

Micasa: Housing Financing in Peru

Series Introduction

From shacks in the shantytowns of Lima, Peru, to tin-roofed mud huts in the slums of Gujarat, India, insecurity of tenure and uneven income streams force the poor to build their homes tentatively, one wall at a time. Yet the poor lack access to financial institutions and financial products tailored to the way they build. This, despite the fact that in so many developing cities around the world a majority of the population lives in slums—60 percent of Nairobi's population, 82 percent of Lima's population — and that most housing is built informally and progressively.

The Cities Alliance launched the Shelter Finance for the Poor Initiative to focus on the still nascent practice of financial institutions providing housing finance to poor clients on commercially viable terms. These loans are distinct from mortgages in that they are typically not for the purchase or construction of new units, but rather for home improvement and progressive building. They are being offered as a new product line largely by a generation of financial institutions that built their success on providing working capital loans to the urban poor, and are

now looking to expand and diversify their products. To date, few of these experiences had been viewed through the prism of scale and sustainability. This is the framework applied to five case studies examined under this Series: Mibanco in Peru, SEWA in India, FUNHAVI in Mexico; a wholesale fund facility in Ecuador, and the enabling environment for shelter finance in Kenya. A synthesis paper identifies emerging policy recommendations on taking housing finance for the poor to scale.

The objective of the Series is to look at shelter financing in practice through the prism of scale, sustainability, and outreach to the poor, and learn about best ways to encourage and promote this emerging practice.

Introduction

In mid-2000, Mibanco, Latin America's second largest regulated microfinance institution, with 70,000 active borrowers, launched Micasa ("my home")—its housing product. Within a short period of 12 months, Micasa achieved impressive results in terms of scale—3,000 active clients and a \$2.6 million portfolio. This scale, combined with low incremental costs have ensured Micasa's profitability; as of June 2001, Micasa was generating approximately \$15,561 a month in incremental net income. Moreover, Micasa is actually reaching a poorer set of clients with its housing loans than Mibanco does with its microenterprise loans.

Unlike traditional housing finance, Micasa is an adaptation of Mibanco's successful microenterprise lending

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methodology that provides the finance needed to complement the poor’s progressive process of housing construction. Micasa has achieved rapid and profitable growth because its product was developed and launched within Mibanco’s existing branch and lending infrastructure—there was no need to develop new offices or hire new loan officers. Micasa is also interesting because it does not require borrowers to have any specific assistance in designing or supervising their constructions. Thus far, anecdotal results suggest that the quality of constructions financed is, at a minimum, acceptable. Micasa’s emerging experience in housing finance indicates that adapting microenterprise techniques to housing lending may be less difficult than previously imagined.

Background

Lima, the capital city of Peru, is a sprawling metropolis of roughly 8 million people, four-fifths of whom live in households classified as “poor,” earning less than \$340 per month. These poor residents live in substandard housing with dirt floors and without running water. Although few households have legal title to their property, 80 to 90 percent of poor households claim de facto ownership of the place where they live. Half or more of the poor households plan to improve or expand their homes every year.

In this context, evidence of robust demand for housing finance abounds. However, supply has lagged far behind. Heretofore, most private financing of housing improvement for low-income clients has come from diversion of microenterprise loans, or from consumer

loans wherein lenders allow borrowers to use the funds for housing. The fact that the poor have unstable income sources and lack legal titles to their property has dissuaded private-sector mortgage lenders from supplying more options. What is more, government programs have been slow to fill the gap, despite a relatively effective titling program for the property of the poor.

Mibanco and ACP—its nongovernmental organization (NGO) predecessor and essentially the same organization under a different legal structure—developed a successful, efficient microenterprise lending methodology and customer-focused organization through several decades of learning by doing, and have consequently grown to become the second-largest microfinance institution in Latin America. In searching for new growth areas and ways to better serve their clients’ financial services needs, Mibanco looked to their early experiences rebuilding earthquake-devastated homes in Northern Peru, and to later market research showing that Mibanco’s microenterprise clients also had a substantial need for housing finance. Making small adjustments to its microenterprise lending methodology, Mibanco launched Micasa in mid-2000.

Since its initial launch, Micasa has experienced very rapid growth, reaching almost 3,000 clients and \$2.6 million in outstanding portfolio in just 12 months, and has grown to represent almost 6 percent of Mibanco’s total portfolio. Management predicts that it may grow to make up as much as half of the bank’s total portfolio within a few years.

How Micasa Works

Target Market

There are two target markets for Micasa loans: 1) Mibanco's traditional customer base of micro-entrepreneurs, and 2) low-income, salaried workers living in the same communities. Not surprisingly, the profile of Micasa clients during the first 12 months closely matches the profile of Mibanco's microenterprise borrowers. By adding low-income workers to its target market, however, Mibanco has ended up serving poorer households. Although many loan officers initially rejected the idea of working with low-income, salaried workers, feeling that they were "too risky" as clients, this group now accounts for one-third of Micasa's loans. As with Mibanco's microenterprise borrowers, half of Micasa clients are women, and 80 percent are between 25 and 55 years of age.

The Product

"Progressive-build" lending: Micasa supports the existing housing strategies of low-income households—building and improving their home in progressive stages. Micasa loans finance on-going investments in upgrades and improvement projects such as converting wooden walls to brick, replacing zinc roofs or dirt floors with cement, or adding additional rooms, one at a time. In terms of loan guaranties, Mibanco has taken a page from its microenterprise lending practices, securing most of its

Micasa loans with household assets rather than mortgages.

Terms and conditions:

Though similar to Mibanco's microenterprise loans, Micasa's housing loans are larger, have longer terms, and lower interest rates. This reflects the tendency for housing loans—in contrast to microenterprise loans—not to be income-generating, meaning that housing borrowers are less able than microfinance borrowers to repay the loans out of increased income. It should be noted, however, that this is not always the case. Sometimes housing loans do generate additional income for the borrower in the form of additional rental income, or expansion of a home-based microenterprise.

Relative to Mibanco's microenterprise loans, Micasa's **interest rates** are approximately 4/5 the microenterprise rate for smaller loans and 9/10 for larger amounts. These rates contain no subsidy, and are sufficient to cover the full cost of providing the loan. Though **loan term** limits on Micasa loans (36 months) are broader than microenterprise loans (24 months), clients do not automatically take the maximum term—63 percent of existing Micasa clients opt for loans with a 6- to 12-month term. **Loan amounts** must be greater than \$200 and no more than 90 percent of the cost of the project to be financed. Overall, these amounts tend to be larger than the loans Mibanco disburses for microenterprise; median loan size for Mibanco's working capital loans is \$500, while

the comparable figure for Micasa loans is \$1,000.

Construction Assistance:

Micasa does not provide its borrowers with any technical assistance in the planning, supervision, or implementation of their construction projects. While they require clients to submit a construction budget as part of their loan application, Micasa has no formal process for evaluating this budget. Through experience, loan officers have learned to evaluate whether a given construction budget is reasonable, but to date they have not been given formal training in any aspect of construction.

Delivery Methodology

The evaluation and disbursement of Micasa loans is essentially identical to that of Mibanco's traditional microenterprise loan. Loan applications for new clients typically take three days from the time the application is submitted to the time the loan is disbursed. However, repeat loans (for the same purpose) are generally processed in one day. Mibanco achieves such rapid processing times by decentralizing the loan approval decision as much as possible, giving its loan officers—who typically manage over 300 clients at a time—much discretion. An average prospective client requires anywhere from 50 to 80 minutes to complete the entire application process.

Follow-up Methodology

To encourage good repayment, loan officers will often pay a visit to first-time clients the week prior to their scheduled loan payment, encouraging them to make their payments on time. Additionally, since most clients build progressively, they expect to take out successive loans, once they have finished repaying their first. This serial borrowing provides an additional incentive for clients to make their payments on time, since rapid approval of subsequent loans will depend on clients' repayment history on previous loans.

Late repayment rates for Micasa are low, with just 0.6 percent of outstanding balances past due more than 30 days. These low figures in part reflect the youth of the Micasa product. By comparison, the portfolio at risk greater than 30 days in Mibanco's overall portfolio averaged just 2.7 percent at the end of June 2001.

Sustainability and Outlook

In the first 12 months, Mibanco amassed nearly 3,000 Micasa clients. At the same time, product profitability estimates suggest that Micasa is sufficiently profitable to allow Mibanco to continue growing the portfolio. However, such strong growth and early profitability should not suggest that all microfinance institutions (MFIs) expand their portfolios to offer progressive-build housing loans will automatically achieve similar results. Much of Mibanco's early success relies on its well-trained loan officers, smooth functioning processes and procedures, and advanced

management information systems. Housing loans, when they do not generate any additional income for the borrower, leave less margin for error in estimating clients' available income. Thus, two preconditions should be applied to MFIs considering adding housing improvement lending to their portfolios. First, MFI's must be confident in the quality of the capacity-to-repay analysis conducted by their loan officer's. Second, procedures and processes for an MFI's existing microenterprise lending program should be operating smoothly and efficiently.

One of the challenges for Mibanco in the future (and one of the challenges for many microfinance institutions looking to get into the housing market) is the question of where medium-term sources of funds will come from. As the longer-term Micasa loans take on a more substantial share of the total portfolio, Mibanco will need to identify more medium-term liabilities to keep the term of its liabilities in line with its assets.

Most microfinance institutions have limited access to commercial sources of funds with terms greater than one year, yet progressive housing improvement loan terms can be as long as five years and average 12 to 18 months. Mibanco is currently able to fund its medium-term Micasa loans because of a five-year government loan; however, as the portfolio grows, additional sources of longer-term capital will be required to avoid liquidity problems. If housing finance programs in Peru and other countries are to continue to grow, reliable access to medium-term funding sources will need to be available in the not-too-distant future.

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Lessons Learned

Progressive-build financing vs. traditional mortgage lending:

Micasa matches the progressive, one-step-at-a-time construction that poor clients usually use to build their homes, with successive short-to-medium term loans. This challenges the traditional belief that housing finance for the poor requires large loan amounts over long-terms with government subsidies to keep the payments affordable. Micasa's loans average \$1,000 with terms of less than 24 months, and mortgages are seldom used as guarantees because taking a formal mortgage is generally too expensive for the lender and too time-consuming for the borrower. In short, loan terms and conditions for progressive-housing improvement loans more closely resemble microenterprise loans than mortgage loans.

Construction assistance may not be necessary:

Most housing finance for low-income borrowers is coupled with design, planning, and construction assistance by technical experts. Traditionally, it has been believed that such assistance reduces the cost of projects, and ensures the quality of construction. However, Mibanco's innovative approach holds that households can manage portions of the technical process on their own and still achieve an acceptable level of quality, and that households have a strong preference to make their own design decisions. Indeed, a small study made up of 10 client interviews and a focus group of 20 clients indicated that clients were generally satisfied with the quality of their constructions and that none of the structures investigated were sub-standard.

The importance of interest rates:

Traditionally, the low-income borrowers have been thought to be particularly interest-rate sensitive. However, Mibanco's experience shows that other factors may be more important—simplicity, flexibility, and speed of disbursement are likely the primary factors in households' decisions to borrow.

Housing investment may be income-generating:

Whereas housing investments are generally considered as consumption spending, housing improvements often generate income for the borrower through rentals or by providing additional space for home-based microenterprise.

Outstanding Issues and Conclusions

Several key questions remain for financial service providers with existing or emerging low-income housing portfolios.

Whether and how to provide construction assistance as an integrated part of lending to low-income households?

At a minimum, the experience collected to date suggests that loan officers need to be trained in how to evaluate construction budgets and simple aspects of design. However, further experimentation and documentation of the existing evidence is needed to better understand the costs and benefits of providing construction assistance.

How effectively can housing improvement finance reach the extremely poor?

Mibanco's lending primarily targets poor households—those at or just below the poverty line. Other programs in Peru

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and elsewhere are generally similar. It remains to be seen whether sustainable housing lending programs can or should try to reach substantial portions of the “extremely poor” or whether these households are best served by subsidized or partially subsidized services.

Looking forward, the challenges faced by Mibanco’s management will include: managing and sustaining the early growth, accessing medium-term capital, maintaining portfolio quality and administrative efficiency as fewer Micasa clients come from the existing base of microenterprise borrowers, and determining whether and how to provide some form of construction assistance to borrowers.

Mibanco’s early success strongly suggests that many of the principles and “best practices” developed in microenterprise lending are highly appropriate to the provision of housing finance to the same families. Moreover, the process of integrating a progressive housing loan program into an existing microenterprise lender may not be as difficult as previously thought, particularly given that many housing investments do often generate additional family income, such as rent or additional space for a microenterprise.

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