Developments in Philippine Housing Finance

by Zorayda Amelia C. Alonzo

THE HOUSING SITUATION: AN OVERVIEW

As in other Asian countries, the housing situation in the Philippines is characterized by the emergence of a continuing demand for affordable housing units in response to increasing population and household size, both in the urban and rural areas. Affordability poses a challenge due to such factors as low income levels, inadequate supply of desired units and limited accessibility to housing finance packages.

Housing need for the period 1992 to 1998 is estimated at 3.72 million units, which is admittedly huge and far greater than what government can respond to by itself. This total need consists of an estimated 2.86 million units comprising future housing needs resulting from population growth; plus some 873,000 in housing backlog, consisting of doubled-up dwellings, substandard units which require upgrading, and those displaced and literally homeless—pushcart people living in the streets, parks, etc. Through the National Shelter Program the government target is to provide housing assistance to 1.2 million households, representing only 33% of the identified housing need for the given period.

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THE NATIONAL SHELTER PROGRAM

Housing the nation is a major concern of the Philippine government. Under the current administration of President Fidel V. Ramos, socialized housing is a flagship program of the Social Reform Agenda, with the objective of providing the Filipino population, especially the lowest 30%, with adequate and affordable housing.

The National Shelter Program seeks to:

- Increase accessibility of homeownership for lower income families;
- Provide stable, sustainable and viable long- and medium-term home financing;
- Provide security of land tenure for the beneficiaries of urban land reform and provide areas for priority development;
- Encourage greater private sector participation in housing initiatives, both from the formal and non-formal sectors;
- Ensure equitable distribution of benefits to the geographic regions of the country; and
- Curtail the proliferation of squatters and squatting syndicates.

In 1981, the national government adopted a total system approach in housing finance, production and regulation. An interacting network of housing agencies with specific functions, namely funds generation, mortgage purchase, mortgage guarantee, regulation and socialized housing production was established and maintained. A housing finance system, with the long-term objective of integrating savings mobilization, secondary trading and credit insurance, was put into place. Unfortunately, the system failed to take off beyond the primary mortgage market, and even the mortgage origination set-up with a single mortgage lending institution was sub-optimal.

Subsequent shifts in housing policies and programs were undertaken in line with the United Nations Global Shelter Strategy. In 1986, a Revised National Shelter Program was implemented with the primary objective of developing a self-sustaining and equitable housing delivery system through increased private sector participation in both housing finance and production. In addition to the set-up established in 1991, Executive Order No. 90 provided a source of funds for housing finance through the country's social insurance and provident institutions: the Social Security System (SSS), the Government Service Insurance System (GSIS) and the Home Development Mutual Fund (HDMF).

Program Components

The components of the government's shelter program include the following:

1. The development of resettlement sites to generate service homelots for displaced families;

2. The community mortgage program, a financing scheme which enables slum dwellers and residents of blighted areas to own the lots they occupy where owners are willing to sell, re-block their structures and introduce basic housing facilities or utilities through a community mortgage;

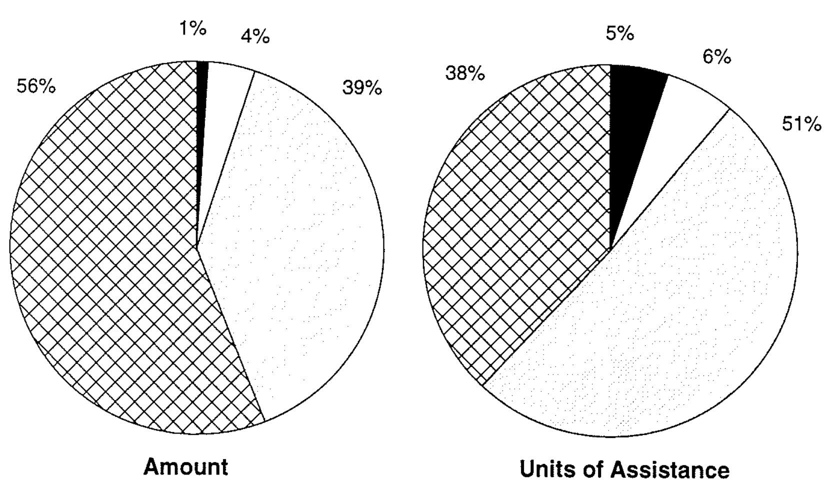
3. Direct housing provision for the employed sector through the Unified Homelending Program and regular mortgage financing programs of the various shelter and funding agencies;

4. Indirect housing provision via developmental loans and a system of guarantees through private developers, landowners, local government units and financial institutions to enable them to mobilize their resources to accelerate shelter delivery.

For the period 1993 to April 1997, figures from the Housing and Urban Development Coordinating Council (HUDCC) indicate that housing assistance has been provided to 732,812 households, representing 59.11% of the 1.2 million target for 1998. This corresponds to a total expenditure of P98.9 billion. A breakdown of this accomplishment by program component is shown below.

Figure 1. National Shelter Program Expenditure by Program Component (1993–April 1997)

	Amount		*Units of Assistance*	
	Amount	*Percent*	*Units*	*Percent*
Community Mortgage Program	P 1.265 B	1%	39,704	5%
Resettlement	P 3.685 B	4%	45,785	6%
Developmental Financing	P 38.954 B	39%	371,067	51%
Individual Mortgages	P 55.038 B	56%	276,256	38%
Total	P 98.942 B	100%	732,812	100%



REFORMS IN HOUSING FINANCE

Housing finance institutions in the Philippines generally follow the trails of experience left by their counterparts in the Asian region. This is particularly true for the Home Development Mutual Fund (HDMF) or the Pag-IBIG Fund, a provident fund system which was created in 1980, following the models set by the Central Provident Fund (CPF) of Singapore and the Employees' Provident Fund (EPF) of Malaysia. As a housing finance institution, however, Pag-IBIG Fund has learned considerably from the experience of such institutions as the Government Housing Bank (GHB) of Thailand and the Housing Development Finance Corporation (HDFC) of India. As part of the Asian Coalition of Housing Finance Institutions, the Fund derives valuable inputs from neighboring Asian countries for integration into its own housing policies, systems and procedures. These inputs have contributed to Pag-IBIG's expansion and evolution as the Philippines' premiere housing finance situation.

The Philippine government recognizes the need to provide an enabling environment for the housing sector through the establishment of the proper regulatory and fiscal framework. Government legislation relative to housing, however, consisted primarily in sourcing housing finance from budgetary appropriation. Owing to unforeseen developments within a particular fiscal year, however, legislated allocation for housing has not been fully released.

In support of socialized housing, the Abot-Kaya Pabahay Fund was created by law in 1990, providing for annual government budget appropriations for the provision of amortization support to qualified social housing beneficiaries. This would be accomplished through partial subsidies granted on their monthly loan repayments, i.e., a buy-down subsidy for the first five years of the loan term; developmental financing amounting to 80% of total project cost for the proponents of low-cost housing projects; and cash flow guarantees to the UHLP funders for the social housing loans they originate. This program has taken off, although at a very slow pace, still to make an impact on the considerable demand for affordable housing.

A landmark legislation in housing is Republic Act No. 7742, providing for mandatory membership in the Home Development Mutual Fund (HDMF), otherwise known as the Pag-IBIG Fund.

Pag-IBIG Fund is the Philippines' provident fund for housing finance, a nationwide savings system anchored in the pooling of small savings to generate long-term funds which can efficiently address the long-term finance requirements of members. The Fund was originally conceived to answer the need for a financial institution to mobilize savings with government propelling the system through decreed employer counterparts. In the course of its 16-year existence, Pag-IBIG Fund has expanded into a stable housing finance institution with an asset base of P52.0 billion and a nationwide network of regional and branch offices. To date, its membership base stands at 3.6 million and its housing loan portfolio aggregates to over P45.0 billion.

As mentioned earlier, funds for the government's Unified Homelending Program (UHLP) are principally provided by the Social Security System (SSS), Government Service System (GSIS) and the Pag-IBIG Fund, all of which are social security/pension or provident funds.

The funds allocated by these three funding agencies were, until 1995, channeled through the NHMFC, which was supposed to be the government's primary mortgage lender for the UHLP. NHMFC purchased housing loan mortgages delivered by originating financial institutions and private developers. In 1996, however, the Corporation found itself unable to honor its commitments to "take out" the mortgages delivered in 1995 by its originators. This occurred despite a takeout value of P13.2 billion which the Corporation released for the same year.

Pag-IBIG Fund, having become once again a mandatory Fund in 1995, undertook the payout of NHMFC's unhonored mortgage commitments, beginning April 1996. It completed the bail-out by June 1996, releasing some P5.6 billion. This move restored the much-needed liquidity into the housing finance system, averting what otherwise would have been a crisis in the housing sector.

The experience likewise pointed anew to the weaknesses of the housing finance system and triggered policy decisions to adopt a package of measures to address these weaknesses.

Figure 2. Unified Homelending Program 1987–1995

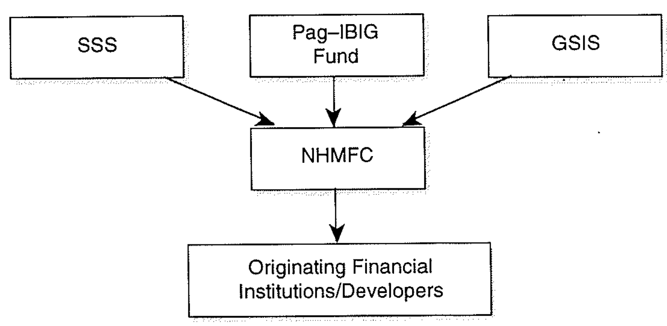
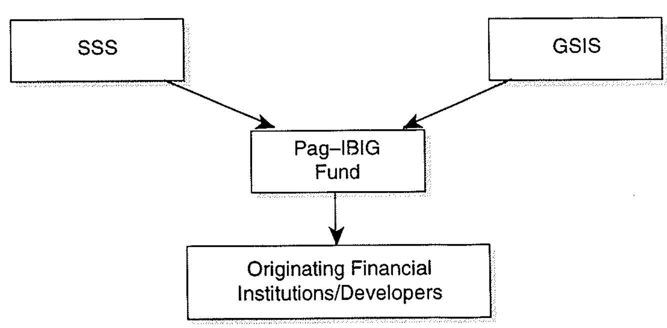


Figure 3. Unified Homelending Program in Transition (1996–Present)



ISSUES IN PHILIPPINE HOUSING FINANCE

As in most developing countries, the traditional perception of a housing finance system is one based primarily on the provision of government subsidies. This has resulted in a segmented housing finance system which has proven to be hardly sustainable.

Housing finance requires a continuous flow of funds to ensure its viability and sustainability. Traditional sources of these funds include personal or household savings, and compulsory savings schemes, such as provident or pension funds, life insurance and other social security systems. But, as the Philippines has experienced, even these sources can prove inadequate when collection levels are low and cost recovery is negligible. The Social Security System (SSS), Government Service Insurance System (GSIS) and the Pag-IBIG Fund all have responsibilities and commitments to their respective members to maintain financial availability, liquidity and growth. These legitimate concerns guide investment decisions and take precedence over providing support to the housing finance system.

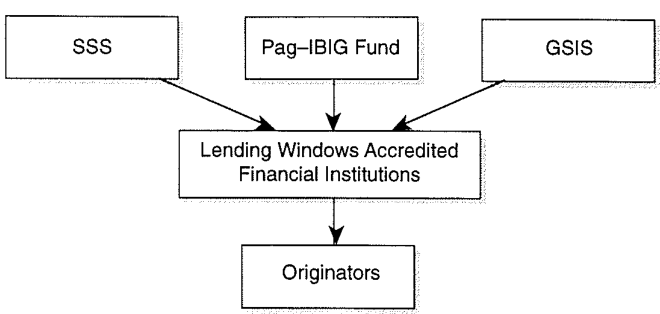
As a policy shift away from the existing Unified Homelending Program (UHLP) with a single mortgage lending window, policy makers have modified the shelter program by providing for a Multi-Window Lending System. Other financial institutions may now be accredited as conduits for housing funds released by the three funding agencies. In turn, each lending window may accredit their own originators for mortgage loans. In effect, the idea of a single lending window for the government's housing program has finally been set aside, and the finance market for socialized housing will be open to increased private sector participation.

Along with this modification, efforts are being undertaken to address the issues of housing subsidies, the need for a viable and sustainable source of funds, and the shift to market-based lending as a prerequisite to integrating the housing finance system into the country's financial markets.

Housing Finance Subsidies

Housing finance is a key component of housing policy. Governments must provide the appropriate environment for the mobilization of adequate funds for housing. There are several critical lessons which can be learned from this evolution of housing finance in the Philippines.

Figure 4. Multi-Window Lending System (to begin September 15, 1997)



The social goal of a housing finance system is generally to provide affordable credit to the lower income sectors. The most common strategy to address this need is to require government housing finance institutions to charge low interest rates on mortgage loans, supposedly for the benefit of the marginalized sectors. But are all the beneficiaries of these subsidized loans really in need of them?

In the Philippine setting, the housing market can be segregated into three general categories: the ultra-poor or marginalized sector who cannot afford to pay for any type of housing; the low-income sector with low affordabilities but who can pay, given the right package and some measure of financial assistance; and the middle/high income sectors who can afford to borrow at market rates.

Under the prevailing scenario, government provides assistance to the marginalized and the low-income sectors through the Community Mortgage Program (CMP), the Abot-Kaya Pabahay Fund, and through the UHLP's 9% socialized housing loan packages. The upper low-income to middle-income sectors are served through the UHLP's economic housing loan packages with an interest rate of 12% per annum; and the upper middle and higher income brackets can use the UHLP's 16% loan packages and the services of the private banking system with its market-rate mortgages.

Policy analysts and some policy makers argue that government assistance should rightfully be directed primarily to the first sector—the urban poor, the poorest of the poor. The situation is such, however, that some beneficiaries of socialized housing can very well afford to access housing finance at market rates.

In a paper[1] entitled *A Study of Housing Subsidies in the Philippines,* the conclusion is that "the present housing finance system provides large implicit and explicit subsidies that do not reach the target clientele." An analysis of the income profiles of NHMFC's UHLP borrowers further revealed that "the relatively large interest rate subsidies provided to the low-income groups are offset by the bigger loan amounts available to the high-income groups."

The same paper takes a look at NHMFC's UHLP portfolio from 1993-1995, showing that only 38% of UHLP beneficiaries belonged to the low-income group, while 33% and 29% belonged to the middle- and high-income brackets, respectively. In terms of loan value, only 28% of total disbursements reached the low-income group, while the balance of 74% went to the middle- and high-income brackets. The irony of the situation is that 53% of delinquent loans originated from the upper income groups. The study, therefore, argues that "the UHLP program is dominated by the middle- and the high-income members of the pension funds. The principle of cross-subsidization does not seem to work well, since the high-income borrowers were able to capture most of the interest and arrears subsidies."

Figure 5. Incidence of Housing Subsidies

UHLP Portfolio 1993–1995	*Low*	*Income Group* *Middle*	*High*
% of Beneficiaries	38	33	29
% of Loan Value	26	33	41
% of Delinquent Loans	11	36	53

This misdirected use of government funds is in itself a major deterrent to the development of a strong and viable housing finance system. Economically unwise subsidies drain national budgets at a time when most governments are trying to reduce public expenditures. In order to address this issue, the HUDCC and the housing agencies have modified the UHLP guidelines to limit access to the 9% socialized housing loans to the marginalized and low-income groups.

Housing Finance Alternatives

Another issue is the need to tap alternative sources of funds to ensure the viability and sustainability of the housing finance system. The pension funds and provident funds have limited resources. Increased private sector capital must be infused into the system; to do so, competitive rates of return must be provided. This can only happen if the government shelter finance program integrates itself into the country's financial system by adopting loan policies and guidelines attuned to market disciplines. This should address the problem of generating quality.

Over recent years, the country's economic recovery has spurred a real estate boom, resulting in tremendous growth in the property sector—residential, commercial, industrial. The residential sector has remained the most promising among these three components, owing to the increasing demand levels. As mentioned earlier, the government has historically been able to address only 30%—40% of the demand for housing. The private sector, through the private commercial banking system, accounts for the balance.

The country's commercial banks have been providing residential mortgage financing programs at competitive rates and terms, focusing on the upper middle- and higher income segments of the population. Banks offer loan amounts over P500.000 with maximum terms of 15 years, at market rates reviewed every year or every other year over the loan term. As prescribed by the Bangko Sentral ng Pilipnas (BSP or the Central Bank), the loan-to-collateral value ratio is at 60%—70%. Standard bank credit practices are observed in loan evaluation and processing; and strict monitoring of collection efficiency levels is undertaken. The BSP has been closely monitoring the real estate loan portfolios of commercial banks owing to the recent developments in Thailand, where the banking system's exposure to the real estate sector has exceeded comfortable levels.

A BSP survey reveals that the total exposure of the banking system to the real estate sector is at 11% of their loan portfolio. As of December 1996, the banking system's total loan to the financial services and property sector reached P211.12 billion, up by 70% from P123.94 billion in 1995.

Given their sizeable residential mortgage portfolios, private banks have tested the market for alternative mortgage instruments. Securitization of mortgages provides a liquidity mechanism for housing finance. This instrument has been gradually gaining acceptance as an alternative to liquefy an institution's long-term mortgage portfolio, thereby generating more funds to plow back into the financial system. Since 1988, several institutions in the country have floated various types of mortgage-backed or asset-backed instruments in a seeming attempt to integrate housing finance into the capital markets.

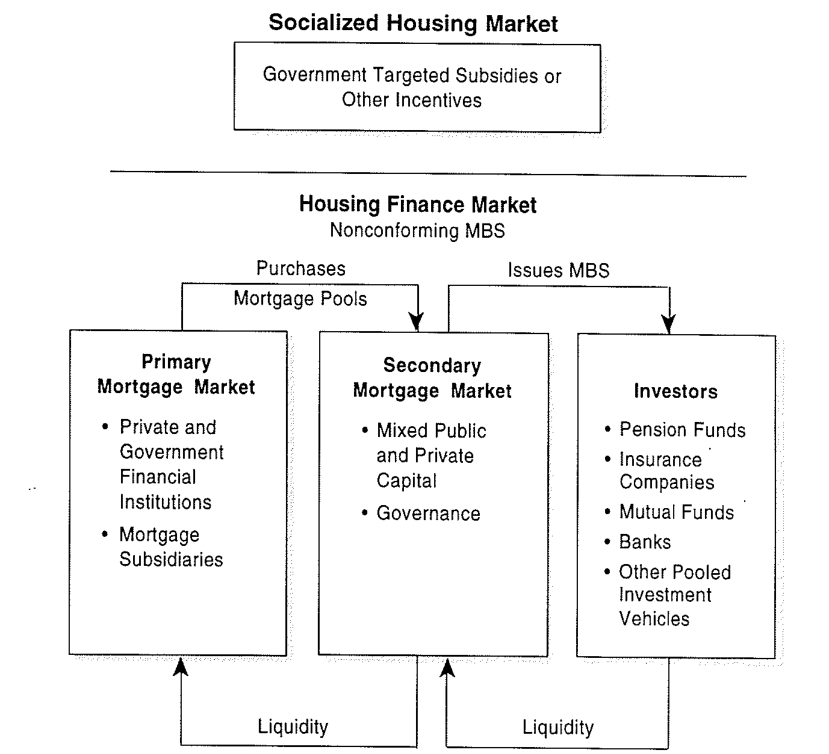
In March 1994, Pag-IBIG Fund made its initial entry into the capital market with the issuance of P500 million worth of one-year mortgage-backed bonds. This marked the first phase of the Fund's mission to elicit investor awareness and gain investor confidence in the viability and profitability of mortgage-backed investment instruments. In February 1997 the Fund launched the first tranche of its P1.0 billion mortgage-backed securities for the year, with Citibank N.A. and the Philippine National Bank as joint financial advisors and placement agents. The initial tranche of P450.0 million was 1.5 times oversubscribed, indicating significant interest among private institutional investors for this type of instrument.

THE VISION FOR PHILIPPINE HOUSING FINANCE

In examining the Philippine housing finance sector as part of the initiatives to strengthen public-private sector partnership, the Department of Finance (DOF) is pursuing measures to help develop the primary and secondary mortgage markets, mainly through the process of asset securitization. This vision is shared by the World Bank as it notes in a study, "The potential market for mortgage-backed securities in the Philippines is fairly large, both in absolute terms and relative to other Asian countries. However, much of the potential has yet to be realized, as the market is undeveloped. In order to achieve a more modern housing finance system inclusive of a secondary market that offers a broader range of mortgage products to a wider array of borrowers, a program of complex legal, regulatory, institutional and fiscal reforms relating to the capital market is required. These reforms would not only allow the housing finance system to tap the capital markets as the institutional investor base becomes more developed, but would also help promote the development of securities markets and the financial system."[2]

As DOF envisions it, the securitization of mortgage loans is an excellent beginning. Private sector financial institutions are expected to lead the process, with government providing assistance via a developmental regulatory framework and, in the interim, the necessary catalytic role through selected government financial institutions.

Figure 6. The Vision for Philippine Housing Finance



A secondary mortgage market, with the active participation of the private sector financial institutions, is seen as the mechanism which can provide continuous liquidity to the housing finance system. This works best with market-based housing finance operating as an integral part of the financial sector. Government institutions, for their part, need to take stock of the quality of their mortgage portfolio to determine whether they can be recycled to generate additional funds for re-lending.

Thus, the vision for a viable and sustainable Philippine housing finance system should include the following:

- Ensuring that the target beneficiaries of government's socialized housing subsidies are rightfully served;
- Separation of government's subsidized lending mechanisms from regular mortgage lending transactions, the terms of which shall be market-driven; and
- Increased private sector participation in housing finance, both in the primary and secondary mortgage market; this should lead to the development of an active and liquid secondary mortgage market.

Indeed the housing sector plays a more important role in a country's welfare than many realize, directly affecting not only people's well-being, but the function of other economic sectors as well. The provision of housing is a long-term program, requiring massive capital contributions from both the government and private sectors. The demand for housing will continue to grow. Government can only address a third of the country's housing need. This leaves much room for private sector institutions to fill the gap; and it creates a need for funding which can be satisfied by the capital markets through securitization. The success of these partnerships can only lead to the development of a truly sustainable system for housing finance in the Philippines.

NOTES

[1] Llanto, Orbeta, Sanchez and Tang, *A Study of Housing Subsidies in the Philippines,* 1997, HUDCC and Philippine Institute for Development Studies (PIDS).

[2] World Bank/FNMA Mission Report, *Philippines Housing Finance: Reforming Public Provision and Promoting Private Participation.* June 1997.