

Many Paths to a Home

EMERGING BUSINESS MODELS FOR
LATIN AMERICA AND THE CARIBBEAN'S
BASE OF THE PYRAMID



ABOUT OPPORTUNITIES FOR THE MAJORITY

The Opportunities for the Majority (OMJ) initiative promotes and finances market-based, commercially viable business models that engage private sector companies, local governments, and communities in the development and delivery of quality goods and services for the base of the pyramid (BOP) in Latin America and the Caribbean.

Created in 2007 as part of the Private Sector Group of the Inter-American Development Bank (IDB), OMJ provides finance to small, medium-size and large companies, financial institutions and funds to support the development or expansion of business models that serve BOP markets. OMJ has supported BOP business models in 18 countries of the region in different sectors such as health, education, housing, and financial services, among others.

ACKNOWLEDGEMENTS

This report was written by Christy Stickney for OMJ, under the supervision of Luiz Ros, Lourdes Gallardo and Viviane Azevedo and with the valuable contributions of Cynthia Boruchowicz and Lina Salazar Ortegón. David Einhorn provided editorial assistance. The team would like to thank Rahul Desai, Mónica Fernández Álvarez de Lugo, Manuel Fernandini, Daniel Granada, Nathaniel Jackson, Dana Martin, Claudia Martínez Ochoa, Susan Olsen, Christian Schneider, and the rest of its OMJ colleagues.

Finally, this report would not have been possible without the contributions of OMJ's clients, whose experience inspired this report.

RIGHTS AND PERMISSIONS

The opinions expressed in this publication are those of the authors and do not necessarily reflect the views of the Inter-American Development Bank, its Board of Directors, or the countries they represent.

The unauthorized commercial use of Bank documents is prohibited and may be punishable under the Bank's policies and/or applicable laws.

Copyright © 2014 Inter-American Development Bank. All rights reserved; may be freely reproduced for any non-commercial purpose.

Contents

Foreword 4

Executive Summary 6

Introduction 12

CHAPTER 1

Base of the Pyramid Housing Markets: A Vast Opportunity for Business..... 16

CHAPTER 2

One Big Step: The Complete Housing Solution..... 28

 Business Model #1:
 A Complete Solution via a Micro-Mortgage and Subsidy Model 30

 Business Model #2:
 A Complete Solution via a Rent-to-Own Model 33

CHAPTER 3

Step by Step: The Incremental Housing Solution 38

 Business Model #3:
 A Leap Forward in the Incremental Building Process:
 the Core House Model 39

 Business Model #4:
 Home Improvements..... 43

CHAPTER 4

Insights and Recommendations

For Base Of The Pyramid Housing Market Ventures..... 52

REFERENCES 61

Foreword

THE LACK OF ADEQUATE HOUSING IS A PROBLEM THROUGHOUT LATIN AMERICA AND THE CARIBBEAN (LAC). Almost 40 percent of families in the region live in a house beyond repair, have no title, or lack water, sewerage, electricity, adequate building materials, or space. It is estimated that by 2015, that number will increase by 10 percent. The demand for improved housing among the base of the pyramid (BOP) has been consistently strong and represents a relatively steady proportion of the overall income of this segment of the population. Yet the supply of innovative and tailored solutions continues to be limited. Only an investment of at least \$310 billion will close the region's current housing gap – that is, 7.8 percent of LAC's GDP.

The Inter-American Development Bank (IDB) believes that the private sector can play an important role as a provider of quality, tailor-made, and affordable housing

solutions. The Bank's Vice-presidency for Private Sector has gained valuable experience when it comes to private-sector-based housing solutions. Through its Opportunities for the Majority (OMJ) initiative, in particular, the IDB is promoting market-based solutions to meet the housing needs of the BOP. As of 2013, OMJ's housing projects totaling \$80.3 million represented 27 percent of its total active portfolio.

This report presents and analyzes promising business models financed by OMJ that are enabling companies and other organizations to provide services and products to the BOP and in doing so help address the region's pressing housing deficit. The business models show that BOP families have both the willingness and the economic capacity to make a down payment and pay monthly installments for a finished housing solution. They also demonstrate that BOP families can afford to take out a loan for home construction or improvements

if financial products are designed to take into account their particular circumstances, which include labor informality or low formal wages, lack of appropriate collateral, and a volatile wage-earning scheme.

Most importantly, these models expose the vast opportunities for the private sector to enter and serve the BOP market. Demand at the BOP is latent and growing, and business models with the potential to serve this market segment are in need of adequate financing. This shows that the market opportunity is there for developers, suppliers of construction materials, financial institutions, and impact investors.

One message that is clear from this report is that there are, as the title of this report states, “Many Paths to a Home.” Pioneering companies and organizations in different countries and with different business models are demonstrating that it is viable to access

the BOP and make a profit at the same time. These companies and organizations are using a market-based solution to improve access to housing for low-income families. Through this report, the IDB wants to show that investing in the base of the pyramid is not only possible; it is also a win-win situation for our region. There are still many opportunities for other innovative companies and organizations to get ahead of the curve, invest in this underserved market, and take part in a dynamic market-based approach to meeting the region’s need for quality housing.

LUIZ ROS

Manager / Opportunities for the Majority

Executive Summary

WHAT IS THE PATH TO A HOME? For most people living in Latin America and the Caribbean (LAC), the journey to obtaining adequate shelter is a challenging and ongoing process. The region's low-income majority, often referred to as the "base of the pyramid" (BOP), is generally left to fend for itself when it comes to building and financing housing, without significant support from either the public or private sector. The fact that over 58 million LAC households are in need of adequate shelter – including the homeless and those needing improved housing structures, increased space, secure tenure, and/or basic infrastructure – signals an urgent call for new solutions. Increasingly, the private sector is seen as a potential source of valuable products and services to improve BOP housing, and a growing number of private sector players and new business strategies are emerging in response to the vast and highly attractive housing markets found among LAC's BOP.

The Opportunities for the Majority (OMJ) initiative of the Inter-American Development Bank focuses on stimulating private sector involvement in providing market-based, value-added goods, services, and economic opportunities to the BOP. These strategies respond to compelling business opportunities while simultaneously addressing unmet needs of the region's poor majority. OMJ's portfolio of projects includes 11 investments in housing-related ventures, representing approximately 25 percent of its total portfolio.¹ This report is intended to showcase promising business models emerging from within OMJ's portfolio of housing projects and to highlight the compelling qualities of LAC's large and largely untapped housing market at the BOP.

¹ For practical purposes, this report will examine nine projects out of the 11 in the portfolio. The other two business models financed by OMJ (Caja Maynas and Caja ICA in Peru) share the same features and characteristics



Understanding the region's vibrant BOP housing markets is critical to informing and encouraging business ventures.

- Current investment by the BOP in its housing solutions is estimated at approximately \$56.7 billion annually in LAC, confirming the buying power of this sector.
- The BOP's capacity and commitment to improving its housing is evidenced by the steady growth of low-income neighborhoods and informal settlements, particularly on the urban periphery.
- BOP housing markets are not uniform, but rather comprised of a variety of market segments requiring tailored products and approaches, and may be classified in terms of households' current housing realities, needs, preferences, and income levels and sources.
- The supply of well-targeted and integrated products and services to these markets is scarce, further accentuating the extent of the existing business opportunity.
- Current housing practices among the majority of the BOP involve incorporating elements such as land, infrastructure, financing, and construction inputs (designs, materials, and labor) into slow and costly incremental stages undertaken over many years according to families' specific priorities and available resources.
- As with other BOP sectors, housing is also affected by high rates of informality in terms of land ownership, housing construction practices, and families' income sources. These, along with other limitations, contribute to a range of BOP housing market failures.

Promising business approaches in the private sector effectively target specific BOP market segments with innovative products and strategies that convert market failures into opportunities. The projects featured within OMJ's housing portfolio support a variety of products that may be classified broadly within two types of BOP housing solutions:

- 1 A "complete" housing solution – A home that is newly built by low-cost housing developers and includes titled land and basic infrastructure (e.g., streets, public areas, schools) and services (e.g., water, sanitation, electricity).
- 2 An "incremental" housing solution – A process that contributes to the progressive improvement of BOP housing, and may result in a broad range of solutions such as land purchase or titling, core house construction, minor improvements (e.g., bathrooms, floors, plastering) or major improvements (e.g., adding a room, roof, or second story).

This report describes two different approaches to delivering each type of housing solution, resulting in a total of four business models as detailed in the following box.

FEATURED BUSINESS MODELS

1. MICRO-MORTGAGE MODEL

This model combines a more traditional form of mortgage financing, tailored to low-income earners, with direct government subsidies to provide access to formally built homes constructed by low-cost housing developers within relatively large development projects. Keys to this model are:

- Selling mortgages directly at developer sites
- Applying a multi-faceted credit scoring and upfront savings scheme to reduce risk in lending to clients without formal credit histories
- State-of-the art information systems and payment services at convenient locations.

3. CORE HOUSE MODEL

This model links several strategic partners into a unique value chain, resulting in a newly built basic house on a family's existing property – a significant step forward in the incremental building process. The houses that are built meet government standards for low-income housing, including access to basic services (e.g., water and sanitation), and their design facilitates rapid, low-cost assembly as well as future room additions. The model involves leveraging a federal direct-subsidy program that covers approximately 40 percent of the cost of the house. The remaining cost is financed by medium-term unsecured loans. Therefore, this approach currently targets public employees, given their steady income streams and access to direct payroll deductions, which help to reduce the lending risk.

2. RENT-TO-OWN MODEL

This model provides access to new, developer-built homes by incorporating an innovative rental scheme that allows families to build a payment history over several years while saving sufficient capital to make the down payment on a mortgage loan. Critical to this model is the supply of low-cost housing built by developers at certified standards of quality, including the provision of basic services and infrastructure. Also necessary is the link with mortgage lenders committed to issuing mortgages once clients have met the necessary obligations upon completion of their rental period.

4. HOME IMPROVEMENTS MODEL

This model encompasses a broad array of approaches to supporting the BOP's incremental building processes, whereby short-term, unsecured loans (frequently referred to as "housing microfinance") are extended to low-income homeowners to finance a home improvement. Home improvement financing may be accompanied by a variety of construction-related inputs such as technical assistance for home improvement planning and construction oversight; access to building materials with guaranteed quality and/or at discounted prices; and access to qualified construction labor. These additional services and linkages frequently involve building alliances between financial institutions and construction firms, suppliers of materials, and other private sector entities – effectively creating new value chains for BOP housing markets.

CONCLUSIONS

The following conclusions may be drawn from these emerging business approaches:

- The growing participation of private sector entities combined with the diversity of approaches to BOP housing markets affirm the broad appeal and vast potential of these markets for businesses.
- The provision of more complete housing solutions – involving titled land, formally designed and built homes, and basic infrastructure and services – are tied to certain necessary contextual factors such as the availability of long-term capital to finance low-income mortgage portfolios, and tend to favor families earning income through formal employment.
- Less complete incremental housing solutions are closely tied to how most of LAC's BOP currently creates housing, can be tailored to most contexts in the region, and are accessible to most of the BOP, including the informal sector. Nevertheless, there are still challenges for home improvement business strategies to effectively combine construction-related services with financing, and to integrate solutions with broader urban development plans and guidelines.

RECOMMENDATIONS FOR THE PUBLIC SECTOR INCLUDE

- Targeting direct-demand subsidies to the lowest-income groups, particularly those that cannot access market-based solutions, for both new housing and home improvements.
- Applying supply-side incentives that motivate and guide lenders and builders without crowding them out.

RECOMMENDATIONS FOR DONORS AND SOCIALLY-MINDED INVESTORS INCLUDE

- Directing funding and impact investments to BOP housing business ventures that show promise in generating both financial and social returns.
- Supporting continued innovation and knowledge creation with respect to business models that can add social value and effectively reach scale.



“Governments must play a large role in building a better housing sector, but families and the private sector should be – under the right regulatory and policy framework – the main actors in improving housing conditions. The investment opportunity for the private sector is enormous, as is the opportunity for millions of families to substantially improve their quality of life. Focusing more attention on low-income housing is a win-win situation for our cities. On the one hand, it generates employment and economic growth. On the other, it helps reduce social inequality and improve the prospects for all children.”

– Luis Alberto Moreno, President, Inter-American Development Bank, in the Prologue of the IDB’s 2012 publication entitled “Room for Development”



Introduction



HOUSING IS BOTH A HUMAN PRIORITY AND A POWERFUL ECONOMIC DRIVER. The housing needs in Latin America and the Caribbean (LAC) are compelling, given that 37 percent of all households, or over 58 million families, need new or improved housing to meet basic minimum standards (Bouillon 2012)². Most of these housing needs are felt by the region's low-income majority,

frequently referred to as the “base of the pyramid” (BOP)³, representing 360 million people earning less than \$272 (2005 PPP) monthly per capita. Traditional housing markets have largely ignored the BOP, as formally built homes are too expensive, and mortgage financing is only available for the highest income segments of most countries' populations.

² UN Habitat defines adequate shelter as meeting criteria that include adequate space, security, and durability, as well as secure tenure and access to basic services (water and sanitation).

³ The term “base of the pyramid” was coined by C.K. Prahalad and Stuart L. Hart in their 2002 article, “The Fortune at the Bottom of the Pyramid.”

While solutions to low-income housing needs are often perceived as a responsibility of the public sector, clearly government resources alone are insufficient to meet such an immense need. Families themselves, together with the private sector, are taking center stage in developing adequate housing for the BOP. The strategic role of government is increasingly seen as providing regulatory frameworks and supportive policies that strengthen housing markets. Meanwhile, the provision of improved housing for the BOP is emerging as a vast and highly attractive market for the private sector. Companies such as housing developers, financial intermediaries, and suppliers of construction materials are moving into this market by offering an innovative array of tailored products, services, and linkages that make improved housing affordable and accessible to low-income families.

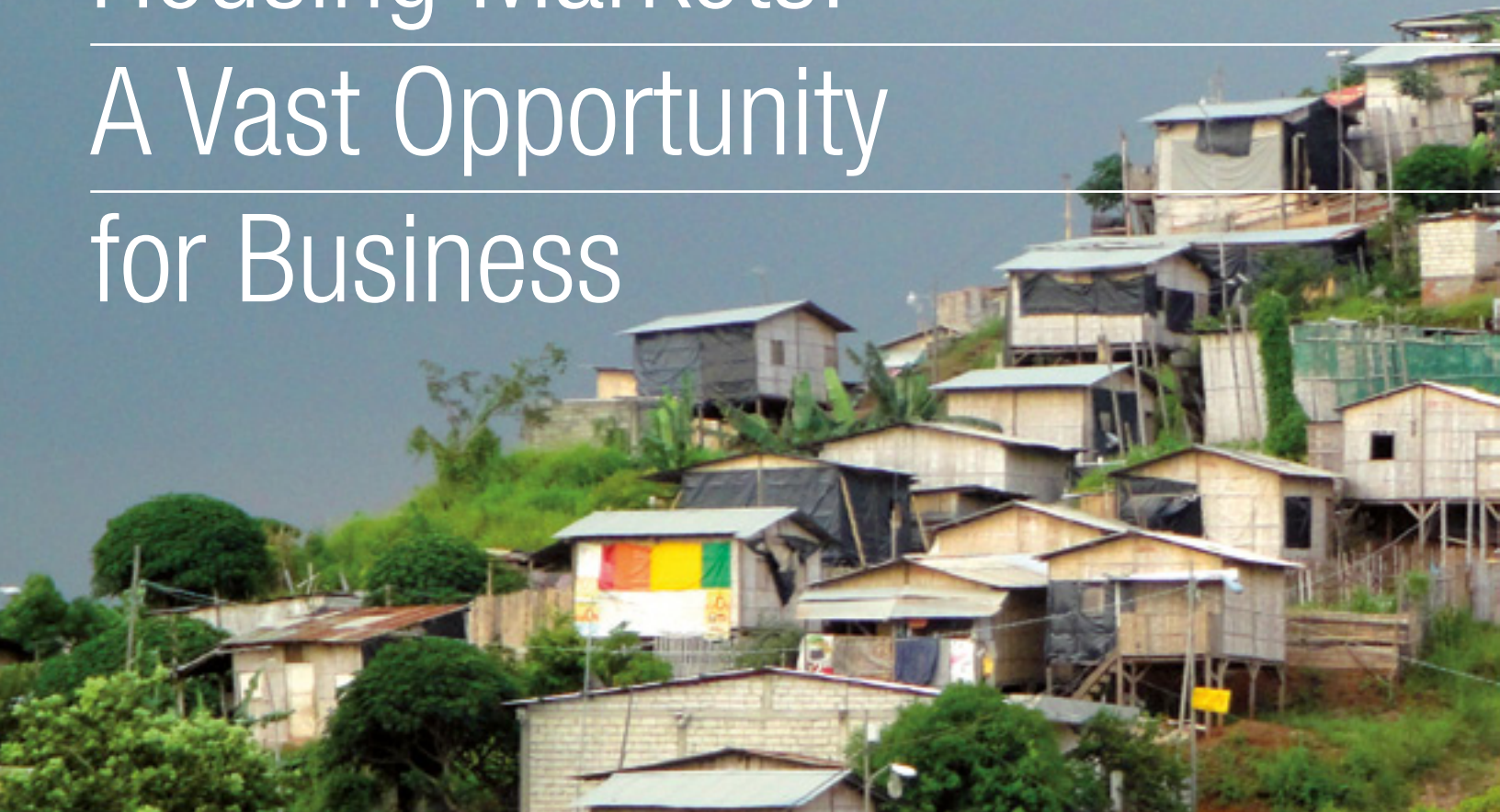
The IDB's Opportunities for the Majority (OMJ) initiative was conceived to stimulate private sector involvement in providing valuable goods and services to the BOP – strategies that respond to compelling business opportunities while simultaneously addressing unmet needs of the region's poor majority. Since 2007, OMJ has approved 52 projects/transactions in LAC totaling almost \$350 million in financing through direct loans and partial credit guarantees. Innovations in the BOP housing market have emerged as a strategic focus of OMJ's efforts, with 11 approved projects resulting in investments representing approximately 25 percent of OMJ's overall portfolio.

OMJ's housing portfolio includes projects that target specific segments of the BOP, delivering well-tailored products and services through a variety of channels. The types of private sector entities undertaking these projects are predominantly financial institutions; however, many of them work in partnership with low-cost housing developers, suppliers of construction materials, NGOs, and government housing programs to deliver a more complete product. OMJ's housing projects are currently located in Colombia, Mexico, Peru, Nicaragua, and Paraguay (see facing page). By highlighting examples from OMJ's housing portfolio and identifying key insights and lessons arising from these initiatives, this report seeks to draw attention to LAC's vast and largely untapped housing market at the base of the pyramid and celebrate the range of promising business models emerging within the region.



OMJ HOUSING PROJECTS FEATURED

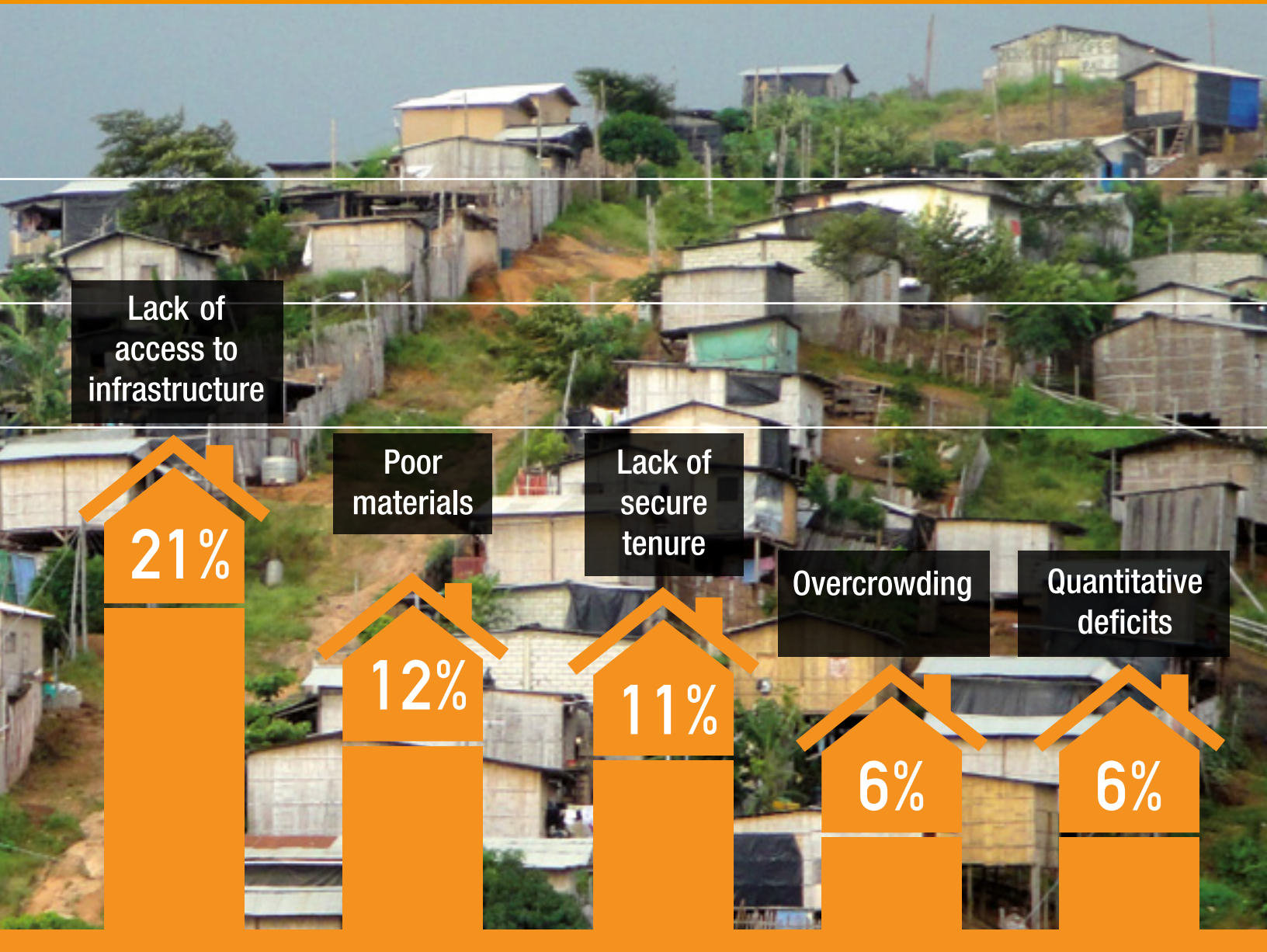
Base of Pyramid Housing Markets: A Vast Opportunity for Business



ALONG WITH FOOD AND CLOTHING, HOUSING IS A FUNDAMENTAL PRIORITY FOR THE BASE OF THE PYRAMID. Housing needs within LAC are compelling. According to the IDB's 2012 study *Room for Development*, of the 130 million urban households in LAC, 5 million house another family, 3 million are residences that are beyond repair, and 34 million lack either legal land titles, access to water or sanitation, adequate flooring, or sufficient space (Bouillon 2012).

Housing shortages are frequently cited in terms of quantitative and qualitative deficits: the former refers to new housing units needed to satisfy the number of existing

households, and the latter refers to deficient housing that must be improved to meet minimum standards of size and quality. For example, in the countries represented within OMJ's housing portfolio, Colombia and Mexico report total (quantitative and qualitative) deficits affecting approximately 35 percent of all households, while Peru and Nicaragua reveal rates of approximately 75 percent. (Bouillon 2012, p. 29) Diagram 1.1 shows the magnitude and classification of housing deficits in the region. The estimated investment needed to close the entire housing deficit in LAC is approximately \$310 billion (Bouillon 2012, p. 50).



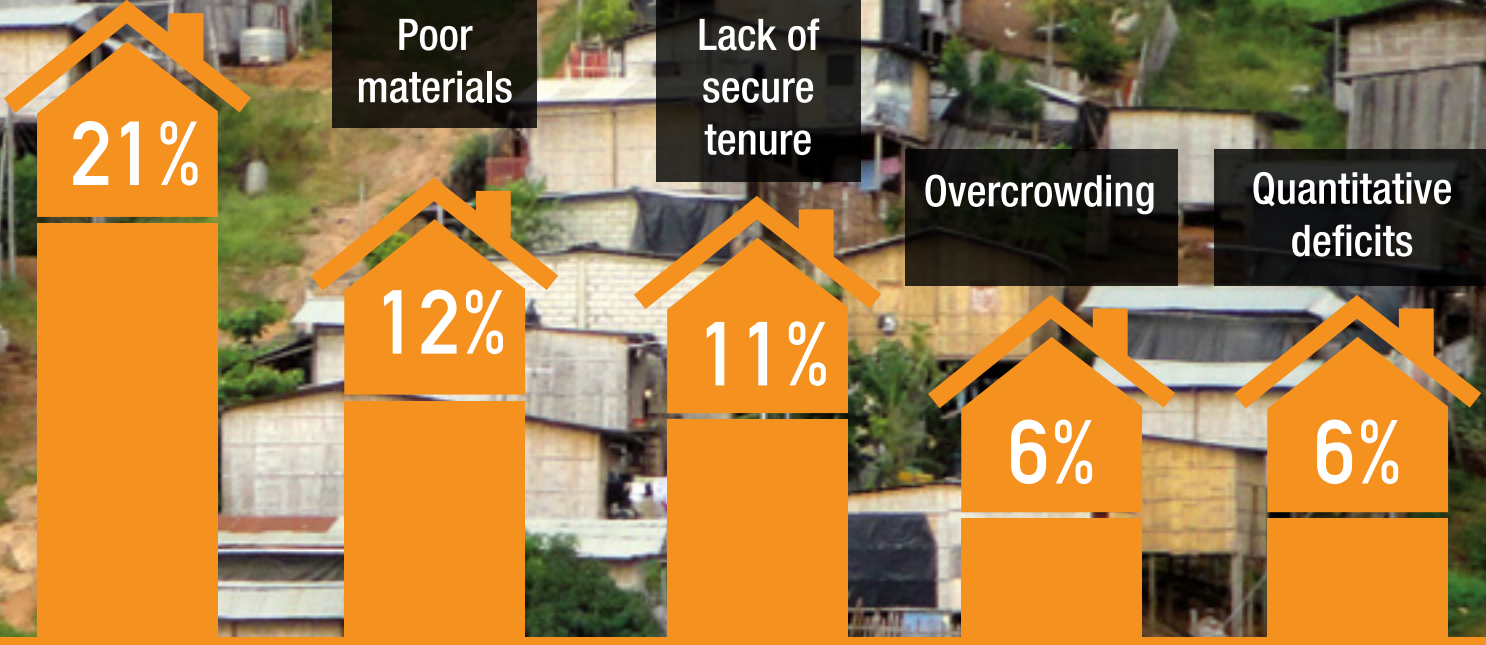
Lack of access to infrastructure

Poor materials

Lack of secure tenure

Overcrowding

Quantitative deficits



4%
Lack of electricity

3%
Inadequate roof



15%
Lack of sanitation

6%
Dirt floor

9%
Lack of piped water

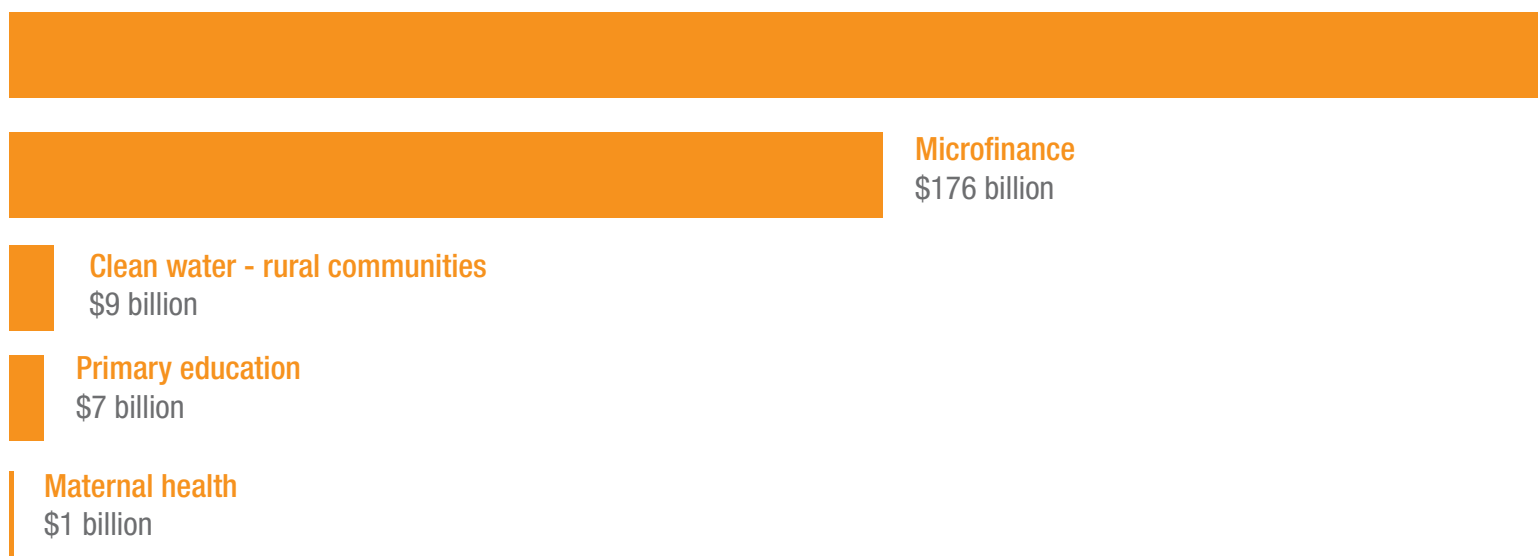
2%
Inadequate walls

DIAGRAM 1.1
MAGNITUDE AND CLASSIFICATION
OF HOUSING DEFICITS

Note: Percentage of households as of 2009. Numbers in each category may not add up to the totals due to overlapping

Source: Bouillion (2012).

DIAGRAM 1.2 POTENTIAL INVESTMENT CAPITAL REQUIRED FOR BASE OF THE PYRAMID BUSINESS SECTORS OVER THE NEXT 10 YEARS



The social benefits of improving housing extend well beyond the physical advantages of increasing space and adding securely built structures. Existing studies reveal a positive correlation between improved housing and family health, children's education, and a family's overall well-being (Bouillon 2012). Moreover, a home is the greatest asset owned by most families, providing financial security as well as the potential for income (via rental or home-based business activity), financial leveraging, or resale.

LAC is the most urbanized region of the developing world, with approximately 80 percent of its population currently living in cities (Bouillon 2012, p. 56). Thus, most of the region's housing needs, demands, and market-based activities are concentrated in urban settings. Urban families tend to have higher incomes and are able to invest more in housing solutions. Urbanization offers efficiencies and economies of scale that, in turn, reduce individual transaction costs of products and services associated with housing construction and financing. Nevertheless, rapid rates of urban migration stress housing supplies and drive up land prices, making these less affordable to the BOP.

How does this immense need translate into business opportunities related to the BOP in LAC? The four points outlined below – the BOP's buying power, the fact that housing solutions are happening regardless, the stratification of housing demand, and spotty supply – provide insights into better understanding these dynamic markets.

THE BOP HAS BUYING POWER. The BOP represents approximately 4 billion people worldwide. The World Resources Institute has estimated that this population invests approximately \$331.8 billion annually in housing – second only to the purchase and preparation of food (Hammond et al. 2007). BOP housing demand is noted to be consistently strong, representing a relatively steady proportion of overall BOP incomes. A 2010 study conducted by J.P. Morgan revealed that affordable urban housing is by far the largest impact investment opportunity within BOP markets, as compared to other sectors such as water, health, education, and microfinance (J.P. Morgan 2010). This study estimated that 393 million households worldwide can afford improved housing, representing between \$117 billion and \$432 billion in potential annual revenues, and requiring investments of \$214-\$785 billion over the following ten years, as portrayed in Diagram 1.2 above.

Large urban BOP housing markets in LAC signal a significant business opportunity. LAC's BOP housing market is the second largest in the world (after Asia), investing approximately \$56.7 billion annually in housing (Hammond et al. 2007). Mexico's urban BOP housing markets represent \$16 billion in annual expenditures, while Colombia and Brazil report urban BOP spending for housing at over \$8 billion per year (Hammond et al. 2007).

Source: JP Morgan (2010)

The original publication provided ranges to refer to the potential investment capital required. For the sake of this diagram, we present the numbers as averages.

HOUSING IS HAPPENING. While formal housing markets have generally left out the BOP, clearly the low-income majority is solving its housing needs on its own, even if through informal means. This means that construction is undertaken without technical designs, does not necessarily adhere to formal codes and regulations, and involves local builders who tend to lack formal training in construction methods. Throughout Latin American countries, over 50 percent of housing is built incrementally, one step at a time, as resources become available (Bouillon 2012). Homeowners are at the center of their housing processes, engaging in what is often referred to as “self-construction.” Rather than benefiting from housing value chains that link necessary products and services, BOP households are often required to individually pursue each component of home building. This tends to result in slow and costly processes for families and society at large. Nevertheless, it is often the only solution accessible to this population. Notably, over 25 percent of Latin America’s urban population currently resides in informal settlements (Bouillon 2012). The growth of low-income neighborhoods throughout the region is a testament to the great investment already being made in housing, and signals the vast potential of this largely untapped market.

BOP HOUSING DEMAND IS STRATIFIED. BOP housing markets are not simply a monolithic block in pursuit of a standard solution to their housing needs. Rather, these markets may be best understood by segmenting households based on existing living situations, future needs and aspirations, and income levels and sources. Throughout LAC, a family’s housing needs vary depending on whether the family is currently living in its own home, living with other family members, or renting. Another key consideration is whether the property the family is living in provides secure tenure, or whether the family faces the threat of eviction or forced relocation. Other variables highlighted by market studies include demographic information such as average household age and housing solution preferences (in terms of design, materials, and space). Clearly not every BOP family is seeking to change its existing living situation; however, the region’s documented housing deficits combined with existing market studies confirm that most households aspire to improve their housing conditions. These scenarios and their commonly associated housing needs and aspirations are summarized in Table 1.1.

TABLE 1.1 TYPOLOGY OF COMMON BASE OF THE PYRAMID HOUSING SCENARIOS IN LATIN AMERICA AND THE CARIBBEAN

CURRENT HOUSING SCENARIO	HOUSING NEEDS/ASPIRATIONS
A. Existing homeownership with secure tenure, whether formally or informally documented.	Progressive home improvements, potentially including core house construction, expansions, enhancements, or repairs.
B. Cohabiting with other family members or friends, often characterized by overcrowding.	Rent a separate home, or purchase a home or land to begin incrementally building a home.
C. Renting a home, possibly with inadequate living conditions or at a burdensome cost.	Purchase a home or land to begin incremental construction of a home.
D. Squatting illegally and living in a temporarily built shelter.	Legalize current land ownership or purchase another property to begin building incrementally.

Scenario A in Table 1.1 is the predominant segment of LAC's BOP, as home ownership rates are high – reported at over 73 percent regionally (UN Habitat 2011).⁴ Among countries represented within OMJ's housing portfolio, Colombia has a relatively low home ownership rate of 48.1 percent,⁵ while Peru, Mexico, and Paraguay report home ownership rates of approximately 70 percent,⁶ and Nicaragua's rate is a soaring 84 percent.⁷ Indeed, qualitative deficits reported throughout the region significantly supersede quantitative deficits, further emphasizing the extent and implied sense of urgency of this population (Bouillon 2012, p. 27). As highlighted in Table 1.1, this market segment is most interested in gradually building or improving their homes, and will seek products and services that facilitate this.

Scenarios B and C represent segments that may either seek to purchase a home – whether new or used – or choose to acquire land and begin the process of incremental house construction. The size of these segments will vary widely from one context to another, yet are most notable within urban contexts, particularly those experiencing significant growth due to migration.

Scenario D is predominantly an urban phenomenon, and is characterized by the lowest-income segments of the BOP that have few other alternatives at their disposal. This includes families that build their shelter in high-risk zones subject to flooding, landslides, or other natural disasters. Scenario D is also a reality of post-disaster situations in which significant numbers of BOP households are displaced or left homeless. Those families seeking a more durable solution will either pursue secure tenure in their current residence (generally prior to significant investments in construction) or else acquire a more permanent property that will allow them to build progressively. A few of the more fortunate might benefit from government or philanthropic efforts to relocate families to new residences; however, most will need to resort to solutions available on the market.

Further segmentation of the BOP is necessary to understand households' income levels and sources, as these have direct implications on the cost of solutions they can afford, and the types of financing that will be accessible to them. For the sake of this report, the LAC BOP is divided into six segments, based on monthly income per capita.

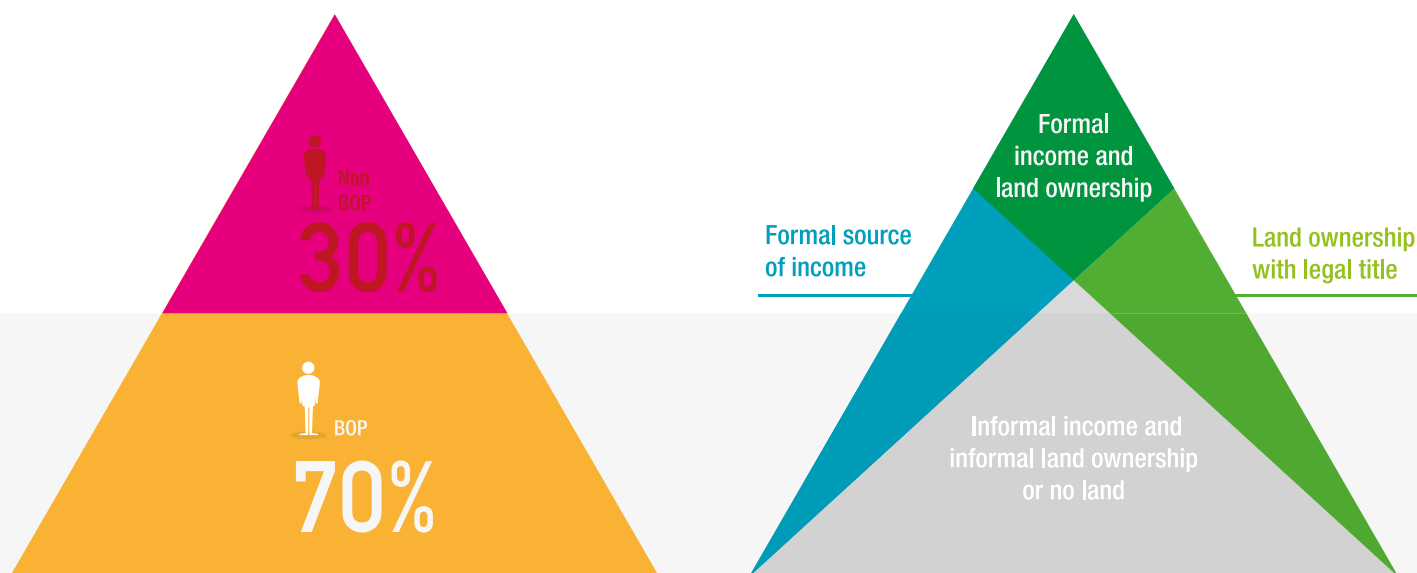
⁴ Home ownership rates generally refer to declared owner-occupancy (rather than confirmed formal ownership), which in LAC is approximately one-third informal tenure.

⁵ According to the National Statistics Department (Departamento Administrativo Nacional de Estadística - DANE), 2012 Quality of Life Survey. http://www.dane.gov.co/files/investigaciones/condiciones_vida/calidad_vida/Presentacion_ECV_2012.pdf.

⁶ The specific rates are 68.5 percent for Peru (Instituto Nacional de Estadística e Informática 2011); 71 percent for Mexico (Instituto Nacional de Estadística y Geografía 2011); and 73.9 percent for Paraguay (Dirección General de Estadística, Encuestas y Censos 2010).

⁷ National Institute of Development Information of Nicaragua (Instituto Nacional de Información de Desarrollo de Nicaragua), 2005.

DIAGRAM 1.3 INCOME, LABOR PROFILE, AND LAND OWNERSHIP OF THE BOP IN LATIN AMERICA



Families earning under \$272 monthly per capita income (or approximately \$9 daily, 2005) are considered part of the BOP. As mentioned above, this lower-income majority represents approximately 70 percent of households in LAC (Diagram 1.3).

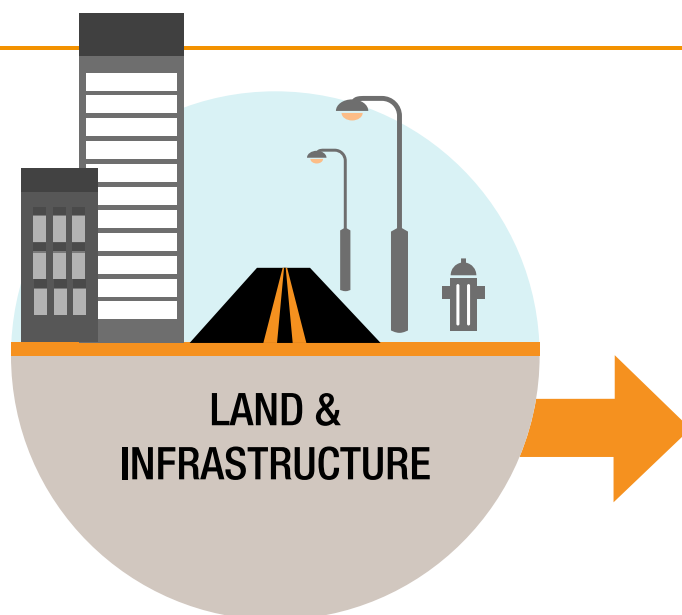
Regarding income sources, the BOP may be separated into two categories based on whether a household's income is earned through formal sources – such as formal employment or officially registered businesses – or informal sources, which are generally not taxed, monitored, or regulated by the government. The informal sector includes salaried laborers, daily wage-earners and self-employed entrepreneurs who earn income that is not officially reported or tracked. Countries such as Peru, Colombia, and Mexico have reported that almost 60 percent of their urban residents earn their income from the informal sector.⁸ Given that most informal sector laborers are within the BOP, this clearly implies that the majority of the BOP earns its income through informal sources. Diagram 1.3 provides a graphic representation of these two distinct classifications of the BOP.

While home ownership is high in LAC, many households, particularly among the BOP, do not possess a legal title. Informal tenure accounts for approximately a third of all home ownership in the region (Torche and Spilerman 2008), with the majority concentrated among the BOP. These figures suggest that less than half of the BOP owns housing with a formal title, as shown in Diagram 1.3. Possession of titled land is a particularly important factor when considering lien-based financing options, and has a direct impact on future property values and resale possibilities.

SUPPLY IS SPOTTY. While demand for housing among the BOP is vast, the supply of value-added integrated products and services to this market is spotty at best. Most formally built housing is sold to the upper-income minority, and formal financing – particularly mortgage markets – rarely reaches into the BOP. Moreover, the predominant method of incremental house construction is generally unassisted by tailored products or services, as millions of families throughout the region are left to their own resources to seek out needed materials, labor, and financing.

⁸ The specific rates are 58.8 percent for Peru (Economic Commission for Latin America and the Caribbean [ECLAC] 2011), 59.9 percent for Colombia (ECLAC 2011), and 59.1 percent for Mexico (Instituto Nacional de Estadística y Geografía 2013).

DIAGRAM 1.4 BASE OF THE PYRAMID HOUSING COMPONENTS



All of this speaks to a great opportunity to offer well-targeted and strategically integrated products and services that are accessible to BOP markets and address their aspirations. Indeed, an increasing number of private sector companies are moving into this market as they come to recognize its attractive qualities and minimal competition. Nevertheless, it is critical that market ventures take into account the existing realities and significant barriers faced by this population. The following section describes common realities of BOP housing markets, including key market gaps that represent both business opportunities and important challenges to be addressed.

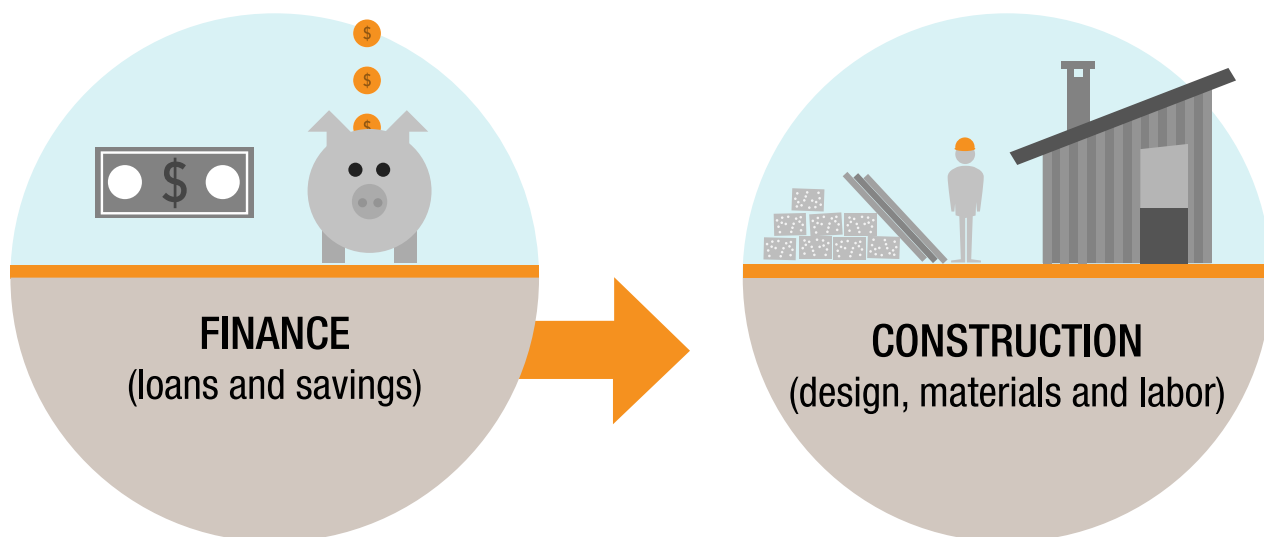
BASE OF THE PYRAMID HOUSING REALITIES.

Diagram 1.4 shows that BOP housing processes incorporate three key components that may follow a logical sequence, but which are more likely to be addressed gradually and even repeatedly as housing is built progressively. Each of these components is described below in greater detail.

1. ACCESS TO LAND AND INFRASTRUCTURE

Families within the low-income majority access land for their homes through a variety of means that may not involve formal purchase of titled property. Common practices include informal purchase or exchange, inheriting from family members, residing on communal property, or occupying within an informal settlement. Because of these informal means of acquisition, BOP families often reside in marginal neighborhoods or slums that lack basic infrastructure and services such as water and electricity. In extreme cases, low-income families may settle on properties or in geographic areas that are unsafe for residential use due to natural or human risks. Furthermore, informal land ownership may imply insecure tenure, or the threat of being evicted or relocated.

While BOP homeowners would clearly prefer to reside on formally owned properties, the cost of purchasing titled land – particularly within urban centers – is increasingly unaffordable. For those who choose to formally purchase a home, this often involves relocating to a lower-cost development on the urban periphery, displacing existing social networks, and potentially requiring onerous commutes to and from their places of work.



2. ACCESS TO NECESSARY FINANCES

BOP families have very limited options when it comes to accessing financing for home purchase or construction. Conventional housing loans involve mortgage liens and therefore are limited to the purchase and sale of property that is legally titled. Furthermore, low-income families often lack formal credit histories to qualify for a loan, and their sources of income are largely undocumented. For the self-employed, income streams tend to fluctuate, further complicating a long-term loan commitment, while low-earning salaried employees are often laden with consumer debt. Down payment requirements for mortgage loans present yet another hurdle for a population that has limited savings. Unfortunately, even government subsidy programs intended to assist this sector often include a prior savings requirement that is beyond the means of this population.

Given the constraints outlined above, BOP families depend primarily on their own means of financing house construction, mobilizing small amounts of savings, stockpiling materials, and investing remittances in their gradual building projects. They may also resort to consumer credit, or re-direct loans intended for their business to housing construction. However, these loans are not particularly well-suited for financing housing due to their relatively high interest rates and shorter terms. While increasing numbers of microfinance institutions are adding home improvement loans to their offerings, these still represent a small percentage of their overall portfolios.

3. CONSTRUCTION DESIGN, MATERIALS, AND LABOR

As mentioned above, the majority of BOP housing is built informally, without technical designs, compliance with construction codes or urban development guidelines, professional oversight, or formally-trained labor. Low-income families, seeking to keep costs low, find it hard to justify the added expense of paying for technical plans and oversight. As a consequence, construction is often poorly designed in terms of the use of space, lighting, and, more importantly, structural soundness. This is particularly critical in geographic areas that face the risk of natural disasters such as earthquakes, hurricanes, and floods.

These families tend to purchase construction materials in small quantities and stockpile them informally until they have enough to undertake a project. The quality of these supplies varies widely, and poor storage practices result in a high percentage of damage and loss. Labor is frequently provided by family members, friends, or someone within their network of trusted acquaintances, rather than by persons with professional qualifications. Thus, the construction quality of a vast majority of BOP homes ultimately rests in the hands of these informally trained builders. Table 1.2 summarizes the key market challenges faced by the BOP in accessing each of the components of housing.

TABLE 1.2 SUMMARY OF BASE OF THE PYRAMID HOUSING MARKET CHALLENGES

COMPONENT	MARKET CHALLENGES
LAND AND INFRASTRUCTURE	Lack of legal titles reduces financing options and property values.
	Illegal land use may result in insecure tenure (e.g., threat of eviction).
	Formal land purchase is unaffordable for much of the BOP, contributing to the expansion of low-income settlements on the periphery of urban centers.
	Informal settlements frequently lack infrastructure and basic services.
FINANCING	The unbanked lack formal credit histories, limiting their access to financing.
	The lack of formal guarantees, particularly legal land titles, also limits access.
	Informal workers' income streams are more difficult to verify and tend to fluctuate, and are therefore less compatible with long-term financing obligations.
	Families without savings struggle to meet down payment requirements for a home purchase or to qualify for subsidies for which prior savings are obligatory.
CONSTRUCTION (DESIGN, MATERIALS, AND LABOR)	Construction undertaken without qualified technical design or oversight means higher risk of poor durability or structural insecurity/instability.
	Uninformed budgeting may result in projects that are left uncompleted, or in families overpaying.
	Materials are purchased in small quantities, at higher cost, and may not meet quality standards.
	Most families have no safe place to store materials, so supplies are frequently exposed to damage and theft.
	Hiring unskilled labor – often the norm in low-income neighborhoods – may result in poor construction quality.

The success of business ventures in BOP housing has been to convert market challenges into creative strategies and solutions. Initiatives such as the 11 projects within OMJ's housing portfolio exemplify market-based housing solutions that offer products and services that were designed to respond to the specific housing needs and income sources of a defined target group within the BOP. Several of these projects apply innovative approaches to addressing various market challenges listed in this report by integrating strategic partners in order to deliver a more

complete housing solution. The different approaches can be categorized under incremental housing solutions or complete housing solutions. The latter include a newly built home, on legally-registered land, and within a development that provides basic infrastructure and services. The incremental solution type may include the construction of a core house, major improvements and additions, and/or minor improvements and repairs. A classification of housing solutions is presented visually in Diagram 1.5.

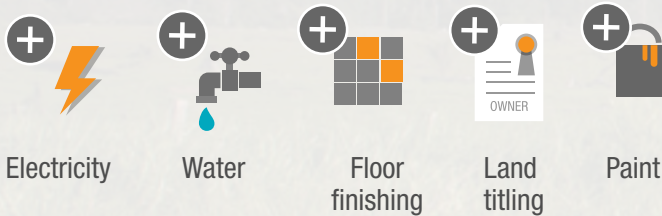


DIAGRAM 1.5 TYPES OF HOUSING SOLUTIONS

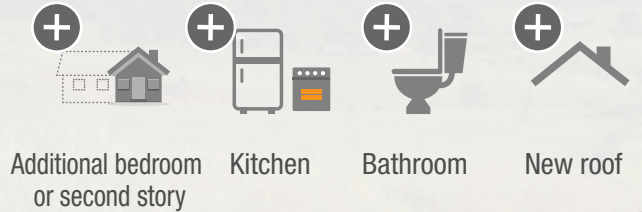
OPTION 1

INCREMENTAL SOLUTION

MINOR IMPROVEMENTS AND REPAIRS

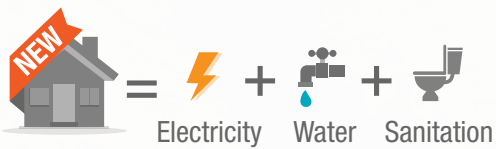


MAJOR IMPROVEMENTS AND ADDITIONS



 = Secure tenure

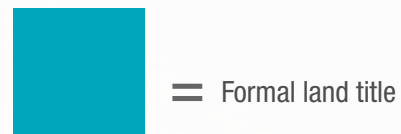
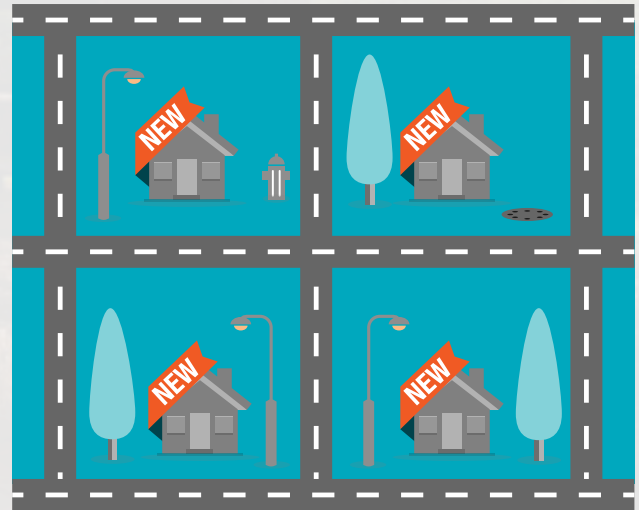
CORE HOUSE BUILT ON HOMEOWNER'S PROPERTY



OPTION 2

COMPLETE SOLUTION

NEWLY BUILT HOMES WITHIN DEVELOPMENTS



One Big Step: The Complete Housing Solution

THREE OF THE PROJECTS WITHIN OMJ'S HOUSING PORTFOLIO FOCUS ON PROVIDING A "COMPLETE" HOUSING SOLUTION INVOLVING A NEWLY BUILT HOUSE. These relatively low-cost homes are located within a larger development that offers basic infrastructure (e.g., streets, public areas, schools, commercial space) and access to basic services such as water, sanitation, and electricity. The housing units follow standard designs and meet government regulations while keeping costs low. Low-income housing developers tend to build large projects, usually upward of 100 units, as a means of compensating for the relatively low margins on sales of individual homes, and to cover the associated infrastructure costs.

A complete housing solution – a new home that is well built and offers basic services and infrastructure within a planned neighborhood – is the dream of many families. Those who aspire to own a home for the first time, and who probably do not own property themselves, are likely candidates for such a product. In terms of the scenarios in Table 1.1, a complete housing solution is a particularly well-suited product for families living under Scenarios B and C, that is, those who are either cohabiting with other family members or friends, or who are renting.

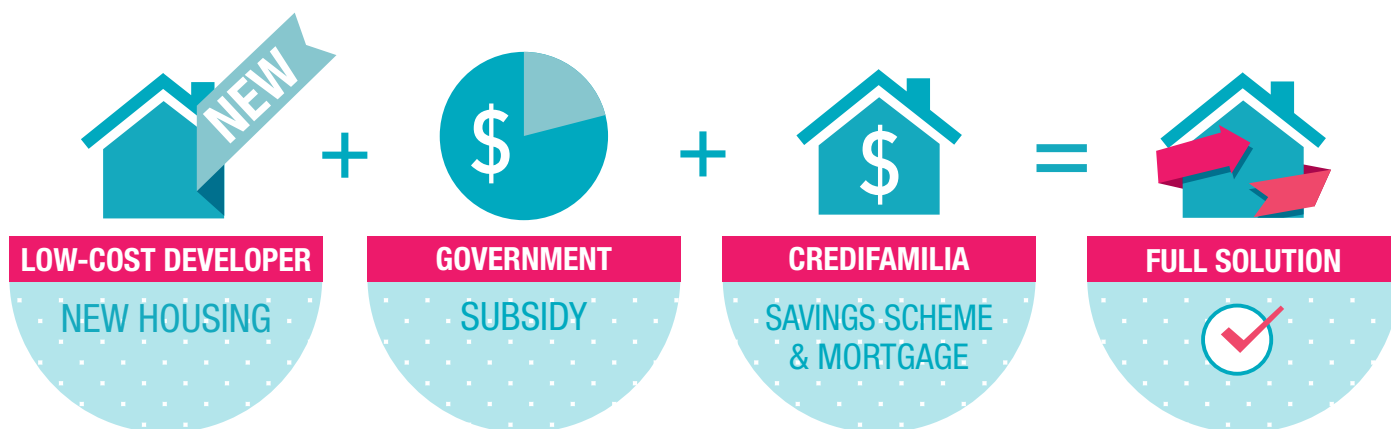
The compelling value of this type of a solution is evident: a family is given the opportunity to eventually own a well-built home with a legal title and access to basic infrastructure and services, while being granted immediate access to all the social, economic, and physical benefits of living in it. Moreover, families accessing this type of a solution will build a significant financial asset, which may be leveraged or sold in the future.

Within the OMJ portfolio, two different business models are being applied to reach the same housing outcome:

1. The first model, implemented by Credifamilia in Colombia, combines a more traditional form of mortgage financing, tailored to low-income earners, with government subsidies.
2. The second model incorporates a rent-to-own scheme, allowing families to build a payment history and sufficient capital to meet their down payment to qualify for a mortgage loan. Comfama in Colombia and RAFCASA in Nicaragua are pilot testing this second model, working in partnership with commercial mortgage lenders Bancolombia and BDF (*Banco de Finanzas*).



BUSINESS MODEL #1: A COMPLETE SOLUTION VIA A MICRO-MORTGAGE AND SUBSIDY MODEL



IMPLEMENTING INSTITUTION: CREDIFAMILIA, A HOUSING-FOCUSED FINANCIAL COMPANY IN COLOMBIA

This first model adapts conventional housing market features – formally built homes and mortgage financing – and employs relevant products and services to increase accessibility for the BOP. As mentioned above, homes are built by developers that specialize in low-cost housing construction within relatively large development projects. This type of housing production is a strong feature within the Colombian setting, where the government has been active in engaging private-sector developers to produce a much-needed supply of low-income housing, and in regulating the sector to ensure that construction codes and urban development guidelines are being followed.

Within this context Credifamilia is the only regulated financial institution in Colombia that specializes in low-income housing finance. Its product mix fills a much-needed gap in the country's BOP housing market, where traditional lenders have been reluctant to enter due to high operational costs and perceived risk.

BUSINESS CASE #1 CREDIFAMILIA: A VISION FOR A NEW TYPE OF HOUSING LENDER

Colombia's financial crisis in the late 1990s and early 2000s led to a severe contraction of financial markets, directly affecting mortgage lending. While in 1996 bank mortgage portfolios represented 26.5 percent of all lending in Colombia, this figure fell to only 6.6 percent in 2010. Moreover, loans for low-income housing represented less than 25 percent of banks' mortgage portfolios, as traditional lenders faced challenges in penetrating BOP markets due to high operational costs and the perceived risk of serving this segment of the population.

Within this context, Juan Sebastian Pardo, Credifamilia's CEO and founder, recognized a unique opportunity to create the first regulated financial institution in Colombia to specialize in low-income housing. Pardo realized that reaching the BOP required a tailored financial product and distribution channel, which involved adapting microfinance lending techniques and partnering with low-income homebuilders.

Credifamilia became a regulated financial institution in January 2011, and by early 2014 the company had successfully proven its founder's belief that its business model had potential to reach significant scale. After three years of operations, Credifamilia had reached the operational break-even point, and the company was originating between \$3 million and \$4 million in mortgages per month – over 80 percent of them for low-income housing.

The company successfully completed raising a second round of capital, doubling its initial equity, and in 2013 became the youngest financial institution in Colombian history to achieve a \$50 million mortgage-backed bond issuance. This has marked a new chapter in the Colombian capital markets, as Credifamilia's model is demonstrating to traditional investors that low-income housing is indeed a legitimate market for business.

Credifamilia's model incorporates the following elements that make low-income housing accessible to its target group:

- Micro-mortgages between \$3,000 and \$28,500 are offered to qualifying families at 5-15 year tenors.
- Loan applications and pre-approvals are handled at housing development sites, increasing visibility while reducing overhead.
- Loan evaluation incorporates microfinance practices for clients working as independent or informal sector workers.⁹
- A multi-faceted credit scoring system and structured savings program reduce risk in lending to clients without formal credit histories.
- Once pre-approved, low-income families (earning less than four minimum wages) may apply for government subsidies, which are applied to their required down payment (set at a minimum of 30 percent of total home value).
- Families unable to meet the remaining down payment obligation may participate in a 6-12 month savings plan while their home is being built.
- State-of-the-art information systems facilitate efficient loan processing and monitoring.
- Loan servicing is made both cost-effective and accessible by utilizing popular sites to receive loan payments, such as supermarkets and convenience stores.

⁹ These practices include methods of calculating a family's informally documented income and expenses to determine repayment capacity.

TARGET POPULATION: Credifamilia's target market is low-income families earning between one and four minimum wages and therefore qualifying for government housing subsidies. While Credifamilia has designed its program to qualify self-employed workers, these workers currently comprise less than 10 percent of its total portfolio.

PARTNERS AND LINKAGES: Credifamilia's tight connection with housing developers is not a coincidence. Several low-income housing developers were the founders and primary shareholders of the company, allowing for synchronized coordination between developers and mortgage lenders. Nevertheless, Credifamilia does not limit its outreach to its shareholder group, as approximately 50 percent of current business is conducted at non-shareholder development sites.

The other critical linkage within Credifamilia's model is the connection with the government's housing subsidies. Subsidies are processed either through employees' benefit funds (*Cajas de Compensación*¹⁰) or directly through the National Housing Fund¹¹ (FONVIVIENDA) in the case of people working independently or in the informal sector.

LESSONS AND CHALLENGES: Credifamilia's model is uniquely suited to the Colombian context, where low-income housing developers are actively engaged in producing housing that follows clearly set guidelines and standards. Colombia also has a healthy and well-regulated financial system, and mortgage markets are steadily growing. As the institution expands, and as others consider this type of a model within similar or varying contexts, the following lessons and challenges are relevant:

- Extending long-term loans to independent and informal sector workers is a serious challenge because of the difficulty in verifying their incomes and the fluctuations in their income streams. As Credifamilia seeks to increase participation among this sector, it will be valuable to capture further lessons regarding practices that accurately project income streams and tailor repayment plans to clients' repayment capacity.
- This model is contingent upon the availability of government subsidies to meet down payment requirements and make housing prices affordable. Where subsidies are unavailable, institutions may consider whether some type of savings scheme might be employed to help make the complete "house with micro-mortgage" package accessible.
- Also critical to this model is an ample supply of low-cost new housing within developments that meet minimum quality standards. Thus, the participation of private-sector builders that are sufficiently supported and regulated by government entities is a key prerequisite.
- A common concern of families relocating to new housing developments is the impact on their existing social networks and access to current income sources, networks, and markets. Credifamilia works with developments that include, at a minimum, the basic services and infrastructure necessary for families to thrive in their new environment, including access to needed health and educational facilities and public transport.
- Access to sources of long-term capital is necessary for the growth of this model. Credifamilia is pursuing additional capital through (1) government financing for its low-income mortgage portfolio through the Territorial Development Financial Inc. (FINDETER);¹² (2) mortgage securitization; (3) issuance of mortgage bonds; and (4) financing from local commercial banks and/or multilateral development banks.

¹⁰ The Cajas de Compensación are private non-profit entities that form part of a national system of 43 Employee Benefit Funds in Colombia. These entities are funded by 4 percent payroll contributions from public and private sector employers, and are mandated to provide social security functions (e.g., health care, education, and housing) and certain financial services, along with cultural activities and recreational options for their employee affiliates.

¹¹ The Fondo Nacional de Vivienda (FONVIVIENDA) is a Colombian public entity that operates under the Ministry of Environment, Housing and Territorial Development.

¹² The Financiera de Desarrollo Territorial S.A. (FINDETER) in Colombia is a mixed capital financial institution that operates under the Ministry of Finance.

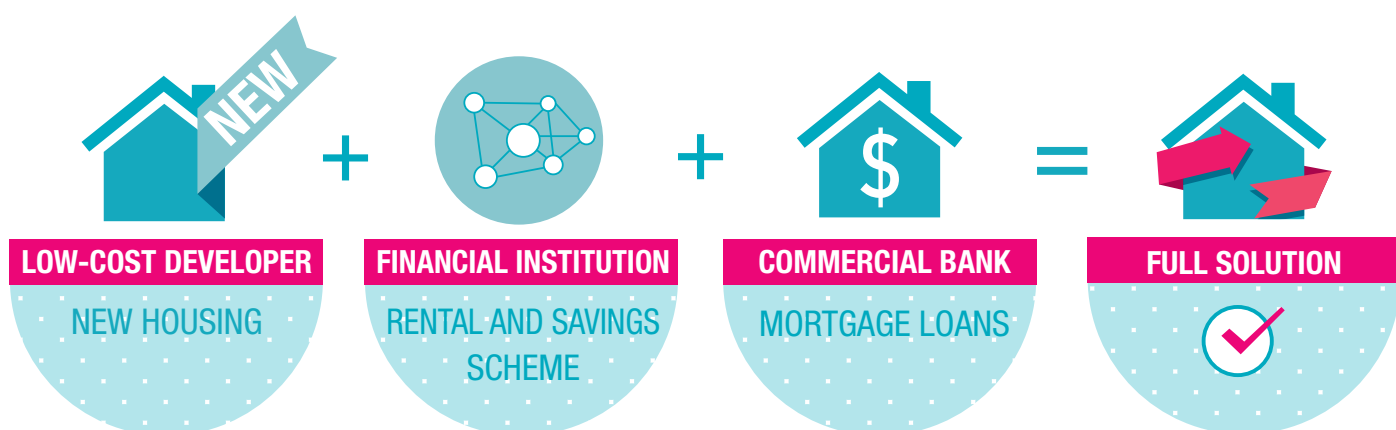
IMPLEMENTING INSTITUTIONS: COMFAMA, AN EMPLOYEE BENEFIT FUND IN ANTIOQUIA, COLOMBIA, AND RAFCASA, A FINANCIAL SERVICE COMPANY IN NICARAGUA

The second business model involves the same two essential components of traditional housing markets – formally built homes and mortgage financing – but connects these two via an innovative market-based rental scheme that facilitates access to families that would not otherwise qualify for a mortgage loan. Critical to this model is the supply of low-cost housing built by developers at certified standards of quality, including the provision of basic services and infrastructure. Also necessary is the linkage with mortgage lenders committed to issuing micro-mortgages once clients have met the necessary obligations upon completion of their rental period. Interestingly, this model is not contingent upon a subsidy component. Rather, both institutions have intentionally pursued the rent-to-own model as a means of developing a market-based approach to making low-income mortgage financing accessible without dependence on an uncertain supply of public subsidies. Targeted demand-driven sub-

sidies, nonetheless, would be a beneficial complement to this strategy, increasing access for lower-income groups and potentially catalyzing demand for social housing mortgages.

RAFCASA is a financial service company in Nicaragua that prequalifies families for Banco de Finanzas (BDF) mortgage loans, seeking to penetrate the relatively untouched market of low-income informal sector workers – both salaried and self-employed – that represents approximately 75 percent of Nicaragua’s population.¹³ Most of RAFCASA’s work to date has focused on a savings-first scheme that enables families to qualify for mortgage loans after completing a savings plan set according to their required down payment. The rent-to-own scheme was designed as a solution for those families who are unable to contribute the needed amount of savings up front. Instead, they are offered the possibility of occupying a new home during a two-year rental period, whereby their rental payments include a contribution to their future mortgage down payment. Upon conclusion of the two-year period, families assume a mortgage loan from BDF to complete their housing payments.

BUSINESS MODEL #2: A COMPLETE SOLUTION VIA A RENT-TO-OWN MODEL



¹³ According to the International Foundation for the Global Development Challenge (Fundación Internacional para el Desafío Económico Global Nicaragua), 2010.



BDF, the actual recipient of OMJ's project financing, is the fourth largest commercial bank in Nicaragua, and has the most substantial social housing portfolio in the country. Part of the bank's strategic objective is to further downscale its mortgage products to low-income segments in Nicaragua. The partnership with RAFCASA is playing a critical role in reaching this objective.

Comfama, as a non-profit employee benefit fund in Colombia,¹⁴ seeks to provide a range of social benefits to its member employees through a variety of products and services that leverage the fund's capital and its network of associated institutions. Despite Antioquia's relatively strong economy, the department continues to face significant quantitative housing deficits. Thus, the rent-to-own scheme¹⁵ was conceived as a targeted initiative to provide housing solutions to particularly low-income families in need of a complete housing solution. The types of families targeted have not been able to previously access a government housing subsidy, cannot meet down payment requirements necessary to purchase a home, and do not have a formal credit history enabling them to qualify for a mortgage loan. Similar to RAFCASA, these families will enter into a rental agreement (in this case a three-year commitment), whereby a portion of their monthly rent will be applied to their future down payment. Comfama, through its network of associated employers, has direct access to employee salary histories, and can collect loan payments through direct payroll deductions.

The rent-to-own model involves the following four essential steps:

1. Purchase of new homes from low-cost housing developers. The cost of these new homes will be no more than \$20,000 in Nicaragua and \$23,000 in Colombia. In the case of RAFCASA, the rental homes are held by BDF, and then sold to the client at the moment the client's rental agreement converts to a mortgage. Comfama safeguards purchased properties in a separately established trust, and their care is overseen by contracted property managers.
2. Families are qualified to enter into rent-to-own agreements. RAFCASA and Comfama conduct loan evaluations of interested clients to ensure they comply with minimum criteria,¹⁶ and those approved enter into formal rental agreements.
3. Families occupy homes and pay into rental and savings schemes. During this time the families are building a payment history in the formal financial system, contributing to their future down payment, and qualifying for their upcoming mortgage.
4. Families assume mortgages from partner commercial banks. Their mortgages will typically have maximum loan terms of 20 years and market-based interest rates.

¹⁴ Caja de Compensación, see footnote 10.

¹⁵ Comfama's program is also referred to as "social housing leasing" ("arrendamiento social"). The formal financial term in Colombia for this product is "leasing habitacional".

¹⁶ Criteria include an acceptable rating from a credit bureau, not being over-indebted, and having no lawsuits pending.



TARGET POPULATION: Both institutions target families that aspire to own a new house and are able to meet payment obligations, but are below a particular income threshold. RAFCASA primarily seeks to attract informal sector workers earning less than four minimum wages, while Comfama works with associated employers to reach out to their employees earning approximately two to three minimum wages.

PARTNERS AND LINKAGES: The rent-to-own model entails linkages with two key partners: low-cost housing developers and commercial mortgage lenders. A supply of low-cost housing is needed to launch the rent-to-own scheme, but developers are often reluctant to produce low-cost units without being confident of sufficient effective demand to reach the scale needed to compensate for lower margins. The relationship with mortgage banks is particularly critical, whereby down payment amounts, as well as other mortgage requirements, are clearly established up front, and rental payments are honored as confirmation of a client's payment history. The agreed-upon down payment required by BDF is 7 percent of the total home value, which is approximately half of BDF's standard requirement (10-15 percent). Bancolombia requires 20 percent of value, by qualifying the rented homes as "used," which is lower than the standard 30 percent mandated by Colombian law for new low-income housing.¹⁷

Comfama, the largest employee benefit fund in the department of Antioquia, works closely with its associated employers to market this new product to qualifying employees. Due to its nature as a Caja de Compensación, Comfama can only target employees who are affiliates of the benefit fund. Comfama also hopes to leverage its affiliate networks and presence in the department to influence low-cost housing developers to increase the supply of housing units available for market-based financing schemes such as the rent-to-own model. By creating greater effective demand for low-income housing, Comfama hopes to encourage developers to invest in building more units.

¹⁷ Colombian housing law allows up to 80 percent loan-to-value (LTV) on mortgages issued to low-income households for used homes whereas only 70 percent LTV is permitted for new housing.

LESSONS AND CHALLENGES: The rent-to-own model is new to both Comfama and RAFCASA and is being pilot tested as part of their OMJ-financed project. Therefore challenges and lessons are just beginning to emerge. The following are among those already encountered or anticipated:

- As mentioned above, extending long-term loans to informal sector workers is challenging because of the fluctuations in their incomes. RAFCASA intends to pursue this sector with the rent-to-own scheme, but it is already facing challenges, as families' existing levels of debt constrain them from assuming the projected housing obligations. Expansion into the informal sector with long-term loans is an issue that merits further study as RAFCASA's pilot project progresses.
- This model is also contingent upon the existence of low-cost new housing that meets minimum quality standards. Comfama has faced challenges in this respect, as the limited supply of developer-built homes is currently being consumed by government housing programs. Its hope is that the rent-to-own program will generate a virtuous supply cycle by helping to produce more qualified buyers and thus incentivizing developers to step up their supply of units – thereby invigorating BOP markets.
- As with the micro-mortgage model, these programs involve relocating families into a new development, potentially disrupting their existing social networks and access to income sources, markets, and other services. As pilot projects advance, it will be valuable to learn how each institution accommodates these factors.
- As with the micro-mortgage model, the rent-to-own model also entails mortgage financing, which requires access to long-term capital for lending institutions. It is reasonable to assume that commercial mortgage lenders will only venture into BOP markets, already perceived as costly and risky, when they feel confident that capital is available.

MARKET SOLUTIONS OFFERED BY BUSINESS MODELS

Both the micro-mortgage and rent-to-own business models address a broad range of market gaps in existing BOP housing markets by offering complete solutions. Table 2.1 summarizes these market solutions.

TABLE 2.1 MARKET SOLUTIONS PROVIDED BY MICRO-MORTGAGE AND RENT-TO-BUY MODELS

COMPONENT	MARKET SOLUTIONS
Land and Infrastructure	Families receive formal titles with homes purchased.
	Housing developments include basic services and infrastructure.
Financing	Mortgage loans are made accessible to low-income families through savings schemes that enable them to meet down payment requirements, and rental periods that allow them to create a payment history.
	The high cost of complete solutions is brought down by leveraging government subsidies (specifically, Credifamilia).
Construction (Design, Materials and Labor)	Housing developers build low-cost designs while meeting government standards for quality, safety and durability.
	Materials meet quality requirements and are purchased at bulk rates negotiated by developers.
	Housing developers directly contract and oversee all construction labor.

CONTEXTUAL FACTORS FAVORING THESE MODELS

The following contextual factors are critical for business models such as the micro-mortgage and rent-to-own schemes that seek to deliver a complete housing solution to the BOP:

- 1 A significant population of stable income earners who do not have sufficient resources to purchase a home or to qualify for a conventional mortgage.
- 2 Access to long-term capital to finance mortgage portfolios, which is often tied to broader macroeconomic stability, allowing for the growth of mortgage markets and related capital markets, including bond sales and securitization.
- 3 A well-regulated low-income housing development sector to ensure the quality of low-cost construction.
- 4 Existence of government programs that provide direct demand subsidies to low-income families purchasing new homes, particularly in the case of the micro-mortgage model.

The next chapter presents two more business models that contribute to the second type of housing solution: a home that is built and improved incrementally.

Step by Step: The Incremental Housing Solution



MOST PROJECTS WITHIN OMJ'S PORTFOLIO CONTRIBUTE TO THE INCREMENTAL HOUSING PROCESS, whereby housing is built progressively over many years in accordance with families' priorities and available resources. Market-based solutions are extremely varied, though most involve some form of financing via an unsecured loan and occasionally include services or linkages with service providers that support families' construction processes.

An incremental housing solution may entail one or several of the following:

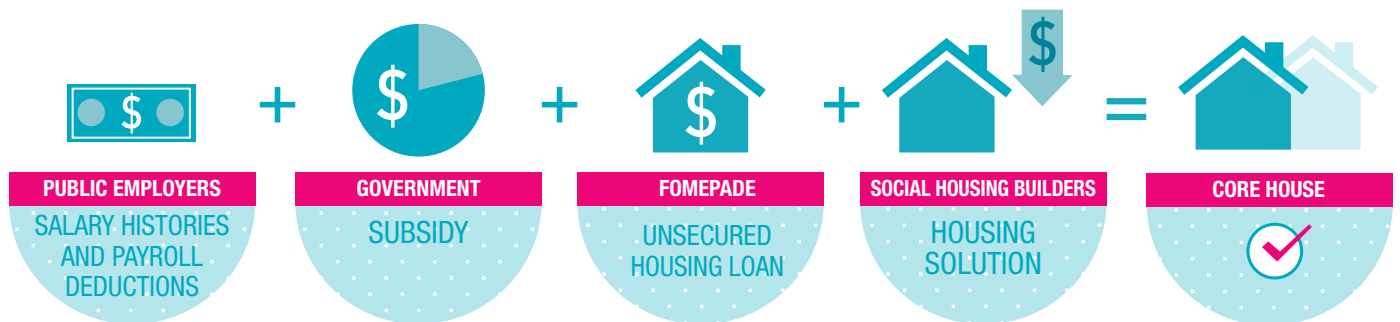
- Land purchase or titling
- Initial house construction, whether rustic or involving a well-designed basic unit or "core house"
- Basic improvements such as pouring concrete floors, plastering walls, adding divisions, painting, adding doors or windows, adding bathrooms or kitchens, and other nonstructural work
- Larger improvements and additions, such as building a roof, adding a second story, adding rooms, or other projects involving structural changes to the house
- Home repairs and basic maintenance
- Adding connections to public utilities, such as water or electricity.

Support for incremental housing construction is relevant to a broad spectrum of the BOP market, as most households already live in their own home and aspire to improve it (Scenario A in Table 1.1). Even those families living with others, renting, or illegally squatting may opt for this solution, starting with the acquisition of a plot of land, should they aspire to own a home. Certainly for the lower-income sectors, this may be their only viable option.

Within OMJ's housing portfolio, nine projects contribute to incremental housing solutions, applying a variety of financing strategies and an even broader array of construction-related services and linkages. One project in particular is highlighted below, that of FOMEPADE in Mexico, as it represents a unique model serving a specific niche (public sector workers) with a "core house" solution (Model #3). This is truly a leap forward in the incremental building process. The fourth business model incorporates the remaining initiatives that produce a broad array of home improvement solutions under the umbrella of "incremental housing" construction.



BUSINESS MODEL #3: CORE HOUSE MODEL



IMPLEMENTING INSTITUTION: FOMEPADE, A HOUSING FINANCE COMPANY IN MEXICO

The core house business model links several strategic partners into a unique value chain, resulting in a newly built basic house on a family’s existing property. Houses built meet government standards for low-income housing, including access to basic services – either connections to public sources or alternative technologies (e.g., solar panels to generate

electricity, water filters) where public utilities are unavailable. Their modular design facilitates rapid, low-cost assembly, and also future room additions. By focusing specifically on low-income state and municipal employees, FOMEPADE has found a niche market of salaried workers who are not affiliated with either of the publicly-funded mortgage programs. Steady income streams and direct payroll deductions enable FOMEPADE to extend medium-term unsecured loans at very reasonable rates.

BUSINESS CASE #2 FOMEPADE: PURSUING A BASE OF THE PYRAMID HOUSING MARKET NICHE

FOMEPADE was founded in 2006 by Juan José Gutiérrez Chapa (current President of the Board), a successful businessman and pioneer in the Mexican microfinance industry as one of the founding partners of Banco Compartamos, Latin America's largest microfinance institution. Chapa's vision for FOMEPADE was to become Mexico's leading financial institution in providing a key missing product: long-term, unsecured housing loans for the region's low-income majority. He sought to target families whose incomes are insufficient to qualify for mortgage loans, and who have traditionally resorted to incrementally building their homes with a combination of savings and consumer credit.

In order to reduce the risk involved in making long-term, unsecured loans, FOMEPADE designed a payroll deduction program to target the 6 million low-income employees in Mexico with no access to federal housing programs. Specifically, the company chose to focus on low-income public employees, given their need for housing finance and their relatively stable employment. When FOMEPADE began its operations in 2007, it quickly became apparent that most of the company's targeted clients were overburdened with consumer credit. Therefore, before offering financing for housing, FOMEPADE created a strategy to refinance clients' existing debts. Finally, in 2012, FOMEPADE was able to launch its housing product, and by 2013 the demand for the new product was so high (130 percent portfolio growth) that the company was required to raise additional equity, doubling in size. Over the next 12 months, FOMEPADE expects the housing portfolio to continue to expand rapidly.

FOMEPADE was established in 2006 as a nonbank financing company dedicated to providing financial services to BOP employees of state and municipal governments. Most of these workers cannot access formal sources of housing finance because of their low incomes and high levels of indebtedness. Thus, FOMEPADE assumed a two-pronged approach of (1) consolidating and refinancing all outstanding credit to assist clients in paying off their debt and cleaning up their payment histories, and (2) subsequently extending housing loans to assist families in building either a core house or undertaking a home improvement.

The core house model involves financing from three sources:

- 1 Government subsidies, which cover approximately 40 percent of the house cost
- 2 A family's down payment, representing 5 percent of the cost
- 3 FOMEPADE's unsecured loan, of less than \$6,000, over 5-10 year terms and at very competitive interest rates.¹⁸

Once families are approved for a given loan amount, they are allowed to choose a housing model from selected developers that matches their financing. Core house designs measure approximately 38 square meters, and include at least two bedrooms, a bathroom, a kitchen/dining area, and a service patio (for laundry, etc.). FOMEPADE's selected social housing developers are certified by federal government housing institutions¹⁹ to ensure high-quality construction, and their work is overseen by technical advisors²⁰ hired by FOMEPADE to authorize disbursements based on work completed.

TARGET POPULATION: FOMEPADE's program targets state and municipal employees who are earning less than five minimum wages. Most are either living in overcrowded conditions with other family members, or are renting space from someone else (Scenarios B and C in Table 1.1). If they do not already own land, many are granted space to construct on properties owned by other family members.

¹⁸ As compared with peer lenders extending unsecured loans for new house construction in Mexico.

¹⁹ Either the Sociedad Hipotecaria Federal or the Comisión Nacional de Vivienda.

²⁰ CNI Consultores, a specialized engineering consulting company.

PARTNERS AND LINKAGES: The core house model links three strategic partners to create a unique value chain for clients:

- 1 **Social housing developers** are innovative, socially-oriented businesses that have developed extremely low-cost housing solutions that can be built quickly. The housing designs follow government regulations in terms of space and construction quality, and often involve nontraditional materials and construction technologies. Due to their economical designs, plus the fact that homes are built on previously-owned properties, final housing solutions cost under \$10,000.
- 2 **Public sector employers** (state and municipal) provide the client base for FOMEPADE's programs. They promote FOMEPADE'S products and services, provide salary histories for borrowers, and facilitate direct payroll deductions for loan payments.
- 3 The **government subsidy program** (through the National Housing Commission,²¹ CONAVI, significantly increases affordability by covering up to 40 percent of the cost of the housing solution.

LESSONS AND CHALLENGES: FOMEPADE's core house model was launched in 2012 and as of December 2013 the program had disbursed a total of 825 loans for this product. The experience to date has revealed a number of valuable lessons and challenges:

- The core house model relies heavily on aligning the operations of the financing and construction partners so as to seamlessly deliver products and services, and ultimately reach scale with quality and efficiency. Moreover, while the financial institution is generally poised to expand geographically in offering this product (throughout its branches or other points of sales), the low-cost builders tend to be more constrained in their growth capacities, suggesting a need to invest in increasing outreach or for the financial institution to branch out and partner with a variety of construction service providers.

- FOMEPADE, as the direct vendor of the integrated housing product, must ensure the quality of the homes built and compliance with environmental and urban development guidelines. It has resolved this challenge by working only with social housing developers that are certified by the federal government, and by contracting qualified technical advisors to oversee their work.
- Social housing developers work with specific housing designs and nontraditional building materials and technologies to reduce costs while guaranteeing quality, yet these may not be fully understood or appreciated by clients. Therefore, it is important to carefully explain the reasons behind the designs, materials, and technologies being offered, preferably quite early in the loan approval process.
- FOMEPADE found that low-income public workers are often saddled with consumer debt, so a strategy was needed to pay off their loans prior to taking on a housing loan.
- FOMEPADE also discovered that low-salaried workers are generally unaccustomed to taking on larger, long-term debt. This has added to the challenge of selling the core house product.
- Government subsidies are crucial to completing the financial package of this business model. However, given that the future provision of subsidies is uncertain, it would be beneficial to create alternative financing scenarios that would ensure affordability for the target population.
- The process of self-building, whereby families directly provide a portion of the unskilled labor needed to build their homes, was initially thought to be a strategy that could reduce labor costs. However, experience has revealed that it is very difficult for families needing to earn income to provide the necessary labor. Thus, the definition of "self-build" is shifting toward the concept of a "self-managed" construction process, whereby families are equipped to provide oversight of home building without directly engaging in construction.

²¹ The Comisión Nacional de Vivienda (CONAVI) in Mexico designs, coordinates, and promotes housing policy and programs. It operates under the Ministry of Agrarian, Territorial and Urban Development.

The core house model engages with three strategic partners (public employers, social housing developers, and government subsidy programs) to deliver an

integrated product that addresses a broad range of market gaps. Table 3.1 summarizes the market solutions resulting from this model.

TABLE 3.1 MARKET SOLUTIONS PROVIDED BY THE CORE HOUSE MODEL

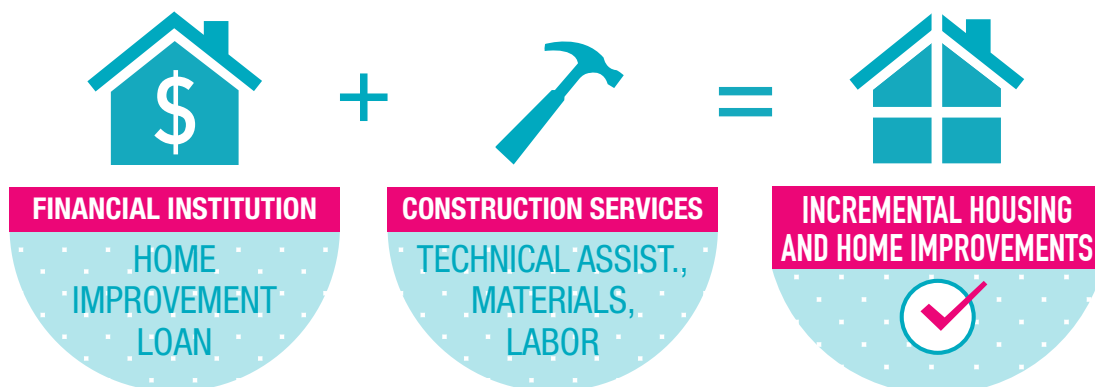
COMPONENT	MARKET SOLUTIONS
Land and Infrastructure	Possession of a formal title is not an obstacle for families, provided secure tenure is validated.
	Housing designs include basic services or connections for future access.
Financing	Affordable financing is offered at medium terms and relatively low rates.
	Government subsidies significantly reduce housing costs (by approximately 40 percent).
	Payroll deductions add efficiencies for both clients and the lending institution, and also reduce lending risk, contributing to lower interest rates.
Construction (Design, Materials and Labor)	FOMEPADE goes a step further by refinancing clients' existing debt to assist them in paying off their debts prior to assuming a housing loan.
	Social housing developers utilize very low-cost designs that meet government standards for quality, safety, and durability.
	Developers utilize alternative construction materials or methods that significantly reduce costs without compromising quality.
	Housing developers directly contract and oversee all construction labor.

CONTEXTUAL FACTORS FAVORING THE CORE HOUSE MODEL

The following contextual factors are necessary conditions for the core house model:

- 1 A significant population of stable formal employees who do not have sufficient resources to purchase a home or to qualify for a conventional or micro-mortgage.
- 2 Marginalized (low-income) but gradually developing neighborhoods with a high rate of home ownership, yet where legal land titles may be scarce.
- 3 Presence of social housing developers that can produce high-quality, low-cost housing on individual properties.
- 4 Existence of government programs that provide direct subsidies to families for construction of core houses.

BUSINESS MODEL #4: HOME IMPROVEMENTS



The vast size and dynamic nature of the BOP incremental building market is exemplified by the diverse range of products and services being generated to serve this market, as well as the variety of actors entering the playing field. OMJ-funded projects that finance home improvements include institutions such as microfinance banks, employee benefit funds, municipal savings and loan funds, a wholesale financing institution, and a cement company. Furthermore, these institutions work in partnership with an even broader range of entities, including social housing developers, non-profits, retail lenders, government subsidy programs, hardware stores, and engineering/architectural firms. Both Comfama and FOMEPADE provide support for home improvements in addition to their housing products.

One of the hallmarks of market-based approaches to supporting progressive housing is the adaptation of microfinance lending practices to finance incremental building. Home improvement lending (or “housing microfinance” as it’s frequently referred to within the microfinance sector) is generally characterized as relatively small, short-term, unsecured loans. This type of lending is becoming increasingly common among financial institutions expanding into the BOP, as an estimated 30 percent of microfinance institutions in LAC are now offering housing microfinance loans (UN Habitat 2011).²² Most experiences to date confirm that home improvement loan portfolios tend to be of high quality, and that it is a product with great appeal to a lender’s client base. Table 3.2 provides a comparison between key characteristics of home improvement and micro-mortgage loans.

²² However, housing microfinance accounts for less than 10 percent of microfinance institutions’ combined portfolios, and actually decreased in portfolio share between 2006 and 2011 according to Mix Market data. <http://www.slideshare.net/MIXdsheth/latin-american-and-the-caribbean-microfinance-market-trends-20062011>.


TABLE 3.2 COMPARISONS BETWEEN HOME IMPROVEMENT LOANS AND MICRO-MORTGAGES

LOAN ASPECT	HOME IMPROVEMENT LOAN	MICRO-MORTGAGE LOAN
Loan Amounts	Smaller; average is \$80–\$5,000	Larger; average is \$15,000–\$30,000
Loan Terms	Shorter; 12–36 months on average	Longer; 5–20 years
Guarantees	Unsecured loans frequently requiring a co-guarantor	Mortgage lien on property
Interest Rates	In the lower range of microfinance market rates. Usually 25%–50%, though they may be higher in less competitive markets	Low rates; typically under 15%
Frequency	May involve several successive loans	One-time loan

The growing range of experiences in home improvement lending is equipping the private sector to penetrate large segments of BOP markets that earn informally, build informally, and do not necessarily possess a legal land title. Examples 1-3 show specific practices and insights gained by OMJ-supported projects in financing housing solutions for the BOP. The business appeal of this underserved market is underscored by the growing presence of nonfinancial institutions – primarily building material suppliers like CEMEX, in Mexico, and Corona in Colombia, along with an increasing number of hardware stores and home centers – that extend home improvement financing to the BOP.

EXAMPLE 1: SAVINGS-LED HOME IMPROVEMENT LENDING

Clients with no prior credit history or documented sources of income often struggle to qualify for housing finance and even home improvement loans, as lenders will give priority to existing clients over new ones. Patrimonio Hoy, a division of CEMEX in Mexico, attracts very low-income clients by limiting their requirements to presenting valid identification and saving \$19 over five weeks before qualifying for a loan. In this way, Patrimonio Hoy can observe a client’s ability and willingness to make weekly payments prior to assuming a loan.



EXAMPLE 2: GOVERNMENT SUBSIDIES FOR HOME IMPROVEMENTS

Central to FOMEPADE's home improvement program is helping families secure government subsidies, which cover up to 40 percent of the cost of an improvement. Mexico's federal subsidy program (through CONAVI) authorizes up to three successive subsidies per home to finance improvements, contributing significantly to the financing of incremental construction.

EXAMPLE 3: LESSONS IN HOME IMPROVEMENT LENDING FROM PERU

Caja Sullana, a municipal savings and loan fund in Peru, launched a home improvement loan product with financing from OMJ. The following lessons emerged from its experience:

- Initially requiring mortgage guarantees resulted in lackluster product growth, as the underwriting process was too slow and costly for both clients and the lending institution. Now that Caja Sullana is issuing unsecured loans for amounts under \$5,000, it has seen a significant increase in demand.
- The home improvement loans are a popular product that attracts and retains clients, and improves the institution's competitiveness in the market.
- Caja Sullana's home improvement loans charge lower rates and generate lower margins than other loan products, so the fund's goal is to sell these clients other products and services in addition to housing loans.

Nevertheless, proven business models that successfully link financing to value-added construction services and produce a more complete or integrated housing solution are much less common. As seen in Chapter 1, BOP families that seek to improve their homes face a host of challenges to appropriately design their projects, purchase materials, and secure qualified labor such that they are ensured of high quality, durability, and low cost. Financial intermediaries motivated by a combination of social and business outcomes may see clear benefits in providing a more complete or integrated solution. The remainder of this section is dedicated to highlighting examples of projects from OMJ's portfolio that seek to provide a more complete home improvement solution, and to sharing the insights and lessons derived from these initiatives.

Table 3.3 summarizes the construction support provided within each institution's specific business model. This support is divided into three categories:

- 1 **TECHNICAL ASSISTANCE:** Informed guidance to families in planning, designing, budgeting, and/or supervising a construction project.
- 2 **CONSTRUCTION MATERIALS:** Alliances with material suppliers that result in high-quality products, discounts, and/or delivery services for families.
- 3 **QUALIFIED LABOR:** Access to construction workers with the necessary technical skills and who charge fair market rates.

TABLE 3.3 DESCRIPTION OF CONSTRUCTION SUPPORT BY INSTITUTION

INSTITUTIONS	TECHNICAL ASSISTANCE	CONSTRUCTION MATERIALS	QUALIFIED LABOR
Visión Banco (Paraguay)	Vision Banco's partner, Habitat for Humanity Paraguay (HFHP), advises families in construction design and budgeting, and provides direct oversight to construction projects.	Materials purchased directly by HFHP from suppliers at discounted prices.	HFHP and families jointly select and hire laborers, and HFHP supervises their work.
FOMEPADE (Mexico)	Certified social housing developers undertake larger improvements, with outsourced technical advisors providing oversight. Nonstructural home improvements receive more limited technical assistance directly from suppliers of materials.	FOMEPADE is negotiating with suppliers of materials to provide quality materials at discounted prices. With larger improvements, materials are purchased directly by developers.	Housing developers directly hire and oversee construction when it involves larger improvements.
Comfama (Colombia)	Technical assistance from contracted engineers/architects assists in project design and planning, and confirms construction quality and full investment upon completion.	Comfama offers quality materials at discounted prices through its network of affiliated suppliers.	Comfama is expanding a network of recommended contractors that provide quality work at fair prices, which can be offered to interested clients.
Patrimonio Hoy (Mexico)	Patrimonio Hoy is introducing on-site technical assistance in design, planning, budgeting, and conducting follow-up visits.	High-quality materials are sold at discounted prices and delivered to clients' homes.	
PRODEL (Nicaragua)	PRODEL manages provision of technical assistance to families, charging a fee through partner financial intermediaries, and subcontracting qualified advisors based on demand.		
EDYFICAR (Peru)	Basic assistance is provided by loan officers in planning and budgeting improvement projects.	EDYFICAR is building alliances with cement companies and their networks of hardware stores to attract more clients. Suppliers offer competitive prices and home delivery.	EDYFICAR is seeking to organize (train and certify) masons, starting with its existing client base, given the key role of masons in building quality works.

Probably the most common, costly, and complex added service is the provision of technical assistance for construction, which might be classified into the following three levels of involvement:

- 1 **Basic assistance** is given to families for planning and budgeting their home improvements, and typically a follow-up visit is conducted to ensure that the improvement project was completed and the loan properly invested. This type of assistance is considered appropriate for smaller improvements that are not highly technical or do not require structural changes to the home, and may even be undertaken by trained loan officers or other existing staff of the financing institution, such as in the case of EDYFICAR (Peru).
- 2 **Qualified technical** assistance is provided on-site by trained architects or engineers who are equipped to professionally design projects and may also oversee the actual construction at specific points during the building process. This more specialized assistance is particularly helpful for clients undertaking large or complex improvements, frequently involving structural changes. The service is usually provided by a partner other than the financing institution, such as in the cases of Comfama (Colombia) and PRODEL (Nicaragua).
- 3 **Housing developers** work directly with the family to build the desired improvement, and assume the responsibility of purchasing needed materials and overseeing the work of contracted laborers. Visión Banco in Paraguay works in partnership with Habitat for Humanity Paraguay as the housing developer for financed home improvements, while FOMEPADE (Mexico) contracts social housing developers to undertake only larger improvements that require more qualified professionals to engage in design and oversight.

While access to construction materials and qualified labor is generally managed through linkages with partners, generating perceived benefits for all parties, the provision of technical assistance is particularly complex in that the service is often costly, and cost-recovery is challenging – particularly given that low-income families are generally unaccustomed to purchasing qualified technical services for construction design or for oversight of their incremental housing processes. Furthermore, scaling up of technical assistance is also complex, as the geographic coverage and growth of construction service providers is not always well aligned with the operational dynamics of financial service providers.

The institutions described above cover technical assistance costs through a variety of strategies:

- **Basic assistance** is generally covered within the loan interest rate, particularly when provided by a financial institution's loan officers, such as in the case of EDYFICAR (Peru).
- The costs of more **specialized assistance**, provided by a partner institution, are higher and may be partially absorbed by socially driven institutions seeking added value for their clients, such as in the case of Comfama (Colombia). PRODEL (Nicaragua) has chosen another option, whereby clients are charged a 3 percent fee at loan disbursement that covers the cost of specialized technical assistance. Business Case #3 describes PRODEL's technical assistance model in greater detail.
- **Housing developers** include their costs within the price of the housing solution that is sold to families. Models that involve housing developers tend to undertake larger improvement projects – in essence combining several incremental steps into one. In order to make these larger loans affordable, lenders either have to extend the loan terms (e.g., Visión Banco in Paraguay allows up to five years) or pursue government subsidies (e.g., FOMEPADE in Mexico mobilizes CONAVI subsidies).



BUSINESS CASE #3: LESSONS FROM PRODEL – TECHNICAL ASSISTANCE DELIVERY

PRODEL, a second tier financial institution and foundation in Nicaragua, is a pioneer in the delivery of technical assistance to families undertaking home improvements and has been refining its business model for the past 19 years. It has made more than 78,000 loans for home improvements accompanied by technical assistance services. As a wholesale fund, PRODEL lends capital to 18 retail institutions operating throughout Nicaragua, and also sells them technical assistance services, provided directly to their loan clients. While financial intermediaries are often reluctant to engage in nonfinancial services that are outside their realm of expertise, the purchase of PRODEL's technical assistance services has resulted in an attractive partnership.

PRODEL's business model for technical assistance involves the following:

- Training and certifying technical advisors in the geographic areas where PRODEL's partners operate
- Contracting these advisors on a demand-based, fee-for-service basis rather than as full-time employees, adjusting to the fluctuations in service demand
- Charging financial institutions a relatively small technical service fee (3 percent), which is passed on to their clients
- Focusing technical assistance on what PRODEL calls the "agreement session" (sesión de entendimiento), in which the family, technical advisor, and hired builder meet prior to loan processing to agree on the improvement plan – specifically the design, materials, and budget.
- While technical advisors make two or three oversight visits during construction, it is the family that supervises work based on the established plan.

Although technical assistance may be somewhat costly and complex to deliver, many financial intermediaries are motivated to find ways to offer these services alongside home improvement loans. Reasons cited by the institutions include social objectives – such as improved planning for families and ensuring that the project is completed – as well as business goals, such as increased competitiveness and client retention for retail lenders.

LESSONS AND CHALLENGES: The wide range of experiences in incremental housing and home improvements has revealed a number of broader lessons and challenges:

- Home improvement loans that follow basic principles of microfinance are proving to be a very popular and accessible product for low-income families – particularly among those working informally, building informally, and who may not possess a formal land title.
- Financial institutions are increasingly discovering the virtues of home improvement loans as an attractive business opportunity for reaching new markets, retaining existing clients, and diversifying their portfolio with a low-risk product.
- Incremental housing models that integrate construction-related services with home improvement loans offer a more complete solution to families, often involving some form of technical assistance, preferential access to materials suppliers, and connections to qualified construction labor.
- Institutions operating on a large scale benefit from a strong negotiating position for building alliances and linkages to enhance their product. Comfama (Colombia), as the largest employee benefit fund in the state of Antioquia, has been able to leverage its large network of affiliated companies to negotiate spe-

cial rates from construction material suppliers for its home improvement loan clients. Similarly, EDYFICAR (Peru) has found that the size of its housing portfolio (92,000 clients) and national presence (178 branch offices) are important assets in negotiating partnerships with large material suppliers and their networks. Business Case #4 explains the nature of these partnerships. Key to EDYFICAR's success has been reaching financial sustainability and scale with a relatively simple model of housing finance delivery prior to adding construction-related enhancements.

- The provision of technical assistance in connection with home improvement lending presents a variety of questions for further study:
 - What kind of technical assistance is most important for families and most valued by them?
 - How much are families willing and able to pay for technical assistance?
 - What is the best means of providing this technical assistance? Should it be provided in-house or by an external expert?
 - What models facilitate reaching scale with financing and technical assistance?
- The slow and costly process of providing needed services and infrastructure to upgrade informal settlements – where most incremental building takes place – signals the importance of linking private sector initiatives with urban development efforts.
- Effective connections with construction laborers and their networks merits further innovation, given the critical role that they play in determining the quality and cost of home improvements among the BOP.

BUSINESS CASE #4: SELLING LOANS THROUGH SUPPLIERS OF MATERIALS

EDYFICAR has been pilot testing the sales of its home improvement loans through chains of hardware stores in Lima, Peru, and is poised to expand these networks throughout the country. These alliances are attractive to both partners, as hardware stores increase their sales by offering clients access to credit via EDYFICAR, and also earn a commission on all loans approved. Meanwhile, EDYFICAR benefits from gaining new clients who may eventually purchase financial products in addition to home improvement loans. Finally, clients benefit from competitive prices and home delivery of materials.

Table 3.4 summarizes the market solutions addressed by the home improvement business model.

CONTEXTUAL FACTORS FAVORING THE HOME IMPROVEMENT MODEL

TABLE 3.4 MARKET SOLUTIONS PROVIDED BY HOME IMPROVEMENTS

COMPONENT	MARKET SOLUTIONS
Land and Infrastructure	Possession of a formal title is not an obstacle for families, provided secure tenure is validated.
	Financing may be directed to land purchase, titling, and adding connections to public utilities.
Financing	Microfinance lending practices (e.g., credit evaluation techniques, smaller loan sizes, shorter terms) accommodate clients with no formal credit histories and informal income sources.
	Unsecured loans employ alternative guarantees such as cosigners and open access to families with few legal assets.
Construction (Design, Materials and Labor)	Complements families' existing patterns of building progressively, resulting in economically affordable solutions/steps.
	Some programs offer access to construction guidance, technical designs, high-quality materials, and/or qualified labor.

Contextual factors favoring the home improvement model include the following:

1. An extensive informal sector in need of improved housing and unable to qualify for a mortgage or even an unsecured longer-term loan, yet with sufficient income to pay for a home improvement loan.
2. Communities characterized by widespread incremental housing construction.
3. High rates of homeownership, even where legal titles may be scarce.
4. A strong and vibrant microfinance sector offering a diversity of products.
5. Macroeconomic growth that benefits BOP incomes, and/or significant flows of remittances to this sector.
6. Direct subsidies for home improvements are an added benefit when available. Among the countries represented by OMJ's housing portfolio, Mexico's federal subsidy program (through CONAVI) is unique, offering up to three subsidies for improvements for the same house. The subsidies are directly disbursed to the financial intermediary granting the loan and cover approximately 40 percent of improvement costs.

Insights and Recommendations for Base of the Pyramid Housing Market Ventures

As the diverse approaches to BOP housing discussed in this report have demonstrated, this sector offers compelling market opportunities for well-targeted and tailored solutions. A wide range of private sector actors, including financial service providers, suppliers of construction materials, housing developers, and local NGOs, are moving into this market with products and services that are designed to transform market failures into business opportunities.

What insights can be derived from these various private sector approaches to supplying housing for the BOP? From the 11 projects within the OMJ housing portfolio, two types of housing solutions were identified at either end of the spectrum: the complete solution and incremental house construction. For each of these solutions, two business models were described as distinct approaches in providing these solutions. The final chapter makes comparisons across the four models and offers insights to support the continued growth and development of value-added housing products and services for the BOP.

Business approaches to housing for BOP markets, such as the projects and models highlighted in this report, are developed through a thoughtful process that entails the following:

- Thorough study of the nature of BOP housing processes within a given context, describing how housing (and land) is acquired, built, and financed.
- Clear assessment of market opportunities and failures, including the identification of key strategic partners who might offer value-added services in connection with the loan product, as well as potential competitors and their products and services.
- Design and effective delivery of products, services, and linkages that respond to these market realities.

Indeed, the models presented in this report are not intended for cut-and-paste application, but rather to facilitate an appreciation of common features and a comparative analysis between approaches. It is expected that the documentation of these models will stimulate further contextually-appropriate innovation that leads to increased housing opportunities for the BOP.

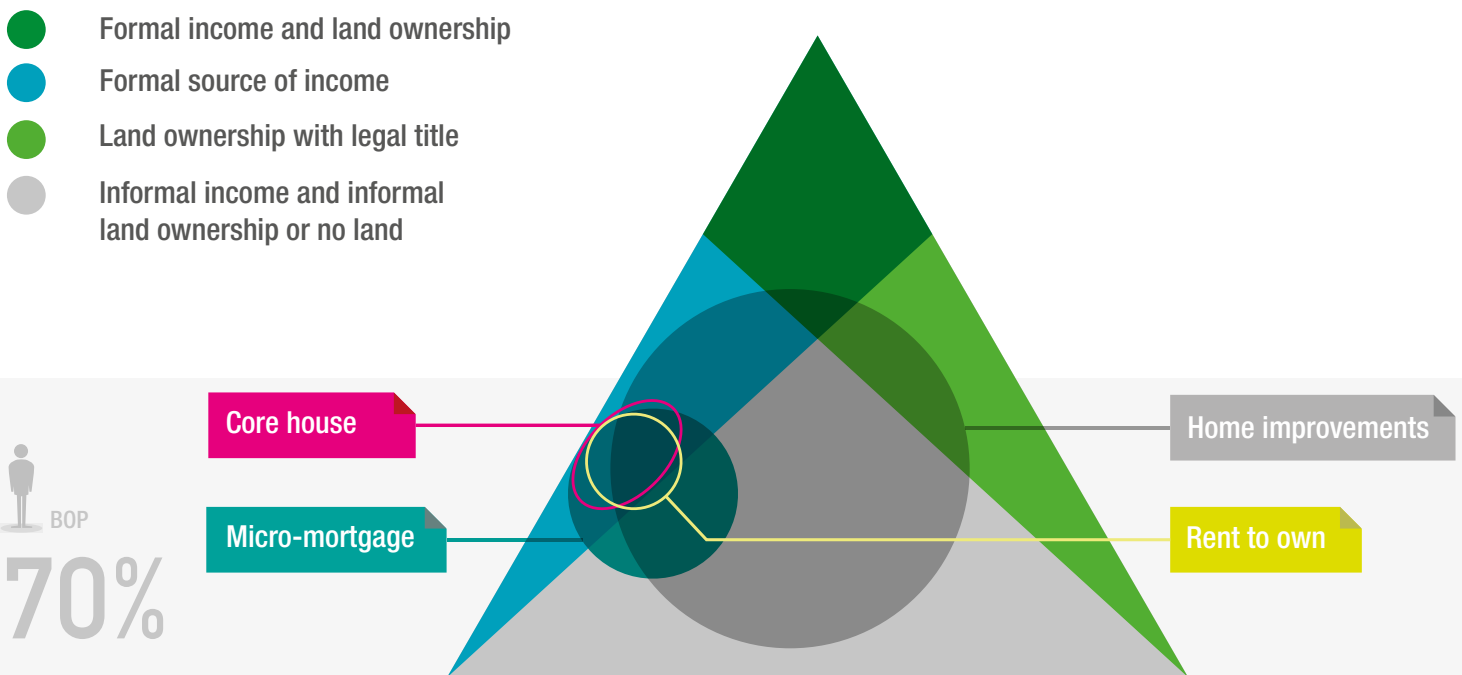


COMPARING TARGET MARKETS

Each of the business models was designed to target specific BOP markets that must be understood by their housing needs and priorities, as well as their income levels and sources. Income levels are directly associated with the cost of a solution a family can afford, while income

sources influence the family's access to different types of financing. Diagram 4.1 displays the income pyramid presented in Chapter 1, highlighting BOP segments served by each of the four business models.

DIAGRAM 4.1 TARGET POPULATION BY BUSINESS MODEL



From Diagram 4.1, the following observations may be made:

- There is a correlation between a family's income level and the amount of investment it will be able to make in a housing solution. Common estimates suggest that between 20-35 percent of a family's income may be applied to housing-related expenses. Therefore, income levels affect both the type of products or services a family is able to purchase, and the amount of financing it can access to acquire these. In other words, housing solutions that are more costly – such as a new home bought through the rent-to-own model – will not be accessible to the lower-income segments of the BOP unless direct subsidies are secured to reduce their costs.
- Private sector initiatives, such as those represented within the OMJ housing portfolio, will rarely consider segments earning less than the local minimum wage within their target market, as this group's resources are too constrained to afford most market-based housing solutions.
- The formally-employed BOP is a particularly suitable market for longer-term loans (over five years), because of its well-documented income histories, the projected stability of its income streams, and the potential for direct payroll deductions. Nevertheless, as reported in earlier chapters, low-income segments of the formally employed are often saddled with debt (primarily consumer loans) and/or may carry poor credit histories, creating a serious obstacle for housing lenders. Furthermore, in smaller countries, such as in much of Central America, these markets may not be large enough to allow for a highly targeted product to reach significant scale.
- The fourth model – incremental housing and home improvements – is the only strategy that effectively reaches a large portion of the informal sector, representing the majority of LAC's BOP. Since incremental solutions are the primary option available to this vast segment, critical priorities are to (1) reduce the transaction costs of building and financing these stages through improved technology and economies of scale, and (2) improve the quality of this construction in a way that is financially sustainable.

COMPARING HOUSING SOLUTIONS

Below is a description of the type of housing solution and related benefits produced by each of the business models:

- **The micro-mortgage and rent-to-own models** result in a high-value solution for families and society at large, providing a complete housing solution built according to set standards, and access to basic services and infrastructure. Families benefit from these models immediately, while at the same time building a financial asset that can be leveraged or sold in the future. Furthermore, these solutions follow urban development guidelines and municipal plans, ultimately costing less for individuals and municipalities than the gradual upgrading of informal settlements.
- **The core house model** offers the unique benefit of building a low-cost, high-quality house on a family's existing property, resulting in a more affordable and relatively complete solution. The core house solution also includes access to basic services such as water and electricity. Since families are not required to relocate in order to obtain a new house, their social and economic networks remain intact.
- **Home improvements** match the building and financing patterns that are already in progress, adding value to the current process. While the first three models directly reduce quantitative housing deficits, adding to the supply of adequately built homes, the fourth model is particularly suited to addressing qualitative deficits. Throughout LAC, both types of housing deficits are significant in real terms, but qualitative deficits are notably greater – superseding quantitative deficits by a factor of five at a regional level, and in even greater proportions in the poorest countries (Bouillon 2012).

COMPARING CONTEXTUAL FACTORS

Table 4.1 lists the contextual factors favoring each business model. From these factors, the following additional observations may be made:

- The first two models (micro-mortgage and rent-to-own) depend on (1) the existence of long-term capital to finance mortgage portfolios, and (2) the presence of well-regulated, low-cost housing developers.
- The first and third models (micro-mortgage and core house) rely on a steady supply of government direct-demand subsidies, whereas models two and four (rent-to-own and home improvements) are completely market-based, although they could benefit from subsidies, if available.
- Model four (home improvements) is contingent upon high rates of home ownership and a large informal sector – two factors that are common throughout LAC. Favorable to this model is (1) a vibrant microfinance sector contributing to the supply of home improvement financing, and (2) economic growth that is benefiting BOP incomes, thereby increasing the BOP's potential for investment in improved housing.

TABLE 4.1
CONTEXTUAL FACTORS FAVORING EACH OF THE BUSINESS MODELS

1. MICRO-MORTGAGE	2. RENT-TO-OWN	3. CORE HOUSE	4. HOME IMPROVEMENTS
<p>1. A significant population of stable income earners who do not have sufficient resources to purchase a home or to qualify for a conventional mortgage.</p> <p>2. Access to long-term capital to finance mortgage portfolios. This is often tied to broader macroeconomic stability, allowing for the growth of mortgage markets and related capital markets, including bond sales and securitization.</p> <p>3. A well-regulated low-income housing development sector to ensure the quality of low-cost construction.</p> <p>4. Existence of government programs that provide direct demand subsidies to low-income families purchasing new homes.</p>	<p>1. A significant population of stable income earners who do not have sufficient resources to purchase a home or to qualify for a conventional mortgage.</p> <p>2. Access to long-term capital to finance mortgage portfolios. This is often tied to broader macroeconomic stability, allowing for the growth of mortgage markets and related capital markets, including bond sales and securitization.</p> <p>3. A well-regulated low-income housing development sector to ensure quality of low-cost construction.</p>	<p>1. A significant population of stable formal employees who do not have sufficient resources to purchase a home or to qualify for a conventional or micro-mortgage.</p> <p>2. Marginalized (low-income) but gradually developing neighborhoods with a high rate of home ownership, yet where legal land titles may be scarce.</p> <p>3. Presence of social housing developers that can produce high-quality, low-cost housing on individual properties.</p> <p>4. Existence of government programs that provide direct subsidies to families for construction of core houses.</p>	<p>1. An extensive informal sector in need of improved housing, and unable to qualify for a mortgage or even an unsecured longer-term loan, yet with sufficient income to pay for a home improvement loan.</p> <p>2. Communities characterized by widespread incremental housing construction.</p> <p>3. High rates of home ownership, even where legal titles may be scarce.</p> <p>4. A strong and vibrant microfinance sector offering a diversity of products.</p> <p>5. Macroeconomic growth that benefits BOP incomes, and/ or a significant flow of remittances to this sector.</p> <p>6. Direct subsidies for home improvements are an added benefit, when available.</p>

CONCLUSIONS

The portfolio of projects presented in this report exemplifies the types of innovations and approaches that are needed to increase housing options for the base of the pyramid. The projects described within the first three models – micro-mortgage, rent-to-own, and core house – are still in the early stages of development and growth. As these advance, it will be important to capture lessons pertaining to the following questions:

- What segments of the BOP are being served by a model, and how does this relate to the projected target market? For example, for the micro-mortgage model, outreach thus far has been primarily to the formally employed. Since the intention is to increase participation from the informal sector, it will be valuable going forward to assess whether this has been achieved, and if so, what facilitated it.
- What is the level of client satisfaction with the products and services received? What is the social impact of these different housing solutions?
- How is scale reached with each of the models? What further insights will facilitate their replication?

Among the projects engaged in the home improvement model, it is notable how many have added services and linkages to enhance BOP incremental housing processes. These experiences will undoubtedly contribute valuable insights to the broader housing finance industry, where home improvement financing is increasingly delivered in isolation from other value-added construction services. Key questions to address through future research and documentation include:

- What are clients' perceptions of these added services?
- What is the impact of these services on housing costs and quality?
- Which of these models are able to reach scale?
- What are the factors that facilitate reaching scale?

FUTURE TRENDS AFFECTING BASE OF THE PYRAMID HOUSING IN LATIN AMERICA AND THE CARIBBEAN

Looking ahead, it is likely that the following factors will impact BOP housing markets in LAC:

- As high rates of urbanization and urban migration are projected to continue in LAC, and urban growth will concentrate primarily in secondary cities with less than a million inhabitants (Bouillon 2012), there will be more pressure to supply urban housing and more demand for urban land. Housing deficits and markets are increasingly being treated as essentially an urban phenomenon. Public and private sector solutions to this reality will need to address the following questions:
 - o How will the region provide affordable access to urban land for the BOP?
 - o What new types of construction (e.g., multi-level and multiple-family dwellings) will allow for providing that kind of access?
 - o How do we increase the supply of adequately-built and reasonably priced rental units for the BOP?
 - o Given that over 27 million urban households in LAC lack adequate infrastructure, particularly water and sanitation, how will cities increase access to these basic services as they continue to grow (Bouillon 2012)?
- As LAC, along with the rest of the world, becomes more attentive to the effects of climate change on weather patterns, and greater focus is placed on disaster mitigation and risk reduction, this will raise the importance of safe and durable construction. Cities will seek to increase resilience through improved planning and urban guidelines, which need to be incorporated into private sector efforts among the BOP.
- Further strengthening of microfinance regulation and support in LAC countries will increase opportunities for home improvement lending to expand as an attractive product. As such, it will be important to ensure that BOP housing products are recognized and supported by regulators and investors.
- Over time, increased private sector involvement in BOP housing markets will lead to greater diversification and specialization of housing products to this sector.
- Countries within the region that experience extended periods of economic stability and growth are likely to see increased BOP investment in housing.

RECOMMENDATIONS

Encouraging greater private sector involvement in BOP housing markets, particularly with products and services that add social value, will require strategic support from key actors within the public sector and from donors and socially-minded investors.

CONSIDERATIONS FOR THE PUBLIC SECTOR

- Direct demand subsidies are needed to increase the affordability of market-based housing solutions for the poorest segments of the population. These subsidies should be tailored to the range of low-income housing solutions needed, including incremental home improvements. Public financing for BOP housing loan portfolios should be structured to stimulate private sector investment, rather than crowding it out. Supply-side incentives may include offering capital at market rates to retail lenders, providing guarantees for the issuance of low-income mortgage bonds, and/or developing secondary mortgage markets to facilitate the growth of this sector.
- Municipalities are encouraged to stimulate the growth of local BOP housing markets by legalizing and upgrading informal settlements (e.g., Managua, Nicaragua), and providing urban land for low-income housing development (e.g., Bogota, Colombia). Furthermore, regulatory frameworks tied to supportive policies are needed to ensure that private sector initiatives contribute to sustainable urban development.
- Banking regulators would do well to recognize unsecured housing loans as a distinct financial product from mortgages and consumer loans, and to develop appropriate regulations and guidelines to support this growing practice among retail lenders.

CONSIDERATIONS FOR DONORS AND INVESTORS

- Market-based ventures that seek solid business returns along with social impact will benefit from supportive investments, whether in the form of technical assistance grants, targeted financing, or patient capital.
- Knowledge creation is critically needed in topics related to the successful creation of value-added business strategies and models that effectively serve BOP housing markets. Directing funding and technical assistance for continued research on the issues identified in this report will help inform the growth of this sector and guide future support and investment.

The projects described in this report represent only a sample of the promising BOP business models emerging throughout LAC. Over the coming years we hope to see an even broader range of BOP housing solutions and a variety of profitable business models supplying them. As we consider the future housing needs of LAC, we hope that there is increased clarity that the vast and dynamic housing markets at the base of the pyramid are a welcoming destination for business investment and innovation.

REFERENCES

Bouillon, Cesar Patricio (ed.). 2012. *Room for Development: Housing Markets in Latin America and the Caribbean*. Development in the Americas Series. Washington, DC: Inter-American Development Bank.

Hammond, Allen, William J. Kramer, Julia Tran, Rob Katz, and Courtland Walker. 2007. *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid*. Washington, DC: World Resources Institute.

J.P. Morgan. 2010. Impact Investments: An Emerging Asset Class. JP Morgan Global Research, 29 November. <http://www.rockefellerfoundation.org/uploads/files/2b053b2b-8feb-46ea-adbd-f89068d59785-impact.pdf>.

Prahalad, C.K., and Stuart L. Hart. 2002. The Fortune at the Bottom of the Pyramid. *Strategy & Business*, Issue 26 (First Quarter).

Torche, Florencia, and Seymour Spilerman. 2008. Household Wealth in Latin America. In *Global Distribution of Personal Wealth*, by James B. Davies. New York: New York University.

UN Habitat. 2011. *Affordable Land and Housing in Latin American and the Caribbean*. New York: United Nations.

