The Role of Housing Finance during the Current Process of Transformation in Europe

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I am delighted that I have the opportunity to speak to you about the role of housing finance in three fundamental transformations taking place in Europe.

These are:

- The opening of the European single-market at the beginning of 1993,
- The integration of Eastern Europe, and
- The reunification of East and West Germany.

THE OPENING OF THE SINGLE-MARKET IN EUROPE

As of January 1993, all restrictions concerning the provision of financial services and the establishment of branch offices of financial institutions among the twelve European Community (EC) member countries[1] have been removed. And, because of the soon to be passed agreement between EC and the seven European Free Trade Association or EFTA countries[2], this complete freedom of trade and services will be extended beyond the EC countries to include the EFTA countries as well, probably as of the middle of 1993. The exception to this is Switzerland, whose citizens decided against it.

Along with the unfettered capital movement now available to the credit institutions of the EC and EFTA members, a new borderless playing field has opened up, authorizing new markets and areas of competition, generating limitless possibilities, but also an equal amount of risk.

In this new borderless single-market, there is now a limitless range of products and services, which can be offered by credit institutions from their respective headquarters.

In addition, the regulation concerning the establishment of branch operations in EC and EFTA countries follows the principle of the land of origin. This means that the licensing and supervision of credit institutions is governed by the regulations of their country of origin.

A consequence of the opening of the EC single-market is that within the same market area there will be credit institutions with different finance systems which will be in direct competition with each other.

Will these new fields of commerce and the resulting heightened competition truly give a European dimension to the typically, nationally oriented building and housing finance markets? After the first two months of the European single-market, it is still too soon to tell.

Even before the opening of the single-market, many of the primarily larger European housing finance institutions have already examined the opportunities, which a commercial expansion into other member countries would provide. Unfortunately, the euphoria, with which the European single-market was greeted years ago, has given way to an earthier realism.

There are still far too many impediments to a true internationalization of housing finance in Europe. Besides language barriers and multiple attempts of national officials and housing finance firms to protect home markets against foreign competition, a harmonization of civil, tax and public laws is still lacking.

Only when, for example, the mortgagelaws, the trade laws, the consumer protection laws, and the tax laws pertaining to the interest on debt—to name some of the most important areas— are harmonized, will the housing finance provider truly be able to operate without border restraints.

Perhaps you are thinking, why don't housing finance institutions in Europe adjust their operations to conform to the legal and tax codes of the respective host countries, just as all large banks do for their international branches.

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There are two important reasons for this:

First of all, the customers of housing finance providers are not international, experienced corporate clients, but rather the so called "Mr. Everybody". This customer group does not think "Europeanly", rather prefers almost exclusively national, well known products.

Therefore, in spite of the single-market, foreign firms will have a long start-up phase before they have won the trust of foreign customers. This process will most likely be accelerated only after a single currency has removed monetary barriers.

The second hurdle for the housing finance providers is that they must be continually present, and in direct contact with their customers in order to sell their products.

Breaking into a new market requires a very cost intensive distribution network. If one does not want to go through the very lengthy process of successively establishing one's own marketing network, or cooperation with another partner.

However, collaboration with housing finance providers in the respective host countries is quite difficult to establish. This is because, as a rule, they are in a direct competitive relationship with each other, which often precludes any kind of closer participation.

In addition, the density of banks in central Europe is so high that the resulting competitive displacement would be borne by the inexperienced competitors in the new market, who would first have to overcome the skepticism of the potential customer group.

It is my impression that this critical description of the current situation in western Europe for a European-wide expansion of housing finance institutions is shared by most other housing finance groups. Therefore, rather than try and build a European-wide market, most housing finance providers are focussing on strengthening their existing customer ties by providing them with financial services abroad. In a few cases, institutions are trying to focus on certain niches with their services, while waiting for the slow integration of the EC and EFTA member countries.

THE INTEGRATION OF EASTERN EUROPE

Much more interesting than those for western European are the prospects for the export of housing finance services to eastern Europe. In every country of eastern Europe apartment units and even real estate are in the process of being privatized. Some of these units have already been converted to private ownership.

Interest in the introduction of a functioning housing finance system in eastern Europe is quite great, because it seems to offer a solution to the unmeasurable problem of providing adequate living space. A tremendous added burden is the high, in some cases galloping inflation that has not yet been brought under control.

In Hungary, and in the Czech and Slovakian Republics they seem to be on the best track to solving this problem. The preparations for the essential framework, as for example, the introduction of a housing finance system along the lines of the German and Austrian Bauspar-system, have been most successful there. It is this particular system which is being tried, because it guarantees, by its intrinsic combined savings and finance model, the optimal exploitation of private investment sources for housing construction, combined with a low fixed rate of interest.

THE REUNIFICATION OF EAST AND WEST GERMANY

The course described above was also followed in the former GDR, after the reunification of Germany. Here the main goal was to make the specific, prevailing problems of housing finance independent from State support.

Housing supply in the former GDR has a central significance. In purely statistical terms, the housing supply in eastern Germany is greater than the supply in what was once West Germany. However, 11% of the 7 million housing units in the former GDR are uninhabitable, and another 40% are seriously defective. This very large replacement requirement suggests an estimated housing deficit of the order of 800,000 to one million units. The result of this is that the investment requirements for new projects and modernizations are enormous. Experts have estimated the cost will be about DM 550 billion by the year 2000.

The sorry state of the housing stock has been occasioned by a social system hostile to the formation of private ownership, which resulted in a housing ownership ratio of only 20 %. Highly subsidized rent prices were between 2% and 4% of an average family's net monthly income. They were certainly not adequate to permit the necessary repair and modernization work. Since the currently necessary volume of investment funds cannot be raised by the government alone, it is imperative to mobilize private capital as well.

After Germany's reunification the following housing policy measures were adopted:

- The introduction of the Bausparkasse system. Within a very short time the Bauspar- system has been accepted by the citizens in the former East Germany. It is widely used for the accumulation of private capital for housing purposes.
- Incremental increase of rental rates in order to ensure cost-covering rental prices and to mobilize private initiative for the renovation, modernization and construction of apartments. The idea behind this is that there will only be a willingness to construct apartment units, when there is the possibility of an adequate return on investment through

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The formal private sector includes the Housing Finance Company of Kenya which is the largest institution, Savings and Loan Kenya Ltd,and the East African Building Society. There are other smaller building societies and some finance is also provided by insurance companies, employers and savings and credit co-operatives.

The problems and constraints confronting the financing of human settlements development in Kenya are of three types. The first problem characterizing formal private sector housing finance is that Kenya has too many financial institutions. It has (1989) 24 commercial banks, 30 building societies and 38 life and general insurance companies. This makes housing finance institutions vulnerable as they have to compete for funds with many other institutions.

A second problem is that a large proportion of funds held by housing finance institutions tends to be of a short-term nature. Typical savings accounts have seven days notice and deposit accounts have maturities ranging from seven days to three years, yet these institutions have to commit funds and mortgages with maturities up to 20 years.

A third problem is that housing finance institutions consider the permitted spread is inadequate for viable operations. In consequence a variety of application fees are charged to borrowers, thereby restricting access to mortgage finance to middle and high income households. Connected to this is the problem that are the numerous constraints which limit the access of low-income households to housing finance. These include:

(a) The high administrative cost of small loans.

(b) The fact that sites and services and expandable core housing are not generally regarded as providing sufficient collateral.

(c) The assumption (generally inaccurate and biased) that the loan repayment default rate is higher among low income households.

(d) The use of the rule of thumb 25 % gross income as the maximum permissable mortgage repayment (low income households often have other "hidden" sources of income in addition to official sources and are often able and willing to pay more).

(e) The conservative practice of limiting repayment payments to around 18 years.■

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cost-covering rents. Additionally, tenants will only be interested in buying the flats in which they live, if the rent/ownership differential is in favour of ownership.

- The privatization of the existing housing stock.

- Extensive state sponsored assistance for housing construction.

People are obviously taking a great interest in obtaining credit for the modernization, construction and purchase of housing. Unfortunately, two years after reunification, substantial impediments still exist. Many of the land registers were destroyed or made illegible when the former GDR regime collapsed. This often makes it difficult, or even impossible, to prove ownership, since after 1945 several property expropriation waves occurred. Since reunification, the State has decided that expropriated properties be restored to their rightful owners. Because of these pending claims, a multitude of real estate contracts have been blocked, probably for years to come.

The progress of processing of restitution claims is unfortunately quite slow. So far 2.5 million individual claims have been brought forward, but only 14% of these have been completed. Additionally many of these remaining claims will have to be settled in a court of law.

For specific commercial investments, exception to the principle of restitution is made and the former owners, whose property was expropriated by the communist regime, must content themselves with indemnification.

Furthermore, problems continue to exist because the former GDR real estate laws have not yet been revoked. As a result, there are still quasi-rights of use that have never been entered into the land registers, but must be respected nonetheless. In such cases, evidence of the existence of such rights is often difficult to furnish.

Another problem is that public authorities are often unable to adequately provide services. This is sometimes because of personnel shortages, sometimes because of a lack of qualifications of the authorities themselves. This is particularly true in the case of the land register office, as well as with the municipal authorities. Urban planning and zoning offices are just in the process of being established.

Along with the issues of the qualifications of public officials, there are additional political frictions regarding city planning as it relates to the zoning and funding of schools, kindergartens, hospitals and public transportation.
In the two years since reunification, because of obvious problems, the majority of housing loans have been granted without collateral. Since the existing legal framework allows housing finance Institutions to grant unsecured loans only to a certain monetary limit, housing projects to date have been primarily less expensive modernizations.

The normalization of housing finance In eastern Germany cannot be anticipated for several years. Only after the pending restitution claims have been settled, and the land register offices, as well as the municipal planning authorities are able to fulfill