Habitat for Humanity®

Terwilliger Center for Innovation in Shelter

Building the Business Case for Housing Microfinance

Sub-Saharan Africa

In partnership with

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Building the Business Case for Housing Microfinance (in Sub-Saharan Africa)

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About the Mastercard Foundation
The Mastercard Foundation seeks a world where everyone has the opportunity to learn and prosper. The foundation's work is guided by its mission to advance learning and promote financial inclusion for people living in poverty. One of the largest foundations in the world, it works almost exclusively in Africa. It was created in 2006 by Mastercard International and operates independently under the governance of its own board of directors. The foundation is based in Toronto, Canada. For more information and to sign up for the foundation's newsletter, please visit **mastercardfdn.org**. Follow the foundation at @MastercardFdn on Twitter.

About the partnership
Habitat for Humanity Canada, Habitat for Humanity International and the Mastercard Foundation partnered to implement a six-year project in Africa titled "Building Assets, Unlocking Access." This project, carried out by Habitat for Humanity's Terwilliger Center for Innovation in Shelter, provides technical assistance to six leading financial institutions in Uganda and Kenya as they develop housing microfinance products and nonfinancial support services for people living on less than US$5 per day. The aim is to enable these people to secure adequate and affordable housing and improve their living conditions.

About Habitat for Humanity International
Driven by the vision that everyone needs a decent place to live, Habitat for Humanity began in 1976 as a grassroots effort on a community farm in southern Georgia. The Christian housing organization has since grown to become a leading global nonprofit working in more than 70 countries. Habitat for Humanity operates in 12 countries in Sub-Saharan Africa through a number of housing initiatives. It has witnessed a growing demand for financial services that address housing needs among microfinance institutions and clients. For more information, visit habitat.org.

About the Terwilliger Center for Innovation in Shelter
This project is implemented by Habitat for Humanity's Terwilliger Center for Innovation in Shelter. Habitat established the Terwilliger Center to work with housing market systems by supporting local firms and expanding innovative and client-responsive services, products and financing so that households can improve their shelter more effectively and efficiently. Habitat can have exponentially more impact by improving systems that make better housing possible for millions more families. The role of the Terwilliger Center stays true to Habitat for Humanity's original principles of self-help and sustainability by focusing on improving systems that enable families to achieve affordable shelter without needing ongoing direct support. To learn more, visit habitat.org/TCIS.

Contributors to this publication
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Abbreviations

AMFI – Association of Microfinance Institutions (of Kenya)

AMFIU – Association of Microfinance Institutions of Uganda

APR – Annual percentage rate

BOP – Base of the pyramid

CAHF – Center for Affordable Housing Finance in Africa

CEO – Chief executive officer

FI – Financial institution

FSP – Financial service provider

GLP – Gross loan portfolio

HFHI – Habitat for Humanity International

HMF – Housing microfinance

HSS – Housing support services

KWFT – Kenya Women Microfinance Bank

MFI – Microfinance institution

MHFC – Micro Housing Finance Corporation Ltd.

NS – Nyumba Smart

PAR – Portfolio at risk

SME – Small and medium enterprises

SSA – Sub-Saharan Africa

UFX – Ugandan shillings

Building a business case for housing microfinance

Financial service providers are discovering that vast business opportunities exist within the lower-income housing markets of the developing world. Housing is a basic human need, and for the majority of households, their home (including land) constitutes their greatest financial asset. Market studies of the "base of the pyramid," or BOP — defined as the approximately 4 billion people with incomes under US$3,000 per year in local purchasing power — have identified housing as one of the three largest market sectors (along with food and energy).[4] A 2014 study by McKinsey estimates that meeting the increasing demand for urban housing from low-income households worldwide would cost $2.3 trillion by 2025, representing additional revenues of approximately $200 billion-250 billion annually for the construction industry.[2] Nevertheless, for this lower-income majority, representing over 70 percent of the world's population, financing options for housing remain scarce and largely informal.

In the developed world, housing finance is synonymous with mortgage lending and represents one of the key building blocks of the banking sector. In less-developed countries, however, mortgage markets tend to be shallow and frail, hampered by political and economic instabilities, weak and unsupportive legal regimes, and limited access to long-term capital or secondary markets. The "depth" of national mortgage markets, measured as the ratio of mortgage portfolio values to gross national product, or GNP, averages 40 percent for high-income countries but less than 1 percent for low-income countries.[3]

These supply-side limitations are felt even more acutely by the BOP, who face myriad obstacles to accessing a mortgage loan. In developing countries, much of the BOP does not own property with a formal title because of faulty land registries and the high costs and legal complexities associated with securing freehold ownership. Banks limit mortgages to borrowers with stable, documented income streams, and in many cases, only the formally employed can secure a loan. The costs and complications associated with registering mortgages and implementing foreclosures in less-developed markets constrain mortgage supply to only higher-priced homes. Down-payment requirements create yet another hurdle for borrowers with limited savings.

Box 1: What is housing microfinance?

Housing microfinance, or HMF, refers to microfinance products that consist of small, nonmortgage-backed loans offered for relatively short terms and in succession to support the existing incremental building practices of low-income populations. Comparisons with microenterprise and mortgage loans are listed in Table 1.

In the absence of affordable housing solutions and accessible financing options, the majority of lower-income families resort to building incrementally based on their needs and available resources. This progressive building process may be carried out over several years or even decades, and may entail acquiring land, building an initial structure, and following with a series of expansions and improvements.

Increasingly, financial institutions serving BOP markets have come to realize how microfinance loans tailored to these incremental building patterns hold great potential for addressing housing needs and building financially high-performing portfolios. These housing microfinance loans represent relatively small sums, borrowed for a much shorter term than a mortgage, to match both the income streams of low-earning clients and the construction costs of their incremental building steps. A critical feature of housing microfinance is that loans are not typically secured with a mortgage lien, and in many cases, possession of a formal land title is not a requirement. See Table 1 for a detailed comparison of housing microfinance, microenterprise and mortgage loans.

Table 1: Comparisons of microenterprise, housing microfinance and mortgage loan products

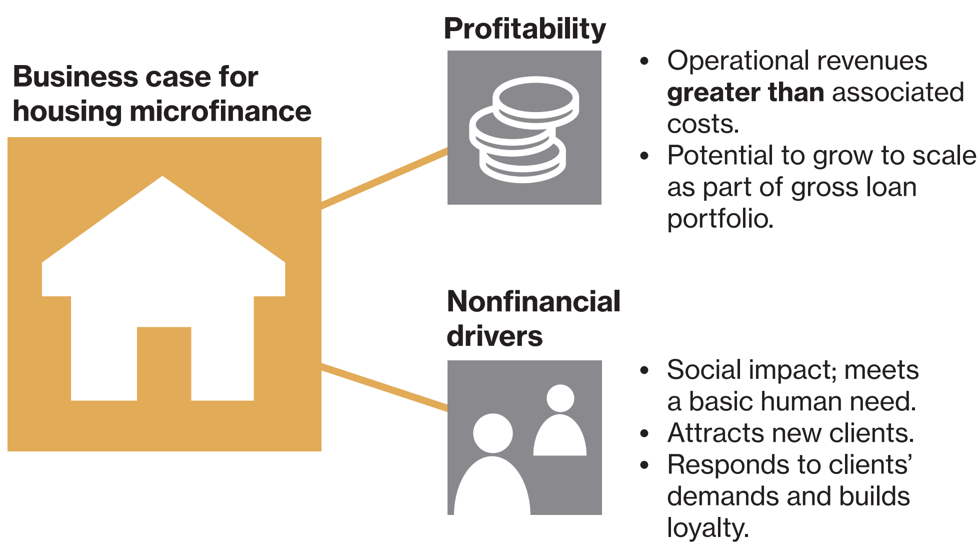
	Microenterprise loan	Housing microfinance	Mortgage loan
Loan use	Working capital	Home improvements, repairs and incremental construction	Home purchase or new home construction
Loan amount	Small: Average between $300 and $1,000	Medium: Average between $500 and $2,200	Large: $5,000+
Loan term	Shorter: Between three and 12 months	Medium: Between 12 and 36 months (average is 18 months)	Longer: Between five and 30 years
Guarantee or collateral	Personal guarantees, moveable assets and inventory	Personal guarantees and informal association with the property	Formal mortgage
Interest rate	Higher: Usually above 20 percent	Similar to microenterprise loans	Lower: Usually below 20 percent

Over recent decades, housing microfinance products have become increasingly prevalent among financial service providers, particularly microfinance lenders, who are already well-versed at serving the BOP. Financial institutions that have ventured into housing microfinance have found it to be a very popular product with their clients, experiencing rapid uptake and high-quality portfolios. Findings, for example, based on responses of over 100 financial institutions to a survey implemented by Habitat's Terwilliger Center in 2016-17 indicate that globally housing microfinance portfolios have continued to outperform general microfinance portfolios in terms of PAR30 (portfolio at risk over 30 days). Excluding institutions that focus solely on housing, 62 percent of respondents said PAR30 for housing microfinance products is lower than PAR30 for their general microfinance portfolio.[4] Although housing microfinance loans are not formally backed by a property lien, the informal association with the borrower's home creates a strong incentive for repayment. Socially minded financial service providers are especially drawn to introducing housing microfinance because of the clear impact on clients' well-being. Housing microfinance is also seen as an effective means of diversifying a portfolio that's heavily concentrated in business lending or of attracting new client segments such as low-earning salaried employees. Furthermore, financial service providers frequently report that housing microfinance helps them retain good clients by offering loans for a slightly longer term and tying them directly to improving a household's most valued asset.

Financial service providers have also found that launching a successful housing microfinance product requires addressing certain challenges. For those concentrated on micro- and small-enterprise lending, transitioning to financing nonproductive assets requires a change in underwriting policies and practices. This step is even bigger for microfinance institutions dedicated primarily to group lending, because housing microfinance usually requires developing policies and procedures that incorporate larger loans into the group guarantee structure, or creating an individually guaranteed loan product with distinct underwriting criteria. Microfinance lenders also need to address the risk of overburdening customers with too much debt when layering housing microfinance loans on top of existing enterprise loans. A common barrier to housing microfinance portfolio growth is the hesitancy of operations staff to sell an unfamiliar product, especially one that might not be perceived as central to the financial institution's mission. Housing microfinance lenders also frequently find it challenging to effectively assist their clients in ensuring that loans are used to finance sound, durable and well-priced construction.

For these reasons, robust housing microfinance portfolios tend to rely on a thorough product development process, resulting in a clear product differentiation that leads to steady uptake and low impairments without generating negative competition with other internal products. Furthermore, when taking housing microfinance to scale, these intentions need to be supported by a solid business case (see Figure 1), that clearly demonstrates the product's contribution to the financial service provider's financial goals, along with other business priorities. Although housing microfinance has often remained a boutique or secondary product of the smaller microfinance institutions that have ventured into housing finance, a growing number of regulated microfinance institutions have created a clear business case for adopting housing microfinance and have seen significant growth in recent years. Operating with extensive branch networks and accessing a broad source of capital, including lower-cost deposits, these financial service providers have developed compelling cases for growing housing microfinance portfolios, becoming leading housing lenders among the BOP.

Figure 1: Business case for housing microfinance



How do we define the business case for housing microfinance?

As shown in Figure 1, the business case for housing microfinance as has been defined for this publication is looking at two angles:
1) The profitability of the housing microfinance loan product, whereby operational revenues exceed associated costs (direct and indirect), and the clear potential to grow to scale relative to the financial service provider's overall portfolio.
2) The product's nonfinancial added value and sustained delivery, such as its contribution to social impact, ability to attract new clients and market segments, and success at building loyalty among existing ones.

Table 2 provides a glimpse of the housing microfinance portfolios of 20 financial service providers that are currently borrowing from the MicroBuild Fund[5]. They were selected from among a total of 44 investees because of the higher representation of housing microfinance lending in relation to their overall loan portfolios.

Table 2: Sample of financial service providers with significant housing microfinance portfolios*

Micro-finance institutions	Country	Number of housing micro-finance loans outstanding	Outstanding housing micro-finance loan portfolio (US$M)	PAR 30 housing micro-finance (%)	APR (%)	Average loan size (US$)	Housing micro-finance gross loan portfolio as a % of total
MFI1	Ecuador	31,414	212.24	2.30%	15.4%	6,756	41%
MFI2	Cambodia	7,473	44.33	0.24%	18.0%	5,932	9%
MFI3	Guatemala	20,435	36.55	0.01%	32.0%	1,789	32%
MFI4	Peru	21,434	35.05	4.55%	33.8%	1,635	17%
MFI5	Nicaragua	27,216	24.58	1.75%	35.6%	903	24%
MFI6	Kenya	1,618	21.96	6.08%	34.8%	13,574	46%
MFI7	Sri Lanka	12,877	21.28	6.17%	26.0%	1,652	6%
MFI8	Ecuador	2,243	19.53	0.04%	17.0%	8,706	15%
MFI9	Kazakhstan	22,407	17.26	1.20%	41.0%	770	8%
MFI10	Cambodia	6,047	16.76	0.67%	21.0%	2,772	7%
MFI11	Nicaragua	20,606	12.83	0.98%	24.0%	1,245	21%
MFI12	El Salvador	4,167	10.76	0.22%	32.9%	2,583	30%
MFI13	Costa Rica	1,110	9.44	0.03%	16.0%	8,506	1%
MFI14	Kosovo	4,026	8.58	1.39%	24.0%	2,131	25%
MFI15	Georgia	5,279	7.18	1.04%	33.2%	1,360	10%
MFI16	Colombia	7,096	5.86	6.25%	47.0%	826	7%
MFI17	Georgia	9,058	5.79	0.90%	23.0%	639	3%
MFI18	Dominican Republic	3,499	5.74	4.25%	30.9%	1,640	21%
MFI19	India	22,659	5.20	1.21%	25.0%	229	15%
MFI20	Peru	2,356	5.06	2.15%	38.0%	2,146	14%
MFI21	Nicaragua	4,734	4.41	0.36%	37.5%	931	20%
MFI22	Kyrgyzstan	2,949	3.97	0.70%	37.0%	1,345	39%
MFI23	Panama	408	3.64	1.93%	21.6%	8,927	13%
MFI24	El Salvador	11,976	3.16	0.17%	30.0%	527	15%
MFI25	Lebanon	2,374	2.69	0.57%	28.0%	1,131	4%
MFI26	Bosnia-Herzegovina	1,016	2.18	0.59%	22.0%	2,150	11%
MFI27	India	14,086	1.68	0.10%	24.1%	119	1%
MFI28	Armenia	723	1.44	4.70%	20.0%	1,993	6%
MFI29	Honduras	125	0.38	0.00%	33.5%	3,050	1%

***All figures are as of June 2017.**

One of the notable cases of housing microfinance growth is that of Mibanco, Peru's largest microfinance bank and one of the pioneers of housing microfinance in Latin America. (Product details are listed in Table 3 below.) Its "Micasa" ("my house") loan product has grown significantly in recent years, reaching over 201,000 clients and representing approximately 18 percent of Mibanco's entire loan book as of May 2017. The product has gained share within a highly competitive market through simplified and expedient loan processing.

Micasa aligns with the bank's mission of transforming the lives of its clients through financial inclusion, contributing to national growth. Operating within a highly mature and competitive microfinance market, Mibanco affirms that Micasa is instrumental in building client loyalty, given that it is a product that directly impacts the household, benefiting the entire family.

> Micasa "is a strategic product because it has allowed us to meet a basic need among our target market without losing sight of our profitability."
>
> — Carlos Vallejos, a Mibanco Senior Analyst and product lead for Micasa

Table 3: Micasa loan characteristics

Loan characteristics	Mibanco – Micasa
Target market(s)	Entrepreneurs operating in the informal sector, and informal employees. Peri-urban and rural.
Type of loan	Individual loan.
Loan sizes	Minimum of US$92.
Loan terms	Minimum of one month, maximum of 60 months.
Guarantees or collateral	All adult household residents sign the loan agreement. Association with the home produces psychological collateral.
Interest rate	15.39-90.12 percent

Setting the stage in Sub-Saharan Africa

The need for housing finance is particularly acute in Sub-Saharan Africa, where housing shortages and poor quality housing are pervasive among the predominantly rural-based populations, and high rates of urbanization are stretching very limited supplies of adequate housing and urban land, driving costs beyond the affordability levels of BOP residents. On the supply side, mortgage markets are shallow and fragile, and maturing microfinance industries are just beginning to grant strategic importance to products beyond traditional microenterprise loans.[6]

Africa's BOP is the region's primary consumer market, possessing over 70 percent of purchasing power.[7] African economies are some of the fastest growing in the world, and investors are showing increased interest in housing opportunities among the lower-middle-income sectors.[8] Leading microfinance institutions have focused primarily on extending financial services to Africa's predominantly rural population, reaching out to the unbanked. This has resulted in institutional infrastructure and capacity that facilitate extending a broader range of financial services, such as housing microfinance, to microfinance institutions' existing rural and peri-urban customer base. As Africa's microfinance sectors continue to grow and mature, increasing cases of successful BOP housing finance are likely to surface, along with pioneering products to address the urban housing challenge.

The following conditions characterize low-income housing finance markets in Sub-Saharan Africa and affect how housing microfinance is developed and delivered.

1. **Underlying the expansive gap between supply and demand in Africa's housing markets is the issue of affordability, whereby the high costs of land and construction are confronted with the region's low incomes.** Simply put, houses built and sold through formal markets are unaffordable to the majority of Africans.[9] Calculations by the Center for Affordable Housing Finance in Africa, or CAHF, indicate that, for example, fewer than 30 percent of urban households in Kenya can afford to purchase developer-built homes with mortgage financing, and only 3.5 percent of Uganda's urban households can afford them.[10] Regionwide, CAHF's estimates suggest that less than 15 percent of Africa's urban population can afford to purchase this type of housing. Thus, conventional financing tied to such solutions faces limited market demand among Africa's low-income majority.

2. **Africa's changing demographics will dramatically increase the demand for nonconventional housing finance in the growing settlements surrounding major cities.** Although Africa is predominantly a rural continent, with only 40 percent of its population living in cities, it is considered the second-fastest urbanizing continent, behind only Asia. It is expected that by 2050, Africa's urban population will represent 55 percent of the continent's total population, compared with 64 percent and 86 percent in Asia and Latin America, respectively. This change will bring with it the many challenges of fast and uncontrolled urbanization, such as housing informality and poor sanitation.[11] UN-HABITAT estimates that every day over the next 15 years, African cities will need to accommodate an additional 40,000 inhabitants.[12] This dramatic increase in demand on urban land and housing is driving up prices, making housing unaffordable to much of the BOP, and leaving them with only the options of either renting or building incrementally on the urban periphery, in slums and informal settlements.

   Kenya, for example, needs an estimated 132,000 additional units per year to house new urban dwellers and is carrying an existing housing backlog of 1.85 million units. Since an average of 50,000 formally built homes are produced each year, the deficit is increasing by approximately 82,000 units per year.[13] The majority of Kenya's urban residents (82 percent) are tenants, as urban housing costs are high and formal financing is not accessible.[14] Approximately 61 percent of urban Kenyan households are currently living in slums,[15] and in Nairobi an estimated 92 percent of all slum residents are renters.[16] Uganda faces similar challenges, with an estimated housing deficit of 1.6 million units, a majority of household income being informal and undocumented, and income levels being too low to qualify for financing to purchase formally built homes.[17] Evidence suggests that less than 15 percent of Africa's urban population can qualify for or afford conventional housing finance.[18] These realities highlight the urgency of supplying alternative housing finance options for Africa's growing urban population.

3. **Housing microfinance is particularly suited to the building and financing needs of the majority of Africa's population.** Despite the rise of rental housing in urban settings, homeownership predominates throughout Sub-Saharan Africa. In Kenya, 71 percent of households own their homes.[19] The 2012 government census revealed 77 percent owner-occupancy rates in Uganda. Throughout the region, homes are built informally, with local materials and unskilled labor. Many of these homes are of poor quality, unsafe or overcrowded, and urgently in need of upgrades, repairs or expansions. A May 2016 report by Uganda's Ministry of Land, Housing and Urban Development estimated that approximately 900,000 homes fall into this category.[20] Because most rural African households reside on land held with customary tenure, formal housing finance is not an option. Within these constraints, housing microfinance opens access for a large segment of the BOP that seeks to buy land and build housing incrementally.

4. **In order to penetrate Africa's BOP markets, housing microfinance lenders must take into account families living on land with customary ownership rights, while supporting their pursuit of formal title.** An estimated 90 percent of Sub-Saharan Africa's rural land is not formally registered or documented, and therefore cannot be used for mortgage financing.[21] Africa's complex and fragmented land policies and administrative systems have made it difficult and costly for households to secure freehold title on their property. These conditions lead to heightened insecurity around tenure and create conditions that are ripe for exploitation.

   Determining legitimate forms of land ownership within each context, and identifying means of validating these so that household tenure security is confirmed, is critical to the advancement of **housing microfinance** in Africa. Financial institutions frequently set loan thresholds according to these different types of land tenure, and raise loan ceilings with increased formalization. A promising practice observed among financial service providers is to offer **housing microfinance** for land purchase and formalization expenses, accompanied by referrals for land surveyors and service providers that can assist customers in the formalization process.

Alternative BOP housing finance products are also emerging, such as "micromortgages" – smaller mortgage-backed loans to finance the sales of newly built lower-cost housing. Micromortgage portfolios have grown recently in densely populated urban areas of countries like India, where lenders such as Micro Housing Finance Corporation Ltd., or MHFC, benefit from low-cost public financing and alliances with private developers to extend longer-term mortgage loans to finance the purchase of new low-rise construction. MHFC's micromortgages are targeted to BOP households working in the informal sector, with loans averaging rupees 5 lakhs (approximately US$7,800), and extended for tenures up to 15 years.[22] Their micromortgage APRs range between 13 and 15 percent, and customers are required to make down payments of at least 15 percent of the value of the financed home. Market systems that join affordable housing options with finance are sorely needed throughout the rapidly urbanizing landscape of the developing world. Unfortunately, similar efforts have experienced far less success in Sub-Saharan Africa, where the high costs of securing titled urban land and constructing new, formally built housing outprice the affordability ranges of the BOP.

The above conditions reveal a scenario in which the great need for housing microfinance-type products combined with minimal supply of housing finance tailored to BOP markets in Sub-Saharan Africa signal a compelling business opportunity for financial service providers, particularly among those committed to extending financial services to the low-income majority. The remainder of this publication is dedicated to walking through the business cases of two financial service providers operating in Sub-Saharan Africa: Kenya Women Microfinance Bank, or KWFT, and Centenary Bank in Uganda. Both are part of the "Building Assets, Unlocking Access" project under the partnership between the Mastercard Foundation and Habitat for Humanity (see Box 2).

The following section of this publication offers a framework for developing and analyzing the business case for housing microfinance at a given financial service provider. The presentation of the two business cases from KWFT and Centenary Bank follows this framework, and reveals insights regarding contextual, institutional and financial conditions that make housing microfinance a winning product for each of the financial service providers.

Finally, the closing section offers concluding considerations for other financial service providers and investors as they consider services that support the housing needs of the BOP.

Box 2: The Building Assets, Unlocking Access project

Building Assets, Unlocking Access, implemented by Habitat for Humanity's Terwilliger Center for Innovation in Shelter, has provided technical assistance to help six leading financial institutions in Uganda and Kenya develop housing microfinance products and nonfinancial support services for people living on less than US$5 per day. The aim has been to enable BOP households to secure adequate and affordable housing and improve their living conditions.

Introduction to the housing microfinance business case framework

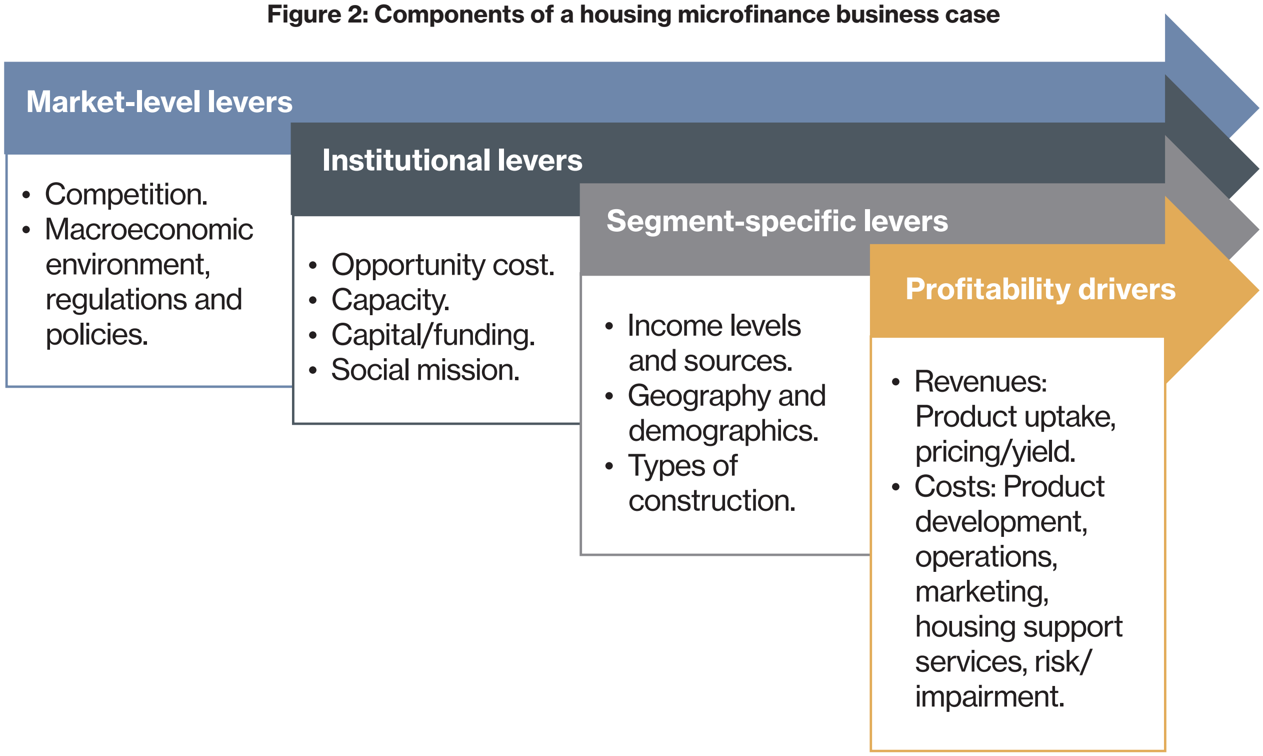
Most financial service providers recognize before launching a housing microfinance product that their clients frequently use or divert funds borrowed through existing product lines to finance housing construction. Incorporating a dedicated housing finance product may be initially perceived as daunting and foreign, requiring expertise in housing construction, building codes and mortgage markets, and therefore outside the scope of a financial service provider's core business. However, for many lenders, housing microfinance loans represent only a moderate adaptation of existing lending products and practices, tailoring these to incremental housing construction. A greater challenge lies in how housing microfinance is perceived and communicated by the operations staff members who sell the product. Thus, the success of a housing microfinance product relies on the creation of a clear business case that justifies developing and growing a distinct housing microfinance product, rather than simply allowing existing loan products to be used for home improvement purposes.

A compelling business case will answer, at least, the following questions:

1. What demand-side factors create a compelling case for offering a housing microfinance product?
2. What is the nature and extent of the market demand, and what is a viable value proposition that the financial service provider can provide in response to this demand?
3. What is the financial service provider's competitive advantage in offering this housing microfinance product?
4. What differentiating features make it a strategic product within the institution and the broader housing finance market?

To address these key questions, a business case takes into account market and contextual conditions, institutional realities, and financial goals. It is also important to clearly identify which BOP market segments will be served with the housing microfinance product. The following framework, adapted from the Consultative Group to Assist the Poor,[23] was developed to facilitate comparisons between the cases presented in this publication, and to guide financial service providers in building a robust business case for their own housing microfinance portfolios.

Figure 2: Components of a housing microfinance business case



Market-level levers

These are conditions that are external to the financial service provider and help in determining how a housing microfinance product will succeed. The following are key levers to take into consideration:

Competition: What are the existing sources of housing finance for the BOP (formal and informal), and what are the terms and conditions of these loans? *Note: housing microfinance competition tends to be higher in more mature microfinance markets, particularly surrounding urban centers. Nevertheless, the supply of targeted housing microfinance remains well below demand in most contexts.*[24] *The business case for housing microfinance is often strengthened in highly competitive microfinance markets, as housing microfinance becomes a means of retaining and increasing revenues from existing clients, while also attracting new clients (e.g., salaried employees). Where housing microfinance markets are more developed, financial service providers seek further niche differentiation through targeting specific market segments (e.g., low-income salaried workers) with more tailored products and services.*

Macroeconomic environment, regulations and policies: How do economic realities, including macroeconomic and political instabilities, affect housing microfinance portfolios? What is the level of maturity of the financial and specifically microfinance industries in terms of responsible lending? How are regulators mandating and supporting good lending practices? Are they encouraging and incentivizing lenders to add differentiated microfinance products for housing? How do land tenure status and the security of housing microfinance loans affect the growth of housing microfinance portfolios of institutions within the different tiers of regulatory frameworks? How do land markets and tenure systems support or impede financing for housing? Are government programs creating an enabling environment for housing lenders or competing with them as direct lenders?

Institutional levers

These refer to characteristics of the financial service provider that inform how housing microfinance responds to institutional priorities and aligns with operational and financial realities. The following are key levers to be addressed:

Opportunity cost: How do housing microfinance portfolio returns compare to other products of the financial service provider? Does housing microfinance pricing lead to healthy or unhealthy competition with these other products?

Capacity: How easily does housing microfinance dovetail with existing operational and administrative functions (e.g., policies, systems and processes)? Will the current sales force be able to sell housing microfinance loans, or is a specialized staff necessary? *Note: larger, regulated financial service providers tend to offer housing microfinance through their existing sales forces, which are equipped for multiproduct sales.*[25]

Capital/funding: How will the financial service provider fund the growth of the housing microfinance portfolio? Can the financial service provider finance growth with existing sources of capital, or will new sources need to be identified? Will lower-cost funds be needed? Will they need to be for longer terms? Where and how will these funds be sourced, and how will this impact the financial service provider's capital adequacy?

Social mission: How well does housing microfinance address the social mission of the financial service provider? How does the social mission inform or shape how the housing microfinance product is designed, priced and delivered? How does the mission influence priorities and practices that help to ensure that housing microfinance loans are invested well and that construction is safe and durable?

Segment-specific levers

Identifying the intended target market and use of housing microfinance loans is necessary for ensuring that the product is appropriately designed and marketing strategies are well-aligned. While mainstream housing microfinance is directed to financing the incremental home construction of entrepreneurs and employees of the informal economy, certain financial service providers have chosen to concentrate on specific niche markets (see Boxes 3 and 4). The following should be taken into consideration when defining a housing microfinance target market:

Income levels and sources: Which BOP segments will be served by the housing microfinance loans? What income ranges will be targeted? What income types or sources will be targeted (e.g., self-employed, formal salaried, informal salaried)? Will housing microfinance-loans be extended exclusively to existing clients, or also sold to new clients? *Note: Although the majority of financial service providers pilot test their housing micro-finance loans with existing clients, portfolio growth usually entails extending housing microfinance to new clients as well.*[26]

Box 3: Housing microfinance market niche – financing rental housing

Letshego Kenya has created a clear business case for targeting finance to owners of urban rental housing. The financial service provider is part of Letshego Holdings Ltd., an 11-country pan-African commercial financial services company. While initially focused on microenterprise lending via a Grameen-type group-lending model, Letshego Kenya's staff became aware that many clients were using loans to invest in housing construction. In 2012, Letshego launched a housing microfinance product, offering up to KS500,000 (US$5,000) for 12- to 24-month terms. Upon discovering the booming market for urban rental housing, Letshego decided to direct its housing loans to this sector. Letshego realized that growing urban populations are placing increasing demand on rental properties, and most of the younger urban residents are opting to rent. Letshego currently offers loans for sums between KS1 million and 2.5 million (US$10,000-25,000) for terms up to 72 months at 14 percent flat interest. Its focus is on urban centers, such as Nairobi and other up-and-coming cities of Kenya.

"We found a niche that enabled us to grow." – CEO, Letshego Kenya

The CEO of Letshego Kenya explained the rationale behind the business case for rental housing finance. The institution's brand promise is "improving lives," and housing finance meets this goal by investing in shelter. Furthermore, Letshego attempts to share a long-term view with its customers, seeking to grow together. Thus, as clients requested housing loans, Letshego felt compelled to add this product. Because housing finance entails larger loans and results in a higher-quality portfolio, profitability is solid. Moreover, financing for rental housing is an "unexploited niche," where there's negligible competition and plenty of room to grow. Currently, just over 50 percent of Letshego Kenya's loan portfolio is in housing.

"Housing just grows. The demand is there." – Head of microfinance, Letshego Kenya

Box 4: Housing microfinance market niche – low-income public-sector employees

Select Africa is a retail financial services group that operates in four countries of Sub-Saharan Africa — Kenya, Malawi, Lesotho and Swaziland — and is primarily dedicated to extending housing microfinance loans to unbanked public-sector employees. Select began lending in 1999, having identified low-earning civil employees as a stable, underserved market, and began securing loan repayments through direct payroll deductions. The financial service provider soon discovered that clients were frequently using personal loans to finance housing. Thus, it developed a product tailored to support incremental housing construction that entails larger loans (e.g., US$200 on average in Malawi and US$750 on average in Kenya) over longer tenures (an average of five years). Select currently serves approximately 55,000 borrowers, and over 60 percent of its loan book is invested in housing in Malawi, Lesotho and Kenya.

Select's commitment to housing microfinance responds to its social mission, whereby the financial service provider seeks to positively impact low-income housing markets in Africa. The company's stakeholders include development finance institutions and impact investors, who support Select's social mission with patient capital. Select offers housing support services through partnerships with third parties, such as Habitat for Humanity in Malawi, Lesotho and Kenya. Longer terms and higher repayment rates positively impact housing microfinance portfolio returns, but Select recognizes the importance of securing longer-term, low-cost funding to grow this product. As a non-deposit-taking institution, Select is seeking to grow both its investor base and its sources of local currency borrowing.

Geography and demographics: Will housing microfinance loans target clients of a specific sex or group of people? Will loans be directed to rural populations, or urban, or both? How will these definitions shape the product's characteristics or how it's sold among different groups or in different locations?

Types of construction: Will housing microfinance loans be directed exclusively to building one's own primary residence? Will housing microfinance loans be approved to finance the construction of rental units (residences)? Or housing developers? Or construction of commercial properties? *Note: With funding support from interested investors, many financial service providers are offering loans for specific housing-related products. Box 5 provides several examples of these types of programs.*

Profitability drivers

Central to the business plan is demonstrating the housing microfinance portfolio's financial viability and contribution to meeting the financial service provider's financial goals. The profitability of a housing microfinance portfolio is determined by the following drivers, which contribute to either revenues or costs:

Revenues

Product uptake: Once the product is rolled out, what is the rate of portfolio growth? This will influence how quickly the product reaches financial viability, increases profits and claims market share.

Pricing/yield: What is the direct income generated by the housing microfinance portfolio from interest and fees?

Box 5: Loans for specific housing-related solutions

Over the past decade, microfinance lenders have stepped up their offering of nonbusiness loans tied to specific social, health and environmental outcomes. Often prompted by targeted financing from interested investors and donors, many microfinance institutions have crafted loan products that promote sales of housing-related solutions to increase clean water supply, improve sanitation, generate solar products or reduce firewood consumption. These are frequently managed as a subset of housing microfinance loans, and coded in order to generate needed reports to respective funders. The loan products vary in terms of the tightness of their connection with the solution being financed, ranging from direct sales and delivery of a specific product to broader, cash-based housing microfinance loans that include financing for the type of solution being promoted. Examples follow below.

- **KWFT** offers its clients loans to purchase rainwater catchment systems (including large tanks), water filters, energy-efficient cook stoves and solar panels. Each of these is delivered as a specific product and serviced by the selected vendor. Such loans do not face any risk of fund diversion, as no cash is disbursed. This direct connection with a specific product requires a tight alliance between the bank and the vendor to ensure timely delivery, and high-quality products and support services. The KWFT staff says that when these alliances break down, loan repayments may be jeopardized.

- **Centenary Bank** provides loans specifically for water, sanitation and electrical power connections, which are captured under the umbrella of its home improvement loan product. It also recently launched CenteSolar to finance the purchase and installation of solar energy systems. These loans are disbursed in cash to the borrower, supported by a supplier invoice. Centenary Bank does not engage with specific vendors, as customers are left to make their own selections.

- **Mibanco's** Crediagua program functions as a promotional effort by loan officers to finance access to clean water solutions such as water utility connections and elevated tanks, and is frequently bundled into larger home improvements. The bank reports that approximately a third of Micasa's portfolio comprises loans that include some type of water-related improvement.

Costs

Product development: What costs are associated with designing and testing a new housing microfinance product? What are the costs of training operations staff and adjusting internal systems and processes to support housing microfinance portfolio growth?

Operations: What delivery channels and staff times are involved in processing housing microfinance loans? What servicing is required once loans are disbursed? How does the length of loan tenures impact these costs?

Marketing: What are the marketing strategies and associated costs for launching and growing a housing microfinance portfolio? How are housing microfinance product distinctions highlighted through marketing strategies?

Housing support services: What nonfinancial services are supplied to assist housing microfinance clients in managing the costs and quality of their housing construction?

What does it cost the financial service provider to offer these services directly or through nonfinancial housing service providers? Although the majority of African financial service providers consulted for this study did not offer extensive housing support services beyond loan processing support, Box 6 provides a summary of Habitat's findings after testing a variety of housing support service delivery models around the world.

Central to the business plan is demonstrating the housing microfinance portfolio's financial viability and contribution to meeting the financial service provider's financial goals.

These findings support the housing support service "light" approach taken by both KWFT and Centenary Bank as appropriate for facilitating housing microfinance at scale.

Risk/impairment: How secure are housing microfinance loan guarantees? What is the financial cost of nonperforming housing microfinance loans? *Note: Across the microfinance industry, housing microfinance loans consistently outperform business loans in terms of portfolio quality.*[27]

Box 6: Housing support services — a snapshot of the state of the practice

"Housing support services" refers to nonfinancial housing-related support that is provided to housing microfinance borrowers. These services are intended to facilitate access, reduce costs or increase the quality (e.g., security, durability or value) of the housing construction undertaken. Over the past 10 years, Habitat for Humanity tested a variety of housing support service business models in coordination with financial service providers offering housing microfinance, seeking to identify those services that resulted in the greatest customer satisfaction and highest construction quality, and that were also sustainable and could be delivered at scale.

In February 2017, Habitat for Humanity's Terwilliger Center for Innovation in Shelter concluded a study of 34 financial service providers around the globe to assess the current status and trends in providing housing support services alongside housing microfinance. Three types of housing support services strategies emerged from the surveyed institutions:

Market linkages: Financial service providers formed partnerships with other private-sector actors to strengthen the value chain of goods and services offered to families undertaking incremental housing construction. These tended to result in added benefits for borrowers, such as favorable prices from construction material suppliers or lists of recommended masons. Financial service providers also supplied printed materials to equip their customer base with basic project know-how and construction tips to enable them to make more informed decisions as consumers of shelter-related goods and services.

Loan-related services: Financial service providers assisted borrowers in determining how to segment and prioritize their home improvement goals, and ensured that the costs of the proposed project were consistent with the client's current borrowing capacity. These steps contributed to housing microfinance sales and appraisals, and tended to be streamlined and standardized such that loan officers could deliver them as part of housing microfinance loan processing.

Qualified technical assistance: In a few cases, borrowers were offered advice or direct assistance from a qualified construction professional (typically an architect or engineer). These services tended to be offered by a third party, such as a local Habitat for Humanity program, although in a few cases they were provided in-house by the financial service provider.

The study findings indicated that:

- **Financial service providers with growing housing microfinance portfolios tended to concentrate their housing support services on loan-related processes,** such as home improvement project planning and budgeting, which could be carried out by their existing sales force.
- Financial service providers found that **market linkages were difficult to maintain, and clients tended to value these less than was expected.** The only sustaining, large-scale partnership identified was an alliance between Mibanco and HatunSol (a financing program that operates under UNACEM cement company), which serves primarily as a sales channel for capturing new Micasa borrowers.
- The sustainable provision of **qualified technical assistance in conjunction with housing microfinance remains an unproven model** for financial service providers with growing portfolios. The few that had attempted to offer this service had either discontinued it or were reducing supply.

Walking through two business cases: KWFT and Centenary Bank

This section presents the housing microfinance business case for two leading microfinance banks in Sub-Saharan Africa: Kenya Women Microfinance Bank, or KWFT, and Centenary Bank of Uganda. Both of the countries where these financial service providers operate face very high housing deficits that are confronted with extremely low levels of mortgage loan penetration, signaling a critical demand for alternative financing options.[28] These conditions are compounded by low levels of land title ownership, hampered by complex and fragmented land registry systems. Moreover, the high cost of urban land has made homeownership unaffordable for much of the BOP; therefore, while homeownership is prevalent among rural dwellers, the majority of urban BOP residents are renters.

Recognizing the clear market opportunity, KWFT and Centenary Bank joined the "Building Assets, Unlocking Access" project under the partnership between the Mastercard Foundation and Habitat for Humanity. They received technical assistance provided by Habitat's Terwilliger Center for Innovation in Shelter to develop housing microfinance products and nonfinancial support services for people living on less than US$5 per day. As a result of the project, KWFT and Centenary Bank are now delivering loan products that make housing finance accessible to the BOP, addressing two primary constraints faced by borrowers: (1) accepting customary land ownership as a legitimate claim of secure tenure, and (2) assisting customers in segmenting their homebuilding aspirations into incremental and affordable steps that can be financed through a housing microfinance product. Furthermore, they have initially concentrated housing microfinance lending in rural and peri-urban markets, building on their existing client bases and institutional presence and capitalizing on the high rates of homeownership.

Both of the countries where these financial service providers operate face very high housing deficits that are confronted with extremely low levels of mortgage loan penetration, signaling a critical demand for alternative financing options.

While both KWFT and Centenary Bank are regulated microfinance-focused banks that are driven by a combination of social and financial objectives, their specific business drivers and resulting strategies for building a robust housing microfinance portfolio reveal notable distinctions. On the one hand, KWFT has ramped up delivery of unsecured housing microfinance loans through its existing network of branches and clients, leveraging its unique presence throughout rural Kenya to achieve a steady uptake in its popular new product. By maintaining similar interest rates to its core products and lending through existing loan groups, which help mitigate the costs and risks associated with making small loans in sparsely populated areas, KWFT has succeeded in generating increasing loan revenues at relatively low additional cost. Centenary Bank, on the other hand, offers housing microfinance as an individual loan product at a significantly lower rate than its other microfinance products, grabbing up market share and growing steadily with an enviably high-performing portfolio. Capitalizing on its extensive outreach and low-cost funding base, Centenary Bank makes a clear business case for a larger-ticket-sized, lower-yield product that both draws in new customers and increases borrowing among existing clients, while producing a higher-quality portfolio than its mainstream microfinance products.

Kenya Women Microfinance Bank (KWFT)

Kenya Women Microfinance Bank traces its roots back to the early 1980s, when a group of professional women from diverse backgrounds joined to establish a financial institution aimed at providing financial inclusion to women of Kenya in order to improve their economic status and livelihoods. In 2008, KWFT became a subsidiary of Kenya Women Holdings Co., and in 2010 the Central Bank of Kenya granted the bank a license to operate as a deposit-taking microfinance bank.[29]

The bank currently serves over 800,000 clients across the country through a decentralized network of over 245 offices located in 45 of Kenya's 47 counties, along with KWFT agents and a mobile banking facility. Throughout its growth, the bank has remained dedicated to serving women in rural areas, extending approximately 80 percent of its outreach to rural contexts, including villages and communities where no other financial institutions are present. The managing director, Mwangi Githaiga, describes the bank's key to success as the adoption of a "triple bottom line" pursuing social, financial and environmental outcomes, which is sustained by its socially motivated investor group.

In late 2013, KWFT signed a technical assistance agreement with Habitat for Humanity's Terwilliger Center for Innovation in Shelter, which led to housing microfinance market studies. The baseline survey highlighted the high demand for housing finance among KWFT's existing client base. Product design was completed in 2014, and pilot testing took place from November 2014 through April 2015, followed by the product rollout in July 2015.

The Nyumba Smart Loan product ("Beautiful Home" in Swahili) was designed to help KWFT clients access decent housing, thereby improving household living conditions and quality of life. The housing microfinance product is directed to women microentrepreneurs living in rural and peri-urban locations, who also form the target market for KWFT's primary loan product, the group-based "Biashara" (business) loan. Key housing microfinance loan features are highlighted in Table 4. As of June 2017, KWFT's Nyumba Smart product reached 38,705 loans disbursed, totaling KSH2,765 million (US$26.8 million).

Jane, a client of KWFT, received a Nyumba Smart loan of 200,000 Kenyan shillings, or about US$1,976, in 2015 and used it to start building her home. She mentions that she saw a picture of a house at KWFT that she liked, and she wanted to build something similar. She had her own *fundi*, a local worker, who looked at the picture and gave her a plan and a budget needed to build such a house. "I used this guy to help with the construction and also put a lot of my own time to supervise all the work," she says. In May 2016, her house was complete and she moved in.

Table 4: Housing microfinance Nyumba Smart loan characteristics – KWFT

Loan characteristics	KWFT – Nyumba Smart
Target market(s)	Women entrepreneurs, primarily living in rural areas.
Type of loan	Primarily issued to members of a group who mutually guarantee one another's loans. Also individual loans (less than 10 percent of total loans).
Loan sizes	$50-$10,000 Average: $700
Loan terms	Up to 60 months Average: 18 months
Guarantees or collateral	Personal and group guarantees for loans under $5,000. Loans above this are secured with "tangible assets": collateral, registered land.
Interest rate	24 percent flat (36.8-41.7 percent APR) plus 2 percent application fee and 2.25 percent insurance, on par with other microfinance products.

Market

The Kenyan housing sector is divided into rural and urban markets with notable distinctions. The majority of the population lives in rural and peri-urban locations characterized by high rates of homeownership on family "homesteads," which grow by adding new housing units as children mature and form their own families. In rural Kenyan society, the physical appearance of one's home is very closely tied to social status, thus compelling families, and particularly women, to pursue opportunities to gradually improve their residences.

On the other hand, tenants comprise over 80 percent of the residents of the capital city, Nairobi.[30] Given the high price of urban land and the ongoing connection to their original home, renters often choose to build on their family homestead while continuing to rent in the city. Others acquire less expensive land in the informal settlements on the urban periphery, and build gradually. Both types of goals align with the incremental, self-build process undertaken by the majority of Africa's BOP.

"The issue of housing brought itself in a very natural way from our clients." – Mwangi Githaiga, managing director, KWFT

The demand for housing among KWFT's existing client base was evidenced through the diversion of loan funds to housing from other products, and confirmed by KWFT's own market studies. Customary land ownership prevails throughout Kenya, particularly among low-income rural residents. Given the bank's history in lending to customers without formal title, extending housing microfinance to improve clients' residences was not perceived as an overly risky venture.

KWFT is the largest of 13 regulated microfinance banks, holding 42.9 percent of market share among this category of financial institutions as of December 2016.[31] In terms of competition, the bank's staff did not perceive alternative housing finance options among their client segments, particularly in the rural areas where KWFT concentrates its operations. As highlighted in the previous section, Select Kenya and

Letshego Kenya are directing housing microfinance to specific BOP markets among low-earning public servants and owners of low-cost rentals. The Association of Microfinance Institutions in Kenya, or AMFI, confirmed as part of this study that microfinance institutions, in general, have been slow to move into housing microfinance, remaining primarily dedicated to their core business of microenterprise lending.[32] Furthermore, government-sanctioned interest rate caps on commercial bank loans (which do not apply to microfinance) have further diminished the supply of mortgage financing to all sectors, particularly to the BOP,[33] and have widened the distinction between microfinance and commercial lenders, as the latter are driven to seek lower-cost and lower-risk opportunities. All of these market factors signaled a compelling business opportunity for KWFT to launch its housing microfinance product.

> "KWFT is driven by the triple bottom line approach – profit, planet and people – while developing its products. KWFT focuses on the products' ability to generate returns (profit), their impact on the environment (planet), as well as their ability to transform their customers' lives (people). All products are designed to improve the livelihoods of the clients and their families, uphold their dignity, save them time and energy, earn them income, and conserve the environment."
>
> – From KWFT's website: kwftbank.com/our-story

Institutional

Institutional conditions within KWFT proved highly favorable to launching Nyumba Smart. The bank's extensive geographic coverage and multiproduct offerings created a robust operational platform from which to sell housing microfinance. Loan officers had years of experience in selling loans for specific housing-related products, such as iron sheet roofing, water tanks and purifiers, cook stoves, and solar power systems. The addition of a more broadly encompassing home improvement loan was perceived by the bank's staff to be a natural next step.

> "This is something that is touching the lives of our clients in a very positive way."
>
> – Mwangi Githaiga, managing director, KWFT

"My feeling is that we got into this product a little too late," says Mwangi Githaiga, the bank's managing director. "We should have been there 10 years ago." Central to KWFT's commitment to Nyumba Smart is the product's direct contribution to the bank's social impact. Bank leadership is quick to acknowledge how visible improvements in clients' homes accompanied by customers' expressions of gratitude give evidence of the product's clear connection to the bank's mission. Furthermore, KWFT has received public recognition from various government entities, including the president of Kenya, the Kenya BankersAssociation and other members of the banking industry, for its contributions to improving housing conditions. These strengthen KWFT's public image as a socially motivated financial institution at a time when the bank seeks to differentiate itself from mainstream commercial banks.

To reduce the opportunity costs of introducing a potentially more complicated loan product that was outside of its core business lending, KWFT streamlined loan processes and offered only "light" housing support services, tied to the credit application process. Furthermore, by charging similar rates and fees for Nyumba Smart as its other microfinance products, KWFT claimed similar yields and no evidence of internal competition with its other loan products. Initial growth of the housing portfolio has been financed from existing resources, but the bank may look to outside borrowing as it continues to grow Nyumba Smart. Housing microfinance loans currently comprise just over 5 percent of the total loan portfolio, and the bank's intention is to grow its housing portfolio to at least 10 percent.

Segment

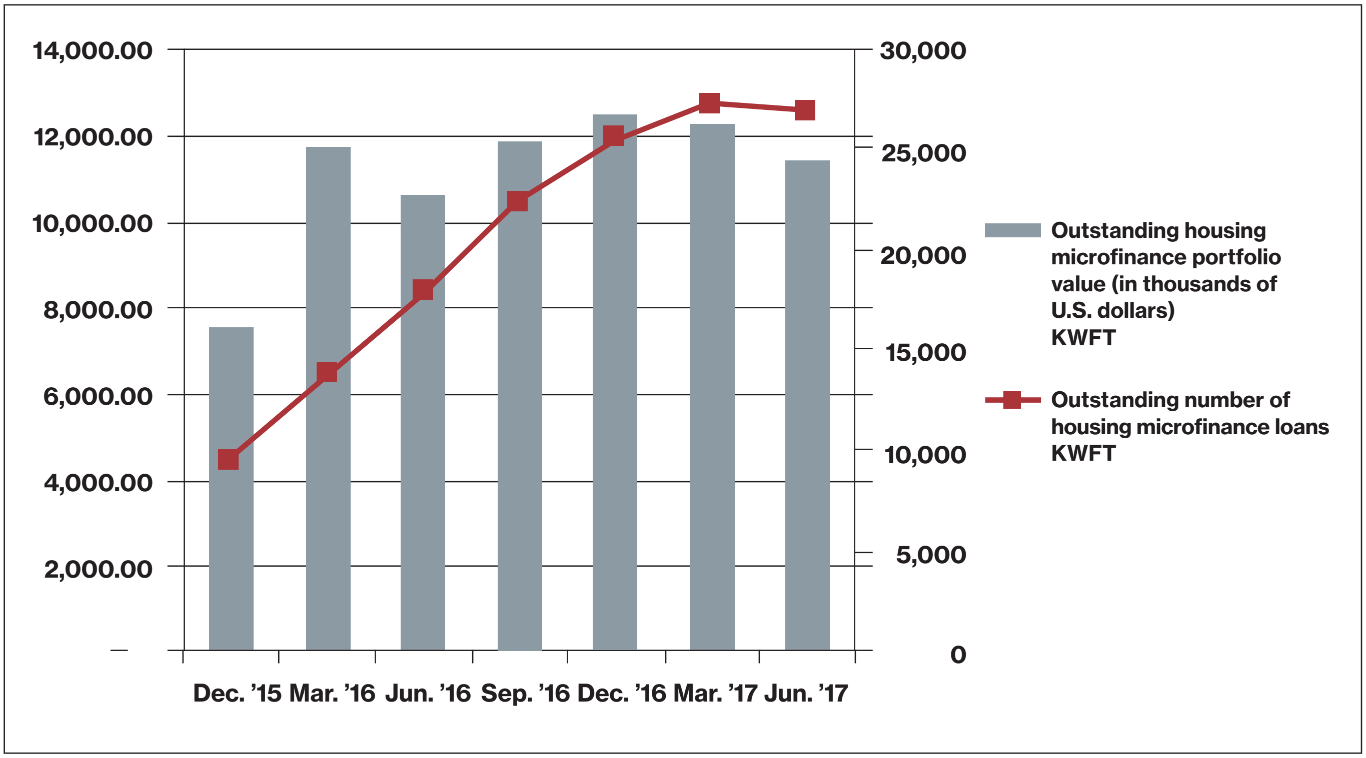
In keeping with its primary customer base, KWFT has directed its Nyumba Smart loans to women entrepreneurs. Although the product was piloted in both rural and peri-urban branch offices, uptake has been significantly greater in rural areas, representing 73 percent of total housing microfinance loans as of March 31, 2017. The bank's staff explained that this is due to the rural focus given to the product and the expectation that loans would be delivered primarily through existing loan groups, which operate predominantly outside urban areas. Housing microfinance loans have been used primarily to improve existing homes or build additional homes for relatives on family homesteads. Savings, stockpiled materials and resources from other family members are often leveraged with the housing microfinance loan, enabling the family to undertake a larger or more complete home improvement project.[34]

> With products like Nyumba Smart, "You can create an emotional relationship with your customer. ... This is how they become a loyal customer."
>
> – Mwangi Githaiga, managing director, KWFT

Profitability drivers

Revenues: KWFT cites the swift growth of the Nyumba Smart portfolio as clear evidence of the product's success, surging from 1,061 loans on April 30, 2015, when pilot testing concluded and national rollout began, to 26,887 loans outstanding as of June 2017. (Figure 3 is a graph of Nyumba Smart's growth.) Sales of the Nyumba Smart product have allowed KWFT to re-engage lapsed clients and draw in new customers (approximately 5 percent of total), while building loyalty among existing clients with a longer-term product that is directly tied to the clients' most valuable family asset. "Clients who were on the way out have stayed on due to the product," a KWFT unit manager reports. "It is helping with client retention." The Nyumba Smart pricing is consistent with KWFT's other microfinance products, contributing to similar yields.

Figure 3: Growth of Nyumba Smart Loan



Costs: Nyumba Smart was developed with technical assistance from the Terwilliger Center through a partnership with the Mastercard Foundation, thereby reducing some of the startup costs. The product was initially sold to existing clients through KWFT's extensive network of branches and loan officers, and marketed by word-of-mouth promotion, resulting in minimal added costs. The bank has concentrated its housing support services on assisting clients in planning their home improvement projects, which feeds into loan underwriting processes that ensure loan affordability and construction budget accuracy. Furthermore, the Nyumba Smart loan product has a longer term — averaging 18 months compared with a maximum of 12 months for microenterprise loans — resulting in less frequent origination costs.

Nyumba Smart adds diversification to KWFT's loan portfolio, which is heavily concentrated in working capital loans (80 percent of total). Over 95 percent of housing microfinance loans are unsecured and under US$5,000, backed by personal guarantees. Because KWFT has directed the majority of Nyumba Smart loans through groups, loan processing costs have been kept low, and repayments are high. As of March 31, 2017, KWFT reported that the product's PAR30 rate was one-third of the rate of KWFT's overall portfolio. Nevertheless, 2017 was a challenging year for many financial institutions in Kenya, as most banks experienced rising loan delinquencies across their portfolio, mainly because of external factors (e.g., political instability surrounding presidential elections). Strong loan administration and management practices need to remain a priority for the bank as the housing microfinance product surges ahead, with the recognition that rapid growth may be favorably skewing portfolio risk indicators.

As revealed by the detailed profitability analysis found in Appendix A, the financial performance of KWFT's housing microfinance product makes it a compelling product for the bank.

Centenary Bank

Centenary Rural Development Bank started operations in 1983 as a trust under the Uganda National Apostolate (Catholic Church). Ten years later, it was registered as a full-fledged Commercial Bank. Today, it is a leading commercial microfinance bank in Uganda that has remained focused on its mission "to provide appropriate financial services, especially microfinance, to all people, particularly in rural areas, in a sustainable manner and in accordance with the law."

As of June 2017, the bank has served over 1.4 million customers, representing over a third of the banking population, and over 200,000 of them are borrowers. Centenary Bank reaches its clients through a network of 69 branches, 172 ATMs, phone banking (CenteMobile), internet banking, and point-of-sale terminals. It will soon begin agent banking.

Centenary Bank offers a wide variety of products and services to its customers, including loan products and various types of savings and current accounts. After noting that a significant proportion of business loans were being diverted to finance housing, in 2012 the bank developed and launched a micromortgage loan, the Home Improvement Loans product, or HIL; for the purchase or construction of both residential and commercial property, followed by CenteLand Loan for land purchases and processing land titles — the major obstacle for most of the bank's clients who had land.

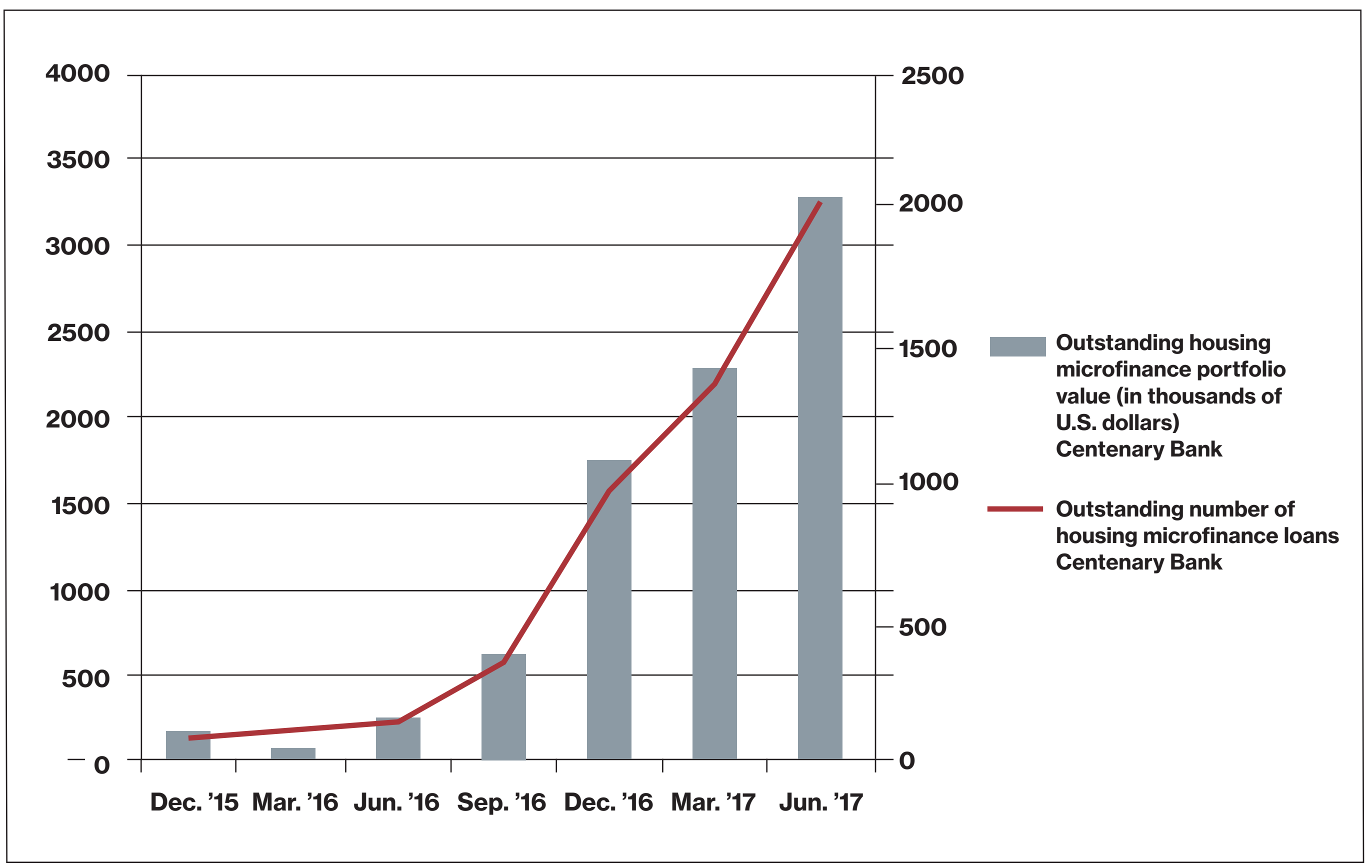
In 2013, the bank entered into a partnership with the Terwilliger Center for Innovation in Shelter that facilitated the development of a new housing product called CenteHome loans. These loans were tailored to finance construction of houses for lower-income populations by accepting customary land ownership as security on the loan and promoting incremental housing construction, whereby improvements are broken into smaller, more affordable steps. The bank piloted the product in two branches between August 2015 and May 2016, and CenteHome is now undergoing a staged rollout, with 47 branches offering the product as of October 2017. Product highlights are featured in Table 5, and portfolio growth is shown in Figure 4.

Asiimwe, a client of Centenary Bank, received a CenteHome loan of 2.3 million Ugandan shillings, or about US$690, and used it to purchase roofing, windows and doors to complete the basic construction of his house. The loan is for 24 months. He took it in September 2016 and will finish paying it off in September 2018 with monthly repayments of 122,754 Ugandan shillings, or about US$35, a month. When he finishes repaying this loan, he plans to try to earn more money, add it to savings, get a new loan, and build a bigger house. "I don't want to stay in a small house," he says.

Table 5: Housing microfinance CenteHome loan characteristics – Centenary Bank

Loan characteristics	Centenary Bank – CenteHome
Target market(s)	Existing and new clients engaged in microenterprises or agriculture, and salaried employees such as civil servants. Both rural and peri-urban residents.
Type of loan	Individual loan.
Loan sizes	$30-8,275 Average: $2,000
Loan terms	Up to 60 months Average: 24 months
Guarantees/security	Secured with the land on which housing is developed, with or without registered title. Also personal guarantees.
Interest rate	25 percent APR plus UGX15,000 application fee and 2 percent commitment fee (9 points below microenterprise loans).

Figure 4: Growth of CenteHome



Market

In Uganda, as in much of sub-Saharan Africa, housing for the low-income majority is a pressing need that is addressed through piecemeal, individual efforts, rather than by either government or private-sector solutions. Over 70 percent of housing in Uganda is "self-built" by a process of informal and incremental construction and financed primarily from household savings.[35] Rural families tend to reside in homesteads, as in Kenya, and national owner occupancy rates are very high – estimated at 77 percent according to the 2012 national census. Centenary Bank is the second largest among 24 registered commercial banks operating in Uganda, and is the leading financial service provider dedicated to serving BOP markets. Centenary Bank has offered housing finance to its customers over the past 15 years, but as with many other formal lenders, these loans were restricted to borrowers possessing legal land titles, a very small minority of landowners.

Several Tier I and Tier II microfinance institutions have begun offering housing finance[36]:

- Opportunity Bank of Uganda, or OBUL, offers housing microfinance loans primarily through its existing loan groups as small, incremental financing that's priced similarly to its business loans.
- PRIDE Microfinance provides housing microfinance as individual loans to group members at a preferential interest rate.
- UGAFODE offers both very small (under US$1,000), unsecured "flexible housing loans" and also "micromortgages" for significantly larger sums, which are backed by a formal mortgage agreement.
- Finance Trust Bank is growing its Smart Home Loan, which finances all stages of incremental housing, including land purchase and titling. The bank recognizes all forms of land tenure and lends only up to US$5,500 for construction on unregistered land.

Consumer loans from commercial banks are a significant source of unsecured housing finance, but these are restricted to the formally employed. The Bank of Uganda, which acts as the regulatory body for financial service providers in Uganda, has neither specifically recognized housing microfinance nor mandated policies regarding its provision. Housing microfinance remains relatively invisible to the banking sector, as housing microfinance portfolios are obscured under the general heading of unsecured microfinance lending. Thus, housing finance for the BOP is on the rise, but supply is still very limited in relation to demand.

Motivated by the vast unmet demand for housing finance, Centenary Bank realized the opportunity to extend smaller, unsecured loans and engaged a local legal instrument, known as the "Kibanja mortgage," to increase the security of housing loans above a set threshold.[37] By opening access to clients with customary land ownership and offering its product at below-market rates, the bank has strategically positioned CenteHome and is progressively capturing market share throughout Uganda. This was evidenced during conversations with other financial service providers entering into housing microfinance, who referred to CenteHome as their point of reference within that market.

Institution

Centenary Bank offers a broad range of financial products and services, and its sales force is experienced in selling the full range of offerings. The bank's prior experiences in extending home improvement loans, along with product-specific loans for water, electrical power and sanitation solutions, have paved the way for growing a more comprehensive and robust housing microfinance portfolio. Furthermore, the bank views increasing access to housing finance as a means of meeting its mission to "provide appropriate financial services, especially microfinance, to all people, particularly in rural areas." With its extensive network of branches and solid image as the leading microfinance bank in Uganda, Centenary Bank is well-positioned to roll out its CenteHome product nationwide.

The bank is also aware of challenges that need to be mitigated as the CenteHome housing microfinance product grows. A key concern is ensuring that CenteHome loans are not diverted to other purposes, effectively "cannibalizing" existing products with higher interest rates. Thorough loan analysis and monitoring are seen as priority measures. Another issue is ensuring sufficient capital at low enough prices to match the product's pricing structure. The bank's leadership recognizes that this may entail identifying competitively priced, longer-term capital than the small, short-term deposits that finance much of the bank's lending. Centenary Bank is well-positioned to access the capital needed to grow, given its sound financial performance and high capital adequacy.[38]

Segment

CenteHome was initially targeted to existing customers of Centenary Bank and is now being offered to new clients and market segments. The product has been particularly popular among low-earning public servants, such as teachers and policemen, with small but stable incomes. CenteHome's initial growth built on the bank's existing outreach, which is concentrated in rural and peri-urban settings throughout Uganda. While loans are primarily directed toward residential projects, financing may also include construction of rental properties. The bank's staff perceive high growth potential for CenteHome in urban and peri-urban areas, where housing demand is on the rise, borrowing capacity is high because of higher levels of economic activity, and loan sizes are generally larger.

Profitability drivers

Revenues: Centenary Bank views CenteHome as a winning product because of its rapid growth and popularity among various client segments. Since its pilot launch in 2015, CenteHome has grown to 2,198 loans outstanding as of June 2017, and the product's rollout is expected to be completed to all 69 branches during the first quarter of 2018. Although initially marketed to existing loan clients, it is now attracting new markets of low-earning salaried workers, such as public servants. Key to the product's success is its below-market interest rate, which is strategically positioning CenteHome within an underserved market as the leading housing microfinance product and point of reference for other lenders. Larger loan sizes and longer terms contribute to increased revenues; nevertheless, CenteHome's pricing results in lower yields compared with the bank's other microfinance products.

Costs: The operational costs of CenteHome are mitigated through leveraging Centenary Bank's strong brand, large client base and extensive operational infrastructure to deliver the product. Moreover, the bank's sound equity structure, whereby 18 percent of assets are composed of retained earnings, created a supportive funding base for launching the new product. The technical support from Habitat's Terwilliger Center for Innovation in Shelter, through the partnership with the Mastercard Foundation, helped reduce the cost of housing microfinance product redesign and pilot testing. The Terwilliger Center also trained the existing sales force, who was experienced in selling multiple products, so they could promote and efficiently process CenteHome loans. Housing support services are bundled with loan processing and delivered by these same loan officers. Housing support services are focused on helping clients identify, segment and prioritize affordable housing projects, and verifying accurate construction costs. During rollout, marketing costs have been kept low, focusing primarily on word-of-mouth promotion among clients and internal training and targets for staff. Centenary Bank, with support from the Terwilliger Center, developed an extensive branding and marketing strategy for CenteHome that just recently started as the product rolled out nationwide.

CenteHome's costs benefit from its low-risk performance. The bank's underwriting strategies, employing Kibanja mortgages for loans between $1,500 and $4,000, have helped to ensure low PAR for the CenteHome portfolio, which is currently below half the PAR rate of the entire loan book. As mentioned before, in an effort to provide a full range of financial services, the bank also lends for land purchase and titling costs under the CenteLand product. Clients of either product who possess land under customary ownership are encouraged to seek full title and are given a list of preselected surveyors who can facilitate land processing and titling. By formalizing property ownership, clients increase their land value and tenure security, while the bank develops a pool of customers who can access larger loans with mortgage guarantees.

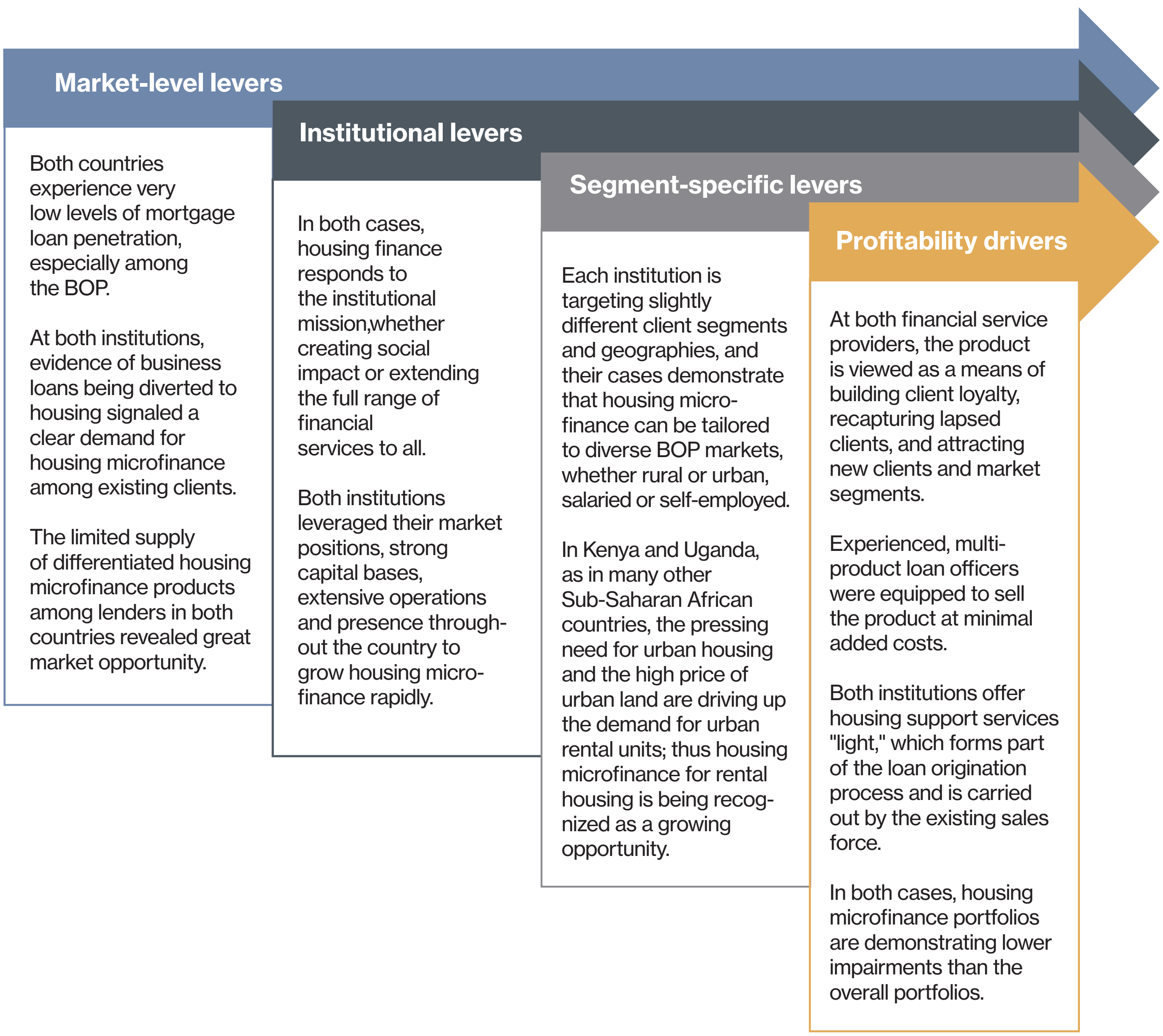
A more in-depth analysis of CenteHome's financial scenario is found in Appendix A.

Conclusions

The initial sections of this publication set forth a justification for developing a housing microfinance business case, and offered a framework for doing so. The previous section provided a more in-depth description of the housing microfinance business cases of two microfinance banks in Sub-Saharan Africa: Kenya Women Microfinance Bank, or KWFT, and Centenary Bank in Uganda. This last section begins with a review of the findings from the two business cases (Figure 5), provides several overarching observations, and suggests insights to be considered by financial service providers and investors as they contemplate venturing into housing microfinance.

Findings overview

Figure 5: Summary findings overview from the business case for housing microfinance of KWFT and Centenary Bank

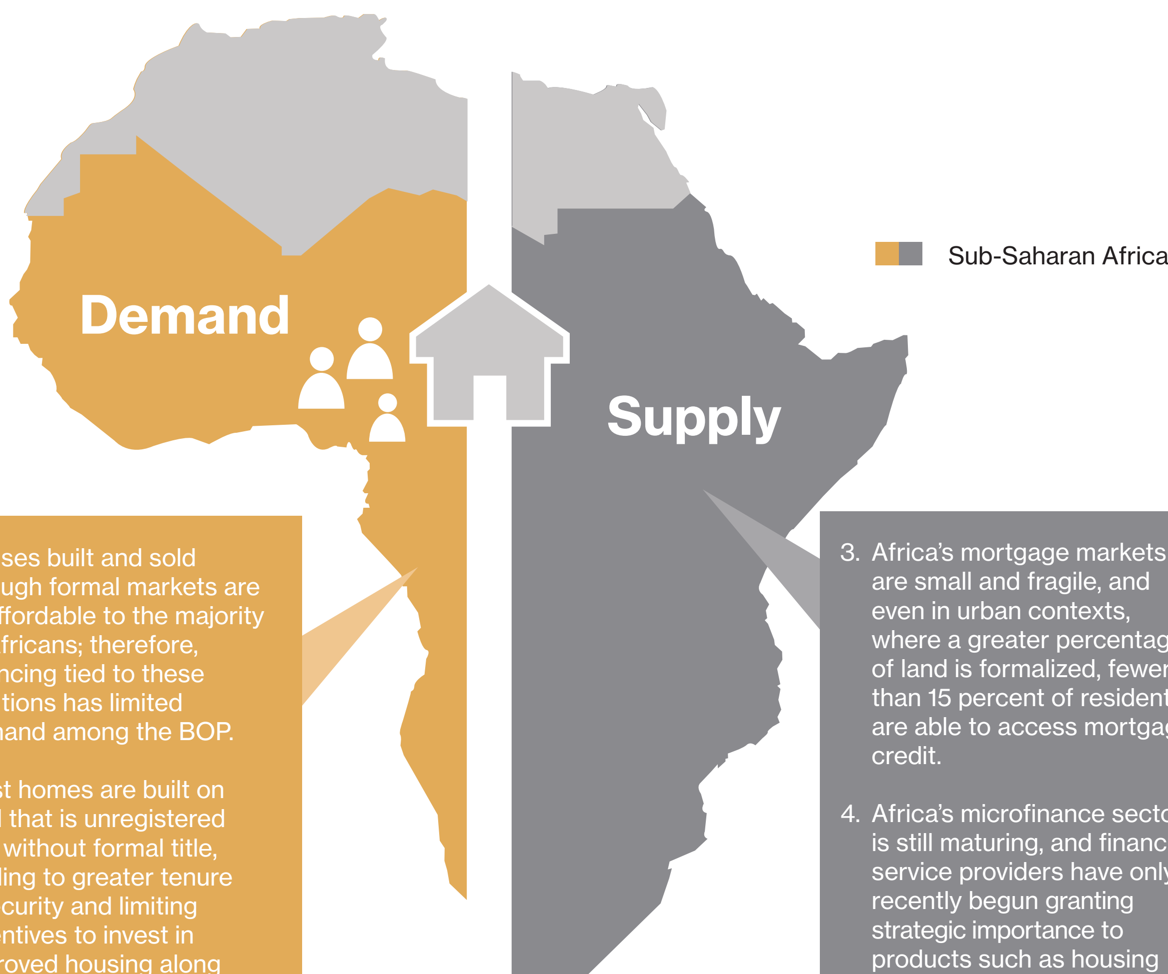


Housing microfinance is emerging as a product to help reduce the housing market gap at the BOP

As was stated at the start of this publication, the business case for housing microfinance is born out of the immense market gap that exists between the growing demand for housing at the base of the pyramid and the vastly limited supply of appropriate financing.

A visual depiction of this gap is presented in Figure 6. Housing microfinance has emerged from within the microfinance industry as a product that's uniquely tailored to the financial capabilities and building practices of the low-income majority. Several regulated financial institutions are now taking housing microfinance to scale, giving evidence of what comprises a strong business case for housing microfinance. What follows is a list of more generally applicable observations that arise from their business cases.

Figure 6: Africa's housing finance market gap



1. Houses built and sold through formal markets are unaffordable to the majority of Africans; therefore, financing tied to these solutions has limited demand among the BOP.
2. Most homes are built on land that is unregistered and without formal title, leading to greater tenure insecurity and limiting incentives to invest in improved housing along with the financial options for doing so.
3. Africa's mortgage markets are small and fragile, and even in urban contexts, where a greater percentage of land is formalized, fewer than 15 percent of residents are able to access mortgage credit.
4. Africa's microfinance sector is still maturing, and financial service providers have only recently begun granting strategic importance to products such as housing microfinance, that lie beyond the scope of traditional microenterprise lending.

Lessons arising from the housing microfinance business cases

1. **Remember the double bottom line:** A solid housing microfinance business case is built on a clear connection between housing microfinance and the financial service provider's mission. As the Terwilliger Center's *2016 State of Housing Microfinance* report reveals, the greatest motivator for undertaking housing microfinance among surveyed lenders is the positive impact it has on families' well-being, producing noticeable social benefit. Is housing finance viewed as key to ensuring full financial inclusion? Is it a necessary component of institutions offering the full range of financial services? Or is housing finance seen to be outside the financial institution's "core business" of enterprise or consumer lending? As housing microfinance portfolios grow and reach scale, financial performance becomes of increasing importance; nevertheless, the product's connection to a financial service provider's core mission is also vital to ensuring continued dedication to growing housing microfinance among operations staff, and a devoted pursuit of needed funding.

2. **Selling incremental housing:** Since housing microfinance does not closely resemble mortgage loans, which involve property liens, long terms and low interest rates, it is harder to distinguish from other products with similar loan sizes, tenures, guarantees and even pricing. What then is the differentiating feature of housing microfinance? An initial assumption among financial service providers is that the provision of nonfinancial construction-related services, or housing support services, alongside financing is what makes housing microfinance unique. However, the extent of housing support services tends to diminish as portfolios grow, loan processes are streamlined and cost efficiencies are prioritized for the sake of profits.

   Interestingly, financial service providers have come to find that a key feature of housing microfinance is how it's marketed, often involving a process of educating clients about the benefits and realities of incremental housing construction. Loan officers often engage directly with customers to help them determine how to break down and prioritize their home improvement aspirations, while ensuring that project costs are in line with borrowing capacities. Sales strategies that involve orienting potential customers help to position housing microfinance within the market as well as within the financial institution, presenting housing microfinance as a key component of incremental housing construction and thereby giving this process visibility, intentionality and structure. Thus, both internal marketing (e.g., staff training) and customer sales become critical to selling housing microfinance as a unique product offering.

3. **Pricing: What does the market say?** Another common assumption is that housing loans must be priced lower than business or consumer loans, based on the observation that mortgage rates are relatively low and because housing is considered a nonproductive asset. In actual practice, financial service providers are pricing housing microfinance on par with, below or even above their mainstream loan products. Although lowering housing finance costs to end-users is a worthy goal, it's helpful to note that costlier housing microfinance products are still highly valued by BOP customers, which bodes well for financial service providers that are concerned about reaching profitability in a relatively short period. As portfolios continue to grow and competition increases from other lenders, we can hope that the favorable profitability drivers of housing microfinance – the larger loan sizes, longer terms and high repayments – will nudge prices downward.

4. **Land tenure is a process, too:** Housing microfinance is intimately connected to land ownership and tenure, and a key to the product's success is unlocking the potential for financing home improvements on land with customary or informal title. In many contexts, such as Kenya and Uganda, restricting housing microfinance to construction on formally

owned land significantly constrains portfolio growth, especially among the BOP. Thus, a strong business case for housing microfinance will take into account contextual land tenure realities, addressing the following:

a. Identifying legitimate forms of land tenure and practical means of verifying each.
b. Determining loan policies (e.g., maximum loan sizes) that correspond to differing levels of tenure formality.
c. Seeking ways to strengthen the association between a client's loan responsibility and their property (e.g., Uganda's Kibanja mortgage).

In much of Sub-Saharan Africa, as in other contexts where land administration systems are weak and struggling, the process of land formalization is slow, costly and complex. Therefore, most families can advance only by taking small, incremental steps. Financial service providers such as Centenary Bank have promoted housing microfinance as a means of strengthening families' tenure status by offering loans and assistance to clients to take steps toward formalization.

5. **Growth trade-offs:** New housing microfinance products are often initially directed toward existing clients, "rewarding" them with credit that's in high demand while seeking to build their loyalty. On the one hand, this practice facilitates rapid growth by mobilizing additional credit to known customers. However, if credit analysis is insufficient, portfolios are prone to deteriorate from client overindebtedness. Furthermore, if housing microfinance is not intentionally marketed outside existing clientele, growth will eventually be stymied.

   Many financial service providers, like Centenary Bank, recognize that housing microfinance is also a strategic product for attracting new clients and even market segments (e.g., low-income salaried workers, remittance recipients, pensioners), which may result in less aggressive growth rates, as compared with the former, given necessary marketing and client screening. Nevertheless, this kind of growth brings greater portfolio diversification, spreading risk across a broader and more varied client base while expanding the financial service provider's overall market.

6. **Funding housing microfinance growth:** Securing long-term capital becomes a critical issue when pursuing housing microfinance growth. Financial service providers recognize that housing microfinance is a capital-intensive product, particularly when undergoing rapid growth, because of its relatively larger ticket size. The impact of loan terms on financing is another factor to consider. Although the cases presented in this publication revealed average loan terms of 18-24 months for housing microfinance, which is only a moderate increase over business or consumer loan tenors, these averages may rise in response to changes in the repayment capacity of their client base, or other external factors. Notably, financial service providers serving particular market niches, such as public employees and rental property owners, are delivering housing microfinance at significantly longer terms.

The following observations can be made regarding funding scenarios for housing microfinance portfolios:

- **Deposit-taking institutions** benefit from a relatively low-cost source of local capital to finance housing microfinance, but the longer terms associated with housing microfinance loans may result in greater asset-liability mismatch with this kind of funding.
- **Borrowing from international sources** is an option when capital adequacy is sufficient and pricing is appropriate. However, in countries such as Kenya and Uganda, borrowing in local currency is highly preferred because of the high costs associated with hedging hard currency loans.
- **In terms of equity,** financial service providers owned by socially motivated investors are likely to find support for a housing microfinance business case, and may be better equipped to price housing microfinance at lower rates

because of more modest return expectations in comparison with commercial investors.

- **Equity structures** that maintain a significant proportion of retained earnings and high capital adequacy are also well suited to grow promising new products such as housing microfinance.

The case for launching and growing housing microfinance is supported by a growing body of experiences from financial service providers around the world, responding to housing market opportunities as well as institutional priorities and capacities. The pressing demand for housing microfinance is evidenced by the rapid uptake and high repayment performance that these financial service providers have experienced. Unique market niches within BOP housing sectors are being identified and exploited through tailored housing microfinance products. Looking ahead, as Sub-Saharan Africa's financial services industries continue to grow and mature, housing microfinance is likely to become a mainstream offering, as it is more fully recognized as the financing option that addresses the growing housing needs, the incremental building patterns and the land tenure realities of the region's BOP.

APPENDIX A: A detailed profitability analysis of housing microfinance at KWFT and Centenary Bank

Although the microfinance providers interviewed for the case studies cited "social impact" as a reason to position their housing microfinance product, each of them stressed that the economic viability of their housing microfinance product was paramount to scale. Typically, the financial service providers consider housing microfinance products as non-income-generating or nonearning assets and thus sensitive to pricing. None of the financial service providers interviewed had access to long-term capital funding from local banks or government institutions, thus they rely greatly on customer deposits, access to foreign capital, and retained earnings. Factors contributing to the overall profitability include:

- Funding costs and interest rate margins.
- Delivery/service cost.
- Credit quality.
- Risk appetite.

Kenya Women Microfinance Bank (KWFT)

Kenya's banking sector comprises about 42 commercial banks, one licensed mortgage finance company and 13 deposit-taking microfinance institutions, or DTMs, now known as microfinance banks, including KWFT.[39] Additionally, Kenya has the largest savings and credit cooperatives, or SACCO, and second largest borrower base in the continent.[40] KWFT has managed to distinguish itself from others with its sustained focus on a triple-bottom-line approach and its emphasis on serving rural clients. As of December 2016, KWFT's return on allocated equity was 4.8 percent, and it retained earnings at 4 percent of total assets – lower than other microfinance banks. Given its structure of ownership, KWFT doesn't have access to large amounts of equity capital; only 25 percent of its shareholding is through strategic investors; the remaining is held equally by KWFT Holding, the staff and board of directors, and women clients. Below is the financial highlight of KWFT as of December 2016.

KWFT key financial data — December 2016

	In millions of Kenyan shillings	% of total assets
Loans and advances outstanding	22,188.6	69%
Cash and balance	2,179.8	7%
Total assets	32,153.4	
Customer deposits	17,156.1	53%
Borrowed and managed funds	9,074.1	28%
Retained earnings	1,434.7	4%
Impairment	158.4	1%
Total equity	4,755.7	15%
		% of total earned income
Interest and fees on loans	6,936.3	92%
Interest expense	1,946.0	26%
PAT (profit after taxes)	224.0	3%

Funding costs and interest rate margins: KWFT has to rely on external borrowings to fund its portfolio. Although KWFT has been able to mobilize deposits, the customer deposits comprise 53 percent of its total assets, whereas loans and advances constitute about 70 percent of its portfolio. The average term of deposit is under 18 months, and the weighted average interest rate on short term is 6 percent. External borrowing consists of 28 percent of total assets. Total weighted finance cost on interest-bearing liabilities is high at 7.5 percent (11 percent on external borrowing). In 2016, 92 percent of KWFT's income contribution was through its core business of lending. KWFT's portfolio yield is around 28 percent, with a funding ratio of 8.6 percent resulting in a net interest margin of 18.9 percent. Recently imposed interest caps by the government do not affect microfinance institutions in Kenya, but KWFT adheres to client protection principles. Although KWFT has received strong support from overseas microfinance impact investors, typical borrowing costs have been higher because of hedging of local currency loans, squeezing the net interest margin further. KWFT's strategy is to focus on increasing low-cost customer deposits in its funding mix.

Delivery/service cost: KWFT's operating expense ratio is about 22.4 percent, and cost per borrower is KES30,316 (about US$294). In 2016, the average loan size of KWFT's overall portfolio was KES94,071 (about US$914) with the Biashara, asset financing, construction and personal loans registering higher average loan size of above KES10 million (about US$105,000); Nyumba Smart's average loan size is about KES49,000 (about US$475). With a large focus on rural operations and smaller loan size, KWFT experiences high penetration costs; its cost-to-income ratio is very high at 96 percent, which is partially mitigated by the group lending methodology.

Credit quality: Ninety-three percent of KWFT's portfolio is concentrated in small to medium enterprisesand microcredit loans (which also include Nyumba Smart), along with 4 percent in consumer loans and 1 percent in agriculture. KWFT has managed to keep impairment and write-off at low levels of 3.3 percent and 1.6 percent, respectively. In general, financial institutions across Kenya, including KWFT, have witnessed a decline in credit quality in the past two years. For many financial institutions in Kenya, 2017 was a challenging year, as most banks experienced rising loan delinquencies across their entire portfolio, resulting mainly from external factors (e.g., political instability surrounding presidential elections). Strong loan administration and management practices need to remain a priority for the bank as the housing microfinance product surges ahead, with the recognition that rapid growth may be favorably skewing portfolio risk indicators.

Risk appetite: KWFT takes a comprehensive approach to risk management. Its Tier 1 capital to risk-weighted assets was 23 percent in December 2016 compared with the minimum requirement of 12 percent by the Central Bank of Kenya. KWFT doesn't have large reserves; as such, it takes a holistic view of all products in assessing enterprise-level risks. KWFT's intention is not high returns but to take a relative level of risk that will allow the institution to fulfill its social mission. This is also reflected in its strategy of offering Nyumba Smart to existing clients (95 percent of Nyumba Smart loans).

As a deposit-taking institution, KWFT is required to maintain regulatory requirements.

Nyumba Smart

As of December 2016, Nyumba Smart was about 6 percent of KWFT's overall gross loan portfolio and 11 percent of the total loans. Of the total products offered (11 as of December 2016), Nyumba Smart has shown outstanding performance with the lowest levels of portfolio arrears in terms of number of loans and KES value. Only 2 percent of Nyumba Smart's portfolio was in arrears, compared with high arrears – in double digits – registered for the Biashara and other loans of the institution. The management considers Nyumba Smart as the leading product among all the "touch life"[41] or "credit plus" products in terms of profitability (articulated in terms of low level of reserves), which has shown solid growth that has overtaken other products since it launched. Growth has especially been strong in eastern and western regions where other players don't operate, giving KWFT a competitive advantage.

KWFT has deliberately kept the interest rates similar to its other products to avoid creating any distortion in the market; lowering the yield could also result in leakage to microenterprise loans. One of the opportunity costs of offering Nyumba Smart has been the increase in resources (especially time) required for continuous monitoring. Requirement of additional documents has also resulted in longer processing time.[42] KWFT also cited reputational risk caused by poor-quality structures, as it doesn't view housing support services as its core competency.

Since the Nyumba Smart product's success is tethered to another product, the bank acknowledged the need to take a larger view and offer Nyumba Smart to salaried workers residing in peri-urban areas – larger size and a shift toward the urban market would also result in lower operational costs.

Centenary Bank

With nearly 24 commercial banks operating in an already crowded finance sector in Uganda, Centenary Bank has remained a dominant player with solid performance and good growth in terms of gross loan portfolio, deposit base and number of clients. Although lending to the BOP is its core business, the bank has diversified its sources of income. Sixty-six percent of its total income is from lending; the remaining is through interest earned on investments. With a return on equity of 24.8 percent in 2016 and 28.3 percent in 2015, Centenary Bank has outperformed the industry benchmark of around 7.8 percent. Expansion of branch network and launch of new products are typically funded through retained earnings. As of December 2016, retained earnings comprised about 18 percent of the balance sheet.

Funding costs and interest rate margins: As shown in the table below, Centenary Bank finances most of its lending (54 percent of total assets) through its deposits

Centenary Bank: Key Financial Data – December 2016

	In millions of Ugandan shillings	% of total assets
Loans and advances outstanding	1,247,702.8	54%
Cash and balance with BoU	314,099.4	14%
Total assets	2,315,749.3	
Customer deposits	1,626,614.2	70%
Borrowed and managed funds	118,034.7	5%
Retained earnings	422,951.7	18%
Impairment	14,983.5	1%
Total equity	485,017.0	21%
		% of total earned income
Interest and fees on loans	306,477.2	66%
Interest expense	46,817.3	10%
PAT (profit after taxes)	109,909	24%

(70 percent of total assets), 67 percent of which is in savings accounts, 23 percent current accounts and the remaining in time deposit; average term for deposits is under 12 months; average interest rate on deposits varies between 2 and 12 percent. Centenary benefits from significant availability of low-cost deposits. The finance cost on interest-bearing liabilities is very low, at 1.9 percent. The bank's overall yield on average loan portfolio is at 24.9 percent and a total funding expense ratio of 4.1 percent, resulting in a net interest margin of 20.8 percent. Although the bank tries to preserve a diversified funding mix, given its strong deposit base, it relies less on other sources of funding, especially foreign capital. Less than 5 percent of its total debt is through borrowing, 80 percent of which is financed by European Investment Bank at subsidized rates of under 2 percent for microfinance and small- and medium-enterprise activities while the remainder is financed by two local lenders. Funds received in local currency are often priced at prohibitively expensive rates because of hedging costs. The cost of funding is also based on the prevailing prime rate, which was around 22 percent as of December 2016, but only commercial, corporate, leases and overdraft loans are linked to this rate. The bank assigns the T-Bill rate to determine financial costs for CenteHome.

Delivery/service costs: The average cost of delivering the loan products for the bank is around 14 percent, and about 12 percent for deposits including the interest rate. The bank's cost-to-income ratio is high: 68.1 percent in 2016. This is largely due to the heavy investment in technology to upgrade its core banking system to improve service delivery. Its operating expense ratio is about 23.1 percent. In December 2016, the bank's average loan size in U.S. dollars ranged from $385 (microenterprise loans) to $21,900 (mortgage loans), with housing microfinance loans at $1,185.

Credit quality: Centenary Bank's portfolio quality is evident in its low level of impairment. Overall PAR over 30 days is at 1.9 percent of the average portfolio, and loan write-off is at 0.9 percent. The PAR is considered low compared with the industry benchmark, especially in the context of the Ugandan market. Salary and microenterprise loans have been the major contributors to the impairment.

Risk appetite: Like KWFT, Centenary Bank follows a comprehensive framework in aligning its overall strategy, fund allocation and risk. As of December 2016, the bank's capital adequacy ratio was 26 percent, indicating that the bank is well-capitalized. Centenary has a well-established risk, compliance and governance process, and bank-level risk appetite and tolerance are communicated to business units with defined targets for loan products.

CenteHome product

Although the new CenteHome product has been rolled out to just over half of the bank's branches, the product has been growing steadily since its first pilot in early 2016. As of December 2016, the new CenteHome loans were about 8 percent of the total home improvement loans and about 5 percent of the home improvement loan portfolio. As Figure 5 shows, CenteHome has grown significantly since its launch, adding almost UGX1 billion each month. Its nonperforming loan portfolio was 0.29 percent at the end of 2016. As of March 2017, the bank had an outstanding loan portfolio of UGX8,823.4 million across 1,542 loans and total PAR30 of 3.7 percent. Although CenteHome's performance slid earlier this year, primarily becauseof problem loans at four branches, the typical ratio of nonperforming loans has been below 2 percent versus the bank's target of 3 percent. The bank cites timely repayment by clients — there is a sense of ownership with CenteHome — as the main reason for low levels of nonperforming loans.

At 5 percent of the total loans outstanding, the entire home improvement loan portfolio (which includes CenteHome) is still a small percentage of Centenary's overall portfolio but the largest contributor to the overall net profit, contributing 41.2 percent in March 2017. The low levels of provisioning and low write-offs have resulted in home improvement loans' higher yield of 29.5 percent. Economic viability has been proved in the months since CenteHome launched, but the key to growth will depend on access to long-term funding, given the maximum term of five years. Finally, while the cheap pricing has resulted in the quick uptake of the product, the bank will need to closely monitor the loan usage, as it is likely that clients will divert the low-priced loans to other uses.

End notes

[1] *The Next 4 Billion. (2007)*. IFC and World Resources Institute.

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[3] Policy Research Working Publication 6756. (2007). The World Bank.

[4] Prieto, S., and Simmons, E. *The 2016-17 State of Housing Microfinance: Understanding the Business Case of Housing Microfinance,* page 36, published by Habitat for Humanity International's Terwilliger Center for Innovation in Shelter, 2017.

[5] The MicroBuild Fund is a US$100 million investment fund for housing microfinance, launched by Habitat for Humanity International in 2012. The fund is one of the first microfinance investment vehicles to demonstrate the viability of housing microfinance by offering financial institutions longer-term capital to grow housing microfinance loans for low-income households. For more information on the fund, visit **habitat.org/TCIS**.

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[22] www.mhfcindia.com/loan-terms.html and www.samhita.org/micro-housing-finance-corporation-mhfc/

[23] This business case framework was adapted from the youth savings framework presented by T. Kilara, B. Magnoni and E. Zimmerman in CGAP Focus Note No. 96, "The Business Case for Youth Savings: A Framework," CGAP, July 2014.

[24] In response to the more than 2.3 billion unbanked worldwide, the 2017 ResponsAbility MSME Finance Outlook estimates 10-15 percent growth in the global micro-, small- and medium-enterprise finance market this year, but only 5-10 percent growth in Sub-Saharan Africa because of a combination of political and economic instabilities and restrictive regulations. Thus, one may deduce that housing microfinance growth, which tends to trail behind micro-, small- and medium-enterprise finance growth, is also falling well below current levels of market demand.

[25] Only 18 percent of the 83 financial service providers surveyed for *The 2015-16 State of Housing Microfinance* published by Habitat for Humanity reported having specialized loan officers dedicated to housing microfinance, rather than selling the product through existing loan officers. (pg. 20)

[26] For example, *The 2015-16 State of Housing Microfinance* reports that 83 percent of responding institutions offer housing microfinance loans to new clients in addition to existing clients. (pg. 18)

[27] *The 2016-17 State of Housing Microfinance* reveals significantly lower PAR30 rates for housing microfinance portfolios as compared with the responding institutions' overall portfolio performance. An average PAR30 rate of 2.61 percent was reported for housing microfinance, while 4.92 percent was the reported average for the total loan portfolio. (pg. 28)

[28] A World Bank study estimates that only 1.2 percent of the adult population in both Kenya and Uganda have an outstanding loan for housing purchase, and their ratio of mortgage debt to GDP lies well below 3 percent, compared with 70 percent in developed countries. Demirguc-Kunt, Asli, and Leora Klapper "Measuring Financial Inclusion: The Global Findex Database," World Bank Policy Research Working Paper 6025 (2012).

[29] All deposit-taking microfinance banks are regulated by the Central Bank of Kenya.

[30] From HOFINET website (http://www.hofinet.org/countries/country.aspx?regionID=8&id=86). Data from *2009 Financial Sector Deepening Kenya Report*.

[31] Central Bank of Kenya (2016). Bank Supervision Annual Report 2016.

[32] Based on an interview with AMFI staff on May 4, 2017.

[33] The Central Bank of Kenya reported a total of 24,460 registered mortgage loans within the banking sector at the close of 2016.

[34] A baseline report of an impact study that was undertaken as part of the Building Assets, Unlocking Access project found that the majority of clients surveyed had used additional resources to finance their home improvements, specifying the following sources: 60 percent personal savings,
14 percent other resources, 6 percent family members and 5 percent financial institutions.

[35] CAHF (2016). *Africa Housing Finance Yearbook*.

[36] In the case of OBUL and PRIDE, the products were developed with technical assistance from Habitat's Terwilliger Center under the Building Assets, Unlocking Access project implemented in partnership with the Mastercard Foundation. In the case of UGAFODE, the microfinance product was developed with the support of Habitat for Humanity Uganda, and the one from Finance Trust Bank was developed with the support of the Terwilliger Center under a contract financed by Incofin IM.

[37] While properties held in a Kibanja agreement serve as legal collateral, the mortgage is not registered and thereby does not result in a lien. Thus, the property may be pledged simultaneously to other lenders, and ownership may be transferred before the loan is fully repaid.

[38] Centenary Bank reports 24.8 percent return on allocated equity, or ROE, in 2016 and 28.3 percent in 2015, and 26 percent capital adequacy as of Dec. 31, 2016.

[39] Source: www.centralbank.go.ke.

[40] Source: www.cgap.org, CGAP-MIX Sub-Saharan Microfinance Analysis.

[41] Refers to a classification of nonbusiness loans that pursue social impact, such as housing, renewable energy, education, sanitation and water.

[42] Longer processing time is a result of:

- Getting cost estimates of material from artisans and then using it to apply for the loan (either as an individual or a group).
- Cost estimate, which has to be signed by client or member of the family.
- Map leading to the home and location of the house having to be drawn on the cost estimates.
- KWFT assessing the clients' source of income and determining the ability to repay.
- Land tenure verification.

Habitat for Humanity®

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