International Union for Housing Finance
IUHF - A global organisation meeting your interests in housing finance

Welcome to the February 2008 Edition of the IUHF Newsletter

by Adrian Coles, Secretary General
International Union for Housing Finance

The first IUHF Newsletter of 2008 brings you a range of articles on developments in mortgage markets across the world, at a time of considerable uncertainty in many financial markets.

However we start with a lesson from history, in recognition that at a time of such turbulence, past actions can provide valuable insights. IUHF Executive Committee member, Alex Pollock, suggests that proposals for government intervention in the US mortgage market would benefit from reviewing previous government action, notably the creation of the Home Owners' Loan Corporation following the Great Depression. Thankfully we are currently not facing quite the same issues as in the 1930s, but the article shows that carefully designed government intervention can have beneficial effects.

The next two articles examine the European Commission's White Paper on the Integration of EU Mortgage Credit Markets, the first draft of which was finally published in December 2007 after numerous postponements. Both Annik Lambert, Secretary General of the European Mortgage Federation, and Christian Konig of the European Federation of Building Societies are broadly supportive of the white paper, in that it postpones regulation of mortgage lending in the EU to allow further analysis and consultation to take place. Among the other objectives of the white paper is the aim to remove obstacles to cross-border supply of mortgages.

The following couple of articles look at the Bauspar system, which aims to help people finance house building. This combines a saving phase prior to making an investment, with a loan phase after the investment. In the current climate where risks and uncertainty are all too prevalent, the Bauspar system is put forward as a more assured way to promote home ownership. Khan Prachuabmoh, President of the Government Housing Bank of Thailand examines the potential role Bausparen could play in their housing market, and Sven Zschoerper of the European Federation of Building Societies reviews the Federation's fifteenth European Congress, a key focus of which was the role of Bausparen in Europe.

Given the substantial rise in property prices experienced in many countries in recent years, one of the main problems facing potential homeowners across the world is that of affordability. How this issue applies in India's urban areas is discussed by Kapil Wadhawan of the Dewan Housing Finance Corporation, as is the need for an integrated approach to address these affordability problems.

Finally, Andrew Gall from the UK's Building Societies Association summarises changes that have taken place in Japanese housing finance, including the creation of an agency which aims to develop the securitization of mortgages in Japan to enable private lenders to offer long term fixed rate loans.

I hope that you find this edition of the Newsletter enjoyable. If you would like to write an article for the next edition on interesting or exciting developments in your institution or housing market, please send your contributions, with a photo, to acoles@housing finance. org or kbaker@housing finance. org by the end of April 2008.

Crisis Intervention in Housing Finance: Some Lessons of US History

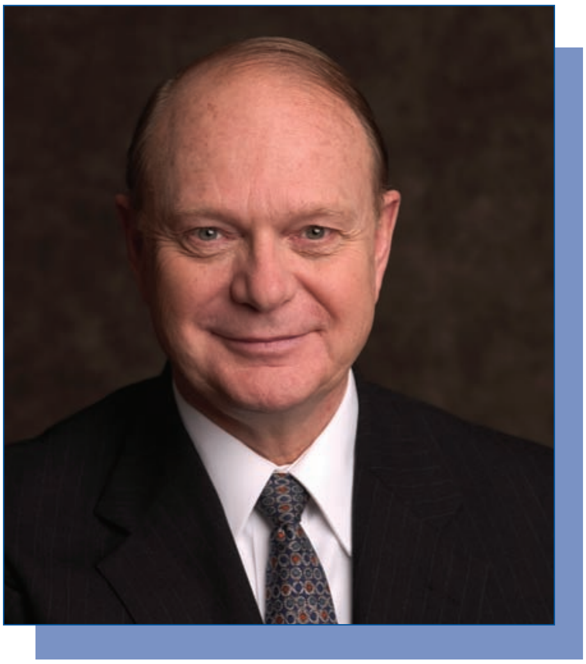
by Alex J. Pollock

The housing and mortgage bust which inevitably followed the housing and mortgage bubble continues its downward course in 2008. American public discussion is now full of proposals for government interventions in the mortgage market.

This is a recurring phase of housing finance busts. There is a political imperative to Do Something. In a financial panic, everybody wants to get a government guarantee, and "Emergency Housing Acts" are common, historically speaking. History is clear that government actions are always taken. It is only a question of which ones. Government responses may sensibly include temporary actions to avoid a self-reinforcing downward spiral or debt deflation, to "bridge the bust" and then be withdrawn as normal private market functioning returns, as described in my talk, "The Cincinnatian Doctrine," at the 2006 World Congress. Temporary programs should inhibit as little as possible personal choice and the long run innovation and efficiency of the market, and they should not bail out careless lenders and investors or speculative borrowers.

The current U.S. housing bust has been described as the worst since the Great Depression. But while our current situation is serious, it is minor compared to what was happening in 1933, a financial and economic collapse virtually impossible for people today even to imagine.

In 1933, about half of mortgage debt was in default. (On September 30, 2007, serious delinquencies in the U.S. were 2.95% of total mortgages.) In 1933, unemployment had reached about 25%. Thousands of banks and savings and loans had failed. The amount of annual mortgage lending had dropped by about 80%, as had private residential construction. States were passing moratoria on foreclosures.



Alex J. Pollock.

The average borrower that the Home Owners' Loan Corporation (HOLC) eventually refinanced was two years delinquent on the original mortgage and about three years behind on property taxes.

The prelude to this vast crisis was, as always, a period of good times and confident lending and borrowing: the 1920s featured interest-only loans, balloon payments, the assumption of rising house prices, and firm belief in the easy availability of the next "refi," all familiar in our most recent bubble. Then came the defaults, the debt deflation, and "frozen" markets.

The Home Owners' Loan Act of 1933 directed the creation of HOLC in its Section 4, which took only three and a half pages of text. The subsequent history is well worth studying. HOLC grew to have about 20,000 employees, but was from the beginning designed as a temporary program, as described in 1935, "to relieve the mortgage strain and then liquidate."

The Treasury was authorized to invest $200 million in HOLC stock. How much was $200 million in 1933? If simply adjusted to the current dollars by the Consumer Price Index, it would be the equivalent of about $3 billion today. If adjusted by the change in GDP per capita since 1933, it would be about $20 billion. As a proportion of GDP, it would be over $46 billion.

The act originally authorized HOLC to issue $2 billion in bonds, or ten times its capital. Using the same three adjustment factors, this would be the equivalent of about $30 billion, $200 billion, or $468 billion today.

The fundamental idea was that for three years HOLC was to acquire defaulted residential mortgages from lenders and investors, giving its bonds in exchange, and then refinance the mortgages on more favorable and more sustainable terms. The lender would thus have an earning marketable bond, although with a lower interest rate than the original mortgage, in place of a frozen, non-earning asset.

The lender would often take a loss on the principal of the original mortgage, receiving less than the mortgage's par value in bonds. This realization of the loss of principal by the lender was an essential element of the reliquification program – just as it will be in our current mortgage bust.

HOLC's investment in any mortgage was limited to 80% of the appraised value of the property, with a maximum of $14,000. With an 80% new mortgage, therefore, the maximum house price to be refinanced would be $17,500 in 1933 dollars. Adjusting this by the Consumer Price Index would result in a current house price of about $270,000. Using the Census Bureau's change in median house prices since 1940 would suggest a current equivalent of approximately $1 million – so HOLC could be imagined to be able to operate today even with California house prices.The act set interest on the new mortgages to be made by HOLC to refinance the old ones it acquired at not more than 5%. The spread between this mortgage yield and the cost of HOLC bonds generated an average spread of about 2.5%.With long term Treasury rates of about 4% today, an equivalent spread would give a lending rate of 6.5%.

During its life, HOLC made more than one million loans to refinance troubled mortgages, which was about 20% of all the mortgage loans in the country. By 1937, it owned almost 14% of the dollar value of mortgage loans outstanding. This was a remarkable scale of operations. Today, 20% of all mortgages would be about 10 million loans, and 14% of outstanding mortgages would be about $1.4 trillion – approximately the total of all subprime mortgage loans.

HOLC tried to be as accommodating as possible with its borrowers, but being an at-risk lender, it did end up itself foreclosing on about 200,000, or 20%, of its loans. Since all these loans had started out in default and close to foreclosure, this seems to me a quite respectable performance.

The Home Owners' Loan Act provided that the directors "shall proceed to liquidate the Corporation when its purposes have been accomplished, and shall pay any surplus or accumulated funds into the Treasury."

In 1951, they did, returning to the Treasury an accumulated surplus of $14 million.

Alex J. Pollock is a resident fellow at the American Enterprise Institute and a Past President of the IUHF.

White Paper on the Integration of EU Mortgage Credit Markets

by Annik Lambert, Secretary General, EMF

2007 was finally the year of the Commission's White Paper on the Integration of EU Mortgage Credit Markets, designed, in principle, to shape the future of the European mortgage credit industry.

Given the number of times the White Paper's publication had been announced and then postponed, it is true to say that doubts had begun to develop that it would ever see the light of day. However, this uncertainty ended with a sharp awakening for the Industry when, in October 2007, a first and unofficial draft was circulated, which gave ground to the Industry's main concern that the Commission's proposal for mortgage credit policy would, in part, be regulatory and consumer protection based, thereby implying that a financial sector as important to the EU's economy as mortgage credit is could be reduced down to this single aspect!

To recap, at the end of 2006, residential mortgage loans outstanding in the EU amounted to €5.8 trillion – approximately 50% of the EU's GDP – and provided a means of access to housing for approximately 67% of the EU's population. Europe's mortgage markets have witnessed a boom over the last 15 years, which has resulted in more and more citizens being able to step on to the housing ladder.

As things stand now, it appears that this early disclosure was salutary in that it provoked a strong reaction from both a number of Member States as well as from the Industry itself, and led to several significant questions being raised – notably on the occasion of the European Mortgage Federation's 5th Annual Conference, which gathered together representatives and a number of stakeholders of Europe's housing credit markets. Indeed, the draft White Paper's content was rather at odds with the Industry's understanding of the findings of the different

Annik Lambert.

working groups (the Forum Group, the Mortgage Funding Expert Group – MFEG – and the Mortgage Industry and Consumers Dialogue Group – MICDG), in which the Federation was very actively involved over the last five years.

As such, the more general approach adopted by the European Commission in the final version of the White Paper, which was published on the 18th of December 2007, is completely different from the first draft as it leaves regulation off the agenda for the time being. Rather, the Commission favours the pursuit of further analysis and continued consultation with the different stakeholders on the proposed policy orientations as well as the undertaking of specific impact assessments, including a cost-benefit analysis, for each measure proposed.

Considering that the Commission agrees with the Industry's conclusion that further integration

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will be supply-driven through lenders establishing cross-border activities, the importance that is still granted to consumer protection issues throughout the Commission's four main objectives as detailed in the White Paper may appear surprising.

Against this background, the Industry clearly supports the Commission's first objective, namely *the facilitation of cross-border supply and funding of mortgage credit*. Indeed, if integration is to be supply-driven, then it is clearly a necessity to remove disproportionate obstacles that inhibit lenders from offering their products across Members States' borders. The pursuit of this objective thus implies a number of measures with respect to land registers, enforcement procedures and valuation as have been expressly recommended by the EMF since 2003. Therefore, the Federation supports the proposal of measures such as the publication of regular scoreboards and the issuance of EU Recommendations to the Member States with respect to access to land registers and the transparency, cost and maximum length of foreclosure procedures. The EMF also supports the decision to follow-up the work and findings of the MFEG as summarised in its report dated the 22nd of December 2006 and will, as such, volunteer to participate in the Expert Group on Securitisation which is to be launched during the course of 2008.

The second objective set out in the White Paper is to encourage the *increase of product diversity*. This objective is also supported by the Industry, but it is important to note that the Industry's focus here is much more on product diversity and innovation not being hampered by potentially detrimental measures, rather than on their enhancement by way of the Commission proposing specific incentives. The Industry is also much more positive than the Commission on the ability of markets to offer a complete or at least very wide and continuously increasing range of products to consumers (see EMF & MOW 2003 and 2006 Studies).

The Commission's third stated objective is the *improvement of consumer confidence* with respect to the conclusion of a financial operation which, for most individuals, is of major significance. Strangely, although being third in the list of objectives, this issue appears first when it comes to the measures proposed by the Commission to achieve the four objectives. Unsurprisingly, the issues for further examination under this objective are the following: *early repayment*, which is considered to be a crucial point whilst at the same time is also recognised as a most sensitive and complex issue; *pre-contractual information*, the improvement of which has been undertaken within the context of the MICDG through the updating of the Code of Conduct; *Annual Percentage Rate of Charge (APRC)*, which as a tool of comparison is part of the pre-contractual information and, last but not least, *responsible lending and borrowing*, not discussed as such during the various working groups' meetings, but which suddenly featured in the final version of the White Paper on the back no doubt of the sub-prime lending crisis in the US and its consequences on EU financial markets in the second half of 2007.

In summary, the Industry's positions on these issues are as follows: on early repayment, the Industry supports a contractual right of early repayment that would result in a situation whereby only borrowers choosing the option would pay for it instead of the costs of the option being mutualised. With regard to pre-contractual information, the EMF has always supported and indeed has promoted the principle of clear, complete and adequate consumer information, with the Code of Conduct being the concrete result of this. The Industry is therefore of course willing to keep the Code up-to-date as was discussed by and initiated during the MICDG's meetings. The Industry also supports the introduction of an APRC that would be calculated on a narrow basis contrary to the choice made for the Consumer Credit Directive. As for responsible lending, the fact that no legal definition of the concept exists could make its introduction a legal and economic uncertainty, which is clearly not supported by the Industry! The Industry is however in favour of the further investigation of the question of cross-border access to credit registers and the Federation will volunteer to participate in the Expert Group on Credit Histories that is to be launched by the Commission during the course of this year.

The last of the Commission's objectives as set in the White Paper is the facilitation of customer mobility, i.e. the unhampered possibility for the consumer to switch mortgage lenders, which the Commission wishes to encourage so as to increase competition amongst lenders. The EMF is currently investigating issues relating to tying and bundling procedures and the link between the granting of mortgage credit and the requirement to open a current account with the same credit institution that arise here.

Finally, the Commission, through its White Paper, has also announced the launching of a significant number of surveys and studies designed to further inform its thinking in these areas, all of which are broadly supported by the Industry.

In conclusion, the White Paper finally published in December 2007, despite its strong consumer orientation, appears to be a reasonably balanced policy document that proposes a number of potentially interesting measures in the interest of the further integration of European mortgage credit markets. At the end of the day, it very much looks as though, based on a number of studies and evidence provided by the Industry, the Commission has acknowledged that there is perhaps less of a business case for pro-active intervention than it had appreciated at the beginning of its investigations into the integration of these markets; this is an acknowledgement that the Industry finds very commendable. The present financial crisis and so-called 'credit-crunch' has of course also contributed to the Commission's general reflections and its conclusion that it must be careful not to promote any measures that could prove detrimental to what is currently a somewhat bruised market.

Nevertheless, the EMF strongly believes that in the coming years mortgage credit will remain the highly efficient and successful market that it is today, which has enabled an increasing number of households to obtain access to home ownership over the years, whilst at the same time developing an accumulation of wealth. As such, it will continue to make a very significant contribution to the development of the EU's economy.

European Union: Intentions to Regulate Mortgage Credit

by Christian König, European Federation of Building Societies

The European Union, lawmaker for 27 European States and around 500 million inhabitants, published its intentions to deal with mortgage credit for the EU on 18 December 2007 within its so called White Paper on the Integration of EU Mortgage Credit Markets.

These intentions to regulate the mortgage market will not only influence home loan and mortgage providers within the European Union but also might serve as an example in other countries around the globe.

The European Union as an internal market should be without obstacle whatsoever in order to satisfy the demand and supply of cross border mortgage credit. In reality the Internal Market for financial services products has not developed as the Internal Market for goods. Especially, cross-border supply or demand of mortgage credit has not advanced substantially. Statistics for the EU have proven that less than 1% of EU consumers have ever taken up a mortgage loan in another EU Member State. This assessment encouraged the European

Commission to investigate the existing obstacles further. After a long consultation with stakeholders and consumers, a summary of possible measures for the EU has been published within this White Paper.

The mortgage industry welcomed the European Commission findings within the White Paper that acknowledged that there is currently no immediate need to regulate the mortgage area. Further cost and benefit analysis need to be conducted in the future. This message was a clear indication to some EU Member States, who pushed the EU lawmaker to regulate this credit area.

Nevertheless, the Commission believes in the necessity of initiating legislation in the future because it was proven that the EU mortgage credit market was not integrated. Due to existing language barriers and to the preference of consumers to choose local providers, the Commission also considers fostering integration by facilitating mergers, acquisitions, establishment of branches, etc. At the same time the EU Commission wants to improve consumer confidence as well as consumer mobility.

The White Paper is mainly based on the cost and benefit study from London Economics (L. E.) conducted for the European Commission in 2005 in order to economically justify legal measures. This study was already in 2005 heavily disputed by the lenders and Member States all over the EU. Nevertheless, the European Commission repeats the GDP growth forecast from the L. E. study of 0.6% and the growth of private consumption of 0.4% if the mortgage market were integrated, without going into further detail.

The European Commission realises that product variety is limited in most Member States due to legal and economic barriers but also due to restricted and commonly used refinancing techniques. In this area, the European Commission announces the evaluation of measures in order to achieve more product diversity and ensure a high level of consumer protection as well as financial stability.

An efficiently working market implies a high level of consumer confidence. This could be achieved by introducing a responsible lending obligation, such as creditworthiness checks. Member States therefore have to ensure that lenders are entitled to have free access to foreign databases within the framework of the data protection legislation. Furthermore a high level of advice is mandatory to increase the level of consumer confidence. However, the EU Commission does not intend to impose a mandatory obligation for lenders to advise their customers. The EU Commission announces the creation of a new expert group in 2008 on "credit history", which might elaborate common standards.

The EU Commission believes that consumer mobility is a crucial factor for a well functioning internal market. The ability to cancel long-term contracts and switch to another is one of the targets of the Commission. The Commission is clearly objecting to product tying and bundling as uncompetitive behaviour, even though it realises that product bundling could reduce prices. The EU Commission criticises the banking sector for selling a mortgage only with a current account or insurance from the same credit institution. The European Commission is of the opinion that bundling of products creates obstacles for cross-border competitors and therefore indirectly points to Belgium and France which have the highest concentration of bundling in Europe.

Different rules on early repayment seem to be the most important obstacle for the further integration of EU mortgage markets. Although the EU Commission does not announce any concrete solutions for this area, it wants to initiate a dialogue with Member States and the European Parliament and waits for the result of the second reading of the Consumer Credit Directive in the European Parliament. The discussion within the European Parliament on the consumer credit proposal clearly indicates that the majority of MEP's do not favour European rules limiting the early repayment right as proposed by the European Commission.

The existing European Code of Conduct (the Code) on pre-contractual information for home loans and the efforts of more than 5,000 credit institutions in implementing these information standards all over Europe are not properly reflected. The EU Commission considers this Code to be inefficient, without further proof. The Commission is of the opinion that this Code is not applied all over Europe and the content, which the EU Commission supported during negotiations in 2001, is outdated. Furthermore, the European Commission criticises the fact that this Code does not have any compliance or redress scheme. Finally the Code does not regulate at what time the pre-contractual information has to be given to consumers. The Commission announces taking the revised standardised information sheet from the Code and testing it with average consumers.

Credit institutions and intermediaries have to assess the creditworthiness of their customers by evaluating credit databases. The Commission indicates that it does not want to introduce binding rules on advice.

In addition to the consumer protection issues in the area of mortgage credit, the EU Commission is considering issuing a recommendation which refers to Member States in order to foster a more efficient, cheaper and reliable foreclosure procedure. Furthermore, Member States will be asked to facilitate the online accessibility of the information contained in land registers. Member States should also mutually recognise valuation standards; later on, the Commission intends to draw up common standards.

The EU Commission announces further investigation of market practices and prudential standards for the management of liquidity mismatch risk, arising for instance from using short-term funding for long-term mortgage loans, mortgage lenders' incentives to move risk off balance sheet, prudential standards and the transparency of banks' exposures to securitisation transactions that are directly or indirectly related to mortgage credit. The Commission additionally wants to establish a new expert group on securitisation, which should also assess the risk practice of the US sub-prime market. In 2008, the Commission will initiate a study on non-deposit lenders. After this assessment, the EU Commission will decide which policy approach it will take in relation to these institutions. In this context the EU Commission emphasises that product diversity is one of the main goals of an internal market. The EU Commission also indicates that it has serious doubts concerning the stability of these financial systems.

In 2010, the EU Commission would like to launch a study on equity release loans. The EU Commission already notes that existing national rules could be an obstacle for these products, if they limit the interest rate level.

A lot of legal initiatives have been taken worldwide relating to the mortgage credit lately. Spain changed its mortgage credit legislation in December 2007, France modernised the mortgage credit law in March 2006, the US House of Representatives passed its "Mortgage Reform and Anti-Predatory Lending Act of 2007" in November 2007 and the European Commission envisage a longer term strategy in order to create the biggest internal market of the world for mortgage credit with this White Paper. Mortgage lenders will face changes wherever they are doing business.

Thailand's GH Bank and EFBS host successful Bauspar seminar

by Khan Prachuabmoh, President, Government Housing Bank of Thailand

Thailand's Government Housing Bank (GH Bank), the European Federation of Building Societies (EFBS) and the Fiscal Policy Office of Thailand's Ministry of Finance co-organized a Bauspar Financing System seminar in Bangkok, Thailand on November 30, 2007.

The seminar held at the JW Marriott Hotel in Bangkok was attended by more than 100 senior housing-finance industry officials, including those from the Bank of Thailand, the Ministry of Finance as well as senior officials from the Government Housing Bank and Thai commercial banks.

GH Bank's President Khan Prachuabmoh welcomed the guests and reminded everyone that his Bank has always recognized that home ownership is a critical element of a stable and prosperous society. GH Bank, he said is always searching for fundamentally-stable alternative housing-finance sources that would help it increase home-ownership, one of GH Bank's major missions.

As a participant in drafting the May 2005 Bellagio Housing Declaration, GH Bank affirmed that sound, sanitary and affordable housing for everyone is central to the well-being of nations. It also asserted that housing is more than shelter; it is a powerful engine that creates opportunity and economic growth, and that:

(a) Housing is a sustained national priority: Housing is a long-term process that requires a stable policy framework and national priority attention.

(b) Housing as an engine of social and economic development: It brings significant benefits in terms of employment creation, domestic capital mobilization and social well-being in the face of the major challenges posed by population growth and urbanization.

As an integral part of its continuous search for new housing-finance alternatives, GH Bank was asked by

Khan Prachuabmoh.

the Ministry of Finance to consider a study on "Building Societies" that are prevalent in Europe. During the study, we discovered that the German building society or so-called "Bausparkassen" was a very interesting model that could be successfully adapted for Thailand.

The Bauspar system has become a very important factor for providing housing-finance for Europe and beyond, and we realized that a seminar explaining the intricacies of a "Bausparkassen" would be very valuable for everyone in Thailand.

At the same time, the current sub-prime crisis in the US has forced many policy-makers to re-examine how their specific countries addressed housing-finance issues. The Bauspar system was placed before us as a viable alternative.

We knew that the Bauspar system has been successful in many parts of Europe and we were happy that EFBS officials graciously consented to make a presentation in Bangkok

to our most important and influential housing-finance industry professionals.Andreas Zehnder, EFBS Managing Director and two colleagues, EFBS Legal Advisor, Christian Konig and Holm Breitkopf, Business Analyst with BHW Post Bank flew into Bangkok and made a most successful presentation.

Zehnder told the audience that the Bauspar system was an integral part of the German financing system. The Bauspar system, he said encouraged Germans to build savings through Bauspar contracts that eventually concluded with lower-than-market interest-rate mortgage loans. "The contract-holders usually saved enough for a 40 to 50 per cent down payment over a four-to-five year period," he said.

Because the Bauspar system is a closed-funding system, Zehnder said that the current sub-prime problems currently roiling the US housing-finance would not occur for German home Bauspar borrowers. "Our foreclosure rate is about .03 per cent," he said.

The Bauspar system avoids the vagaries of capital markets because of its closed-structure. "We only lend out money that is available within our system of savers and borrowers," he said.

Zehnder told the Bangkok audience that the US mortgage system's sub-prime problems will result in many US home owners losing their homes. "Some statistics show that more than a million people may be forced out of their homes before the current crisis is over. This will never happen with a Bauspar system," he claimed.

Legal advisor Konig explained to the audience that different Bauspar legal structures have been successfully adapted for many countries throughout Europe, especially in eastern European countries such as the Czech Republic, Slovakia, Romania and Hungary. "In Slovakia, three Bausparkassen have been started since 1992 and they now represent 60 per cent of the Slovakian mortgage market," he said.

BHW Post Bank's Holm Breitkopf explained the business aspects of establishing and operating Bausparkassen. "The important thing is ensuring that a system is in place to manage the cash-requirements during its funding and allocation life-cycles," He also stressed that continuously developing and implementing new savings and mortgage products were critical for success. "Remember we are competing with commercial banks and other mortgage lenders," he said.

Zehnder emphasized that Bauspar systems have been instrumental in further developing savings cultures, especially in developing countries. "Many people in Germany buy Bauspar contracts for their children and other young people buy their first savings contract when they obtain their first job," he said.

A lively panel chaired by Ballobh Kritayanavaj, GH Bank's Research and Information Services Head dug deeply into the savings aspects of Bauspar contracts and how the system can be successfully implemented in Thailand.

Sirichai Sakornratanakul of the Export Import Bank of Thailand and a German university graduate said that the Bauspar system would do much to help alleviate Thailand's abysmal savings rate of less than 3 per cent of GDP. "The Bauspar system may help us improve our savings culture in Thailand," he said.

Another German university graduate, Chodechai Suwanaporn, director of the Finance Ministry's Financial System Policy Division, said Thailand may need to conduct more research before implementing the Bauspar finance scheme. He said a legal framework should be created first, the better to facilitate the system.

The German government's annual premium incentives for low-income savers were also discussed as viable alternatives that would help encourage savings in Thailand.

At the seminar's conclusion, most attendees left with many ideas on how the Bauspar system could help more Thais obtain their dream homes.

"Bausparen – a safe way to home ownership"

by Sven F. Zshoerper, Association of Private Bausparkassen, Germany

"Bausparen – a safe way to home ownership" was the motto of the XV European Congress of the European Federation of Building Societies (EFBS) which took place in the "Golden City" of Prague from October 24th to 26th, 2007.

Well known politicians, bankers, academics, international organizations, government representatives and media used the opportunity to participate in the international congress and listen to top speakers. The EFBS' congress, held every three years, has already become a renowned platform not only for Europeans but also for a steadily growing quantity of interested delegations from all over the world.

It was not by chance that Prague had been chosen as the venue for the congress. During the last few years, the Czech Republic has become the number two market for Bausparen in Europe and consequently stands for the extremely successful establishment of Bausparen in many new EU countries.

The EFBS joins the endeavors of its European member associations and institutions to foster home ownership and support housing finance. It therefore represents its members' interests in the European Union and guarantees that they are kept informed about all relevant developments. It also ensures the mutual exchange of information regarding housing finance issues.

The opening speech was given by the former German Minister for Environment, Nature Conservation and Nuclear Safety and Minister of Housing as well as Undersecretary General with the United Nations Dr. Klaus Töpfer. Mr. Töpfer stressed the importance of generating property for the social and economic development of any country but especially for the developing ones. He further pointed out that only by saving can sustainable wealth be generated and, hence, the Bauspar system is an ideal tool for development and prosperity. Mr. Töpfer, moreover, expressed his concerns regarding the possible economic and social impact of the U.S. subprime crisis and recalled the spurious criticism the Bauspar system had been confronted with by exponents of the Anglo-Saxon system. "It cannot be correct […] accusing us of subsidizing the Bauspar system but at the same time spend no single word on the fact that the [U.S.] taxpayer now has to pay for […] a failed housing policy […]."

Mr. Töpfer concluded by again stressing the importance of savings and the sustainability of generating housing proprietary.

Five different sessions delivered insight into the most recent developments and problems of housing finance in Europe and other world regions. The first session dealt with the topics "Savings, inflation and housing property acquisition". Prof. Dr. Francke (University of Freiburg, Germany) gave a short lecture on how investments in the real estate sector of some European countries that featured insufficient saving rates could be financed. He also lectured on the question if house price inflation is a result of increasing money supply or if money supply is increased by the demand for property.

Ms. Cantor-Grable (Genworth Financial) presented the business segment of private mortgage insurance (MI) and how MI can provide the balance between meeting current and prospective housing demands and managing lender risks in the mortgage market. She stressed that MI could deliver protection for lenders and investors from borrower default on residential mortgages; that it also could does help to foster home ownership with low down payment. However she made clear that it is not life insurance nor payment protection insurance, nor is it necessarily sub prime.

The second session was dedicated to "risky and less risky types of housing finance, also with a view on foreign currency problems". Mr. Doug Duncan (Mortgage Bankers Association) provided actual information on the sub prime crisis and pointed out that severe developments, in his view, can only be observed in a couple of U.S. states. Mr. Dübel (Finpolconsult) explained how reflationary monetary policies, mortgage-equity-withdrawal tax distortions, adjustable rate mortgages and non-traditional credit products, amongst other problematic developments, led to the current sub prime crisis in the United States.

Mr. Kunert (Austrian Volksbanken-AG) and Dr. Zöllner (Austrian National Bank) explained problems concerning foreign currency loans, a loan type that is still prevalent in Austria. Mr. Kunert pointed out that foreign currency loans in Austria originally became popular due to the fact that the Austrian money markets were quite small-sized. Mr. Kunert stressed that "customers who opt for foreign currency loans have to be able to afford it", alluding to the speculative character and the risks of foreign currency loans. Dr. Zöllner expects the previous Austrian trend to take out foreign currency loans to fade, due to changed interest margins and exchange rates, therefore he believes in the Bauspar system's chance to regain market share.

In the course of the third session, which dealt with the different developments of housing finance in Poland and the Czech Republic, Mr. Furga (Polish Banking Association) illustrated in detail the problems the Polish housing finance sector was faced with during the transformation period in the early 90s. He explained that, due to continuous governmental reorientations regarding possible housing finance systems, none of them was definitely successful. He further reported that the current situation on the Polish housing market is affected by excess demand for housing, high and increasing price levels and speculative investments in property by foreigners. In view of the developments in the US, the UK and Spain, Mr. Furga considers restarting discussions on the reimplementation of the Bauspar system in Poland as desirable. Ms. Grabmüllerova (Ministry of Regional Development, Czech Republic) described in detail the Czech housing market and the underlying demographic developments. She also displayed the dynamic expansion of demand for mortgage loans and the impressing development of the Bauspar system in the Czech Republic. Ms. Grabmüllerova also described the Czech subsidy scheme for housing finance, its progress and prospective development.

Session four was dedicated to the demographic changes in Europe and their implications for housing policies. Mr. Gerhardt elucidated the developments of certain population groups and their accompanying changing roles within society. He also alluded to the importance of taking measures in order to be able to handle the consequences of reduced labor markets or increased expenditures for social care – costs evolving from demographic change. Dr. Gräf (Deutsche Bank Research) pointed out that, although there are different scenarios regarding demographic development in Germany, the aging process of society cannot be stopped. He stressed the problems resulting from the disequilibrium between persons fit for work and retirees. In case no counteractive measures are taken, Dr. Gräf predicts a significant decrease of work force and negative effects on economic growth. He further explained that, due to budget restrictions of the state pension insurance, state pensions will decrease. As to housing demand, Dr. Gräf predicts an increase in demand for living space until 2020, however demand will decrease significantly after 2030. Dr. Braun (Empirica) showed that, in spite of a decreasing population, the number of households of elder persons will increase and push demand for housing and, hence, for housing finance.

The last session addressed the growing importance of new media for managing financial affairs. Mr. Gardner (Mortgage Bankers Association) illustrated how electronic documents may be used to streamline the mortgage process and why e-mortgages can result in a competitive advantage for mortgage lenders. Mr. Woloszyn (HP Poland) described the growing importance of new media, especially due to time savings and resulting cost savings.

Ms. Rehm (Quelle Bauspar AG) and Mr. Fleiss (Bausparkasse der österreichischen Sparkassen AG) illustrated the development of new media during recent decades, especially how the internet has already caused immense changes with respect to marketing and sales, and to what extent prospective developments will probably influence sales and marketing of Bauspar contracts.

For further information regarding the congress and its program, please visit the EFBS' webpage www.efbs.org or our congress website www.eubv2007.com.

Affordable housing – need for an integrated approach

by Kapil Wadhawan, Vice-Chairman and Managing Director, DHFL (Dewan Housing Finance Corporation Limited)

Kapil Wadhawan

India is a country that is rapidly urbanizing. Nearly 36 per cent of India's population is likely to be urbanized by 2025, increasing the demand for housing stock.

The current housing shortage in urban India alone is to the tune of 30 million dwelling units. This is an issue that calls for a collaborative effort from policy makers, financial institutions and private sector participants such as insurance companies, real estate developers and non-governmental organizations. It is not enough if there are many willing lenders of residential mortgages to moderate income segments, what is absolutely necessary is the production of adequate number of houses that can be acquired by prospective home owners with assistance from housing finance institutions.

The home ownership rates of the top 8 cities in India in terms of mortgage outstanding, as of last year are shown in Table 1.

In large cities such as Mumbai and New Delhi, most growth of housing stock takes place in the suburban centers. This trend of growth in the suburbs is not very different from some of the other developing economies such as Brazil and Mexico. As urbanization occurs, the supply of housing does not match with demand and increasing number of households are forced to move into the suburban areas to find a suitable residential accommodation.

However, a large share of the new housing starts is aimed at the upper middle income and the upper income households. Let me illustrate this point with an example.

In big cities such as Mumbai and New Delhi, new housing projects are normally described as under:

- 2/3/4 BHK apartments with amenities
- 2/3 BHK apartments without amenities

BHK refers to a configuration of the apartment, with BHK standing for Bedroom, Hall (Living room) and Kitchen. Needless to say, 2 BHK apartments would be priced higher within the metropolitan area of a city, compared to a similar configuration in the suburbs. It follows that low and middle income households would find it difficult to acquire a residential apartment within the vicinity of a large city and would be forced to move to the suburban areas for owning a home.

It has been seen that the number of housing units developed under the 1 BHK configuration is a fifth of the number of units in the higher configuration. Clearly, the housing development in urban areas is loaded in favor of the upper income households.

Table 2 gives an illustration of the type of dwelling unit those households in various income groups can afford.

Table 1

Cities	Home Ownership Rate	Average value of housing outstanding (Rs.)
Delhi	65%	982,000
Mumbai	60%	700,000
Pune	67%	580,000
Bangalore	40%	875,000
Chennai	40%	714,000
Hyderabad	51%	703,000
Kolkatta	38%	466,000
Ahmedabad	73%	345,000

Table 2 clearly proves that lower income households need to put up with either sub-standard own housing in a distant suburb or remain in rented accommodation until they move to a higher income category. Taken together with figures in Table 1, we can conclude that acquiring their own home is beyond the reach of many Indians in a rapidly urbanizing India.

Moderate income households have remained outside the home ownership spectrum due to a combination of the following factors:

- Lack of adequate access to formal sources of credit to construct or buy a house.
- Rising land prices and cost of construction due to increasing urbanization.

Mainstream financial institutions have refrained from reaching out to this segment to due to one or more of the following reasons:

- Lack of collateral
- Income uncertainty
- Perceived high default risk
- High transaction costs

Recently attempts have been made to classify Indian households on the basis of their consumption patterns and not merely on the basis of their household income. There are approximately 206 million households in India – Table 3 provides a classification of these households on the basis of their usage of daily consumption items.

Table 2

Net Monthly income(Rs.)	8,500	10,000	12,500	15,000
Approximate size of dwelling unit (sq.ft)	352	435	582	698
Loan eligibility (in Rs.)	300,000	369,000	495,000	594,000

The above calculations are based on: Rate of interest, 11%; Instalment to Income Ratio, 40%-45%; Loan to Value Ratio, 85%; Tenure of loan, 15 years; Customer buying price per square foot – Rs.1000.

Table 3

Number of households (in millions)	83	71	21	19	6	4	2
Description of household	Poor	Strugglers	Ordinary (lower income)	Aspirers (Middle income)	Achievers (Upper income)	Rich (Upper middle income)	Super rich (High net worth households)

The target segments for DHFL have been the households circled in red in the above table. Over the years, we have destroyed many myths regarding lending to these segments – most importantly the myth that default rates are high among them. As a business enterprise, DHFL has built a profitable business model around the low and middle income segments in India.

However, recent developments in the Indian economy have made home acquisition a difficult proposition for low and middle income households. Rising land prices, rapid urbanization, rises in input costs for construction, higher transaction costs of home finance and rising interest rates have all contributed to the slow growth in home ownership in urban centers.

Thus, creating new and affordable housing stock is the only way to enhance home ownership for majority of Indians. For this to happen, the following key players have to come together to evolve an integrated solution:

- Government and the financial regulators
- Real Estate Developers
- Financial institutions engaged in mortgage business
- Insurance companies
- Non-governmental organizations / Micro-finance institutions

Government and the financial regulators have to create enabling conditions for housing finance institutions to access low-cost capital from the world markets. Government could also play an active role in promoting affordable housing in urban centers by making affordable housing an important part of urban planning and policy. Government could make amendments in the rulebook to accord higher Floor Space Index (FSI) to developers who focus on developing affordable housing. Floor Space Index is a ratio of developable area to the total land area on which development is carried out.

Real Estate developers need to recognize the opportunity in the underserved segments where economies of scale can be achieved due to large unmet demand for housing.

Financial institutions engaged in the mortgage business need to come together to expand the market for financing affordable housing

Insurance companies need to introduce innovative products such as default guarantee insurance so as to expand the reach of housing finance to underserved segments.

Micro-finance institutions and non-governmental organizations need to be linked up with leading financial institutions to create access to housing finance for economically weaker sections of society. Government and the financial regulators can play a major role in creating these linkages.

We have learnt some very valuable lessons from the sub-prime crisis in the United States. The chief lesson is that exotic financial product innovations do not necessarily lead to higher home ownership rates.

I am not advocating the adoption of aggressive lending practices-a situation that might lead to lending without adequate risk mitigation – I am proposing a composite solution to ensure that first time home buyers get what they truly deserve – a home to call their own.

The Japan Housing Finance Agency and the Japanese Housing Market

by Andrew Gall, Business Economist, The Building Societies Association

Reducing the Japanese Government's direct provision of housing loans has led to a number of changes in the Japanese housing market and the creation of a new agency that aims to develop securitization to support the provision of long-term fixed rate loans by the private sector.

The Japanese Housing Market

In Japan, the number of houses and the number of households have been increasing consistently over recent decades, to just over 45 million households by 2003. In addition, the homeownership ratio has remained at roughly 60% for the last 30 years. Construction of around 1.2 million houses has started in each of the last ten years.

In 2007 the land price in residential areas of Japan recorded positive annual growth for the first time in 16 years, growing just 0.1% in the year. Since 1991, land prices had declined year on year following the boom of the late 1980s.

Since the year 2000, outstanding loans have stabilised at around Y180 trillion ($1.6 trillion), having grown considerably since the end of the war. The state's stimulus packages following the bursting of the 1980s bubble increased the proportion of balances held with the public sector, but the private sector's share of balances has grown steadily since 2001. In 2006, around Y21trillion mortgages were originated, the vast majority of which were originated by the private sector.

Long term fixed rate mortgages have grown in popularity in Japan, accounting for 16% of lending in the first half of 2006, compared to just 5% in 2004. Most loans made (about 70% to 80%) are hybrid adjustable rate mortgages. However, a survey by the Japan Housing Finance Agency found that in 2006 over 70% of Japanese consumers would prefer interest rates fixed for the duration of the loan.

Japan Housing Finance Agency

Inaugurated in April 2007, the Japan Housing Finance Agency (JHF) is an administrative agency wholly owned by the Japanese government. It was formerly the Government Housing Loan Corporation (GHLC), which lent to the general public at low fixed interest rates. However, the JHF has now ceased direct lending to households, instead focussing on developing securitisation to enable private financial institutions to create a steady supply of long-term fixed rate housing loans.

JHF operates independently from the government, generating fee income from securitization rather than depending on borrowing or subsidies from the state. This forms part of wider reforms in Japan aimed at streamlining the Government's operations and reducing the burdens on national finances.

www.housingfinance.org

In a structure similar to Fannie Mae in the US, JHF purchases housing loans from private financial institutions and issues mortgage backed securities to the capital markets, using these loans as collateral. Via securitisation, JHF transfers the interest risk and prepayment risk of long term fixed rate mortgages to the capital markets. This structure encourages private banks and financial institutions in Japan to offer long-term fixed rate mortgages.

As well as continuing to administer loans succeeded from the GHLC, JHF also securitises a portion of these outstanding loans.

Another major part of JHF's business is the underwriting of insurance for long-term fixed rate housing loans made by private financial institutions, guaranteeing the timely payment on securities backed by these loans. This role is more comparable to that of Ginnie Mae in the US.

While a relatively small proportion of total mortgage lending in Japan is securitized, the market for residential mortgage backed securities has grown rapidly since the first issue of such securities in 1997. By 2006, nearly Y6 trillion in 2006 (around $50 billion) of mortgage backed securities were issued, and mortgage backed securities issued by JHF dominate the Japanese market.

JHF raises funds for its securitization business primarily through the issuance of monthly mortgage backed securities. The collateral for these securities is mainly purchased long-term mortgages, as well as some loans originated by JHF or GHLC. The mortgage backed securities are over-collateralized with the inclusion of funds raised from issuing straight bonds. JHF's monthly mortgage backed securities are purchased mainly by insurance companies (holding 39%, at September 2007) and banks (28%).

JHF conducts a number of supplemental operations, originating loans for certain public projects such as disaster mitigation or urban regeneration that cannot be financed through the private sector.

As a state-owned institution, the JHF also provides information and consultation services relating to Japanese housing, one of its aims being to raise the financial literacy of borrowers in Japan.

Seiichi Shimada (right), President of the JHF meets Adrian Coles, Secretary-General of the IUHF in London, January 2008.

Mortgage Loan Business Asia

Since the 1997 Asian financial crisis, Asian governments have stepped up their efforts to improve the structure of the housing finance system. In the primary market, the share of private housing has increased substantially. In addition, commercial banks and other private financial institutions have gained importance in mortgage loan origination, and more diversified mortgage products have become available to households. In the secondary market, mechanisms for mortgage-backed securitisation have been established in most Asian economies, although the market is still not fully developed.

Looking back, the regional financial crisis had brought things to a head in the Asian banking industry; the excessive exposure to corporates had resulted in a build-up of non-performing loans (NPL) and, subsequently, the industry's concerted efforts to shift its focus to the retail segment. With increased awareness of the importance of risk management, retail loans, particularly residential mortgages, have been experiencing amazing growth.

Some commercial banks devised extremely aggressive marketing campaigns to ramp up the size of their housing portfolios. This included intensive advertising campaigns, waivers of processing and administration fees, gift offers and other incentives, on the spot loan approvals without sufficient documentary evidence and loan to value ratios that exceeded 100%. This was supplemented by cutthroat competition on the pricing front, with each new player trying to undercut the other. Still, different nations have different policies on home ownership and different systems to support.

A new conference, happening on the **17th & 18th March 2008, Singapore,** intends to expand and reinforce the current mortgage product portfolio and upgrade the existing product, looking into the impact of the US sub-prime mortgage crisis on Asia institution's risk management strategy and improve the quality of mortgage loans that is being distributed in the mortgage market evolution.

WHY SHOULD YOU ATTEND? Grab this opportunity in:

- **Learning** about the mortgage trends, legislation and regulation policies issued in Asia
- **Transforming** mortgage delinquency to a performing portfolio
- **Realising** the challenges of product innovation in the sub-prime market
- **Expanding** the mortgage product portfolio in meeting the shifting needs of customers
- **Identifying** the innovative financing trends and schemes in Asia
- **Developing** innovative mortgage product to outperform the competitors
- **Discovering** the impact of Basel II on mortgages and credit risk management
- **Minimising** risk in the Asia market and explore the benefits of Basel II legislation
- **Learning** how to drive the business forward though e-channel

Key Topics:

- Responding to the current economic and social dynamics that drives the mortgage market
- Attracting and retaining your customers by generating optimal customer experience to outperform your competitors
- Exploring the Impact of Basel II on mortgages and Credit Risk Management
- Managing mortgage risk from the perspective of Probability of Default (PD) as well as Loss Given Default (LGD)
- Designing and Developing innovative mortgage products to outperform competitors

** IUHF members are entitled to a 10% discount upon registration. Please contact **'Ms. Tan Peng Pheng'** for more information.

For **event brochure**, please contact:

Name: Ms. Tan Peng Pheng
Tel: 00 603 2723 6699
Email: TanP@marcusevanskl.com

New Members

The Union is delighted to welcome the following new member since the publication of the last *Newsletter*.

FinMark Trust, South Africa – **www.finmarktrust.org.za**

IUHF
www.housingfinance.org

INTERNATIONAL UNION FOR HOUSING FINANCE

27TH WORLD CONGRESS, SOUTH AFRICA, 2008

SUN CITY RESORT, PILANESBERG GAME RESERVE, SOUTH AFRICA

29 SEPTEMBER TO 03 OCTOBER 2008

For further information please contact the conference organiser:

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tiffany@soafrica.com
www.soafrica.com

or view the conference website www.IUHF2008.com

for further information on Sun City please go to
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