

Social inclusion through housing micro lending: lessons from Central America

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Abstract

Central America is one of the most unequal regions in the world in terms of income distribution. Urban low-income households, most working in the informal economy and with lack of solid collaterals, have with few exceptions been excluded from accessing capital for housing improvement or new housing from the formal banking system.

In recent years however, there is an increased number of non-traditional financial institutions that provide low-income sectors with innovative financial schemes, especially combining micro credits with savings and self-help schemes sometimes complemented with subsidies from the State. The micro-lending schemes suggest that the housing needs of the poor can be financed in a way that is economically viable for the financial institutions and affordable by the poor.

Based on the low-income housing micro-credit experiences implemented in Central America supported by the Swedish International Development Cooperation Agency (Sida) the paper will analyze the potentialities and limitations of these programs to increase social inclusion and possible ways to measure their impact. The analysis draws from the author's own experience working with these micro finance programs.

Introduction¹

For the past twenty years, Sida has supported diverse initiatives in local development and low-income housing in Asia, Africa and Latin America. These initiatives are aimed at improving the living conditions of the urban poor, especially those families living in slums and unplanned areas. The programs are executed through a variety of actors including central and local governments, NGOs, private financial institutions and community based organizations. Diverse instruments have been developed which include the strengthening of management capacities at national and local levels in:

- a. the provision of secure land tenure, including women's access to land;
- b. the introduction, expansion, management and maintenance of basic services and infrastructure through the promotion of partnership schemes between local governments and poor urban communities ;
- c. the development of innovative finance schemes, including micro-lending for housing improvements and income-generating activities, and most recently;
- d. the rehabilitation of historic urban districts and the establishment of a base for heritage preservation.

A common characteristic of these initiatives is the strong involvement of the targeted families and communities in the design and execution of the programs, as well as in the

¹ Parts of the present paper are based in a document prepared by the author for Sida on March 2005 called 'Can low-income housing supported programs make a difference to fight urban poverty?'.

cost recovery and sustainability of the projects and the institutions that support and promote these processes. The programs seem to be tailored to local needs, demands and conditions, and participation is seen as a vehicle for promoting social and democratic development. Aspects such as relationships to on-going programs, opportunities and operational considerations, interest and capacity on the recipient side and involvement of other donor agencies have been taken into account in their planning and implementation.

In spite of the relevance of these initiatives, a systematic effort to study their impact is still incipient. Sida and the institutions responsible for the programs in the region have dedicated important energies and resources in the last decade to set up and ensure that the programs can continue after Swedish resources diminish. External and internal follow up, monitoring and evaluation mechanisms have clear operative goals so that lessons learned can immediately be translated into the implementation schemes. Less attention therefore has been given to assess their social impact.

The current paper summarizes the goals and methods to be used in an in-depth research aimed to assess the effectiveness that these low income housing and local development programs have for urban poverty reduction and social inclusion in Central American².

The Central American context

During the 1990s, the Central America region achieved significant urbanization levels.³ In 2003, it had a population of about 38.6 million, of which 52% lived in urban areas, and about 42% of this urban population lived in slums and other informal settlements (see Table No. 1). The region's income distribution is also one of the most unequal in the entire world (UN-HABITAT 2003).⁴ These sharp socio-economic differences generated the conditions for the social unrest that characterized the region during the 1980s and 1990s, especially in Guatemala, El Salvador, Honduras and Nicaragua.

The region has also been affected by natural disasters, which have contributed to rural to urban migrations and loss of economic activity⁵. More recently, spread urban violence has created a sense of citizen insecurity and fear. Urban violence is becoming part of the daily challenges that the poor and professionals have to face daily in their cities.

The result of these factors has been raising urban poverty levels and social disintegration, with growing demand for land, housing and services, as well as migration of hundreds of

² The study will be carried out between September 2004 and August 2009 by HDM Lund University with support from Sida. The research methodology will be developed in collaboration with practitioners from the programs during 2005. Field work will take place in 2006 and 2007. Policy makers, members of the donor community, academics, practitioners and clients from the programs will be involved in the analysis of the findings. A series of documents on the research will be published in international scientific journals.

³ Central America is composed of Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama. Since Belize and Panama do not have a Sida supported programs, some data for these countries is not included in Table No. 1.

⁴ According to the Gini coefficient which measures income inequality ranging from 0 (perfect equality) to 1 (perfect inequality) four countries have coefficients above 0.5. Nicaragua has 0.584; Guatemala 0.582; Honduras 0.564; El Salvador 0.519 while Costa Rica has 0.473 and Panama 0.49 (see Table No. 1).

⁵ Hurricane Mitch in 1998 caused economic damages of about US\$ 9 billion. The direct estimated damages of the 2001 El Salvador Earthquakes add to about US\$250 million (McDonald et al, 2001).

thousands of people to other countries, especially the USA and Canada, but also to neighbouring countries such as Costa Rica. This international migration has increased the volume of remittances being sent from members of families living abroad.⁶

As in other parts of the world more than 85% of low-income housing improvements and new housing construction in Latin America are made by the poor households themselves in the majority of the cases, without any technical or financial assistance by formal private or public institutions. The majority of professionals, including civil engineers and architects in Latin America are usually trained to work and focus on the remaining 15% of the so-called formal housing sector (HDM, 2005).

Commercial private financial and banking institutions in the region, usually avoid involvement in housing finance for the poor because the lack of solid collateral and stable income and the low profit margins that these sectors represent. Public sector finance also has also failed to reach the poor. Low-income households, most working in the informal economy, have with few exceptions been excluded from accessing capital from formal private or public financial institutions. (Center for Urban Development Studies 2001).

In recent years however, there is an increased number of non-traditional financial institutions that service these sectors with innovative financial schemes. The experiences show that the housing needs of the poor can be financed in a way that is economically viable for the financial institutions and affordable by the poor. Some of these institutions and schemes have been supported by international donor agencies, including Sida.

Sida supported programs

Since 1988, Sida has allocated resources in the order of US\$ 50 million for this purpose. The resources from Sida are channelled through different institutions and programs:

- a. the Housing Promotion Foundation (FUPROVI) in Costa Rica;
- b. the Urban and Rural Social Housing Development Foundation (FUNDEVI) in Honduras;
- c. the Foundation for Local Development (PRODEL) in Nicaragua;
- d. the Salvadoran Integral Assistance Foundation (FUSAI) in El Salvador, and;
- e. the Local Development Trust Fund (FDLG) in Guatemala.

In spite of country differences the model of work promoted by Sida in the region has been relatively simple. The programs are based in lending credits to low-income families to improve or to expand their existing house or build a new house. Credits are given directly to clients (FUPROVI in Costa Rica and FUNDEVI in Honduras) or through specialised non-traditional financial intermediary institutions that give long term and short-term loans. PRODEL in Nicaragua and FDGL in Guatemala function as second tier organisations. FUSAI gives loans through a financial institution it has created (see Table No. 2).

⁶ About 10% of Guatemala's population has migrated to the USA and Canada and about 30% of the households receive remittances (OIM, 2004). Average households in Central America receive about US\$2,000 per year on remittances (see Table No. 1). In the majority of cities, the income from remittances exceeds by far the monthly family income earned locally in formal or informal economic activities.

The credits are sometimes combined with subsidies coming from governmental sources (in Costa Rica, Honduras and El Salvador) and complemented with savings, self-help and labour input efforts by the beneficiary families. In some of the programs, lines of credits (at the beginning of the FDGL programme in Guatemala and currently FUNDEVI in Honduras) or matching funds (PRODEL in Nicaragua) are given to municipalities for the improvement and provision of basic services in existing and new low-income settlements. The financial assistance given by these intermediary institutions is complemented with technical, social and legal assistance that helps the clients to gain access to secure land tenure, the introduction and expansion of basic services and infrastructure, and the possible and appropriate designs for the improvement and expansion of their houses. All the programs use the concept of incremental and gradual housing solution that is compatible with the capacities of savings, repayment of loans and in-kind, monetary and labour contributions of the participant families⁷.

In new formal settlements the institutions are involved in the planning and lay out of the new settlements, providing directly or through state institutions, the necessary infrastructure and basic services, assisting in land titling, lending to the families, giving technical assistance for the construction of the houses through self-help methods and resettlement of the families and occupancy of the new houses. In existing 'informal' settlements, the steps can be reversed: lending can take place before the building or improving the house, and before the provision of infrastructure and basic services. In some cases only basic services are introduced with little possibilities of lending given the income level of the target population. Thus, different approaches have been developed to work both with formal and informal settlements.

Credits are usually given at a non-subsidised interest rate. In the majority of the programs these rates reflect but do not necessarily match the market interest rates that exist for mortgage loans in the formal sector. They range from 14% per annum to the clients in Nicaragua to 23% in El Salvador. The programs accept a wide variety of collateral and securities by the households (especially mortgage, the use of pawns and co-signed loans) (see Table No. 2). The flexibility in the use of collateral has allowed the incorporation of low-income sectors (having monthly family incomes that range between US\$100 and US\$ 500) to the programs even if they have not fully resolved their land tenure.

Once the credits are recovered, the resources are reinvested by the programs as new loans to families of the same income strata. This ongoing operation has allowed the creation of various revolving and rotating funds. The basic principle that guides these funds is to maintain during a relatively long period of time, the value of the original seed capital given by Sida or other resources so that it can be reinvested in the same target population. Thus, the recovery of the funds and the maintenance of its value become in the mid and long term, an important tool for urban poverty alleviation as they are able to continue

⁷ As Mittlin (1997) points out, the construction process by which low-income households organize the building of their housing is, by necessity, incremental and over a long period, as they do not have the resources and cannot afford to build complete houses immediately or to cover the costs of homeownership. Recent studies suggest that low-income households use their savings, labour and other resources to build their houses over a period of between five and fifteen years (Ferguson 1999).

financing new poor clients. Sida's policy through the region has been that housing subsidies is primarily a responsibility of national governments that act as counterparts of the international co-operation in this type of programs. That is the reason why the majority of the funds allocated by Sida have been channelled to finance three main components of these programs:

- a. loans (including micro-loans for housing improvement and new housing construction);
- b. technical assistance (both to executing agencies and the target population) and;
- c. institutional development, especially of those institutions that serve as intermediary of the funds.

Outcomes

By the end 2004, the five programs had benefited more than 90,000 low-income families of the main urban areas of the region, or about 450,000 people in the improvement of their habitat conditions. This represented about 3% of the total urban population of the five countries and about 6% of the total urban poor. It is still a small number compared to the demand, but it shows that small investments if channelled in an appropriate way can have effects in the living conditions of the poor. The average investment cost per person is about US\$ 110. It is estimated that Sida resources have mobilised another US\$ 50 million of national and local contributions. National resources come in the form of subsidies and local resources in monetary and in-kind forms, and labour force contributions by municipalities, community organisations and participant families.

The majority of low-income families that have participated in the programs had the capacity of repayment of a loan. In monetary terms, they earned at least one minimum wage per month. Yet, there were invariably some households that were too poor to have the minimum capacity of income required for repayment. These families were assisted by other means, mainly through the infrastructure component.

In four countries the majority of clients of the programs are women. In Costa Rica 60% of the loan clients are women, in Nicaragua 62%, in Honduras 60% and El Salvador 55% (see Table No. 2). This fact seems to be the consequence of deliberated policies that programs have tried to promote in which financial (both as loans as well as subsidies) and technical resources are targeted to urban poor settlements where normally there is a significant number of households headed by women.

Measuring the impact of the programs

In spite of the mentioned outcomes, it is still not sufficiently evident and documented how these interventions, especially through alternative financial mechanisms such as micro lending for housing improvements, the introduction and expansion of basic services and secure land tenure, have uplifted and transformed the poor communities in the cities and towns where the programs have operated. Understanding the current debate on the impact of microfinance on poverty reduction helps to define more clearly the parameters needed to evaluate the social outcomes of these programs.

During the last ten years, important efforts have been done by the donor community to assess the direct and indirect impact of microfinance programs. The majority of the literature however concentrates on the impact of micro-lending for micro-enterprise activities⁸ and to a lesser extent on housing improvement. Probably the reason for this is the fact that housing microfinance is just beginning to emerge from the shadows of micro enterprise lending and mortgage-based housing (Daphnis and Faulhaber, 2004).⁹

Yet, even studies on micro enterprise activities have as their focal point the understanding of the institutional performance of lending institutions in their quest to achieve self-sufficiency and financial sustainability than in measuring the social impact or the 'outreach' of their work.

A frequent question asked is whether or not the microfinance institutions are reaching the poorest of the urban and rural poor. CGAP (2004) now acknowledges that donors have learned more over the past decades about the best ways to support the emergence of inclusive financial systems than on improving indicators to measure and monitor social performance. It also recognizes that financial services, especially micro-credits are not a magic bullet for all poor people. In other words, probably the micro finance institutions are doing well, while the poor are not necessarily being reached.

With regards to the direct impact of the programs, some elements seem to be easier to measure and are regularly reported by the micro lending institutions that deal with micro-enterprises and those working in housing improvement (e.g., the geographic locations of the target population; the number and gender of clients served and their level of income or how far in the income distribution has the credit programs reached; the loan amounts given per client and per economic activity or per type of the housing improvement, the interest rates used, the commissions charged for technical assistance and legal aspects, the loan use repayment periods, the securities and collateral requested, the eligibility criteria per income strata, and the processing time and administrative costs per loan).

According to Meyer, Nagarajan and Dunn (2000) however, the conceptualization and measurement of 'outreach' is still not well developed. One of the main problems is that micro lending institutions cannot address the question of how their criteria of targeting the poor relate to existing national poverty measures (including poverty lines). They propose some proxies and benchmarks to overcome this limitation. Some of the indicators proposed relate to the household income and the level of per capita consumption expenditures; and to the characteristics of household demographic (age, gender, education and size), the characteristics of the housing conditions (roofs, walls, floors and land tenure) and the access to public infrastructure and services.

⁸ The Consultative Group to Assist the Poor (CGAP), a consortium of 28 public and private development agencies working together to expand access to micro financial services for the poor in developing countries on a large scale, has promoted a series of studies and publications mainly on lending for micro-enterprise activities. For more details on these studies see: <http://www.cgap.org/publications.html>

⁹ On recent applied studies for micro credits for housing improvement see for example the work of: Cacnio (2001); Centre for Urban Development Studies (2000); CHF (2005); Cities Alliance (2002); Daphnis and Faulhaber (2004); Daphnis and Ferguson (2004); Homeless International (2000); Mitlin (1997); PRODEL (2005); Stein (2001); Stein and Castillo (2004).

Recent studies on the other hand have shown the limitations of working with national poverty measures. Satterthwaite (2004) contends that policy makers, practitioners and academics should be careful on using poverty lines based on assumptions such as the US\$ 1 per capita per day as a means to define and measure poverty, as they tend to underestimate the realities of the urban poor.

One of the main characteristics of the urban poor is their dependency on a periodic income cash flow for their survival that in many cases is not only inadequate, but also unstable and uneven. Food, cooking fuel and water, as well as transport and other vital services are generally purchased with money. Land and housing, even a cheap shack built of scrap materials, are expensive goods in the majority of urban settings of the developing world. Thus, the monetary cost of living is therefore higher for urban than for rural households.

Other studies also suggest that poverty, especially in urban areas, as conceived by the poor themselves cannot be defined exclusively in terms of money-metric poverty lines or low incomes. It also requires using broader concepts of deprivation and insecurity and analyzing how the poverty situation of a household changes during a period of time: from impoverishment to increased levels of welfare or from exclusion to social inclusion (Rakodi and Lloyd-Jones, 2002). Any attempt to place monetary values on aspects of personal, household and social deprivation involves so many arbitrary assumptions that it is likely to be meaningless (Rakodi, 2002:5).

The widening of poverty definitions both in terms of the way it is measured and how poor people understand their current and future situation has implications to development cooperation aid. If poor people are seen not as objects of aid but as citizens with rights and legitimate demands, who have resources, capabilities and rational economical strategies of survival that can contribute to more effective poverty reduction it will have significant consequences on the way policies and programs are designed and implemented (Satterthwaite, 2004). This will also have connotations on the methods used to assess and evaluate the impact of these programs.

According to Wright and Copestake (2004) assessment methods for micro-lending institutions should enable both *proving* that programs have social impacts while also *improving* the organizational development that allows generating better impacts. Thus, micro lending projects should be able to assess on the one hand, the direct impact on the material conditions of the poor, while on the other, the 'non material' impacts that micro lending projects usually generate (e.g., more understanding of acquired techniques, skills and abilities by the poor; changes of perceptions and attitudes in relation with their personal and household situation and in their relationships with other local power structures, including grass root organizations, local governments and NGOs, development of safety networks and enhanced strategies and capacities to face risk situations, etc.).¹⁰

¹⁰ An assessment of urban poverty reduction cases in the developing world, some including savings, micro-credit, and self-help schemes for housing improvement as means to empower local communities can be found in Mitlin and Satterthwaite (2004). For the assessment of new micro-finance instruments such as micro-insurance and its possible impact on reducing the vulnerability of the poor see Morduch (2004).

Some final epistemological remarks

Microfinance for housing improvement is at the end of the day an arrangement between means and ends aimed to reduce poverty. To measure its social impact requires however, the construction of a social model that looks beyond its rationality and enables to understand its limits. Following Serrano's Critic of the Scientific Reason (2004) this requires defining what is *not possible, not probable, not feasible, not convenient* and therefore *not legitimate* to happen. And it is from this critical perspective that we will be able to determine the *most suitable and legitimate* solutions that are *able to be implemented*, and that are *likely to happen* in order *to integrate* and *not exclude* the urban poor. This is what the research aims to do.

Table No. 1: Central America: Selected Social and Economic Indicators

General Information	Belize	Costa Rica	El Salvador	Guatemala	Honduras	Nicaragua	Panama
Population in millions (2003)	0.27	4.0	6.5	12.3	7.0	5.5	3.0
Urban population (% of total population) (2003)	48%	61%	59%	46%	46%	57%	57%
National Poverty Rate	NA	22.0%	48.3%	57.9%	53.0%	50.3%	37.3%
Poverty Rate. Urban Population	NA	19.2%	43.1%	33.7%	57.0%	31.9%	15.3%
GNI per capita in US\$ (2003)	3,370	4,300	2,340	1,910	970	740	4,060
Percent of total income earned by the richest 20% of the population	NA	51%	56.4%	60.6%	59.4%	63.6%	52.8%
Percent of total income earned by the poorest 20% of the population	NA	4.5%	3.3%	3.8%	2.2%	2.3%	3.6%
Gini coefficient	NA	0.46	0.518	0.582	0.564	0.584	0.490
Life expectancy at birth	71	79	70	66	66	69	75
% of women headed households	NA	23.2	28.8	20.5	25.3	27.8	NA
Urban unemployment Average annual rates (2004)	NA	6.7%	6.3%	8.0%	8.0%	10.2%	NA
Average household remittances received by households in 2003 (US\$)	NA	2,800	2,300	2,150	2,060	1,170	NA

Sources: WRI (2003) and World Development Institute, The World Bank (2005) statistics.

Table No. 2: Basic characteristics of the housing programs in Central America

General Information	FUPROVI Costa Rica	PRODEL Nicaragua	FUSAI El Salvador	FUNDEVI Honduras	FDGL Guatemala
Year of establishment	1987	1994	1993	1992	1999
Type of organization	Non Governmental Organization (NGO)	Governmental program transformed into a private foundation	NGO. Loan operation transformed to a financial institution called Integral	Governmental program transformed to Public Foundation	Public Trust Fund
Total housing loans disbursed to 2004	25,000	17,000	15,000	26,000	3,900
Number of persons that improved their housing conditions	125,000	85,000	75,000	130,000	19,500
Numbers of shelter loans (divided by land, infrastructure, houses if Possible)	75% for new housing (includes services and land title). The rest for housing improvements.	95% of shelter loans are for housing improvements and repairs	25%: new housing; 22%: site and services; 16%:land titling; 37% for housing improvements	60% for housing improvements and 40% for new housing in new sites.	95% for housing improvements and 5% for new housing
What are loans given for?	Buying + titling of land, housing improvement and new housing construction + introduction or improvement of basic services + infrastructure	Buying +titling of land, housing improvement and new housing construction + introduction or improvement of basic services + infrastructure)	Buying + titling of land, housing improvement and new housing construction + introduction or improvement of basic services + infrastructure)	Buying + titling of land, housing improvement + new housing construction + introduction + improvement of basic services + infrastructure	Buying + titling, of land, housing improvement, and new housing construction + introduction or improvement of services and infrastructure.
Type of institution: retailer or second tier	FUPROVI is a retail lender that gives loans to organized groups or individual clients	Second tier institution that intermediates funds through Microfinance Institutions (MFI). Each MFI lends to end user clients	Retail lender through Integral (a MFI) to groups and individual clients	Retail lender to individual clients	Second tier institution that intermediates funds through 8 MFI and cooperatives.
Average size of shelter loan to clients <i>in US\$</i>)	3,000	817	1,061	1,840	1,100
Maximum size of shelter loan US\$	7,000	1,500	3,500	3,500	3,750
Interest rate on shelter loans: <i>reflects values between 2003-2004</i>)	To clients: 19% per annum over outstanding balance	To clients: 14% per annum over outstanding balance	To clients: 23% per annum over outstanding balance	To clients: 20% per annum over outstanding balance.	FDLG to MFI: 8% per annum over outstanding balances. From MFI to clients 18% per annum over outstanding balance.
Maximum loan period	Up to 10 years for new construction. 8 years for improvements	Up to 4 years from the MFIs to the clients	Up to 7 years to clients	Up to 10 years for new houses; 5 years for improvements	FDLG – MFI: 6 years MFI – Client:3 years
Deposit required	No monetary deposit or down-payment required beforehand. Labor and in-kind contributions of families should be at least 20% of the total value of the solution.	No monetary deposit or down-payment required beforehand. Labor and in-kind contributions of families should be at least 10% of the total value of the solution.	No monetary deposit or down-payment required. Labor and in-kind contributions of families should be at least 10% of the total value of the solution.	No monetary deposit or down-payment required. Labor and in-kind contributions of families should be at least 10% of total value of the solution.	Not applicable for housing improvement
Savings requirements	No savings for housing, yes for micro-enterprises	No savings for housing, yes for micro-enterprises	No savings for housing, yes for micro-enterprises	No savings for housing	No savings for housing.

General Information	FUPROVI Costa Rica	PRODEL Nicaragua	FUSAI El Salvador	FUNDEVI Honduras	FDGL Guatemala
Collateral requirements	As loans are relatively big they have to be mortgaged.	Depends on the amount to lend. Less than US\$700 land title is not required, and pawns, fiduciary and solidarity collaterals can be used.	Land title or in process of legalization is required to mortgage loan. Depending on amounts pawns, fiduciary and solidarity collaterals used	Although fiduciary and solidarity collaterals have been used mortgage loans are preferred for the majority of its loans	For housing improvement, different types: mortgage, fiduciary, also solidarity groups (new in housing improvement loans).
Required tenure status	Legal title or in the process of legalization	Recognition of ownership right and legal tenure (not necessary full title)	Legal title or in the process of legalization	Legal title or in the process of legalization	Does not apply.
Maximum ratio of income/repayments <i>Portion of monthly family income to repay loan during given period.</i>	25%	15-25%	30%	30%	30%
Charges made by the MFI to lender for securing loan	2% loan commission for administrative fees and 2.5% for legal costs	1% for legal fees and administrative fees	2.5% for administrative fees; 2.5% upfront for transaction costs 1% for legal costs and 1% for life insurance	6% for administrative and transaction costs and 1% for legal costs.	Does not apply for housing improvement.
Cost recovery data? Portfolio at risk measured as % of total loan portfolio with arrears of more than 30 days.	6%	5%	6%	30%	MFI-FDGL = 0% Clients-MFIs = 1%.
Percentage of loans to women in housing improvement?	60%	62%	55%	60%	33%
Do you provide technical assistance?	Yes, and there is a loan commission of 10%.	Yes and there is a 4% commission charged up front to the loan	Yes	Yes	Differs: from 3% of total loan for a six month period to same amount charged through the interest rate.

Sources: Background documentation prepared by the author for Diana Mitlin for UN-Habitat based on the following sources: FUNDEVI (2005); PRODEL (2004); Daphnis and Faulhaber Ingrid (2004) Stein and Castillo (2004); Microfinanza srl (2003), information provided by FDGL through its Director Maritza Canek in March 2005, and the following websites: <http://www.bch.hn>; <http://www.fuprovi.org/>; <http://www.fusai.org.sv>; <http://www.fdlg.org.gt>; <http://www.bch.hn> <http://www.ratingfund.org/spanish/docs/Apoyo%20Integral%202003.pdf>

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