public-sector finance for further schemes, thus accelerating or scaling up the response to the challenge of urban renewal; and
- establish local CLIFF agencies that can operate as lasting local institutions.

to provide a source of finance for income generation and housing investment.⁶⁹ In Comprehensive KIP 2003, some 30 per cent of the initial investment revolving fund (US\$33,000) per area was used to capitalize a revolving fund specifically allocated to housing. Between 2001 and 2003, an estimated 860 households had borrowed for housing improvements.⁷⁰ The delivery of housing loans was integrated with the provision of enterprise lending, as well as physical improvements to the area. Similar strategies have been used in a number of other programmes, including the Programme for Integrated Urban Renewal in El Salvador to assist in the rehabilitation of *mesones* in San Salvador after the earthquake. These are old houses now subdivided with tenants in each room. The programme provided for the improvement of infrastructure (with substantial finance) and then offered loans for housing improvement and micro-enterprise development.⁷¹

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 (through subsidies), with additional monies through loans taken by communities and repaid by individual members. Through a not-for-profit company, *Samudhaya Nirman Sahayak*, communities draw down the funds they need to pre-finance land, infrastructure and housing development. The scale of activities has resulted in additional donor finance being drawn into the process through the Community-led Infrastructure Financing Facility (CLIFF), which is described in Box 6.9.

The example of SEWA gives some indication of the potential for housing finance agencies to work in alliance with groups seeking sources of funds and organizational potential for upgrading. One further programme is the Comprehensive Kampung Improvement Programme (KIP) introduced in Surabaya, Indonesia, during the late 1990s and following on from earlier improvement strategies for these low-income areas. In these earlier strategies, the experience was that housing investment took place as the local environment was upgraded. In the Comprehensive KIP, revolving funds within communities have been capitalized

Land development

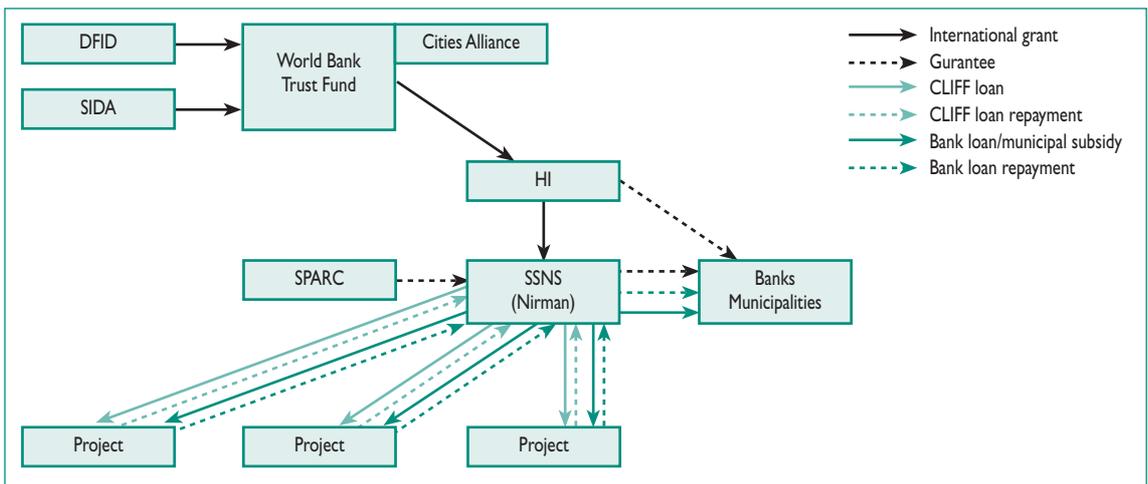
A further model offering a more comprehensive development strategy than shelter microfinance is the strategy of combining small loans for housing improvement with land development.⁷² One illustration is the case of El Salvador where low-cost subdivision regulations established during the early 1990s have helped to stimulate a low-income land development industry of 200 firms.⁷³ After

Figure 6.1

The Community-led Infrastructure Financing Facility (CLIFF) process

Note: DFID = Department for International Development (UK)
 SPARC = Society for the Promotion of Area Resource Centres
 HI = Homeless International
 SSNS = Samudaya Nirman Sahayak

Source: D'Cruz, 2004b.



developing the area and selling the household a serviced plot, many of these developers offer a small loan (often around US\$1,000) to build an initial core unit. It appears that this strategy has resulted in affordable secure tenure over the last decade, and – with greater supply – has lowered real estate prices in real terms. However, there are concerns about housing quality, and households who face difficulties at the end of the period may fail to secure a legal title.⁷⁴ A similar system is used by the Salvadoran Integral Assistance Foundation (FUSAI), a microfinance agency that has also started to be operational in land development in order to address the needs of clients. FUSAI acquires the title to the land and undertakes the cost of infrastructure development. Once serviced, the land is subdivided and allocated to families who have been accepted by FUSAI according to income and capacity to pay criteria. Families receive the land title once they pay back the loan. The amount to be financed by the loan equals the price of the house, including road and infrastructure development, minus the subsidy received from the state, minus the value of the self-help contribution by the family.⁷⁵ Similar initiatives are ongoing in Bolivia where Banco Sol has an agreement with a major developer and construction company in Santa Cruz.⁷⁶

The discussion here highlights the growing diversity of approaches that are grouped together within shelter microfinance. This final discussion on neighbourhood development (slum upgrading), together with the servicing of greenfield sites, has suggested a number of distinct neighbourhood and housing strategies that include a role for small-scale housing loans:

- *Improvements of existing housing units:* this is the dominant approach at present within shelter microfinance. Small-scale loans are provided to households with reasonably secure land tenure to enable the extension and/or improvement of accommodation.
- *Linked land purchase and housing loan developments:* private development companies prepare serviced land (and, perhaps, basic housing units) for sale with additional loans for housing development.
- *Linked land development and/or upgrading paid for with a capital subsidy and housing loan developments:* this has been discussed in Chapter 5 in the context of complete housing (paid for by saving, subsidy and loan); but the subsidy funds might be used to prepare a serviced plot with additional loans being taken as the household can afford to improve the dwelling.
- *Linked settlement upgrading and housing loan:* a further option may be for the government (either development agency and/or municipality) to upgrade the area, with households then taking additional loans to improve the dwelling.

In the case of the final three options, there are two distinct strategies that are considered in this chapter and Chapter 7. Shelter microfinance considers those strategies that are based on individual lending to the household by the microfinance agency. Without community capacity (and in the absence of state upgrading programmes), it is not

possible for shelter microfinance to do more than loans for housing improvement.⁷⁷ Chapter 7 looks at an alternative approach, community funds, which places more emphasis on collective capacity and which lends to groups of low-income households within a defined area and/or group. In some cases, the approaches within community funds have led into much larger-scale upgrading or land development strategies with the involvement of a much greater number of agencies. Notable examples are the *Baan Mankong* programme in Thailand (which has emerged from the work of the Community Organization Development Institute, or CODI) and the upgrading of 100 settlements in Phnom Penh, Cambodia, which was catalysed by lending from the Urban Poor Development Fund.

OTHER PROVIDERS AND SOURCES OF FINANCE

The preceding discussion concentrated on the growth in provision of small-scale loans for housing by NGOs and microfinance agencies. However, there are numerous sources of finance for small loans, although there are few large programmes that offer opportunities to finance incremental housing development at scale. One reason for the lack of scale is a lack of capital. The discussion of the development of this sector has concentrated on microfinance agencies and NGOs, both of whom receive external development assistance. Many of the providers considered below have had no external source of finance. The lack of loan capital is relevant to all providers and is discussed further in Chapter 8 as one of the challenges facing the sector.

Small loans tend to be offered by less formal financial markets and they may have a number of characteristics that differ from formal financial markets.⁷⁸ Access to finance may depend upon social networks based on religion or ethnicity. In some cases, households secure finance from neither formal nor informal financial markets, but borrow or otherwise obtain from friends and family. In this case, there may be further obligations in addition to repayments, with the loan being simply one component within a dense set of reciprocal exchanges. The following discussion focuses primarily on small loans being offered by institutions and organizations, rather than those being offered through entirely personal networks. Table 6.3 draws on one recent analysis that identified several key types of providers.⁷⁹

The potential significance of commercial micro-lenders can be illustrated in the case of South Africa. Like most countries in the South, South Africa has always had informal money lenders who ignore official interest rate restrictions. During the mid 1990s, however, revisions to the Usury Act created the possibility of formal commercial microlending at unregulated interest rates. These commercial microlenders, shown in Table 6.4, now comprise 64 per cent of registered institutions with the Microfinance Regulatory Council. Table 6.4 also illustrates the importance of larger banks. These commercial micro-lenders serve a market that is predominantly formally employed, with access to a bank account. The council estimates that about 11 per

There are numerous sources of finance for small loans, although there are few large programmes that offer opportunities to finance incremental housing development at scale

Institutional type	Area of focus
Microfinance agencies (large)	Those already working with more than 100,000 clients. Housing loan programmes may have emerged from disasters and may be a 'reward' for successful enterprise lending.
Microfinance agencies (medium)	Medium scale with 10,000 to 100,000 clients. May use similar principles for housing as for enterprise lending. May be short of suitable longer-term capital for such lending.
Northern NGOs	Some lend directly and some provide wholesale funds. They may provide limited technical assistance.
Co-operatives, mutuals and municipals	Locally owned and locally started housing programmes. May be part of networks for the sharing of experiences.
State housing programmes	May have limited capacity to offer small loans. Major source of second-tier funding, but limited outreach.
Commercial agencies	Some downscaling to housing generally faster than microcredit. Security and collateral is a major issue. Could mobilize large amounts of capital.
Local NGOs	Mainly involved in housing from a community perspective. Most are small with less than 1000 clients.

Source: adapted from Escobar and Merrill, 2004, pp38–39.

Table 6.3

Sources of small housing loans

cent of disbursements from such institutions are used for housing.

In South Africa and other countries, there are also examples of commercial banks seeking to reach the lower-income market with smaller loans for housing. One example is the Banco de Desarrollo in Chile, which has a small lending programme for housing with 15,000 current loans and an average size of US\$1200 per loan.⁸⁰ As noted earlier, Banco Davivienda in Colombia is now considering developing a small loan facility for housing.⁸¹ However, such initiatives appear to be limited since many banks do not see it as profitable to develop lending into the small-loan housing finance sector.

In addition to the commercial microlender industry, there are some alternative forms of housing finance that have emerged, including lines of credit from building materials suppliers and hire purchase of individual items such as sanitary ware. In some cases, there are longstanding practices within these or associated industries (such as furniture). In Chile, companies such as Easy, Homecenter and Home Depot provide people with building materials and have credit systems to which it is very easy to have access, providing that proof of income can be offered. Home building materials supply chains (such as Elektra in Mexico) may also enter this business on a more significant scale. Elektra (a large electrical appliance chain) has now formed a bank that provides credit for building material packages suitable for starter homes. A further Mexican programme, *Patrimonio Hoy*, is run by Cemex and encourages women to save together for the purchase of building materials. At the end of five weeks, the programme will advance raw materials worth ten weeks of savings. After three years of operation, *Patrimonio Hoy* had 36,000 customers and over US\$10 million in extended credit; the customer base is reported to

Table 6.4

Registered microlenders, 2003

Type	Branches	Percentage of total
Banks	2387	32.7
Publicly listed, non-bank	15	0.2
Private commercial microlenders	4687	64.2
Trusts	116	1.6
Section 21 (non-profit) companies	54	0.7
Co-operatives	42	0.6
Total	7301	100.0

Source: www.mfrc.co.za/detail.php?s=95.

be growing at the rate of 1500 to 1600 individuals per month.⁸²

Although remittances are not a provider of small-scale investments in housing finance, they are emerging as a significant source of finance for housing investment. Their current scale is estimated to be US\$200 billion a year, placing remittances as the second largest inflow to the South after foreign direct investment.⁸³ The largest receivers of remittance income are India, Mexico, the Philippines, Morocco and Egypt. Their growing scale has resulted in a number of institutional innovations to capture these financial flows and to more efficiently enable housing investment.

For example, Mexico's remittance income equalled 1.5 times the tourist income in 2002.⁸⁴ Although precise data is hard to come by, it appears that a significant proportion of such remittances are invested in housing.⁸⁵ An indication of the scale of such funds is the interest shown by financial agencies and building material companies in facilitating such investment. Box 6.10 describes the commercial systems that have been established to assist in housing investment in Mexico for workers based in the US.

The other set of institutions that may be concerned to provide small-scale loans are traditional home lenders. Traditional home lenders face substantial barriers in engaging in microfinance due to the relatively high costs associated with lending, which have been noted earlier.⁸⁶ Such institutions may require a mortgage lien as security for their home loans, while most shelter microfinance agencies work with other sorts of collateral. The culture and underwriting standards of traditional home-lending institutions suit lending to the middle class and those with higher incomes, while these institutions have difficulty with the practices required for lending to low-income households, such as reconstructing informal income and securing alternative forms of collateral.

State programmes offering small loans are potentially important, although they have not featured much in the development of the sector. In general, there has not been large-scale state finance for small-scale lending to support incremental housing development, although there are some exceptions to this situation, including the programmes discussed in Chapter 7 in which small loans are offered through collective mechanisms. Further exceptions are where small housing improvement loans have been associated with larger-scale upgrading (slum improvement programmes). In other cases, governments have sought to provide capital for NGOs interested in providing small loans for housing development. In India, the government has sought to provide capital through HUDCO from the early 1990s. A number of NGOs have taken up these funds, while some have struggled to manage the restrictions within the programme.⁸⁷ The Colombian government has recently taken a loan from the Inter-American Development Bank (IADB) that includes financing for 10,000 microloans for housing improvement. There may be a significant number of other programmes. Households buying serviced land from the city of Windhoek in Namibia can ask to repay over eight years at an interest rate of 15 per cent.⁸⁸

There are signs that there is a growing interest in financing these approaches and more groups interested in participating in activities. In Peru, the state housing authority is channelling housing funds to microfinance agencies, municipal savings and loan co-operatives, as well as some microfinance banks, in an effort to provide appropriate finance.⁸⁹ There also appears to be increasing interest at the municipal level in Latin America. The municipal funds in Peru offer little direct lending for housing, although the scale of their activities suggests that they have a major impact upon the financial choices of many of the residents. There are now 14 such funds throughout the country, with total deposits of US\$200 million and an annual growth in deposits of US\$40 million.⁹⁰ Belem in Brazil provides a further example of the potential role of the municipality. Collaboration between the municipality, civil society, the Banco de Povo and the community itself has resulted in a flexible loan programme offering loans of up to US\$500 for a variety of activities, and housing loans have also been made available through a new programme.⁹¹ One quarter of borrowers have improved their sanitation provision, reflecting urgent and pressing needs in the low-income neighbourhoods.

There have been some deliberate attempts to draw formal financial institutions closer to the microfinance sector. The discussion of social housing in Chapter 5 highlights the programme *Tu Casa* in Mexico, and there is a very similar component within an IADB loan to Colombia.⁹² In both cases, small home improvement grants are a minor part of loan and subsidy programmes that are primarily concerned with funding complete houses.

Cooperatives and other voluntary sector agencies

There is a range of voluntary sector agencies, such as co-operatives, and credit unions, that seek to extend credit to their membership and that may offer small loans for housing. These may also include less formal rotating savings and credit associations (ROSCAs). In general, the loans offered by such providers are not intended for housing improvements; but in some cases they are used for this purpose. A significant problem for such small-scale lenders is that the size of the loans is generally not sufficient for housing improvements. The issues are illustrated by an analysis of the Women Credit Union in Sri Lanka.⁹³ The housing needs of the members led to external finance being raised to enable the union to offer housing loans. However, such credit was limited and, thus, few loans could be allocated. The Kenya Union of Savings and Credit Co-operatives established a housing fund in 1998 through an agreement with the National Co-operative Housing Union (NACHU). However, funds also appear limited, and by 2003 the fund had extended 33 loans valued at 40 million Kenyan shillings.⁹⁴

Although informal financial mechanisms are used for incremental improvements in Hyderabad, such finance often cannot be accessed by the poorest.⁹⁵ Many of the ROSCAs require regular payments that are difficult for the poor to meet. The more flexible systems that do not require monthly payments have higher participation from the poor.⁹⁶

Box 6.10 Mexico and remittances

Cemex is a Mexican company and the world's third largest cement producer. Since 2002, Mexican residents in the US can buy cement and other building materials directly in eight Cemex branches in the US (a subsidiary called Construmex) and have the materials delivered directly to a chosen address in Mexico. Since it began this service (early 2002 to October 2004), US\$3 million have been taken in construction sales. The company estimates that the building materials needed for a 100 square metre completed two-bedroom house cost US\$6700.

The new mortgage banks, the Sociedad Financiera de Objeto Limitado (SOFOLES), have also sought to capitalize on similar funds and two have opened branches in the US, with a third operating in the US via an intermediary. However, the sales of mortgages have been slow, in part, because Mexican migrants come from communities with self-build traditions. Presidents Bush and Fox launched a bilateral organization, Partners in Prosperity, in 2001. In November 2004, the programme stated:

BANSEFI [Banco del Ahorro Nacional y Servicios Financieros], together with housing finance public institutions INFONAVIT [Instituto del Fondo Nacional de la Vivienda para los Trabajadores] and FONHAPO [Fondo Nacional de Habitaciones], have continued working under the Programa de Recepción de Aportaciones de Mexicanos en el Extranjero to allow Mexican migrants living in the US to transfer money to their families in order to obtain housing benefits and pay mortgage debts. Sociedad Hipotecaria Federal (SHF) is funding the Raíces programme where mortgage intermediaries (SOFOLES) grant loans to Mexicans living in the US to acquire a house in Mexico.

Source: Connolly, 2004a, b.

Housing and/or savings and loan co-operatives and mutuals are a further source of loans in Latin America.⁹⁷ Also notable are the housing and mutual aid co-operatives of Chile (Federación Unificadora de Cooperativas de Vivienda por Ayuda Mutua, FUCVAM), which provide loans and assist with construction. Although it might be anticipated that housing co-operatives would provide appropriate sources of finance, in practice many seem to concentrate on the provision of complete houses. This might be explained by their need to build 'officially' and conform to building regulations and/or by their own need for collateral. Box 6.11 discusses a scheme in Kenya to provide both housing and income support to low-income groups in Nakuru and highlights some typical problems of affordability that have been experienced elsewhere. Housing People in Zimbabwe faced very similar difficulties and found that many of those turning to housing co-operatives had higher incomes. Although such organizations often make considerable efforts to reach down to low-income groups – for example, Housing People helped one group of domestic workers – this tends to be exceptional. NACHU in Kenya has made some efforts to offer loans for land purchase and (household-level) infrastructure development to its member co-operatives. However, it is hard to assess the scale and affordability of this programme, and other loans are orientated towards those who have landownership.⁹⁸ The Nala Makazi Housing Co-op in Dodoma, Tanzania, has also managed to raise capital for housing construction and is currently developing housing for those living in informal settlements.⁹⁹ However, the scale is again very small. Similar problems appear to be prevalent in Latin America where credit unions will extend loans for housing improvement and purchase to lower income

Although remittances are not a provider of small-scale investments in housing finance, they are emerging as a significant source of finance for housing investment

Box 6.11 From self-help group to housing co-operative in Kenya

Between January and February 2003, members of the Nakuru Housing and Environment Co-operative (NAHECO) in Kenya have accessed seven housing loans from the National Housing Co-operative Union (NACHU) amounting to 360,000 Kenyan shillings and microcredit loans amounting to 140,500 Kenyan shillings. The membership of the co-operative has increased from the initial number of 15 groups from the three low-income settlements to 30 groups drawn from seven low-income settlements. The increased membership to NAHECO has resulted in increased savings. NAHECO has taken up a role of coordinating local self-help activities and people show confidence and trust in the operations of the group.

However, the poorest within the area are unable to benefit from this programme. The participatory needs assessment results showed that 92.6 per cent of people living in the three project settlements were tenants living in dilapidated housing; 70.9 per cent of them were very poor, with no land on which to construct own housing. One of the criteria for accessing credit for housing through NAHECO is possession of land or the ability to save enough to buy some. This is a major weakness in identifying the target group and formulating the guidelines for accessing credit through NAHECO. This implies that the poorest of the people in the target area may be excluded from benefiting from the project.

Source: Ng'ayu, 2003.

households; but they require that households have savings deposits equal to about 25 per cent of the loan, which the poorer households are unlikely to find affordable.¹⁰⁰ One exception to lending for incremental housing is the co-operative Jesus Nazareno in Bolivia, which provides small loans with a solidarity group guarantee for the purchase of land.¹⁰¹ However, titles are held by the co-operative until repayment is completed, and this suggests that the loans are to those able to afford secure tenure and title.

Despite such difficulties, the significance of many small providers is emphasized by a recent assessment of the microfinance sector in Peru.¹⁰² Major institutions offering small loans include self-managed communal funds and co-operatives, NGO programmes, local microfinance agencies, municipal funds, rural funds and the protection funds of some workers' unions. An estimated US\$25 million may be loaned each year to housing, of which about 67 per cent comes from the savings and loan co-operatives.

Box 6.12 Acquiring loan finance in South Africa

The Kuyasa Fund is a non-profit microfinance institution based in Cape Town, South Africa. Since 2001, it has reached more than 2643 clients with US\$1.8 million of housing loans. Portfolio at risk is 15 per cent and write-offs are 5 per cent of cumulative disbursements. Women constitute the vast majority of Kuyasa borrowers at 72 per cent, and account for 70 per cent of the value of loans taken.

The Kuyasa Fund has been unable to obtain any loan equity locally, and the wholesale equity and start-up grants have all come from offshore donor sources. Although the parastatal National Urban Reconstruction and Housing Agency (NURCHA) has assisted with loan guarantees, none of South Africa's housing-related parastatals have been willing to lend or grant Kuyasa any funds on the grounds of 'high risk'. Kuyasa, however, has already demonstrated conclusively that its lending performance is better than that of mortgage lenders operating in the same market. Recently, the National Housing Finance Corporation has courted Kuyasa management with the offer of a loan, but on terms that made it unviable for Kuyasa. Once again, the parastatal cited risk as its main concern. Kuyasa's difficulty in attracting local equity, even in the face of solid performance, reflects the continuing dominance of the mortgage mindset and risk aversion in South Africa's parastatal housing finance sector.

Source: Baumann, 2004; Van Rooyan, 2004.

Sources of capital finance

How do microfinance agencies secure capital for their lending? Some providers draw on their own capital, notably the private sector and, for the most part, the small-scale voluntary organizations, such as credit unions. However, most agencies who wish to expand their lending have to find significant sources of capital.

Although consumers in South Africa have been successful in accessing and using small loans and targeted savings for incremental housing improvement, the policy and regulatory environment has not been developed with this approach in mind, and there is no source of wholesale finance or technical support for such institutions.¹⁰³ The NGOs who have developed this model cannot drive the development of a pro-poor housing finance sector alone. Groups such as the Kuyasa Fund now face a major constraint in the lack of capital to expand lending (see Box 6.12).

Such NGOs and other microfinance agencies have four sources of funds: deposits, development assistance, governments and the private sector. The problem remains even in countries with a well-developed microfinance sector, such as Bangladesh. Despite the creation of an apex financing institution, the Palli Karma-Sahayak Foundation (PKSF), agencies such as the Grameen Bank remain short of capital to finance microloans for housing.¹⁰⁴

Although many agencies encourage deposits and, as noted in Box 6.14, in SEWA's case these savings provide 80 per cent of capital, availability of medium-term capital is recognized to be a constraint. This is a problem even in the context of the Central American agencies funded by SIDA that generally receive medium- to long-term support (an average of nine years per programme).¹⁰⁵

Microfinance organizations, for the most part, seek to be viable commercial enterprises. The small number of agencies studied by Cities Alliance are broadly successful in this aspiration.¹⁰⁶ Micasa (the housing programme of Mibanco in Bolivia) broke even on a cash-flow basis, including the initial investment in adjusting the management information system, within nine months; if performance continues at current levels, it is expected to generate a return on loan portfolio of between 7 and 9 per cent, compared with its overall return on loan portfolio of 3.4 per cent. FUNHAVI, the Mexican agency, was operationally self-sufficient after six years of business and moving towards full financial sustainability.

However, both these agencies appear to have had sufficient capital to expand their activities to a profitable level. Proa (also in Bolivia) has a model that would work without a subsidy only if volumes increased.¹⁰⁷ The programme has money from a mutual savings association at 9 to 10 per cent and on-lends at 13.5 to 15 per cent. Given current volumes, a higher fee (margin) is required; but this is not allowed by the mutual association providing the funds. The expansion of the programme from US\$175,000 to US\$500,000 of new loans per month would allow costs to be covered. The success of this strategy is critically dependent upon securing adequate capital to expand lending.

This aspiration to be financially viable without access to financial support has a number of implications for the

nature and development of microfinance. Many microfinance organizations face a balance between reaching down to the poorer households with smaller loans and minimizing administration and management costs by offering larger loans. In general, the emphasis has been greater on cost-effective lending. There is a widespread belief (supported by many experiences) that access to credit is rather more important than the price of credit and, hence, that microenterprise lending can charge interest rates that are relatively high in comparison to the formal financial markets (although low compared to informal money lenders). However, housing loans are often considerably larger and therefore the interest rate charges are more significant. In some cases, lenders have developed specific housing products with lower interest rates; these are generally commercially viable even if they are not fully market based.¹⁰⁸

Some bilateral donors have funded shelter microfinance activities for a considerable period (almost 20 years) including Swedish Assistance (Box 6.13) and USAID. However, the multilateral donors – such as the IADB and the World Bank – have only begun to learn about and develop programmes in this area over the last few years. In their absence, Northern NGOs have played a very significant role in supporting such initiatives. These NGOs have included Misereor (Germany) and CordAid (the Netherlands), as well as specialist housing and urban development groups such as SELAVIP (Belgium) and Homeless International (the UK).

Shelter microfinance and subsidies

There is a difference of opinion between microfinance agencies about the need for housing subsidies. On the one hand, there is a belief that subsidies are necessary because of the traditional association between subsidies and low-income housing and because of the larger size of housing loans.¹⁰⁹ On the other hand, it is widely accepted that microfinance needs to perform without subsidy finance in order to be able to expand as market conditions permit. Sector commentators suggest that subsidies should not be offered through interest rates or permitted defaults, and that subsidies, if offered, should be managed separately outside of the loan operation.¹¹⁰ For example, subsidies might be provided through capital grants for housing investment or through the provision of water and sanitation services. Chapter 5 discussed the use of small loans to top up housing subsidy finance.

Despite such recommendations, this is not necessarily common practice. In situations in which there is no state support, there appears to be an effective cross-subsidy from enterprise to shelter lending, as the interest rates are lower in the latter. In some countries, particularly in Asia, subsidies are available through reduced interest rates and microfinance agencies have become a conduit to deliver state support to the poor. In some cases, the subsidy is provided in the form of an interest rate reduction. Grameen Bank and SEWA have both accessed low-interest sources of funds and pass on this subsidy.

Box 6.13 Swedish International Development Agency (SIDA) assistance to low-income housing in Central America

Since 1988, the Swedish International Development Agency (SIDA) has financed housing and local development programmes in Central America with total resources of US\$50 million. By the end of 2003, the programmes had helped approximately 80,000 low-income families, or about 400,000 people, in the main urban areas of the region to improve their habitat conditions. The resources from SIDA have been channelled through different institutions and programmes – namely, the Foundation for Housing Promotion (FUPROVI) in Costa Rica, the Local Development Programme (PRODEL) in Nicaragua, the Salvadoran Integral Assistance Foundation (FUSAI) in El Salvador, the Urban and Rural Social Housing Development Foundation (FUNDEVI) in Honduras and the Local Development Trust Fund (FDLG) in Guatemala.

SIDA's policy throughout the region has been that housing subsidies are primarily the responsibility of national governments, who act as counterparts to the international agency. That is why most of the funds allocated by SIDA have been channelled to finance three main components of these programmes: loans (including microloans for housing improvements and new housing), technical assistance (both to executing agencies and the target population) and institutional development, especially of those institutions that manage the Swedish funds.

Source: Stein with Castillo, 2005.

TERMS AND CONDITIONS

There is a considerable diversity in the nature of shelter microfinance as provided by the many different organizations who are active in this sector. One commentator illustrates such differences thus:

In Mexico, CHF International and FUNHAVI [Fundación Habitat y Vivienda A. C.] have developed a home improvement loan that features an average loan amount of US\$1800, a repayment period of 18 months for first-time borrowers and a 54 per cent effective annual interest rate. The Grameen Bank's housing loans typically are repaid over ten years. They are offered at an interest rate that is 10 per cent below rates assessed for microenterprise loans, and first-time clients are not eligible for such loans.¹¹¹

The average size of the Grameen Bank housing loan is 13,386 Bangladesh taka (US\$224).¹¹² This contrast demonstrates the significance of local context in developing appropriate housing finance solutions. The difference between these approaches reflects the type of housing solution that is acceptable and affordable to the borrowers, and the solution that is likely to be approved by the authorities if they have a significant presence. The contrast also reflects the target group for lending activities and the operating constraints and choices of the agency. For example, as is sometimes the case for microenterprise lending, some microfinance agencies prefer to give fewer larger loans, thereby reducing their administration costs and increasing their financial returns for a given amount of loan capital.

Savings

The link between housing investment and savings extends well beyond the microfinance sector. In the North, traditionally families have saved for several years simply to access conventional mortgage finance. Savings is a particularly significant component of the contract-savings schemes in Western Europe, notably the German Bausparkassen and UK building societies.¹¹³ Similarly, many microfinance programmes for housing, particularly in Asia and Africa, have savings requirements.

Savings has a place in microfinance for many reasons. Savings is a strategy to assist with repayments in which borrowers have to demonstrate a capacity to make regular payments and accumulate sufficient funds for the required down payment or deposit. Microfinance agencies may try to get would-be borrowers to save at a rate equal to loan repayments, in part to reduce the risk to lender and borrower. The required savings period typically lasts between 6 to 12 months before a loan is granted.¹¹⁴ One notable example is Bank Rakyat Indonesia (BRI), which has mobilized more than US\$2.7 billion in voluntary savings through 16.1 million savings accounts; however, saving on this scale is very unusual. A further reason to encourage savings is to assist the agencies themselves in acquiring funds.¹¹⁵ In SEWA's case, the bulk of the bank's loan portfolio arises from client deposits, although additional finance for housing loans is provided by the government through HUDCO.¹¹⁶ The importance of saving can be illustrated for the case of SEWA:

In order to be eligible for any loan from SEWA Bank, for example, the would-be borrower must have a regular savings record at SEWA Bank for at least one year. What is important for SEWA is that the savings history is stable and consistent. SEWA Bank's experience is that facilitation of a strong savings habit correlates significantly with high loan repayment rates – hence, a client's savings record serves as the main form of collateral for loans.¹¹⁷

The significance of savings to the clients of microfinance agencies has long been recognized. The experience of the Kuyasa Fund in South Africa is that clients use their savings to augment the subsidy that they receive from the state. A very notable estimated 65 per cent of Kuyasa clients only save and do not take loans.¹¹⁸

Collateral and security

Collateral is an asset pledged to a lender until the borrower pays back the debt. Its major role is in reducing lender risk and it is widely recognized that a key challenge for shelter microfinance is that of loan security.¹¹⁹ Many microfinance agencies seek to minimize the need for collateral by using existing client history (enterprise lending). A further strategy used for lending for income generation is small repeat loans as a way of building up repayment skills and capacities and providing an incentive for repayment.

However, the larger size of shelter microfinance makes this strategy more difficult to follow.

Another strategy used by microenterprise lenders is that of group guarantees. However, this strategy has been found to be problematic for housing loans, again because of the bigger loans and longer loan period.¹²⁰ This may explain the problems faced by the Group Credit Company in South Africa (which tried and failed to replicate Grameen Bank strategies in offering small loans). Difficulties are related to the longer period of the loans and, hence, the lack of need for the group unless repeat income-generation lending is also taking place. The use of group guarantees should not be confused with group loans, which include a collective responsibility to manage and repay the loan (see Chapter 7).

In the absence of such strategies, a wide range of collaterals are used, including mortgages, personal guarantees, group guarantees, fixed assets and/or pension/provident fund guarantees.¹²¹ Pension fund collateral is used particularly in South Africa and Bangladesh, and more recently in Namibia, but is not significant elsewhere. In a recent study of microfinance agencies' practices, the following are identified as collateral:¹²²

- land title and buildings;
- chattel mortgage/lien on assets;
- obligatory savings;
- assignment of future income (wages);
- personal guarantees (co-signers);
- joint liability and group guarantees (character-based lending); and
- other financial assets (for example, life insurance policies and pension funds).

One difficult area is the extent to which legal title is a requirement of lending. One commentator argues that 'Client ownership of the home or land is preferred: it is against the policy of some lenders to provide credit for housing on squatted land.'¹²³ Moreover, in some countries such as the Dominican Republic, lenders may not be legally allowed to extend housing loans without a formal property title.¹²⁴ However, despite an emphasis on land ownership, the use of title deeds as collateral for microfinance loans is limited, and one study of 80 such organizations found that only one quarter use it.¹²⁵ For example, the experience of Mibanco in Peru is also to avoid the use of land titles. The agency relies on the same informal collateral of household assets and co-signers used for microenterprise loans (despite the mass land-titling programme that has taken place in Peru, discussed in Chapter 4). Mibanco found that land titles are expensive to use as guarantees, and that poor clients do not want to use title as collateral for a loan of less than US\$1000.¹²⁶ Banco Sol uses such collateral but considers that there are major risks because of the poor standard of deeds and title documentation.¹²⁷

Alternative strategies are varied. In some cases, such as the Grameen Bank, home loans are only given to those who have experience in enterprise lending and a good repayment record. Alternatively, social collateral such as

guarantees from other residents involved in the programme may be used. A further option is holding the para-legal documents to the property, or other non-mortgage collateral such as jewellery. Some lenders take a mortgage lien when the costs and legal structure permit for larger loans, such as for the construction of a core unit. In the case of PRODEL in Nicaragua, experience suggests that for loans under US\$700, there are other types of collateral as effective as a mortgage.¹²⁸ PRODEL gives loans to families who do not have full land ownership, but that are able to demonstrate security of tenure – for example, co-signers who could put up their properties for mortgage, valuable objects and municipal certificates that show security of tenure, although not necessarily land title. Only half of the more than 5000 loans provided up to the year 2000 were mortgaged, and delinquency rates were still very low.

Although not collateral, a further common requirement is to specify the maximum percentage of income that can be used for housing loan repayment. A maximum percentage of 25 to 30 per cent of income in housing repayment is widely used by agencies. However, the effectiveness of this constraint can be questioned as precise incomes are not that easy to establish. Lenders may have different conditions for salaried workers and entrepreneurs.¹²⁹

Interest rates

In many cases, interest rates for shelter loans are lower than those for enterprise development, even when offered by the same agency.¹³⁰ In most cases, the rates are fixed as the loans are for relatively short periods and it is very difficult for low-income households to cope with the uncertainty of variable rates. In a study of four Bangladeshi microfinance agencies offering loans for housing, the interest rate was lower in every case.¹³¹ Although the Grameen Bank's explanation rests on the social significance of housing, it is also notable that higher interest rates would be unaffordable for the target group, given loan size and repayment periods.¹³²

Setting the level of interest rates is clearly a difficult issue. Interest rates must be acceptable to borrowers and one report on SIDA's experience suggests that interest rates cannot diverge greatly from (even if they are not identical to) mortgage rates.¹³³ Most agencies seek to at least cover the cost of inflation and administration, with an allowance for defaults and bad loans. Box 6.14 summarizes SEWA's experience in setting interest rates for housing loans. An alternative approach used by Habitat for Humanity in Africa and the Middle East is to use a variable inflation index on the loan, which is pegged to the price of a bag of cement.¹³⁴ This allows repayments to maintain their real value.

Loan periods

There is a very significant difference in the loan periods of different shelter microfinance programmes. One recent survey of 15 agencies offering small loans for shelter finds that the loan periods differ by between 20 months and 15 years.¹³⁵ It might be anticipated that longer loan periods

Box 6.14 Self-employed Women's Association (SEWA) interest rates for housing, 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 since 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.

would be used for larger loans, potentially secured on the property, as the incentive for small repeat lending could not be used. In practice, this does not appear to be the case and some of the small loans have long repayment periods, with some larger loans featuring shorter repayment periods. However, the longer loan periods may be misleading. For example, one case is People's Dialogue in South Africa, where in most cases the loans are bridge financing for the state housing subsidy and are paid off rapidly once the subsidy entitlement has been accepted and finance released.

Technical assistance

A further area related to the provision of subsidies is that of technical assistance. Many of those lending for shelter microfinance seek to provide assistance in construction activities. For example:

- FUSAI is an NGO in El Salvador that is working in housing-related activities. In 2002, it decided to separate its housing financing activities from construction support in order to maximize the efficiency of both operations.¹³⁶
- Proa, a Bolivian NGO lending for housing improvements, has technical staff who prepare plans and budgets. They receive a commission on each loan (US\$40) and secure additional payments from the households if required.¹³⁷
- SEWA found that its members were increasingly asking for other services related to housing (in addition to loans). The Gujarat Mahila Housing SEWA Trust (MHT) was established to provide SEWA members with technical services related to housing, including advice on improving and extending existing houses, building new houses and infrastructural services. The MHT plays a key role as an intermediary with government departments in accessing schemes, including those related to infrastructural facilities and environmental improvement.

Box 6.15 Grameen Bank loan package, Bangladesh

In Bangladesh, the families who are members of the Grameen Bank typically live in small shelters of jute stick, straw, grass thatch, bamboo and dried mud. Each year a family has to spend about US\$30 to repair the house after the monsoons. For an equal amount of money, a family can repay a housing loan for a strong, well-constructed house with a floor area of 20 square metres. The bank views housing loans as investment rather than consumption since a secure and well-constructed house aids the health and well-being of the family and helps them to break the vicious circle of poverty. The house can be used for storage for their small businesses, and time and money are saved in not having to continually repair the jute-stick shelters.

The Grameen Bank has developed two standard house designs. The smaller one costs US\$300 and a larger version costs US\$625. In many cases, the family adds their own savings to the loan and spends up to US\$800–\$1000 on their home and its furnishings. The houses vary in appearance throughout the country, but have the same basic structural components. There are four reinforced concrete pillars on brick foundations at the corners of the house and six intermediary bamboo or concrete posts, with bamboo tie beams, wooden rafters and purlins supporting corrugated-iron roofing sheets. This provides stability in the flood and strong monsoon wind and protection from the heavy rain during the monsoon season. In cases of severe flooding, the house can be dismantled and the components stored and reassembled later. A sanitary latrine must be provided with each house. Families can build the houses themselves with the help of friends and neighbours. Local skilled carpenters carry out the roof construction.

Source: www.bshf.org and www.grameen-info.org.

- FUNHAVI (Mexico) goes one step further and requires borrowers to buy construction materials from it (as well as providing technical advice). However, this is also a financial measure, as it buys at wholesale and sells at retail prices.¹³⁸

Opinions differ about the viability of such services for microfinance agencies. One argument is that the more developed microfinance agencies do not offer such services.¹³⁹ A related view is that 'Construction assistances in the context of housing microfinance does not appear to be a predictor of financial performance.'¹⁴⁰ Some, such as Asociación para el Desarrollo de Microempresas (ADEMI) (Dominican Republic), argue that it is up to clients to manage their own affairs. Groups such as the Co-operative Housing Foundation argue that it is a necessary service and the content helps to reduce default rates. Another position is that of the Kuyasa Fund in South Africa, which does not want to provide these services itself, but recognizes the need to work alongside those who can provide technical assistance around construction issues.

In some cases, such as the Grameen Bank in Bangladesh, the loan is for a defined package of building materials, which minimizes the need for technical assistance (or greatly eases its provision) (see Box 6.15).

Orientation towards women

There is an emerging preference to lend to women in many of these institutions, based on the reliability of repayment.¹⁴¹ Women borrowers are 'current good practice'

and there is a particularly strong predisposition towards lending to women in Asia.¹⁴² The Grameen Bank, for example, argues that the title to the house constructed with loan finance is vested with the borrower, and in 95 per cent of cases this is the woman. By having title to the house, the woman obtains financial security and an improved status within the family and society. In the case of FUNHAVI in Mexico, 38 per cent of the clients are women.¹⁴³ According to the Kuyasa Fund, South Africa, women are 72 per cent of the borrowers.¹⁴⁴ In the case of PRODEL in Nicaragua, more than 60 per cent of the housing improvement loan recipients and 70 per cent of the microentrepreneurs are women.¹⁴⁵ Such figures are indicative of the more general position: women are often predominant among borrowers, but few funds exclusively serve women.

In the case of shelter, the role of home carer is often defined by gender and given to women. Hence, women may have a greater interest in investing in housing even if they are less likely to be the formal 'owner' of the dwelling.

Income generation

Although the primary focus of the initiatives discussed above is on savings and lending for shelter improvement, some of these programmes recognize the evident links between shelter and livelihoods. Some agencies, such as SEWA, have long recognized the close connection between home-based enterprise lending and housing improvement loans.¹⁴⁶ Improving the infrastructure in the areas in which SEWA is working resulted in an average 35 per cent increase in small enterprise earnings.¹⁴⁷ Through experiences such as these, there is a growing awareness of the links between enterprise and shelter investment.

There are three notable ways in which these programmes are linked to enterprise lending. The first is through lending for income generation. In many cases, shelter microfinance is offered along with income-generation loans. In some cases, it is a condition of the lending organization that income-generation loans are taken first, in other cases, one or other might be taken. The justification for the first strategy is that successful income generation is needed to be able to afford housing investment and related loan repayments. The argument in favour of the second strategy is that many 'enterprise' loans are diverted to housing investments and repayments proceed successfully.

Second, housing investments are more directly linked to income generation in a number of ways. Housing construction activities may be to improve a business or production area, such as a small shop or a workroom. In some cases, they may not even be related to a productive or vending enterprise directly, but may be providing a room to rent. Finally, the more ambitious schemes have explored the possibility of creating commercial centres to improve local livelihoods and to strengthen the local economy. Generally, these strategies belong to initiatives with more ambitious development objectives (see Chapter 7).

FORESEEN CHALLENGES

Although shelter microfinance might not be effective in every context, there is now widespread experience and understanding of the process and considerable appreciation of the approach in many countries. There are two notable challenges facing the shelter microfinance sector. The first is the nature of the beneficiary group and the difficulties faced by very poor households due to problems of affordability and lack of secure tenure. The second is sources of funding. Although other issues may be of specific concern to particular programmes, these two subjects are those that appear to be the most significant.

Affordability

Microfinance for shelter may contribute to a more holistic approach to development than that generally associated with microfinance. In so doing, it may be addressing some of the concerns raised about its ability to assist some of the poorer families.¹⁴⁸ By reducing expenditure on basic needs (such as rent, repairs to housing and water costs), lending for land, infrastructure and housing may increase remaining income and reduce vulnerability. As demonstrated in the case of the Grameen Bank (see Box 6.15), housing investment reduced repair costs and essential expenditures.

These programmes appear, in general, to reach the income groups served by microfinance agencies lending for enterprise development and families with similar incomes in the formal sector. The bias of microfinance agencies towards the somewhat higher income groups has been recognized for some time. This bias reflects the need of the agencies to secure high levels of repayments and give out larger loans (with the administration costs therefore being a smaller proportion of the loan). It also reflects the self-selection of their clients, with the more vulnerable avoiding the problems of debt, or beginning and dropping out of the programmes. Many shelter microfinance programmes appear to be targeted at the higher income urban poor, sometimes those with formal employment (at least one member of the family) and often those with diversified household livelihood strategies. As is the case with SEWA, successful income-generation borrowing may be required prior to housing loan applications. In many cases, land tenure is required.

The target group of those agencies reviewed by Cities Alliance is profiled thus:

...these financial institutions describe their clients as the economically active poor in the informal sector. They are largely serving their existing poor clients with this new loan product, and most provide housing loans as a reward for good past performance on microenterprise loans.¹⁴⁹

In the cases of the agencies considered, Mibanco's clients have an income that is around or below the poverty line for Peru (where 50 per cent of the population have incomes below the poverty line). FUNHAVI in Mexico serves clients who earn between two and eight times the local monthly

minimal wage of US\$125. SEWA Bank's clients are all poor self-employed women – predominately street vendors, labourers or home-based workers. In 1998, an estimated 76 per cent of SEWA borrowers had annual household incomes below US\$415 and half of these had annual incomes below US\$276. Clearly, the group that is being reached is poor and in need of housing investment. However, these are large income categories and they may say little about how far below the poverty line such programmes are able to extend.

In some cases, shelter microfinance is linked to state subsidy programmes (notably in Latin America), and this may extend their reach downwards towards lower income groups. The Step-by-Step programme in Ecuador, for example, helps households to raise the deposit they need in order to secure the direct demand subsidy and therefore afford improved housing. However, as noted in Chapter 5, such programmes may include further loans and, hence, the poorest may not be able to afford the costs of inclusion.

The use of other mechanisms and, notably, the requirement for secure tenure, may further define the client group as being the poor, but not so poor. The greatest difficulty faced by the poor is that, in general, these programmes offer small loans for housing improvement and therefore cannot address the large numbers who do not have tenure security (if not a full title). A further illustration of such restrictions is given for one housing loan programme in India in which only those households who were occupying the house on an ownership basis were selected and tenants on rent were excluded; this was based on the consideration that such households would not be in a position to join the shelter upgrading programme.¹⁵⁰

It might be argued that any household able to afford a loan is not going to be the very poorest; therefore, the shelter microfinance programmes will inherently struggle to reach down to those with lower incomes. The group that is being reached by these programmes is clearly benefiting from the assistance. Moreover, without access to loans, housing investment is very inefficient. For those who do secure loans, the benefits can be considerable. In addition to the income benefits discussed above, Box 6.16 describes some of the health consequences. Shelter microfinance appears to be effective in improving the housing conditions of a group eager to invest in its own dwellings. It has a significant role in a system of housing finance, while, at the same time, there is a need to be realistic about the limitations of the strategy in reaching the poorest.

Securing capital

As noted above, securing sufficient loan capital is difficult. Lack of capital emerges as being a very significant constraint on expansion. Banco ADEMI (in the Dominican Republic) cited lack of capital as the principal challenge that the organization faces in providing housing credit, for which there has been substantial demand.¹⁵¹ These difficulties reflect a general constraint on the microfinance sector and usually do not appear to be specifically related to housing lending; however, as illustrated in the example of Bangladesh, there may be even more limited sources in the case of housing. As noted earlier, in the case of some

Box 6.16 Improving shelter, improving health

The few impact evaluations conducted of shelter finance point to positive results for the poor. An evaluation of Plan International's Credit for Habitat programmes in Bolivia and Guatemala showed that clients invested their US\$200–\$800 loans in roofing, walls, floors, tiling, water, sewage and electrical connections, as well as additional rooms. Seventy-eight per cent of clients said that home improvements improved family health. Clients with Grameen-financed homes in Bangladesh – equipped with Grameen's construction standards of cement pillars and sanitary latrines – had 50 per cent fewer incidences of illnesses than those without Grameen houses. Their houses suffered far less structural damage during the devastating floods of 1987 and since, compared with non-Grameen homes. An impact assessment of the Self-employed Women's Association (SEWA) Bank's slum upgrading programme in India, which included progressive housing loans, reported increases in literacy (school children enrolment), productivity (increase in number of working hours), income and health (lower incidences of illness and, thus, lower health expenditures), and increased marriage opportunities, higher status and respect in the community for women borrowers. In sum, housing finance loans serve poor households and help them to improve their livelihoods.

Source: Malhotra, 2003.

agencies, viability is related to the scale of activities, and capital for expansion will result in profitable lending and potentially an easing of capital constraints.

Very little is known about the aggregate balance of sources of funding for shelter microfinance. A recent study of the total capital of the larger microfinance agencies in Bangladesh highlights some interesting trends.¹⁵² It is notable that finance from the commercial banking sector increased from 3 to 11 per cent of total capital between 1996 and 2002. Donor finance has dropped fairly dramatically through a similar period (from 58 to 17 per cent), although this partly reflects the growing significance of the Palli Karma Sahayak Foundation, a public–private apex body that channels funds to microfinance agencies, which has increased its significance by providing 12 per cent of capital in 1996 and 24 per cent of capital in 2002. However, the analysis suggests that the strategy used by these agencies may not be easy to replicate in other countries and it is not so evident that shelter microfinance can succeed in ensuring a growing and secure capital base. A further specific suggestion is that Palli Karma Sahayak Foundation should extend its activities and provide finance for housing.¹⁵³

Shelter microfinance agencies may face a particularly difficult balance in setting interest rates that weigh borrowers' demands against their own financial needs. Interest rates must be acceptable to borrowers.¹⁵⁴ In some countries, subsidized interest rates for mortgage loans may increase pressure for reduced interest rates. Such factors, as well as longer-loan terms and required concessions for affordability, may explain the use of favourable interest rates in the case of small loans for housing.

As is evident from this discussion, microfinance agencies face an issue of scale. To be profitable, they have to increase the quantity of lending. There is evidence that this is driving their expansion into shelter microfinance; but for the smaller agencies, lack of capital to expand operations appears to be a significant constraint. One view is that the shorter lending terms of shelter microfinance may better fit the short-term funding sources (with the bulk of financial

liabilities often one year or less) available to financial institutions in the South; therefore, more conventional housing lenders should be active in this area. Such a match of demand and supply may help to account for the strong interest being shown in this area. The greater interest demonstrated by the private sector may assist in reducing the capital constraint; however, it is equally evident that this is unlikely to happen in all countries. The Banco Davivienda in Colombia is currently working with the government to examine the possibility of offering loans of less than US\$2800 to be repaid in up to five years for homes valued at less than US\$15,000.¹⁵⁵

Nevertheless, it is equally apparent that longer-term loan repayment periods are also common in shelter microfinance agencies, despite the small size of the loans. Raising funds for shelter microfinance may be more complicated than for enterprise lending because of these longer loan periods. In the case of microenterprise lending, donor support has placed emphasis on building the institutional capacity of lending agencies and assisting in the accumulation of their capital base. There has been a resistance to providing concessional funds for on-lending. Despite this, it has been argued that one problem is that such agencies have had access to funds at a modestly concessional rate, which have been built into the cost basis of their operation. As a result:

... one recent ambitious effort to raise funding for major MFIs [microfinance institutions] on international capital markets ran squarely into this problem – lack of demand for the funds. Very few MFIs wanted funds on the resulting market terms.¹⁵⁶

Shelter microfinance products continue to be developed, and there are reasons to believe that more agencies are entering this area and that those that are here already are expanding their activities. Can shelter microfinance continue to scale up? Lack of financial capital does appear to be a significant constraint. However, there are more agencies interested in this area in some countries, notably the private sector, municipal government and central government. In some cases, they are working with existing microfinance agencies; in others, they are developing their own products. In part, the growth of shelter microfinance has been driven by the commercial interests of existing microfinance agencies and the need to consolidate and extend their own market base. In the Latin American context, this has happened in a number of countries in which direct-demand subsidies already exist or are being introduced. Microfinance can help to secure subsidies and add value to the construction process. In other cases, microfinance agencies have responded to their own analysis of need and have been able to secure funds from the state to extend their services. As a result, shelter microfinance as a sector is witnessing the expansion of existing agencies, new NGO and microfinance agency initiatives and new interest from groups that were not previously involved in offering small loans.

It is not so evident that shelter microfinance can succeed in ensuring a growing and secure capital base

NOTES

- 1 This chapter is based on a draft prepared by Diana Mitlin, University of Manchester, UK, with assistance from a number of urban researchers listed in the Acknowledgements.
- 2 See, for example, those discussed in ESCAP, 1991; *Environment and Urbanization*, 1993; Arrossi et al, 1994; Mitlin, 1997; Jones and Datta, 1999; Center for Urban Development Studies, 2000; *Environment and Urbanization*, 2001; ACHR, 2002; Daphnis and Ferguson, 2004; Malhotra, 2003.
- 3 There has been some experimentation and the case for housing microfinance is explored in Daphnis and Ferguson, 2004.
- 4 ESCAP, 1991.
- 5 Ferguson, 2004b, p4.
- 6 Mutagwaba, cited in Government of Tanzania and UN-Habitat, 2003, p31.
- 7 See Okpala, 1994, p1572.
- 8 Ballesteros, 2002, p3.
- 9 The Center for Urban Development Studies (2000) divides the groups into two based on the nature and purpose of the originating agency (microfinance or shelter advocacy). The alternative division used here, which divides by the terms and conditions of the loan and, in particular, by whether loans are collective or individual, has the advantage of distinguishing those agencies able to lend for land and infrastructure (which must necessarily be collective) and those for whom shelter finance is primarily restricted to housing improvement.
- 10 Smets, 2002, p77.
- 11 Malhotra, 2003, p225.
- 12 Datta, 1999, p204.
- 13 Kamete, 2000, p254.
- 14 Okwir, 2002, p95.
- 15 Okonkwo, 2002, p97.
- 16 Biswas, 2003.
- 17 Smets, 2002, pp65, 87.
- 18 Smets, 2002, p65.
- 19 Moss, 2001, p33-4.
- 20 Baumann, 2003, p88.
- 21 Government of Tanzania and UN-Habitat, 2003, pp53-54.
- 22 Gough, 1999.
- 23 Datta, 1999, p203.
- 24 Gough, 1999.
- 25 Wahba, 2001.
- 26 Nell et al, cited in Baumann, 2004.
- 27 Civil society is a term used to refer to the not-for-profit and voluntary sector. It is also referred to as the third sector in some texts. The distinctive features of such agencies are that they are not part of the state, nor are they commercial companies. Although not all such organizations are registered (for example, as charities and/or voluntary associations), many of those offering loans and/or savings facilities are likely to have some kind of registration. The exception is the large number of less formal savings groups including those that fall under the title of ROSCAs (rotating savings and credit associations). They are not discussed here as few offer sums substantial enough for shelter investment.
- 28 Ferguson, 2003.
- 29 CGAP, 2004.
- 30 Biswas, 2003, p51.
- 31 Smets, 2002, p75; Mohamed, 1997.
- 32 Wahba, 2001, Appendix 1.
- 33 SANMFI, cited in Biswas, 2003.
- 34 Biswas, 2003.
- 35 Ferguson, 1999, p191.
- 36 Hoek-Smit, 1998, p41.
- 37 Arrossi et al, 1994, p58.
- 38 Co-operative Housing Foundation, 1993, p38.
- 39 Co-operative Housing Foundation, 1993, p41.
- 40 Jones and Mitlin, 1999, p27.
- 41 Ferguson, 1999, p93.
- 42 Connolly, 2004b, p9.
- 43 A further Mexican example is FOSOVI, an NGO active in Mexico City. Between 1998 (when it was set up) and 2000, FOSOVI granted 1266 housing loans to families (SELAVIP, 2003, p43). The maximum loan per family is US\$1000 and the loan period is 36 months. Capital has been secured through a partnership with local government, local savings and loan societies, NGOs and popular movements (residents' associations). About one quarter has been for the construction of a core house and half for the extension of an existing house; the remaining loans were for the improvement of facilities such as toilets or the improvement of housing quality. Families organize themselves into groups to receive the loans and this group helps in the material purchasing and construction process.
- 44 World Bank, 2004a, p3.
- 45 Smets, 2002, p181.
- 46 Connolly, 2004b.
- 47 Center for Urban Development Studies, 2000.
- 48 Arrossi et al, 1994, p54.
- 49 Stein with Castillo, 2005.
- 50 McLeod and Mitlin, 1993.
- 51 Smets, 2002, pp195-197.
- 52 Sheela Patel (director of SPARC), pers comm, 2004.
- 53 McLeod, 2002, p204.
- 54 Forero, 2004, p41.
- 55 Mutua et al, 1996.
- 56 Ferguson, 2003, pp26-27.
- 57 Malhotra, 2004, p222.
- 58 Escobar, undated, p21.
- 59 Escobar, undated, p24.
- 60 Malhotra, 2003, p222.
- 61 Mutua et al, 1996, p182; Escobar and Merrill, 2004, p36; Ferguson, 2004a, pp24-25.
- 62 Ferguson, 2003.
- 63 Ferguson, 2003.
- 64 Vance, pers comm, 2004.
- 65 See Renaud, 1999, p760, for a discussion of such processes in the US.
- 66 Stein, 2004, p116.
- 67 PRODEL, 2002.
- 68 Cities Alliance, 2002.
- 69 Silas, 2004.
- 70 Septanti, 2004, p8.
- 71 Murcia de López and Castillo, 1997, p173.
- 72 Ferguson, 2003.
- 73 Ferguson and Haider, cited in Ferguson, 2003.
- 74 Escobar, undated, p36.
- 75 Stein with Castillo, 2005.
- 76 Escobar, undated.
- 77 Stein with Castillo, 2005.
- 78 Smets, 2002, p9.
- 79 Escobar and Merrill, 2004, pp37-38.
- 80 Escobar and Merrill, 2004, p41.
- 81 Forero, 2004, p41.
- 82 Prahalad, cited in Connolly, 2004b.
- 83 Ratha, 2003.
- 84 Ratha, 2003.
- 85 Connolly, 2004b, p3.
- 86 Ferguson, 2003.
- 87 Cities Alliance, 2002, p3; Smets, 2002.
- 88 Gold et al, 2002.
- 89 Escobar and Merrill, 2004, p40.
- 90 Cabannes, 2002.
- 91 Cabannes, 2004.
- 92 IADB, 2003.
- 93 Albee and Gamage, 1996.
- 94 Gitau, 2004.
- 95 Smets, 2002, p129.
- 96 Smets, 2002, p130.
- 97 Escobar and Merrill, 2004, p39.
- 98 Gitau, 2004.
- 99 Gitau, 2004.
- 100 IADB, 2003, p4.
- 101 Vance, 2004, p142.
- 102 Escalante, 2004, p59.
- 103 Baumann, 2004.
- 104 Hoek-Smit, 1998, p39.
- 105 Stein with Castillo, 2005.
- 106 Malhotra, 2003.
- 107 Ferguson, 1999, p196.
- 108 Escobar and Merrill, 2004, p58.
- 109 See, for example, Christen, 2004, pxiii.
- 110 CGAP, 2004.
- 111 Daphnis, 2004a, p3.
- 112 Grameen Bank, 2004.
- 113 Ferguson, 2004b, p4.
- 114 Vance, 2004, p141.
- 115 Escobar and Merrill, 2004, pp45, 48.
- 116 Biswas, 2003.
- 117 Biswas, 2003.
- 118 Van Rooyan, 2004.
- 119 Christen, 2004, pxiii.
- 120 Jones and Datta, 1999, p21; Escobar and Merrill, 2004, p58.
- 121 Escobar and Merrill, 2004, p61.
- 122 Vance, 2004, p139.
- 123 Escobar and Merrill, 2004, p62.
- 124 Daphnis, 2004b, pp108, 110.
- 125 Vance, 2004, p135.
- 126 Malhotra, 2003.
- 127 Escobar, undated, p26.
- 128 Stein with Castillo, 2005.
- 129 Escobar, undated.
- 130 Escobar and Merrill (2004, p57) note that six of the eight agencies they profile offer lower interest rates, and one of the other two agencies may also offer lower rates.
- 131 Hoek-Smit, 1998.
- 132 Hoek-Smit, 1998, p38.
- 133 Stein with Castillo, 2005.
- 134 Escobar, undated, p19.
- 135 Escobar and Merrill, 2004, p56.
- 136 CGAP, 2004.
- 137 Ferguson, 1999, p196.
- 138 Malhotra, 2003, p221.
- 139 Escobar and Merrill, 2004, p62.
- 140 Daphnis, 2004b, p105.
- 141 Arrossi et al, 1994, p63.
- 142 Escobar and Merrill, 2004, p51. This emphasis on women is also true for microenterprise lending, although in some cases it has resulted in the woman in a family taking the loan but not being in control of the investment.
- 143 Malhotra, 2003.
- 144 Van Rooyan, 2004.
- 145 Stein, 2004, pp117-118.
- 146 Biswas, 2003.
- 147 Center for Urban Development Studies, 2000.
- 148 See concerns expressed by Hulme, 2001.
- 149 Malhotra, 2003, pp219-220.
- 150 Lall and Lall, 2003, p15.
- 151 Davies and Mahony, 2001, p15; Pedro Jimenez, executive vice-president, Banco ADEMI, Housing Microfinance Questionnaire, 7 March 2001.
- 152 Zaman, 2004, pp9-12.
- 153 Hoek-Smit, 1998.
- 154 Stein with Castillo, 2005.
- 155 Forero, 2004, p41.
- 156 Ferguson, 2003, p27.

COMMUNITY FUNDS¹

Community funds are of growing significance in assisting the poor to address their shelter needs. As the role of the state has diminished, increased emphasis has been placed on alternative strategies to support secure tenure, access to basic services and improved dwellings. The increase in microfinance has resulted in a growing diversity of approaches to providing the small loans required to help self-build communities address their multiple needs. Community funds offer small loans to households but route these loans through community organizations. The emphasis on collective loans is for many reasons; but one is that the loans support investments in land and infrastructure, which are necessarily made by a group working together. This chapter describes community funds, identifying their key characteristics, and discusses trends within this sector. It looks specifically at a number of key challenges, notably the affordability of their strategies and sources of funds.

It should be said immediately that it is difficult to assess their changing significance for several reasons. First, although the strategy is not new, there have been few overviews to date. Without an established baseline, it is not possible to consider what has changed. Second, the distinctions with microfinance are often not that clearly drawn, with a graduation rather than a clear dividing line. As shown in Chapter 6, both community funds and microfinance seek to assist an incremental development process through the use of small loans. Community funds work with group loans, thereby enabling them to address the needs of those without land and/or infrastructure. As a result, they place greater emphasis on the priorities of the lower income families. They may also offer loans for housing; in general, these are also managed at the community level, although the investment takes place at the household level. Some community funds lend for income generation and use more conventional microfinance approaches for their income-generation loans, further confusing the distinction.

WHAT ARE COMMUNITY FUNDS?

The growth of shelter microfinance initiatives has been paralleled by a further development – that of socially orientated savings and loans for shelter improvement. Community funds are financial mechanisms that encourage

savings through establishing and strengthening local savings groups, providing collective finance for shelter improvement (which may include any one or more of the following activities: land purchase, land preparation, infrastructure installation and service provision, as well as housing construction, extension and improvement). Community funds offer loans to groups due to their interest in supporting land and service acquisition. Their most distinguishing characteristic is the way in which funding is perceived – rather than the mechanisms of the financing process. Community funds use savings and loans to trigger a development process – not simply to increase the access of the poor to financial markets. They seek to strengthen the social bonds between community members (building social capital) so that existing finance within the community can be used more effectively and external finance can be integrated within community development strategies. Significantly, they believe that small loans for individualized investment in private dwellings cannot address the multiple needs of the poor, and that finance and financial skills are required for tenure and investments in infrastructure and services. Community funds are targeted at group borrowing and therefore may include those with lower incomes.

One approach common to some of the programmes grouped together in this chapter is an emphasis on savings for shelter improvement and the use of collective strategies both to reduce the risks for the individuals involved and to build relations between low-income citizens and development agencies and/or the state. Collective saving and lending seeks to offer a number of administrative and, sometimes, political advantages. The programmes go beyond the simple role of the credit agency to integrate financial and social approaches in the search for long-term development that works for the poor. Box 7.1 describes how such approaches have catalysed pro-poor social change in Phnom Penh, Cambodia. In this case, the management of the fund built relationships between civil society and the municipality which resulted in a common recognition that upgrading was a better development strategy than relocation. In other cases, community funds have a more limited conceptualization and offer loans only for one (or sometimes two) specific activities.

As with many such development trends, there is no single source for the innovations around community funds and the approach has emerged from a combination of

Community funds offer small loans to households but route these loans through community organizations

factors. And as with shelter microfinance, one of these has been the recognition by housing professionals of the inefficiencies in housing investment that arise from a lack of access to loan capital. Other factors of notable importance have been the following:

- Non-governmental organizations (NGOs) are seeking to use donor monies more effectively; there is also a recognition of people's willingness to invest in their own neighbourhood (land and infrastructure) and dwellings, suggesting an interest in repayment of external finance.
- State agencies are attempting to find more effective ways of addressing housing need and building based on their experience of what has not worked in the past. The growth of community-managed infrastructure, such as in water, indicates that development agencies (including national governments) are looking for new mechanisms to extend access to essential services.
- There is a growing expertise in poverty reduction and a greater awareness of the role of assets in securing improved livelihoods. This has been coupled with a longstanding recognition that basic infrastructure is important in improving health with multiple benefits.
- More recently, there has been an awareness of the scale of differentiation within low-income groups. As the importance of reaching the poorest has grown within development, so has a willingness to look at new methods that might be effective in securing inclusion.

Many microfinance enterprise initiatives are premised on the understanding that increasing incomes is an effective strategy to reduce poverty. Shelter lending is, in part, consistent with that strategy, but also seeks to enable households to reduce expenditure, using their monies more effectively to achieve their goals. Community funds that offer comprehensive borrowing 'windows' are designed around the premise that increasing incomes is simply one component of a poverty reduction strategy. A number of dimensions of urban poverty have been identified and Box 7.2 outlines specific poverty reduction strategies to address such features, which are embedded within the community fund approach.²

While Table 6.1 differentiates between microfinance and community fund approaches, the relationship between microfinance and community funds can best be represented as a continuum. At one extreme are agencies who seek to operate according to the criteria of financial markets; at the other are those who offer highly subsidized loan programmes, with a premium being placed on the inclusion of those most in need. In between lies a range of agencies who seek to blend a commitment to improved financial services with the recognition that poverty has multiple causes that cannot all be addressed through finance. As noted in Chapter 6, many shelter microfinance agencies use lower interest rates for shelter lending. Some have linked up with more comprehensive development programmes that

Box 7.1 The Urban Poor Development Fund in Cambodia

Since the first democratic election in 1993, and increasingly after the economic crisis and greater political stability after 1997, development and investment in Phnom Penh have escalated significantly. As a consequence, commercial and public development agendas have collided with the needs of the poor within the city. As elsewhere, the poor have been left worse off as a result; they have been struggling to secure a place in the city in the face of aggressive commercialization of land markets.

In 1998, the Urban Poor Development Fund was formed. The fund is a collaboration between the Squatter and Urban Poor Federation (SUPF), the municipality and local non-governmental organizations (NGOs). The fund was initially intended for shelter loans for a community relocated in an inner-city development, but has diversified into other areas in response to community needs. Between 1998 and 2003, more than 18 relocations of low-income communities took place, with great variance in the viability of the new sites. The development of the fund has had to respond to such needs. Relocation was the only option offered to communities facing eviction.

Frustrated with the lack of alternatives, several organizations considered a new City Development Strategy. Building on the relationships within the fund, this emerged as a joint programme of the Municipality of Phnom Penh (MPP), the United Nations Human Settlements Programme (UN-Habitat) and the Asian Coalition for Housing Rights (ACHR), the SUPF and the Urban Resource Centre, a local NGO. The organizations initiating the strategy believed that developing a shared vision of the city's development between various stakeholders was essential. Preparatory studies for the strategy led to a consensus that *in situ* upgrading needed to be an option.

The fund used its fifth anniversary event (24–26 May 2003) to promote the strategy of on-site community improvement. The approaching national election provided added incentive for the government to launch the pro-poor upgrading initiative. Prime Minister Hun Sen gave the opening speech, in which he announced his policy for the upgrading of 100 settlements in one year in Phnom Penh with 500 settlements in five years.

Source: ACHR, 2004.

offer support for neighbourhood development and (slum) upgrading. Equally, community funds seek to use more stringent (market-orientated) financial conditions with regard to their lending for enterprise development, while placing greater development emphasis on lending for tenure security, infrastructure improvements and housing.

In practice, there is considerable overlap of interest between community funds and microfinance. Microfinance institutions are anxious to consider new ways of reducing

Box 7.2 Addressing urban poverty with community funds

Aspect of poverty	Poverty reduction strategy
Income	Enterprise development
Assets	Housing and land investment
Poor-quality housing	Housing and infrastructure investment
Inadequate public infrastructure	Negotiations with authorities; improved infrastructure from community investment; community-managed investments
Inadequate basic services	Negotiations with authorities; direct investment by the community; community-managed investments
Limited or no safety net	Emergency funds and savings
Inadequate protection of poor groups	Stronger community organizations; political negotiations
Voiceless/powerless	Stronger community organizations; federations and networks; political negotiations

Box 7.3 Catholic Social Services in Pakistan

Catholic Social Services began their housing loan programme in Karachi, Pakistan, in 1981 when a group they were working with in Benaras Colony was resettled on the edge of the city following eviction. The community of 200 households had had their houses demolished. They were offered land far from where they were living; without any other resources, the community remained homeless. The non-governmental organization (NGO) provided interest-free loans of 4000 rupees (US\$160) to each household with a repayment period of three years. The loan size later increased to 6000 rupees.

As the programme expanded, it worked with more communities. Individuals in need who came to the NGO were encouraged to form co-operatives that were able to manage the finances. In general, the NGO worked through these co-operatives, which took collective responsibility for loan management, including repayments. Maximum loans were just sufficient to build a single room. By 1993, the programme had expanded to 830 families, with some 347 loans having been successfully repaid.

Source: Ghouri and Nihal, 1993, pp 18–25.

poverty – many of them remain mission-led development agencies – while community funds face similar issues of loan and debt management and are anxious to learn about new tools and mechanisms so that they are better able to address such management challenges. The continuum includes programmes that place more emphasis on collective aspects (including strengthening local organizations and improving relationships with political/state agencies) and others that highlight market-orientated financial investments. Some microfinance agencies recognize that money is just one aspect of what is needed. Banco Sol in Bolivia and others in Ecuador and elsewhere have separated their credit activities from technical assistance services as they have grown; one group has concentrated on credit and another on technical assistance (particularly marketing).³ Some conventional microfinance agencies are very serious about seeking to add value to their financial strategies; they are careful to assess the needs of their clients and adapt their programmes accordingly.

TRENDS

Securing land and services requires a collective effort and savings provides a good organizing basis for such efforts

As noted above, community funds are embedded in a social development approach to addressing need. The small scale of traditional housing programmes for the poor has led to a search for more effective ways of improving housing and addressing the shelter needs of the poorest at scale. The challenge has been to use the relatively small amount of funds effectively and to ensure that those benefiting from the programme have a strong sense of ownership, driving and developing the programme to meet their needs: savings and loans programmes offer these advantages. While slightly higher income groups can be assisted with programmes that offer only housing improvements, lower income groups require more holistic development interventions. Securing land and services requires a collective effort and savings provides a good organizing basis for such efforts. Many of these programmes were piloted by NGOs who were working with groups in acute need of housing, perhaps under threat of eviction. Box 7.3 offers an example of the kinds of activities that lie behind the development of some community funds.

While such programmes developed in tandem with the evolution of microfinance, they already had a significantly different approach, with an emphasis on the collective and a comprehensive position on addressing development needs that expanded beyond purely financial services.

As communities, sometimes supported by NGOs, became successful at securing land, they needed to access funds for upgrading and improvement. Some of the money they could raise themselves, and they could provide their own labour; but this was not enough to finance the houses without any loan capital. At this point, securing finance becomes a major issue. NGOs have been using revolving funds as one option to assist families with finance. One example is the work of the Carvajal Foundation in Colombia, which set up a number of programmes to assist with housing improvements. Its approaches included setting up material banks in low-income settlements to assist small businesses involved in the production of building materials to secure their market, thus helping to ensure that house builders can get access to what they need without high transportation costs.⁴ Other traditions are characterized by the *Fundación Vivienda y Comunidad* in Argentina, which raised approximately US\$600,000 from one Northern NGO in 1987 for a fund that offered money under three distinct funding ‘windows’: full subsidy; part loan and part subsidy; and full loan. Activities included income generation, improvements in services such as education, and neighbourhood improvements such as water supplies.⁵

The success of such initiatives built up confidence among NGOs, and more ambitious plans were developed. NGOs (and other civil society groups) began to consider ways in which families could be assisted to save and to develop mechanisms to draw in state subsidy funds. The scale and effectiveness of NGO innovation began to be reflected in government programmes. NGOs argued that such programmes deserved state support because they offered a real sense of capacity and confidence to low-income communities. Problems of selection and dependency (which were associated with more traditional welfare assistance) were avoided as participants were ‘self-selected’, perhaps through savings activities. Further benefits were low administration costs as management roles were taken on by the community, and the fact that loan repayments enabled the available subsidies to be ‘stretched’ much further than was previously possible when the full costs of housing were subsidized. The vision was one of pro-poor, inclusive poverty-orientated development. Such a tradition is in keeping with the principles of social justice that are at the root of many of the NGOs who instigated microfinance programmes. NGO experiences, together with those of the Uruguayan housing co-operatives during the late 1960s, led to the design and development of a programme in Mexico, Fondo Nacional de Habitaciones (FONHAPO), which is one of the earliest examples of state support for flexible collective loans channeled through multiple agencies for shelter improvements (see Box 7.4).

The willingness of some governments to explore these processes has increased ambition among those interested in working with these funds. Funding support

Box 7.4 Fondo Nacional de Habitaciones (FONHAPO), Mexico

FONHAPO is a state institution which still has a role in Mexican government housing policy; but its most significant international influence stems from its work in the early and mid 1980s.

FONHAPO sought a strategy that would enable it to reach the 60 to 70 per cent of the population whose incomes were below 2.5 times the minimum wage. During this period it provided loans to intermediate organizations, either public, private (such as financial institutions and development trusts) or social (co-operatives and other legally constituted social organizations). Five types of housing project were financed: sites and services; incremental housing; home improvements; finished dwellings; and production and distribution of building materials. FONHAPO, in contrast to the other housing institutions, progressively favoured financing partial housing solutions over finished dwellings.

FONHAPO offered a flexible range of credit packages, including small loans, on a large scale. The value of the loans was expressed in terms of multiples of the local daily minimum wage, the maximum value being 2000 minimum wages (about US\$6000 in 1988). The amount of money loaned depended upon the income of the head of household. Those earning less than the minimum wage could be loaned up to 1200 daily minimum wages (about US\$3700 in 1988), those earning between 1 and 1.5 minimum wages could be loaned up to 1600 daily minimum wages (US\$4900) and those earning between 1.5 and 2.5 minimum wages could receive up to the maximum loan of 2000 minimum wages. The credit limits for sites and services, incremental housing, home improvements and finished housing were 600, 2000, 1150

and 2000, respectively (US\$1847, US\$6157, US\$3540 and US\$6147 in 1988).

A deposit of between 10 and 15 per cent had to be paid by the final beneficiaries. An initial subsidy of between 15 and 25 per cent was offered on the value of all loans. Additionally, a further 15 per cent would be offered for prompt repayment. This implied a direct subsidy of 30 per cent of the loan value for the larger loans for incremental or finished housing, and up to 40 per cent of the loan value for smaller loan packages. On the basis of a maximum payment of 25 per cent of the beneficiary's monthly income, the amount and number of repayments were calculated in terms of percentages of minimum wages at the time of contracting the loan. These payments would escalate according to the increase in minimum wage. In this way the real value of loans repayment was maintained approximately in line with inflation. In all, it was estimated that the total subsidy to the beneficiaries would average at 50 per cent – that is, the repayments from two loans would finance one more of similar amount.

Between 1982 and 1988, just over 10 per cent of new dwellings, including core houses, financed by the public sector can be attributed to FONHAPO, using just 4 per cent of the available funds. This was accomplished by giving high priority to smaller loan packages for core housing and site and services, and to public and private housing organizations. Between 1982 and 1994, FONHAPO finished 203,657 core housing units, 115,870 sites-and-services projects, 179,661 home improvement loans and 1730 finished houses.

Source: Connolly, 2004a.

has spread from being primarily Northern NGO, notably those with the larger budgets in Holland and Germany, to include national governments. In some cases, notably the UK and Holland, the programmes overlapped with self-help housing traditions that had emerged during the 19th century and with long-established state support for owner occupation. There were sufficient synergies to enable the expansion of funding for these programmes. In a limited number of cases, funds were also sought from the commercial banking sector within countries. The Society for the Promotion of Area Resource Centres (SPARC) accessed first the Housing and Urban Development Corporation (HUDCO), a state housing bank, and then Citibank funds; however, in both cases guarantees were needed from European NGOs (see Chapter 6). These initiatives benefit from a further trend, which was the increasing realization by NGOs focusing on infrastructure improvements that, in an era of cost recovery, soft loan funds offered the best possibility to secure development assistance to expand access to services. NGOs such as WaterAid began to undertake increasing numbers of programmes to improve access to water services that combined community management with soft loans to repay water infrastructure investments.⁶

The growing interest of state agencies in community funds has been due, in part, to the movement of staff between the two sectors and, in part, to the recognized

mutual benefits from close collaboration. In countries such as Chile, Mexico, the Philippines and South Africa, professionals with experience in housing NGOs have moved to posts in government poverty-reduction programmes. They have begun to draw on multiple experiences to design housing loan programmes to address the needs of the poor. It should be emphasized that this discussion is not about government programmes to provide conventional mortgage finance to lower middle-income households, but about non-conventional lending programmes. A further example is the Community Mortgage Programme (CMP) in the Philippines (see Box 7.5).

Part of the motivation for state involvement in such programmes has been an awareness of the need for poverty reduction in urban areas, coupled with the knowledge that neighbourhood and housing improvement is essential. Previous solutions were recognized to have failed and from the 1980s onwards there was a growing interest in working with the self-help capacities of the poor. The earlier generation of NGO programmes was restricted to a specific group that the programme works with and/or a predetermined spatial area. State programmes have to grow beyond such restrictions in order to achieve scale and inclusion (within the specific rules of the programme). Box 7.6 explains the evolution of the community fund process in Thailand as it emerged from more traditional approaches to addressing housing need.

Box 7.5 Community Mortgage Programme (CMP), the Philippines

The Community Mortgage Programme (CMP) is a housing finance programme in the Philippines that allows poor families and households living on public and private lands without security of tenure to have access to affordable housing. Between 1989 and 2003, it assisted 140,650 poor families in securing housing and tenure in 1126 communities, with a total loan volume of 4.404 billion Philippine pesos and an average loan size of 31,000 Philippine pesos.

The CMP was established in the post-Marcos era of the Philippines in an attempt to address the housing needs of the poor. Lending is for residents at risk of eviction who have organized themselves into a community association. Each group has an 'originator,' generally a non-governmental organization (NGO) or local government that is responsible for assisting with the development of the land. The average loan size in 2001 was US\$665 per household. The repayment period is 25 years and the (state-subsidized) interest rate is 6 per cent. While originally conceived of as a housing loan programme for groups of the urban poor, the high price of land (especially in Manila) means that many groups borrow only for land purchase. In these circumstances, residents and community associations use multiple strategies to secure infrastructure and improve their homes.

Source: Porio et al, 2004; *CMP Bulletin*, 2004.

There has been increasing interest in community funds during the last decade. The growth is supported by a general acknowledgement that small-scale lending has been somewhat successful and that urban poverty is growing. The trend towards small loans for shelter improvements has received a considerable boost by the popularity of microfinance. For NGOs and governments seeking to put in place comprehensive and integrated programmes to address urban poverty, experimentation with loan packages that incorporate savings and building collective community capacity have been popular. There are two noteworthy

Box 7.6 The evolution of shelter improvement strategies in Thailand

The concept of upgrading slums in Thailand began during the late 1970s. At first there were attempts to secure cost recovery for the improvements; but there was little support within low-income communities. As a result, a subsidy model was used and 128,000 households benefited from improvements financed by the National Housing Authority. However, land tenure was not offered and the community had little say in what was done.

During the early 1990s, the conventional strategies of medium-rise rental flats and relocation were used by the state to address the needs of those being evicted from inner-city land as rapid economic growth took place. In keeping with other trends, there was a willingness to decentralize these funds for upgrading to municipalities. However, at the same time, the Urban Community Development Office (from 1992) began to build up the capacity of local communities through savings and loan funds, which offered finance for income generation and shelter improvements. Several hundred savings schemes rapidly emerged and these communities began to negotiate with their local municipal offices. The office included the Urban Community Environment Activities Project, which offered small grant funds to savings groups to undertake further neighbourhood improvements. This project required communities to work with municipalities and other city-based professionals (such as university and NGO staff), and the results demonstrated just how effectively communities could use grants.

As the national funds for upgrading were decentralized, some municipalities began to work with the communities who were already improving their own situation. When the government made a commitment to address the needs of 300,000 households in 2000 urban-poor communities in 200 cities within five years (the *Baan Mankong* programme), the strategy of offering infrastructure grants together with subsidized housing loans to organized local communities was accepted.

Source: CODI, 2004.

current trends related to the development of such funds: first, the growing interest by local government in these approaches, in part related to the use of such funds to extend essential infrastructure; and, second, the expansion of Shack or Slum Dwellers International (SDI), a community/NGO network whose strategies incorporate savings and lending activities for shelter improvements.

Decentralization to local government in both Asia and Latin America is opening new possibilities, both in terms of funding and of meeting responsibilities towards their citizens. In Latin America, democratization and decentralization appear to be associated with increasing support for shelter improvements, including community funds and microfinance. In Fortaleza, Brazil, the local government was willing to contribute to innovations using the *mutirão* tradition of collective building.⁷ The longstanding participatory budgeting process in Belo Horizonte, Brazil, has extended outwards from infrastructure and services to address housing need; the municipality built 1600 units up to 2002, just under half as a result of consultations within the participatory budgeting process.⁸ As the quality of consultation has improved, so municipal housing strategies have begun to reflect the priorities of the poor, moving away from medium-rise construction to land titling in squatter and informal areas. In Maracaibo, Venezuela, the plight of the poor has continued despite oil wealth. Recognizing the need to address poverty, a new municipal programme has offered loan finance; additional funds were then offered by a local NGO, *Nuevo Amanecer*. A first round of 50 loans demonstrated the ease of the process. The municipality, NGOs and grassroots organizations are committed to expanding this fund and making it available to other neighbourhoods. Financial support has recently been obtained from the *Fondo Intergubernamental para la Descentralización* through the local municipality, and the programme has been expanded to reach 267 households.⁹

In Asia there is a similar interest at some local levels. In Kathmandu, the Urban Community Support Fund (UCSF) is a pool of resources which the urban poor can draw upon to assist them with the development of their communities. The UCSF was launched on 30 May 2004 at the city hall, with a financial contribution from the mayor.¹⁰ In the Philippines, local authorities have been drawn into the funding process over a longer period through the CMP, which has allowed them to be 'originators' (that is, to support local communities through the process and provide technical assistance with a small fee payment attached). In some cases, they have made their own resources available – for example, in the city of Muntinlupa in Metro Manila, over US\$1 million has been provided to assist families within the programme.¹¹

A further area of interest is the use of community funds for utility investment, for which the local authority may be formally responsible. Infrastructure investments and land purchase that involve loan finance have generally required some level of external development support because the technical issues may be more complicated and because a collective investment is generally required.

However, there has also been experimentation (and increasing interest) in lending for infrastructure. Box 7.7 describes a fund for microhydro investments in remote Peruvian villages, while Box 7.10 describes a fund for water investments in Faisalabad, Pakistan. In both cases, new relationships with local authorities needed to be secured. Even where the local authority does not directly offer financial support, it may be interested in working with the fund (once they realize the potential) to improve local services. In the case of microhydro investments, a further linked component has been lending to individuals for enterprise development once the electricity supply has been secured. A similar example is Genesis Empresarial in Guatemala, which also lends for electrification (in rural areas) and potable water projects (sometimes with public assistance).¹² In this case, the groups are very small, between 4 to 12 members. *Fundación Pro Vivienda Social* in Argentina primarily provides housing loans, but will extend these to provide infrastructure loans to small groups where there is clear evidence of solidarity and strong cooperation.¹³ WaterAid is a UK NGO that assists in the provision of water. In its work in Bangladesh, WaterAid finances seven local NGOs working in Dhaka and Chittagong to provide services using a full-cost recovery strategy.¹⁴ Local communities are provided with a range of facilities, including water points and sanitation blocks. Management committees collect fees that repay construction and installation costs, and which cover maintenance. The capital costs are repaid to the NGOs who use these monies to finance further investment.

Contrasting approaches to community funds can be seen in Namibia, where there is both a government fund (the Build Together programme) and civil society fund (the *Twahangana* Fund) managed by a local NGO, the Namibia Housing Action Group, on behalf of the Shack Dwellers Federation of Namibia. Box 7.8 describes the Build Together programme and the work that it does to support housing development. The Build Together fund is relatively close to shelter microfinance in that it supports individual housing investments, albeit through a local committee. The *Twahangana* Fund is financed by international development assistance (Northern NGOs) and the Namibian government. It provides loans to savings groups in order to develop services and income-generation activities. To date, the government has contributed Namibian \$2 million (US\$300,000) in loan finance to the fund and almost Namibian \$2.5 million (US\$ 385,000) has been donated by international development assistance. In addition, the government has routed Namibian \$4.35 million (US\$670,000) of Build Together loans through *Twahangana* to help to reach lower income households who are typically involved in Build Together. The civil society fund gives smaller loans (for land purchase, infrastructure development and enterprise investment) and is acknowledged by the government to provide essential support to assist low-income groups in benefiting from the state programme.

The Shack Dwellers Federation of Namibia is a member of Shack/Slum Dwellers International (SDI). Within the NGO sector, there are numerous individual initiatives in this area; but there is one multi-country initiative of

Box 7.7 A community fund for electricity services in Peru

A community fund to assist in the extension of electricity through small hydro installations was started in 1994 in Peru under an agreement between Intermediate Technology Development Group (ITDG) and the Inter-American Development Bank (IADB). The finance model has developed over time and has demonstrated that loan finance to small villages and private farmers can leverage local capital and government funds for locally owned and sustainable rural electrification. The financial model combines subsidized loans and technical assistance through shared efforts between technical cooperation agencies and government institutions (local, regional and central governments). Its purpose is to meet the small-scale electricity requirements in isolated rural areas of Peru that cannot be served with the conventional grid system. To date 26 loans, totaling US\$850,000, have been made for the same number of installations, which has leveraged US\$3.5 millions – a total installed capacity of 1.6 megawatts benefiting 5000 families

The loans range from US\$10,000 to US\$50,000, with a 10 per cent interest rate, reimbursement terms of one to five years and variable periods of grace depending upon the financial situation of the client(s). Guarantees vary slightly depending upon clients' circumstances and whether they belong to the public or private sector. Borrowers include local governments, small entrepreneurs (mostly farmers and/or livestock breeders), farming co-operatives and peasant communities. The installations have been ranging from 4 kilowatts to 130 kilowatts; the larger ones in villages, the smaller for private businesses. Villages (the public sector) must show a positive cash flow, including short- and medium-term investment plans, whereas private entrepreneurs must submit actual and collateral guarantees.

The project's total capital now stands at US\$700,000, of which US\$400,000 represents the initial capital (under the 1994 agreement) and US\$300,000 the increase approved by the IADB in 2000. During the first part of the project, the focus had been the implementation of hydro schemes, while since 2001 there has been a very important component of promoting small-scale business and employment-generating initiatives, utilizing the power generated.

Loan recovery is a significant and complex task that requires careful monitoring of clients, frequent consultations with the bank and notices of payment deadlines. In the event of any delay or non-payment, the loan agreements contain regulations that permit legal recovery actions. So far, no enforcement actions have been required. A small consulting firm, AFIDER, is used for this work and to conduct financial appraisals of each project.

Source: Sánchez-Campos, 2004.

particular significance. SDI is a network of grassroots organizations and support NGOs who share a focus on savings and credit as one component of a programme to transform relations within low-income communities, and between local communities and local authorities. Within SDI, collectively organized and locally managed savings funds comprise a strategy to reconstitute grassroots organizations into democratic and accountable organizations. Through savings, communities learn financial skills and how to manage systems of financial accountability. Lending for housing, land and infrastructure responds to the local priorities of members.

Shack/Slum Dwellers International has emerged from an NGO–community-based organization (CBO) partnership between SPARC, the National Slum Dwellers Federation and *Mahila Milan* in India, and their peer exchanges with similar groups that emerged in South Africa. Over the last 15 years this has evolved into an international movement with affiliates in more than 12 countries. SDI groups have spawned a host of local community-owned and NGO-administered funds. In Cambodia, the Philippines, South Africa, Nepal, Sri Lanka, Zimbabwe and Kenya, federation groups have established their own funds, which they lend to savings schemes. State contributions have been obtained in South Africa, Namibia and, more recently, Nepal. Otherwise

Through savings, communities learn financial skills and how to manage systems of financial accountability

Box 7.8 Build Together, Namibia

The Build Together programme in Namibia was established in 1991 (operational from 1992) in order to offer financial support to people who use self-help efforts to construct their own housing. The programme lends money to low- and very low-income groups and families in urban and rural areas who are thought to be too risky by the commercial financial institutions. The programme offers loans for land purchase, housing and a range of infrastructure and services. Loans vary between US\$460 and US\$4900, with a graduating interest rate and repayment period of 20 years. The interest rate is 5 per cent for loans of between US\$460–\$3700 and rises to 9 per cent for the maximum loan of US\$4900. The implementation of the programme has now been decentralized to local authorities. Local Build Together committees with multi-stakeholder membership, including representatives of those receiving loans, are established to oversee the implementation of the programme. The role of these groups is to identify communities and families in need of housing or housing improvement in their area. Groups should also consult with individuals on how the community wants to solve their problems, prepare an implementation programme and submit it for funding. The committee checks the credibility of loan applicants and monitors their building. It also plays a key role in monitoring the repayments of the borrowers.

There has been a very high degree of participation of women in the programme, with over 45 per cent of the beneficiaries being women-headed households. The programme seeks to encourage more women to take part, thus enabling them to learn building skills and to be involved in the process. They will also be encouraged to form savings and credit societies to meet their regular credit needs, as well as to improve their houses. Families who wish to benefit from the programme are encouraged to set up a local organization for their settlement. The rules stipulate that only those living within the settlement can be office bearers, although external advisers can be appointed. This group negotiates with the Build Together committee to secure loan finance to develop the area.

Since 1992, 11,187 families have been supported to improve their shelter. Local authorities have been assisted to build 323 houses for those in special need and 2830 dwellings have been created from the redevelopment of previous 'single quarters' areas. A further 13,656 families have benefited from the upgrading of informal settlements.

Source: Helao, 2004.

Securing an adequate capital base is difficult for non-state (and, sometimes, state) initiatives, as has already been discussed in the case of shelter microfinance (see Chapter 6). The situation is more complex for community funds because of the interest in providing subsidy and increasing affordability.

FUNDING SOURCES

The importance of mixed funding sources is evident from a number of examples and, notably, the study of a number of community fund programmes.¹⁶ In some cases, funds have been established by government and located within a state agency with access to subsidies. In other cases, the fund has been set up by civil society organizations and financed through a combination of state funds, NGO monies, community contributions and, generally, international development assistance agencies. In both cases, the communities may make direct contributions to the fund through deposits to secure loans.

An important and common characteristic of community funds is that some subsidy is provided – either through state funds or international development assistance. This is a further significant difference with regard to conventional microfinance and its individualized housing loans.¹⁷ While conventional microfinance programmes may offer a subsidy, in general there is an understanding that this should be avoided. Within community funds, greater priority is placed on achieving poverty reduction goals and neighbourhood improvement. Subsidies may be needed for institutional survival if interest rates are below the level required to maintain the real value of the fund. Equally or alternatively, subsidies may be required to reach everyone in a community or to reach very low-income communities. These funds are viewed as an alternative strategy for achieving equitable development, rather than an attempt to bring financial markets down to a traditionally excluded group. In this context, rather than the perception being that money is lost through a subsidy, it is considered that funds which simply grant finance are used effectively because ownership is strong and some of the investment made is returned through repayments.¹⁸

There are several routes through which subsidies are delivered. The primary sources are direct subsidies, interest rate subsidies, additional support (for example, community development and technical assistance) and unintended subsidies when delayed payment and/or default occur. Some of the different approaches can be exemplified thus:

- In Faisalabad, the *Anjuman Samaji Behbood* (ASB) has not been charging interest on loans from their fund to improve water supplies (see Box 7.10). Technical assistance was initially provided by another NGO, the Orangi Pilot Project, to ASB free of charge. ASB has also been assisting the community in which it works free of charge.
- In the Urban Community Development Office (now the Community Organization Development Institute) in Thailand, the associated housing loan activities

these urban poor funds are financed by international development assistance and by local fundraising. In some cases, such as in Zimbabwe, the savings scheme members also contribute to these national funds. The Indian Federation has developed a further model that integrates loan and subsidy finance within the construction process. More recently, it has been pioneering the Community-led Infrastructure Financing Facility (CLIFF) programme (see Chapter 6).

SDI affiliates attempt to secure state contributions in order to enable the poor to afford adequate improvements in shelter. Box 7.9 describes how the People's Dialogue on Land and Shelter and the South African Homeless People's Federation used the subsidy funding that they secured in South Africa. Through their own community fund (*uTshani* Fund), local savings schemes facilitated access to state subsidies by providing bridging finance, thereby enabling community groups to develop for themselves and at their own pace. The analysis of their experience suggests that this approach is effective, generating secure assets for some of the poorest households. However, during recent years problems have been caused by considerable and continuing delays in securing the subsidy funds.¹⁵

This example (and others) demonstrates the potential of such strategies; but it also highlights the issue of funding.

Lending for housing, land and infrastructure responds to the local priorities of members

charge an interest rate of 3 per cent, which is cross-subsidized by a higher interest charged on commercial lending. The aggregate interest charges aim to cover inflation and administration, not to provide an equivalent market return on capital. Technical support is provided free of charge. Shortly after the office merged with another organization and became the Community Organization Development Institute, the government introduced the *Baan Mankong* programme, which offers grants for infrastructure with the community, with additional monies for re-blocking and relocating.

- In Peru, the ITDG fund to extend electricity supplies through microhydro is designed to facilitate the process of leveraging additional resources from local authorities, with success in some cases. The interest rate charged to borrowing communities is 10 per cent a year, well below microfinance rates.

Direct subsidies. As noted above, grant-based subsidies may be offered to supplement loans and extend the scope of the programme. In Fortaleza, Brazil, the *Cearah Periferia* developed two programmes during the mid 1990s. In Casa Mehlor, Brazil, with local authority participation, the funding delivered to households was one-third saving, one-third subsidy and one-third loan.¹⁹ A further programme, PAAC (Programa de Auto Ajuda e sistenciana Casa), was undertaken without local authority financial support and the subsidy fell by 50 per cent to one-sixth of the available finance, with an additional loan element making up the difference. In Thailand, the *Baan Mankong* programme of the Community Organization Development Institute, a parastatal development agency, offers infrastructure subsidies to organized communities for each family of US\$625 for *in situ* upgrading, US\$1125 for re-blocking and US\$1625 for relocation.²⁰ Additional loan funds are available for housing improvements. In Guatemala, Genesis Empresarial assists the groups who receive loans for water and electrical supplies to apply for public grants.²¹

Bridging finance for state funding. In a small number of cases, community funds have been used to bridge finance state direct subsidies, enabling them to be used by communities in ways that more closely follow a locally driven development process (see Chapter 5). In these cases, the direct (capital) subsidy is not attached to the community fund as such; but the fund is a means of obtaining the subsidy. In South Africa, the South African Homeless People's Federation and the People's Dialogue pioneered a new route for the state subsidy that funds land, infrastructure and a dwelling unit (as described in Box 7.9). The loan fund of the federation, the *uTshani* (or grassroots) Fund, helped to spread the use of the People's Housing Process subsidies – a particular form designed for self-help housing but not widely used, accounting for only 2 per cent of the total number of subsidy releases.²² In India, SPARC, the NGO that works with the National Slum Dwellers Federation, provides local groups with development finance (bridging loans) to enable them to build and, hence, secure access to state subsidies that can

Box 7.9 Adding value: The *uTshani* Fund, South Africa

The *uTshani* Fund of the South African Homeless People's Federation was set up in 1994 to provide an opportunity for federation members to experiment with a self-build approach to housing. It was hoped that success in this regard would lead to greater government willingness to release housing subsidies directly to organized poor communities rather than through commercial developers. From 1995 to 1999, the *uTshani* Fund received substantial grant funding, including 10 million rand (US\$1.5 million) from the South Africa Department of Housing and many millions more from European donors who supported the federation's strategy. It on-lent this money to federation members who used it to start building houses while waiting for subsidy approval. During this period the *uTshani* Fund facilitated the construction of almost 15,000 houses, all of them larger and of better quality than comparable developer-built products.

The *uTshani* Fund provides several positive examples of a way forward for South African low-income housing finance. First, accessing finance directly and controlling its use allowed federation members to produce much better houses than the Reconstruction and Development Programme (RDP) driven model that has dominated the post-1994 housing drive. Second, *uTshani* showed that ordinary households could manage external housing finance successfully and at low cost if supported by an appropriate institutional framework with clear rules. Third, *uTshani* was able to act as a financial management tool for community-based residential land acquisition and development, allowing the federation to produce some of South Africa's best examples of community-driven housing.

Taking a somewhat conservative view of the benefits secured, making modest assumptions about the value that has been generated and only considering those benefits that can be quantified financially, the development investment in the People's Dialogue on Land and Shelter and the South African Homeless People's Federation has created a net present value of 540 million rand (in 2000 prices) or US\$47 million. In just eight years, the *uTshani* process has created assets worth seven times the value of the original investment. With average monthly incomes for federation members of 700 rand, these assets have directly contributed to adding to the well-being of some of South Africa's poorest urban citizens. The overwhelming bulk of the value added is attributable to the housing that has been developed. In contrast to much privately developed state housing in South Africa, a federation house is worth considerably more than the resources put into it. Values of three to eight times the cost of the building materials and skilled labour have been suggested and sometimes offered by potential non-federation purchasers, although few federation members have been interested in selling. The value of federation houses stands in sharp contrast to the experience of many RDP housing developments, where beneficiaries have resold their new houses at far less than the amount spent on them by the state.

Source: Baumann and Mitlin, 2003.

only be drawn down once developments are complete. In both cases, communities add to loan releases with their own savings. In the Philippines, delays with the Community Mortgage Programme (CMP) resulted in the NGOs raising international development assistance to enable them to establish a fund to bridge finance CMP funds. In other cases, such as in Chile, NGOs such as Cobijo have also been working with low-income residents to assist them in accessing the state housing subsidy programme.²³

One advantage for the communities involved in community management options within such programmes (or in the context of any self-help initiative) is lower costs or – for a fixed subsidy amount – improved housing. For example, the housing developed by the National Slum Dwellers Federation in India is designed to maximize the use of the available subsidies. In Sholapur, Maharashtra, the National Slum Dwellers Federation (NSDF) has developed a design and building strategy that secures terraced houses

Box 7.10 Funding water improvements in Pakistan

Faisalabad is one of Pakistan's largest cities. Two-thirds of Faisalabad's population live in areas with little or no official provision for services, and most new housing and land developments take place without official approval. Less than half the city's population have piped water and less than one third are connected to the sewer system. The *Anjuman Samaji Behood* (ASB) is a non-governmental organization (NGO) active in the city. The area in which they are working is Dhuddiwala – one among many informal settlements in Faisalabad – with a population of 8080 in 1999.

In 1994, ASB developed a successful microcredit programme for local businesses. The NGO agreed to help the community secure water improvements. Staff used and adapted the model developed by the Karachi-based NGO, Orangi Pilot Project. The model requires that those inhabitants of each lane within a settlement that want improvements have to organize and work out how to pay for the immediate cost of the water supply and sewer infrastructure and the connection charges. The Water Supply Committee felt that before such a process could happen, it needed funds to lay the main pipeline to the water mains. Then, individual lanes' inhabitants could lay their own distribution lines and households would connect to them and pay their share, so the project costs would be recovered. A loan for a revolving fund was received from WaterAid to cover the cost of laying 1100 running feet of main pipeline. The community invested 1,028,367 rupees to complete this work (around US\$18,700) which was only one third of the cost of water authority initial estimates for this project (3.2 million rupees). A self-financing piped water supply and underground sewer system were developed between 1995 and 1999, with 253 houses benefiting from in-house connections to water and 1300 houses with sewers. By 1999, 73,500 rupees had been recovered from the WaterAid loan (300 rupees per household). Within the first three years, slightly more than 30 per cent of households had been connected to the system. The Water Supply Committee was responsible for collecting payments for water connections, keeping accounts, purchasing construction materials and supervising the construction of the main line and the distribution lines in the lanes.

Many other communities are now asking ASB for technical assistance in laying sewage lines, and a second phase of the programme is under way, developing a new collector sewer to serve 1000 households.

Source: Alimuddin et al, 2004.

for 62,000 rupees. There is a subsidy of 40,000 rupees, and households use savings or borrow to cover the additional 22,000 rupees. While the NSDF has built 350 houses, ten times this number have been built by local trade unions and financed by the state. Until the NSDF started building houses, the cost of such a basic unit was 100,000 rupees – with a subsidy of 40,000 rupees, this left a large amount for the families to find. After seeing what the NSDF could do, the costs in the other projects fell to 75,000 rupees.²⁴

Interest rate subsidies. As noted in Chapters 4, 5 and 6 of this report, there is widespread use of lower interest rates in the case of shelter loans because of the longer periods of repayment and in order to improve affordability, recognizing that while shelter improvements may assist income generation, this is not necessarily the case. State-financed community funds are associated with subsidized interest rates. This discussion is elaborated upon in 'Terms and conditions'.

Delayed repayment. In the more successful programmes, it is evident that community groups generally take repayment responsibilities very seriously. Even if the subsidy is greater than for other programmes, higher collection rates may assist in making up this shortfall. For example, in the Philippines,

the CMP has the highest collection efficiency rate (CER) of 75 per cent compared to the other government housing loan programmes, such as the Unified Home Lending Programme (UHLPL), which has a lower collection rate of 54 per cent.²⁵ By 2004, the CMP collection rate had risen to 78.67 per cent.²⁶ The CMP is assessed as being among the most cost effective of state housing programmes, with an overall average loan amount of 27,946 Philippine pesos (about US\$665) per family, which accounts roughly for 15 per cent of the average loan amount of other housing programmes.

Subsidies may be offered through measures to allow delayed repayments. Several experiences suggest that there are significant delayed repayments that reflect the economic situation at the household, local, city and national level, and that communities are unlikely to be able to manage to secure repayments from all their members at any given point in time.²⁷ In part, this reflects the ability of communities to manage collective repayments for the benefit of all members:

- SPARC (India):
Our system never says that repayment is 100 per cent! We discovered that about 65–70 per cent of communities were able to repay on time in any single month. The others have a problem and need longer to repay. Now we assume that, at any given time, there will be 30–40 per cent of people who don't have money in their pocket for that period. It's not designed in this fantasy that it is 98 per cent. We are not saying that people don't repay that money; but we always find that about 30 per cent of people need to extend beyond the initial point. (ACHR, CODI and IIED, 2004)
- Build Together (Namibia):
Our general experience is that women are very good at completing the programme; but men are not so good. The loan recovery rate is about 75 per cent. The groups that work with the Shack Dwellers Federation of Namibia, they are better able to manage these problems. (ACHR, CODI and IIED, 2004)
- Maracibo (Venezuela) has a savings process that has developed into a loan programme. Approximately 30 per cent fall into a grey zone, and there are many reasons for this. One reason comprises the economic difficulties that have been experienced by some Latin American economies. People have to manage this economic crisis and it is difficult for them all to manage it easily. Generally, after some time, when people begin to cope with their difficulties, repayments start again.

In Thailand, several groups were forced into difficulty at the time of the financial crisis during the late 1990s. The Urban Community Development Office offered rescheduling loans at zero interest rate to enable communities to sort out their problems.²⁸ This was successful in offering a period in which people could re-establish their livelihoods and continue paying.

While the need for a subsidy might imply a lack of scale, some of the programmes described here have been successful in reaching large numbers of those in shelter need. Rather than attempt to be viable within financial markets, such programmes have sought expansion through state poverty reduction programmes. In some cases, the programme use loan finance to access subsidies; in other cases, the state subsidy is integrated within the programme. The belief is that community funds should be able to demonstrate their advantages and mobilize the political support needed for their continuation. Sources of funding are both national governments (in some instances) and development assistance. While many of the original supporters of this work were Northern NGOs (notably, Cordaid, Homeless International, Misereor and SELAVIP), international development assistance agencies have become increasingly interested in supporting such initiatives. Funding for the initiatives described here has been provided by the UK Department for International Development (DFID), the European Union (EU), the Inter-American Development Bank (IADB) and the Swedish International Development Agency (SIDA).

A further source of finance is that of commercial financial institutions. A number of groups who manage community funds have sought to draw in commercial banks. At a minimal level, loan funds are released through banks, thereby encouraging the poor to see such institutions as something that they might use. In CLIFF, a donor-financed programme working with SPARC, the National Slum Dwellers Federation and *Mahila Milan* in India, there is an expectation that urban poor groups will become strong enough to be able to borrow from the banks. There is also the assumption that the banks will recognize their financial responsibilities and develop ways of reaching the poor. However, there is an increasing recognition that the answer may not be to extend formal banking services to low-income communities since this may be expensive and it may be better for the community to organize it for themselves. In response to the economic crisis and the recognized need to restructure the financial system, there is an ongoing review in Thailand. Communities explained to the review group that they had access to financial services which they provided for themselves. The committee had been thinking of taking the banking system to the grassroots level; but after the meeting they changed their minds and were looking at how the banks should work with the grassroots financial systems. There was no longer talk of formal and informal systems – there was a recognition that all groups are part of a whole and the best solution may not be to integrate the informal with the formal.

TERMS AND CONDITIONS

The emphasis on local funds has resulted in a complexity of arrangements within community funds themselves. In the simplest form, the fund passes a loan to a community for a specifically defined shelter-related activity. The community then collects repayments and passes them back to the fund. In some cases, communities also manage local revolving

funds (capitalized by their own savings), which are used to give small loans to members for multiple purposes and which are then augmented by the larger-scale community fund. As a result, a wide variety of terms and conditions may be found.

Strengthening collective capacity: savings

Savings plays a central role in community funds. However, the programmes may differ in the speed and the intensity of savings. This difference reflects both the orientation of the programme itself and the possibilities within different countries. For example, in a large number of countries (including those with experience of informal savings and loan mechanisms), communities have been sceptical about the value of savings for shelter investment, and loan finance has been provided rapidly once the savings commitment was fulfilled. This is particularly true of countries that have experienced rapid inflation and/or where the state has confiscated or temporarily frozen savings.

These programmes are primarily orientated towards urban-poor neighbourhoods which often have insecure tenure and inadequate services, with families who are using self-build strategies to provide themselves with housing. They are intended to benefit those without secure land tenure, adequate basic services and/or suitable housing. As already noted, in many cases, emphasis is put on collective benefits and on reaching the poorest. In some cases, where funds are restricted, benefits may be limited to particular improvements. For example, some funds, such as the *Twahangana* Fund in Namibia, may prioritize land tenure and basic services with the understanding that a full package is likely to be too expensive for many residents.²⁹

As noted above, while finance is integral to these approaches, the role of finance is set within a comprehensive development approach. Finance becomes the means to build strong communities, as well as the resource needed to improve material conditions. The emphasis is on using savings (occasionally lending activities are the primary mechanism) to build the collective capacity of the community to address their development needs. There are several reasons for this. First and foremost, there is the understanding that development that is affordable for the urban (and, sometimes, the rural) poor will need to include local authorities to secure state subsidies (where possible) and/or to negotiate reductions from unaffordable regulations. Such changes are only possible when the poor engage the state as a group; changes in rules, regulations and/or financial procedures are unlikely to happen for (poor) individuals. The savings process equips communities with new skills and an associated new consciousness, enabling them to strategically engage with the state to obtain the redistribution of resources and regulatory reforms that assist in their access to secure tenure, basic services and housing.³⁰ In the case of the example illustrated for Faisalabad (see Box 7.10), the community had to negotiate with the water authorities and with local politicians who sought to develop an alternative process.

Second, with an emphasis on solutions that work for the poorest, land purchase and infrastructure development

Communities are encouraged to work together to save money?

Box 7.1 | Alternatives to relocation in Thailand

The experience of Thai urban poor groups has been that communities cannot afford the costs of land purchase if they also need to construct housing, even with the subsidized interest rate that the Community Organization Development Institute (CODI) provides. During the mid 1990s prior to the financial crisis in Thailand, groups did buy land. The first communities threatened with eviction were eager to purchase land and resettle. In these first housing schemes funded by the Urban Community Development Office (UCDO) in Thailand (1992–1996), some 54 per cent had previously been renting land and the remainder had been squatters.

The high prices meant they could only afford plots outside the city centre. Even before the financial crisis, some families struggled to secure their livelihood in these areas. Unable to find alternative sources of income, they continued with their existing work and managed either high transport costs or renting minimal accommodation closer to their previous inner-city locations. Other savings groups learned about these experiences through the community networks that had been established. They realized that relocation was a difficult strategy and that families would have been better remaining in their existing locations. Now networks actively discourage households from relocating. As the financial crisis came to an end, the community networks developed alternatives. Rather than lend money for relocation, they would work with communities threatened with eviction to strengthen their capacity to negotiate with their landowners. The costs are lower and the location is better with regard to income-earning opportunities.

Source: Boonyabancha, 2004.

become important, perhaps more important than housing improvement. Land purchase and infrastructure development can only be undertaken with groups – they are unaffordable for the poor (even for the not so poor) as individualized developments. The activities of securing land (either by purchase, lease or rent) and installing infrastructure need strong groups with financial management capacity. Land purchase may be to secure existing land or to purchase new land if a community is threatened with eviction. In some cases, the communities can afford to purchase land on the market (or with their own negotiating capacity securing a discount from the owners). In other cases, savings provides the means to bring communities together and successfully negotiate a subsidy or change in policy from the state. Box 7.11 explains how communities in Thailand found that although peripheral land was affordable for communities, in the longer term it was too expensive. A more effective strategy was to join together into city networks and then use collective strength to negotiate for communities to remain in their existing locations. In these first housing schemes funded by the Urban Community Development Office (UCDO) in Thailand (1992–1996), some 54 per cent had previously been renting land and the remainder had been squatters.³¹ A higher proportion (72 per cent) had owned the structure on the land.

Infrastructure is similar to land in that it is likely to benefit from a greater collective capacity. In this case, there are also issues related to installation and ongoing management. While some improvements to infrastructure can be made by individual borrowing (for example, water storage tanks to take account of irregularly supplied water), many infrastructure improvements require group efforts. For instance, in a typical project, families in a low-income settlement in Dakar, Senegal, borrowed to install a water

supply system and drainage channels; the investment paid for itself within a year due to savings in medical bills.³²

Third, there is the recognition that collective action can save money. Communities are encouraged to work together to save money – perhaps through group purchase of building materials (with associated discounts) and/or through joint work programmes. Even where lending is for housing improvements, collective involvement may offer additional benefits. In some cases, community funds enable groups to construct units for each of their members. In many cases, construction is organized collectively, with all participating in the construction process.

A fourth reason for the emphasis on savings is that managing collective finance builds within communities an understanding of how to manage money. Many development programmes that seek to be people centred want to give communities financial responsibility. However, building this capacity once a large-scale externally funded project has begun is very difficult. Local community leaders often fail and that failure knocks their confidence, while associated allegations of corruption and mismanagement further divide communities. Locally managed savings and loan programmes ensure that communities embed financial management within their own organizations and associated social relationships. Groups learn by trial and error to set up robust systems, to call for assistance when needed and to manage problems along the way. By starting with their own funds, they increase their ownership of this learning process. Finally, these approaches often encourage the community to use their savings to set up local funds, capitalized by savings, which can lend to members for emergencies and/or enterprise development and thereby offer immediate material benefits. This further develops the skills and experiences of financial management as fund managers learn from successes and mistakes. Typical emergencies are health expenditures when a family member falls sick or transport costs to get to work or to take up a livelihood opportunity.³³

Despite the merits in saving with lending activities, in some countries this is not possible due to financial regulations. This is a problem both for conventional microfinance as well as community funds. A recent report from ACHR, CODI and IIED suggests that:

... in Nicaragua, government regulations prevent loan agencies, except for a few authorized by the superintendency, from taking savings. Today, there are some 300 non-profit organizations lending to the poor; but none are allowed to collect savings.³⁴

Interest rates

Interest rates are generally subsidized, especially for land purchase and infrastructure, but often also for housing investment. Three major reasons emerge for this policy: practical, political and social. On the practical side, many of these early programmes evolved with an interest rate subsidy because the relatively large size of the loan made affordability difficult if market rates were used. Even land

and infrastructure are often sizeable investments. Additional costs were incurred in some cases because of the involvement of local authorities and other state agencies who had standards and regulations that needed to be complied with. Politically, the policies may have been influenced by communities who were familiar with state support for housing through a reduced interest rate. This appears to be particularly strong in Asia where, for example, the Bangladeshi, Indian, Thai and Philippine governments all have programmes with interest rate subsidies for low- (and low-medium) income households. Inevitably, this influenced the expectations of the communities participating in the funds. For example, when the Urban Community Development Office (UCDO) (now the Community Organization Development Institute, or CODI) in Thailand first met to discuss interest rates, the community members of the board negotiated for 3 per cent. This was considerably below inflation at the time. Box 7.12 describes the decision-making process. Interest rates for water investment in Bangladesh and Pakistan are both set to zero (see Box 7.10 for Pakistan).³⁵

From a social development perspective, inclusion of the poorest and affordability are critical. As noted above, interest rate subsidies are common and, in some cases, they have been preferred to capital subsidies despite the discussions against this strategy in some of the literature and the position of some international agencies. The preference for interest rate subsidies is because there is no direct grant involved. The concern is that if something is offered for free, there will be a struggle within the community to secure such a free resource. The advantage of interest rate subsidies is seen as being that the subsidy depends upon action that the community takes by participating in the programme. A further advantage is that communities are believed to be more motivated to repay when they can see that most of their contribution reduces their loan balance. In this context, community funds rarely seek to charge rates that are equivalent to market rates for commercial lending. The interest on shelter-related loans may be set in order to cover inflation costs and administration charges (thereby maintaining the real value of the fund) or may be below this amount.

The state funds demonstrate a willingness to offer subsidized interest rates. In Namibia, the Build Together programme recently reduced its interest rate to 5 per cent.³⁶ Clearly, it is much easier for state programmes to offer interest rate subsidies than it is for NGO initiatives to set interest rates to cover inflation and administration. While the need to raise continued funding might have been thought to deter NGOs from using subsidized interest rates, this does not always appear to be the case. As noted in the discussion of SIDA's programme in Chapter 6, interest rate subsidies appear to be important, in part, because they are considered alongside mortgage rates in many countries, and the practices in the formal housing finance institutions influence those in the small loan market. In India, the state housing agency, the Housing and Urban Development Corporation (HUDCO), has made some subsidized loans through NGOs and other civil society organizations for

housing development, aware of the benefits of such an approach.³⁷

Community funds may carry on even in very difficult economic contexts if there appear to be strategic advantages. In Zimbabwe, the loan fund of the Zimbabwean Homeless People's Federation (the Gungano Fund) is continuing to offer loans despite the present economic difficulties and the high current rates of inflation (600–800 per cent). Continued lending is taking place because the difficult political climate has enabled a number of councils to negotiate development standards and, hence, to lower the costs of improvements with higher densities, partial infrastructure and delayed housing construction. By 2002, nine local authorities had committed themselves to releasing land that they own to the urban poor, and seven had released plots with tenure to more than 2000 households.³⁸

Collateral and security

There are two distinctive characteristics of the collateral strategies used by community funds. First, there is reliance upon community systems and community collateral rather than claims over the individual borrowers. Second, in cases of land purchase, legal title deeds may be used.

However, the difficulties of loan security are considerable because of the different attitude towards non-repayment. How can programmes distinguish between those who genuinely need more time to pay and the free riders who are exploiting a poverty-reduction orientation for their personal gain? The microfinance agencies described in Chapter 6 solve this problem through a combination of incentives (access to additional loans) and threats (for example, foreclosure). Community funds may use these strategies; but they also rely on local knowledge to address the problems of information for those issuing the loans. Local loans managers help to institute checks and balances within the system to ensure that abuse is minimized. In the Community Mortgage Programme in the Philippines, 61 per cent of accounts are over six months overdue, although (in terms of collection efficiency) the programme performs relatively well, with a rate that exceeds that of most housing loan programmes in the Philippines.³⁹ Box 7.13 suggests some measures to reduce these problems, including greater emphasis on the individualization of plots. This last measure may weaken incentives to strengthen group practice in community funds.

NGOs may find themselves taking on the role of guarantor to give the communities space to develop systems and to gain confidence, and because links with more conventional financial institutions require it. For example, in India SPARC found that a role emerged around maintaining books and providing information about the performance of local revolving funds. Community leaders were worried that they would be pressurized into giving loans, or that they would have other problems. Therefore, as the NGO, SPARC set up a fund financed by grants, and this fund operated like a guarantee for the savings. Communities established revolving funds using their savings.

Locally managed savings and loan programmes ensure that communities embed financial management within their own organizations and associated social relationships

Box 7.12 Determining housing interest at the Urban Community Development Office (UCDO), Thailand

When the Urban Community Development Fund (UCDF) was established, the UCDO board calculated that it could be self-sustainable with an annual average interest rate of 7 per cent. These monies would cover all administration expenses, including the community development process (an estimated 4 per cent), with a small allowance for inflation (which was relatively low). The setting of the terms and conditions of the loan processes was immediately a political rather than a technical issue. The idea of a 'shared' interest rate with a proportion remaining with the community organization developed during the initial study phase from the experience with earlier loan funds. These groups (and, later, the networks) were allowed to add a margin to cover their own costs and to provide funds for development costs or their community welfare fund. The decision on this margin or on an additional rate depends upon agreement made within the community and ranges between 2 and 10 per cent.

Achieving the aggregate figure of 7 per cent return across all loans was an objective used to design the interest rate structure for the various loans, considering the amount of capital, repayment period and use made of the loans. The more conservative board members were anxious that UCDO loans did not undercut existing financial markets. When they understood that the reason why they did not undercut existing financial institutions was because the community itself added to the interest rate of the office, there was a discussion about why the office itself should not benefit from high interest rates. Eventually the board agreed that the interest charges would be shared with the savings schemes.

In reality, the actual average interest gained across all lending was only 5 per cent. This shortfall was caused by the high percentage of housing loans requested during the initial years. The interest rate on housing loans is only 3 per cent. However, only one third of the total fund was being loaned to communities and the rest remained on deposit. The interest earned on deposit was generally sufficient to compensate for the shortfall. Therefore, annual average interest gained from all the monies in the fund has averaged 7 per cent. Total expenses for all development activities and management costs have averaged 3 per cent a year.

Source: Boonyabancha, 2004.

If thefts occurred, then the community saving was supported through additional resources provided by SPARC. In effect, SPARC acted as guarantor and this gave communities the courage to carry on. As activities increased, the NGO came under pressure from the communities to secure more capital, thereby enabling them to expand their local funds

Box 7.13 Group credit for housing loans: strengthening the Community Mortgage Programme (CMP) in the Philippines

Within the Community Mortgage Programme (CMP) in the Philippines, repayment performance is unsustainable and highly variable. The strength of the community is affected by its size, with smaller communities having a better repayment performance, and by whether or not the project is on site or off site. Off-site projects have a lower repayment rate as there are problems with cooperation (members come from different areas) and livelihoods may not be well established in the new area. To improve the repayment rate, there is a need to establish and strengthen collective action and joint liability in CMP community organizations as an anchor of programme sustainability. This requires the CMP to take into consideration key principles that have evolved from the experience of group lending. Groups have to agree on internal rules; they have to monitor loan performance and uncooperative behaviour; and they must rely upon members' deposits rather than external sources to increase the borrower's incentive to repay.

There is also a need to resolve land issues in group lending for housing. Site selection and planning are necessary conditions for a CMP scheme to work. Government has to act on ownership conflicts and titling problems and include the individualization of plots as an important part of the incentive system.

Source: Ballesteros and Vertido, 2004.

with external capital, and with that came a system of peer accountability. If one community failed to repay the capital that they had borrowed, another investigated the non-repayment and supported the community to resolve any problems. SPARC became a wholesale banker; each transaction was identified and the information sent back to communities. Like a bank, every transaction is identified and that information is provided each month to the national federation.

As is the case with shelter microfinance, community funds seek to ensure that households do not overburden themselves with debt, and most do not let households borrow such that repayments are more than 25 per cent of their income. However, there are problems with estimating incomes and, in practice, this restriction may not be effective.

Loan periods

Loan periods seek to recognize the fact that considerable care is needed in any loan programme for low-income groups since the capacity of such groups to repay is obviously limited. They also have a limited capacity to cope with sudden stresses (such as higher interest rates) or shocks (such as maintaining repayments when their income falls). 'Good practice' among loan programmes for low-income groups should actually support them in avoiding loans or in taking the smallest loans they need with rapid repayment periods (to minimize interest charges), rather than maximizing the size and number of loans (which would be the conventional measure of 'success' for most loan programmes). Such loan programmes should also ensure that they have measures to help those who find it difficult to repay. And, obviously, loan programmes work best for low-income groups where the cost of what is to be funded by a loan is kept down.

Loan periods appear to be longer than those used for shelter microfinance with, for example, terms of 25 years in the Philippines and 10 years in Thailand. In part, this is because of the large size of the loan relative to family incomes. It is also acknowledged that land purchase, for example, may be only a part of the investments that the family needs to make. NGO loan periods are lower and are generally less than five years. While some appear longer, such as those of the *uTshani* Fund in South Africa, the design reflects the fact that funds are primarily released as bridge finance for the state subsidy.

Technical assistance

Community funds generally place some emphasis on technical assistance, in part because access to land and infrastructure may be more difficult than simple house construction. However, advice is not limited to the difficulties of land purchase and subdivision and/or infrastructure installation. Support is often given to forging links with the local authority both with regard to the professional staff responsible for municipal rules and regulations, as well as the politicians. It appears that once it

is accepted that a subsidy is part of the process, some of the subsidy is allocated to technical and professional advice.

In general, technical advice concerning land and infrastructure development is provided by professional staff attached to the government department and/or local NGOs. In many cases, such as in Namibia, Zimbabwe and the Philippines, support may be given by local authority staff even if they do not make a financial contribution. These relationships are important to the development of future opportunities, and the strategies have been successful, most recently in Cambodia.⁴⁰ One agency using community funds, Shack/Slum Dwellers International, has developed an alternative strategy, using the need for technical assistance to further build the confidence of communities through skill-sharing exchanges. Communities teach one another to survey land, install water pipes and construct houses. This has the double advantage of being low cost and strengthening relationships between communities. Such exchanges generally take place within the city and help to develop stronger city-based networks that can offer further assistance.⁴¹

Income generation

Community funds differ significantly in their attitude towards income-generation lending. Some funds have a specific focus on a particular activity and have no interest in lending beyond that activity. More conventional microfinance lending may take place alongside the work supported by the community funds with a different set of staff, procedures and, often, clients. In other cases, the funds have developed a number of windows offering an integrated lending package for their members, almost universally with more conventional microfinance strategies being used for the enterprise component. Interest rates are generally higher, loan periods are shorter and the size of loans is smaller. One of the most complex is the Community Organization Development Institute in Thailand.⁴² The Urban Community Development Fund managed by the institute has developed a number of lending windows (see Table 7.1). Revolving fund loans top up small community-managed savings funds and may also be used for small microenterprise loans. All of these loans are managed by the local savings schemes; in most cases, they will add a margin of up to 5 per cent from this rate charged by CODI to provide funds for essential community administrative expenditures and to provide a pool for selected projects. The scale of these funds depends upon the additional charge chosen by the savings scheme.

The more ambitious schemes have explored the possibility of creating commercial centres to assist with income generation. This reflects the priority within some local communities to create employment opportunities and increased incomes. While the better-off households may be able to benefit from individual income-generation loans, more inclusive strategies require more comprehensive attempts to strengthen the local economy. The schemes recognize that many small enterprises have marketing difficulties. By creating commercial centres, such

Types of loans	Annual interest (percentage)	Maximum term
Revolving fund loan	10	3
Income generation	8	5
Community enterprise	4	7
Housing improvement	8–10	5–15
Housing project	3–8	15
Network revolving fund loan	4	5
Revival loan	1	5
(Miyazawa) Loan to reduce community crises and debt	1	5
Guarantee loan	Fixed rate +2	Flexible

Source: Boonyabancha, 2004.

Table 7.1

Summary of Urban Community Development Fund loans (from 2000)

initiatives seek to offer generalized opportunities that draw larger numbers of consumers to one place. The evident intention is to increase expenditure within the locality, thereby helping to ensure that more income circulates locally and seeking a virtuous economic cycle. For example, *Cearah Periferia* constructed small neighbourhood shopping centres in Fortaleza, Brazil, that provided a mix of productive units with space for selling. Similar strategies were tried in South Africa by the People's Dialogue and the South African Homeless People's Federation. The objective in both cases was to enable entrepreneurs to more easily sell their goods and to encourage residents to buy locally, thereby increasing demand for local products and seeking a community multiplier effective. In Fortaleza, this was taken one step further with the development of a community credit/debit card, which was managed within one neighbourhood and which added to the circulation of finance within the local economy as families used it to buy purchases from local retailers. An alternative strategy to enhance income-generation potential has been to increase the demand for specific goods. In Thailand, the Community Organization Development Institute (CODI) has enabled groups of tradespeople in individual income-generation activities to come together to make larger investments. For example, waste collectors in Khon Khan developed a wholesale company to buy their goods at a fair price and to prevent them from being cheated by existing wholesalers.

CHALLENGES

Community funds face very similar challenges to those faced by agencies supporting shelter microfinance initiatives. How can they secure the funding they need for long-term viability and how can they be effective in reaching out to those in need of shelter investment?

Long-term strategies for continued viability

A particularly different challenge faces community funds as they develop – what should their strategy be with respect to the state? Fundamentally, this is about strategies that maximize possibilities for scaling up funds while retaining a process that can be controlled by local communities. Links to the state are almost certainly essential if funding on the required scale is to be available. However, there is a concern

that funds will be bureaucratized. There are broadly three models in the programmes reviewed here:

- 1 state agency;
- 2 independent agency with state contributions to a central fund;
- 3 independent agency with state contributions to local activities supported by the fund.

The experiences in Thailand and the Philippines have been discussed above. UCDO started life under the National Housing Authority and CODI (UCDO's successor) is now a public agency with its own funds. There are advantages to being within government, such as preferential access to state finances and legitimacy when convening other groups – for example, local government. However, the agency can also be vulnerable to political pressures, and the process may need to be managed carefully. In the Philippines, there has been considerable support for community fund approaches, with a high level of institutionalization of people's organizations and NGOs within state housing strategies:

In recent years, NGOs, in particular, have also provided housing communities with financing and services for site and home development. The NGOs, through funds from private and international donors, offer bridge-financing facilities to housing communities... Community-based programmes have raised a need, which apparently cannot be adequately supported by government housing programmes, by the formal financial markets or by the business sector.⁴³

However, there are also difficulties in raising the required funds. One source of difficulties, evident in the Philippines, comes from a lack of acceptance of incremental housing strategies:

... the CMP has also failed to obtain the support of government officials, including heads of housing agencies, because of the perception that it legitimizes the existence of squatters and degraded neighbourhoods in urban areas... At the heart of this issue are the different perspectives informing what constitutes a valid housing solution.⁴⁴

As a consequence, the CMP has, at times, been starved of funds. For example, between January 1993 and September 1998, only 19.5 per cent of the total expenditure on housing was allocated to poverty-orientated housing projects (socialized housing) and only 1.33 per cent to the CMP.⁴⁵ It has now been proposed that a social housing finance corporation should be established in the Philippines to enable the CMP and other initiatives to be managed within a supportive state framework. The advantage of being independent and somewhat removed from government is that a positive political context can offer benefits; but if and

when state strategies shift to other approaches, the fund can consolidate without being threatened. One of the reasons for the reduction of support for FONHAPO's innovative programme in Mexico was that the general trend shifted in favour of market-based solutions and the agency was unable to protect its approach.⁴⁶

Nevertheless, a critical strategy of community funds is to secure state support both for central lending activities and to subsidize local development initiatives so that they can be inclusive and affordable. It is very difficult for a process that does not secure national funds to achieve scale even if it is successful in attracting donor support. In South Africa, the South African Homeless People's Federation, based around a network of savings schemes, became very strong. At one point, the intention was to set up a state fund. However, government distanced itself from the federation, claiming that it was difficult for it to support a single initiative.

The challenge of inclusion

Community fund programmes are designed for relatively stable communities who are in need of finance to secure land tenure and upgrade their neighbourhood. In some cases, communities choose to resettle. In other cases, they remain where they are and invest in their existing location. Such investments do not necessarily imply land purchase. Many communities have taken small loans to make improvements that are designed to improve the quality of their immediate lives and the visual appearance of the settlement and, hence, the likelihood of longer-term residency even if legal tenure cannot be secured. With regard to the challenge of inclusion, community funds may struggle to include all residents living within the settlement. They may also find it difficult to assist those who do not live permanently in the city.

Throughout Asia, Latin America and Africa, conventional development processes have failed to deal with many groups of poor people. In some cases, these are the poorest; but this is not always the case. There are particular groups who are vulnerable, such as illegal migrants. For example, Nicaraguans living in Costa Rica, Peruvians in Ecuador or West Africans in South Africa are often treated as non-citizens. Such groups often fall outside of any development scheme and are excluded from the benefits that others can secure. Community funds struggle to reach these groups and others who live in very distinct geographical areas or who do not have a permanent location. A major reason is that savings schemes build up links between neighbours in geographical areas. It is difficult for those who are working but not living in the city to join in, or for those who are very mobile. In Latin America, the Urban Management Programme tried to set up savings schemes with a group of street sellers in Quito; but it failed, in part, due to the attitude of local government.⁴⁷

In respect of activities within the settlements, policies for inclusion in savings and loans schemes may be difficult to operate effectively. To take a very different example from Asia, the Grameen Bank in Bangladesh has very strict criteria

Community fund programmes are designed for relatively stable communities that are in need of finance to secure land tenure and to upgrade their neighbourhood

and tries to ensure that only the very poor take part. It is nervous that the richer groups within the community will be too strong and will determine the rules and regulations. In other countries, such as Thailand, such a highly targeted policy would not work easily.⁴⁸ Within urban-poor communities, there is a lot of sharing between residents. CODI seeks to look at the community more holistically and inclusively, with rich and poor alike. However, CODI staff recognize that there is the danger that the process will be difficult for the poor. The difficulty with more inclusive groups is that the rules they adopt are hard for the poor to comply with. The practice of daily saving in India helps to ensure that even the poorest can participate. The livelihoods of the poor are generally managed daily (or in three- to five-day cycles), not monthly. Groups who save monthly exclude the poor. At the same time, richer households may not be interested in a process that requires them to save daily.

A group who may face exclusion is tenants. It may be difficult to ensure that tenants are granted equal rights as tenure is secured and development takes place. One area that has managed to overcome its differences and work together to develop their area equitably is Huruma in Nairobi, Kenya.⁴⁹ In this case it was facilitated by the requirement that agreement between all residents had to be reached before development could occur.

A further aspect of inclusion is that of gender. There is a widespread understanding that the centrality of women is important. In part, this is because women are concerned about their neighbours, about who is sick and who needs what; it is also related to the level of poverty and vulnerability experienced by women. Women's community role means that if women are central to managing the savings process, then it is likely that there will be fewer problems with exclusion within the community. However, this requires that the process is orientated towards women taking up a leadership role. While this seems prevalent in the case of savings and loans, in some contexts the shift to construction encourages higher levels of involvement by men. In the experiences of the Gungano Fund, Zimbabwe, and the *uTshani* Fund, South Africa, women are members of the savings schemes and are among those who take the loans; but a significant percentage of titles are registered in the name of the man. Nevertheless the high level of activity from women often continues. In the Community Mortgage Programme, for example, 70 to 90 per cent of community board members and officers are women and the assessment from research is that women are considered to be the more reliable managers.⁵⁰ Some of the groups have a

demonstrated capacity to move from housing on to other needs, such as daycare centres.

The microfinance agencies have noted the difficulties that they have in reaching some of the poorest groups, and such problems have been recognized in the case of community funds. For example, while even the poorest in the settlements supported by WaterAid in Bangladesh are better off as a result of the investments in water facilities, some individuals cannot afford to pay for adequate supplies of clean water.⁵¹ With a requirement for full-cost recovery, local communities have to cover the costs that are required. Inclusion issues may be particularly strong in the case of more formal processes, such as those associated with government funds. The situation within the CMP is assessed thus:

If we take the income level of beneficiaries at the time of CMP application, the programme has reached those coming from the bottom three income deciles (3178 Philippine pesos and below) ... with the majority coming from the second- and third-income deciles (2600 Philippine pesos to 3178 pesos)...⁵² Only a small percentage (7 per cent) of the beneficiaries came from the bottom segment or the first-income decile (2600 Philippine pesos and below)... [Moreover], substitution of beneficiaries⁵³ and/or selling of rights have occurred (ranging from a low 5 per cent to a high 35 per cent) because of inability to pay the amortization due to loss of income because of sickness, death or unemployment. In some cases, the beneficiary has moved to another place because of marital separation, death and job transfer... That the CMP beneficiaries do not come from the poorest of the poor is further supported by their occupational profile and income sources. Almost half (45 per cent) derived their income from low-wage work (e.g. employee, nurse/teacher, factory worker and services) or from the informal sector (vending/selling, transport service workers). Most families have several income earners who pool together their earnings in order to pay the amortization, as well as meet their basic survival needs.⁵⁴

NOTES

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|--|--|--|---|
| 1 This chapter is based on a draft prepared by Diana Mitlin, University of Manchester, UK. | 7 Cavalcanti et al, 2004. | 15 Baumann and Bolnick, 2001. | 22 Baumann and Bolnick, 2001. |
| 2 Mitlin and Satterthwaite, 2004b, p15. | 8 Cabannes, 2004, p30. | 16 Mitlin and Satterthwaite, 2004b, p13. | 23 Saborido, pers comm (2004). |
| 3 ACHR, CODI and IIED, 2004. | 9 Gonzáles de Kauffman and Rincón, 2004. | 17 Mitlin, 2003. | 24 SPARC, pers comm (2004). |
| 4 Arrossi et al, 1994, pp130-134. | 10 Lumanti, pers comm (2004). | 18 Mitlin, 2003. | 25 Porio et al, 2004. |
| 5 Arrossi et al, 1994. | 11 Porio et al, 2004, p63. | 19 Cavalcanti et al, 2004, pp172-173. | 26 <i>CMP Bulletin</i> , 2004, in SELAVIP, 2004, p93. |
| 6 Hanchett et al, 2003. | 12 Escobar, undated, pp40-41. | 20 CODI, 2004. | 27 ACHR, CODI and IIED, 2005. |
| | 13 Escobar, undated, p43. | 21 Escobar, undated, p41. | 28 Boonyabanha, pers comm (2004). |
| | 14 Hanchett et al, 2003, p44. | | |

- 29 Mitlin and Muller, 2004.
- 30 Mitlin and Patel, 2005.
- 31 Boonyabancha, 2004.
- 32 See Gaye and Diallo, 1997.
- 33 Patel and D'Cruz, 1993.
- 34 ACHR, 2004, pp3–4. Some financial regulations prevent organizations from lending and collecting savings. While this may be well intentioned, there are evident problems in lending without saving opportunities. In addition to the benefits described here, without savings people are less likely to build up assets to enable them to repay loans in times of difficulty, or to develop the habit of regularly making payments. Hence, they may be more vulnerable.
- 35 Hanchett et al, 2003, p47.
- 36 Ministry of Regional, Local Government and Housing, 2003.
- 37 Escobar and Merrill, 2004, p66.
- 38 *Hifi News*, 2002; SELAVIP, 2004, pp129–134.
- 39 Ballesteros, 2002, pp21–23.
- 40 ACHR, 2004.
- 41 Patel and Mitlin, 2002.
- 42 Boonyabancha, 2004.
- 43 Ballesteros, 2002, p12.
- 44 Porio et al, 2004, p60.
- 45 *CMP Bulletin*, January 1998, cited in Porio et al, 2004.
- 46 Connolly, 2004a, b.
- 47 Cabannes, pers comm (2004).
- 48 ACHR, CODI and IIED, 2004.
- 49 Weru, 2004.
- 50 Porio et al, 2004, p75.
- 51 Hanchett et al, 2003, pp48–49.
- 52 This study opted to use the lowest three mean income decile criteria (bottom 30 per cent), rather than the poverty threshold definition of poverty (4945 Philippine pesos in 1994 and 6231 pesos in 1997). However, comparing the two indicators of poverty shows how much deficit the poor suffer in terms of their income and basic needs for survival (for example, almost 100 per cent deficit of the third decile's average monthly income of 3544 Philippine pesos versus the poverty threshold of 6321 Philippine pesos).
- 53 Substitution of beneficiaries occurs when an original member of the organization cannot/refuses to fulfil his duties to the association and decides to forfeit his access rights to the CMP project. Reasons include death, migration, inability to pay or loss of faith in the project.
- 54 Porio et al, 2004, pp72–73.