

# HOUSING FINANCE INTERNATIONAL

The Quarterly Journal of the International Union for Housing Finance



- ➔ **Pro-poor affordable housing: the issues we know, the answers we need**
- ➔ **An overview of the housing sector in developing countries with a focus on India's reforms**
- ➔ **The demand for housing in Port-au-Prince, Haiti**
- ➔ **Investment in housing: demand versus supply side subsidies**
- ➔ **A review of recent developments in the Irish mortgage market and an assessment of the future prospects**
- ➔ **"Managing risk" in the delivery of housing finance: Australia's mortgage lenders**



# International Union for Housing Finance

## Housing Finance International

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# Editor's introduction

↳ By Andrew Heywood

The world is moving fast at present. Crises pile on top of one another, while economic and financial initiatives follow each other in quick succession with little time for review or reflection. The Euro zone crisis adds a new dimension almost daily as the Greek bailout is agreed, then half agreed then not agreed and so on.

A quarterly journal like HFI cannot hope to keep up with the vicissitudes of day to day news. Our primary role must be to provide the in-depth analysis behind the news and to temper the excitement of daily reporting with cool detachment. HFI has the ability to take a historical perspective on markets, sometimes going back 30 years or more in order to understand how a particular market arrived at its present position. It is the breadth of coverage and the ability to provide considered analysis that has built the reputation of HFI over the years.

Considered analysis remains our primary focus but in this issue, for the first time, we have included as an additional feature a series of news columns offering a roundup of events and/or recent developments in different global regions. The columns are provided by organisations with a sound overall grasp of what is going on in their region. The aim is to provide a convenient way for readers to catch up with what has been happening in terms of news, events and activities. In this issue we feature brief news columns on Africa, the Asia Pacific region and Europe. In addition Ronald Sanchez Castro of UNIAPRAVI has produced a valuable overview of economic trends, housing finance and government policies for Brazil, Chile, Colombia, Mexico and Peru. This will underpin future columns covering his region.

We will aim to gradually extend this regional coverage going forward. Feedback on these new items would be very welcome; we want to ensure that HFI is as relevant as possible.

## Problems of poverty

Problems of poverty around the globe figure prominently in this issue. Zaigham M. Rizvi offers a brief and punchy think-piece highlighting the importance of housing in pro-poor strategies. He goes on to stress the importance of government initiatives in the facing of some daunting global statistics; one in three people living in cities live in a slum. Mr. Rizvi uses his article to announce the establishment of an Asia Pacific pro-poor regional network covering housing finance.

In a fascinating article Francis Eddu draws attention to the changing geographical distribution of the world's population and the issues posed by urbanisation and industrialisation. Having discussed the issues surrounding slum formation, he goes on to look at the efforts of the Government of India to introduce reform, drawing on the UN global Shelter Strategy (GSS) and the Global Housing Strategy (GHS) currently being developed.

Haiti is not a country that has received much coverage in HFI so we are very pleased to include an article by Yvonne Cao et al analysing the demand for housing in Port-au-Prince in the wake of the devastating earthquake that struck the area in 2010. The article describes how households were segmented and surveyed to ascertain their resources and needs in the context of efforts to rebuild.

## Subsidy, Ireland and risk assessment

Housing subsidy to stimulate new-construction, particularly of affordable housing, has always been a difficult issue with strong disagreement between those favouring supply-side subsidy and those supporting demand-side measures. In a closely argued debate Filiep Loosveldt and Wolfgang Amann debate the issues in a European context in a pair of linked articles.

The ramifications of the banking crisis continue to play out. Within Europe, Ireland has been harder hit than many states. In this issue of HFI Dara Deering offers a timely analysis of the challenges facing the Irish banks. She charts the impact of the crisis on Irish banks including a 95% reduction in new lending and some nationalisation. She then goes on to examine the measures taken to rebuild the Irish banking system including mergers and regulatory reform.

The Australian housing and mortgage markets are widely believed to have emerged from the banking crisis in a relatively healthy state compared to some other markets, notably those of the US. This is often ascribed to better risk management by Australian lenders. In an important article Mary Tomlinson examines the approach to risk management of the Australian banks in order to analyse the degree to which they were better at managing risk than banks elsewhere and thus contributed toward a favourable outcome to the crisis.

## Book reviews

Regular readers of HFI will have noticed the occasional book review in HFI. It is our intention to gradually increase the number of books that we review, thus helping to increase awareness of important new contributions to the housing finance field. If you are about to publish (in English) a book on some aspect of housing finance and believe that a review in HFI would be justified please ask your publisher to contact:

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# Contributors' biographies

Associate Prof. Dr. **Wolfgang Amann** is owner and director of the IIBW – Institute for Real Estate, Construction and Housing Ltd., based in Vienna/Austria. He is a lecturer at FHW – University of Applied Sciences, Vienna. Dr. Amann is an expert consultant for the Austrian Parliament, (sub) co-ordinator of the working group “Legal aspects of building, land and planning” of the European Network for Housing Research (ENHR) and member of the “Real Estate Market Advisory Group” of UNECE – United Nations Economic Commission for Europe.

**Yvonne Cao** is a Senior Research Analyst at NORC at the University of Chicago. She has managed household surveys and evaluation research in numerous countries, including Benin, Burkina Faso, Indonesia, Malawi, Morocco, Namibia, and the Philippines.

**Dara Deering** is Executive Director with responsibility for Retail Banking in KBC. KBC Bank Ireland provides personal and business banking services in Ireland and is a wholly owned subsidiary of KBC Group NV. Dara has worked in leadership positions in the Retail Financial Services industry for a number of years and is currently chair of the Irish Mortgage Council, part of the Irish Banking Federation.

**Dr. Francis Eddu** is an independent consultant based in Hyderabad, India. He holds an advanced degree in international development and provides consulting services to NGOs.

**Filiep Loosveldt** – through his firm PANAREA – is the Managing Director of UEPC (European Union of Developers and House Builders): [www.uepc.org](http://www.uepc.org). As Manager of PANAREA Ltd, with registered office in 8790 Waregem, Lijsterlaan 1, Filiep Loosveldt's main activity is consulting in the field of territorial planning, housing, the environment and related subsectors for various public and private bodies. He is also the President of the working group “Legislation & Europe” of the Belgian Professional Union of Real Estate Developers' (UPSİ-BVS).

**Zaigham M. Rizvi** is Secretary General of the Asia Pacific Union for Housing Finance, email: [zaigham2r@yahoo.com](mailto:zaigham2r@yahoo.com)

**Kecia Rust** is the coordinator of FinMark Trust's Centre for Affordable Housing Finance in Africa, and manages the Secretariat of the African Union for Housing Finance. She is a housing policy specialist and is particularly interested in access to housing finance and the functioning of affordable property markets. Kecia holds a Masters of Management degree (1998), earned from the Graduate School of Public and Development Management, University of the Witwatersrand. She lives in Johannesburg, South Africa.

**Ronald Sánchez Castro** is Technical Adviser to the Inter-American Housing Union.

**Raymond Struyk** was a Senior Fellow at NORC at the University of Chicago at the time this analysis was done; he is now an independent consultant. He has helped develop housing finance systems in Hungary, Russia, Egypt and Rwanda and has related consulting assignments in a number of other countries. His publications include *Housing Finance: New and Old Models in Central Europe, Russia, and Kazakhstan* (with Jozsef Hegedus).

**Mary R. Tomlinson** is a Visiting Fellow at Swinburne University of Technology's Institute for Social Research. Her financial sector experience is derived from her period as a General Manager at the Banking Council, South Africa, where she engaged with the country's housing finance institutions in formulating policies to move mortgage lending down-market.

**Mark Weinrich** holds graduate degrees in political science and economics from the University of Freiburg, Germany. He is the manager of the Department of International Affairs in the Association of Private German Bausparkassen and the Head of the Department of Economic Affairs for the International Union for Housing Finance in Brussels.

**Aaron Wilson** is a Research Assistant at NORC at the University of Chicago. He has provided support for a range of international surveys and impact evaluations in Egypt, Lesotho, Ghana, Morocco, Namibia, and elsewhere.



# Africa: increasing attention on the emerging middle class

➔ By Kecia Rust, African Union for Housing Finance

The sight of cranes and earth movers across a series of developments, and news of new housing finance approaches in multiple countries, suggests that opportunities to be found in Africa's growing middle class may well be the next frontier for investors bruised by recent global economic events. The housing shortage across the continent is substantial, especially in urban centres where the rate of population growth is much greater than the rate of new housing construction. While the majority of this demand is among the low income, often impoverished population, recent research from the African Development Bank highlights the opportunities to be found in an emerging middle class.

*“Africa’s middle class has increased in size and purchasing power as strong economic growth in the past two decades has helped reduce poverty significantly and lift previously poor households into the middle class”.*

By 2010, just over a third of Africa's population, or nearly 313 million people, earned between US\$2 - \$20 per day. This is three times the population in this category in 1980 and double the number in 1990. Of course, 36.5% of Africa's population in 2010 earned less than \$2 per day, and another 19% earned more than \$20 per day. It is with this stark sense of inequality that Africa is often viewed. The nuance of the other 44% of the population that earns enough to have something to spend, but not so much that it will travel elsewhere to buy it, is the new dimension to the picture that investors are beginning to appreciate. In the past year alone, at least four new funds have been established which extend beyond the traditional focus on South Africa to a regional scope, and regional housing developer and financier Shelter Afrique announced that their US\$27 million bond was fully subscribed despite unfavourable economic conditions. New housing

developments at Tatu City in Nairobi, Kenya; in the mining belt of Lubumbashi, Democratic Republic of the Congo; targeted at civil servants in Abuja, Nigeria and in Namibia; comprising of condominiums in Addis Ababa, Ethiopia; built as part of Chinese investment in Angola; and so on, all point to increasing interest and opportunity across the continent.

Increasingly, governments are also shifting their focus from a traditional welfare approach to the provision of subsidised housing for the poor, to one that encourages private sector investment in the middle market.

In late 2011, in Kampala, Uganda, a three-day meeting was held jointly organised by the government of Uganda, the US Department of Housing and Urban Development, the Nairobi-based UN Habitat, the US government, and UN officials. Banks and Tanzanian, Kenyan and Ugandan finance, housing and lands ministries were represented at this meeting which was called to deliberate on strategies to promote innovative financing for affordable housing in East Africa. The deliberations placed a great emphasis on the central role of housing in poverty alleviation and eradication. The various governments agreed that mortgage finance, land regularization, and tenure security would be centerpieces of their financial reforms. In March, housing ministers from the five East African community partner states will meet with private sector real estate players in Nairobi, Kenya, to discuss further strategies to attract international capital and expand housing supply in the East African region.

Tanzania has been working in this space for some time, and with support from the World Bank established the Tanzania Mortgage Refinance Company (TMRC) in 2011. The TMRC is a mortgage liquidity facility created as a private sector institution owned by the banks, with the sole purpose of supporting banks to do mortgage lending by refinancing their mortgage portfolios. Licensed by the Bank of Tanzania, the TMRC is a non-deposit taking financial institution. The TMRC serves as a secure source of long term funding at

attractive rates, while ensuring sound lending practice amongst its member banks. It is hoped that in the long run, the TMRC will lead to the establishment of specialized housing finance companies in the private sector.

In South Africa, there has been a decisive shift in government policy to promote housing finance and development for the 25% of the population that earns too much to qualify for the housing subsidy but too little to afford the cheapest newly built house. Termed “the gap market”, this comprises households who earn between R3500 – R15 000 per month. In his February 2012 State of the Nation Address, President Zuma announced a new subsidy that would offer households in this income bracket a top-up subsidy (on a sliding scale depending on income) that they could match with finance to buy housing. Two additional measures seek to give substance to this intervention: the development of a mortgage guarantee fund, and the introduction of a tax incentive to promote the delivery of housing costing less than R300 000, both of which are also promised for implementation within 2012. With these three interventions, plus increasing interest by practitioners in both the construction and finance sectors, it is hoped that the delivery profile in South Africa will shift substantially towards the growing but still under-served middle market.

A new mortgage insurance mechanism in Ghana may have a similar expectation for accelerated delivery in the middle market, to the guarantee fund that South Africa is developing. The National Insurance Commission in Ghana has introduced a new financial mortgage Collateral Replacement Indemnity Policy (CRI), which targets the lower to middle income mortgage market. The insurance package is aimed at bridging the gap for borrowers who lack the savings necessary to pay the requisite deposit for a mortgage, but who have the capacity to pay over a particular period. As such, the scheme will be particularly interesting for first time homebuyers who haven't yet amassed equity in previous property.

A new housing loan scheme introduced by the Government Institutions Pensions Fund in Namibia and targeted at civil servants offers an innovative approach to the multiple constraints on accessing housing finance by low-income earners. The scheme will offer pension-backed mortgages to civil servants earning up to N\$20 000 per month, to enable the borrower to buy a house or land, to construct a new house, or to renovate an existing house. Pension-backed lending, where a loan from a third party is secured by the withdrawal benefits of the borrower's pension fund rather than the title of the property, is legally possible in a number of southern-African countries, but up until now has

only been a significant feature of the housing finance market in South Africa. In Namibia, First Capital Real Estate, a non-bank lender, will manage the pension-backed mortgages. The scheme is being hailed as a pioneering step towards alternative housing funding arrangements. Namibia's experience in drawing pension fund and capital market capacity into the affordable housing sector is certainly something other countries will also watch as they develop their own strategies. Within Namibia, it may also lead to other, private-sector pension funds conceding the use of pension assets as security for housing lending, something they have been reticent to support in the past.

With all of these developments, the African Union for Housing Finance has been steadily growing, with now 34 members from 16 countries. This body of housing and housing finance practitioners operating in Africa seeks to develop the institutional capacity of its members to enable them to effectively participate in addressing housing finance challenges on the continent. The annual conference, held each September or October in a member country, is planned this year to take place in Windhoek, Namibia. Non-members are also invited to attend – for more information, visit [www.auhf.co.za](http://www.auhf.co.za)

# Asia Pacific region

↳ By Zaigham M. Rizvi, Secretary General of the Asia Pacific Union for Housing Finance

The Advisory Board of the Asia Pacific Union for Housing Finance (APUHF) at its last meeting held on Jan. 30, 2012 at Delhi elected Mr. R.V. Verma as Chairman of APUHF. He replaces Mr. Abdul Qadeer Fitrat, the ex-Governor of the Central Bank of Afghanistan. The Board also paid tribute to the services of outgoing Chairman Mr. Fitrat, who has played a key role in the establishment of APUHF and in making it an effective forum in such a short span of time.

The Board also admitted three new members onto the Advisory Board namely:

Ms. Enkhbayar Tsedendorj – CEO, Mongolia Mortgage Corporation, Mr. Raharjo Adisusanto – President SMF, Indonesia and Mr. Masahiro Kobayashi – Chief Economist, Japan Housing Finance Agency. The Board extended its greetings to Mr. Yaseen Anwar of the State Bank of Pakistan and Vice-Chairman of the APUHF on his elevation as Governor of Pakistan's Central Bank.

In June 26-29, 2011 the APUHF held its mid-year event, the Workshop on Housing Finance at Ulaanbaatar, Mongolia. The Workshop was the initiative of Ms. Enkhbayar Tsedendorj – CEO, Mongolia Mortgage Corporation. It was the first of its kind event in Mongolia, and was a great success, with wide participation of experts and HFCs from around the world. The Workshop was jointly sponsored by the Mongolia Housing

Corporation, KFW and APUHF. The papers presented at the Workshop are available on the APUHF website ([www.apuhf.info](http://www.apuhf.info)).

In January 29-31, 2012 an International Housing Conference was jointly organized in Delhi. The theme of the Conference was 'Growth with Stability in Affordable Housing Markets'. It was again a well-attended event with participation from many international experts on housing, representatives from multilateral agencies and stakeholders in housing and housing finance. It is hoped that proceedings of the Conference will take the issue of "Affordable Housing for All" into viable and sustainable on-the-ground solutions. The papers presented at the Workshop are available on the APUHF website ([www.apuhf.info](http://www.apuhf.info)).

By way of background on the APUHF, it is mentioned that a need was felt to establish a regional knowledge sharing platform for Pro-Poor Housing as a result of different initiatives by UN-ESCAP, UN-HABITAT, NHB, World Bank Group, and ADB. The proposal was conceived and advocated by Mr. Zaigham Rizvi, the World Bank Consultant on Housing and Mr. R.V. Verma of National Housing Bank, India. The participants of the Regional Policy Dialogue on Pro-poor Housing Finance, held at New Delhi, India on 30-31 January 2008 decided to establish a regional network on pro-poor housing finance. Meetings were held within the framework of the NHB-ESCAP-UN-HABITAT

project, including meetings in Chiang Mai and Bangkok in 2009, which further emphasized the need for such a network. Discussions on the nature and shape of the network were also discussed in such a meeting in New Delhi in 2010. Consequently a regional platform in the name of Asia-Pacific Union for Housing Finance-APUHF was established with its Headquarters at the National Housing Bank, Delhi. The geographic scope of the network includes countries of Central Asia, South Asia, South East Asia, East Asia and the Pacific. The Mission of APUHF is "to develop pro-poor housing finance systems and mechanisms so that affordable housing finance is available to all".

APUHF as a platform acts as a knowledge sharing and networking medium. The forum intends to promote cooperation and coordination among the South Asia Countries in determining their housing and housing finance solutions. APUHF will also track the events and happenings in the housing markets globally. The forum focuses on initiatives taken by the different member countries in their own regional contexts. The users of the platform will include member country institutions engaged in housing and housing finance such as housing finance institutions, construction agencies such as builders, co-operatives, government agencies, etc., policy and regulatory bodies, central banks and international finance Institutions.



# Europe: a shifting regulatory landscape

↳ **By Mark Weinrich, Manager of the Department of International Affairs in the Association of Private German Bausparkassen**

The European Central Bank, the Fed and other central banks around the globe have been keeping interest rates low in order to stimulate the economy. Flooding the markets with easy money seems to have lured the Bulls back. Stock markets have rallied in the last few weeks and there are also some more positive signs though the outlook for the real economy is less bright. There is growing optimism that the euro-area debt crisis will be contained after the European finance ministers agreed on a second massive bailout for Greece on 21 February after months of wrangling.

In return for this €130 billion bailout and a private creditor debt write-off worth about another €100 billion, the Greek government is pledged to implement fully a severe austerity package of pay, pension and jobs cuts, as well as finding further savings. For the moment, Greece appears to have been saved from defaulting on its debt but the outlook is less bright: the Greek economy continues to shrink, the budget deficit is still worrisome and there are many other signs that suggest that Greece will eventually have to default, or that a third bailout will be required.

This raises the question of which way is the right one to solve the crisis: The austerity measures imposed by European governments or the printing of money like the United States is doing? While the austerity measures have a bad impact on economic development, continuing to spend money that one does not have will only magnify the problems in the future.

It is also questionable whether the policy of easy money is able to fulfil its goal: It has apparently increased the appetite for risk amongst private investors, but Europe may still be headed for a double-dip recession. While the economic situation in Europe is of great concern, European housing finance institutions have to struggle as well with other issues: Basel III/ CRD IV, the European Directive on credit agreements relating to residential property and the European Directive on deposit guarantee schemes, to name only a few.

The Basel III rules are intended to strengthen the regulation, supervision and risk management

of the banking sector. The new framework will increase the amount of capital which credit institutions will be required to hold and establishes global liquidity standards. While there is much focus on the increases in capital requirements the new liquidity rules might pose a greater challenge to the housing finance industry. The European housing finance institutions are concerned that some elements of Basel III may threaten long-standing business models, as well as constraining the ability of others to lend for housing.

The transposition of the Basel III rules into binding EU legislation (CRD IV) has entered a decisive phase. The European Commission has made its proposal and the European Parliament as well as the Council are reviewing it and proposing amendments. The discussion indicates that the European lawmakers are striving for the principle of maximum harmonisation in order to keep a level playing field (a "single rule book"), but they signal at least in the light of the political situation a soft approach to some of the elements of the liquidity provisions and the leverage ratio. CRD IV is expected to be adopted in mid-2012, with a view to its implementation on 1 January 2013.

Apart from the reform of the banking supervisory regime, European banks are also struggling with the future impact of the reform of the deposit guarantee schemes. In the wake of the financial crisis the EU-wide protection for depositors has been increased already to €100,000. The Commission has made a proposal that further harmonises numerous aspects of deposit insurance. At the core of the reform is the aim of harmonising the level of contribution and the target fund level. According to the current debate between the European Parliament and the representatives of the 27 governments from the EU Member States in the Council, deposit taking institutions will be required to pay within the next 15 years between 0.5 – 1.5 % of the covered deposits to the relevant national deposit guarantee schemes. Furthermore, there is discussion that credit institutions with a higher risk profile may have to contribute more than banks with average risk and that the payout period could be shortened. However, the more ambitious approach of the European parliament is being

met with resistance in the Council. The final outcome of the reform is therefore still unclear.

Credit institutions in many jurisdictions around the world are also facing a huge challenge due to the efforts of regulators and legislators to impose restrictions and safety nets within the consumer protection area for mortgage loans. In Britain the size of the currently debated FSA Mortgage Market Review from the end of last year with around 600 pages illustrates the amount of regulatory challenges for British mortgage lenders. In addition, all lenders in the European Union will have to cope with the directive on credit agreements relating to residential property which was proposed by the European Commission. According to the European Commission the intention of this directive is to establish a common market for mortgage credit with a high level of consumer protection in the European Union. Apart from common standards in the areas of advertisement and pre-contractual information, the EU lawmakers propose standards on the calculation of the annual percentage rate of charge as well as standards concerning a right of early repayment and early repayment fees. It is also intended to regulate credit intermediaries. During the discussion new ideas were forwarded of which the most surprising is the creation of a mortgage register in which every mortgage credit and security contract would have to be registered together with an alpha-numeric code. Especially worrying for mortgage lenders is the proposal to offer total contractual flexibility to the borrower which would mean that the consumer could switch the lender, the security, the currency of the loan or even transfer his debt to another consumer. It is apparent that the proposals do not only increase the risk of litigation but that they might even undermine well-established, sustainable business models and damage national housing finance cultures. The final outcome of this reform is still unclear.

Mortgage lenders in Europe have to cope with substantial economic and regulatory challenges. The hope of the banking industry is that the regulation takes a softer and realistic approach so that it can concentrate on reversing the trend of subdued mortgage lending that troubles many countries in Europe.

# Housing finance in the Latin America

## LAC-5: Brazil, Chile, Colombia, Mexico and Peru

↳ By Ronald Sánchez Castro, Technical Adviser, Inter-American Housing Union

### Economic situation

The World Bank estimates that the global economy will grow by 2.5% in 2012 and 3.1% in 2013 (less than the 3.6% estimated in June 2011). This slower growth will be largely due to the escalation of risks affecting the economy of Europe. In Latin America and the Caribbean (LAC) the economy is expected to grow 3.6% in 2012 but will recover in 2013 to the levels of 2011, reaching 4.2%. For the LAC-5 group the average estimated growth would be 4% in 2012 and 5% in 2013.

LAC-5 has less fiscal discretion to implement countercyclical policies than in 2008 and inflationary pressures since 2009 have forced the governments to implement various adjustment policies. The remarkably large accumulation of international reserves in LAC-5, which by 2010 represented 21% of GDP, should enable them to cope with possible external shocks.

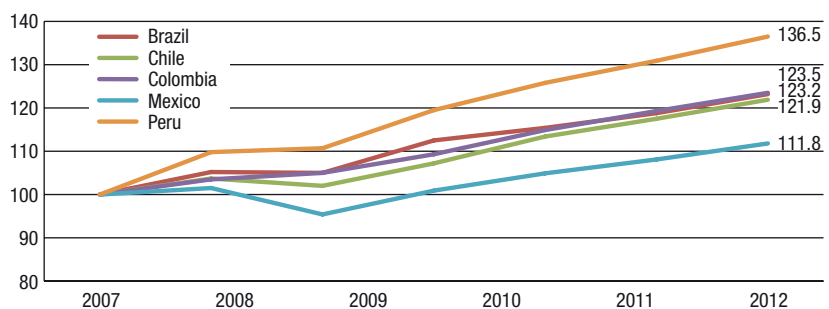
Despite the apparent slowdown, for the LAC-5 between 2007-2013, average cumulative growth is predicted to be more than 15%, Peru will grow more than 28%, while Brazil, Chile and Colombia more than 10%. Also their per capita GDP would have increased on average to about 24%.

The risks for Latin American are the increased risk aversion, restrictions on external financing and lower exports mainly raw materials to developed countries. However, LAC-5 shows strong macroeconomic fundamentals. In addition to international reserves, there are low levels of public indebtedness, better management of monetary policy and exchange rate, decreasing dollarization, better financial supervision, trust from consumers and entrepreneurs. Among other things, these should help mitigate potential risks from slower growth in developed economies.

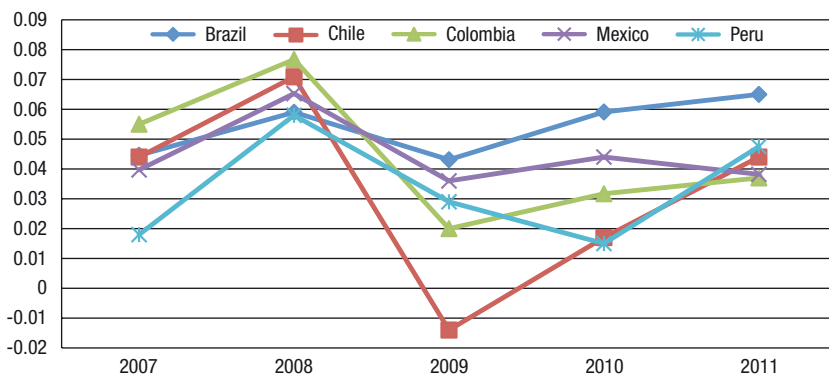
### Housing shortage

LAC-5 have a qualitative and quantitative high housing deficit, and taking published data from

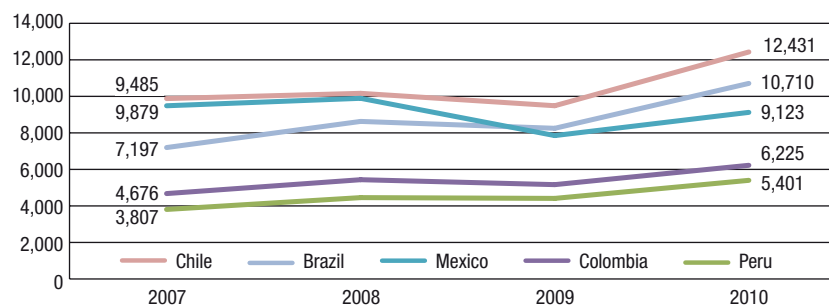
Growth of GDP 2007-2013, 2007 = 100



Inflation 2007-2011



GDP per capita at current prices(In U.S. \$)



Source: Own elaboration based on World Bank data

national censuses, it is estimated that household formation increases on average of 2.74% annually for LAC-5. This reflects high demand for housing.

The qualitative housing deficit is made up of houses that need to be improved as they have deficiencies in the quality of them (whether in materials, overcrowding, the basic services, etc.). On the other hand the quantitative deficit is the number of adequate homes that need to be built. For LAC-5, the qualitative deficit is 66% and the quantitative deficit 34%. The great challenge for LAC-5 is to reduce the housing deficit gap by implementing various housing public programs, seeking private sector participation, and attending to several socioeconomic issues; especially in low-income sectors.

## Public policy

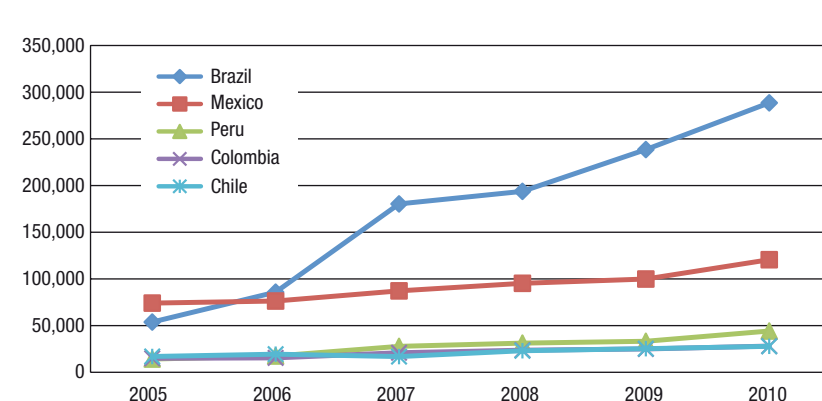
In the LAC-5, public policies to address the housing deficit aim to facilitate access to housing for low-income sectors through subsidies, and to promote financing of housing, mainly with the ABC scheme<sup>1</sup>, that is, financing the home purchase by savings, subsidy and credit.

In Brazil, the MCMV program has contracted construction of 1 million homes between 2009-2010, and expected a further 2 million homes between 2011-2014. It highlights the financing with resources of FGTS<sup>2</sup> through *Caixa Economica Federal*, the main funder of social housing, with a 70% share of the Brazilian market.

In Chile, housing subsidy is varied and well targeted. There are other subsidies to reward a good location, the rural subsidy, leased housing, and a new program *My Neighborhood*, which seeks to improve the quality of life through regeneration of neighborhoods with problems of urban and social integration.

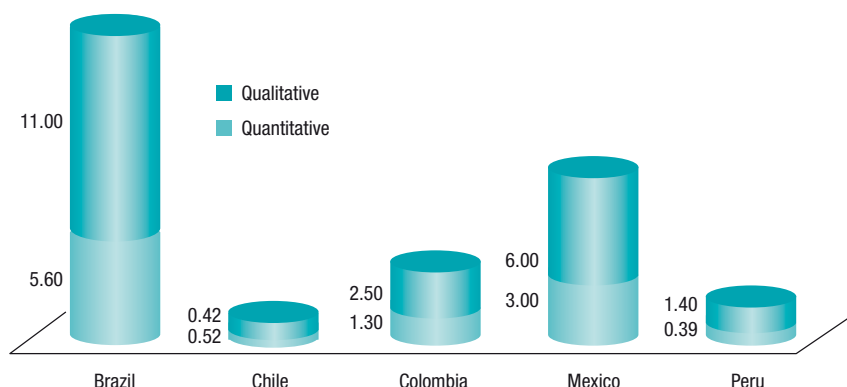
In Colombia, the Family Housing Subsidy is given mainly through *Cajas de Compensación Familiar*. The National Savings Fund promotes family savings, improves access to credit and allows

International reserves (includes gold, U.S. dollars at current prices) U.S. \$ Mill



Source: Own elaboration based on World Bank data

Housing deficit, millions of units



Source: Inter-American Conferences, Seminars, Forums and courses of UNIAPRAVI, and own estimates

Country	Government Programs
<b>Brazil</b>	Program "My House My Life" (MCMV*): funds to lease, guarantees for refinancing and insurance, rural housing and financings with resources of Guarantee Fund for Services Time (FGTS*), etc.
<b>Chile</b>	Housing subsidy: Housing Solidarity Fund (FSV*), DS40 and Heritage Program Family (PPPF)
<b>Colombia</b>	Family housing subsidy (SFV*) Interest rate subsidy Voluntary Savings Incentive Contract - National Savings Fund (FNA*) Impulse Macroprojects
<b>Mexico</b>	Subsidy: National Trust Fund for Popular Housing (FONHAPO*) and the National Housing Commission (CONAVI*). Credit of Institute of National Housing Fund for Workers (INFONAVIT*) and the Housing Fund of Institute of Security and Social Services for State Workers (FOVISSSTE*) Integrated Sustainable Urban Developments (DUIS*)
<b>Peru</b>	"Own Roof" Program Material Bank (Banmat) "My Land" Program Integral Program of Improvement to Neighborhood and Towns (PIMBP) Credit MIVIVIENDA

\* By its Spanish acronym

<sup>1</sup> ABC Scheme, by its Spanish acronym: ABC= Ahorro + Bono + Crédito

<sup>2</sup> Guarantee Fund for Services Time (FGTS By its Spanish acronym), is a fund composed of contributions by employers to protect workers in case of unemployment (8% contribution of each worker's salary). FGTS is operated by Caixa Economica Federal.

subsidy allocation simultaneously. Subsidy on the interest rate implemented in April 2009, increased home sales by 40%. Also the government is pushing to build 1 million houses between 2010 and 2014, and promotes the Macroproyectos that are large-scale urban developments.

In Mexico, the government subsidizes through FONHAPO and CONAVI. The participation of INFONAVIT and FOVISSSTE is very important on financial housing, who have more than a 65% market share. The DUIS, driven by the Federal Mortgage Society (SHF) seeks to co-ordinate public and private players, in order to promote new sustainable urban development areas, and have the potential to supply more than 1 million homes.

In Peru, the government promotes the Own Roof program for low-income sectors, the My Land program to facilitate the supply of urban land for social housing, and PIMBP, which seeks to improve the quality of life for residents. The Credit Mivivienda promoted by the Mivivienda Fund, is the main program to boost finance housing with the active participation of private banks, resulting in reduced borrowing costs and increased access to housing.

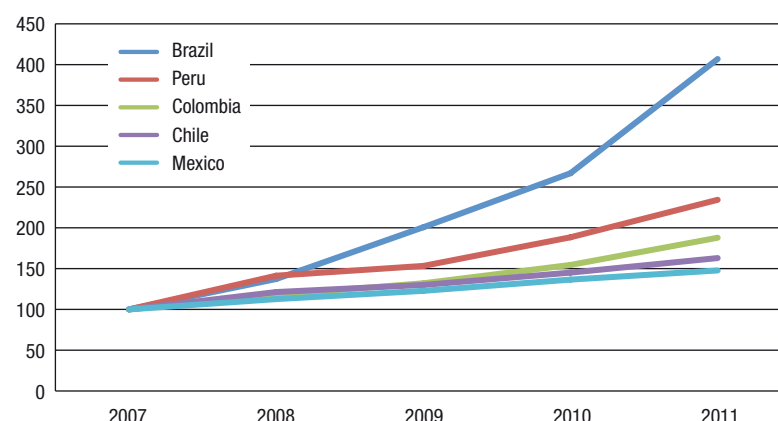
### Housing finance

The outstanding balance of housing loans increased fourfold in Brazil between 2007 and 2011, driven by the MCMV program and funding resources of the Brazilian System of Savings and Loan (SBPE). In Peru balances increased about 250% of which about 70% is explained by increased lending from private banks and 30% from the Mivivienda Fund. In Colombia, Chile and Mexico housing loan balances grew between 150% and 200%. According to own calculations based on published data from the Superintendent of Financial Institutions and Central Banks.

Despite the growth of housing finance in the LAC-5, its share of GDP is very low (in developed countries is about 80%). According to own estimates based on published data from the Superintendent of Financial Institutions and Central Banks, in Chile it is close 20% and in Mexico 10%. In Brazil, Peru and Colombia it is close to 5%.

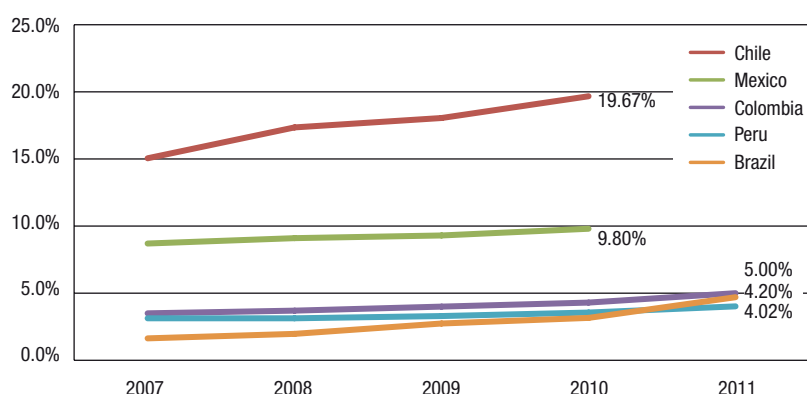
Interest rates on housing loans have been falling on last decade to average 10% for LAC-5. Also, the default levels of housing loans in LAC-5 have remained below 5% over the past 5 years. This context shows that LAC-5 is expanding housing loans maintaining the quality of portfolio.

**Balance financial housing LAC-5, 2007 = 100**



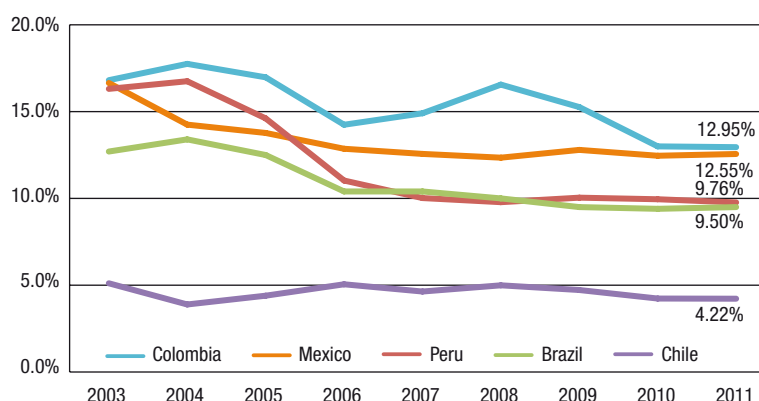
Source: Superintendent of Financial Institutions, Central Banks, Own estimates

**Mortgage portfolio / GDP, LAC-5**



Source: Superintendent of Financial Institutions, Central Banks, Own estimates

**Credit interest rate for housing in local currency, annual average 2007-2011**



Source: Superintendent of Financial Institutions, Central Banks, Own estimates

The ability to finance housing has increased in recent years, Brazil has financed more than 1 million homes annually, Mexico over 600,000 (although, in previous years it reached about 750,000), Chile has financed more than 140,000 houses a year, Colombia 115,000 houses and Peru around 50,000. However, annual household formation is also high and in some countries exceeds the number of loans.

Mortgage backed securities have contributed to financing long-term housing. By 2010, the LAC-5 issued more than US\$ 27 billion, although volumes are still low. There are initiatives in Peru and Brazil to strengthen instruments such as covered bonds, to extend funding for housing and to reduce interest rates.

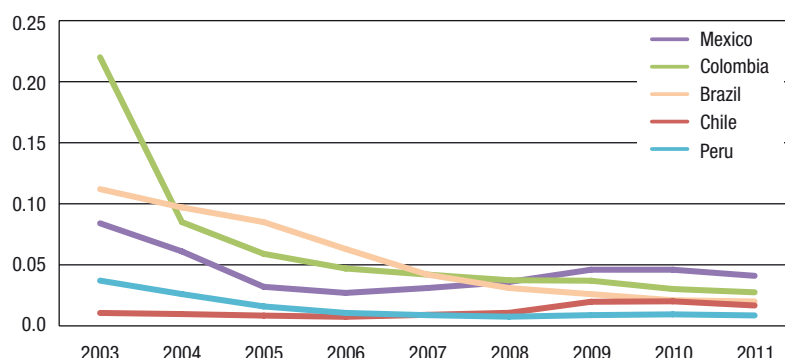
## Conclusion

The LAC-5, from their past experiences, has strengthened its system of housing finance, where today the private sector predominates in the finance of housing and construction, while the States assumes the role of promoter of the sector.

There is great potential for expansion of housing finance. There is large unmet demand, the economic outlook is favorable, and there are public policies aimed at reducing the housing deficit gap, in this sense the region is becoming attractive for investments in the housing sector.

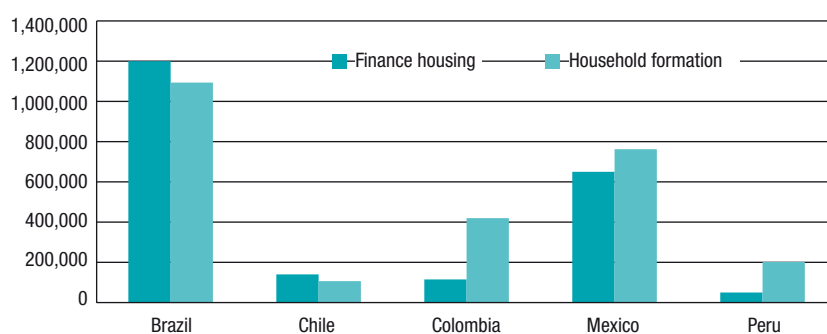
Given the good overall picture of housing finance in the LAC-5, funding through the capital market is a great opportunity to expand credit and reduce borrowing costs. In this context and considering the global economic context, the domestic market could boost the development of the secondary market, with active the participation of investment funds and insurance.

### Mortgage credit quality, 2003-2011



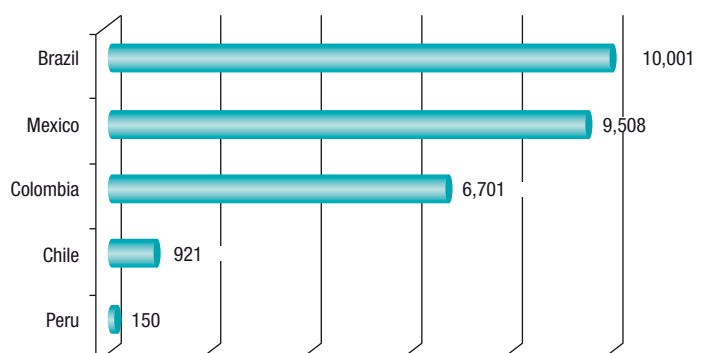
Source: Superintendent of Financial Institutions, Central Banks, Own estimates

### Funded housing and household formation, annual average



Source: Inter-American Conferences, Seminars, Forums and courses of UNIAPRAVI, and own estimates

### Mortgage backed securities accumulated 2010 in mill U.S. \$



Source: Superintendent of Financial Institutions, Central Banks, Titularizadora Colombiana, and own estimates



# Pro-poor affordable housing: the issues we know, the answers we need

↪ By Zaigham M. Rizvi

## 1. Pro-poor housing and housing finance, a primary

Housing is a basic need and fundamental right of every human being. Housing provides space and shelter for households to live in privacy, security and dignity. It also provides a point of reference from which one can get other services and utilities from city fathers/administrators. Access to housing is a key social determinant to ensure social status and well-being of households. Provision of adequate housing to the citizens of a country is an essential component of Millennium development goals.

Housing is also a key driving force behind a country's economy. In the western world about 270 industries are linked to housing, and in the Asia-Pacific region it is believed to be more than 40 industries that have direct linkage with the housing and construction sectors. It is a labour intensive industry providing ample employment to both skilled and unskilled workers. A slow-down in housing markets can translate into a slowdown in capital markets as well as labour markets, leading to an overall slowdown of the economy. A well functioning and well governed housing market is crucial for economic prosperity of a country. It also has a critical role to play in a country's GDP growth.

To provide housing finance is in fact to give economic empowerment to those who cannot afford it on their own. Thus effective housing finance institutions (HFIs) and access to housing finance are the key drivers of housing supply. They provide the vibrancy and push in the real estate segment of the economy. Housing finance is productive for lenders as well as to real estate developers, and also for the final beneficiaries, the borrowers. How effective the HFIs are in accelerating the growth of the real estate sector and the economy is measured by the Mortgage Debt to GDP ratio.

Figure 1 shows the size of the housing finance industry (in terms of outstanding mortgages as a share of GDP) in some selected world economies.

For the purpose of review and analysis, the paper will focus on Social Housing. Social Housing is that market segment where both demand and the shortage and backlog are substantial, and where market forces do not meet this unsatisfied demand as this market is not commercially attractive for the developers. State intervention, by way of promoting land supply, fiscal giving incentives and subsidies may be needed to promote supply. The Pro-Poor housing is at the bottom of this pyramid and has the major share of the housing shortage, and is where affordability remains the critical issue.

## 2. South Asia and Pacific regional scenario

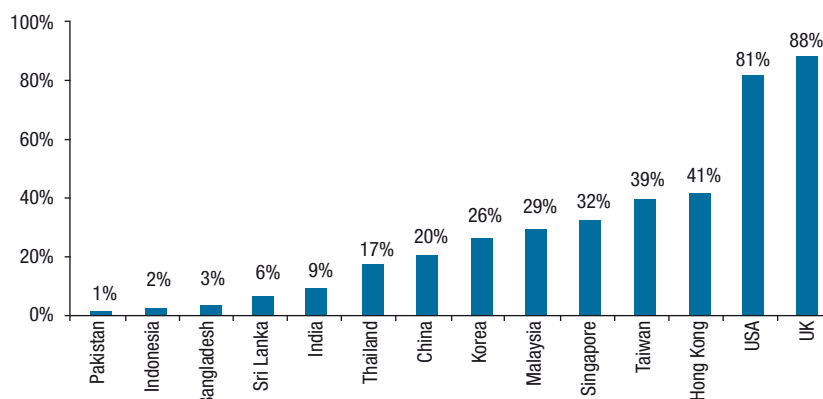
South Asia is the area where one out of four person of the planet lives. If we are to include China in this equation, then every second person on this planet is from this region! Unfortunately, most of the urban housing shortage in the region is amongst economically weaker sections of society. Pro-Poor low-cost housing supply and finance is the main issue for people in the Asia-Pacific region. Urban India alone is facing a housing shortage of about 27 million units, nearly all of which are in the economi-

cally weaker sections of the society. (Source: Presentation made by NHB at Affordable Housing Conference Delhi Jan 29-31, 2012). This remains the main challenge in nearly all major metropolitan cities of the region: from Kabul to Karachi, Mumbai, Dhaka, Manila and Jakarta. On Pro-Poor Housing, the fact remains that the "Issues we already know, Answers we need." The time has come for Pro-Poor Housing to be put under the spotlight and to find viable and sustainable solutions.

Yet, for the foreseeable future, low income/low cost housing will remain an unaffordable basic need of the downtrodden and poorer segments, until government sponsored comprehensive programmes are launched for pro-poor housing. The issue has assumed alarming dimensions; and solutions have to move forward from political slogan sing to the planners' "drawing boards", for "on-the-ground" execution. These pro-poor programmes should also address the issue of availability of finance in wider horizon with easy access at affordable cost.

The housing shortage in the Asia-Pacific region is generally analyzed from the aspect of urban housing, since the people living in the rural areas, not facing any land scarcity, manage to

Figure 1



Source: Paper presented by NHB at Affordable Housing Conference in Delhi, Jan 29-31, 2012



find affordable housing solutions. In rural areas, the main challenge is to get access to finance through a rural housing microfinance system.

The factors contributing to urban housing and housing shortage are:

- Urbanization rates (driven by economic factors)
- Population growth rate
- Depletion of existing stock (very conservatively taken at 1 per cent of the existing stock), and
- The changing number of people per household (a cultural phenomenon)

Over the last five decades, Asia has seen enormous urbanisation and demographic changes. One of the most dramatic changes of all has been the migration of people from villages to cities. The percentage of people living in Asian cities and towns, as compared to total country populations, is increasing rapidly. In 1950, about 232 million people lived in urban areas, which represented about 17% of Asia's total population. In 2005, Asia's urban population had risen to 1.6 billion people, or about 40% of the region's total population. (Regional Project on Pro-Poor Housing in Asia-Pacific, a Compendium of Seven Select Countries, UNHABITAT 2010). There is no doubt that as the Asian region continues to develop, the level of urbanisation will increase. The United Nations estimates that urbanisation in Asia between 2005 and 2010 will increase at the rate of about 2.5% each year. At this rate, about half of Asia's total population will live in urban areas by the year 2025 i.e., every second Asian will be an urban person. By the year 2030, it is expected that 54.5% of Asia's population will be urbanised. This means that by 2030, one out of every two urban residents in the world will be in Asia. (Expanding Housing Finance to the Underserved in South Asia by Tatiana Nenova, the World Bank Publication, 2010)

## 3. Housing conditions in urban Asia

Currently, one out of every three people living in cities of the developing world lives in a slum. UN-HABITAT estimates reveal that in 2005, more than half of the world's slum population resided in Asia, followed by sub-Saharan Africa, Latin America and the Caribbean. In Asia, slum prevalence varies from a high of 43% in Southern Asia to a low of 24% in Western Asia, while in Latin America and the Caribbean, 27% of the urban population was classified as living in slum conditions in 2005. (Regional Project on Pro-Poor Housing Finance in Asia-Pacific: A Compendium of Select Countries. UNESCAP Study April 2010).

The innovations in pro-poor housing finance in these countries include the Housing Microfinance Programme of the National Housing Bank in India, Ger Area Project sponsored by Japan Fund for Poverty Reduction (JFPR), The Women's Bank programme in Sri Lanka, the Baan Mankong program in Thailand, the Subsidized Home Mortgage programme in Indonesia, and the micro-housing finance programme of Tameer Bank and the Kashaf Foundation in Pakistan.

## 4. Regional platform: Asia-Pacific Union for Housing Finance

The participants in the Regional Policy Dialogue on Pro-poor Housing Finance, held at New Delhi, India on 30-31 January 2008 decided to establish a regional network on pro-poor housing finance. Meetings held within the framework of the NHB-ESCAP-UN-HABITAT project, including the meetings in Chiang Mai and Bangkok in 2009 further emphasized the need for such a network. Discussions on the nature and shape of the network were also discussed immediately following the SAHF meeting in New Delhi in 2010 (The Asia-Pacific Union for Housing Finance APUHF was originally named as South Asia Housing Forum). Consequently a regional platform in the name of Asia-Pacific Union for Housing Finance- APUHF ([www.apuhf.info](http://www.apuhf.info)) was established with its Head Quarter at the National Housing Bank, Delhi. The geographic scope of the network includes the countries of Central Asia, South Asia, South East Asia, East Asia and the Pacific. The Mission of APUHF is "to develop pro-poor housing finance systems and mechanisms, so that affordable housing finance is available to all".

## 5. Pro-poor housing: issues and possible answers

### 5.1 Components of affordable pro-poor housing supply and finance are:

- Affordable Finance with Expanded Outreach
- Affordable Serviced Land
- Affordable Construction Cost (Role of Construction Technology and Construction Materials)
- Regulatory and fiscal support to create an enabling environment for viable and sustainable market based solution for manufacturing scale supply of low-cost housing
- Less dependence on direct funding support from the Government and opting for cross subsidy and smart subsidy models

- Affordable Finance with expanded outreach
- Affordable serviced land (through land banking and/or private-public partnership models)
- Affordable construction costs (Role of construction technology and construction materials)
- Regulatory and fiscal support to create an enabling environment
- Government to provide external infrastructure support.
- Creation of specific regulatory regime for low-cost/low-income housing

### 5.2 Creation of an enabling environment:

- Mortgage guarantee fund and mortgage subsidy fund at state level
- Strengthening loan recovery and foreclosure laws
- Facilitate bankable titles
- Creation of long-term liquidity facility institutions
- Ensure access to finance (conventional and faith-based finance)
- Set up specialized housing finance institutions for low-income and micro housing finance.
- Develop mortgage guidelines in terms of income assessment, titles scrutiny, affordability, product design and selection, loan recovery, foreclosure etc.

### 5.3 Awareness of issues and sharing of answers:

- Need for continuous dialogue and dissemination of experience and technology between local, regional and global institutions involved in low-cost housing construction and finance (platforms like Asia-Pacific Union for Housing Finance, International Union for Housing Finance, Affordable Housing Institute etc.)
- Set up local study centers for research on housing related issues (e.g., Monitor India)

### 5.4 Risk mitigation:

- Mortgage insurance and title insurance institutions
- Mortgage guarantee funds
- Alternative forms of collateral
- Mortgage counseling and consumer education
- Share experiences on risk mitigation models
- Credit bureaus (generally having nil credit histories)

**The issues we know – the answers we need.**

# An overview of the housing sector in developing countries with a focus on India's reforms

↳ By Francis Eddu

Due to an unprecedented demographic shift towards urbanisation, more humans reside in urban areas as the agricultural sector no longer dominates as the source of sustenance in human history for various reasons. The current trend of urbanisation has given rise to the term 'urban age' (British Broadcasting Corporation [BBC], 2011). The developing countries by the year 2030 will house 80% of urban humanity of an estimated urban population of five billion of the total global population of 8.1 billion (United Nations Population Fund [UNFPA], 2007).

Sixty-one percent of the world's population will live in Asia in 2025, and India will reach the population of China (which will see a decline in population). South Asia, because of the high fertility rate, will see a high population growth, whereas South-East Asia will experience moderate and East Asia low growth in the year 2025. The European Union will have less than 6.5% of the world population during that year. The developing countries cities will account for 95% of urban growth in the coming decades, and the number of slum dwellers will double between now and 2025 to more than 1.5 billion (UN, 2007).

The effective management of the cities in this region is imperative for economic growth and social development. Some cities are being managed well to tackle the rapid urbanisation, whereas many cities are also failing with negative consequences (United Nations Human Settlements Program [UN-HABITAT], 2003).

Urbanisation and industrialisation complement the efforts of a low-income country to rise to the middle-income category and vibrant cities are necessary for high income. As such, urbanisation is the process of transformation to industrial society and then to post-industrial from agrarian (World Bank, 2009). Quite often, rural areas tend to receive attention from devel-

opment practitioners and donors rather than the urban poor. Because the life expectancy of the urban poor is the lowest and emerging urban issues new and challenging, there is a need to examine the opportunities and constraints in relation to improving their lives. The complexities and the growth of cities were visible in the developed world a few centuries ago, although it may seem unprecedented in the present day developing countries. The developed countries experienced significant challenges and their performance was not that satisfactory during the rapid urbanisation period in their societies.

The ratio of the number of urban dwellers in 1975 was almost equal between the developed and developing countries. By 2005, however, the ratio stood 1 to 3. The developed countries grew by 30% in the thirty years whereas the developing countries saw 400% growth. By 2050, this ratio is projected to be 1 to 5, particularly in Asia where 11 out of the top 20 megacities (more than 10 million inhabitants) of the world will be located (European Commission, 2009).

According to an International Energy Agency and OECD study a sum of 200 trillion of dollars is needed from now till 2030 for infrastructures and housing out of which 25 trillion would be for energy, 45 trillion for waste, water, telecommunications and water, and around 120-130 trillion for construction, housing and development of commercial and industrial buildings. For the Europeans, it could be a great opportunity to contribute to sustainable development by working through their partners (European Commission, 2009).

## 2. Slum Formation

During the early Industrial Revolution in Britain, the living conditions of newly urbanising areas

were abysmal, often muddy or poorly drained and without sanitation. The term 'slum' could have originated either in English or German. Urban slums contain poor housing and human living conditions, inadequate sanitation and crime, but not all slum dwellers live in deprivation. A UN expert group for operational purpose defined a slum as having five shelter-related characteristics: insufficient access to safe water, presence of unsanitary conditions, poor quality housing, over-crowding, and insecure tenure (UN-HABITAT, 2003).

There is an overwhelming consensus on developing countries' failure to tackle rapid urban growth. There are no common solutions for a city or a country. There are well-known reasons for the absence of basic services and infrastructure in cities because of officials and service providers' reluctance to work in the slums due to illegality and informality of such settlements (UN-HABITAT, 2003).

Today's urban poor are generally yesterday's rural poor. Since the 1950s, the number of people working in the agriculture sector has declined by 30% in developing countries. The rural poor moved to cities to escape social and economic hardships, droughts and crop failures, civil conflicts, among others. The poor find cities as places of opportunity and prosperity to improve their lives and become less poor as cities provide choices and opportunities if they function properly (BBC, 2011). The transition from rural life to cities does not necessarily lead to middle class prosperity; many also fall by the wayside, experiencing harsh and miserable human conditions similar to the Industrial Revolution period from 1780 to 1840 in Britain (Agence France-Press, 2011).

There are around one billion slum dwellers today, with the highest percentages in Asia, Africa and

Latin America and their number is predicted to double by 2030. The increase in rural to urban migration is prominent in Latin America, as well as in Asia and Africa. In Latin America 75% of the population live in urban areas, and nearly 30% live in slum conditions in this region (Wright, 2002). In Asia 40% live in cities, and 60% of the world's slum dwellers live in Asia (UNFPA, 1996). Within less than 20 years, around 1.1 billion people from rural areas will migrate into Asia's cities – about 137,000 each day (Asian Development Bank, 2008). In African cities, the concentration of slum dwellers is the highest, around 72% (African Recovery, 2003). The deterioration of basic infrastructure such as roads, electricity, piped water, sewerage, etc., has forced people in large African cities to relocate to cheaper, unplanned settlements on the urban periphery.

While cities grow, they also become very diverse in many spheres, quite visible are affluent and poorer neighbourhoods. The poor neighbourhoods that are a majority in developing countries lack basic services. As a result, the poor residents are exposed to chronic environmental health challenges due to insufficient access to drinking water and sewage facilities, and inadequate solid waste disposal (Cohen, 2006).

The absence of secure tenure is one the important factors in the formation of slums. Slum people without secure tenure are constrained in improving their neighbourhoods. Secure tenure is the prerequisite for access to social and economic opportunities. Studies have indicated that slums with secure tenure to housing and land, either formal or non-formal, undertook community initiatives to improve their surroundings (UN-HABITAT, 2007).

The formation of slums in certain major cities of the developed countries in the past was due to economic cycles. The existence of slums is attributed to economic cycles, national income distribution trends, and a country's economic policies. Since 1970, neoliberal capitalism is also seen as one of the causes for the creation of slums. The negative impact of globalisation and structural policies has pushed the poor into periphery (Engelhardt, 2006).

From the early 1990s the issues of urban housing have been getting a quite a lot of attention from international agencies, and there has been a shift in the practice and understanding of housing by governments, from provider to enabler to regulator. For instance, two world conferences in Vancouver in 1976, and Istanbul in 1996 deliberated and developed various policies and initiatives to adequately mitigate housing problems in the world (Golay, & Ozden, n.d.)

## 3. United Nations role in housing

The UN in the year 1988 designed the Global Shelter Strategy (GSS) to the Year 2000. The rationale behind it was that there was an urgent need to address the lack of shelter available for more than 1 billion people in the developing countries. Because of the rapid urbanisation, the developing countries were faced by strains and challenges, including homelessness and extremely poor shelter in urban slums and poor rural villages. About one-third of people in these regions were found to be homeless, with 30 to 50% of the population in squatter and slum settlements. There was insignificant progress even after of the efforts of government and the international community following the Vancouver 1976 UN Habitat Conference on Human Settlements. These and other factors were behind the design of the GSS to the Year 2000 (United Nations, 1990). The core aim of the GSS was to provide adequate shelter for all by the year 2000. The term 'adequate shelter' was an extension of the Year of the Shelter for the Homeless 1987. The components of adequate shelter were: privacy, space, security, lighting and ventilation, basic infrastructure and geography for connectivity at an affordable cost. However, the conditions differed from country to country. Since these deliberations took place in the decade ending 1980, it envisaged the year 2000 as a target which were to be carried out by individual countries to suit their parameters and goals. The GSS had two underlying goals: it incorporated an 'enabling' approach to facilitate policies and actions in shelter-related process and production. Second, it focused on low income groups, including a range of demand sectors (UN-HABITAT, 1990). The GSS was a landmark strategy that provided guidelines in housing policy and practice, promoted national housing strategies and improved the housing conditions in more than 100 nations. It also brought to the fore the slum and poverty on the international agenda (UN-HABITAT, 2011).

In the year 2012, the UN-HABITAT launched the Global Housing Strategy (GHS) to the Year 2025 in the draft form in Nairobi, Kenya, which has been built on the GSS to the Year 2000. There have been marked political, social, economic and environmental changes in the world since the GSS was designed in the year 1988. The GHS is more in tune with challenges and opportunities for the 21<sup>st</sup> century.

## 4. India Reforms and Initiatives

For the Government of India (GOI), there have been continuous changes in the policies towards

the urban poor -- from 1970s to 1980s there was a strategy of 'slum free cities' which included either voluntary or forced resettlement of slums from core areas. Since the slum dwellers are vital parts of the economy of cities, the resettlement strategy had weaknesses with regard to geography and transportation. The later strategies were on upgrading and rehabilitating of slums through the National Slum Development Programme (NSDP) and providing shelter to urban slum dwellers through Valmiki Ambedkar Awas Yojana (VAMBAY), which is a federal-states partnership programme that focuses on housing for the slum dwellers. Since its formation in the year 2001, the VAMBAY disbursed large funds to assist construction and upgrading of housing units for slum dwellers (Business Correspondent, 2005).

There were constitutional amendments and a paradigm shift on urban poverty in India. Since the early 1990s, the accent of GOI was on decentralisation of urban governance. The 74th Constitution (seventy-fourth) Amendment Act, 1992, envisioned 'institutions of self governance' to tackle urban poverty through:

- Empowered urban local bodies (ULBs) that have an important role in reduction of urban poverty, slum degradation and improvement, and urban planning,
- A fiscal system with adequate funds for poverty reduction, and;
- Urban reforms (Weist, 2005).

According to a United Nations Economic and Social Commission for Asia and the Pacific (2008) study, if land and land management authority and decision-making lies with national governments, the local governments will be disabled or have a limited role in dealing with land-related problems in their cities. In addition, expensive regulatory and rigid laws on available land do not recognise the needs of the poor, who need affordable and flexible support. The Jawaharlal Nehru National Urban Renewal Mission (JNNURM) established in the year 2005 by GOI is the premier agency for urban reforms and to address urban issues. The JNNURM aims to remove statutory provisions and procedures that are a barrier to the land and housing market functioning, considered one of the important reasons for the slums growth in Indian cities. It promotes conferment of property rights and the establishment of governance structures that will make civil society accessible to the urban poor. The disbursement of JNNURM funds are contingent on the reforms undertaken by the states. One of the rationales behind the establishment of JNNURM is to achieve the Millennium Development Goals (Ministry of Urban Development, (n.d)).



Rajiv Awas Yojana (RAY) is named after former prime minister and was set up in the year 2009 with an aim of uplifting slum dwellers and the urban poor. It was built upon the JNNURM experiences. Some of the programme objectives of RAY are to make Indian cities slum free within five years with an emphasis on providing property rights to slum dwellers. In addition RAY will make available basic amenities such as sanitation, water, roads, physical and social infrastructure facilities in slums and economical weaker locations with inclusive approaches, including subsidised credit.

In the summer of the year 2011, the GOI approved phase-1 of RAY. The federal government will provide 50% financial assistance to states that confer property rights for slum dwellers, encourage low-cost housing and undertake reforms through policies to tackle the land and housing shortages. The scheme target is 32 million people in 250 cities with a population over one hundred thousand for the 12th Plan period (2012 - 2017). To strengthen affordable housing, the erstwhile programmes of Affordable Housing in Partnership and the Interest Subsidy Scheme for Housing the Urban Poor have been included in RAY. For private sector involvement in slum development, the states and cities can utilise the federal assistance to secure the viability of gap funding (Frontier India, 2011).

One of the key components of the scheme is the provision of credit enablement of the urban poor and the availability of institutional finance for affordable housing. The federal government also decided to form a mortgage risk guarantee fund to encourage lending to the urban poor for housing purposes with a corpus fund (Frontier India, 2011).

Some of the other policies that are under review are affordable housing and availability of basic infrastructure in urban areas, including slums. These would need the involvement of civil society, government and private sector to undertake planning, community development, re-design slums for cheaper provision of infrastructure material and construct group housing colonies.

Because of the magnitude of the need for affordable housing and the capacity barriers encountered by public agencies such as housing boards, municipalities and urban development departments when initiating large scale group housing projects, it is incumbent on them to engage private sector players in the development of affordable housing on an ownership, rental or rental-cum-ownership basis and to scale up. If the private sector is unable to participate, it becomes necessary to mobilise resources by

public agencies to defray the cost of affordable housing, civic infrastructure and services for the urban poor (Ministry of Housing & Urban Poverty Alleviation, n.d.)

RAY does take into consideration financing aspects. In general, banks and other financial institutions are hesitant to lend to low and poor segments for affordable housing because of perceived credit risks as these categories lack credit history and there are foreclosure difficulties with loans. Credit enhancement via appropriate fiscal, legal and institutional mechanisms, such as intermediation of public and private housing departments is required to enable an adequate capital flow for this scheme (Ministry of Housing & Urban Poverty Alleviation, n.d.).

## 5. Conclusion

Rapid changes are occurring in the cities of developing countries. Urbanisation is being associated with urban poverty in these countries with large masses of people living in squalid conditions. It is apparent that most developing countries share common urbanisation and shelter issues, although there is no single universal approach or solution for decent housing. Inadequate social services and planning in providing basic services are resulting in the growth of slums and in urban inequality. It is necessary to complement rapid urban growth with basic urban infrastructure.

Influenced by the UN and the Millennium Development Goals (MDGs) efforts are being made to reform the institutions, regulations and policies to create housing opportunities in various countries and find alternate solutions to slum formation. India's experiences and the UN global housing policies' framework should provide insights and knowledge on the state of housing.

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# The demand for housing in Port-au-Prince, Haiti<sup>1</sup>

↪ By Yvonne Cao, Raymond Struyk, and Aaron Wilson

## 1. Introduction

The Haitian housing stock suffered grave damage as a result of the January 2010 earthquake. Over a million people were made homeless; approximately 105,000 houses were completely destroyed and over 208,000 were damaged. This destruction dramatically worsened already extremely poor living conditions of many Haitians (International Housing Coalition, 2011).

Recovery and reconstruction have been slow. The design of effective policies by the Government of Haiti assisted by the donor community for helping households to repair damaged units or occupy new ones either as owners or renters has been hindered by the pervasive lack of information on what families can afford to contribute to improving their living conditions. Understanding the situation appeared to be particularly difficult as it was believed that many pre-earthquake households were living in separate properties. Sometimes housing for the whole household to live together was not available; in other cases, the family's strategy was to have a few members protect its claim on a damaged dwelling or to live in a camp in order to have access to infrastructure services in case a better housing solution materializes for those living in a temporary camp.

The last comprehensive survey that covered both income and housing for Port-au-Prince was conducted in 2001. USAID commissioned the study underlying this article to partially fill the information void and create a solid base for policy development. In particular, this article presents

information on household incomes and housing and communal services (housing-associated infrastructure services) from statistically reliable samples of households living in three area types in the Port-au-Prince Metropolitan Area (PaP): temporary camps, lower-income communes and middle-income communes. (Communes are districts within PaP.) The data from each area type can provide a basis for policy design for a particular group.

Before turning to the findings on housing demand, the next section reviews the general economic and housing situation in Haiti before the earthquake to provide essential contextual information. The third section provides an overview of the survey's design. The fourth presents information on household incomes and housing affordability and the final section concludes. Overall the results are quite discouraging. The rents associated with even basic housing—dwellings with sheet metal roofs, sanitation provided by pit latrines, and water sources external to the dwelling or its yard—are unaffordable to half of the population.

## 2. Haiti: The basics

Haiti is classified by the World Bank as a low income country. Per capita 2010 GNI was USD 650, up one-third since 2006. Only one-half of the population of 9.8 million is literate. The poverty rate (headcount) was 77% in 2001, the last year for which necessary data is available (<http://data.worldbank.org/country/haiti>).

Given these economic parameters, housing conditions are expected on average to be poor. This expectation is supported by the information in Table 1. The first two columns provide information for PaP from a large 2001 representative survey of the whole island, and the last four columns contain information from the 2011 USAID Haiti Housing Survey. The total figures for these areas (last column) are not comparable with those of 2001 because the 2011 survey covered only parts of the metro area, which are not statistically representative of PaP as a whole.

The first table column shows that in 2001, 69% of households' primary source of water was a public tap or stationary water vendor, 42% used a shared neighborhood latrine as their toilet facility and only 14% used a flush toilet (WC). On the other hand, 92% had access to electricity and 28% reported owning both the land and the dwelling they occupied. The table's second column presents analysts' estimates of the middle-class families' housing circumstances ten years ago (Nathan Assoc., 2010). There are major differences in water sources (39% of the middle class had a tap in their home or courtyard) and toilet facility (34% of the middle class used a WC while 42% of all households used public latrines).

The final four columns report summer 2011 data for sample temporary camps, a lower-income area (but not a slum) and a middle-income area. Despite the limited comparability, a couple of points stand out. The earthquake's destruction is evident in the lower incidence of households having electrical service in 2011 than in 2001.

<sup>1</sup> This report was prepared under contract with the Financial Sector Knowledge Sharing (FS Share) project, managed by Chemonics International, Inc. for USAID. The Haitian firm, BRIDES, carried out the sample design and conducted the household survey on which the analysis is

based. Views expressed are strictly the authors' and not necessarily those of any of institution named as involved with this project.



The reduction in water services from tap sources presumably reflects water pipe damage. Despite the destruction there is a large increase in the incidence of WCs as the toilet facility in the middle class zone compared with all middle class PaP households in 2001.

In terms of housing finance, the first point is that overall the financial sector in Haiti is underdeveloped with the ratio of private sector credit to GDP being just 12%, one of the lowest ratios in the world. Mortgage lending has been very limited with banks exercising conservative underwriting standards, particularly regarding clear

titles to property securing loans. Continuing the traditional pattern, outstanding mortgage loans amounted to only USD 68 million in March 2011, with lending concentrated among three banks. Banks have expressed interest in granting more mortgages but have a limited pool of borrowers who meet their underwriting standards, and they are impeded by the absence of clean titles and by very high transaction costs (Hedstrom, 2011). Microfinance institutions (MFIs) have undertaken a small volume of housing lending in the past and may expand operations with help from the donor community (Magowan, and Gewinner, 2011).

### 3. Household survey design

The survey's object was to obtain comprehensive information on income, housing, and communal services for a representative sample of households, i.e., the persons now living together, and to obtain income information for other family members who are believed likely to move back into the pre-earthquake household if a larger unit is found<sup>2</sup>. Each household reported on as many as three different housing situations. All reported on their current dwelling; those who had moved in the 18 months preceding the interview reported on their unit before the

**Table 1: Dwelling characteristics in Port-au-Prince metro area, 2001 and 2011a**

Dwelling Attribute		2001 Entire PaP Metro Area <sup>b</sup>			2011 Metro Zones Surveyed in Summer <sup>c</sup>		
		All classes	Middle class only	Camps	Lower-income communes	Middle-income communes	Total
Average rooms per unit		1.8	2.4	1.2	2.9	2.9	2.4
Percentage of units with access to electricity		92.2	96.0	34.1	82.9	82.7	68.7
Primary source of water used at home (percent distribution)	Public tap/vendor (with fixed source)	69.1	50.2	49.0	35.5	34.0	38.6
	Tap in courtyard	13.0	23.5	5.6	10.3	13.3	10.5
	Tap in home	7.8	15.9	4.7	19.5	19.9	15.4
	Well in neighborhood	4.8	3.9	1.6	6.8	5.5	4.6
	Well in courtyard	2.2	1.3	0.7	4.5	4.2	3.3
	Tanker Truck	1.3	2.5	24.0	16.3	14.9	17.8
	Treated/Bottled water	0.9	1.3	7.4	2.6	3.1	4.3
	Rainwater collection	0.4	0.3	0.2	2.7	2.0	1.6
	Spring or river	0.4	0.0	2.5	0.0	0.2	0.8
	Other	0.4	1.2	4.2	1.8	2.8	3.0
Type of toilet facility (percent distribution)	WC	13.9	34.5	7.7	55.6	55.8	41.9
	Covered latrine	23.1	28.9	15.2	34.7	35.0	29.2
	Uncovered latrine/hole in courtyard	19.7	12.9	1.6	3.9	3.8	3.2
	Latrine for neighborhood	42.3	22.9	69.5	1.4	1.5	21.0
	Other arrangement	1.0	0.8	6.0	4.4	3.9	4.6
Type of tenure (percent distribution)	Owner (land and building)	27.9	39.8	1.8	18.7	38.3	24.0
	Owner (building)	13.5	12.6	23.3	7.7	12.1	14.3
	Renter / Leaseholder	52.8	43.2	74.2	47.9	43.8	53.5
	Other	5.7	4.4	0.7	25.7	5.8	8.2

a. Data are not comparable between 2010 and 2011 because 2011 data are only for selected Metro zones.

b. Source: Nathan Associates calculations based on ECVH database.

c. Source: 2011 USAID Haiti Household Survey.

<sup>2</sup> The following statement was made by the interviewer to the respondent at the beginning of the interview: "By 'household' I mean all the persons who live with you currently and who take a meal together at least 4 times a week. It's possible that other people who lived with you before the earthquake do not live with you any longer today. It is also possible that some people who did not live with you before the earthquake do live with you now. I would first like you to focus

on the people who live with you only, then I will ask you questions about other people who could come back to live with you if your residential situation changed. We will thus talk about « current household » (those who live with you now) and « recomposed household » (all of those who will live with you once your residential status changes).

earthquake; and, if they have plans to change dwellings or renovate their current unit in the next year, they gave information on the type of unit they realistically thought they could rent or purchase or have as a result of the renovation.

The sampling plan generated a representative and statistically reliable sample for each of the three area types: temporary camps, a lower-income area, and a middle-income area. The results are reliable for areas included in the three samples but cannot be extrapolated to the whole of the metropolitan area. The total targeted number of interviews was 3,401, of which 3,365 were completed. (Full information on the survey design is in Struyk, Cao, and Wilson, 2011).

The questionnaire's focus was on acquiring information on respondent households' income and their housing and communal circumstances<sup>3</sup>. The decision to focus on income here was based on the belief that the respondent was more likely to know more accurately about the current incomes of household members who were part of the larger household at the time of the earthquake who are now living elsewhere than about current spending on various items. The questionnaire asks about various sources of income, e.g., employment, self-employment, pensions or other such payments, and remittances, for each adult who is a member of the core household, i.e., the members of the pre-earthquake household being interviewed, plus any persons new to the household since the earthquake. (The full household consists of the core household plus members of the pre-earthquake household who are likely to be reunited with the core household if suitable housing is found.) The questionnaire also obtained broad information on the core household's non-housing expenditures, detailed information on housing and communal services expenditures, and a simple inventory of main durable goods owned.

Interviews were conducted in summer 2011 in person using paper-and-pencil. All interviewers were bilingual in French and Creole and questionnaires were prepared in both languages. Creole is much more commonly spoken than French; both are official languages (Haggerty, 1989).

## 4. Results

### 4.1 Household incomes

The presentation starts with information on the summer 2011 monthly household income distribution for the areas surveyed (Table 2). Data are for full households, as defined above. The differences between core and full household incomes are quite modest. Respondents were asked if persons who had been household members before the earthquake and not living with them currently would return to the core household if larger or better housing were found. Only 0.7% of respondent households located in the lower- and middle-income zones responded that someone would rejoin the household. The figure rises to 3% for camps—still a modest share and rather lower than we had anticipated. The difference in the mean monthly income for those in the camps between the core and full households is significant at 5.6%. Even though the incidence of full households compared to core households among all respondents is small, it is higher for those in the camps. These statistics yield an important lesson for future household surveys in Haiti: outside of camps one can obtain quite reliable estimates of household income without asking about members of the pre-earthquake household now living elsewhere.

Table 2 shows data for 10 income deciles for each of the three zones and for all households combined (last column). The entries are the mean reported household income for each decile in Haitian Gourdes (HTG). For example, the mean income for the 7th income decile for core households in all three zones combined is HTG 15,575 or about USD 389. (HTG: USD exchange rate was about 40:1 at the time of the survey).

One can calculate the housing purchasing power of households in this group by applying the share of household income one thinks such a household could reasonably spend on housing, including or excluding expenditures on associated utilities. Households in the 7th decile devoting 25 and 40% of their income to housing would have monthly housing purchasing power of HTG 3,934 and 5,509, respectively. Of course, it is likely that respondents under-reported their

incomes to some extent. The values in the table can easily be adjusted upward for the extent of under-reporting a reader expects.

As anticipated, the mean monthly income values for households in the camps is consistently and substantially lower than those of households living elsewhere in the low-income and the middle-income zones. This makes sense: more than 18 months after the earthquake most households remaining in the camps are likely those who have the fewest resources to use in acquiring better housing. The mean monthly income in the lower-income zone is about HTG 19,929, more than twice as high as that of households living in the camps.

The mean incomes of the lower-income and middle-income zones are quite similar—the difference being only 5.5%. For the 2<sup>nd</sup> through 6th income deciles, incomes are consistently higher by a non-trivial amount for middle-income zone households than for those in the lower-income zone. But then they are quite similar for the two areas until the highest decile where the middle-income zone is distinctly higher. The overall difference is somewhat less than anticipated and may be due to post-earthquake household relocations.

### 4.2 Possible remittances for improving housing

Remittances are an important part of total household income in Haiti. Hence, beyond the household's own resources, there is a distinct possibility that a family could obtain supplemental resources even beyond usual remittances specifically to improve its housing<sup>5</sup>. In order to get a full picture of households' resources, the survey asked about this possibility, and the results are displayed in Table 3. A small share of the respondent group, about 5%, thought they could get such help. Of these, 19% thought they would receive a single payment, on average worth about HTG 74,350. The other 81% opined that they would get multiple payments averaging 4.2 payments each, with a total average value of about HTG 156,300, a comparatively large sum equivalent to about nine months' mean household income.

<sup>3</sup> Many analysts believe that household consumption is a better measure of well-being than income (e.g., Deaton and Grosh, 2000).

<sup>4</sup> If respondents provided accurate information, this finding suggests a low incidence of households keeping a few family members in camps when others are living elsewhere in better housing so as to secure any benefits that may accrue to camp dwellers. On the other hand, camp dwelling households could be renting out a dwelling they control while staying in a camp. Concerns of this

type are expressed in "Haiti's Tent Cities: Nowhere to Go," *The Economist*, September 10, 2011, p.42.

<sup>5</sup> The specific question asked was: "If your household has the opportunity to improve your residential situation, do you think that your extended family and/or friends who live outside of Haiti could lend you or give you some money to do it? I am not talking about the remittances that you might have mentioned earlier [when income sources were asked about]."

### 4.3 Financing plans for those planning dwelling purchase or improvement

For policy purposes it is important to know the share of households planning to improve their housing in the near term, i.e., defined as the 'next year' in the survey, and among those planning such action the share and characteristics of those who plan to purchase a dwelling or build a new one. The basic facts are that a remarkably high 29% of all surveyed households said they planned to improve their housing in the next year. Of these 14% said they planned to repair or renovate their current dwelling and the balance of 86% plan to purchase or rent a unit and relocate. Among all those planning to improve their housing, about 65% plan to own their future home. These households are not concentrated among the well-to-do but have an income distribution similar to that of all households shown in Table 2.

To provide basic information on the potential demand for finance, the focus in this section is on those households who plan to purchase an existing unit, build a dwelling, or improve their current unit and have a plan for financing the upgrade. This is a quite limited group of households, about 16% of owner-improvers or 1.8% of all households that are represented by 62 households in our sample. Table 4 presents two sets of income distribution figures: one based on the household's reported income and one adjusted to include only the income sources that could be verified by a third party such as a bank. In the survey whenever a respondent was asked about an income source, she was also asked if the income from the source could be verified by a third party. There are only 41 valid observations. So the information should be treated only as suggestive of the true pattern.

On the whole, verifiable income for these households is about 60% of reported income, although on a per-household basis usually all or none of its income is verifiable. The figure is much lower—38%—for the lowest income quintile and highest for the third quintile, 77 percent. Overall, the data suggests a substantial divergence between total household incomes and the amount of income a financial institution could verify for purposes of loan underwriting.

**Table 2: Metropolitan Port-au-Prince household monthly income estimates, mean income by income decile for full households**

		Zone			
		Temporary camps	Lower-income communes	Middle-income communes	Total
		Total income (gourdes)	Total income (gourdes)	Total income (gourdes)	Total income (gourdes)
		Mean	Mean	Mean	Mean
Full income decile	Lowest 10%	888.33	1546.95	1473.90	1365.16
	Second decile	1982.86	2949.31	3531.18	3105.20
	Third decile	2730.46	4087.80	5242.70	4378.60
	Fourth decile	3887.15	5855.21	7641.57	6337.86
	Fifth decile	4893.29	8206.03	10046.27	8395.61
	Sixth decile	5916.31	11373.40	13527.25	11864.21
	Seventh decile	7505.42	17704.98	18074.07	15739.02
	Eighth decile	9885.39	24803.86	24652.55	21426.71
	Ninth decile	14504.34	36089.20	36900.15	31755.38
	Highest 10%	33985.48	86530.90	90193.95	77250.96
	Total	8557.03	19933.39	21125.95	18130.31

Household income distribution (all non-zero incomes). Valid n = 1948

**Table 3: Estimates of remittance assistance households planning to improve their housing could receive**

Mean		Percentages & HTGs	Count
Proportion of households that could obtain financial help from outside Haiti		4.9	164
Frequency of help	One payment at beginning	18.6	29
	Periodic payments	81.4	127
Estimated size of one-time payments (HTG)		74,361.08	24
Frequency of periodic help, percent distribution	Monthly	30.2	35
	Each trimester	47.4	55
	Other	22.4	26
Estimated size of each periodic payment (HTG)		31,626.42	99
Estimated number of payments		4.19	86
Total value of multiple payments (HTG)		156,295.21	84

Household income distribution (all non-zero incomes). Valid n = 1948

### 4.4 Rental costs and the affordability of alternative housing packages

We now address the types of accommodation that can be rented or afforded at various income levels<sup>6</sup>.

About half of the dwellings in our sample not located in camps are rentals.

The analysis is for renters because we have better data on rents than on dwelling values. Data on dwelling values are thought to be less accurate for two reasons. First, households'

<sup>6</sup> There is a rich literature on housing affordability. See, for example, Struyk (2005) and Quigley and Raphael (2004).

estimates of the current price of their unit should they put it on the market at the time the survey is done have proven to be remarkably reliable overall in a range of countries. In Haiti, however, household estimates could be somewhat less well informed than is typical given the instability of the housing market. Second, in light of the uncertainty just noted, the survey coded values of resident-owned homes into only five wide categories which are not sufficiently exact for the type of analysis reported here. Concentrating on rentals also makes sense given the challenges to formal borrowing indicated earlier.

We begin by exploring how much renters are spending now on rents and on communal services. These calculations are done excluding households living in the camps at the time of the survey and those who have a special arrangement with the owner, for example, the dwelling is rented from the employer of a household member or a relative. Then we compute the rent of three modest housing bundles. Finally, we compare the cost of the rental options and household's ability-to-pay. The combined information presented here should permit planners to determine the housing options available to households at different points in the income distribution.

## 4.5 Renters' expenditures

To provide an orientation to the overall rental environment, Table 5 shows the distribution of rents and the cost of communal services for the same dwellings by rent decile. As for the income data presented earlier, table entries are the mean value, e.g., rent, for a particular 10% of the distribution. Dwellings included in this table and in the analysis described below are those rented on a market basis, i.e., the landlord is not a family member, and neither is the resident receiving any sort of rental assistance from his or her employer<sup>7</sup>.

Communal services' costs are the sum of the expenses for electricity, water, fuel, and garbage collection. Expenses were gathered on payments to both formal and informal suppliers, such as water vendors and payments to those who have illegally tapped public electricity lines, for example.

Rents reported by respondents are rather lower than those cited by knowledgeable observers about the same time. While housing experts visit-

**Table 4: Estimates of monthly income of households planning to improve their housing and the share of their income that can be verified**

		Mean total income	Mean verifiable income	Verifiable/ total income <sup>a</sup>	Valid n
Income quintile	Lowest 20%	1,079	241	.38	8
	Second quintile	4,593	2,843	.63	8
	Third quintile	9,374	7,230	.77	9
	Fourth quintile	18,305	9,194	.49	9
	Highest 20%	46,714	24,428	.57	7
	Total	15,156	8,378	.57	41

n = 41

Average is the mean value of the ratio of verifiable income to total income computed for each household.

**Table 5: Distributions of market rents and associated communal services payments, mean monthly expenditures for each rent decile, in htg**

Decile	Rent Distribution	Communal Services' Cost Distribution
Lowest	363	940
2 <sup>nd</sup>	685	1,059
3 <sup>rd</sup>	950	1,184
4 <sup>th</sup>	1,207	1,259
5 <sup>th</sup>	1,459	1,199
6 <sup>th</sup>	1,802	1,242
7 <sup>th</sup>	2,302	1,531
8 <sup>th</sup>	3,101	2,190
9 <sup>th</sup>	4,487	1,652
Highest	16,219	3,429
Overall Mean	4,796	1,555

n = 298

ing Haiti during the summer of 2011 put informal housing rents in the HTG 2,000-4,000 range, the mean rent in the table does not reach HTG 2,000 until the 7<sup>th</sup> decline, where for this group of dwellings the mean rent is HTG 2,302. The lowest decile mean monthly rent is the equivalent of less than 10 US dollars. Both rents and service costs rise steadily with incomes, although the pattern is a little less steady for communal services.

Expenditures on communal services are substantial and clearly need to be taken into account when considering what housing package a household can reasonably afford. Indeed, only dwellings in the higher six rent deciles have rents higher than communal services expenditures. Occupants of

dwellings in the lowest four rent deciles are on average spending several hundred HTG a month more on communal services than rents.

## 4.6 Pricing rental housing bundles

We defined three housing bundles to represent the large middle of the housing distribution. Units are neither those constructed of the least durable materials and with the worst communal services nor the largest and best equipped. As shown in Table 6, four dwelling characteristics were used in defining the dwellings to be priced. (Use of more attributes was precluded by the need to have prices for a minimum number

<sup>7</sup> In the sample about 7% of respondents rent from their relatives and 47% report having an arrangement with their employer. (This share seems very high but we have no way of verifying it.) An additional 5 reported paying no rent, perhaps because they are squatters, and a few others

truly trivial amounts. All of these observations are excluded from the tabulations presented in this section. We are skeptical about the large share of households renting units associated with an employer but dropped them to be conservative in establishing basic rent patterns.



**Table 6: Estimates of monthly income of households planning to improve their Housing and the share of their income that can be verified**

Characteristics & Payments	Dwelling		
	A	B	C
<b>Characteristics</b>			
Number of rooms	1	1	2 or 3
Roof building material	Sheet metal	Sheet metal	Concrete
Water source	Non-piped	Piped water	Piped water
Toilet facility	Pit latrineb	Pit latrine	Flush
<b>Monthly housing payments</b>			
Rents	2,995	3,843	3,602
Communal services	1,317	1,580	1,623
Total	4,312	5,423	5,225
nc	22	27	92

All types of flush toilets are included regardless of whether they flush into a sewer, septic tank, pit latrine or other location.

Piped water includes water piped into the house or the yard or the neighbor's yard.

Number of rental units whose occupants reported information on all four characteristics and whose units have the specific attributes.

**Table 7: Unit types affordable for households devoting 25 percent or 35 percent of 'full' income to rent and communal services payments**

Income Deciles	Percent of Income Spent on Rent and Communal Services			
	Income as reported		Income inflated by 40 percent	
	25 percent	35 percent	25 percent	35 percent
Lowest	--	--	--	--
2 <sup>nd</sup>	--	--	--	--
3 <sup>rd</sup>	--	--	--	--
4 <sup>th</sup>	--	--	--	--
5 <sup>th</sup>	--	--	--	--
6 <sup>th</sup>	--	--	--	BC
7 <sup>th</sup>	--	BC	BC	BC
8 <sup>th</sup>	BC	BC	BC	BC
9 <sup>th</sup>	BC	BC	BC	BC
Highest	BC	BC	BC	BC

Unit types are defined in Table 5.

of units each of which had all characteristics in a particular bundle with which to compute the average rental costs<sup>8</sup>). Two were physical dwelling attributes: the number of rooms and the material used for the roof. The other two addressed the quality of communal services:

the source of water used by the household and the type of toilet facility.

Unit type A is the lowest quality unit and unit type C the highest. The pattern for communal services spending is as anticipated, with occu-

pants of better units spending more per month. Occupants of Type A units spend HGT 1,317 while those occupying Type C units spend HGT 1,623. Frequently the price per unit of informally provided communal services is higher than those provided by municipal systems. We do not have price per unit data, but costs per household are not higher in our sample for those using informal services versus publicly provided services.

The results for monthly rents differ from those for communal services in that rent on the Type B and C units are statistically the same, although the nominal rents for Type B units (which are physically lower quality units than Type C) are about 5% higher. While Type B units have roofs of sheet metal and the toilet facility is a pit latrine, Type C has a concrete roof and a flush toilet.

Importantly, the analysis team faced strong challenges in establishing usually observed relationships between household income and various housing quality measures and between rents and housing quality. That experience combined with the information in Table 6 could indicate one or both of two situations. The first is that the post-earthquake housing market is quite inefficient in transmitting price information on different options to those searching for housing. Given Haiti's nascent real estate information systems, this could be anticipated. The second is that the housing market is segmented for some reason with certain groups of households preferring to live within certain areas. Each of these areas naturally comes with its own set of communal services. Particularly after the earthquake's destruction one could imagine a premium being charged in areas with the combination of greater housing stock damage and particularly strong attraction for certain groups<sup>9</sup>.

## 4.7 Incomes and rents

This section brings together the information on household incomes and the rent and communal services' costs of the unit types just described to provide a realistic picture of the distribution of effective housing purchasing power. The results are displayed in Table 7, which shows which of the three housing types described above households at different points in the income distribution can afford. Two different assumptions about the share of income households can devote to housing are

<sup>8</sup> For this analysis it was necessary to include units where the occupants reported that the landlord of the dwelling was the employer of someone in the household. Sample size with only units that were for certain rented at "market rates" was too small to provide any level of confidence in the results. It is worth noting that when the "non market" units are added, rents are actually higher than

when they are excluded, which suggests it is better housing that is being assisted by employers if indeed respondents understood the question on employer assistance and answered it accurately.

<sup>9</sup> This phenomenon has been documented for in U.S. urban housing markets. See, for example, Schnare and Struyk (1976).

employed: 25 and 35%. In addition, we also test the effect that a substantial, 40%, under-reporting of household income has on effective demand with households continuing to devote 25 and 35% of income to housing.

The results are sobering. Under the most optimistic assumption of income being underreported and households devoting 35% of their incomes to housing, only households in the top half of the income distribution can afford any of the three defined housing types. Where these higher income households can afford to rent a unit, they can afford the B/C packages. The jump in the mean decile incomes of about HTG 2,000 per month in the range of the 3rd to 5th income deciles gives sufficient purchasing power for the BC type rather than the cheaper A type. Worth noting is that in the market there is a distribution of the rents for each unit type, i.e., not all units are rented for the mean rent shown in Table 7. Presumably households in the income decile just below the lowest one in the table where rental costs are affordable could afford at least a Type A unit. This does little, however, to change the overall pattern.

### 5. Summing up

The purchasing power of Haitian households is clearly limited for dwellings with even quite modest features. Even under optimistic assumptions about the share of income households can spend on housing and related infrastructure services and significant increases in incomes for possible under-reporting, households in the lower half of the income distribution cannot afford the modest units defined.

Nevertheless, a significant share (29%) of Haitian households, drawn from across the income spectrum, has concrete plans to improve their housing in the next year. A substantial majority

plans to purchase a dwelling, with one-third targeting better rentals.

Most would-be purchasers plan to borrow funds, usually from family and friends. There may be more opportunities for formal financing than the population knows about or new financing vehicles may emerge from the donor community's work with the Government of Haiti that will encourage lending on less stringent terms with more households borrowing. At the same time, those with plans for improved housing may underestimate the cost of home purchase or improving their current dwelling or find borrowing more difficult than anticipated. This would stimulate the rental market and put greater pressure on rents. In short, a great deal of uncertainty remains in a very challenging environment.

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# DEBATE

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The debate as to whether to adopt supply-side or demand-side subsidies for housing development has been a feature of housing policy discussion over a period of at least 30 years, particularly in the affordable housing field. Although demand-side subsidy has gained ground over this period supply-side measures have their supporters and some states, such as the UK, have continued to adopt both approaches, at least until the latest round of fiscal austerity measures.

In the two articles that follow Filiep Loosveldt and Wolfgang Amann explore the arguments in favour of one approach or the other. The Loosveldt/Amann debate is expected to go into a second round in our Summer 2012 issue. Contributions from other readers would also be very welcome.

# Investment in housing - the case for demand and supply-side subsidies; the example of the Belgian housing market<sup>1</sup>

↪ By Filiep Loosveldt

## 1. Economic diagnosis is essential

Because of the great economic importance of living and housing, a comprehensive economic diagnosis of what is happening in the various residential markets is absolutely essential. We are living in times of need - regarding both the residential markets and in terms of budget opportunities - with the result that policy makers should pay attention to how effective and cost-efficient their interventions are.

## 2. There is not only one housing market

There is not only one housing market. People looking for a place to live can find this within various rental and private housing markets. What is more, every city, town or village has a few specific properties that are reflected in the local housing markets. New-build house prices depend not only on the actual building costs because the price of land depends on environmental factors such as the availability of private and public services (education, health care, etc.), mobility, quality of living, a well-paid job, safety, added-value prospects, etc. We also find this dependence on environmental factors in pricing in the second hand buyer's markets and rental markets.

## 3. The various housing markets function in the same way as communicating vessels

Various housing markets can indeed differ greatly - from new-construction luxury villas to letting furnished rooms - yet they still do not function independently of one another. There are

numerous forms of interaction and the current overall housing supply can circulate between various housing markets.

A house has concrete foundations in the ground but over the span of its entire life cycle it can form part of various housing markets. In this way, immovable property offers great long-term flexibility in terms of the preferences of owners, buyers or tenants.

The various housing markets function in the same way as communicating vessels, which is illustrated perfectly when one analyses the number of households that find a new house every year. For example, in 2009, approximately 262,000 households in Belgium were looking for housing - to buy or rent - and 43% of these bought an existing house. 43% found rented housing and approximately 11% were able to opt for a new self-build project, while 3% chose to buy a new house.

Every household does, after all, have certain preferences - it would rather own than rent a house, for example - but can strive to satisfy these preferences, albeit with some flexibility. A considerable number of households first look for a house on the private rental market, so that they can, in the meantime, save up enough to later buy a house. And if there is no building land in the preferred area, you can decide to buy an existing house and renovate it.

## 4. Impact of government interventions

The dynamics of multiple "market destinations" for one and the same house and household

preferences are greatly influenced by government interventions. All housing markets are subject to regulation and the private new-build market, in particular, is heavily restricted by spatial planning. Taxes can also cause scarcity and distort the housing markets. On the other hand, subsidies are key in other markets, such as social rented houses.

The subsidy policy makes it possible to market social housing at prices that are artificially low when we compare these to the reference prices on the private markets. In addition, there are also measures which cause the prices of new-construction houses to rise substantially. A restrictive policy regarding spatial planning can make the price of building land increase and the continuous increase in technical requirements for new-build houses also has price implications. And then there is, of course, the extremely high tax burden weighing on new development.

## 5. An increasing number of households are driven to the private rental market

The government probably does not intend to make new-construction housing more expensive and to drive consumers into a second hand buyers' market thus initiating a price rise. Apart from the intention, this also makes buying an existing house asymmetrically<sup>2</sup> more expensive, which makes those with the lowest budgets opt out, so that these must then turn to the rental market, which is perceived by a considerable number of investors as risky due to the new rent legislation. An

<sup>1</sup> Based on the result of a recent Belgian study entitled "Housing in times of need, moving to renovate the housing policy" by the independent think-tank, Itinera. See the French version at: [http://www.itinerainstitute.org/upl/1/fr/doc/Itinera\\_FR\\_DEF\\_LR.pdf](http://www.itinerainstitute.org/upl/1/fr/doc/Itinera_FR_DEF_LR.pdf)

<sup>2</sup> In fact, the prices for the cheapest houses have increased much faster than the prices of more expensive houses. This asymmetrical increase of prices cannot be explained by changes in the interest rates of mortgage credits, but is mainly caused by the increase of the amount of possible buyers on the market of second hand houses.

increasing number of households are driven to the private rental market, and these homes are becoming scarcer. This is causing longer waiting lists for social rental houses and the pressure on the government budgets will soon become unsustainable.

### 6. The rise in the demand for houses is currently steeper than the increase in supply

The price increase for houses and apartments is consistent with structural factors. The rise in demand for houses is currently steeper than the increase in supply. This relative supply gap amounts to between 20,000 and 24,000 houses per year in Belgium. 2/3 of the increase in the demand is caused by external immigration. During the period 2008-2011, the annual increase in the number of Belgian households was between 45,000 and 50,000. The prices of the cheapest houses in Belgium rose by 51% between 2005 and 2009, while the prices of the most expensive houses rose by "only" 23%. These remarkable asymmetric price dynamics are the result of a typical process: when there is an increase in the demand, those with the lowest purchase budgets are driven away from the second hand buyer's markets because of the limited elasticity in the supply of second hand privately owned houses.

Newcomers to our country with quite some purchasing power as well as disillusioned aspiring candidates for the purchase of new-construction house add to the increase in demand on the second hand buyer's market. One's own contribution to acquire a house has become systematically more important, especially since 2005. The personal contribution currently amounts to between EUR 55,000 and EUR 70,000.

Housing market scarcity rises when the growth in the number of households is greater than the growth in the number of houses. When there are more households per available house, prices are put under pressure. This phenomenon is currently manifesting itself in Belgium, and definitely in Flanders. This is making the prices of existing houses increase asymmetrically and affordability of all the markets are being put under pressure. In fact, the prices for the cheapest houses have increased much faster than the prices of more expensive houses. This asymmetrical increase of prices cannot be explained by changes in the interest rates of mortgage credits, but is mainly caused by the increase of the amount of possible buyers on the second hand buyer's market.

### 7. The only sensible answer to scarcity is an increase in supply

All other policy options will continue to be inadequate if the supply is not increased. The supply of private modest new-construction houses can be stimulated by way of selective subsidies because the number of households able to finance these houses increases very elastically if there is a relatively limited reduction in the cost price of a new-build project. Every new-build house makes room for another house in the privately owned or rental housing market. These can be made accessible to the relevant target group of tenants by way of a rent subsidy. This group is so large - currently already totalling 270,000 households - that social housing construction can offer only a fraction of the answer.

### 8. General rental subsidies are inevitable in the long term

Efficiently applying rental subsidies does necessitate an increase in the number of houses to avoid a strong increase in private rental prices. A joint approach of rental subsidies and more new-build houses is essential and, moreover, by far the cheapest policy option.

Offering a total solution for the issue of ability to pay in the rental market implies that the government would immediately be able to help all target group households outside social rental. This is approximately 272,000 households in 2012, with the result that only financial support with a mechanism for rental subsidies can offer a solution. In practice, it is not possible, indeed, not even advisable, to offer an immediate total solution by way of rental subsidies.

Adequate expansion in the number of houses by way of additional houses can prevent the situation where allocating rental subsidies can lead to an explosion in private rents. Due to the ripple effect, the type of new-build housing does not really play a role. Therefore, we advocate that rental subsidies be implemented progressively, so that other means can be used to simultaneously stimulate construction of private average new-build housing.

To avoid a bidding war between the subsidised and non-subsidised rental sectors when new rent contracts are concluded, one might consider making the rental subsidy dependent on a few conditions:

- the rental price may not exceed the reference rental of an average rented house, which

depends on the type of house or number of rooms and the area;

- The amount of rental subsidy depends on the composition of the household, on the income, household assets and reference rental;
- Rental subsidy must be applied for and it will only be granted after an interview in which the above-mentioned terms and conditions are discussed.

Compared to building additional social houses, the joint approach of rental subsidies and more private new-build houses makes it possible to achieve one and the same supply objective at a fraction of the cost price.

If we calculate all the costs, the cost price of the joint approach only amounts to 22% of the bill for social housing construction. This should come as no great surprise because building new social rental houses for households who, in essence, want to rent, is not the optimum solution when it comes to using resources.

It is more logical that higher incomes fund new houses so that older houses become available for those with lower incomes. If this mechanism is changed, one is confronted with a fundamental cost problem. After all, new-construction generates not only living assets for the clients but also mitigates the scarcity and, by so doing, also produces important positive external (monetary) effects.

If it is not possible to immediately provide a total solution for the 272,000 target households, one must structurally develop a partial solution. The annual production of average houses can be increased by 10,000 houses in two ways. The government can build 10,000 social houses, for example. Alternatively, the private new-construction production of 10,000 modest houses can be stimulated by means of a targeted purchase subsidy of EUR 30,000 per house, for example. Some of these private houses make it possible that existing houses become accessible to the rental market for the target group by means of rental subsidies, which means that these tenants pay as much as those in social rental.

Opting for social houses - which, in this case, is a combination of (semi) public social rental and social ownership housing - turns out to be much more expensive than promoting a combination of rental subsidies while encouraging private modest house building (by means of targeted purchase subsidies for modest new-construction private houses). In practical terms, the second policy option - private production with rental subsidies - offers the same benefits

as opting for social housing construction, but only at 22 % of the cost price of the social construction option.

This amounts to an accumulated additional cost of EUR 41.5 billion for 10,000 houses for the period between 2012 and 2045. This is therefore the enormous additional cost for opting for social housing instead of for additional private housing construction that is linked to rental subsidy mechanisms<sup>3</sup>.

This result should come as no surprise. The target group does, after all, consist of households who specifically want to rent – their low income excludes a private house or new-build project – but they have difficulty in paying or cannot pay the private rental prices. By producing (semi) public social rental housing, the government offers some of these households

a new-build house. This causes a substantial operational deficit for the social housing companies because the target group has a low income and therefore cannot finance the capital needed for the construction of the new-build house.

Nonetheless, the social housing companies must attempt to recover the capital payments because the government subsidises the rental cost and not the principal sum. Moreover, in the case of social housing construction, there is an efficacy loss of 15% because of the frictional vacancy and persons occupying social housing at a rental that is too low in comparison to their level of income. This business model can only lead to a deficit.

We can also put the question as to whether these households with a low income will be benefited by the mirage of a new-build house.

It is, of course, pleasant to be allowed to occupy a new-build house when you cannot pay for a cheap private rental house but this solution strongly tends towards over-provision for a very limited group, while no solution is offered for the majority of the target group.

From the point of view of the allocation, the letting of existing and relatively cheap rental houses to the lowest income brackets is the policy option with the lowest budget and opportunity cost.

In addition, thanks to the promotion of the private new-construction of modest houses, the lower middle classes, who can no longer afford new-build housing, will also benefit from a more relaxed secondary private market. This will also combat the erosion of the private rental market via sales to future owners.

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<sup>3</sup> This is the vacancy of houses that is necessary for the good functioning of the social housing market.

# Investment in housing – the case for supply-side subsidies

↳ By Wolfgang Amman

European countries have shares of rental housing between below 10% in several CEE countries and above 60% in Switzerland. The EU average is between 25% and 30%. But statistical data are tricky because of uncertainties regarding the nature of cooperative housing in some countries and the classification of (informally) rented owner-occupied apartments (Amann, Mundt, 2011; Andrews, Caldera Sánchez, Johansson, 2011).

Facing these disparities, it is difficult to define a necessary or desirable share of rental housing for individual countries. Supply of sufficient rental housing has comprehensive social and economic rationale. It is not at all only for the accommodation of those who cannot afford owner-occupation. It is definitely easier to transparently allocate social assistance in rental apartments than in own property. Rental housing fosters labour mobility and adequate accommodation at different stages of the life cycle. In mature economic environments it may be economically rational for tenants to rent instead to buy. Rental housing is an important investment opportunity for institutional and private investors and is hence an important asset class. Rental housing is much easier to manage, maintain and refurbish, compared to owner-occupied housing. It has therefore advantages in terms of the sustainable development of our built environment.

As it is hardly possible to define an absolute objective of a reasonable share of rental housing, the concept of consumer choice may apply. If tenure status is the result of a rational choice by households, a reasonable equilibrium should appear. The consumer choice concept promises high economic efficiency. But a rational choice is only possible if a sufficient and attractive supply of different housing opportunities exists in the market.

Owner occupation of property is in many countries strongly promoted by tax benefits. Owner occupied property is also perceived as an insurance against political and economic risks. This

is particularly visible in transition countries. The ambition to own property makes families scrape money from any source and to invest pecuniary and labour resources to an astonishing extent. Hence, rental housing is a rational alternative only for specific groups of the population in a specific economic environment. It may become a priority consumer choice for big parts of the population in economically mature and politically stable countries. In a more vulnerable environment, rental housing is an alternative primarily for young households, migrants to the boom regions and the poor.

Countries may benefit from the economic and social advantages of growing rental housing sectors, if they establish friendly framework conditions. One is the regularisation of informal rents in the existing housing stock. Formal rents have to be protected from unfair competition from informal rents. Another framework condition is the establishment and empowerment of management and maintenance schemes for all housing sectors. A third condition is a reduction of tax benefits for owner occupied property.

But first and foremost, rental housing must be economically rational for target households. A simple calculation illustrates the point. If we assume the economic conditions of a typical Western European country (e.g. Germany or Austria), we may calculate with construction costs of 1,500 €/m<sup>2</sup> and costs of building land of 300 €/m<sup>2</sup> useable floor space. If we finance such a building with a mortgage loan of 20 years with a fixed interest rate of 7%, the monthly annuities will be not less than 14 €/m<sup>2</sup>. Adding reasonable fees for management, maintenance and a refurbishment fund, with VAT and energy, it adds up to 20 €/m<sup>2</sup>. An average household of the second income quintile in a typical Western European country has a disposable household income of monthly € 2,000 (EU-SILC). Hence, a 70m<sup>2</sup> rental apartment would require 70% of that income. This is obviously not reasonable. Certainly there are several options to reduce

annuities and other costs. We may extend the maturity of the loan to 25 years, succeed in obtaining finance with only a 6% interest rate, invest some cheaper own equity, reduce the endowment of a refurbishment fund, or introduce indexed mortgage payments. But even under these conditions it is difficult to fall below 14 €/m<sup>2</sup> in total, or 50% housing cost ratio for our sample household.

The perception of a politically reasonable maximum housing cost ratio has increased over time. Today, in most countries an average of 30 to 35% is perceived as affordable (Chiquier, Lea, 2009). In our simple calculation this level may be achieved only with substantial public support. Housing costs should be reduced to only 8.50 €/m<sup>2</sup>, either with supply side or demand side subsidies. One reasonable model with a combination of both could look as follows:

- A municipality provides building land at a low cost, e.g. half of the mentioned value (in return the municipality may get a right of allocation).
- The interest rate for the remaining investment is reduced to around 3% (average over total financing). This may be achieved with public soft loans, or grants in combination with commercial loans, or guarantees.
- With indexation the resulting rents may be reduced to around 10 €/m<sup>2</sup> (without energy costs).
- Additional assistance may be allocated with means-tested housing allowances.

Under such conditions rental housing will be economically rational for many households and consumer choice will establish a rental sector. But is it also economically rational also as public policy? This question has ambiguous answers. Subsidies for owner-occupied housing may stimulate new construction at lower public costs. But it is impossible to solve all social issues with owner-occupation. In many countries the middle classes are served with



owner-occupation and free-market rents and vulnerable groups with municipal housing.

This leads us to the principal question of dual rental markets vs. integrated rental markets, which has been intensively discussed in housing research for many years (e.g. Kemeny, 1995; Kemeny et al., 2001; Kemeny et al., 2005; Amann et al. 2012; Mundt, Amann, 2010). Promotion of ownership to the middle classes and municipal housing to the poor will lead to dual rental markets. Integrated rental housing markets appear, if large rental sectors produce supply accessible for major sections of the population with rents only slightly below free market levels. Proponents of the former argue lower public costs, as only small social housing sectors require State funding. This argument could be disproved, as housing policy schemes with a focus on residual social housing mostly provide other benefits to higher income groups, such as allowance schemes and in particular tax benefits for owning property. Public expenditures for housing are very difficult to assess. Public soft loans, grants, annuity grants, allowances, tax rebates or guarantees have quite different cash flow effects and influence housing consumption differently. It is therefore hardly possible to calculate consistent discounted net present values for different subsidy schemes. Nevertheless, some indications show that countries with integrated rental markets, such as Austria, the Netherlands or some Scandinavian countries do not have higher public housing expenditure rates compared to countries with dual rental housing markets (PRC, 2005; Amann, Mundt, 2011).

The rental model proposed above allows for affordable housing with only moderate public expenditures. Under present financial market conditions, financing with 3 to 4% interest rate with no further public assistance is feasible e.g. with the Dutch Guarantee Fund Model (see e.g. Priemus, 2008) or the Swiss model of an intermediary organisation issuing bonds for affordable housing (Lawson et al., 2010). Other interesting capital market instruments to allow for low financing costs are the Danish mortgage bond (UNECE, 2005) or the Austrian housing bond (Lawson et al., 2010).

Low financing costs further require a low risk institutional setting. In several Western European countries, e.g. Austria, limited-profit housing associations (LPHA) have developed into financially mature organisations. With their strong equity base, a vacancy risk close to zero and a kind of implicit State guarantee, they are first class borrowers with very favourable market financing conditions. Within such a framework

specialised housing organisations may provide rental housing which is affordable for the majority of population. If supply of affordable rental housing is sufficient, additional housing allowances are required only for the most vulnerable households to quite a limited extent. Austria, as an example, provides housing allowances to only 6% of households.

Such models of affordable rental housing work not only for prosperous Western European countries. With similar results they may be applied to transition countries. For many countries in South East Europe and of the Commonwealth of Independent States (former USSR), lower construction costs, lower legally defined maintenance fees and higher inflation rates allow for rents of approx. 2,50 €/m<sup>2</sup>, which fits the much lower incomes in those countries (Amann, 2009).

With these arguments we have already partly answered the question, whether demand-side or supply-side subsidies produce better results. Following liberal market theory, the best way to achieve optimum housing provision in terms of allocation and affordability is the least possible State intervention into market functioning. With this approach the problem of low income households may be solved most efficiently by increasing their purchasing power with housing allowances. Debates on the superiority of the one or the other model have a tendency to argue in black and white. They often include arguments about the deficiencies of the other model, which only become evident, if implemented in a pure form. Market liberals argue against distortions of budget funded public housing, which is almost free almost for everybody. Keynesians by contrast decry market failures, socially unbearable price developments, segregation and altogether the social coldness of markets. As a matter of fact, hardly anywhere the one or the other model is implemented in its pure form.

As discussed above in the context of dual vs. integrated rental markets, the argument of proponents of demand-side subsidies that such systems are less costly to the public, can be falsified. It is politically hardly possible to limit assistance to most vulnerable households only. Pressure from the ballot-box inevitably leads to promotion of schemes also for the majority of population, often with expensive tax rebate schemes for owner occupied property.

The simple calculation provided above shows another aspect. Of course it would be possible to bridge the gap between the market-based 14 €/m<sup>2</sup> to the affordable 8.50 €/m<sup>2</sup> with demand side allowances and leave the supply side to the free-market alone. This would have equal

public costs, if free-market housing providers and specialised affordable housing organisations work with similar effectiveness (from the point of view of the public interest, not primarily of business performance). Certainly market competition is a strong driver for effectiveness. And certainly a command economy produces inferior results. However this question cannot be answered in black and white, but requires differentiated consideration. Today's social housing organisations differ a lot from the stereotype of socialist housing cooperatives of former days. The best of them have developed into highly professional enterprises in a competitive market with high volumes, a strong equity base and consumer orientation. The public service obligation of affordable rental housing provision to households in need (EU jurisdiction) may be achieved with supply-side subsidies to such organisations at lower public costs for the following reasons:

- Housing allowances in a free-market environment have a strong tendency to push up prices and create windfall gains. This may result in a reciprocal effect of rising rents, increasing demand for allowances and a further upturn of prices (Mundt, Amann, 2009). This can be avoided with housing production on a cost coverage principle.
- Usually such organisations are protected against outflow of capital. (Limited) profits have to be reinvested in housing construction and housing refurbishment. This results in accumulated undisclosed reserves. Growing financial maturity improves the market power of such companies towards financing and construction services.
- Many of these organisations have a very long business history with a very clear core competence. Economies of scale may reduce costs.
- In some countries, effective schemes of audit and control of social housing organisations are in place. Such schemes reduce risks and contribute to knowhow exchange. Thorough public supervision has effects on the capital market similar to a public guarantee.

All these aspects contribute to a reduction of financing costs without financial implications for the public. Additionally, supply-side subsidy schemes have immediate effects on new construction, whereas with housing allowances such effects depend on price elasticity of supply. Subsidies on bricks and mortar allow for immediate implementation of ambitious energy and ecological standards. This is much more difficult with demand-side subsidies. In terms of public costs supply-side subsidies are on a par



or better than demand-side subsidies. But they additionally offer important positive externalities. But at last, the two models can be combined.

Within a comprehensive legal scheme of checks and balances, ownership of such specialised housing organisations may not be limited to municipalities, funds or charity organisations, but be open to individuals, to the financing sector or real estate companies. The EU ruling on Services of General Economic Interest (SGEI) provides an effective framework. It seems to provide great potential for new business cases between State and market.

As a result of our considerations we may summarize that affordable rental housing requires State commitment. But this commitment goes beyond financing. It also includes the establishment of low risk housing organisations, a stable economic environment and an appropriate legal framework. Well established housing promotion schemes may go with moderate public expenditure. Housing subsidies have very complex effects. Nevertheless, subsidies of bricks and mortar seem to be more beneficial than demand side subsidies, but the latter may well be combined as means-tested addition with the former. Services around affordable rental housing are not at all allocated in a non-competitive or off-market habitat. Quite the contrary, in the context of integrated rental markets they operate in a very competitive environment which includes associated financing and construction services. Specialised affordable housing organisations may develop a new and very promising business case even for private owners, under the EU ruling on Services of General Economic Interest.

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# A review of recent developments in the Irish mortgage market and an assessment of the future prospects

↳ By Dara Deering

## 1. Introduction

The Irish Mortgage Market has been radically changed, since its boom in 2006, in the aftermath of the international credit crisis in 2007/08 and the collapse of the property market in Ireland. This change has led to many interventions by Government, the Central Bank and the Sector itself. This paper reviews recent developments, their impact on the Irish Mortgage Market and assesses the prospects for the market going forward.

## 2. Mortgage market growth

Competition in the mortgage market in Ireland was relatively benign in the 1990s. Towards the end of that decade, competition strongly intensified, with the entry of several International Banks into the market.<sup>1</sup> Lower interest rates and greater competition resulted in a strong increase in demand for mortgages against a backdrop of strong economic growth, population increases of c. 17%<sup>2</sup> and employment levels doubling. During the period 2002-2006, other incentives such as investor tax relief, the introduction of 100% loan to value mortgages and tracker rates propelled an already overheating market to even higher levels of lending. House prices increased by 155% (from €122,013 to €310,632) between 1999 and 2006 and new mortgage origination increased from €6.5bn in 1999 to a peak of €39.9bn in 2006. Mortgage stock increased from €22.2bn to €121.9bn over the same period.

In 2007/08, the global financial crisis (credit crunch) began to unfold. Initially triggered by

subprime lending concerns in the US, the crisis quickly moved to liquidity and ultimately to bank solvency. As a consequence, many markets witnessed the collapse of large financial institutions and the bail out of banks by national governments. Ireland was not immune to the international crisis which exacerbated problems in its own banking system, resulting in a deep recession and a sharp rise in unemployment from 4.5% in 2006 to 14.4% in 2011.

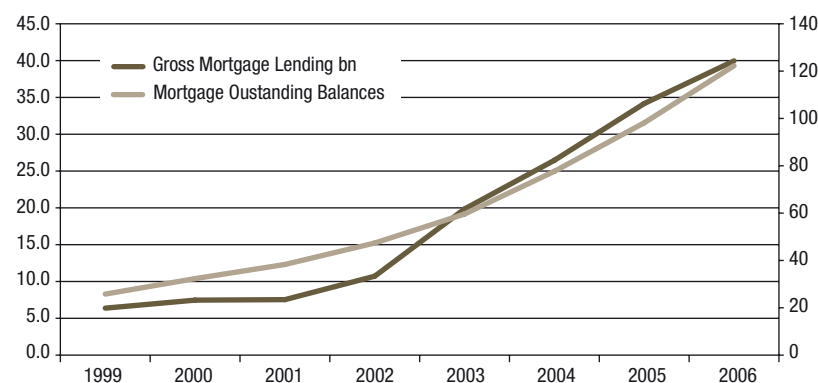
Bank solvency, the over reliance on wholesale funding and the need for greater regulation all became apparent. Many of the Irish owned banks

were nationalised with reduced lending on the part of some foreign-owned banks in Ireland. Ultimately, the compound impact of a deep recession, a banking crisis and an overheated mortgage market has led to a strong correction in the mortgage market. New lending volumes have contracted by 95% from their peak in 2006 with new lending in 2011 of just €2.5bn.

## 3. Mortgage market funding

To fund the rapid growth in mortgages, banks had to look beyond their traditional customer deposits. At the peak of the lending boom, the

Figure 1 Gross mortgage lending and mortgage stock 1999 to 2006



Source: Department of Environment, Heritage and Local Government, Irish Banking Federation, Central Bank of Ireland

<sup>1</sup> Including Bank of Scotland (Ireland), Royal Bank of Scotland (RBS), Danske Bank (trading as National Irish Bank), Rabobank Ireland, KBC Bank Ireland.

<sup>2</sup> Population and Labour Force Projections, Irish Central Statistics Office – April 2008 (1996-2006)

national savings rate fell to 2.2% of GDP, while the level of outstanding mortgages reached €148bn, 90% of GDP<sup>3</sup>.

With the arrival of the Euro, Banks began to access cheaper wholesale funding and international corporate customer deposits. However, by altering the mix of funding, the liability profile of the banks had fundamentally changed. Balance sheets now carried a higher refinance risk from both a liquidity and cost perspective. With the seizing of global credit markets, it became all too apparent that in stressed market conditions, a funding dependence on international deposits and wholesale funding was too risky. It also highlighted that margins were not sustainable.

As liquidity in the wholesale funding markets disappeared, there was an outflow of non domestic funds in Ireland and the cost of funding rose considerably. With the medium and long-term debt markets effectively closed, funding moved to short-term (overnight to 12 months lending). Given that Irish banks and indeed the Irish Sovereign have experienced significant rating downgrades it remains very difficult for Irish Banks to access international funding markets. The net result has been an increased dependency on the Irish Central Bank and ECB for short-term funding.

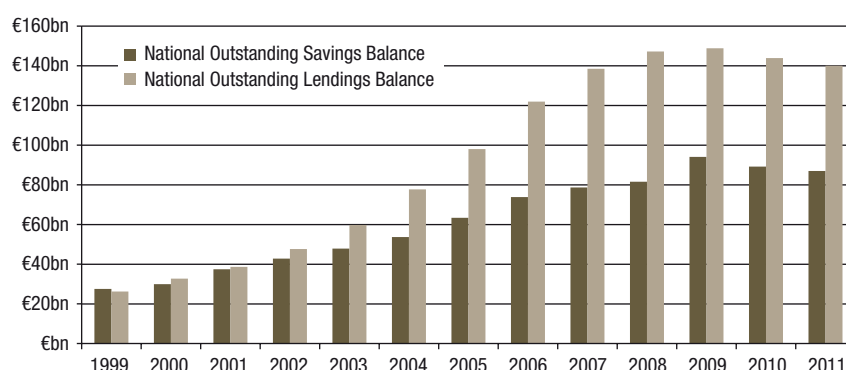
The Central Bank of Ireland introduced its Financial Measures Programme in March 2011. The programme seeks to address, amongst other things, the funding imbalance by imposing a loan to deposit ratio of no higher than 122.5%. Irish Banks are required to achieve this by 2013 through a combination of deleveraging non-core assets (some €73bn) and by increasing the proportion of retail deposits.

#### 4. Policy responses – strengthening the economy

The Irish Government has taken significant corrective measures to stabilise the economy as a result of the shocks experienced from the global financial crisis. The Government's focus has been on three key areas:

- i) Restoring sustainability to the public finances
- ii) Repairing the banking system
- iii) Restoring competitiveness

**Figure 2 National outstanding mortgage balances<sup>4</sup> and savings balances<sup>5</sup> for 1999-2011**



Source: Central Bank of Ireland

**Table 1: Six domestic banks' funding profile changes**

€bn	Dec-08	Dec-09	Jun-10	Dec-10
Retail	152	146	148	136
Corp/NBFI	103	80	72	32
Debt capital markets	140	123	120	69
Repo	35	34	34	23
Interbank	54	16	14	7
Central bank	37	62	58	142
Total	521	461	446	409
Central bank as % total funding	7%	13%	13%	35%

Source: Central Bank Financial Measures Programme Report, 31 March 2011 (chart 5, pg 40)

#### 4.1 Restoring sustainability to the public finances

Following the announcement of the IMF/EU bailout in November 2010, the Irish Government announced its four-year National Recovery Plan with an additional €15 billion (9.4% of GDP) in consolidation measures for implementation over the period 2011-14. The latest consolidation package has been significantly front-loaded with savings of €6 billion (3.7% of GDP) expected in 2011. The consolidation plan is weighted two-thirds (€10 billion) towards spending cuts, and one-third (€5 billion) in revenue enhancements to be implemented over the four-year period. With a new Government elected in February

committed to the austerity programme, Ireland's approach to addressing its budgetary difficulties has met with the approval of many, including the European Commission, the ECB, the OECD and the IMF. The key objective of Ireland's medium term fiscal strategy is to restore expenditure and taxation to more sustainable levels. Ireland is targeting a reduction in its deficit to below 3% of GDP by 2014.

#### 4.2 Repairing the banking system

Over the period 2008 to date, the Irish banking landscape has changed substantially. The strategic roadmap deployed by the Government has involved much change for domestic financial

<sup>3</sup> Source Hypostat 2009

<sup>4</sup> National outstanding mortgage balances as reported by the Central Bank of Ireland is the aggregate value of all residential mortgage balances in the Irish market.

<sup>5</sup> Savings balances as reported by the Central Bank of Ireland is the aggregate value of all retail savings balances in the Irish market.

institutions. The first part of this roadmap dealt with the reorganisation of responsibility for banking. This was followed by the merging of some domestic institutions and the orderly winding down of others. Going forward, at the centre of the Irish banking landscape are two domestic pillar banks – Bank of Ireland and Allied Irish Bank (AIB). Irish Nationwide and Anglo Irish Bank have been put in wind down mode and EBS has been merged with Allied Irish Bank. Irish Life is in the process of de-coupling from its banking arm, permanent tsb. Meanwhile, the Foreign Banks operating in Ireland, particularly Ulster Bank and KBC, are likely to remain active players in the retail financial services landscape following consolidation in the domestic sector.

The next step was the recapitalisation of the banks. The amount of capital required was determined by the Central Bank of Ireland in conjunction with BlackRock Solutions following their Prudential Capital Adequacy Review (PCAR). The overall objective is to create a sustainable, appropriately-sized banking system that is in a position to provide new lending to support activities that are essential for economic growth and recovery.

### 4.3 Restoring competitiveness

There are also necessary competitiveness adjustments underway.

The Harmonised Index of Consumer Prices (which excludes mortgage interest payments) is the appropriate measure for comparing inflation across the euro area. Irish inflation was considerably higher than that in the euro area in the early years of monetary union, resulting in a deterioration of our price competitiveness. In 2009 and 2010, however, Irish price levels declined while those in the euro area continued to increase, helping to improve competitiveness. European Commission forecasts expect Irish inflation rates to remain below those in the euro area as a whole, further improving Ireland's relative competitive position.

### 5. Regulatory responses: supporting customers in difficulty and changes in consumer protection legislation

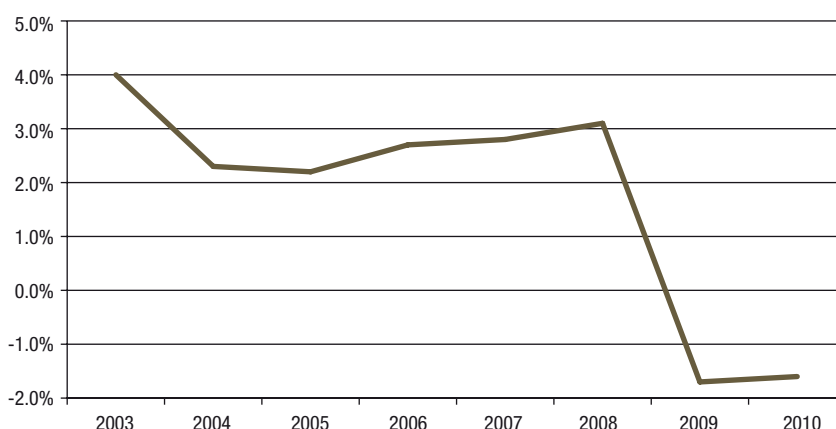
The number of outstanding home loan mortgages in the country at the end of December 2011 is 768,917, with over 483,000 of these mortgages approved during the years 2004-2008 according to statistics from the Department of Environment

**Table 2** Going concern domestic banks plus main foreign banks



Source: Department of Finance - Going Concern Irish Banks

**Figure 3** EU harmonised index of consumer prices – Ireland



Source: Central Statistics Office

and Local Government. In effect, a large proportion of mortgage loans were granted at a time of historically high property prices and incomes. Yet these households ability to service their outstanding debt has been significantly affected by both the international and domestic economic downturn with unemployment now at 14.2% and real declines in average disposable income due to reduced working hours, pay cuts, tax rate and interest rate changes.

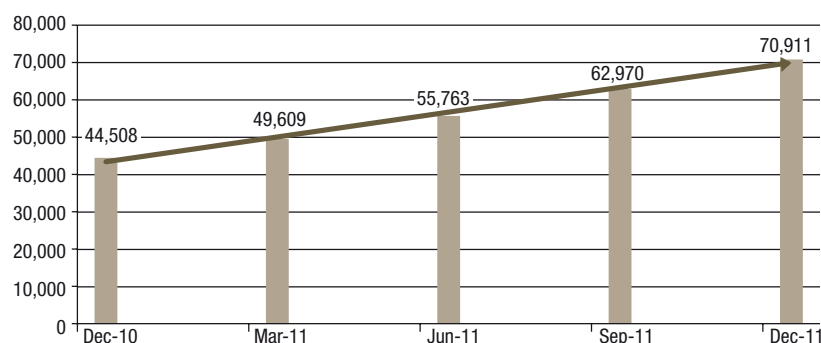
The latest Central Bank of Ireland arrears data indicates that as of December 2011, 9.2% of outstanding primary dwelling loans were in arrears of more than 90 days past due. This compares with 3.7% at the end of December 2010. All indications are that arrears trends will

continue to increase for some time yet. The pressure on households has been somewhat mitigated by the low interest rate environment and a high level of tracker mortgages.

A key dynamic in the mortgage market in Ireland is the low level of repossessions. Taking a property into possession has always been seen as a last resort in Ireland, and the number of properties actually taken into possession is clear evidence of this – running at 21 per 100,000 here compared to 82 per 100,000 in the UK for example. Keeping people in their home remains a key pillar of policy and regulation, therefore going forward any real change in the level of repossessions is likely to be in the buy to let sector rather than the owner occupier sector. At the

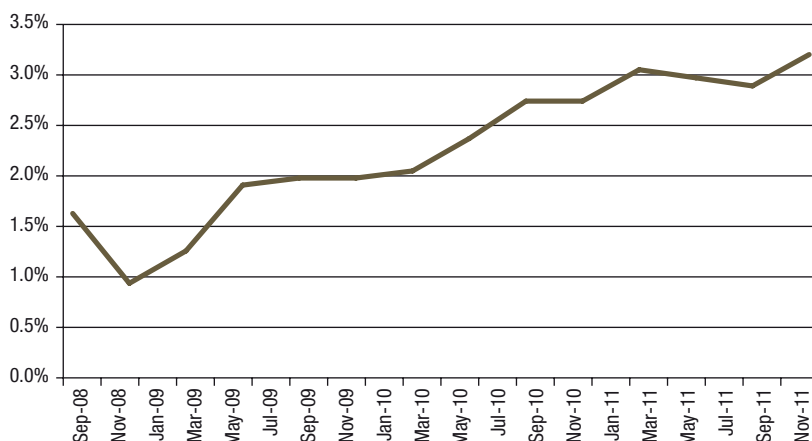


**Figure 4 Home loan mortgages > 90 days in arrears**



Source: Central Bank of Ireland

**Figure 5 Standard variable rate margins Ireland September 2008–December 2011**



Source: Company Competitor Data

same time continued declines in property values act as a disincentives for repossession as losses are crystallised in fragile market conditions.

In February 2009, the Central Bank of Ireland launched a new code of conduct setting out how regulated lenders must deal with consumers who are in arrears. This code is known as the Code of Conduct on Mortgage Arrears (CCMA). Further protections to the Code were added in December 2010 following the report of the Mortgage Arrears and Personal Debt Group. These new protections, which came into effect on 1 January 2011, include the Mortgage Arrears Resolution Process (MARP) which sets out the framework that regulated lenders must follow in handling cases of arrears and pre-arrears while adding some beneficial protections for consumers.

Most recently, the publication of the Inter-Departmental Arrears Working Group recommended a range of advanced forbearance solutions and the establishment of an independent mortgage advice function. These recommendations are being considered by all stakeholders at present.

Against this backdrop, in November 2011, the Central Bank of Ireland required all banks to submit details of their Mortgage Arrears Resolution Strategy (MARS). These plans had to include an overview of how banks will deal with both their home loan and buy-to-let mortgage books including treatment strategies for customer segments, the use of NPV tools and decision trees to determine the best outcome for customers and a more proactive approach to mortgage customers who may not yet be in difficulty but are deemed to be high risk.

Finally, Draft Heads of a Personal Insolvency Bill were published on 25 January 2012. The draft bill includes amendments to the Bankruptcy Act and the introduction of three new non-judicial debt settlement arrangements to deal with unmanageable unsecured debt and unsustainable mortgage debt in Ireland. The key amendment to the Bankruptcy Act is the reduction in the automatic discharge period from 12 years to 3 years. As currently drafted, the three non-judicial debt settlement arrangements are as follows:

- A debt relief certificate which allows for the full write off of qualifying unsecured debt up to €20k following a one year moratorium
- A debt settlement arrangement which provides for the settlement of unmanageable unsecured debt after a specified period of time where a debtors liabilities are €20k and over
- A personal Insolvency arrangement which provides for the settlement of unmanageable unsecured debt and restructuring of unsustainable mortgage debt after a specified period of time where a debtors liabilities are €20k and over

Key interest groups are currently making representations on key elements of the bill and it is expected that draft legislation will be published at the end of April 2012.

## 6. Sector responses – fewer players, increases in margins, reduction in risk appetite

Foreign and domestic banks operating in Ireland are still reeling in the aftermath of the global crisis and the collapse of the property market. Bank of Scotland (Ireland) which included their retail brand, Halifax, exited the market in 2010. At the same time, many of the remaining foreign banks operating in Ireland have switched their focus to repairing their balance sheets, managing arrears in their existing mortgage books and gathering new deposits. New mortgage lending is not a priority. In the medium term it is likely that the demand for mortgages will only be met by a few market players.

With the on-set of the credit crisis, margins in Ireland reached unsustainable levels. As a result, many banks have taken steps to bring margins more in line with the UK and Europe. Over the period September 2008 to December 2011, the average difference between the cost of funding mortgages and the rate charged to borrowers for variable mortgages in Ireland over ECB increased from 1.63% to 3.20%. With the need

to introduce further austerity measures in late 2011, there was, and continues to be, pressure on state owned or supported banks to pass the recent and expected ECB decreases which will bring about its own challenges as banks raise funds above the ECB base rate.

Another consequence of the collapse of the property market is a reduction in risk appetite. At the height of the market, 100% loan-to-value (LTV) mortgages were widely available. LTV's have reduced to 80-90%. Lending volumes have reduced from €40bn in 2006 to just under €2.5bn in 2011. Furthermore, Banks have directed the limited amount of credit available to support home owners with lending to the investor market, equity release and to refinancing reduced considerably.

The proportion of lending to First Time Buyers has increased from 17% in Q1 2008 to 47% in Q4 2011. In comparison, over the same period the proportion of lending to the investor market has decreased from 20% to 3%.

## 7. Market outlook

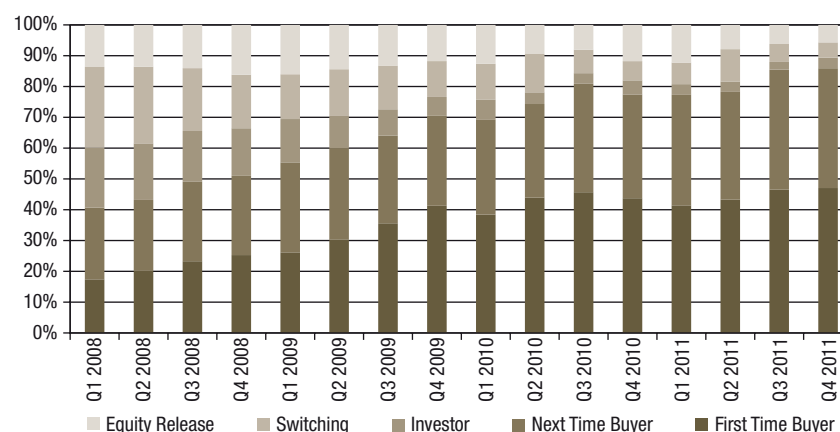
Against the backdrop of a radically changed financial landscape, a challenging Government programme for recovery and an open economy dependent on a global recovery, the mortgage market going forward will be very different than the one Ireland has experienced in the last decade.

Demand for mortgages will be very strongly influenced by consumer sentiment and confidence about economic growth while the supply of mortgages will be strongly influenced by the speed at which banks can execute their deleveraging plans, increase margins to address viability and stem the flow of customers in difficulty meeting their mortgage repayments. The supply factors have been covered earlier in this paper. The key factors impacting mortgage demand are described in more detail below.

### 7.1 House price correction

Residential property prices at a national level, fell by 16.7% in the last twelve months according to the December 2011 CSO house price index. However, in Dublin residential property prices are 19.3% lower than a year ago. At a national level, the peak to trough is showing a decline of 47%, while in Dublin prices have dropped by 55% since peak. There are also variations by property type. In Dublin the price of a house has dropped by 54% while the price of an apartment has dropped by 58%.

**Figure 6 New lending to buyer segment Q1 2008 to Q4 2011**



Source: Irish Banking Federation

**Table 3: Vacant units per 1,000 households**

No of Vacant Units per 1,000 Households	No of Local Authority areas in this category
3-5	5
6-10	8
11-15	13
16-20	2
21-44	6

Source: Department of Environment, Heritage and Local Government

Potential buyers need to be confident that house prices have stabilised. For this to happen we need to see an increase in property transactions – the virtuous circle. In 2006, according to statistics from the Department of Environment and Local Government, 111,253 homes were purchased and financed by a mortgage. If we factor in cash purchases, the number of property transactions was substantially higher. In 2011, using comparable figures from the Irish Banking Federation, the number of property transactions financed by a mortgage reduced to just 11,131.

The impact of the planned intervention in the market of the National Asset Management Agency (NAMA) is unknown. NAMA is preparing a deferred consideration product to encourage mortgage demand by allowing that 20% of the purchase price of the house may be cancelled for the borrower if the value of the property falls during the first five years of the mortgage.

In the short term we are likely to see further decline in house prices albeit at a slower pace

than in recent years, followed by stabilisation and some nominal level of increases in the medium term.

### 7.2 Equilibrium of housing stock in certain regions

Building activity has decreased considerably over the last number of years and the expected number of house completions in 2011 is circa 10,000 compared with 93,000 units in 2006. While the statistics prove that building activity has reduced, there has been much debate about the level of unfinished housing stock carried over from the boom. Encouragingly, the Department of Environment's National Housing Development Survey of 2876 unfinished developments in 2011 showed an improvement over the 2010 position. 13 areas have 10 or less vacant units per 1,000 households. It is likely that as the supply and availability of property continues to reduce in certain counties that we will see regional variations in market recovery.

## 7.3 Stabilisation of rental yields

Whilst rents in Ireland have dropped, they have not decreased at the same rate as house prices and as a result, rental yields for new investors are at their highest in many years. According to the latest Daft Rental Index<sup>6</sup>, current indications are that rents appear to have levelled in urban areas, with evidence of increases in certain areas. In fact, similar to the levels of house supply there seems to be regional variances emerging. "As previous quarterly reports have shown, national rent indices still appear to mask a rural/urban split within the Irish rental market, with rural prices continuing to fall, albeit at a slow pace, and these falls being offset by increasing rents in urban areas. Similarly, the stock of available properties available for rent continues to fall. In January, the total number of rental properties stood at 16,023 (v 16,932 January 2011); a 5.7% decline on the previous year's levels"<sup>7</sup>

According to Daft, the average rental yield in Dublin city centre is 8.1%<sup>8</sup> and looking forward rental yields are likely to increase in urban areas based on a marginal growth in rent and further reduction in house prices. This level of yield is likely to attract investment activity in the future.

## 7.4 Improved affordability

Another key factor driving demand for mortgage lending is mortgage affordability. EBS, in conjunction with DKM Economic Consultants<sup>9</sup> produces a quarterly index to track affordability for new home buyers. The latest Index released in November 2011 shows mortgage affordability is at the optimum level for buyers in twenty five years. The average First Time Buyer working couple require 12.4% of their net income to fund mortgage repayments<sup>10</sup>. This is down from 26.4% in the peak at the end of 2006.

Notwithstanding the fact that interest rates will increase over time, affordability will continue to be a positive driver of market demand given the significant correction in house prices.

## 7.5 Population growth

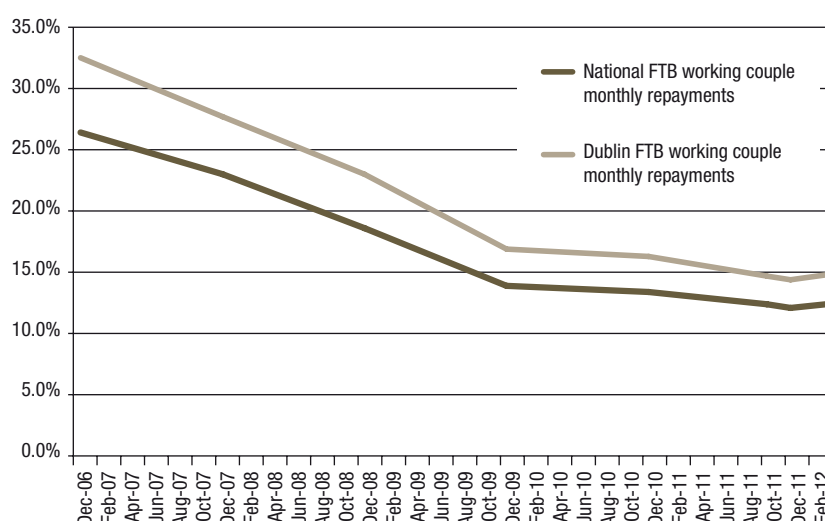
The total Irish population is currently 4.6m. Based on CSO estimates, Ireland's population is set to grow to 5.2m by 2016. Almost 40% of Ireland's population are aged 25-49 which is the prime segment for house purchase. This is higher than the EU average.

While many would-be purchasers are renting today, as the economy and job prospects improve and as confidence returns to the housing sector, many of these renters will potentially become home owners in the future.

## 7.6 Propensity to purchase

Underpinning the factors outlined above is a strong historical propensity of Irish consumers to buy their own homes. Although home ownership

**Figure 7** Affordability for new home buyers December 2006 to March 2012 (forecast)



Source: EBS/DKM Affordability Index

**Table 4: Proportion of population aged 25-49 years**

Area	2008	2009	2010
EU (27 countries)	36%	36%	36%
Euro area (17 countries)	37%	36%	36%
Euro area (16 countries)	37%	36%	36%
Ireland	39%	39%	39%

Source: EuroStat

**Table 5: Comparison of owner occupier rates**

Country/Region	Owner Occupier Rates
Ireland	74.5%
UK	69.5%
Germany	43.2%
EU 27	68.2%

Source: EMF/Hypostat Report 2009

<sup>6</sup> Daft.ie is one of Ireland's largest property website

<sup>7</sup> Daft Q4 Bulletin

<sup>8</sup> Daft Rental Yield Calculation: Monthly rent x 12 divided by purchase price x 100

<sup>9</sup> <http://www.dkm.ie>.

<sup>10</sup> Based on: average FTB working couple, both on average earnings, and CSO RPPI which suggests an average FTB property price of €148,000

rates have reduced, ownership of property in Ireland still exceeds that of the UK, Germany and the EU 27 average. Given that Ireland has one of the younger populations in Europe this is likely to have a positive impact on demand for housing in the future.

While these factors will support a recovery in the mortgage market, there are several downside risks that may impede recovery such as the wider international economy, the impact of future austerity measures in Ireland and the European debt problem. Assuming these downside risks are overcome in the short term and the Irish economy gains some positive traction, recovery in the mortgage market should begin to take place.

### 8. Conclusion

The mortgage market has gone through a period of considerable change as a result of the confluence of an international credit crisis in 2008 and an overheated domestic property market. New mortgage lending has decreased significantly, and we have seen a number of responses from the Government, the Central Bank of Ireland and the Sector itself.

The Government has responded with measures to restore sustainability to the public finances, repair the banking system and restore competition all of which are well advanced. The Regulator has responded with robust capital assessment processes, increases in regulation to support

customers in difficulty and most recently a request for all banks to prepare and implement a mortgage arrears resolutions strategy to help deal with the arrears issue for residential mortgages in Ireland. The Sector has responded with measures to improve bank viability and reduction in risk appetite for new lending.

These changes will ensure that the banking sector emerges from this crisis stronger and better able to withstand future shocks. While demand for mortgages remains subdued, the underlying demand factors remain strong. While we don't expect nor want mortgage volumes to return to pre-crisis levels, Ireland needs a normalised level of activity to support sustainable economic growth and homeownership.



# **'Managing risk' in the delivery of housing finance: Australia's mortgage lenders**

↪ **By Mary R. Tomlinson**

## **1. Introduction**

The extension and leveraging of credit, particularly housing finance, was at the heart of the Global Financial Crisis (GFC). Irresponsible lending to homebuyers occurred most notably in the United States. Australia's claim to have stood apart from other countries by not duplicating irresponsible lending is viewed as one of the reasons it has been able to weather most aspects of this storm. Naturally this outcome raises the question as to why Australia's mortgage lenders were better than those overseas at 'managing risk', which results from the delivery of housing finance?

This paper examines recent work by the Reserve Bank of Australia (RBA), financial sector representative and regulatory bodies and academics focusing on the extension of housing finance in Australia over the past two decades. It aims to explore how the financial sector, primarily Australia's four main banks and a class of non-bank mortgage lenders, was able to significantly expand the scale of housing finance delivery during this period. It seeks to examine a range of factors, for example, financial deregulation, increased competition amongst mortgage lenders, innovation and relaxation in lending practices, and how these factors affected the way mortgage lenders 'managed the risks' that resulted from this new form of lending.

The intention is to draw a more nuanced picture of mortgage lending with the aim of answering the following: 1) where has housing finance risk been located? 2) How was this risk managed? And 3) has it been managed in such a way that

it is the borrowers rather than the lenders that are most exposed if, and when, the housing market reverses?

## **2. Background**

Similarly to other Western economies, during the past twenty years housing finance in Australia passed through a period of deregulation, which resulted in a more efficient market-driven system linked to international capital markets (RBA 2011; Berry 2010; Green & Wachter 2007; Ellis 2006). The new system grew out of the large-scale reforms that took place in the Australian financial system during the 1980s, including the relaxation of foreign exchange controls, the floating of the Australian dollar and the ending of direct central bank quantitative controls on domestic credit and interest rates (Berry, 2010).

With respect to deregulation, Australia, similar to the United States: 1) provided an environment for an influx of new housing finance providers; 2) increased competition amongst housing finance providers; 3) innovated in the lending products made available to borrowers; and 4) increased the ability for homeowners to withdraw equity from their appreciating houses (RBA 2011; Berry 2010; Green & Wachter 2007; Ellis 2006).

A further key element in the changing housing finance environment was the rapid rise of the secondary mortgage market, which starting in the mid-1990s became a new source of mortgage finance through the use of securitisation. Special purpose vehicles were created to receive pools of residential mortgages that

were structured into Residential Mortgage Backed Securities (RMBS) and then sold to investors (Austrade 2009). Ownership was therefore removed from the originating institution's balance sheet and transferred to the wider investment community. Because originators no longer carry financial and reputational risk they may be less inclined to apply the same level of diligence to who they are lending to than if the loans remained on their books.

In Australia, one of the drivers behind securitisation was the introduction in the 1990s of compulsory superannuation. Fund managers looking for low risk, long-dated debt viewed RMBS as a good investment (Green & Wachter, 2007). In the United States mortgages were similarly packaged, however, as the demand for mortgage-backed securities increased the extension of lending into the higher risk subprime market became a means for feeding growing investor appetite. Problems arose when rating agencies failed to distinguish between low risk and higher risk securities, a situation that was only revealed to investors when the GFC hit.

Looking back, except when it came to subprime lending, Australia can claim a high degree of convergence with other national housing markets in its restructuring, and the resulting significantly liberalised housing finance sector. As this liberalisation fortuitously coincided with a period of relatively low inflation and nominal interest rates, these factors came together in a large increase in the supply of housing credit<sup>1</sup>, increasing the demand for housing stock. Housing prices therefore rose along with household indebtedness (RBA 2011; Berry 2010; Ellis 2006; Green &

<sup>1</sup> Housing credit increased at an average annual rate of 15% in the two decades prior to 2007 (RBA 2010).

Wachter 2007). Concerns are now being raised as to whether Australians are simply 'highly geared' or 'over-geared'?

### 3. Australia's evolving housing finance sector

Before proceeding with further examination of how the housing finance sector has evolved, the different classes of mortgage lenders, banking and non-banking, are clarified below.

#### 3.1 Banking: retail banks, building societies and credit unions

From the beginning of the last century through to the end of World War I, mortgage finance was provided by state government-owned savings banks and then by large clearing banks after World War II (Berry 2010). Hence, up until the 1990s the banks<sup>2</sup>, and to some extent building societies and credit unions, were the main source of mortgage finance in the country. Being authorised<sup>3</sup> and regulated deposit-taking institutions (ADIs) meant they were able to source their funds for lending purposes through their customer base. This was important because during this period the difference between the mortgage rate and the RBA cash rate was often negative, causing banks to rely on their customer base for funding their mortgage book (MFAA 2009).

#### 3.2 Mortgage originators, brokers

A review of the financial system in the early 1980s (Committee of Inquiry into the Australian Financial System 1981) resulted in a sweeping away of regulations. Deregulation and lower inflation meant that by the early 1990s the bank spread between the RBA cash rate, the overnight money market interest rate, and the deposit rate was substantially reduced inducing a new class of non-bank lenders<sup>4</sup> to enter the housing finance market using borrowed funds to carry out their lending activities. As mortgage originators were able to borrow at the now reduced RBA cash rate, this lower rate, combined with the fact that they did not have to service the costs of expensive branch bank operations, meant that they were able to undercut the bank's mortgage lending rates (MFAA 2009; Ellis 2006).

In addition, between August and December 1994, the official interest rate increased by 2.7%. This large jump caused many homebuyers to seek out lower interest rates, which were now available through these non-bank mortgage originators. Borrowers therefore shifted away from banks to mortgage originators causing them to rapidly grow their share of the mortgage market (MFAA 2009). As a response to the competition from the mortgage originators, banks reduced their interest rates and streamlined their operations to make them more cost-efficient and competitive (MFAA 2009; Ellis 2006).

At the same time that these changes were occurring, a group of operators recognised the need for consumers to be able to navigate this more complex borrowing environment, which now included both banks and non-bank lenders. Setting themselves up as 'mortgage brokers', they marketed themselves as able to represent the borrower's needs by assisting them to choose amongst the various options that were available at the time (MFAA 2009).

#### 3.3 Securitisation

Securitisation of mortgage loans has been extensive and the Australian market became one of the largest in the world (Ellis 2006: 14; Green & Wachter 2007, p. 18). The RMBS market in Australia grew rapidly, with a compounded annual growth rate of 31% for the decade from June 1997 (AUD \$13.6 billion) to June 2007 (AUD \$204 billion). This was substantially greater than the growth of Australian residential mortgages during the same period, which grew at a compounded annual growth rate of 15.7% to AUD \$870 billion in June 2007 (Austrade 2009, p. 6). Not only did lending grow significantly during this period, but outside investors became a major source of funding and Australia, similar to the USA, became a major participant in the post-2000 global housing boom.

Berry (2010, pp. 131 – 133) states that this circumstance could have been expected, "to deliver a greater degree of volatility to mortgage markets than had been apparent in years past". He notes that the financial market turmoil in 2007 – 08 focused on a number of non-bank originators active in the secondary market. The non-transparent nature of mortgage securities derivatives

and the manner in which they are regulated added a further element of potential instability.

Hence, when the global downturn occurred in 2008, securitisation in Australia contracted significantly, similar to elsewhere in the world. When overseas funding dried up the RMBS market contracted by 41%. Although the conventional wisdom was that Australia's RMBSs were of a high quality<sup>5</sup>, there was little differentiation in the minds of overseas investors (Austrade, 2009, p. 6). The smaller non-bank lenders became unviable, while banks, in a better position financially, were able to remain in the mortgage market and even increase their share.

Since 2008, to support competition in mortgage lending, the Australian Office of Financial Management has been mandated to purchase up to \$8 bn of RMBS, of which \$4 bn was to be made available primarily for non-ADIs (RBA 2010).<sup>6</sup> The intention was to replace the foreign investors that had left the market and help rebuild the non-ADI market. Further additions to the programme have occurred with the Office having invested just over \$12 bn in RMBS (Austrade 2009, p. 8; RBA 2010). More important is that this move can be interpreted as a signal to lenders that they can rely on government, for the time being, to step in and purchase any new loans they are likely to extend.

And while mortgage lending could be viewed as fairly risk-free for the lenders (as described in the following section) recommendations have been made to government to support a programme that would, *inter alia* "provide investors with high quality mortgage-backed securities that are *secured* by a government guarantee **and** underlying mortgage-insured property" (MFAA 2009, 9). In the world of investment finance, a 'government guarantee' is the Holy Grail, when it comes to mitigating risk arising out of lending activities. To date the government has side-stepped this issue. Notable is the fact that during 2008 – 09 the Australian government did, in fact, provide a guarantee to banks on deposits of up to one million and on their wholesale borrowings.

In the United States, it was the well-known Government Sponsored Enterprises Fannie Mae and Freddie Mac, which provided an 'implicit

<sup>2</sup> More recently foreign banks have entered the country bringing inflows of capital into the mortgage market.

<sup>3</sup> ADIs are authorised by the Australian Prudential Regulatory Authority (APRA) (Austrade 2009).

<sup>4</sup> Non-ADI lenders are not prudentially supervised by the APRA, but are required to abide by Australia's consumer protection laws (Austrade 2009).

<sup>5</sup> The Australian Securitisation Forum (ASF) recently established minimum standards for issuers of RMBS. The standards are intended to aid investors in being able to judge the comparability of SPVs (Austrade 2009, p. 8).

<sup>6</sup> Government has been increasing its investment in RMBS, with total purchases climbing to \$23 billion in 2010 – 11, but still below the pre-GFC market of \$60 billion (The Age, 20 October 2011).

guarantee' over the mortgage loans it purchased and securitised for both bank and non-bank originators that induced the scale of irresponsible lending that occurred<sup>7</sup>.

### 4. Loan features and risk mitigation mechanisms

Increased competition in Australia's mortgage market resulted in more flexible and relaxed terms<sup>8</sup> for consumers. Mortgage loans became cheaper and borrowers were offered new products, including a range of lending instruments that could address the issues of irregular income and impaired credit history<sup>9</sup> (MFAA 2009).

Advertising and promotion of such products grew exponentially, as is apparent from watching television. Potential borrowers, living through a period of what appeared to be seemingly endlessly rising house values, were therefore enticed by the growing view that purchasing a house was a relatively 'risk free' investment. With new sources of global and investor capital on hand, lenders in the USA and Australia, both driven by competition over profits, searched for ways to attract new customers through the use of these new, innovative and flexible instruments.

#### 4.1 Loan to value (LTV) ratio

Prior to deregulation of the housing finance sector it was necessary for potential buyers to save a large deposit to qualify for a loan to buy a house, often 20%, resulting in a LTV of 80%. During the past decade, however, because of the housing boom average house prices rose much faster than average incomes. As prices steadily increased, the requirement for a 20% deposit moved beyond the reach of many homebuyers (MMFA 2009)<sup>10</sup>.

Moreover, in the competitive lending environment that arose in the late 1990s, and continued for a decade, the nominal interest rate, rather than the real interest rate, ended up determin-

ing the maximum loan size to be granted. This resulted in a larger loan and smaller deposit than had previously been the case.<sup>11</sup> Hence, it was, as Ellis (2006, p.4) argues, the substantial disinflation that was occurring in the economy which increased borrowers' capacity to pay off a loan and therefore drove the move towards increasingly larger mortgages. That is, disinflation meant that nominal interest rates fell and borrowing capacity increased (Yates and Berry 2011, p. 1137).

*The Financial Times* recently reported on a Merrill Lynch exercise that examined how Australian banks calculate mortgage approvals. Analysts compared the four major banks' Approval In Principle (AIP) systems using the banks' online service calculators as a starting point. With the same income and various default living cost assumptions a household could qualify for a mortgage loan ranging from \$457,000 at Commonwealth Bank, \$467,000 at NAB, \$472,000 at Westpac and \$475,000 at ANZ (*The Financial Times*, 20 August 2011). By using artificially low default living costs, banks are able to inflate the level of debt borrowers take on, increasing their profitability but placing additional risk on the mortgage system.

#### 4.2 Terms and interest rates

The typical loan term for an Australian home loan is 25 years for a variable rate mortgage. Also available have been 'honeymoon loans', which are a variable rate mortgage, but where the interest rate is fixed (50 – 100 basis points less) for a short period, say one to two years, compared with the rest of the contract term (Austrade 2009).

Davis (2010) notes that in Australia, mortgage contracts once signed with a bank give the bank the discretionary right to change the interest rate of the loan whenever, and to whatever rate they desire. This is in contrast to the situation overseas where mortgage contracts are often fixed rate or can only be adjusted when linked to some specified indicator rate set by government.

Such flexibility is valuable to banks since it covers all of its interest rate risk when, for example, their cost of funding increases. A debate has arisen in Australia over whether banks should be able to adjust loan interest rates when there has been a significant change to bank funding costs, relative to the cash rate. In other words, should both existing and new borrowers bear the risk of cost fluctuations or should it be the bank's shareholders who bear the risk (Davis 2010)?

Notable is the fact that during 2011 the National Consumer Credit Protection Act came into effect. In contrast to the previous Consumer Credit Code, there is a commitment to the principle of 'responsible lending'<sup>12</sup>, with mortgage lenders being required to: 1) make reasonable inquiries into a borrower's financial situation; 2) take reasonable steps to verify a borrower's financial situation; and 3) make an assessment as to whether the contract is 'not unsuitable' for the borrower. A lender, or broker, must therefore assess whether the borrower has the capacity to repay a loan without 'substantial hardship'<sup>13</sup> (Australian Finance Centre 2010).

#### 4.3 Low-doc and non-conforming loans

Prior to deregulation of the housing finance sector, lenders required borrowers to prove that they had sufficient and regular income as well as an unblemished credit history (MFAA 2009). Low-doc loans were developed as a means of assisting self-employed borrowers, or those with irregular incomes, to be able to purchase a house. These loans account for about 7% of approvals (RBA 2010).

It is generally assumed that subprime mortgage lending, i.e. low-doc and non-conforming loans, have been largely made by non-bank lenders. However, due to a lack of transparency regarding the type of exposure the various types of Australian institutions have on their books, it is difficult to judge to what degree the formal banks have been involved in this type of lending over the years.

<sup>7</sup> Fitch Ratings is currently undertaking a review of its current criteria for rating Australian RMBS transactions (Fitch 2011).

<sup>8</sup> Because there are no publicly available official statistics on loan characteristics information is gleaned from unofficial sources, e.g. bank pamphlets and anecdotal evidence.

<sup>9</sup> In the United States, there has been a shift away from traditional face-to-face loan granting practices towards the use of credit scoring or automated underwriting practices. Credit scoring has also been adopted in Australia (Ellis 2006). Experian has announced plans for a credit bureau in Australia which will be a joint venture between ANZ, Citibank, Commonwealth Bank, GEC Capital, NAB and Westpac (*The Australian*, 6 May 2011).

<sup>10</sup> Yates and Berry (2011), state that in the 40 years to 2010, real house prices grew at an average rate of approximately 3% per year, broadly in line with average growth in real GDP. Nominal house prices grew at an average rate of over 9% per year because of high inflation in the 1970s.

<sup>11</sup> For example, if a borrower could afford a loan of \$100,000 when the interest rate was 10%, he/she could afford to service a loan of nearly \$160,000 if rates were to fall to 4% (Ellis 2006, p. 5).

<sup>12</sup> A national survey of 3,200 banking staff by the Financial Sector Union revealed that banks, particularly the big four, are increasingly using financial incentives to motivate staff to approve more loans as a means of meeting performance targets (*The Age*, 6 June 2011).

<sup>13</sup> 'substantial hardship' is currently undefined in the Act.



### 4.4 Home equity withdrawals

Another similarity between the United States and Australia is the ease with which equity can be withdrawn from residential property. Berry (2010, p. 133) describes the increasing "fungibility" of housing as an accessible store of wealth. In the mid-1990s, household mortgage debt increased as homeowners released housing equity through the use of flexible mortgage products, accounting today for about 7% loan approvals (RBA 2010; Wood & Parkinson 2009). Withdrawn capital is often used to take up other investment opportunities, often the purchase of rental properties.

### 4.5 Mortgage insurance (MI)

Blood (2004) describes mortgage default insurance as a type of credit enhancement, which has been used mainly for two reasons. First, it is used to expand access to home mortgage financing and, therefore, to homeownership by inducing lenders to relax their loan approval standards. The Australian government created, but later privatised, a mortgage insurance vehicle that protected mortgage lenders from default (Yates and Berry 2011, p. 1136).

MI will be required if a mortgage contract is higher than the traditional LTV of 80%. Over time, in both the USA and Australia, maximum LTVs, that used to be around 80%, gradually moved upward to 95% and even 97%<sup>14</sup>.

Second, it is used to stimulate the flow of funds from capital markets into the housing and mortgage sector by reducing risk to the investor. Most securitised pools consist of loans that are privately<sup>15</sup> insured, either with standard 100% loan-level coverage or bulk insurance. In Australia, MI provides 100% cover.

### 4.6 Full recourse lending

Australia's federal legal system places full recourse for residential mortgages onto the borrower. This means the lender can pursue full recourse through the borrower's other assets, including future income (Austrade 2009). This is in addition to foreclosing on the collateral of the

property and is in contrast to the United States where borrowers, in some cases, are able to simply walk away from their underwater loans.

In sum, the Australian mortgage market, along with the USA market and others, has been viewed as the "the most flexible and complete" (IMF 2008, p. 106 in Murphy 2010, p. 340). The shape of the market resulted in borrowers finding it much easier to access mortgage finance in order to purchase a house than was the case prior to deregulation. Borrowers have been able to bridge affordability gaps, which previously would have precluded them purchasing a house, by accessing mortgage loans with much higher LTVs than had been the norm. Moreover, they have been offered a choice of various mortgage lending options that are able to assist some households to enter the market that would in previous times not been eligible. From the lender's side, the risk these loans entail has been mitigated through the use of variable interest rate loans, fully covered mortgage insurance and the ability to attach not only the immovable asset, but other assets owned by the borrower as well. In addition, both banks and non-bank lenders have used securitisation to move loans off of their books, reducing their risk even further.

## 5. Non-performing loans (NPLs)

Fitch Ratings (2011) reports that Australian household debt as a percentage of disposable income has risen from 49.4% in December 1991 to 156.4% in December 2010. At the same time, interest payments to disposable income have risen from 9% in 1989 - when the residential mortgage interest rate was around 17% - to the current 11.9% in December 2010, when the residential mortgage interest rate was around 7.5%. Moreover, as house prices have risen housing affordability has been squeezed with a dwelling price to income ratio of 6, almost twice that of the United States at 3.2 (Burke & Hulse 2010). These indicators reveal a substantial rise in the indebtedness of Australian borrowers. Today as the economy weakens, job losses begin to occur and interest rates rise households are coming under increasing pressure<sup>16</sup> to service much higher debt levels.

In comparing NPLs in the United States, with Australia, there is no doubt that the former stands far ahead of Australia with close to 10 per cent versus less than 2% overall default levels. Early this year arrears on prime RMBS<sup>17</sup> of 30 days or more hit a record high of 1.79%, while arrears on low-doc loans of 30 days or more hit 6.74% and arrears on conforming low-doc loans went over 5% (The Age, 26 May 2011). Noteworthy is the fact that in 2006, when the USA housing market just began softening its NPL rate was almost identical to Australia's rate which was 1.5 at the time. When the housing market reversed, the increase in USA's non-performance was dramatic, spiking to 10% within two years (REIA 2010).

The RBA, Deputy Governor, Ric Battellino has recently stated the Bank's concern about the lending that was done post-GFC when the federal government increased the First Home Owners Grant as a means of stimulating homeownership (The Age, 27 May 2010). At the same time the official cash rate fell from 7.25% to 3%, which drew a large number of first-time buyers into the market. Between November 2009 and 10, the RBA raised the rate to 4.75%, where it has remained until it was lowered to 4.5%, the first cut since April 2009.

In addition, he raised concerns about a growing number of home owners in Perth and South East Queensland who bought at the peak market during 2006 and 2008 and are now falling behind in their mortgage payments, stating, that these regions were repeating the experience of Western Sydney, which still has an elevated level of housing loans arrears, "following unscrupulous lending a decade ago" (The Australian, 27 May 2011).

In September 2011, Moody's Investor Service announced that the ability of the Australian home owner to keep up with their mortgage payments has declined over the past year. This was in spite of the strength in the economy, in particular in the mining sector. Since 2010, mortgage performance was showing a material deterioration. Noteworthy is the fact that the biggest declines in mortgage performance are being seen in Queensland and Western Australia, the two states that have been the

<sup>14</sup> A recent report by Merrill Lynch notes that after tightening lending criteria at the start of the GFC banks have been progressively lowering it as they compete for new customers, (ANZ at 92%, National Australian Bank at 95% and Westpac and Commonwealth Bank at 97%) (The Age, 21 May 2011).

<sup>15</sup> In the United States, timely payment coverage on securitised loans is provided by government-sponsored enterprises.

<sup>16</sup> In Fujitsu's 2010 *Mortgage Stress Report*, using a definition of 30% of income going onto mortgage repayments, and based on a series of questions it developed to diagnose mortgage

stress, it found there were approximately 581 000 households in some degree of mortgage pain and predicted that by December 673 000 households would be in some degree of discomfort, with 290 000 in severe stress. The risk factors were linked to higher interest rates coupled with effective falling net incomes and rising cost of living.

<sup>17</sup> Fitch Ratings has also recently downgraded 54 tranches of RMBS from ratings watch "stable" to "negative" which represents approximately \$1.5 bn of the \$80 bn in RMBS transactions (The Age, 26 May 2011).



biggest beneficiaries of the mining boom. This is partly explained by the fact that non-mining jobs account from most of the employment in both states and such jobs have lagged behind the mining sector.

## **6. Negative equity and house price risk**

Wood & Parkinson (2009) note that since 1996 house prices have increased at rates well above consumer price inflation in all Australian cities. During the boom that began in 1996 and then lasted until 2003 – 04, prices rose to approximately 2.7 times their 1990s level. In 2004 a plateau was reached and prices started to decline, first in Sydney, followed by Brisbane and Canberra. Today, Melbourne and Perth appear to be catching up to the downturn that hit the other cities earlier. Moody's (2011) states that homes purchased after 2007 have lost over 7% of their value.

Wood & Parkinson argue that house price decline and the build-up of negative equity might be accommodated if those affected had other forms of savings to fall back on. Since many of the buyers over the past few years have been younger couples who have no cushion of savings to fall back on, and hold other debt, they don't foresee such an outcome. After carrying out an analysis of the position of homeowners, they concluded that price declines of 10% could leave over 300,000 Australians with negative equity<sup>18</sup> in their home.

## **7. Conclusion**

Since the onset of the GFC, the Reserve Bank of Australia has repeatedly pointed to its limited direct impact on the Australian banking system (RBA 2009a in Murphy 2010, p. 343). One of the reasons stated for this outcome included the fact that the Australian banking system had not duplicated the use of overly risky mortgage lending practices as had occurred in the USA. Any effects of the crisis were mainly located in terms of the drying up of funding, which hit the non-bank sector much harder than the retail banks, as many of the former were forced into liquidation while the banks, being better positioned to manage the rising cost of funding, were able to avoid a similar outcome.

This paper, instead of focusing on the widely expressed concern that the seemingly endless rise in house prices has been the main cause of increasingly high levels of mortgage debt has sought to approach this high level of indebtedness through a different lens, that is, through the banks' lending practices. It raises the question as to whether the ways the banks mitigate their risk in the delivery of housing credit also helps to create a situation where households find themselves over-borrowed, particularly when the economy and housing market reverse.

More specifically, it argues that deregulation of the housing finance system led to increased competition among lenders which resulted in an easing of credit standards (RBA June 2011). Moreover, various forms of risk mitigation were crucial to them moving beyond the sound lending practices that, prior to deregulation, had governed the ways banks did their business. Understanding what drives the delivery of housing credit, and how its risks are mitigated, are therefore key to understanding why there is increasing risk in the housing system arising from irresponsible lending and over-gearing.

The ability to package and transfer mortgage risk through RMBS, the use of variable interest rates to cover interest rate risk and mortgage default insurance to cover borrower repayments risk, along with the additional security of being able to attach a borrower's assets through full recourse lending, serves to eliminate nearly all of the lender's risk. For mortgage lenders, operating in a highly competitive environment, these practices have greatly extended the size of the potential borrowing public to whom they market their products.

In Australia, there is a segment of the housing sector, made up of developers, property and bank economists, and real estate industry representative bodies, that has continuously argued that house prices will more than likely indefinitely rise and that there is very little chance of a housing bubble. For example, the Real Estate Institute of Australia (REIA) in its paper, *Australian Housing Prices: Bursting the Bubble Myth* (2010) strongly counters the view that the market is beginning to look like the American market by attempting to demonstrate that mortgages in the United States were far riskier than in Australia and that house prices are likely to continue rising as they have in the past

because of chronic housing shortages, increasing population through in-migration and so on.

At the same time, it is clearly the case that there are a number of attributes of the Australian housing finance system, for example, grants and favourable taxation policies, that have promoted home ownership and underpinned the housing market's success. Moreover, other factors, for example, the country's booming international export market has also contributed to it. China and India's demand for Australian minerals and natural resources has resulted in a growing economy and strengthened the Australian dollar; however, this situation has also increased the risk of inflation. As a result, for a period, it forced the RBA to push up interest rates from the lows they had dropped to during the GFC. Consequently households that took advantage of the low rates and the First Home Owners Grant being offered during that period are now finding it more difficult to manage their rapidly increasing mortgage payments.

In 2011, with a new round of economic uncertainty coming out of Europe and the USA, it is unclear whether China's demand for Australian exports will continue at previous levels or will slow. If Chinese demand slows and Australia slides into recession, the housing market may not be able to sail as easily through another round of global economic downturn as it did previously.

Americans, in the middle of the last decade were also of the opinion that their housing market would only move in one direction. Moreover, when the turn came, specific housing markets, for example Seattle's, felt it was sheltered from the problems being experienced in, say, Nevada and Florida where the downturn started. Two years after the crisis began these markets turned as well.

In attempting to answer the question of whether Australia's housing market survived the GFC because its lenders were better at managing risk than their counterparts overseas, the latest global economic crisis is starting to reveal that it was more likely forceful government intervention that propped up the market rather than sound lending practices that helped it avoid the earlier economic crisis. With NPLs starting to increase and house prices flattening it remains to be seen whether mortgage originators have been as responsible as Australian's have been led to believe.

<sup>18</sup> A signal of financial stress is failure to keep up with repayment schedules. In Wood and Parkinson's analysis, homeowners with negative equity were more likely to fall behind in their repayment schedule (11%) than those with positive equity (4%).

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