



COMPREHENSIVE MARKETING SYSTEMS, INC.

COLLECTIONS PROGRAM
FOR THE SRI LANKAN
NATIONAL HOUSING DEVELOPMENT AUTHORITY

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PREPARED FOR:

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PRE/H

PREPARED BY:

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INTRODUCTION

Comprehensive Marketing Systems, Inc. ("CMS") was contracted by the Office of Housing to provide technical assistance to the Government of Sri Lanka and the National Housing Development Authority ("NHDA") to facilitate effective implementation of the Million Houses Program ("MHP"). This technical assistance effort was conducted January 1 through January 18, 1985.

This document assesses the progress of the MHP; and develops options available to the NHDA in engaging experienced private institutions to undertake appropriate loan administration responsibilities.

I. BACKGROUND

The five year Million Houses Program ("MHP") commenced January 1, 1984 with an emphasis on delivering affordable shelter solutions to lower income families. The earlier version of Sri Lanka's self-help effort provided public funds for the construction of housing that was intended for the use of lower income families, but proved ultimately to be affordable only to upper income households. The Million Houses Program, as it is today, reflects a major shift in policy and strategy by the Government of Sri Lanka. To ensure affordability for lower income families, the MHP now provides low interest loans directly to low-to-moderate income families to finance the construction or improvements of housing and services.

The AID Office of Housing provided the assistance to the Government of Sri Lanka is financing this endeavor through its Housing Guaranty Program. The Office of Housing also established the following criteria for the use of housing guaranty monies.

- (1) Loans would render assistance to low income families (below median income);
- (2) Loan limitations were to be sufficient to provide adequate shelter solutions; and
- (3) A cost-effective recovery program was to be implemented.

Based upon these criteria, the Office of Housing

approved the disbursement of fourteen-million dollars (\$14M) funding for the Sri Lankan Government.

In July 1984, approximately mid-course of the MHP's initial year, the Office of Housing initiated an appraisal of the progress of MHP. The purpose of the appraisal was to ascertain the effectiveness of the Sri Lankan Government in meeting the three criteria set forth by AID; and make recommendations for the program's improvement.

The consultants determined that the implementation of the MHP could be improved by decentralizing, to the extent possible, NHDA's loan administration responsibilities.

Follow-up technical assistance was provided by Comprehensive Marketing Systems, Inc. ("CMS") in January 1985 to evaluate NHDA's progress in carrying-out the appraisal team's recommendations; and to assist in the refinement of strategies for improving NHDA's overall capacity to recover cost.

II. SUMMARY OF APPRAISAL FINDINGS: JANUARY 1984 THROUGH JUNE 1984

The MHP is an ambitious program that is based on Sri Lanka's self-help tradition. The program has the benefit of enthusiastic and motivated staff in the central and district offices that work to facilitate shelter solutions in accordance with program goals and the Office of Housing criterion.

This section summarizes the key findings detailed in the September 1984 appraisal report submitted to AID and NHDA.

A. LOANS TO LOWER INCOME FAMILIES

Based on site visits and discussions, the consultants determined that MHP loans made to families in rural areas appeared to be reaching the low income target group. The appraisal team noted, however, that program data on loan activity was not consistently maintained.

Recommendation(s):

- NHDA should establish a system for tracking loan activity and the MHP beneficiaries that will enable administrators to assess program performance.

B. ADEQUACY OF LOAN AMOUNT

The maximum loan limit of 7,500 Rupees appeared adequate to finance shelter improvements. The Appraisal indicated that many families were able to construct entire houses in the traditional wattle and daub technique; while in some districts upgrading and improvement techniques had proven to be more feasible, given the local needs and cost of materials.

Recommendation(s):

- The cost and type of improvements made with MHP loans should be analyzed periodically (i.e. annually or 18 month intervals) to determine if changes should be made in the loan amount, interest rate, or in the building technique.

C. COST RECOVERY

The primary focus of the MHP and its administrators had been on production of units. While the guidelines for the RSPMHP were well defined for loan delivery, the collections and delinquency resolution procedures were not clearly outlined. Consequently, a MHP cost recovery program was virtually non-existent.

Another factor prohibiting effective cost recovery of MHP monies was the inadequacy of the public sector institutions to administer loan programs due to lack of trained staff and insufficient accounting/financial systems. This problem was enhanced by the traditional prejudice of borrowers that loans made by public sector institutions are grants or gifts from the government. Borrowers often do not feel obligated to repay the government, but do generally feel a greater sense of responsibility to pay on private debts.

Recommendation(s):

- The responsibility for activities such as disbursing funds, repayments, billing and accounting should be shifted from NHDA to existing private sector lending institutions that carry-out

these activities as a normal function of their day-to-day operations. Specifically, a financial institution, such as a commercial bank, could undertake the disbursement and collection responsibilities for MHP; and a servicing bureau and/or mortgage institution could manage the accounting and posting of payment tasks. The recommendation for the involvement of the private sector was predicated on the utilization of existing systems, assuming that those systems could, in fact, support NHDA's collection efforts.

- Develop within NHDA an automated management information and tracking system that could provide NHDA with timely and accurate information on the status of individual loans and program progress, as well as overall program activity. Such information would be made available to all levels of program implementation (i.e. Ministry, District, Local and Gramodaya Mandalas-Pradeshiya Mandalas). And, the systems would interface with the private servicing system to automate the flow of information within NHDA.
- Develop a plan to strengthen and increase the uniformity of the Gramodaya Mandalas' role in (a) marketing the program; (b) promoting the relationship between the private sector lender (upon their participation) and the borrower; and

(c) assist in recovering payments from delinquent borrowers.

The "Sri Lanka Housing General Appraisal Report," which was prepared under Contract Number HG-002, provides the detailed findings of the appraisal effort.

III. SUMMARY OF PROGRESS: JULY 1984 THROUGH DECEMBER 1984

The January technical assessment effort was initiated to review MHP activities and assess progress in implementing the policy and organizational recommendations made by the appraisal team. This technical assistance visit was conducted January 1 through January 18, 1985.

A. PROGRAM GOALS

During its first year of operation, MHP provided assistance to 41,621 families which represents approximately 10,000 villages. This volume was achieved despite the slow start which produced less than 3,000 loans during MHP's first three months. NHDA estimates that approximately RS 198,000,000 or \$7,650,000 was disbursed during the 1984 program year. MHP is the first single-family housing program to achieve such coverage.

Of the 41,621 approved loans, 15,687 or 38% of the families had completed construction. The NHDA found this rate of completion unacceptable and has taken these two key actions to improve the situation:

- (1) shortening the time frame for completing construction (currently six months); and
- (2) monitoring overall progress more closely.

B. COST RECOVERY

The Government of Sri Lanka is working to develop an effective cost recovery program. It has modified MHP accounting procedures; incorporated commercial banks in the

loan disbursement process, and is developing a pilot program that shifts the primary loan administration responsibilities to the thrift institutions. Although it is a move in the right direction, these activities will not provide in a successful cost recovery system.

An overview of the activities in these areas follows:

(1) Accounting

It is notable that NHDA has made efforts to streamline its accounting system. Accounting procedures are still manual but the time involved in the posting of disbursement and collection entries has been cut in half. Forms and documents were merged or eliminated, thus reducing the overall size of a loan package and, subsequently, the amount of staff time required for processing.

(2) Participation of Commercial Banks

In an attempt to involve private lenders in the program, NHDA and several commercial banks are cooperating in a system where the borrower, upon receiving loan approval, is instructed to open an account in the nearest bank (if conveniently located) where the MHP loan funds are deposited. While this scheme has been effective in introducing low income borrowers to banking, it falls short of shifting time consuming tasks from NHDA. The NHDA must still originate loans, and deposit each individual loan into the bank where accounts are

then established. The participating banks are not involved in the repayment of monies.

(3) Inclusion of Thrift Institutions

NHDA representatives have indicated that greater use of commercial banks may be infeasible because the banks often are not located in the villages; consequently, borrowers are reluctant to travel long distances to make payments. Instead, the NHDA authorized the Kandy District to initiate a pilot project. Senior NHDA officials suggested that the use of thrift societies be explored as a viable private sector alternative. The use of thrifts in the MHP would facilitate the institution building objective of the Sri Lankan Government.

NHDA initiated a pilot project in the Kandy District that incorporated the use of thrift societies as a mechanism for transferring the collection and disbursement activities to the private sector. Several advantages to using thrift societies in the implementation of MHP were cited. They include:

- accessibility to borrowers;
- large number of institutions - over 3,000 registered societies exist in Sri Lanka compared with 550-plus service offices of the two largest commercial banks;

- lowest delinquency rate (near zero) of any institution in the country;
- cooperatives regulated through a government controlled entity which establishes standard operating guidelines and strict auditing and financial oversight.

C. CONCLUSION

The MHP has achieved its 1984 production goals. It also appears to be on schedule for attaining the 40,000 loans targeted for program year 1985. While impressive, these production figures illuminate the need for an effective accounting and cost recovery system that can handle the rapidly growing portfolio. NHDA does not have the resources required to manage the vast MHP portfolio.

Although NHDA has attempted to involve private institutions in the program, it has not been successful in significantly reducing its loan management responsibilities. Discussions indicate that Sri Lanka's banking community is not receptive to assuming major responsibilities in the cost recovery effort. Although some commercial banks have agreed to establish checking accounts for borrowers, their participation has not reduced any of NHDA's program operation responsibilities.

The thrift institution, on the other hand, has emerged as a private entity with adequate loan management experience to assume many of NHDA's collection, accounting and delinquency resolution responsibilities. However, only four

districts will have the organizational capacity to assume MHP implementation by the end of the 1985 program year.

Our findings indicate that a single approach to cost recovery may not be feasible. Instead, NHDA should continue to identify experienced private institutions; assess their capabilities; and develop a strategy or multiple strategies that will coordinate the abilities of the private sector that will maximize NHDA's cost recovery efforts.

IV. DEVELOPING A COMPREHENSIVE STRATEGY FOR COST RECOVERY

CMS has recommended that the NHDA prepare a comprehensive strategy for utilizing private institutions to assume, to the extent possible, the MHP loan administration responsibilities. This strategy will coordinate the roles and responsibilities of the implementing institutions. It will also include specifications that will outline standardized procedures for performing the loan administration functions to ensure adherence to the MHP policy.

This section begins to examine private sector options available to NHDA; their implementation roles; and the resulting change in the NHDA's responsibility.

Under the Million Houses Program, the NHDA is charged with the following loan administration responsibilities: origination; inspection; disbursement; collection; accounting; billing; delinquency resolution; and general administration. Figure 1 illustrates these functions. The described functions represent distinct administrative, lending and servicing disciplines which require specialized skills. CMS recommended organizational and operational changes in the program that would culminate in a reduction of the NHDA's responsibilities in cost recovery and establish private sector institutions in key roles in the MHP debt management efforts.

MODEL I

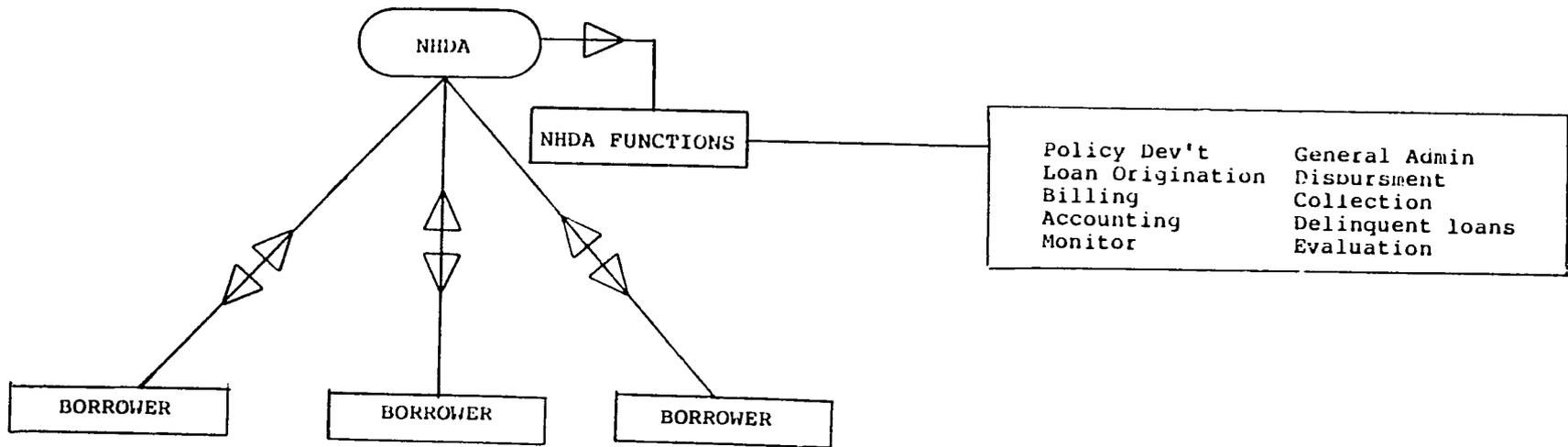


Figure 1

NHDA and MLGHC recognize the MHP implementation problems. Further, they agree that shifting, to the extent possible, the loan administration responsibilities to experienced institutions would be an efficient way to implement the MHP cost recovery effort. However, several constraints have surfaced that affect the decentralization objectives. Although there are institutions that have lending and/or servicing experience, the size of the loan portfolio, as well as its nationwide distribution prohibit a single institution from assuming the full responsibility for NHDA loan administration tasks.

Another concern is that MHP is in immediate need of a cost recovery system that can service the expanding loan portfolio. 40,000 loans were made in 1984; another 40,000 are scheduled for the 1985 program year. However, there still is not an adequate system for accounting or collection of the loans. The longer MHP goes without a system, the more implausible it becomes for NHDA to achieve effective cost recovery.

A comprehensive strategy to utilize the capabilities of multiple institutions in a cooperative effort will begin to address the volume, distribution and time constraints. For example, the Kandy District effort has defined the capabilities of the thrift institution. The program developed should incorporate, where possible, the participation of thrifts in the implementation of the MHP. The following models illustrate possible uses of thrifts; and the resulting impact on the NHDA's role in lending and servicing.

A. THRIFT MODEL

The Kandy District will operate a direct loan program through the district banks, which would eliminate NHDA's day-to-day lending and servicing responsibilities. Expansion of the Thrift Model to other districts could offer an adequate mechanism for reducing NHDA's responsibilities, as well as, for establishing a systematic cost recovery program. The utilization of thrift institutions offers immediate advantages:

- (1) Thrifts are already in the business of providing loans; therefore, the existence of systems would alleviate a lengthy start-up time.
- (2) There are over 3,000 thrift societies located throughout Sri Lanka, including the more rural and inaccessible villages. The inclusion of thrifts in the MHP would facilitate greater repayment of debt, as the thrifts are more accessible than banks.
- (3) With more than 3,000 thrift societies, the volume of loans that a particular society would service is manageable; and would not necessitate a major increase in resources.

Furthermore, the thrift institution has its own internal control system that oversees the activities of the individual societies; and consequently, would substantially reduce excess monitoring by NHDA. The entire thrift institution is under the auspices of the Commission of Cooperatives, a department of the Sri Lankan government. The Commission

registers thrift societies and ensures that they have adequate systems in place to manage monies. For instance to be a government approved organization, thrifts must maintain accurate records. Thrifts, therefore, keep books, file reports, and are annually audited by the Federation of Cooperatives. The Federation also establishes the guidelines and regulations that govern the operation of the thrift societies. The Federation is government financed and monitors the activities and the financial transactions of the societies through annual audits.

The cooperative banks serve as a conduit for disbursing and collecting monies. They also provide training and general support to the thrifts. In the described pilot, the district cooperative bank (DCB) essentially acts as a lender; and oversees the origination and servicing activities of the thrift societies. As Figure 2 indicates, in the Thrift Model, NHDA makes a loan to the DCB. The bank and its individual thrift societies then assume the responsibility for lending monies to borrowers and servicing loans. Under this scheme, it is the Cooperative Bank's obligation to repay the loan. NHDA does not deal directly with the MHP borrowers.

The existence of the DCB enables NHDA to fully realize its decentralization objectives. With the lending and servicing responsibilities transferred to the DCB and the thrift societies, NHDA can concentrate on the general program administration and monitoring.

MODEL II

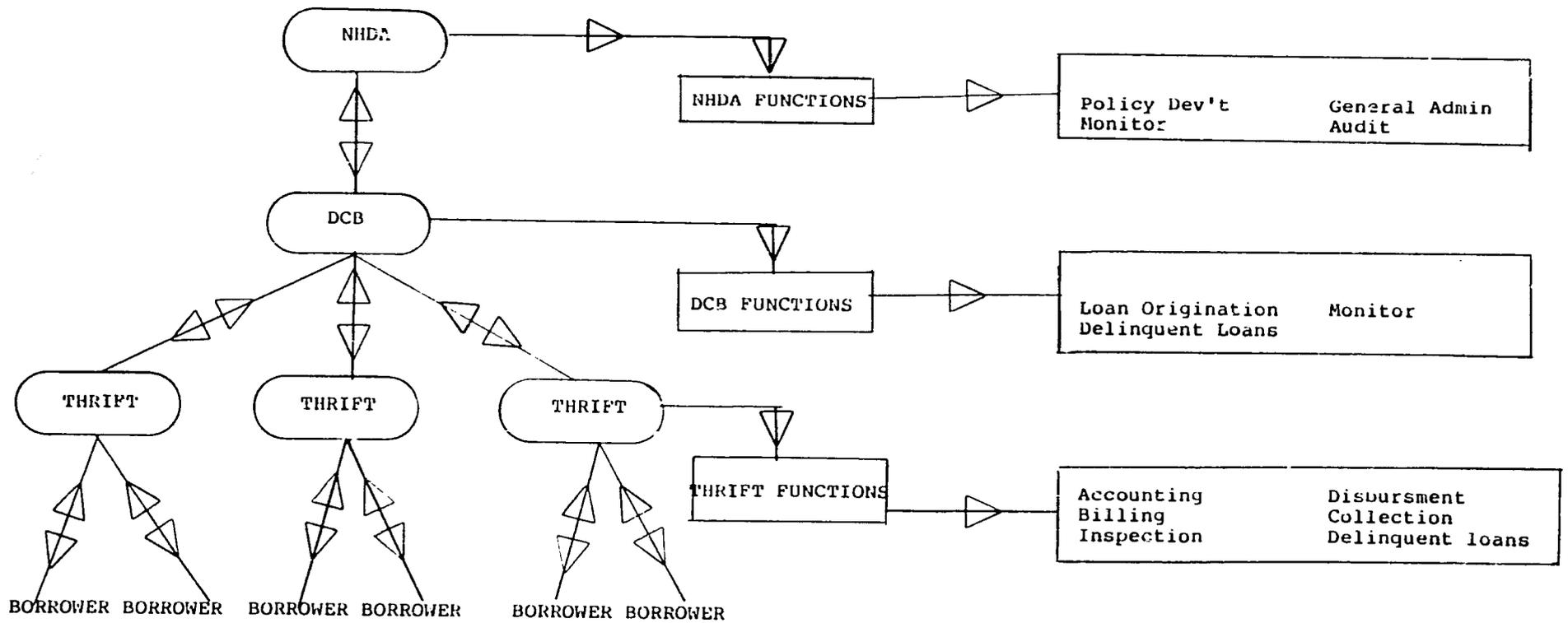


Figure 2

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Although the consultant acknowledges the potential that exists with the Thrift Model, it also bears a major limitation that prohibits its widespread use, in the near future. There are only two district banks in Sri Lanka. Four will possibly exist by the end of the year. However, under this scheme the remaining twenty districts would have no coverage.

B. MODIFIED THRIFT MODEL

A modified use of thrifts offers an approach that could be implemented in tangent with or in place of the Thrift Model. Instead of making a single loan to DCB, NHDA under this scheme, lends MHP monies directly to the individual thrift societies. Under this modified plan, funds might be disbursed in one of two ways:

- (1) Thrifts would receive a loan from NHDA and the thrifts would in turn set up an account for the borrower to hold the entire loan amount; or
- (2) Thrifts would deposit the loan monies incrementally into the borrowers account.

In both instances thrift society approval is required to withdraw funds.

As Figure 3 indicates, the responsibilities of the thrifts under the modified model do not change. However, the absence of the DCB necessitates that NHDA exercise greater oversight responsibilities; and be available to provide technical assistance to the thrift societies.

MODEL III

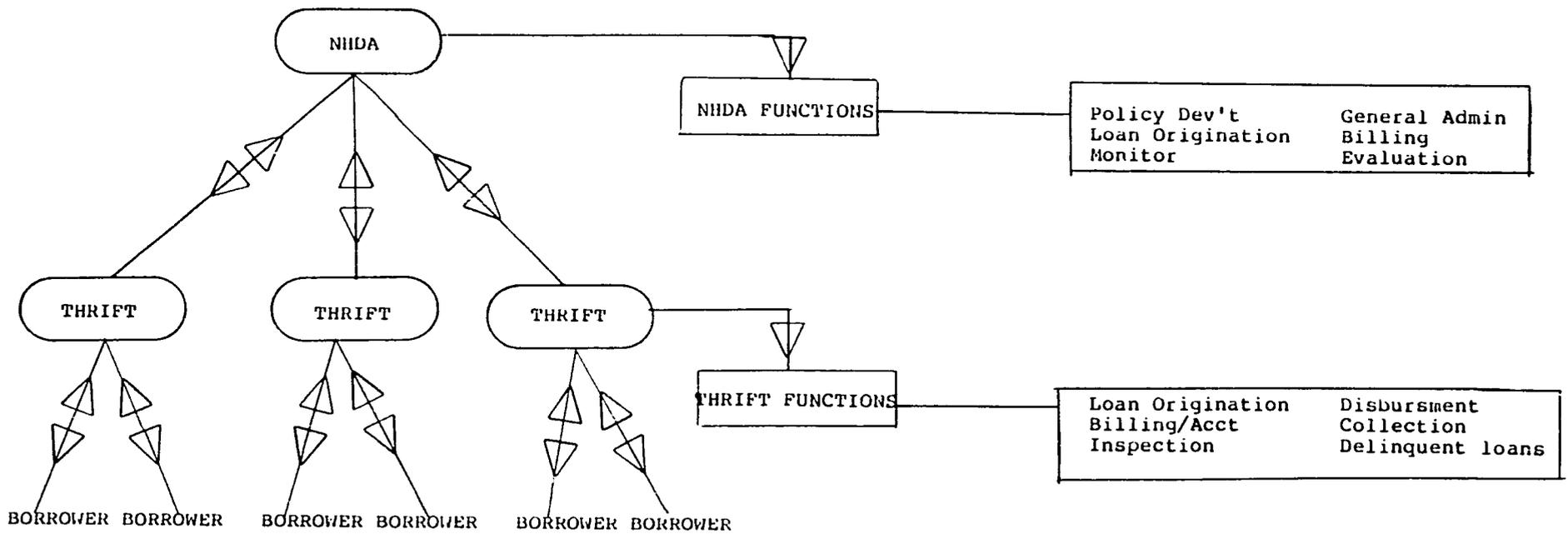


Figure 3

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C. SERVICE BUREAU MODEL

In districts where the thrift societies are not strong or are inexperienced, a servicing bureau can be incorporated into the scheme. The servicing bureau can assume the accounting and billing responsibilities. As Figure 4 illustrates, the NHDA would continue to disburse the funds and assist in collection efforts. The servicer would post the payments and provide overall accounting. The inclusion of a servicer saves the NHDA valuable time in performing the accounting function.

In each of the presented models, NHDA retains the responsibility for administering the project; including setting policy, allocating funds for districts, tracking, project monitoring, and evaluating the outcome of everyone's efforts. To facilitate these program administration responsibilities, it is recommended that the NHDA develop an in-house automated system that will accommodate the tracking of program activity.

The models presented suggest options available to the NHDA and the Sri Lankan Government for organizing private institutions to assume segments (either geographically or by function) of the MHP implementation. The thrift institution appears to be an effective mechanism for dealing directly with borrowers. However, the degree of its involvement must be examined further.

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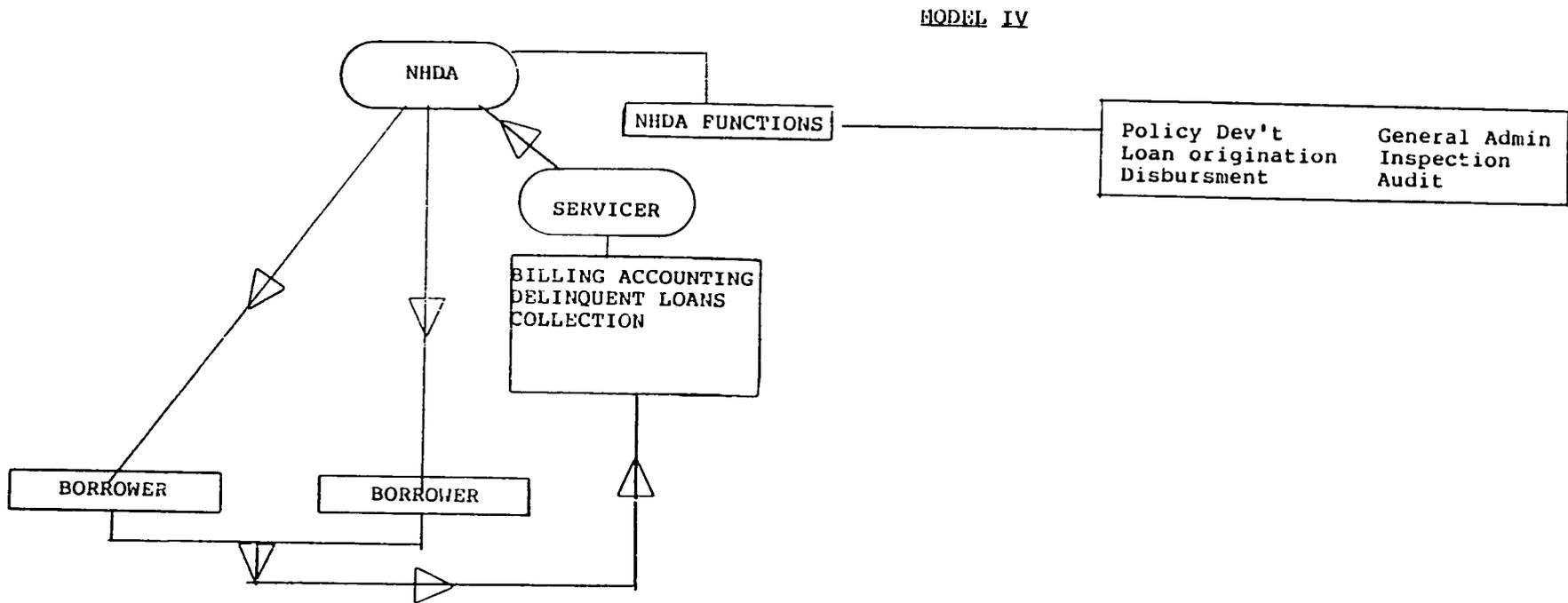


Figure 4

CMS will work with the NHDA to test the feasibility of utilizing multiple institutions in carrying out the lending and serving responsibilities. The feasibility analysis will identify capable institutions; and determine if multiple models can operate simultaneously. CMS will also assist NHDA in developing specifications and guidelines for the use of private organizations in implementing the Million Houses Program.