

## Looking Back at the World Congress

*by Adrian Coles, Secretary General, International Union for Housing Finance*

Welcome to this final edition of the IUHF *Newsletter* for 2006. This is a retrospective issue looking back at our highly successful 26th World Congress, held in Vancouver, British Columbia, Canada in September. I felt that this was a magnificent event.

First, a big "thank you" to our organisers and hosts, the Canada Mortgage and Housing Corporation. Their team, lead by Pierre David, Executive Director of CMHC International administered the arrangements leading up to the World Congress superbly. It is no small task to put together a conference (with an excellent supporting social programme) featuring over 50 speakers and 220 delegates from all over the world, ensuring that everybody turns up at the right place and at the right time – CMHC appeared to do this with no trouble whatsoever! Of course, a huge amount of work lies behind such a successful outcome – for which many thanks are due from all the delegates, speakers and the IUHF Secretariat.

Many thanks also to all the speakers (including the moderators of the sessions), who were of a universally high standard. That the Congress gave delegates so much to think about was down to the high quality of the speakers we had. Many speakers travelled huge distances to present their thoughts; the IUHF is very grateful to them.



Pierre David, Executive Director of CMHC International.



Karen Kinsley, President and Chief Executive Officer, CMHC.

Finally many thanks to our outgoing and incoming Presidents. Ted McGovern has done an excellent job over the last two years, despite his many responsibilities as Chief Executive of EBS Building Society in Ireland. He would have been sorely missed were we not in the very fortunate position of having Renu Karnad, Executive Director of Housing Finance Development Corporation of India, to take over. I, and the Executive Committee of the Union, very much look forward to working with Renu over the next two years.

This edition of the Newsletter comprises a series of summaries prepared by some of the speakers and reflecting their presentation at the Congress, along with part of an article that I



originally wrote for the UK magazine *Mortgage Finance Gazette*, covering the opening, keynote session of the Congress. I am very grateful to those that responded to our request to summarise their thoughts for the Newsletter. I hope you enjoy reading them. All of the detailed presentations can be found at <http://congress.housingfinance.org/Presentations.php>.

While wishing you all a successful 2007, don't forget to look forward to 2008, when the 27th World Congress will take place in South Africa, hosted by the Banking Council of South Africa. Given the success of the recent event I can hardly wait!

## A Bubble – or Something Longer Lasting?

by *Adrian Coles, Secretary General, International Union for Housing Finance*

The keynote opening session of the Congress was on the question of whether recent rapid increases in house prices all over the world represented a housing bubble which was about to burst with calamitous consequences for relatively indebted owner-occupiers, or whether current house price levels were a natural economic reaction to long-term expectations of low interest rates.

Interestingly, the financial supplement to Canada's *National Post* that very morning had carried a report from the Royal Bank of Canada singling out the Vancouver housing market as "unsustainable". The researchers said that a typical family would now have to spend over 72% of their pre-tax

income to meet all the expenses of owning an average two storey home. They felt that Vancouver was now passing even the frenzy of the 1990s and that "these are the most stressful conditions Vancouver has been dealing with on record" (*see attached picture*). Clearly house price tensions are not just being felt in various hotspots around the UK.

Professor Robert Shiller of Yale University was the first speaker. His view was that there was a serious risk of a worldwide recession in housing finance markets in 2007. Not only is there unprecedented volatility over time, there is increasingly less difference between the behaviour of various markets across the world. The same factors seem



Adrian Coles.

to be affecting all markets; it was probable that a recession in one major market would be accompanied by recessions in many others.

Professor Shiller made the important point that by far the greatest risk facing homeowners was a fall in the value of their house. It was odd that financial markets had developed in such a way so as to provide, as a matter of routine, insurance for homeowners against risks such as burglary, flooding and fire, but had not developed a service to provide protection against what was now a much more important risk – an unanticipated decline in the value of their most important asset. Indeed, improved fire detection and security devices had reduced the risks that homeowners traditionally insured against.

Professor Shiller also pointed out that speculation in housing as an asset had increased worldwide. There was a sharp increase in many markets, for example, in what in the UK is termed buy-to-let lending. Professor Shiller felt that current trends were unsustainable. His solution – on which he was actively working – was the creation of liquid financial markets in which people were able to trade house prices. His firm had developed house price futures markets for 10 US cities. Homeowners could buy the appropriate instrument on these markets – possibly through a financial intermediary – and protect themselves against the consequences of house price falls. The futures markets for the contracts which were currently traded in the US on house prices were predicting house price reductions of 6 to 8% in each of the relevant cities by next August.

The other speaker in this session was Jim Power, a leading media commentator in the Republic of Ireland. He presented a case study on the Irish experience. Strong economic growth, a fall in interest rates and unemployment, a reversal of previous emigration trends towards net inward migration and the development of a much more competitive mortgage market had led to a strong growth in housing market activity. Ireland has a population of just 4.2 million and in recent years has completed around 80,000 new houses per year, a remarkable statistic to UK eyes which has a population fourteen times as great as Ireland, but struggles to complete three times as many new dwellings each year. His overall conclusion was

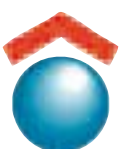
that the Irish housing market experience was justified by solid fundamentals and that the risks of a significant recession - a bursting of the balloon - were relatively low.

During the panel discussion with which the Congress ended, there was further discussion of the general upbeat attitude that had characterised some of the other presentations during the conference and the question arose as to whether the overall sense of optimism was justified. What were the risks that might bring down the market?

One American speaker felt that there were two worldwide issues; the first was sub prime credit losses. In very few countries had this market experienced a recession. There was no historical precedent that had enabled lenders to judge whether the additional rates of interest which they were charging for such lending fully reflected the risk that was being taken on. There was a view that risk-based premiums were being competed away in an unwise manner.

The second concern was about the impact on markets of speculative investment flows into the housing market, which could much more easily be reversed than the typical long-term owner occupier commitment to housing. The Chairman of the BSA in the UK, Matthew Bullock, added a further risk that might possibly dent the overall optimistic scenario. Lenders in every country would need to consider the likely regulatory reaction to a downturn. Would politically-sponsored regulatory amendments to foreclosure procedures, for example, make it more difficult for lenders to realise their security on non-performing loans? It is quite possible that in the event of widespread foreclosure action, political pressure would come to bear on governments to enable homeowners to stay in their homes even when loans were not being serviced.

Other speakers emphasised the impact of what some called “bubble economics” on the housing options available to lower income groups, which were generally felt to have deteriorated in the developed world in recent years, and in the high levels of financial sophistication now required by even the average homeowner to be fully aware of the range of mortgage options available.



## Thoughts on the 26th IUHF Congress in Vancouver

*by Renu Karnad, President, International Union for Housing Finance, and Executive Director, HDFC, India*

In life there are a few moments that one cherishes a little more than others – perhaps for me, the experience of being at the 26th IUHF Congress in Vancouver will certainly be one of those. It was indeed an overwhelming experience for me to be bestowed the honour of being the new IUHF President, especially since all my predecessors belong to an illustrious set of housing finance professionals with worldwide expertise.

It is hard to imagine that the IUHF is fast approaching its centenary year, but given the fact that this organisation has such a distinguished history, it once again reiterates the importance of housing and housing finance across all countries. Despite being a small organisation, I think its members are tightly woven together. We must appreciate that though the IUHF has no full-time staff, it is an organisation that runs so efficiently. For this, I once again commend Adrian and his team for

doing such a splendid job of administering the affairs of the IUHF.

I thought I'd just share a few thoughts that triggered in my mind after the Vancouver conference. Having looked at a myriad of opinions and ideas of housing finance experts across the globe from a national, business and consumer perspective, it became rather apparent that though global markets, including housing markets are increasingly behaving in similar trends, the importance of local knowledge can never be ruled out. Secondly, we need to constantly explore and create innovative solutions at affordable costs and this is best done on platforms like the IUHF, which facilitates a sharing of ideas from across the globe.

I do believe that there is a lot more work in the field of housing finance that still needs to be done, particularly in many countries of Asia and Africa. Many of these countries barely have any



Ted McGovern, Renu Karnad and Adrian Coles.

penetration of formal sources of funding for housing. I strongly feel that we must be able to draw upon the resources, experiences and expertise of IUHF members more actively and work together on specific projects in countries that are keen on further developing their housing finance systems. It is therefore important that we get more representatives to become IUHF members from

countries trying to grow their housing finance markets.

Finally to sign off, I must once again congratulate the entire team of CMHC that were perfect hosts in every way. While I eagerly look forward to the next IUHF Congress in South Africa in 2008, for any IUHF member traveling to India, here's an open invitation to visit HDFC!

## The Cincinnatian Doctrine

*by Alex J. Pollock, Resident Fellow at the American Enterprise Institute and a Past President of the International Union for Housing Finance*

**W**hat is the proper role for the government in the financial system, and in housing finance, in particular? This is among the “essentially contestable questions” – those which may be debated for decades and centuries without clear resolution.

The two dominant theories are respectively derived from two great political economists: Adam Smith and John Maynard Keynes.

In *The Wealth of Nations*, published in the famous year 1776, Smith set the lasting intellectual framework for thinking about the productive power of competitive private markets, which has transformed the world. In this view, government intervention is particularly prone to creating monopolies and special privileges, which generate undeserved monopoly profits (economic rents), constrain competition, and reduce productivity. It thus results in less wealth being created for the society and ordinary people are made worse off.

Keynes, writing amidst the world financial collapse and economic crisis of the 1930s, came to the opposite view: that state intervention was both necessary and beneficial to address problems which markets could not solve on their own. When financial behavior is dominated by fear and extreme uncertainty, only the compact power of the state, with its sovereign authority to compel, tax and borrow, is available to move things forward.

Considering at length this debate of ideas and prescriptions for political economy, the noted economic historian, Charles Kindleberger, asked, “So

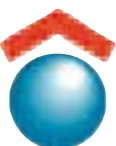


Alex J. Pollock

should we follow Smith or Keynes?” He concluded that the only possible rational answer is: “Both, depending on the circumstances.” In other words, the answer is different at different times.

### A Proposal

Kindleberger was the author (among many other works) of *Manias, Panics and Crashes*, a wide ranging history of the financial busts which follow booms, first published in 1978, and prescient about the financial crises of the following



generation. A fifth edition of this book, updated by Robert Z. Aliber, has brought the story up to our more recent dot-com mania and subsequent scandals, to which the same fundamental patterns continue to apply.

Kindleberger, surveying several centuries of financial history, observed that financial crises and scandals occur, on average, about once every ten years. This matches my own experience in banking and finance, which began during the “credit crunch” of 1969, then the collapse of the Penn Central Railroad and the U.S. commercial paper market in the next year, and various other memorable busts since. The most senior representative to the 2006 World Congress of Housing Finance, Howard Sexton, Chairman of the Southern Cross Building Society, New Zealand since the 1960s, has told me that once every ten years matches his experience, too. It seems to take financial actors less than a decade to forget the lessons their predecessors painfully learned.

This pattern gives rise to my proposal for balancing between Smith and Keynes, which expands upon Kindleberger’s insight of “Both, depending on the circumstances,” by quantifying how much we should have of each. Since crises and scandals occur about 10% of the time, the proposed mix is as follows:

#### Pollock Proposal

Adam Smith: 90%, for normal times

J.M. Keynes: 10%, for times of crisis.

In normal times, we want the economic efficiency, innovation, productivity and resulting economic well-being of ordinary people created by competitive private markets. But when the financial system hits its periodic crises, the intervention and coordination of the state can be helpful. This intervention should, however, be temporary. If prolonged, it will tend to monopoly, bureaucracy, less innovation, and less growth. In the extreme, it will become socialist stagnation.

So the Keynesian actions should be temporary. We should have the 90% Smith, 10% Keynes mix, with

the state interventions withdrawn after the crisis is over.

This is the *Cincinnatian Doctrine*, modeled after the Roman hero Cincinnatus, who flourished in the fifth century BC. Cincinnatus became Dictator of Rome, being “called from the plough to save the state”. In the classic Roman Republic, the dictatorship was a temporary office, which the holder was expected to resign after the crisis was addressed. Cincinnatus did - and went back to his farm.

Cincinnatus was a model for the American founding fathers and for George Washington, in particular. Washington became the “Modern Cincinnatus” for saving his country twice, once as General and once as President, and returning to his farm each time. When he probably could have become King of America after the Revolution, he resigned his command instead. Upon hearing this, George III famously remarked, “If this be true, he is the greatest man of the age!”

But those who attain political and economic power do not often have the virtue of Cincinnatus or Washington. The key problem with this doctrine is therefore: how to get the intervention to withdraw when its time has passed? When monopoly profits, market power, and the bureaucratic interests of government agencies become imbedded in the financial system, how do we return to the proper Smithian competition for the next 90% of the time?

#### The American GSEs as an Example

Consider as notable examples of this problem the American Housing “Government-Sponsored Enterprises” (the “GSEs”), a \$ 5 trillion sector of the US housing finance system.

Each of the GSEs was created as a response to particular circumstances of a real or perceived crisis in housing finance, in the following years:

Fannie Mae	1938
Federal Home Loan Banks	1932
Freddie Mac	1970

The existence of each GSE reflected some specific historical moment. Each GSE got government sponsorship with special benefits, privileges and advantages for its shareholders, because it addressed pressing problems for politicians at the time. Every GSE represents a deal made with the government to trade privileges for helping with such problems in line with the Keynesian theory.

It would be astonishing if the circumstances of the time did not change dramatically in the course of several decades—as of course they have. Fannie was created solely to buy FHA-insured mortgages, a function it no longer performs. The Federal Home Loan Banks were created to focus entirely on small, local, mutual savings associations, but their principal customers are now giant interstate banks. Freddie was created to solve the shortage of mortgage credit caused by interest rate ceilings on deposits, but these ceilings were ended two decades ago. In short, none of the circumstances which prompted the creation of any of the GSEs still exists. The original deals are all “passé”, indeed completely irrelevant.

But these government interventions have not been withdrawn, and all the GSEs are still here, having developed in ways never intended or foreseen by their designers. They are all huge issuers of debt with the implicit guaranty of the government, of enormous size, financial influence and political importance, and enjoy billions of dollars of economic rents (monopoly profits). They are now very hard to control, the accounting scandals of Fannie and Freddie of recent years notwithstanding.

GSEs are the marriage of government privileges and private benefits, created in crisis for purposes now outmoded. Unlike other marriages, they should always end in divorce - in other words, the Cincinnatian Doctrine should be applied. But how?

**Applying the Cincinnatian Doctrine to the GSEs**

The following steps should be taken to move the GSEs in a Cincinnatian direction:

- First of all, abolish their perpetual charters and replace them with limited-life charters of ten years duration. Giving the GSEs perpetual charters was a

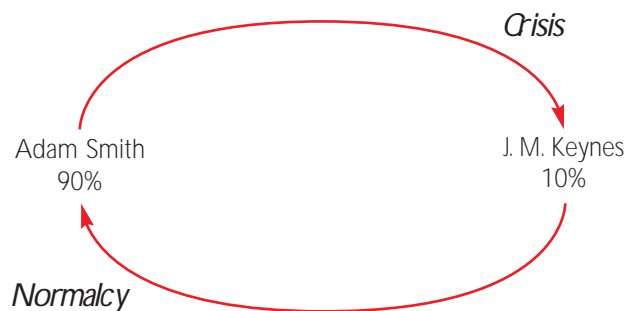
major mistake. With a limited-life charter, there is at least a regular chance to reconsider the deal with the government and take account of the inevitably changed circumstances.

- Foster competition among and for GSEs in all sensible ways. Competition will curtail their market power and economic rents, and increase the probability of ultimate privatization.
- Apply the logic that GSEs are in reality joint ventures in partnership with the capital of the government. As former Congressman J J Pickle of Texas observed about them, “The risk is 99% public and the profit is 100% private.” If this formula were corrected and the profit was divided according to the risk bearing, it would increase the motivation of the GSE managers to pursue privatization.
- Clearly target privatization as the goal, once the original crisis has passed.
- Insure that all future interventions, in response to the crises of the future, have limited-life charters or sunset provisions.

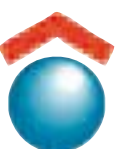
In short, unlike Cincinnatus, GSEs and other state interventions will not voluntarily go back to private life. They need to be forced.

**Summary**

We may summarize the Cincinnatian Doctrine as the following cycle:



...and so on ad infinitum.



## The German Bauspar System

*by Andreas Zehnder, Chief Executive, Association of Private German Bausparkassen*

The emerging markets are especially interested in adopting a successful housing finance model already implemented in developed countries. That is why more and more international housing financiers are exploring these new markets.

So do the German Bausparkassen. Since they were allowed to do business abroad in 1992, they have successfully established subsidiaries in eastern European but also in Asian markets.

The Bauspar system basically is built up on a contractual savings scheme that links a period of contractual savings remunerated by interest rates at levels below market rates to the right to receive a housing loan at a rate that is also fixed below market rates at the time of the conclusion of the overall Bauspar contract.

So, once the Bauspar contract is concluded, we can divide the whole process into three components:

1. The savings period: Normally 40 to 50 % of the contract sum is saved in monthly instalments and thus allocated to the community of Bausparers.
2. The allocation: In general, the customer saves for five or six years, before a loan offer is made to him. Once the customer has completed the savings period, he is entitled to a loan. The size of the loan usually consists in the difference between the contract sum and the amount saved. Since the Bauspar system is managed as a closed system, banks refinance the loans they provide to their customers via previous savings and repayments.
3. The loan period: The customer repays his loan on the basis of the agreed and fixed interest rate.

The Bauspar system can look back on a long tradition in Germany and it still enjoys great popularity. Currently, the Bausparkassen manage



Andreas Zehnder.

about 33 million Bauspar contracts worth 1670 billion.

With a market share of about 37% Bausparkassen are the most important housing financiers in Germany. Bausparen plays a pivotal role for first-time-buyers, especially young families, who do not have enough own funds. For them, the fact that for getting a Bauspar loan a second ranked mortgage normally is sufficient is essential. Bauspar loans also are very important in the case of financing renovation or modernization projects which normally require lower financing volumes.

Bausparen bears several more advantages that definitely are very important for emerging economies and countries in transition:

Due to its closed character the Bauspar system customers are not affected by fluctuations of interest rates on the capital markets. Also, interest rates are fixed. These facts result in a high long-term predictability and reduce interest rate risk.

Also, the Bauspar system encourages people to build up own capital in order to finance their homes. Using own funds encourages people to make economic decisions and fosters their identification with the desired home. It also reduces their investment risk and their leverage.

Many transition countries suffer from a low savings ratio, because people lost their confidence in the banking sector. As the Bauspar system is a quite simple and well understandable but also a very secure system, it may help the savings ratio and people's confidence in the financial sector to recover. In this way, the Bauspar system may possibly help to stabilise the financial sector in general – an important factor affecting economic growth.

For countries in transition in general, Bauspar loans are of great importance also because many buildings have not been renovated and modernised for a long time. As Bausparkassen also provide smaller loan amounts that exactly meet renovating and modernisation costs, they often represent the only institutions that can help people financing these projects.

Furthermore, the Bauspar system is able to reach parts of the population that normally wouldn't get any loan offer. Because these parts of the population still are quite eminent in many emerging economies, the Bauspar system also can perform an important social function.

However, there are some preconditions that have to be fulfilled in order to successfully introduce a Bauspar

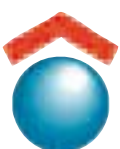
system. These preconditions can be structured in economic and legal preconditions.

Regarding the economic aspects, macroeconomic stabilisation is of great importance. Especially inflation rates should be low to encourage people to save and to guarantee a true positive interest rate.

With respect to the legal conditions, the Bauspar system needs a legal framework that is characterised by a working legislation, especially concerning title registration and foreclosure. Additionally, the introduction of a regulatory body that monitors the Bausparkassen is recommendable.

The Bauspar system has been implemented in several European countries like the Czech Republic, Slovakia, Croatia and Romania. Outside Europe it has also been adopted by China and India. Its introduction has been discussed in the Baltic States, Kazakhstan, Ukraine, Belarus, Azerbaijan and Armenia. In Russia, the Bauspar system is intended to be introduced as soon as possible.

To sum up: the Bauspar system represents a simple and well functioning method – not only to provide affordable housing finance – but also to foster preconditions for a stable financial sector and continuous economic growth. It is therefore the ideal alternative for countries in transition and the emerging markets in general. This is why Bausparen goes global.



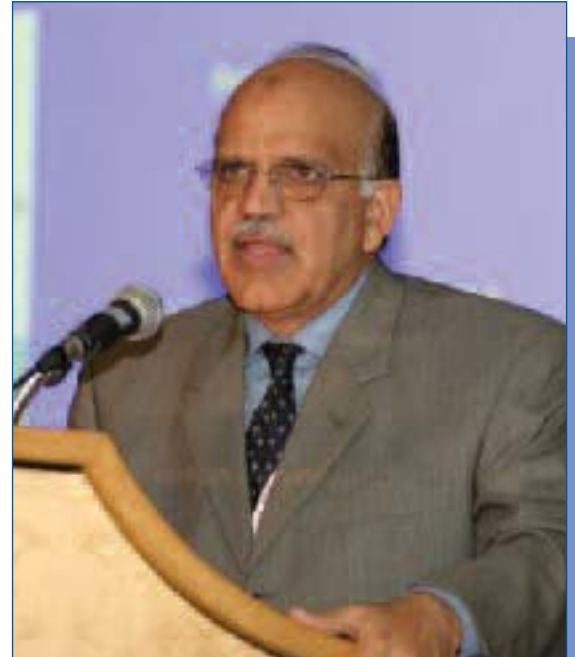
## Expansion of HBFC's Presence Through the Out-Reach Program

*by Mr Zaigham Mahmood Rizvi, Managing Director, House Building Finance Corporation (Pakistan)*

### Introduction

House Building Finance Corporation (HBFC), founded in 1952, is the oldest housing finance institution in Pakistan, and is amongst the oldest housing finance institutions in the Asia-Pacific region. In the last two years, it has undergone radical changes. HBFC has now made it its top priority to aggressively seek new business, especially from the small & medium segment, by massively expanding its presence in the country and designing "Shariah Compliant" asset and liability products to reach faith-based clientele as well. The physical presence has been expanded through the *Expansion of Out-Reach Program (EOP)*. Till 2005, even after 52 years of existence, HBFC was present in just 55 cities of Pakistan. With the launching of EOP, its presence has increased to 80 locations and by the end of 2007, the EOP program will enable HBFC to be present in 150 cities of Pakistan! It is cost-efficient

Under this programme, HBFC trains "Service Representatives" who are selected after a thorough screening process and "franchises" HBFC's client service business to them in selected urban & rural locations. These Service Representatives serve the clients in their assigned territories by operating "Representative Offices". Once EOP has proven successful, HBFC intends to use it to cut its operational expenses by replacing some of its currently non-profitable branches (at least 25) by Representative Offices. EOP is not an un-tested model, as similar models have proved successful in next-door India where two of its main housing finance institutions, Housing Finance Development Corporation of India (HDFC) & Dewan Housing Finance Corporation Limited (DHFL) heavily rely on a similar program to reach large and wide-spread clientele.



Mr Zaigham Mahmood Rizvi.

### System of Appointment, Training, Remuneration

When it comes to the selection of Service Representatives, HBFC is equal-opportunity employer. Applicants, whether male or female, should have a minimum qualification of graduation. Preference is however given to those with an MBA degree or a similar qualification. The candidate has to be from the same area to ensure his acquaintance and familiarity with the clientele and working conditions. Service Representatives are provided with both "off-site" and "in-house" training. "Off-site" training is conducted at the Pakistan Institute of Bankers (IBP) which is one of the most prestigious and oldest training institutes for bankers in the country. As far as "in-house" training is concerned, it is provided by attached Branch Managers who make fortnightly visits to Representative Offices to offer guidance to Service Representatives in handling their clients.

Service Representatives are provided a salary in the form of a fixed payment amounting to \$ 250 per month for an initial 1-2 years. This is to cover the operation expenses of Representative offices in the initial period when business slowly picks up. Service Representatives get a commission on a monthly basis, upon deal closure and on subsequent recovery of the loan from the same clientele. The commission on recovery is paid after having met a "floor level". The commission rate gets enhanced as performance moves towards 100%.

are a lot of people who would not avail themselves of services provided by conventional housing finance institutions as interest is prohibited in Islamic Shariah (Law). HBFC sees this as an opportunity, for it is coming up with "Shariah Compliant" asset and liability products to tap this segment. It has expanded its asset-side product range with the help of technical advice from premier Islamic Banks like Meezan Bank. HBFC has already floated a General Takaful (Insurance) Company, and will be shortly launching a Life Takaful Company. Liability products like REITS, MBS, Bonds (Sukuk) are being developed. HBFC has plans to launch Long-Term "Real-Estate Islamic Funds"; Sukuk in the Middle-East and the Far-East.

**Another Form of Out-Reach**

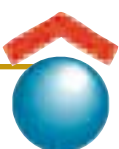
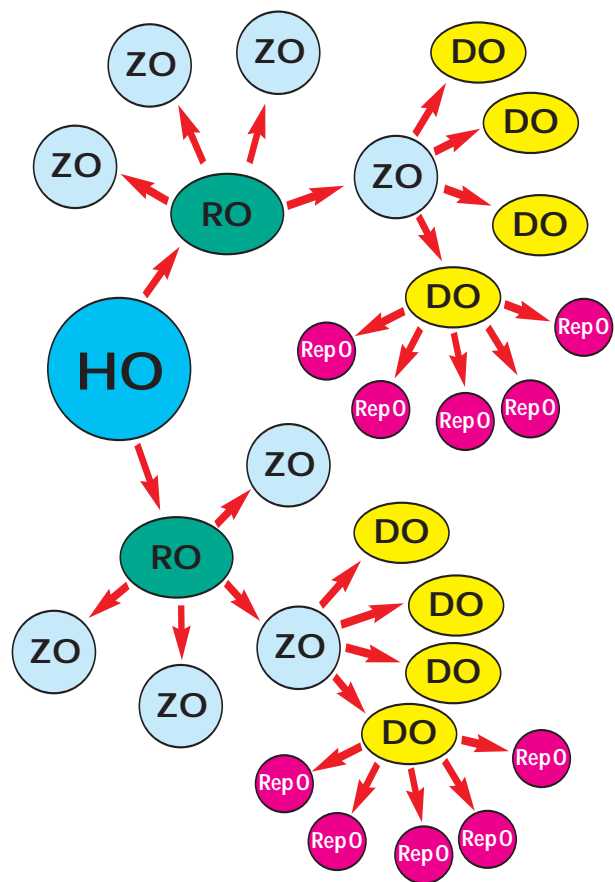
Pakistan is country with more than 150 million Muslims. Islam is a way of life for most of them. There

**A visual model of HBFC's Expansion of Out-Reach Program**

**Key**

- HO Head Office
- RO Regional Office
- ZO Zonal Office
- DO District Office
- Rep O Representative Office

Administrative Coverage	Current		Planned	
	Ratio	Count	Ratio	Count
HO to RO	1:3	3	1:2	2
RO to ZO	1:4	12	1:4	8
ZO to DO	1:5	58	1:4	30
DO to RPO	-	25	1:4	120



## Natural Disasters and Housing Finance: The Case of Turkey

*by Dr Feyzullag Yetgin, CEO, Emlak Konut REIC, Member of the Board, GYODER (The Association of Real Estate Investment Companies)*

### **The Real Estate Industry in Turkey**

In our economy, whereas GNP has grown by 7.6% in 2005, the construction and real estate industry has demonstrated a growth of 21.5%. Outcomes in the first quarter of 2006 show similar prospects for this year. These sectors have always been important trailers of the Turkish economy, directly and indirectly affecting 240 industrial sub sectors and providing employment opportunities for many people. The ratio of construction and real estate sectors in the GNP of Turkey has been at an average of 10% for decades. The figures for domestic cement sales (35 million tonnes in 2005) and annual construction permits (500 thousand units in 2005) signal the return of the real estate industry to the golden days.

Turkey offers excellent opportunities for all property markets, despite growing pains with regard to the traffic, overcrowded metro and bus stations, and the accelerating income gap between rich and poor. The rapidly growing economy has triggered great demand for better housing, retail centers and more modern office buildings. The development of the real estate sector which started in major cities is now extending to smaller cities of Turkey as well. However, Istanbul still remains the focal point of this development.

The potential of, and opportunities in, the Turkish property market are abundant due to market dynamics. Increasing population, migration from rural to urban areas, an unsaturated housing market with annual estimated demand of 600,000 units, low property prices compared to other countries, increased public sensitivity to quality and reliability, renewal and reinforcement requirements especially for earthquake risks and the need for urban regeneration are the factors driving the booming property market. On the other hand, the real estate investments have always been the most



Dr Feyzullag Yetgin.

conventional and profitable instrument for the majority of Turkish citizens.

### **Residential Sector in Turkey**

The property sales figures in the last three years are on the rise with the momentum gained by the increase in the accessibility of housing loans. The high housing demand has resulted in an increase of almost 40-45% in US\$ residential prices in 2004 and 2005. Many investors and developers have started the construction of new projects and the real estate market dynamics have recovered to the before crisis level.

Residential demand has shown a shift from luxurious projects to middle scale apartments and residences in metropolises. There is a strong preference for real estate having proper zoning and earthquake-resistant appropriate and registered new projects.

## The Mortgage Market

As seen in global examples, an effective housing finance system with long term housing loan possibilities leads to the development of residential markets as well as to an expansion of housing demand. The existence of an efficient housing system actually constitutes the basis for the emergence of a consistent, continuous and predictable housing demand. Such a housing demand causes the residential sector to respond by producing and diversifying new housing, by shortening the project work time, by creating new possibilities, and by getting institutionalized. Contrary to global examples, Turkey's housing sector has so far developed without an effective and institutionalized financing system.

The mortgage system and housing loan possibilities is expected to become the most important determinants of the housing sector in Turkey in the next decade, as the mortgage system is in the process of being established and the housing loans market is developing. Economic stability and improvement, the decline in inflation and in interest rates have prepared the take off phase of the housing loans market in the past two years. The second most important step in the mortgage system will be completed with the full preparation of the legal framework and the effective functioning of the system.

In developing countries, while housing loans constitute 10-15% of national gross product, housing loans in Turkey have reached from a few million dollars two years ago to around 13.8 billion dollars today. This figure, however, constitutes 3.5% of gross national product and will increase with the enactment of the Mortgage Law. The housing loans stock is expected to increase to 40-50 billion dollars in the intermediate term and will even grow higher in the long run.

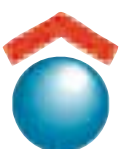
## Earthquake Risks and Rehabilitation Requirements

96% of the total surface area and 98% of the population are situated in zones of varying degrees of seismic risk in Turkey. 76% of industrial centers are located in earthquake prone areas. A significant portion of the housing stock (40%) of Turkey, which is more than 17 million, should be renovated in terms of age, quality and earthquake risk and the housing stocks of the settlement units on Northern and Southern Anatolian fault lines must be strengthened for earthquake risk.

Turkey has met nearly half of its housing need (55%) by unlicensed buildings and the majority of the existing buildings is of a substandard low quality nature. Such a wide need for repair and renewal necessitates a planned and well designed urban regeneration. Many municipalities in Istanbul have initiated urban regeneration projects to rehabilitate unlicensed shanty town housing regions.

Considering the size of the financial resources that will be required when in particular the poorly constructed settlements characterizing our metropolitan cities with unattractive scenes, and buildings holding earthquake risk, are being transformed into contemporary, civilized and safe settlements, it is an obvious fact that direct foreign investment and mortgage funds are essential.

The real estate sector in Turkey is on the edge of a fundamental change. As unfortunate and devastating they may be, the earthquakes in 1999 also gave rise to the much needed political, public and civil support for changing the face of the real estate industry for better. Today, we see an ever increasing public sensitivity to the quality of real estate and reliability of developer. This can only mean good news for real estate sector, which so much needs long-term financial markets.



## Developing Mortgage Capital Markets in Emerging Economies

by Dr Michael Lea, Cardiff Economic Consulting, USA

Developing mortgage capital markets is a topic of increasing interest in emerging economies. Access to wholesale funding is important as it can expand the supply of funds available for housing and help lenders manage the associated risks of housing lending. Developing this channel can help lenders meet the large and growing demand for housing in emerging economies.

There are many challenges in developing wholesale funding channels in emerging markets. In addition to creating the legal and regulatory infrastructure, lenders must view wholesale funding as an attractive option; investors must view the securities as attractive investments; and the loans that form the collateral for borrowing must be well documented with performance history. Credit enhancement is a key ingredient in wholesale finance. It can come from external sources in the form of government, private insurance or international financial institution (IFI) guarantees, or from internal sources through structuring and prioritization of cash flows.



Dr Michael Lea.

There are a number of different instruments lenders can use to access capital markets, including mortgage (covered) bonds, mortgage pass-through

Mortgage Bonds	Structured Finance (Asia, Africa)	Structured Finance (LA, CEE)	Conduits	Liquidity Facilities
Chile	China	Argentina	Argentina	Malaysia
Colombia	Hong Kong	Brazil	Brazil	Trinidad
Poland	Korea	Colombia	Colombia	South Africa
Czech Republic	Malaysia	Chile	Hong Kong	India
Hungary	Philippines	Mexico	Korea	Jordan
	Morocco	Panama	Trinidad	
	South Africa	Trinidad	Thailand	
		Latvia		
		Russia		

Source: L. Chiquier, O. Hassler and M. Lea, *Mortgage Securities in Emerging Markets*, World Bank working paper, March 2004 updated.

and pay-through securities (structured finance) issued by lenders and/or conduits, and bonds issued by liquidity facilities which provide over-collateralized loans to or make recourse purchases from primary market lenders. The table shows the experience of issuing mortgage securities in emerging markets – by country and instrument.

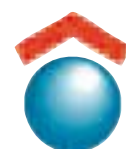
Chilean mortgage bonds and the debt issued by Cagamas, a Malaysian liquidity facility, are successful examples of wholesale finance for housing in emerging markets. In both cases the securities finance a significant portion of the market (70% in Chile, 20% in Malaysia) and are issued on a recurring basis. There are several other promising examples of mortgage securities issuance in emerging markets. Specialized lenders (Sofols) in Mexico have successfully securitized pools of mortgages to middle and lower income borrowers using partial credit guarantees from the national mortgage bank (Sociedad Hipotecario Federal), IFIs (IFC, FMO) and recently with only internal credit enhancement. The Sofols have issued over \$1 billion in securities including dollar denominated issues sold in the US. Liquidity facilities in Jordan and Trinidad have been successful in their respective markets and Titularizadora Colombiana, a secondary market conduit in Colombia, has securitized over 30% of the outstanding mortgage debt.\*

While there have been several success stories, one should keep in mind that in most countries mortgage securities will account for only a fraction of total

funding at best. Retail deposits form the largest pool of funds for housing lending in emerging markets. Depository institutions in many countries are well capitalized and liquid and do not perceive a need to access typically higher cost capital market financing. In many countries the institutional investor base is limited and the legal and regulatory framework for mortgage security issuance is under-developed.

Despite these challenges the future for mortgage security issuance in emerging markets is bright. The creation and growth of institutional investors provides an attractive source of long term funds in a number of countries. Legislation creating a sound legal and regulatory infrastructure (eg, facilitating the creation of special purpose issuance vehicles and true sale transactions) has been passed in a number of countries. As investors become more comfortable with the collateral and issuers the premiums they require will fall making wholesale finance more competitive with retail. Private international investors looking for yield and currency exposure can provide an important supplementary source of funds, often buying the higher yielding subordinate securities. Reflecting these trends we should expect to see the number of countries and volumes of issuance grow in the coming years.

\*The loans purchased and securitized by TC are part of a large scale financial restructuring process after an economic downturn in the late 1990s. It remains to be seen whether the company will continue to fund as high a percentage of new lending.



## Growing Rapidly While Controlling Costs

by *Mike Lazenby, Chief Executive, Kent Reliance Building Society (UK)*

One of the hardest industries to work in is financial services in the UK.

It is hard because -

- there are lots of players,
- there is increasing regulation,
- customer expectations are very high and increasing
- new entrants are invading home ground

Although the financial services industry has survived and relied upon the apathy of the customer, some customers are waking up to the fact that they are not getting the best deal.

We believe that we can survive the fierce competition. We do not have massive budgets to sway customer views and buying habits. We cannot advertise ourselves into people's minds. We cannot be advertisingly clever – we cannot even afford to be dull and boring.

We do not play by the rules. We do not conform – because our customers do not conform. Our industry gets hung up on calling customers members. We need to get a life. There are much more important issues to deal with – like how to survive the penetratingly hard market in which we operate.

The problem is we are a building society and so we think we have a right to exist because people like building societies. Ask 100 people in the UK if they would rather do business with a bank or a building society and the majority will say a building society – but they will not know why. Ask them which building society they belong to and they will probably name a former building society now turned bank.

We operate in a hostile market and our margins are under severe pressure at a time when costs are forced upwards by onerous legislation

We glibly say that as mutuals we can put members first – and we can – but I am not convinced that we



Mike Lazenby.

do. If we did then our costs would be lower, our products better and our proposition more robust.

We go on and on about mutuality – most of our customers do not understand mutuality and care even less. We have opportunity but we have to seize the moment....

....and that is what tiny little Kent Reliance is doing.

There is rarely a day goes by when we do not challenge why we do what we do and remind ourselves that we have no right to exist. We look for ways of improvement continuously. We could not be described as complacent and we could not be described as normal and though we may not be liked – we are not easily forgotten

And we may be small but we make a difference and we have a story to tell

We make life hard on ourselves when all we have to do is give the customer everything that they want, at the time that they want it and at a good

price – the customer definition of good being below cost if not free. Simple isn't it?

In a margin shrinking world we have to be innovative. We have to be more efficient. We have to be more effective.

We have huge external cost pressures - not least employment law, high employee costs and liabilities, infrastructure modernisation, cost of legislation, cost of compliance. We have to step up a gear, increase the pace, make a noise. The essence of efficiency is to get more – much more ...with less – much less

We determined that we could achieve much more for much less if we did not think we could do it all ourselves. We carried out a fundamental review of who and what we were and are. We remembered why we are here. We are not here specifically to be the driving force in our communities. We are not here to be the mainstay of local employment. We are not here to line the pockets of a few well paid employees. We are here to offer value for money products at a competitive price and if we cannot do that then why exist?

In the mutual sector, because we are not so infatuated with profit we measure our efficiency through our management expense ratio – our management costs expressed as a percentage of our costs.

Over the last 10 years we have reduced our costs by 58%. We have almost the lowest costs but certainly the fastest reducing costs in the industry – but we are not there yet – we have to do better.

That is why we are being what some would say is radical by outsourcing - which is not new and not radical. It is not even innovative. We have outsourced things for years. Deeds management, legal work , internal audit. But what we had not done until now was to have a mindset that looks at the possibility of outsourcing everything to someone else. And that is exactly what we are doing.

- As long as we keep control
- As long as we can fulfil our legal and regulatory obligations
- As long as we can get it done better by someone or somewhere else

And hopefully for us most of that somewhere else is India.

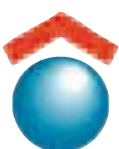
We have come a long way but we are nowhere near winning because there is no finish line. All we can do is do the best that we can with what we have. And if we can be different, be radical, be effective...and have some fun too, then that is great.

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## New Members

A very warm welcome to four new members of the International Union. The following members have joined since publishing the August 2006 edition of the *Newsletter*.

- 1) The Development Fund, USA – [www.tdfs.org](http://www.tdfs.org)
  - 2) The Norwegian State Housing Bank, Norway – [www.husbanken.no](http://www.husbanken.no)
  - 3) Ely & Company, Inc., USA – [www.ely-co.com](http://www.ely-co.com)
  - 4) Housing Microfinance c/o Johnson Capital, USA – [www.johnsoncapital.com](http://www.johnsoncapital.com)
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## The Growth of the Indian Market

by *R. V. Verma, Executive Director, National Housing Bank, India*

The Indian housing finance industry has witnessed dramatic changes over the past eight to 10 years. Housing credit is today riding the retail boom in the financial sector. The lenders' business in this segment has been reinforced by sustained exponential growth in demand. The continued fiscal benefits, rising incomes of the people, the growing number of young earners and their preference for early homeownership have all combined to contribute to this growth. The annual disbursements have risen from the level of INR 64.33 billion (US \$ 1.41 billion) in 1996-97 to Rs.860 billion (US \$ 18.90 billion) in 2005-06.

In recent years, commercial banks have entered this market and are playing a major role in driving this segment of retail lending. Competition in the market has brought better terms to the borrowers in pricing and range of customised products and services. In the banks' retail portfolio, housing loans occupy a major space of nearly 54%. Added momentum comes from the rapid expansion in the retail portfolio of the commercial banks. While the deregulation and expansion in the industry have led to aggressive lending rates in the market, the liquidity in the system has also come under strain from time to time, resulting from relatively high credit growth.

The housing finance industry is poised for continued growth in the coming years. The credit expansion is becoming increasingly liquidity-driven and to keep pace with the growing demand, the lending institutions are securitising their assets and leveraging their business. The MBS (mortgage-backed securitization) is emerging as the future funding vehicle for the sector. There is significant appetite in the industry for MBS. The financial and the capital markets continue to see strategic reform-linked developments that have added to this growth momentum. These include new legislations seeking to remove the impediments and improve the efficiency of the MBS market.



R.V.Verma.

To kickstart the MBS transactions in the country and provide a direction to the market, the NHB Act was amended in June, 2000 to include specific provisions for securitization transactions. The amendments have positioned NHB as an intermediary between the primary lenders (originators) and the potential investors in the MBS market. Acting on the amendment, the NHB kicked off the MBS transactions, the first of its kind in India, in August, 2000. During the subsequent period, the market has witnessed a number of issues under different structures. Clearly, the industry, the originators and the investors alike, have demonstrated a need for MBS. With growing interest and appetite in the market, a number of policy guidelines are being considered to streamline and harmonize the market. These measures include regulatory guidelines, and an accounting, taxation and legal framework. The industry expects to see, in the near term, a fair convergence among these guidelines in the best interest of the industry and the MBS market. NHB is seeking to offer an intermediaries' platform to the lenders for securitizing their portfolios and placing them in the

investors' market. Besides, the NHB is also exploring setting up of a mortgage guarantee insurance company that would add further depth to the MBS market. This will no doubt trigger further expansion in the housing finance market in general and MBS market, in particular, adding also a measure of stability to this expansion.

Following the liberalization measures initiated in 1990-91, the Indian financial sector and the capital market have witnessed significant reforms which have added new depths to the country's financial system. The community's savings are channelled through efficient capital market instruments. The measures have improved the prospects and the market for MBS. Significantly, the primary mortgage market has also grown in tandem with the financial sector and the

capital market bringing about better integration of the primary and the secondary market. The Government is in the process of passing new legislation to include securitized debt instruments under the Securities and Contracts Regulation Act of the Union of India, which is the principal Act governing the capital market transactions. This measure is expected to facilitate trading in mortgage backed securities and bring larger volumes of MBS issues in the market. At the level of State Governments too, critical policy inputs, such as reduction in stamp duty and registration of securitised instruments have made transactions more viable and efficient. Overall, the commitment to securitisation is demonstrably high as articulated in various policy pronouncements and the users' growing appetite as revealed in the market.

## The Competitive Effects of Risk-Based Bank Capital Regulation: An Example from US Mortgage Markets

by *Andreas Lehnert (with Diane Hancock, Wayne Passmore and Shane M. Sherlund)*

*Abstract (prepared by Andreas Lehnert)*

**B**asel II bank capital regulations are designed to be substantially more risk sensitive than the current regulations. In the United States, only the largest banks would be required to adopt Basel II; other depositories could choose to adopt such standards or to remain under the Basel I capital standards.

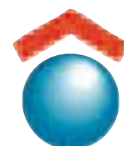
We consider the possible effects of this two-pronged or "bifurcated" approach on the market for residential mortgages. Specifically, we analyze whether those institutions that adopt Basel II will enjoy lower costs than nonadopters and whether they have an incentive to retain mortgages in their own portfolios. We find that (1) despite the large differences in regulatory capital requirements between adopters and nonadopters, it is unlikely that there will be any measurable effect of Basel II implementation on most mortgage rates and, consequently, any direct impact on

the competition between adopters and nonadopters for originating or holding residential mortgages; (2) the most significant competitive impact may be felt among mortgage securitizers; and (3) adopters might have increased profits from some mortgages relative to nonadopters because they will capture some of the deadweight losses that occur under the current regulatory regime, but nonadopters would likely retain their market shares.

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Andreas Lehnert.



## Vancouver: A Great Experience

by *Deepak Parekh, Chairman, HDFC, India*

After many years of attending IUHF events, I'd like to consider myself an old hat at the World Congress. And yet, each conference never ceases to surprise me with the sheer diversity of speakers, innumerable interaction opportunities and best of all, the informal atmosphere around the event. The latest Vancouver conference just reinforced my belief that these events impart a truly holistic view of the global housing finance market, changes occurring within individual countries and across regions and new housing finance solutions that can be adopted and adapted by different institutions.

I commend the IUHF for being able to collate together a broad spectrum of speakers from both the public and the private sector and of course, from many different parts of the world. To site an example, a comparison between mortgage insurance in the United States and Serbia aptly demonstrates the diversity of views put forth to the audience. For delegates from countries without certain legal provisions, say a mortgage foreclosure act, the conference helped them hear views from countries that were able to develop their housing finance market without foreclosure laws. Thus, such forums do well to spread global best practices in the housing finance arena.

Further, we also witnessed the similarities that are taking place across the world. Interest rate movements are now globally linked, which in turn have impacts on borrowing costs and house prices. Reforms are universally accepted as a must to improve both housing finance and the mortgage market itself. New ideas on the role of the government as a facilitator, not a provider, anathema just a couple of decades ago, are now being actively proposed. Even new methods of housing finance, such as microfinance loans, are now being discussed. The point we should note from all this is that globally, all finance providers are concentrating on one central issue – to ensure that as many people as possible have access to mortgage finance.



Deepak Parekh.

In my own personal experience, I can name a number of business relationships that have emanated due to a chance meeting at the Congress. Experiences like these are extremely important because they aim to connect the global housing finance network leading to face-to-face interactions between individuals who one might have otherwise never met. Not only does this help facilitate the spread of ideas, but it also builds bonds between people and countries. Further, the Congress is also a platform for institutions just starting out in the business of housing finance to meet their peers who have been in the business for years.

Lastly, I thoroughly enjoyed the social programmes. This allows one to experience a new culture and see things that perhaps in one's normal business schedule one might not have found time to do so. To sum up, the recent IUHF meet at Vancouver was a great success and, like always, I look forward to the next one.