Financing the Housing Sector in the Asia-Pacific Region

By Jeffry Stubbs

THE HOUSING SECTOR

MOST housing in the developing countries of the Asia-Pacific Region (the Region) is built by individuals serving as their own general contractors, often with their own labour. The land development sector is small and housing developers often operate on the basis of advances by clients when little or no institutional finance is available to either the developer or the client. The housing sector in most countries in the Region has been constrained by policies based on the direction of credit to selected industrial sectors. Housing was thought of as a consumption good, and given a low priority. In this context, most countries created special housing finance institutions, such as the National Home Mortgage Finance Corporation in the Philippines or the House-Building Finance Corporation in Pakistan, funded by central banks or from other protected sources, which provided housing finance for the middle classes often at below-market interest rates. Many countries also created development authorities or housing authorities to provide much-needed land and public housing, often at below market prices. These and the housing finance institutions were generally short of funds. The housing sector as a whole was inefficient, and unable to respond to rapidly increasing demand.

In the 1980s, Governments in the region began to move away from directed credit policies, towards market-oriented policies. At the same time, strong and well managed housing finance institutions emerged in countries as diverse as India, the Housing Development Finance Corporation (HDFC); Thailand, the Government Housing Bank (GHB) and Korea, the Korean Housing Bank (KHB). These pioneer institutions showed that the housing sector could support a well-run, profit-making housing finance institution even in the presence of a relatively weak legal framework (India) and highly competitive financial markets (Thailand). They became market leaders and encouraged other institutions to enter the market.

The principal factors that contributed to the pioneer institutions' success were:

(i) a strong market orientation based upon the perception that people would save, and borrow at market rates, if appropriate instruments were offered them;

(ii) close monitoring of accounts to ensure that repayment problems, if any, were dealt with before they become serious;

(iii) sound financial management based upon business principles.

Table 1 shows the degree of market penetration of housing markets by financial institutions in selected countries. Pakistan and Sri Lanka have both given high importance to social housing, and have achieved a significant degree of market penetratrion - largely through central bank-supported housing finance institutions. However, such funding of housing finance institutions in both countries is now being reduced and their market penetration is decreasing.

Indonesia and the Philippines, with higher GNPs per capita and higher levels of investment in housing per capita, have nevertheless achieved lower levels of market penetration. Housing finance institutions in both countries lend at interest rates far below market levels, and have been unable to mobilize sufficient resources.

Thailand and Korea, with higher GNPs per capita, have provided housing finance at levels of 20 and 62 per cent of investment in housing respectively, substantially higher than the other four developing countries and, in the case of the latter, well on the way to the 177% per cent recorded in the United States. The key to their success lies in their ability to mobilize funds from the private sector.

There is, as expected, a correlation between GNP per capita and degree of market penetration. The curve suggests that Thailand, with a per capita GNP of US$840 may have reached the "take-off" stage at which the housing finance sector can begin to expand rapidly, while countries such as Pakistan, Sri Lanka., Indonesia and the Philippines are still approaching "take-off".

One result of a stronger housing finance system is that housing markets become more competitive and efficient. An excellent example is to be found in Bangkok, where the financing provided by GHB and others has helped create a private housing sector building houses for almost all income levels (some cost as little as US$4,750).

Most countries in the region have developed in-situ slum upgrading and sites and services programme, implemented by public agencies. While these have helped to improve the housing of the poor, they have generally fallen short of their targets. Most countries are now looking for additional ways to help the poor house themselves, inter alia, through simplifying land registration procedures and supporting the development of community-based organizations (CBO) and NGOs involved in the housing sector.

CBOs, which include co-operatives, have demonstrated in countries as different as Pakistan and the Philippines a capability to acquire land and/or provide some basic infrastrucuture services, sometimes on their own but often with the support of an NGO or a public agency. It thus appears that such entities can play a stronger role in the sector. In order for this to occur, however, there is a need for developing partnerships between the public and private sectors and financing mechanisms for the latter.

One very interesting innovation is the Community Mortgage Programme in the Philippines, under which groups of people often living in squatter settlements, are provided loans to help them acquire land, and technical assistance to help them form community associations, obtain loans and subdivide their properties.

Looking to the 1990s, it is likely that the successful development of housing finance institutions in India, Korea and Thailand will be emulated by others — and there are signs that this is already underway. Sri Lanka, after a very successful experience of its million houses programme, has recognized a need to put its housing finance institutions on a stronger footing and taken steps to strengthen them, including adoption of market-oriented lending rates and variable interest rate mortgages. Pakistan has approved the creation of private sector housing finance institutions. India is establishing regional housing finance institutions modelled on HDFC. Nepal and several countries in the South Pacific are also considering strengthening their housing finance institutions.

The innovations described above have raised a number of issues for policy-makers in the region: To what extent should housing finance policies be based upon considerations of affordability? How can liquidity be created and maintained in a fledgling institution? And to what extent should central bank or other protected funding be utilized in the development of housing?

- Affordability should remain a goal, but it should be achieved through developing the housing sector, not through housing finance policy. Experience has shown that some people will pay market interest rates, no matter how high, because the value of their housing investment is even higher. When some people are able to borrow, an industry can be created.

- In order to balance the "hardening" of financial terms implied by the strategy described above, governments should develop carefully focussed and targeted

Table 1 : HOUSING FINANCE IN SELECTED COUNTRIES

Country	GNP Per Capita (1987,US$)	Population Number (1988, Million)	Population Growth %	Investment in Housing Per Capita (US$,Current Prices)	Housing Finance from financial institutions Per Capita (US$,Current Prices)	Housing Finance as a % of Investment in Housing
Pakistan	350	105.4	3.1	9.16	1.58	17
Sri Lanka	400	16.7	1.8	9.86 (1988)	1.83	19
Indonesia	450	175.2	2.3	20.43 (1987)	1.36	7
Philippines	590	58.7	2.8	29.32 (1980)	3.50	12
Thailand	840	54.6	2.5	36.04 (1987)	7.30	20
Korea	2,690	42.0	1.5	141.30 (1988)	88.30	62
USA	18,560	243.9	-	953.00 (1989)	1689.00	177

programmes, implemented through local authorities and CBOs, that will address the needs of the poor.

- The British building societies and some regional institutions, particularly the GHB of Thailand, have done an excellent job of maintaining liquidity through market-oriented lending and use of variable interest-rate mortgages, enabling them to pay market rates of interest for savings.

- Central bank or of the protected funding of housing finance institutions may be necessary during the initial development of these institutions, to help them rapidly establish a place in the market. However, long-term support of housing finance institutions involving deep subsidies should be avoided.

THE ASIAN DEVELOPMENT BANK

Overall Operations

The Asian Development Bank (ADB), an international partnership of 51 member countries, is engaged in promoting the economic and social progress of its developing member countries (DMCs) in the Asia-Pacific Region. The ADB is owned by the governments of 35 countries in the region, and 16 countries in North America and Europe. The ADB began functioning in December 1966 with its headquarters in Manila, the Philippines. In 24 years of operations, it has become a major catalyst in promoting the development of the most populous and fastest-growing region of the world today. The ADB's assistance includes loans and equity investments in projects as well as technical assistance, assistance in development planning and co-ordination of assistance.

Lending Policies and Technical Assistance

The financial resources of the ADB consist of ordinary capital resources comprising subscribed capital, own resources and funds raised through borrowings, and Special Funds, comprising contributions made by member countries and amounts previously set aside from paid-in capital. About two-thirds of Bank loans are made from ordinary capital resources at a variable interest rate which is currently 6.36 per cent a year. These are generally made to member countries which have attained a higher level of economic development. The remaining one-third of loans are made from the special funds on highly concessional terms. These loans are interest-free but have a one per cent service charge to cover administrative costs. They are almost exclusively given to the poorest borrowing countries.

Although the resources of the ADB are primarily used to cover shortfalls in foreign exchange requirements, it is recognized that in many cases the use of its resources to finance local expenditures, particularly for projects having a large social content, would be acceptable. Broadly, in the low-income DMCs, the ADB will finance up to 80 per cent of total project costs, in middle income DMCs up to 60 per cent, and in the higher income DMCs up to 40 per cent of total project costs. ADB financing can be provided for civil works, procurement of equipment and materials, consultant services, training and interest during construction on the ADB's loan.

In addition to its loan programs, an important element of the ADB's development role is the provision of technical assistance. Technical assistance, which is predominantly grant financed, is particularly needed by the ADB's smaller and less developed member countries where there are frequent gaps and shortages in technical know-how and expertise. It largely comprises the provision of consulting services, including both firms and individuals, training and incidental equipment and facilities. It can be utilized for project preparation and implementation, sector studies, policy formulation, institution building and assistance to examine problems of national and/or regional concern. It is also utilized for conducting conferences, seminars, workshops and training courses for participants from one or more member countries, thus promoting the role of the Bank as a development resource center.

Assistance to the Urban Sector

The ADB's assistance to the urban sector, which has included provision of both loans and technical assistance, began in 1976, with an integrated urban development project in Bandung, Indonesia. Since then, a total of US$ 880 million has been lent for 18 loan projects in Bangladesh, Fiji, Hong Kong, Indonesia, the Republic of Korea, Pakistan and Thailand. Assistance for housing has usually focussed on selected cities or areas and included components such as in-situ slum upgrading, sites and services and core housing.

In addition to its loan projects the ADB has financed a number of technical assistance projects in support of the housing sector. In 1983, the Bank sponsored a regional seminar on "Financing of Low-Income Housing". In 1987, a regional seminar examined major National Urban Policy Issues". In 1988 technical assistance was provided to Pakistan and Sri Lanka, to survey the housing and financial markets of these countries and their housing finance institutions and prepare recommendations for development of their housing finance sectors. In 1989, the ADB provided technical assistance for institutional strengthening and a study of resource mobilization for the housing finance sector in Fiji.

In January 1991, the ADB and the Economic Development Institute of the World Bank sponsored a regional seminar on the "Access of the Urban Poor to basic Infrastructure Services in Asia and the

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"*Sites-and-Services and Subsidies, The Economics of Low-Cost Housing in Developing Countries,*" The World Bank Economic Review, January 1987. Their analysis compares the interest rate to the rate of inflation during the year of the appraisal.

2 For example, studies of agricultural credit policies have shown that the provision of concessional credit can never successfully offset other distortions in the economy, and in fact, such policies can easily lead to more concentrated distributions of wealth and income. See Claudio Gonzalez-Vega, *Cheap Agricultural Credit: Redistribution in Reverse,* in Dale Adams, Douglas Graham, and J.D. Von Pischke, *Undermining Rural Development with Cheap Credit,* Westview Press Boulder, 1984.

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Pacific" which we hope will point the way for Bank assistance in the 1990s.

EMERGING THEMES IN ADB'S ASSISTANCE

Three themes have been common to the Bank's assistance to the housing sector since its inception:

(1) support for programs focussed on the poor;

(2) institutional strengthening; and

(3) achievement of sector-wide financial replicability.

The ADB's assistance for the housing sector in the 1990s is likely to involve the following:

(i) a continuation of in-situ upgrading and sites and services programs, with a greater role for community-based organizations, NGOs and private firms.

(ii) the development of efficient land markets and local governmental institutions;

(iii) the development of market-oriented housing finance institutions capable of mobilizing savings from the private sector;

(iv) assistance for sector studies, feasibility studies, institutional strengthening, training, workshops and seminars focussed on the policy and operational aspects of the sector. ■

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1989, compared with 0.54% for mortgage banks and 0.84% for all banks.[6] The excess of *other receipts over other expenses* has consistently improved over the past few years. When interpreting these results, it must be borne in mind that taxes are also included in this "extraordinary" account. Since legally dependent building and loan associations do not show their tax expenses separately but include them in "other" expenses, for the sake of uniformity the taxes paid by the other building and loan associations have also been included in this item.

Despite the above-mentioned pressure on their profits, building and loan associations further increased their *own funds* in the 1980s, too, by ploughing back substantial parts of their profit for the year. In 1989 building and loan associations' capital averaged roughly 5.3% of their volume of business. That was distinctly more than in the case of mortgage banks (2.5%) and other banks (3.6%). All in all, building and loan associations thus seem to be well equipped at the beginning of the 1990s to assume a major financing function in connection with the upswing which has got under way in housing construction, even though they will probably not be able to resume their old role, fostered as it was by substantial government promotion. ■

NOTES

1 The last article published on this subject was *"Recent developments in building and loan association business"* in Monthly Report of the Deutsche Bundesbank, Vol. 35, No. 4, April 1983, p. 25.

2 In this context, this is understood to mean aggregate borrowing by the housing sector (as defined in the capital finance account) plus outpayments of allocated savings deposits.

3 The statistical term "volume of business" used here - and customary in analyses of bank balance sheets - is identical with "balance sheet total" in the case of building and loan associations.

4 Excluding building and loan associations.

5 The year 1980 is disregarded here, because the relatively high profit for the year was primarily due to the fact that private building and loan associations had to release major amounts of general loan-loss provisions in a manner affecting the profit and loss account.

6 Excluding building and loan associations.