Strategy: Down Marketing Housing Finance Through Community Based Financial Systems

Meera Mehta, Ph. D.

March 1994

Prepared for
Indo-US Housing Finance Expansion Program

Abt Associates Inc.
Management Support Services Contractor
B2/13 (2nd Floor)
Vasant Vihar
New Delhi 110 057

USAID Project No. 386-0526-00-C-2295-00

CONTENTS

PREFACE AND ACKNOWLEDGEMENTS

In the quest for economic and financial reforms, issues of growth have become of prime importance. However, to make this growth sustainable and equitable, it is essential to address the questions of access to credit for all sections of the society. In the past, this has largely meant subsidized endeavours. But these have proved to be unsustainable and ineffective. During the last decade there has been a significant increase in community based finance systems. Unfortunately, and ironically, in housing finance the emphasis on loans with subsidized interest rates still continues. No effort has been made to use the more sustainable community based systems to enhance the reach of the low income groups to housing finance despite the increasing demand from these systems for housing finance.

This study explores the potential of using community based finance systems for downmarketing housing finance. This will help to enlarge the market for housing finance. It will also help to strengthen the community based finance systems, if appropriate partnerships between formal finance institutions and the Communit based Finance Systems are developed.

This study has been undertaken for the Abt Associates, Massechusettes, who are the Mnagement Support Systems contractors to the USAID, for the Indo-USAID Housing Finance Expansion Program. I have benefitted a greatly from the stimulating discussions on the study approach and its initial findings with Ms. Sally Merrill, Mr. Richard Genz, Mr. M. Prabhakaran and Mr. Harry Garnett of the Abt team at different stages of the work.

This part of the study is based on the initial review and analysis of the HFIs and CFSs through a study done at the National Institute of Urban Affairs, New Delhi, to which I was an advisor. I would like to acknowledge the excellent discussions and support in this study, especially from Dr. Dinesh Mehta and Ms. Saswati Ghosh of the NIUA. I also acknowledge the excellent support from the network of my past students, especially, Mr. V. Satyanarayana, Ms. Padma Desai, Mr. Adwait Khare, Ms. Swati Tanna, Mr. Abhijit Tanna, Ms. Esther Kumar and Mr. Rajesh Sharma, in a variety of tasks.

The officials of the housing finance institutions, NGOs, community finance institutions and cooperatives took time out from their busy schedules to discuss and provide all possible information. I am thankful to them for this. It is the 'dreams' and 'visions', especially of the people working at the grassroots with these community based finance systems, which have helped me to go beyond mere statistics, to visualize more systemic responses towards developing a system that reaches the poor .

The findings of this study and the proposed strategy are envisaged to be implemented through a number of carefully developed pilot projects. I hope that these will help to attain the twin objectives of downmarketing housing finance and strengthening the community based finance systems.

Meera Mehta
New Delhi.

July, 1994.

ABBREVIATIONS

ABHFL	-	Andhra Bank Home Finance Limited
APSRTC	-	Andhra Pradesh State Road Transport Corporation
AVAS	-	Association for Voluntary Action and Services
BCC	-	Baroda Citizens Council
BDA	-	Bangalore Development Authority
BMC	-	Bombay Municipal Corporation
BOB	-	Bank of Baroda
BDCB	-	Bhavnagar District Cooperative Bank
CBCU	-	Community Based Credit Union
CBHFL	-	Cent Bank Home Finance Limited
CBO	-	Community Based Organisation
CCS	-	Credit Cooperative Society
CFF	-	Central Financing Facility
CEDMA	-	Centre for Development, Madras
CFHL	-	Can Fin Homes Limited
CFI	-	Community Finance Institutions
CFS	-	Community Finance Systems
DCA	-	Delhi Catholic Archdiocese
DDA	-	Delhi Development Authority
DHFL	-	Dewan Housing Finance Company Limited
DPG	-	Development Promotion Group
DRAS	-	Death Relief Assistance Scheme
ECCS	-	Employees' Credit Cooperative Society
EIS	-	Environmental Improvement Scheme
EMI	-	Equated Monthly Instalment
ETC	-	Employees' Thrift Cooperative
EWS	-	Economically Weaker Sections
FGHFL	-	Fairgrowth Home Finance Limited
FTCA	-	Federation of Thrift and Credit Associations
GGVL	-	GIC Gruh Vitta Limited
GIC	-	General Insurance Company
GOI	-	Government of India
GRUH	-	Gujarat Rural Housing Finance Corporation Limited
HDFC	-	Housing Development Finance Corporation
HFI	-	Housing Finance Institution
HH	-	Household
HUDCO	-	Housing and Urban Development Corporation
ICU	-	Informal Credit Union
INDBHFL	-	Indian Bank Housing Finance Limited
KHB	-	Karnataka Housing Board
KKNSS	-	Karnataka Kolageri Nivasigala Samyuktha Sanghatane
LICHFL	-	Life Insurance Company Housing Finance Limited

LIG	-	Low Income Group
LWS	-	Lutheran World Services
MAS	-	Mutual Assistance Scheme
MM	-	Mahila Milan
NGO	-	Non-governmental Organization
NHB	-	National Housing Bank
NSDF	-	National Slum Dwellers' Federation
PARSHFL	-	Parshwanath Housing Finance Company Limited
PRTW	-	Participatory Research cum Training Workshop
PNBHFL	-	Punjab National Bank Housing Finance Limited
PTC	-	Primary Thrift and Credit Cooperative
RATC	-	Regional Association of Thrift Cooperatives
RBI	-	Reserve Bank of India
RTCS	-	Regular Thrift Contribution Scheme
SATC	-	State Association of Thrift Cooperatives
SAYAHFL	-	Saya Housing Finance Company Limited
SECS	-	Salary Earners' Credit Cooperative Societies
SBIHFL	-	State Bank of India Home Finance Limited
SCB	-	Slum Clearance Board
SPARC	-	Society for Promotion of Area Resource Centres
TC	-	Thrift Cooperative
UBSP	-	Urban Basic Services for the Poor
UTI	-	Unit Trust of India
VBHFL	-	Vysya Bank Housing Finance Limited
WTC	-	Women's Thrift Cooperative

The last two decades have seen dramatic changes in housing policies the world over. Within less than a generation, public policies and outlooks in this sector have changed significantly. The last few years have seen the collapse of old orthodoxies. There is a continuing search for new paradigms which are both market friendly and ensure a better coverage and reach to all sections in society. Within the realm of housing policies there is a realization of the changing role of the government and the need to focus on enabling policies, especially related to land and housing finance.

The last decade in India has seen considerable developments in the housing finance system. While the role of private retail lending for housing finance has increased manifold, it still accounts for only 20 percent of the estimated total housing investments in the economy. There is thus ample scope for further expansion of the housing finance system in India.

The expansion of housing finance system poses two critical problems. First, in order to ensure adequate resource mobilization, it must be done in commercially viable terms. This becomes even more important in view of the financial sector reforms underway in the country, which will lead to decline in the directed credit systems. Secondly, however, such expansion must also ensure a better coverage and reach across different sections in society and not lead to increased conspicuous consumption of housing by a small section. It is within this two fold objective that this study explores the possibilities of a commercially viable downmarketing strategy for the housing finance industry.

Study Outline :

The role of newly emerging HFIs in financing the groups below median income is very limited at present, with its share of about 13.5 percent of total lending. This is despite the fact that there is an explicit demand from these groups as evidenced by thier borrowings from informal sources. Thus, the major issue in downmarketing of formal HFI lending appear to be that of an appropriate matching of the demand for housing finance among the low income households to that of the requirements of the HFIs. This study pertains to evolving a downmarketing strategy for housing finance through the variety of community based financial systems. It has looked at 18 NGOs working in cities all over the country as well as the urban cooperative credit systems in three states. We have also interviewed 8 HFIs for their willingness to participate in these linkages. This report presents a summary of these studies based on a detailed two part report which also has profiles and case studies of 8 HFIs, 18 NGOs and 6 cooperative societies (NIUA, 1994). The final section brings together these findings to identify the basic design principles and detailed guidelines for evolving a downmarketing strategy for housing finance in India.

Community Based Finance Systems (CFS):

The review focusses on two different types of CFS, namely those developed through the efforts of the Non Governmental Organizations (NGOs) and the others which have come up through the network of cooperative finance institutions. There is a considerable overlap amongst these two systems, as many of the NGOs have used the cooperative systems for developing their finance systems. Occasionally, an NGO has specifically focussed on developing cooperative finance systems.

The NGO linked CFSs seem to be at different levels of development. Those NGOs which have focussed on strategising and creating external linkages have been able to expand their activities considerably, with an NGO linked Community Finance Institution (CFI) like the SEWA Bank having over 30000 members. The two forms of CFSs, the single and multi tiered ones present differing opportunities in terms of growth potential, controlling establishment costs and creating external linkages. It is necessary to evolve the linkages with these CFSs in relation to the organizational structures which have emerged. However, the linkages need to help strengthen the CFS by assistance on financial management and adequate spreads to cover the establishment costs. A review of the savings and credit operations suggest very systematic procedures with an emphasis on personal rapport, flexibility and group/social pressure for recovery rather than the conventional notions of high interest rates, long repayment periods and very safe collateral. It, therefore, seems essential to ensure that these characteristics are preserved in any linkage arrangement by allowing the NGO linked CFIs to originate and service the loans. The available subsidies, if any, need to be devoted to strengthening these CFSs, rather than being used for lower interest rates.

The urban cooperative finance systems are quite widespread in India with a network of over 32000 urban credit cooperative societies (UCCS), with a total working capital of Rs. 32 billion and a membership of over 15 million, as well as about 1400 cooperative banks, with a total working Rs. 134 billion by 1991. About 75 percent of the UCCS were based at the place of work and organized as employees' service credit cooperatives whereas the other were neighbourhood based. Their savings and credit operations are also based on personal rapport with emphasis on developing regular thrift habits. Their financial performance, however, varies considerably and any effort at linkages will need to assess each society carefully. The costs of management are lower than those of the NGO linked CFSs. As the ECCSs are able to do payroll deductions, the risks are considerably less. However, their reach is limited to the workers in the formal sector. The urban cooperative banks require specific policy changes like revising the ceiling limits on housing loans for inclusion as priority sector, permission for lending to primary housing societies, for extending lending operations for housing built on land exempted from the Urban Land Ceiling Act, revising the limits on housing finance and the possibility of receiving refinance from the NHB for housing loans for the non scheduled cooperative banks. Some of the smaller cooperative banks will also benefit from technical assistance for servicing longer term housing loans.

Compared to the experiences of cooperative finance system of operating a commercially viable housing finance activity, albeit on a small scale, the existing efforts by the HFIs to reach the households below the median income groups seem to focus on use of earmarked funds from donor agencies for specific projects. These emphasise lower interest rates and longer repayment periods designed as a project lending rather retail facilities for individual borrowers. Downmarketing of housing finance on commercial terms is perceived to be difficult by the HFIs, essentially due to three problems; i) lack of adequate affordability in relation to the prevailing housing prices, ii) likelihood of high credit risks and iii) very high transaction costs to reach the poorer households.

PROPOSED STRATEGY FOR DOWNMARKETING :

The strategy envisaged for downmarketing housing finance to moderate and low income groups, in urban areas, is based on using the existing CFSs. The important objectives of this strategy are to help enlarge the market for housing finance for the emerging housing finance institutions in the country on commercial terms, and to enable large segments of the urban population to improve their living conditions through a better access to credit for housing and community level infrastructure facilities.

The third objective of this strategy goes beyond the confines of housing finance. It is envisaged that it will also help to consolidate the different forms of community based finance systems by enabling them to expand their activities in a viable manner, enhancing their savings mobilization potential and help to integrate these systems with the general financial systems in the country. These structures would be far more replicable than the public housing projects with their limited reach.

Key Design Principles:

The development of a downmarketing strategy for housing finance requires a careful identification of the perceived constraints for a commercially viable system and the key design principles which attempt to overcome these constraints. Our review of the existing housing finance institutions suggest three main areas of constraints for a commercially viable downmarketing strategy. These are illustrated in Table 1 along with the main design principles to deal with these. We would highlight the approach which moves away from the conventional notions of reaching the low income groups through subsidies with an overemphasis on mortgage security. The strategy aims towards more innovative efforts at evolving more appropriate loan products and enabling larger spreads to meet the higher establishment costs. The underlying premise of this approach is that wider access to housing finance is more critical for the low income groups than access to a limited few at lower costs. This strategy will also be far more sustainable in the long run.

Table 1 : Constraints and Key Design Principles

	Constraint		Design Principles
1.	High Credit Risk		
		i.	Measures to cover credit risk including insurance cover
		ii.	Delinquency Risk Fund
		iii.	Appropriate Underwriting
2.	Affordability for Housing		
		i.	Design of appropriate new loan instruments
		ii.	Selection of appropriate markets
		iii.	Technical support
3.	High Transaction and Servicing Costs		
		i.	Developing CFI capabilities
		ii.	Adequate scale of operations
		iii.	Spreads to cover establishment costs

Types of Linkages:

In view of the basic design principles, two types of linkages between the HFIs and community based finance Systems are envisaged in this strategy. The first is based on Financial Intermediation by a CFI through a Bulk loan from the HFI/FI. Basically the arrangement involves a bulk loan from the HFI to the Community Financial Institution (CFI) with specified terms and conditions for on lending to the households. The CFI will have the responsibilities for loan origination and servicing and, would, therefore, also bear the credit risk. Many of the NGOs surveyed for this study, expressed a desire for such independence and freedom. In this arrangement, the limit on total bulk loan maybe specified in relation to the capital base of the CFI or the thrift and credit groups under a NGO federation/association. The basic aim of this linkage would be to use the grass roots strength of the CFI for downmarketing and use the housing finance to consolidate the CFI itself. Within this, two forms of intermediation are visualised.

i. Multi-tier Intermediation
ii. Single-tier Intermediation

The multi-tier intermediation uses the structure of federation or the apex agencies, which in turn lends to the primary CFI. The CFI in this case may either be linked to NGO or to the

Table 2

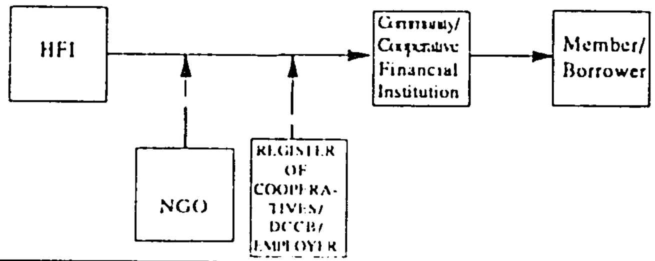
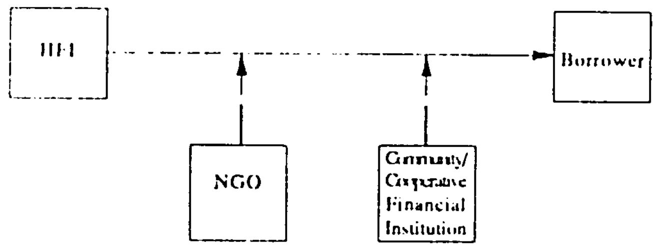
HFI-CFI LINKAGES FOR HOUSING FINANCE

BEST AVAILABLE DOCUMENT

TYPE OF LINKAGE	ORGANIZATIONAL LINKAGES	INSTITUTIONAL RESPONSIBILITIES
A. BULK LOANS/ LINE OF CREDIT Loan purposes include home construction/purchase, purchase of land, plot, home upgradation/extention individual and/or community infrastructure **a. Multi-tiered Intermediation** i. NGO-Federation- Thrift and Credit Group Model	NGO - - → Federation/Regional Association HFI → Federation/Regional Association - - - Thrift & Credit Group → Member/Borrower	HFI — Providing bulk credit — Defining credit and underwriting terms — Providing financial management assistance Federation — Appraise and monitor TCGs for bulk credit — Mobilize DRF — Technical support — Market information Thrift and Credit Group — Loan origination and servicing
ii. Employer-ECCS Model	HFI → Employer - - ECCS → Member/Borrower Registrar of Cooperatives/DCCB - - → (HFI–Employer), (Employer–ECCS)	HFI — Providing bulk credit — Defining credit and underwriting terms Employer — Ensuring payroll deductions ECCS — Loan origination and servicing Registrar/DCCB — Assist in identifying ECCS
iii DCCB-UCCS Model	HFI → DCCB → UCCS → Member/Borrower Registrar of Cooperatives/DCCB - - → (HFI–DCCB), (DCCB–UCCS)	HFI — Providing bulk credit — Defining credit and underwriting terms. DCCB — Appraise and monitor TCGs for bulk credit — Mobilize DRF — Technical support and market information. UCCS — Loan origination and servicing

Table 2 (cont'd)

HFI-CFI LINKAGES FOR HOUSING FINANCE

TYPE OF LINKAGE	ORGANIZATIONAL LINKAGES	INSTITUTIONAL RESPONSIBILITIES
b. **Single-tiered Intermediation** iv. NGO linked CFI Model		HFI — Providing bulk credit — Defining credit and underwriting terms NGO / REGISTRAR/ DCCB/ EMPLOYER — Facilitate appraisal of CFI, generation of DRF and loan servicing — Technical assistance and market information CFI — Loan origination and servicing
B. **NGO FACILITATION** Loan purposes include home construction/purchase, Major house upgradation/ extension v. NGO Facilitated housing loans		HFI — Loan origination and servicing NGO/CFI — Facilitate loan origination — Loan servicing

HFI — Housing Finance Institution
DRF — Delinquency Risk Fund
NGO — Non-governmental Organization
ECCS — Employees' credit cooperative society
UCCS — Urban credit corporative society
TCG — Thrift and credit group
CFI — Community/cooperative financial institution

cooperative institutions. In the single-tier intermediation, the HFI will deal directly with a primary CFI, which again maybe either linked to an NGO or be a primary cooperative society. The NGO or the cooperative registrar would facilitate the identification and assessment of the CFI. The detailed institutional responsibilities are shown in Table 2.

The second form of the linkage is the <u>NGO/CFI facilitated direct lending by HFIs</u>. This arrangement is similar to the one that some of the HFIs like HDFC, LICHFL, Griha Vitta and GRUH have been currently experimenting. In this linkage, the loan agreement is directly between the HFI and the individual borrower, though the process is facilitated by the NGO or the credit cooperative society. The latter may help in loan origination and also actually service the loan on behalf of the HFI, at a fee. The credit terms and underwriting criteria suggested in Table 4 will also be applicable here. The basic aim of this linkage would be to encourage the HFI to develop a working knowledge of lending to these groups more directly, though its costs may be kept under a check by using the NGO-cooperative structures for loan servicing.

Financial guidelines:

The emphasis in the HFI-CFI linkages for bulk loans for housing finance is on developing the basic financial principles for giving bulk credit to the community based financial institutions so that the risks are minimized and more appropriately shared. This will make it possible to replicate this arrangement on a larger scale in the future. The important elements of these are highlighted in Table 3. Major changes from the existing practices relate to the loan products in terms of purpose and security requirements, creation of a delinquency risk fund which is linked to the recovery performance of the CFI, allowing adequate spreads to cover the higher transaction costs of the CFI at least in the long run, legal registration of the CFI and not only the NGO and the limits on bulk credit linked to the net worth of the CFI. Such financial guidelines need to be worked out jointly by the HFI/FI and CFI. These will get refined through the implementation of the pilot projects. However, initially negotiation with an open mind are essential to evolve mutually beneficial set of guidelines.

Table 3 : Financial Guidelines For HFI-CFI Linkages

1. Mutually agreed upon and flexible purpose of loan, credit terms and underwriting
2. Delinquency risk fund.
   Group insurance to cover housing loans in the event of death
3. Necessary spreads to cover establishment costs.
4. Legal form for the community finance institutions - to permit borrowing of bulk credit.
5. Plan of operations for the bulk credit to be submitted by the community finance institutions (CFI).
6. Limits on bulk credit (overall debt equity ratio of around 10 for CFI).

Support Systems:

The linkages between the HFIs\FIs and CFIs can succeed only through a supportive mechanism. There are three main components of a Support Package. The first one is Technical support for evolving viable projects for housing and/or community level infrastructure. The CFIs often donot have the necessary expertise to guide their borrowers and do proper assessment of the proposed housing action.

Another totally neglected area is market information for these groups regarding available housing options and the related prices. A property information service would help to overcome this to a great extent. It would also enable the NGO or the cooperative to develop a better understanding of the housing costs. The third part of the support relates to the building up the financial management capacities of the CFIs through a better reporting system and through better auditing services. Appropriate training in this regard is essential.

Such a support system will need to be evolved by national level agencies like the National Housing Bank in the initial period. Subsequently the HFIs or regional associations should take up these tasks. Such a system maybe supported initially through a grant carefully planned for phasing out. Over time, however, it must operate through a fee structure which will make it self supporting over time.

Towards Pilot Projects:

While the downmarketing strategy envisages expansion of the housing finance system to lower income groups on a widespread basis, the process may be initiated through selected pilot projects. The pilot projects need to be selected carefully to represent different models discussed above and aim for replicability. They will also need specific support systems as discussed above.

While the design of the pilot projects will imply benefits both for the HFIs and CFIs, it is likely that the process needs to be facilitated, both by creating opportunities for interaction amongst the potential partners and by providing the necessary inducements by a careful use of subsidies for insurance cover, risk fund and support systems related to technical assistance, developing market information and training in financial management for the community based financial institutions. This support, through the necessary subsidies will need to come from the National Housing Bank or the USAID.

The different NGOs will, however, require considerable efforts to meet certain pre-requisites like legal registration, developing a plan of operations, mobilizing funds for Delinquency Risk Fund and compilation of essential financial reports. Such assistance would also be helpful in enabling the other smaller NGOs with nascent arrangements to become a part of the downmarketing strategy. Similarly, the HFIs will also need to make considerable adaptations in their lending procedures. Specifically, they will have to extend the concept of bulk lending to CFIs. Most HFIs at present use this concept for lending to the corporate sector in any case. Secondly, they will also have to design new lending instruments (especially for non-mortgage lending) and evolve suitable financial guidelines for these linkages.

Conclusion:

The growth of housing finance system in India in recent years has not been accompanied by significant downmarketing. The downmarketing strategy as outlined above is cast in a pareto optimal mould, as the benefits accrue to both the sides; the HFIs developing a commercially viable expansion of their markets and the low and moderate income households gaining access to housing finance which has largely eluded them so far. An additional benefit in this process will also be a further strengthening of the different forms of Community Finance Systems in the country and their integration with the general financial systems in the country in the coming years. These efforts, however, require careful design, the will to innovate and improve from 'learning by doing' and above all the readiness to respond to the constraints of the partners in a positive manner in these partnership experiments.

SECTION ONE

INTRODUCTION

The last two decades have seen tremendous changes in housing policies the world over. Within less than a generation, public policies and outlooks in this sector have changed dramatically. The last few years have seen the collapse of old orthodoxies and a continuing search for new paradigms which are both market friendly and ensure a better coverage and reach to all sections in society. Within the realm of housing policies there is a realization of the changing role of the government and the need to focus on enabling policies, especially related to land and housing finance.

The last decade in India has seen considerable developments in the housing finance system. The role of private retail lending for housing finance has increased manifold. For example, in the period from 1987 to 1991 , the total institutional finance for housing is estimated to have increased from 900 to 2600 million rupees. Even then this constituted just 20 percent of the estimated total housing investments in the economy. There is thus ample scope for further expansion of the housing finance system in India.

The expansion of housing finance system poses two critical problems. First, in order to ensure adequate resource mobilization, it must be done in commercially viable terms. This becomes even more important in view of the financial sector reforms underway in the country, which will lead to decline in the directed credit systems. Secondly, however, such expansion must also ensure a better coverage and reach across different sections in society and not lead to increased conspicuous consumption of housing by a small section in society only. It is within this two fold objective that this study explores the possibilities of a commercially viable downmarketing strategy for the housing finance industry.

The limited information available on the share of below median income groups in the retail lending indicates some down marketing efforts by the housing finance companies being made already. However, the available evidence suggests that only 13.5 percent of the institutional lending is for families below the median income (JPS, 1993). This is unfortunate as the demand for housing by the households below the median income has been well documented. Mehta and Mehta (1989) report housing expenditure of nearly 17 per cent of monthly income among low income households as against just 5 per cent, for higher income groups. NIUA (1991) reports that access of formal housing finance is quite limited for the low income groups. In this survey of 2000 households, 41 per cent households were found to be using finances from informal sources. Nearly 31 percent of households borrowed for short term period at interest rates exceeding 24 per cent per annum. Flexible collateral, easy accessibility and quick processing were the three main factors that seem to have forced the low income households to borrow from informal sources. Mehta and Mehta (1992) based on a study of two cities in Gujarat also highlights the greater financial leverage achieved by lower income households when they had access to institutional finance as compared to the middle and upper income households.

Thus, the major issue in downmarketing of formal HFI lending appear to be that of an appropriate matching of the demand for housing finance among the low income households to that of the requirements of the HFIs. Downmarketing of housing finance on commercial terms is perceived to be difficult by the HFIs, essentially due to three problems; i). lack of adequate affordability in relation to the prevailing housing prices, ii). likelihood of high credit risks and iii).very high transaction costs to overcome the other problems.

The need for such alternatives has been increasingly recognised in the general financial framework of the country. For example, the Chief of the Central Bank (RBI) was quoted in a recent public address to have pointed to the need for "People's participation credit delivery and recovery and the linking of formal credit institutions with (low-income) beneficiaries through intermediaries such as non-governmental organisations could be thought of as alternative mechanisms for meeting the credit needs of the poor" (Economic Times, 1994).

Innovative financing arrangements and linkages which enable the use of alternative mechanisms for assessing creditworthiness, group security, door to door collection of savings and loan instalments, and alternate collateral are needed to increase the reach of HFIs.

Study Outline :

This study pertains to evolving a downmarketing strategy for housing finance. The initial terms of reference for the study focussed exclusively on the identification of NGOs as potential intermediaries to reach the low income households. The study began with a list of eight potential NGOs which have done significant work in the housing sector and/or setting up of community - based finance institutions for mobilizing savings and providing credit to the low income groups. As we began the work, the list of eight NGOs was expanded to 18 NGOs. This was necessitated to understand the diversity of housing related activities and the range of experiences associated with the community based finance systems.

While examining the formal organisational structure of these community based financial institutions, it was found that most were established under the cooperative financial institution statutes. It was thus deemed appropriate to dwell deeper into the cooperative finance institutions and their potential role in down marketing housing finance. India has a wide network of over 30,000 registered primary non-agricultural credit cooperative societies. In the states of Andhra Pradesh, Gujarat and Maharastra, where a large number of urban credit cooperatives are located, detailed case studies were undertaken to assess their capacity for participation in housing finance.

This report presents a summary of our analysis of the major Housing Finance Institutions, the NGOs and the Cooperative Finance Institutions. The next section presents the major findings of these existing systems. This summary is based on a detailed two part report on this analysis along with profiles and case studies of 8 HFIs, 18 NGOs and several cooperative societies (NIUA, 1994). The final section brings together these findings to identify the basic design principles and detailed guidelines for evolving a downmarketing strategy for housing finance in India.

SECTION TWO

COMMUNITY BASED FINANCE SYSTEMS

A Summary of Study Findings

During the last decade, there has been a growing awareness of the importance of community based approaches in developmental action and processes. Whether it is in the national policy outlooks or the agenda of the international agencies, there is a consensus on the potential offered by the community based systems. This study has focussed on two different types of community based finance systems (CFS), namely, those developed through the efforts of the Non Governmental Organizations (NGOs) and the others which have come up through the network of cooperative finance institutions. There is a considerable overlap amongst these two systems, as many of the NGOs have used the cooperative systems for developing their finance systems. We present the main findings of the detailed studies of these two finance systems in several Indian cities.

2.1 NGO LINKED COMMUNITY FINANCE SYSTEMS

Our review covers 18 different NGOs spread throughout the country and who have been involved with housing and/or finance related activities. Out of these, 12 have been involved with community based finance systems. Table 2.1 highlights the profiles of these 18 NGOs.

Coverage and Organizational Roles :

While limited coverage and reach has often been cited as limitations of the NGO sector, our analysis suggests that some of the NGOs have a large and expanding coverage. This increase in scale and coverage is critically linked to evolution of appropriate organisational roles and linkages. The three critical roles in this regard are.

Grass roots base with a single activity	-	through community groups or own organisation delivery of a single service in one or a few communities.
Developmental activities	-	many related activities like provision of education and health services, savings and credit groups, training for income generating activities, etc, in one or more communities.
External linkages and strategy	-	to mobilise resources, receive technical assistance, enhance interactions and expand the coverage.

All the three roles are critical for an effective coverage and expansion of NGO operations. Thus, those NGOs which have combined these roles, like SEWA, BCC, SPARC, FTCA, etc have enhanced their coverage significantly and effectively.

Table 2.1
NGO Profiles

NGO (Year of Inception)	Areas of Operation	Coverage	Housing/Infrastructure Related Projects (No.of Projects)	Finance Related Activities		
				Form S - Single tiered M - Multi tiered	Members/ Size	Purpose of Credit
SEWA (1972)	Ahmedabad, Gujarat, MP, UP	50000 members of SEWA Union	1 Project - New housing (150)	Co-operative Bank (S)	25000 Members	IGA Housing
BCC (1966)	Baroda	30 Slums, 1300 HHs	1 Project - New housing (200)	Unregistered Thrift and Credit Association (S)	4000 Members	IGA Housing Infrastructure Health
SPARC (1984)	Bombay, Kanpur, Banglore	5 Federations covering many slums	2 Projects - New housing (350)	Unregistered Thrift and Credit Groups with Federations (M)	5 Federations (Members not known)	IGA Consumption Crisis
FTCA (1989)	Hyderabad, AP, TN, Karnataka, Kerala, Goa, Pondichery	14 Regional Associations and 380 T&C Associations 282000 members		Regd/Unregd Thrift and Credit Groups with 14 Regional Associations with National Federation (M)	380 TC Groups with 282000 Members	IGA Consumption Housing
AVAS (1980)	Bangalore	12 Slums	4 Projects - New housing (435) Upgradation	-	-	-
VIKAS (1978)	Ahmedabad, Jambusar Taluka, Gujarat	Not Applicable	4 Projects - New housing (325) Emergency Shelter (50) Infrastructure Maintenance	-	-	-
LWS (1974)	Calcutta, Orissa, WB, AP, TN	21 Slums in Calcutta, 2 Slums in Cuttak 40000 Persons		-	-	-

Table 2.1 continued ....

NGO (Year of Inception)	Areas of Operation	Coverage	Housing/Infrastructure Related Projects (No.of Projects)	Finance Related Activities		
				Form S - Single tiered M - Multi tiered	Members/ Size	Purpose of Credit
Sharan (1979)	Delhi	6 Slums 75 T&C Groups 1675 Members		Unregistered Thrift and Credit Groups with 3 Federations (M)	75 Groups with 1700 Members	IGA Consumption Health
Deepalaya (1978)	Delhi	21 Slums 15000 Children 214 CBOs with 31 Lakh members		Regd/Unregd Thrift and Credit Groups (M)	188 Groups with 20000 Members	IGA
CEDMA (1977)	Madras, Vellore, Ennore	27 Slums	3 Projects - Self help housing (925)	-	-	-
Shramik Bharati (1986)	Kanpur, Kanpur District	10 Slums		Unregistered Thrift and Credit Groups (M)	67 Groups with 1500 Members	IGA
Adhikar (1989)	Bhubaneshwar, Rural Areas of Orissa	1-2 Slums 27 T&C Groups with 875 members		Regd/Unregd Thrift and Credit Groups with 1-2 Federations (M)	25 Groups with 875 Members	IGA
CASP-PLAN (1979)	Bombay, Delhi, Pune	3 Areas in Delhi		Credit Cooperatives (S)	3 with 200 Members	IGA
Punervas (N.A)	Delhi	6 Slums 4000 HHs	4 Projects - New housing Cooperative Housing (4000)	-	-	-
DPG (NA)	Madras, TN, AP, Karnataka, Pondichery	Not Applicable	2 Projects - New Housing (129) Drinking water (bore weils in 40 villages)	-	-	-

Housing Related Experience :

About half of the 18 NGOs have been involved with housing related activities. General discussions, however, suggest that housing related experience is limited, as dealing with housing projects puts considerable and intensive demands on them. As a result their housing activities have been quite limited. Involvement with housing projects require access to land or a secured tenure. In most cases, the NGOs have been working with slum dwellers, where the tenure related problems inhibit new housing construction. Housing projects by NGOs have been taken up, only with a supportive land policy by the government with intensive involvement in the housing process. Some NGOs have been involved in providing support for legal issues related to tenure and evictions.

While most NGOs expressed a keen interest in housing and infrastructure of the communities, there is often a lack of technical expertise which is essential to develop specific projects. Support to develop such projects with community participation is a very important need. Secondly, financial innovations to cater to different preferences for scheduling of payments of different borrowers need to be evolved even in a project approach.

In comparison to specific housing projects, however, more NGOs are inolved in housing finance through community organisations. These provide finance, especially for house repairs and upgradation. An additional area where NGOs can prove effective is the information on opportunities in the housing market. At present, the information about low income housing market is very weak. However, given their access to low income communities, a market information system catering to their needs would be very useful and assistance should be provided for this.

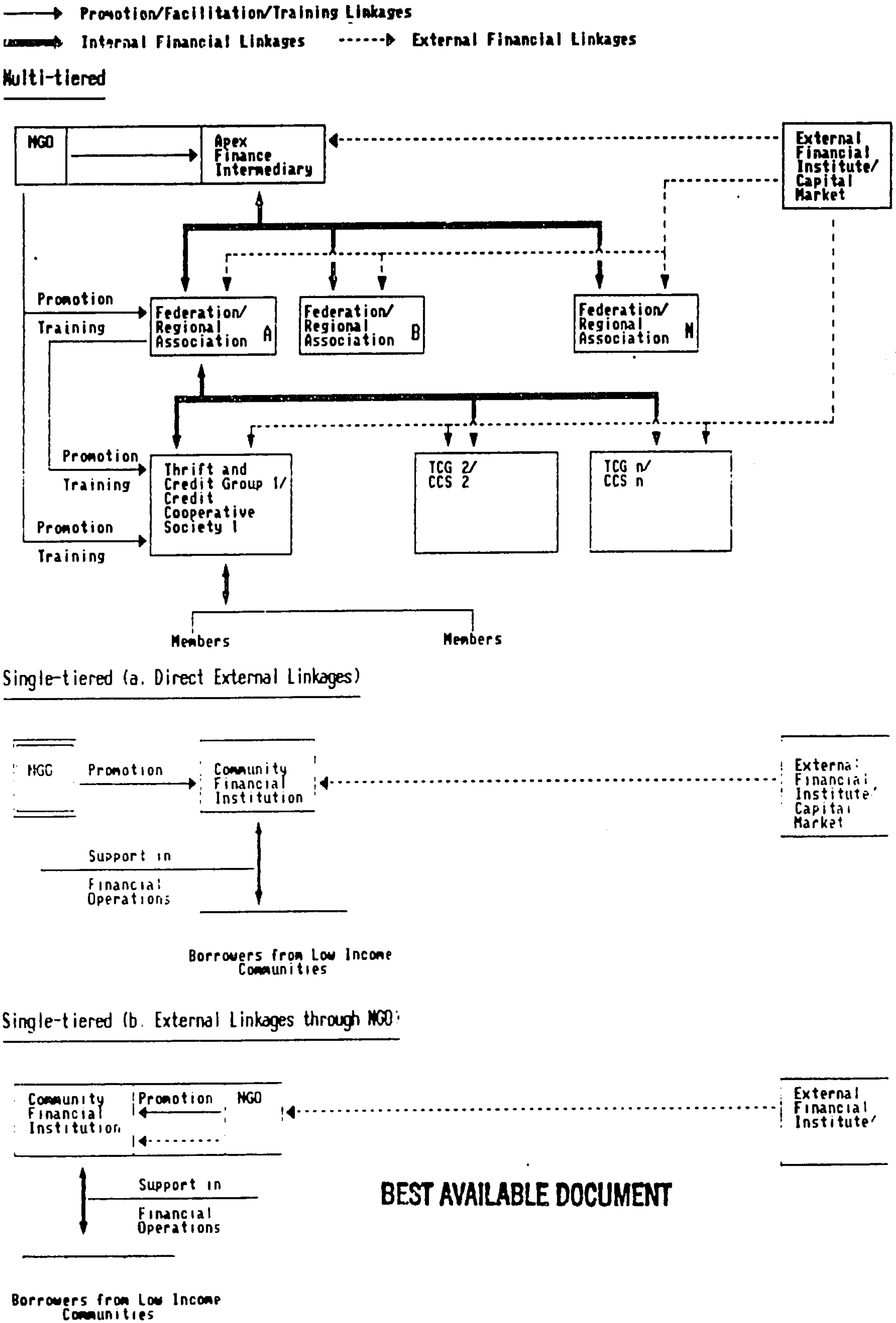
Forms of Community Finance Systems :

Out of the 18 NGOs surveyed, 12 have been involved with thrift and credit related operations. This is in response to needs emerging from the communities, especially for crisis and income generation related activities (e.g. SEWA, SPARC, Sharan) or indirectly through repayments for housing related loans. (e.g. AVAS, CASP-PLAN). Only in one case, the FTCA, the NGO has specifically focussed on activities related to development of finance systems. In a few cases, these operations have led to a separate financial institution, as for SEWA, FTCA or BCC. This is also being visualized by some of the other NGOs like Sharan and SPARC, and will probably emerge as a strong organizational form for all NGOs.

Multi-tiered System : Figure 2.1 highlights the two generic forms of community based finance systems. The first is a **multi-tiered system** which is a financial arrangement of a thrift and credit groups, linked to an NGO supported hierarchy of financial institutions.

In this model, the initial efforts are linked to the development of small savings groups, which begin with 12 to 25 households. The decisions regarding terms and conditions and procedures for compulsory savings and credit, as well as actual sanction of credit to members are done by the groups themselves. Over time, as more groups develop, there is generally an attempt to form federations or associations of several groups, both in order to share the financial resources as well as exchange ideas regarding improvements in systems and provide management training and support. In most cases, except for FTCA, there is no separate apex

Figure 2.1
Forms of NGO Linked Community Finance Systems



financial intermediary of all the federations/associations.

NGOs which have been using this model include FTCA, SPARC, Sharan, Deepalaya, CASP-PLAN, Adhikar and Shramik Bharati. Their organizational and financial structures are illustrated in Table 2.1. These NGOs make considerable efforts to develop the groups and continue to provide organizational and management support. Even a small NGO like Adhikar, seems to have made attempts to inculcate seeds of financial discipline amongst the groups by laying down the accounting procedures to be followed. Others like SPARC and Sharan have also realized the importance of sustainability. However, their efforts at introducing systems have been at the centralized level with complete automation through computer based packages.

In this perspective, it is necessary to review the FTCA experience which represents an advanced version of this model, even though it is a relatively new NGO. FTCA's experience stands apart in several ways. First, its focus is explicitly on the development of thrift and credit societies only. Secondly, it has introduced a clear and logical organizational structure, where the local decision-making is retained by the thrift and credit groups which may or may not be registered. (75 percent are registered as non-agricultural cooperative societies under the relevant State Cooperative Acts). The extent of operational sophistication is thus dependent upon the group characteristics. However, at the level of the Federation and the apex financial intermediary, greater sophistication in financial management is possible to introduce and is being developed with external donor agency support. Attempts are also being made to move towards supporting the establishment costs at these levels through financial operations.

SPARC also envisages a similar structure in their vision for 'Jansampati', which is visualized as an apex financial intermediary serving the federations in different cities. Under the federations are the different thrift and credit groups which aren't always legal registered entities and largely operate on an informal group basis. Vikas Centre for Development, in Ahmedabad has also suggested a similar model in their proposal for a Habitat Development Fund (HDF). However, its focus is more on the 800 existing informal and unregistered thrift and credit groups which Vikas has surveyed through a research study for HDFC.

Single-tiered System : The second generic form of **single-tiered system** is based on a larger community based institution with low income groups being its direct members rather than through the smaller savings groups as in the case of the earlier model. The decision-making is thus more centralized, though it is through their representatives on the Board of this Financial Institution. For example, in SEWA Bank, the members elect the managing committee of the Cooperative Bank. This model, though not widespread, represents two examples of NGO linked financial arrangements, namely SEWA Bank in Ahmedabad and the Community Savings and Loan Association (CSLA) by BCC in Baroda.

Comparison of the Mutli-tiered and Single-tiered Models : The two forms, in actual operations present different opportunities and constraints. The first is in terms of the growth potential of the CFS. The first model presents far greater possibilities in this regard, as it is possible to expand the system even in areas where the NGO may not have any significant presence through thrift and credit groups. In fact, even SEWA Bank has been using the group approach to expand in the rural areas. It is also possible to incorporate the existing thrift and credit groups as is being done by the regional associations under the FTCA, and proposed by Vikas centre for Development. This means that the expansion can be delinked from intense NGO inputs which tend to be very expensive and time intensive.

The second comparison should be with regard to internalizing the establishment costs. On one hand, in the multitiered model there is a possibility of linking the services and pooling of resources at appropriate levels. As proposed in case of the FTCA, these costs can then be covered at each level by surpluses generated by appropriate financial services. However, if the nature of services at each level are not carefully identified, this may only end up in adding unnecessary costs at each level. This will ultimately increase the costs for the borrower. In relation to the development of role and functions of the NGO structures, the lowest level of the thrift and credit group in the three tier structure in the multitiered model focuses on the grass roots base. The middle tier of federation or regional association as in the FTCA structure, focuses more on the developmental activities including those related to finance. The top/apex tier concentrates on the external linkages and strategy development.

In this aspect, the second model of NGO linked financial intermediary is likely to be more dependent on the NGO for meeting its establishment costs, albeit indirectly. This is mainly due to the fact that the grass roots base comes from the NGO operations and not directly as in the case of the group based model. In this model, the scale of operation of the NGO and its grass roots strength become crucial for the success of the financial intermediary also.

The third aspect relates to the potential for external resource mobilization and access to credit for an individual member. In the group model, there is far more flexibility with regard to external resource mobilization as illustrated in Figure 2.1. An institution in any tier has the opportunity to mobilize external resources, depending on its abilities and preferences. On the other hand, individual credit-worthy members of a poorly performing society, maybe unnecessarily constrained for funds. In the second model, while there is less flexibility for mobilizing external resources, an individual member has more direct access to a larger institution and its greater resources. For an external finance institution, the multitiered model makes it easier to reach a large number of small groups through a single institution.

Savings and Credit Operations:

The main difference in these NGO linked community based financial arrangements are the procedures and mechanisms used for savings and credit. These are highlighted in table 2.2. The main observations which emerge from these are as follows:

Savings Mobilization: Unlike the conventional notions that these groups do not have any capacity to save, the CFSs very clearly demonstrate the possibility of mobilizing savings from these groups. The average savings amounts are, however, not very high and range from Rs. 15 to Rs. 50 per month. However, introduction of special savings schemes for housing and infrastructure provision have generally evoked a very positive response. Unfortunately, detailed and systematic data on savings patterns is not maintained to draw more meaningful results.

Table 2.2
Savings and Credit Operations - NGO Linked Community Finance Institutions

NGO	Savings			Credit			
	Collection method	**Frequency of collection**	**Rate of interest (%)**	**Rate of interest (%)**	**Repayment period**	**Maximum loan**	**Minimum savings**
SEWA	Door to door collection by bank's field staff. Savings boxes provided	Weekly/monthly	As per RBI guidelines. Higher rate than comm. banks	10.5 to 16.5% as per RBI guidelines, based on loan amounts	1 to 3 years (can give long term loans for 10 years also)	Maximum unsecured loan Rs 15000	Repayment/savings round checked
BCC	Savings collected from members & deposited with accountant	Weekly (Friday/Sat.)	6%	12 % p.a	20 months	Rs 2000	Minimum balance at 20% of loan amount for a period of 6 months
SPARC	Door to door collection by community volunteers	Daily	Not known	12 % for Consumption 24 % for Productive	Fixed by borrower not exceeding 2 years	Generally not exceeding 2500	Minimum savings period is verified but not specified
Sharan	Deposited by members in group meetings	Monthly	Varying rates for each group decided by them	Interest rates decided by each group. May vary from bank rate	12 months maximum	Rs 2000	Decided by each group
FTCA	Done by each group separately	Monthly	Varying rates for different groups (9 to 16%)	Varying for different groups (14 to 24%)	-	Varying for different groups (Rs 1000 to Rs 40000)	33.3 % of loan amount
AVAS	Saving boxes provided	Monthly	Bank rate for Savings Accounts				

Table 2.2 continued ....

NGO	Savings			Credit			
	Collection method	Frequency of collection	Rate of interest (%)	Rate of interest (%)	Repayment period	Maximum loan	Minimum savings
Deepalaya	Deposited by members to group leaders	Monthly	Bank rate for savings accounts	No interest charged	NA	NA	Min. balance of 10 % of loan amount for 6 months
Adhikar	Deposited with any official of co-operative.	Monthly	Bank Rate	24 to 60%	Max 18 months	Rs 2000 to 6000	Amount not specified but min of 1 year
CASP-PLAN	Deposited by members with any official of credit co-op.	Monthly	Bank rate	14 %	12 months	6 times contribution/ savings	For 18 months

i. Method and frequency of collection: There are essentially two methods of collection being used. The first is door to door collection by paid staff (whose costs are generally covered by other programmes of the NGO which are financed by grants) or by community volunteers. The collection frequency varies from daily (reported only by SPARC) to weekly or monthly. The second method, which is used by most in the group based arrangement, is either monthly collection during the group meetings or members directly depositing with the group/society leaders. Many NGOs have also introduced the system of special collection boxes which are kept by the women/members to collect savings as and when possible. These are then opened in the presence of the member and NGO or CFI staff/community volunteer.

ii. Returns on savings and other incentives: It is interesting that the returns offered on savings are generally not high, despite the fact that in many cases, the interest on loans are kept high. In most cases, it is linked to the prevailing bank interest rates for savings accounts. In some cases, however, no interest is paid at all. The main attraction for the low income groups to save in these CFSs is thus not the returns but the possibility of access to loans at rates far lower than the informal 'moneylenders'.

In many cases, the NGOs have also attempted to introduce other incentives related to insurance, special savings scheme related to housing or community infrastructure, as done by SPARC in Bombay and BCC in Baroda slums. The FTCA in Hyderabad has, through its regional associations, introduced a death relief scheme.

iii. Minimum savings requirements: Most NGO linked CFSs, like the credit cooperatives reviewed in the next section, have minimum savings requirements which carry some, at times very severe, penalties for delayed payments. While this is very important for inculcating a habit of regular thrift, it does not link the savings to the household economy directly. Most NGOs do not have innovative savings instruments related to time deposits or monthly incomes, as done by the more mature cooperative societies.

Credit Operations: The credit operations in the CFSs are in direct contrast to the prevailing notions of financing the low income groups.

i. Small, short term loans: In most CFSs, the credit policies focus on creating access to the maximum possible number of borrowers by keeping a ceiling on the maximum loan amounts and lending for short to medium term only, which permits the maximum roll- over of funds. The shorter terms are also felt to be essential for reducing the credit risk. In most cases, there is some attempt to assess the credit-worthiness by previous savings and repayment records. Some of the agencies require a minimum savings period of 6 to 12 months. Some of the CFSs also require a minimum savings balance, ranging from 10 to 33.3 percent of the loan amount. This assesses the past savings behaviour and provides a hedge against default.

ii. Loans for different purposes: Another important aspect of lending to the low income groups relates to their need for credit for a variety of purposes, ranging from crisis, consumption, income generating activities as well as for housing and infrastructure services. Of the different CFSs, only SEWA (50%) and BCC (66%) show a significant proportion of the lending for housing, largely for repairs and upgradation purposes. In the case of AVAS and CEDMA, housing loans from other financial institutions have been routed through them. Some of the thrift and credit groups/societies under FTCA have been providing housing loans upto Rs. 40,000 for housing construction.

iii. Cost of credit: Probably, the most important finding relates to the rather high interest rates at which credit is given. This is especially true when the group/community decide the rates on their own. The interest rates range from about 12 to 36 percent. These are generally fixed in relation to the prevailing 'market rates' in the locality. This finding is in direct contrast to the usual misconceptions about subsidised interest rates on the grounds of affordability.

iv. Security for loans: A large proportion of the loans are unsecured and based on the direct knowledge of the borrower. In some cases, the personal guarantees of one to two other members is required, especially for larger amounts. In cases of registered financial institutions, like the cooperative societies or cooperative banks, the value of unsecured loans cannot exceed Rs. 20,000. For secured loans, the security is largely in the form of gold or other movable property.

Mortgage loans are not found in any case, except when an external financing institution has used the NGO as a facilitator while lending to the households directly or to their housing cooperative. The two specific cases in this regard have been AVAS, for its Sudhamnagar project and SPARC for two of their housing projects in Bombay. In both the cases, the loans have been provided by HDFC. The experience in these suggest the need to introduce more innovations at the project level to deal with the delays in project implementation as well as repayments.

v. Default and delinquency: It is very common to hear claims of very high 'cost recovery' by most NGO linked CFSs. However, systematic evidence based on an analysis of the available records is often not readily available to ascertain these observations. Only for three of the CFSs such analysis was available. Amongst these the delayed payments range from 8 to 16 percent of outstanding loan balance for SEWA. The FTCA reports recovery rates for the primary thrift and credit cooperatives in the range of 75 to 100 percent.

The only other NGO, BCC, which was able to give a detailed estimate for delinquency, reported 31 percent of total loan accounts to be in default. While this rate may seem very high, it must be remembered that the loans are made for a maximum of 20 months and that the detailed reports as prepared by the BCC-CSLA are the first step to pursuing better loan recovery by any financial institution. Further despite the delays in payments, there are often some regular payments being made by these defaulters. This suggests that a better assessment of the credit-worthiness of the borrower initially, or more sensitive loan instruments with periodic adjustments of the repayment period are necessary. More importantly, linkages using the CFSs need to build up reserves to compensate for the likely delinquency.

Discussions with the staff of many NGOs and their financial intermediaries suggest that bad debt is almost absent. For example, for BCC only 1 percent of the loan accounts were actually bad debt. The main reasons for these were linked to death and riots. Even in these few cases, their savings and shares with the CSLA were to the tune of 38 percent of the outstanding loan balance.

Financial Performance and Management of Community Finance Systems:

The reporting systems in most of the CFSs are rather weak even though the basic record keeping is being done at the group level in all of them. This makes it difficult to assess the financial performance. However, for at least three of these, namely, SEWA Bank, Community Savings and Loan Association (CSLA) of BCC and the FTCA and its regional associations, better financial reporting permits this to some extent.[1]

Capital Structure: The details of capital structure presented in Table 2.3 show the importance of thrift and deposits, which range from 50 to 90 percent in the total capital employed. For SEWA Bank, the debt equity ratio is already high, though its plans to enhance its equity base may provide the possibility of further deposit mobilization and borrowing. In fact, it has shown considerable growth in deposit mobilization in recent years.

For FTCA, the capital, for itself and the RATCs, has essentially come from capital and other grants from donor agencies as well as the deposits from the PTCGs under different schemes like the Death Relief Assistance Scheme (DRAS), fixed deposits and the Regular Thrift Contribution Scheme (RTCS). The volumes under these schemes are so far not really adequate to cover the costs. The debt equity ratios of 2.7 for the Primary Thrift and Credit Societies (PTCG) under the RATC Hyderabad are lower than for SEWA Bank and BCC-CSLA, suggesting the possibilities of further credit absorption, especially as the utilization of available funds is very high at almost 90 percent.

Lending and profitability: The analysis presented in Table 2.3 shows rather contrasting performance for SEWA Bank and BCC-CSLA. Both have reasonable profit levels, comparable to some of the HFIs, though lower than the leading ones like HDFC and LIC Housing. However, in both these cases, the profitability has declined over the last three years. The reasons for this appear to be different. In the case of SEWA Bank, the reasons maybe attributed to the decline in credit to deposit ratio. As it does not report the interest income from lending and investments separately, this may only be speculated. It may also be linked to the rising cost of funds which may have resulted from the changing structure of deposits. On the other hand, in the case of CSLA - BCC, the declines seem to be related more to considerable expansion in lending with problems of the delayed payments. The data available from them suggest that about 31 percent of the loan accounts are in default. For SEWA, the delayed payments as a proportion of recoverables are to the tune of 16 percent.

SEWA Bank's low credit to deposit ratio suggests the possibility of increased lending from their own funds. Further, SEWA has recently increased its authorized share capital from Rs. 3 million to Rs. 5 million. It may thus be able to more than double its share capital over the next few years. This will also allow it to mobilize far greater funds, either through deposits or external borrowings. On the lending side, SEWA has so far avoided long term loans, concentrating only on short and medium term loans. It is however, now set to consider these both to improve its credit-deposit ratios, and therefore, profitability, as well as satisfy the emerging demand for housing finance from its members.

---

1 We would, however, point out that this assessment is based on the reported and published figures as the scope of this assignment did not permit more detailed inquiries into the accuracy of the reported information.

Table 2.3
Financial Performance of SEWA Cooperative Bank, CSLA-BCC, FTCA and RATC, 1992-93.

		SEWA Bank Ahmedabad	CSLA-BCC Baroda	FTCA Hyderabad	R A TC Hyd
a.	CAPITAL STRUCTURE				
1.	Deposits/Owned Funds	8.9	3.3	-	-
2.	Debt Equity Ratio (Deposits+Borrowings)/Owned Funds	9.4	4.0	-	-
3.	Liability Structure Total Liabilities and Owned Funds (Rs Lakhs)	671.2	11.6	15.7	26.1
	(Percentage to total)	100	100	100	100
	Share Capital	3.4	15.7	-	-
	Reserves	6.2	4.4	50.2*	7.8*
	Deposits+Compulsory Savings	86.0	65.9	49.8	92.2
	Borrowings	4.3	14.0	0.0	0.0
b.	OPERATIONS				
4.	Debt-Coverage Ratio (Income-op. exp)/Int.exp.	1.2	-	-7.4	0.7
5.	Cost coverage ratio (Income-int. exp.)/op. exp.	1.4	2.4	0.1	0.7
6.	Cost of Funds (%)	8.1	0.0	5.0	9.4
	Returns on Lending (%)	11.4	2.4	9.6	16.4
	Spread (%)	3.3	2.4	4.6	7.0
7.	Loans Outstanding/Deposits (%)	38.4	136.7	51.8	76.5
8.	Loans Outstanding/Working Capital (%)	30.6	87.9	25.8	70.5
9.	Rate of recovery (%) (Ontime payments as a % of total recoveries)	84.0	-	-	-
10.	Est. Cost/Outstanding Loans (%)	10.7	2.0	88.0	9.1
c.	PROFITABILITY ANALYSIS				
11.	Profits as a % of total assets	1.2	2.4	-	0.08
12.	Profits as a % of Shareholders' Funds	13.8	12.2	-	-

Sources: Based on the Annual Reports of SEWA Bank, CSLA-BCC, FTCA and RATC.
Note : * Resources includes capital grants received from donor agencies

Despite the high fund utilization and a spread ranging from 2 to 12 percent across the different PTCGs under the RATC Hyderabad, their aggregate performance shows rather low profits at 2.4 per cent return on assets and 9.7 percent returns on total equity. This may hint either at high transaction costs or significant delays and defaults in loan repayments.

Costs of Operation: It is often not recognized that the costs of reaching the low income groups are likely to be very high. This is evidenced by the available data from these three institutions. The reported establishment costs for SEWA Bank at about 10 to 11 percent of the outstanding loans are almost double those reported for the urban credit cooperative societies for Gujarat. The reported costs for BCC-CSLA are very low at 2.0 percent in 1992-93. However, in both these cases, the actual costs as absorbed by the parent NGO are very high. While we do not have the information for SEWA, BCC's estimates are that the value of time spent by BCC staff on CSLA activity is as high as 22 percent of all loan assets.

This is also true for FTCA and the various RATCs under it. At present, the establishment costs are being met by grants from external donor agencies. However, there is a consciousness regarding this and attempts are being made to introduce financial services whose spreads will in the future be able to cover these costs. The different deposit mobilization schemes and lending permit the RATC to cover 66 percent of its costs at present. Its spreads are as high as 7 percent. The picture for the FTCA itself is different, with the financing services having been started only recently, and the considerable reliance on subsidies for meeting the establishment costs. However, the funding agencies have shown awareness regarding these and there is discussion on the possibility of capital expansion to cover the costs. It is in this regard that the possibility of routing bulk housing finance through this arrangement also needs to be explored.

2.2 URBAN COOPERATIVE FINANCE SYSTEMS

The cooperative movement in India has been quite widespread with a very large network of primary cooperative institutions which is supported by a governmental structure of financial, regulatory and training institutions.

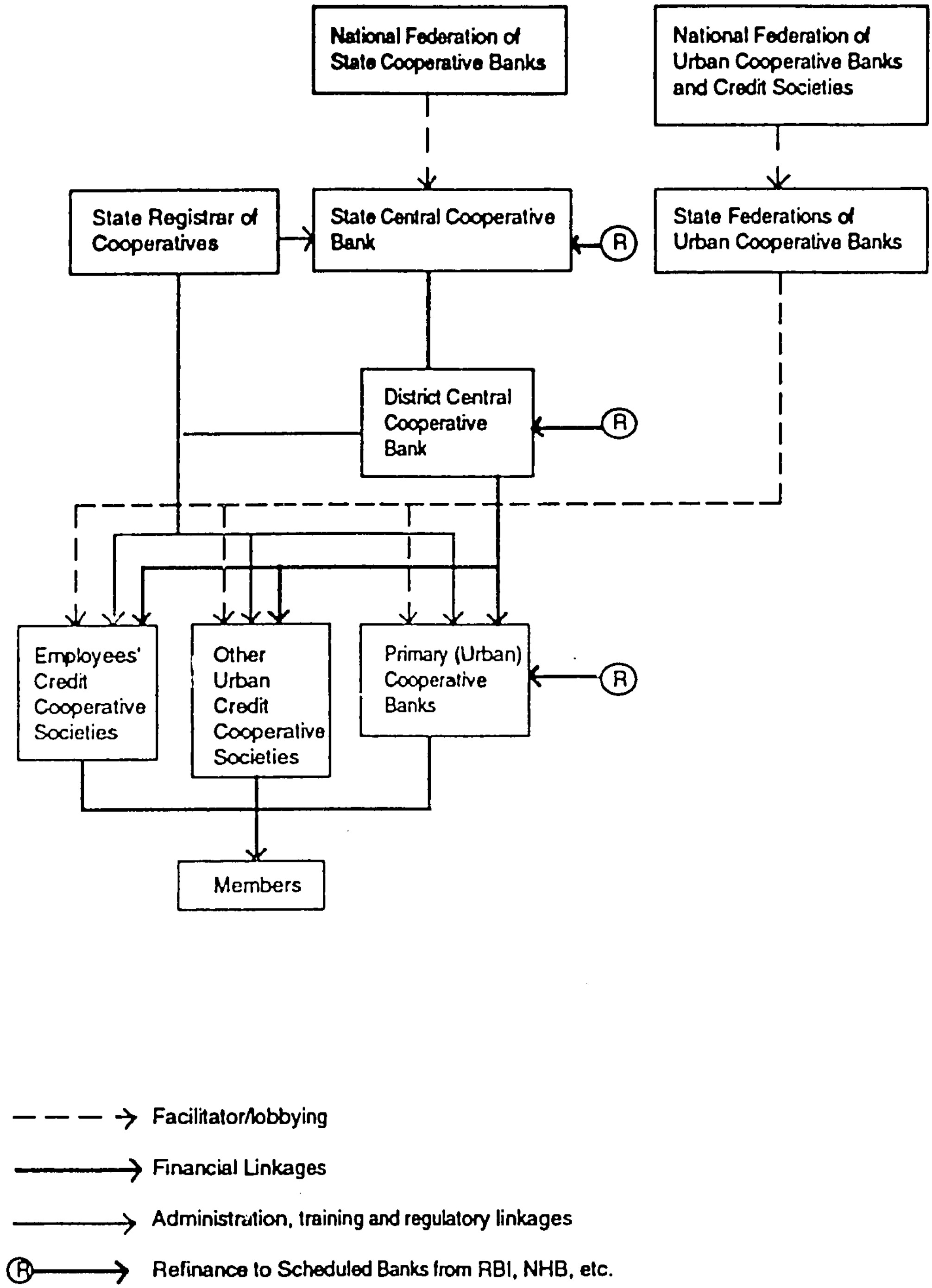
Types of Urban Cooperative Financial Institutions:

Within the cooperative structure in the country, there are two primary cooperative financial institutions which operate in the urban areas, the primary cooperative banks and the primary non-agricultural cooperative credit societies (PNASs). As a large proportion of these institutions are in the urban areas, they are also referred to as 'urban cooperative banks' (UCBs) and Urban Credit Cooperative Societies (UCCSs). There are basically two types of credit societies, namely the Employees' (or Salary Earners') Credit Cooperative Societies (ECCSs) and the other Urban Credit Cooperative societies (UCCSs). In 1990-91, of the total PNASs, almost 75 percent were of the former type, that is the SECSs. The overall organizational structure of the urban cooperative finance institutions is illustrated in figure 2.2.

Cooperative Credit Societies: As it is common to relate the cooperative movement with the rural sector, it is not often recognized that there are over 32000 credit cooperative societies in urban centres in India with over 15 million members. Their total outstanding lending in 1990-91 was around Rs. 20 billion, with deposits of Rs. 12 billion and a total working capital

FIGURE 2.2

COOPERATIVE FINANCE INSTITUTIONS IN URBAN CENTRES



BEST AVAILABLE DOCUMENT

of Rs. 32 billion (NAFCUB, 1992). Inquiries and discussions with the concerned cooperative officials suggest that these societies cater largely to the lower middle classes and low income groups, though specific studies of the income profiles of their members are not available. Their main source of funds are the deposits of their members and their owned fund, with a relatively low debt equity ratio of 2.1. As their credit deposit ratio is very high, there is a possibility of enhancing their operations through external borrowing. However, this needs to be done carefully, as the experience of different societies for overdues on loans and overall financial viability is quite varied. Thus external borrowing needs to be closely linked to incentives for improved financial management.

Cooperative Banks: In addition to these societies, the other important cooperative financial institutions are the 1400 primary urban cooperative banks with over 3400 branches throughout urban India. The available evidence regarding the spread across size class of cities in Gujarat highlights their importance in small and medium sized urban centres.

The cooperative banks mobilize deposits from the household sector and lend to both the small trade and manufacturing enterprises as well as the households. They can thus essentially be classified as Savings Banks. Their close rapport with the households for savings mobilization make them ideal vehicles for financing the household sector. The total membership of these UCBs was about 14 million in 1990-91 with outstanding loans of over Rs. 80 billion and deposits worth Rs. 101 billion.

The UCBs have a higher aggregate debt equity ratio at 6.9, though they are dependent only on deposit mobilization. Credit deposit ratios are lower than those of the UCCSs and ECCSs, though comparable to the commercial banks in general. Their larger scale enables more profitability and possibility of absorbing the overdues. Thus, in Gujarat, none of the cooperative banks made losses in 1990-91 and the percent share in Maharashtra was also only 3.4.

While recent studies on the relative shares of these cooperative institutions in savings mobilization and lending to the household sector are not available, an older study covering the period from 1951 to 1975 highlights the very important role of these societies and cooperative banks. During the period from 1971-72 to 1975-76, the cooperative institutions' share of total borrowings by the households was as high as 31 percent as against only 5.6 percent of the savings (Swami, 1981). The available data for 1989-90 and 1990-91 suggests that the share of cooperative banks in net deposits by the household sector had increased to 14.9 and 18.1 percent.[2] In 1990-91, the aggregate deposits of the urban cooperative institutions were Rs. 11,337 crore (NAFCUB, 1992a), or 5.24 percent of the aggregate deposits of the scheduled commercial banks.[3]

---

[2] The total net deposits for cooperative banks for these two years were Rs 1428 and Rs 1497 crore (NAFCUB, 1992a) and for the household sector were Rs 9572 and Rs 8248 crore (CSO, 1993) respectively.

[3] The aggregate deposits of the scheduled commercial banks were Rs 216279 crore (RBI Bulletin, November 1993)

Table 2.4

Financial Status of Urban Cooperative Societies and Urban Cooperative Banks, India

(All monetary values are in Rs Lakhs)

		Cooperative Societies		Cooperative Banks	
		All India	Average Per Society	All India	Average Per Bank
	Total Number	32080		1397	
	Members ('000s)	14957	466		
I.	CAPITAL STRUCTURE (June 1991)				
1.	Share Capital	65419	2.04	44807	32.07
2.	Own Funds	19703	0.61	103276	73.93
3.	Deposits	118009	3.68	1015689	727.05
4.	Borrowing	58579	1.83	0	0.00
5.	Working Capital	319692	9.97	1338953	958.45
6.	Outstanding Loans	197586	6.16	800313	572.86
II.	ANNUAL PERFORMANCE (1989-90)				
1.	Net Deposits	10871	0.34	142816	102.23
2.	Loan Advances	195221	6.30	98296	n.a.
	(1990-91)				
1.	Net Deposits	14956	0.47	149680	107.14
2.	Loan Advances	200185	6.23		n.a.
III.	FINANCIAL RATIOS				
1.	Deposits/Owned Funds	1.39		6.86	
2.	Debt Equity Ratio (Deposits + Borrowings)/Owned Funds	[illegible]		6.86	
3.	Loans Oustanding/Deposits	[illegible]		0.79	
4.	Loans Oustanding/Working Capital	[illegible]		0.60	

Source : NIUA (1994)

Notes : The Financial ratios are based on aggregate statistics only, as detailed information on individual societies/banks is not available

Table 2.5
Comparative Financial Status and Performance

		Employees' Credit Cooperative Societies			Other Urban Credit Coop. Societies *		Urban Cooperative Banks		
		Andhra Prdesh 1986-97	Gujarat 1991-92	Maharashtra 1990-91	Gujarat 1991-92	Maharashtra 1990-91	Andhra Prdesh 1986-97	Gujarat June 1991	Maharashtra 1990-91
1.	No.of Societies/Banks	2541	2724	6117	620	4790	61	288	381
2.	Average Membership per Society/Bank	298	450	441	392	447	7327	7228	11717
3.	Average Working Capital per Society/Bank (Rs Lakhs)	1.00	6.94	17.34	5.25	5.65	4.60	119.70	100.97
4.	Financial Ratios								
a.	Deposits/Owned Funds	0.82	0.91	0.30	1.33	1.16	6.43	5.19	6.28
b.	Debt Equity Ratio (Deposits+Borrowings)/Owned Funds	1.37	1.30	0.61	1.62	1.43	6.43	5.19	6.73
c.	Loans Outstanding/Deposits	2.60	2.30	3.57	1.68	1.24	0.73	0.81	0.78
d.	Loans Outstanding/Working C	1.08	0.75	0.75	0.67	0.62	0.70	0.58	0.59
5	Liability Structure (Percentage to total)								
a.	Share Capital	16.80	31.69	27.94	21.96	17.67	3.93	3.28	3.26
b.	Reserves	25.44	11.69	34.32	16.28	23.50	9.53	12.88	9.68
c.	Deposits	34.72	39.68	18.48	50.71	47.84	86.53	83.84	81.31
d.	Borrowings	23.04	16.93	19.26	11.05	10.98	0.00	0.00	5.75
6.	Operational Performance								
a.	Percentage of Societies/Banks making loss	30.54	15.01	6.16	12.42	23.07	19.67	0.00	3.41
b.	Loans Overdue as a % of Loans Outstanding	23.66	3.82	3.82	14.66	14.79	8.54	11.42	12.61
c.	Structure of Overdue Loans as % of Loans Outstanding								
	Upto 1 Year	-	1.29	.	3.92	-	-	3.16	3.85
	1 to 2 years	n	0.84	n	4.73	-	-	1.79	1.49
	2 to 3 years	a	0.79	a	3.15	n	n	1.84	1.24
	Over 3 years	-	0.90	.	2.86	a	a	4.63	6.02
	Total	23.66	3.82	3.82	14.66	14.79	8.54	11.42	12.61

Source : Relevant State Level Registrar of Cooperative Societies

Note : 1. * Details of UCCS are not available for Andhra Pradesh

2. The Financial ratios are based on aggregate statistics only, as detailed information on individual societies/banks is not available

BEST AVAILABLE DOCUMENT

Financial Operations of Credit Cooperative Societies:

The main functions of the SECS, UCCS and UCBs are to mobilize thrift and enable their members to have access to credit. The regularity of thrift is an important consideration in deciding on the credit-worthiness of the member. The UCBs with a far greater volume also offer regular banking services.

Capital Structure: Most of the credit cooperative societies, as we observed earlier, have a far greater reliance on their own funds, with the debt equity ratios generally not exceeding 2.0. However, there is some tendency to rely more on deposits, once a certain volume of owned funds is achieved. The basis and extent of different sources are explained below in greater detail.

Share Capital: Besides an entrance fee, a new entrant to a society has to buy shares of the society, which are generally Rs. 10 each. The share capital is also enhanced by conversion of the compulsory savings to share capital at the end of a given year. This helps in enhancing the owned funds of the society. The member is generally willing for such conversion as the interest on deposits is lower than the 12 percent dividend paid by most of the societies. Secondly, any member who does not have adequate deposits (25 percent of the loan amount) is required to retain some percent of the loan as share capital. Some societies make it compulsory for the members to have a specified percentage of the loan amount as shares. For example, SECS of the Bhavnagar District Cooperative Bank requires the members to buy 10 percent of the loan amount as shares for the first loan and 2 percent of the loan amount for the second loan, till the member has at least 25 percent of the maximum permissible loan amount in the society's shares.

The society bye-laws generally also put a maximum limit on the total shares which can be held by an individual member. Given the cooperative nature of the society, the voting rights are not linked to the share capital. Each member has only one vote.

External Borrowings: According to the State Cooperative Acts in some of the states or by convention, the PNASs are permitted to borrow from the respective District Central Cooperative Banks.

In Gujarat, the DCCBs have been lending to the PNASs under the 'incidental finance' facility or through the over draft facility. The loan has to be repaid in 1 year, though in most cases, if the repayment is found satisfactory, the loan is renewed. The interest is 16.5 percent, with a penal interest rate of an additional 1.5 percent for delays. The data for Gujarat indicates that on an average 58 percent of the ECCSs and 50 percent of the UCCSs had borrowed in this manner during 1990-91. The borrowings were, however, of very low values and generally did not exceed 2 to 3 times the net owned funds.

The PNAS is not constrained by any RBI regulations regarding the interest rate to be charged on lending. Thus the decision regarding spread for the borrowings from DCCB is essentially a decision of the executive committee. In most cases, the rates are in the range of 18 to 19 percent. Our studies of a few societies suggest that the UCCSs tend to charge a slightly higher rate of interest, probably due to greater problems with delayed payments. In some cases, the societies borrow from the DCCB for a specific purpose like purchase of

Table 2.6
Financial Performance of Selected Urban Credit Cooperative Societies

	Name	Members	Liabilities and Owned Funds (Rs Lakhs)	Reference Date	OPERATIONS: Debt Coverage Ratio	Cost Coverage Ratio	Average Cost of Funds (%)	Average Return on Loans (%)	Average Spread (%)	Loans/ Working Capital (%)	Establishment Cost/ Outstanding loans (%)	PROFITABILITY: Return on Assets (%)	Return on Equity (%)
A.	**EMPLOYEES CREDIT COOPERATIVE SOCIETIES (ECCS)**												
1.	Maharashtra Housing Board ECS	3302	123.8	30.3.93	2.1	3.9	8.2	8.9	0.7	77.2	1.7	3.8	8.0
2.	Mahaned Dairy Emploees Cooperative	425	6.0	30.3.93	1.9	1.9	13.5	11.0	-2.5	96.8	3.8	3.5	6.3
3.	Bhavnagar Dist Co-op Bank ECS	373	56.7	30.6.93	0.0	5.2	0.0	3.5	3.5	95.0	0.7	2.7	11.0
4.	ST ECS	1912	165.2	30.6.93	2.4	2.7	13.3	17.1	3.8	94.4	4.4	5.4	13.3
5.	Excel Industries	931	66.0	30.6.93	18.7	3.7	1.4	13.1	11.7	77.9	4.2	8.9	16.3
6.	Blind Men's Association Staff Cooperative	157	21.1	30.6.93	2.1	22.2	16.5	10.8	-5.7	97.2	0.3	5.5	8.8
7.	Ahmedabad Cotton Mills ECS	724	28.6	30.6.93	2.2	6.5	11.0	7.2	-3.8	36.3	1.3	6.3	13.8
B.	**URBAN CREDIT COOPERATIVE SOCIETIES (ECCS)**												
8.	Shramik Credit and Supply Cooperative Society	450	3.1	30.6.93	0.0	5.4	0.0	9.2	9.2	49.5	1.8	7.8	8.5
9.	Rajpur Bhagyodaya Credit and Supply CS	538	6.3	30.6.92	0.0	4.2	0.0	10.9	10.9	94.7	2.6	8.0	10.2
10.	Samaj Sahayak	1962	49.5	30.6.91	2.0	6.9	8.6	13.7	13.7	68.5	1.1	5.6	18.7
11.	Sahayak Credit and Supply Cooperative Society	2068	54.4	30.6.92	2.5	4.0	9.0	10.0	10.0	33.3	1.7	4.0	7.1
12.	Platinum Credit and Consumer Cooperative Society	1684	159.0	30.6.92	1.8	6.9	12.2	19.2	19.2	65.0	1.6	5.8	27.4
13.	Yerala Cooperative Society	9122	263.4	31.3.92	1.9	1.4	3.6	10.3	10.3	77.7	7.1	1.6	7.0
14.	Salgaan Sanmitra Cooperative Society Ltd	5855	317.5	31.3.92	1.5	1.8	10.2	14.4	14.4	71.1	4.6	2.2	8.0

BEST AVAILABLE DOCUMENT

televisions by the members, as was done by the Ahmedabad Cotton Mills' Employees' Cooperative Credit Society. In such cases, the members had to produce a bill as proof of purchase for this loan.

It must be pointed out that for the DCCBs, lending to the PNAS, especially the SECS is a preferred option, due to the higher rate of interest, good repayment records and relatively lower transaction costs. In fact, in most cases, these societies have a good rapport with the DCCBs and it is easy for the DCCBs to assess their track record as there is regular accounting done by the society and annual audit by the Cooperative Registrar's office. Of the societies reported in Table 2.3, only 2 of the 7 UCCSs had external borrowings, while 4 of the 7 ECCSs had external borrowing. In both cases the borrowings have not exceeded the share capital.

The details of the DCCBs from Bombay and Ahmedabad suggest that they have adequate additional resources with credit to deposit ratios being low at 0.5, as against a permissible 1.0. If it is possible to work out some arrangement for them to extend housing finance to the PNASs, it will be possible to use it as an incentive to augment their own resources. Thus, HFCs can in fact consider lending to DCCBs on a part refinance basis for onlending to the SECSs and UCCSs for housing purposes, based on their assessment of these societies depending on their past repayment record.

Savings Mobilization: Most societies have a compulsory thrift system. Under this, an amount decided at the formation of the cooperative society, is to be saved by each member every month. The amounts may range from as little as Rs. 10 to Rs. 100 and more. The amounts are decided on the basis of ability and willingness of a large proportion of the members. Over time, the society may also increase this amount. The interest to be paid on savings is also decided by the society. Of the societies reported in Table 2.3, this has ranged from as low as 6 percent to a higher return of 14 percent. The deposits with the PNASs are not covered by the deposit insurance, as are the deposits with the banks.

The procedures for savings mobilization vary for different societies. In most cases, the members are expected to make the deposits in the office of the cooperative before a fixed date every month. Most societies also have penal charges in case of delayed payments. For SECS, however, the compulsory savings are deducted directly from the monthly salary of the employee through an arrangement with the employer.

Some of the larger and/or older societies have also introduced different savings instruments like fixed deposit schemes where the amount is doubled in five years, or other time deposits.

Credit - Assessment, Disbursal and Recoveries: Credit is available to all members. There is generally a minimum period of regular compulsory savings required by all societies before a member becomes eligible for a loan. This varies from 6 months to about 2 years. The procedures for sanctioning the loans are simple as the executive committee generally has a fairly good knowledge of the member. Essentially, the procedure involves applications by all the interested members by a specified date each month. The loans are sanctioned on the basis of date of application. Rejections are not many (about 5 percent for the selected societies). Depending on the cash flow situation there maybe waiting lists, in which case the application is carried over to the next month. For the older societies, the borrowing limits from the DCCB provide adequate funds. This is largely due to the limits on maximum loan size and the dominance of short term loans. For example, the available details for Gujarat suggest that 92 percent of the loans advanced during 1991-92 were for a short term.

Purpose of Loans: The loans are available for any purpose. However, they are largely used to meet social obligations, health related expenses and also for housing upgradation or construction. The details for Gujarat suggest that the ECCSs had given 14 percent of the short term and 33 percent of the medium and long term loans for housing during 1991-92 with a total value of Rs. 227.6 million.

Loan sizes: The size of the loan is generally linked to the savings and is four to five times this amount. Alternatively, as noted above, a certain proportion of the loan amount is required as shares. There are clear limits in all the PNASs regarding the maximum loan amounts available to any member. Clearly, this amount is linked to the total resources of the society and are determined by both owned funds (share capital and reserves) as well as deposit mobilization. The former of these also determine the total borrowings possible from the DCCB. At the initial formative stages of a cooperative, the maximum loan amounts are low, in the range of Rs. 500 to Rs. 2,000. Over time, as the funds position improves, the maximum loan amounts are also increased. For example, for the Shramik Credit Cooperative Society in Ahmedabad which is only 6 years old, the maximum loan amount is only Rs. 2,500. However, for the Platinum Credit and Consumer Cooperative Society in Bhavnagar, which is 34 years old, the maximum loan amount is Rs. 50,000 and the maximum repayment period is 50 months.

The detailed analysis of loan sizes for Gujarat, highlights the fact that credit cooperative societies focus on giving a large number of smaller loans. Thus, generally over 50 to 70 percent of the loans are for less than Rs. 1,000. In terms of the value, however, the largest share is of loans between Rs. 1,000 and Rs. 5,000. Even for ECCSs, the loans above Rs. 10,000 are about 20 percent of the total loan amounts advanced.

Security for Loans and Defaults: The loans advanced by the credit cooperative societies are unsecured and largely based on personal surety/guarantee of other members. The UCCSs also gave 16.4 percent of the total loans using immovable property as security. (Refer table 4.13).

The real effective security in cooperative society lending thus is group and peer pressure. The rapport of the executive committee with the members and a quick follow-up are critical in this approach. Further, the high priority given to the past repayment records and regularity in thrift for credit sanctions also act as an incentive for regular payments. This is evident from the detailed information on delayed payments presented in Table 4.14 for Gujarat. During 1991-92, only about 3.5 percent of the borrowers had defaulted. The total default amounts ranged from 3.8 to 14.6 percent of the total outstanding loans for the ECCS and UCCS respectively. Unfortunately, as the available data does not report the total recoverables, it is not possible to ascertain the recovery rates.

Profitability: At an aggregate level, as we reviewed earlier, the cooperative societies in Gujarat show a better performance with only 12 to 15 percent of them making losses. The ECCSs in Maharashtra perform even better. However, amongst the UCCSs in this state, almost a fourth are in the red. The profitability analysis shown for the selected societies in Table 2.6, range from 7 to 27 percent on shareholders' funds and 1.6 to 9 percent on the total working capital. We explore the possible explanations for this performance below.

Spread on Operations: For a financial institution, one of the main aspects of profitability relates to the spread achieved. Interestingly, for the selected credit cooperative societies, the spread was negative for three ECCSs and ranged from 0.7 to 11.7 for the others. For UCCSs, the spreads were generally higher with only one society having a low spread of 1.1 percent. For all others, these ranged from 4.2 to 10.9 percent.

Costs of Management: Compared to the very high management costs reported for the NGO linked financial systems in the previous chapter, the credit cooperative societies show a much lower level of costs. For the 14 selected cooperative societies, the establishment costs ranged from as low as 0.27 percent of the total outstanding loan balance to the highest at 7 percent. For most, however, the costs were largely in the range of 1 to 2.5 percent. Further, in most cases, the financial operations adequately covered these costs with the cost coverage ratios being generally in the range of 3 to 5 with no significant difference between the ECCS and UCCS.

The detailed analysis for Gujarat for 1991-92 suggest somewhat higher costs of management, including depreciation and other expenses at about 6 percent of the outstanding loans.

Role of Urban Cooperative Banks (UCBs):

The UCBs play a significant role both in mobilizing household deposits and, especially, in lending to the household sector. They have a fairly good rapport with their members which can be extremely useful for housing finance also. In fact, the available data for Gujarat suggests that the urban cooperative banks played an important role in housing with the outstanding loans of over Rs. 16460 million for this purpose in 1990 at about 11 percent of the total lending. Detailed studies of the Anyonya Cooperative bank in Baroda, Gujarat showed that the housing loans as a proportion of total outstanding loans has come down from 51 percent in 1984-85 to 33.4 percent in 1989-90 (Karvekar, 1991 and Mehta and Mehta, 1992).

The possible reasons for this based on the discussions with some of the leading banks in Ahmedabad, Baroda and Bombay are as follows.

Housing as a Priority Sector: The UCBs are required to lend 60 percent of their funds for the priority sector. For housing, the loans of less than Rs. 25,000 are considered as a part of the priority sector. Given the price levels for housing, this limit makes the price to loan ratios unattractive for potential borrowers. On the other hand, for many of the banks, the credit to deposit ratios are rather low, ranging between 0.5 to 0.6, suggesting the potential for increased lending. It would thus be advisable to increase the loan ceiling for housing to be included as a priority sector, at least in line with the NHB pattern for refinance. The recent revision in the ceiling on housing loans to Rs. 200000 for inclusion as priority sector for the commercial banks needs to be extended to the cooperative banks also.

Limits on Extent of Housing Finance: The RBI, through its circular in 1989, has fixed the maximum limit on lending for housing and other block capital loans at 10 percent of total deposits. While this limit may not affect the very large UCBs, some of the smaller UCBs, which had an extensive portfolio for housing, have been constrained by this limit. It is of course possible to overcome this constraint by creating linkages for long term funds through loans or refinance as these are not included in the limit.

Possibility of lending to Primary Housing Cooperative Society: At present, due to the State Cooperative Acts, the UCBs which are also considered as primary ones, are not permitted to induct the primary housing societies as members. If this is permitted, it would enable the UCBs to improve their lending for housing purposes considerably. This requires a change in the state level Cooperative Acts.

Permission to lend for schemes under Section 21 of ULCRA: At present, the UCBS are not permitted to lend for housing schemes taken up under Urban Land Ceiling exemptions. As these schemes are cheaper and compatible with the affordability of the borrower groups, such a permission will enhance their role in reaching the lower middle classes for housing finance. It maybe pointed out that HDFC has been permitted to lend for schemes under Section 21 of ULCRA.

Technical Assistance/ Refinance/ Risk Fund: Some of the smaller UCBs like SEWA do not have the experience of long term mortgage financing. They would benefit from technical assistance and some support in the form of a risk fund in the initial years to get them started. This may also be true for other Women's UCBs. This approach will help larger cooperative societies that do not require additional funds. These finance institutions will be able to improve their credit/deposit and credit/working capital ratios and, therefore, improve profitability. However, initially it may be helpful to provide refinance (line of credit) for this purpose which will help to build up their expertise and confidence for long term lending. Subsequently, they will be able to carry out these activities with their own funds.

Refinance by NHB to Urban Cooperative Banks: NHB's refinance facilities for housing loans upto Rs. 50000 are currently available only to the scheduled cooperative banks. Many of the smaller cooperative banks have been lending for housing or have a tremendous potential, especially for reaching the households in smaller urban centres and those below the median income. It will, therefore, be useful to consider the possibilities of refinancing even the-non-scheduled cooperative banks, if the UCB generates adequate volume of housing loans.

2.3 DOWNMARKETING BY HOUSING FINANCE INSTITUTIONS

As we reviewed in the first section, the role of the emerging housing finance institutions in reaching the households below median income has been rather limited so far. The available estimates suggest that the finance to these groups probably does not exceed 15 percent. The only company which had a specific mandate to serve these groups was HUDCO, a company fully owned by the Government of India. It earmarks 55 percent of its lending for these groups. Besides HUDCO, the only other company which has made specific attempts in this regard is the HDFC through its project financing for the KFW line of credit which is meant for households with a monthly income of less than Rs. 1000. The only other attempts have been through projects financed by LICHFL and GIC Grihvitta for low income workers in Bombay through payroll deductions.

HUDCO's emphasis for the low income finance has been by offering subsidized interest rates and more favourable credit terms, especially longer repayment periods and higher loan to cost/price ratios. It has largely operated through the public housing agencies for providing bulk finance for what has been termed as 'social housing'. Over the years, however, public agencies have found it difficult to provide housing within the cost ceilings imposed by HUDCO. HUDCO has recently also introduced a scheme to provide loan assistance to NGOs for housing projects on a pilot basis. However, even in this the emphasis is on a specific project and inadequate attention is paid to developing viable finance systems.

The emphasis on subsidized interest rates is also evident in the HDFC projects through KFW line of credit. KFW, a German development bank has sanctioned a total of DM 55 million (about Rs. 770 million) in two lines of credit. The first one was of DM 25 million. Under this, HDFC has so far sanctioned 43 low income projects for Rs. 400 million and disbursed almost Rs. 160 million. loans to low income households have been either given directly to households with NGO facilitation or routed through the NGOs. The loans to low income households are at 7 percent interest to be repaid in 22 years with a 1.25 percent spread for HDFC but none for the NGOs.

The only notable case of using the Community based Finance systems for housing finance is by the GRUH in Gujarat. It has attempted to use the cooperative societies for identifying potential borrowers and assessing their creditworthiness. However, their attempts to use these structures for intermediation have not materialized. However, GRUH emphasizes that this would a far better arrangement.

On the whole the HFIs have been extremely wary of reaching out to the households below the median income. while most of them visualize the possibilities of expanding market opportunities through such reach, they feel that specific constraints, especially related to a perceived high credit risk, lack of affordability for housing and high transaction costs, inhibit such expansion. However, our discussions with eight of the leading HFIs suggest that all but one was interested in experimenting with innovative measures. In the next section we present a strategy for enhancing the reach of low income groups through a downmarketing approach using the community based finance systems discussed earlier in this section.

SECTION THREE

STRATEGY FOR DOWNMARKETING

The strategy envisaged for downmarketing housing finance to moderate and low income groups, in urban areas, is based on using the existing finance systems. It is hoped that this will in turn consolidate and develop these systems further. The strategy may be initiated as a series of pilot projects, which can be replicated widely. This necessitates a gradual approach which builds on the strengths of these pilot projects while also recognizing their inherent limitations.

Many of the problems related to housing for low income groups, especially regarding legal access to land at affordable prices and those related to foreclosure laws, have long been pursued in housing policy. It must be recognized that solutions to these will emerge only gradually. This strategy, therefore, takes the current conditions as system limitations and suggests indirect measures to overcome these. In a longer term perspective, demand pressures created through the improved access to credit for housing will itself help find solutions to these constraints.

3.1 OBJECTIVES OF DOWNMARKETING STRATEGY :

This strategy, if successfully implemented, will fulfill three important objectives. First, it will help to enlarge the market for housing finance for the emerging housing finance institutions in the country on commercial terms, and secondly, it will enable large segments of the urban population to improve their living conditions through a better access to credit for housing and community level infrastructure facilities.

The third objective of this strategy goes beyond the confines of housing finance. It is envisaged that it will also help to consolidate the different forms of community based finance systems by enabling them to expand their activities in a viable manner. These structures would be far more replicable than the public housing projects with their limited reach. More importantly, they will help to integrate these systems with the general financial systems in the country.

Consolidating and Integrating the Community Based Financial Systems: The recent literature on housing finance has repeatedly emphasized the possibility of enhancing household savings rates and general finance system development with better housing finance systems. In a similar vein, the downmarketing strategy as envisaged in this paper will also help in the consolidation of the different forms of community based finance systems in the country and lead to their better integration with the general financial systems. The emphasis on such arrangements for housing finance will also mean a change from the subsidised interest rate financing, that has been the mainstay of public policy for low income housing finance in India so far. The emphasis now shifts to supporting development of commercially viable community based finance systems. Any available subsidies must be consciously utilised for the initial building up of such systems. These efforts however, need to be designed to become financially self-sustaining in the medium to long term.

Enhancing Savings Mobilisation: It must be realised that the access to housing finance can also be critical to sustaining and increasing the desire for regular thrift by the low income groups. The experience of SPARC (housing savings) and BCC (group infrastructure savings) suggest that it would be possible to enhance savings, if access to housing finance is possible. In fact, discussions with SPARC personnel suggest that in later years, it was difficult to sustain the flow in their housing savings scheme as the housing loans did not materialize. Similar observations were also made by another NGO, Sharan in Delhi. They indicated that in their savings groups, there is now a demand emerging for larger loans and for purposes related to housing. However, such loans would require funds beyond those available with the community based systems themselves. There is thus a need to ensure that the system does not collapse only on account of lack of funds.

3.2 CONSTRAINTS IN DOWNMARKETING AND KEY DESIGN PRINCIPLES:

The development of a downmarketing strategy for housing finan requires a careful identification of the perceived constraints for a commercially viable stem and the key design principles which attempt to overcome these constraints. Our rev :w of the existing housing finance institutions suggest three main areas of constraints for a commercially viable downmarketing strategy.

1. High Credit Risk:

The first and the most emphasized constraint stated by many HFIs relate to the high credit risk perceived in lending to these groups. Our review of the community based financial systems, either those linked to the NGOs or the cooperative institutions, suggest that while delinquency is likely to be prevalent, bad debt is not very common. This has also been the experience of HDFC which has largely used the NGO mode for routing its KfW line of credit, meant for the low income groups.

These experiences suggest that appropriate financial arrangements and strong grass roots base is essential for controlling the bad debt. A better tracking of actual extent of bad debt is essential. However, the discussions with NGOs suggest that this may occur due to either death or other calamities like fire or loss of income/assets due to riots. In fact some of the NGOs linked CFIs have either their own insurance schemes (like the Death Relief Assistance of FTCA) or started to avail the group insurance facilities of LIS (as done by SEWA as well as SPARC for their members).

Greater check on delinquency on the other hand probably requires better underwriting criteria, more sensitive lending instrument design and a financial mechanism to cover the delinquency risk. In the case of the Community based Financial Institutions (CFIs) which have grown beyond a small community controlled group, better record keeping for tracking the defaulters' - is also important.

Table 3.1
Downmarketing Housing Finance
Constraints and Key Design Principles

Constraint		Design Principles
1. High Credit Risk		
	i.	Measures to cover credit risk including insurance cover
	ii.	Delinquency Risk Fund
	iii.	Appropriate Underwriting
2. Affordability for Housing		
	i.	Design of appropriate new loan instruments
	ii.	Selection of appropriate markets
	iii.	Technical support
3. High Transaction and Servicing Costs		
	i.	Developing CFI capabilities
	ii.	Adequate scale of operations
	iii.	Spreads to cover establishment costs

Specifically, the following **design principles** emerge as important to overcome the perceived constraint of high credit risk.

i. Measures to cover the credit risk: In the initial period of downmarketing strategy, the risk of bad debt will need to be borne by the community based (NGO linked or the cooperative) intermediary financial institutions or through subsidies for insurance cover. This is important to first create a willingness by the HFIs to initiate the downmarketing. Over time, as the experience builds up and a better assessment of actual levels of credit risk become known, this arrangement may change.

The linkage arrangement needs to also support the CFI to introduce better systems of record keeping and loan recovery which are prerequisites to good financial management. In addition and more importantly, the CFI must also be encouraged to introduce some type of insurance cover for bereavement and loss/damage to property. The experiences of FTCA for death relief assistance scheme or of SEWA and SPARC's insurance cover through group insurance need to be emulated. The linkage must include these insurance arrangements as a part of the cover for the larger housing loans. In the initial period, the insurance cover may be provided through subsidies as essential.

In addition to these measures, the CFIs have largely focussed on group and peer pressure to minimize the credit risk and this must be continued. In case of the Employees Credit Cooperative Societies (ECCS), payroll deductions with the employers' consent will also help to reduce the credit risk to a minimum.

ii. Delinquency Risk Fund: Delayed payment or delinquency is likely to be quite common, as suggested by the limited data available about the CFIs and the discussions with them. In order to cater to cover this risk, the HFIs must be ensured of payments in time. This may be achieved by keeping a delinquency risk fund as a block balance or deposit with the HFI. It may be drawn upon by the HFI in case of delayed payments by the CFI. The size of this fund must be linked to the past recovery performance of the CFI, so that it acts as an incentive to improve the cost recovery performance. At the end of the loan period, the unutilized deposit with the accumulated interest will be returned to the CFI.

iii. Appropriate Underwriting: The bulk loan arrangement must also require and encourage the CFI to move towards appropriate underwriting criteria for housing finance for these groups. Besides the instalment to income ratio (IIR) used by most of the HFIs, a minimum period of regular savings and regularity in the repayment of past credit need to be emphasised. It is the latter criteria which have been used by the CFIs in the past. For larger loans, participation in special savings scheme for housing can be made mandatory.

The HFI also use a cap on loan to cost/price ratio for determining the loan amount. However, as we discuss below, the control of credit risk is linked more to the other arrangements rather than the security of mortgage, it would be preferable not to use this consideration at all. In fact, unduly low ratios would necessitate the use of other more expensive sources of finance like the moneylenders, increasing the possibility of credit risk on CFI finance.

2. Affordability for Housing:

The second constraint relates to a perceived lack of affordability for the low and moderate income households in relation to the prices of available options in the housing market. Many of the HFIs have posed this as a major constraint.

The question of affordability is, unfortunately, not spelt out clearly. Housing affordability is generally viewed only in the context of household income. It should, in fact, be examined in the context of the terms at which finances are available, the ability of the household to make the downpayments and the proportion of the monthly income (the instalment to income ratio), that would be made available by the household to service the loan. Table 3.2 highlights the affordable housing costs under a range of these parameters. Our inquiries in some of the cities that were visited, suggest that the range of affordable costs presented in Table 3.2 are adequate to meet the

Table 3.2
Maximum Affordable Housing Costs (Rupees)

HH Income Rs per month	Instalment to Income ratio (%)	Repayment period (Years)	Interest Rate (% per annum)			
			12.0		18.0	
			Loan to cost ratio		Loan to cost ratio	
			0.9	0.7	0.9	0.7
1500	0.1	2	3541	4463	3338	4292
		5	7493	9209	6563	8439
		8	10255	12335	8450	10865
		15	13887	16091	10349	13306
	0.25	2	8851	11158	8346	10731
		5	18731	23023	16408	21097
		8	25637	30839	21126	27162
		15	34717	40227	25873	33265
2800	0.1	2	6609	8331	6232	8012
		5	13986	17191	12252	15752
		8	19142	23026	15774	20281
		15	25922	30036	19319	24838
	0.25	2	16523	20828	15579	20030
		5	34965	42977	30629	39380
		8	47855	57566	39435	50702
		15	64806	75090	48297	62096

costs related to housing upgradation, housing construction costs (without the land component) and community infrastructure provision. Even for purchase of new housing, some options, which match the affordability of the households in the 40th-50th percentile, are available in the formal housing market. For example, in Ahmedabad, private sector housing in the eastern periphery is available at Rs. 75,000. This matches the affordability levels of the households in the income range of Rs. 2500 to Rs. 3000. The prices in the informal markets are even lower and well within the reach of households even in lower income brackets.

These observations suggest the urgent need of information about local housing markets, especially for those options which fall within the affordable range of below median income groups. Secondly, technical systems which help lower the costs of construction for new house as well as for upgradation should be made available to these groups. This will help improve the effectiveness of credit targeted at them. More importantly, it becomes necessary to provide housing finance for a variety of purposes which are more in tandem with the affordable levels to facilitate incremental improvements.

Specifically, the following **design principles** emerge as important to overcome the perceived affordability constraint.

i. Design of Appropriate Loan Instruments: It is necessary to design appropriate loan instruments which are more in tune with the affordability and housing market conditions. This requires two major changes. First, the purposes for housing loans must include besides new housing, home upgradation, purchase of land and community infrastructure projects. Secondly, the loan amounts need to match the affordability, permitting much smaller amounts.

Thirdly, and most importantly, the new instruments must permit non-mortgage based loans, especially in order to cover the options in the informal housing. This requires a clear change in the conventional HFI lending and may be promoted through bulk lending to the CFIs. Initially, such lending may be promoted as far as the loan amounts are small enough to be covered by other forms of non mortgage security or guarantees.

ii. Selection of Appropriate Markets: The question of affordability for new housing is linked to selection of appropriate markets. This necessitates a proper information system about the affordable housing options in the given housing markets. The pilot projects must support the building up of a market information system for the low and moderate income groups. It would be also necessary to select appropriate markets where such affordable options are likely to be available.

iii. Technical support: To maximize the effectiveness of available credit and to help formulate community level projects, technical support for the CFI should also be a part of the pilot project. Such support, however, must be properly costed and accounted for, in order to move towards meeting these costs from the surpluses of financial operations.

High Transaction and Servicing Costs:

The third constraint pertains to the high transaction or loan servicing costs associated with downmarketing. The HFIs are often reluctant to make small loans to the below median income families as this would add to their administrative costs of loan servicing. However, reaching this group through NGOs or Cooperative institutions is probably more expensive route. Our analysis for the community based finance systems highlights the high establishment costs of NGOs as compared to the HFIs. Unfortunately, adequate data is not readily available to ascertain the possible effect of economies scale on these costs.

Analysis of the available data suggests that as compared to the NGO linked CFIs, the loan servicing costs are lower amongst the cooperative societies, both because of the decentralised loan administration and availability of voluntary staff. Some of the services required for training and regulatory functions are also being met through government supported machinery in the cooperative sector at the state and district levels. Some NGOs like the FTCA in Andhra Pradesh, have also been providing these services to their members. This is possible given the large scale of its operation. The NGO operations are generally supported by grants from national and international donor agencies. Over time, it is necessary to make a realistic estimate of the total costs of NGOs' operations, pertaining to housing finance, to make the system replicable in a commercially viable manner. The system, then, needs to be designed to meet these costs from the surpluses generated through financial operations.

It is with this commercial viability in mind that the following **design principles**, for alleviating the constraint of high establishment costs, are suggested.

i. Scale of Operations: The arrangements must aim at an adequate scale of operation for a given CFI. This requires a careful assessment of the demand for housing finance and requisite time for external support until the CFI moves towards sustainable level. This means that in the initial period the CFI maybe supported through grants to meet the establishment costs which are phased out over a carefully designed time period. If the linkage is established without such a plan of operations, there may be serious difficulties for the CFI to sustain its activities.

Any linkage arrangement developed in the pilot project should ideally be related to a community based financial arrangement providing all types of credit, so that there is a scope for generating surplus from the financial operations to cover the establishment costs. It should not be confined only to a specific housing project as has been done in the past by both HDFC and HUDCO, unless they are designed with a purpose to develop or strengthen a CFI.

ii. Spreads to Cover Establishment Costs: The interest rates to be charged on housing loans must be decided by the CFI, depending on their rate structure for other loans. However, adequate spread must be available to meet the establishment costs over a defined period. Initially, grants may be provided to set up a system, with an explicit plan for phasing out the grant.

Table 3.3
Comparative Assessment of Establishment Costs

Institution	Establishment costs as percent of outstanding loans
NGO Linked Institutions, 1992-93	
- SEWA Bank, Ahmedabad	10.7*
- BCC - CSLA, Baroda	2.0 (20.0)**
- RATC - Hyderabad	9.1
HFI - 1992-93	
- GRUH	2.5
- LICHFL	0.8
- CHFL	1.2
- CBHFL	1.0
- SBIHFL	1.6
- GGVL	2.2
- HDFC	0.9
- HUDCO	0.3***
Cooperative Societies	
- ECCS, Gujarat, 1991-92	6.4
- UCCS, Gujarat, 1991-92	6.1
- Selected UCCS in Gujarat and Maharashtra, 1992-93	0.25 to 4.35
- Selected ECCS in Gujarat and Maharashtra, 1992-93	1.08 to 7.07

Source : From the relevant annual reports of different financial institutions. For Gujarat, State Registrar of Cooperatives.

Note :
* Does not include the probable costs of SEWA Union Employees.
** Including the CSLA estimate of the value of BCC staff time spent for CSLA activities.
*** HUDCO provides only bulk loans.

Even in cases where the HFI plans to use the CFI or NGO only as a facilitator with direct loans to the households, the establishment costs for the NGO or CFI need to be costed, recognized explicitly and covered by a service charge paid to the CFI by the HFI.

iii. Capacity for Financial Management: In order to recover the establishment costs entirely through its financial operations, the CFIs have build up their capacity for financial management, without sacrificing their special measures for savings and credit operations. The linkage arrangement must encourage this capacity building through necessary training and interaction with the HFIs.

3.3 TYPE OF LINKAGES:

In view of the basic design principles, two forms of linkages between the HFIs and community finance institution (CFI - NGO linked or cooperative) are envisaged.

i. HFI-CFI Linkages for Bulk Loans for Housing:

Our review of Cooperatives and NGOs has illustrated a wide variety of arrangements as well as different stages of development of community based financial institutions. They range from the nascent financial arrangements like those with SPARC, Sharan, Adhikar, to the more developed ones like SEWA, FTCA and the Community Savings and Loan Association of the BCC. Similarly, amongst the cooperatives also, there are many which are very small with low credit absorption capacity, while others have grown fairly large with a greater absorption potential. There are substantial regional variations in the availability of such arrangements. In all cases, however, the strength of these community based systems is their close rapport and linkages with the community and their members. It is this rapport that has to be used to further develop and strengthen the systems.

In response to these, the Downmarketing strategy envisages a linkage arrangement between the HFI and the community finance institution (CFI) which is flexible enough to accommodate institutions at different levels of development and promotes their further consolidation and strengthening. Basically the arrangement involves a bulk loan from the HFI to the Community Financial Institution (CFI) with specified terms and conditions for on lending to the households. The CFI will have the responsibilities for loan origination and servicing and, would, therefore, also bear the credit risk.

Many of the NGOs surveyed for this study, expressed a desire for such independence and freedom. In this arrangement, the credit risk would be borne by the CFI and the limit on total bulk loan maybe specified in relation to the capital base of the CFI or the thrift and credit groups under a NGO federation/association. The basic aim of this linkage would be to use the grass roots strength of the CFI for downmarketing and use the housing finance to consolidate the CFI itself.

Institutional Arrangements:

In order to evolve a successful and viable linkage arrangement, it is important to define the role of different institutions. Based on our review of the community finance systems, different potential models are identified as illustrated in Table 3.

Basically, two forms of intermediation are visualised.

i. Multi-tier Intermediation

ii. Single-tier Intermediation

The multi-tier intermediation uses the structure of federation or the apex agencies, which in turn lends to the primary CFI. In the single-tier intermediation, the HFI deals directly with a primary CFI. The description of each is provided in subsequent sections.

Multi-tiered Intermediation

Under this framework, there are many possible options to link the existing networks of primary CFIs, Cooperative Societies and the HFIs. Three of the potential approaches arising from the study are described below.

i. NGO-Apex Federation-Thrift and credit group model: In this model, the bulk loans for housing are envisaged to be routed through an apex federation or regional association of thrift and credit groups. The review, assessment and monitoring of the TCGs can be handled better by this federation or association, which will also take on the responsibility of mobilizing the Delinquency Risk Fund (DRF). However, the loan origination and servicing will be done by the primary CFI or Thrift Group which may or may not be a registered entity. This arrangement will mean spreads at two to three levels (federation, regional association and TCGs), However, the different activities, as they take place at appropriate scale are likely to be more cost effective. The institutional responsibilities for different activities are also highlighted in Table 3.

ii. Employer - ECCS model: The second model envisages use of the widespread structure of Employees' credit cooperative societies (ECCS) in the country. The HFI can, with the help of the state/district registrar of cooperatives and the district central cooperative bank, identify potential ECCS. This selection may be based on their past financial performance. The bulk loan would be routed either through the District Coop. Bank/Employer to be given to the ECCS. The employer will also play a facilitating role to permit payroll deductions. This model thus, has very low or no delinquency risk.

iii. DCCB - UCCS model: Compared to the NGO linked arrangements, bulk loans to be routed through the Urban Credit Cooperative Society (UCCS) require a greater scrutiny and appraisal. However, our earlier review suggests that there are many large and viable UCCSs in operation. The bulk loan may be routed either through the DCCB, to be onlent to the UCCS. The role of DCCB needs to be considered only in case where no NGO linked federation structure is already available. The activities related to technical assistance, market information, etc. are crucial for the UCCS to service large volume of loans.

Single-tiered Intermediation:

iv. NGO linked CFI model: In this model, the NGO linked CFI assumes far greater responsibility. The CFI in this case may be a primary Credit Co-operative Society, cooperative bank or registered under any other relevant Act. The legal basis is, however, essential, as described below. The HFI bulk loan will be given directly to this CFI, with the NGO only facilitating the liaison. NGO will, however, be involved in the loan recovery process indirectly by the deployment of its staff, as has been happening for the SEWA bank and BCC linked CSLA. In order for the CFI to shoulder all the envisaged activities, it must operate at an adequate scale. It is likely that access to funds for housing finance can itself aid in this process.

The different institutional responsibilities for different activities in the four models are highlighted in Figure 3.1.

ii. NGO Facilitation:

The second form of the linkage is the facilitation of direct lending by HFIs. This arrangement is similar to the one that some of the HFIs like HDFC, LICHFL, Griha Vitta and GRUH have been using to some extent. In this linkage, the loan agreement is directly between the HFI and the individual borrower, though the process is facilitated by the NGO or the credit cooperative society. The latter may help in loan origination and also actually service the loan on behalf of the HFI, at a fee. The credit terms and underwriting criteria suggested in Table 3.5 will also be applicable here. The basic aim of this linkage would be to encourage the HFI to develop a working knowledge of lending to these groups more directly, though its costs may be kept under a check by using the NGO-cooperative structures for loan servicing. Direct payroll deductions for employment based Credit Cooperative Societies are also possible. In other cases, a risk fund to cover the delinquency risk may also be required.

3.4 FINANCIAL GUIDELINES:

The emphasis in the HFI-CFI linkages for bulk loans for housing finance is on developing the basic financial principles for giving bulk credit to the community based financial institutions. So that the risks are minimized and more appropriately shared. This will make it possible to replicate this arrangement on a larger scale in the future.

i. Purpose of loan, Credit terms and Underwriting: A major change in the general outlook in the housing finance industry will have to be made in terms of the different purposes for which loans may be given. These should include, besides the house construction or purchase, purchase of land plot, house repairs, house upgradation/ additions, addition of sanitation facilities and community infrastructure. While most HFIs are not likely to have the experience of community infrastructure projects, this is an important demand from the low income groups in urban areas. Further, many studies have shown that provision or improvements in community

Figure 3.1

HFI-CFI LINKAGES FOR HOUSING FINANCE

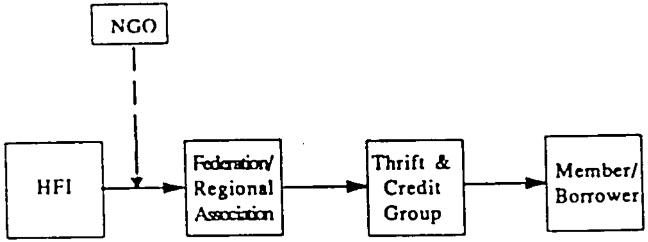
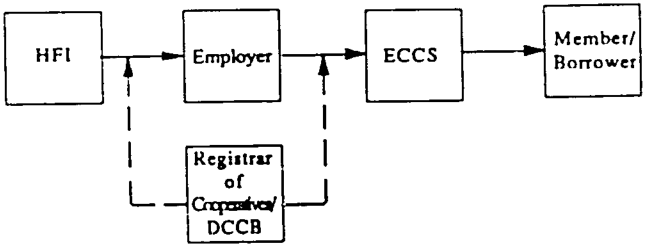
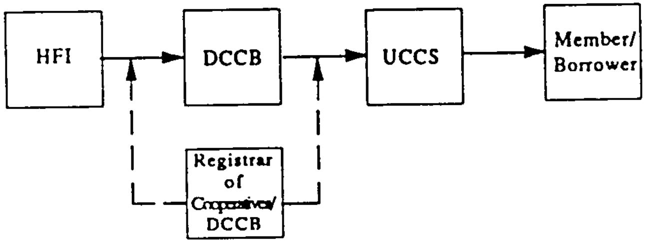
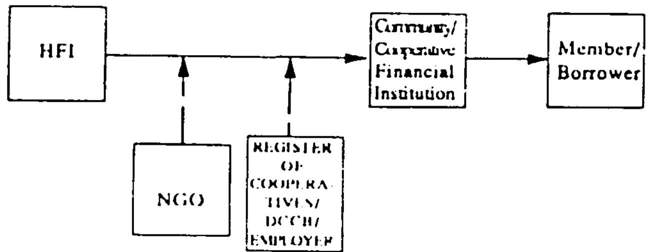
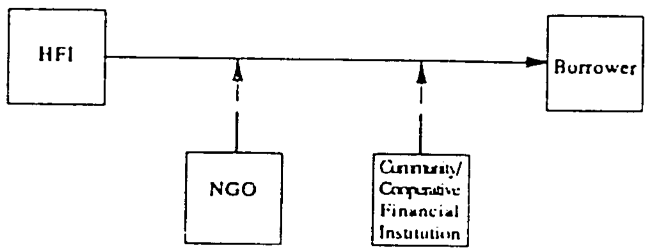
TYPE OF LINKAGE	ORGANIZATIONAL LINKAGES	INSTITUTIONAL RESPONSIBILITIES
A. BULK LOANS/ LINE OF CREDIT Loan purposes include home construction/purchase, purchase of land, plot, home upgradation/extention individual and/or community infrastructure. **a. Multi-tiered Intermediation** i. NGO-Federation- Thrift and Credit Group Model		HFI — Providing bulk credit — Defining credit and underwriting terms — Providing financial management assistance Federation — Appraise and monitor TCGs for bulk credit — Mobilize DRF — Technical support — Market information Thrift and Credit Group — Loan origination and servicing
ii. Employer-ECCS Model		HFI — Providing bulk credit — Defining credit and underwriting terms Employer — Ensuring payroll deductions ECCS — Loan origination and servicing Registrar/ DCCB — Assist in identifying ECCS
iii DCCB-UCCS Model		HFI — Providing bulk credit — Defining credit and underwriting terms. DCCB — Appraise and monitor TCGs for bulk credit — Mobilize DRF — Technical support and market information. UCCS — Loan origination and servicing

Figure 3.1 (cont'd)

HFI-CFI LINKAGES FOR HOUSING FINANCE

TYPE OF LINKAGE	ORGANIZATIONAL LINKAGES	INSTITUTIONAL RESPONSIBILITIES
b. **Single-tiered Intermediation** iv. NGO linked CFI Model		HFI — Providing bulk credit — Defining credit and underwriting terms NGO / REGISTRAR/ DCCB/ EMPLOYER — Facilitate appraisal of CFI, generation of DRF and loan servicing — Technical assistance and market information CFI — Loan origination and servicing
B. **NGO FACILITATION** Loan purposes include home construction/purchase, Major house upgradation/ extension v. NGO Facilitated housing loans		HFI — Loan origination and servicing NGO/CFI — Facilitate loan origination — Loan servicing

HFI — Housing Finance Institution
DRF — Delinquency Risk Fund
NGO — Non-governmental Organization
ECCS — Employees' credit cooperative society
UCCS — Urban credit corporative society
TCG — Thrift and credit group
CFI — Community/cooperative financial institution

BEST AVAILABLE DOCUMENT

infrastructure will help augment demand for housing finance considerably. Annex 1 gives the details of the community infrastructure loans.

Table 3.4
Financial Guidelines For HFI-CFI Linkages

1. Purpose of loan, credit terms and underwriting as per Table 3.5.

2. Delinquency risk fund as per Tables 3.6 and A.1.
   Group insurance to cover housing loans in the event of death - Rs 7-9 per annum per Rs 1000 of outstanding loan.

3. Necessary spreads to cover costs.

4. Legal form for the community finance institutions - to permit borrowing of bulk credit.

5. Plan of operations for the bulk credit to be submitted by the community finance institutions (CFI).

6. Limits on bulk credit (overall debt equity ratio of around 10 for CFI).

SUPPORT SYSTEMS

1. Technical support.

2. Market information.

3. Accounting, auditing and monitoring for the use of loans.

Table 3.5 illustrates the suggested credit terms and underwriting criteria which maybe linked to the loans for different purposes. For large loans beyond, the amounts generally handled by these CFIs, mortgage security may be essential. However, for smaller loans, group guarantee or peer pressures may be sufficient. In specific cases, where mortgage is not possible, flexibility in accepting lease papers or other documents suggesting defect security of tenure, should be accepted.

ii. Delinquency Risk Fund : To cover the risk of delinquency, a Delinquency Risk Fund (DRF) should be required in proportion of the bulk loan from the lending agency (HFI). The DRF is essentially a deposit kept with the lending agency to cover the delinquency risk. It earns interest at the standard deposit rate and would be owned by the CFI. The balance, if any, would be paid back to the borrowing CFI at the end of the repayment of the loan under the bulk credit.

Table 3.5
Suggestive Credit and Underwriting Terms of Different Loan Purposes For Outlending by CFIs

Loan purpose	Loan amounts (Rupees)	Repayment period (Years)	Security	Maximum Instalment to Income Ratio (%)	Minimum Period of Regular Savings	
					Loan amount (Rs)	Years
House construction purchase	Maximum to 60,000	5 to 15 years	- For loans above 20,000, mortgage - For loans less than 20,000, two known guarantors or gold or LIC policy	25.0	Uptill 20,000 Above 20,000	1 2
Purchase of land plot	Maximum 30,000	5 to 8 years	- Mortgage - Lease papers from public authorities	15.0	Uptill 20,000 Above 20,000	1 2
House upgradation/ repair (including toilets, and other water-sanitation facilities)	25,00 to 20,000	Upto 5 years	- Two known guarantors or gold	10.0 (Total housing expenditure to not exceed 35% of income)		1

Table 3.5 contd. : Suggestive Credit and Underwriting Terms of Different Loan Purposes For Outlending by CFIs

Loan purpose	Loan amounts (Rupees)	Repayment period (Years)	Security	Maximum Instalment to Income Ratio (%)	Minimum Period of Regular Savings	
					Loan Amount	Years
House extensions	2,500 to 60,000	2 to 15 years	- For loans above 20,000, mortgage - For loans less than 20,000, two known guarantors or gold or LIC policy	25.0 (Total housing expenditure to not exceed 35% of income)	Uptill 20,000 Above 20,000	1 2
Community infrastructure	Uptill 5,000 for household covered	2 to 8 years	- Mortgage of land or - Compensating block balance - size (5 to 30%) linked to availability of approval of public agency	10.0 (Total housing expenditure to not exceed 35% of income)		1

While the CFI will not be able to have access to this account till the loan is fully repaid, the HFI may draw against the DRF, if the CFI fails to make a regularly scheduled loan payment or makes only a partial payment.

The size of the DRF should be linked to the assessed recovery performance of the CFI, and may range from 1 to 15 percent, as illustrated in Table 3.6. The details of the method used for determining the size of DRF, as a percent of the bulk credit, are given in Table A.1. This linking of DRF with the repayment record of the CFI can act as an incentive to improve the cost recovery performance of the CFI.

Savings for Housing: In order to meet the DRF requirements, the CFIs maybe encouraged to start a Savings scheme for housing. Some of the NGOs, notably, SPARC has operated such a savings scheme with considerable success. Similarly, BCC has, very recently, introduced a savings scheme for receiving group finance for community infrastructure. Studies of low income housing suggest that there are considerable unanticipated delays linked to external factors like permissions, linkages for services, etc. The savings pool can help provide bridge loans to meet such contingencies.

Table 3.6
Delinquency Risk Fund Requirements (as a % of total loan)

Rate of Interest on Bulk Credit to be Repaid in 12 Years	Recovery Rate (Recovery as a % of Total Recoverable/Demand at any given Month)			
	95%	85%	75%	60%
12%	0.8	2.7	5.1	9.8
15%	0.9	3.1	5.8	11.2
18%	1.1	3.5	6.6	12.7
20%	1.2	3.8	7.1	13.7

Note: See Table A.1 for details of the methods used.

iii. **Necessary Spreads:** The spreads necessary on such bulk credit arrangement should ideally cover both establishment costs and the credit risk. While the actual data on bad debt has not been available for most CFIs, the estimate from BCC-CSLA and discussions with several CFIs suggest that it is not very high. The risk of delayed payments will be covered by DRF as discussed above.

The question of establishment costs may be linked to the scale of operations. While detailed estimates for the scale effects are not available, the FTCA provides an example for sharing services at different level. As contemplated for the FTCA, it is essential to plan for the establishment costs at each level to be met with the surplus from the financial services/operations at that level. In fact, the FTCA and RATCs under it, suggest that the routing of housing finance through these CFIs can itself contribute to the improvements in their cost coverage ratios.

For example, for the Hyderabad RATC, to meet the shortfalls in current cost coverage, as well as the additional establishment costs attributable for housing loans, would probably require total loan volume of 5 million rupees a year with a 1.0 percent spread. It is likely that the RATC may require at least 2 to 3 years to reach such a target. However, in the interim period, the establishment costs can be supported by a grant with a clear mandate to cover the costs from financial operations beyond this period. Thus, as a principle, while in the long run, the spreads should cover these costs, in the initial period, it is necessary to support the system development through grants. The costs will reduce in the future with increased scale of operations and can be absorbed by the financing arrangement without any subsidies.

A different aspect of the permissible spreads relates to the general lending rates adopted by the CFI. Some of these have been lending at high interest rates of 18 to 24 percent. Ideally, they should be permitted to charge these rates with an explicit proviso that a part of the profits will be kept as a special reserve which can be used for DRF requirements for the future loans or be used for the necessary technical support services. (and its records) in the future. Over time, the DRF requirement can be linked directly to the repayment performance for the bulk credit itself.

iv. Legal Form of the Community Financial Institution: An appropriate legal status for the community financial institution (CFI) to be able to receive the bulk credit is essential. Our review of NGOs suggest a variety of legal forms ranging from simple registration under the Societies Act, or as a primary credit cooperative society or even as a primary urban cooperative bank. The legal form should permit receipt of bulk credit for housing related activities.

It must be emphasized that while almost all the NGOs reviewed are registered under some appropriate Act, many of the CFIs linked to the NGOs have not been registered so far. For example, the savings and credit groups with SPARC, Sharan, Deepalaya, etc. Despite this HDFC, for its KfW funds, has lent to the NGO in such cases. HUDCO under its new scheme of financing NGOs also plans to do this. However, it is useful to insist on registration of a CFI or a membership of some federation. This would facilitate rating of CFI through annual audits of cooperative departments. Such ratings would help route the Bulk loans to the CFIs from the intermediaries.

v. Plan of Operations for the Bulk Credit: The CFI wishing to receive bulk credit in this arrangement need to develop a Plan of Operations for one to three years. Such a plan needs to cover the different loan purposes for which the bulk credit for housing finance is sought, the general socio-economic and housing profiles of the borrower groups and the prevailing housing costs. The selection of actual borrowers and loan amounts within the permissible underwriting criteria should, however, be left to CFI.

vi. Limits on Bulk Credit: The total volume of bulk credit can be controlled by keeping a limit on the bulk credit to equity ratio. In instances when the CFI can pass on mortgage assets to the HFI, the outstanding loans on this need not be included in this ratio. The overall debt equity ratio for the CFI should be around 10.0.

3.5 SUPPORT SYSTEMS:

The linkage of HFIs and NGO can succeed only through a supportive mechanism. The support system described below need to be evolved by national level agencies like the National Housing Bank in the initial period. Subsequently the HFIs or regional associations should take up these tasks.

i. Technical Support: In the housing sector a variety of support activities related to technical inputs for construction have received attention. Our review of NGO experience also suggests the need to have such supports for them to venture into housing related activities. In fact, most of the NGOs, who have been engaged in housing related activities have had such support, through either in house technical expertise or linkages with other agencies. A lack of such support has often limited their scope in such activities, (e.g. Sharan). Such support would help the borrowers to evolve better and more cost effective solutions. It will also help the agency to better assess the repairs, upgradation and construction costs.

The need for technical support is very essential for developing projects for community infrastructure provision and upgradation also.

ii. Market Information: Besides the technical inputs, another totally neglected area is market information for these groups regarding available housing options and the related prices. A property information service would help to overcome this to a great extent. It would also enable the NGO or the cooperative to develop a better understanding of the housing costs. Such a system maybe supported initially through a grant, but must operate through a fee structure which will make it self supporting over time.

Such support systems covering both the technical inputs and the market information should be developed to assist the borrowers to use the loans more effectively.

iii. Accounting, Auditing and Monitoring for the Use of Loans: The review of the NGO linked financial arrangements suggest the need for introducing better accounting procedures for the CFIs. In the cooperatives such practices are quite common, with a regular annual auditing. The FTCA and RATCs also provide such services and training for these to the member thrift and credit societies. The costs of these services also need to be accounted for properly and support services for these need to developed. In specific pilot projects, the emphasis on development of these systems must receive priority. Proper reporting systems are essential to improve financial management. The system, however, need to be simple and easily understandable by the staff of the community based financial institutions.

The CFIs are often weak in offering different innovative lending instruments to their members. However, they have attempted to keep flexibility in lending arrangements. Many of the CFIs do not use the concept of EMI in their lending operations. It would be particularly useful to develop the necessary illustrations of EMI and or repayment schedules for different financing terms, in simple tabular formats. This should be used as ready references by the CFIs.

The main responsibility to monitor the use of loan for housing related purposes will need to rest with the borrowing CFI. However, it is likely that lending for housing is new for the CFI, or has not been monitored in the past. It would be necessary to assist the CFIs to evolve cost effective monitoring mechanisms. Ideally, the monitoring should be integrated with the support services discussed above.

3.6 TOWARD PILOT PROJECTS

While the downmarketing strategy envisages expansion of the housing finance system to lower income groups on a widespread basis, the process may be initiated through selected pilot projects. The pilot projects need to be selected carefully to represent different models discussed above and aim for replicability. They will also need specific support systems as discussed above.

Institutional Roles:

While the design of the pilot projects will imply benefits both for the HFIs and CFIs, it is likely that the process needs to be facilitated, both by creating opportunities for interaction amongst the potential partners and by providing the necessary inducements by a careful use of subsidies for insurance cover, risk fund and support systems related to technical assistance, developing market information and training in financial management for the community based financial institutions. This support, through the necessary subsidies will need to come from the National Housing Bank or the USAID.

Potential Agencies to Participate in Pilot Projects:

For the models identified earlier, it is possible to suggest some of the potential agencies. For the bulk loan arrangement, two NGO linked models have been suggested. For the first, multi-tiered intermediation, FTCA or source of its regional associations already have the appropriate structure in place. Other NGOs like SPARC and Sharan also have nascent arrangements aimed at similar models. On the other hand Vikas, in Ahmedabad has also developed a similar proposal but lacks the grass roots base as yet. An NGO like AVAS has considerable strengths on the housing front and needs to be supported to develop financial systems. For the second model with single-tiered intermediation, there are two NGO linked financial institutions, namely the SEWA BANK and the Community Savings and Loan Association of the BCC.

The different NGOs will, however, require considerable efforts to meet certain prerequisites like legal registration, developing a plan of operations, mobilizing funds for DRF and most importantly compilation of essential financial reports. Such assistance would also be helpful in enabling the other smaller NGOs with nascent arrangements to become a part of the downmarketing strategy.

Similarly, the HFIs will also need to make considerable adoptions in their lending procedures. Specifically, they will have to extend the concept of bulk lending to CFIs. Most HFIs at present use this concept for lending to the corporate sector in any case. Secondly, they will also have to design new lending instruments (especially for non-mortgage lending) and evolve suitable financial guidelines for these linkages.

For identifying the specific cooperative institutions without the NGO linkages, it will be necessary to work in liaison with the Federations of Cooperative institutions as well as the state and district level Registrar of Cooperatives and State and District Central Cooperative Banks.

CONCLUSION:

The growth of housing finance system in India in recent years has not been accompanied by significant downmarketing. The downmarketing strategy as outlined above is cast in a pareto optimal mould, as the benefits accrue to both the sides; the HFIs developing a commercially viable expansion of their markets and the low and moderate income households gaining access to housing finance which has largely illuded them so far. An additional benefit in this process will also be a further strengthening of the different forms of Community Finance Systems in the country and their integration with the general financial systems in the country in the coming years. These efforts, however, require careful design, the will to innovate and improve from 'learning by doing' and above all the readiness to respond to the constraints of the partners in a positive manner in these partnership experiments.

ANNEXE 1

PROJECT LOANS FOR COMMUNITY INFRASTRUCTURE

Many of the settlements inhabitated by the low and moderate income households suffer from severe infrastructural deficiencies. However, financing improvements in the community level infrastructure poses at least three problems. First, in many cases, the land titles are not clear. Thus, though there maybe implicit security of tenure, formal legal tenure may not be possible. Often, the public authorities allow the settlement to exist, but authorization can take a long time as it is linked to political influences and would imply financial commitments to provide basic amenities through subsidies. Secondly, as a concomitant of this process, the households/communities from these settlements expect to receive subsidies at some stage and therefore, would prefer to wait for these. Even when there is an ability to pay for these services through loan finance, this is not availed of or it is difficult to access this finance due to the land tenure problems. Thirdly, the finance for this purpose would require to be made on a community/group basis as the investments have to be made on a joint basis also. The second envisaged financial linkage of a Project loan for community infrastructure attempts to overcome some of these problems.

Essentially two forms of organizational linkages are envisaged. In the first case, the involvement of the public agency is included in case the freehold tenure is not available. The advantage in this would also be that the community can pool the resources from the subsidies of the public agency with the loan resources and it becomes possible to finance without freehold tenure. In the second model, the arrangement maybe directly with a CFI. In this arrangement, the loans maybe given for the settlements without the tenure also. However, in this case, the size of the DRF will be higher to cover at least a part of the bad debt risk also.

Table A.1
Delinquency Risk Fund - Approach to Measures

Total loan Amount (Rs) (L)	100,000
Rate of Interest (%) (I)	20
Repayment Period (R)	12
Recovery Rate (% to demand) (RR)	60

Year (t)	Required annual debt servicing (ADS)	Total Demand (D)	Actual Collection (C)	Shortfall to be met from DRF (SH)
1	22039	22039	13224	8816
2	22039	30855	18513	3526
3	22039	34381	20629	1411
4	22039	35792	21475	564
5	22039	36356	21814	226
6	22039	36582	21949	90
7	22039	36672	22003	36
8	22039	36708	22025	14
9	22039	36723	22034	6
10	22039	36728	22037	2
11	22039	36731	22038	1
12	22039	36732	22039	0
			Present value of shortfall to be met from DRF at discount rate (12 %)	13713
			DRF as % of loan	13.7

1. Required Annual Debt Servicing (ADS) = L
2. Total Demand (D_t) = $ADS_t + SH_{t-1}$
3. Annual Collections (C_t) = $D_t * RR / 100$
4. Shortfall in Collections (SH_t) = $D_t - C_t$

ANNEXE 2

EXPLANATIONS FOR TERMS IN THE REPORT

Non Governmental organization (NGO) :

A generally registered legal entity which is set up on the principle of non profit and/or cooperation amongst its members to carry out developmental activities in either low income communities or for promoting and supporting the other such agencies or CFIs. Most NGOs are registered under an appropriate Act like the Cooperatives Act, Societies registration Act, Public Charitable Trusts Act or Section 25 under the Companies Act. Most NGOs also receive grants from national or international agencies or the government for carrying out their activities.

Community Finance Institution (CFI) :

A registered or unregistered agency primarily dealing with savings and credit activities with direct participation and control by a 'community' which maybe based in a neighbourhood or a collection of individuals at the place of work or based on a certain characteristic like occupation or common geographic origin. The CFI may be developed by the community itself or be promoted through the efforts of an NGO or governmental agency.

The CFI may be either a primary institution with members coming directly from the community or an apex institution which offers financial services to the member primary CFIs. The CFI can also mobilize external resources as permitted by its legal form.

Some of the CFIs arenot registered and continue to operate on an informal understanding amongst the members, though even these generally have a fairly systematic though flexible set of procedures. The others which are registered are generally under an appropriate Act like the Societies Registration Act, Cooperative Act (as a primary non agriculture society or a primary cooperative bank) or as a non profit development corporation under section 25 of the Companies Act.

Primary Non-Agricultural Society (PNAS) :

Within the cooperative structure in the country, there are two primary cooperative financial institutions which operate in the urban areas, the primary cooperative banks and the primary non-agricultural cooperative credit societies (PNASs). As a large proportion of these institutions are in the urban areas, they are also referred to as Urban Credit Cooperative Societies (UCCSs). There are basically two types of credit societies, namely the Employees' (or Salary Earners') Credit Cooperative Societies (ECCSs) and the other Urban Credit Cooperative societies (UCCSs). The ECCSs are organized at the place of work and enable payroll deductions. The UCCSs are organized by a group of individuals coming together on the basis of place of residence, geographic origin or caste. Both of these are controlled/regulated under the respective State Cooperative Acts. They are regularly audited by the Registrar of Cooperatives.

Urban Cooperative Banks :

Urban Cooperative Banks are also organized under the State Cooperative Acts. They are, however, also controlled/regulated by the Reserve Bank of India. Many of the PNASs graduate to become a UCB. They essentially operate as a Savings bank. They play a significant role in financing the household and the small enterprises sector. They also offer many banking services. They are regularly audited by the Registrar of Cooperatives.

REFERENCES

Achwal, Madhav (1979), *Voluntary Agencies and Housing*, UNICEF, New Delhi.

ASAG, (1987), *Information Programme on the Role NGOs and Community Based Groups Active in Human Settlements Projects in Asia*, ASAG, Ahmedabad.

Census of India, (1991), *Housing and Amenities Statistics.*

CSO, (1993), *National Accounts Statistics - 1993*, Government of India.

Economic Times, (1994a), News item on *RBI chief for change in banking framework*, 18th, March.

Economic Times, (1994b), Editorial on *Poverty of the Rich*, 1st. May.

FTCA, (1993a), *Statistical Information of Member Thrift Cooperatives of RATCs as on 30th Nov 1993*, FTCA, Hyderabad, mimeo.

FTCA, (1993b), *4th Annual Report*, 1992-93.

FTCA, (1993c), *Loan Document for Central Finance Facility*, FTCA, Hyderabad, mimeo.

Gautam, A. (1988), *Housing Finance Amongst Low Income Groups*, Unpublished Thesis, School of Planning, Ahmedabad.

Gupta, D.B., Kaul, S. and Pandey, R. (1993), *Housing and India's Urban Poor*, Har-Anand Publishers, New Delhi.

Jhabvala, R. (1992), *Access of Poor to Urban Land: An Experience of Self-Employed Women's Association*, SEWA, Ahmedabad, mimeo.

JPS Associates, (1993), *Baseline Financial Profiles of Housing Finance Companies in India*, New Delhi.

Karvekar, S., (1991), *Towards an Appropriate Housing Finance System - A Case Study of Vadodara*, Unpublished Dissertation, School of Planning, Ahmedabad.

Mehta, M. and Mehta, D., (1989), *Metropolitan Housing Market: A Study of Ahmedabad*, SAGE Publications, New Delhi.

Mehta, M. and Mehta, D., (1991), *Towards Appropriate and Affordable Housing Standards*, Report for the National Buildings Organisation, School of Planning, Ahmedabad.

Mehta, M. and Mehta D., (1992), *Housing Finance Systems in Medium Sized Cities in Gujarat*, Report for the National Housing Bank, School of Planning, Ahmedabad, mimeo.

NAFCUB (1992a), *Statistical Profile of Primary Non-Agriculture Credit Societies, NAFCUB*, New Delhi.

NAFCUB (1992b), *Statistical Profile of Primary Urban Co-operative Banks, NAFUB*, New Delhi.

NIUA, (1991). *Informal Sector Housing Finance*, Report submitted to the National Housing Bank, NIUA, New Delhi.

NIUA (1992), *Alternative Institutional Arrangements for Slum Improvement: The Case of Ekta Vihar*, NIUA, New Delhi.

NIUA (1994), *Downmarketing Housing Finance through Community Based Finance Systems*, Report submitted to the Indo-USAID Housing Finance Expansion Programme, New Delhi, mimeo.

RATC, Hyderabad, (1993a), *Loan Document for Mutual Assistance Scheme*, Hyderabad, mimeo.

RATC, Hyderabad, (1993b), *Annual Report, 1993.*

RATC, Hyderabad, (1993c), *Model Rules for Mutual Assistance Scheme*, Hyderabad, mimeo.

RBI, (1993a), *RBI Bulletin, October 1993.*

RBI, (1993b), *RBI Bulletin, November, 1993.*

SEWA, (1988), *SEWA in 1988*, SEWA, Ahmedabad.

Sisodia S.S., (1993), "Non-Agricultural Cooperative Credit in India", Paper for the VII International Reiffeigen Cooperative Seminar, Bangkok, mimeo.

Struyk, R.J. and Raviez R.M., (1992), *Housing Finance in LDCs: India's National Housing Bank as a Model?*, The Urban Institute Press, Washington, D.C.

Sivashanmugham, M. and Ahmed, Istiyak, (1988), *Role of NGOs in the Shelter Process of Low Income People with Special Emphasis on Housing Finance: The Case of DCA*, IHSP, HSMI, New Delhi.

Veld, H.O., (1993), *Federation of Thrift and Credit Associates, An Evaluation Report*, mimeo.

VIKAS (n.d.) *Habitat Development Fund*, VIKAS, Ahmedabad, mimeo.