

EVANGELICAL SOCIAL ACTION FORUM, KERALA

Foreword

Evangelical Social Action Forum is part of a series of cases that will be included in a study on housing microfinance in India, conducted by the Centre for Micro Finance at the Institute for Financial Management and Research. The purpose of the case studies is to identify innovative practices among Micro Finance Institutions (MFIs) and others operating for providing an access to finance for housing and the demand for this emerging service for the poor. The study presented in the following pages provides an in-depth look at how ESAF manages to offer a loan product with one of the longest tenures (8 years) and highest capital amounts (Rs. 50,000) on the market.

Section I: Background on ESAF

1. History of ESAF

The housing Evangelical Social Action Forum (ESAF) was registered in 1992, under the 1955 Travancore Cochin Literary, Scientific and Charitable Societies Registration Act. Its founder president, Rev. Itty Mathew, and many of the original members belonged to the Union of Evangelical Students of India (UESI). While ESAF started as a charitable organization, ESAF's Micro Credit program, which included housing loans from the start, was launched in 2002, as a means to empower the poor. During the first three years of its existence, ESAF's Micro Finance program enrolled 50,000 members. Between 2005 and 2007, 135,000 new Sangam members joined the organization, and 900 new employees were hired, so that today ESAF has a staff of 1,200 for 184,000 clients served. This phenomenal expansion is generally attributed by ESAF staff to the success and compatibility of the ESAF microfinance programme to their clients. ESAF's growing reputation also resulted in easier access to finance.

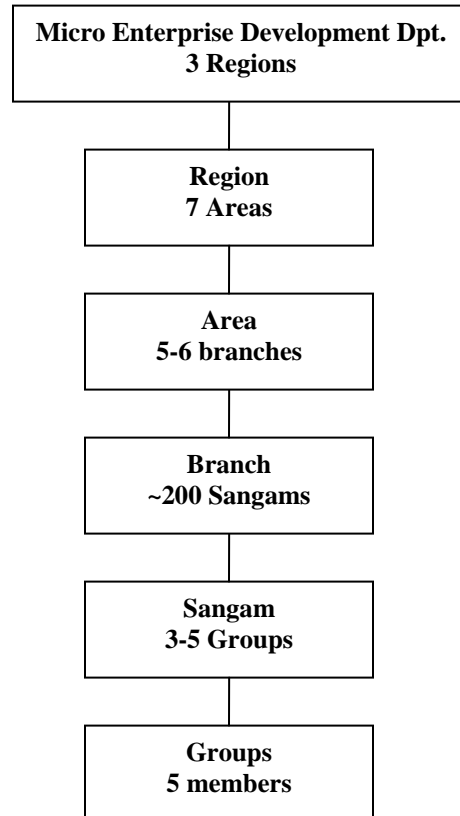
Besides its Micro Enterprise Development activities, ESAF offer the following services:

- Business training for Sangam members,
- Retail shops for handicrafts made by Sangam members,
- Consulting services on Natural Resource Management
- A chain of 4 supermarkets, with 17 new ones planning to be opened in 2007-08 thanks to Asian Development Bank funding.
- 1 hospital and 2 pharmacies
- Relief work after natural disasters such as landslides, floods, and the Tsunami.
- Activities with HIV infected people

2. ESAF's Micro Finance activities besides housing

Overall Structure

ESAF offers Micro Finance products in 6 States: Kerala, Tamil Nadu, Karnataka, Maharashtra, Chhattisgarh and Jharkhand. However, 150,000 members, i.e. more than 80% of ESAF members, are situated in Kerala. ESAF is organized in 7 departments, including the Micro-Enterprise Development department (MED), which runs the Micro Finance program. The diagram below shows ESAF's Micro Finance Program architecture:

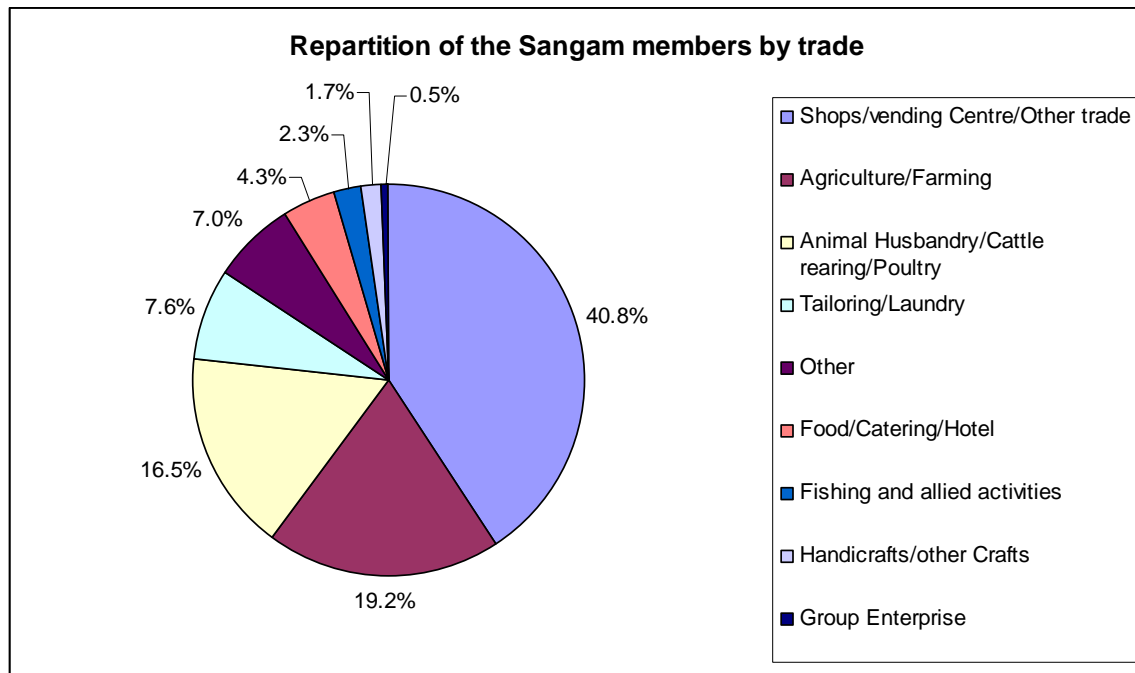


To determine whether an applicant is eligible to become a Sangam member, she must answer 9 questions by yes or no, and gets 1 point per answer showing that she falls in the category. Only persons with a score above 4 points are eligible to become members. The questions are (in brackets the answer which gives 1 point):

- Do you own your home? (no)
- Do you have toilets in your home? (no)
- Do you have access to drinking water in your home? (no)
- Does somebody in your house have an addiction like tobacco or alcohol? (yes)
- Do you belong to a Scheduled cast or a backward community? (yes)
- Do the people living in your house earn more than Rs. 24,000 per year (yes)

Though the purpose of this questionnaire is to ensure that the Sangam members fall in the poorer strata of the population, since one only needs a score of 4 to be eligible, families who earn over Rs. 24,000 per year are able to become Sangam members.

The repartition of the sources of income of the Sangam members is shown in the diagram below:



Source: ESAF PPT, July 2007

ESAF operates principally in rural areas, which explains the importance of the categories Agriculture/Farming and Animal Husbandry/Cattle rearing/Poultry.

Micro Finance Products – except housing products

Every Sangam member has to buy a life insurance product, which costs Rs. 70 per year, and has the possibility of enrolling in health insurance schemes - an option chosen by less than 5% of Sangam members. It is also required from every Sangam member to save Rs. 10 per week, which ESAF uses as part of its risk management system, as will be detailed in the section on the housing loans. When a member leaves the Sangam, she gets her savings back with a 5% yearly interest.

Besides its housing loans, ESAF offers 3 Micro Credit Products:

- The Income Generating Loan: this loan is ESAF's main product and is directly inspired from the Grameen Model, and its belief that people should borrow to create or expand their business.
- The General Loan: this loan is in effect a "mini-IGL" which can be used for any purpose. Borrowers can cumulate this loan with an IGL or a housing loan, but no more than two simultaneous loans overall are allowed.
- Vyapar Vikas Yogna Loan: this loan is particularly interesting since it is not intended for Sangam members¹, but for people who work in the market place and seek to

¹ Sangam members and relatives are not eligible for this loan

increase their business through a loan. A number of innovations were put in place to compensate for the lack of Joint Liability mechanism (borrowers do not belong to a Sangam), including taking the installments on a daily basis, and the fact of ensuring that the borrower has assets in the shop for an amount equivalent to the loan applied for. The customer basis for this loan is different from the IGL borrowers, since they are on average richer than IGL borrowers and predominantly male, whereas 95% of IGL borrowers are women.

The main financial characteristics of these loans are described below:

Table 1: Characteristics of the IGL, GL and VVY loans

| | Income Generating Loan | General Loan | Vyapar Vikas Yagna |
|--------------------|---|--------------|--|
| 1st cycle (max.) | Rs. 10,000 | Rs. 3,000 | Rs. 10,000 |
| 2nd cycle (max.) | Rs. 15,000 | Rs. 3,000 | Rs. 15,000 |
| 3rd cycle (max.) | Rs. 20,000 | Rs. 3,000 | Rs. 20,000 |
| 4th cycle (max.) | Rs. 20,000 | Rs. 3,000 | Rs. 25,000 |
| Rate of Interest | 12% per annum - flat basis. | | 18% per annum - flat basis. |
| Admission fee | 1% of the Loan amount will be collected at the time of loan disbursement | | Rs.105 (Membership, Passbook, Insurance) |
| Technical Fee | 2% of the Loan amount will be collected at the time of loan disbursement. | | N/A |
| Loan Period | 1 year | | 120 days |
| Repayment Period | 50 installments | | 100 installments |
| Repayment Schedule | weekly | | daily |
| Gestation Period | 2 weeks | | 20 days |
| Upfront payment | N/A | | The interest should be paid in full |

Source: ESAF

Section II: The housing product

1. Product overview²

While ESAF has offered these loans since the beginning of its Micro Finance activities because it believed in the importance of housing in the empowerment of the poor, its housing loans add up to only 2% of its portfolio. One of the main reasons for this situation is that ESAF has been more focused on developing its IGL loan and expanding its outreach then convincing its existing Sangam members to take up housing loans.

ESAF offers two housing products:

- the House Construction Loan, provided to Sangam member for the construction of a house which must have a plinth area below 450 square feet.
- the House Repair Loan, provided to Sangam member for the repair or extension of an existing house. Typically, these loans will be used to improve the roof or the floor of the house, or expand it by one or two rooms, often including the kitchen.

The main features of these loans are described in the table below:

Table 2: ESAF's housing loans main features, as of July 2007

² Based on a paper sent by Ashok Mamem to the CMF in June 2007, entitled "ESAF Housing Program" and a PowerPoint presentation made by Mr. George to the CMF in June 2007.

| | | Housing Repair Loan | Housing Construction Loan |
|-----------------|------------------------------|-----------------------------|-----------------------------|
| Characteristics | Maximum amount (Rs.) | 15-25,000 | 50,000 |
| | Tenure (including gestation) | 4 years | 8 years |
| | Gestation Period | 4 months | 1 year |
| | Repayment Schedule | Monthly | Monthly |
| | Interest rate | 10% half-yearly diminishing | 10% half-yearly diminishing |
| | Processing charge | 2%, upfront | 2%, upfront |
| | Legal charge | N/A | Rs. 100 |
| Performance | Nb. of loans | 244 | 110 |
| | Rs. Outstanding (Million) | 3.9 | 4.2 |
| | Rs. Disbursed (Million) | 6.1 | 5 |
| | Default rate | ~ 24% | ~ 30% |

Source: Compiled by the author from ESAF sources

2. Eligibility criteria

Both loans are available to Sangam members who have completed 1 year of membership and have a credit history of 100% on-time repayment.

Applicants to the construction loan will also need to:

- Own at least 3 cents of own land with proper title, or be a prospect to the newly constructed house. In most places the value of a cent of land will vary between Rs. 5,000 and 10,000, though it can reach up to 2-3 lakhs in some areas where ESAF operates.
- Have the guarantee of the spouse or any other earning member of family

Besides these eligibility requirements, ESAF tries to give the priority to those whose present shelter is structurally unsafe.

3. Disbursement

In both cases the loans are disbursed in a staggered manner, with ESAF staff visiting the house to make sure that the stage is completed before moving the loan to the next stage.

- **For the House Construction Loan**, these stages are:
 - Stage 1: Rs. 25,000, disbursed after completion of foundation
 - Stage 2: Rs. 15,000 disbursed just before roofing
 - Stage 3: Rs. 10,000 disbursed after completion of roofing

The loan's gestation period takes end after the disbursement of stage 3, or one year after the disbursement of stage 1 if stage 3 has not yet been completed

- **For the House Repair Loan**, these stages are:
 - Stage 1: Rs. 15,000, disbursed after completion of what ESAF staff and home owner have agreed as being the first stage
 - Stage 2: Rs. 10,000, disbursed after completion of what ESAF staff and home owner have agreed as being the second stage

The loan's gestation period takes end after the disbursement of stage 2, or 4 months after the disbursement of stage 1 if stage 2 has not yet been

In both cases, as for all ESAF loans, the borrower must collect the loan at ESAF's branch office, which is in fact the procedure for all other loans as well. Contrary to other ESAF loans, the installments are collected on a monthly basis.

4. Risk management

One of the most striking features of Table 2 on page 5 is the very high default rates of the HRL (~24%) and the HCL (~30%). However, these rates are as of July 2007, i.e. a Monsoon period, whereas the default rates as of December 31st 2006 were less than 4%. Furthermore, in July 2007 the loans which were overdue for more than 4 installments added up to only 0.08% of the overall outstanding amounts. ESAF managers are not concerned over the default rates, and are confident that they will be repaid in close to a 100% of the cases, thanks to the quality of their relationship to the Sangam members and the efficiency of the 6 risk management techniques they have put in place:

- **Sangam guarantee:** When a member defaults, the amount she owes is taken out of her savings. If there is a balance left in her favor she will get it when she is dropped out of her Sangam. If she still owes some money to ESAF and there is no chance of getting it back, ESAF takes the balance out of the other Sangam members' savings, with their written consent. Though the loan is individual, this Sangam guarantee makes it in effect a group loan.
- **Documents:** In the case of the HCF, ESAF requests original documents, whereas for the HRL only their photocopies are required. The documents requested are: the original title deed, the original Encumbrance Certificate for 13 years (to make sure there is no other mortgage on the land) and the latest land tax receipt. ESAF has never taken to court any of its defaulters nor tried to expropriate them by any other means. The documents are used mainly as a psychological pressure on the borrower.
- **Flexibility:** ESAF encourages its members to pay in advance some installments and then authorizes them to skip some payments for the same amount when they need to, to for instance, during Monsoon season. ESAF sometimes gives some flexibility in the repayment schedule, as was the case during the 2007 Monsoon, when all Sangams of a heavily rain-affected region did not need to make their payments for two weeks.

- **Visits:** for both loans ESAF staff visit the house and check for themselves that the construction is going on as planned, and if it is not, they will not disburse the full amount of the loan
- **House size:** for its Construction loan, ESAF has limited the size of the houses for which it makes loans to 450 square feet, in order to make sure the borrower will not build a house she cannot afford.
- **Tenure discrepancy:** ESAF is funding its housing programs thanks to loans with a 10-year tenure. The discrepancy between this 10-year tenure and the 8 or 4-year tenures of its housing loans provides added security for ESAF to make its own repayments on time, even if some of its members default.

5. Financing model

ESAF finances its housing program thanks to three loans:

Sources of funding for the housing programs

| Lender | Amount (Rs. Million) | Tenure (yrs) | Interest Rate |
|----------------------|-----------------------------|---------------------|----------------------|
| State Bank of India | 10 | 10 | 7.5% |
| Habitat for Humanity | 2 | 10 | 5% |
| HDFC | 1 | 10 | 10% |

Source: Compiled thanks to interviews and ESAF PPT

All loans have a 10-year tenure although more than half loans disbursed are HRL which only have a 4-year tenure, and even the construction loans have a 8 year tenure. This enables ESAF to mitigate its own default risk, and maximize the chances of having recovered the whole amount of the loan it makes when it needs to refund its own creditors. The loan given by Habitat for Humanity is well below market rate, which would raise questions on the scalability of ESAF's housing loans if it were its major source of funding. ESAF is currently looking for new funds to expand its housing products which currently represent less than 2% of ESAF's portfolio.

6. Demand

ESAF has recently created a Research and Development department, but this department has not yet worked on the housing products, which are not currently ESAF's priority. Besides ESAF's assertion that nearly all its housing borrowers have Below the Poverty Line income, there is no precise study of their incomes, assets, occupations, etc.

Regarding the demand for housing loans, again no studies are available. However, 2 facts seem to indicate that the demand is high:

- ESAF managers on the ground estimate that a significant portion of the IGL loans are in fact used for housing purposes, as is the case in many other MFIs across the country.
- ESAF is currently considering an increase in the maximum amount of its HCL. ESAF staff on the ground wishes this amount to be raised to 1 or 1.5 lakhs, because the current amount (Rs. 50,000) is too small to build a house. Some managers believe the amount should be raised to 1 or 1.5 lakhs.

It is difficult to determine without any precise data at hand, whether customers could indeed afford to repay higher loans. Nonetheless, the fact that the current monthly installment of a construction loan is Rs. 860 when the weekly installment of an IGL Loan is Rs. 340 (~Rs. 1360/month) seems to indicate that ESAF borrowers could afford higher loans.

7. Housing-related products and services

ESAF offers no technical assistance, bulk buying services, housing insurance or any other housing related services, because it has made too few housing loans to make economies of scale justifying dedicating resources to developing such services.

The only case where ESAF has coordinated house constructions is not for its housing products but for the post-Tsunami relief efforts (see below).

ZOOM: ESAF's post Tsunami programs

ESAF has conducted three post Tsunami programs in partnership with Habitat for Humanity, itself one of the channels of the international aid for tsunami affected regions. These programs resulted in:

- 537 houses repaired between April 2005 and January 2006 in Vaniyakuddy, Tamil Nadu
- 71 houses rebuild in EP Turai, Tamil Nadu
- 107 houses repaired in Allapuzah region, Kerala

These projects did not target specifically Sangam members (there were not any Sangams in the area of the first project), except in the last case where 60% of beneficiaries belonged to a Sangam.

In each case, Habitat for Humanity funded more than 70% of the total cost, while ESAF funded the rest. The operational process was the following:

1. ESAF gets in touch with either the parish priest or the head of the Panchayat to get a list of the people who should benefit from the project.
2. Habitat screens the list based on a number of criteria including income and whether the project involved using asbestos, which Habitat does not fund.
3. Once the list is final, one ESAF engineer and one Habitat engineer visited each house to determine the amount of money necessary to repair/rebuild it

4. ESAF coordinate the work, buying the supplies, dealing with the contractors, etc. The homeowner is supposed to help in the process by doing non-qualified tasks, like carrying bricks.

Section III: Conclusions

ESAF has been providing its clients with a housing microfinance product, both for new construction and for repair since 2002. Significantly, ESAF construction loans are larger (~ Rs. 50,000) and longer (~ 8yrs) in comparison to housing loans provided by other MFIs. ESAF also has strong financial partners in the form of banks who are willing to lend for their housing programme. Typically, MFIs find it difficult to access medium to long-term funding. Thus, offering a housing product leads to an asset-liability mismatch. In the case of ESAF, they have ten year funding for loans which are usually not more than 8years long. Thus, they have a cushion of two years to repay this loan, during which period the loan can be used productively for other investment or lending purposes.

In spite of these benefits, ESAF's housing loan portfolio is only approximately 2% of their entire portfolio. Furthermore, the repayment rates are significantly lower than they are for the standard microfinance product. Given that microfinance institutions are extremely sensitive to repayment rates, it is understandable that housing loans form a much smaller portion of their overall portfolio. Furthermore, as MFIs expand, they have two choices. They can expand the number of products they offer or they can expand geographically. Usually, MFIs pick the latter option since the economic viability of small microfinance loans has been long established. This choice is also supported by various financial institutions who are more comfortable lending for 'productive purposes' rather than for what they see as 'consumption' loans.

This case study has shown that ESAF has managed to offer its members a housing loan product with a high principal amount and a long tenure in a durable way, since the product is 6 years old. This is in itself an accomplishment showing the robustness of ESAF's model. Nonetheless, the case study also stressed the limited scope of these products.