

Strengthening the Capacity of the Housing Sector in Iraq

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Introduction

The UN Iraq Trust Fund has funded the Strengthening the Capacity of the Housing Sector in Iraq project and it seeks to build capacity among Iraqi central and local authorities to address the housing problems of the country.¹ Phase I of the project started in mid 2004 and is due to be completed in June 2006.

Should additional funding become available, Phase II needs to make an important contribution towards transforming the crude reality of Iraq's housing sector. The Iraqi government will be required to introduce good governance and adopt best practices releasing the necessary resources, from both the public and private sector, to rehabilitate the country's existing housing stock while developing an efficient market for housing and finance products for Iraqi households requiring housing solutions.

This paper explores how the private, public and non-profit sectors can collaborate with Iraqi authorities to enhance financing and construction of housing for all incomes with special consideration for middle and low-income urban poor. The following urges that the Iraqi Housing Fund should act as the driving force for institutional and policy reform in housing and finance, by channeling public resources, through

private intermediaries, to offer mortgages and home-improvement loans.

Implementation should focus on a bottom-to-top approach by designing a series of urban pilot projects in planning, financing, and home construction with an eye to building institutional and human resource capacity. This approach should allow the government to continue operating while adopting a systematic approach to combating housing problems.

Background and general trends

While reconstruction challenges seem overwhelming, Iraq's biggest challenge is to return to the levels of economic prosperity and political stability that the majority of the population enjoyed in the late 1970s. However, the means through which such goals can be achieved need rethinking and reform.

Over the past 30 years, the Iraqi central government controlled all aspects of planning, administration, and delivery of services – including finance and development. Once the country reaches national unity and stabilization, Iraqis will likely want more participation in the decision-making processes as well as an increased access to the benefits of urbanization. They will seek a more efficient

delivery of services—to include increased access to finance, wider opportunities for economic development and wider participation of all stakeholders. It makes sense that after years of a highly state-oriented and centrally commanded economy, Iraqis will move towards a market-driven and more socially responsible global economy.

Housing sector

The housing backlog in Iraq is estimated at 1.6 million units and is steadily increasing with the influx of returning refugees. With the population growing at a 2.7 percent a year, the shortages will continue to deteriorate unless there is a major expansion of the housing stock.

Demand Side

The housing backlog in Iraq is estimated at 1.6 million units and is steadily increasing with the influx of returning refugees. The Iraqi population is estimated at around 26 million. According to the 2004 Living Conditions Survey in Iraq (UNDP), the size of the Iraqi household ranges from 6.0 and 9.0 persons. The housing stock is estimated at between 2.8 to 3.5 million units. According to this UNDP survey, at least 10 percent of the nation's total dwellings are

¹ The United Nations Development Group (UNDG) Iraq Trust Fund is administered by the United Nations Development Programme on behalf of itself and Participating United Nations Organizations. This is the first time that the UN is administering a multi-donor reconstruction trust fund in a joint partnership with the World Bank. This is also the first time that the UNDG organizations, pursuant to the Secretary General's reform agenda, have adopted common planning, funding, coordinated implementation and reporting arrangements for such a large scale operation, which is referred to as the "UN Cluster approach". Most importantly, this arrangement assists key Iraqi ministries such as the Ministry of Planning and Development Cooperation to work with UNDG as one entity, facilitating coordinated, collaborative joint programming.

overcrowded – which means a deficit equivalent to more than 400,000 units. In addition, it is estimated that 63 percent of some 2.5 million dwellings are units that are totally or partially destroyed, or in poor condition with limited electricity, water and sewerage. More than 3,500 new units a year will be required to accommodate people who would otherwise have to stay in emergency shelter or move in with friends and relatives. With the population growing at a 2.7 percent a year, the shortages will continue to deteriorate unless there is a major expansion of the housing stock.

Supply Side: Housing finance

The Iraqi government continues to view housing as social service expenditure and not as an investment. This position needs revisiting. Housing is a key engine for economic growth, creating jobs, generating wealth and promoting individual investment. Housing and basic infrastructure are expected to emerge in Iraq as important investments (rather than just expenditure) leading to a greater role for the financial services sector, the building and construction sector and individual private investors.

A preliminary assessment of the financial service in Iraq reveals that both public and commercial banks have hardly extended credit to the corporate sector. Public and private banks rarely offer mortgages and only offer expensive short-term loans, which are beyond the means of moderate and low-income households.

It is necessary to engage both public and private financial institutions in home lending. The government should facilitate building capacity among formal finance institutions and help local community banks to operate in the mortgage market. Competition among providers will stimulate innovation and cost-saving, thus making loans more affordable to more customers. The beginning of the change in housing finance and housing delivery in Iraq should start with a solid partnership between the public and private sectors. For example, in a pilot-limited size intervention and relatively

secure locations, HSBC as Dar Essalaam Investment Bank and Standard Chartered are currently operating in northern Iraq.

Currently there are three obstacles preventing the development of a dynamic housing finance market in Iraq. First, the housing market is hampered by limited capacity and inadequate production. Second, banks are not issuing enough long-term loans, thus preventing the growth of a secondary market. Third, the country's prudential and regulatory framework governing real estate transactions is underdeveloped, preventing private investment in the housing sector.

The first problem identifies the needs of the growing and more urbanized population. Access to adequate and affordable housing and inexpensive financing for those with moderate and low-incomes, can prevent the proliferation of slums and improve the quality of life of many Iraqis.

Resolving the second problem is less complicated, but still a challenging task. Iraq, an oil-rich country, requires long-term investment to develop a dynamic housing market. To boost retail long-term lending, commercial and specialized banks in Iraq will require additional funding. At least for a couple of years, a prudent increase in lending will not endanger or overexpose financial institutions to a dangerous imbalance in the assets to loans ratio. Mortgage capabilities need to be expanded among commercial banks as well as the development of affordable financing for the urban poor – steps that are vital for creating the primary mortgage market.

Iraq needs to channel as much of the investment and savings that arise from local economic activities into the housing sector. Savings reduce the need for additional credit to purchase a house. Governments should undertake policies to stimulate savings for housing (equity as opposed to debt finance) and provide intelligent subsidies that improve the housing solution for lower-income households within their domestic budget constraint; any gap in funding should target priority groups with demand-side subsidies designed to achieve

social equity while enhancing market efficiency.

The ability to access long term funding through the issuance of mortgage securities can enhance the supply of funds and facilitate improved risk management by lenders. A targeted objective of the Iraqi Housing Fund should be to reduce the liquidity risk and provide together with the Central Bank the ultimate backstop for liquidity. A liquidity facility is a second floor finance institution that provides loans to lenders and funds itself through bond issuance.

The objective will be to design for Iraq an efficient liquid market that treats mortgages as commodities. Funding long-term assets will mean a larger, more stable and affordable pool of resources, a bigger investor base and more money for homeownership. It is necessary, however, first to build a robust primary market.

Finally, in order to attract private capital investment the third problem requires macroeconomic stability and an effective legal framework for property ownership, mortgage lending and real estate transactions. It also requires adequate laws, property title systems and judicial processes allowing households to establish ownership and pledge collateral. For investors, property rights registration recognizes that investment in the private corporate world has a sole objective: selling or transferring ownership to a buyer as an exchange for a return, be it social or economic.

The Iraqi Transitional Government in 2004 created the Iraqi Housing Fund (IHF) on the assumption that banks do not have sufficient capital to fund long-term mortgages and that the lack of a secondary market prevented retail banks from selling their loans and recovering their capital.

The Iraqi Housing Fund (IHF)

The purpose of the IHF is to provide financial resources to undertake housing programs. The Fund is intended to have a

two phase development: First, providing resources needed to implement housing projects; reviewing housing projects and making recommendations to the Board of Trustees; introducing and sponsoring necessary legislative reforms and new regulations in the housing and housing finance sector; partnering with the private sector to develop implementation capacity among other stakeholders different to the government; and building and strengthening the institutional capacity of the Ministry of Construction and Housing, other ministries and local authorities to coordinate, supervise, evaluate and fund the projects. The second phase of development sees IHF as a liquidity facility, issuing bonds.

Order (11) for 2004 Housing Fund commits the IHF to support private banks and private construction companies. During most of 2005, with little administrative capacity and logistics, the IHF continued to make direct retail efforts to public officials for building a house in individually owned plots of land. The IHF needs to reform its bylaws to allow the establishment of a more flexible, executive and mandate-driven institution, capable of designing resource mobilization strategies. Such strategies would include voluntary and compulsory saving schemes, and government issued securities and bonds fully engaging the private and public banking sectors.

Response Strategy: Agreements between the Ministry of Construction and Housing (MoCH) and UN-HABITAT

For housing to fulfil its potential in social and economic development, it is important that the Iraqi Government makes housing a priority. Iraq's housing policy requires a deliberate and embracing strategy to assess the market; adopt long term planning and growth management; mobilize private capital for mortgage financing and; engage the private sector and community based organizations to improve delivery of housing and infrastructure.

UN-HABITAT under the Iraqi-Trust Fund and within the project to strengthen the capacity of the housing sector in Iraq in response to a clear demand from the Ministry of Construction and Housing (MoCH) to prepare an action and implementation plan, focuses on a number of pilot urban projects covering four strategies below:

1. Increase land availability and manage urban growth

Planning. The reconstruction in the housing sector will be tied closely to policy decisions regarding decentralization, land management, planning and popular participation. Iraq requires a stronger regional planning strategy that views affordable housing as a foundation for community growth, and requires local authorities to explicitly assess their housing needs. An institutional framework has to be created with residents, advocates, community groups, and local planners meeting and discussing needs.

Like others countries around the world, Iraq will require municipalities and governorates to adopt housing elements in their mandatory general and strategic plans. Among other things, each local authority must develop plans and programs, and identify sites, to accommodate a "fair share" of its region's new growth for all kinds of housing, affordable and market-rate housing alike.

Officials must adopt growth management approaches instead of growth control policies. Growth control policies are usually implied in rigid Master Plans, and are designed to limit the growth of the housing stock. Growth management policies on the other hand, accommodate future growth and projected development. Growth management planning usually focuses on increasing density, mixing housing types, and promoting regional fair shares of housing.

Strategic objectives:

- Initiate a 20-year planning program for land supply (large mixed use development) including provision for basic services.

- Ensure the participation of communities and the empowerment of women in decisions affecting their well-being.
- Ensure a long-term scenario to secure new housing and land lots to adequately address population growth.
- Initiate pilot public/private partnership programs in land supply and basic services.

2. Housing finance to increase affordability and the role of the IHF

Housing finance plays an important role in improving the housing markets of a country. Housing finance around the world has moved from subsidizing the cost of very few low-quality housing, to a more enabling finance market providing capital requirements for corporate and individual investors. Greater availability of resources will allow for a more competitive and productive market, delivering better and more affordable housing units. Housing finance can also boost production of more diverse units, developed by the private sector and community based organizations.

What is needed is an inclusive and participatory policy enabling and empowering poor people. This policy should involve these beneficiaries and capture their initiative and solidarity to leverage social capital, inexpensive labour and underestimated savings. The first step will be to incorporate the assets of the poor into formal city economies by securing tenure and property titles for those in the informal sector.

A second step needed is to approach not only the private sector but also to include community groups and non-governmental organizations in home delivery and micro-financing. New housing finance, in both the primary and secondary markets, can provide a relatively safe alternative for foreign investors or local non-traditional sources.

Since Iraq is now more urbanized, the country will need to adopt a third step to develop housing finance mechanisms for poor people. Financial assistance could help banks and lending institutions build,

improve or add to their existing housing unit. An alternative vehicle for affordable housing finance is microfinance (e.g. revolving loans). Compared with traditional financing, the loan to value ratio of micro-financing is smaller. If run by the community, costs will be lower and expensive foreclosures will be rare.

The Iraqi Housing Fund (IHF) should adopt a new set of written operational procedures following international standards in corporate governance and personal accountability and should design an operational strategy that includes inter-institutional agreements. The IHF should be the driving force behind institutional reforms in the housing sector in Iraq.

There is a need to engage old and new parties in housing finance. The expansion of mortgage capacity should not just be with existing banking institutions, but should also boost a new industry of regulated institutions that specialize in local housing finance, including savings and loans.

The IHF should play the role of a good partner and a strong player in the housing market promoting proper laws and procedures (such as foreclosure laws) that are conducive to the private sector – especially to banks interested in operating mortgage finance instruments. The IHF should aim at developing specialized lending products for low-income populations that do not meet the conditions of conventional lending (collateral, credit history, tax payments, etc).

Fund monies shall be maintained and managed separately from other general government accounts, and project-based and financial operations shall be transparent, with annual external, independent audits. Procedures awarding housing and infrastructure projects under the fund should adhere to high international procurement standards of transparency, accountability and fair competition. There

should be procedures built into the Fund's operation to ensure that program goals and activities are well-planned and executed according to internationally accepted development standards.

To leverage resources into the mortgage sector, the IHF can issue bonds in capital markets to raise money to loan to lenders. So rather than local banks relying exclusively on commercial loans and personal savings deposits to fund loans, the IHF can supplement these sources with capital, loaned or "advanced" to local lenders leveraging resources through bonds backed by the government.

Finally, the IHF has to build confidence in the housing market by setting up accounting and auditing mechanisms for transparent and correct management of resources, assets and subsidies.

Strategic objectives:

- Initiate a 10-year program for short and long-term financing of housing.
- Initiate a 20-year program to open Housing Savings Accounts and other incentives to mobilize private savings for short term funding to the housing sector. Through savings, Iraq will establish a new group of bankable clients and a collection of geographical information regarding the needs for housing and capacity among households to take loans.²
- Provide technical assistance for policy and regulatory reform focusing on private/public partnership finance systems – to provide a front line of community-based finance and micro-finance providers. This effort will also handle property registration and asset valuation, construction finance, long-term finance, risk insurance, foreclosure and repossession, underwriting, loan management, securitization and capital markets.
- Provide technical assistance to the Iraqi Housing Fund as a housing promoter

and liquidity facility. Reform the Iraqi Housing Fund, with the aim that the Fund be responsible to ensure that enough urban land is available for private housing development, and to guarantee that enough and affordable financing is available through out the country.

At least initially, it will be desirable to reach an agreement indicating that resources budgeted for housing, land management, and basic infrastructure from existing budgets of the relevant Ministries will be transferred or allocated to, and spent through, the Iraqi Housing Fund.

A 3 percent maximum administrative fee will be charged to help supplement the IHF functioning and supporting the Boards, project Committees, IT and procedures, external audits and capacity building among the fund and related ministries.

- Within the IHF establish one or more Project Committees representing Ministry of Construction and Housing (MoCH), Ministry of Finance (MoF), Ministry of Planning and Development Corporation (MoPDC), and relevant regional and local authorities.
- Define sustainable and better targeted subsidies.
- Closely follow policy and regulatory reform of the Real Estate Bank and the deregulation of mortgage financing in Iraq.
- Closely follow policy and regulatory reforms to the pension and insurance sector in Iraq to help attract institutional investors in order to build a secondary market in Iraq.
- Closely follow larger reforms in the financial sector.
- Initiate pilot public/private partnership programs in mortgage lending to purchase, construct and rehabilitate housing units.

² Usually governments make sophisticated calculations to estimate housing needs. Suppliers, public and private, limit their development to large cities where there is a working housing market. By opening accounts in the place of their preference, demand is decentralized and in favor of a more regional approach to housing delivery instead of focusing in the capital and main cities.

3. Improving productivity and affordability in the construction sector

Housing Delivery. Iraq's response to the current housing crisis has been and continues to be state-driven with very limited involvement by the private sector. The state has assumed the responsibility of providing housing and has not adopted an enabling strategy engaging both the private sector and local communities and their organizations. The country lacks an enabling legislation to facilitate private sector investment in housing and basic service. Also constraining private participation in the housing market are the legal rent restrictions, weak financial services, and the rising costs of construction.

A short-term objective should be to raise equity capital. However raising equity capital to develop housing projects is more costly and problematic for affordable housing due to the greater perceived risk. That does not mean private equity cannot finance large affordable housing developments. If Iraq adopts some of the prudent measures suggested in this document, equity investors will supply operating capital and supply affordable products to the low-income housing market. Nevertheless, it is also true that in other countries non-profit organizations, community based groups and charitable foundations provide some of the funding. Hence the importance of engaging local community groups to deliver affordable housing.

Strategic objectives:

- Initiate a 10-year housing program at market rates with special emphasis (25%) addressing the needs of vulnerable groups.
- Initiate a 15-year urban upgrading program addressing the needs of low-income social groups living in sub-standard neighbourhoods.
- Provide technical assistance for policy and regulatory reform, focusing on a private/public partnership as well as delivery systems, self-help programs, building materials, construction

technology and building codes and standards.

4. Institutional and human resource capacity

Capacity Building. While human capital, in the form of trained experts and professionals far exceeds that of many developing countries, the institutional framework is quite weak and not well oriented for addressing the housing shortfall and improving the quality of the existing housing stock.

Strategic objectives:

- Reform the institutional framework to manage the housing sector. Change the role of the public sector from being the supplier of housing to being an enabling body that regulates the market, encourages others' participation and ensures affordable and quality housing.
- Restore central and local authorities' institutional capacity to manage the sector and implement reform.
- To improve housing finance and banking the Ministry of Construction and Housing and Ministry of Finance need to be re-examined.
- Reform the Iraqi Housing Fund, and form an ad-hoc housing board that will bring together government, financial institutions, developers and NGO's.
- Build capacity among policy makers to analyze housing and urban data and deliver support policies and strategies.
- Upgrade the cities' planning departments and set up a specialized training program for participatory planning.
- Training of technical professionals to work in real estate development.
- Build capacity among the private sector to manage and run the mortgage sector.
- Organize training, workshops and study tours for added exposure to international practices.
- Introduce office administration, business information, and communication technology to better manage sector data and enable the design of an urban observatory in Iraq.

- Introduce privatization measures over a period of 5-10 years.
- Open up the construction and building material industry to private sector competition, in a manner that maintains present levels of productivity.
- Build capacity among state-owned companies to run as private enterprises.

Conclusions

The financial services industry in Iraq is only partially developed and does not provide housing finance, other than through one national housing bank. The National Real Estate Bank has been the sole service provider of mortgages and home loans but there is a well functioning and extended network of private finance institutions. State-owned corporations in Iraq need to focus on a more regulatory and policy-making role and leave to the private sector to leverage and channel the enormous amount of resources needed for the housing sector. It is key to note that most needed resources will come from the local market, and only some foreign seed capital (grants or loans) can be expected to boost financing activities.

As public resources are limited and Iraq's priorities focus on achieving security, macro economic stability and increasing revenue through oil production the housing sector needs to rely in the internal market.

The country needs to develop a sound and strong housing finance market. A better housing market can encourage saving and creates wealth. Improving delivery of housing will reduce the impact of squatter settlements – something the country needs to address as soon as possible as displacements have worsening since the war. It also means releasing state owned land to the market. Privately owned land should be easier to assemble and construction fees and standards should be kept to a minimum to keep housing affordable.

Finally, the government should avoid distorting the market and encourage the private sector to participate in the housing

finance and housing market. As macro stability and security is achieved in the country and competition increased affordability will be achieved. At the beginning housing finance will probably only benefit a small proportion of the population. But as in many other countries around the

world, competition and global capital markets should pass on benefits to those households with limited income.

It is expected that the housing sector in Iraq will lead to improved cities. Building and infrastructure construction can contribute to

create jobs and generate most needed income to poor households. A functioning housing market will contribute to bring security to the country, enhanced economic development and macroeconomic stability.