

Housing Microfinance in Practice: LOLC Cambodia

Summary

Considered one of Asia’s new “tiger economies,” Cambodia has shown strong economic growth over the past two decades. However, a significant portion of the population remains close to the poverty line, and an estimated 10 million people lack access to affordable housing in Cambodia. Lanka Orix Leasing Company (Cambodia) PLC, or LOLC, one of the top five microfinance institutions in Cambodia, responded to this challenge back in 2012 by introducing a housing microfinance product designed for low-income borrowers.¹

Through technical advisory support from Habitat for Humanity’s Terwilliger Center for Innovation in Shelter and investment capital from Habitat for Humanity’s MicroBuild Fund, LOLC was able to refine the design of its housing product and expand its offering to include construction technical assistance for borrowers. As of December 2018, LOLC’s housing microfinance product had 10,060 active loans.

This case study provides insights on housing microfinance product development with particular focus on the support processes necessary to sustain this product, such as creating specialized positions and conducting staff trainings throughout the process. In addition, the case study delves into what comprised LOLC’s opportunity, the value and array of partners who helped enable an expanded offering, the adaptations made to the product to make it more successful, and finally the social impact and financial returns achieved to date.



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¹ LOLC Cambodia. (2016). *2016 Annual Report*. http://www.lolc.com.kh/eng/fin_annual.aspx.

Institutional overview

Lanka Orix Leasing Company (Cambodia) PLC, or LOLC, is one of the top five microfinance institutions in Cambodia, and it has provided financial products and services to the underserved, low-income market since 1994.² Formerly known as TPC (Thanekha Phum Cambodia), the institution serves more than 230,000 borrowers and over 180,305 savings depositors through 77 branches covering all 25 provinces of Cambodia. It has a gross loan portfolio of US\$487.5 million and US\$232.7 million in savings deposits as of December 2018.

Market environment

The Asian Development Bank, or ADB, considers Cambodia one of Asia's new "tiger economies." Fueled by the construction, tourism and garment production industries, Cambodia has shown strong GDP growth over the past two decades. In line with this economic growth, poverty has fallen dramatically in Cambodia, from 47.8% in 2007 to 13.5% as of 2014 (based on the national poverty line).³ Yet an estimated 4.5 million Cambodians hover near the poverty line. The United Nations Development Programme's Multi-Dimensional Poverty Index reveals that when other aspects of poverty — education, health and living standards — are taken into consideration, 33.8% of the population remains in poverty.⁴ World Bank data states that, as of 2015, access to water and improved sanitation is still lacking, with 70% lacking access to a piped water supply and 58% lacking access to improved sanitation.

In terms of housing, approximately 55.1% of Cambodians live in slums.⁵ The Cambodian government has estimated that at least 10 million Cambodians still lack access to decent housing. According to the Cambodia National Housing Policy, about 2 million houses need critical improvement to meet minimum quality standards, and an additional 1.1 million in new houses will be needed by 2030 because of population increases and rural-to-urban migration.⁶

In conjunction with the lack of access to decent housing is a lack of secure land tenure, which affects the most vulnerable populations in Cambodia. An inability to demonstrate ownership of land places households at risk of losing their shelter and can preclude them from accessing traditional forms of financing for home improvements. However, since the government reinstated individual property ownership laws in the 1990s, the forms of property ownership in Cambodia have been constantly expanding. Two kinds of titles are now used for financial transactions: soft and hard. Hard titles provide the most *secure* form of land ownership in Cambodia and are registered at the national level with the Ministry of Land Management, Urban Planning and Construction. Soft titles, however, are the most *common* form of ownership, based on observations made by LOLC's staff. Soft titles are registered only at the council (Sangkat) and district (Khan) levels. It is possible to convert soft titles into hard titles, but many LOLC clients with soft titles expressed a high level of confidence in their land tenure security and stated that they have not seen eviction to be an issue.

The Cambodian microfinance market has made vast inroads in providing access to financial services to low-income households with widespread presence in most counties of Cambodia. Based on a report by the Microfinance Index of Market Outreach and Saturation, or MIMOSA, in May 2016, an estimated 20% of the Cambodian adult population are active microfinance borrowers.⁷ Although the products and services offered by microfinance institutions in Cambodia typically focus on entrepreneurial purposes, the competitiveness of the market has driven microfinance providers to examine the needs and preferences of their clients beyond enterprise loans and to design an array of additional financial

² LOLC Cambodia, 2016.

³ *The World Bank in Cambodia: Overview*. (2018). World Bank. <http://www.worldbank.org/en/country/cambodia/overview> (Accessed Aug. 31, 2018).

⁴ "Cambodia Has Region's Fastest Growth Rate in Human Development." (2017). United Nations Development Programme, Press Release. March 22, 2017. <http://www.kh.undp.org/content/cambodia/en/home/presscenter/pressreleases/2017/03/22/cambodia-has-region-s-fastest-growth-rate-in-human-development.html> (Accessed Aug. 31, 2018).

⁵ Asian Development Bank. (2018). "Poverty in Cambodia." <https://www.adb.org/countries/cambodia/poverty> (Accessed Aug. 31, 2018).

⁶ Habitat for Humanity. (2017). "Cambodia." <http://habitatcambodia.org/wp-content/uploads/2017/04/Cambodia-Country-Profile-17.pdf> (Accessed Aug. 31, 2018).

⁷ "Cambodia: Interim Update." (2016). *Microfinance Index of Market Outreach and Sustainability*. Accessed Aug. 27, 2018. <https://cmanetwork.org/files/OIDWORKSHOP/MIMOSA%20Report%20%20Cambodia%20May%202016.pdf>.

products to better serve those clients. Housing microfinance has been gaining increasing attention from microfinance institutions in Cambodia.

Widespread access to financing, however, has introduced concerns regarding client cross-borrowing. LOLC estimates that around 40% of its clients possess existing loans with other microfinance institutions. Market saturation has only contributed to this as institutions compete for market share. In response to this, the Cambodian government has begun to increase regulation around the microfinance industry. During the first quarter of 2017, the Cambodian National Bank issued an 18% interest rate cap on the microfinance market, intensifying pressure on microfinance institutions to maintain their financial performance and sustainability. To mitigate the risk of client overindebtedness, the microfinance institutions in Cambodia work together with the Credit Bureau to consolidate their data and closely monitor the loan behavior of current and potential clients.

Housing microfinance product alignment

While it is evident that there is a great need for housing in Cambodia, LOLC's awareness of the need (and opportunity) for a housing finance product came directly from its client base, as clients requested the product from loan officers and branch managers. Living in a typhoon- and flood-prone country, households, particularly in rural areas, wanted to invest in strong and durable homes. Despite unfamiliarity with housing microfinance, LOLC saw this as an opportunity to fulfill its social mission to provide "economic opportunities to transform the quality of their [clients'] lives and their communities through the provision of effective and sustainable client-empowering services" and to improve its social performance indicators as measured by the Poverty Probability Index.

From a strategic perspective, there were other reasons to consider developing a housing finance product. The increasing competition in the Cambodian microfinance landscape threatened customer loyalty. Retaining clients was a primary driver in LOLC's decision to address customer demand and offer a housing microfinance product. In addition, a housing finance product presented an opportunity to diversify the institution's loan portfolio and potentially improve financial performance while receiving training and funding from the development sector.

Product development process

In late 2011, LOLC launched a loan product for home improvements with support from the Overseas Private Investment Corporation, or OPIC, in three branches. A year after its launch, the loan product was available in 11 branches and showed modest growth, serving 549 clients with a portfolio valued at US\$1 million. Growth of the housing portfolio was constrained by the limited availability of funding, but the initial positive performance enabled LOLC to build strong partnerships. Funding from these partnerships enabled LOLC to expand its housing portfolio to US\$5.9 million and serve 2,530 housing clients by early 2015. However, LOLC continued to face challenges in expanding the housing portfolio because of the limited funding sources.

In May 2015, LOLC received an investment of US\$2 million from Habitat for Humanity's MicroBuild Fund to expand the housing portfolio. In addition to the capital infusion, Habitat's Terwilliger Center for Innovation in Shelter provided LOLC with technical support in the refinement of the product and the development of internal systems to bolster scaling up the product. LOLC and the Terwilliger Center started by conducting a customer satisfaction survey to understand client satisfaction levels with the existing product features, the effectiveness of communication, the delivery strategies for construction technical assistance, and the impact on housing quality outcomes. In addition, the survey probed the potential demand for new features of an enhanced housing product. Using these findings, LOLC refined the terms of the product to a loan amount of up to US\$15,000 and terms from three to 60 months. This design reflects the flexibility and affordability levels of LOLC's clients.

With the product terms defined, the team developed a comprehensive housing product strategy for expanding the housing portfolio, which included identifying opportunities for new products, strategic areas and/or geographies for expansion, and cross-selling and bundling of housing microfinance products with other finance products. To achieve the objectives of this strategy, LOLC made significant investments in terms of time and resources to ensure that they had the internal capacity needed to deliver the housing product to their clients. A key factor in the success of LOLC's housing program was the

support and commitment provided early on from their board and top management to advance the housing strategy and build institutional capacity through the creation of new staff positions.

With leadership support, a product champion was appointed who supervised, managed and assisted the implementation of the advisory services provided by the Terwilliger Center. The product champion role is a relatively unusual approach within the microfinance sector, where a dedicated product development function is less common. The product champion helps ensure long-term sustainability by closely monitoring the product's performance with an eye toward opportunities to refine the product in line with client and market demand. The champion then helps operational teams realize these opportunities.

In addition to the product champion, LOLC recognized a need to help clients optimize the use of their housing loans, so management added a second new position to the team: a civil engineering specialist. This individual's role is to supervise the housing program, regularly inspect clients' construction projects, and provide trainings to loan officers on the latest construction knowledge.

LOLC encountered numerous challenges in finding qualified applicants for both of these new positions. Because of the nascent nature of the roles, the new hires often ended up splitting their time between the intended mandate and other functions. Retaining the new hires also was difficult. The roles required extensive on-the-job training in product development and management, which is generally not available within the sector. Once staff members who had attended these trainings were able to demonstrate a competitive advantage within the microfinance sector of Cambodia, LOLC had to wrestle with the challenge of retaining those staff members. To improve retention, LOLC focused on offering competitive salaries and benefits, providing opportunities to grow, and promoting a culture that values its employees and fosters confidence in their capabilities.

LOLC also invested in building the capacity of its existing staff to better address the needs and concerns of clients. The Terwilliger Center trained LOLC's loan officers on basic technology and construction cost estimation. These trainings equipped the loan officers with the construction knowledge necessary to more accurately estimate costs of construction projects and more effectively assess the loan amounts needed by clients, which is important for mitigating risk and future delinquency issues. The training also equipped key staff members to train additional team members — a training of trainers — so that the team could scale up the product as demand increases. In branches with particularly high demand, LOLC appointed specialized loan officers to handle housing finance-related transactions.

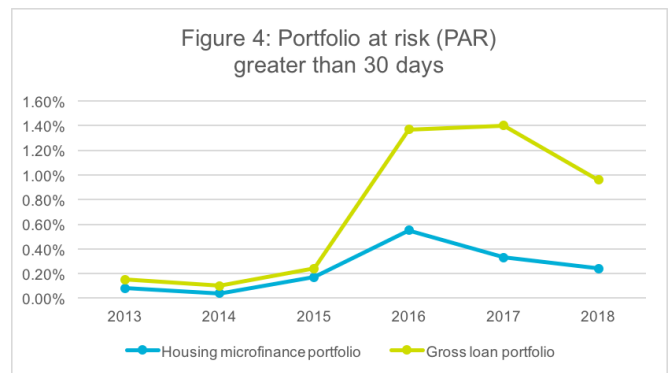
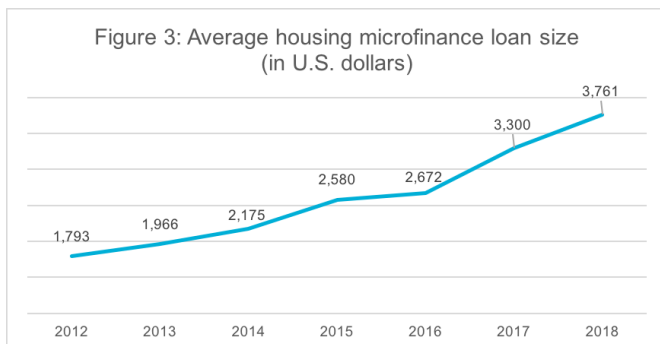
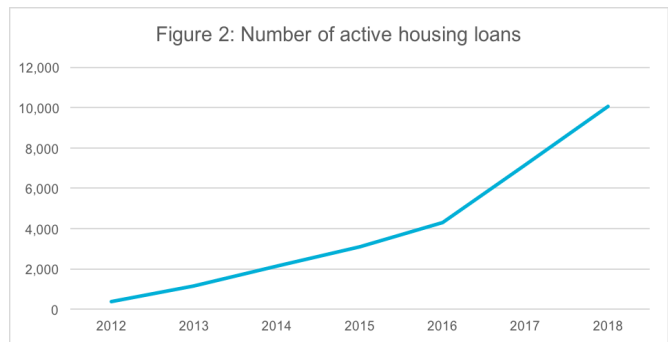
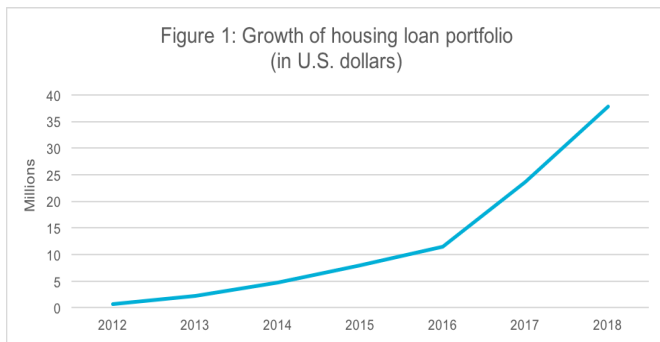
Another challenge LOLC encountered was onboarding and introducing the operations staff to the new product. Laying out a strong foundation for a new product requires a lot of work. Effective trainings and communication from management on loan features, target markets, growth targets and incentives helped align the staff's vision with the newly created product strategy. Once institutional capacity was built out, LOLC turned its focus to consumer education.

With guidance from the Terwilliger Center, LOLC developed marketing materials to educate clients on construction best practices. The materials were used to guide clients through the decision-making process as they considered their desired home and the incremental construction projects necessary to achieve that goal. Materials included brochures with standard housing designs, quality parameters, and tools to enhance the quality of construction. These materials make discussing technical elements of housing quality simple for loan officers and help build customer loyalty. The Terwilliger Center then helped LOLC design the communication strategy for promotion, positioning and effective service.

Housing finance product performance

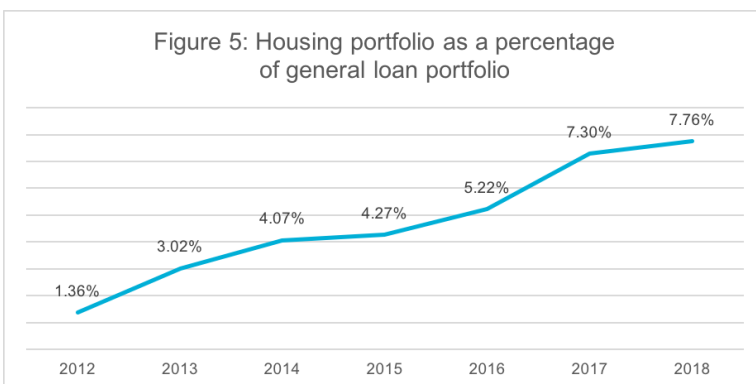
FINANCIAL PERFORMANCE

LOLC's housing microfinance product has experienced robust growth since 2012, when it first received a capital infusion from OPIC and later from MicroBuild. Figure 1 demonstrates the portfolio growth of nearly 56.7 times between 2012 and December 2018.



Similarly, the average loan size for the housing microfinance portfolio has constantly increased since 2012 (Figure 3). The increase in the average loan amount is an indicator that the institution is increasing in competency and familiarity with the housing microfinance product. The housing product's affordability factor and the asset-building value significantly motivate clients to diligently pay their loan obligations. This is confirmed by the strong performance of the housing portfolio, in terms of portfolio at risk, relative to the general portfolio (Figure 4).

The housing microfinance product has also been increasing as a percentage of the overall portfolio (Figure 5). Considering the performance of the product in terms of portfolio quality, this constant growth shows promise for further increases in LOLC's exposure in this segment. LOLC originally expected the housing portfolio to increase by 0.4% annually between 2017 and 2020, with a target of comprising 7.4% of the overall portfolio by 2020. This goal has been surpassed, with housing microfinance representing 7.76% of the total loan portfolio as of December 2018.



From the success of the initial product, LOLC expanded its housing offerings further, introducing a solar power loan product focused on enabling rural clients to access renewable energy and partnering with Water.org to develop a loan product specifically addressing water, sanitation and hygiene, or WASH, improvements. Because of its strong financial performance and solid commitment to the social mission, LOLC was granted an extension to its MicroBuild loan of US\$2 million and approved for a new loan of US\$1 million.

SOCIAL IMPACT

LOLC's housing microfinance product provides low-income households with access to financial products and competent housing support services to improve their living conditions. LOLC clients report an average 90% satisfaction rating, based on a client satisfaction survey. Clients list product flexibility and staff communication as the best features. Through the housing microfinance product, LOLC instills an increased sense of pride for its clients, along with improved safety and better health and sanitation.

As of December 2016, approximately 4,300 households had improved their homes through the home improvement loan product. Just over half (53%) of these households experienced significant changes in their home conditions and are now in their second or later cycle of home improvement loans (corresponding to more advanced stages of their home improvement plan). Home improvements may include home repairs, home renovations, upgrades to water and sanitation facilities, and other complementary improvements.

In addition to the safety and convenience these homes provide, borrowers frequently report that their improved home has increased their sense of self-worth and provides a sense of pride and accomplishment. Culturally, a house serves as a source of pride for the people of Cambodia. This finding is well in line with LOLC's vision of seeing low-income households "empowered to live their lives with dignity, social and economic security and justice."

Conclusion

LOLC, one of the largest players in Cambodia's mature microfinance market, saw the shortfall of adequate, affordable housing as an opportunity to both meet a critical social need and to maintain its leading position in a highly competitive microfinance market. In direct response to client demand, LOLC launched a housing loan product. Early performance showed potential for this product to scale up and serve millions more.

With investment capital from the Overseas Private Investment Corp., or OPIC, and Habitat's MicroBuild Fund, and with advisory services from Habitat's Terwilliger Center for Innovation in Shelter, LOLC committed to refining and expanding its housing portfolio. By improving the design of its housing microfinance product, adding consumer education to its offered services, and investing in building the capacity of its team, LOLC was able to meet the needs and affordability parameters of its clients. In particular, creating specialized positions and focusing on training its staff in housing have allowed LOLC to realize robust growth in the housing portfolio and client base since the product's inception. The LOLC case study demonstrates the value of investing in and developing the technical expertise of staff members, as this enables them to more effectively promote the product and assist clients throughout the loan period, which leads to greater customer loyalty and increases the social and financial impact of the organization.

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HABITAT FOR HUMANITY INTERNATIONAL
322 W. Lamar St., Americus, GA 31709-3543 USA (800) 422-4828 fax (229) 924-6541 publicinfo@habitat.org habitat.org

TERWILLIGER CENTER FOR INNOVATION IN SHELTER
270 Peachtree St. NW, Suite 1300, Atlanta, GA 30303-1246 (800) 422-4828 (229) 924-6935 TCIS@habitat.org habitat.org/tcis