Informal Shelter Finance: An Enabling Strategy in Action

By Harold O. Wilson

THIS article describes a mechanism through which formal sector financial institutions can become involved in lending for shelter and community development in the informal settlements of the developing world. The program is a practical application of the enabling strategy proposed by the United Nations and is modelled after a loan program implemented by the Co-operative Housing Foundation in Central America. The program—called *Shelter the World*—mobilizes and links formal and informal shelter development resources to assist the poor in carrying out their own housing and community improvement strategies.

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The Enabling Strategy

Population growth and migration to urban areas in the developing world are creating a need for shelter and community improvement assistance that is unprecedented in human history. In 1850, most human settlements were rural in character. By 1920, only 14 percent of the world's population lived in urban areas. By 1985, according to the United Nations Development Programme's *Human Development Report 1990*, the number of people living in cities had nearly tripled. In the developing world, the urban population had quadrupled, from 285 million to 1.15 billion.

By the year 2000, it is anticipated that half the world's 6.1 billion people will live in cities. The ten largest cities will range in size from 13 million to more than 24 million inhabitants, and eight of the ten will be in developing countries. The explosive growth in the world's cities is placing tremendous pressure on urban environments and is contributing to the informal development of crowded settlements that ring almost every city in every developing country.

The residents of such communities are, however, resourceful. On their own initiative and with their own meager resources, they struggle to improve their homes and neighborhoods. Over time, they save what they can or borrow from friends and make incremental improvements to their living conditions. Families in informal settlements generally work without government support and outside of government control as they make improvements to their shelter. Often, they are assisted in their efforts by a network of builders, producers of construction materials, and non-conventional lending institutions which operate outside the formal construction and finance sectors. In fact, the vast majority of housing for the poor in developing countries is produced in this way.

Recognizing the global need for shelter assistance and the initiative demonstrated by low-income families in providing for themselves, the United Nations has adopted an enabling strategy to promote the development of adequate affordable housing. *The Global Strategy for Shelter to the Year 2000* describes the strategy as "an approach whereby the full potential and resources of all the actors in the shelter production and improvement process are mobilized; but the final decision on how to house themselves is left to the people concerned. Ultimately an 'enabling concept' implies that the people concerned will be given the opportunity to improve their housing conditions according to the needs and priorities that they themselves will define."

The strategy clearly recognizes that worldwide shelter and community development needs are so vast that they cannot be solved unless the resources of formal sector institutions are brought to bear and the poor are given a role in meeting their own needs. The validity of the enabling strategy is recognized by the major international donor agencies.

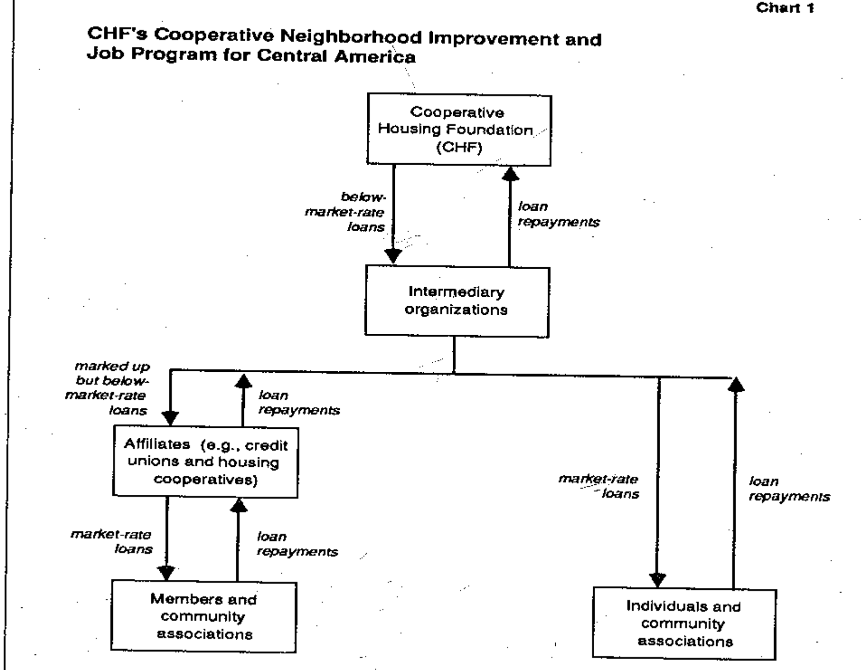
The Program Model

The Co-operative Housing Foundation (CHF) has developed and successfully tested a financing and development model that transforms the enabling strategy from a concept to a replicable program. The program model has been recognized by the United Nations Centre for Human Settlements, which is awarding CHF the 1991 Habitat Scroll of Honour for its work.

In 1985, with a grant provided by the United States Agency for International Development (USAID), CHF initiated the Co-operative Neighborhood Improvement and Job Program for Central America. The purpose of the program was to establish a permanent, private sector system to finance and develop shelter and community improvements in response to the needs of the poor in the region.

The program model is simple (Chart 1). CHF collaborates with indigenous intermediary organizations to design local housing and community improvement programs and provide financing for their implementation. The non-profit intermediary organizations—co-operative housing federations, credit union federations, and other non-governmental organizations—make loans to their affiliates, which are often democratically-controlled membership organizations such as credit unions and housing co-operatives. The affiliates then make loans to low-income member families for construction of a small house or home improvements. The affiliates also make loans to community associations for the development of community improvements such as potable water supplies and sanitation services. In addition, the affiliates make working capital loans to small businesses involved in producing or supplying building materials. In many cases, CHF works with intermediary organizations who make loans directly to individual borrowers or community associations because they do not have affiliates.

Chart 1



For example, CHF collaborates with the Federation of Women's Associations of Honduras (FAFH), an advocacy and educational organization that provides services to women. Together, CHF and FAFH designed a home improvement loan program targeted to low-income, female headed households in Tegucigalpa. CHF provided a loan to FAFH, which in turn provides small loans to women in informally developed settlements. Ana Saturnina López Medina is typical of the women assisted by the program. A mother of eight who was abandoned by her husband, Ana Saturnina bakes and sells sweetcakes to support her family. She qualified for a $900 loan and used the funds to make lasting improvements to her simple home. The new brick bedroom and retaining wall along the back of the lot provide needed space and security for her family.

Under the terms of CHF's program, beneficiary families pay market rates of interest on their loans. Loans from CHF to the intermediary organizations are generally for a term of three to five years and carry an interest rate that is slightly below market rates. The intermediary group marks up the funds slightly but also provides loans to its affiliates at below-market rates. The affiliates subsequently loan the funds to beneficiary families or community associations at market rates of interest, thus earning interest income that is used to administer the program and set up a reserve against losses.

Low-income families are the target population for the loans. Those who participate in the program have generally been excluded from obtaining loans through the formal financial sector because they do not conform to traditional eligibility requirements. For example, many are self-employed or live in houses that do not meet standards set by building codes or on land that is not legally owned or registered with the government, making them ineligible for credit. Beneficiary families have incomes that are below the median, but, like the working poor everywhere, can repay loans that are calibrated to be affordable. The average loan amount is less than US$1,000. The default rate is less than three percent.

CHF secures its loans and mitigates against losses in a variety of ways. In some cases, beneficiaries are required to provide cosigners for their loans or authorize a payroll deduction process to ensure repayment. Peer pressure among community members also encourages repayment. In fact, intermediary organizations and affiliates play a significant role in organizing the beneficiary community and monitoring the repayment process. The intermediary organizations and their affiliates accept mortgages on land if it is practical and pledge all mortgages and guarantees to CHF. The organizations' assets are also pledged to CHF as security, when such assets are available.

Benefits of the Program

CHF's program has operated in all the countries of Central America except Nicaragua. In the program's first five years, CHF made loans to 28 intermediary organizations, who made loans to at least 80 affiliated institutions (Table 1). Together, these organizations made nearly 7,500 loans to low-income families for shelter-related activities. In addition, participating organizations made loans for community improvements and working capital loans to small businesses involved in building materials production and supply. More than 44,000 low-income individuals in the region are benefiting from the program and now have a safer, healthier, improved quality of life. CHF's program has also demonstrated that small loans for shelter and community development result in a significant level of employment in informal settlements. It is estimated that more than 18,500 work years have been generated by the loan program in Central America.

Over several years, USAID provided CHF US$11.5 million in grant funds for loans under the program. The program leveraged the equivalent of US$2.7 million in beneficiary down payments and counterpart lending by intermediary organizations, and an estimated equivalent of US$3.6 million was provided through in-kind contributions in the form of land, materials, and labor.

Funds were further leveraged in Costa Rica, Guatemala, and Honduras by securing accreditation of a number of intermediary organizations with formal sector housing finance institutions that purchase mortgages. In Costa Rica, for example, CHF worked with the Federation of Credit Unions (FEDECREDITO) and 19 affiliated credit unions to establish a nationwide lending program for basic house construction and home improvements. As a result of CHF's training and technical assistance, FEDECREDITO was accepted by the National Home Mortgage Bank (BANHVI) as an accredited mortgage loan originator. Through its arrangement with BANHVI, FEDECREDITO has generated more than US$6.1 million in mortgages for low-income families and accounts for more than 10 percent of BANHVI's disbursements.

In Guatemala, the Insured Mortgage Corporation (FHA) has accredited the National Federation of Housing Co-operatives (FENACOVI) as a mortgage originator, making FENACOVI the only non-commercial banking institution in Guatemala to be given that status.

The National Housing Fund (FOVI) is a major actor in the housing finance sector in Honduras. Its primary role is to discount construction loans with formal financial institutions in order to channel funds provided by USAID to low-income families. Prior to the implementation of CHF's program, FOVI found it difficult to reach low-income families because formal sector lending institutions were resistant to serving the poor. Only when FOVI began to work with the intermediary organizations participating in CHF's program was it able to reach its target population in significant numbers.

In addition to its tangible results, CHF's program has validated three important

Table 1

Benefits of CHF's Co-operative Neighborhood Improvement and Job Program for Central America

Activity	Quantity
Intermediary organizations participating	28
Home improvement loans made	4,653
House construction loans made	2,818
Families benefiting from community improvement loans	1,213
Small business loans made	124
Individuals benefiting (average family size of five)	44,040
Work years generated	18,854

principles:

- Low-income families will use available credit in a responsible, cost-effective manner to create decent shelter and healthy living environments for themselves.
- The working poor are good credit risks when they are involved in planning and implementing their own housing and community improvement strategies.
- Local non-profit organizations can be effective financial intermediaries capable of operating loan programs and managing improvements to the physical living conditions of low-income families.

A Global Application of the Model

As a result of the success of its program in Central America and its commitment to the principles noted above, CHF created Shelter the World, a global lending program for shelter and community improvement. The Shelter the World fund is capitalized by private contributions and designed to support worldwide application of the program model developed and tested by CHF in Central America. Loans are made through CHF's programs to nonprofit intermediary organizations, who then make loans to low-income families for home improvements and construction, to small businesses for building materials production, and to community associations for neighborhood improvements.

To capitalize the Shelter the World fund, CHF is seeking investments from individuals, organizations, foundations, and corporations. A number of individuals have contributed, as have organizations such as the Credit Union National Association (CUNA) Foundation in the United States. The largest investment to date has been a US$1 million low-interest loan provided by the prestigious John D. and Catherine T. MacArthur Foundation in the United States.

Shelter the World is currently providing loans in Central America and the Philippines, where CHF has ongoing programs in place. As funds become available, however, CHF plans to initiate Shelter the World activity in Africa as well as other Asian and South American countries.

The Role of Formal Financial Institutions

Through Shelter the World, formal sector financial institutions can participate with confidence in financing shelter improvements in the informal settlements of the developing world. Successful participation hinges on making institutional commitments

- to assist the working poor with their shelter and community improvement needs;
- to work with community-based, nonprofit organizations that serve the poor,
- to accept the incremental shelter development process used in informal settlements, which includes construction that does not meet formal standards and occupancy of land without legal title; and
- to seek additional investments and provide matching funds to be loaned locally.

The following steps would be taken to develop a program that enables a formal sector financial institution to participate in lending for shelter and community development in a targeted informal settlement. CHF would assist the financial institution in identifying an intermediary organization to serve as a link to the targeted community. CHF would assist the financial institution, the intermediary organization, and the potential beneficiaries to develop a shelter loan program that is responsive to the community's needs. Following an investment from Shelter the World, the financial institution would invest an equivalent amount in local currency and, if possible, secure an additional investment from local industries or other sources.

In one approach, the funds would be loaned to the intermediary organization, which would subsequently offer modest loans in the targeted community for shelter upgrading, basic house construction, small businesses, or neighborhood improvements. The intermediary organization would publicize the loan program, screen loan applicants, and service the loans. In another approach, the funds would be deposited with the financial institution and loaned directly to individuals or community associations in informal settlements. The intermediary organization would promote the loan program in the community, screen potential borrowers, and help service the loans.

The model is flexible and lends itself to a variety of relationships between the financial institution and the intermediary organization, depending on local circumstances. In addition, it can be adapted to conditions in most developing countries. Most important, it offers an effective mechanism for formal sector financial institutions to serve low-income members of the community.

Conclusion

A billion people in the developing world are in need of improved shelter, and their numbers are growing daily. If their needs are to be met, a strategy that enables them to build their own homes and improve their own communities is essential. If adequate resources are to be available, loan funds from formal sector financial

→ 39

SUPERVISION . . .
→ 26

as this are enormously valuable, I am sure, in bringing together representatives from very many countries, but few parts of the industry have a formal multinational framework beyond that which exists within the European Community. Yet in banking and in many other areas of financial services we have a global market-place. The need to consider, and perhaps organize, the industry on a more comprehensively multinational scale may be increasingly important in the years ahead.

We saw the case for it, as well as the difficulties in achieving it, during the developing countries debt crisis in the 1980s. In handling the intensely difficult process of organizing an estimate of the exposure to the major banks of the world to the developing countries, the banks had great difficulty in marshaling themselves effectively. A new forum was created to handle this - the Institute for International Finance - to try to provide a focus for the major banks of the world on these and other issues of common concern, but the progress for all sorts of reasons, good and bad, has been slow. It has, however, become a place where bankers and officials can come together to discuss global financial issues.

Another particular initiative has I think been useful. When I was Chairman of the Basle Committee on Banking Supervision, following the principle that practising bankers and supervisors need to keep in close touch, I set up an annual meeting with a group of the Chairman of the European countries banking federations - an informal meeting, low profile, at which the important macro-prudential, and some not so macro-prudential issues in the banking field could be aired and discussed and the particular concerns and preoccupations of each side put on the table and frankly and freely debated. A small step but a useful one to extend the principles of dialogue which I discussed earlier in my remarks on national environment.

Mr Chairman, I have ranged wider than the particular concerns of the industries represented here today but I believe that the topic of this session goes to the heart of the way in which all financial service business with fiduciary responsibilities to customers, clients, depositors, investors or policy holders need to approach their relationships with the authorities who watch over their activities. I hope we have had a fruitful dialogue; I hope too we may have reached a consensus on these important issues. ■

INFORMAL FINANCE
→ 30

institutions must be mobilized for their use.

CHF has developed and tested a program model that transforms the enabling strategy promoted by the United Nations into action. It unites formal sector financial institutions and nonprofit intermediary organizations in a partnership that enables low-income families to organize, plan, and carry out their own shelter and community improvement initiatives. As resources become available, Shelter the World is applying the program model on a global scale, providing a mechanism for formal sector financial institutions to provide shelter financing for the poor of the developing world. ■

JAPAN . . .
→ 38

One of the major problems that private financial institutions have at present is how to avoid the risk of housing loans. Most private financial institutions raise the funds for housing loans mainly from the short-term deposits that their customers make. The private financial institutions have to bear the risk of changing interest rates in the long term when they make housing loans.

Compared with a business loan, a housing loan is usually a smaller amount and has a longer repayment term. The interest rate is lower than that of a business loan. In short, private financial institutions have to bear the risk, in spite of a lower profit, when they make housing loans.

As mentioned before, the demands for business loans are decreasing, while the demands for individual loans such as housing loans are increasing. In this situation, many private financial institutions have put greater emphasis on housing loans and made efforts to decrease the risk. For instance, they adopted adjustable-rate housing loans to avoid the risk of changing interest rates. Furthermore, some private financial institutions began to securitize their housing loan credits.

The Japanese economy has so far depended on exports. Now, it is under international pressure to make its economic structure more dependent on domestic demand. One of the effective measures to accomplish this international obligation is the promotion of housing construction, because the housing industry links with other industries. It is not too much to say that the key to promote housing construction lies in the further development of housing finance by both public and private financial institutions. It is expected that, in the near future, the provision of housing finance by both public and private financial institutions will play a more important role not only in the housing industry, but also in the nation's economy. ■