Housing Finance in Development :
Is there an emerging paradigm for developing countries in Asia?

by Nasser Munjee

Major transformations are currently taking place in Asia. During the past decade, the newly industrialised countries of the region (Hong Kong, Singapore, Korea and Thailand) have doubled their share of world exports. The range of goods traded are increasingly moving into higher value added and technology based industries; imports of consumer goods have declined as an increasing percentage of these goods are now being produced more cheaply at home. Foreign domestic investment is also a source of continued competitiveness for these nations as the successful internationalisation of production processes moves across borders in the Far East.

Improved standards of living (and thus higher wage costs) are being overcome by relocating investments (through joint ventures, direct investment, licensing and sub-contracting) in labour surplus economies such as China and now India. Unfortunately the comparative advantage of cheaper labour is sometimes offset by poor infrastructure development. In India, for example, highly restrictive land legislation and the relative neglect of urban development planning and investment, especially urban finance, has resulted in extremely low investments in urban infrastructure such as housing, roads, water supply, telecommunications and power. The poor quality (and high costs) of these services can result in substantial costs of doing business and unless these services are upgraded they can slow the process of economic liberalisation considerably.

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SUPPLY SIDE PROBLEMS

A number of countries have tried to address this problem partially. Thailand concentrated on amending and computerising its land titling system so that the response time on the supply side of land markets were minimised. Today it is possible to get a housing project off the ground within six weeks. Some would argue that this is too fast resulting in far too many projects being approved. In the past five years, the supply curve for housing has been flattened so that it is now thirty times more responsive than it is in Korea. On the other hand, investments in infrastructure lag far behind the demands made by the growth of national income. Anybody who has visited Bangkok cannot fail to be caught up in a fearful traffic jam or notice that sewerage treatment plants need to be installed as a matter of some priority. Korea and Malaysia (and indeed India) have far more rigid controls and, as a result the supply curve for housing is much steeper resulting in much higher house prices. Recent policy changes in Malaysia have resulted in a movement much closer to the Thailand model with one window approvals. However, as land is a stat subject, wide variations will emerge depending on the priorities of local administrations.

I began this paper by focusing attention o the supply side of the housing sector a many policy decisions that affect the effective demand for housing are still to be foun here. In more developed economies, these effects are felt when the housing (or property market) cycle runs counter-cyclically t the rest of the economy owing to lag effects Projects begun in times of buoyant deman are completed in time of recession leadin to major problems for both developer an financier. In developing economies th problem lies in Government intervention i land markets. The heart of any efficien housing finance system, whatever manne it may be structured, is an operational lan market (even though it is not entirely efficient) with fairly unambiguous titling ar rangements. In the absence of this, housing finance can at best be peripheral in th demand function for housing. This arise as access to housing finance through formal housing finance institutions become extremely difficult if:

- Clear titles are not available, (Sri Lank and Indonesia for example). In Sri Lank housing finance institutions are assistin borrowers with title clearance and th insurance companies also offer title insurance.
- Foreclosure is not possible without length

court procedures. In this case alternative security is required - Personal Guarantees, hypothecation of other assets etc. It also often precludes access to housing finance institutions of self employed households (India, Pakistan).

The house price to income ratio can exceed affordable limits limiting the role of housing finance in the demand function for housing. In this case, owing to constraints in the land market, (slow response times, lengthy procedures, government interventions, zoning regulations) house prices are driven up as a result of the premiums on land. Average house prices as a relation to annual income tends to rise between 7% to 15% - that is nearly 7 to 15 annual income are required to buy the average house. At this point, housing finance can exacerbate the problem of demand supply imbalances by further pushing up prices. Home ownership is driven towards those who possess an asset which can be traded in for home purchase : typically ancestral lands, jewellery, savings. In effect the demand function for housing is influenced more by the wealth effect than income.

The foundations of a formal financial network servicing the housing sector depends very much on these supply side factors. Constraints imposed by the supply side, leading to unreponsiveness and low levels of affordability, cannot then be remedied by subsidising the demand side - especially housing finance. Policy initiatives are required on the supply side first which would facilitate the process of financing housing - initiatives which governments are extremely reluctant to pursue.

In a recent special issue of the weekly journal *The Economist*[1] celebrating its 150 year history, the Peruvian entrepreneur and economist, Hernando de Soto argued forcefully that in the next 150 years, developing countries that will demonstrate most progress will not be those that concentrate solely on their macro-economic policies, but those that place their energies in ensuring that property rights are widespread and protected by law. His central thesis is that civilised living in market economies is based on the order that formalised property rights ensure for efficiency in exchange. This is especially true of the daily exchanges taking place in financial markets - promissory notes, bonds, contracts, guarantees, swaps - it is only possible because widespread property rights permit massive and sophisticated and yet low cost exchange. Efficient operations of financial markets without clear property rights would be unthinkable.

In the USA, housing constitutes over 40% of family assets; in developing countries land and housing would be in the region of 70 - 80%. In Peru, 90% of rural and a half of urban property rights are not protected by law. (Formalised titles are not available; most transactions are based on informal arrangements). A similar situation exists in most of Asia excluding the newly industrialised countries. It is this factor which is the main element that ensures that the poor remain outside the market economy. Without clear title, uncertainty of ownership makes land or housing difficult to market. Without a clear definition of rights over property its transfer, rent or mortgage is rendered ineffectual - something the poor can least afford.

The World Bank in its shelter sector policy paper which defined the paradigm of developmental interventions for the sector for two decades, concentrated essentially on the supply side - designing approaches to shelter which, in the first instance, reduced costs and enhanced affordability and in the second, attempted to ensure replicability of projects given the new approach. Its latest paper - defining the 'new conventional wisdom' entitled "Housing : Enabling Markets to Work", is based on a considered evaluation of two decades of experience with its earlier strategy and in essence tries to balance the forces of both supply and demand rather than just supply as in its earlier strategy.

All this may seem obvious, though very often it is not the crux of policy initiatives. Policy makers are all too ready to prescribe new institutions such as housing banks to cater to poor households through interest subsidies ; and international agencies to push "low income lending" through formalised housing finance institutions. It is this aspect, the nature of the system of finance to be promoted and the institutional arrangements that the system will necessitate that seems to me to be the key issue requiring much greater emphasis especially in the Asian context. Despite major revisions in conceptual thinking exemplified by the new approaches for the 1990s of all major international development agencies active in the shelter sector, including the World Bank, USAID and UNDP, a new systemic approach to the issues host governments are grappling with in the region has not emerged.

THE INSTITUTIONAL CONTEXT IN ASIA

Financial sector reforms have swept Asia with unpredictable force. China, Vietnam, Pakistan and India are all on the path of transition from either highly repressed or at best highly controlled economies to market driven regimes. A major platform of this liberalisation is the opening up of the economy to international trade, foreign direct investment and exchange rate reform. In India, the major initial impact of this liberalisation has been the influx of direct foreign investment in industry given the possibility of 51% ownership of corporate bodes and the entry of a host of foreign institutional investors in India's capital market. (In 1993-94 the total inflow of investment was over US$4 billion). The barriers between traditional markets and institutions are disintegrating with a speed hitherto unimagined leaving traditional, specialised institutions with market opportunities never before available. Resource raising markets have also undergone major change as interest rate controls, specific tax concessions and regulatory reform take place in the new context. The flow of funds in the

Table 1 : Performance Indicators of Selected Housing Finance Institutions in Asia *All figures in US$ millioi*

Institution	Net Worth 1991	Net Worth 1992	Net Worth 1993	Housing Loans Outstanding 1991	Housing Loans Outstanding 1992	Housing Loans Outstanding 1993	Profit after Tax 1991	Profit after Tax 1992	Profit after Tax 1993
Government Housing Bank, Thailand	100.11	133.54 (33%)	190.42 (43%)	1,493.93	2,035.94 (36%)	2,775.37 (36%)	25.71	37.03 (44%)	51.17 (38%)
Housing Development Finance Corporation, India	47.82	59.03 (23%)	102.23 (73%)	678.93	816.6 (20%)	978.99 (20%)	14.59	17.71 (21%)	33.58 (90%)
Home Development Mutual Fund, Philippines	609.61	710.43 (17%)	824.68 (16%)	284.07	335.04 (18%)	397.18 (19%)	9.86	18.93 (92%)	29.07 (54%)
Home Insurance & Guaranty Corporation, Philippines	29.70	31.23 (5%)	35.28 (13%)	3.06	3.94 (29%)	4.18 (6%)	2.93	2.73 (-7%)	3.19 (17%)
Korea Housing Bank	300.09	312.46 (4%)	342.41 (10%)	10,217.10	12,303.98 (20%)	14,340.69 (17%)	50.09	29.05 (-42%)	39.93 (37%)

Note : Figures in parentheses indicate growth over previous year

economy is no longer predicated by the directed credit system; it is now determined by portfolio investors on a risk return calculation.

Rapidity of change creates opportunities as well as risks. The quality of management in the new environment takes centre stage for institutional transformation and diversification if traditional businesses are to survive and new ones emerge. Management problems are likely, therefore, in my view to be much more complex than hitherto. Certainty and tradition are likely to fly out of the window and be replaced by uncertainty and constantly changing responsiveness to the external environment; much more difficult to deal with than the older and slower pace of change. The learning process within institutions will need to be interfaced with reality on a continuing spectrum. It's a progressively more complicated world but on the other hand we have more sophisticated tools to deal with it. It all suggests that we will need to run faster in order to survive - especially in the realm of ideas and the pace at which we are able to execute them in practice.

Surprisingly, housing finance in Asia is heavily dominated by governments in the region. The Philippines has three institutions, the Home Development Mutual Fund, The Home Insurance Guaranty Corporation and the National Home Mortgage Finance Corporation all of which are co-ordinated by a Council established by Government. Indonesia's Bank Tabungan Negara is a reformed government savings institutions which is now the prime housing finance lender largely dependent on liquidity credits from the government; Pakistan and Bangladesh both have a House Building Finance Corporation funded by the Treasury; Sri Lanka has a sixty year old State Mortgag and Investment Bank also funded by go\ ernment guaranteed debentures. Vietnar has the Habubank which funds construc tion and state housing. Surprisingly, eve Japan has a state dominated housing f nance sector. Malaysia is slightly differe as it has a form of building society structur dominated by the Malaysia Building Soc ety and the Borneo Building Society (Berha both institutions established with assis ance from the Commonwealth Develop ment Corporation. Interestingly Malays also has an active secondary market oper tion with the Cagamas being the maj investor in secondary market paper. Hou ing finance in Malaysia is heavily dom nated by the commercial banks and th Treasury housing loans division rather th specialist lenders to the industry.[2]

Thailand too has a wholly owned gover

ment institution, the Government Housing Bank, which presently functions autonomously and competitively with the rest of the financial system. It raises its own resources through deposits and lends to households on competitive terms. Indeed, it recently lost the advantage of tax concession on its deposit taking activities and now has to compete with the rest of the banking system.

The Korea Housing Bank was set up by government in 1967 to systemise the flow of housing finance in the Korean economy. Today it not only undertakes housing finance as a "private sector activity" it also manages the government's National Housing Fund which result in its share of total housing loans outstanding being 86% (37% by the Bank and 49% by the Fund). Despite the importance attached by government in Korea to the housing sector, Korea still suffers an acute shortage of housing of about 2.75 million units.

India has been very different; the housing finance industry began with a private sector company - the Housing Development Finance Corporation which in turn with partnerships with several public sector banks promoted a number of housing finance companies. The government only subsequently established the National Housing Bank to promote, regulate and refinance the emerging housing finance institutions. As a result, both the private and public sector coexist with 18 firms in the industry, six of which are significant, though HDFC still has the largest market share. Table 1 gives the performance indicators for selected housing finance institutions in Asia.

INTERNATIONAL DONOR AGENCY CONTRIBUTION

The International donor community have been active in promoting shelter strategies in developing countries since the early 1950s. The United Nations Centre for Human Settlements (Habitat), The United Nations Development Programme, The World Bank, The United States Agency for International Development and the Asian Development Bank have been particularly active in the field of shelter and urban infrastructure.

In the late 1980s and early 1990s, much of the conceptual foundations on which international donors have based their operating policies for both housing and urban development issues have undergone major reevaluations drawing both on the lessons from past experience and reflecting current thinking on development.

The origins of this new emphasis started with the International Year for Shelter and the New Agenda for Human Settlements adopted by the UN in 1987 and The Global Strategy for Shelter to the year 2000, adopted by the UN General Assembly in 1988.

Asia has been the experimental ground for many of these approaches, the best example being that of sites and service projects which was the anchor of the World Bank's earlier strategy of concentrating on the supply side. In the 1980's, however, the Bank shifted focus to institutional development on the demand side by experimental loans to building the housing sector through the development of housing finance institutions. Housing Finance project lending has been undertaken in India (HDFC) and Indonesia (Bank Tabungan Negara). The Asian Development Bank is currently undertaking a loan and technical assistance programme to Sri Lanka to reform the housing sector as well as the housing finance institutions that currently exist. The UNDP have looked at Nepal and Bhutan and the International Finance Corporation have undertaken equity support to HDFC in India and Papan Sejhatera in Indonesia and is considering equity in a new company in Bangladesh.

Given the revival of interest in housing finance institutions in the region, a number of private sector ventures are beginning to emerge. Bangladesh Housing Finance Company is a new institution to be promoted by a local development institution and the International Finance Corporation, the International Housing Finance Company in Pakistan by the Pakistan Industrial Credit and Investment Corporation (and two other smaller ventures by private groups) and in Sri Lanka the HDFC of Sri Lanka is now beginning to take off and will soon be privatised. Both Malaysia and Philippines, disappointed that the existing mortgage lenders are unable to meet the needs of lower income households are both considering the establishment of housing banks.

The pattern that seems to emerge in Asia would suggest the following. Countries in the region which did not have conventional mortgage lending institutions are now striving to establish them mainly in the private sector (India, Nepal, Vietnam). Those that have state owned housing banks are attempting to create a more diversified market with private sector participants (Bangladesh, Pakistan, Sri Lanka and Indonesia) and finally those that have developed a fairly extensive housing finance system for middle income borrowers, are seeking methods to extend the system to assist lower income households (Malaysia, Thailand, Korea, Philippines).

Whatever system eventually emerges, they will all be dependent on the degree to which they can integrate themselves into the rapidly changing financial systems of most countries in the region. Their resource base will define the type of institution that they eventually evolve into. Very often a housing finance institution is viewed essentially as a housing institution and not a financial institution thus blurring the critical distinctions that have to be made in institutional structuring (and therefore of integrating into the financial system). Policy makers focus attention on the asset side of the balance sheet rather than on the liabilities side. Institutions that are structured in this way very soon find that mobilising resources becomes the major constraint for their lending operations. This is true for new institutions that are just getting off the ground as it is for institutions that are in the process of transformation from being government funded toward more market funded entities. Examples abound of institutions that have been established on the basis of objectives defined on the asset side of their balance sheets without a clear strategy on the long term resource base. Most housing banks fall into this category and become dependent, in one way or another, on a governmentally supported resource flow.

TECHNICAL ASSISTANCE FOR INSTITUTIONAL DEVELOPMENT IN HOUSING FINANCE

The two major international agencies that have been active in this field have been the World Bank and USAID. Both institutions have essentially provided funds to housing finance institutions to:

- strengthen them as institutional lenders in the housing sector in general and to develop independent resource bases in the domestic market; and
- to encourage the creation of innovative lending options which would encourage greater access to housing finance for poorer households.

The World Bank over the past two years, however, has been re-appraising its record in lending to financial institutions in general and development banks in particular. Its most recent 'pause' in this type of lending can be explained by the fact that it would like to reassess the role that these institutions play in the financial system in general; whether they perpetuate a directed credit regime and whether the Bank's lending encourages greater independent resource raising strategies or whether it builds greater dependence as one line of credit follows another. The matter seems to have moved out of a single institution's domain to one that involves the country's financial strategy in the medium run.

The Asian Development Bank has yet to enter housing sector lending in a major way and is watching the Sri Lanka programme as a possible model for the future.

USAID, though it still has had strong ongoing housing finance assistance programmes in Pakistan and India in the Asian region (the Pakistan programme has wound up recently), seems to be moving towards the theme of privatisation in the provision of infrastructure investments in Indonesia and India as future programmes. This approach is supported by UNDP in its Urban Management Programme at the Global level as well as its Asian version based in Kuala Lumpur. Housing and habitat issues have been subsumed under this umbrella under the broader theme of 'poverty alleviation'. A major housing finance initiative under this programme is the Asian Coalition of Housing Finance Institutions.

The Asian Coalition jointly hosted a workshop in London last November with the Development Planning Unit of University College, London University which brought together shelter professionals from the international donor agencies, major housing finance institutions in Asia and Africa, independent consultants, government officials experienced in the field and independent Non-government organisations and networks operating in the field to discuss the following:

- The New Emerging Strategies for Shelter and Urban Development in Developing Economies;
- Current Programmes for the Support of Shelter Sector Developments: Project Formulation, Technical Assistance and Training;
- Implementation Strategies for the Emerging Paradigm and their implications for Institutional Development.

Within the shelter sector, the need for more efficient housing markets, a better understanding of housing finance mechanisms and the development of appropriate institutions to attract funds and make available housing finance is central to the new agenda. The London conference focused on the latter - institutional development - througł which multiple objectives can be met.

This process will be pushed further in the next two years with preparatory work currently being undertaken for the major UN conference *HABITAT II* to be held in Istanbul in June 1996. The Asian Coalition is coordinating the shelter finance agenda fo Asia and concentrating on the issues discussed at the London meeting. As the directed credit system collapses in all majo economies of the region and the nature o specialisation in financial services undergoes major revision, the role of governmen controlled/owned institutions will be substantially effected. As Asia is dominated b the latter, major policy options will need t be considered to integrate this process int the broader financial system as has occurred in Thailand.

That progress depends on shared learnin is a basic dictum of the scientific enterpris or of institutional growth. If this principle i coupled with a genuine commitment to pu in place an environment that encourages it perpetuation and a constant refinement o the technique it suggests (the principle o learning by doing) the results that it implie can be quick and effective. The need fo recognising this has, perhaps, never bee as urgent as it is at the present time. Th Asian agenda is to push it forward with a the strength at our disposal.

NOTES

1. See article *The Missing Ingredient : Wha poor countries will need to make the markets work* in this issue.
2. See article *Housing Finance and th Malaysian Economy* in this issue.