# Developing a Housing Microfinance Product: The First Microfinance Bank's Experience in Afghanistan

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# Abbreviations

| | |
|---|---|
| AKAM | Aga Khan Agency for Microfinance |
| AKPBS | Aga Khan Planning and Building Services Pakistan CTA |
| CTA | Construction Technical Assistance |
| FMFB-A | First Microfinance Bank of Afghanistan |
| GI | Galvanized Iron |
| HF | Housing Finance |
| HIL | Home Improvement Loan |
| HMF | Housing Microfinance |
| IFC | International Finance Corporation |
| KFW | German Development Bank |
| LO | Loan Officer |
| MCB | Mortgage and Construction Bank |
| MENA | Middle East and North Africa |
| MFI | Microfinance Institution |
| MISFA | Microfinance Investment Support Facility for Afghanistan |
| NGO | Non-governmental Organization |
| PAR | Portfolio At Risk |
| SWOT | Strengths-Weaknesses-Opportunities-Threats |
| USAID | U.S. Agency for International Development |

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# Executive Summary

The objective of this case study is to document an example of the successful design and implementation of housing microfinance (HMF) products by analyzing the approach taken by the First Microfinance Bank of Afghanistan (FMFB-A) from 2009 to 2013. This report aims to encourage other lenders to follow suit and offer housing-related loans to low-income earners. It is part of IFC's MENA Microfinance Knowledge Management project, which aims to raise awareness among microfinance institutions (MFIs) about the importance of risk management, product development, and transformation.

FMFB-A was established in 2003 with the mission to reduce poverty and promote financial inclusion by providing its clients with access to financial services. Shareholders of FMFB-A are the Aga Khan Agency for Microfinance (AKAM), Aga Khan Foundation USA, the German Development Bank (KfW), and the International Finance Corporation (IFC). FMFB-A has a nation-wide presence in Afghanistan and serves over 53,000 clients with an outstanding portfolio of $64.5 million (as of March, 2015). Housing finance accounts for about 17% of its total portfolio (about $8 million as of December 2014). FMFB-A is currently the only MFI in Afghanistan that offers a housing microfinance product.

FMFB-A implemented a rigorous, albeit flexible, approach to the roll-out of its HMF products in Afghanistan. The idea to develop an HMF product at FMFB-A started in 2007 as a response to client demand. Its aim has been to increase access to housing microfinance for Afghanistan's low-income households in urban and rural areas. It also sought to improve the quality of housing for this segment by offering construction technical assistance (CTA) services.

The launch of the HMF product offering was organized in three phases.

1. Phase I – Market research and product design (2007-2008). As FMFB-A was the first lender to launch HMF products, detailed market research was vital to developing its offerings. Additionally, FMFB-A conducted an internal capability evaluation.

2. Phase II – Pilot test of the newly-designed HMF product in select branches (2008-2009). Four branches were selected to test the product design. FMFB-A then refined the initial product offerings and adjusted its business plan.

3. Phase III – Consolidation and expansion of the national roll-out strategy (2011 – 2013). After the successful launch of the HMF product in urban areas, FMFB-A developed a rural product and moved into rural geographies along with the introduction of CTAs. However, prior to that, additional market research was done to understand the clients' needs and also the demand for CTAs in rural areas.

## The factors critical to FMFB-A's success included:

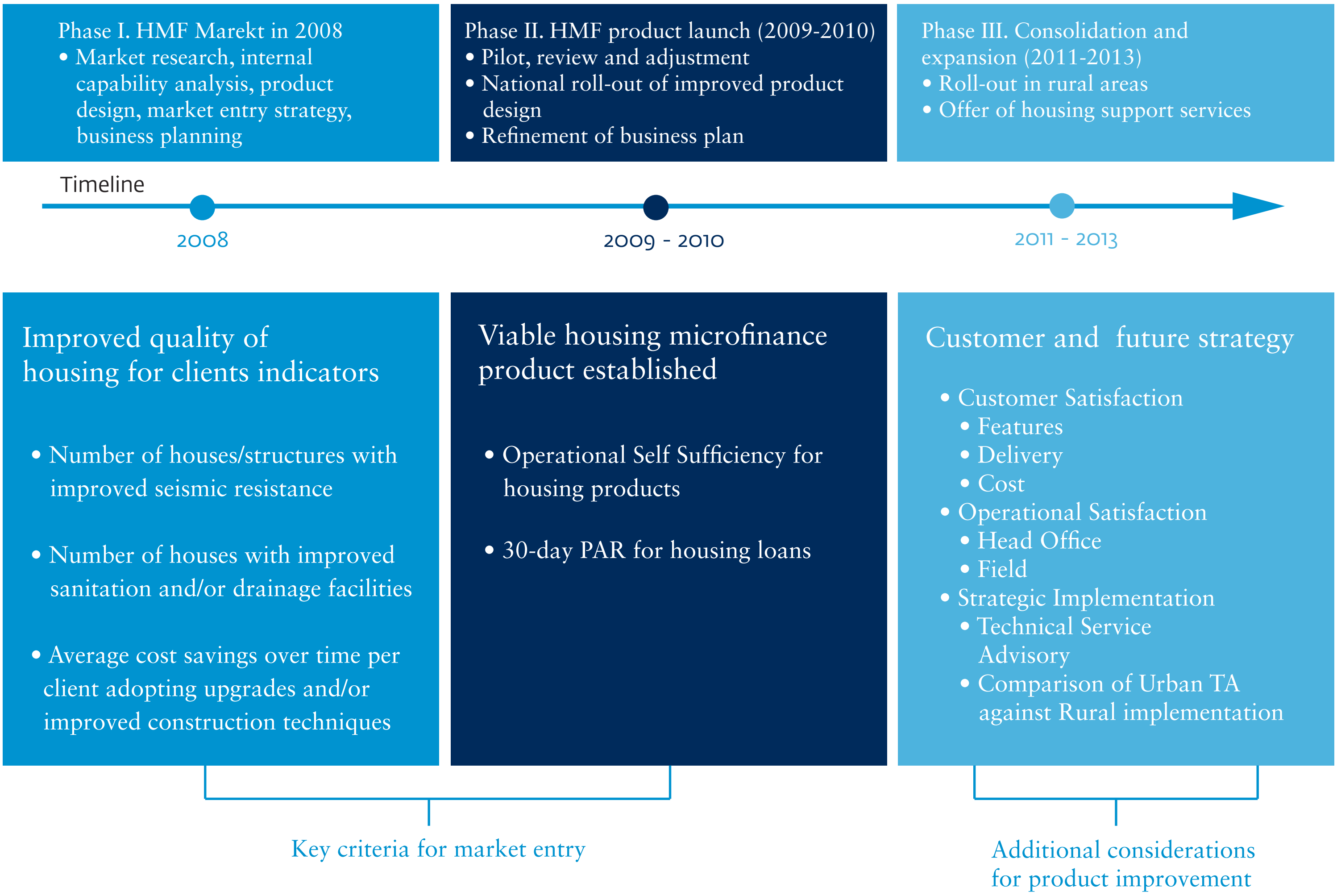
- Thorough market research and an internal review, which allowed the institution to better understand the dynamics of Afghanistan's housing market and FMFB-A's own capabilities;

- Appointing an "HMF product champion" whose primary responsibility was to manage this process;

- Conducting a critical review of the pilot,which helped hone the HMF products and FMFB-A's marketing approach.This review allowed for a successful national roll-out in the first year; and

- Continuous review of the performance of the HMF products by management. FMFB-A's management has measured the success of the HMF product development process by using the indicators captured in Chart 1.

**Chart 1 Evaluating FMFB-A's Success in Rolling-out HMF Products**




*Source: FMFB-A, authors*

Following the market assessment, the goal of the first phase was to design a product that catered to the needs of low-income earners in the informal sector and also allowed for a return. It was also important that the HMF products were well integrated with the existing organizational set-up. The pilot assisted in verifying whether the proposed offerings complied with these criteria. Key indicators to measure the success were operational self-sufficiency and better housing conditions for borrowers.

The goal of the second phase was to develop a new product and tap into new market segments so that FMFB-A could maintain its competitive edge and meet the needs of its rural clients. At that time, FMFB-A actively offered CTA services to its clients to increase the value of its HMF products. Key indicators to measure the roll-out progress were customer and staff satisfaction as well as continued operational sustainability and profitability.

Following this strategy, FMFB-A has managed to improve housing conditions for the Afghan people in the areas where it is operating. It has also successfully developed a replicable and scalable HMF model. Within five years, its portfolio grew from $500,000 to $11 million. FMFB-A also increased its share of female borrowers while portfolio quality, measured by PAR ratios, remained at the levels FMFB-A recorded for its micro loans. It is likely that FMFB-A will play a leading role in the Afghan HMF market for the foreseeable future.

## Lessons learned from FMFB-A's experience

a. First-mover strategy wins time, financial resources, and market recognition. With no existing competitors in the HMF sector, FMFB-A entered the market with a "first-mover" advantage. Being the first provider of HMF loans allowed FMFB-A to meet customer needs, acquire superior brand recognition, and build customer loyalty. It also gave the lender time to perfect its products and services.

b. Product design should be based on market demand, a client needs assessment, and an internal capacity evaluation. Before rolling out the HMF products and before launching its construction technical assistance, FMFB-A conducted market surveys, which were used to design the product prototype. The pilot was used to refine product features and marketing strategies for further roll-out. FMFB-A exerted extensive effort to understand the market demand for this product

c. A critical review of the pilot project can ensure a successful national roll-out. During the pilot review, FMFB-A learned that some product features required changes before a national roll-out could be considered. For example, the loan size sought by customers was higher than FMFB-A initially projected. This experience of "testing the water" provided valuable insights into the market and FMFB-A's internal capacity. That was instrumental in tailoring products to customer needs and strengthening internal infrastructure to prepare for the product expansion.

d. A concise marketing strategy is key to customer outreach. When a product is not well known, the choice of a marketing strategy is key to ensuring broad customer outreach. Marketing strategy, both internal and external, should be tailored to the characteristics of the targeted audience in order to achieve maximum effectiveness.

e. Offering CTA services can increase customer satisfaction and enhance loan quality. FMFB-A found that construction costs in Afghanistan were rising and many clients were unaware about how to build safely. So, it advised home owners on construction techniques, building materials, sanitation, ventilation, energy efficiency, and ways to prevent earthquake damage. Combining the loan offering with construction technical assistance helped raise awareness about safe construction, reduced future repair costs, and potentially improved the quality of the loan.

f. A scarcity of qualified staff requires strategic internal capacity building and a smart allocation of talent. In order to build up in-house technical expertise, increase outreach to female customers, and maintain staff skills, FMFB-A had to deploy its employees strategically to maximize resource utilization. It made a conscious effort to recruit more female loan officers, and offered continuous training.

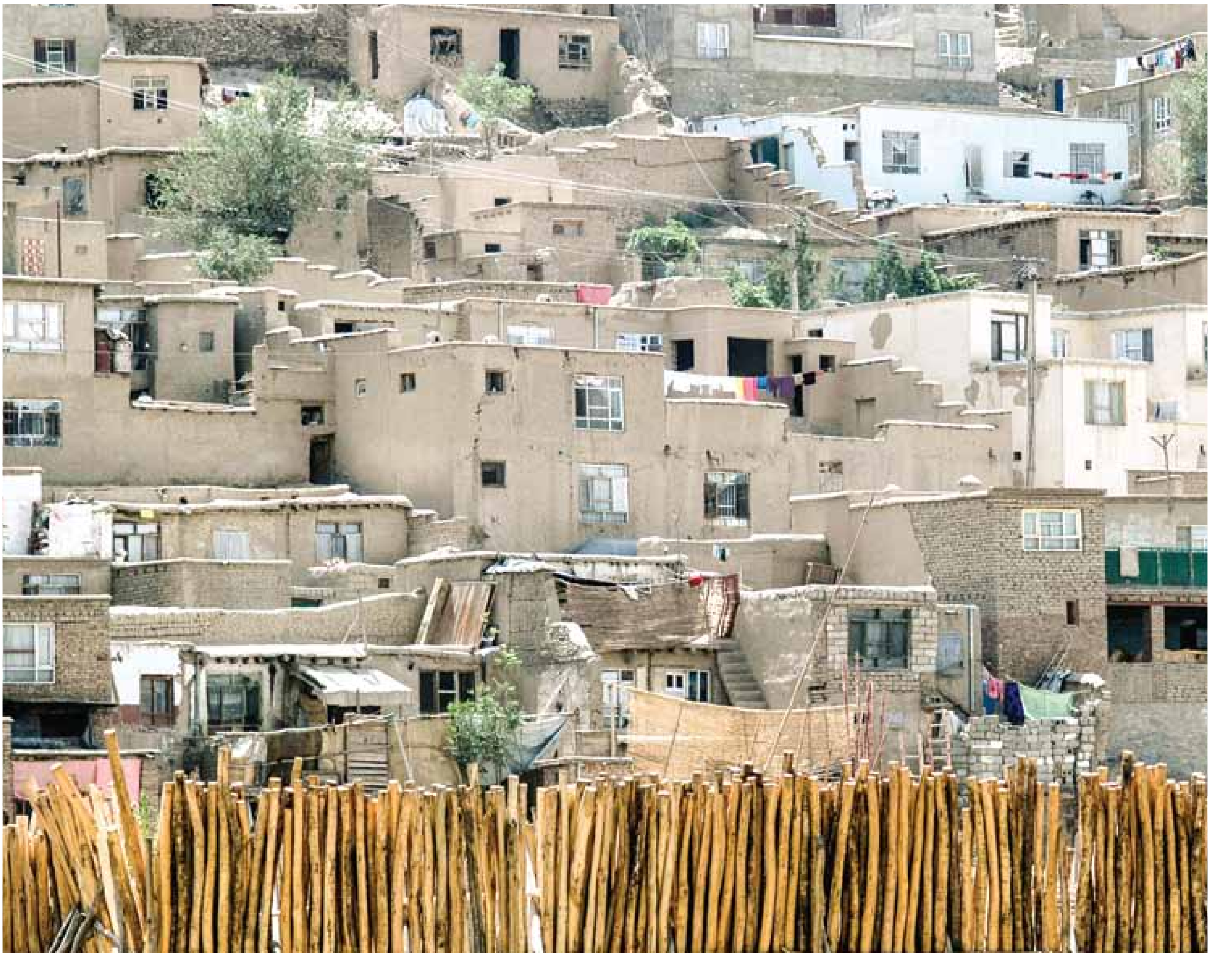
# A. Background and Context

The First Microfinance Bank of Afghanistan (FMFB-A) was established in 2003 with the mission to reduce poverty and promote financial inclusion by providing its clients with access to financial services. It has been supported with the financial and technical resources from multiple international development agencies, such as the Aga Khan Agency for Microfinance (AKAM), International Finance Corporation (IFC), the German Development Bank (KfW), and the U.S. Agency for International Development (USAID).

Over the years, FMFB-A's operations have grown from a single credit product to finance the short-term needs of microenterprises to more diversified offerings reaching an ever-broadening segment of beneficiaries. Seeking to increase the availability of quality housing to low-income earners, FMFB-A successfully developed, launched, and operated a housing microfinance (HMF) product line coupled with construction technical assistance. To date, FMFB-A is the only financial institution in the country to offer HMF products, which are now available in 21 urban and six rural branches throughout Afghanistan.

This case study presents FMFB-A's experience in developing and implementing HMF products and covers the period from 2008 to 2013. It aims to provide guidance to other lenders on how to offer such products.

The case study provides an overview of the economic environment in Afghanistan and looks at the housing and housing finance markets.Then, it focuses on FMFB-A's product development and implementation process from pilot, to roll-out, to expansion. The last section summarizes the key lessons learned by FMFB-A, which may provide guidance to microfinance institutions in other regions that are considering HMF products.



# B. Afghanistan's Housing Challenges at the Outset of the Project

At the outset of the project, in 2008, Afghanistan was characterized by the following features:

## 1. A stabilizing economy

After more than three decades of wars, internal conflicts, and violence, Afghanistan was left in tatters. However, thanks to foreign aid and some political stability, the economy had slowly begun to recover. In 2008, GDP grew by 3.6 percent and in 2009 by 21 percent. Despite that, structural conditions for sustainable growth were largely absent and the challenges remained significant. Afghanistan remained one of the poorest countries in the world with a per capita GDP estimated at only $325 and its social indicators were some of the lowest in the world. While economic growth rates were high, approximately 80-90 percent of economic activity was estimated to be informal, human capital was poorly developed, and the bulk of investment and development activity, as well as a large portion of recurrent expenditures, were still financed through international aid.[1]

**Table 1. Key Population Indicators**

| | |
|---|---|
| **Population** | 27 million (2008) |
| **Population growth rate (average annual)** | 3.4% (2001 – 2008) |
| **Population aged 0-14** | 49% (2008) |

*Source: World Bank*

## 2. An underdeveloped financial sector

At the outset of the project, the formal financial sector in Afghanistan was underdeveloped and very fragile. The microfinance sector was characterized by rapid growth with weak institutions, which eventually led to a repayment crisis in 2008. The crisis was a result of rapid client outreach, which had come at the expense of proper due diligence in lending, compliance with internal control processes, and internal monitoring of performance. In addition, although the banking sector appeared relatively stable at the time, a few years later, it suffered from the Kabul Bank crisis[2] , which was a byproduct of inadequate supervision by the country's central bank. Given this weak financial landscape, access to financial services for the Afghan population was and remains rather limited. At the individual level (in 2008), only 9 percent of those aged 15 and above have an account with a formal financial institution[3] . Similarly, only 3.4 percent of firms in Afghanistan hold a bank loan or a line of credit and only 1.4 percent of Afghan firms use banks to finance their investments[4] .

[1] *C. Ward, D. Mansfield, P. Oldham and W. Byrd, Afghanistan – Economic Incentives and Development Initiative to reduce Opium Production, World Bank and DFID, February 2008, p. 1.*

[2] *Kabul Bank held about one-third of the of the banking system's assets of $4 billion. The government had to shoulder $825 million for the cost of the lender-of-last-resort facility loans that covered the deposit guarantee. Kabul Bank was subsequently put into receivership, revoking shareholders' rights altogether. The bank's deposits and good assets were then transferred to a bridge bank, New Kabul Bank, whose privatization is ongoing.*

[3] *Global Findex Data, 2011*

[4] *World Bank, 2008*

## 3. A significant housing gap exacerbated by a weak enabling environment

In 2008, the housing market was characterized by large unmet demand, a severely damaged housing stock, few new affordable housing developments and, as a result, a massive expansion of informal settlements. Table 2 provides some key data on the housing and housing finance sectors in Afghanistan in 2008.

**Table 2. Key Indicators of the Housing and Housing Finance Sectors in Afghanistan**

| | |
|---|---|
| **Number of people living in urban areas (percentof total)** | 23 percent(2008) |
| **Housing deficit** | 1 million units (2006);<br>1.5 million units (2014) |
| **Mortgages/GDP** | < 1 percent |

There was a large demand for housing for several reasons:

- Population growth and rapid urbanization created huge demand for housing in urban areas. Since 2001, the country had experienced a steep rise in its population and most of the growth had happened in urban areas. and in certain provinces: Kabul, Herat, Nangarhar, Balkh, and Kandahar. By 2008, about 23 percent of the Afghan population lived in urban areas[5]. Attracted by improved employment prospects, people were moving to cities and district towns. For example, in Kabul, where an estimated 700,000 returnees had settled since 2001[6] , the population grew by 15 percent a year between 1999 and 2002. It would continue to grow by at least 5 percent a year as a result of migration and natural growth[7].

- The relatively high percentage of young people also created a high demand for housing. With the youngest population in the world – an estimated 57 percent under the age of 18[8] - the demand for housing was expected to increase further as these young people began to seek jobs and start families in cities.

- The increase in the return of refugees from the Islamic Republic of Iran and Pakistan, estimated at about 6 million, aggravated the housing problem in Kabul as well as other large cities, such as Jalalabad, Mazer-e Sharif, and Kandahar.

On the supply side, most of the housing stock was damaged or destroyed in conflicts or Afghanistan's frequent earthquakes. In addition, Afghanistan suffers from a lack of building codes and appropriate construction material. Since a construction industry had barely existed in the country, most of the materials had to be imported, making houses more expensive.

In urban areas, the housing shortage led to an expansion of informal settlements with no access to basic services (see Figure 1). It was estimated that 75- 80 percent of homes were without access to water[9]. A World Bank assessment in Kabul showed that informal settlements provided shelter for 80 percent of the city's population (2.44 million people), covered 69 percent of its residential land, and with the land value excluded, represented fixed private capital investment of $2.5 billion[10]. It was also estimated that in the informal settlements (legal and illegal) of Kabul, with mostly self-constructed dwellings, more than two-thirds of houses were occupied by more than one family. A study by the Aga Khan Trust for Culture reported that almost 9 out of 10 families in informal housing lived in only one or two rooms[11].

[5] *Ministry of Economy, 2005.Population Census of 1384. Kabul.*

[6] *UNHCR (United Nations High Commissioner for Refugees), Statistics Division; Pakistan, Population Census Organization; and Pakistan, Ministry of States and Frontier Regions, 2005. Census of Afghans in Pakistan, 2005. Islamabad: United Nations High Commissioner for Refugees.*

[7] *World Bank, 2005. Kabul Urban Land Crisis: A Summary of Issues and Recommendations. Kabul Urban Policy Notes Series, no. 1. Energy and Infrastructure Unit, South Asia Region, World Bank, Washington DC.*

[8] *Islamic Republic of Afghanistan, 2005. Interim Afghanistan National Development Strategy: An Interim Strategy for Security, Governance, Economic Growth and Poverty Reduction. Vol. 1. Kabul.*

[9] *S. Farhan Fasihuddin, Housing Microfinance Capacity Building in Afghanistan, Presentation given at FinNet Meeting 2011.*

[10] *World Bank 2005. Why and How Should Kabul Upgrade Its Informal Settlements? Kabul Urban Policy Notes Series, no. 2. Energy and Infrastructure Unit, South Asia Region, World Bank, Washington, DC.*

[11] *Aga Khan Trust for Culture. 2006. Baghe Babur &GozarGah Area Survey Initiative, Preliminary Report. Historic Cities Program, Kabul*

Despite the enormous need for housing, only a few new housing developments were under way. Housing initiatives were subsidized through free land allocation and were not targeted at those who needed housing support most. Instead, they were directed at middle-class residents with businesses or salaried employment. The price of housing was further exacerbated by costly imported materials, unskilled labor, and a lack of low-income housing developers.

A poorly functioning and inappropriate legal and regulatory regime had prevented financial institutions from entering the housing finance market. Given the lack of bankable titles and an efficient land administration, lenders faced difficulties inregistering mortgages. Women faced particular challenges in gaining ownership of or title to property. The typical way for a woman to obtain home ownership was through inheritance. As men were typically the legal holder of the property, access to finance was restricted for women, especially in cases where lenders required property as collateral[12].

In addition, it was not possible to foreclose on a property without court orders and these proceedings took a very long time. Limited knowledge of housing finance products and restricted access to long-term liquidity in local currency were other important constraints. As a result, the housing market represented for lenders an overly risky proposition.[13]

## 4. A pent-up demand for housing microfinance

As conventional mortgages were not available in Afghanistan the vast majority of the population relied on informal sources for their housing finance needs. As much as 70 percent of the world's population access shelter through "incremental building", a process of slowly improving shelter by adding components of a house. This process of incremental building leads many clients of microfinance institutions to divert business loans for this purpose. This reinforces the fact that there is demand for housing microfinance products.

Unlike traditional mortgages, housing microfinance relies on not only the property as collateral (given that there is often uncertainty surrounding title), but also on an assessment of the client's creditworthiness that takes into account the incremental building approach.

Given the country's severe housing shortage and large size of informal settlements, as well as the challenges facing the development of the formal mortgage market, this micro-lending approach, which specifically targets home improvements and basic construction, was a more feasible vehicle to provide much-needed finance to low-income groups. Moreover, the microfinance sector had a comparative advantage of a country-wide branch network as well as experience in handling borrowers with informal income sources. HMF also provided an opportunity to improve access to finance for female borrowers as loans could be granted, using title deeds as collateral which belonged to their husbands or close relatives.

As mentioned earlier, up until 2008, no MFI offered specific HMF products. However, the size of the unofficial HMF market was estimated at about $21 million to $27 million, although the actual demand may well have been much larger. The World Bank estimated that if 50 percent of the 325,333 homes in the informal sector in Kabul needed improvements costing $750,[14] the potential market for home improvement would have been about $122 million. Provided people would borrow about 50 percent of the required amount, the potential total loan volume at the time would be about $61 million.

### The Afghan Microfinance Sector

The microfinance sector in Afghanistan had been growing significantly in recent years. In 2003, the Microfinance Investment Support Facility for Afghanistan (MISFA) was established as an apex institution with the primary objective of promoting microfinance lending and entrepreneurship. MISFA currently supports five microfinance institutions, including FMFB-A, operating in 23 provinces and 111 districts.

While financial services are expanding, these institutions have yet to broaden their offerings to meet new demand, including an appetite for housing finance and mid- to long-term loans.

At the end of March 2008, the Afghan microfinance industry recorded over 303,000 active borrowers, served by 19 MFIs with an outstanding portfolio of $192 million (IFC's Consolidated Microfinance Database, 2014).

[12] *S. Narain, 2006. A Gender Strategy for the First Microfinance Bank, Afghanistan. Gender Entrepreneurship Markets (GEM) Initiative, IFC, Washington DC.*

[13] *World Bank and IFC, 2008. Housing Finance in Afghanistan: Challenges and Opportunities. Washington, DC.*

[14] *World Bank and IFC, 2008. Housing Finance in Afghanistan: Challenges and Opportunities. Washington, DC.*

## 5. A greenfield market for housing finance

Despite the considerable demand for housing finance, no MFI had entered the market. When the management of FMFB-A considered the implementation of housing microfinance products in 2008, it was faced with the situation summarized in Table 3.

**Table 3. Incentives and Obstacles to the Introduction of HMF Products in Afghanistan**

| Incentives | Obstacles |
|---|---|
| Considerable demand for housing arising from increasing urbanization and a young, growing population | Weak legal and regulatory framework (especially in the areas of land administration and registration, and enforcement of liens) |
| Somewhat stabilized and growing economy | High cost of construction material; limited capacity in the construction industry |
| Significant potential demand for home improvement and incremental construction | Continued violence and insecurity in certain areas of the country |
| Better understanding of financial needs of low income earners at MFIs | Lack of longer-term funds in local currency |

To launch HMF products successfully, FMFB-A needed to develop a thorough understanding of the demand for housing finance products. FMFB-A management considered conducting a detailed market assessment to identify the potential and effective demand.

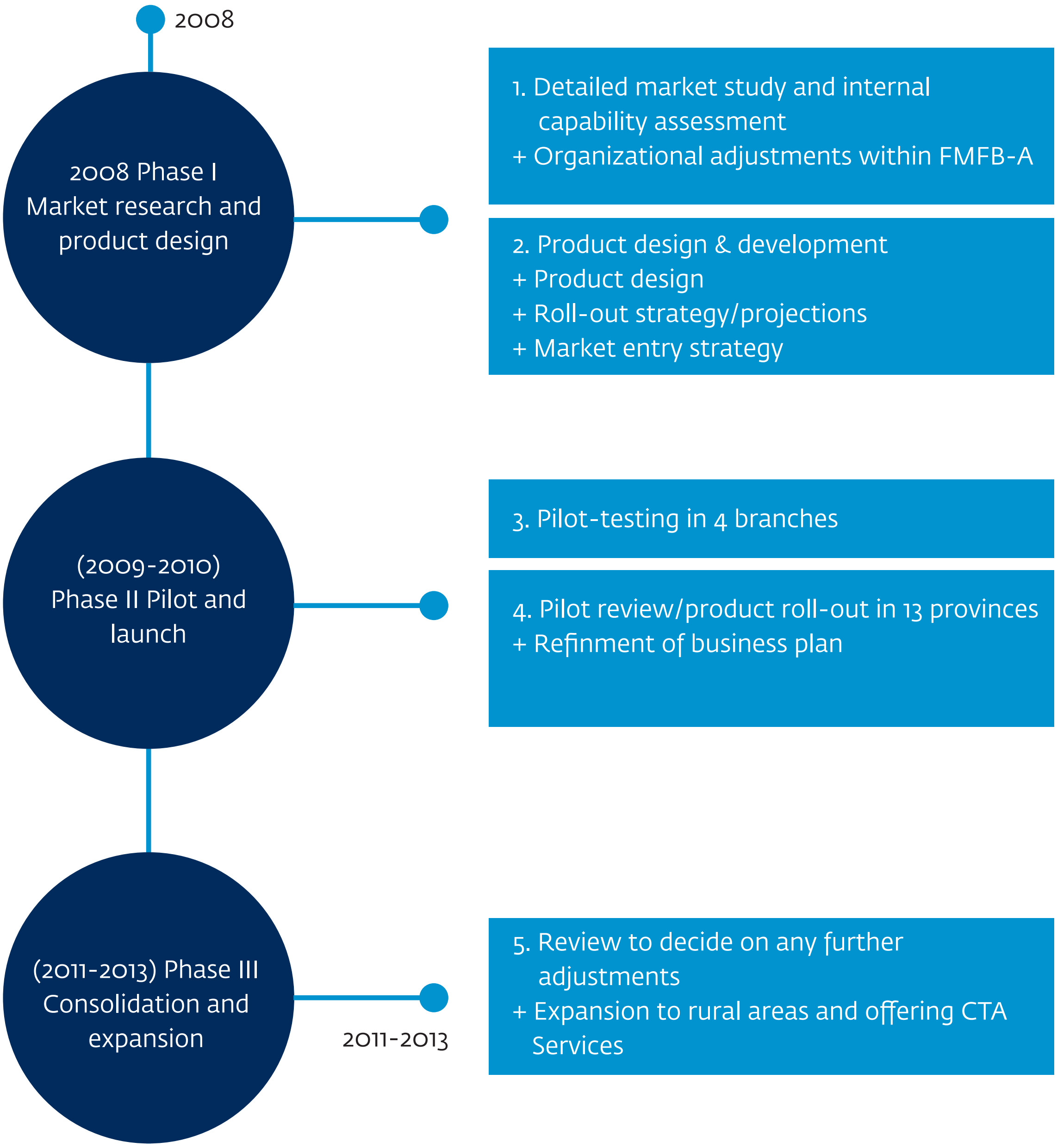
In general, effective demand for housing finance products can be deemed to exist if the following criteria are met: i) there is a need for habitat improvements, upgrading, incremental building, etc. in the communities where the targeted population lives (i.e. potential demand); and ii) potential borrowers demonstrate the willingness to borrow to complete these improvements and they can afford the loan (i.e. effective demand). Other important factors to consider are sufficient ability among staff members to process HMF loans, effective guarantee mechanisms to limit risks, lending methodologies and policies designed for high-risk areas, and cost-effective ways to reach rural clients. FMFB-A needed to consider all these factors before venturing into the housing finance space.

# C. FMFB-A's Strategy to Enter the Housing Finance Market

The development of an HMF product at FMFB-A began in 2008. USAID, AKAM, AKF, IFC, and KfW assisted FMFB-A management in the design of a market entry strategy, the development of HMF products, and the launch of new offerings. The process was organized in three distinct phases, which are described in further detail below and illustrated in Chart 2.

- Phase I – market research and product design (2007-2008).
- Phase II – launch of HMF product at FMFB-A through pilot-testing and the refinement of the roll-out plan and business projections (2009 – 2010).
- Phase III – consolidation and expansion of the national roll-out strategy (2011 – 2013).

**Chart 2. Implementation Process to Launch Housing Finance Products at FMFB-A**



# D. Phase I – Market Research and Product Design

## 1. Detailed market and design study

A detailed market assessment was commissioned by FMFB-A in late 2007 and completed in 2008. Its goals were to (i) identify the target clientele, (ii) determine the potential demand and the size of the market (effective demand), and (iii) determine affordability levels of the target segment. The market research allowed FMFB-A to gain clarity on the type of projects for which customers were likely to approach them for financing, and which later shaped the design of the product. The main findings of the research were:

- There was considerable demand for both home improvement loans (HIL) and new construction.
- No other lenders had entered the housing finance market in Afghanistan, which meant that FMFB-A would benefit from a first mover advantage.

## 2. Internal capability evaluation

The goal of this assessment was to identify the necessary organizational adjustments needed to introduce an HMF product within the organization and the costs of implementation. The evaluation took into consideration the following elements:

- Interest and willingness to expand into housing products;
- Financial and operational performance; and
- Funding and other resources needed for pilot implementation and scale up.

The proposed design for the housing finance products (especially the housing microfinance loan) largely built on FMFB-A's operations and capabilities. But there was a need to make a few adjustments in areas such as underwriting and loan administration (including servicing and collection), monitoring, risk management, and IT-infrastructure. FMFB-A also needed to develop a marketing approach and train staff members.

The results of the market research and the internal capability evaluation are summarized in the form of a SWOT analysis, which is depicted in Chart 3.

**Chart 3. Simplified SWOT Analysis of FMFB-A in View of Housing Finance Market Entry**

| Strenghts (S) | Weaknesses (W) |
| --- | --- |
| • Young and dynamic staff<br>• Well-developed standards and procedures<br>• Good reputation in market<br>• Wide branch network | • Insufficient capacities within staff to process housing loans<br>• Weak marketing and sales approach<br>• Level of client retention unclear |
| **Opportunities (O)** | **Threats (T)** |
| • No MFIs offer HMF products<br>• FMFB-A collects deposits<br>• Female borrowers are barely served by formal finacial institutions | • Weak legal framework<br>• Market potential could be much smaller than expected (low literacy rate, high levels of informal employment)<br>• Volatile environment |

The findings of the internal capability evaluation revealed that:

- FMFB-A's structure appeared well-equipped to take on the implementation of the HMF product offering;
- FMFB-A benefited from a wide branch network and good reputation in the market as it already offered a number of other loan products. Therefore, it seemed prepared to handle the implementation of an additional product with a longer tenor and higher loan amounts; and
- Staff members lacked the technical knowledge and sales skills needed for the housing product.

## 3. Product design

Based on the findings of the market research and internal capability evaluation, the HMF product features were determined for the pilot, as summarized in Table 3. FMFB-A management decided to keep maximum loan limits relatively low, set at $1,400, in comparison to business loans. This was also done to allow FMFB-A's management to gain a better understanding of client repayment patterns and to minimize the credit risk. It was projected that the average loan size would amount to $700.

In order to manage credit risk, the prototype design of the HMF product envisaged a linked savings component to reaffirm the assessed repayment capacity of the borrower, provide further collateral to the bank, and promote asset building with the client. A borrower was required to save for three months before requesting a loan. The amount saved was to be equal to three monthly payments and would be inaccessible to the borrower during the term of the loan.

**Table 4. HMF Loan Features at Pilot Stage**

| | |
|---|---|
| **Loan amount** | $100 – $1,400 |
| **Loan tenor** | 6 - 24 months |
| **Interest rate** | 2.08 percent per month on declining balance (25 percent p.a.) |
| **Eligibility** | - Afghan national<br>- Age between 18 – 65<br>- Entrepreneur or salaried employee |
| **Collateral** | - Personal guarantor<br>- Household assets<br>- Title deed |
| **Loan purpose** | - Improvement<br>- Extension<br>- New construction |

It was agreed that the loans could be used for either home improvement or construction to cover activities such as home repairs and upgrades, structural changes, new home completion, connection to basic utilities such as water and electricity, solar energy installation, house insulation, and hygiene improvements, such as septic tanks. The home was required to be the primary residence of the borrower or borrower's property within the jurisdiction of the FMFB-A branch where the loan was granted. Additionally, salaried employees who applied for a loan were required to open a current account at FMFB-A and to have their salary transferred into this account.

Disbursement of the loan proceeds was made in a single tranche to reduce time and administrative burden. FMFB-A was able to set this policy for two reasons: (i) the loan amounts were relatively small; and (ii) FMFB-A management believed that their underwriting methdologies are well enough developed to ensure the correct deployment of the funds. [15]

Finally, to strengthen their internal capability to deliver this product, management invested in building the capacity of their staff both in terms of housing finance and marketing skills.

## 4. Business and implementation plan (including market entry strategy)

The findings of the market research and the internal capability analysis were used by FMFB-A's management to develop a preliminary business plan, profit targets, as well as a cost and risk analysis (management of credit, interest rate and liquidity risk, as well as appropriate funding instruments). FMFB-A management considered this exercise critical to having a clear understanding of the investments necessary for a successful market entry as well as realizing the potential benefits of the HMF product offering. Setting measurable objectives was also viewed as pivotal to ensuring commitment of all staff to the new product.

The implementation plan outlined the steps and timeline necessary to implement the new products within FMFB-A's organization. It also identified the branches in which the pilot was to take place to test the new products. At the end of the pilot phase, the business plan and the implementation plan would be revised based on the results achieved during the pilot.

To ensure a smooth implementation process, management appointed an "HMF product champion" whose primary responsibility was to manage this process. He enjoyed the full support of management so that he was in a position to initiate the steps necessary for a successful product launch within FMFB-A's organization.

[15] *Disbursement is typically considered a tool to ensure that the funds are used for housing purposes. Often the interest rate offered is lower and/or the term is longer than for business loans. To avoid cannibalizing their business, MFIs need to ensure a correct deployment of the funds. The disbursement in several tranches linked with on-site visits could be one option. Another option is to transfer the money directly to the construction material provider or builder. This policy requires, however, arrangements with hardware stores and/or builders as well as the availability of a transfer mechanism to ensure a quick payment of small amounts to the beneficiaries.*

# E. Phase II – Pilot Test and Nation-wide Launch

## 1. Pilot Test

The goal of the pilot was to test the product in order to make adjustments before its nation-wide roll-out. It was decided to pilot the HMF product in four branches targeting parts of Kabul and Herat provinces. The pilot branches were selected according to the following criteria: (i) the proximity to the new target group; (ii) the availability of up to two staff members to dedicate time to more intensive marketing activities; and (iii) the ability to easily organize local marketing activities to attract new customers. The length of the pilot was fixed at nine months (from September 2008 to May 2009) The first loan disbursements were made in early 2009.

In preparation for the pilot, HMF policies were distributed to the branches and specific training sessions were held with branch managers and loan officers. A reference for the development of the policies and the review of the product design became IFC's Housing Microfinance Toolkit. Its objective is to provide guidance to lenders, investors, developers and policy makers on how to introduce HMF products and improve existing HMF offerings.

The toolkit also offers an orientation on operational practices and policies, including risk management and funding models as well as appropriate training methodologies, programs, and samples. It covers the whole value chain of the housing finance process, including marketing and customer service, underwriting (application processing, file building, and closing), funding, and loan servicing (collection, and file administration). IFC's HMF Toolkit[16] is geared towards emerging markets and takes into consideration the realities, constraints, and risks of these economies. A brief description of the toolkit is shown in Annex 1.

## 2. Results of the pilot phase

The review of the pilot involved both FMFB-A senior management as well as branch managers and loan officers (LOs) from the pilot branches. Table 5 provides a summary of the objectives set for the pilot and the results achieved. While the number of loans disbursed was below target, a higher average loan amount led to a higher than projected total loan portfolio size. Eighty percent of the loans were used to finance home refurbishments.

**Table 5. Planned Versus Actual Results for the Pilot Test**

| Criterion | Planned | Actual |
|---|---|---|
| Number of loans disbursed | 750 | 586 |
| Average loan size | $700 | $1,251 |
| Total loan portfolio size [17] | $452,000 | $552,000 |
| Portfolio at risk (PAR) > 30 days [18] | 2 percent | 1.2 percent |

*Source: FMFB-A*

The evaluations also showed that more than 90 percent of loans were disbursed to men. Outreach to female clients was lower due to a fewer number of female LOs participating in the pilot. After the completion of the pilot, a detailed review was undertaken. Table 6 shows a summary of the review. It also shows the actions which were initiated by FMFB-A management to improve the HMF product offering. The review concentrated on product design and institutional capacity to process the loans.

[16] *This toolkit was developed as part of the IFC's advisory activities at FMFB-A. The toolkit has now been updated and incorporates experiences and best practices from other emerging markets where housing microfinance offerings have been implemented.*

[17] *This number already includes repayments made during the pilot.*

[18] *PAR is a ratio of the unpaid principal balance of all loans with payment past-due over the total loan portfolio. It is a standard measure of portfolio quality in microfinance.*

**Table 6. Pilot Findings and Actions Taken**

| Item | Findings | Actions Taken |
|---|---|---|
| **Product Design** | | |
| Client Feedback | • Clients needed more money to finance the construction. | • Maximum loan size to be increased. |
| | • The pre-savings requirement was not popular with clients and was therefore removed. | • Restructuring of the savings requirement: 5 percent of the loan repayment to be channeled into a savings account. |
| Borrower Profile | • Higher defaults of those clients who took out a business and HMF loan at the same time. | • Introduce a maximum loan exposure (combined for all loans) of $5,000 for every client. |
| **Institutional Capacity** | | |
| Marketing Strategy | • Marketing is not effective: only 20 percent of branch staff in the pilot branches could explain the housing loan product to a potential client.<br>• Outreach to female clients should be improved. | • Redesign marketing approach.<br>• Recruit more female LOs. |
| Staff Capacity Building | • There was a shortage of analytical skills for loan appraisal.<br>• Technical evaluation in branches was done by LOs who received some orientation from technical officer (engineer) based at the head office. | • Detailed training modules to be developed and implemented for LOs.<br>• Technical evaluation module to be developed for technical appraisal. |
| Documentation | • Some information was missing in loan forms e.g. details of house to be improved, client's estimate of improvements, etc.<br>• Technical officer was unable to visit and appraise all requests. | • Forms to be revised to capture all pertinent information about proposed improvements.<br>• Staff to be further trained.<br>• Train deputy branch managers on technical appraisal. |

*Source: FMFB-A, Enclude*

## a. Feedback from clients

Feedback from clients was obtained through discussions during loan appraisal, loan disbursement, monitoring, and loan closure. There were no written responses as literacy levels among many clients were very low.

### Loan Size

Confirming what the market research had previously revealed, the pilot review noted that clients did in fact have the capacity to take larger loans than those initially proposed by management. Average loan size during the pilot was $1,251 against a projected average of $700[19]. Based on this analysis and feedback from the four pilot branches, it was agreed to increase the maximum initial loan size to 100,000 Afghanistan Afghanis (about $2,000) and the maximum for subsequent loans to 200,000 Afghanistan Afghanis ($4,000). There was no need to extend the loan tenor, which was up to 24 months.

### Savings requirement

The following was concluded from the pilot with regards to the savings requirement:

- Home improvement in Afghanistan occurred primarily within a six-month period from April to September. Requiring potential borrowers to save for three months caused many people to miss the season to repair/ complete their houses;

- The initial amount of savings itself was a hindrance to those who needed to do improvement as many of them did not have savings. However, they had operating businesses or were earning salary from jobs in government and private sector.

- As all other FMFB-A products did not require pre-loan savings, the housing loan was perceived by clients to be an expensive product compared with business loans.

In view of the above, management reduced the pre-loan savings period to less than one month and the initial savings amount to 150 percent of a monthly installment. Moreover, the mandatory savings requirement for loan eligibility was also removed. However, because the loan amount in most cases was not sufficient to do the improvement required, borrowers returned to the branches to request the release of their blocked savings to complete work on the house. At a pilot review workshop, the participants recognized the value of savings as additional collateral and as a means to encourage clients to build an asset base. To address the challenges above, it was proposed to change the savings requirement from pre-loan to ongoing where clients would deposit at least 5 percent of the loan installment monthly together with repayment of principal and service charge. Loan officers at the branches were charged with monitoring deposits from clients and following up with those who were not saving regularly.

## b. Borrower profile

During the pilot, 94 percent of housing loans were disbursed to microentrepreneurs and the rest of the disbursements were to salaried employees. An attempt was made to categorize the micro entrepreneurs by industry or type of business but this was unsuccessful as industry codes for housing clients were changed to “home improvement” during the pilot.

Additionally, clients who took out more than one loan (a business loan in addition to a home improvement loan, for example) experienced higher default rates than those with just one. To avoid the over-indebtedness of clients, the maximum loan exposure for each borrower in urban areas was capped at $5,000 across small business loans and agriculture loans.To avoid arrears for salaried employees, staff ensured that the date on which the installment was due corresponded with the date on which the borrower receives his/her monthly salary to permit the repayment amount to be directly subtracted from the salary payment.

[19] *This experience is quite common at most MFIs which have entered the housing market.*

## c. Marketing, sales strategy, and capacity building

The four pilot branches used a combination of different marketing methods to reach potential clients. The most common method used was word-of-mouth by the LOs. Other methods included the distribution of leaflets, poster, banner, meetings with village (Shura) heads, and short presentations at social gatherings.

The pilot review revealed that some staff members could not adequately explain the product features and processes to a potential client. These were the branch manager, deputy branch managers, loan officers designated to disburse home improvement loans, and some client relations officers. Prior to the launch, the home improvement loan had been introduced in the pilot branches through a one-day presentation made by the marketing manager. The presentation had included the rationale for the product, product features, target clients, type of home improvements to be financed, and the loan process.

During the pilot period, the average number of HMF loans disbursed by a loan officer was four. The branches which used more aggressive marketing strategies (e.g. direct phone calls to potential customers) disbursed a higher number of loans. These branches were also understood to have had more extensive training of their LOs.

As a result of the above findings, a decision was made by management to increase the marketing budget. The national product roll-out was to be accompanied by more active use of leaflets, posters, and banners in cities and at branches, creating more awareness among potential customers and the public at large. Specific sales incentives for LOs were also considered. In addition, it was decided to increase training to LOs at the branch level. This included training on loan product features, the loan policy, and sales techniques. A detailed training module on HMF products and operations was prepared for the LOs, branch managers, and other staff members who are involved in the processing of HMF loan. Based on the results of the pilot review, some changes to the initial HMF loans features were made. The main changes, as cited above, were an increase in the maximum loan amount and a different structuring of the savings requirement. Thus, the market research and the internal capacity assessment were already quite effective in determining the elements of a successful HMF product offering. Table 7 shows the revised features of the HMF product that was later rolled out nationally.

**Table 7. HMF Loan Features After Pilot Review**

| | Features Prior to Pilot | Features modified After Pilot |
|---|---|---|
| Loan amount | \$100-\$1,400 | \$2,000 1st cycle,<br>\$3,000 2nd cycle<br>\$4,000 3rd cycle |
| Loan tenor | 6 - 24 Months | Same |
| Interest rate | 2.08 percent per month on declining balance | Same |
| Eligibility | - Afghan national<br>- Age between 18 – 65<br>- Entrepreneur or salaried employee | Same |
| Collateral | - Personal guarantor<br>- Household assets<br>- Title deed | Same |
| Loan purpose | - Improvement<br>- Extension<br>- New room construction | Same |
| Other features | N/A | For rural clients, adjustment of repayment terms possible to take into consideration seasonal fluctuations in incomes |

*Source: FMFB-A*

# 3. Nationwide roll-out of FMFB-A's HMF product offering

To prepare for the roll-out of HMF products across all branches, management concentrated on the following areas, based on the outcomes of the pilot test:

a. Increased training activities at the branch level. FMFB-A's in-house construction engineer and staff from the audit department developed two training modules.

- Financial appraisal: It covered areas such as loan product criteria, underwriting guidelines, loan processing, and servicing customers with payment difficulties.

- Technical appraisal: The objective of this training was to improve the staff's understanding of construction processes and facilitate the assessment of the financial and technical viability of the proposed project for which the applicant was seeking finance from FMFB-A.

The existing training material, which was originally prepared for the pilot, was revised to capture the changes in the product design. Additionally, a training manual was developed to ensure that future FMFB-A staff members could be adequately prepared for their job. The content of the training is shown in Annex 2.

The training was delivered to branch managers, deputy branch managers, credit administrators and assistants, loan officers, front line staff (customer relations officers), branch assistants and savings officers. A total of 345 staff members were trained, of which 60 percent were LOs.

b. More concise sales and marketing strategy. To improve the public's awareness of its HMF product offering and facilitate the sales of HMF loan products, management concentrated on the following areas:

- Improving product branding: In the Dari language, the Home Improvement Loan was branded "Tameer", which translates into "building" or "construction". The brand delivered a clear and understandable message to clients and was aimed at creating customer loyalty.

- Sales support activities: The following material and methods were strengthened to incentivize more active sales among LOs:

  * Brochures (leaflets) advertising the product and explaining product features were distributed directly to potential clients;

  * Posters that highlighted loan purpose and key product features were displayed in shops where construction materials were sold. The posters also included a one-year calendar to motivate shop keepers to hang the posters;

  * Stand banners that advertised the home improvement loan were developed and strategically positioned in FMFB-A's branches;

  * Field staff were encouraged to increase word-of-mouth marketing to potential and existing clients, who in turn, were encouraged to refer other good clients.

In order to promote better linkages between individual client activities, management encouraged staff members to recognize ways of selling more than one product to an individual client. For example, a client who has saved at FMFB-A for a couple of months could be a target for a housing finance loan and can use the savings as equity for the housing project. The equity and the savings would then help him or her complete their housing project faster than having to save the whole amount. Additionally, loan officers could use savings as an indicator of a client's discipline and ability to put aside a certain amount regularly

Picture 2. Newly designed marketing material for FMFB-A's HMF product offering

*Source: FMFB-A*

c. Increased internal awareness. As the pilot revealed, only 20 percent of staff could effectively convey the HMF features and processes to potential clients. FMFB-A's management required branch managers to keep all staff members informed about product updates. Additionally, management implemented performance-based bonus payments, which were tied to the number of loans sold and PAR during a certain period to incentivize LOs.

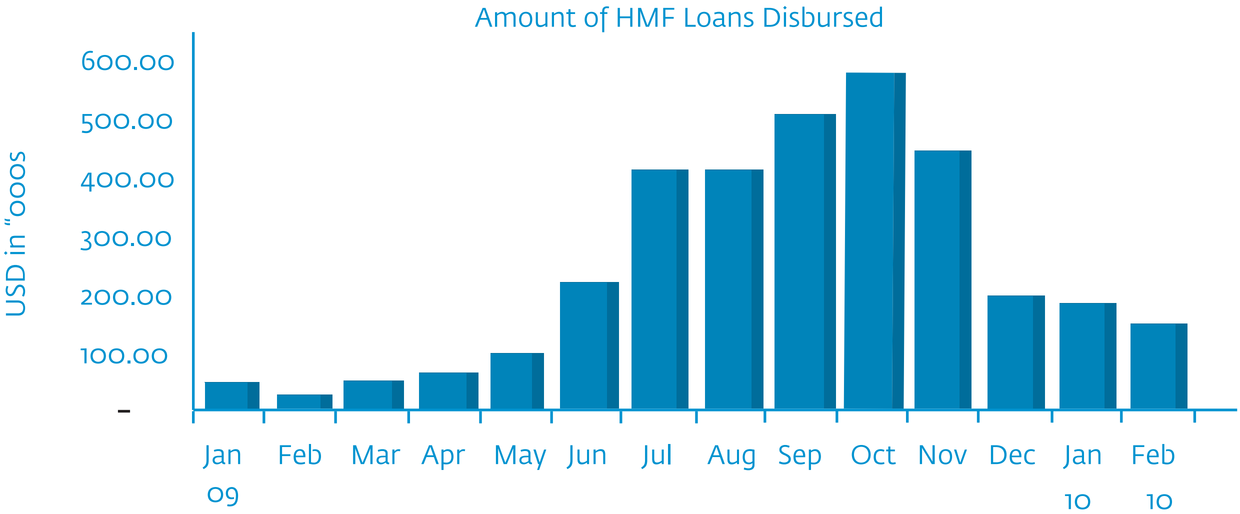
d. Clear and achievable targets. Based on the finding of the pilot, management set the following targets for the first year of the national roll-out of FMFB-A's HMF products:

- At least 5,968 loans disbursed amounting to $4,694,702;
- Roll-out in nine branches over five months;
- Regular updates of the loan policy guidelines and further training activities as required;
    - Number of loans disbursed;
    - Amount disbursed;
    - Portfolio outstanding;
    - Portfolio at risk (PAR); and
    - Portfolio by branch, gender, and loan purpose (type of house improvement).

## 4. Portfolio performance in the first year of the national roll-out (2010)

Actual disbursements exceeded, by far, the objectives set for the first year of the national roll-out. By the end of 2010, the value of loans outstanding increased to $6,759,010 and the number of loans outstanding totaled 5,282. The average loan amount was $1,179. Monthly loan disbursements showed that there was a seasonal demand, possibly related to weather conditions, as monthly loan disbursement peaked in July to November 2009 and decreased rapidly in December 2009 and January 2010 (see Chart 4).

**Chart 4. Monthly Disbursement of HMF Loans by FMFB-A (in thousands of US Dollars)**




*Source: FMFB-A*

# F. Phase III – Consolidation and Expansion of the National Roll-out Strategy (2011 – 2013)

To capitalize on the loan performance in the years 2009 and 2010, management set more ambitious targets to allow for a replicable and scalable model to expand FMFB-A's HMF product offering. Management achieved the goal of increasing outreach to those who do not have access to financial services in urban and rural areas. The following targets and measures were set by management and aimed at a robust and wide-reaching expansion of its HMF activities:

- To build a housing finance portfolio of 10,000 loans amounting to more than $11 million by the end of 2011;
- To improve the housing stock and quality of construction through construction technical assistance (CTA) services and home improvement innovations bundled with a loan offer; and
- To achieve long-term sustainability by covering inflation-adjusted costs with revenues generated from the HMF loan business and achieving a surplus to finance any further expansion;

FMFB-A launched the HMF product in urban areas before expanding the offer to rural areas. The reason for this strategy is that incomes in urban areas are typically higher than in rural areas and higher incomes generally translate into higher affordability levels. Additionally, financial literacy among consumers in urban areas is usually higher, which facilitates the introduction of new financial products.

As already mentioned above, rising migration to urban areas has led to an increased demand for housing which has also propelled the demand for housing finance. These two trends were also confirmed by the market research. Therefore, it was quite obvious for FMFB-A to launch the HMF products in urban areas. After the successful completion of the pilot, FMFB-A management achieved a better understanding of the market dynamics and felt confident enough to increase the penetration of its products in other provinces of the country.

## 1. Increased focus on rural areas

To get a better understanding of the market conditions and the individual needs of potential customers from rural areas, FMFB-A conducted a demand and repayment capacity survey in the rural areas in April 2011. This study also included some market intelligence on the demand for construction technical assistance (CTA) services as management believed that customers would value these additional services. In rural areas, most people either build houses on their own or rely on the help of family members. As there is often a lack of appropriate skills in construction, the offer of CTA services could provide guidance to borrowers on safer construction methods.

The survey came up with the following key findings: (i) FMFB-A could tap into a promising market given the significant demand among rural Afghanis for home improvement; (ii) a key challenge would be the assessment of incomes, which are typically linked to seasonal agricultural activities and a considerable degree of informality; and (iii) most customers would also value CTA services.

In December 2011, a pilot test of a new rural housing product was started based on the above findings and was launched in five rural branches: Balkh, Badakhshan, Herat, Bamyan, and Jabul Siraj. In the pilot phase, FMFB-A's disbursement target was 200 loans worth $200,000. This would help ascertain the average cost of housing improvements in rural areas, test the management information system for seasonal repayment schedule, and improve process flows while also trying to determine the cost involved in disbursing and monitoring these loans.

## 2. Introduction of CTA services

FMFB-A also worked on the introduction of CTA services[20] as an additional feature to the HMF product offering. FMFB-A signed a contract with Aga Khan Planning and Building Services Pakistan (AKPBS) to obtain advisory support in the development of a package of CTA services to be offered to clients[21]. In addition, the mandate also comprised capacity building measures for FMFB-A staff and the construction of demo houses. These houses are aimed at providing an example of how environmentally driven techniques can improve living conditions and mitigate natural disaster risks given that Afghanistan is earthquake-prone. The demo houses were built in Kabul, Samangan, and Kishm.

The AKPBS team carried out an initial assessment in Kabul and identified several areas to target improvements in housing standards and construction practices, including:

- Technical drawings and designs;
- Sizing and location of doors and windows for seismic resistance, ventilation, and energy efficiency;
- Double glazing for windows and thermal insulation;
- Masonry techniques;
- Binding walls to foundations and new additions to existing structures;
- Roofing materials and weight; and
- Design and placement of latrines and wells.

The team also noted that several of AKPBS's environment upgrades would be appropriate to address important housing and quality of life challenges in Afghanistan. These innovations included:

- Seismic-resistant solutions and techniques;
- Water warming facilities;
- Bed racks;
- Kitchen worktops and utensil cabinets;
- Thermal insulation techniques;
- Lightweight roofing techniques;
- Roof hatch windows; and
- Dry pit compost latrines.

Based on the observations and findings of the visit, AKPBS proposed a capacity building and training strategy for FMFB-A's technical officers which would cover four major areas of housing construction: (i) disaster risk mitigation; (ii) earthquake resistant construction; (iii) thermal and energy efficiency; and (iv) basics of water and sanitation. FMFB-A staff travelled to Pakistan to learn from AKPBS's work there. With the help of AKPBS, FMFB-A was able to achieve the following:

- Specific two-week training course for the technical officers who were supposed to provide CTA services to customers of FMFB-A. The training also included visiting local carpenters and masons to build models of roof hatch windows, fuel-efficient stoves, double-glazed windows, and improved latrines. A draft set of construction guidelines was designed which served as the basis for the construction advisory services.

- Delivery of "demo houses". These houses were built to make up for the limited number of officers who were capable of providing construction technical assistance. It allowed FMFB-A to showcase good construction techniques and offer guidance for appropriate building standards[22]. Due to the considerable construction cost, FMFB-A only erected these houses at select branches. Fewer houses were constructed than planned due to challenges in land ownership and permission. Despite that, feedback indicated that where available, these houses were considered an effective tool for disseminating information about construction standards and building materials.

*20 CTA services, or housing support services, enable homeowners to improve their house on their own. They can comprise all areas of the housing value chain. Annex 3 includes detailed information about housing support services.*

*21 In Pakistan, AKPBS is mandated to assist local communities in areas such as habitat risk reduction, energy efficient building and construction improvement, water supply and sanitation, and natural resources conservation. With the two countries having much in common, AKPBS' experience in Pakistan proved valuable to FMFB-A in Afghanistan.*

*22 Houses were built with walls reinforced with galvanized iron wire lintels (to support the weight above the doors and windows) and plinth seismic bands to strengthen the building against earthquakes. Partial wall insulation using locally available material, such as wooden shavings, wooden battens, plastic sheeting and galvanized iron wire, would make the house warmer during the winter and cooler in the summer.*

# G. Key Takeaways and Lessons Learned

## 1. Challenges remaining in the housing and housing finance sectors

Recent research has shown that the primary challenges to housing development have remained unresolved during the past five years. As already mentioned above, these problems include shortage of land in major cities, clear land titles, destroyed or undersupplied housing infrastructure (utilities, roads, etc.), and lack of a legal framework (building codes, housing finance regulations, foreclosure laws, etc.). All these problems are further exacerbated by the lack of affordable housing finance for the majority of Afghanis[23].

Currently, the supply of housing finance in Afghanistan by banks and microfinance institutions (MFIs) is very limited given that MFI clients have demonstrated a significant demand for housing finance, which they have satisfied by resorting to business micro-loans, borrowing from relatives and friends, or using their savings. Despite the recognition of sizeable untapped mortgage and home improvement markets, banks still do not consider the environment conducive to developing a significant housing finance practice. Similarly, banks are concerned about housing affordability given their clients' low incomes. MFIs are also concerned about their ability to assess clients and make projections about their income, which are key for longer term loans.

## 2. Lessons that can be applied to other countries

Despite the unprecedented challenges in Afghanistan, there are a number of lessons that can be learned from FMFB-A's experience that would be applicable in other markets. Many MFIs in other markets have experienced a sizable growth in their portfolios and are looking to reach new customer groups. The remainder of this paper shares some key areas which have been vital to FMFB-A making inroads into the HMF market in Afghanistan.

### a. First-mover strategy reaps benefits in terms of time, financial resources and market recognition.

With no existing competitors in the housing microfinance sector, FMFB-A entered the market with the "first-mover" advantage. Being the first provider of HMF loans allowed FMFB-A not only to acquire superior brand recognition and customer loyalty, but also to have more time to perfect its product and services based on the experience gained during the pilot phase. In addition, FMFB-A was able to take full advantage of financial support from the international donor community, which was interested in developing the housing finance market in Afghanistan. In fact, FMFB-A managed to leverage its partnerships with IFC, KfW, and USAID, which brought in more funding to FMFB-A to support its product expansion and capacity building efforts.

### b. Product design should be based on market assessment and an internal capacity evaluation.

Before rolling out the HMF products in urban and rural areas - and before launching construction advisory services - FMFB-A started with market surveys which were used to design product prototypes. It also conducted a pilot run, which was used to refine product features and offer a strategy for further roll-out. This experience of "testing the water" provided valuable insights into the market and the institution's internal capacity, which was instrumental in improving the product offering and strengthening internal infrastructure in preparation for product expansion. In the case of rural clients, for example, it was observed that they are more inclined to seasonal repayment schedules because of the nature of their cash flow, which is dependent on agriculture and rural activity, including livestock.

### c. A critical review of the pilot results is essential to ensuring a successful national roll-out of HMF products.

In the case of FMFB-A, during the pilot phase, the following lessons were learned, which helped ensure a successful roll-out of the product:

- The loan size sought by customers was higher than FMFB-A initially projected;[24]
- Clients' repayment willingness could be increased by requiring them to contribute 10 – 20 percent of the project

23 IFC, *Afghanistan Housing Sector Assessment*, October 2013.

- The decision to roll-out the HMF product in urban areas first was considered an adequate response to prevalent demand patterns in Afghanistan. It also helped to test the product before its offering in rural areas, where demand patterns are different and where market penetration is more difficult because of low incomes and low financial literacy levels; and

- The disbursement of the loan in tranches is typically considered a tool to ensure that the proceeds are deployed for the housing projects and are not used for other purposes. FMFB-A opted for disbursement in one single tranche.

d. A concise marketing strategy is key to customer outreach.

When a product is new to the market, the choice of marketing strategy is key to ensuring broad customer outreach. Marketing strategy, both internal and external, should be tailored to the characteristics of the targeted audience in order to achieve maximum effectiveness.

e. Offering CTA services can increase customer satisfaction and enhance loan quality.

Advising clients on the selection of building materials, construction techniques, and innovative methods and interventions that address earthquake resistance, sanitation, ventilation, and energy efficiency was an effective way of adding value to FMFB-A clients and boosting sales. Combining the loan offering with construction technical assistance helped raise awareness about safe construction, reduce the cost of future repairs, and ultimately improve the quality of the loan.

f. A scarcity of qualified staff requires strategic internal capacity building and a smart allocation of talent.

To maintain the high caliber of staff and improve their capabilities, FMFB-A management:

- Hired technical officers. As FMFB-A is not an engineering company, attracting and retaining qualified technical officers was difficult, particularly in rural areas. Ultimately, FMFB-A was able to recruit and retain 11 technical officers. In order to increase the efficiency of those employed, the function of the technical officers was adjusted to focus more on appraising/assessing projects that included structural changes or improvements rather than cosmetic or minor construction techniques, discuss innovative housing upgrades, and monitor quality. Loans for minor (non-structural) projects, such as painting and plastering, were assessed and monitored by deputy branch managers instead of technical officers. FMFB-A also hired a full-time senior technical officer, based at its head office, who was responsible for training and coordinating with technical officers at the branch level. In areas where technical officers are not available, basic training was provided to deputy branch managers on conducting technical evaluations.

- Built demonstration houses. The construction of demonstration houses was another way to deal with the limited availability of qualified technical officers as they offered an alternative means of easily conveying basic information to clients. Construction guidelines can be shown to borrowers and masons through examples in the demonstration houses. The feedback was that they were an effective means of promoting and raising awareness of improved construction practices. However, the number of demonstration houses that can be constructed is limited due to their high cost.

- Provided extensive staff training. Most of the FMFB-A clients were new to housing loans and lacked sufficient financial literacy as well as construction knowledge. Educating customers on the housing microfinance product, the lending process, and construction techniques became a critical responsibility for loan officers and technical officers. It was therefore essential to provide adequate training to all staff, especially new staff, in all branches. Regular training (e.g. semi-annual) on housing microfinance topics and new developments within FMFB-A for established employees working in the field was also recommended. Given that it was not always feasible to provide training face-to-face in light of the security situation in Afghanistan, other means of communication, such as newsletters and teleconferences were implemented to ensure frequent communication with the regions.

## 3. Current state of FMFB-A's housing finance operations

FMFB-A has made significant strides in rolling out a successful housing microfinance loan product with a resulting well-performing portfolio. This is an important achievement given the security situation, operational challenges, and poor regulatory environment in Afghanistan. What makes this achievement even more remarkable is that no other MFI in the country (or any other financial institution for that matter) has to date entered the HMF market in Afghanistan despite FMFB-A's demonstrated success.

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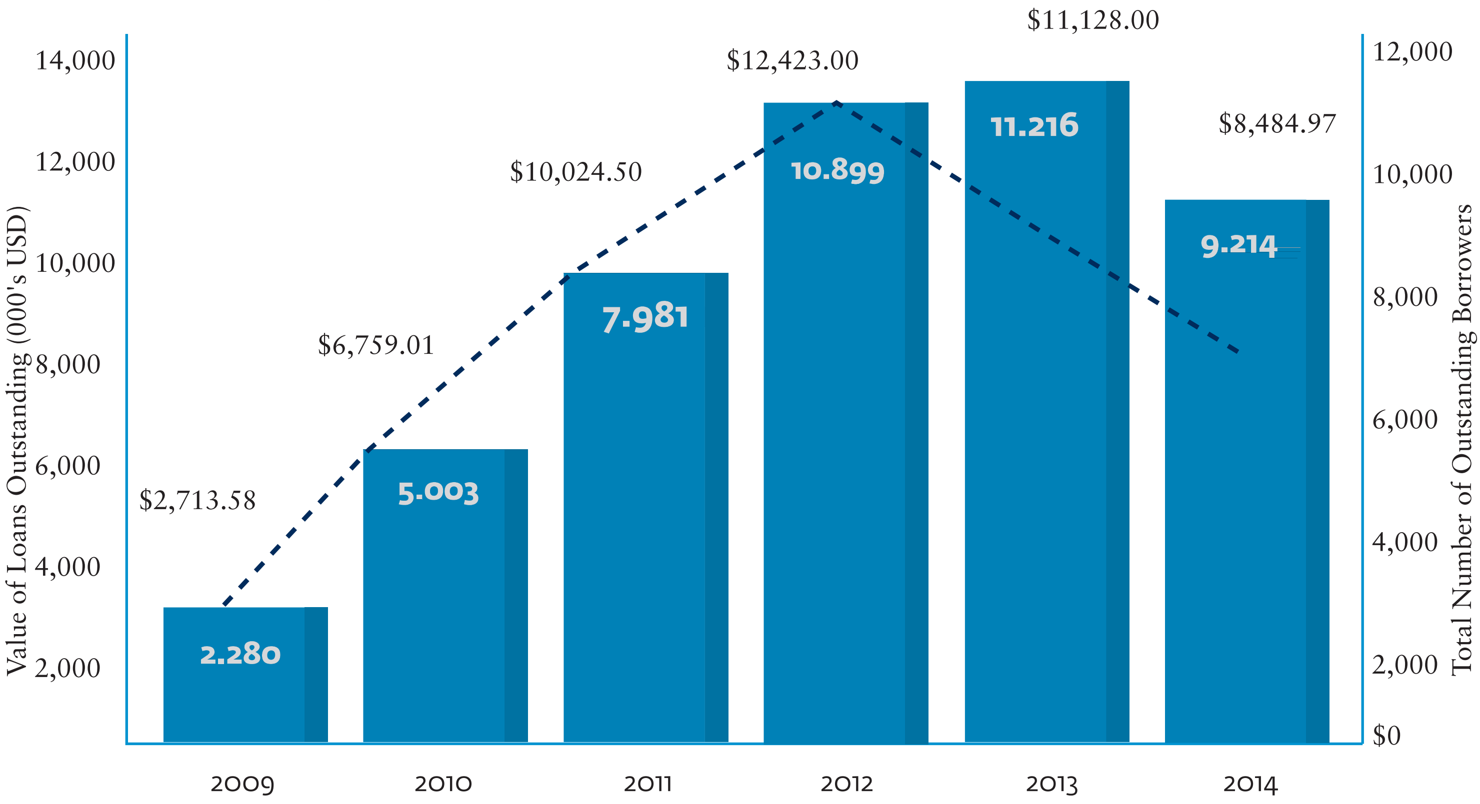
[24] *FMFB-A's experience has been very similar to other lenders which also launched HMF products. However, in the pilot phase, it is recommended to offer lower loan amounts initially until staff gains a better understanding of the borrowers' payment patterns.*

Since the launch of the HMF program, FMFB-A has experienced a steady and exponential growth of its HMF portfolio. The institution has managed to transform potential demand for housing finance into an actual supply of financial products which have specifically targeted informal low-income earners (both self-employed and salaried employees) from urban and rural areas.

At the end of 2009, the loan portfolio outstanding already amounted to $2.7million. With the significant growth presented in the graph below, FMFB-A has managed to keep its PAR at very low levels. As of Dec, 2014, housing microfinance loans account for about 17% of FMFB-A's total lending. The percentage of female borrowers increased from 7.7% of the total housing loan portfolio in 2009 to 19% at the end of 2013.

**Chart 5: FMFB-A's Housing Portfolio in USD thousand (2009 – 2014)**




*Source: FMFB-A*

Critical to the successful implementation and expansion of lending activities has been the support from FMFB-A's shareholders, the quality of the consulting services provided by IFC and AKPBS, support from other partners such as USAID, and the diligence in the preparation of the product launch (market research, internal capability analysis). Another critical factor for success was the flexibility and responsiveness of management, which allowed for adjustments to loan products based on changing demand patterns. FMFB-A management continues to review the performance of the HMF loan portfolio and is ready for further adjustments to retain a competitive edge in the Afghan housing finance market.

# H. Annex 1 – IFC's Global Housing Microfinance Toolkit

The Global Housing Microfinance Toolkit ("the Toolkit") has three objectives:

- To provide a practical guide for managers of microfinance institutions (MFIs), banks, and non-bank financial institutions (NBFIs) for introducing new housing improvement loan products, or expanding their existing housing microfinance (HMF) portfolio;
- To provide a practical guide to housing development entities, such as investors, real estate developers and other entities considering entering into or engaging in the business of financing housing improvements for low-income households; and
- To provide an efficient means for IFC's Housing Advisory Services, as well as IFC housing finance projects globally, to engage with the management of housing finance entities and other stakeholders, including those considering entering into housing finance or investing in housing entities.

The HMF Toolkit consists of seven modules with supplementary documents in annexes:

- Module 1 provides an overview of housing microfinance lending, including the conditions that underpin successful microfinance programs and the functions that are involved in microfinance lending. It provides the rationale for providing HMF lending programs, compares HMF loans with other microfinance products, and defines the characteristics of HMF loans.
- Module 2 provides the Housing Microfinance Feasibility Assessment guide and outlines steps that a microfinance organization should take to complete the assessment.
- Module 3 describes how to design HMF products and provides a set of sample products that together could meet a range of household needs.
- Module 4 describes the types of financial, credit, and operational risks that are associated with housing microfinance lending as well as approaches for identifying, quantifying, and mitigating them.
- Module 5 provides guidance to financial institutions on the funding of an HMF portfolio, the types of funders and funding available, advantages/disadvantages of each, and an overview of the fundraising process.
- Module 6 provides financial institutions with an outline of a construction technical services (CTS) training program for HMF lending staff and a financial literacy training overview.
- Module 7 provides an example of a policies and procedures manual that lays out step-by-step procedures for a lender to follow in carrying out HMF lending.

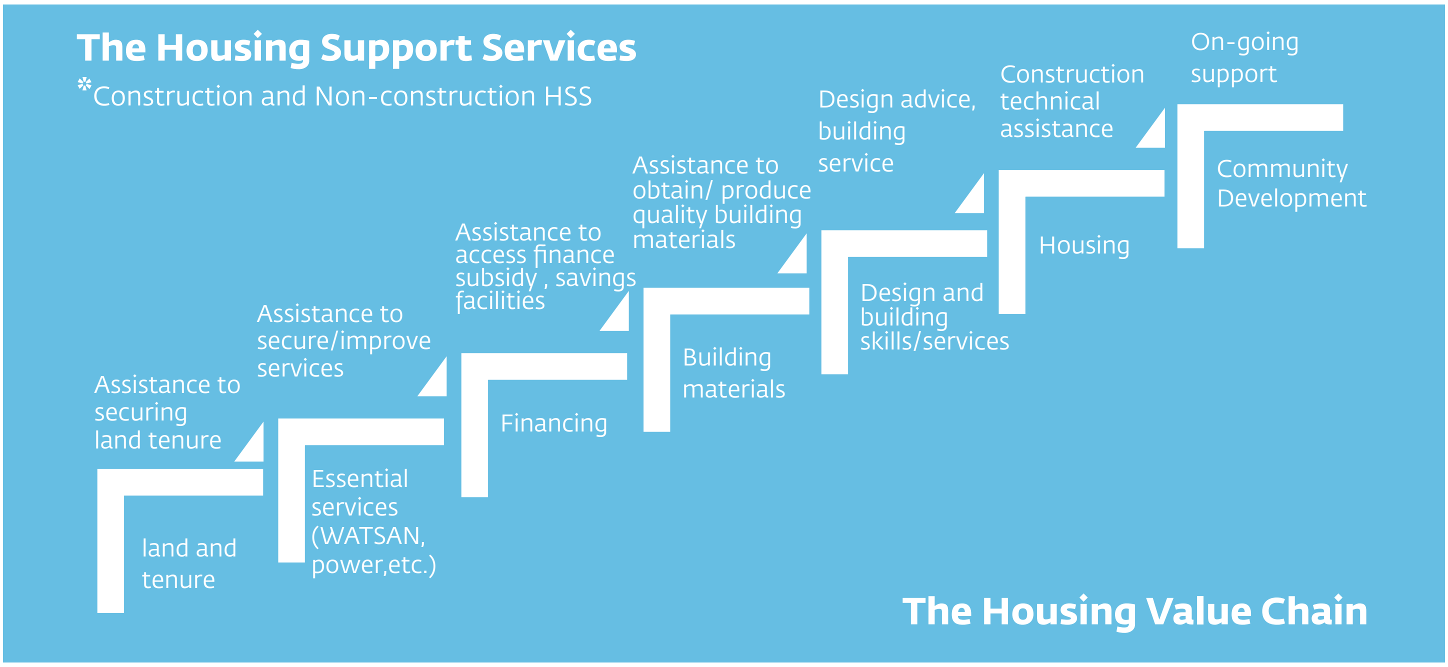
An addendum to the modules provides:

- A sample set of housing microfinance products;
- Examples of forms and documents that a lender could use to effectively manage the housing microfinance lending process;
- A sample of a completed loan file, as well as sample loan tracking documents as they would appear in the files of a HMF lending institution;
- A sample set of responsible finance guidelines and policies that an institution could include in core operations;
- Other materials to help lenders understand and manage the HMF lending process;
- Examples of risk management tools and approaches which an MFI could use to help manage risk associated with HMF; and
- A list of potential HMF funders which MFIs could approach to fund their HMF loan products.

# J. Annex 3 – Construction Technical Assistance (CTA) services

As already defined above, housing support services, or CTA services, are products and services that enable home owners to improve their house on their own. They can comprise all areas of the housing value chain. See Chart 6 for details on the housing value chain.

**Chart 6. The Housing Value Chain and Corresponding Potential Housing Support Services**




*Source: Habitat for Humanity*

Housing support services can range from providing support to the registration process of land titles, advice on the construction process, and tips for community development. There are broad categories:

1. Pure technical information. The lender provides to customers brochures, videos, contact lists of masons etc. These services can be provided by staff. Professional support is required to design the brochures or any other material.

2. Professional services. The lender provides the support to the design and planning process, trainings, support to permit processing, etc. It may include visits by technical staff to the borrower's home. The lender may cover these services through a co-operation agreement with an architect or other service providers.

3. Construction technical assistance/engineering advisory. The lender provides on-site support to the borrower at her/his housing unit. This can range from basic (repairs) to structural work (masonry, plumbing etc.). This latter category is the most intensive form of housing support services and typically requires the employment of an engineer.

# K. Annex 4 - Linkages between Construction Technical Assistance and Financial Services

An important consideration in determining how to deliver housing support services is creating an effective link between the provision of these services and housing microfinance. While it has already been demonstrated that housing microfinance, solely as a financial product, can be offered sustainably and at scale, this is less evident when it is linked with housing support services. Several of the key questions that must be resolved when designing these links include:

1. Are the housing support services delivered as an optional service or as a mandatory component of the housing microfinance loan ?

2. Are these services provided by the microfinance institution or by a separate organization ?

   a. If by a separate organization: How will the two organizations operate effectively to deliver both services to the same clients ?

   b. If the microfinance institution directly delivers the housing support services: Will the existing field staff assume these functions, or will new positions be created?

3. In either case, how will these costs be covered ?

One helpful way to design housing support service delivery is to determine whether the services are to be conducted as an essential component of the housing microfinance loan, or whether they are seen as optional or occasional. The former might imply services that are required and relatively standardized steps in the loan due diligence and follow-up processes. These services are likely to be delivered by the microfinance institution's staff, and their costs are usually included in the price of the loan. The second suggests relatively customized services that are delivered by a separate business unit that charges on a fee-for-service basis. Clearly, a microfinance institution may offer both types of housing support services, employing multiple linkages. Another helpful way to understand the links between housing support services and housing microfinance is to classify them according to the institutions involved in delivering the housing support services. There are three classifications of linkage methods:

- In-house: Housing support services are delivered by the staff of the microfinance institution, whether via loan officers or construction specialists;

- Linked: Housing support services are delivered by the staff of another organization operating in partnership with the microfinance institution;

- Embedded: Housing support services are delivered by the staff of another organization but are placed within the offices of the microfinance institution.

# L. Annex 5 –Lessons and Trends in Delivery of Construction Technical Assistance

Although successful models, clear guidelines and best practices have yet to be identified. lessons and trends are beginning to emerge in the area of housing support services and their effective delivery alongside housing microfinance.

The following key lessons were identified from existing experience,[25] and may inform future design of housing support services:

### What clients value:

Evidence suggests that clients place a high value on training and technical services that inform and guide them in planning and carrying out their intended home improvement projects, such as:

- Segmenting and sequencing desired improvements into financially feasible steps;
- Creating a basic plan for specific improvements, including an estimate of materials and costs;
- Receiving guidance in avoiding common errors associated with the type of improvement; and
- Receiving guidance in how to select materials and construction laborers.

Clients also appreciate having access to more qualified technical services when needed, and in many cases they are willing to pay for these, provided they are not mandatory but optional. This suggests the need for creating a demand-driven method of providing more specialized and customized services.

Furthermore, clients value alliances with materials suppliers that result in price discounts, product delivery services, and other forms of preferred treatment.

### What microfinance institutions value:

Microfinance institutions tend to value linking housing support services to housing microfinance for any or all of the following reasons: the perceived social impact this generates, the contribution this makes in reducing loan risk, and the increased competitive advantage this earns them among clients.

Moreover, lessons emerging in housing support service delivery are consistent with many of the principles adopted by institutions that provide business development services linked to microfinance. The following guidelines, slightly adapted, apply well to housing support services.[26]

- Assess the market: Learn about existing supply and demand of services in the low-income housing markets, including informal and indigenous sources. Determine what clients already have, including sources of financing, and what they need to improve their homes with quality and at low cost;

- Determine a core competency: Providers of housing support services must determine what specific services are to be delivered efficiently alongside housing microfinance. "Have a broad vision, but a narrow specialization." Without this, housing support service provision will not reach sustainability;

- Be client-driven: In order to remain relevant, housing support service providers need to keep a pulse on clients' needs and preferences with respect to services offered, delivery methods, and pricing.

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[25] *See Habitat for Humanity, "Housing Support Services: Do They Add Value to Housing Microfinance?" Atlanta, January 2013, p. 8*

[26] *Lessons adapted from "Synergies through Linkages: Who benefits from Linking Microfinance and Business Development Services", MertenSievers and Paul Vandenberg, 2007.*

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