Housing Finance in Asia : An Agenda for Today

By David Painter

HOUSING finance has been making steady, positive progress in the developing countries of Asia since the mid-1980s. The Government Housing Bank of Thailand has gone from strength to strength while leading an unprecedented housing boom in Bangkok. They have become an important role model for emerging housing finance institutions throughout the region.

The housing finance system is deepening and broadening in India with the launching of the National Housing Bank. The NHB is working hard to stimulate the creation of many new housing finance companies that are emulating the pioneering work done by the Housing Development Finance Corporation Ltd. of Bombay.

In Pakistan, the government is initiating a major effort to encourage the development of a private sector housing finance system. They are already making use of the experience and expertise available in Thailand and India. Several housing finance companies are about to be established.

The Indonesian housing finance system is under active review by the government, based on far reaching policy studies conducted by the Ministry of Housing. A major liberalization of the system is being considered which would open mortgage lending to the private sector for the first time.

Sri Lanka is engaged in the design of an important innovation in housing finance. The government intends to dismantle interest rate ceilings on housing loans and substitute the use of direct grants to low income families to "buy down" their loans to affordable levels.

In short, housing finance is coming of age in Asia. With these changes, housing finance institutions are becoming better integrated with the overall financial sector of these countries.

Issues and Myths

Against this backdrop, there is a need to develop an agenda which housing finance institutions should be pursuing today in Asia. Three points should form the common core around which broader agendas for individual countries can be constructed.

The three key issues are:

(i) the accessibility of the system;
(ii) the mobilization of savings; and
(iii) the separation of financial and social goals in housing finance.

In connection with these three issues, there are also three myths that need to be exposed:

- the myth of affordability.
- the myth of term matching.
- the myth of the mortgage loan.

Issue No. 1: Focus on Access, not Interest Rates

Accessibility of the housing finance system is the first issue. Unless positive real interest rates are charged to borrowers and paid to savers, the housing finance system will dry up and a country's housing sector, as well as the whole economy, will contract. If loan prices are repressed, then the only way to maintain housing finance institutions will be with subsidies. In turn, that will drain national budgets at a time when most governments are trying to reduce public expenditures.

The often heard rationale for government repression of housing loan interest rates is that it is necessary to make housing "affordable", especially to low income families. This is myth number one.

The myth of "affordability" is widely believed and universally pernicious. Housing of some kind is affordable to the vast majority of families in every country. In developing countries, over 80% of affordable housing is provided by the private informal sector. Informal housing, whether in tidy but illegal subdivisions or in slums and squatter areas, is currently developed without the aid of the housing finance system. Low interest rates don't make this housing affordable; appropriate lot sizes and low standards of construction make it affordable. The housing product is the principal determinant of affordability, not the financing.

The appropriate role of a housing finance system is to make as much credit as possible available to all those who can qualify to borrow. Access, not the interest rate, is the issue for today. Repressed interest rates cut off the flow of savings to housing finance institutions. With less savings there is less lending. With less lending it is not the low income families that get the few loans available. Low and even middle income families lose access to the housing finance system while only the rich and well connected have the power to get loans. This process does not promote affordability for low income housing, and it diverts subsidies to those who need them least.

The only way out of this morass is to explode the myth of affordability, by paying a real financial return to savers while finding ways to finance the kind of housing products that people really can afford. This in turn requires that lending rates cover the market cost of funds and the margins necessary to keep the lender in business. This does not always mean that lending rates go up. Surprisingly, in Thailand the Government Housing Bank both increased its deposit rates and decreased its lending rates by improving efficiency and thereby operating on smaller margins with greater volume.

Issue No. 2: Focus on Savings Mobilization

The second issue on the housing finance agenda is savings mobilization. Savings are the fuel needed to run a housing finance system. Savings may be corporate or personal, large or small, long-term or short. But no matter what kind of savings we talk about, they are like any other kind of fuel - you won't get any unless you pay the price required by the supplier. This price is primarily reflected in the interest rate paid to the suppliers of funds, but not entirely. The cost of providing convenience of saving, special services to savers, and liquidity of savings are also important parts of the "price" for mobilizing those savings.

The housing finance system needs all the savings fuel it can get in order to broaden its accessibility to all segments of the public. Actions and policies which place restrictions on savings mobilization will choke the housing finance institutions and reduce their accessibility.

One unfortunate method of restricting savings mobilization for housing finance is for regulators to require lenders only to accept "long-term" savings. The definition of long-term may vary from six months to two years, but the effect is the same: reduced liquidity for the saver. The rationale for such policies can be found in another myth:

the myth of "term matching".

The myth of term matching says that since housing finance institutions lend long-term, they should utilize long-term savings as their liability base. This is supposed to reduce the financial risk of interest rate fluctuations and help assure the liquidity of the lender. In fact, unless the term of all savings exactly matches the term of all loans, this supposed protection is only a myth.

The term on which savings are mobilized is far less important to a housing finance institution than the stability of its liability base. (Of course, it is essential that lenders are able to adjust the yield on their loans to accommodate changes in their cost of funds, but this does not require restrictions on the term structure of their liabilities).

In general, long-term savings are only offered by corporate savers in large deposits at relatively high interest rates. This kind of savings thus tends to be "lumpy"—flowing in and out of the liability base in large increments. This lumpiness can create instability in housing finance institutions by periodically straining their liquidity position. This result is quite the opposite of the effect predicted by the myth of term matching.

On the other hand, personal savers put greater value on the liquidity of their deposits. They are generally prepared to accept somewhat lower interest rates in order to have access to their funds within 30 days or less. This may sound unstable to some regulators, but it is not. By having many personal savers, their individual withdrawals can be smoothly offset by deposits from other savers. The stability of the overall level of small, short-term deposits held by many personal savers is a well documented fact. Housing finance institutions should be allowed to benefit from that stability and not be constrained by the myth of term matching.

It may take time to discredit the myth of term matching. In the meantime, housing finance institutions need to focus increased attention on the savings market. Within the limits imposed by regulations, lenders must seek out and exploit the special niches in the savings market to increase their funds mobilization. The experience of the Housing Development Finance Corporation of India is highly instructive in this regard. From the beginning, HDFC devoted serious attention to innovating in the savings market, just as it did in the lending market.

As the power of the myth gradually wanes, housing finance institutions should devote special attention to mobilizing the deposits of small individual savers. For these savers the "price" of their funds is more heavily weighted to the factors of liquidity, convenience, and special services. Special programs to attract small savers should be designed to use these factors to mobilize their funds for housing finance at reasonable rates of interest.

Issue No. 3: Separate Financial and Social Goals

The last issue for the agenda concerns the need to separate financial and social

goals in the housing finance system. It should be recognized from the start that both sets of goals are equally valid. What is important is to find ways to pursue both sets of goals in ways that avoid confusion and conflict between them.

The basic rule is simple to state: don't use government institutions as financial intermediaries; and don't use financial institutions to perform the functions of government. However, the difficulty often comes in defining the boundary line between financial and governmental functions.

In the housing finance system, the social goal is generally to provide "affordable" housing loans to low income families. The financial goal is to convert savings into housing loans on a profitable basis. In many Asian countries these two goals have come into conflict. Governments have often required housing finance institutions to offer low interest rate mortgages to low income families. Where this was done, the financial goal of the system was undermined. Once the housing finance institutions could no longer afford to mobilize savings, the resources for new "affordable" mortgages dried up and so even the social goal of the system was lost. At that point it was common to see non-financial Housing Authorities start to make mortgage loans using funds from the government budget. This has been universally unsuccessful from a financial standpoint and often socially unsuccessful as well.

At least part of this confusion and conflict of goals arises from the prevalance of yet another myth — the myth of the mortgage loan. This myth proposes that all lending for housing should be accomplished through mortgage loans. This myth ignores the fact that most low income families in Asia are not able to mortgage the kind of housing they can afford, i.e. informal housing. The myth also tends to wrongly focus government attention on mortgage lending to achieve social goals in the housing sector.

Policy makers and housing finance institutions need to get beyond the myth of the mortgage loan. They need to think more broadly about how to successfully finance affordable housing for all income groups. To do this it will be necessary to have a more sophisticated understanding of the housing loan market. Some segments of the market can qualify for mortgage loans. Some segments may only qualify for personal loans for home upgrading. Some loans will need to be small, others large; some will need to be short-term, others long-term. Flexibility in terms and loan instruments is essential.

Even with this increased flexibility, not all families can afford to borrow the funds they need for housing at market rates of interest. However, this does not mean that the rates offered by housing finance institutions must be artificially repressed by government to achieve social goals. There is another way to solve this problem, and the Government of Sri Lanka is about to launch an effort to put it into practice.

The Sri Lankan concept is relatively simple and aims to re-establish the appropriate roles for government and financial institutions in the housing finance system. To begin with, the market for housing finance is recognized to be segmented:

(l) Some families are able to qualify for mortgage loans at market rates of interest. They will obtain all their housing finance from housing finance institutions.

(2) Some families can only qualify for mortgage loans smaller than their financing needs. They will borrow what they can afford at market rates, and will be qualified for a supplementary grant from the government based on social policy criteria.

(3) Some families may not be able to mortgage their property but could finance at least part of their housing needs with a small personal loan.

(4) Finally, a small percentage of families may not be able to afford any market rate housing credit. They will receive only small government grants based on social policy criteria.

This conceptual framework allows social and financial goals to be pursued effectively in tandem. The myth of the mortgage loan is overcome. Housing finance is seen as a flexible package of credits and grants operated by financial institutions and government institutions respectively.

Conclusion

Policy makers and housing finance institutions need to work together to find ways to:

- Increase the accessibility of housing finance systems;
- Improve the effectiveness of savings mobilization; and
- Separate financial and social goals in lending.

In the process, it will be necessary to expose a few myths that have been holding back the full development of housing finance in Asia. ■

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