

Introduction

The Maltese Islands cover an area¹ of 315.59 sq. km. Out of this area 69.43 sq. km. is used as a built up area. The rest of the Maltese archipelago is divided in portions such as agricultural fields, green areas, cliffs and other wooded land as those used by the general public for recreational purposes. One has to keep in mind that the built up area of the Maltese Islands from 4.5% or 11sq. km. in 1957 has risen to 21.97% in 1997, in fact Malta has the largest room volume per person in Europe². From 1957 up to 1985 the number of dwellings increased by 70% as compared to the 10% increase in population, during this period the urbanised area increased by 348% in Malta and 226% in Gozo³.

The reason for such increase in households is because housing units, despite the increase in prices, have been fairly affordable. This is evidenced by the fact that in the 1995 Census owner occupied dwellings amounted to 81,242 i.e. 68% of all households, one of the highest rate of home ownership in Europe. Housing has been affordable due to the Government housing policies (as will be shown later on in this text) and due to commercial house loans.

¹ “*Malta in Figures 2000*” COS Publication Central Office of Statistics Malta.

² “*Public Housing Initiatives in Malta since 1955*” –Lockhart Douglas G.

³ “*Dramatic increases in land urbanization*” Local News The Malta Business Weekly 31/8 – 6/09/95

This dissertation will analyse the effects housing finance has on our society particularly dealing with three main aspects: social housing policies; banking perspectives of housing finance and the effect which housing finance has on Maltese economy. The fourth chapter deals with European systems of housing finance. Being a prospective EU member country, it is important to analyse and compare the European housing finance system with the local scenario.

Interviews were held as per Appendix I with local experts on this subject; namely Mr. Carmel Esposito, Director Social Housing; Mr. J. M. Formosa ex Chairman of Lohombus Bank Ltd. and present GM Mortgages Housing Finance Division at Bank of Valletta Plc. and Professor Lino Briguglio, Head of Economics and Banking & Finance Departments University of Malta. Apart from these interviews I also had meetings with representatives of other banks and bodies such as the Planning Authority and the Housing Authority to enhance my research on the subject. Unfortunately my efforts to conduct an interview with the Ministry of Finance personnel were not successful.

The dissertation will analyse the causes why house loans have increased from £700,000 (Sterling)⁴ in 1968 to Lm 224,089,000 in 1999. This is done by using the econometrics model of simple linear regression and analysing the effects that several variables might have on house loans.

⁴ This amount is derived from newspaper clippings regarding Lohombus Bank Ltd., which was then known as Barclays Finance Corporation (Malta) Ltd.

Chapter I – Social Housing Policies

I.a Malta's Position

The Maltese Government in the early 1960 started the campaign of home ownership schemes and the first government aids were offered to the public to achieve this goal. In fact from 1960 up to 1999 the Government through its social housing policies offered schemes to the public which made housing more affordable. The following list shows the types of aid offered by the Government⁵:

- 1961 to 1970 the Government allocated on average 154 dwellings per annum which was increased to 835 units per annum for the period 1971 to 1981. These were offered at a low rental value, which still holds to date.
- 1970 it started with its policy to clear slums
- 1973 the Housing Authority was developed with the aim of providing dwellings to those families in need and who could not afford to purchase their own dwelling. The first dwellings offered by the Housing Authority were in 1977 and were heavily oversubscribed.

⁵ “Public Housing Initiatives in Malta since 1955” – Lockhart Douglas G.

- 1979 the HOS (Home ownership scheme) was introduced in which couples were granted plots at low ground rent and offered long term finance to erect their dwellings
 - 1979 to 1986, eight issues of housing plots were offered totalling 7,000 plots
- Government continued with its policies to aid people financing their dwellings, however such aid has diminished highly throughout the years as is shown in following table.

Table 1: Housing provided by the Housing Authority 1995 to 1999

Year	Sale/Rent	Apartments	Houses	Maisonettes	Cluster Houses
1995	Sale			167	65
1996	Rent	235	7		
1996	Sale	91		81	36
1997	Sale	24	1	136	
1998	Sale	18		5	10
1999	Sale	36		97	5

Source *Housing Authority*⁶

This table shows how much the role of social housing provided by the Malta government through the Housing Authority has diminished. In fact, present government aid consists of grants and subsidies to arrange one's dwelling⁷. During a short interview Mr. Esposito, Director of Social Housing stated that to offer low rent housing, the Government has to purchase the land at commercial price, which

⁶ Dr. Maja M. Brinkworth – Research and Policy Development Officer, Housing Authority.

⁷ These schemes which are offered by the Housing Authority are described in the Government Gazette dated: 8/10/99; 15/2/99; 11/6/99; 19/1/99; 13/8/96 and 29/8/95.

is not feasible. Hence the Government has to limit itself to offer the above mentioned grants to help in some way prospective homeowners.

The development of the Planning Authority, set up in 1993, to see that property erected or purchased conforms to the required regulations on housing may have had an adverse affect on the supply of housing.

Table 2: Construction Activity in Malta

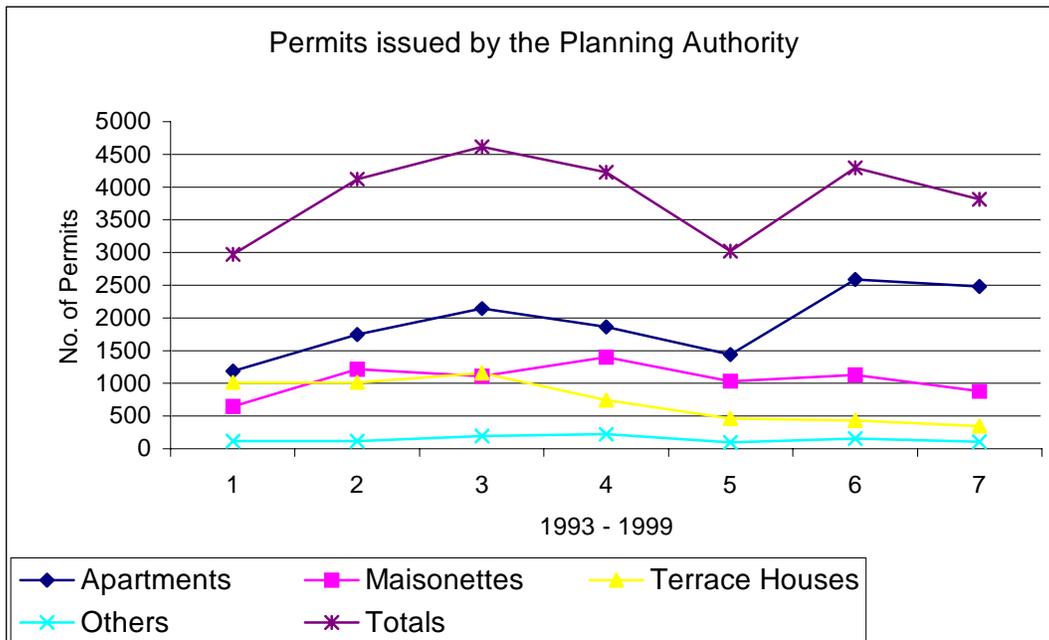
Year	Dwellings under Construction	Commencement of Dwellings	Dwellings Completed
1980	7366	2374	2567
1981	8797	3274	1733
1982	9744	2719	1762
1983	10912	N/A	1174
1984	N/A	1566	N/A
1985	7528	N/A	2194
1986	7133	N/A	2809
1987	4854	2309	2132
1988	5798	1599	1936
1989	6546	1871	2186
1990	4855	4024	4029
1991	5080	4251	4225
1992	4256	5184	5651
1993	2803	4546	4605
1994	2134	3641	3426
1995	2478	4042	3168
1996	2607	3913	3360
1997	2784	1795	1614

The figures for 1997 cover up to June.

Source: Planning Authority and Central Bank Quarterly Review March 98.

In fact, from 1st January 1993 up to the 18th October 2000 the Planning Authority⁸ received 54,789 applications for residential buildings and rejected 6,491 application i.e. 11.85%. This shows that on average, the Planning Authority rejected almost 930 units for residential purposes. As is demonstrated in Table 2 the construction activity has decreased slightly from 1993 onwards. This table shows that during the first years after the Planning Authority was developed the activities have decreased on all scenarios. However, these activities showed signs of improvement two years later.

Figure 1



Source: Central Bank Quarterly Review.

⁸ Mr. Karen Vella – Communications Officer, Planning Authority November 2000.

The reason for such an improvement might have been either that contractors became more familiar with the regulations imposed by the Planning Authority or that these contractors were submitting more permits to construct apartments having more than one unit as Figure 1 shows, whereby the permits for apartments have increased with respect to those for terraced houses.

The 1995 Census on housing shows that there are 35,723 vacant dwellings out of 115,023 (33,781 are rented dwellings while 81,242 represent owner occupied dwellings). Out of these 35,723 one has to deduct property used as summer and second residence i.e. 8,123 bringing the total number of vacant dwellings to 27,600. The main reason for such a situation is probably the present rent laws, which have been in force since the pre World War II days when they were enacted for emergency purposes only.

I.b Rent Laws

The British model regarding tenants' security has inspired Maltese legislations on house controls since 1925⁹. The *Reletting of Urban Property (Regulation) Ordinance 1939* main provision was that it was unlawful for the lessor, at the expiration of the period of tenancy, to refuse the renewal of the lease or to raise the

⁹ Lino Delia at the "Land and housing markets in Malta" Conference Proceedings 1995.

rent without the permission of the Rent Regulation Board¹⁰. This ordinance became extended year after year until 1942 when the *Ordinance XXII* made it permanent. Further legislations continued to be enacted with the main purpose of safeguarding the interest of the tenant. The *Rent Restriction (Dwelling Houses) Ordinance*, which had as its main provision that of controlling the rent, charged on dwelling houses with the introduction of the concept of *fair rent*, which determined the calculation of the rental fee. The legal rental fee was 3% per annum on the value of the site and 3.25% on the value of improvements¹¹. These rental fees were frozen according to the value of 1939, which as time passed became more unrealistic and hence landlords were losing money on their assets¹². These measures which were still in force in 1995 killed the local rental market for Maltese residents. Maltese landlords preferred leaving their property vacant rather than renting to Maltese citizens.

The following table shows the amount of rent paid by tenants in rented dwellings as per 1995 Census. Furthermore it also shows that more than half the dwellings rented cost less than Lm 50 a year in rent, which is a very low rate to pay considering the prices paid nowadays for house loans, which easily amount to Lm 80 a month in repayment.

¹⁰ Alexander Demarco – “*Aspects of the housing market in Malta: 1980 – 1994*”.

¹¹ Lino Delia (see 9)

¹² Dr. Wenzu Mintoff at the 1995 Land & Housing Markets in Malta Conference

Table 3: Rent paid per annum and the respective number of rented units

Rent paid /annum in Lm	No. of rented units
01 to 50	17343
51 to 100	9672
101 to 150	2190
151 to 200	1085
201 to 250	472
251 to 300	336
301 to 350	93
351 to 400	189
401 to 450	98
451 to 500	184
501 to 550	78
551 to 600	192
601 to 650	12
Total	33781

Source: 1995 Malta Census

The rental market has also another problem associated with it and this relates to the age of these dwellings. The next table shows the distribution of the rental housing provided by the Maltese Government and private landlords, indicating the age of the dwelling.

Table 4: Rented dwellings distribution and respective age of these dwellings

Age of dwelling	% Private Rented	% Government Rented
before 1939	58%	20%
1940 to 1959	22%	18%
1959 to 1979	16%	50%
1980 to 1989	4%	12%

Source: Denis H. Camilleri (1999) “Updated Maltese residential property facts”

This table clearly shows that most of the rented dwellings were built prior to 1939 and hence might be in need of some maintenance. This is where the conflicts start

between the landlords and the tenants, because by law it is the obligation of the landlord to make any maintenance that the rented property might need from time to time. However, because of the low rent received, landlords are sometimes reluctant to spend any money on maintenance.

Several attempts to revitalize the rental market were proposed but none had the desired effect. The *Housing Laws Amendment Act 1995* provided that as from 1st June 1995 all leaseholds entered prior to this date were to be regulated under the general principles of civil law¹³. This meant that contracts of lease shall cease *ipso jure* i.e. expire on the term agreed upon and it shall not be necessary for either of the contracting parties to give notice to the other. In fact as Mr. Esposito stated landlords were still reluctant to rent even to the Maltese Government for social housing policies because they feared that legislation might change against them once again.

Judge Riccardo Farrugia tried to reconcile the opposing interests of the landlords and tenants and argued that rents must somehow increase but still there cannot be an immediate and total liberalisation of rents. As reported on *The Times* 28th September 2000 the proposed amendments were handed over to the Speaker of the House of Representatives. The proposed amendments were that there should be an immediate increase of 20% to the present rental charges and a further 10% increase

¹³ Provisions, Civil Code Chapter 16 of the Laws of Malta Title IX – Contracts of Letting and Hiring

every five years. The landlords considering the rental fee charged consider these increases as too low. For example, if a tenant pay a rent of Lm 50 and suffers an increase of 20%, he will only pay an extra Lm 10 i.e. Lm 60 yearly the next year and then a further Lm 6 increase for the next five years. This would bring the total to about Lm 90 after five years, which if taken per annum is still a very low rental fee of Lm 7.50 per month.

I.c Position in the EU and other European Countries

The European Union has no rent laws, nor are there any EU laws on emphyteusis or agricultural leases. Thus, if Malta were to become a member of the EU it would bring no changes to our current rent laws since national laws apply in such sector. On the other hand EU citizens cannot be discriminated against having a residence in Malta. Under EU law, any EU citizen has the right to purchase property in other EU member countries and can also transfer the necessary funds to purchase or rent such property. However, regarding the outcome of EU residents wanting to purchase property in Malta, the Government has publicly declared that this matter has yet to be negotiated¹⁴. According to Mr. Esposito another problem with being an EU member is that any EU citizen has the right to apply for Government support to be provided with social accommodation as if he was a Maltese citizen.

¹⁴ MIC Malta EU Information Centre Edition 1 “*Questions and Answers on Malta & the EU*”

The rental market problem is not only a Maltese phenomenon, but exist also around European countries. However in contrast with Malta some countries have succeeded in reviving this market through certain schemes as is shown below¹⁵:

- Poland offers subsidies to landlords to encourage them to put their property on the rental market. In this way the landlord apart from the rent will acquire additional income from the Government.
- In Austria tenants receive allowances from the Government based upon the number of persons living in the dwelling i.e. basing these calculations upon floor area per person plus the individual income of the household. In this way tenants might make certain maintenance needed on the property without going to the landlord. In this way landlords could be encouraged to put their property on the rental market knowing that they will not fork out cash to maintain such property also.
- In the UK, housing benefit is a personal housing allowance system devised to meet up to 100% of housing costs in the not for profit sector. This sum depends upon the level of household income.
- Germany offers housing allowances known as the *Wohngeld* which are set so that rent paid after the allowances divided by the net income will not be more than 25 to 30% of the household income.

¹⁵ Judith Wayne (1999) “*Housing Affordability – A perspective on the issues*”; Dr. Maya M. Brinkworth and Sue Vella (1999) “*Can social housing applicant afford market prices*” and Denis H Camilleri (2000) “*A case for rent deregulation*”

- Holland has a more drastic measure of dealing with housing supply. Any abandoned property or property not kept in a well habitable state is seized by the Government and put to auction. In this way landlords would have to well maintain these properties.
- Finland followed a housing rental market deregulation in 1991, between 1992 and 1996 an estimated 50,000 rented private dwellings came into the Finnish housing market.

These are measures, which the Maltese Government might consider to adopt to revive the local rental market. If Maltese households were to find property to rent rather than purchase I believe that housing prices might diminish because of the competition between the rental and purchasing market. Otherwise, prices will continue to increase even as compared to our incomes.

I.d Prices and Incomes

According to the Household Budgetary Survey 2000, 81.8% of all households had a net income of less than Lm 8,000 per annum. The prices asked for property that as shown in the following table makes it difficult for households to purchase such property unless some sort of financial aid is given.

In fact in a survey¹⁶ conducted by “*The Malta Independent*” it was discovered that according to 64.3% of those interviewed, the major problem which Maltese families nowadays face is the shortage of money or consumption power. While 7% regarded long-term debts being their main problem. Both figures/percentages deal with consumption power and the direct effect of house loans (only house loans are advances offered on a long-term basis).

Table 5: Average prices of dwellings as at 1998.

Locality	Type of Dwelling	Average Asking price
North West Area	Terraced House	Lm 59,214
	Flat	Lm 27,668
	Maisonette	Lm 32,309
North Harbour	Terraced house	Lm 60,198
	Flat	Lm 61,240
	Maisonette	Lm 40,320
Gozo	Terrace house	Lm 41,230
	Flat	Lm 28,348
	Maisonette	Lm 34,926
South	Terraced house	Lm 50,123
	Flat	Lm 23,302
	Maisonette	Lm 29,616
Central Zone	Terraced house	Lm 63,162
	Flat	Lm 30,115
	Maisonette	Lm 41,608

**Source: Paul V. Mifsud – “Affordability of Land and Housing in Malta” (1999)
*The Sunday Times, The Times, Frank Salt Ltd., Dhalia Ltd.***

Dr. L. Mintoff¹⁷ argued that the price of land was indirectly affected when the Government throughout the years distributed plots of land, which totalled to more than 8,000 free of charge or at a price below their market prices. The other effect of

¹⁶ The survey was published on *The Malta Independent on Sunday* dated 18th March 2001

¹⁷ Speaker at the National Conference “*The land and housing markets in Malta*” (1995)

such systems was that because of the large measurements of such plots, there was wastage of land space. The law of the BDA¹⁸ brought with it a speculation subsidized by the Maltese Government. Due to the large size of these plots, the typical Maltese residence became a three-bedroomed unit.

Table 6: Average Asking Price vs. Disposable Income

Year	Average Asking Price for Flat	Average Asking Price For T/House	Average Disposable Income per Person
1980	Lm 6,950	Lm 15,030	Lm 2,353
1981	7,100	15,193	2,751
1982	7,270	15,483	3,214
1983	7,573	16,277	3,190
1984	8,833	16,900	3,237
1985	9,185	18,255	3,243
1986	9,350	19,330	3,313
1987	9,700	20,267	3,393
1988	10,137	21,533	3,548
1989	10,233	22,783	3,846
1990	10,333	23,979	4,200
1991	10,840	26,762	4,483
1992	11,467	29,167	4,784
1993	13,100	33,800	5,015
1994	20,243	43,860	5,584
1995	25,240	52,993	5,827
1996	30,167	61,500	6,232
1997	26,541	56,995	6,390
1998	29,967	63,302	6,770
1999	31,330	61,422	7,883

Source: *The average prices are computations derived from a study conducted by Mr. A. Demarco using The Times as his main source. The prices were considered using three main areas i.e. south, north and Sliema areas. For the disposable income the sources used were The National Accounts 1989, 1998; The Economic Survey Sept. 2000 and Central Bank Quarterly Reviews.*

¹⁸ Building Development Areas Act 1983 main provisions were to establish building development areas and regulate building development. These powers were vested in the minister of works.

House prices rose not only in absolute terms but also in relation to personal income, even when Malta underwent a period of wage freeze from 1982 to 1985. The above table will show the average asking price for a flat or a terraced house throughout the years as compared to personal disposable income. The following graph will give a clearer picture of how prices fluctuated with the disposable income.

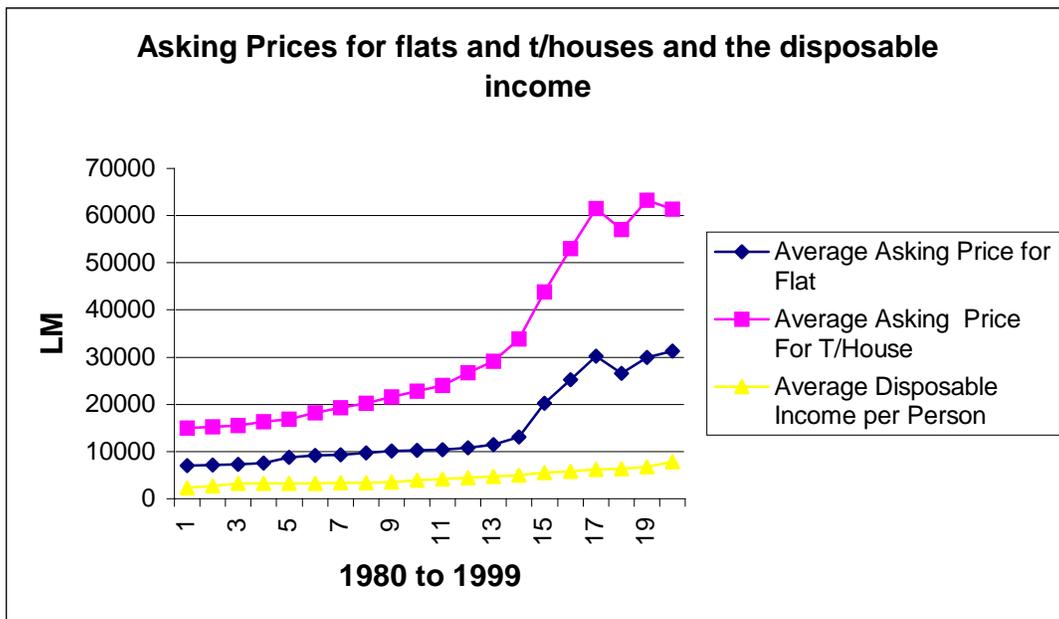


Figure 2.

As is clearly shown in Figure 2 a small increase in disposable income brought a larger increase in prices. What is evident also is that the prices of flats and terraced houses have increased almost in the same proportion except that terraced houses have undergone a higher increase than flats. This increase in the prices for terraced houses might have been the result of why people wanting to purchase their property opted for a flat or an apartment, as they were cheaper. This justifies the fact that

flats/apartments were constructed in larger numbers as indicated in Figure 1 since they were more affordable.

This situation can be better shown using the Housing Affordability Index (HAI) as developed by Mr. D. H. Camilleri (1999). An HAI of 100 signifies that a family earning the median household income will just afford a median/average residence. A figure for HAI below than 100 signifies that the household will have to do away with certain other necessities so that it can live in this type of dwelling.

Table 7: Housing Affordability Index

Year	Mortgage Monthly Payment (Lm)		Median Family Income (Lm)	Qualifying Monthly Income (LM)		Housing Affordable Index (HAI)	
	3-bed/r	2-bed/r		3-bed/r	2-bed/r	3-bed/r	2-bed/r
1982	60	42	184	240	168	77(70)	110(100)
1987	69	49	242	276	196	88(76)	123(108)
1992	108	72	320	432	288	74(61)	111(92)
1997	165	106	427	660	424	65(46)	101(71)

Source: Denis H. Camilleri (Autumn 2000) “Housing & poverty in Malta an Updated valuation model for residential premises.” BOV Review 22. Figures in bracket represent households with a single wage earner.

This table shows that despite the increase in disposable income from Lm 184 to Lm 427 per month, the HAI figure has gone down for both types of dwellings. If a couple were to purchase a three-bedroom unit in 1997 it had to do without a lot of necessities to afford such unit since its HAI stands at 65. The situation is worse for a family with a single wage earner since the HAI is 46, hence this family to afford a three-bedroom unit has to do without most necessities. This is why young couples

prefer to purchase two-bedroom apartments since through the HAI index of 101 it is an indication that such a unit can be affordable.

Concluding Remarks

The shortage in the supply of housing units for residential purposes has been boosted up by two main circumstances. The first relate to the existent rent laws which have been in force since 1939 and a solution has yet to be found to revive the local rental market. The second aspect relates to the Government policies in which throughout the years it has granted or offered at a small fee/rent/price several plots of lands which have drained out Malta's reserved area for urbanisation. Because of these two aspects Maltese residents do not have other options but to purchase from private contractors. This involves paying large sums of money, which with present income policies would be impossible for most people. The only alternative will be to seek help, generally in the form of a house loan.

Chapter II – A Banking Perspective

II.a Housing Finance

The aim of a housing finance system is to provide funds for home owners to refurbish their homes or for prospective home buyers to purchase and refurbish their homes. As with other lending activities housing finance serve to channel funds from surplus units to deficit units i.e. the intermediary function of banks. Banks perform such activity at a profit, which is the difference between the interest rate banks pay for deposits and the interest rate, the bank charges for the loans. This difference is called the margin and it represents the bank's income.

All loans offered by banks are granted following basic principles of lending denominated by the word *C-A-M-P-A-R-I* that stands for Character, Ability, Margin, Purpose, Amount, Repayment and Insurance.

The Maltese housing finance system requires that a minimum sum have to be made available by the prospective borrower before the bank grants the house loan. In fact local banks offer the house loan as an end finance i.e. making the dwelling habitable. In order to grant the loan the first 15% or 20% of the total sum needed has to be contributed by the borrower. Such system is also used in other European

countries. For example, in Germany the Bausparkassen¹⁹ system requires households to accumulate a certain minimum amount of savings in order to be eligible for a subsidised house loan. Around the world²⁰ housing finance is an old service as is indicated below:

- the US the Federal Home Loan Banks has offered such service since 1930s
- in Japan the Government Housing Loan Corporation was formed in 1950
- in France the mortgage law dates back to 1852
- in the UK building societies started operating in the 1920s
- the first Danish mortgage bank was set up in 1797 as a direct consequence of the need to finance the rebuild of Copenhagen after a great fire in 1795

A certain minimum amount of savings in order to be eligible for a subsidised house loan. Around the world²¹ housing finance is an old service as is indicated below:

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¹⁹ Palgrave Encyclopedia – “*housing finance*” – PP. 320 - 323

²⁰ Palgrave Encyclopedia; Housing Finance International issues June & September 2000; T.J. Gough “*The economics of building societies*”.

²¹ Palgrave Encyclopedia; Housing Finance International issues June & September 2000; T.J. Gough “*The economics of building societies*”.

II.b History of Maltese housing finance system

In the early 1900s housing finance did not exist in Malta and the existing six banks²² did not offer such a service since their lending activities were mainly short term. A possible reason for this inexistent housing finance system was because in those days the norm was that landlords rented out their property to tenants.

In 1967 the Central Bank of Malta Act was passed and a year later the Central Bank of Malta was established. In 1970 the Banking Act was enacted and five banks obtained the license to operate as banks namely Barclays Bank, National Bank of Malta, The BICAL, Tagliaferro Bank and Lombard Bank. In 1974 a merger between the National Bank of Malta Ltd. and Tagliaferro Bank saw the birth of Bank of Valletta Ltd. and a year later the Maltese Government in partnership with Barclays Bank International Ltd. acquired 60% equity holding in a new bank named Mid Med bank Ltd. The turning point in lending facilities came in 1976 when Investment Finance Bank and Lohombus Corporation were developed and offered medium to long term finance respectively. The first bank

²² The banks in Malta in the early 20th Century:

- a) The Government savings bank
- b) Cassa di Risparmio del Apostolato della Preghiera
- c) Anglo Maltese Bank
- d) Banco di Roma
- e) Credit Foncier d'Algier et de Tunisie
- f) Joseph Scicluna et Fils

dealt mainly with companies while the second provided mainly affordable long-term housing finance for the first time in Malta.

Lohombus Corporation²³ saw its origins in 1968 when Barclays Bank opened its Barclays Finance Corporation (Malta) Ltd., which mainly offered finance to local residents. This subsidiary had already £1.9 million issued in loans, which were classified as follows; £1 m allotted to local industry, £0.2 m for tourism and £0.7 m as house loans. In 1976 the Mid Med Finance division or Medfincor was formed and offered house loans for a maximum value of Lm 15,000 repayable in a period of twenty years. Advances in excess of Lm 15,000 were directed to the Investment Finance Bank.

In April 1977 Medfincor transferred 50% of its equity holding to Bank of Valletta Ltd. and hence Lohombus Corporation was formed. Lohombus Corporation held a monopoly in the housing finance market from 1977 to 1995. As the name implies Lohombus Corporation was not a bank and in fact could not engage in intermediation activities and hence could not accept deposits from the public. The licence to operate as a bank was granted in January 1995 when Mr. Francis J. Vassallo, Governor of the Central Bank of Malta granted this institution a *“...License to carry on the business of banking in Malta as a credit institution carrying out activities as authorised by the competent authority.”* Hence Lohombus Bank Ltd. was developed. In fact, it started accepting deposits from the

²³ Facts related to Lohombus Corporation are derived from the personal files of Mr. J.M. Formosa

public in one of its three main deposit accounts namely the Bronze, Silver and Gold Accounts. Another vital change that occurred for this bank was that it was also granted the license to offer loans up to Lm 30,000 for a maximum repayment period of 30 years. Such condition was important because it gave the opportunity for prospective borrowers to pay less monthly repayments and hence people were in a position to borrow more money considering the fact that housing prices were increasing.

In 1995 Mid-Med Bank purchased the shares of both the Central Bank and those of Bank of Valletta Ltd. and hence became the major shareholder. In 1999 Mid-Med Bank Ltd was purchased by HSBC and hence brought the end of Lohombus Bank Ltd. and the birth of HSBC (Malta) Home Loans.

During the period 1968-1995 Lohombus Corporation was a Government²⁴ owned entity and offered loans at almost in exactly the same rate by which it obtained funds. In fact Lohombus borrowed its funds from other banks at 6.5%. Lohombus offered its products to three types of sectors within the market and each sector carried with it a particular interest rate. In fact it offered loans under the social housing schemes at 6.5%, those under the housing authority schemes at 7% and then there were other loans issued at 8.5%. The bulk of the activities for this

²⁴ Lohombus Corporation had its shares divided as follows; Maltese Government 35%, Mid-Med Bank Ltd. & Bank of Valletta Ltd. 20%each and The Government & Housing Authority the remaining 25%

institution were, however, those related to social housing schemes, which were not highly profitable.

Table 8: Lohombus Corporation/Bank Ltd.

Financial Year	Loan balances	Undrawn	Total sanctioned
31st Dec. 68	Lm 850,079	Lm 227,291	Lm 1,077,370
31st Dec. 69	2,096,215	937,561	3,033,776
30th Sep. 70	3,434,776	488,448	3,923,224
30th Sep. 71	4,085,546	473,000	4,558,546
30th Sep. 72	4,544,726	474,000	5,018,726
30th Sep. 73	4,353,704	472,500	4,826,204
30th Sep. 74	4,379,193	471,300	4,850,493
30th Sep. 75	5,387,304	459,213	5,846,517
31st Dec. 76	6,501,288	341,789	6,843,077
31st Dec. 77	4,344,009	301,139	4,645,148
31st Dec 78	4,814,828	609,900	5,424,728
31st Dec. 79	6,131,922	872,038	7,003,960
30th Sep. 80	7,246,048	1,404,829	8,650,877
30th Sep. 81	9,911,067	6,369,154	16,280,221
30th Sep.82	14,793,382	8,837,781	23,528,163
30th Sep. 83	21,239,318	11,129,158	32,368,476
30th Sep. 84	28,079,357	8,913,221	36,992,578
30th Sep. 85	33,525,159	6,625,953	40,151,112
30th Sep. 86	38,165,665	5,244,346	43,410,011
30th Sep. 87	42,042,122	6,716,786	48,758,908
30th Sep. 88	49,081,841	8,944,036	58,025,877
30th Sep. 89	57,273,805	10,350,724	67,624,529
30th Sep. 90	65,603,413	10,375,248	75,978,661
30th Sep. 91	73,071,676	10,289,545	83,361,221
30th Sep. 92	80,901,989	11,743,488	92,645,477
30th Sep. 93	87,979,492	8,550,842	96,530,334
30th Sep. 94	88,326,611	7,047,480	95,374,091
30th Sep. 95	88,684,756	7,286,868	95,971,584

Source: J. M. Formosa

Above table shows the growth in house loans, which Lohombus Corporation/Bank Ltd went through in its monopolistic days.

One may notice that in the last three years there was a decrease in the amount of undrawn balances even though loans continued to increase. This means that borrowers were utilising the loan earlier than they used to do before, another reason might be that people were purchasing finished property and hence the loan would have to be availed of in full immediately to pay off the seller. Another aspect one may notice from Table 8 is the hefty increase in loans that occurred in the early 1980s. One recalls from earlier parts of this dissertation that the Government had contributed more than 7,000 during those days. Hence people having acquired a free plot from the Government sought out financing from Lohombus Corporation. This increase might also show that prior to 1980 house loans were not popular with the Maltese households mainly because of the following reasons:

- Government rented its property cheaply
- There were government schemes whereby people could acquire a plot of land at a cheap price and then construct the dwelling as time pass
- Household income was on the low side and hence people could not afford such a service
- Housing was affordable since people used to find property on the rental market

II.c Taking over of Lohombus Bank Ltd.

The advantageous position that Lohombus Bank held in the financial services sector was evident when Mid Med Bank Ltd. wanted to become the main shareholder of this bank. The following table compares the loans issued by Lohombus to total loans offered for housing finance by other bodies, which prior to 1995 did not have the advantages of offering long term financing and subsidised interest rates as Lohombus had.

Table 9: Outstanding loans 1980 – 1995

Year	Lohombus Loans Outstanding	Total House Loans Outstanding	Difference
1980	Lm 7.246 m	Lm 9.116 m	Lm 1.87 m
1981	9.911	12.708	2.797
1982	14.793	18.765	3.972
1983	21.239	25.516	4.277
1984	28.079	32.222	4.143
1985	33.525	38.052	4.527
1986	38.165	42.047	3.882
1987	42.042	46.488	4.446
1988	49.081	54.353	5.272
1989	57.273	64.441	7.168
1990	65.603	77.328	11.725
1991	73.071	84.427	11.356
1992	80.901	94.287	13.386
1993	87.979	98.885	10.906
1994	88.326	120.03	31.704
1995	88.984	132.559	43.575

Source: *Central Bank Quarterly Reviews and Mr. J. M. Formosa*

The above table shows clearly the dominion, which Lohombus Bank Ltd. had, which only in the early nineties that the difference was above Lm 10 million. In

1995 the difference reached its peak because Mid-Med Bank took over Lohombus and Bank of Valletta Ltd. started offering house loans on its behalf. However, it is clearly shown that Lohombus Bank still had the peoples' preference as regards to housing finance due to its above mentioned advantages. Such advantages however began to diminish by 1996 when Bank of Valletta Ltd was also granted the license by the Minister of Finance, Mr. John Dalli to grant house loans on a long-term basis (thirty years) as Lohombus Bank did.

There are several reasons, which suggest why Mid Med Bank Ltd. wanted to reacquire what was once its (Medfincor) as is shown below:

- Mid Med Bank would have a competitive edge as regards housing finance and other services over its competitors. This is because such an advantage might also spread over other forms of services such as insurance.
- Mid Med bank wanted to enter the market of insurance policies and this was one of the main stepping stones to infiltrate such a market. As reported in The Malta Business Weekly²⁵ Mid Med Bank premiums received would range from Lm 250,000 to Lm 300,000.
- The prices of land and building were continuously on the increase and people demanded these loans heavily as is shown in table 10. In fact the average loan Lohombus provided range from Lm 5,968 in 1987 up to Lm 12,506 in 1995.

²⁵ Journal 18-24 April 1996 – “*Mid Med Life gets the Lohombus tender*”.

- Lohombus total own funds stood at Lm 9,579,599 in 1995 and an annual profit was registered each year from 1992 up to 1995 of about Lm 1 million each year. This bank showed that it had potential despite the low margin it had for its products.

The growth of Lohombus Bank Ltd. made banks realise the potential which housing finance has in our local scenario, despite their particular characteristic i.e. long-term repayment and relatively low interest rates.

II.d Housing Finance in a Bank's Portfolio

One of the ways in which a bank makes profit or earn income is through the interest rate, which it charges its customers for credit facilities. The norm in Malta is that interest rates are always on the decrease however, the opposite can occur i.e. interest rates can increase. This is why banks when offering a house loan, which involves a long term repayment safeguard their interest in the contract by adding such statement “...*the said rate of interest is to be fixed by the bank in its sole discretion, from time to time.*” With such a statement the bank is in a position that if the interest rates increase the bank is in a position to increase such interest rates and hence remains profitable.

Except for house loans, all types of advances, which a bank offers are reviewed every year, or upon a specified period (according to the type of credit). The amount of a house loan is specified according to the applicant's gross annual income. When the contract is signed between the bank and the borrower for a house loan, the loan repayment programme is scheduled according to this gross annual income (or joint income) and remains operative for the whole period of the loan. Reviewing the house loan say every five or ten years will allow the bank that if the gross income has increased it is only fair that the monthly loan repayment will also increase under a new agreement. In this way, the bank will be repaid earlier and hence engage in further profitable activities. Mr. J. M. Formosa General Manager Housing Finance Division Bank of Valletta Plc has a different opinion regarding early repayment of a house loan. He believes that house loans act as to literally *anchor* the customer and hence serve to enhance a long-term relationship with the customer. This long-term relationship will serve the bank in its cross-selling activities. In other types of products customers can simply switch from a bank to another if such customer is not satisfied and at no additional costs. However, this does not apply to house loans because changing banks involves heavy costs on the customers such as legal fees. This is why house loans serve to anchor customers because once customers are being served well they will not change bank. Having a good customer relationship is important for every bank.

Table 10: Lending Repayment Programmes

Types of loans	Repayment Period	Rate	Amount	Monthly Repayment
House Loans	30 years	Lm 15K 6.25% Over Lm 15K at 7.25%	10000	61.6
			20000	126.5
			30000	194.7
			50000	331.1
			100000	672.1
Personal Loan and Car loan (Same Bases)	5 years	Secured 7.25% Otherwise it range from 8.5% to 9.5%	10000	199.19
			20000	398.38
			30000	597.57
			50000	995.95
			100000	1991.9
		hence at 9.5%	10000	210.02
			20000	420.02
			30000	630.06
			50000	1050.1
			100000	2100.2
Business loans	10 years	Secured at 8.25%	10000	122.65
			20000	245.3
			30000	367.95
			50000	613.25
			100000	1226.5
		For speculators such as construction 9 to 9.25%	10000	128.03
			20000	256.06
			30000	384.09
			50000	642.8
			100000	1280.03
Student Loans	5 years	4.25%	10000	78.64

Source: Bank of Valletta Plc

The costs which the bank incur from such a service relate to the opportunity costs of these funds being used in other more profitable lending activities. In fact, house

loans are the only type of advances given for a maximum period of thirty years and the interest rate charged is also the lower from all other activities. Because of these reasons the repayment programmes for house loans are the lowest and hence render fewer funds in the short run. In the long run the concept is reversed because the repayments are done for a longer term. In fact considering above table a house loan for Lm 10,000 at 6.25% for thirty years will be repaid at Lm 61.6 monthly. This repayment programme will total Lm 22,176. However, one has to consider the time value of money because in thirty years such value is likely to diminish.

It is also easily seen that house loans are the lending activities with the lowest and longest repayment programme and hence banks will take more time to recover such funds. Mr. Formosa agrees with the concept that house loans are most costly product for the bank or the less profitable, however because of their importance in enhancing customer relationship these loans are much important to banks in general.

II.e Trends in housing Finance

In Malta there are four commercial banks namely the APS Bank Ltd., Bank of Valletta Plc, HSBC (Malta) Plc and Lombard Bank Ltd. The only bank which does not offer house loan on a long-term period, is Lombard Bank Ltd.²⁶ In fact, this

²⁶ Meeting with Lombard Bank Ltd. officials, February 2001.

bank offers house loans only to certain types of customers (those having a long term relationship with the bank and enjoy certain types of banking facilities) and for a period not exceeding five years.

The other banks offer house loans in almost the same way. The norm (as at December 2000) is that interest rate is charged at the rate of 6.25% for sums below Lm 15,000 and 7.25% for sums exceeding Lm 15,000. The contribution of the spouse is generally taken in consideration for a period of five years after the date of marriage. The Apostleship of Prayer Savings Bank²⁷ (APS Bank) provides the only difference related to interest rate, since it offers the first Lm 20,000 at 6% and the rest at 7.25%. The loan amount is calculated by the three banks as that in which the repayment does not exceed 25% of the monthly gross income of the applicant. The amount granted for house loans by Bank of Valletta Plc, must not exceed 80% of the amount needed to purchase or refurbish the dwelling, while for HSBC²⁸ (Malta) Plc the loan amount must not exceed 90% of the sum required.

HSBC, unlike the other banks offers specified house loans to foreigners and the loan is also designated in foreign currency mainly in US Dollars. In fact, it lends a sum up to US\$ 80,000 for a flat and US\$ 134,000 for a villa or t/house. The rates offered are at 2.5% over the respective six-month LIBOR rate and adjusted automatically every six-months.

²⁷ Meeting with APS official at Floriana February 2001

²⁸ Derived from Brochures obtained from HSBC (Malta) PLC Office, November 2000

APS provides another difference in housing finance tools, it offers the Aplus Account which is a combination of having a chequebook, a savings account and a house loan all in one account. The main principle of a loan account is that it follows a reducing amount basis i.e. the applicant is offered a sum of money which in return he has to deposit regular repayments. In this way the principal or loan balance will diminish regularly (if payments are effected when due). But the APlus is more of an overdraft account. This is because the customer would have his/her salary being directly credited to this account and then he/she will withdraw it gradually as they please. The only condition is that they must not withdraw the sum agreed between them and the bank, which concerns the house loan repayment amount. Hence when the customer does not withdraw the salary all at once he will be saving on interest since more is deposited than required by the loan agreement. Another feature of this account is that the customer is offered a further 10% on the loan amount taken, which can be, used for any purpose whatsoever.

This demonstrates that the characteristics of the products offered by different banks are almost the same and no bank tries to outsmart the other by offering phenomenal advantages. Even when certain marketing promotions are offered, they are very similar to each other. One can say that housing finance is a homogenous product offered within an oligopoly. An oligopoly²⁹ can be defined as a *market structure*

²⁹ Edwin Mansfield in **Microeconomics** – 8th edition, chapter 11 “Monopolistic Competition and Oligopoly”

characterised by a small number of firms and a great deal of interdependence, actual and perceived among them... oligopolies contain so few firms that each oligopolistic firm formulates its policies with an eye to their effect on its rivals. If house loans are homogenous and no bank tries to win the housing finance market and gain advantage over its competitors, hence one can wonders how house loans have increased so highly in these last twenty years.

II.f The increase in House Loans

House loans are a function of four factors i.e. household disposable income, the number of dwellings sold, the price of the dwellings and the money supply. On an *a priori* basis one can say that when these four factor increase house loans will subsequently increase. I am going to perform simple regression analysis, which measures the percentage change in the dependent variable caused by a percentage change in the explanatory variable. In my case the dependent variable is the house loan which will be denoted by **Y** and **X** denotes the independent/explanatory variable. Since data on new house loans issued each year from 1980 to 1999 were unavailable, the incremental value of house loans per year will be taken when considering the regression analysis with housing units sold, prices of dwellings and disposable incomes. These factors have actual figures per year i.e. are flows and hence I will be using the incremental value so that house loans will also be an

approximation of per year value. With regards to money supply (stock) since it has an increasing value per year thus the outstanding balance for house loans per year will be taken. I am going to consider the regression as a simple linear regression than the error term, which is a random variable, will have its expected value equal to zero.

The equation for a simple linear regression analysis is the following:

$$Y = b_0 + b_1 \cdot X$$

Where Y represents the house loans and X the other factors. The intercept i.e. when the value of X is zero is denoted by b_0 . The slope of the regression is denoted by b_1 and this is sometimes called the coefficient of linear regression, which measures the responsiveness i.e. the percentage change in X , which brings about a percentage change in Y .

All the calculations, figures and tables relating to these analyses are found in Appendix II.

(a) The first relation to analyse will be:

$$\text{House Loans} = b_0 + b_1 \cdot \text{No. of units sold}$$

In this relation the coefficient has a value of 332.54 which indicates that as the number of units sold increases by 1%, the value of the house loans in Maltese Liri

will increase by 332%. This reflects the case that the more units are sold the more house loans are granted so as to make housing affordable. The intercept in this case has a figure of 7,769,760 this means that when units sold is zero the value of house loans is at Lm 7.769m. This figure shows that about Lm 7.7m are taken by households to refurbish their property and not to purchase any property. This shows that refurbishing ones property is also important with regards to housing loans granted.

R squared test is used to see that the overall fit of an estimated model is useful to evaluate the quality of the regression used. The range of values for R squared lies between 0 and 1. If there is a perfect linear relationship between these two variables than the coefficient will be very close to 1; unfortunately in this relationship R squared has a value of .009 which implies that it is a poor fit, hence a failure of the estimated regression equation used. Furthermore the adjusted r square value has a negative figure which confirms that the relationship is a poor relationship. In such a case there can be other variables more important in deciding upon the number of units sold and this makes sense because I believe that the number of units sold does not depend on house loans but on the demand for housing.

(b) The second relation will relate:

$$\textit{House Loans} = b_0 + b_1 \cdot \textit{Price of housing units}$$

In this relationship the coefficient is 0.14 i.e. a 1% increase in the price of dwellings will bring with it an increase of 0.14% increase in house loans. Thus the more the prices of units increase the more house loans will increase. This is a true value because the price of a unit is a factor, which determines the value by which a house loan is granted to the client and hence if prices increase it is only natural that house loans increase in value. The only peculiar aspect in this case is that on an *a priori* basis I would have considered the coefficient to be much higher, considering the fact as explained above that the price of the dwelling is one factor which determines the amount of the house loan to be granted. This can only reflect that prices are increasing at a very high rate and one fear if the situation arise that housing finance will not be sufficient to meet the price of the dwellings.. The adjusted R squared value is 0.8033, which is very close to 1, and hence implies that the equation is almost a perfect fit.

(c) The third relation considers the following:

$$\text{House Loans} = b_0 + b_1 \cdot \text{Money Supply}$$

By the simple fact that money and credit are related factors one will immediately consider this equation to be a perfect fit. In fact the adjusted R squared value is 0.994 which is almost 1. The coefficient of regression is 0.10, which implies that for every 1% increase in money supply; house loans will increase by 0.10%. This is on the low side because banks do not offer only house loans but have other credit

facilities and hence such facilities will benefit also from increase in money supply. What one needs to mention here is that the intercept has a negative value and this is because if money supply is zero house loans will not be granted.

(d) The final relationship will be as follows:

$$\text{House Loans} = b_0 + b_1 \text{ Average Disposable Income}$$

Disposable income is also a determining factor to value the amount of house loan to grant the customer. The coefficient between these two variable is 4549.21 so an increase in disposable income by 1% say Lm 10 will imply an increase in total house loans by about Lm 45,500. This relationship is also almost perfectly fit because its R squared coefficient value is 0.83. The intercept in this case has a negative sign, which indicates that if disposable income is zero there will be no loans granted.

To further test these relationships one can use the t test so as to determine whether the correlation between these variables is significant. Using a 95% probability and 20 observations, thus 18 degrees of freedom, the value of t should read 2.101. Any amount greater than 2.101 will imply that the relationships are significant which in our case involves the last three relationships which have a t value of 8.86, 56.57 and 9.37 respectively. The only relationship, which has a value below the 2.101, is that regarding the number of units sold, which has a t value of 0.42. This is also the case with R square coefficient being at 0.009.

So using these statistical³⁰ analyses tools, one can conclude that house loans are in reality affected highly by the prices of units sold, the money supply and the disposable income. These factors are also evident in a country's economic position and affect highly a nation's economy.

The weaknesses of these analyses evolve around two aspects the first is the low degrees of observations that I have been able to obtain. Twenty observations is too low a figure so that accurate results can be obtained. The second problem relates to the fact that data involving economic time series as the ones described in this text often tend to move in the same direction, reflecting an upward or a downward trend. Thus a high R squared value might not reflect the true association between the variables but may simply reflect the common trend present in them. This problem often lead to spurious correlation and hence to avoid this problem a trend variable³¹ is usually used.

Concluding Remarks

Malta has witnessed the birth of house loans in the late 1960s when European countries were experimenting with new forms of housing finance such as securitization. We have seen the gradual decrease of the rental market at the

³⁰ A.H. Studenmund “*Using a practical guide – Econometrics*”.

³¹ Damodar N. Gujarati “*Basic Econometrics*” Third Edition

expense of an increase in home ownership and such a fundamental characteristic was the house loans offered. House loans were the only means of making housing affordable at the going price.

Housing finance market have undergone through a lot of changes especially when housing finance was being offered from a Governmental subsidised body to a private entity and later on to various private entities. We have seen the fall of monopolistic housing finance at the expense of an oligopolistic housing finance market, even if one consider that this change was not as effective as it used to be. This is because all private entities offering house loans do so in almost exactly the same way.

House loans represent two contrasting points for banks. They are highly costly but highly profitable in the long run. This is because house loans serve as the basis on which a long term relationship between a customer and the bank develop. House loans can be an easy tool for cross selling activities especially with regards to insurance.

Finally through regression analysis one can observe how house loans are effected highly by money supply, wages and prices of housing³². Thus one can argue that house loans has an indirect effect on the local economy.

³² As already stated a house loan is offered on the bases that it does not exceed 80 or 90% of the sum needed to purchase or refurbish. The repayment amount must not exceed 25% of the gross annual income of the applicant involves.

Chapter III – Economic Aspects

III.a Housing Finance as contributor to GDP

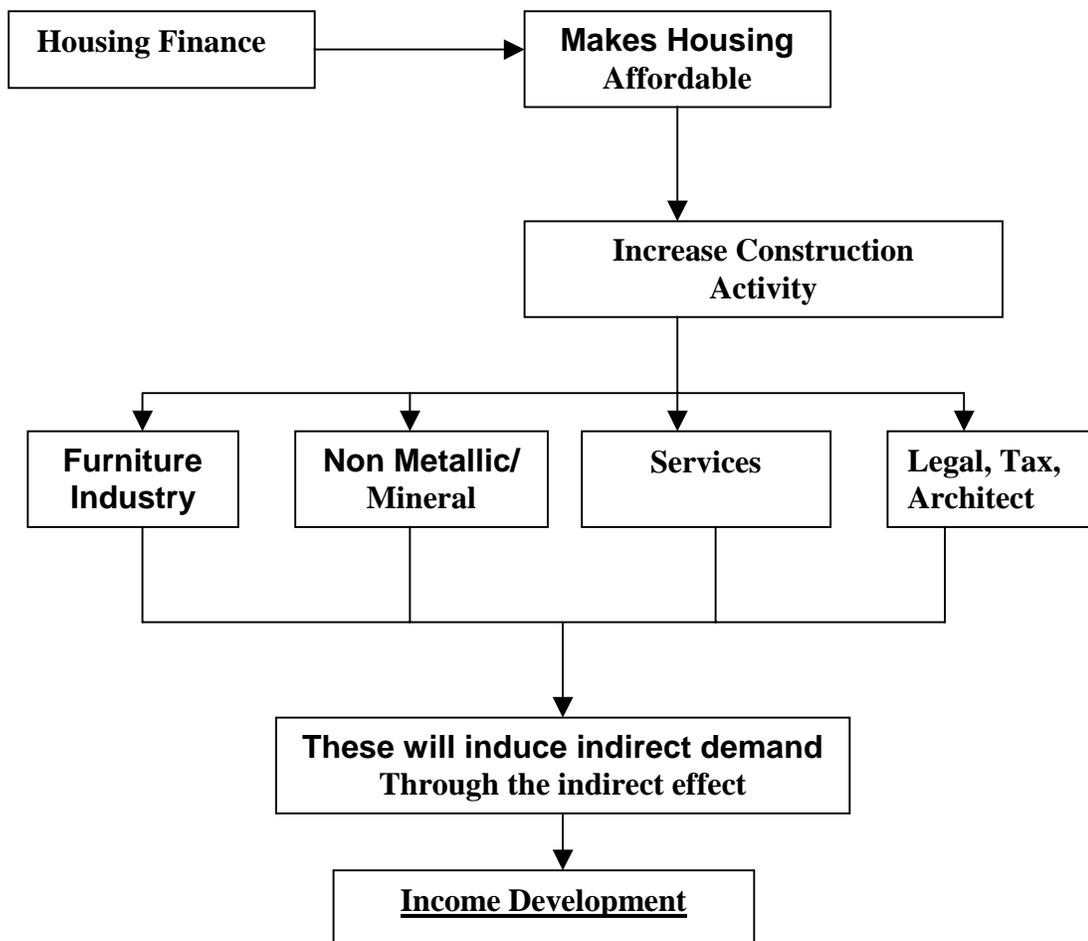
Maltese GDP (at current factor cost) is represented by summing up the totals for each year of the income of various sectors within the Maltese economy. These sectors are:

- Agriculture and fishing
- Mining, quarrying and construction
- Manufacturing
- Government enterprises
- Transport, storage and communication
- Wholesale and retail trade
- Banking, insurance and real estate
- Income from property
- Public administration
- Private services

Some of these sectors are highly affected by the real estate market and housing finance such as the construction activity and aspects relating to banking services. However, one cannot say exactly how much these sectors' contribution is devoted to housing finance because, for example, banks do not offer only house loans and construction activity does not revolve only around building dwellings for private use but it involves the whole of the construction activity around the island. Property income represents the net receipts from the land ownership and buildings including an imputed amount for owner occupied houses and interest earned from

local sources. Although one cannot say exactly by how much housing finance contributes to our GDP it is important to note that through such a service the construction industry in Malta can increase its activities and thus offers a positive economic impact.

III.b Income factor



Source: Profs. L. Briguglio
Figure 3.

This figure shows the different types of industries that are affected within the Maltese economy by the construction industry. Thus construction activity is not limited just to workers within that industrial sector but spreads also to other types of workers in different industries. The greater the construction activity, the better for the local scenario since more jobs will be created. As with any investment spending, expenditure on new housing or construction implies an increase in a country's assets. This spending also increases the national income because it generates contributions from the various economic groups as is shown in Figure 3. A negative aspect of increased construction activity is the environmental costs, which Malta has to endure.

According to Professor Briguglio housing represents:

- The consumption of one's residence i.e. household consumes the service of having a residence. If the household would not have a residence of its own the household would have to pay some sort of rent for alternative accommodation. Thus owning a home is a form of consumption.
- Having a house loan represents a long term repayment programme and hence in a way people are not paying a loan but saving to purchase an asset and when the house loan will be fully repaid the dwelling will be fully owned by its inhabitants. Another feature of a house loan is that the repayment is fixed at beginning of loan and hence through time money loses value. In this way people

would be paying less for something worth more (if the prices of housing increases, otherwise the opposite will happen).

- An increase in housing will have a multiplier effect on our economy through various other bodies as explained earlier on.

Table 11: Property sold to Foreigners

Year	No. of units sold To Foreigners	Total Sales (Millions of Lm)	Total Sales to Foreigners
1980	245	32.6	Lm 2.5m
1981	275	30.4	2.9
1982	175	32.2	2.1
1983	144	23.3	1.8
1984	147	31.6	1.6
1985	162	28.8	1.5
1986	281	36.3	2.7
1987	351	33.8	3.6
1988	671	58.1	8.4
1989	899	54.9	12.1
1990	717	64.7	11.6
1991	386	72.6	7.6
1992	315	62	6.3
1993	283	55.9	7
1994	359	66.1	9.6
1995	256	82.8	8
1996	258	135.8	8.5
1997	162	163	5.7
1998	155	131.8	6.9
1999	219	178.1	10.6
	6460	Lm 1,374.8m	Lm121.0m

Source: Joe M. Zahra “Settur li johloq gid u impjegi” (a sector which contributes to wealth and employment) – IN-NAZZJON 10th August 2000.

The above table illustrates the fact that Malta has a market for housing which attracts foreign residents to purchase property here. The more foreigners Malta has, the more funds will be channelled through the Maltese economy. Dr. Rudolph Ragonesi (1995) states that *“property acquisition by foreigners should not be restricted, as it is not in conformity with the liberal policy movement. Moreover foreign residents have led the way in rehabilitation of abandoned farm and town houses.”* Mr. Douglas Salt (1995) continues with Dr. Ragonesi and states that *“the spending power of people (foreigners) who own a property here is equivalent to that of 104,900 tourist arrivals per year. It is therefore healthy to have a good pool of foreign residents”*. This shows that the income the nation derives from these foreigners is not limited just to the price they pay for their dwelling but also to the money they spend for their daily activities. Real estate agencies know the potential of these foreigners and in fact they attend regularly overseas property fairs. Local banks sometimes also send their representatives to attend these fairs so that if financing is needed by prospective buyers the right advice would be given there and then. As already stated HSBC (Malta) Plc has a house loan product specifically designed for these foreigners.

Housing has a direct positive effect on Government finances since in every contract of sale where property is involved the Government receives a form of income known better as the duty on documents. This tax stands at 3.5% for sums lower than Lm 20,000 and 5% for higher sums. Between 1980 and 1999 a sum of Lm

1,374.8m arising from 185,510 Units sold was spend according to declared housing sales³³. This sum might not be the actual sum paid for such units because purchasers of dwellings tend to lower the price they declare on such contract so as to pay less taxes. In fact working with the above figures the total duty received by the Maltese Government from such activities will total to Lm 48.35m in this twenty-year period.

III.c Costs related to Housing Affordability

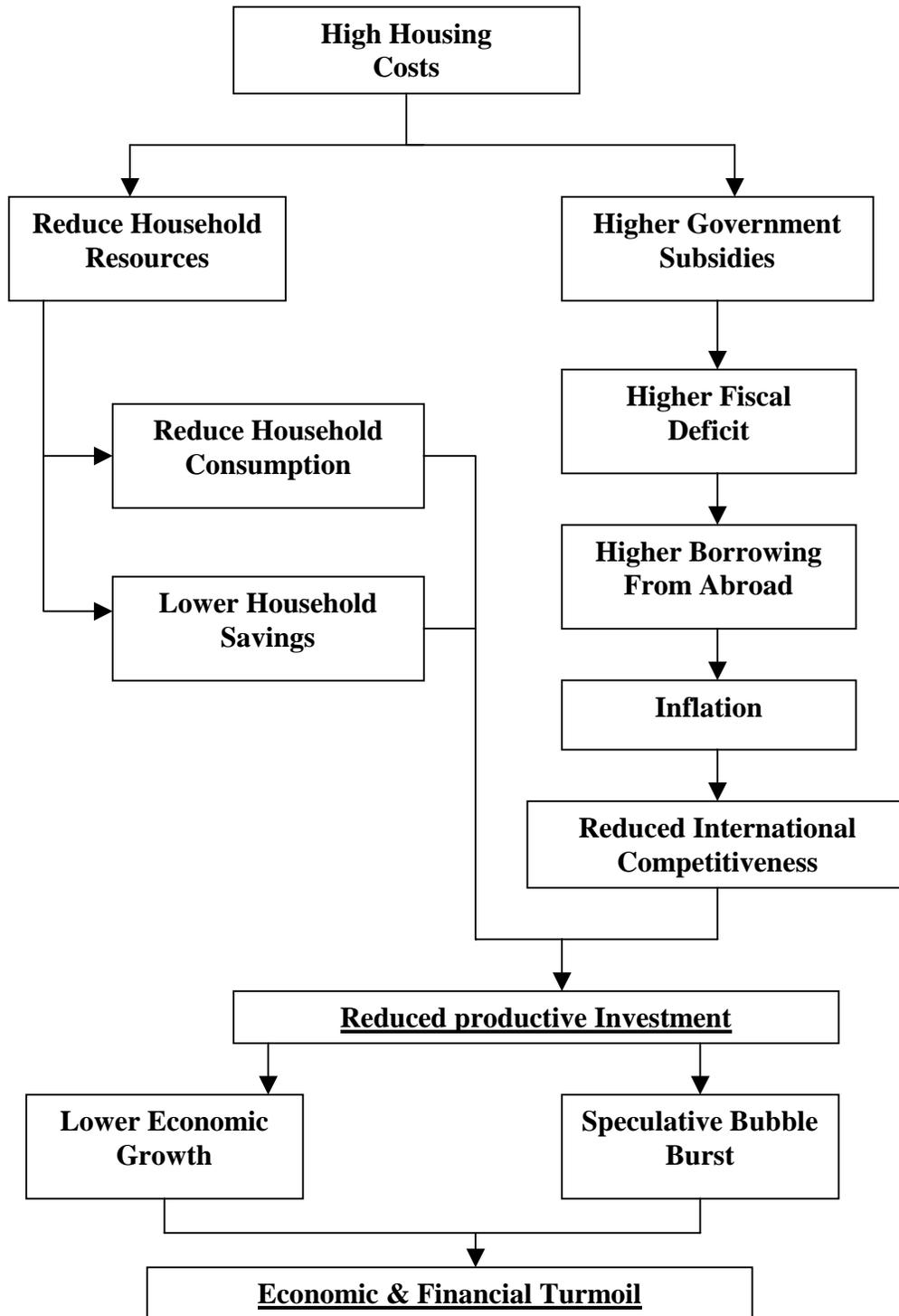
Home ownership through housing finance is a commodity that comes at a very high cost. In fact the ratio of mortgage fees to national income stood at 14% in 1994 and increased to 18% in 1998³⁴ for Malta, one of the highest in Europe. In fact the same ratio in France and Italy was less than 1%, that of the UK, Spain and Germany less than 5% while that of Holland was less than 8%. Apart from these mortgage fees there are additional costs incorporated such as the transfer duty fees which average 4.5% and insurance of 1.5% of the purchase price.

The following figure is a simplified version, which Cordina has devised and it shows the effects that higher housing costs could have on the local economy.

³³ Joe. M. Zahra “*Settur li johloq gid u impjegji*” August 2000 (See Table 11)

³⁴ Judith Wayne “*Housing Affordability – a perspective on the issues*” 1999 and Denis H. Camilleri “*Updated Maltese residential property facts 1999*”

Figure 4. Cost Factor of Housing Finance; Source: G. Cordina (1999)



Mr. Cordina³⁵ argues that high housing costs originate from three main factors; the first of which relates to the fundamental characteristics of the demand and supply of housing. For prices to remain in equilibrium or constant demand has to meet supply, the contradictory aspect of such a phrase is that in Malta, supply is well above demand for housing. This is because since there are existing vacant dwellings and in its *Structure Plan* the Planning Authority calculates that by the year 2010 there will be a supply of 62,190 units as compared to a demand of about 27,490 units which means an excess supply of about 55,000 units. Considering this excess supply one wonders how prices keep on increasing in Malta and the reason given is that what is supplied is not always demanded by households since people's tastes, habits and demographic developments change rapidly.

From the supply point of view, the availability of land and the legal/regulatory framework makes it difficult for contractors to meet the demand as requested by prospective buyers. One of the main problems for the contractors is the availability of land for construction purposes. In fact the Planning Authority states that ***“...it would be relatively easy to allocate additional land to that already zoned for housing, however this would be an unnecessary and unsustainable action given the potential of vacant dwellings, vacant land zoned for housing and the potential for the use of Government policy to facilitate affordable housing.”*** This statement

³⁵ G. Cordina *“The relatively high cost of housing in Malta: Implications for economic performance and Policy”* (1999)

proves that it is not easy finding available land for construction purposes, in fact in Malta the price of a plot as compared to the price of the unit increased from 7% in 1970 to 58% in 1998³⁶.

Mentioning just these factors it is already clear that it is difficult to match the demand and supply for housing, thus prices will continue to fluctuate.

The second factor relates to the speculative bubble, which has developed because of the expectation that housing prices will increase, have actually contributed to the real increase in housing prices. As with any investment when people believe that prices will eventually increase they will invest more and hence will push the price further up. This is what happens in the housing market in Malta.

The third and final factor is related to the Government subsidies, which indirectly often helped to boost prices up as was shown in the previous chapter.

The following table shows that investment in dwellings and construction has always increased except during the period between 1997 and 1999, when Malta went through two general elections and the associated instability might have had adverse effects on investment.

³⁶ Judith Wayne (1999)

Table 12: Gross Fixed Capital Formation

Year	Total Fixed Capital Formation	Dwellings & Construction	Average Sale of One Unit**
1980	Lm87.074 m	Lm31.533 m	Lm 3136
1981	105.597	41.37	3142
1982	120.121	50.02	3766
1983	131.63	50.96	4750
1984	126.453	48.661	4710
1985	125.871	41.197	4500
1986	122.327	44.779	5240
1987	153.453	49.103	5230
1988	166.405	50.168	4685
1989	188.437	55.294	5525
1990	232.611	64.672	5530
1991	239.144	64.512	5530
1992	240.874	67.343	5620
1993	276.804	73.624	5740
1994	305.388	85.141	6130
1995	365.175	107.971	7410
1996	345.265	120.17	13580
1997	326.443	114.932	17520
1998	333.561	112.116	18600
1999*	314.6	99.3	20750
	Lm 4307.224 m	Lm 1372.886 m	

Source: *Joe. M. Zahra and Abstracts of Statistics 1998, 1990 and 1987.*

**** This sum is derived by dividing the total sales with the number of units sold i.e. that declared in the actual contract of sale.**

As is shown above despite fall in the dwellings and construction activity the prices of dwellings still continued to increase in this period (1997 – 1999).

Other costs associated with housing market and which will have a more drastic affect than the ones mentioned above will occur in the event that housing prices will fall. The extent of the damage will depend on the magnitude of the fall in

prices. If this event were to happen most of the Maltese households (at least those having a house loan) would see their liabilities exceeding their assets. This would bring substantial economic and financial turmoil.

Similarly, if interest rates charged on house loans were to increase households would have to increase their repayment programme, which would decrease further their consumption power. A lower consumption power would affect the nation economically since demand for other products would fall, resulting in higher unemployment and lower wages.

Concluding Remarks

Housing finance in the form of a house loan represents both a cost and an income. It is a cost because prospective borrowers would see their consumption power diminish in order to repay the house loan. The income reflects the investment, which a household makes when purchasing a dwelling to reside in. Most households purchase a unit for their personal use and not as a part of a business activity. The norm in Malta has been that prices have always been on the increase (*up to now*) and hence borrowers would have their liabilities (house loan) diminish by way of repayments and their assets increasing because of the increase in the housing prices.

Such affects can also be seen on the nation's economy whereby the construction industry helps highly to increase the nation's wealth. In fact, from table 13 one can deduct that dwellings and construction industry represent almost one third of the total fixed capital formation for Malta.

Finally, such a service also helps in increasing Malta's GDP and this place Malta in a very similar position (as will be explained later on) as that of other European countries, which are members of the European Union.

Chapter IV – European Perspectives on Housing Finance

IV.a Mortgage Loans within the EU

In the European Union and Norway mortgage loans outstanding as at end 1998 stood at EUR 3 trillion, which represents 33% of GDP³⁷. The largest outstanding markets, in terms of mortgage loans, are Germany, the United Kingdom, France and the Netherlands. The markets that have increased the most during this ten-year period are Portugal, Spain, Ireland and the Netherlands. The impressive expansion of European mortgage markets since the late 1980s is the result of number of factors, of which deregulation in the financial sector and low interest rates (as a consequence for preparing for the introduction of the single currency unit) stand out in particular. This environment has led to intense competition on mortgage markets across Europe and greater affordability of housing, thereby creating favourable conditions for high demand for mortgage loans.

Malta's percentage change of house loans outstanding in this same period was of 358.89% which makes it second top after Portugal. The dynamic increase in

³⁷ Judith Hardt and David Manning - OECD June 2000 "*European mortgage markets: structure, funding and future development.*"

mortgage markets has outpaced the growth of GDP over the same period, thereby increasing its weight in the national economies.

Table 13: Residential Mortgage loans in the EU, Norway and Malta.

Country	Volume Outstanding	Volume Outstanding	% Change
	1998	1988	1998/1988
BE	55 528	24 830	224%
DK (3)	104 823	69 406	151%
DE	1 012 998	451 244	224%
EL	7 037	2 673	263%
ES	122 637	35 951	341%
FR	262 121	184 765	142%
IE (3)	20 888	6 783	308%
IT	81 449	30 719	265%
L U(1)	3 615	3 154	115%
NL	220 537	77 721	284%
AT(2)	9 531	4 461	214%
PT	31 941	5 063	631%
FI	33 765	27 400	123%
SE (3)	98 998	85 507	116%
UK	647 284	345 284	187%
EU-15	2 713 152	1 354 961	200%
NO	54 332	39 082	139%
MLA	195 054	54 353	359%

Source: *Judith Hardt and David Manning June 2000; European Mortgage Federation and National Sources*

Notes:

(1) Figures refer to 1997 and 1994.

(2) Figures refer to residential and non-residential mortgage loans.

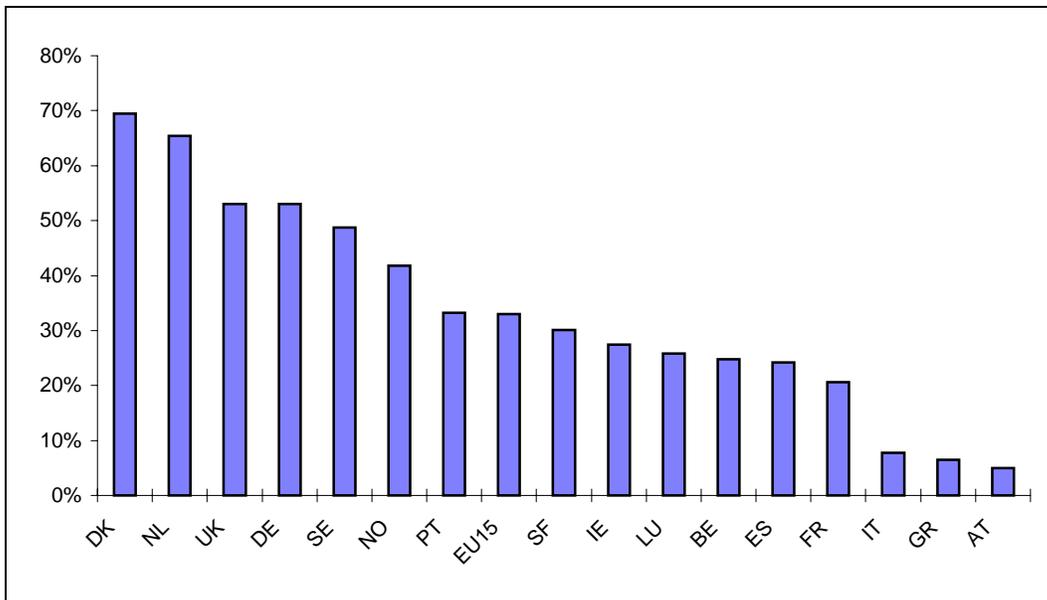
(3) Figures provided for 1988 refer to the closest available year: DK (1992), IRL (1990), S (1990).

(4) EUR million, end of year EUR exchange rates.

Malta's percentage increase in this period could have been much higher if one consider that throughout this ten-year period Malta had a monopolistic housing

finance market, which might have restricted supply. Another reason might be the development of the Planning Authority, which as explained before have had an adverse effect on the housing supply. The importance of mortgage markets differs widely across different EU Member States as is shown in the following figure.

Figure 5: Size of mortgage markets (loans outstanding as a % of GDP as at end-1998)



Source: *European Mortgage Federation and National Sources, Eurostat (GDP figures)*

The large differences in the size of the mortgage markets in the national economy reflect the fact that mortgage markets retain, by and large, strong national characteristics.

For example in Denmark³⁸ which as is shown above has the highest percentage of loans outstanding to GDP has undergone a period of great prosperity in the housing market since 1995. In fact prices on property has increased by 7 – 10% per annum and construction activity increased by 20% in 1996. The mortgage lending rose to DKK52bn in 1996 from DKK37.3bn in 1995.

Malta's position within this scenario is at 14.32%, which is one of the lowest percentage among the EU and Norway. This figure shows that Malta has potential for further growth. Such growth might have been hindered because of our national characteristics and certain policies, which have been made throughout our history (already been mentioned). Recall in early chapters that Malta has the largest room volume in Europe and this with regards to size is a problem for example Italy and Greece which are larger countries than Malta have lower percentage value as is shown in figure 5.

Buckley³⁹ argues that “... *decision relating to having a sound, stable macroeconomic environment as well as an appropriate legal and regulatory framework with well functioning enforcement systems for a housing finance system should be addressed within the national or regional responsibility*”. This emphasises highly the fact, that even within the European Union, certain measures

³⁸ Torben Gjede – “*Mortgage Finance in Denmark*” (1997)

³⁹ Robert Buckley World Bank Economist – OECD June 2000

are conducted according to the interest of the nation. Housing finance because of its economic effect is one of these measures.

IV.b The EURO

On 1st January 1999 the Euro⁴⁰ became the common currency of Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Netherlands, Portugal and Spain. The European Central Bank now has responsibility for the conduct of a single monetary policy in all of these countries. Greece joined the third and final stage of EMU on 1st January 2001 and if the Danish electorate vote in favor of the Euro in the 28th September 2001 referendum, the most likely date for Denmark's EMU entry is estimated to be 1st January 2002. Thus by the year 2001 most of the EU Member countries will adopt the single currency EURO as their main currency. The Euro is likely to have profound impacts on European banking, housing and mortgage markets. The convergence of inflation and interest rates and the elimination of exchange rate risk will remove major barriers to cross-border lending and savings. With the creation of a liquid single capital market loan portfolios will be given in Euro across Europe. Hence loans and deposits will be effected in Euro. However the problem arise since housing demand and prices will

⁴⁰ Judith Hardt & David Manning (2000) and McLennan, Duncan and Mark Stephens, "*EMU and the UK Housing and Mortgage Markets*"

be effected on a national basis. Thus countries would have housing market whereby the prices will be set according to national characteristics and the mortgage financing according to European Central Bank policies, which will not affect equally each and every member country.

All in all the Euro should lead to greater cross border opportunities for mortgage lenders and the more the competition exist the better the situation for the consumer will be. The lack of exchange rate risk and greater price transparency will open up opportunities for borrowers to take out loans in other member states. Such developments may result in change on the property markets. Stable economic conditions should result in greater price stability of housing, while lower interest rates should improve access to owner occupied housing.

IV.c Europe's Housing Finance Market

Increased competition, coupled with rapid technological advances, has pushed mortgage lenders to develop new financial products and new methods to market these products to the customer. Product innovation will have to continue to keep up with the needs of an increasingly sophisticated and financially astute customer. As the completion of the single currency approaches, Euro-denominated mortgage products that can be sold cross borders have emerged.

The traditional model of a house loan is that of a borrower going to a bank to acquire this credit. On its behalf the bank will make use of the deposits it acquires from its depositors to issue the loan. Thus the monitoring and risk associated with the loan remains at the bank's discretion.

As in America, European banks and financial institutions are now offering housing finance using the secondary mortgage market. Securitization refers to the process in which financial intermediaries' pool and package loans (e.g. mortgages) for sale as securities. Securitization refers to the conversion of previously untradeable assets into securities that can be bought and sold, hence provides for cash. The Euro may be beneficial to development of a secondary market if it leads to greater use of securitization as a funding vehicle.

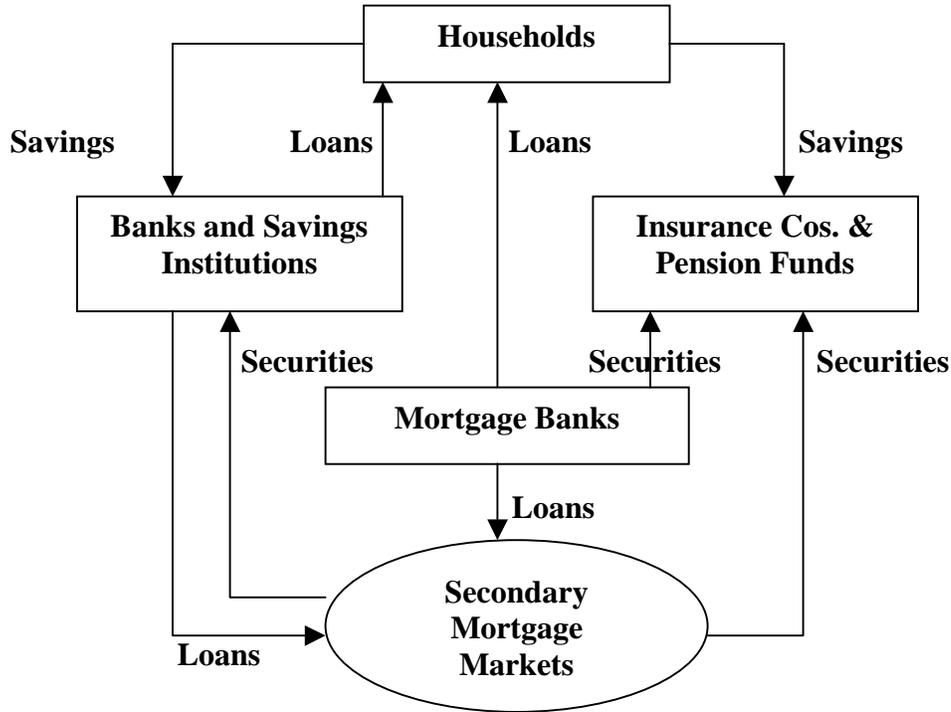
The secondary market mortgage system involves having mortgage bankers being temporary lenders who originate loans for sale in the secondary market. Thus retail mortgage banks deal directly with consumers, while wholesale mortgage banks buy loan from correspondents which usually will be other (smaller) mortgage banks.

This system⁴¹ involves the sale of mortgage loans or mortgage backed securities (explained earlier on) by specific pools of mortgages. Hence there will be the transfer of risk and ownership of the mortgage loans to *third* parties, hence these

⁴¹ Michael J. Lea – “*The Applicability of Secondary Mortgage Markets to Developing Countries*” (1994)

mortgage loans will be removed from the balance sheet of the originator of the loan.

Figure 6: Housing Finance using Secondary Mortgage Markets.



**Source: Michael J. Lea. co-editor *Housing Finance International* (1994)
“The Applicability of Secondary Mortgage Markets to Developing Countries”.**

Secondary mortgage is in use in at least 16 different countries and another twenty countries are discussing the creation of a secondary market⁴².

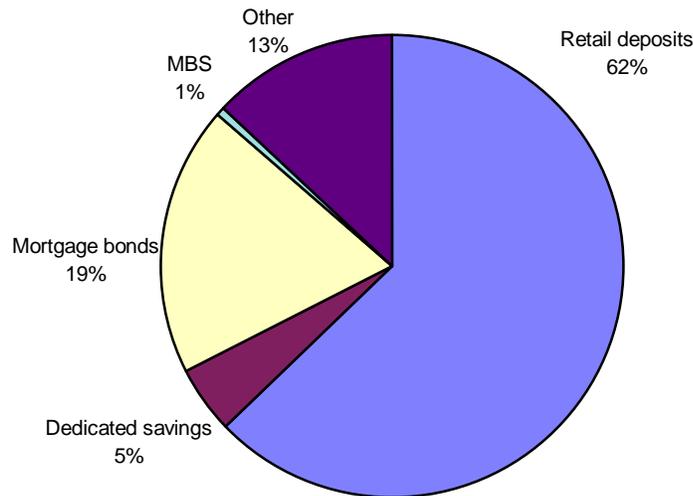
⁴² Michael J. Lea “*Secondary Mortgage Markets: international perspectives.*”

A secondary mortgage market can provide significant benefits to housing finance system. The primary benefit is an increase in the availability of funds for housing. This is because house loans are removed from the balance sheet of the original lender through securitization and hence these lenders would have more funds available to offer more loans to customers. A primary characteristic of secondary mortgage market is *standardisation* of the mortgage instrument and such a concept reduces transaction costs. Such factors can lead to lower relative mortgage rates and hence can improve affordability of housing finance for borrowers through the offering of longer maturity mortgages and alternative mortgage instruments such as indexed loans i.e. loans which are indexed or pegged to a certain measurement such as foreign currency.

IV.c.i Funding Systems around Europe

Around European countries there exist various modes of how mortgage banks and other institutions finance or fund their mortgage loans. Despite the advantages mentioned of the secondary mortgage markets, this is not the system mostly used in Europe. In fact the most commonly used method of financing is by utilising the retail deposits, which represent a total of 67% as compared to the instruments used in secondary mortgage markets i.e. mortgage bonds (19%) and mortgage backed securities (1%) as is shown below.

Figure 7 - Funding methods used in the EU (% based on volumes outstanding, end-1998)



Source: *Estimations based on contribution from EMF national members and own calculations*

A mortgage bond is a security giving the holder of the bond a claim against the issuer and enjoying a degree of special security because it is backed by mortgage loans. Mortgage bonds are generally issued by specialist mortgage banks, and are regulated by law. They are financial securities which have as a collateral the corresponding bundle of mortgage loans, and represent guaranteed claims against what are considered to be particularly secure types of credit institution.

On the other hand mortgage backed securities is the end product of the secondary mortgage markets, which has the primary function to secure funds from investors to

lend to prospective homeowners. Mortgage backed securities (securitization) refers to the process of turning cash-generating assets into securities that can be marketed to investors. The assets supporting the securities are removed from the balance sheet of the originating institution or, in some cases, never appear on the balance sheet of the originator.

In the case of mortgage bonds, the originating institution keeps the assets on its balance sheet and maintains ultimate responsibility for the credit risk of the bond. The mortgage loans and the bonds remain on the balance sheet of the originating mortgage credit institution. The use of mortgage backed securities, by contrast, involves the sale of mortgage loans and their complete removal from the balance sheet⁴³.

Concluding Remarks

Housing finance system in Malta is very similar to European systems. As per Table 13 and Figure 5 Maltese ratios are well in conformity with other European countries.

The main difference from some European countries is that Malta does not have secondary mortgage markets whereby house loans can be written off the banks'

⁴³ Judith Hardt and David Manning (2000)

balance sheet through securitization. To make use of securitization Maltese financial and banking system has to undergo certain changes⁴⁴ as regards to:

- the legal regulatory framework
- the economical scenario – for securitization to be an attractive investment, transactions have to involve large sums of money
- the IT infrastructure which is a fundamental tool for the operand of securitization

The inability of securitization (*at the moment*) within the Maltese scenario is evidenced highly by the fact that Lohombus Corporation had issued around Lm 60m worth of bonds, which however were never traded on the market.

Maltese housing finance system is still a baby if confronted with other European markets and hence there might be chances for improvements in such a sector. One must not follow blindly other systems but must try to adapt a new system that will conform well with Maltese system of housing finance and domestic characteristics of the housing market.

⁴⁴ Michael J. Lea (1994)

Conclusion

Housing finance has been the pillar in facilitating the Governments' policies of increasing home ownership in Malta. This is mainly because prices of dwellings have increased highly in relation to Maltese wage structure. The concept of high prices was mainly because of the unwise use of available land for construction purpose. Housing finance does not merely relate to house loans offered by banks but through the years this text has indicated how the role the Government played has diminished in housing finance while that of commercial banks has increased via house loans.

Housing finance had brought about some changes within the Maltese socio-economic activities. This is because housing is a vital aspect in every society, which represents a standard of living. People can judge the way a person lives by looking where the person resides. This is one factor which housing finance has brought on Maltese society. Nowadays the majority of young couples in search for their first home goes and seeks to find a three-bedroom unit, even if a one-bedroom unit at this point is enough. A three-bedroom unit is obviously more expensive but with housing finance this sale is made available within the reach of Maltese households. One can say also that housing finance has facilitated the concept of social mobility. This is because people now have preferences and because housing

finance made housing affordable and thus people can choose where they would want to live and not merely what they can afford on their present income. This is highly evidenced by the fact that the population in certain villages (despite that prices of property are not high within this area) have suffered a decline in population while in other parts of the area where housing prices are sky high have undergone an increase in population⁴⁵.

One must bear in mind that the only option available to people who want to find an accommodation is to purchase their property because of the nonexistent rental market. The rental market reflects a situation way gone its days since the present system is based on laws enacted more than sixty years ago. This system must change, however one has to be careful not to create havoc to the Maltese system such as lowering the prices of dwellings as this would bring economic turmoil in the country.

Paying a house loan involves certain sacrifices from by the borrower since the household consumption power will diminish. One must keep in mind also that one person's cost is another person's income. This reflects the position of a house loan borrower since when the borrower is repaying the loan he is also saving for the future and if prices of the house increases the borrower at maturity of the loan would have invested wisely since his asset prices has increased. Obviously the contrary would happen if prices were to fall. Housing finance aims to increase the

⁴⁵ Abstract of Statistics 1990 and 1998

construction activity around Malta and this would have a positive affect on Malta's GDP due to increase in employment and increase in wealth through the increase in assets.

House loans are a vital aspect for a bank's strategy in establishing a long-term relationship with customers. The fact that house loans represent a high cost because of their low interest rate and long-term repayment period does not affect a bank's portfolio. In fact, house loans are one of the services in which a banks' products are advertised upon the local media. This might be because purchasing a property also means investing in real estate and such an investment has been happening in Malta since old times. In fact, real estate is one of the most commonly used investment tools done by our forefathers. House loans have also a positive relation as regards to money supply, disposable income and prices of dwelling and if these factors increase house loans will definitely increase too. On the other hand if house loans increase, these three factors will also increase in magnitude through the respective relationship. The only factor which house loans does not affect is related to the sale of units and this probably happens because when a person purchases a unit, he does so not because there is a house loan but because there is a demand for that unit. House loan will probably help in satisfying that demand.

Malta's housing finance system is similar to the European mode and if securitization were to be implemented successfully in Malta I do not believe that Maltese banks will lack behind other European banks with regards to such financing.