LOW INCOME SHELTER FINANCE IN SLUM UPGRADING

INDIA URBAN INITIATIVES

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1.0 EXECUTIVE SUMMARY

1.1 Overview

This report summarizes findings from the USAID-sponsored project on models of financing for slum upgrading in India, undertaken on behalf of SPARC, a prominent NGO involved in slum upgrading in India and internationally for over two decades, and the National Housing Bank of India (NHB), one of whose main goals is enhancing housing finance for low income households. In preparing the recommendations, the Urban Institute and SDS India have worked together with USAID and an Advisory Group formed for this project. In addition to SPARC and NHB, the Advisory Group includes banks, HFCs, foundations, MFIs, builders, and Indian research institutions addressing shelter and microfinance.

Constraints to Slum Upgrading. Many international organizations, donors, and community groups are now addressing the increasing scourge of urban slums worldwide. The World Urban Forum in Vancouver in 2006 helped broadcast the urgency of the situation: over 1 billion people now live in slums worldwide and the number is growing rapidly. The Government of India, especially via the JNNURM, and the Indian states and municipalities are now devoting very major resources to slum upgrading. Yet progress has been slow, given the complexity of taking action. The report's authors, the Advisory Group, and USAID have summarized the key barriers to slum upgrading in India as follows:

- Lack of city-wide strategies for land & slums;
- Lack of community mobilization capacity;
- Lack of participation of developers in low-income housing projects;
- Lack of housing finance for low income households;
    - Lack of urban MFIs;
    - Lack of microfinance for housing;
    - Lack of medium-term funds for microfinance;
- Failure to adequately leverage subsidies and household loans and contributions to reach the maximum number of slum households;
- Lack of participation of banks in construction finance in slum projects; and
- RBI cap on FI lending for real estate activity.

This report primarily addresses the topics indicated in bold: lack of finance for low income housing, lack of participation of banks in construction finance in slum projects, and suggestions for credit enhancements to better leverage subsidies and household contribution. Our recommendations are addressed to NHB, banks and HFCs, urban MFIs, and developers.

1.2 Findings

The Urgent Need for Pilot Projects to Demonstrate Comprehensive Slum Upgrading Models. The Advisory Group has concurred that a comprehensive national policy for shelter delivery in slum upgrading will not be developed at the current time. Similarly, NHB does not anticipate a mandate at the national level for credit enhancement mechanisms for low income housing and shelter finance in slum upgrading. The hope is that such policy developments could follow from successful slum upgrading pilots. In essence, the pilots must show some clear successes if funds are to be devoted to national efforts.

The next steps therefore are to form a slum upgrading consortium. The consortium, a PPP, would seek to gain the cooperation of four or five cities, help develop city-wide slum upgrading plans, and organize community groups. Financial partners – banks and MFIs- would then be sought to provide construction and/or microfinance for housing loans (MFH). The MFH loans are not mortgage loans, but rather, are similar to non-collateralized micro loans, but may be somewhat longer-term or larger than most micro-enterprise loans. Following household surveys to determine affordability, the possibilities for combining subsidies and MFH would be determined.

Housing Subsidies, Microfinance for Housing Loans, and Affordability. A number of India's major cities are in the process of planning for, or undertaking, slum upgrading. The contexts vary along many dimensions, including land availability, tenure security, density, the availability of subsidy funds, the availability of shelter loans to slum dwellers, and so forth.

As one example, an innovative slum upgrading project in Mumbai, Oshiwara II, established a model for a public/private partnership among the organizing NGOs (SPARC and NSDF), a private sector bank providing construction finance (ICICI), and a guarantee for the bank loan from USAID's DCA. Mumbai is exceptional, however; land prices are such that the TDRs are adequate to finance the developers, and thus neither housing subsidies nor household borrowing was necessary.

In other cities, in contrast, a subsidy component is much more likely to be needed, as land prices are lower and it is not feasible to rely solely on TDRs to finance the projects. Household contributions in the form of savings and MFH loans can make a major contribution and help leverage subsidy funds, enabling the city to cover more slum areas and help support the very poor. Various combinations of MFH and subsidy funds, combined with low cost building approaches, can provide cost-effective approaches. Household surveys of slum dwellers, in India and elsewhere, reveal a remarkably broad income distribution in the slums, and many can afford modestly-sized housing loans.

MFIs, Banks, and Foundations: New Developments in Low Income Finance in Urban Settings. India is now host to a wide variety of innovative pilot projects in low income housing lending and microfinance. For example, the World Bank/FIRST has supported the Monitor Group in developing pilot projects for modest income housing finance. The Gates Foundation is supporting ICICI in a moderate income housing finance project in Chennai, and SEWA and CHF are developing slum upgrading projects in Nagpur. ICICI has pioneered various bank/MFI partnerships in microfinance, including securitization of MFI portfolios.

A key constraint, however, is the lack of urban MFIs – and therefore urban microfinance and microfinance for housing. The focus of India's microfinance industry has traditionally been rural, and key MFIs have only recently begun to address the urban populations. In addition, MFH, a rapidly growing micro loan product in many parts of the world, is not widely available in India. Although SEWA Bank has offered MFH for many years, it has not spread among other MFIs.

Credit Enhancement Policy in Slum Upgrading. Increasing down market lending, whether for housing or micro-enterprise loans, can often benefit from credit enhancement. Different types of credit enhancement are suitable for different target groups in down market lending strategies. With regard to housing, India is planning on addressing several approaches. For mortgage loans to households with incomes close to the current target groups of the banks and the HFCs – private mortgage guarantee insurance (MI) may be appropriate. NHB has been involved in bringing private MI to India for some time. For more modest income households in the Monitor pilots, another type of MI, funded for the pilot by foundations and donors, may be tested. The common theme, however, is that collateralized mortgage loans are being supported with a partial guarantee.

In contrast, for slum households with MFH loans, a different form of credit enhancement is appropriate. These MFH loans are not collateralized, and the guarantee process differs accordingly. It should also be noted that strong community organizations are important for the household finance aspects of slum upgrading. While the housing microfinance loans would be to individuals rather than to a group, the community groups are crucial for assistance with underwriting, eligibility, servicing and peer pressure in repayment.

1.3 Recommendations

Form a Public/Private Partnership for Shelter Development in Slum Upgrading. The Advisory Group agrees on the need for coordinated action on the part of a broad array of groups to address the multiple issues in slum upgrading. In order to undertake the tasks required to initiate the actions, a Public/Private Partnership - PPP - should be formed representing the key actors. These include:

- municipal authorities, including the mayor, city planners, subsidy fund managers;
- SPARC, NSDF, and other NGOs dedicated to community organization and coalition building;
- financial institutions, including banks and MFIs willing to develop and market low income financial products; and
- the National Housing Bank, together with donors or foundations able to help develop and fund credit enhancement mechanisms for supporting downmarket lending.

SPARC has already taken the lead in engaging cities in this process, and has initiated discussion with Pune and Bangalore. SPARC has also drafted a detailed proposal for the actions needed for community-managed slum upgrading. SPARC and its community organization partners Mahila Milan and NSDF have extensive experience in community organizing, and will also seek to work with other NGOs. The municipal authorities will be urged to develop slum upgrading plans targeting major slum areas. Together with MHUD, and JNNURM, the municipal authorities would address subsidy policies for infrastructure services and housing. NHB has agreed to lead the finance aspects of these efforts and to develop credit enhancement tools that will support lending to low income households.

The consortium must work closely together, and it is suggested that the consortium meet at least quarterly.

Bank/MFI/NGO Partner Models in Financing for Slum Upgrading. One of NHB's key roles will be to develop the framework for financial planning and the financial model specific to the slum upgrading context in each city. NHB will take the lead in bringing financial institution partners into the PPP and helping determine what type of bank/MFI/NGO model is appropriate to facilitate microfinance for housing loans for qualified slum dwellers. At issue are which partner carries the MFH loans on its books and how outreach, underwriting, and servicing are to be handled.

Development Credit Enhancement Mechanisms. In addition, it is likely that a credit enhancement product will be needed to facilitate this lending, and NHB can work with the partners and the consortium to determine the parameters of the guarantee policy. Clearly, the banks need to see the project design and financing expectations before they will agree to a role in the project; the credit enhancement is expected to help the banks overcome the risk barriers that are traditionally assumed for such low income projects.

In order to learn as much as possible from the pilots, it would be useful to seek cities with different profiles for housing needs, land availability, and densities, and thus develop different slum upgrading strategies. Depending on city size and density requirements, construction finance for mid-rise developments may be required along with household loans. The need for construction finance for mid-rise buildings in higher density cities adds to the complexity of financing process, as compared with smaller cities where microfinance for housing loans can be applied to improve or build single family dwellings. Thus, it may be necessary to provide a credit enhancement for the construction loans as well.

Undertake Household Surveys. Information from household enumeration and household surveys is crucial to determining eligibility, ability to pay, and savings capacity. Worldwide, household surveys have been proving invaluable to assist in developing approaches to subsidy policy and MFH loans to households in slum upgrading programs; as noted, slum households are far from homogeneous as far as income levels. Key data would include:

- Household descriptors
- Household income distribution
- Household sources of livelihood
- Savings rates

Getting accurate information on income from household surveys has always been difficult. The consumption approach should be used in addition to, or perhaps instead of, the traditional questions. This is an approach utilized worldwide and can be based on the World Bank's Living Standards survey.

Develop and Test Savings Programs in Slum Upgrading Projects. Savings play two crucial roles in low income lending: first as an important underwriting tool, demonstrating ability and willingness to pay, and second as collateral for MFH loans, whereby savings may be kept on deposit at the lending institution. India has had vast experience with savings groups. However, access to banks and banking services has been a serious barrier for urban low income and slum households. Both appropriate savings products and the means to link the poor and the financial institutions are required. Again, the potential lenders must be involved at an early stage of the project to help NHB develop savings products.

Include Income Generation Projects. Income generation should be an integral part of the slum upgrading process to enhance affordability and repayment capacity. Leakage from slum upgrading will occur unless the households have the means to stay involved and pay their loans. Thus, based on experience in livelihood generation, it is suggested that income generation activities be included in the plans. It should also be noted that for households whose income generation activities are wholly or in part based in the home, MFH loans can support improved income generation.

2.0 INTRODUCTION

This project was sponsored by USAID on behalf of two key entities in low income housing in India: the National Housing Bank of India, charged with assisting mortgage finance and low income shelter lending, and SPARC, a leading urban NGO with experience in worldwide as well as in India. A key aspect of the work was to convene an Advisory Board to meet with USAID project staff who helped and guide the project's work and develop the conclusions. The Advisory Board included members from the National Housing Bank, SPARC, USAID, banks, HFCs, MFIs, builders, and research institutions addressing issues in low income lending.

In the past year in India, the landscape for low income shelter lending has changed dramatically, due to public policy initiatives, private sector and NGO activities, and policy initiatives and funding from international foundations and donors. Initiatives have come from NGOs such as SPARC, NSDF, and SEWA; from banks, particularly ICICI; from public bodies such as JNNURM, and the Mumbai Slum Rehabilitation Authority; from research by IFMR; and internationally from the Gates Foundation and MSDF. All of this activity is propelling low income shelter finance far more rapidly than only months ago.

Examples of these recent initiatives include the following:

Banks, Donors, NGOs, and Foundations

- SPARC, with ICICI, USAID's DCA, and CLIFF, piloted a construction finance loan for NGO-led slum upgrading;
- SEWA, SEWA Bank and CHF are piloting a slum upgrading program in Nagpur that combines MFH with JNNURM subsidies;
- The Monitor Group, supported by FIRST, is planning pilots for housing loans and low cost new home construction for modest/low income households;
- The World Bank may help set up a credit guarantee scheme for the Monitor pilot, with the participation of MSDF and the Acumen Fund;
- ICICI/Gates/DIG are developing a Service Center for modest income housing finance in Chennai;
- IFMR is studying of urban MFIs, microfinance for housing, market analysis for the Chennai project, and the first of several studies for savings products;
- MSDF is studying microfinance for new construction; and
- ICICI is developing MFI agent models and securitization of MFI portfolios.

Government: NHB and RBI

- The sub-committee for potential risk mitigation measures for low income housing lending is headed by Mr. S. Sridhar, CEO of NHB;
- RBI has reduced the risk weights for low income housing loans under Rs. 2 lakh, reducing them from 75% to 50%; and
- Approval of mortgage guarantee insurance in India is proceeding, with Mr. Verma. Executive Director of NHB, heading the Working Group. As discussed in this report, this could be important for the Monitor and Chennai target groups.

Slum Upgrading Consortium and a Credit Guarantee Pilot. Given these innovative initiatives, India is now providing models of ***modest income*** shelter finance development to be shared with the rest of the world. However, the plight of ***slum households, and other low income households***, with regard to shelter finance is not being adequately addressed. In this context, the main task for this project was to devise models of shelter finance for slum upgrading and redevelopment. Such financing strategies are to be part of a coordinated upgrading effort, as described below. In addition, the project is offering suggestions to NHB on leveraging low income shelter finance via credit enhancement mechanisms, and in particular, to structure such a credit enhancement to be compatible with that proposed for modest income shelter finance pilots being implemented by Monitor. For slum households, similar to the Nagpur households as discussed in this report, a credit guarantee scheme for low income housing is a very relevant risk mitigation technique.

As agreed at the last meeting of the Advisory Committee for this low income shelter project (October 2007), NHB will join SPARC in 4 or 5 slum upgrading pilots, focusing on the finance aspects of the program. SPARC has already entered into discussions with Pune and other cities, the idea being to seek a variety of urban settings with regard to size, density, slum populations, and so forth. USAID intends to solicit assistance from a number of sources to help support the consortium in its efforts.

Outline of the Report

Section 3.0 provides a housing loan affordability analysis based income data for slum households in a number of cities in India. An income analysis of the Nagpur slum upgrading project is presented, illustrating various combinations of microfinance for housing loans and subsidy funds. The data reveal that many of the slum households can afford microfinance for housing loans that will make a significant contribution to improving their housing. When combined with the subsidy funds available to Nagpur from JNNURM, the analysis illustrates how increased household contribution to slum upgrading can leverage the subsidy funds.

However, the issue in India, as in many other countries, is how to achieve slum upgrading at a significant scale. In India, the lack of urban MFIs and the relative absence of experience with microfinance for housing, limit the scope of loan/subsidy combinations in the short-term. Historically, MFIs in India have focused on rural issues, but are now moving into urban areas. Section 4.0 provides an overview of international practice in microfinance for housing and notes the recent move toward more urban MFIs in India.

Section 5.0 discusses examples of credit enhancement policies that can assist both down-marketing of mortgage finance to modest income target groups and down-marketing of microfinance for housing to slum households. Examples elsewhere show that incentives for sharing risk can assist in low income shelter finance and slum upgrading projects.

Finally, Section 6.0 presents the project’s recommendations.

3.0 ALTERNATIVE AFFORDABILITY MODELS FOR HOUSING FINANCE IN SLUM UPGRADING

Numerous challenges face urban slum upgrading, including granting land tenure rights to slum households; alignment of landholdings for ease of movement and provision of network services and community facilities; reclamation of part of the habitation for alternative developments, in some cases; and, facilitating the households to access shelter loans for upgrading or the dwellings. Although each of the issues is important for sustainable slum upgrading efforts, this study focuses, as noted, primarily on issues relating to the last issue above: low income housing finance. This section provides a case study of alternative affordability models for funding housing with various combinations of shelter loans and subsidy funds. The analysis uses data assembled for a slum upgrading project in Nagpur that is being undertaken by the Nagpur Municipal Authority with the assistance of SEWA and CHF.[1] The data include individual household incomes, which have been aggregated into quintiles for use in the affordability analysis.

The financing plan for households participating in slum upgrading should be based on an assessment of the following:

- Household affordability: the ability to mobilize the capital from own sources including stock of savings, sale of jewelry and household assets, and borrowings (often interest free) from employers, friends and relatives;
- The loan absorption capacity of borrowers in terms of ability to service a shelter loan;
- The creditworthiness of the households from the perspective of financing institutions – banks, housing finance companies (HFCs) and micro finance institutions (MFIs);
- The implications of lenders' risk perception on their willingness to lend and the terms of the lending; and
- The manner in which public subsidy funds (or other funds) are used to fill the gap between dwelling cost and households ability to mobilize resources, including borrowing.

The assessment of alternative models for housing finance in slum upgrading presented here is based on analysis of data for 6,322 slum households in Nagpur, living in temporary and semi-permanent dwellings in 16 slum settlements in the city. The Nagpur Municipal Corporation (NMC) has prepared a Detailed Project Report (DPR) for upgrading these 16 slum settlements by providing new dwellings on the same site to these 6,322 households along with basic urban services. In Nagpur city, 37.5 percent of the people live in slums according to 2001 Census. The 30,108 slum households are spread over 427 settlements, of which 292 are notified slums, and 81.6 percent of the households live in temporary and semi-permanent dwellings.

3.1 Costs of Slum Upgrading and Household Affordability Analysis

The Nagpur Municipal Corporation has prepared 7 prototypes of new dwellings to be constructed at the existing site for the slum households. The built up area of the dwellings ranges from 24 to 36 m2, with costs between Rs. 113,000 and Rs. 154,000. On average, the dwelling size is 25 m2 and the unit cost is Rs. 141,967. The dwellings are to be constructed as row housing and are single or double-storey structures. The project will be executed by private sector construction companies, with a cost of construction for a 25 m2 dwelling for slum households of approximately Rs.142,000. This cost is adequate in urban centers in

[1] CHF International kindly provided the data for this analysis; it includes income information for individual households in 16 slum settlements in Nagpur.

India such as Nagpur, since the costs do not include land; the cost of construction does not vary greatly across cities in the country (not nearly as much as the cost of the land).

As would be expected, studies in India have confirmed that slum households have substantially lower median income levels than the median for the city in which they live. However, income levels vary considerably across cities and within the slums in each city. Illustrative examples come from collaborative policy research by the Society for Development Studies (SDS) and the World Bank, in a project entitled Information-Based Strategies for Urban Management. As part of the policy research, an extensive ward level database based on household surveys was developed for Bangalore, Bhopal, Jaipur and Pune. The data in table 3.1 show that the median income level of slum households is substantially lower than the city average (varying between 17.1 percent of the city average in Jaipur and 77.9 percent in Pune) and varies widely across these cities.

In the examples that follow in sections 3.2 and 3.3, the resource mobilization capacity of households for upgrading or new dwellings is variously assessed for three hypothetical scenarios:

- Scenario I - households having access to home loans at current lending terms for the formal mortgage sector: 11%, an “ideal” situation, but not likely.
- Scenario II - households having access to home loans though a financial intermediary in the form of NGO, cooperative or MFI in partnership with a bank at an interest rate of 14% and a term of 3 or 5 years: a more likely situation. Thus, it is assumed that financial intermediation impacts the resource mobilization capacity of households through higher loan costs via higher interest rate and a shorter repayment period.
- Scenario III - households having access to home loans through a financial intermediary at more realistic lending terms for low income households – 17% interest and a term of 3 years: also more likely.

Table 3.1: Loan Mobilization Capacity Of Slum Households For New Dwellings[2]

Scenario I	Bangalore	Bhopal	Jaipur	Pune
Median Income - Citywide (Rs. per month.)	8,666	5,722	4,699	6,304
Median Income - slums (Rs. per month.)	5,376	3,126	802	4,909
House Cost (Rs.)	141,967	141,967	141,967	141,967
EMI (30% Income)	1,613	938	241	1,473
Scenario II				
Home Loan (roi-14%; term 5 years)	138,207	80,364	20,618	126,202
Loan as % of cost	97.4	56.6	14.5	88.9
Scenario III				
Home Loan (roi-17%; term 3 years)	113,580	66,046	16,945	103,717
Loan as % of cost	80.0	46.5	11.9	73.1

The financial institutions in India, as elsewhere, have been apprehensive about launching direct lending operations with slum households. Discussions with housing lenders in India confirm that the small loan size

[2] Income data are based on consumption estimates using the modified version of World Bank Living Standard Measurement Survey (LSMS) methodology. The data are for to 2001-2003. Source: SDS-World Bank Policy Research on Information-Based Strategies for Urban Management.

and large number of accounts would raise their costs of loan management, and that the operations with numerous slum households might not be viable. Thus, the lenders are keen to have an intermediary - an MFI, NGO, or cooperative – to undertake loan origination, delivery, and collection. This, using Scenarios II and III, Table 3.1 illustrates affordability for slum households in Bangalore, Bhopal Pune, and Jaipur

Households in the first three cities have a reasonable capacity to service a shelter loan for a dwelling costing Rs. 142,000. As noted, Scenario II assumes an annual rate of interest of 14 percent, a loan term of 60 months and Equal Monthly Installments (EMI) of 30 percent of monthly household income. Under this Scenario, slum households have the capacity to mobilize a home loan equivalent to 56.6 percent to 97.4 percent of the (assumed) dwelling cost in three of the cities. Slum households in Jaipur, however, have the ability to mobilize only 14.5 percent of the cost.

This financial intermediation, however, would clearly have higher cost implications for the borrowers, for example, in terms of higher interest rates and, possibly, shorter loan terms. Thus, an alternative loan structure is presented as Scenario III in table 3.1. The interest rate has been increased by 3 percentage points to 17 percent and the term reduced from 5 to 3 years. Even with these changes, slum households in Bangalore, Bhopal and Pune have reasonable affordability for servicing a loan covering 46.5 percent to 80.0 percent of the dwelling cost.

3.2 Nagpur Affordability Analysis: Housing Loans and Subsidies for Slum Upgrading in Nagpur

The Nagpur Municipal Corporation has assumed that the households participating in the slum upgrading project have limited affordability for new or improved dwellings. Thus, a limited number of slum households are being provided with a subsidy equaling 88 percent of the dwelling cost and are being facilitated to access a housing loan to meet their own contribution of Rs. 17,000 towards the cost of dwelling unit (Rs. 142,000). The total cost of construction of 6,322 rehabilitation units is estimated at Rs. 897.8 million, with a subsidy component of Rs. 790.0 million and household contribution (home loans) of Rs. 107.8 million.

As indicated in table 3.2, the Nagpur slum households participating in the project, with median income of Rs. 2,000 per month would have to service a loan of Rs. 17,000 at the current market lending terms for housing finance lenders. Scenario I assumes an annual interest rate of 11 per cent and loan term of 60 months; the EMI for the loan would be Rs. 371, which is 18.6 percent of the median monthly income for the Nagpur households – well within the accepted norm of 30 percent. Analysis of household affordability for each quintile also supports the finding that the households have the ability to service the loan of Rs. 17,000 on these “ideal” terms. The EMI as percentage of median monthly income varies between 9.8 for households in Quintile V (relatively better off group) and 30.9 percent in Quintile I (the relatively poor group).

However, as noted, although the financial institutions may accept that the project participants have adequate loan absorption capacity, they are apprehensive of launching direct lending operations and would like to have an intermediary: a cooperative, NGO, or MFI. This financial intermediation would have cost implications for the borrowers in terms of a higher interest rate and shorter loan term; thus the interest rate in Scenario II is expected to rise by at least 3 percentage points to 14 percent per annum and the loan term may fall to 3years. The repayment of higher EMI of Rs. 582 would still be affordable for households in Quintile III where the EMI would account for 29.1 percent of the monthly income, and clearly to the higher income groups. Affordability suffers, however, for the lower income groups. Thus, while the loan in

Scenario II would be beyond the repayment capacity of households in Quintiles I and II, the EMI would be affordable for Quintile III, IV and V households (see table 3.2).

Table 3.2: Nagpur Slum Households' Affordability Analysis

Income Level/ Affordability	Quintile I	Quintile II	Quintile III	Quintile IV	Quintile V	All Households
Income Range (Rs. per month)	150-1,500	1,500-1,800	1,800-2000	2,000-3,000	3,000-15,225	150-15,225
Median Monthly Income (Rs.)	1,200	1,500	2,000	2,500	3,800	2,000
Households with Regular Savings (%)	15.91	20.06	29.89	37.13	48.51	29.89
Average Dwelling Cost (Rs.)	141,967	141,967	141,967	141,967	141,967	141,967
Subsidy (88% of Cost) (Rs.)	124,931	124,931	124,931	124,931	124,931	124,931
Home Loan (Rs.)	17,036	17,036	17,036	17,036	17,036	17,036
Scenario I						
EMI (@ 11%, 5 Year Term) - HFC	371	371	371	371	371	371
EMI as % of Income (HFC)	30.9	24.7	18.6	14.8	9.8	18.6
Scenario II						
EMI (@ 14%, 3 years term) - (MFI)	582	582	582	582	582	582
EMI as % of Income (MFI)	48.5	38.8	29.1	23.3	15.3	29.1

3.3 Equity Concerns and Leveraging Subsidy Funds in Nagpur

As noted, the Nagpur Slum Upgrading Project covers only 6,322 households out of a total of 24,579 households living in temporary or semi-permanent dwellings and only 16 slums settlements out of 427 slum pockets in the city. This raises an important issue: equity concerns for applying all subsidy funds to only a few households versus spreading the subsidy across all households in Nagpur. In addition, given the differential affordability capacity for housing loans, it should be possible to better leverage the subsidy funds. In sum, two key issues are:

- *Equity*: the provision of highly subsidized new dwellings (covering 88 percent of the cost) to only one-fourth of the slum families in Nagpur raises equity concerns, since a significant proportion of the households not covered by the Project do not have the affordability to upgrade their dwellings without access to subsidy (as well as housing loans); and

- *Leveraging household resources using the subsidy funds*: the resource mobilization potential of households participating in the project, from own sources and home loan, is not being fully harnessed since a uniform subsidy is being provided to all households.

The potential for citywide coverage of slum households under the Project and provision of differential subsidy based on household affordability is examined below.

3.3.1 Simulations of the Resource Mobilization Capacity of Households

In Scenario I (the "ideal" situation), shown in table 3.3, cost of loan is assumed to be 11 percent; the loan-to-value ratio (LTV) may vary between 50 and 70 percent, the loan repayment capacity (EMI) is between 25 to 35 percent of monthly income; and loan terms of 3, 5, and 7 years are utilized. The table shows the amount of resources that the median income household could afford under these various terms.

However, in the more likely situations, in contrast, Scenarios II and III, the cost of loan would be substantially higher in order to cover the assumed risk and the operations cost of a financial intermediary. The interest rate assumed to be 14 or 17 percent, and the loan term is 3 years, due to the more limited capacity of intermediary to manage relatively longer term loans. The LTV is likely to be 50 percent and monthly loan repayment ability may be assumed to be between 15 – 25 percent of the household income. The resource mobilization capacity of slum households in these hypothetical scenarios is presented in table 3.4.

Table 3.3 Household Resource Mobilization Capacities For Median Income Households Under "Ideal Market" Terms (Rs.)

Loan Term (in years)	EMI as % of Monthly Income		
	25%	30%	35%
LTV – 70%			
3	25,453	26,180	30,544
5	33,629	40,355	47,081
7	41,722	50,067	58,411
LTV – 60%			
3	25,453	30,544	35,364
5	39,234	47,081	54,928
7	68,146	58,411	68,146
LTV - 50%			
3	30,544	36,652	42,761
5	47,081	56,497	65,913
7	58,411	70,093	81,776

Note: Estimates are based on 11% rate of interest and calculation are made for the median household Income of the Nagpur slum households in the database.

Table 3.4: Households' Resource Mobilization Capacity: More Likely Situations (Rs.)

	Income Quintiles					Median
	QI	QII	QIII	QIV	QV	
EMI as % of Monthly Income	25%					
RoI – 14%	17,556	21,944	29,258	36,574	55,592	29,258
RoI – 17%	16,830	21,036	28,048	35,060	53,292	28,048
EMI as % of Monthly Income	15%	20%	25%	30%	35%	25%
RoI – 14%	10,534	17,556	29,258	43,888	77,828	29,258
RoI – 17%	10,098	16,830	28,048	42,072	74,608	28,048

Note: Estimates based on LTV of 50% and loan term of 3 years.

3.3.2 Project Cross-subsidization and Lower Cost Approaches to Construction

The affordability assessment of slum households in Nagpur shows that without any subsidy they do not have the resource mobilization capacity for a new dwelling (and would at best be able to undertake upgrading of their existing dwellings if provided with access to a housing loan). Thus, access to new dwellings by these households is highly dependent on subsidy support, and a case can be made for approaches that provide support for more households – e.g. a wider distribution of the total subsidy funds of Rs. 790 million available to the NMC, rather than restricting the distribution to 16 slum settlements. The possibilities of project-level cross subsidization by higher income to lower income households should be explored. The households in Quintiles IV and V might receive a lower subsidy amount or be charged a higher interest rate to subsidize the interest rate charged for households in Quintile I and II. In addition, various lower cost approaches to construction can greatly assist with affordability.

On-site New Dwellings – Cross Subsidization by Subsidy. One approach in a subsidized development program would be to use subsidy funds to leverage household resources to achieve higher program coverage. As has been discussed, the NMC is planning to provide a uniform subsidy of Rs. 124,931 per dwelling unit to be constructed in 16 settlements under the slum upgrading project, without taking into consideration the variation in resource mobilization capacity of households across income groups. However, a differential subsidy approach is feasible. The subsidy requirement for a citywide coverage of the slum upgrading project with differential unit subsidy by income groups is estimated at Rs. 2,646 million (Table 3.5). The approach would help NMC to achieve its objective of providing new dwellings measuring 250 sq. ft. to slum households with lower per unit subsidy of Rs. 113,919.

Table 3.5: Differential Subsidy Model for Citywide Contractor-driven Slum Upgrading in Nagpur

Income Quintiles	No. of HH	Unit Cost of Dwelling (Rs.)	HH Resource Mobilization Capacity (Rs.)	Subsidy Required per HH	Total Subsidy (in Rs. million)
QI	4,916	141,967	10,098	131,869	648.3
QII	4,916	141,967	16,830	125,137	615.2
QIII	4,916	141,967	28,048	113,919	560.0
QIV	4,916	141,967	42,072	99,895	491.1
QV	4,915	141,967	74,608	67,359	331.1
All HH	24,579	141,967	28,048	113,919	2645.6

Note: the household resource mobilization capacity is taken from Scenario III, assuming an interest rate of 17% for a 3 year loan.

3.3.3 Cost-Saving Models in Slum Upgrading

Alternative modes of cutting costs should also be explored. The examples below use the Nagpur data to look at a community construction approach, using land a resource as is done in Mumbai slum upgrading projects, and assuming that households only upgrade their units rather than obtaining new housing.

On-Site New Dwellings – Community-Driven Project. NMC is planning to provide slum rehabilitation tenements in single and double-storey structures and the project is to be executed by private contractors. The contractors have estimated the cost of construction of slum tenements at Rs. 600 per sq. ft. However, if the households and community groups were to take up the responsibility of constructing the new dwellings themselves, the cost of construction could be reduced to Rs. 350 per sq. ft. and the unit cost would be as low as Rs. 87,500 per dwelling. The subsidy requirement for a citywide coverage of the community-driven slum upgrading project, with differential unit subsidy by income groups, is estimated at Rs. 1,307 million (Table 3.6). The approach would help NMC to achieve its objective of providing new dwellings measuring 250 sq. ft. to slum households with lower per unit subsidy of Rs. 59,452.

Table 3.6: Subsidy Required for Citywide Community-driven Slum Upgrading in Nagpur

Income Quintiles	No. of HH	Unit Cost of DU (Rs.)	HH Resource Mobilization Capacity (Rs.)	Subsidy Required per HH	Total Subsidy (in Rs. Million)
QI	4,916	87,500	10,098	77,402	380.5
QII	4,916	87,500	16,830	70,670	347.4
QIII	4,916	87,500	28,048	59,452	292.3
QIV	4,916	87,500	42,072	45,428	223.3
QV	4,915	87,500	74,608	12,892	63.4
All HH	24,579	87,500	28,048	59,452	1306.9

Note: the household resource mobilization capacity assumes Scenario III, an interest rate of 17% for a 3 year loan.

Using Land as a Resource. The slum upgrading could be financed by making intensive use of land under slum habitation and using it as a resource for providing new dwellings to the slum households (Mumbai Slum Rehabilitation model). The builders implementing the project may be given incentive FSI (Floor Space Index) to construct free-sale tenements and cover the cost of providing affordable dwellings to the slum households. In Mumbai, builders implementing slum rehabilitation projects are able to fully cover the construction cost of slum tenements with the incentive FSI and the rehabilitation tenements are provided free of cost to slum households. In view of the relatively lower land prices in Nagpur compared to Mumbai, the builders may not be able to fully cover the cost of rehabilitation tenements with the incentive FSI and the beneficiaries would have to contribute to meet the shortfall from own sources and home loan. In certain locations where the land prices are very low and the contribution of builders and households is not able to fully cover the cost of rehabilitation units, there is the case for subsidy support on differential basis across income groups based on household affordability.

Upgrading Only Approach. As noted, the affordability analysis of Nagpur slum households shows that they do not have the ability to pay for new units without subsidy. However, in the absence of subsidy support, the slum households may be facilitated by NMC to upgrade their existing dwellings. The three complimentary components that should be provided by the municipal authorities for a facilitating package for a household-led upgrading project are:

- Access to a housing loan for upgrading ;
- Land-titling for tenure security; and
- Provision of basic urban services.

In this example, the households' affordability for upgrading has been assessed at Rs. 28,048 per unit and the total outlay on upgrading all slum tenements in the city is estimated at Rs. 843.8 million (Table 3.7). The households' resource mobilization plans include home loan equivalent to 50 percent of the upgrade cost.

The NMC would need to facilitate flow of home loan of Rs. 421.9 million for citywide slum upgrading efforts and this may be feasible only with financial intermediation of an NGO, cooperative, or MFI.

Table 3.7: Home Loan Required for Citywide Upgrading of Slum Tenements in Nagpur

Income Quintiles	No. of HH	Affordable Upgrade of Existing DU (Rs.)	Total Upgrade Outlay (in Rs. Million)	Home Loan Requirement (in Rs. Million)
QI	4,916	10,098	49.6	24.8
QII	4,916	16,830	82.7	41.4
QIII	4,916	28,048	137.9	68.9
QIV	4,916	42,072	206.8	103.4
QV	4,915	74,608	366.7	183.3
All HH	24,579	28,048	843.8	421.9

Note: the household resource mobilization capacity is taken from Scenario III, assuming an interest rate of 17% for a 3 year loan.

The other complimentary inputs to home loan facility should be provision of urban basic services in the slum habitations, including water, waste management services, street pavements and street-lighting, among others, and security of tenure. While the former is the core responsibility of NMC and would largely contribute to improvement of quality of life in the habitations, latter would encourage the households to invest in home improvement and lenders to provide home loan to households.

Summary of Financing for Alternative Slum Upgrading Plans. Slum households are not uniformly extremely poor; many have sufficient income to afford modest housing loans. The use of subsidy funds in only 16 habitations in Nagpur rather than coverage of all the 427 habitations introduce citywide inequities and limits leveraging of household resources using subsidy funds. Households with no subsidy support cannot afford new dwellings and the maximum affordable loans can cover only cost of house upgrade.

Table 3.8: Financing Plan for Alternative Slum Upgrading Models

Slum Upgrading Model	Total Subsidy (Rs. in million)	Total Housing Loans (Rs. in million)
Contractor-driven Construction of New Dwellings in 16 Slum Habitations, Uniform Subsidy per unit	790	108
Contractor-driven Citywide Construction of New Dwellings, Differential Subsidy per unit	2,646	422
Community-driven Citywide Construction of New Dwellings, Differential Subsidy per unit	1,307	422
Citywide Upgrading of Existing Dwellings by Slum Households	-	422

Household/community driven approach to construction of new dwellings is cost effective and would require less subsidy. Project design with community-driven construction of new units and differential unit subsidy based on household affordability across income groups would help leverage higher amount of local resources. With an increase in subsidy by less than twice the amount planned presently under the Nagpur Project, coverage would increase four times and include all slum households in the city. Table 3.8. summarizes the total cost – for subsidies and housing loans - of the various options.

3.4 Other Partners in Slum Upgrading: Developers, Construction Finance, and NGOs

The conclusions above are based on the premise that loans would be available to the slum households and that NGOs, cooperatives, and/or MFIs would serve as financial intermediaries and community organizers. Thus, the involvement of these groups needs to be addressed. This section summarizes the comments of selected developers, financial institutions, and NGOs in India that were interviewed in the course of this project. Sections 4.0 and 5.0 then provide a discussion of worldwide efforts in developing low income housing loan products – microfinance for housing – and credit enhancements that provide risk-sharing support to involving financial institutions in lending for low income households.

In India, previous slum upgrading efforts were largely driven by government agencies – the government agencies being the benefactor and the slum households the beneficiary. These programs were subsidized with budgetary funds and a top-down planning and delivery approach was adopted. The beneficiary contribution to the cost of the new dwellings was minimal and there was little community involvement in the planning, designing and delivery process. In the case of slum upgrading projects implemented with credit support from financial institutions, the recovery rate from the households was very low and this discouraged the government agencies from adopting this delivery route for upscaling slum upgrading efforts.

In the present scenario of high slum concentration in cities, phasing out of government subsidies in development programs and low availability of land for large-scale green-field rehabilitation projects, there is the strong need to mobilize private sector partners in slum upgrading efforts. The key private sector players that could contribute greatly to such efforts are financial institutions, private sector real estate developers and builders, and the civil society. The potential role of these players and the factors that could facilitate their greater involvement in slum upgrading are discussed below.

Private Developers. The involvement of private sector real estate developers and builders (private developers) in slum upgrading projects in the past has been as contractors to government agencies and they were paid on a work rate basis. The private developers have the lead role in implementing these projects and take the responsibility for land assembly (redevelopment of encroached land or green-field), mobilization of contributions of slum households towards cost of new dwellings and construction finance from financial institutions, and construction and delivery of dwellings. It emerged during discussions with the private developers, the Confederation of Real Estate Developers' Association of India (CREDAI) and the Maharashtra Chamber of Housing Industry (MCHI), that the private developers are willing to take the lead in slum upgrading projects but require a conducive policy environment. This is missing in most states in the country, except Maharashtra. The facilitating policy may be framed by state governments on the lines of Slum Rehabilitation Scheme (SRS) in Maharashtra, where the private developers are given an incentive FSI based on the floor area of free slum tenements constructed.

The private developers' participation in low-income housing is dictated by the market demand for low-income housing priced on a full-cost principle. The low-income households have low affordability for units priced on full-cost principle and the financial institutions are apprehensive of lending to them due to their low repayment capacity. Low-income housing can be given a boost by providing direct subsidy to low-income households to bring down the unit cost within their affordability. This could be in the form of capital subsidy, by way of providing subsidized lands for low-income housing projects, a supply-side subsidy for construction, or interest rate buydown to improve the loan absorption capacity of the low-income households.

Slum Upgrading in Mumbai and Elsewhere in India. Discussions with the private developers participating in SRS in Mumbai revealed that construction finance is not a roadblock in executing residential projects, including slum upgrading, in the prevailing buoyant real estate market. The two major sources of finance for these projects are, first, construction-linked payments by buyers of residential units (free-sale units in the case of slum upgrading projects) and, second, construction finance from financial institutions by offering project land as collateral. In the case of slum upgrading projects, other on-going projects are offered as collateral by the developers to financial institutions. The developers are able to contract construction finance with relative ease from financial institutions despite frequent advisory from the Central Bank to financial institutions cautioning against lending for real estate projects in view of the buoyant market conditions.

There are three caveats to this model, however:

- the exceptionally high land price and high demand situation prevailing in Mumbai, which permits the use of free-sale units to help finance construction costs, does not exist in most other areas of India;
- there are too few large and experienced NGOs able to undertake effective community organization; and
- many small builders and/or socially-oriented builders cannot obtain construction finance because the banks view their balance sheets as too weak.

The land-price/housing demand/regulatory situation prevailing in Mumbai, which “finances” house construction in the slums via the use of tradable development rights (TDRs) does not exist elsewhere in India. Analysis by the World Bank suggests that this structure results, in part, from excessive regulation governing land administration and construction (and Mumbai would benefit greatly from reform of the plethora of land and building regulatory restrictions).[3]

In addition, a major roadblock for the private developers in implementing slum upgrading projects throughout India is the lack of facilitating interface with the community through the Non-governmental Organizations (NGOs). NGOs such as SPARC take the responsibility for mobilizing the community into cooperative society for implementing slum upgrading project, agreement between the community and builders on deliverables and delivery schedule, and moving the community members to transit camps during the construction phase. In the absence of the NGO interface, the private builders assume this responsibility, and many of them are not professionally equipped. This leads to construction delays and cost over-runs. There simply are not enough NGOs with the experience and resources of groups like SPARC and NFSD to take on slum upgrading on a large scale in multiple cities in India.

Finally, NGOs such as SPARC, are concerned that private builders do not provide adequate housing to slum dwellers. NIRMAN, the construction arm of SPARC, has undertaken slum development projects in Mumbai (the Oshiwara projects). However, because NIRMAN could not obtain construction financing, this project has required a bridge loan from CLIFF, and a construction loan guarantee from USAID’s DCA program.[4]

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[3] Reforming Mumbia’s Real Estate Raj: a Prelude to a Business Plan, World Bank, Draft, December 2005.

[4] Independent Evaluation of the Community-Led Infrastructure Finance Facility, Cities Alliance and GHK, September 2006.

Financial Institutions and Construction Finance. Financial institutions in India have widespread lending operations to private developers to finance construction of residential projects, including slum upgrading. The financial institutions are providing increasing construction finance exposure to private developers since the default rate in the sector is low compared to other economic sectors, the loans are adequately secured through mortgage of project lands and LTV ratio is low in construction finance. The added business incentive for financial institutions in such lending operations in most cases is that the construction finance to private developers is converted into home loan for buyers.

In contrast to SRS in Maharashtra, the households covered under slum upgrading projects in other parts of the country are not necessarily provided with free rehabilitation housing and have to contribute towards the cost. In the case of slum upgrading projects being implemented in Nagpur, for example, the households have to mobilize 12 percent of the house cost from own account. The affordability analysis of the slum households in Nagpur revealed that, first, a large proportion of the households require access to home loan facility to mobilize own contribution and, second, they have the capacity to repay the home loan.

As discussed above, from the perspective of the analysis of loan absorption capacity of the slum households in Nagpur, the financial institutions are in principle willing to provide home loans to them but are concerned by issues relating to loan delivery and recovery mechanism. The average size of the home loan for slum upgrading would be small while the number of accounts would be large, entailing high operations cost for the financial institutions and the lending operations are likely to be financially unsustainable. Thus, the financial institutions would like to join with a financial intermediary for loan delivery and recovery. This may take the form of bulk lending to the intermediary, with or without risk sharing, or limiting the role of the intermediary to disbursement and collection with no risk sharing. ICICI has been particularly innovative in developing models for joining with MFIs[5].

The measures suggested by financial institutions in India to address their default concerns include the following:

- In the case of subsidized slum upgrading projects, as in Nagpur, the subsidy funds may be placed with the financial institution, which in turn would pay the contractors and other vendors on agreed terms. This mechanism has been suggested for two reasons: first, past experiences show that government funds are not disbursed for the project (as happened in the case of central government slum upgrading scheme – VAMBHAY) despite the loan disbursement and this leads to high default rate for financial institutions; and, second, the financial institutions could leverage the subsidy funds and profits from the operations would set off the potential default by the borrowers.

- In contrast to the prevailing practice of upfront subsidy to slum households for new rehabilitation units, the households could be given a back-end subsidy. For example in Nagpur, the households would be provided with a unit subsidy of Rs. 125,000 for a rehabilitation unit costing Rs. 142,000. In case a household defaults in repayment of the home loan of Rs. 17,000 and the financial institution liquidates the collateralized financed property for recovery of principle

[5] See Malcolm Harper and Marie Kirsten, “ICICI Bank and Microfinance Linkages in India”, Small Enterprise Development, Vol. 17, No. 1, March 2006; and Bindu Ananth “Financing Microfinance – the ICICI Bank Partnership Model”, Small Enterprise Development, Vol. 16, No. 1, March 2005.

and interest, the balance sale proceeds including the subsidy amount would be given to the household. It is suggested that the loan amount to the borrower may stand at Rs. 142,000 and after the household repays Rs. 17,000 and the interest thereon, the loan amount of Rs. 125,000 (subsidy) may be waived off. This would be an incentive for the household to repay the home loan since in the case of default and liquidation of collateral, the household would not get the subsidy amount.

- According to the statute of the National Housing Bank lending norms for housing, a borrower cannot be dispossessed of the collateralised property if the loan amount is less than Rs. 100,000. Since the average loan size in the case of most slum upgrading projects would fall below this cut-off, there is the need for a clause in the loan agreement that in case the borrower defaults in payment of 6-12 consecutive installments (instead of conventional 3 installments), the financier would have the right to take possession of the collateralized property.

In addition, the use of a credit enhancement to encourage financial institutions to lend in slum upgrading and other low income housing projects, is discussed in section 5.0.

NGOs. Civil society organizations need to play a complimentary role to private developers and financial institutions for implementing slum upgrading projects. In the case of private developer led slum upgrading projects, NGOs may provide them with a facilitating interface with the community and take the responsibility of mobilizing the community into cooperative society for implementing the project and to reach an agreement with the builders on deliverables and delivery schedule. More importantly, the NGOs can be the watchdog to ensure quality control and compliance of the private developer to the agreed deliverables. In case of project with low-rise developments, the NGO could facilitate the community to perform the tasks conventionally assigned to private builders and take the responsibility of construction of dwellings. This would reduce construction costs to better enable the housing cost to fall within the affordability parameters of the households.

4.0 HOUSING FINANCE IN URBAN LOW INCOME AND SLUM UPGRADING PROJECTS

The affordability analysis of households from the Nagpur Slum Upgrading Project, discussed in section 3.0, illustrates the important contribution from housing loans that households can provide to upgrading projects. In the models estimated for Nagpur, microfinance for housing loans, defined below, combined with subsidy funds, provided meaningful leverage of the subsidy funds, and cross-subsidization expanded the options further. Nagpur is clearly but one example, however. Nearly all of India's cities face housing deficits for the poor. *How can household contribution be brought to greater scale in slum upgrading and low income housing projects around India? What types of "financial infrastructure" are needed?*

This section discusses some of the key financial inputs needed for providing shelter for the urban poor and urban slum households in India. These include the expansion of urban MFIs, the introduction of microfinance for housing (MFH) in more of the urban MFIs, and, importantly, encouraging banks and MFI lenders in urban areas to partner or to directly engage in low income shelter lending. As discussed in the Introduction, there are innovative efforts underway to downmarket shelter finance in India, and also a number of new bank/MFI efforts in microfinance. Indian NGOs and banks are pioneering several models of downmarket shelter lending and slum upgrading including a slum upgrading project with a multi-family construction loan to a "social' builder and another combining MFH with subsidy funds from JNNURM monies. And, as will be discussed in section 5.0, two "modest" income pilot projects in mortgage finance are also underway, which are likely to contribute lessons for going downmarket with modest income shelter finance; these projects involve NGOs, foundations, banks, and builders.

However, despite the promise of the various projects underway, there are significant barriers in India to accessing the inputs necessary to provide finance to slum and other low income urban households. First, India's MFIs have focused largely on rural areas, and only very recently are some of the major MFIs increasing their urban presence. Second, a very limited number of banks and HFCs have been willing to undertake downmarket lending schemes; additional bank participants and bank/MFI partnerships will be necessary for successful slum upgrading. Third, although MFH is growing rapidly worldwide, it has not been widely developed as a loan product in India. Finally, the low and modest income shelter lending is likely to require a partial guarantee; suitable credit enhancement schemes are not yet available, but will hopefully be developed and tested during the Monitor pilot project and the slum upgrading pilot proposed in this paper.

In sum, despite the progress in these pilot projects, for slum upgrading in particular, more players must be involved. This includes the municipalities, who are ultimately responsible for solving issues regarding land, land tenure, infrastructure, and city-wide planning for slum eradication. It also includes MFIs, NGOs, and others who are addressing livelihood issues for the very poor. *MFH on its own cannot be effective in a context lacking these inputs.*

This section first discusses the MFH loan product in other emerging markets, and then provides an overview of the financial inputs for low income shelter finance available in India.

4.1 Microfinance for Housing: a Growing Loan Product for MFIs

Microfinance for housing (MFH) is a subset of microfinance, designed to meet the housing needs of the poor and very poor, especially those without access to the banking sector, or to formal mortgage loans. MFH is designed for low-income households who wish to expand or improve their dwellings, or to build a home in incremental steps, relying on many small loans. MFH differs from formal mortgage lending in two key ways: the loans are smaller and shorter term, but more importantly they are usually not collateralized by the property. MFH clients generally cannot qualify for formal mortgage loans, for a variety of reasons, including low income, informal sources of income, lack of land title (although some microfinance institutions make this a precondition) and a dwelling that does not meet formal building standards. Relative to micro enterprise loans - namely working capital and fixed assets loans to micro entrepreneurs - MFH loans are, in some cases, somewhat larger and of longer duration. However, housing and micro enterprise loans may sometimes be indistinguishable: first, many micro businesses are conducted in whole or in part from the home, and secondly, many micro lenders have learned that some portion of their enterprise loans are being used for housing.

Who Offers Microfinance for Housing?[6] MFH is offered by a wide variety of institutions, including MFIs, banks, NBFIs, cooperatives, credit unions, and NGOs. A major distinction can be made between financial institutions whose main product line is micro enterprise loans (MFIs, banks and NBFIs) and institutions whose main purpose is improving the shelter situation of the poor, often NGOs or housing cooperatives. MFH is growing rapidly but it is still far from reaching the scale that would begin to satisfy estimated demand.

Latin America has largest MFH portfolio, the largest number of MFIs offering MFH, and the most active lenders. MFH is now growing rapidly in Africa and Asia; examples of lenders include the Kuyasa Fund (South Africa), NACHU and Jamii Bora (Kenya), UML (Uganda), PRIDE (Tanzania); Egypt (several large banks), Morocco (several MFIs), Grameen (Bangladesh), BRI (Indonesia), CARD (Philippines), and Habitat for Humanity (Vietnam). Growth in the MFH portfolios depends of course on many factors, but several of the most important are the overall growth of the lender, its liquidity, and the loan product allocation decisions between micro enterprise lending and other loan products, including MFH.

Table 1: Loan Features and Underwriting Requirements

Loan Feature/ Institution	SEWA Bank	Grameen Bank	CARD	ADEMI	FUNHA VI	Kuyasa Fund	ACCION Latin America
Loan Size	$333 average; $4444 max	$100 - $600	$359	$4000	$3000	$700	$300 to $3500
Maximum Term	120 months	120 months	12 months	36 months	20 months	24 months	120 months
Security	1 yr savings; 2 co-signers	5 co-signers	5 co-signers	Collateral-ized	2 co-signors	6 months savings	Mostly co-signer
Savings Required?	Yes	Yes	Yes	No	No	yes	No
Linked or Stand Alone	Linked	Linked	Linked	Stand alone	Stand alone	Stand alone	Stand alone

[6] This information is drawn largely from Sally Merrill and Nino Mesarina, “Expanding Microfinance for Housing”, Housing Finance International, December 2006.

Loan Feature/ Institution	SEWA Bank	Grameen Bank	CARD	ADEMI	FUNHA VI	Kuyasa Fund	ACCION Latin America
Time with Organization	1 year minimum	2 years minimum	1.5 years	Not required		Not required	Not required
Gender-based?	Women only	Mostly women	Mostly women	No	No	Mostly women	No
Land Ownership	Not required	required	required	Not required	Not required	required	Mostly not
Housing Technical Assistance	Assistance for Illiteracy	No	No	No	Yes	No	Mostly not

Table 1 illustrates MFH loan features for selected lenders in Latin America, Asia, and Africa; table 2 documents portfolio size (in 2005). Worldwide, there is large variation in both size and term, with MFH loans ranging from $300 to $3500, with a term of 1 to 10 years. For the Accion network in Latin America, an average MFH loan is $2280, which is approximately three times larger than working capital loan and may have a longer term – up to four years rather than the typical 12-24 months for enterprise loans. A large proportion of MFH is for upgrading and expansion. Finally, there is some evidence that NPLs for MFH are lower than the delinquency rate for working capital loans.

Table 3 illustrates funding sources for various institutions that offer MFH. Institutions that are registered as banks rely on demand deposits, while NBFIs seek savings accounts. Importantly, table 3 also illustrates another type of distinction that can be made among institutions offering MFH: (1) microfinance institutions that fund themselves on strictly commercial terms, at market rates, and (2) those that are also subsidized through various combinations of donations, grants, and donor or government funds. Many large microfinance institutions, such as BRI and the ACCION network in Latin America, are self sufficient. Others, in contrast, have always received some level of subsidy from donors and foundations, and defend this approach on the ground of affordability. Subsidy funding may take the form of infusions of capital or funds to increase liquidity.

Table 2: Micro Institution Portfolios and Micro Housing Loans

Institution	Total Portfolio 2005	Total Housing	Housing Loans as a percentage of the total portfolio	Percentage of Home Improvement loans in housing portfolio
ACCION Network offering housing loans	$624,324,129	$116,784,223	18.7%	62%
ACCION total Network	$ 1,340,000,000	$116,784,223	8.7%	60%
Mibanco	$206,729,374	$30,864,706	20%	50%
BancoSol	$130,106,032	$45,083,923	35%	50%

Institution	Total Portfolio 2005	Total Housing	Housing Loans as a percentage of the total portfolio	Percentage of Home Improvement loans in housing portfolio
SEWA	$5,415,555	$1,638,812	27%	80%
BRI	$8,572,000,000	$85,300,000	1%	N/A
UML	$11,325,566	$1,223,204	10.8%	N/A
Kuyasa Fund	$2,970,000	$2,970,000	100%	50%

Table 3: Funding for Microfinance for Housing Loans

Type of Funding	Banco Sol	SEWA Bank	SPARC	CARD Bank	BRI	Grameen Bank	Mibanco	NACHU	Kuyasa	FAMA
Mandatory Savings		X	X	X		X			X	
Deposits	X			X	X	X	X	X		X
Commercial Credit	X		X				X		X	
Donor Funds		X	X	X		X			X	X
Foundation Funds		X	X	X		X			X	X
Public Funds		X	X							
International Finance Corporation						X				
Credit Enhance-ment			X						X	

The Context Needed for Effective MFH. Three factors limiting the utility of MFH in slum upgrading should be noted. First, as noted, MFH cannot be maximally effective unless it is operating in a broader context that includes solutions to land availability, tenure security, and infrastructure provision. Second, in cases where multi-family construction is required, there is a separate need for construction finance; MFH serves only as the "take-out" finance. Third, in many instances, slum households cannot afford a MFH loan adequate to finance a complete new dwelling; subsidies and/or planned incremental development must be part of the planning for upgrading.

Households will invest in improving their dwellings if there is a potential for real incremental development – that is, *if their investment can produce an increase in the asset value of the dwelling.* Most slum dwellers do not own their land, and government must provide tenure security at a minimum, as well as finance the infrastructure. High land prices and location issues are difficult to solve; center city land is more expensive than in outlying areas. However, greenfield (rather than in situ) redevelopment on marginal land will not be effective if households are moved beyond reach of employment or transportation at reasonable cost.

Density is also an issue, and of course, is closely tied to central versus more marginal locations. Worldwide, MFH has most frequently been used for loans to individual households for upgrading or incremental construction of single family homes, in most cases the lenders require tenure security, and in many cases ownership of the land, as noted in Table 1.

For some of India's smaller cities, this approach is relevant, as households seek to improve single family dwellings. For many of India's large cities, however, low income and slum upgrading housing projects must seek higher density solutions via multi-family buildings and this requires construction finance prior to the "take out" finance of the individual households. The community organization aspects of slum upgrading projects also add measurably to the complexity of the operations. Although the loans are individual, the peer group approach to savings, origination and servicing is a crucial aspect of finance in slum upgrading.

4.2 Urban Microfinance and Low Income Shelter Lending in India

Another issue which must be addressed is whether India currently has the infrastructure to carry out the financial aspects of slum upgrading - at any scale - in urban areas. This requires urban MFIs and/or banks willing to undertake low income lending and/or form partnerships with MFIs and NGOs. It also requires loan products that can support various slum upgrading models in which the household contribution will include MFH loans as well as savings. In addition, the ability of the poor to access these financial services, and to participate in savings programs with appropriately-designed savings products, is another crucial hurdle. Thus, the answer to the question posed above is probably no at present: the financial infrastructure is not yet in place - but the situation is changing.

Urban Microfinance in India. While India is home to extensive MFI activity, until very recently the predominate focus has been on rural areas. The fact that NABARD is the regulator for MFIs is in itself revealing. In addition, the focus of the apex group Sa-Dhan, the Association of Community Development Finance Institutions, has correspondingly been on its members, most of which are rural.

Recently, this picture has been changing, especially among some of the large MFIs such as SPANDANA, SDS and BASIX, all of which are increasing, or planning to increase, their activities in urban lending. The Centre for Microfinance at the Institute for Financial Management and Research (IFMR) has done a study of urban microfinance in India, conducting case studies of SEWA Bank, Ujjivan, Working Women's Forum, Indian Bank's Microsate Branch, Village Welfare Society, and Sharada's Women's Association for Weaker Sections.[7] As noted by IFMR, in contrast with the development of microfinance in rural areas, there has been a near absence of urban MFIs. Lack of access to financial services such as bank branches and ATMs forces the urban poor to rely for credit on street lenders, who may charge up to 10% per day. A major survey of microfinance in India also notes the imminent expansion of urban microfinance.[8] As other examples of urban efforts, in 2005, ACCION partnered with Unitus to form the Unitus-ACCION Alliance for India; and in 2007, with India's YES Bank, to form a microfinance subsidiary, YES Microfinance India, which

[7] Centre for Microfinance at IFMR, "Reaching the Other 100 Million Poor in India: Case Studies in Urban Miocrofinance", 2006. Chennai, India

[8] Prabhu Ghate, "Microfinance in India: A State of the Sector Report", Microfinance India, New Delhi, 2006. The study cites four new and one existing urban MFI (two in Bangalore, and one each in Ahmedabad, Kolkata, and Mumbai); all are negotiating with equity investors to enable them to expand rapidly as NBFIs.

will provide financial services to the country's urban poor. Finally, there is also a need to have MFIs, and urban-focused MFIs, spread more broadly throughout India, altering the relative concentration in the south.

Microfinance for Housing in India. Although microfinance for housing was pioneered by SEWA almost two decades ago, as compared with many other emerging markets there has been little growth in MFH in India. In other emerging markets, MFH is offered mainly by urban MFIs, which is perhaps one reason.

This picture is also changing. Another report by the Centre for Microfinance has also documented MFH lending in MFIs in 4 southern states: Tamal Nadu, Kerala, Karnataka, and Andra Pradesh. The Centre evaluated 13 MFIs offering housing products. The problem for slum upgrading, however, is that these lenders were primarily in rural areas. However, MFH can be expected to grow as urban MFIs expand. For example, for Ujiivaan, 35% of the non-business loans were for housing. Importantly, as first determined by SEWA, consumer loans often used for housing. SEWA's MFH loans are larger than other kinds (Rs. 25,000); 24% of borrowers take out housing loans.

The loan products used for MFH deserve some comments. Generally, microfinance for housing loans worldwide are individual loans, rather than group loans. Experience has shown that group loans are not appropriate for housing loans. The MFIs in IFMR's urban case studies, noted above, all rely on peer-based lending, including the joint liability groups based on the Grameen model and the SHGs developed in India. However, for housing microfinance, IFMR notes that individual loans are more popular.

A summary document has also been published by the Centre, which notes the loan product characteristics of the MFH loans studied by them, and confirms the individual loan approach; this certainly represents a shift away from the traditional group lending methodology.[9] The MFH loans tend to be larger and longer-term than micro enterprise loans in India, as elsewhere. Most are uncollateralized, and rely on co-signers and guarantors. Many are "linked" – that is, only borrowers having successfully completed more than one micro enterprise loan are eligible. The loans may also be linked to savings. The MFH loans are generally for upgrading, as they are not sufficient for a new unit; however, some households are also borrowing elsewhere (e.g. street lenders) to gather enough for a new unit. Some situations also involve subsidy. Finally, a market interest rate environment is recommended by both the Centre's study and that of Prabhu Ghate.

In sum, it is expected that MFH will grow in India as MFIs expand their operation in urban areas, as the MFI product mix is broadened, and as slum upgrading projects continue to develop. As discussed in section 3 above, the current Nagpur financing model assumes that MFH is an integral part of the overall financing, and this approach will hopefully expand. What is also needed is action on bank/MFI partnerships, as discussed below.

MFI/Bank Partners in Low Income Lending. A common approach to low income lending in many countries is to join forces between a bank and an MFI or NGO, each playing the role best suited to its skills, location, and balance sheet. Several partnership models are in use by banks and MFIs worldwide. Two common ones are:

(1) Loans stay on bank's balance sheet and MFIs act as agents for origination and servicing; banks may do the recovery on defaulted loans. MFIs receive fees for sourcing, underwriting, and collection; on the

[9] Centre for Microfinance at IFMR, "Current Status of Housing Micro Finance in India", 2006, Chennai, India

other hand, they may be penalized for defaulted loans that cannot be recovered. ICICI and its MFI partners use this model.

(2) Loans are made by MFI, which also originates and services; banks provide line of credit to the MFI to enable it to have enough liquidity. This puts the MFI out front as a lender, giving it both the opportunity to cross-sell but also places its balance sheet at more risk.

This approach to microfinance has already growing in India: Prabhu Ghate notes a large increase in commercial bank lending through bulk lending and the partnership model. There are also new and innovative products, such as portfolios buyouts and securitization; ICICI has been particularly innovative in developing these financial products

5.0 CREDIT ENHANCEMENT POLICIES FOR MODEST AND LOW INCOME HOUSING: PROJECTS WORLDWIDE AND IN INDIA

Overview. This section discusses the potential for credit enhancement policy to enable a successful introduction of microfinance for housing (MFH) in slum upgrading pilot projects in several cities in India. The ultimate goal would be a nation-wide credit enhancement facility lodged within the National Housing Bank, able to be utilized on a national basis as shelter lending extends downmarket – whether in a slum upgrading context or for MFH used in any other low income lending program. However, given the scale such an effort would entail in India, it seems appropriate to test the concept on a pilot basis first.

Credit enhancement for mortgage lending – namely mortgage guarantee insurance (MI) – has long been a feature of developed country mortgage markets, and is now spreading to many emerging markets. MI is also being developed in India, spearheaded by NHB.

Similarly, credit enhancement for micro-enterprise and SME lending is a tool used worldwide for micro-enterprise loans in both emerging and developed markets. The key example of this in India is the CGTSI program management by SIDBI for lending to SMEs.

Credit enhancement for modest and lower income housing lending is a much more recent phenomenon of downmarket lending, introduced to assist with MFH in both slum upgrading programs and other programs wishing to extend housing loans to households whose income does not allow them to qualify for formal mortgage loans. Such credit enhancement programs have been utilized in Chile, Thailand, Indonesia, and Morocco, and are now being introduced in Mexico.

In India, pilot projects for modest income mortgage lending, with affordable housing, is being conducted by the Monitor Group, supported by FIRST and the World Bank. It is planned that a credit enhancement be tested in the pilots. This would be a variant of formal-market MI, as the loans anticipated under these programs are strictly collateralized mortgage loans, not MFH.

However, it is also strongly recommended that a credit enhancement program for MFH be introduced for the proposed pilot programs for slum upgrading; for the sake of a convenient label, this would be called MI-Micro. Lower income households can and do pay their micro-enterprise and MFH loans. Having MI-Micro would assist more banks and HFCs to enter and test the low income market. The MFH loans can be a vital component of low income housing and slum upgrading, allowing better leverage of subsidy funds and household savings, and helping assure that households are committed to developing and maintaining their units.

5.1 Mortgage Guarantee Insurance as a Credit Enhancement for Formal Sector Mortgage Lending

Table 5.1 summarizes the extensive use of MI in formal sector mortgage lending. MI has long been a key feature of the mortgage markets in the U.S., Canada, the U.K., Australia and New Zealand. More recently, MI has become a common feature of mortgage market in Europe, and it has been introduced, or is being developed, in a number of emerging markets.

Table 5.1: Mortgage Guarantee Insurance

Countries with MI integral to mortgage systems	New private MI in Developed Markets	MI in Emerging Markets
US Canada UK Australia New Zealand	Spain Italy Ireland Sweden Germany Israel Portugal	Mexico, Columbia Latvia, Estonia South Africa Dominican Republic, Guatemala Kazakhstan (India, Thailand, Poland – under study or development)

MI is now about to be introduced in India, with NHB taking a lead role in its configuration and regulatory structure. This will be an important benefit for the formal mortgage lending sector. As in other nations, MI can be used by the banks and HFCs to share risk in mortgage loans that have lower down payments than conventionally offered or other deviations from the usual underwriting rules. The goal is to make mortgage loans more affordable to a larger number of households; MI is not to be used as a substitute for ability to pay, however, as the subprime crisis in the U.S. reminds us. Over many years, however, in the U.S., Canada, and the U.K., both privately-sponsored and public mortgage guarantee insurance programs have helped the expansion and stability of the formal mortgage sector.

5.2 Slum Upgrading and Pilot Projects in Modest Income Shelter Lending

Two pilot projects in modest income mortgage lending are now being developed in India: a pilot being done by the Monitor Group and another by the Development Innovations Groups (a non-profit), supported by the Gates Foundation, and ICICI Bank. The Monitor Groups is planning for two pilots in Mumbai and one in Ahmadebad, while the DIG/ICICI pilot is taking place in Chennai. The Monitor pilot also plans to include a credit enhancement mechanism, which will be supported by the Michael and Susan Dell Foundation and the Acumen Fund, s social investment fund. The Chennai pilot, which has targeted a higher income group, does not plan to at this time to include a credit enhancement; if it is ultimately decided that might be helpful, however, MI could be very relevant.

The potential for credit enhancement in slum upgrading projects should also be considered. As discussed in section 3.0, the Nagpur slum upgrading project is combining subsidy funding with household savings and MFH loans. Our analysis of the household income data from Nagpur suggests that many of the Nagpur households can afford much larger MFH loans than called for under the program, and this would have the effect of much greater leverage for a given amount of subsidy funds. The key questions that need to be addressed for all three of the shelter programs being discussed here are the following:

- How is substantial household contribution going to be mobilized?
- Can credit enhancement assist? Under what circumstances?
- What type of credit enhancement fits with different loan types? Household groups?

Figure 5.1 illustrates the target income ranges (low and high) for the three comparison groups: the Nagpur slum households, the Monitor target groups, and the Chennai (ICICI/Gates/DIG) pilot. Table 5.2 provides more details on income and household employment characteristics, and, in addition, suggests what type of credit enhancement might be most appropriate: MI or MI-Micro (or none at all). Income is the lowest for the Nagpur slum households, although looking at the data in quintiles, as done in section 3.0, provides evidence of a rather wide range between the highest and lowest quintiles. Next is the Monitor low income group, and households who are self employed or from the unorganized salaried group. The Monitor formal salaried group and the targeted households in Chennai have the highest income; the target income range for these households was chosen to be "just below" the usual income cut-offs for the formal sector mortgage lending now being provided by banks and HFCs in India.

Figure 5.1 Target Income Groups for Pilot Mortgage Lending Projects and Nagpur Slum Upgrading

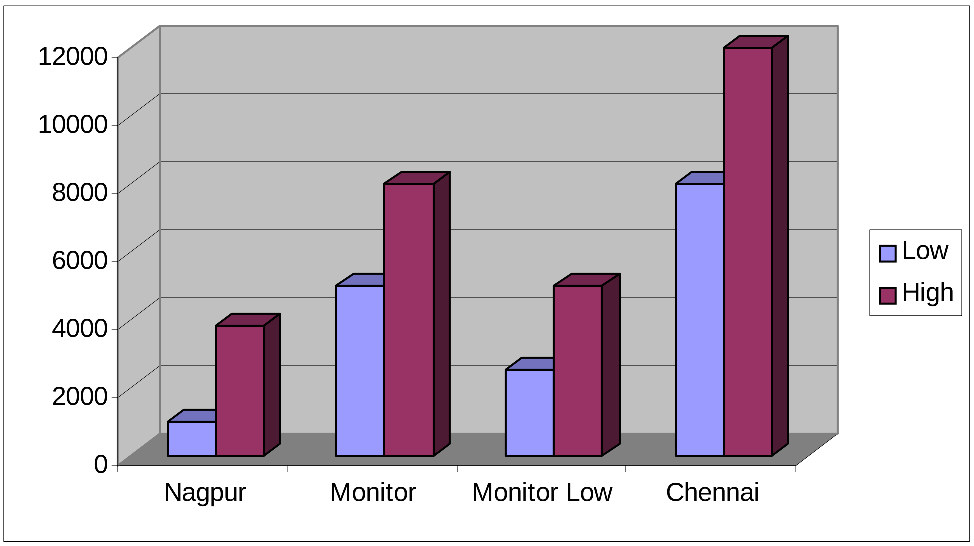

Table 5.2 Target Income Groups and Credit Enhancement Potential in Nagpur, the Monitor Pilot, and the Chennai Pilot

Project	Monthly Income	Credit Enhancement?
Nagpur: 16 Slums with Housing Subsidy	Rs. 1000 (QI median) Rs. 38000 (QV median)	Small loans at 12% unit cost, may or may not need MI-Micro
Nagpur: non-JNNURM, no housing subsidy	Assume to be same as above for modeling	Larger loans needed; most would need MI Micro
Monitor: formal salaried	Rs. 5000+ Rs. 8000 – 11,000	MI or MI-Micro relevant to this group; being planned
Monitor: self-employed, unorganized salaried	Rs. 5000+	MI- Micro relevant to this group
Monitor: low income	Rs. 2500 – 5000	MI-Micro relevant; MI not appropriate to this group
Chennai: pilot target	Rs. 8000 – 11,000	Could use MI but now planned

Table 5.3 summarizes characteristics of MI and MI-Micro. Clearly, there are major differences between these two types of credit enhancement. MI is designed to serve the formal mortgage market, and is used only with formal mortgage loans, collateralized by the property. Land title is absolutely necessary, the housing must conforms to the relevant standards in place for the particular country, and the MI company

underwrites the loan (the bank has already done so) in order to determine whether or not it will accept the loan for insurance.

Table 5.3: Characteristics of MI and MI-Micro

Mortgage Guarantee Insurance: Credit Guarantee Scheme for Standard Housing	MI Micro: Credit Guarantee Scheme for Low Income Housing
Formal mortgage loan, collateralized by property	Uncollateralized MFH, including upgrade & self-build
Lenders are generally banks, HFCs, mortgage banks	Lenders may include MFIs, banks, and MFI/bank partnerships
Land title is crucial	May or may not require land title, or use quasi-title process
Higher valued homes	May not be standard unit?
MI company carefully underwrites the loan before acceptance	Specific loan requirements, but underwriting may not be as detailed
Standard FI servicing model	Servicing crucial, including MFI/NGO agent, peer pressure
Property valuation	Valuation unlikely?
Foreclosed property auctioned	Other collateral used if foreclosed
Single loan guarantee	Single loan or portfolio guarantee
Well capitalized and regulated; partial guarantee only	Well capitalized and regulated; partial guarantee only

In contrast, MI-Micro is designed to assist with loans to lower income and often self-employed households in the informal sector; these groups generally cannot qualify for formal mortgage loans, nor in most cases afford housing built to a high standard. Most of these households will qualify for MFH loans. Lenders are likely to include not only banks but also MFIs and bank/MFI partnerships. Land title may or may not be required by the lender, as noted in the discussion of MFH in section 4.0. Origination and servicing may be somewhat less formal, including being carried out by NGOs and MFIs to assist their bank partners.

Finally, however, two crucial characteristics should hold for both MI and MI-Micro. First, both forms of credit enhancement should be well capitalized, with sufficient capital backing to cover the anticipated risk inherent in the guarantee. Second, the guarantee should only be partial – in other words, the lending institution should share in the risk; this avoids problems of moral hazard inherent in 100% guarantees – that only the risky loans will be passed on for insuring. The credit enhancement being proposed for those in the Monitor group pilots that qualify for formal mortgage loans has taken this partial guarantee structure into account. The guarantee is expected to take the form of a shared loss in an agreed upon ratio; discussions at this time suggest a bank/guarantee fund ratio 30/70 or 40/60. Private MI worldwide usually provides a guarantee level of 20% - 40% for formal mortgage markets in developed markets. However, the credit enhancement is being established as a type of PPP, and downmarket pilot project, Monitor.

6.0 RECOMMENDATIONS

As a result of the pilot projects now underway, India is providing other emerging markets with examples of policy development in slum upgrading and low and moderate income housing finance. Importantly, the funding models depend on both private finance and household resources to better leverage public funds. The lessons learned are generally applicable worldwide.

Yet, there is much to be learned and much to be done in India. As discussed, slum upgrading is necessarily a multi-dimensional issue. A number of issues must be addressed in concert for slum upgrading projects to achieve success and greater scale, including the access of urban slum households to banks and/or MFIs able to provide microfinance for housing loans and appropriate savings products; NGOs with capacity and skills to undertake community mobilization; city-wide strategies for land; the willingness of developers to participate in low income housing projects; and participation by banks in construction finance in high-density slum upgrading projects.

SPARC, the Urban Institute, SDS, and USAID have drafted a proposal for the actions needed for community-managed slum upgrading with participation by banks and MFIs in providing housing microfinance to the households.

In this context, the recommendations for India include:

Form a Public/Private Partnership for Shelter Development in Slum Upgrading. The Advisory Group agrees on the need for coordinated action on the part of a broad array of groups to address the multiple issues in slum upgrading. In order to undertake the tasks required to initiate the actions, a Public/Private Partnership - PPP - should be formed representing the key actors. These include:

- municipal authorities, including the mayor, city planners, subsidy fund managers;
- SPARC, NSDF, and other NGOs dedicated to community organization and coalition building,
- financial institutions, including banks and MFIs willing to develop and market low income financial products, and
- the National Housing Bank, together with donors or foundations able to help develop and fund credit enhancement mechanisms for supporting downmarket lending.

In order to learn as much as possible from the pilots, it would be useful to seek cities with different profiles for housing needs, land availability, and densities, and thus develop different slum upgrading strategies. SPARC has already taken the lead in engaging cities in this process, and has initiated discussion with Pune and Bangalore. SPARC and its community organization partners Mahila Milan and NSDF have extensive experience in community organizing, and will also seek to work with other NGOs. The municipal authorities will be urged to develop slum upgrading plans targeting major slum areas. Together with MHUD, and JNNURM, the municipal authorities would address subsidy policies for infrastructure services and housing. NHB has agreed to lead the finance aspects of these efforts and to develop credit enhancement tools that will support lending to low income households.

Encourage Development of urban MFIs in India, Microfinance for Housing, and Bank/MFI/NGO Partner Models in Financing for Slum Upgrading. In order to have the financial infrastructure in place to eventually achieve greater scale in slum upgrading, it will be important to encourage major MFIs to continue their expansion into urban areas. Sa-Dhan can assist in this process through information gathering and product development.

Microfinance for housing may also depend on banks' partnering with NGOs/MFIs/NBFIs, providing bank lines of credit, which, as discussed below, could be encouraged with a partial guarantee in the initial projects. Finally, the strength of the NGOs and other community organizations will be important in these MFH efforts, as community peer pressure can be instrumental in achieving acceptable repayment rates.

In sum, it is expected that MFH will grow in India as MFIs expand their operation in urban areas, as the MFI product mix is broadened, and as slum upgrading projects continue to develop. As discussed in section 3 above, the current Nagpur financing model assumes that MFH is an integral part of the overall financing, and this approach will hopefully expand. What is also needed is action on bank/MFI partnerships, as discussed below.

One of NHB's key roles will be to develop the framework for financial planning and the financial model specific to the slum upgrading context in each city. NHB will take the lead in bringing financial institution partners into the PPP and helping determine what type of bank/MFI/NGO model is appropriate to facilitate microfinance for housing loans for qualified slum dwellers. At issue are which partner carries the MFH loans on its books and how outreach, underwriting, and servicing are to be handled.

Development Credit Enhancement Mechanisms. It is likely that credit enhancement products will be needed to facilitate lending for low income households and/or slum upgrading. NHB can work with the partners and the consortium to determine the parameters of the guarantee policy. Clearly, the banks need to see the project design and financing expectations before they will agree to a role in the project; the credit enhancement is expected to help the banks overcome the risk barriers that are traditionally assumed for such low income projects. It is also recommend that RBI place slum upgrading financing in priority sector lending.

There are a number of types of credit enhancement, depending on the type of project:

- Mortgage guarantee insurance (MI) for modest income lending. MI is about to be introduced in India under the auspices of NHB.
- MI – Micro: credit enhancement for microfinance for housing – that is, non-mortgage lending to low income households.
- Construction guarantees for high density slum upgrading projects. Depending on city size and density requirements, construction finance for mid-rise developments may be required along with household loans. The need for construction finance for mid-rise buildings in higher density cities adds to the complexity of financing process, as compared with smaller cities where microfinance for housing loans can be applied to improve or build single family dwellings. Thus, it may be necessary to provide a credit enhancement for the construction loans as well.
- Guarantees for bank line of credit to MFI partner.

NHB feels that the national government will not now put any funding into a "national level" credit enhancement tool for MFH in slum upgrading. Rather, the success of several pilots would point the way to taking such an instrument to much greater scale.

Undertake Household Surveys. Household surveys in slum areas are invaluable to show the income distribution, credit worthiness, ability to pay; such information is crucial to determining eligibility, ability to pay, and savings capacity. Worldwide, household surveys have been proving invaluable to assist in developing approaches to subsidy policy and MFH loans to households in slum upgrading programs; as noted, slum households are far from homogeneous as far as income levels. Key data would include:

- Household descriptors
- Household income distribution
- Household sources of livelihood
- Savings rates

Getting accurate information on income from household surveys has always been difficult. The consumption approach should be used in addition to, or perhaps instead of, the traditional questions. This is an approach utilized worldwide and can be based on the World Bank's Living Standards survey.

Develop and Test Savings Programs in Slum Upgrading Projects. Savings play two crucial roles in low income lending: first as an important underwriting tool, demonstrating ability and willingness to pay, and second as collateral for MFH loans, whereby savings may be kept on deposit at the lending institution. India has had vast experience with savings groups. However, access to banks and banking services has been a serious barrier for urban low income and slum households. Both appropriate savings products and the means to link the poor and the financial institutions are required. Again, the potential lenders must be involved at an early stage of the project to help NHB develop savings products.

Include Income Generation Projects. Income generation should be an integral part of the slum upgrading process to enhance affordability and repayment capacity. Leakage from slum upgrading will occur unless the households have the means to stay involved and pay their loans. Thus, based on experience in livelihood generation, it is suggested that income generation activities be included in the plans. It should also be noted that for households whose income generation activities are wholly or in part based in the home, MFH loans can support improved income generation.

ANNEX 1: ADVISORY GROUP FOR THE LOW INCOME SHELTER PROJECT

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Mathew Titus, Director, Sa-Dhan

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