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Designing financial products for housing development

Tags: Investment, Housing, Land. Case Study

With around 1 billion urban residents living in informal settlements, there is an urgent need to reconsider how development is delivered. This challenge is not just mobilising sufficient finance. It requires rethinking how urban development is structured to create an investment environment where all available resources and capabilities can be mobilised. In a new in-depth study found **here**, ICED outlines how community finance organisations can help to overcome barriers to private-sector involvement in the development of informal settlements.

Despite the large demand for financial services among people with low income, perceived risks associated with unstable earnings, lack of credit history and limited collateral deter business innovation in this sector. The World Bank states that 2 billion people do not use formal financial services and more than 50 percent of adults in the lowest-income households are "unbanked".[1] This is because conventional models and procedures used by formal financial services create barriers for low income households to set up bank accounts and access credit. Many mainstream financial institutions also perceive that providing these services can be high cost and low profit when traditional approaches are taken.

Where low-income individuals are unable to access formal financial services, informal arrangements (such as community finance) provide a means to save, borrow and create assets to invest in housing and improving access to services. Community finance arrangements are attractive to people with low incomes because of ease of access, with little requirement for formal identity documents and no upfront administration charges; ready access to savings when needed for emergency situations; and the ability to save very small amounts of money on a daily basis without penalty. Savings schemes operate as 'peoples' ATMs' for those unable to access banking. Community savings are attractive because of embedded welfare arrangements that may be provided alongside savings and loans. Individuals save small amounts of money to cover medical costs, education or burials and also rely on the support of savings schemes to meet loan repayments when lenders have no income. Typically, these welfare elements are unavailable through commercial bank accounts.

Community finance can also act as a bridge between informal and formal financial services. The social and financial capital developed by savings groups can mitigate risks for commercial banks to enable individual and group mortgage and livelihood lending. Partnership between community savings and banks can utilise savings group membership data to address identification requirements and generate financial histories.

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[1] http://www.worldbank.org/en/topic/financialinclusion

Savings groups can also be used as the basis for group accounts that reduce transaction costs for banks. The digitalization of savings and use of communications technology offers further market potential for innovations that are relevant to people in poverty. The Indian federations, Mahila Milan and the National Slum Dwellers Federation of India, began digitalising loans in the early 1990s, with technical assistance from the support NGO SPARC. The role of SPARC was not to police transactions, but rather to develop documentation and processes that would enable the federations to review transactions and track repayments. Digitalisation subsequently supported the expansion of microcredit beyond emergency loans to income generation and home upgrading.

Box 3: Standard Bank and Shack Dwellers Federation of Namibia

In Namibia, Standard Bank have established practices to engage with community savings activities. Rather than requiring individuals to come into branches, bank staff visits communities to open accounts. Standard Bank has also introduced a policy that members of the Shack Dwellers Federation of Namibia savings groups do not pay deposit fees on their savings accounts, reducing transaction costs for low-income households.[1] Standard Bank now make charitable donations to the savings groups worth NAD 1.5 million (approximately US$120,000) in 2015/16.

Banks can benefit from responding flexibly to the specific circumstances of low-income customers, for example by designing group rather than individual lending arrangements. Working collaboratively with community finance organisations provides an opportunity to create new financial products suitable for people on low and variable incomes and (as shown in the full working paper) to invest in urban development schemes. Creating products that account for the context and needs of residents of informal settlements and providing capital investment into urban development initiatives would enable banks to access a large and under-served market opportunity. Collaborative activity that improves access to formal lending where some risk for banks is underwritten by savings schemes can provide an important means of capitalising business and livelihood activity, thereby stimulating economic development and further demand for financial services.

Table 3. **Improving risk-adjusted returns: the role of community finance**

	Perceived risks and low returns	**Community Finance**
Financial services	**Perceived risks** • Lack of ID and formal address of savers prevents opening accounts. • People with limited credit history are perceived as a higher risk of default. • Low income groups have limited availability / value of collateral usable for borrowing. **Low returns** • Small and irregular deposits have higher transaction costs. • Community level investments are too small scale for commercial investment. • Need for new branches in low-income neighbourhoods.	• Digitalization of savings information can validate savings histories. • Savings funds can be used as collateral to guarantee group borrowing. • Strong social networks can reduce individual borrower risk. • Community finance can help to coordinate repayments for housing and income generation loans. • Use of city and national level community funds can support large scale development investment.
Investment in housing development	**Perceived risks:** • Complexity of informal and illegal land ownership and use. • Limited access to sites with established informal settlements. • Variable application of regulations and politicised decision making. • Risk to sale value on completion of scheme. **Low returns:** • Lower profit on low cost housing than higher value schemes. • Incremental housing is costly to organize by contract with limited formal construction.	• Community enumeration and networks can provide a framework for understanding land use patterns in informal settlements. • Existing relationships between communities and governments can be used to clarify access to land and services, and to negotiate regulatory issues. • Community finance can access and manage state subsidies (sometimes bridge funds are required). • Community initiatives can use savings and donor/governmental subsidies, and subcontract to construction companies.
Delivery of urban infrastructure	**Perceived risks** • Construction risks due to lack of site access / disruption by informal settlers.	• Community involvement in planning and design infrastructure can manage compensation and site access issues.

	• Reputational risks associated with involuntary displacement of informal settlers. • Financial risks associated with compensating beneficiaries where number and legitimacy are uncertain. • Large initial outlay to secure access to pre-finance subsidy monies. • Management of complex political relationships. **Low returns** • Low payment rate from households formally connected to utilities. • High rate of theft from urban infrastructure.	• Community information about entitlements can reduce risks and speed up resettlement. • Use of local labour inputs, organised through community finance to reduce labour costs. • Use of component sharing (co-production) can reduce costs of access and enhance viability of scheme.

Opportunities for extension of financial services to low income communities

There is an existing and under-served market for financial products that address the specific needs of residents of informal settlements. This includes the creation of financial services tailored to people with low and irregular income and lending for group housing and livelihood investment initiatives. The experience of grassroots organisations in Africa and Asia has demonstrated how group savings at city and national level can be used to reduce the risk of investment by banks and provide leverage to attract government and donor subsidies for poverty reducing development investment.

It is clear however, that more needs to be done to demonstrate the market and potential profitability and impact of offering tailored financial services to low income communities. Building on the existing evidence and experience of grassroots organisations, the following recommendations are made.

- Deepen the evidence base through further discussion with banks to identify the specific barriers and risks to creating financial products for residents of informal settlements and collection of further data on the performance of community savings to clarify the market opportunity for group lending and investment.

- Investigate how national and municipal government can provide loan guarantees or interventions to reduce the cost of borrowing for community level housing and livelihood development initiatives

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