The World Bank reviews its housing finance operations

IN OCTOBER 1988 the Infrastructure and Urban Development Department of the World Bank published the *FY88 Annual Sector Review — Urban,* which briefly reviews the Bank's urban operations. This particular report focuses on the most dynamic sub-sector of urban lending, housing finance, for an in-depth assessment.

This article summarises the report, dealing first with urban lending in general and then in detail with the review of housing finance operations.

DURING the past five years World Bank lending for urban development has expanded considerably. In the fiscal year 1988 urban lending was $2,016 million compared with $1,324 million in the previous year and as little as $385 million in 1985. Urban lending accounted for 10.3% of total Bank and International Development Association lending. A total of 19 loans and credits were approved, of which 11 were by the Bank and eight by the International Development Association.

Four projects accounted for half of the total lending — the Tamil Nadu Urban Development Project in Sri Lanka ($300 million), the Housing Development Finance Project in India ($250 million), the Mexico Housing Finance Project ($300 million), and the Rio Emergency Flood Reconstruction Project in Brazil ($175 million).

Policy towards urban projects has moved away from sporadic traditional interventions to broader policy and institutional issues of greater importance for national economies and the productivity of cities. Special attention has been placed on:

(a) Urban administration and municipal finance through devolution of resource mobilisation and investment planning to local authorities.

(b) Land management and regulatory environments to stimulate private initiatives and investment, especially in housing, land development and urban transport.

(c) Housing, not only as a basic human need, but also as a potential contributor to domestic resource mobilisation and financial developments.

The Bank's urban development lending has concentrated on the following areas:

(a) *Municipal development.* Rapid urbanisation has outstripped most governments' ability to cope with the demand for even the most basic services. The Bank has responded by expanding lending for general municipal infrastructure and giving more attention to the overall process of urban management, especially to the need to delegate more responsibilities to local governments. In the fiscal year 1988 there were nine operations that concentrated on municipal development. These addressed the basic objectives of improving the efficiency of public sector management at the state and municipal levels, increasing the local capacity for revenue generation, and improving financing and delivery mechanisms for municipal investments. All nine projects include an institutional strengthening component. Improving local taxation systems has also emerged as a crucial issue, as has improving financing mechanisms for urban investments.

(b) *Urban infrastructure.* In the fiscal year 1988 the Bank approved five urban water sanitation projects ($535 million), two urban transport projects ($180 million) and 13 projects providing a wide range of urban infrastructure facilities ($780 million). A striking feature of the Bank's finance for general urban infrastructure is the heavy reliance on financial intermediaries. The urban infrastructure projects have maintained an increasing concern for operation and maintenance, cost recovery targets for the services, and improving the investment planning process.

(c) *Emergency loans.* Lending for reconstruction activities in the fiscal year 1988 accounted for 16% of total urban lending ($318 million). The three projects responded to different kinds of emergencies: flooding and landslides in Rio de Janeiro in Brazil, an earthquake in El Salvador and civil strife in Sri Lanka.

(d) *Land management.* Over half of the Bank's shelter projects have suffered delays due to land acquisition problems. An increasing number of projects address land acquisition issues directly. Of greater concern is the poor functioning of urban land markets in developing countries. The focus of the Bank's interventions is now broader and land management issues are very important elements in sector work and policy dialogue. The Bank is also expanding its lending support for land management projects in Brazil and Sri Lanka, including

14 →

← 13

studies on land tenure and registration issues. Land information and mapping components were included in five 1988 projects.

(e) *Housing.* In the fiscal year 1988, the Bank lent, through 15 projects, approximately $1 billion for housing, helping to finance investments costing $3.2 billion. Free standing housing finance components or projects accounted for 64% of the total lending volume for shelter. The steady increase in lending for housing finance has justified the selection of housing finance as the special topic for the review of urban operations.

(f) *Poverty alleviation and environmental concerns.* Most of the 1988 urban loans are focused on policies and programmes that support economic adjustment efforts that enable the resumption of economic growth. The renewed emphasis on urban productivity rather than urban poverty does not, however, imply a reduced concern for the urban poor. Twelve of the 19 loans provide a significant portion of their resources directly to the urban poor. Rather, it reflects the fact that the basic cause of urban povery is not lack of employment opportunities but the low productivity of many of the jobs that the urban poor hold and also the fact that the urban poor are the ones who suffer most from distortions in the land, housing and financial markets and from the general shortage of public investment opportunities.

Overview of the Bank's housing finance portfolio

Housing investments typically amount to between 3% and 8% of GNP in developing countries and between 15% and 25% of gross capital formation. Housing is an economic good and also a basic human need. The link between health and housing conditions, for example, is well established. Housing is also the main user of urban land. Finally, housing is a long-lived and costly asset which is heavily dependent on people's ability to borrow.

The housing sector represents an opportunity for the Bank because housing is one of the simplest and safest assets in the economy. Market-rate housing finance can be a very basic part of the Bank's effort to encourage private savings and support a process of financial deepening in the economy.

On the other hand, it is clear that housing finance assistance is fraught with many dangers. After 16 years of Bank experience, and 99 shelter projects in 50 countries, it is fair to say that squatter upgrading and sites-and-services programmes have been a considerable improvement over the public shelter programmes that preceded them. They have provided unquestionable evidence that production of affordable and adequate housing for the poor is possible.

In the six years since the Bank's first housing finance project, 17 projects focusing on housing finance or including major free standing components have been approved totalling $1.5 billion. Table 1 shows the growth in the bank's housing finance lending.

Table 2 shows details of the projects.

Some 13 of the 17 housing finance projects were channelled to financial intermediaries rather than to non-financial public sector housing authorities. In addition, in the cases in which projects relied on government housing programmes, the central objective was a refocusing of the public sector authorities so that the financial sector could more actively participate in the mortgage market. Most of the institutions that have received housing finance loans have either been created in the past 11 years or considerably refocused.

Most of the loans have a number of policy objectives. There have been three broad motivating rationales:

(a) Financial sector reforms.
(b) Broader fiscal policy initiatives.
(c) Housing sector concerns.

The early housing finance projects were primarily concerned with increasing the access to adequate housing for the poor and with controlling or reducing and better targeting housing subsidies. As the macro-economic role of housing finance has become better understood, these projects are increasingly aimed at supporting financial sector reform.

'Fraught with dangers'

An assessment of the effectiveness of housing finance operations

Performance in respect of financial sector objectives has been as follows:

(a) *Resource mobilisation.* More than 40% of the housing finance institutions that receive bank loans have been able to mobilise most of their resources domestically. In most cases interest rates paid by the institutions have been positive. Positive interest rates are essential to provide long-term financial integrity to the intermediation process.

(b) *Risk exposure and contingent liabilities.* In 12 of the 17 housing

16 →

Table 1: World Bank Housing Finance Lending

Fiscal Year	*Number of Operations*	*Lending ($m)*	*Lending as Percentage of Total Urban Lending*
1983	1	60	11
1984	1	5	1
1985	2	90	23
1986	4	466	30
1987	3	199	15
1988	6	672	39

Table 2: World Bank Housing Finance Lending ($m)

	Bank Lending		*Bank Urban Lending*			*Bank Lending for Housing Finance*					
Year	*Total Amount*	*No. of Projects*	*Total Costs*	*Bank Contribution*	*No. of Projects*	*Title*	*Total Projected Cost (TPC)*	*Share of TPC to HF*	*Total Loan Amount (LA)*	*Share of LA to HF*	*% of Urban Lending*
FY83	14,479.0	14	1,279.0	537.2	1	– Morocco I Hsng. Loan to CIH	209.5	209.5	60.0	60.0	11.2
FY84	15,524.2	16	1,080.0	497.0	1	– Zimbabwe Urban Project I	112.6	47.2	43.0	4.5	
FY85	14,406.0	10	1,255.9	384.6	2	– Chile Public Sector Hsng.	576.5	576.5	80.0	80.0	
						– Malawi Urban Project I	18.2	13.0	15.0	10.0	
Total										90.0	23.0
FY86	16,318.2	17	4,763.0	1,540.1[a]	4	– Mexico Low-Income Hsng.	300.0	300.0	150.0	150.0	
						– Indonesia Hsng. Sector	846.5	846.5	275.0	275.0	
						– Portugal Hsng. Finance	56.6	56.6	25.0	25.0	
						– Nigeria Urban Devel. II	85.0	23.4	53.0	16.3	
Total										466.3	30.0
FY87	17,674.0	13	4,695.0	1,324.1	3	– Korea Hsng. Finance	1,442.5	1,442.5	150.0	150.0	
						– Thailand III Shelter	72.4	35.8	21.0	10.0	
						– Ivory Coast Urban Dev. III	304.2	136.2	126.0	38.5	
Total										198.5	15.0
FY88	19,220.7	19	5,114.4	2,016.3[b]	6	– Senegal Hsng. & Mun. Devel.	78.3	13.5 Loan to BHS	46.0	21.7 IDA finances 100% of HL	
						– India Hsng. Devel. Corp.	840.8	840.8	250.0	250.0	
						– Philippines Hsng. Sector	325.0		160.0 80 million for const. industry	80.0	
						– Ecuador National Hsng. II	85.7	24.0 Home Impvt. Loans	60.0 30% for Hsng. Fin.	20.0	
						– Mexico Hsng. Finance	1,576.0	1,576.0	300.0	300.0	
						– Lesotho Urban Sector Reorient.	42.2	14.0	20.4	8.0	
Total										680.0	33.7[c]
FY83-88 Totals				6,299.3	17					1,510.0	23.8

(a) Includes US$400 million Emergency Reconstruction Loan to Mexico.
(b) Includes two Urban Transport Projects.
Includes Mexico Housing Finance Project.
Includes three emergency loans totalling US$318 million.
(c) Would be 44% if emergency loans were not included.

← 14

projects the government's contingent liability was reduced.

(c) *Arrears.* The average percentage of portfolio arrears reported for projects funded by the Bank is about 12%. However, there has been tremendous variation between the projects. For example, the rate reported on the Indian housing finance loan has been less than 1%.

(d) *Interest rates.* Few of the projects involve funds being on-lent at negative inflation adjusted interest rates.

With respect to fiscal policy concerns, the following have been noted:

(a) *Subsidies and target beneficiaries.* The target beneficiaries of housing finance projects are "below the median income" households rather than the very poor. A number of the institutions that have been supported by housing finance projects provide access to concessional finance for very expensive housing even if the projects themselves do not. In a number of projects the average borrowing rate has been implicitly subsidised by the lender. Subsidy targeting has therefore been a concern and an equally important concern has been the efficiency with which housing transfers are mobilised.

(b) *Foreign exchange risk.* In only one case was the foreign exchange risk imposed on the borrowing intermediary.

'Growing demand for housing'

Housing sector concerns have been the most frequent rationale for housing finance projects. These concerns arise because of the inability of most housing production and delivery mechanisms to accommodate the large and growing demand for housing. In many countries the informal sector plays the dominant role not only in the provision of housing services but also in housing finance. Policy objectives have been to demonstrate that many low income households can afford to repay market rate finance and to give greater emphasis to the private sector in providing both housing and housing finance services.

Lessons learned

One lesson learned has been in respect of linkages between housing finance and overall financial sector strategies. The housing finance project in Morocco centred on the Crédit Immobilier et Hotelier and shifted in focus to provide explicitly for improving the competitiveness and ability of the institution to mobilise resources so that it can ultimately operate without any government assistance in a fully mobilised financial system. The project has permitted the Bank to engage in a discussion of what types of deposit instruments can best serve these purposes.

The experience of the World Bank is that housing finance loans can be made at positive real rates of interest with reasonable expectation of satisfactory cost recovery and reliance on domestic resources. However, the development of more competitive sound financial practices is a long-term objective. They may not be achievable in one project.

In every country the housing sector receives a significant share of government transfers. Credit policies and regulatory controls generate large and unmeasured transfers to the sector and as the scale of these transfers increases this aspect of housing finance policy needs more emphasis. Transfers to the sector need to and can be reduced by better targeted, more transparent transfers. Developing housing finance institutions that minimise these subsidies will be central to the agenda.

The Bank's understanding of the broader effects of the implicit subsidies due to financial policies has increased significantly. For example, the shelter study of Pakistan attempts to identify and rank the factors that hinder the effective and more spontaneous development of the housing market. In Pakistan many of the impediments are in the regulation of the housing and land markets; others are in the housing finance system. Housing finance policies are an important source of implicit subsidies to upper-income borrowers but nevertheless are of less importance than basic land management issues.

The Bank is still in a transition from a traditional housing sector analysis which looked at housing needs to a broader analysis that puts housing and the government's housing policies in a broader macro-economic perspective. However, the transition away from sites-and-services and upgrading projects to housing finance operations will not occur rapidly, nor, in many countries, should it occur at all for the near term.

In most of the low income countries the sites-and-services approach remains the appropriate strategy today. In many respects, housing finance projects represent a "second generation" approach that should not be of the foremost priority for many of the Bank's borrowers.

'Second generation approach'

Generally, some regional specialisation of basic housing finance strategies will amost certainly occur. For example, in many higher inflation countries better mortgage and taxation systems may be essential to make housing affordable, to reduce transfers and to help mobilise financial resources. In such an economy housing finance interventions should be of a relatively high level.

On the other hand, if a high inflation country also has a low level of economic and financial development, declining real income and a weak land recordation system, there are many more important sectoral policy issues before indexation is introduced or discussed. ■