

# Building capacity to strengthen access to housing microfinance in Sri Lanka by LOLC Sri Lanka and Habitat for Humanity International

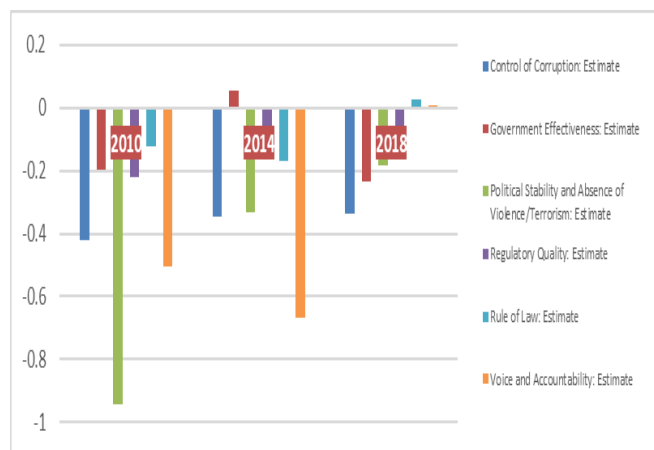
## 1. DEVELOPMENT RELEVANCE

### Economic and poverty context<sup>1</sup>

Sri Lanka is a middle-income country with a gross domestic product (GDP) per capita at USD 4'102 (2018). The average economic growth was 5.6% (2010-2018) and may be attributed to the end of 30 years of conflict and transition from a rural-based economy. The steady economic growth has brought in greater prosperity and brought down the national poverty ratio to 4.1% in 2016 from 15.3% in 2006 / 07. While aggregate figures have been positive, income inequalities and poverty rates have been higher in the conflict-affected North and East. Poverty is also increasingly becoming an urban phenomenon; the bottom 40% live in cities. The World Bank estimates that more than 40% of the population earn less than USD 1.54 a day. Political and economic uncertainties in the last few years, in addition to the large budget deficits, low fiscal revenue, and insufficient tax revenue, have constrained critical development spending on health, education, and social protection, which is low compared to peer countries.

Table 1 <sup>i</sup> : Population and economic indicators	
Population in million (2019)	21.8
GDP growth (2018)	3.2 %
Inflation (2018)	2.1 %
Trade balance (% of GDP) (2018)	-7.3 %
Foreign direct investment (net) (% of GDP) (2018)	3.1 %
Net ODA received (% of GNI) (2017)	0.3 %
Remittances received (% of GDP) (2018)	7.9 %
Economic Freedom Index <sup>ii</sup> (Rank among 186 countries) (2019)	115
Poverty indicators	
GDP per capita (USD) (2018)	4'102.5
Gini Index (0= equality 100= inequality) (2016)	39.8
International poverty rate (2016; at 1.90 USD/day)	0.8 %
National poverty rate (2016)	4.1 %
National rural poverty headcount rate (2012)	7.6 %

Governance indicators chart<sup>iii</sup>, (Sri Lanka, 2010-2018)



### Financial sector context<sup>2</sup>

Sri Lanka has one of the highest levels of financial inclusion with 74% of adults having an account and no gender gap. While account ownership is high, usage of financial services from the formal sector is low and women's participation is particularly poor. The reliance on Microfinance Institutions (MFIs) and community banks is high for women. Only 15% of the adults borrowed from a commercial financial institution.

The microfinance sector consists of nearly 14'000 institutions that directly or indirectly provide microcredit products. Many of these financial institutions are either non-governmental organizations (NGOs), not for profit, or follow a local cooperative structure. There are only a few for-profit MFIs. The segment is dominated by five to seven MFIs that serve the majority of the low-income customer segments. Nevertheless, Sri Lanka has a decent credit bureau in place. The cases of over-borrowing and multiple lending are on the rise because most of the leasing companies are going down-market by offering group microfinance products. Rising delinquency across the institutions are a major concern due to the slowdown of economic growth. During this project, the microfinance sector went through a rough patch, largely due to political interferences which talked about waiving off microfinance group loans below LKR 100'000 (approx. USD 530). As a result, borrowers stopped repaying with the assumption that their loans would be waived off. The microfinance sector of Sri Lanka was still recovering when the Easter terrorist attack and CoVid-19 further created operational problems. The real impact of CoVid19 will be felt in the coming months when MFIs resume their operations in the field.

<sup>1</sup> Adapted from the World Bank's website and a document from United Nations (Maps Approach Supporting SGD Implementation in Sri Lanka 2018)

<sup>2</sup> Adapted from Findex database and the World Bank's website, National Financial Inclusion Survey 2018/19, National Housing Plan, Revised Report January 2017, Housing and Sustainable Urban Development in Sri Lanka Country Report for Third United Nations Conference- Habitat III, Microfinance sector in Sri Lanka: Opportunities and growth strategies (Intellectap), and from team's experience in Sri Lanka

The housing sector in Sri Lanka is segmented between private commercial banks and state-owned banks, with a small number of other financial institutions providing housing loans. The mortgage rate of Sri Lanka as a percentage of the GDP is relatively low at 6%. The private sector provides housing credit to the top 20% of the upper-income group with fixed incomes and permanent employment. Only 11% of the adult population had an outstanding housing loan. Considering these gaps in the overall supply of housing finance products for low-income people from the mainstream commercial banking institutions, MFIs or non-bank financial institutions that specifically target the bottom of the pyramid market, have a big role to play in closing the adequate housing gap.

### **Partner financial institution**

LOLC Finance PLC (LOLC) is the largest non-bank entity in Sri Lanka. Previously, microfinance operations were carried out through its subsidiary LOLC Micro Credit Ltd (LOMC). LOMC was merged with LOLC Finance PLC in March 2018 (just at the commencement of this project), making it the largest MFI in Sri Lanka. This also enabled the microfinance clientele to access deposits, money transfers, and bill payments in addition to the credit products. As of December 2019, LOLC operates across all provinces of Sri Lanka through 139 branches and has USD 782 million gross loan portfolio (GLP) serving 474'688 borrowers through a variety of products.

## **2. INTERVENTION APPROACH**

### **Capacity building needs**

LOLC Sri Lanka and Habitat for Humanity's Terwilliger Center for Innovation in Shelter (Habitat's TCIS) had a prior relationship. Habitat's TCIS has been providing advisory services to LOLC in 2016 for the refinement of their housing microfinance product. The Habitat's MicroBuild Fund<sup>3</sup> had also invested in LOLC. The first phase of the technical assistance focused mainly on the product refinement in which the existing product was customized to make it more client centric. Towards the end of this first phase of the project, LOLC identified other areas which needed advisory support for further improving internal systems as it planned to expand its housing portfolio.

Considering the demand for housing microfinance in Sri Lanka, LOLC wanted to scale up the product outreach within the target group (while keeping the product quality). However, the existing monitoring and supervision activities could not meet the requirements put forward by the growth in the housing portfolio. Therefore, LOLC wanted to improve their internal monitoring and supervision systems / policies, develop the capacity of its staff in the successful delivery of housing microfinance loans, and overall improvement of the product management / product monitoring framework. With the support from SCBF, the Habitat's TCIS was able to assist the institution with further development.

### **Main activity areas (goals, targets, resources & time frame) and outputs**

In view of the above challenges in improving the housing portfolio performance and outreach, the project (July 2018 to April 2020) focused on the following components:

- 1. Streamline the monitoring and supervision framework of field operations:** In order to strengthen the framework, the following interventions took place:

Implementation of standardised monitoring and supervision framework through:

- *Housing loan promotion activity plan*
- *IL supervisor monitoring checklist*
- *Monitoring dashboard for housing loan processes*

- 2. Enhancing and improving the functionality of systems:** LOLC had been pilot testing a remote loan origination system (LOS), which allows originating and capturing loan related information directly in the field using a tablet device and results in paperless operations. The pilot was ongoing in two branches in which both housing and enterprise loans were being originated using the technology. The focus was on understanding existing loan-related workflows in the existing LOS and recommending additional functionalities that would complement the monitoring and supervision process and help with effective decision making. The following recommendations were provided:

- Expand the scope of LOS by including two critical stages of lead generation and credit bureau checks. The same has been approved by the business and IT team and will be integrated within LOS in the phase 2 IT implementation (after the successful rollout of the existing module across all branches).
- *Capture the loan purpose in the system* as it allows LOLC track the usage of loan proceeds such as home improvements, repairs, extension, new construction, etc. and may give important insights on borrower's requirements and behavior.

<sup>3</sup> The MicroBuild Fund is a debt fund, owned and managed by Habitat for Humanity, which provides wholesale lending to microfinance institutions for on-lending towards housing microfinance purpose.

- *Introduction of a Pre-Qualifying Screening Form for the housing loan:* The proposed questionnaire is a simple checklist of mandatory eligibility questions, which help loan officers to determine the eligibility of the potential client for a housing loan

3. **Strengthen the capacity of the staff in the delivery of housing loan products:** Habitat TCIS developed a detailed training module covering the entire loan product’s features and processes for orientation of the field staff and achieving standardization of operations across all branches. The training module for the product clearly outlines product features, all processes in the lending cycle, and roles and responsibilities of staff involved in the delivery and management of the product. Two-day training of trainers’ (ToT) session on the module was conducted for 21 staff, including the field staff and product management team.



4. **Product Development and Management:** A framework featuring the best practices around product development and management was designed. A virtual orientation for the product / credit team was arranged. The main objective was to highlight the best practices on product development and management, which can be incorporated by the existing product / credit team in their day to day practices.

In addition to the SCBF funding, Habitat’s own funding (from the Hilti Foundation) was also used in this project for meeting logistics costs.

### 3. RESULTS ACHIEVED AND NOT ACHIEVED

#### Client level

At the time of the initiation of this project, LOLC already had an established housing finance product (which had been refined by Habitat a few years ago). With limited access to housing finance for low income clients in Sri Lanka, LOLC’s housing loan product carried a good value proposition for low-income clients. The components designed for this project did not directly influence the product design, however, this project really contributed to improving internal systems, policies, and procedures of the organization, which ultimately improve the customer experience.

Mrs. Vipulasena lives with her husband and son in Divulapitiya, Gampaha District, Sri Lanka. The main source of income for the family is through her husband, who is a taxi driver. She has been associated with LOLC for several years now. The family wanted to improve their housing conditions as they wanted a safe and secure place for living. In 2015, they took a group loan of 25’000 Sri Lanka rupees (approx. USD 130) from LOLC. Initially, they wanted improvements in the living room, bedroom, and washroom but later decided to focus only on the kitchen with this loan as it was a pressing requirement. Mrs. Vipulasena was able to carry out basic construction by laying out the foundation and some blocks for their kitchen. She serviced the first loan promptly with the help of her husband’s income. They took a second loan, but even that loan was also not sufficient for completing the kitchen work.

“We are happy and we thank all the LOLC officers and the company who helped us since we couldn’t get this done without LOLC. This was a dream come true and a big step for us in order to make our home actually a better place to live”

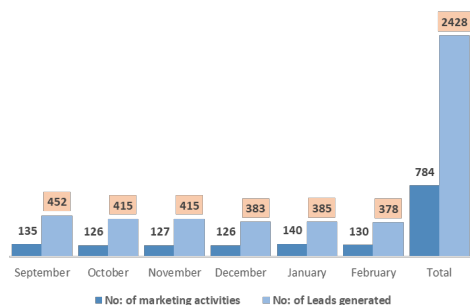
**Mrs. Vipulasena, LOLC’s Housing Loan Client**



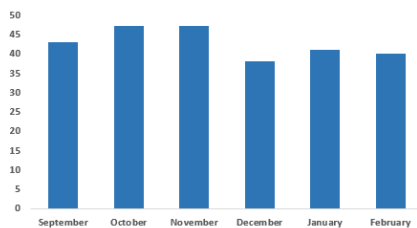
After building a credit history with LOLC, Mrs. Vipulasena applied for an individual housing loan, with her husband as a co-borrower. She took a loan of SLR 325k (~USD 1’700). The higher loan amount allowed her to complete the full construction of the kitchen and achieve the dream of having a good and spacious kitchen. This also allowed them to install floor tiling in the kitchen area and a few kitchen cabinets along with a proper ventilation system. Mrs. Vipulasena has been repaying the loan on time and she is grateful for the support provided by LOLC through its housing product.

Partner financial institution/s level

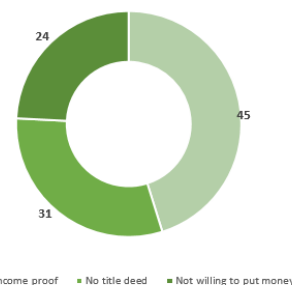
Marketing Activities v/s Leads Generated



No. of Pre Qualifying Screening Forms Filled



The above graph shows the month wise total number of Pre Qualifying Screening form filled by the 50 IL Officers.



Of the total number of forms rejected, the highest reason recorded was absence of income proof (45%), followed by title deed

In the absence of a standardized risk-management and monitoring framework, scaling up a product can pose significant risks. The first component of the monitoring framework has allowed LOLC to have greater visibility and accountability of the field-based operations. Initially, the product ownership was an issue at the branch level as the individual loan officers (who are responsible for housing loans) were reporting to the Group Loan Supervisor, who did not have enough bandwidth and capacity to provide mentoring and monitoring / supervision support to these loan officers. This was impacting the quality and efficiency of the operations. LOLC acted on the recommendation and started hiring Housing Loan Supervisors / Individual Loan Supervisors, responsible for monitoring the performance of individual loan officers and the housing loan portfolio at the branch level. The deliverables produced under the monitoring framework (including checklists and tools) have started to show results as a real-time feedback mechanism on the performance of the loan officers. The framework dictates the frequency of monitoring visits and recording of observations, which helps in effective monitoring.

The promotion activity planning tool helps the supervisors to plan and monitor the effectiveness of promotional activities in a systematic manner instead of an ad-hoc approach. This is also expected to improve the outreach and quality of the leads generated by individual loan officers. The pilot testing of the tools that took place from Sept. 2019 to Feb. 2020 showed impressive results. During this phase, four IL Supervisors actively used the tools and monitored the performance of 50 Individual Loan Officers. All the checklists were comprehensively filled including the qualitative remarks which these supervisors observed in the field.

In terms of improving the functionalities of the LOS system, LOLC was able to add a new field in the system that captures loan purpose and is an important monitoring metric. All the leads that are generated mandatorily go through the preliminary screening form that helps loan officers determine the eligibility of the prospective clients. During the pilot testing phase, 256 prequalifying screening forms were filled, with 200 forms being approved and 56 forms rejected. 45% of reasons for rejection was due to lack of income, 31% due to absence of title deed and 24% by lack of willingness to put margin money. Identifying ineligible customers at this stage is an important step and saves precious time during the loan application and appraisal process. The credit bureau checks the detailed cash flow appraisals which are done only for those clients who pass the pre-qualifying screening form, thus, preventing the organization from spending additional resources on ineligible clients. The long-term plan is to integrate this pre-qualifying screening form as a judgmental credit scoring system within the existing system. Together with the automation of this credit scoring tool and the monitoring dashboard, the organization is expected to improve the overall loan-related workflow management and gain greater control over field operations. All these indicators will eventually feed into the product development process and influence the product design, making it more aligned with the needs, preferences, and capacities of low-income households.

<b>Number of active borrowers</b>	15'826 (total Housing Loan Clients)
<ul style="list-style-type: none"> <li><b>Thereof, number of active women borrowers</b></li> </ul>	Not available for the housing product. For the overall portfolio it is 290'803
<ul style="list-style-type: none"> <li><b>Thereof, number of active borrowers living in rural areas</b></li> </ul>	Not available for the housing product. For the overall portfolio it is 371'910
<b>Total number of loans disbursed</b>	6'337
<b>Total value of loans disbursed (in Local Currency or USD, please specify)</b>	USD 17.02 million
<b>Average loan size (in Local Currency or USD, please specify)</b>	USD 2'685
<b>Portfolio Quality (PAR 30)</b>	43.49%
<b>Total number of clients with payments due for over 30 days</b>	Not available yet

The module on capacity building has helped LOLC create a pool of in-house trained members, responsible for training other staff on housing loans. LOLC is now using the same module and training in its entire branch workforce. The capacity building of staff is expected to address the field level inefficiencies and challenges such as poor compliance to processes, lack of orientation to product promotion and client communication, and a higher turnaround time of applications. These factors would influence customer satisfaction and client retention rate in the medium to long term.

"Training module, monitoring framework and the product management framework introduced by the Terwilliger Center have been really helpful. We can adapt these for our other products as well"

**Mr. Aruna Logus**, Senior Manager, Micro Housing and Enterprise Development, LOLC Finance

With the help of the product management framework, LOLC's core product / credit team learned the best practices around product development and management. Other common tools were introduced that can be applied in their tasks around product management and how the needs of low-income families can be kept at the center while designing products. Another distinguishing feature has been that all the deliverables that were produced under this engagement can be adapted and customized for LOLC's other products. This would result in an organizational level impact which is much higher than envisaged from the project.

The project took place from July 2018 to April 2020 and in terms of potential impact, it was estimated that 7'200 families would gain access to housing microfinance services with an estimated capital mobilization of USD 14.4 million. By the end of the project, *LOLC reached out to 6'337 families (88% achievement) with a total capital mobilization of USD 17.02 million (118% achievement)*. Considering the difficulties (in terms of political, health, and security shocks) which LOLC experienced during the project, the impact numbers generated in the project are satisfactory.

#### 4. LESSONS LEARNT

The advisory support to LOLC Sri Lanka met its objectives as it was geared towards organizational strengthening and risk management. This is particularly important in the context of the macro environment in which LOLC operated during this project timeframe. In the two years of the project, the Sri Lankan economy and the microfinance market underwent significant challenges, including political instability, microfinance loan waivers leading to higher delinquency rates, Easter terrorist attacks, and more recently CoVid-19, bringing the entire country to a standstill.

The design of the advisory package was finalized in consultation with the management team of the MFI and was in continuation of the support provided by the Habitat's TCIS in its previous project. The management team of LOLC played a crucial role in the completion of this project as they assigned a product champion, who worked very closely with the Habitat's TCIS throughout the engagement. The entire product development / credit team worked very closely and extended all the necessary support allowing them to complete all the project-based milestones. Two key members from LOLC's product development team also played the role of in-house trainers along with Habitat's TCIS team and delivered the Training of Trainers to all the participants.

During the initial project phase, the merger of LOMC with the LOLC group resulted in the management prioritizing of streamlining the internal systems and processes. As a result, the implementation of the project recommendations was delayed by a few months. The Easter attacks in April 2019 severely affected the economic sector and the livelihoods of customers. With more resources dedicated to controlling the delinquency rates, the focus was more on business stability rather than expansion, which is also a prudent thing to do in those circumstances. Despite all these factors, they still were able to introduce key elements from the monitoring framework and accomplish the pilot testing phase of those tools / checklists. The recommendations around the IT / MIS have been partially implemented due to the delay in the roll-out of the LOS by the IT vendor. LOLC just very recently completed the rollout of LOS across all branches. It is important to mention that such delays that arise due to the dependency on third parties were not envisaged during the project concept stage. However, such experience is critical and must be used to inform the project design in the future. LOLC remains committed to implementing remaining recommendations in the IT / LOS system during the second phase of IT implementation.

<sup>1</sup> The World Bank Group (2018). World Development Indicators database. Washington, DC. <http://data.worldbank.org>. Accessed (05-04-2020)

<sup>2</sup> Heritage Foundation, (2019) Index of Economic Freedom, <http://www.heritage.org/index/ranking> Accessed (05-04-2020)

<sup>3</sup> The World Bank Group (2018). Worldwide Governance Indicators database. Washington, DC. <http://databank.worldbank.org>. Accessed (05-04-2020)