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- Affordable rental housing in the United States: from financial crisis to fiscal austerity
- Affordable housing sector in Russia: evolution of housing policy through the period of transition
- Trends in home-ownership in Russia: the impact of public policy on the emerging tenure structure and the market of housing finance
- The state of housing finance in Canada and recent developments
- Housing-construction market risks in Turkey: overrated or underestimated?

International Union for Housing Finance

Housing Finance International

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Editor's introduction
Dilemmas in a period of austerity

↳ **By Andrew Heywood**

Providing subsidy to meet housing costs in a period of austerity is usually problematic from a political perspective. The UK Government has recently been reforming the system of UK welfare benefits in order to simplify what has become an immensely complicated set of separate but interrelated benefits, into what will be known as "universal credit". While simplification is undoubtedly much needed, the reform proposals have also been accompanied by a stated aim to "make work pay" and to reduce the burgeoning overall benefit bill.

Universal credit will comprise a single means-tested benefit encompassing payments for those out of work, in low paid work or who are retired on low incomes. Significantly it will contain payments for what is currently known as "housing benefit." Housing benefit currently works on a means-test and meets the entire rent of those on very low incomes (or who are workless and benefit dependent) who live in social rented housing.

The welfare reforms, which will be phased in from April 2013 include some very significant measures with an impact on affordable housing:

- Setting the annual increase in working-age benefits (including rent allowances for those in the private rented sector) at 1% a year for three years; less than the rate of inflation.
- Introducing an overall cap on the level of benefits a working-age household can receive, a measure that will have its first impact on the ability to meet rental payments - including social rental payments.
- Substantially cutting the rental element of the benefit of households deemed to be "under-occupiers", i.e. those judged to be living in a social rented home with too many bed spaces. The aim is to encourage these households to free-up larger social rented homes by moving to smaller accommodation.
- Moving from a system where housing benefit is usually paid directly to social landlords, to one where benefit is paid directly to the tenants, who will then be responsible for paying the rent to the landlord.

Such reforms can be justified as promoting important values such as "responsibility". However, while they will probably contribute towards achieving the first fall in the annual benefit bill for many decades they will have important negative effects; and not just on the living standards of the tenants concerned. The housing associations who build most new affordable housing in the UK have operated on a funding model that requires them to attract private finance from banks and the capital markets to fund this development. The government measures outlined above will have a direct impact on the ability of such landlords to keep rent arrears low, to maintain rent collection costs at reasonable levels and to minimise void periods. In turn this erosion of the income stream and increase in costs will have an impact on the capacity of such organisations to attract investment and maintain financial viability. This comes at a time when the Government has recently cut back the level of supply-side grant for social housing to very low levels, forcing such new housing as is being developed to be let at much higher rents than hitherto. Ironically almost all commentators believe that this will push up the housing benefit bill over the longer-term, thus partially undermining Government's attempts to contain it.

Such dilemmas are not unique to the UK. This issue of HFI provides an opportunity to look at the affordable housing position in two of the most significant global housing markets.

Alex Schwartz, offers an insightful article that examines how the affordable sector has fared in the USA as austerity in the public finances has bitten deeper. His article analyses the position of both "shallow subsidies" that aim to secure sub-market rents and the "deep subsidy" programme that focuses on those households with the lowest incomes. While the position is complex it is clear that there is both a decline in funding and an increased need for affordable housing in the current period.

In what is one of the first two articles on Russia in HFI for quite a while, Andrey Tumanov also addresses issues around the provision of affordable housing. He traces the development of Russian housing policy in this area since Soviet times to the present and examines the difficulties in ensuring sufficient appropriate supply in a situation where in the mid-2000's 61% of Russian families were experiencing difficulties with housing and were dissatisfied to varying degrees with their living conditions.

The second Russian article in this issue compliments the first and thus allows readers to focus on the spectrum of housing activity in the country. Marina Khmelnitskaya examines the trends in home ownership in Russia over the past 20 years, during which owner occupation levels have soared to around 85%. She analyses the development of the mortgage market in Russia, which has been growing rapidly again in the post-financial crisis period and also examines the housing market, which achieved 3.9 million transactions in 2011 out of a total stock of 59.5 million units.

The contrast between the performance of the Canadian housing finance market and that of the USA during the financial crisis has been noted by many commentators. For this issue of HFI the Canada Mortgage and Housing Corporation (CMHC) has prepared an article offering a comprehensive overview of housing finance in Canada. This goes a good way towards explaining its resilience, highlighting as it does such key features as the existence of compulsory government-backed mortgage insurance on those parts of loans that fall above 80% loan-to-value.

Yener Coşkun has provided valuable analysis on Turkey for HFI before. In this issue he focuses on the risks faced by the housing construction industry in the post-financial crisis period. Mr Coşkun also analyses the wider impact of those risks in what has proved to be a volatile if fast-growing national economic environment.

In addition to our regular regional roundups we are very pleased to offer a special feature on deflation in Japan by Masahiro Kobayashi, the Chief Economist at the Japan Housing Finance Agency.

If you have an interest in financial risk and economic stability you should not forget the *28th World Congress* of the IUHF to be held in Vienna from 5th to 7th June 2013. It promises to be a key event, bringing to together a unique collection of experts in this beautiful part of the world. More details of the Congress can be found on the IUHF website.

Contributors' biographies

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Marina Khmelnitskaya is a member of St Antony's College, Oxford. She gained her doctorate from the Department of Politics, University of Oxford. Her thesis was on the subject of politics of housing reform in post-Soviet Russia. In 2011-2012 she held a post-doctoral fellowship at the Russian and Eurasian Studies Centre, St Antony's College. She is an author of several publications about Russian housing policy and is working on publishing her dissertation as a book. Email: marina.khm2012@gmail.com.

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Steve Mennill has held positions of increasing responsibility since joining Canada's national housing agency, Canada Mortgage and Housing Corporation (CMHC), in 1993. Currently, he is CMHC's Vice President of Policy, Research and Planning. Steve holds an MBA, University of Toronto, and a Bachelor in Environmental Studies in Urban Planning, University of Waterloo.

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Alex Schwartz is Associate Professor of Urban Policy at the New School, a New York City-based university. He is the author of *Housing Policy in the United States* (Routledge, 2010), and is the managing editor for North America for the international journal Housing Studies.

Andrey Tumanov is a housing and mortgage specialist at Agency for Housing Mortgage Lending, Russian mortgage developing institution. He has an over 10 years experience in housing finance and real estate studies in Russia and other CIS countries and previously worked for Institute for Urban Economics, leading Russian NGO in urban development. Email: atumanov@ahml.ru

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Housing finance news from Africa: A focus on housing microfinance

↳ By Kecia Rust, African Union for Housing Finance

Rapid urbanization and affordability constraints among the majority of urban dwellers in Africa have put increasing pressure on the growth and sustainability of African cities. With traditional housing financing mechanisms beyond the reach of those most in need, alternative approaches to financing housing have to be found. It is within this environment that housing micro-lenders have emerged as an important source of housing finance for low income earners whose access to more traditional forms of credit is constrained both by their affordability, and the housing circumstances in which they live. With established track records in Latin America and South Asia, efforts to grow this sector formally in Africa have begun to take root.

Of course, the practice of incremental housing construction that a housing microloan would fund, is not new. Low income households across the globe build their houses in stages – and in Africa, the practice of "one room at a time" is also well documented (Malholtra, 2003). Historically, the opportunities to be found in a staged housing delivery process were emphasized by the not-for-profit and NGO sectors. More recently, however, private sector interest in the potential of the sector has resulted in the development of new products, and greater investment activity.

A paper released by the Centre for Affordable Housing Finance in Africa explores the current state of the housing microfinance [HMF] sector in Africa. In the report, Kihato (2013) notes that "*there have been some notable and encouraging advances in the industry, with a steady trickle of new commercial entrants into HMF. Banks, microfinance banks and general microfinance lenders are introducing it, in various shades, as a product within their lending portfolios. Some continue to expand this offering to more and more countries. New commercial entrants are a sign that HMF is still seen as a viable commercial lending operation. Meanwhile the lending activities of less commercially orientated organisations such as housing cooperatives and the NGO sector continues to grow in recognition of the demand and need among lower income earners. The activities of these organisations offer an important contribution to HMF practice in their willingness to take on higher risks, as well as engage with downstream processes such as the house building process itself. They serve as an important repository of knowledge and lessons in this new industry. Further, more and more funding is coming on-stream in the form of grants, loans, equity, as well as technical support, as the sector increasingly becomes an important investment destination.*"

Commercial activity in the HMF sector has been growing for some time. For example, since 2010, home improvement loans have been introduced by Akiba Bank in Tanzania, Centenary Bank in Uganda, African Bank in South Africa, and the Entrepreneurs Financial Centre in Zambia. Select Africa, possibly the leader amongst commercial providers of housing microfinance, has operations in Swaziland, Malawi, Kenya, Lesotho and Uganda, offering loans for incremental home improvement as well as for new housing construction on an incremental basis. Over the past 12 years, Select Africa has disbursed loans to the value of US$ 153.7 million, to 53,539 clients, through a network of 10 branches. At June 2012, their gross loan book was US$31.7m with a 5.7% provision for bad debts.

From a demand perspective, this is just the tip of the iceberg. The MIX Market receives reports from micro lenders across the globe. In 2011, 32 MFIs in Africa reported a gross loan portfolio of US$7.3 billion. It has been established as an industry norm that, in general, 30% of a micro-lender's loan portfolio is used for housing purposes. If this holds, it could suggest that US$2.2 billion or an estimated 2.3 million loans were used for housing purposes. The possibilities of harnessing this demand with better-targeted products that support the specificity of a housing investment are significant.

Certainly, the investment sector has noticed the potential. In the past two years, at least three new funds have come on stream with products targeting the growth of housing microlending on the continent. The New Urban Finance Facility for Africa (NUFF) is being established as a US$100 million facility with the intention to provide catalytic investment in affordable housing and basic services in African cities. Its investments will be made through local banks and microfinance institutions, with the intent of encouraging lending for housing microfinance and other programs for affordable housing real estate development. Initial target countries in Africa include Ghana, Kenya, Tanzania, and Uganda. The NUFF estimates that direct investment in local commercial banks and microfinance institutions will constitute 85% of the fund, with the remaining 15% being invested in a newly established IFC-KFW credit enhancement programme for housing microfinance.

Habitat for Humanity International has established the MicroBuild Fund as its subsidiary, to encourage the provision of housing microfinance and associated housing support services via microfinance institutions. The main shareholders in the US$100m fund are Habitat for Humanity International itself, as well as the Omidiyar-Tufts Foundation. OPIC has invested US$45 million of debt capital in the fund, which will run for at least ten years, providing wholesale loans to between thirty and forty microfinance institutions across the globe. According to Habitat for Humanity International, MicroBuild will provide a source of longer-term social investment capital for financial service retailers who serve the poor so that they can expand their housing microfinance portfolios. Through this effort, it will demonstrate the viability and scale of opportunities of housing microfinance to the microfinance sector, their networks, and the donor and investor communities. The Fund will also provide leading technical assistance in the design and refinement of housing products, and supervise and share best practice with the sector as they emerge. In October 2012, the MasterCard Foundation launched a US$6.6 million, 5-year partnership with Habitat for Humanity to expand microfinance services to maintain and improve homes for disadvantaged families in Ghana, Kenya and Uganda. The partnership will target nine local financial institutions already serving the poor, building their capacity to diversify their products to meet shelter-related needs. The institutions describe this as a pilot initiative, which will be tested for scale and growth.

A third example is the Community Led Infrastructure Finance Facility (CLIFF), a programme managed and part-funded by Homeless international, that enables organisations to access greater resources to deliver adequate and sustainable housing and basic services for slum dwellers. CLIFF provides financial support through capital funds (in the form of a loan, grant or guarantee) to enable implementing partners access finance or on-lend for project construction related costs. Operation funds include the costs of CLIFF implementation and address project preparation, management, documentation, and dissemination phases of the project. CLIFF sources its own, largely grant funding, through the British Department for International Development (also known as UKaid), the Swedish International Development Cooperation Agency and Homeless International. CLIFF and HI work in a number of countries throughout Africa, promoting housing microfinance and incremental housing development. From January 2010 to March 2012 representing its second phase of lending, the cumulative total for funds in its Africa operations amounted to more than US$ 7 million.

Finally, there have been a series of smaller, more targeted, but no less significant investments. In June of last year, Shelter Afrique approved a US$500,000 loan to Makao Mashinani, a housing micro-lender based in Kenya. The loan, expected to touch 2000 families, was provided over seven years, and is the first ever facility to a micro-lender by Shelter Afrique. In Nigeria, Alitheia Micro Home Loans Facility (AMHLF) is a US$15 million facility, operated by Alitheia Capital. The AMHLF provides capital to micro finance institutions for on-lending to finance home improvements, completions, and extensions. The average loan size offered by AMHLF's partner lenders is US$2000. The facility is expected to reach over 11,000 households over a period of 5 years through as many as 10 partners. In Tanzania, the process of establishing a US$ 3 million fund provided by the World Bank to support liquidity for MF institutions to invest in housing microfinance has commenced.

In an effort to harness and channel all of this energy, a group of colleagues working in housing finance came together in 2012 to consider how the housing microfinance sector might be promoted in Africa. The meeting followed a series of consultation sessions held in nine countries in Sub-Saharan Africa, where local practitioners highlighted the key housing issues they were facing and considered what sorts of support might assist them in addressing the challenges. The sessions resulted in the formation of AHMFI, the African Housing Microfinance Initiative (AHMFI). Still in its infancy, AHMFI is a collaboration between FinMark Trust's Centre for Affordable Housing Finance in Africa (CAHF), Rooftops Canada, Habitat for Humanity International, the Swedish Cooperative Centre, Homeless International, and Development Workshop in Angola. The goal of the initiative is to grow and support the housing microfinance sector in Africa, so that it contributes towards better access to effective and affordable housing finance. Key objectives for AHMFI include the following:

- To collate and share information, commissioning research and developing a body of knowledge for housing micro finance practice in Africa;
- To strengthen the capacity of HMF practitioners in Africa through technical assistance and training, thus improving technical performance of HMFIs;
- To provide a networking function for the HMF sector in Africa, creating a directory of services available, enabling linkages between HMF practitioners, and promoting peer learning;
- To be grounded in practice and to continually refine and update from field experience.

All of this activity will be the subject of discussion at the forthcoming, 6th African Microfinance Conference, to be held in Durban, South Africa in August 2013. While the focus of the conference is broad, housing microfinance is one of five subthemes. A special workshop on the last day of the conference will explore how microfinanciers might develop a housing microfinance product line as part of their business. For more information, visit the conference website at http://corecompetency.co.za/amc2013/index.html

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Asia Pacific region

First quarter 2013 housing finance news from Thailand

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

APUHF: MOU for Cooperation between Asia Pacific Union for Housing Finance and AMPCHUD

Recently, the Asia-Pacific Union for Housing Finance expanded its operational scope by signing a Memorandum of Understanding (MOU) with the Asia-Pacific Ministerial Conference on Housing and Urban Development (AMPCHUD) in Amman, Jordan.

Ballobh Kritayanavaj, Senior Vice President of the Government Housing Bank, Thailand and Mr. R.V. Verma Chairman National Housing Banks attended the signing ceremony.

The Asia-Pacific Union for Housing Finance (APUHF) is a knowledge-sharing and networking platform. APUHF's aim it to provide a basis and a platform for exchanges of idea, experiences, events, practices and products in different Asia-Pacific countries which may help in policy design, strategic intervention and design of different instruments for low income housing and the housing finance market, exchange of learning and best practices so as to facilitate a coordinated approach towards "Housing for All" in different countries in the region.

AMPCHUD encourages and promotes the strengthening of Asia Pacific region good urban governance through sustainable advocacy platforms for inclusive urban governance, innovative housing, urban development and land management practices.

India

The National Housing Bank of India (NHB), APUHF and The Asia-Pacific Ministerial Conference on Housing and Urban Development (AMPCHUD) are jointly arranging an international housing Conference in Delhi India on April 11-12. The Conference is expected to receive international and local housing experts.

Thailand: GH Bank's acting president receives Habitat for Humanity award

Laiwan Pongsangiam, Government Housing Bank's Acting President was presented Habitat for Humanity's "High Spirit – Sky's The Limit" award for her "untiring and unlimited energy" helping Habitat Thailand explore and seek out those in most need of help across the country.

Habitat for Humanity recognized key donors for their invaluable contributions to Thai society, by supporting, working and partnering with Habitat for Humanity Thailand.

GH Bank was a major participant in Habitat for Humanity's 2009 Jimmy Carter project wherein many US and overseas volunteers jointly rehabilitated many homes in Chiang Mai. GH Bank and Habitat Thailand also rehabilitate numerous homes for low-income flood victims.

Senior bank officers have worked alongside Habitat Thailand volunteers rehabilitating or building more than 1,000 homes since 2009.

Volunteer leaders throughout the Asia Pacific Region dedicate their thoughts, resources, and labor to help Habitat achieve its goal of a world where everyone has a decent place to live.

CODI's forward-looking strategic initiatives

Thailand's highly successful community-based low-income area redevelopment program, Baan Mankong celebrates its 10th anniversary in 2013.

After a widely-admired decade of innovative operations, the Community Organization Development Institute (CODI) which oversees the Baan Mankong program has been launching new long term strategic initiatives.

"Our objective is to continue ensuring that the communities themselves become larger major participants in the whole redevelopment process," said Thipparat Noppoladarom, Director, CODI.

Baan Mankong was launched in 2003 as a major government initiative to help redevelop poor underprivileged areas nationwide by providing infrastructure and housing finance subsidies.

Although better housing was a critical objective, the Baan Mankong program emphasized the need to ensure the communities themselves were highly involved in the total redevelopment planning and implementation processes.

Thailand: 2013 special low-interest rate loan campaigns

GH Bank has allocated Bt15 billion ($US500 million) for zero per cent interest loans to five specific customer groups: government officers, welfare customers without deposits (monthly payments deducted from salaries), village sub-district administrative branch staff (monthly payments deducted from salary), Fast Track and Regional Fast Track retail customers and Long Term Financing retail customers.

The Bank has also allocated Bt5 billion ($US167 million) in lower interest-rate housing loans to nine professional groups including physicians, dentists, veterinarians, judges, attorneys, pilots, engineers, pharmacists and university assistant professor level employees and above. The loan interest rates will be discounted by 0.25 per cent from normal loan rates for two years.

Bangladesh

The Bangladesh Housing Finance Corporation has submitted a proposal to the World Bank for its assistance in promoting low-Income housing in Bangladesh.

Pakistan

The State bank of Pakistan (SBP) in association with Association of Mortgage Bankers of Pakistan is conducting a Housing Conference on Community Housing and Low-Income Housing Prospects in Pakistan.

Europe

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

In February this year, Eurostat, the statistical office of the European Union, published for the first time house price statistics for the Euro area. The house price index is one indicator of the newly set up Macroeconomic Imbalance Procedure (MIP) Scoreboard, which aims to detect and prevent macroeconomic imbalances within the EU. By including house prices in this Scoreboard, the European Commission acknowledges the fundamental role played by housing markets in the current economic and financial crisis.

The new house price index ended the third quarter of 2012 with negative annual growth rates: prices fell by 2.5% in the Eurozone and by 1.9% in the Euro area. The largest annual increases in house prices in the third quarter of 2012 were recorded in Estonia (+8.4%), Luxembourg (+7.1%) and Finland (+2.1%), and the largest falls in Spain (-15.2%), Ireland (-9.6), the Netherlands (-8.7), and Portugal (-7.7).

The new data from Eurostat show that Ireland, Portugal and Spain have been hit hardest for the fifth year in a row by the severe property crisis. Outlooks are not promising either: the rating agency Fitch warned that prices in Ireland could fall by another 20% before hitting the bottom – on top of the almost 50% decline from the peak to date. Reports from Spain are even more shocking: Spanish top consultants expect house prices in major cities to fall a further 30% in a relentless slide until 2018. The forecast of Fitch ratings for Portugal is – although still depressing – a bit brighter: house prices are expected to fall by "only" another 15%.

Clearly, the news of tumbling housing markets in some countries in the Euro area will loom large for some time to come. Therefore, it seems to be a pressing task to identify the elements that contribute to stability in the housing and housing finance markets. In this regard it might be useful to first identify the housing markets that are characterised by long periods of stability. In a recent study, the OECD compares the standard deviation of house prices in several countries during the period 1970 to 2012 (see figure 1).

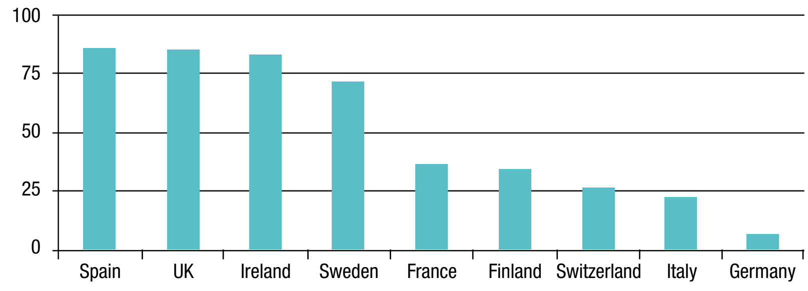
The differences in the standard deviation are remarkable but it stands out that Germany had in the last 42 years the lowest real house price volatility not only in Europe but of all OECD countries. To look at the German housing finance system and housing market in detail is beyond the scope of this column so that the focus here is on the characteristics that stand out.

Of central importance is certainly the German lending practice which is usually characterised as cautious and long-term in nature. Most housing loans have a long duration with fixed interest rates for the whole term and buyers usually bring considerable equity with them. It also stands out that there are no noteworthy subsidies or tax advantages for home owners in Germany – indeed, it is a well-known fact that a favourable treatment of owner-occupied housing can have adverse effects on housing and other markets by distorting investment and tenure choice. Another stabilising element besides the tax/subsidy and financing aspect might be also the availability of different types of housing tenure. In contrast to many other OECD countries, the German housing market is characterised by an almost equal share of owner-occupied and rental housing. A functional rental market may help to attenuate house price inflation. Last but not least, a reasonably efficient designation of new land for development may have helped to accommodate fluctuations in housing demand.

This concise overview of German "best practice" might be interesting – but it will be not very helpful for the most troubled countries (like Spain) that are confronted with an economic recession and high and rising unemployment. House prices are of course affected by the overall economic situation, by factors that lie outside of the housing market and housing finance sphere.

However, a prudent banking supervision regime – as the case of Germany also shows – is able to mitigate house price variability. The countries of the Euro area and the European Union are struggling to find new rules for the banking industry. In the next edition of Housing Finance International an article by Christian König will look in detail at the progress of this attempt.

Figure 1 Standard deviation of real house prices in the period 1970 to 2012



Source: OECD

North America - the lessons of financial history, reprise

By Alex J. Pollock, resident fellow at the American Enterprise Institute at Washington, DC

It has been almost seven years since the mid-2006 peak of the spectacular U.S. housing bubble. With an American housing recovery now at last under way, it is a good time to re-state the repetitive lessons of financial history.

The bubble, the panics and crises of 2007-09, and the extended bust and post-bubble doldrums, present a striking case of recurring financial and political patterns. This is true not only in the U.S., but also in the European housing and government debt disasters.

These patterns notably include the painful dilemmas of governments when using taxpayers' money to offset the losses of financial firms, all in the name of financial stability. The bubble events have already filled dozens of books and thousands of articles in this cycle, but the debates go back at least to 1802, when Henry Thornton, in The Nature and Effects of the Paper Credit of Great Britain, discussed the "moral hazard," as we now call it, necessarily involved.

Financial systems all involve an uncomfortable, and indeed a self-contradictory, combination, arising from the public's deep desire to have short-term assets, especially deposits, which are riskless. Governments feed this desire under the rubric of promoting "confidence." But these short-term instruments fund financial businesses which are inherently very risky, and subject to periodic losses far greater than anyone ever imagined, notably in the financing of real estate.

Consider in this respect Fannie Mae and Freddie Mac, with their government-guaranteed funding: between 2007 and 2011, they together lost $246 billion. This wiped out the aggregate combined profits they made from 1971 to 2006, or the previous 35 years, plus another $140 billion! Quite amazing: Nobody predicted that Fannie and Freddie would fail from making bad loans, and nobody predicted a collapse of this magnitude. But the U.S. government has completely protected all the Fannie and Freddie bond and MBS holders. The repetitive lesson: To combine risky businesses with riskless funding is, in fact and in principle, impossible. But governments around the world insist on trying to do it anyway. They are therefore periodically put in the position of desperately wanting to protect the funding by transferring losses from financial firms to the public, and transferring money from the public to the financial firms, as once yet again in this cycle.

Consider the four approaches available to a government faced with an emerging financial crisis and possible collapse.

First, there is issuing official assurances. For example, this time around in the U.S., there was the official refrain that "the subprime problems are contained" of 2007. Or official statements in the summer of 2008: Fannie and Freddie "are adequately capitalized… They have solid portfolios." Or "Let me just say a word about GSEs [Fannie and Freddie]…They are in no danger of failing." This was just before they failed. Should anyone believe what government officials say in such circumstances?

Second, there is allowing delay in recognizing losses to avoid panic and "loss of confidence," and hoping things will get better. This we know as both regulatory "forbearance" and also as "extend and pretend." It sometimes involves "adjusting" the accounting to stretch losses out over time. Sometimes it works, but often it does not.

Third, there is using the central bank as emergency liquidity provider or "lender of last resort," to expand the "elastic currency" (as the Federal Reserve Act called it in 1913). This was and continues to be energetically practiced by the U.S. and European central banks. They can and did implement Walter Bagehot's classic 19th century advice that in a panic, central banks should lend freely on good collateral. Central banks can extend this notion to lending on dubious collateral, then to inventing new last resort lending structures, as was done in the U.S. for Bear Stearns and AIG. With all this, central bank lending may be enough.

But maybe not enough. For however freely the central bank may be lending, it is by definition providing more debt, not equity. If your equity is gone and you're broke, no matter how much more somebody lends you, you are still broke. In the worst cases like the most recent bust, which involve heavy asset price deflation and the destruction of financial system capital, the losses wipe out the equity of many firms whose liabilities the public thought were riskless. In such times, suddenly no one knows for sure who isn't broke, which stokes the panic. Then something more is required.

So fourth, there is the government (really the taxpayers, needless to say) as provider of new equity capital for financial firms. If successful, this may be a bridge to private recapitalization when normal financial functioning is restored in time. Of course, all four of these government responses may be and indeed were in recent years happening at the same time.

In this cycle, the equity provision in the U.S. was in the form of "TARP," in which the government purchased preferred stock in financial institutions--much of which has now been retired at a profit to the Treasury, as banks have recovered. The U.S. government did the same thing in the 1930s, when its Reconstruction Finance Corporation invested in about six thousand banks, and operated overall at a modest profit. Government investment in bank equity was also prominent in European countries in this cycle, and in Japan and Sweden in the 1990s. A massive government equity injection this time around was the $187 billion of senior preferred stock of Fannie Mae and Freddie Mac which the U.S. government bought and is still holding, with a large unrealized loss, so far.

It is indeed too bad that the taxpayers get transformed into involuntary equity investors in financial firms in this fashion. But no students of financial history, including the history of government guarantees of deposits and other debt, are surprised by any of the four developments we are considering.

They are even less surprised by the inevitable fifth development, which comes after the crisis: a big increase in financial regulation, with complex and costly new rules and multiplied and expanded regulatory bureaucracies. This is accompanied by the reiterated official promise that "this new regulation will ensure that a financial crisis will never happen again." But it always happens again anyway.

The great economic historian Charles Kindleberger, considering four centuries of financial history, observed that financial crises occur on average about every ten years. More recently, Carmen Reinhart and Kenneth Rogoff, surveying eight centuries of booms and busts, reached a similar conclusion. Alas, as far as housing and debt cycles go, there is nothing new under the financial sun.

As memorable as the repetitive lessons of our recent financial adventures seem now, will future financial actors sufficiently remember them? On the historical record, one must doubt it.

Housing finance in Latin America

↳ By Ronald A. Sanchez Castro

In Argentina, the housing credit program PROCREAR has been established since the middle of last year. To date it has benefited more than 68,000 families and the goal is to deliver 100,000 credits in the first year. This program seeks to stimulate the real estate sector during the depression. However, according to the Association of Notaries of Buenos Aires in January 2013 the number of purchases/sales of properties in the Province of Buenos Aires fell 36.1% compared to the same month of 2012, while the value of transactions dropped by 38.3%.

In Brazil, in 2012 Caixa Economica Federal (CEF) reached a new record in home loans nationwide with growth of 33.8% and with a total of R$ 101 billion disbursed. Against this background, the Brazilian System of Savings and Loans (SBPE) reported earlier this year that funding for housing is set to rise to 95.2 billion reais in 2013. For the first month of 2013 the Brazilian Association of Entities of Real Estate Loan And Savings (Abecip) showed that 35,500 properties were financed which represented an increase of 5.4% over the same period last year. Also projections of Secovi-Sp and Sinduscon-SP, indicate that construction will grow between 3.5% and 4% and home sales will grow by 5%.

In Chile, lending for housing finance was very strong last year. In November 2012 it registered an increase of 8.95% over the same month last year. Faced with a possible overheating of the real estate market, the government has implemented more restrictions and increased the underlying costs for banking; so much so that by January 2013 the average interest rate on housing loans in UF increased to 4.43%, the highest level seen since February 2010 when it reached 4.6%. However, expectations for investment in the construction sector remain strong particularly as the Chilean Chamber of Construction (CCHC) estimated that construction investment would record a growth of 7.3% this year.

In Colombia, a strong momentum was given to the 100% subsidy of housing, through a program of 100,000 free units of housing provided by the government. Until the end of 2012 around 75,000 homes were bid for. This intervention has not only boosted the demand for housing, but also the supply of homes, and the provision of finance by banks to builders and developers has been a key element. The government also seeks to expand the provision of housing subsidy to families. Earlier this year the government extended the subsidy ceiling of social housing (VIS) to 12`969,000 pesos. This will ensure that families receive more than 4.02% in subsidy for the acquisition of VIS.

Earlier this year in Costa Rica, the Mortgage Bank of Costa Rica reported that this year it has approved $160 million for about 10,000 family housing bonds. Of these funds it is believed that $ 64 million is intended to serve families in dire need. This measure ensured an upward trend in sector development, but the announcement by the Central Bank of Costa Rica (BCCR) that it is placing a limit on the credit portfolios of colones and dollars will affect private sector banks, and limit access to home ownership for middle class and lower-middle class families. This was illustrated in early March when a number of banks began increasing their dollar rates by between 1 and 1.5%.

In El Salvador, in relation to housing finance the Salvadoran Banking Association (Abansa) determined that the loan transactions last year were valued at $ 2.180 million, representing a slight increase of 1.5% compared to the level of operations for the previous year. Meanwhile, the value of portfolio construction projects contracted by 6.5% from $ 398.3 million in 2011 to $ 371.7 million in 2012. Regarding the latter, earlier this year the Social Housing Fund (FSV) determined that because housing supply is lagging, interest rates will remain at 6% for construction of social housing.

In Mexico, the Institute of the National Housing Fund for Workers (Infonavit) is the largest funder of the nation's housing loans and granted around 578.396 in 2012, which represented a growth of 15.4% over the previous year. Now with a new housing policy, Infonavit among its new guidelines seeks to integrate their actions in financing urban development, redirecting finance to construction in areas where demand is required, boosting loans for housing renovation and promoting initiatives to support new market segments.

In Panama, at the beginning of this year the government decided to increase to $ 40,000 the maximum price of homes that will benefit from 100% preferential interest loans, so that more families can take advantage of this subsidy. It seeks to maintain the good performance shown by the real estate sector in housing sales. In relation to the latter, the National Housing Promoters (Convivienda) have predicted that home sales will grow 16% for this year.

In Peru, the Association of Banks (Asbanc) reported that in November 2012 the banks gave mortgages amounting to S/.23, 308, 23.21% higher than the same month of 2011, and in the face of possible overheating of the real estate sector, the government implemented preventive measures including an increase of 0.75% in the reserve rate set by the Central Reserve Bank (BCR) in order to moderate credit expansion. This was reflected in increased arrangement fees for mortgages, which went from 10% to 20%.

In Venezuela, housing finance is being directed mostly to the program Great Mission Housing Venezuela (GMVV). However, it has also provided grants quite separate from that program, including grants from the National Housing Bank and Habitat (Banavih), which increased the amount of subsidies for the purchase of housing units from 500 million bolivars in 2011 to 2,500 million bolivars in 2012.

Asia Pacific Region - focus on Japan
Is Japan getting out of deflation at last?

By Masahiro Kobayashi, Chief Economist, Global Markets, JHF[1]

The Japanese economy has been suffering from the collapse of bubbles in property markets since the early 1990's and the sluggish state of her economy is often referred to as "lost decades". Actually, the price of land in Japan has been declining for 20 consecutive years since 1992 (Figure 1).

Until the early 1990's, there was a belief, or myth, among Japanese citizens that housing is a good investment because land is a scarce resource. In the late 1980's, the price of land in Japan skyrocketed, together with stock prices. The Nikkei 225, the most representative stock price index, peaked out in the end of the year 1989, followed by the land price.

During the bubble period, the non-financial corporate sector expanded their leverage with the expectation of continued strong economic growth. This turned out to be too optimistic and their excessive investments in production facilities turned into un-utilized assets, or non-performing assets. As the Japanese economy slowed down through the 1990's, these non-performing assets became burdensome on the banking sector as well, which lead to a banking crisis in the late 1990's. The banking crisis in Japan was exacerbated because it coincided with the Asian Currency Crisis and the Russian Crisis in 1997 and 1998.

During the same period, overall inflation pressure has been subdued (Figure 2).

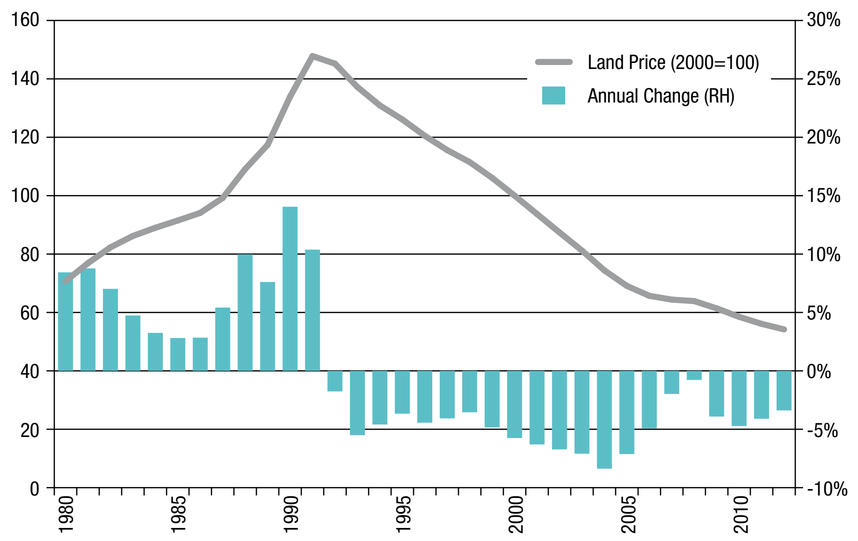
Through the late 1980's to early 1990's when the Japanese economy was in the bubble stage, the consumer price index (CPI) rose more than 2% annually. Since the late 1990's, the CPI growth rate has been negative for most of the observed months. This negative growth of the CPI is translated as disinflation or deflation.

In many countries, especially among emerging economies, the problem of price stability is inflation, not deflation. People are suffering from inflation in emerging economies because their nominal income growth is often less than the CPI growth and hence the real income declines as inflation intensifies. However, deflation is as bad as inflation, especially if deflation persists for many years.

As the overall price of goods and services decline, the market size shrinks and business owners tend to slash jobs or reduce salaries to maintain profitability. If all business entities do so simultaneously, purchasing power of the consumer declines over time, which shrinks the market size. This vicious cycle persists so long as people's expectation for inflation is negative. If they think deflation will continue, they will think it is better to save than consume or invest, thus hoarding money.

People's expectation of persistent deflation has been reinforced by demographic factors. The population in Japan started to decrease since 2010 and is estimated to do so for decades to come (Figure 3).

Figure 1 Land Price in Japan



Source: Japan Real Estate Institute

[1] Views and opinions mentioned in this paper are the author's own and do not necessarily represent that of JHF or the Government of Japan.

Furthermore, within the decreasing population, the proportion of elderly people is likely to increase, which means those of working age have to pay more for social security benefits. The inverse dependency ratio, the ratio of working age population (aged 15 to 64) divided by dependent population (younger than 15 or older than 65), is likely to decline for decades as well (Figure 4).

Demographic factors have a strong impact on housing markets (Figure 5). Figure 5 illustrates the relation of inverse dependency ratio with numbers of housing starts and real land price (nominal land price divided by CPI) in Japan. The period when the inverse dependency ratio is high is referred to as the "population bonus" phase. In the case of Japan, there are two peaks in the population bonus, one in late 1960's and the other in early 1990's. These peaks are almost identical in timing to the peaks in housing starts and the real land price.

Based on a projection by the United Nations, the inverse dependency ratio in Japan is estimated to decline for decades to come. Since a population trend is not easily changed, many people in Japan anticipate that the housing market will shrink over time and housing prices are not likely to appreciate significantly or sustainably in the short term. Such an expectation is stubborn, not only for the housing market, but also for prices overall.

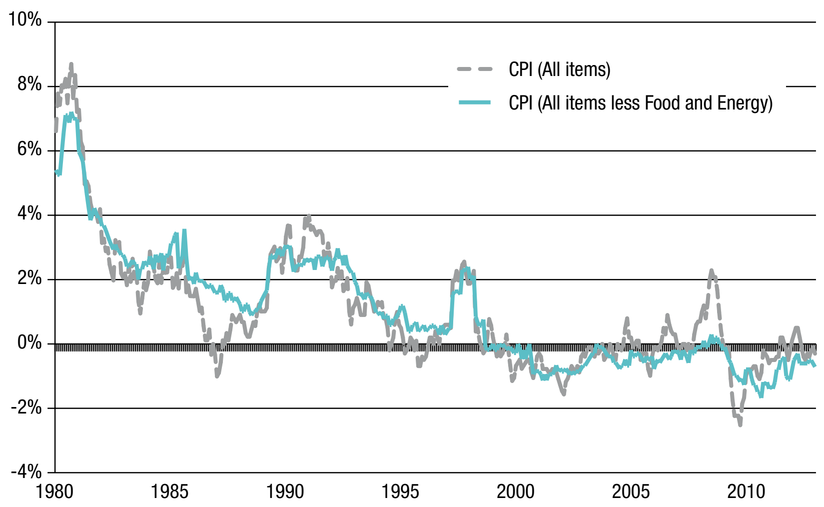
However, in an international context deflation is not necessarily caused by a decrease in the population. Based on the International Monetary Fund's [IMF] "World Economic Outlook (WEO) Database", there are 20 countries in the world which had lower population growth than Japan from 2000 to 2007, 15 of which had negative population growth (many of them are in Eastern Europe). None of these 20 countries have experienced deflation in the same period (Figure 6).

By combining the IMF-WEO data and the UN population projection, we can analyze correlation of the CPI growth with an inverse dependency ratio as well (Figure 7). The outcome is similar to Figure 6. There are 19 counties which had negative growth of their inverse dependency ratio from 2000 to 2007 including Japan. But none of the 18 other countries experienced deflation. These 18 jurisdictions include countries in Western Europe such as Germany, Italy, Netherland, Denmark, as well as countries in Africa. The population bonus is diminishing in some Western European countries because the population is ageing (increase in aged +65) while in some African counties the opposite dynamic demographic trend is active (increase in aged 0-14).

In order to change the pessimistic view of Japanese citizens of the domestic housing market, we have to further analyze other factors that are specific to the Japanese market. At least, we have to advocate that a decrease in the population or diminishing population bonus per se, is the cause of deflation or depreciated property prices.

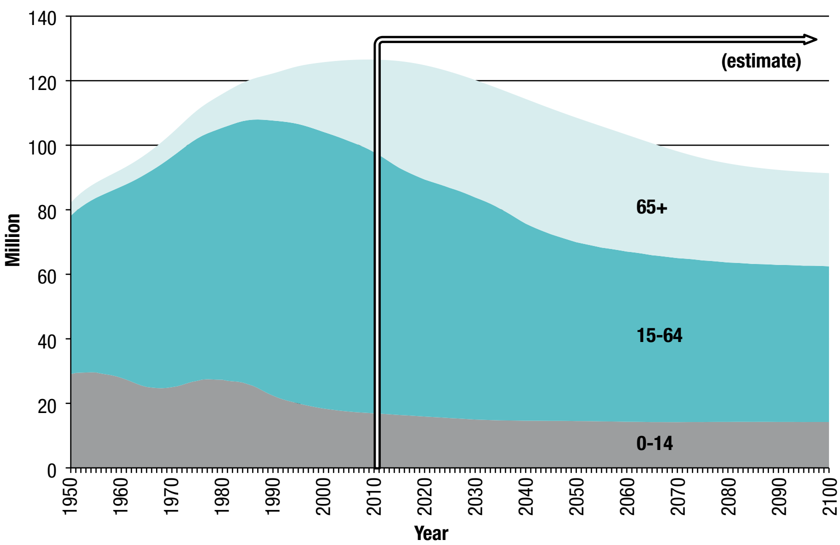
Recently, the Government of Japan has launched a strategic plan to boost the Japanese economy to get out of deflation. Stock prices have picked up significantly and the attitude of individuals seems to have been changing. We hope that this trend continues and has a positive impact on the housing market.

Figure 2 Annual Percentage Change in Consumer Price Index (CPI)



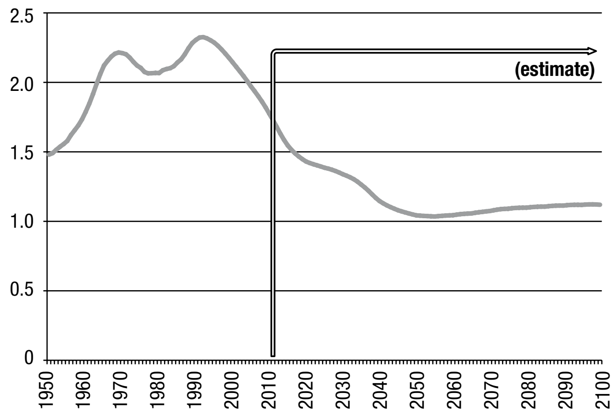
Source: Ministry of Internal Affairs and Communications

Figure 3 Japanese Population by Age Group



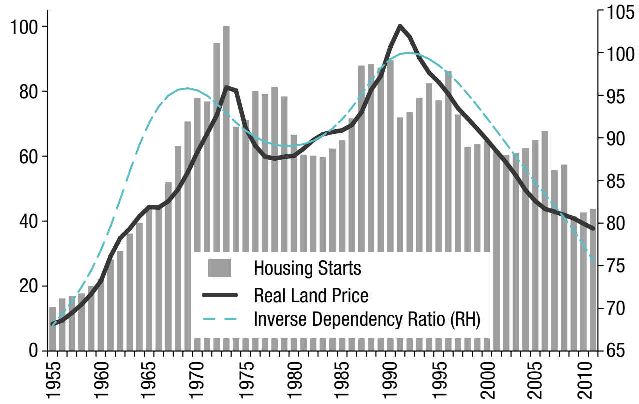
Source: United Nations, Department of Economic and Social Affairs, Population Division. World Population Prospects: The 2010 Revision (June 2011)

Figure 4 Inverse Dependency Ratio for Japan



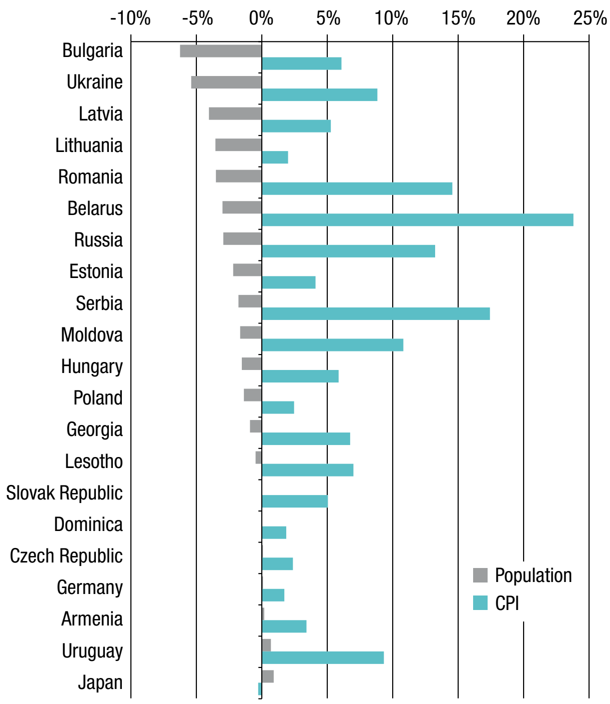
Source: United Nations, Department of Economic and Social Affairs, Population Division. World Population Prospects: The 2010 Revision (June 2011)

Figure 5 Numbers of Housing Starts, Real Land Price and Inverse Dependency Ratio
(Highest level for each is indexed to be 100)



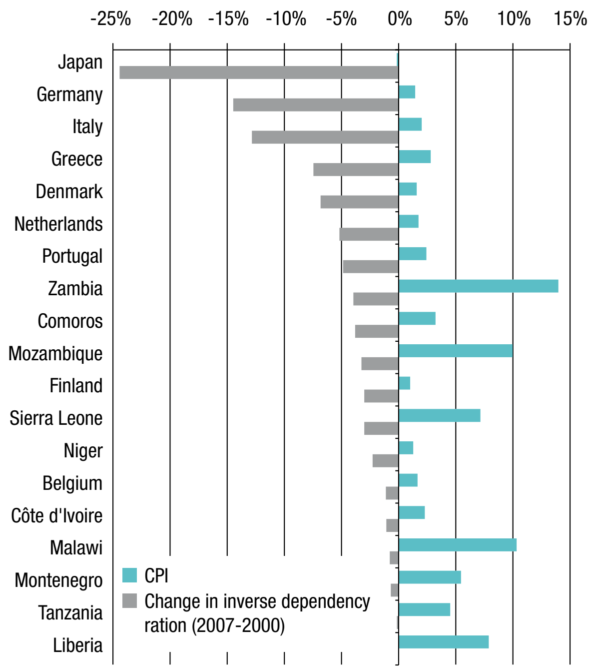
Source: Ministry of Land, Infrastructure, Transport and Tourism, Ministry of Internal Affairs and Communications, Japan Real Estate Institute, and United Nations, Department of Economic and Social Affairs, Population Division. World Population Prospects: The 2010 Revision (June 2011)

Figure 6 Annual Percentage Change in Population and CPI from year 2000 to 2007



Source: IMF World Economic Outlook Database October 2012.

Figure 7 Change in inverse dependency ratio and CPI from year 2000 to 2007



Source: IMF World Economic Outlook Database October 2012, United Nations, Department of Economic and Social Affairs, Population Division. World Population Prospects: The 2010 Revision (June 2011)

Affordable rental housing in the United States: from financial crisis to fiscal austerity

By Alex Schwartz

1. Introduction

If "affordable housing" is defined as federally subsidized multi-family rental housing, there are about seven million units of such housing in the United States. This article will examine how this housing has fared since the housing market collapsed in 2008, triggering the worst financial crisis and recession since the 1930s. The crisis and subsequent recession wreaked havoc on the homeownership sector—causing several million households to lose their homes to foreclosure and putting 20% of all homeowners with mortgages "underwater" with negative home equity. However, the crisis also damaged the rental sector, especially affordable rental housing for low- and moderate-income families. While the housing market has shown signs of recovery since 2012, the prospects for affordable housing in a time of fiscal austerity and growing need remain bleak.

The article is organized in four sections. First, I will provide an overview of the key rental housing subsidy programs in the U.S, with a focus on the Low-Income Housing Tax Credit. Second, I will discuss how the housing crisis and subsequent recession affected the tax credit and other "shallow subsidy" programs and how the government responded. Third, I will discuss the impact of the crisis and subsequent period of fiscal austerity on public housing and other "deep subsidy" programs that serve the lowest income families. I will conclude with some remarks on the future prospects for affordable housing in the U.S.

2. Overview of affordable rental housing in the US

The affordable housing sector in the US consists of two broad categories:

- "Deep subsidy" programs that serve primarily the poorest households and are designed so that beneficiaries spend no more than 30% of their income on rent. These programs include public housing, other "project-based" federal subsidy programs for housing owned by for-profit and non-profit entities, and the Housing Choice Voucher program. They also include several smaller programs, including subsidies for rental housing located in rural areas, and for the elderly and disabled.
- "Shallow subsidy" programs that enable rents to be lower than what the market would charge, but not usually to the point where they are affordable to very low-income households. These programs include the Low Income Housing Tax Credit, tax-exempt housing bonds, and HOME investment partnership block grants. They also include various programs operated by state and local governments.

2.1 Deep-subsidy programs

The federal government currently provides deep subsidies to nearly 5 million households in the US. This includes the residents of 1.1 million units of public housing, 1.2 million federally subsidized units that are privately owned, and 2.1 million recipients of Housing Choice Vouchers (HCV). HCV is a demand-side program that enables recipients to rent privately owned housing of their own choosing. Of the three programs, HCV is the only one to see any growth over the past 20 years. The public housing stock declined by more than 250,000 from 1995 to 2011, mostly because of demolitions. The small amount of new public housing built during this period was almost always part of redevelopment schemes, usually under the Hope VI program (Schwartz 2010). Other project-based subsidy programs have remained relatively flat in recent years around at around 1.2 million units. The HCV program has grown by 169,000 households, from 2007 to 2012. However, most of this growth reflects the transfer of households from public housing or in other federally subsidized developments; only 36% of the growth in the voucher program during this period derives from the inclusion of previously unsubsidized households (Couch 2012: Schwartz 2010).

2.2 Shallow-subsidy programs

Approximately 2.5 million households live in housing that benefitted from one or more shallow subsidy programs. Unlike the deep-subsidy programs, which have seen very little growth over the past three decades, the number of units with shallow subsidies increased steadily each year, with some interruption in the wake of the housing crisis.

The single most important shallow-subsidy program is, by far, the Low-Income Housing Tax Credit. It has helped finance more than 2 million units from its inception in 1987 through 2012. The LIHTC is often used in conjunction with other shallow-subsidies, including tax-exempt bonds and/or block grants provided through the federal Home Investment Partnership program. In addition to the LIHTC and these two other federal programs, many states and localities have also provided shallow subsidies for rental housing, often through inclusionary zoning programs and housing trust funds (Mallach and Calavita 2010; Schwartz 2010. (See Table 1 for an overview of the major deep- and shallow-subsidy programs).

Whereas the deep subsidy programs depend almost entirely on Congressional appropriations, most shallow subsidy programs are designed to leverage private investment. For example, the LIHTC acts as an incentive to attract equity investment in low-income rental housing; tax-exempt bonds are sold by states and localities to private investors to provide below-market-rate interest mortgages to developers of affordable housing. Inclusionary zoning and most housing trust funds are tied directly to private development activity and other real estate transactions. As a result of this connection to market transactions, shallow-subsidy programs were adversely affected by the collapse of the housing market in 2008 and the subsequent financial crisis.

2.2.1 The low-income housing tax credit

Because the LIHTC is central to most of the affordable rental housing built in the US over the past quarter-century, it is important to understand how the program works—especially since these features made the program vulnerable to financial crises. As noted above, the LIHTC has helped finance more than 2 million rental units since 1987, making it the largest active supply-side subsidy program in the U.S. Unlike other subsidy programs, it does not offer direct subsidies to households or real estate developers, and it is not overseen by the federal department of Housing and Urban Development. Instead it is part of the federal tax code.[1]

Established by the Tax Reform Act of 1986 the Low-Income Housing Tax Credit (LIHTC) provides investors with a dollar-for-dollar reduction in their federal income taxes. Investors purchase interests, usually as limited partners, in qualified low-income housing developments and are entitled to claim a tax credit for 10 consecutive years. The amount of the tax credit depends on total development costs, the use of other subsidies, the extent to which the property is occupied by low-income households, and the location of the property. Projects involving new construction or substantial rehabilitation are entitled to a 9% annual credit; projects financed with tax-exempt bonds or that involve acquisition only or minor amounts of renovation receive a credit of about four percent (Schwartz 2010). Properties that receive tax-exempt bond financing are automatically entitled to the 4% credit. State housing finance agencies award the 9% credits to proposed developments according to priorities and criteria specified in their "Qualified Allocation Plans."[2]

As of 2011, each state could allocate $2.15 per capita in tax credits (or a minimum of $2.3 million) for qualified housing developments. Investors receive tax credits for 10 consecutive years, and the property must remain affordable for an additional five years (and usually longer). Investors can reduce their federal income taxes by one dollar for each dollar of tax credits they purchase. The amount of the credit is determined by multiplying the credit (9% or 4%) by the "qualified basis" of the property—which, roughly speaking, consists of the total development cost minus the cost of land and certain other expenses. The qualified basis for properties located areas with high development costs on in census tracts with high poverty rates can be increased by 30%. The cost of providing market-rate units or nonresidential space within the development is excluded from the qualified basis.

Whereas "deep-subsidy" programs house people with extremely low incomes, the LHTC tends to serve households with somewhat higher incomes. The maximum eligible income for the program is set at 60% of the area median family income (50% if fewer than 40% of the units are designated for low-income occupancy; but almost all LIHTC properties are 100% low-income or nearly so).

Until the onset of the crisis, the LIHTC was widely considered one of the most successful housing subsidy programs in US history (Belsky and Nipson 2010; Erickson 2009; McClure 2006). Over time it became increasingly efficient, generating increasing amounts of equity for housing developers. At first, the program generated less than 50 cents in equity for every tax credit dollar—that is, housing developers received 50 cents or less for each dollar in tax credits that were allocated to a project. Transaction costs and investor profit accounted for the other 50%. By the mid-1990s the program yielded more than 70 cents in equity, and by the mid-2000s developers received upwards of 95 cents or more for each tax credit dollar[3] (See Figure 1). As a result of the program's increasing efficiency, developers required less "gap subsidy" to make up the difference between the tax credit equity, the mortgage[4], and the total development costs (Schwartz 2010).

Over time, investors accepted lower and lower yields on their tax-credit investments, thereby

Table 1: Overview of subsidized rental housing in the US (total units)

Deep Subsidy Programs (2011)	
Public Housing	1,117,954
Project-Based Rental Assistance	1,229,240
Housing Choice Vouchers	2,147,617
Other (1)	492,412
Subtotal	4,987,223
Shallow Subsidy Programs (2012)	
Low-Income Housing Tax Credit (LIHTC) (2)	2,518,850
Multifamily Bonds (3)	166,354
HOME Investment Partnership_Multifamily (4)	99,440
Subtotal	2,784,644
TOTAL	**7,771,867**

Sources: Center for Budget and Policy Priorities 2012 (Deep Subsidy programrs); National Council of State Housing Agencies 2012 (LIHTC, Multifamily Bonds), and Unpublished data from the US Department of Houisng and Urban Development (HOME)

Notes:
(1) Includes subsidy programs for the eldery and disabled, for rural areas, and other small programs
(2) Units receiving LIHTC allocations from 1987 through 2010
(3) Excludes 786,537 bond-financed units that were also financed by LIHTC
(4) Excludes an estimated 58,401 units that were also financed by LIHTC

[1] The following discussion of the LIHTC is based on Schwartz 2012 and 2012.

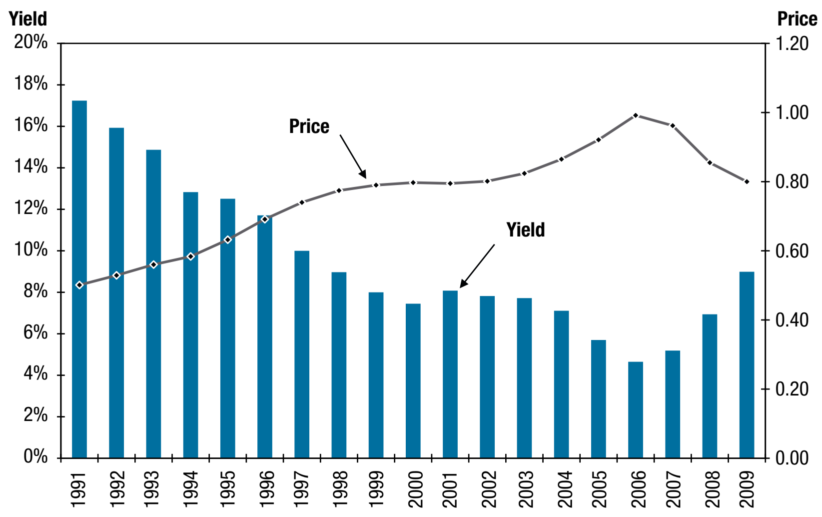
[2] For example, a low-income rental property that costs $10 million to develop, $9 million of which constituted allowable expenses, would generate $810,000 in nine-percent tax credits annually for ten years (9,000,000* 0.09=810,000). For details on the mechanics of the LIHTC see Schwartz 2010.

[3] The amount that investors will pay for tax credits is determined by the yield they desire from their investment (discount rate). The higher the yield, or discount rate, the less investors will pay. For example, if investors demanded a yield of 20%, they would pay $4.2 million for a project that generated $1 million annually in tax credits for 10 years; but they would pay $7.7 million for the same amount of tax credits if they required a yield of five percent.

[4] The LIHTC's rental limits constrain the amount of market-rate financing that can be used. Since rents are capped at what a household earning 60% of the area median income can afford (assuming an affordability standard of 30% of income), mortgage debt service payments combined with other operating costs cannot exceed this amount.

paying more and more for each tax- credit dollar (Ernst & Young 2009). Part of the reason for the decreasing yields, is that the tax credit proved itself to be a relatively low-risk investment (Schwartz 2010). Equally important, financial return was not the only motivation, or even the primary motivation, for investing in tax-credit projects. Investments in LIHTCs helped depository institutions (commercial banks and savings banks) receive favorable "Community Reinvestment Act" (CRA) ratings for their purchases of low-income housing tax credits. The Community Reinvestment Act of 1977 requires depository institutions to serve all areas from which they draw deposits. Poor compliance with the Act can jeopardize a bank's acquisition of another financial institution or its expansion into a new geographic area (Immergluck 2004). Investment in LIHTCs is counted as part of an institution's CRA-related investments. In other words, many financial institutions pursued tax-credit investments primarily for CRA-related purposes, less so for financial gain (Ernst & Young 2009; Smith and Handelman 2009; Joint Center for Housing Studies 2009b).

Figure 1 Low-income housing tax credit: yield and price, 1991-2009



Source: Ernst & Young, unpublished data.

In addition, Fannie Mae and Freddie Mac were obligated by Congress to serve underserved populations and communities (Schwartz 2010). Investment in tax credits was one way of meeting these annual goals. Together, these two institutions accounted for about 40% of all LIHTC investments as of 2006 (Smith and Handelman 2009).

3. The impact of the housing and financial crisis on the LIHTC and other shallow-subsidy programs

3.1 LIHTCs

The housing and financial crises sharply diminished the market's appetite for LIHTCs and for tax-exempt housing bonds. The market for tax credits peaked in 2006, as shown in Figure 1. Yields increased slightly in 2007 as Fannie Mae and Freddie Mac cut back their tax-credit investments for tax-related reasons. As a result, developers received slightly less money for each tax-credit dollar. The situation deteriorated further in 2008 and 2009. The federal government took Fannie and Freddie into conservatorship in September 2008, effectively nationalizing them. As de facto elements of government, they no longer needed to pay income taxes, and even if they did, their billions of dollars in losses would have vitiated the need for tax credits. Making matters worse, the federal government closed down several major banks for insolvency, further reducing the roster of tax-credit investors (Schwartz 2012).

Finally, the crisis diminished the remaining banks' desire for tax credits. With little or no taxable income, banks had much less need for tax credits. Moreover, banks were wary of investing in tax credits over a ten-year period when the volatile economic environment made it extremely difficult if not impossible for a bank to forecast its taxable income from one year to the next. And while demand for tax credits among financial institutions plummeted, there were no investors from other sectors positioned to take their place. Non-financial corporations had long since departed from the tax-credit market, priced out by the banks and the GSEs. Individuals had not been a significant source of investment since the early 1990s[5]. In this economic climate it was highly unlikely that other sectors would suddenly pick up the slack. The Low-Income Housing Tax Credit is an extremely complex program, and even in the best of times non-financial corporations and individuals would be wary of plunging in (Belsky and Nipson 2010; Schwartz 2010; Joint Center for Housing Studies 2009a and 2009b).

As a result of curtailed demand for tax credits, yields increased sharply and the amount of money developers received per tax-credit dollar decreased. Figure 1 shows that the yield of tax-credit investments nearly doubled from 2006 through May 2009, when it reached 8.9%, the highest level since 1997. During this time the amount of money developers received per tax-credit dollar declined by 20%, from 99.2 cents to 80 cents (or lower). By October 2009, developers were receiving about 65 cents per tax-credit dollar, and in some cases less (Ernst & Young 2009; Smith and Handelman 2009; see also Figure 2). In May 2009 it was reported that tax-credit equity investment was likely to total $4 billion to $4.5 billion for the year, down from about $9 billion in 2007 (Pristin 2009; see also Ernst & Young 2010). Demand for tax-credit projects in many parts of the country evaporated altogether.

The federal government, as part of a broader effort to revive the economy, passed legislation in 2008 and 2009 to strengthen the LIHTC program. The Housing Economic Recovery Act of 2008 (HERA) temporarily increased the amount of tax credits that state housing finance

[5] Passive loss restrictions imposed by the Tax Reform Act of 1986 severely limit the ability of individuals to invest in LIHTCs.

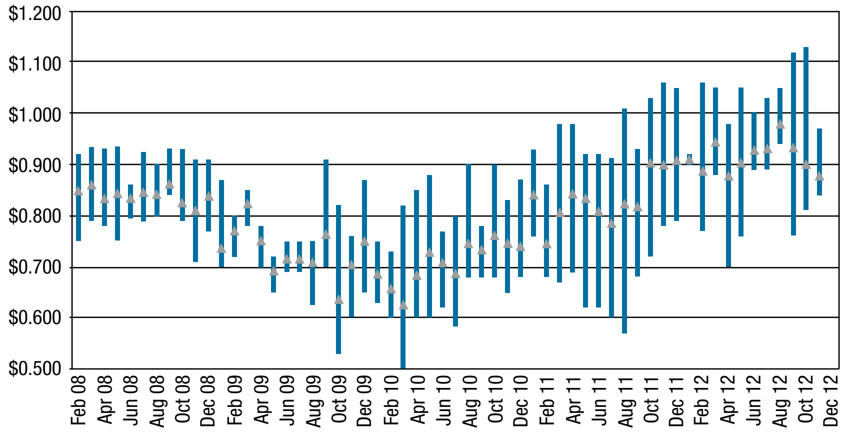
agencies could allocate to low-income developments. It increased the amount of tax credits allocated to each state from $2.00 to $2.20 per capita and it set the larger of the two tax credits at a minimum of 9 percent.

While these measures increased the amount of tax credits that could be allocated – in terms of the number of properties funded and the amount of credits received by individual properties – they did little to improve investor appetite for tax credits. President Obama's economic stimulus bill of February 2009 took a different approach to support the LIHTC and thereby increase housing construction. The American Recovery and Reinvestment Act of 2009 included two provisions for the LIHTC: the Low Income Housing Tax Credit Assistance Program (TCAP) and the Low Income Housing Tax Credit Exchange Program (TCEP). TCAP provided $2.25 billion in grants to state housing finance agencies. These funds provided necessary gap financing to projects that did not receive sufficient equity from the sale of tax credits. Projects that had received tax credit allocations in fiscal 2007, 2008, or 2009 were eligible for the program. The TCEP program allowed state housing finance agencies to exchange a portion of their 9% tax credits (but not their 4% credits) from fiscal 2008 through 2010 for cash grants. Instead of allocating tax credits, the state agencies could then provide funds directly to developers of low-income housing. In effect, the program gave states the option of replacing tax credits with block grants (at 85 cents per dollar of tax credit). Unlike tax credits, block grants enable the states to provide equity directly to eligible housing developments (National Low Income Housing Coalition 2009a and 2009b; Citizens Housing and Planning Association 2009).

The two programs proved to be effective in compensating for the drop in investor demand for tax credits. A national survey of state housing finance agencies conducted by the General Accountability Office found that TCAP and TCEP helped finance 2,373 projects with 126,058 units. The programs enabled hundreds of projects to move forward that had stalled for lack of investor interest. The programs were most essential in 2009, when they accounted for 805 of 1,165 projects that moved towards development (GAO 2012).

By 2012, the market for housing tax credits had largely recovered. In the largest metropolitan areas on the east and west coasts developers were once again receiving $1 or more per tax credit. Investor demand for tax credit-projects was weaker in industrial and rural areas of the county, but prices had improved considerably to around 80 cents per tax-credit dollar. While the market for tax-credits in major metropolitan areas on the East and West coasts tends to be dominated by banks who are chiefly motivated by regulatory concerns (i.e., Community Reinvestment Act ratings) and are willing to accept nominal returns on their investment, investors in tax-credit projects located in other parts of the county tend to seek higher returns (Dockery 2012). The federal conservatorship of Fannie Mae and Freddie Mac weakened the market for tax-credits in areas without a strong bank presence; prior to the crisis the two GSEs accounted for about 40% of all tax-credit investments, and these investments tended to be located in markets where banks had less incentive under the CRA to invest in tax-credit properties. As a result, prices for tax credits were more variable than before the crisis (See Figure 2).

Figure 2 LIHTC pricing trends (Frebruary 2008 - December 2012)



Source: Novogradac & Company LLP

3.2 Tax-exempt bonds

The financial crisis wreaked havoc on the market for tax-exempt bonds. In 2009 it had become nearly impossible for state housing finance agencies (HFAs) to issue tax-exempt bonds for the development of affordable rental housing or to support low-interest mortgages for first-time home buyers. The crisis spooked investors away from any bonds associated with housing. According to the executive director of the National Council of State Housing Finance Agencies, the crisis had "virtually frozen" housing finance agencies "out of the Housing Bond market," and many "HFAs were forced to curtail their lending significantly, while some . . .suspended lending altogether" (B. Thompson 2009).

To address the problem, the Obama administration launched a two-part program in October 2009 to strengthen the finances of HFAs and enable them to continue to support affordable housing. Through the New Issue Bond Program (NIHP), the administration directed Fannie Mae and Freddie Mac to purchase new HFA bonds. The HFA initiative also created a Temporary Credit and Liquidity Program to strengthen the lending capacity of HFAs by acquiring some of their outstanding variable rate debt. By the end of 2011, a dozen state HFAs had received $8.2 billion through this program (La Branch 2012: 102). In 2011, the Obama administration extended the New Issue Bond program through the end of 2012, and the Temporary Credit and Liquidity Program through 2015.

It appears that these efforts enabled HFAs to increase their issuance of tax-exempt bonds. The program helped HFAs finance more than 100,000 single-family homes and more than 24,000 rental units, as of September 30, 2011 (La Branch 2012: 102). These numbers represent an improvement from the previous two years, but are well below the volume of housing bonds issued prior to the crisis (National Council of State Housing Agencies 2012).

3.3 State and local housing programs

State and local housing programs, especially those that leverage resources from the private

Table 2: Budget Authority, U.S. Deparment of Housing and Urban Development, in Millions of 2010 Dollars, FY 2009-2012

						Pct. Change
	2009	ARRA	2010	2011	2012	2009-2012
Tenant-Based Rental Assistance	18,013	-	19,217	18,868	18,914	5.00
Proejct-Based Rental Assistance	8,033	2,142	9,038	9,508	9,340	16.26
Public Housing						
Public Housing Capital Fund	2,624	4,285	2,642	2,095	1,875	(28.55)
Public Housing Operating Fund	4,772	-	5,046	4,742	3,962	(16.97)
Hope VI	129	-	143	103	-	(100.00)
Public Housing Total	7,525	4,285	7,831	6,940	5,837	(22.43)
CDBG Formula Grants	3,901	-	4,217	3,426	2,948	(24.43)
HOME Formula Grants	1,951	2,410	1,929	1,651	998	(48.83)
Homeless Assistance Grants	1,796	1,607	1,971	1,952	1,901	5.83
Housing Opportuniteis for People With AIDS (HOPWA)	332	-	-	-	-	(100.00)
Housing for the Elderly (Sec. 202)	819	-	872	410	375	(54.24)
Housing for the Disabled (Sec. 811)	268	-	317	154	165	(38.38)
Fair Housng and Equal Opportunity	58	-	76	74	71	22.75
Housing Counseling Assistance	70	-	92	-	-	(100.00)
Total Budget Authority (includes items not listed above)	44,452	14,567	46,056	38,153	38,270	(13.91)

Source: National Low Income Housing Coalition 2012.

Notes: Constant $2010 are calculated using the GDP deflator for nondefense federal expenditures; ARRA refers to the American Recovery and Reinvestment Act of 2009.

market lost much of their potency in the wake of the crisis. Before the crisis, for example, 40 states and more than 500 cities and counties operated housing trust funds that generated revenue for a variety of housing-related purposes from real estate transfer taxes and other mostly real-estate-based transactions (Schwartz 2010). When the housing market collapsed most trust funds collected much less revenue than before. The Center for Community Change reports that total revenue collected by state housing trust funds declined by 44% from 2009 to 2010, dropping from $848 million to $481 million (Dastur et al. 2011 7).

3.3.1 Inclusionary zoning

Inclusionary zoning, a second key mechanism by which local governments generated affordable housing, was also undermined by the downturn in the housing market. Inclusionary zoning either requires or incentivizes developers to set aside a portion of new housing for low- or moderate-income occupancy (or, alternatively, build affordable housing at another location, or contribute money to a housing trust fund). As of 2008, about 500 mostly suburban communities located in 25 of the nation's 50 states had instituted some form of inclusionary zoning (Mallach and Calavita 2010: 25). However, with housing starts in 2012 down more than 60% from their peak of 2006, inclusionary zoning programs must be generating far less housing than before (Hickey 2013).

4.Fiscal austerity and deep subsidy programs

Whereas the housing and financial crisis impaired market-based housing subsidy programs, such as the LIHTC, tax-exempt bond finance, housing trust funds, and inclusionary zoning, deep-subsidy programs were far less severely affected. In fact, the government, as part of its economic stimulus legislation of 2009, boosted funding for public housing and other subsidy programs. Federal support for these programs has more recently declined, as a result of fiscal austerity.

The $787 billion stimulus bill, the American Recovery and Reinvestment Act of 2009, included $13.6 billion for housing. Among other things, the bill provided $4 billion for improving the physical condition of public housing, $2 billion for other project-based subsidy programs, and $2.5 billion for the HOME housing block grant program—which was used to fund the above-mentioned TCAP program for stalled tax-credit projects.

Subsequently however, federal funding for most housing programs has declined, especially after the Republicans gained a majority in Congress in the 2010 elections and pushed the Obama administration on a course of fiscal austerity to (ostensibly) reduce the federal deficit. Adjusting for inflation, federal support for public housing declined by 22% from $7.5 billion in 2009 to $5.8 billion in 2012. Funding for the HOME block grant program declined by 48% to $1 billion. Funding also fell sharply for the Community Development Block Grant Program and for housing programs for the elderly and disabled. On the other hand, federal funding for vouchers increased by 5% and for homeless assistance grants by about 6%. Funding for project-based rental subsidy programs increased by 16%. The latter increase mostly reflects the cost of renewing subsidy contracts for existing developments; there has been virtually no growth in the amount of housing produced by these programs (see Table 2).

The reductions in federal funding for public housing and for the HOME block grants are especially unfortunate from the perspective of affordable housing advocates. The public housing stock is old and in need of repair and upgrading. According to an analysis conducted for HUD in 2010, it would cost $25.6 billion to address the accumulated backlog of capital needs and an additional $3.4 billion annually to meet new "accrual" needs (Finkel et. al. 2010). Yet, federal funding for capital improvements has never come close to meeting this need, and has been diminishing. With the exception of the $4.3 billion appropriated for public housing in the stimulus bill of 2009, federal funding for capital improvements, controlling for inflation, has declined from $3.8 billion in 2000, $3.7 billion in 2005, to less than $1.9 billion in 2012. Federal funding for operating subsidies has declined as well. Funding has also declined for the redevelopment of distressed public housing (Hope VI).

The HOME program, while smaller than other subsidy programs such as public housing, Housing Choice Vouchers, and Project-based rental assistance, is nonetheless vital for the production of affordable rental housing. The program is often used as a source of "gap financing" to make developments with Low Income Housing Tax Credits financially viable (Schwartz 2010).

Federal funding for affordable housing was cut back further on March 1, 2013, when Congress and the President failed to arrive at a deficit-reduction plan, thereby triggering automatic budget cuts under "sequestration." In order to authorize an expansion of the government's debt limit in the summer of 2011, the Republican-controlled Congress and the Obama Administration agreed that the government would need to reduce the federal deficit by about $1 trillion over the decade. If Congress and the administration could not agree on a deficit-reduction plan, they put in place a set of automatic budget cuts amounting to $1.2 trillion over 10 years. It was originally thought that the combination of deep cuts to the defense budget and deep cuts to discretionary domestic programs (Medicare and Social Security were exempt) would be so objectionable to Republicans and Democrats alike that they would come up with an alternative plan that would combine revenue increases and spending reductions. However, that did not happen. Sequestration went into effect on March 1, starting with $82 billion in budget cuts in the current fiscal year. The non-partisan Center on Budget and Policy Priorities estimates that the sequester will reduce federal funding for housing vouchers by $971 million in fiscal 2013, causing more than 113,000 families to be cut from the program. Sequestration will decrease funding for public housing by $304 million, homeless assistance by $99 million, Community Development Block Grants by $153 million, and Home block grants by $53 million (Center on Budget and Policy Priorities 2013).

4.1 Federal and local initiatives to preserve public housing in the face of fiscal austerity

To help preserve and improve the public housing stock in a time of inadequate and diminishing federal subsidy, HUD launched in early 2013 a demonstration program that enables housing authorities and nonprofit partners to access private financing to help pay for essential capital improvements. The Rental Housing Demonstration program (RAD) allows a limited number of public housing developments (involving no more than 60,000 units) to be converted to the project-based Section 8 program. This will make the properties eligible for bank loans and for Low-Income Housing Tax credits to finance capital improvements. Debt-service costs will be covered by a "housing assistance payment" from HUD, which is equal to the funds the property currently receives from Public Housing Capital and Operating Funds. Put simply, instead of relying on Capital funds to pay for capital improvements directly, RAD enables these funds to leverage bank loans to finance a much larger scope of work. Additional funds can be obtained through the sale of Low-Income Housing Tax Credits (Hoekman & Griffith 2013; Smith 2013). In January 2013, HUD announced that it had selected 68 housing authorities for the first phase of the demonstration program, involving 11,910 units, just under 20% of the 60,000 Congress authorized for the program (Smith 2013). The program marks a major turn in the public housing program as it creates much more flexibility in the financing and management of individual properties.

In 2012 the New York City Housing Authority announced what is probably a unique initiative to address that city's public housing repair needs. The housing authority will lease open space in public housing developments in Manhattan for the development of market-rate high-rise apartment buildings and other properties. The city expects to gain several hundred million dollars from these transactions. While the plan may enable the city to make much-needed improvements to its public housing stock – the largest in the nation – it is not without controversy. The plan will eliminate playgrounds, parking lots, lawns, and other open spaces in the grounds of public housing developments in Manhattan (Chen 2012; Navarro 2013; Stephens 2013). It is highly unlikely that other cities would be able to emulate this initiative since their public housing developments are not located on sites with values anywhere near those of Manhattan

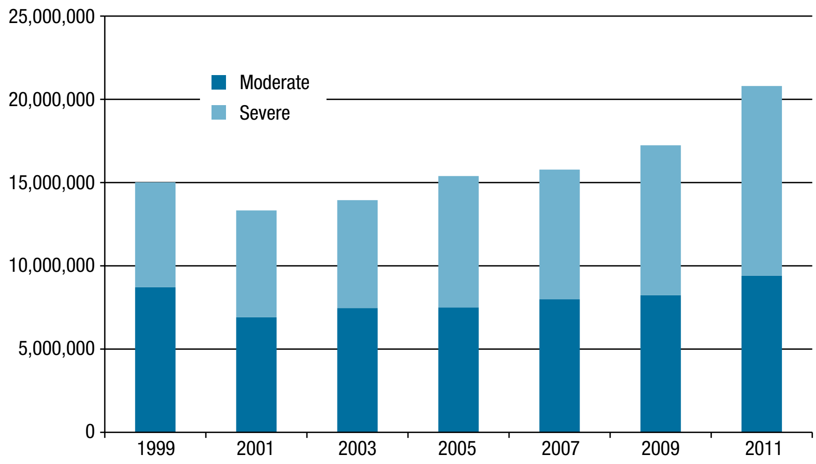
5. The mounting need for affordable housing

Affordable housing in the United States has long been in very short supply. Only one of every four eligible-low income households receives a deep subsidy in the form of public housing, Housing Choice Vouchers, or other rental assistance programs. The number of renters receiving deep subsidies has remained at about 5 million for the past 10 years. While the inventory of housing financed by the LIHTC has increased by about 100,000 units a year, the stock of unsubsidized housing affordable to low-income renters has declined sharply (Joint Center for Housing Studies 2012). For every 100 renters in the United States in 2011 earning less than 30% of their area's median family income, fewer than 40 units were available for occupancy, and fewer than 80 units were available for every 100 renters earning 30 to 50% of their area's median family income (U.S. Department of Housing and Urban Development 2013).

The broader housing sector showed signs of recovery beginning in 2012. Home prices, residential sales, and housing construction posted their first increases since 2005 or 2006 (Joint Center for Housing Studies 2012). Yet the prospects for affordable housing are more dire than before the crisis. While the LIHTC program and tax-exempt bonds have largely recovered, thanks in part to federal intervention, all other federal programs, at least in the short term, are likely to see continued erosion. Cutbacks in some of these programs, especially HOME block grants, will make it increasingly challenging to finance housing with the LIHTC as this program often provides a key source of supplementary funding.

If financial crisis and fiscal austerity have reduced funding for affordable housing, these same forces combined with the most severe recession since the 1930s and a very anemic recovery have sharply increased the need for affordable housing. From 2007 to 2011, the number of households spending more than half of their incomes on rent increased by 3.6 million (46%) to 11.4 million. The number of renters with "moderate" cost burdens of 30 to 50% increased by 1.4 million (18%) (See

Figure 3 **Households with severe and moderate rent burdens**



Source: HUD 2011 and unpublished HUD data from the 2011 American Housing Survey

Note: Severe Rent Burden - 50% or more of income spent on rents; moderate rent burden = 30 to 50%.

Figure 3). These figures pertain to renters only; the number of homeowners spending at least half of their income on housing increased by nearly 1.8 million (19%). Put differently, 29% of all renters in 2011 spent at least half of their income on housing and an additional 24% spent at least 30%. The incidence of severe cost burden is especially high among the lowest income renters. If current trends continue, housing affordability problems in the US are likely to worsen.

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Affordable housing sector in Russia: evolution of housing policy through the period of transition

By Andrey Tumanov

1. Introduction

When the market reforms started, the housing issue was still one of the most important for Russian families: in 1990, the average total floor space per capita was 16.4 sq. m per person, which is 2-3 times lower than in Europe. At that time, the absence of market mechanisms for purchasing and building housing was a great impediment for households wishing to improve their living conditions. According to experts, about 40% of the population had an obvious need to improve their living conditions but was no longer able to receive housing from the state[1]. With the first shift toward the market economy, a gap opened up between the households who could afford to buy housing on the market and those who had no chance in the short-term or long-term to resolve their housing issues on their own.

This article describes the evolution of the housing policy in the course of establishing market conditions in the context of providing opportunities for people to improve their living conditions. The task of providing sufficient affordable housing[2] for the people of Russia has been one of the housing policy priorities for a long time.

2. Brief review of basic features of the Soviet era housing system

For the whole time of the USSR's existence, the soviet state was implementing a centralized housing policy that included the following:

- State property prevailed in construction, housing stock and the management of utility facilities;
- Housing construction was mostly planned and financed from a single center;
- State banks seldom originated housing mortgages and only for cooperative and owner-built housing;
- State apartments were distributed free of charge among the people who were considered in need of improving their living conditions (they were included in special waiting lists);
- It was not allowed to sell state housing but it was possible to exchange it (in most cases, with an illegal additional payment);
- People were allowed to build their own private houses only in rural areas and in towns with a population of less than 100,000;
- Cooperative housing construction was relatively well developed only in the largest cities.

As a result, the major part of housing stock (67%) was owned by the state (which includes housing managed by state enterprises or municipal authorities).

Under a model such as this, tenants had extremely strong rights of occupancy, which could be bequeathed to other residents registered at the same address; this special status was conceptualized as 'quasi-ownership'[3].

Compared to European countries, in 1990, the average per capita in Russia was 16.4 sq. m per person, which was 2-3 times lower than in Europe.

Table 1: Housing Stock in Russia by Tenure

	1989		2000		2011	
	Million. square meters	%	Million. square meters	%	Million. square meters	%
Housing stock, total,	2,379	100	2,787	100	3,288	100
Including						
Private	637	26.8	1,819	65.3	2,838	86.3
State	1,742	73.2	177	6.3	133	4
Municipal			739	26.5	311	9.5
Other			52	1.9	6	0.2

Source: Rosstat data

[1] Kosareva N., Pchelintsev O., Ronkin G. Towards Housing Reform: Analysis and Forecast, Voprosy Economiki, 1990. No. 8. p. 81. (Evaluation relates to the USSR as a whole).

[2] It is worth noting that traditionally in Russia, affordable housing is open market housing that the household can buy on the market using its own and borrowed funds. Such a definition is different from that used abroad where affordable housing would be housing where there is some kind of state subsidy or intervention to make purchase or renting cheaper to begin and/or maintain payments.

[3] Lux (ed.) 2003. *Housing Policy: an End or a New Beginning.* Budapest: LGI-OSI.

The predominant route to housing acquisition was distribution of housing through waiting lists[4] maintained by municipal authorities and state enterprises: by 1990, 9.964 million households were put on such waiting lists (20% of all households); 1.296 million were given free housing (14% of those on the waiting list). The average waiting time until receiving housing through such waiting list was 7.7 years. At the same time, only 50,000 units were acquired through housing cooperatives and 72 thousand – built by individuals as private housing. It is estimated that about 40% of the population who had an obvious need to improve their living conditions were not able to receive housing from the state[5], and 60% of households did not have a real chance to improve their living conditions[6].

Table 2: Total floor space per capita in Russia

Year	Quantity of private households (thousand)*	Quantity of housing units per 1,000 persons	Quantity of housing units per 1 private household	Total area of housing per person (sq. m)
1990	54,703.7	226.8	0.61	7.0
1995	54,925.9	350.6	0.95	17.0
2000	52,711.4	377.3	1.05	19.2
2005	52,711.4	400.2	1.09	20.9
2011	54,560.6	424.9	1.11	23.0

* Estimates on the basis of census data

Source: Rosstat data

Table 3: Provision of social housing in Russia

	1990	1995	2000	2005	2011
Number of households (including single-member) that received housing:					
Thousand	1,296	652	253	151	181
as % of the number of families on the waiting list of those in need of housing	14	8	4	4	6
Number of households (including single-member) that were on the list of those in need of housing (as of the end of the year):					
Thousand	9,964	7,698	5,419	3,384	2,798
as % of the total number of households (including single-member)	20	15	11	7	5
Average waiting period, years	7.7	11.8	21.4	22.4	15.5

Source: calculated using Rosstat data

3. Evaluation of the impact of transition process on housing sector and affordability of housing

At the start of the reform, the country needed to develop a state policy that would help to create a housing market. Two main processes were launched at the beginning of the economic reforms (1991): housing municipalization – transfer of state housing stock to municipalities under enterprise divestiture schemes, and housing privatization, enabling tenants to acquire their unit (initially at little cost and since 1992 – for free) simply by applying for the transfer of ownership.

The first three years of free privatization were marked by its highest rates: by the end of 1995, 12.5 million units, or 36 percent of the housing stock eligible for privatization, had been privatized. By the end of 2008, 26.4 million housing units (1,306 million sq. meters), or 70% of the housing stock eligible for privatization had been privatized.

Even after the soviet times, the waiting list of those entitled to municipal housing under the social rent agreement remained and by 2000 included 5.4 million households or 11% of their total number. By then, the waiting time extended up to 21.4 years. To a large degree, such a situation was due to the lack of financing or any incentives for providing social housing that could be privatized instantaneously. In addition, those families on the waiting list were considered "in need of improving their living conditions" not because of their small incomes but because they had less total floor space per family member than required by rules. With the adoption of the new Housing Code in 2004, a new rule was introduced according to which social housing was provided under a social rent agreement only to low-income households and several other categories. Also, the obligations to those who had already been put on the waiting list prior to 2005 were to be met, no matter what their income or financial status was.

It should be noted that provision of social housing for low-income households never was a real priority of housing policy[7]. Also, the capabilities for constructing or providing affordable housing during this period were very limited by the budget available and the unstable macroeconomic situation. The public construction industry was rapidly falling apart and the market production mechanisms were shaping up very slowly, the total construction volume was declining (in 1990, 61.7 million sq. m were commissioned, in 1995 – 41 million sq. m and in 2000 – 30.3 million sq. m). In this situation, as a result of the liberalization of the ownership rights, private self-build activity was actively coming back to life: while in 1991 5.4 million

[4] Only families that had maximum 5-7 sq. m of housing per person, sometimes up to 9 sq. m, were included in such waiting list.

[5] Kosareva N., Pchelintsev O., Ronkin G. Towards Housing Reform: Analysis and Forecast, Voprosy Economiki, 1990. No. 8. p. 81. (Evaluation relates to the USSR as a whole)

[6] Kosareva N. B., Polidi T. D., Puzanov A. S., Tumanov A. A. Comparative Analysis of Consumption and Expenses in Housing // Report as XII International Scientific Conference on Problems of Development of Economy and Society, Moscow: Publishing House of the Higher School of Economics, 2011, p. 34.

[7] In 1990, the housing policy had the following objectives: ensure a social guarantee of the citizens' housing rights; create state, municipal and private housing stock; create the favorable conditions for raising non-budgetary financing; protect the rights of the housing owners and entrepreneurs working with housing, create competition in the production of construction materials, household goods, construction, plus maintenance and repairs to the housing stock.

Table 4. Housing commissioned in Russia

Year	Housing commissioned			Including		
	Thousand units	Million sq. m	Per capita, sq. m	By households using their own and borrowed funds, million sq. m	By housing construction cooperatives, million sq. m	By public and private professional developers (legal entities), million sq. m
1990	n.a.	61.7	0.42	6.0	2.9	52.8
1995	n.a.	41.0	0.28	9.0	1.7	30.3
2000	373	30.3	0.21	12.6	0.7	17.0
2005	515	43.6	0.30	17.5	0.6	25.5
2011	786	62.3	0.44	26.8	0.4	35.1

Source: Rosstat data

sq. m of such housing was commissioned, in 1996 – 10.0 million sq. m and by 2000 – 12.6 sq. m. The state also provided additional support for individual self-build through the Your House federal target program[8].

As a result of the housing reforms conducted during the 1990s, the principal framework and infrastructure were created for the new housing market and its functioning, the housing construction sector was privatized and the ways were changed in which budgets of various levels could intervene in the financing of housing. This was done by orienting the budgets towards supporting the households in need of better living conditions through subsidies for purchasing such housing. Such subsidy amount may be from 5 to 70% of the construction cost, or the purchase price, of housing and depends on the ratio of monthly income per one family member to the minimum wage (the higher the income, the smaller the subsidy amount) and the time on the waiting list for social housing (the longer the period, the larger the subsidy amount). For certain categories of people (military servicemen, rescue workers, survivors of Chernobyl and other catastrophes), who are subsidized out of the federal budget, the subsidy amount may reach 100%.

Starting in 1998, subsidies for military servicemen to purchase housing have been provided using state housing certificates. Such state housing certificates could be issued to families in need of housing who could use them to buy any housing that had been constructed by adding, if necessary, the required amount of their own or borrowed money. The subsidy (certificate) amount is determined depending on the current market value of housing in the area, the number of family members and the housing area required by social rules[9]. It is noteworthy that there were no restrictions on resale of housing purchased/constructed using state subsidies/certificates. As a result, no affordable housing sector was created, in practice.

In 1997–1998, the legal framework was established for organizing and financing the real estate market. Laws were adopted enabling the development of mortgage financing and the state Agency for Housing Mortgage Lending (AHML) was established. The Agency's key objective was to implement the state policy aimed to make housing more affordable for the Russian citizens. In its operations, the Agency strives to create equal opportunities for all citizens of Russia to obtain mortgage loans. In line with its strategy, the Agency pays special attention to establishing a mortgage market in the regions where the housing and mortgage markets are least developed.

The 1998 crisis significantly slowed down the implementation of the state housing policy: new political decisions were not made and the reform that had been started was happening at a slower pace. Housing market activity slowed and the construction of housing almost stopped.

4. State affordable housing policy in the 2000s: stimulating and balancing demand and supply for housing

In the middle of the 2000s, data received through sociological surveys confirmed that 61% of Russian families were experiencing difficulties with housing and were to some extent dissatisfied with their living conditions. Also, one in four families, according to them, had housing that was in a bad or very bad condition. The total housing volume that the people of Russia needed in 2004 was estimated to reach 1.57 billion sq. m (46% of the housing stock)[10].

By 2005, the Russian Federation had obligations to provide housing for 1 million households and 3.4 million households were on the municipal waiting lists (7% of the total number of families). The average waiting time until housing was to be provided reached 42 and 22.4 years respectively. 3.2% of housing was dilapidated and unsafe, i.e. not suitable for living.

At the beginning of the 2000s, only families with high incomes could afford to buy housing on the market, to a large extent, due to the absence of adequate supply of new high-quality housing (a problem that has yet to be solved). Such a situation was conducive to the continuous growth of housing prices. During the period from 1997 to 2005, real house prices grew by 6.2%

[8] As part of the program, the state contributed to the introduction of new technologies in individual self-build, development of modern designs, provided grants for building detached houses for the households in need in amounts of up to 70% of the construction cost and developed financial mechanisms for raising funds from individuals and banks.

[9] 33 sq. m for 1 person, 42 sq. m for two persons and 18 sq. m per person if a family included 3 or more members.

[10] *Evaluation of the Scale and Dynamics of Changes in Effective Housing Demand and Housing Production in Russia* prepared by the Institute for Urban Economics for OJSC Foreign Trade Bank in 2004.

while real incomes grew by 11.7% during the same period.

In order to solve the problem caused by the imbalance between supply and demand and to create the affordable housing market, at the end of 2004, the State Duma passed a package of laws known as the "package of federal laws aimed at developing the affordable housing market" which defined the new direction of the housing policy.

Since 2005, the housing policy provided for measures aiming to making it more affordable for individuals to purchase housing and to expand the opportunities for low-income families unable to buy housing to improve their living conditions by gaining access to social housing. In this situation, direct financial intervention by the state was proposed in the form of support for establishing certain market mechanisms at the initial stage (for instance, the secondary market for mortgage loans) and by providing grants for certain categories of households (employees of organizations funded from budgets of various levels, young families, military servicemen and others) in order to make housing and mortgage loans more affordable. Free housing was provided by the state only to low-income households in need of better living conditions.

It was proposed to stimulate the market demand from the public, first of all, by developing mortgage financing and creating the pre-requisites for reducing interest rates in the mortgage lending market, making loans more affordable and developing other forms of personal finance (participation in shared-equity construction, housing savings programs etc.). The supply side of the housing market was supposed to be incentivised by creating favourable conditions for expanding housing construction and providing utilities to land plots.

On the whole, following adoption of the laws on affordable housing market development, the state policy was more successful as related to demand stimulation compared to housing supply. During the period from 2004 until 2008, the value of mortgage lending grew by 35.5 times (from RUB 18.5 billion to 655.8 billion), household income – by 2.3 times while the housing construction grew by 1.6 times. This resulted in housing prices growing 21.7% faster than household income.

From the end of 2007 to the beginning of 2008, the government, striving to make housing more affordable for households, including those with medium and low incomes, prepared a draft Long-Term Strategy for Housing Mass Construction for All Categories of Households for the period until 2020. The strategy envisaged ambitious growth in commissioning of housing in 2007-2020 from 61 million to 142 million sq. m per year (one sq. m per person) and of the percentage of families who would be able to buy standard housing using their own and borrowed funds – from 19% to 60%. The global financial crisis of 2008 intervened and this strategy was not approved.

5. The impact of the housing crisis on housing affordability: searching for new mechanisms for increasing affordability of housing

Deepening recession in international markets brought about deterioration in the economic situation in the Russian financial market in 2008. Average mortgage interest rates grew from 12.9% in 2009 to 14.3% in 2009 and the loan term reduced from 18 to 16.5 years. The market for residential mortgage lending felt the full impact of liquidity shortages already in the second half of 2008. While in 2007 volumes of originated residential mortgage loans increased by 87% (y-o-y) to 556 billion Rubles, the rate of growth in 2008 dropped: loans worth 633.8 billion Rubles were issued (14% more than in 2007). In 2009, the volume of mortgage lending continued to reduce: 130.1 thousand mortgage loans were originated for the total of RUB 152.5 billion.

As the overall financial and economic situation in Russia deteriorated, we witnessed the growth of the delinquency rate on all loans extended to the population, including mortgage loans. According to the Bank of Russia estimates based on IFRS, 30+ days delinquent mortgage loans' share in the market was 9.3%, as of February 1, 2010.

In 2009, the number of transactions in the housing market declined by 340,000 to 2.24 million transactions (13.3% y-o-y). Housing price trends underwent changes: not only did the real price of housing start to drop in 2009, but nominal prices fell as well. The recession affected the housing construction sector as well, which, by the end of 2012, has not fully recovered yet.

The anti-crisis housing policy became an integral part of the overall anti-crisis government package of measures in the banking and housing construction sectors. The necessary measures were taken both as part of the implementation of the anti-crisis package of the Government of the Russian Federation during 2009 – 2010, and as part of the activities carried out by Government-sponsored organizations, including those in the housing sector (the Agency for Housing Mortgage Lending, Fund for the Promotion of the Housing and Utility Sector Reform, Russian Housing Development Foundation and Vnesheconombank).

The main common idea behind the anti-crisis package in the housing sector was to achieve a synergistic effect from maximum possible concentration of the state demand and household demand supported by the government in the primary housing and housing construction markets, with the purpose of supporting low-cost housing construction that meets the modern standards of energy performance, environment protection and the requirement of affordability for the middle-income category. Such an approach is based on the idea of using housing construction as a lever for stabilizing the overall economic situation.

The above measures included the following[11]:

- An additional contribution was made by the government to the authorized capital of the AHML to the amount of 60 billion Rubles for the purposes of refinancing mortgage loans and rescheduling mortgage loans for those borrowers who found themselves in a dire situation as a result of the crisis;
- Introduction of the possibility of purchasing apartments using government funds at the stage of construction to provide housing to certain categories of Russian citizens within the government housing provision program;
- Allocation of 250 million Rubles to support household demand for newly built housing by providing facilities to banks to issue mortgages at maximum 11% interest rates;
- Creation of the Agency for Restructuring of Housing Mortgage Loans– ARHML (a subsidiary of AHML) for the rescheduling of mortgage loans for those borrowers who either became unemployed or whose wages were cut. Later the program of ARHML was extended to assist specific categories of borrowers[12] who failed to restore their ability to pay;

[11] For more details of anti-crisis measures, see Nadezhda Kosareva, Andrey Tumanov. Housing Market in Russia: Lessons of the Mortgage Crisis // Global Housing Markets: Crises, Policies, and Institutions. Ed. by Ashok Bardhan, Robert Edelstein, Cynthia Kroll. John Wiley and Sons, 2011.

[12] Borrowers from the company towns (towns, where the larger part of the local population is in the employ of only one enterprise) or borrowers who fall into other most socially vulnerable categories of population for whom the mortgaged housing is their only housing.

- Allowing the use of money from the so-called "maternity capital"[13] to contribute to the improvement of housing conditions (including debt repayment under mortgage loans) immediately after childbirth and receipt of a relevant certificate;
- In order to strengthen the demand for mortgage loans and increase the affordability of mortgage loans, the maximum LTV on mortgage loans, which may be used to secure MBS, was increased from 70% to 80%;
- The Russian Housing Development Foundation was set up to promote housing construction, first of all, economy-class housing affordable to middle-income households. The Foundation pursues the objective of involving federal land, which is either idle or inefficiently used, in business transactions, equipping it with physical infrastructure and allocating it through auctions for housing construction purposes.

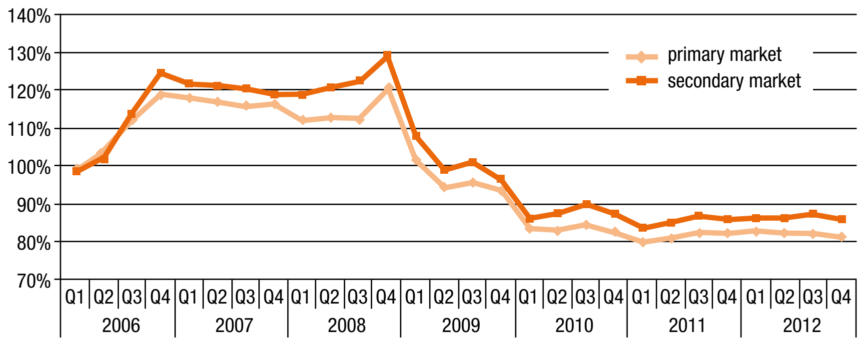
6. Current state of, and prospects for, the housing market and housing finance development

Although in 2011 the statistics show a recovery in the construction sector, certain indicators still point to possible continuation of stagnation. Despite active growth of transactions on the housing market (for the whole of 2011 – 6.4% of the housing stock) and better affordability of mortgage lending, in 2011 housing prices, in Russia on average, demonstrated only nominal growth – about 7% (with average annual inflation of 8.4%). To a large degree, this was due to changes in the demand structure during the post-crisis period towards the most affordable economy-class housing. At the same time, mortgage lending started its active recovery after the crisis[14].

The state affordable housing policy continues to use the following instruments:

1. Free provision of social housing for low income households in need.
2. Stand-alone or mortgage down payment subsidies for purchasing a dwelling for certain categories of households which are defined at state or local levels;
3. Provision of discounted (affordable) mortgages and/or affordable homes through state development institutions;
4. Rent payment subsidies for households staying on waiting lists provided by local authorities[15]

Figure 1 Housing affordability index (real housing prices to real household income ratio, 2005 = 100%)



Source: calculated using Rosstat data

Table 5. Structure of publicly supported housing allocation, 2011

	Totally	Number of households that got housing in newly constructed buildings	% of households that acquired newly built housing
Households that got housing and improved their housing conditions (thousands)	180.8	58.1	32.1
Of which			
1. Off the waiting list (orphans and other special categories)	52.6	11.2	21.3
1.1. Under social rental agreement	16.6	3.5	
2. From the waiting list	128.2	43.3	33.8
2.1. Under housing ownership support schemes	106.8	27.7	25.9
2.1.1. With federal subventions	74.4	13.7	18.4
2.1.2. Through subsidized mortgages	11.8	6.0	50.8
2.1.3. Via other schemes	20.7	8.0	38.6
2.2. Under social rental agreements	21.4	15.6	72.9

Calculated on the basis of the Federal Statistical Survey, Form 4-Housing

[13] Maternity capital – a one-off inflation-indexed sum of RUB 250,000 (as of 2009) paid by the state to mothers at the birth of their second or other subsequent child that could be put towards healthcare, education or improvement of housing conditions, but not earlier than three years after the birth of the child.

[14] For more detailed review of the mortgage lending and housing construction markets, see the analytical reports prepared by AHML (http://www.ahml.ru/en/financ/mmo-reports/)

[15] This mechanism is not commonly used because of the lack of financing at local levels. The well- known example is Moscow.

The obligation to provide housing for social use to 2.8 million families, as of the end of 2011, still exists, with an average waiting time of 15.5 years. The main problem here is municipalities having no funds to construct and purchase housing in order to provide it for social rent.

The federal budget allocates large amounts of funding for housing provision for households that the Russian Federation has obligations to pursuant to Russian laws or as part of special federal programs and measures implemented under co-financing arrangements with regional (local) budgets and out of the funds provided as federal subventions to regions. For the period from 2006 to 2010, housing was provided to 103,393 families of military servicemen (20.2% of the total needed quantity). During 2006-2009, over 130,000 young families improved their living conditions using residential mortgage loans or funds provided by regional and local budgets, and in 2011-2015, it is planned to provide housing to another 172,000 young families (out of more than 217,000 of young families who wish, and are eligible to participate in, the program).

Thus, there is an obvious lack of a sustainable sector of affordable rental housing. The current structure of housing tenure was formed mainly under the influence of the universal homeownership paradigm that prevailed for 20 years, and by universal micro-privatization of municipal rental stock (right to buy). The deadline of privatization has recently been moved (again) to 2015. Therefore, until 2015, the parameters of the social housing stock will depend, to a great extent, on the rate of the housing privatization (and de-privatization[16]) process, which will be affected by various incentives generated by housing market parameters, the structure of state subsidies, the tax regime etc. Until 2015, municipalities will not have clear-cut incentives to enhance housing construction volumes for subsequent social rental. The current status quo also results in the inability of municipalities to construct and keep social rented housing as 'buildings' rather than in the form of flats in mixed property condominiums.

So, the role of rental housing was seen as a residual in relation to privatization and focused narrowly on social policy interventions. Currently, the rental housing sector in Russia is, according to different estimates, from 25 to 30%, the private renting sector is estimated at 8-10% of the country's housing stock, but there are no official statistics, as the overwhelming majority of these tenancies are informal.

Table 6. Housing stock in different countries by tenure (%)

Country	Rent			Owner resident	Cooperative	Other
	TOTAL	Social	Private			
Austria	40	23	17	56	-	4
UK	31	20	11	69	-	0
Netherlands	42	32	10	58	-	0
Germany	54	5	49	46	-	0
Finland	31	16	15	66	0	3
Sweden	44	17	27	38	18	0
USA	32.6	1.0	31.6	66.4	1.0	0
RUSSIA	25.6	14.2(1)	11.4(2)	74.2(3)	-	0.2

1) State and municipal housing stock

2) Including housing stock owned by legal entities – 3.2%

3) Estimate

Source: based on the data provided by: Rosstat, Housing Statistics in the European Union 2010, US Census Bureau, Statistics Canada

Presently, private landlords consist mostly of individuals - typically privatized tenant-owners having alternative accommodation - who want to supplement their income by renting informally to those who are shut out of either ownership or social housing segments: young housing starters, and migrant, divorced and singles, newly poor, and middle-income households. Some renters are simply waiting for their parents, mostly privatized tenant-owners, to retire into family suburban dachas. Wealthy individual buy-to-let investors are another visible category of landlords, with their numbers growing when rents increase faster than prices and vice versa. They are purchasing dwellings in order to earn rental income (buy-to-let) - sometimes several apartments in one or in several buildings. Although intended to produce regular income, these investments are also seen as inflation and pension hedges, and expected to yield medium-term capital gains. Private rental buildings have never existed and they still do not because the current rent payments, although high, still do not create sufficient investment return on "tenement buildings". Individual landlords are willing to lease housing out at the current price because, in the majority of cases, they did not pay to construct or purchase it and the utility bills and maintenance are still heavily subsidized. An investor, when putting his money into the construction of a "tenement building", has to not only get back his investment through the rent but also receive some profit. That is why professional developers today are not competitive on the housing rent market.

The present policy overhaul signals a significant change in viewing rental housing's role as a residual one to seeing it as complementary. Consequently, the government is showing growing interest in policy measures that foster tenure-neutral housing choice and thus imply a significant growth of the formal private rental sector. Furthermore, some policy makers acknowledge that private rental housing could well be a cheaper alternative to the heavily subsidized new construction of social housing.

The current housing policy goal is to develop a balanced tenure structure of housing stock which assumes that by the end of this decade (i.e. until 2020) the formal private rental sector will have grown from 0% (today) to 5-7% of the total stock, and the non-profit rental housing (social, state, municipal) sector will have grown from 0% (today) to 2-4% of the stock, while the informal individual rental sector will have retained its 8-10% share of the stock.

Social rental stock, state and municipally owned, constitutes about 25% of the housing stock. Social rental housing, mostly municipal and some state, is viewed as housing "which has not yet been privatized". As municipalities are usually financially strapped, and are bound to eventually lose this stock, the buildings continue to deteriorate, which might discourage the sitting tenants from buying for fear of excessive renovation costs once taken over. Policy makers

[16] De-privatization is the act of transferring ownership, received through privatization, from the private sector (households) back to the government.

expect this market rental housing, both for-profit and non-profit, to increase its share which will lead to a reducing share for social rental housing stock from the 25% today to 13% in 2020.

In May 2012, the President of the Russian Federation set a rather ambitious goal for the development of affordable housing market by 2020[17]:

- By 2018, to reduce the positive difference between the average mortgage interest rate (in roubles) and the consumer price index to the level not higher than 2.2 percentage points;
- By 2018, to increase the number of housing mortgage loans originated to 815,000 per year;
- By 2018, to provide an opportunity for Russian citizens to improve their living conditions at least once every 15 years;
- By 2018, to reduce the price of one square meter of housing by 20% through increasing the amount of economy class housing commissioned;
- By 2010, to ensure provision of affordable and well-equipped housing to 60% of Russian families wishing to improve their living conditions.

As part of the effort to achieve the above objectives, the Government of the Russian Federation developed and approved in 2012 the state program of affordable and comfortable housing and utility services provision to Russian citizens, this program includes construction of economy-class housing and infrastructure facilities on the land plots used in business transactions that are adjacent to large cities and on the land plots that were provided to state-sponsored entities and are idle or inefficiently used.

The above program consolidated the existing mechanisms for providing support to households in their efforts to improve their housing situation. The program includes the following mechanisms:

- Gratuitous provision of land plots for economy class housing construction subject to restrictions on the sale price of such housing;
- Establishment of the affordable rented housing market and development of non-commercial housing stock for low-income households, including the creation of a legal and financial framework for developing housing construction by non-for-profit developers and housing construction cooperatives[18].

Table 7. Forecast for housing commissioning in Russia by tenure

Parameter	2011 (fact)	2015	2020	2030
Housing commissioning, million sq. m				
In apartment blocks	35.0	47.0	69.8	48.0
in apartment blocks – condominiums	34.0	41.2	55.8	23.0
in apartment blocks – cooperatives	1.0	3.7	7.0	15.0
in apartment blocks of the rental sector	0.0	2.2	7.0	10.0
In houses (detached, housing estates, terraced houses)	28.0	43.0	75.2	72.0
Total housing commissioning, million sq. m	63	90	145	120

Source: prepared by IUE for AHML as part of the report Development and Substantiation of the Measures Aimed to Develop the Rental Housing Sector in Russia, 2012

Table 8. Forecast for housing stock in Russia by tenure

Number of housing units in housing stock, million,	2011 (fact)	2015	2020	2030
Housing commissioning, million sq. m				
In apartment blocks, total, including:	44.1	45.2	46.8	47.6
in apartment blocks – condominiums	43.2	44.1	45.2	44.2
in apartment blocks – cooperatives	0.0	0.1	0.3	1.0
in apartment blocks of the rental sector	0.9	1.0	1.3	2.4
In houses (detached, housing estates, terraced houses)	16.6	17.0	17.5	16.8
Total housing units in housing stock, million	60.6	62.2	64.2	64.4
Number of households, million	53.8	54.7	56.7	58.3
Housing per capita, sq. m/person	23.1	24.6	27.4	32.4

Source: prepared by IUE for AHML as part of the report Development and Substantiation of the Measures Aimed to Develop the Rental Housing Sector in Russia, 2012

It is planned that implementation of the state program will be efficient due to orientation towards:

- Development of the institutions of renting and non-commercial leasing of housing, including development of "cooperative rent" that achieves two objectives at once – control over the labor migration flows and increased importance of the social responsibility of the business;
- Synchronization of the social and economic priorities of the state with the priorities and mechanisms used in housing provision, including development of the program, focusing on stimulating the increase of population (mainly by increasing the numbers of new-borns); creating a set of measures aimed to support young scientists, doctors, teachers in rural areas;
- "Decentralization" of housing policy within the programs of federal subjects where principal attention is paid to the specifics of the economy and traditions in the region, the required specific emphasis is made and the decisions made are more efficient as a consequence;
- Reduction in the cost of one square meter and ensuring pricing transparency;
- State interventions in the primary housing market; this will stimulate supply thus reducing the cost;
- Establishment of the regulatory, organizational and financial systems for housing construction that set strict requirements for access of developers to the market, control over its activities and, at the same time, state support (fiscal, financial and infrastructure-related).

[17] Russian Presidential decree No 600 dated 07.05.2012 On Measures to Provide Affordable and Comfortable Housing to Russian Citizens and Improve the Quality of Utility Services

[18] Such measures include stronger protection of the landlord's and tenant's rights under long-term housing lease, definition of the term "non-commercial lease", regulation of the procedure used to provide housing to households under a non-commercial lease agreement; tax benefits during the construction and provision of housing under a non-commercial lease agreement; arrangement of statistical monitoring of the rental housing market; government guarantees for the loans provided for purposes related to rental housing market development.

Trends in home-ownership in Russia: the impact of public policy on the emerging tenure structure and the housing finance market

By Marina Khmelnitskaya

1. Introduction

Over the twenty years that have elapsed since the end of the Soviet period the tenure structure and the system of housing finance in Russia have changed dramatically. The mass privatisation programme resulted in owner occupation rates of over 85%. Mortgage borrowing, non-existent in Soviet housing practice, has been growing in importance as a source of finance for individual home purchases. In the last few years the Russian mortgage market has demonstrated rapid growth rates. The volume of mortgage credit nearly doubled in 2011 compared to the level reached in 2010, and grew by another 40% in 2012. The volume of mortgage credit issued by Russian banks in 2012 reached RUB 1,029 billion compared to RUB 717 billion in 2011[1]. The development of owner-occupation funded by mortgage finance exemplifies the policy-makers' priority in the housing sphere. The main challenge associated with this objective continues to be the relatively low income levels of the majority of Russian households. In the mid-2000s Russian policy-makers consolidated their efforts to improve the affordability of mortgage finance in a National Project, 'Affordable Housing', one of four national 'priority' projects launched by the government in the social sphere. In 2010-2011 the return to economic growth and the continued increase in personal income levels paired with a downward correction in house prices led to a substantial improvement in housing affordability. In addition, the growing attention of policy-makers to such alternatives to private ownership as rental homes and cooperatives represents a new dimension in the government's housing policy of recent years.

2. Housing privatisation and formation of the housing market in Russia

The structure of housing ownership during the Soviet period was described as the 'East-European' model in which public ownership of housing prevailed by far over other tenure forms. In the 1990s only 30% of the Russian housing stock was held in private or cooperative forms of ownership. Yet, it may be a mistake to regard the remaining approximately 70% as social housing (Lux & Sunega 2010), as the state distribution by and large represented the only means of accessing housing essentially for all occupational groups and income levels. The socialist state, moreover, used housing distribution to reward individuals and privileged groups for their services to the communist regime, while also aiming to provide the necessary minimum standard of living space for the rest of society. The quality of the residential buildings and the level of their maintenance and service provision thus varied greatly according to the occupational background of their tenants and the period of construction. Tenants enjoyed high security of tenure and effectively regarded what was officially public rented housing as their 'own' (see Attwood 2010). After the uniquely East-European model of housing ownership structure, another defining feature of Soviet housing was the existence of massive waiting lists to receive state accommodation. In the late-1980s as much as 23.2% or 8,037 thousand households in the Russian Federation were waiting on these lists for state housing (Goskomstat SSSR 1987, p. 519). Waiting times could be as long as 10 - 15 years.

The policy of housing privatisation to the sitting tenants, which was first permitted in the USSR for certain categories of the housing stock in the mid-1980s and became free and unconditional from 1992 onwards, *de jure* formalised the *de facto* ownership of housing by the majority of Russians. Not surprisingly housing privatisation was regarded as highly popular. Russia has now become a nation of home-owners: according to official statistics by the end of 2011 85.6% of housing in the country was held in private ownership (Surinov 2012, p. 12). The remarkable results of the privatisation programme can be considered as a part of the spectacular expansion of owner-occupation across a range of countries since the 1980s as the policy-makers sought to scale back the role of the state in housing provision and to place the responsibility for meeting personal housing needs with the individuals themselves. In the context of

[1] See the website of the Russian Agency for Home Mortgage Lending (AHML) (Agenstvo po Ipotechnomu Zhilishchnomu Kreditovaniyu, AIZhK), http://www.ahml.ru accessed 11 March 2013.

the shortage of accommodation that characterised Soviet and post-Soviet housing policy the reformers' hope was that private ownership would lead to the optimisation of the housing market and help to attract increased volumes of investment into housing construction while also stimulating the country's economy as a whole.

The liberal reform agenda of the Russian government in the housing sphere from the early days of Russia's market restructuring, in the early 1990s, was assisted by American housing experts from the Urban Institute, Washington. In addition to the focus on the promotion of owner occupation via privatisation, the government sought to develop a system of mortgage credit to fund an effective housing market and the construction of new homes. Numerous legislative initiatives were adopted encouraging banks to get involved in mortgage lending. A secondary mortgage facility, the Agency for Home Mortgage Lending (AHML), designed following the structure of an analogous American body, Fannie Mae, as a prototype, was set up in 1996 (Struyck & Kosareva 1999). An important question for the reformers related to the development of appropriate mechanisms for housing maintenance and management. Due to the fact that the prevalent type of accommodation in Russia happened to be multi-family apartment buildings, a type of 'Association of Home-Owners' residing within a single building (*TSZhs*) was introduced. The associations' role would be to select local service providers and run ordinary and extraordinary maintenance and repairs. Adopting the goal of overall private housing ownership also meant a sharp reduction in the public sector funding of new residential construction. The state was to retain its commitment to social housing provision only for the neediest.

During the 1990s and the early 2000s these liberal reforms elaborated by the government were strongly opposed by the representatives of the leftist parties in the national parliament. The latter, for instance, were successful in blocking the government variant of a new Housing Code, which would institutionalise all the liberal provisions for the Russian housing sphere in one document. The opposition argued that in the context of the economic crisis that engulfed Russia during the first post-Soviet decade, the majority of its people[2] could not afford the increase in the prices of utilities or pay for major repairs of their dwellings (*kapital'nyi remont*), even though these dwellings were now held in private ownership by an increasing number of the people. As a result, in practice local government budgets continued to be responsible for the maintenance and repairs as well as the subsidisation of utility costs for the end users. In reality, however, all of these were chronically underfunded leading to the deterioration of the quality of the housing stock. Equally, the withdrawal of the state from funding the construction of new social housing was opposed as a large number of families had joined housing waiting lists before the Soviet collapse. They were simply less lucky than their more fortunate country-fellows who received public accommodation under the old rules. Thus, some 15% of households[3] continued to be officially placed on municipal waiting lists. In reality the housing conditions of very few of them improved. Due to a substantial budget deficit, on the one hand, and to the rational behaviour of the local authorities[4], on the other, the construction of social housing virtually ceased. Housing construction contracted by half during this period: in 1990 61.7 million sq. metres of housing were completed but in 1999 this indicator dropped to 32.0 million sq. metres.[5]

The macro-economic conditions started to change from 2000 onwards. From recession, Russia turned to rapid growth: in 2000-2007 Russian GDP was growing at high rate attaining between 8.5 and 10% in most years (Rosstat 2011). This growth was halted by the effects of the global financial crisis which hit the country in the second half of 2008. In 2009 GDP contracted by 7.8%. Since 2010, however, economic growth has resumed, albeit at more moderate rates of around 4% in 2010 and 2011. Household income levels over the past twelve years have equally demonstrated a clear upward trend. From 2000 through until 2007 they were increasing between 11.7% and 14.1% annually[6]. Moreover, whereas in 2000 29% of Russians lived below the official poverty line, this number had fallen to 12.8% by the end of 2011. Average monthly income levels went up from R2,281 in 2000 to R20,700.7 in 2011.[7] (See Table 1).

Economic growth helped to relieve somewhat the social tensions within the country. In parallel the level of conflict between the Russian executive and the legislature eased as well. These factors helped to complete the adoption of the liberal framework in housing policy envisaged from the early 1990s. The new Housing Code was finally approved by the State Duma in December 2004[8]. The Code confirmed such controversial measures as the transfer of responsibility for the renovation of apartment blocks from the state to individual apartment owners. At the same time, in the early 2000s it had become clear that the lack of collective action among owners of individual apartments represented a serious problem. The associations of home-owners (*TSZhs*) were formed only in a fraction of residential buildings (around 5% by the early 2000). To address this issue a new form of 'management companies' was introduced to help run multi-apartment blocks on the owners' behalf. Public trust in these structures remains low up to the present time, while their activity is often described as opaque and cases of collusion with local service providers and municipal authorities are reported. As a result, the continuing growth of housing utility and maintenance tariffs as well as the meagre service quality are named by Russians, according to polls, as one of the country's most pressing concerns[9]. Finally, to complete the liberalisation of the housing sphere the new Housing Code reduced the state's responsibility for the provision of social

[2] In the period between 1991 and 1995 household income levels were falling on average by 8% annually, and by 2.1% in 1996-2000. See Rosstat (2011), Table: 1.2 S*erdnegodovye tempy prirosta (snizheniya) osnovnykh sotzial'no-ekonomicheskik hpokazateley*,available at http://www.gks.ru/bgd/regl/b11_13/IssWWW.exe/Stg/d1/01-02.htm, accessed 7 December 2012.

[3] Or 7,698 thousand families, the figure for 1995. See Rosstat (2011) Table 6.44: *Predostavlenie Zhilykh Pomeshcheniy*, available at http://www.gks.ru/bgd/regl/b11_13/IssWWW.exe/Stg/d1/06-44.htm, accessed 7 December 2012.

[4] Municipalities were not interested in construction of new social housing as anything that would be built and distributed to the individuals from the housing waiting lists would be immediately 'lost' to the on-going process of housing privatisation.

[5] See Rosstat, 2012, Table: *Vvod v deystvie zhilikh domov v Rossiyskoy Federatzii*, available at http://www.gks.ru/wps/wcm/connect/rosstat/rosstatsite/main/enterprise/building/#, accessed 7 December 2012.

[6] See Table 1.3. *Tempy rosta (snizheniya) osnovnykh sotsial'no-ekonomichskikh pokazateley*

[7] See 'Table: Chislennost' naseleniya s denezhnymi dokhodami nizhe velichiny prozhitochnogo minimuma', *Federal'naya Sluzhba Gosudarstvennoy Statistiki*, 2012, available at: http://www.gks.ru/free_doc/new_site/population/urov/urov_51g.htm and 'Table: Dinamika srednedushevykh dokhodov naseleniya', *Federal'naya Sluzhba Gosudarstvennoy Statistiki*, 2012, available at: http://www.gks.ru/free_doc/new_site/population/urov/urov_11g.htm, both accessed 3 September 2012.

[8] Federal Law N.188-FZ, adopted on 29 December 2004. *Sobranie Zakonodatel'stva Rossiyskoy Federatsii*, 2005, no. 1, part I, st. 14. However, it should be pointed out that after its adoption the code continued to be criticised for the limitations in its design; whereas such liberal measures as the cancellation of free provision of utilities to specific household groups provoked popular demonstrations in early 2005.

[9] VTsIOM, 2012, *V preddverii vyborov: chto trevozhit Rossiyan*, Press release N 1968, 02 March 2012, available at http://wciom.ru/index.php?id=459&uid=112568, accessed 02 March 2012.

Table 1. Russian socio-economic and housing indicators, 2000-2011

	2000	2007	2008	2009	2010	2011
GDP growth (% to the previous year)	110.0	108.5	105.2	92.2	104.3	104.3
Households living below the official poverty line (%)	29.0	13.3	13.4	13.0	12.6	12.8
Average monthly per capita income (Rubles)	2,281.1	12,602.7	14,948.0	17,008.6	18,887.1	20,700.7
Housing privatisation:						
■ **Share of privatised housing as a percentage of all housing eligible for privatisation (%)**	47	69	70	73	75	76
■ **Share of privately owned housing (%)**	65.2	81.0	82.4	84.0	84.3	85.6
Mortgage Debt to GDP ratio (%)	0.1	1.9	2.69	2.60	2.50	2.70
Housing construction						
■ **Annual volumes (000 sq. metres)**	30,300.00	61,200.00	64,100.00	59,900.00	58,400.00	62,263.90
■ **Annual growth (%)**	94.6	121.1	104.6	93.5	97.6	106.6

Sources: compiled by the author on the basis of the data by Rosstat (www.gks.ru) and AHML (www.ahml.ru)

housing to the poorest 5% of the population. At the start of 2005 some 4.5 million families or more than 10% of Russia's households were placed on waiting lists to receive social housing but this number halved after March 2005 when the Code came into force. Russians were encouraged to improve their housing conditions by making use of mortgage borrowing schemes offered by Russian banks (Amelikhina 2009).

The liberalisation of the Russian housing sphere thus completed in the mid-2000s delivered a number of positive outcomes. The transfer of the bulk of the housing fund into private ownership allowed for the development of a vibrant housing market. In 2011 the number of housing transactions reached 3.9 million out of the total Russian housing stock of 59.5 million housing units. This represents a 12.6% growth on the level reached in 2010[10]. In the first three quarters of 2012 the number of transactions grew by a further 13% compared to the same period of 2011 (AHML 2012, p. 5). In these conditions of robust growth of GDP and of individual income levels the volumes of residential construction increased remarkably. During the 2000s the construction industry was considered to be the star of the Russian economy and recorded growth rates unparalleled by any other sector during the post-Soviet period: the growth rate of the construction sector in 2006 was 16.1% and reached 21.1% in 2007 (Rosstat 2011)[11]. The volume of housing construction picked up from the sadly low levels of the late 1990s to 64.1 million sq. metres in 2008 and, after a temporary recession in 2009-2010, to 62.3 million sq. metres of housing in 2011[12]. Mortgage borrowing has also proliferated substantially. In 2000 the volume of mortgage lending was equal just to R29 billion (World Bank 2003, p. 4). In 2011 Russian banks issued 523,582 mortgages for R717 billion. This means that the number of mortgage loans and the volume of credit grew by 70% and 90% respectively compared to the levels reached in 2010 (AIZhK 2011, p. 10). In 2012, as noted, the volume of mortgage credit exceeded R1,000 billion. While the primary source of housing investment continues to be household savings, the use of borrowed funds is expanding. In 2011 17.6% of home purchases were completed using mortgage credit and 20.5% in the first three quarters of 2012 (AHML 2012, p. 5). In some regions this percentage is higher, for instance according to estimates over a quarter of new housing is bought with the use of mortgage credit in Moscow.

The development of the housing market in the period leading to the global financial crisis, the growth of personal income levels and the increased availability of housing finance in Russia had contributed to the growth of house prices. The greatest annual gains in house prices of nearly 48% and 24% were in 2006 and 2007 respectively[13]. The economic crisis halted the escalation of house prices observed in the mid-2000s: in 2009 they dropped by 7.6% in the primary housing market and 11% in the secondary market. In 2010-2011 prices stagnated with growth rates below the inflation rate (Rosstat 2011)[14]. However, in the first three quarters of 2012 for the first time since 2008, average house prices in Russia grew at a rate faster than inflation: namely they grew by 9.6% compared to the fourth quarter of 2011 (AIZhK 2012, p.5).

As a whole, Russia demonstrates substantial differentials in terms of house prices amongst its 83 regions. In Moscow which is notorious for its high cost of living, property prices according to some estimates increased 78 times over the post-Soviet period[15]. Moscow, nevertheless, appears as a clear outlier. The weighted average price of a square metre in the country in 2011 was R45,965.00. The price of a square metre in Moscow in 2011, however, was R146,363.00, followed by St. Petersburg - R83,117.00. By contrast, among Russia's regions with the lowest house prices were Karachaevo-Cherkessia - R21,651.00 per sq. metre, Adegeya - R28,936.00 per sq metre and Orel - R29,107.00 per sq. metre[16]. In addition to these developments in the housing market, it

[10] See AHML Statistics, available at http://www.ahml.ru/ru/agency/analytics/statsis/, accessed 10 December 2012.

[11] Table 1.3. *Tempy rosta (snizheniya) osnovnykh sotsial'no-ekonomicheskikh pokazateley*.

[12] See Rosstat, 2012, Table: *Vvod v deystvie zhilikh domov*.

[13] Figures for the primary housing market, See: 'Table: Indeksy tsen na pervichnom rynke zhil'ya', *Federal'naya Sluzhba Gosudarstvennoy Statistiki*, 2012, available at: http://www.gks.ru/free_doc/new_site/prices/housing/tab9.htm; a similar price dynamic is evident in the secondary housing market, see 'Table: Indeksy tsen na vtorichnom rynke zhil'ya', *Federal'naya Sluzhba Gosudarstvennoy Statistiki*, 2012, available at: http://www.gks.ru/free_doc/new_site/prices/housing/tab8.htm, both accessed 3 September 2012.

[14] Tables: 24.12 *Indeksy tsen na pervichnom i vtorichnom rynkakh zhil'ya* and 24.13 Srednie tseny na pervichnom i vtorichnom rynkakh zhil'ya.

[15] Kvartiry v Moskve za 20 let podorozhali v srednem v 78 raz', *Ria Novosti*, 20 September 2011, available at: http://ria.ru/moscow/20110920/440486197.html, accessed 12 October 2011.

[16] See AHML Statistics

can be said that the drastic situation of underfunding in the sphere of housing maintenance has improved to some extent. The improving economic performance allowed local authorities to insist on a greater share of utility and maintenance costs being covered by households themselves.[17]

Such a rapid growth of the housing market and the expansion of housing construction are not at all surprising given the history of housing deficit due to the failures of the Soviet housing regime and to the drastic reduction in housing construction during the 1990s. These positive trends, nevertheless, according to some sources have just scratched the surface of the housing demand in the country. Indeed, housing demand in Russia has been recognised as vast by many sources (ex: World Bank 2003). For instance, recent survey data demonstrates that as many as 47.9% of households resided in accommodation smaller than the nationally-established housing norm, whereas nearly 74% of Russians have at least a potential interest in moving to more suitable accommodation (Burdyak 2012a, p. 78, 84). Yet, the same survey indicates that two thirds of Russians do not expect any change in their housing situation in the foreseeable future. Some social scientists argue that for a large segment of contemporary Russian society the housing situation and the outlook continue to be bleak. Survey data indicates that in some cases respondents felt that in the market environment their prospects of improving their housing conditions were lower than during the Soviet period (Zavisha 2012, 2008). What accounts for such pessimism about housing prospects?

3. Challenges to Russian housing policy

This phenomenon is a function of a number of factors, including the outcomes of housing privatisation, the problem of housing affordability and, finally, a host of issues surrounding the development of mortgage finance in Russia. The elements of the latter factor range from the costs of mortgage credit to access to liquidity by Russian banks to the negative perception of mortgage credit among the Russian public. Below I spell out these conditions before turning to the government policy responses aimed at mitigating them.

Housing privatisation (even though most of the housing wealth was distributed to the sitting tenants) has entrenched Soviet-era housing inequalities. For instance, tenants who were allocated better housing units could privatise them free of charge and ended up in possession of valuable housing assets, which could be sold, bequeathed or rented out. By contrast, households who lived outside of the prestigious central areas of Russian cities or in smaller dwellings or worse yet on housing waiting lists found themselves in less advantageous positions. A perception of unfairness developed around the results of the seemingly popular post-Soviet initiative of housing privatisation (Attwood 2012). Many of those who fall on the wrong side in this process view housing as a social right that should be provided by the state (Zavisca 2012).

Over the last decade such societal attitudes stood behind the policy-makers' failure to complete the privatisation process. The government attempted to limit the right to privatise the newly-built public rental housing with the adoption of the Housing Code in 2004. The idea was that this would help to start creating a stock of social housing for low income families. However, this measure was widely opposed and the ban on the privatisation of the newly-built municipal housing was lifted in 2008 by a decision of the Constitutional Court and a Federal Law that followed[18]. At the same time, due to practical considerations - several months prior to the privatisation deadline of March 2010 local departments dealing with the issue were overwhelmed with the amount of applications – and also due to the sensitivities of the Russian election cycle, the deadline for free housing privatisation was postponed several times during the 2000s. The most recent extension was in February 2013. The current deadline is set for March 2015.[19]

Beyond the politics of housing privatisation, over the two post-Soviet decades an entirely new generation grew up who could not possibly benefit from this free transfer of housing assets. These people often share accommodation with the members of their extended family, the latter being fortunate enough to have privatised their home. Similarly affected are the Russians of the younger generation who move to the economically stronger regions, such as Moscow, St. Petersburg or Krasnodar, in search of employment opportunities. These social groups - providing they cannot find housing with relatives - are drawn to rent in the private sector, where they more often than not have to tolerate informal practices, lack of security of tenure and sub-standard quality in respect of rented properties (Shomina 2010). For instance, according to estimates over one million apartments were rented illegally in Moscow alone[20]. This situation of informal rentals arising as a result of social housing privatisation by and large throughout the entire post-communist space was highlighted to the policy-makers in the region by a number of authoritative international studies in the mid-2000s (Dubel et al. 2006; Economic Commission for Europe 2006).

What about mortgage finance? The promotion of owner-occupation funded by mortgages has been the policy-makers' priority from the outset of housing reform in the early 1990s. The greatest challenge that the Russian government met in this direction, not dissimilar to its counterparts elsewhere in the world, is the restricted affordability of mortgage credit. The Russian income levels referred to above are markedly lower compared to income levels that exist in European countries, for instance. The terms of mortgage borrowing, however, are noticeably less borrower-friendly than in Europe. In the mid-2000s, according to some more sceptical expert estimates, a mere 10% of Russians could afford mortgages (Gurtov 2009). The correctives introduced to house prices by the financial crisis referred to above and the continued growth of personal incomes allowed housing affordability to improve. Currently, research shows that 22.6% of Russian households can afford to take out a mortgage (Burdyak 2012a, p. 81). Yet compared to the level of unmet demand for housing this figure continues to represent a relatively modest percentage. In addition to the challenge of restricted affordability the government also has to gear its policies to the idiosyncrasies of the Russian socio-cultural context. While

[17] The subsidisation of the housing maintenance and utilities continues. See for instance research by the Moscow-based Independent Institute for Social Policy, available http://www.socpol.ru/atlas/overviews/social_sphere/kris.shtml, accessed December 10 2012. At the same time, as pointed earlier, the growth of utility tariffs greatly concerns the majority of Russians.

[18] Federal Law N. 84-FZ, adopted on 11 June 2008. *Sobranie Zakonodatel'stva Rossiyskoy Federatsii*, 2008, no. 24, st. 2797.

[19] Federal Law N. 16-FZ, adopted 25 February 2013. Available at http://www.kremlin.ru/news/17573, accessed 26 February 2013.

[20] See: 'Bol'she 1 milliona kvartir nelegal'no sdaetsia v arendu v Moskve', Ria Novosti, 2 September 2011, available at: http://ria.ru/moscow/20110902/428826215.html, accessed 12 October 2011.

Russians are not averse to or disapproving of the idea of consumer credit (Guseva 2008) the perception of unfairness generated in the process of housing privatisation leads them to hold a decided attitude of mistrust and scepticism towards the use of credit in the housing sphere[21]. As comparative research demonstrates, nonetheless, such historically-determined attitudes should not be considered as an insurmountable barrier to the development of mortgage credit in a country. As Vorms (2012, p. 23) argues, similar 'mistrust in respect of credit' is characteristic of French society as well. At the same time, as evident from the healthy track record of mortgage lending in France these obstacles can be successfully overcome providing that appropriate public oversight over housing finance institutions is put in place at all stages of the credit process.

4. Government policy responses from the mid-2000s onwards

Which steps have been taken by the government in order to address the outlined policy challenges? To start with, from 2005 onwards following the adoption of the Housing Code and not dissimilar to the process observed elsewhere in the world (Eddu 2012, p. 17) the Russian government began to redefine its own role in the housing process. From viewing its role as a one of enabler and a regulator the state has started to adopt a more interventionist approach by introducing a number of demand- and supply-side subsidies. The beginning of this learning process can be related to the recognition of the limitations of earlier *laissez-faire* policies. For instance, it was acknowledged that, despite the introduction of all essential elements of the market economy into the Russian housing sphere, over the post-Soviet period there had been a steady reduction in the number of families which were able to improve their housing conditions. In 1990 1,296,000 families moved into new housing units; this number had decreased to 242,000 by 2001. After the Housing Code came into force from 1 March 2005 a mere 151,000 moved into new accommodation in 2005. In the mean time, the needs remained high - 3,384,000 households were placed on housing waiting lists in early 2005 (Starovoytov 2007).[22]

Improving the affordability of owner-occupation has grown to represent the central plank of policy-makers' action. For instance, there is a focus is on reducing the costs of land for construction of residential housing for the so called 'economy-class' (zhil'e ekonom klassa). For this purpose a special Foundation was set up in 2008[23]. Its objective is to identify - particularly within densely built-up urban areas - land plots often nominally owned by industrial enterprises but in reality abandoned by them and transfer such sites to municipalities and developers for the purposes of residential construction. Further, within the framework of a National project 'Affordable and Comfortable Housing' launched in 2006 the government aims to increase the affordability of mortgage finance to specific demographic and social groups, particularly young people, families with children, families of military personnel and young scientists. The subsidisation of mortgage products for these categories is implemented via the AHML. In 2011 subsidies amounted to around R23 billion (AHML 2011, p. 13). Another initiative introduced by the government is the funding and supervision of the renovation of Russia's ageing housing stock and infrastructure. A dedicated foundation was set up in 2007[24]. To date it has assisted the major repairs of 118,000 multi-family residential buildings or 350 million sq. metres of housing throughout the country[25]. The activity of the foundation is, nevertheless, seen by the policy-makers as a temporary measure. The long-term plans are to increase the use of credit for the purpose of funding housing repairs. More broadly, increasing the use of borrowed funds in the housing sphere represents the central element of the policy-makers' efforts to improve the affordability of private ownership. The government's work with Russian banks to improve the affordability of mortgage loans is reviewed in the next sub-section.

5. Housing finance

The central pillar of overall government housing policy continues to be private ownership funded by mortgage loans and to enable this current government policy is mainly focused on developing the institutions of housing finance and increasing the volumes of mortgage borrowing by Russian households. This objective has been expressed in such recent policy documents as 'The strategy for the development of mortgage lending in the Russian Federation until 2030'[26] and 'The strategy for the development of the group of companies 'AHML'[27] adopted in 2010 and 2011 respectively; also confirmed in the 'Strategy 2020'[28] and in the Presidential Decree N600 signed by Vladimir Putin on the day of his inauguration to the presidency, May 7 2012[29]. The policy aim is to ensure that mortgage finance becomes affordable by 50% of Russian households by 2020 and 60% by 2030.

The financial institutions that help individual Russian households which aspire to become homeowners are banks. Over the entire post-Soviet period Russian banks have operated in conditions of high uncertainty related primarily to the macro-economic context, but also to such factors as short or non-existent credit histories of their potential borrowers and the high level of informal employment and income. During the 1990s the economic situation was particularly difficult and terms of mortgage borrowing as a consequence could be described as harsh. Mortgage deposits in most cases were no less than 30%. Borrowing was short term, for around a five-year period, and at 30-35% interest rates on loans in US dollars (Suchkov & Klepikova 1997). However, over the last decade the interest rates on mortgage loans displayed a clear downward trend. Prior to the financial crisis the average weighted interest rate was 12.9%. In 2009 the interest rate for borrowers deteriorated to 14-15%. In 2010 they softened again, so in 2011 mortgages were offered by the banks on average at 11.9% (AIZhK 2011). The amounts of initial deposits range between 10 and 30% of the

[21] The experience of economic crisis, loss of savings and employment lived through by many Russians during the 1990s affect confidence in financial institutions as well.

[22] See Rosstat (2011) Table 6.44: *Predostavlenie Zhilykh Pomeshcheniy.*

[23] Federal Law N. 161-FZ, adopted on 24 July 2008. *Sobranie Zakonodatel'stva Rossiyskoy Federatsii*, 2008, no. 30, part 2, st. 3617.

[24] Federal Law N. 185-FZ, adopted on 21 July 2007. *Sobranie Zakonodatel'stva Rossiyskoy Federatsii*, 2007, no. 30, st. 3799.

[25] The results of the Foundation's work can be viewed at http://www.reformagkh.ru/myhouse/analytics?group=repair, accessed 22 November 2012.

[26] *Strategiya Razvitiya Ipotechnogo Zhilishchnogo Kreditovaniya v Rossiyskoy Federatsii do 2030 goda*, 2010, available at: http://www.ahml.ru/common/img/uploaded/files/agency/strateg_1201.pdf, accessed 16 November 2011.

[27] *Strategiya Razvitiya Gruppy Kompaniy 'AIZhK' na 2011-2020 gody*, 2011, available at: http://www.ahml.ru/common/img/uploaded/files/agency/strategy_ahml_220811.pdf, accessed 16 November 2011.

[28] An important policy document stating the country's key developmental objectives elaborated with the participation of a wide spectrum of Russian and international policy specialists. *Strategiya 2020*, 2012, available at: www.2020strategy.ru, accessed 11 October 2012, pp. 474-475.

[29] *Rossiyskaya Gazeta - Federal'nyi vypusk*, 9 May 2012, available at: http://www.rg.ru/2012/05/09/zhilje-dok.html, accessed 18 September 2012.

property value while the borrowing periods are between 10 and 20 years. A standard annuity loan represents the most wide-spread type of mortgage (Tumanov, 2011). In the second half of 2012 due to the credit squeeze in the euro-zone, Russian banks increased their interest rates on mortgage credits by 0.5-1% (Kovaleva 2012). According to the latest available data for September 2012 the weighted average interest rate on new loans issued in Russian Rubles was 12.3% (AIZhK 2012, p.4). (See Table 2).

Table 2. Mortgage lending in Russia, 2000-2011

	2000	2007	2008	2009	2010	2011
Volumes of Mortgage Credit **■ Number of mortgage loans** **■ Credit volume (billion Rubles)**	- 29	- 556	349,502 656	130,085 153	301,035 379	523,582 717
Average interest rates on mortgage loans taken out in Rubles (%)	21-23	13.4	12.9	14.3	13.1	11.9

Sources: compiled by the author on the basis of World Bank (2003) and the AHML data (www.ahml.ru)

As a result of the reduction in the interest rates and macro-economic growth observed in 2010-2012, as noted, during the last three years the scale of mortgage borrowing in Russia demonstrated impressive annual growth rates - 90% in the volume of credit in 2011 and 50% in the first three quarters of 2012. In 2011 the total mortgage debt on the balance of Russian banks grew by 30.6% and by January 1 2012 it amounted to R1 474 839 million (AIZhK 2011, p. 11). This growth was reflected in the continuous increase in the number of housing transactions cleared with the use of mortgage funds. Nevertheless, while growth may be impressive, the mortgage market in Russia still has considerable room for development. The mortgage debt to GDP ratio - the primary marker used internationally to assess the level of mortgage market development - in Russia in 2011 was equal to 2.72%[30]. This represents a modest level both by comparison with developed economies and with many former socialist countries . Nevertheless, it signifies a substantial increase compared to the level that existed in Russia a decade earlier - 0.1% in 2000 (World Bank 2003).

The current challenge for government policy is to attract a greater number of potential borrowers to take advantage of mortgage lending schemes at a time when the majority of the public remain sceptical about mortgage credit. In addition, the recent history of the global financial crisis causing a rise in home repossessions and the depreciation of housing assets around the globe as well as the continuing turmoil on the European markets further affects borrowers' confidence in Russia. The delinquency rate which increased in 2009-2010, fell during 2011 and at the start of 2012 was 6.0% (AIZhK 2011, p. 12). In 2009 in order to assist borrowers as well as lenders in complex circumstances and boost confidence in housing finance the Russian government established the Agency for Restructuring of Home Mortgage Loans (ARHML). In 2009 the Agency helped over four thousand borrowers (see ibid, p. 26-27). Further, in order to reduce the perception of high risk associated with mortgages at the end of 2011 Russian policy-makers adopted a highly popular initiative of pardoning the debt of failed borrowers. The respective law came into force the following March[32]. This initiative, which is in line with the current efforts of international regulators and the national governments to improve the level of consumer protection in the area of mortgage credit, could also be seen as advancing the popularity of the incumbent governing team during the 2011-2012 round of parliamentary-presidential elections.

Yet, probably the most promising policy direction leading towards greater affordability of mortgage finance is the improvement of the terms of mortgage credit and specifically the reduction of the interest rates on loans originated by Russian banks. At 12.3% at the time of writing (December 2012) they are well above the current inflation rate of 6.6% (AIZhK 2012, p5). The government objective expressed in the policy documents referred to above is to reduce such rates to 1-3% above the inflation rate by 2030.The factor that could help banks to offer mortgages on more borrower-friendly terms is the development of financial instruments which would allow banks access to greater volumes of liquidity, particularly if such could be generated within the country itself. Overall, insufficient levels of investment circulating within the Russian economy represent a condition that has long been recognised by the government and experts alike. Russian banking, simultaneously, is characterised by a large number of banks with a marked divide between large and small banks and a heavy concentration of assets in a few large ones (Juurikkala et al, 2011). Equally, while a large number of credit organisations operate in the Russian mortgage market - 658 according to AHML data - a few state-controlled banks such as *Sberbank*, *VTB* and *Gazprombank* hold an overwhelmingly predominant market share. *Sberbank* alone accounts for approximately half of mortgage loans issued in 2011. Banks rely primarily on internal resources to fund their mortgage operations and the use of capital market funding is low. The largest share of the secondary funding comes from the government's AHML - R51.6 billion in 2011 which was equal to 7.68% of mortgage loans originated during the year[33]. Mortgage securities, at the same time, funded only 3.57% of mortgage loans issued in 2010[34] and around 6% in 2011 (AIZhK 2011, p.14). The scarcity of funding affects large and smaller banks in different ways. Prior to the global financial crisis smaller Russian banks borrowed heavily from abroad. Recently, as the euro-zone plunged into the liquidity crisis, access to funds became problematic again. At the time when large banks have substantial internal resources through deposits - Sberbank again held 50% of deposits in the country (Juurikkala et al., p. 112) - smaller banks might benefit from further development of capital market funding. The Russian mortgage market overall, would, therefore, benefit from making greater use of securitisation and the development of specific financial products such as covered bonds (See Lassen 2012a, b). The robust performance of the latter instrument in the current financial environment should be noted (Stocker 2011).

[30] See AHML Statistics.

[31] To consider Russian mortgage interest rates in comparative perspective, according to the European Mortgage Federation data, these rates in some of the European countries were as little as 2.17% in Finland, 4% in France and 3.75% in the UK; while in some of the EU new member states that share with Russia its socialist past mortgage interest rates ranged from as low as 3% in Estonia and 3.21% in Slovenia to 6.10% in Poland and 8.34% in Bulgaria (EMF 2010, p. 88).

[32] Federal Law N. 405-FZ, adopted on 6 December 2011. *Rossiyskaya Gazeta - Federal'nyi vypusk*, 14 December 2011, available at: http://www.rg.ru/2011/12/14/zalog-dok.html, accessed 13 September 2012.

[33] See AHML Statistics.

[34] *Strategiya Razvitiya Ipotechnogo Zhilishchnogo Kreditovaniya v Rossiyskoy Federatsii do 2030 goda.*

The government is aware of the problem of insufficient securitisation which in the past had been highlighted by international institutions, such as the EBRD (see EBRD 2007). Russian policy-makers aim to significantly increase these volumes, at present using the funds of the AHML and of the state development bank 'VEB'. The latter in 2010 initiated a new housing investment programme. During the summer 2011 VEB started to work on the programme with a number of designated banks (Lassen 2012a, AIZhK 2011, p. 14, 20). In the meantime, the government target expressed in the 2011 'Strategy' was to achieve a dramatic increase in the volumes of securitisation - to 50% by 2015 and to 66% by 2030.[35] Based on the determination of its policy-makers Russia has been described as one of the countries that has the highest potential for the development of the secondary mortgage market and of the covered bonds in particular (Lassen 2012a,b).

In addition to the government policy effort to improve affordability of mortgage borrowing outlined above, Russian housing policy in the recent years has undergone a change associated with the inclusion in the policy of plans to develop affordable rental and cooperative housing options. This new trend is reviewed in a separate contribution to this issue of HFI by Andrey Tumanov.

6. Conclusion

Contemporary Russian housing is a dynamic and fast-growing sphere of the country's economy. The housing policy of the Russian government to date has developed on the basis of the Soviet-era legacies, particularly those of housing shortages, as well as the liberal housing reform that started in the early 1990s. It has also been influenced by fluctuating economic conditions and pressure from the government opposition, primarily so during the first post-Soviet decade. Since the mid-2000s we observe a learning process in Russian housing policy leading towards the development of a more balanced tenure structure, while increasing the affordability of owner-occupation continues to be the locus of the policy-makers' action.

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The state of housing finance in Canada and recent developments

By Steve Mennill

1. Introduction

The Canadian housing finance system performed well through the global financial crisis. This performance has been attributed to a strong regulatory system, the strength of domestic financial institutions supported by the government-backed mortgage insurance framework, and government supported securitization programs. To further strengthen the financial and housing finance system going forward, Canadian lawmakers and regulators have been active in implementing various domestic and international regulatory and policy measures. These are affecting multiple facets of housing finance in Canada, from lenders' funding strategies to underwriting practices and regulatory oversight.

This article highlights key current features of the residential mortgage lending market in Canada, followed by an overview of major mortgage funding sources.

2. Mortgage lending in Canada

2.1 A diverse range of mortgage lenders operate in the mortgage market

Chartered banks are the largest mortgage lenders in Canada. Of total residential mortgage credit outstanding, which was CAN$1.16 trillion in September 2012[1], chartered banks held 75% on their balance sheets, including mortgages that have been securitized[2]. The second-largest group of mortgage lenders consists of credit unions, which hold 12% of residential mortgages outstanding. The remaining balance is held by a wide range of entities including, but not limited to, life insurance companies, pension plans, and non-deposit-taking institutions.

The majority of mortgage lenders in Canada are federally or provincially regulated financial institutions. The Office of the Superintendent of Financial Institutions (OSFI) is the primary regulator of federally-regulated financial institutions in Canada, which includes banks, insurance companies, trust and loan companies, and pension plans. Rigorous supervision and prudent regulation on the part of OSFI reinforces conservative business practices and risk management. Credit unions are regulated at the provincial level, while a small number of lenders are not explicitly subject to a specific regulator aside from complying with the regulations applied to their business and corporation.

2.2 Borrowers benefit from a variety of competitive mortgage products

There is a wide variety of mortgage products available in the Canadian market, which offers borrowers an array of options regarding mortgage terms, type of mortgage rates, prepayment features, amortization, etc.

2.2.1 The 5-year term fixed-rate mortgage with an amortization period of 25 years or less is most common

According to recent surveys, the most common type of mortgages in Canada are those with a 5-year term, fixed interest rate and an amortization period of 25 years or less. For example, regarding the mortgage term, the 2011 Financial Industry Research Monitor's (FIRM) *Residential Mortgage Survey*[3] found that 65% of the borrowers who initiated or renewed in the six months prior to the survey opted for a 5-year term. Another 26% chose a term ranging from 6 months to 4 years, while the remaining borrowers had mortgage terms longer than 5 years. Mortgages are typically renewed at the end of a term until fully paid off.

Regarding amortization, according to the 2012 survey by the Canadian Association of Accredited Mortgage Professionals (CAAMP), 79% of existing mortgages had amortization periods of 25 years or less, and the remaining 21% had amortization periods longer than 25 years.[4]

Canadian borrowers have also shown a strong preference for fixed rate mortgages. According to the CAAMP survey, 65% of existing mortgages were fixed rate, 28% were variable rate, and 7% had a combination of rate options.

2.2.2 Many Canadians are actively using prepayment options to pay off their mortgage sooner

The 2012 CMHC Mortgage Consumer Survey found that many Canadians are actively paying off their mortgages sooner than required by their contract terms. Of recent buyers surveyed, 44% set mortgage payments higher than the minimum required and 31% had already made lump sum prepayments, increased their regular payment or both.

This prudent practice of Canadians is also confirmed by the 2012 CAAMP survey which found

[1] Bank of Canada, Banking and Financial Statistics – December 2012, http://www.bankofcanada.ca/wp-content/uploads/2012/12/bfs_december12.pdf

[2] The new International Financial Reporting Standards (IFRS) have changed the accounting treatment for securitized mortgages. Under IFRS, mortgage assets sold by financial institutions through CMHC's existing securitization programs no longer achieve off-balance sheet treatment in most cases. Federally-regulated mortgage lenders are thus required to consolidate securitized mortgages on their balance sheets.

[3] The Financial Industry Monitor (FIRM) Residential Mortgage Survey, prepared for CMHC by Altus Group Consulting and Ipsos Reid (Fall 2011)

[4] Canadian Association of Accredited Mortgage Professionals, Annual State of the Mortgage Market in Canada, http://www.caamp.org/meloncms/media/ReportFall_20121115.pdf

that 32% of mortgage holders made additional efforts to accelerate payments, e.g. by increasing their monthly payment, making a lump sum payment or increasing the payment frequency (e.g. from monthly to bi weekly) during the year before the survey.

2.2.3 Competition has enhanced borrowers' ability to negotiate better mortgage rates and terms

The "posted" mortgage rates publicly advertised by lenders are not always the actual rates applied to a mortgage. In fact, it has become an increasingly common practice of many lenders in Canada to discount the posted mortgage rates upon negotiating with borrowers. Competition in the mortgage market and the diversity of mortgage lenders (in part a consequence of government-supported insurance and securitization), have enhanced the ability of borrowers to negotiate better mortgage rates and other terms.

The specific mortgage rate discount varies depending on borrower characteristics, mortgage product, lender and market conditions. The 2012 CAAMP survey showed an average 5-year fixed rate of 3.43% for mortgages originated, renewed or refinanced in 2012 while the posted 5-year fixed rate in the same period averaged 5.28%, implying a discount of 1.85 percentage points on average. Note, however, that regulatory mortgage underwriting guidelines still prudently require using the higher 5-year posted mortgage rates to qualify borrowers.

2.3 Mortgage insurance has an important role in Canada's housing finance system

2.3.1 Mortgage insurance is legally required for mortgages with loan to value ratio above 80%

Mortgage insurance plays an important role in Canada's housing finance system. Federally-regulated lenders and most provincially-regulated lenders are required to have mortgage insurance coverage for loans above 80% of the value of the residential property. Mortgage loan insurance helps protect lenders against mortgage default and enables consumers to purchase homes with a minimum down payment of 5% at interest rates comparable to buyers who purchase with a 20% (or higher) down payment. Although the obligation to purchase mortgage insurance rests with the lender, the mortgage insurance premium is typically passed on to the borrower.[5]

2.3.2 Government-backed mortgage insurance framework supports access to mortgage credit and promotes sound mortgage underwriting

In Canada, mortgage insurance is currently offered by Canada Mortgage and Housing Corporation (CMHC)[6], which is wholly owned by the Government of Canada, and two private mortgage insurers.

Mortgage insurers are subject to the government-backed mortgage insurance framework.

Under this framework, the Government provides a guarantee for 100% of CMHC's obligations and 90% of the private insurers' obligations. The Government also sets insurance-in-force limits for CMHC ($600 billion) and the private mortgage insurers ($300 billion) as well as other prudential requirements for mortgage insurance.

Government backing of both private and public mortgage insurance supports access to mortgage credit throughout the economic cycle. Furthermore, the government-backed mortgage insurance framework regulates and promotes prudent mortgage insurance and mortgage underwriting in Canada, contributing to the stability of the Canadian housing market and financial system.

Between 2008 and 2012, the Government revised the criteria for government-backed insured mortgages to support the long-term stability of Canada's housing market. Key revisions to the criteria included the following:

- Reducing the maximum amortization period from 40 years to 25 years for mortgages with less than a 20% down payment;
- Requiring a minimum down payment of 5% for homeowner purchase mortgages;
- Requiring that borrowers meet the standards for a 5-year fixed-rate mortgage (even if they choose a different mortgage type with a lower interest rate and a shorter term);
- Withdrawing the government insurance backing on non-amortizing lines of credit secured by homes;
- Lowering the maximum refinancing amount to 80% of the owner-occupied property value; and,
- Establishing a maximum gross debt-service ratio of 39% and reducing the maximum total debt-service ratio to 44%.[7]

In addition to being subject to the government-backed mortgage insurance framework, private mortgage insurers in Canada are subject to oversight by OSFI. OSFI's regulation and supervision aim to ensure that they are adequately capitalized, engage in prudent business practices and comply with applicable regulations.

CMHC follows prudential regulations as set out by OSFI, including its capital requirements. Furthermore, since 2012, OSFI has been mandated to conduct examinations at least annually into whether CMHC's insurance and securitization businesses are conducted in a safe and sound manner with due regard to potential losses.

2.3.3 As Canada's public mortgage insurer and national housing agency, CMHC facilitates access to housing in all markets across the country and supports financial stability

CMHC is the largest mortgage insurer in Canada. It is also the only mortgage insurer for large multi-unit residential properties, including nursing and retirement homes and is the primary insurer for housing in rural areas and smaller Canadian markets. Approximately 46% of CMHC's mortgage insurance business in the first nine months of 2012 was to address less-served markets and/or to support specific government priorities.

CMHC's mortgage insurance activities are carried out on a commercial basis with no financial

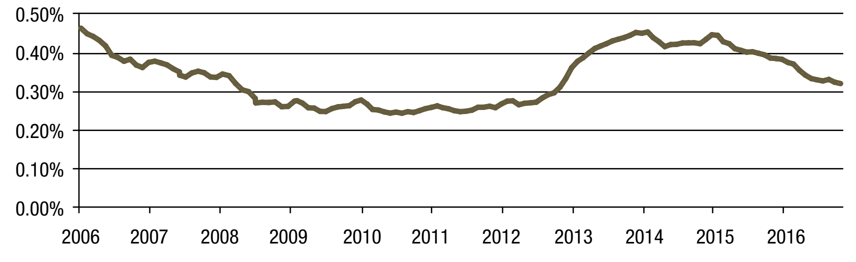
[5] In the case of portfolio insurance, the lender pays the mortgage insurance premium. Portfolio insurance provides lenders with the ability to purchase insurance on pools of previously uninsured low ratio mortgages.

[6] CMHC is Canada's national housing agency. Established as a government-owned corporation in 1946 to address Canada's post-war housing shortage, the agency has grown into a significant national institution.

[7] Gross debt-service ratio is defined as the ratio of the carrying costs of the home, including the mortgage payment, taxes, and heating costs, to the borrower's total income. Total debt-service ratio is defined as the ratio of the carrying costs of the home and all other debt payments to total income.

assistance from the Government of Canada. In 2012, CMHC's mandate was enhanced to include financial stability as an objective of its commercial activities, including mortgage insurance.

Figure 1 Monthly arrears rates for residential mortgages in Canada (2002-2012)



Source: Canadian Bankers Association

2.4 Enhanced mortgage underwriting and financial literacy further contribute to low arrears rates and promote prudent household borrowing

2.4.1 The Canadian mortgage arrears rate has remained low over the past decade

Canada maintained its historically low arrears rate in 2012 with the number of residential mortgages three months or more in arrears falling from 0.38% in December 2011 to 0.32% as of November 2012 (Figure 1), according to the Canadian Bankers Association[8]. Conservative mortgage lending practices in Canada are among the factors contributing to this performance. In its January 2012 peer review of Canada, the Financial Stability Board (FSB) recognized "conservative loan underwriting standards" as one of the important factors contributing to the resilience of Canada's financial system through the global financial crisis.

2.4.2 New requirements further promote sound mortgage underwriting

In addition to the enhanced mortgage insurance criteria under the government-backed mortgage insurance framework, OSFI issued a Guideline for Residential Mortgage Underwriting Practices and Procedures in June 2012 (the Guideline). The Guideline is built on the FSB principles for mortgage underwriting and applies to federally-regulated financial institutions that are engaged in residential mortgage underwriting and/or the acquisition of residential mortgage loan assets in Canada. The Guideline outlines requirements under the five following principles:

1. A comprehensive board-approved residential mortgage underwriting policy;
2. Due diligence to record and assess borrower's identity, background and willingness to service debts;
3. Adequate assessment of borrower's capacity to service debt obligations;
4. Sound collateral management and appraisal processes; and,
5. Effective credit and counterparty risk management that supports mortgage underwriting and asset management, including mortgage insurance.

The Guideline also sets out new disclosure requirements regarding the mortgage lending business of the regulated institutions. OSFI is expected to publish a similar guideline for mortgage insurers in 2013.

2.4.3 Advancing financial literacy coupled with enhanced underwriting promotes prudent household borrowing

The Government of Canada has also taken a number of initiatives to advance the financial literacy of Canadians. Together with the noted measures to enhance mortgage underwriting and mortgage insurance criteria, these financial literacy initiatives help promote prudent household borrowing and address recent concerns that elevated levels of household debt and house prices in some urban centres have increased economic vulnerability.[9]

Financial literacy increases the knowledge, skills and confidence of consumers to make responsible financial decisions. Following the recommendations made by Canada's Task Force on Financial Literacy, the Government of Canada introduced the *Financial Literacy Leader* Act in November 2011. It provides for the appointment of a Financial Literacy Leader, expected to take place in 2013[10]. The Act also expands the power and responsibilities of the Financial Consumer Agency of Canada (FCAC) in coordinating stakeholders' efforts to advance financial literacy, including as it pertains to housing finance and mortgage insurance.

FCAC is also responsible for monitoring compliance with the Mortgage Insurance Disclosure Regulations, brought into effect January 2011, and a new code of conduct related to mortgage prepayment information, which was announced in March 2012. Under this code, federally-regulated financial institutions are required to provide enhanced information to customers about prepayment options associated with mortgage products, such as how to pay off mortgages faster, how to avoid prepayment penalties, and how such penalties are calculated.

3. Mortgage funding in Canada

3.1 Canadian lenders have access to a variety of mortgage funding sources

Canadian lenders have access to a variety of sources to fund mortgages, including deposits from customers and funds raised in capital markets. Retail deposits remain one of the lowest cost funding sources for many mortgage lenders. For example, 5-year guaranteed investment certificates (GIC) rates have generally been lower than 5-year Government of Canada bond rates (see Figure 2).

[8] Canadian Bankers Association, Mortgages in Arrears, http://www.cba.ca/contents/files/statistics/stat_mortgage_db050_en.pdf

[9] CMHC Housing Market Outlook - Canada Edition – Fourth Quarter 2012.

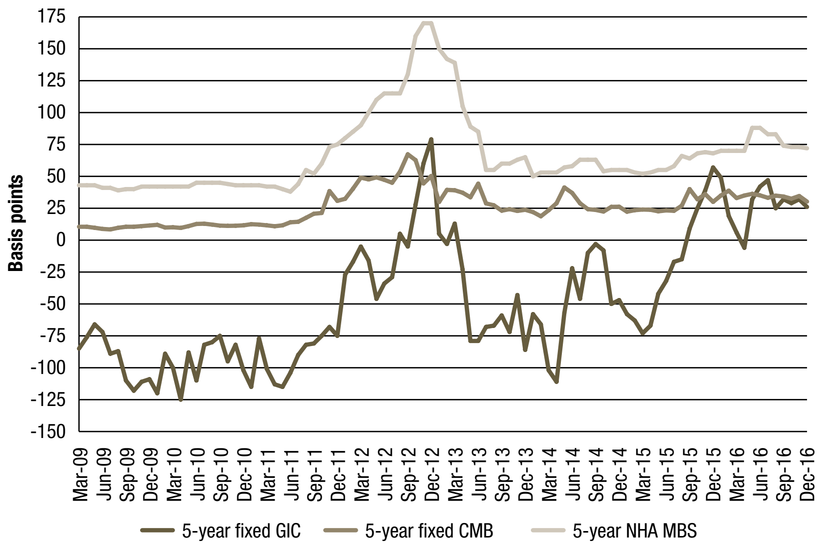
[10] The objective of the Financial Literacy Leader is to provide national leadership by collaborating and coordinating with stakeholders to contribute to and support initiatives that strengthen the financial literacy of Canadians.

Key capital market-based funding sources in Canada are securitization, covered bonds, and other corporate debts. Capital markets offer funding alternatives for deposit-taking mortgage lenders, thereby reducing dependency on deposits, while also providing critical funding options for non-deposit-taking institutions.

Many of the non-deposit-taking lenders are specialized mortgage mono-line lenders, who rely predominantly on capital markets to raise funds. A key source of capital markets based funding is securitization, which, in Canada, includes CMHC's securitization programs and private securitization.

Covered bonds, first issued in Canada in 2007, are a relatively new funding source for Canadian lenders. The rapidly growing issuance of Canadian covered bonds in recent years is an indication that this is becoming a more established funding source for Canadian lenders.

Figure 2 GIC, Canada Mortgage Bonds and National Housing Act Mortgage Backed Securities monthly spreads to Government of Canada bond benchmark (2005-2012)



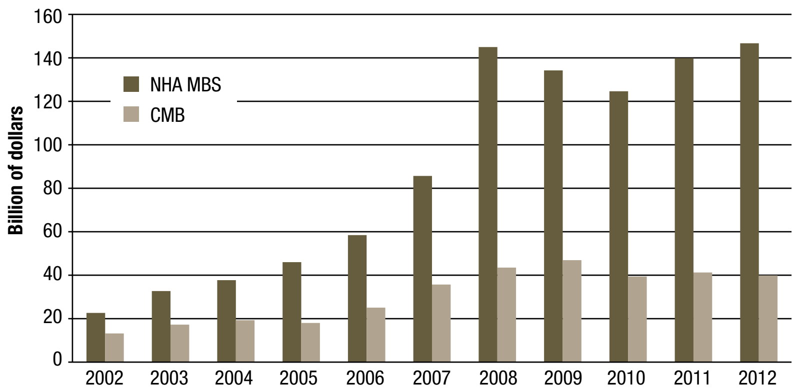
Source: CMHC, Bank of Canada, CIBC World Markets, Scotia Capital Markets

3.2 CMHC securitization programs provide lenders with a reliable supply of funds throughout economic cycles, promoting competition and stability

CMHC has been at the forefront of mortgage securitization in Canada with the introduction of the *National Housing Act* Mortgage-Backed Securities (NHA MBS) program in 1986 and the Canada Mortgage Bond (CMB) program in 2001. These two public mortgage securitization programs allow larger and smaller mortgage lenders to access a stable supply of funds throughout the economic cycle, thus also facilitating competition and promoting stability. Additionally, they offer investors an opportunity to hold high-quality, secure investments in the secondary mortgage market.

Both NHA MBS and CMB carry CMHC's guarantee for timely payment of principal and interest to investors. This guarantee acts as a credit enhancement to lower the cost of funding. CMHC charges a fee for the provision of this guarantee.

Figure 3 Annual NHA MBS and CMB Issuance (2002-2012)



Source: CMHC; Note: The total NHA MBS issuance includes NHA MBS sold to capital market investors and to the Canada Housing Trust under the CMB program, as well as NHA MBS held by the issuers.

3.2.1 The National Housing Act Mortgage-Backed Securities Program

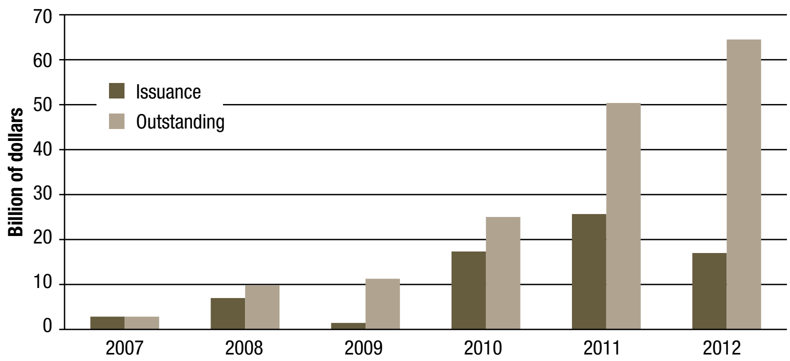
NHA MBS are securities backed by pools of residential mortgages insured by CMHC or the government-backed private mortgage insurers. In addition to the rigorous criteria for the underlying insured mortgages set by the Government of Canada, CMHC also sets stringent requirements for the NHA MBS and the program participants.

Investors in NHA MBS receive monthly installments of principal and interest that are passed on from the cash flow of the underlying mortgages. While the underlying assets are mostly credit risk-free due to the mortgage insurance requirement, investors in NHA MBS still face prepayment risk. Financial institutions may sell the NHA MBS to capital market investors or to the Canada Housing Trust under the CMB program (see section below).

The NHA MBS program has grown significantly over the years with issuance increasing from \$22.6 billion in 2002 to \$146.7 billion in 2012 (see Figure 3) and a total of \$387.4 billion of NHA MBS outstanding in 2012. The increase in issuance has been in response to the demand for funding and a broadening range of lenders participating in the NHA MBS and CMB programs. A notable spike in NHA MBS issuance occurred from 2008 to 2010 due to the increased funding demand during the global financial crisis, including via the CMB and NHA MBS programs as well as the Insured Mortgage Purchase Program (IMPP). The IMPP was temporarily implemented by the Canadian government through CMHC to help facilitate access to longer-term credit for Canadian consumers and businesses during the global financial crisis.[11]

NHA MBS provide lenders with a funding source in addition to deposits and CMB (see Figure 3). Until the onset of the global financial crisis, the NHA MBS spread against the government bond benchmark was around 40 basis points. The spread widened during the crisis, while the costs of private funding sources increased even more. The spread eased lower to a range of 70 to 88 basis points in 2012.[12]

Figure 4 Annual Covered Bonds Issuance and Outstanding (2007-2012)



Source: CMHC, adapted from DBRS Monthly Canadian Covered Bond Report and Issuers' Covered Bond Investor Reports

3.2.2 The Canada Mortgage Bonds program

CMBs are issued by the Canada Housing Trust (CHT), a special purpose trust created to issue and sell CMBs to investors and use the proceeds to purchase NHA MBS. Similar to the NHA MBS program, participating lenders can use the funds obtained from the CMB program for lending. The CMB program, however, enhances the NHA MBS program. Specifically, there is no prepayment risk associated with CMB since it is designed to be similar to most standard bonds in the market with regular interest payments (e.g. semi-annually) and a repayment of the principal at a fixed maturity date.

Since the launch of CMB in 2001, regular issuances, solid performance, and strong investor demand have facilitated a liquid market for CMBs and have established it as one of the most cost-effective funding sources for mortgage lenders in Canada after deposits (see Figure 2). In 2012, there was $39.9 billion of CMB issuance (see Figure 3) and $201.7 billion of CMB outstanding. Funding costs via the CMB programs as represented by the 5-year CMB spread over the government bond benchmark, was in a range of 7 to 14 basis points before the global financial crisis. It peaked at over 80 basis points during the crisis; however, the cost of private funding sources during the crisis increased much more than this. The CMB spread has since come down to a range of about 30 to 39 basis points in 2012.[13]

Over the years, enhancements have further improved lender access to CMB program funding and diversified the CMB products offered to investors, thereby expanding the program's benefits for Canada's financial system, i.e., facilitating funding supply, competition, and promoting financial stability. For example, CMBs now are offered in different maturities (e.g. five or ten years) and interest rates (e.g. fixed-rate and floating-rate notes). The launch of the 10-year term CMB in 2008 not only helped address the funding gaps during the global financial crisis but also is seen by market observers as facilitating the provision of mortgages with terms longer than five years in Canada.

3.3 Private mortgage securitization slow to recover from the crisis impacts

Prior to the recent financial crisis, private mortgage securitization offered a funding source to Canadian lenders, albeit on a smaller scale compared to CMHC's securitization programs. In particular, non-bank mortgage lenders relied more on private securitization for funding with the issuance of residential mortgage-backed securities (RMBS) (mostly backed by uninsured mortgages), asset-backed securities (ABS), and asset-backed commercial paper (ABCP).

Private mortgage securitization in Canada and abroad faced a collapse of investor confidence during the global financial crisis and has since struggled to recover. In Canada, there has been no issuance of private RMBS since 2010 and as of December 2012 there is no outstanding private RMBS.

The ABCP market experienced major restructuring, enhancements, and a declining trend from 2008 to 2010. Renewed investor interest helped reverse the decline and stabilize the market with total ABCP outstanding remaining flat since 2010, going from $25.1 billion in December 2010 to $25.2 billion in November 2012.[14] However, the amount of mortgage assets backing ABCP decreased from $9.5 billion to $6.6 billion over the same period, which included insured mortgages as the largest part, followed by conventional and non-conventional mortgages, respectively.

3.4 Covered bonds

3.4.1 Covered bonds are becoming a more established funding source for Canadian lenders

Since 2007, Canadian federal deposit-taking financial institutions have been permitted by OSFI to issue covered bonds up to a maximum

[11] The Insured Mortgage Purchase Program (IMPP) authorized CMHC to purchase up to $125 billion in NHA MBS from Canadian financial institutions between October 2008 and March 2010. CMHC purchased a total of $69.3 billion NHA MBS under IMPP.

[12] CMHC Securitization

[13] CMHC Securitization

[14] This excludes home equity lines of credit (HELOCs).

limit of 4% of an institution's total assets. Canadian covered bond issuance has grown substantially, from $2.8 billion in 2007 to $25.7 billion in 2011 and $17.0 billion in 2012 (see Figure 4). The total value of covered bonds outstanding was $64.5 billion in 2012, with seven covered bond programs established by the six largest Canadian banks and one credit union. These covered bonds were issued under a contractual framework as there was no dedicated legislation on covered bonds in Canada prior to 2012.

Canadian covered bonds have been offered in various currencies, e.g. Euro, Canadian dollar, U.S. dollar, Australian dollar, and Swiss Franc, targeting different international investors and markets. While the issuances were mostly in Euros during 2007 and 2008, this shifted to a dominance of U.S. dollar denominated bonds thereafter, due in part to stronger U.S. investor demand. In 2012, approximately $16.8 billion of the $17.0 billion in total issuance was in U.S. dollars.

Canadian covered bonds offer mortgage lenders a funding alternative with relatively attractive costs. For example, the spread of 5-year Canadian covered bonds issued in U.S. dollars over the Canadian government bond benchmark was in the area of 70 basis points if backed by insured mortgages, or 90 basis points if backed by uninsured mortgages, at the end of February 2012, according to a report by the Bank of Montreal.[15]

3.4.2 The Canadian Covered Bond Legal Framework facilitates covered bonds funding for lenders

Recognizing the growing importance of covered bonds, in 2012, the Canadian government introduced a dedicated legal framework for covered bonds in Canada, i.e. the Canadian Covered Bond Legal Framework (the Framework). The Framework aims to support financial stability by facilitating diversified funding sources for lenders and by making the market for Canadian covered bonds more robust. The Framework provides greater certainty to investors with the statutory protection of their claim over the cover pool assets. As such, the Framework is expected to broaden the investor base of Canadian covered bonds and improve the supply of funding to lenders.

Key features of the Framework are the following:

- The Framework for covered bonds is available to all federally- and provincially-regulated financial institutions;
- Eligible assets for the cover pool are uninsured residential mortgages for properties with 1 to 4 units;
- Government-backed insured mortgages and NHA MBS are no longer permitted as cover pool assets;
- Investors in covered bonds issued under the Framework benefit from statutory bankruptcy protection over the cover pool assets;
- CMHC is responsible for the administration of the Framework and has established terms and conditions for covered bond issuers and programs under the Framework; and,
- Eligible Canadian financial institutions who wish to issue covered bonds must apply to CMHC for registered issuer and registered program status, and must comply with the Framework.

Since neither the Government of Canada nor CMHC provide a guarantee of any sort on covered bonds issued under the Framework, there is no additional risk to Canadian taxpayers. As well, the administration of the Framework by CMHC will be funded by fees collected from issuers on a cost-recovery basis, thus entailing no cost to the Canadian public.

4. Concluding remarks

Strong domestic financial institutions, a strong financial regulatory system, prudent risk management practices, as well as the government role in housing finance have greatly contributed to the stability of the Canadian financial system through and after the recent global financial crisis. Built on this strong foundation, Canadian policymakers have been active in implementing various domestic and international initiatives to further strengthen financial stability and the housing finance system. As a result, Canada's housing finance system will be well-positioned to meet the needs of Canadians and be in line with international best practices going forward.

[15] BMO Capital Markets. 2012. Domestic Banking and Government Policy: Increasingly Interconnected, http://research-ca.bmocapitalmarkets.com/documents/ffb12e6a-ec62-45a8-9e86-c695e2791907.pdf (May 16, 2012)

Housing-construction market risks in Turkey: overrated or underestimated?[1]

By Yener Coşkun

1. Introduction

Abeunt studia in mores.[2]

Turkish real estate markets, involving housing sub-markets, have shown remarkable growth in the last decade. Foreign institutional/individual investment has also been growing in this period in addition to traditional domestic investments. The critical components, which made contributions to this picture, are mostly related to macro-economic stability and relatively stable growth in GDP and the income/financial wealth of households. Lower mortgage rates and other positive market conditions (i.e. a long period of political/economic stability, economic growth and rising income levels, industry friendly government policies etc.) helped to improve the access to mortgage/construction finance. Despite negative impacts of the global financial crisis, one may also observe that Turkish housing markets still show strength in many respects. Although housing-construction markets have a positive outlook, some argue that there could be excess supply and even a real estate bubble risk. This is currently one of the most widely debated topics in the marketplace and some academic circles, although data constraints limit the discussion.

The paper aims to document the risks of the Turkish housing-construction sector in the post global financial crisis period and to analyze the potential impacts of these risks. This research question is evaluated by a literature search and comparative data analysis. In this context, the first set of questions concerns the attempts to analyze risk parameters of housing-construction loans. Secondly, we will address whether the regulatory framework provides an efficient tool for managing mortgage risks. In doing so, the paper highlights whether the Turkish housing-construction sector may continue to perform well in the near future.

Therefore, from a practical perspective, the paper provides a current picture of the Turkish housing-construction sector with a risk analysis. The paper is organised into four further sections. In Section 2, we will analyze Turkish housing markets in the 2000's by particularly focusing on the post global financial crisis period. Section 3 gives an analysis of the risks associated with the housing-construction sectors, by also including discussion on ponzi finance, and legal/financial risk analysis of the Turkish mortgage market. Finally, section 4 concludes the paper.

2. Some facts on the Turkish housing markets: the post crisis periods

The Turkish economy has experienced three important financial crises and several periods of financial pressure since the 1980's. After the 1982 and 1994 banking crises, the third crisis, called the 2000-2001 banking crisis, resulted in huge economic losses and a brand new political structure in the country. After the crisis, economic recovery came with an IMF and World Bank supported financial stability program and it was accepted as one of the critical reasons for the recent economic revitalization.

Although there is currently no overheating in the economy in terms of aggregate demand, the divergence of growth rates between internal and external demand along with short-term capital inflows causes concerns over financial stability. In this context, the Central Bank of the Republic of Turkey (CBRT) is implementing a new policy mix consisting of low policy rates, a wide interest corridor and higher reserve requirement ratios, with a view of containing the rise in credits and the current account deficit and reducing short term capital inflows to ward off concerns over financial stability. However, key concerns still remain over the medium term, with a current account deficit indicating possible overheating of the economy. The current account deficit declined to 2.3% of GDP at the end of 2009 due to the global turmoil and economic contraction. It started to rise again with the economic recovery, reaching 6.6% of GDP by the end of 2010 (Ernst&Young, 2011: 65). The current account deficit/GDP ratio is consecutively 10% and nearly 6.9% in 2011 and 2012.[3]

Real GDP grew at an average annual rate of 5.2% between the years 2005 and 2008 in Turkey (IUHF, 2010: 1). GDP declined in the period between Q1. 2008 to Q1. 2009 which may be classified as the financial pressure period, mostly arising from the global financial crisis as an important external factor. As a longer declining period, GDP growth declined further between the period Q1. 2011 to Q2. 2012[4]. As also seen in Figure 1, real interest rates have been on a downward trend after 2009.

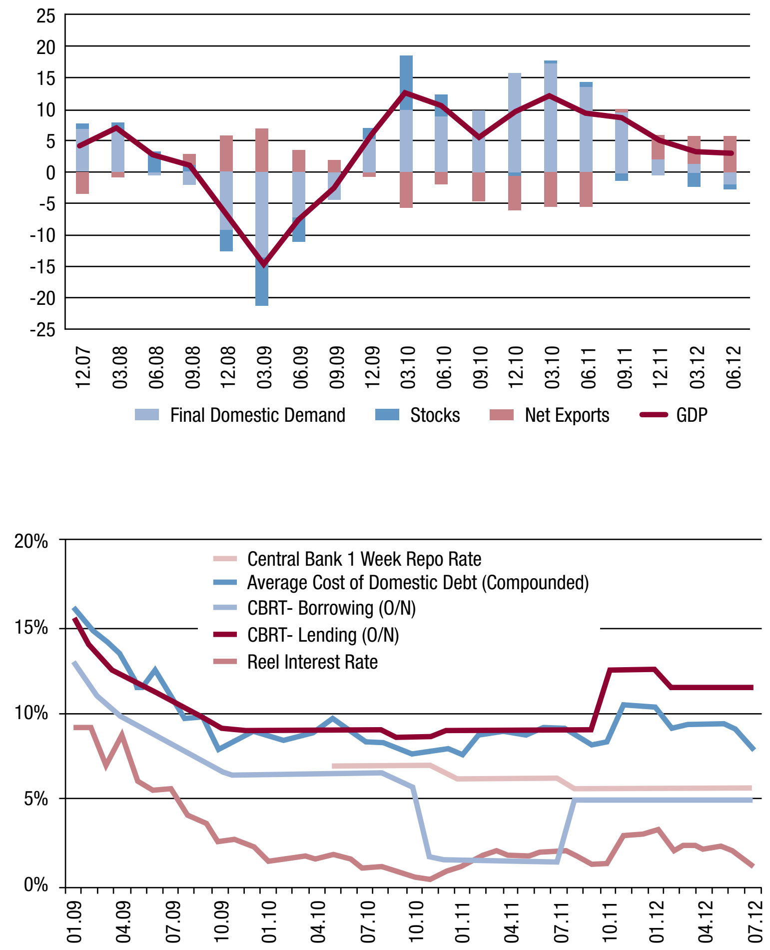
[1] The findings, interpretations, statements and conclusions expressed herein are those of the author alone and do not necessarily reflect the views of the institutions connected with the author. The Author also utilized his PhD thesis for this article. The author thanks Andrew Heywood for his helpful suggestions.

[2] Practices zealously pursued pass into habits.

[3] Available at: http://www.turkishny.com/english-news/5-english-news/93399-morgan-stanley-expects-turkeys-current-account-deficit-69-percent (Accesed on: 08/02/2013).

[4] The rate of GDP increase which was 2.9% in real terms in the second quarter of 2012 points to more moderate growth when compared to the previous periods (BRSA, 2012: 7).

Figure 1 GDP growth (2007-2012) and interest rates (2009-2012) in Turkey



Source: CBRT (2012: 10).

The economic environment of the post 2000-2001 banking crisis period has helped create a housing-construction boom. Total real estate purchases by foreigners were 18,6 billion USD between the years 2004-2011(see, Table 1)[5]. Examining foreign direct investment by sector, the real estate, renting and business activities sector is the 4th largest sector with its 3.6% (share) in 2011. The majority of the companies with foreign capital that have investments in Turkey operate in the wholesale and retail trades, which are followed by the real estate rental and business activities and manufacturing sectors (Republic of Turkey Ministry of Economy, 2012: 10, 19).

The real estate sector was one of the leading sectors immediately affected by a slowdown or contraction of the economy after 2008. The number of construction permits decreased by 12% in 2008 and by 17% in the first 9 months of 2009 compared to the same period in the previous year.The amount of housing loan originations also decreased by 9.7% when the first 9 months of 2008 and 2009 are compared (Deloitte, 2010: 6). As seen in Figure 2, the number of houses sold and in particular building occupancy permits, have positive trends after December 2010.

On the other hand, the positive economic environment helped to improve both housing affordability in big cities and the volume of housing loans. As seen in Figure 2, while mortgage loan interest rates have declined, the Reidin housing affordability index for 10 year mortgage loans had an upward trend during 2007-2012 for Istanbul, Izmir and Ankara. However, the annual growth of loans declined between Q1. 2011 and Q2. 2012 (see, CBRT, 2012: 24), the volume of housing loans and the number of housing loan

Table 1: Foreign direct investment (FDI) inflows by component (1995–2011, USD million)

	1995-2003 (Cumulative)	2004	2005	2006	2007	2008	2009	2010	2011
Cumulative FDI (net)	**11,253**	**2,785**	**10,031**	**20,185**	**22,047**	**19,504**	**8,411**	**9,038**	**15,904**
FDI	**10,255**	**1,442**	**8,190**	**17,263**	**19,121**	**16,567**	**6,629**	**6,544**	**13,891**
Capital (Net)	**9,591**	888	8,053	16,876	18,100	14,313	5,382	5,792	13,297
Inflow	**10,682**	968	8,454	17,533	18,843	14,348	5,464	5,827	15,288
Outflow	**-1,091**	-98	-401	-657	-743	-35	-82	-35	-1,991
Reinvested Earnings	**132**	204	81	106	294	399	788	411	599[a]
Other Capital	**532**	350	56	281	727	1,855	459	341	-5
Real Estate Purchases (Net)	**998**	**1,343**	**1,841**	**2,922**	**2,926**	**2,937**	**1,782**	**2,494**	**2,013**

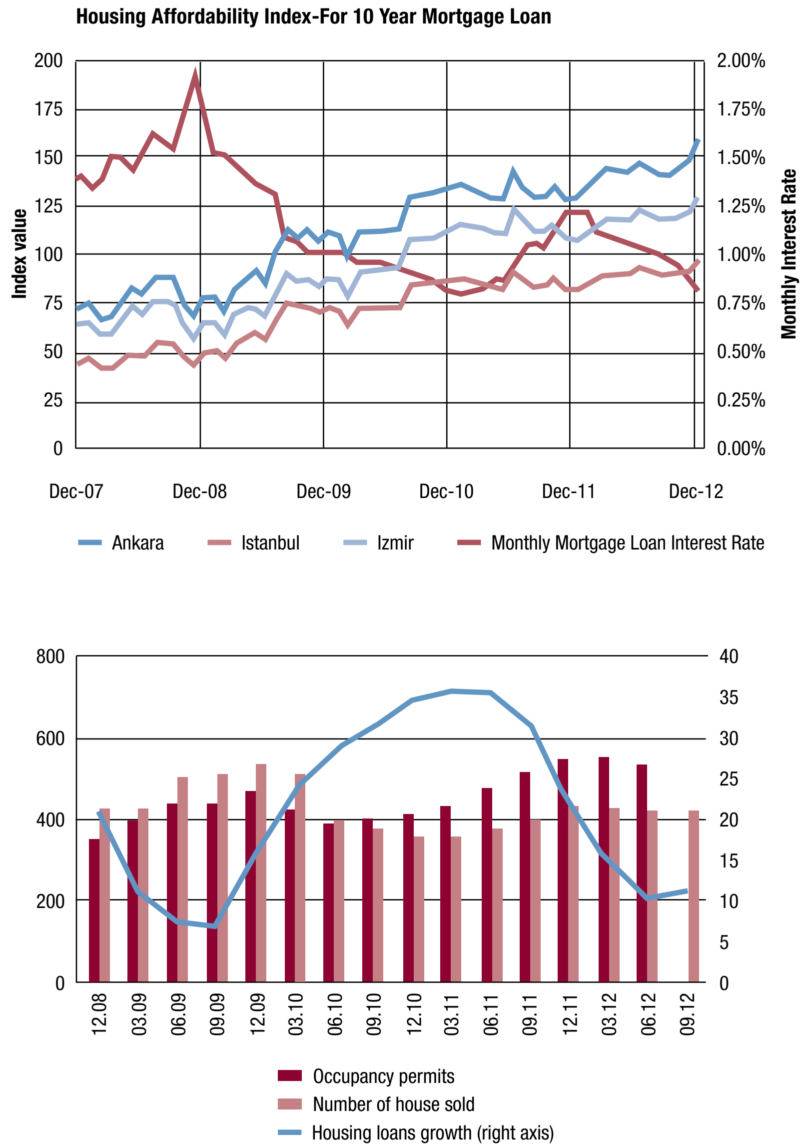
Source: Republic of Turkey Ministry of Economy (2012: 9).

[5] With domestic buyers unable to afford Turkey's high-end housing stock, the government is looking to foreigners to soak up the supply (Wall Street Journal, 2012a). But, as indicated for the London market (see, Heywood, 2012: 39), foreign demand for Turkish real estate also requires a proper analysis to make strategic and targeted policy decisions to deal with it.

borrowers have showed a dramatic increase in the last decade, according to Banking Regulation and Supervision Agency (BRSA) and Turkish Banking Assosiation data. In this context, while cumulative housing loan volume was 266 million Turkish Lira (TL) as of December 2002, the loan volume had reached 83.151 million TL as of September 2012. The number of housing loan borrowers had also increased to 1.368.855 persons in September 2012, compared 16.038 persons in 1997[6]. According to assessments about business confidence and profitability in the report of Emerging Trends in Real Estate Europe, Ireland and Turkey are currently the most optimistic countries in Europe (ULI and PwC, 2012: 32).

According to the TurkStat quarterly house sales data (see, Figure 3), an increasing trend in house sales after 2010 Q1 seems to be a clear signal of recovery after the short-term shock of the global financial crisis. The Turkey Composite House Sales Price Index of Reidin shows that residential sales prices for existing homes increased in Turkey after Q1. 2009 (Reidin, 2012: 4). House prices increased by 11.5% nominally in Turkey and it became one of the countries at the top of the list of high house prices in June 2012 (See, CBRT, 2012: 24). Therefore positive trends in house sales and house sales price data imply that the negative impacts of the global financial crisis were limited in the Turkish housing market. Although a real estate bubble analysis is out of the scope of this paper, increasing house sales prices between the period Q1.2009 - Q2.2012 attract attention. This price appreciation comes with some concerns about growing problems in housing affordability and specifically real estate bubble risk[7].

Figure 2 **Turkey housing affordability index (2007-2012), annual growth of housing loans, number of houses sold and building occupancy permits (2008/12-2012/9)**



Source: TurkStat and CBRT (2012: 24).

3. Risks in Turkish construction-housing markets

3.1 Ponzi finance and the Turkish housing-construction sector

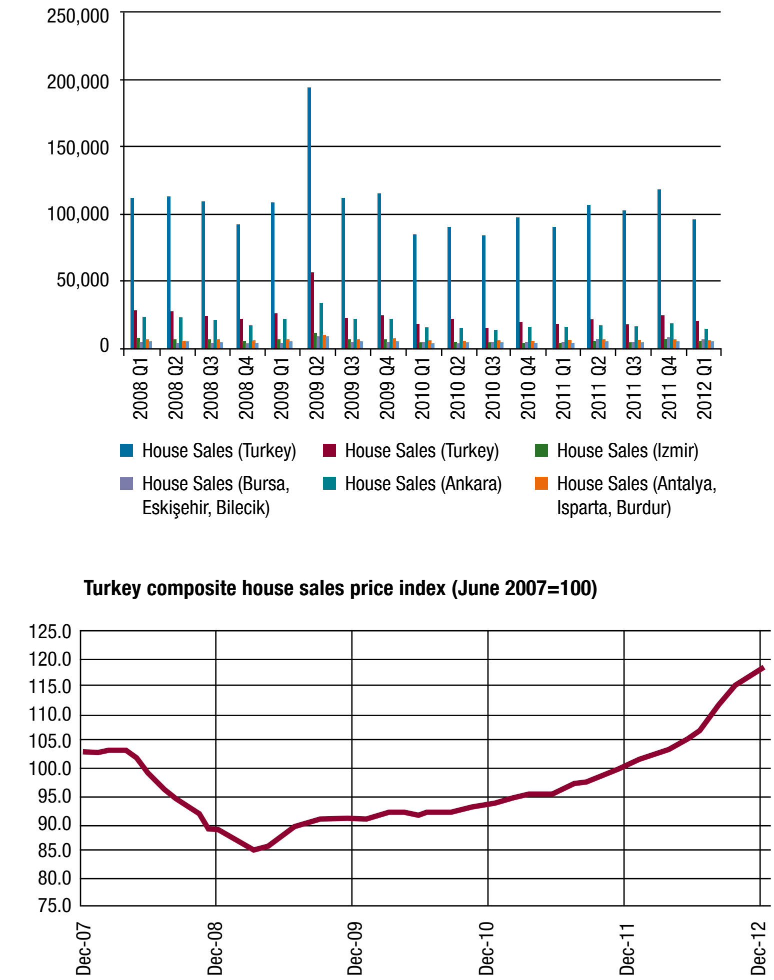
Although academic studies offering the bubble analysis for Turkish real estate markets are very rare, it is observable that some market participants have perceptions of the existence of a bubble or at least concern. IMF (2010) underlines in the context of dynamic housing construction that rapid growth of housing loans (including withdrawal of equity), and credit concentration amongst both developers and end-buyers for the same property pose risks if unchecked[8]. According to observations by the Wall Street

[6] Available at: http://ebulten.bddk.org.tr/AylikBulten/Gelismis.aspx; http://www.tbb.org.tr/tr/banka-ve-sektor-bilgileri/istatistiki-raporlar/eylul--2012---tuketici-kredileri-ve-konut-kredileri-/1213 (accessed: 02/06/2013).

[7] The changing behavior of home prices is a sign of changing public impressions of the value of property, a heightening of interest in speculative price movements (Shiller, 2005: 27).

[8] According to typical industry practices, both developers and home buyers secure loans against the same property. This collateral management approach may inherently increase the risks of credit institutions, households, and developers during the declining phase of the market.

Figure 3 House sales (2008-2012) and House sales price index (2007-2012)



Source: TurkStat and Reidin (2012: 4, 14).

Journal (2012b), Turkey's economic boom has brought worries of overheating, instability and a potential boom and bust in property, much like Turkey's fast-paced economic growth of recent years, which has reached a precarious point. According to industry observers, the massive growth has caused a real estate bubble – at least in Istanbul – and adds to the chances of instability. Moreover, some argue that the construction-housing sectors might begin a cycle of ponzi finance in the near future[9]. As discussed below, growing credit lines and aggressive marketing strategies, observed in the housing-construction sectors, might be the early signs of the inherent ponzi cycles at least for the financially weak firms.

Home ownership is one of the primary financial goals of Turkish households for a range of motives (i.e. investment motive, plus a lack of sufficient social security and alternative investment instruments etc.). But, it seems that market participants treat real estate (and specifically housing) as an investment instrument comparable to "other investment alternatives". To support this observation, we can provide anecdotal evidence of the strengthening of the popular perception of real estate as an investment. For example, magazines/newspapers compare the expected returns from uncompleted/completed office/residential units to the returns from other investment alternatives such as stocks, government bonds, term deposit, gold, or foreign exchange. Additionally, some real estate projects use highly creative marketing strategies such as using various promotions (i.e. selling a residential unit with a free brand new car option as a form of discount, or the sale price discounted by a freely usable internet coupon, a discounted sale price on the condition to find an additional home buyer etc.) or employing attractive marketing language involving the following terms: "highest return", "best investment", "the most profitable investment" etc. In this context, some observers think that these highly aggressive (and probably costly) marketing strategies may be a sign of funding shortages or liquidity problems for some firms. This market environment also resembles the market psychology of previous financial crises, in relation to real estate and housing markets, such as the Japan Banking crisis in the 1990s and the subprime mortgage crisis.[10]

Ponzi schemes[11] inherently and inevitably tend to lead to financial failure/bankruptcy. In Turkey, there were at least three well known ponzi schemes after the 1980's. Cases appeared in the Banking Crisis of 1982[12], including illegal/unauthorized fund-raising by some companies in Anatolia in violation of relevant securities

[9] For a different point of view, see, Rebust (2011: 16).

[10] There have been many historic episodes of destabilizing speculation, although at times the language has been imprecise and at times possibly hyperbolic. Consider some of the phrases in the literature: manias . . . insane land speculation . . . blind passion . . . financial orgies . . . frenzies . . . feverish speculation . . . epidemic desire to become rich quick . . . wishful thinking . . . intoxicated investors . . . turning a blind eye . . . people without ears to hear or eyes to see . . . investors living in a fool's paradise . . . easy credibility . . . overconfidence . . . overspeculation . . . overtrading . . . a raging appetite . . . a craze . . . a mad rush to expand (Kindleberger and Aliber, 2005: 40).

[11] The fact that an entity routinely finances its obligations by issuing new liabilities while representing otherwise to its claimholders is sufficient to qualify that entity as a Ponzi scheme. Ponzi schemes can be divided into two types: the fixed-income Ponzi scheme and the equity-type Ponzi scheme. The eponymous Ponzi scheme, carried out by Charles Ponzi, typifies the fixed-income Ponzi scheme, wherein the debtor issues fixed income securities to finance the illegal scheme. The Bernie Madoff scheme typifies the equity-type Ponzi scheme, wherein the debtor issues securities that, rather than promising a fixed rate of return, promise only to pay out whatever earnings accrue to the investor's account (Winters, 2012: 122-125). The mathematics of a Ponzi scheme ensures that it ultimately collapses by the weight of the fraud (Rhee, 2009: 365).

[12] The initiation of securities related activities in Turkey goes back to as early as the 1980s. Turkish capital market regulations became effective after the 1982 Banking Crisis (the so called Banker Scandal) (Coşkun, 2010: 15-16). One of the typical features of this period was the use of ponzi finance by inefficiently regulated/supervised brokerage houses. Therefore, adressing ponzi finance was one of the primary motives of the first Capital Market Law (no. 2499) in Turkey.

legislations after the 1990's and what is called the Titan case[13]. Ponzi schemes may also occur in the construction/housing sector[14], but there is no reliable data to analyze this possibility. Therefore, instead of analysing the extent to which the perception of the existence of ponzi finance is justified, we will necessarily have to analyze the risks associated with the construction-housing markets in the context of selected risk indicators.[15]

3.2. Risks associated with the housing-construction sector

Market based housing finance initiatives in Turkey were generally unsuccessful. The reasons for the failure of developing affordable mortgage products through a market-based housing finance system may be summarized as: sub-optimal design of housing finance system/instruments/intermediaries and macro-economic instabilities and lack of efficient subsidy mechanisms (Coşkun and Yalçıner, 2011). As analyzed in Coşkun (2011a), primary/secondary mortgage markets are less developed in Turkey. Therefore, one may argue that existing less financialized market conditions may help to minimize the risks of real estate markets. But an important question still left out in this article is whether the Turkish housing-construction sector is less risky because of dsyfunctioning of primary/secondary mortgage markets or should we further analyze the risks of the market? To keep the discussion within limits, we will briefly discuss three issues below which may highlight the risks: housing-construction sector loans, the growing number of unsold residential units and their implications, and finally financial/legal risks from non-performing mortgage loans (NPML).

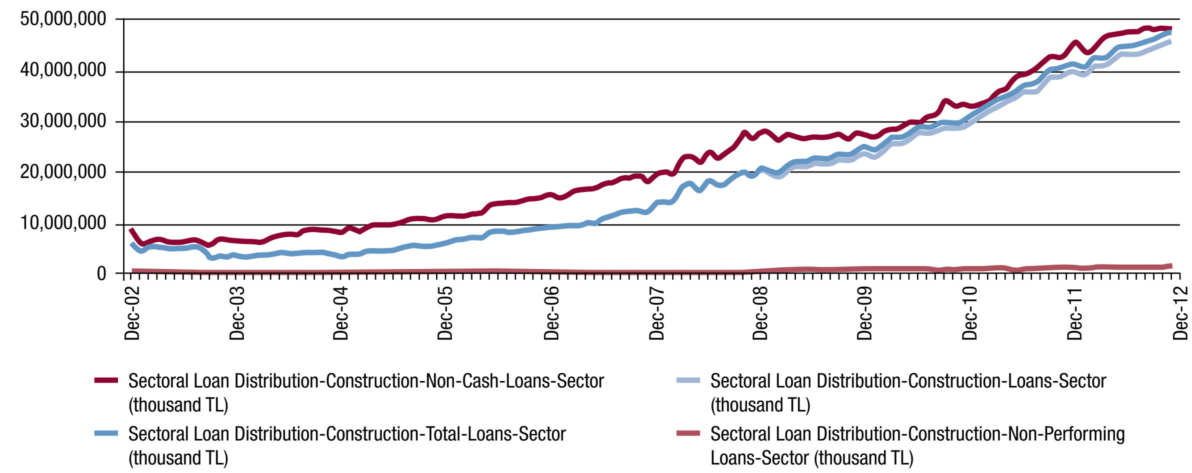
Table 2: Credits used in real estate sector

Periods	Construction Sector Commercial Credits Million TRL	Construction Sector Overseas Credits Million Dollars	Commercial Real Estate Credits Million TRL	Overseas Real Estate Credits Million Dollars (G)
2010 Q4	36.459	7.176	16.616	3.995
2011 Q1	39.937	7.508	23.502	3.840
2011 Q2	43.166	7.533	22.272	3.990
2011 Q3	48.226	7.373	26.828	3.920
2011 Q4	49.314	6.962	26.918	3.864
2012 Q1	51.535	6.737	26.981	4.015
2012 Q2	54.454	6.509	27.741	3.614
2012 Q3	58.403	6.685	29.537	3.280

Source: GYODER (2012: 27).

According to ENR Engineering News Record,the number of Turkish companies among the top 225 contracting companies in the world in 2011 and 2012 are respectively 31 and 33[16]. The construction sector is one of the most important sub-sectors for GDP growth in Turkey (Coşkun, 2011a: 7), and it seems that construction frenzy will continue in the near future due to the comprehensive urban regenaration projects of the government[17]. However, public concern over

Figure 4 **Construction sector loans and construction non-performing loans (2002/12-2012/11)**



Source: BRSA[18]

[13] Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1746742 (accessed: 07/02/2013).

[14] For example, the New Statesman (2011) underlines that the current UK housing market very closely resembles a Ponzi scheme where new investors to the scheme (in this case first-time buyers) pay for the returns to existing members (higher house-prices for owners).

[15] However we have reservations that lack of transparency and ineffective supervision may mask risk management problems of the sector, the construction business has some internal risk control mechanisms, which increase the expected rate of return of the projects. These include using sub-contractors, pre-sales (see, Chiquier, 2009: 163) and land-use intensity etc.

[16] Available at: http://www.yapi.com.tr/Haberler/enr-2011-top-international-contractors-sonuclari-aciklandi-_88886.html; http://www.arkitera.com/haber/index/detay/enr-the-top-225-international-contractors-listesini-aciklandi/9717 (accessed: 03/02/2013)

[17] In recent years a great variety of urban development and renewal projects are starting to be implemented in big cities in Turkey. Although they show different approaches, these projects are important both because of their spatial and physical formations and their social consequences (Dursun ve Ekmekçi, 2010: 2). According to ULI and PwC (2012: 32) the government plans to rehabilitate buildings that are at risk of destruction in an earthquake and launch a state-sponsored construction project to build safe and sustainable cities. Analysts believe the size of this investment could be $255 billion.

[18] Available at: http://ebulten.bddk.org.tr/AylikBulten/Gelismis.aspx (accessed: 01/24/2013).

construction sector loans may arise from two factors: the volume of (cash/non-cash) construction loans and its non-performing portion.

The non-transparent structure of Turkish real estate markets would impair a rational decision-making process for all market players (Coşkun, 2011b: 47) and data availability is one of the most important problems for supervisors/market participants aiming to manage product/firm/system wide risks. In this context, construction sector loan data seems to be one of the rare sources of data. As seen in Table 2, the construction sector has both domestic and overseas debts. The value of the latter loans has been relatively stable in the period of 2010-2012. In Q3.2012 the construction sector overseas credit was 6.7 billion USD and overseas real estate credit was 3.3 billion USD. Construction sector loans may also be analyzed by whether they are cash/non-cash loans and also by their non-performing portion. According to Figure 4, cash and non-cash construction loans have increased dramatically during last decade. According to BRSA data, construction loans have reached 45.8 billion TL as of November 2012 from 5.5 billion TL as of January 2002. To put this number in perspective, we may define that construction (and housing) sector growth has been partially financed by external debt in the last decade.

The increase in the volume of construction loans has raised questions about the potential risks of non-performing construction loans (NPCL). NPCL consist of only 4% of outstanding construction loans as of November 2012. This ratio implies that the risks arising from the construction sector may be limited. But one may also note that the real risks for the construction sector may be higher due to the partially informal nature of the business.

It is estimated that the informal economy makes up an important part of the Turkish economy. For example A.T. Kearney (2011: 15) indicates that Turkey, with an official GDP of €528 billion in 2011, has a shadow economy of about €146 billion and the shadow economy made up 28-29% of GDP in the period of 2008-2011. It is also widely believed that some practices of the construction sector may be related to the informal economy[19]. Therefore, it would be interesting to speculate whether the above official statistics may not reflect all risks of construction business (see, Coşkun, 2013: 75-79). In these circumstances, two questions need to be answered; first, how can we estimate the real risks of the construction-housing sector by also taking into account their informal characteristics, and second, what should regulators/market participants do to improve system/firm wide risk management. However much these future research suggestions would be useful for analysts, no one has satisfactory answers to the above hypothetical questions due to data constraints. But three critical developments related to the construction-housing sector require more attention to better analyze the inherent risks.

One of the most important current debates about Turkish housing (real estate) market is whether market data implies slowdown or even worse whether the growing number of unsold residential units could trigger a housing (real estate) bubble. Binay and Salman (2008: 23) argue that they do not find evidence pointing to a real estate price bubble in Turkey and the price to rent ratio on average has been around 18 for Turkey in the recent past, which is below the world average. To analyze the possible existence of a housing bubble is outside the scope of this paper. However, it may be interesting to note that the number of unsold residential units recently reached 700,000-800,000[21] units according to industry/media news and it is expected that urban regeneration projects will increase the amount of unsold housing stock[22]. The unsold housing portfolio, probably impairing expected the cash inflows of house producers, would be a signal for increased liquidity risk and eventually bankruptcy risk for the housing-construction sector. So, both government and market players should carefully analyse the developments in the unsold house portfolio as an early warning signal for the declining market.

Second, related to the above determination, the government issued a new regulation to increase Value-Added Tax (VAT) on house sales, effective on houses getting a construction permit after 01/01/2013. It is clear that the VAT regulation provides a safe harbour for the existing unsold housing units in the market and aims to increase the marketability of them (see, Emlak Pazarı, 2013: 15-16). It seems that the above tax regulation favors the construction-housing sector in the short term and the approach is probably based on the concerns of firm/system wide risks about unsold houses.[23]

Thirdly and more importantly, in addition to less known companies, some well known big construction firms practically went bankrupt (or at least experienced very serious financial problems) in recent years. Although there is no official data (even market analysis) for the financial failures of housing producers, these developments may change the market psychology and create a reaction on the regulatory side. So, taken as a whole, we may argue that the construction-housing sector may require further attention.

3.3. Legal and financial risk analysis for the Turkish mortgage market

Housing loans are long-term loans and their sensitivity to changes in interest rates are relatively low. Housing loans/cash loans ratio is about 10.35 in Turkish banking sector as of June 2012 and it is thought that this is not a risk factor for the sector (BRSA, 2012: 15, 38). On the other hand, there is a large body of literature on how loan deteriation may create crisis conditions in housing markets and in the wider economy. For example, Demyanyk and Hemert (2008: 4) emphasize that the quality of loans deteriorated for six consecutive years before the subprime crisis in the U.S. The authors indicate that the seeds for the crisis were sown long before 2007, but detecting them was complicated by high house price appreciation between 2003 and 2005; appreciation that masked the true riskiness of subprime mortgages.

In Turkey, the Non-Performing Loan (NPL) ratio was 29.5% as of December 2001 due to the shocks of the local banking crisis and gradually

[19] It has always been customary in many countries to employ a proportion of the construction workforce on a casual and temporary basis to cope with the variations in contractors' workloads. At the end of the 1990s, 74 percent of construction workers in Malaysia were employed on a casual basis, and casual workers were estimated at 85 percent of the construction workforce in the Philippines, 66 percent in Mexico, and 77 percent in the Republic of Korea. In Egypt, an estimated 90 percent of construction workers are either hired on a casual basis or are self-employed (Wells and Jason, 2010: 108). After the service, agriculture and industry sectors, construction sector provides 4 th largest sector in the Turkish economy. However it may be important to note that informal employment was highest in the agriculture sector followed by construction and public works with 62.2% in 2006 in Turkey (Revenue Administration, 2009: 8, 10).

[20] We can't provide further analysis on foreclosures due to lack of data.

[21] There are no official statistics for unsold housing.

[22] I.e.,see,http://ebulten.bddk.org.tr/AylikBulten/Gelismis.aspx):http://www.emlakprojehaber.com/emlakhaber-7320-GYODER_Baskani_Gokkaya_800 _bin_konut_satilmayi_bekliyor (accesed: 06/02/2012).

[23] It seems that government and the construction-housing sector have had a symbiotic relationship in last decade. Growing construction-housing business creates mutual benefits for both sectors. Therefore, this new regulatory framework may be accepted as the cooperation for common short term benefits.

decreased to 3.6% as of December 2008, and then further increased to 5.3% as of December 2009. Since then, the NPL ratio has decreased to 3.7% as of December 2010 due to recovering financial markets and the sale or write-offs of elements of NPL portfolios. Due to strict BRSA regulations, Turkish banks have a conservative provisioning policy on NPLs, with coverage ratio of specific provisions of approximately 84.1% as of December 2010. Nineteen percent of banks' NPL portfolios stem from non-performing credit card loans, which amount to TRY3.8b (€1.8) as of December 2010. Consumer loans, excluding credit cards but including housing, automobile and other retail loans, constitute 18.0% of the total NPL portfolio of banks as of December 2010 (Ernst&Young, 2008: 38; 2011: 68). On the other hand, the non-performing mortgage loans (NPML) to total mortgage loans ratio provides a narrower focus on mortgage credit risk in the banking sector. In this context, the NPML ratio decreased from its peak 5.6% as of May 2003 to 0.8% as of December 2012[24]. It is also observable from Figure 5, showing both the volume of mortgage loans and the NPML for 2002/12-2012/11, that the current NPML level does not create risk for the banking system.

It would be also important to note that defaults in mortgage credits may result in limited negative impacts on the Turkish economy for two reasons. Firstly, the housing loans/GDP ratio is at around 6% in Turkey due to limited access of majority of houseolds to mortgage finance because of income/wealth constraints. Additionally securitization markets effectively create no risk due to lack of (public) securitization. Secondly, current regulations provide a sound risk management framework to credit institutions for managing their housing credit risks. From a broader perspective, we may define that Mortgage Law No. 5582 (2007)[26] (Law) and related secondary regulations provide an effective regulatory framework for the Turkish mortgage market (Coşkun, 2011a: 12) and minimize the credit/liquidity risks of banks.[27]

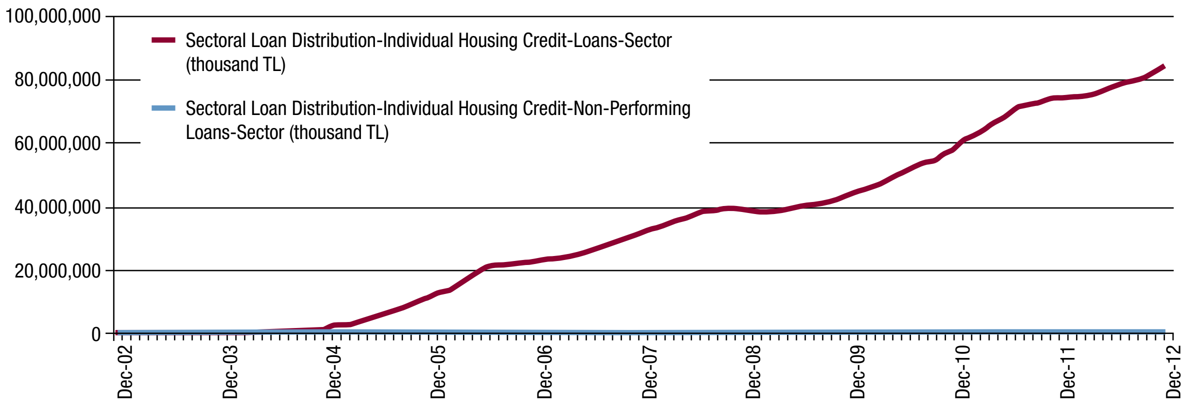
According to the IMF (2007: 41), legal protection of mortgages is strengthened by introducing new registration requirements and this approach accelerates enforcement and foreclosure procedures. Among other regulations, Article 24 of the Law is of specific importance to improve the efficiency of the foreclosure procedures of banks. It is stated in the article 24[28] that if a mortgage borrower defaults on at least two consecutive payments, the housing finance institution (banks, leasing companies and consumer finance companies) reserves the right to claim the payment of the whole of the outstanding loan immediately. Moreover, it is indicated in the Article 1 of the Law that in the foreclosure of the receivables, the creditor can choose to liquidate the mortgage or to distrain[29]. Although this discretion provided by the Law to housing finance institutions may be objectively criticized as unfair legal power over consumer debt in the case of default, it is clear that Turkish banks, as the main provider of mortgage loans, have sufficient legal power to minimize risks arising from housing credits and their securitization.

4. Conclusion

Real estate booms seem just as mysterious and hard to understand as stock market booms. When they happen, there are always popular explanations for them – explanations that are not necessarily correct. Shiller (2005: 11).

The importance of real estate markets has grown in the last decade in Turkey and it seems that

Figure 5 Total housing loans and non-performing housing loans (2002/12-2012/11)



Source: BRSA[25]

[24] Available at: http://ebulten.bddk.org.tr/AylikBulten/Gelismis.aspx)http://ebulten.bddk.org.tr/AylikBulten/Gelismis.aspx (acceesed on 02/02/2013).

[25] Available at: http://ebulten.bddk.org.tr/AylikBulten/Gelismis.aspx (acceesed on 03/02/2013).

[26] For the Law No 5582, See, http://www.cmb.gov.tr/displayfile.aspx?action=displayfile&pageid=25&fn=25.pdf &submenuheader=null (acceesed on 02/07/2012).

[27] In this context, BRSA established 75 % legal ceilings on LTV for residential and other real estate loans in 2010 to limit the housing credit risks of credit institutions Available at: http://www.bddk.org.tr/websitesi/turkce/Duyurular/BDDK_Kurul_Kararlari/88813980.pdf, accessed on 02/14/2012).

[28] The full version of the relevant part of article 24 is below: "If the housing finance institution reserves the right to claim the payment of the remaining credit amount at once, in case one or more payments are not made, this right can only be used on the condition that the housing finance institution fulfils all its liabilities and that the consumer defaults on at least two consecutive payments. For the mortgage finance institution to use this right, it has to give at least a month notice that the payment is due."

[29] The full version of the article 1 is below: " In the foreclosure of the receivables arising from housing finance defined in paragraph 1 of Article 38/A of Capital Markets Law No. 2499, and receivables of the Housing Development Administration that are secured by pledge of a mortgage, the creditor can choose to liquidate the mortgage or to distrain."

the housing-construction industry has also been gradually transformed from its conventional purpose of aiming to satisfy traditional domestic residential demand. In this period, real estate is increasingly accepted as an investment instrument by domestic/international investors thanks to the booming domestic economy. In this process, rising incomes and financial wealth of households are critical components for market growth besides improving affordability. Although it is statistically/officially less predictable, cash inflows arising from the informal economy may be also helping to increase residential (and other real estate) demand.

One of the most important current debates about the Turkish housing (real estate) market is whether the market data implies slowdown, or even worse, whether the growing number of unsold residential units, slowing mortgage credit issuance, and the increasing volume of construction loans could trigger a housing (real estate) bubble. Therefore, the reason for conducting this research is to address the risks of the housing-construction sector. Although little systemic analysis has been conducted on the issue, mostly because of data constraints, the risks of the housing-construction sectors should receive more attention from all stakeholders. Our study aims to inform local/international market participants and policy makers of the current picture of the Turkish construction-housing market with a risk analysis. In this context, we have briefly discussed three points to analyze the risks: housing-construction sector loans, the growing number of unsold residential units and their implications, and finally the financial/legal risks associated with non-performing mortgage loans.

NPL arising from mortgage/construction loans is fairly low in the Turkish housing-construction sectors. Additionally, well known good news is that bad debts which may occur in mortgage loans may result in limited negative impacts on the wider Turkish economy due to limited access to mortgage loans (only 6% of GDP), less developed secondary mortgage markets and more importantly, the existence of a strong regulatory risk management framework for mortgage loans.

However, it may be interesting to note that the number of unsold residential units recently reached 700,000 - 800,000 units according to industry/media information and it is expected that urban regeneration projects may increase the unsold house stocks. Both government and market players should carefully analyse the developments in unsold house portfolios as an early warning signal for the declining market. Secondly, related to the above determination, the government issued a new regulation to increase value-added tax (VAT) on house sales, effective on houses getting a construction permit after 01/01/2013. It is clear that the VAT regulation provides a safe harbour for the existing unsold housing units in the market and aims to increase marketability of them. It seems that this tax regulation favors the construction-housing sector in the short term and this approach is probably based on concerns about firm/system wide risks related to unsold houses. But thirdly and more importantly, in addition to less known companies, some well known construction firms practically went bankrupt (or at least experienced very serious financial problems) in recent years. Although there is no official data (or even market analysis) on financial failures of housing producers, these developments may change the market psychology and create a reaction on the regulatory side. So, taken as a whole, we may argue that the construction-housing sector may require further attention.

The most frightening scenario, related to this highly gray picture, is connected to the following question: what if potential risks relating to the wider economy (i.e. highly indebted state/corporate sectors, twin deficits, fear of sudden capital outflows and expected outcomes in fundamentals) became the component of a new financial crisis. Nowadays market optimists prefer not to link the above "familiar" crisis scenario, (which virtually destroyed the Turkish economy in 1994 and during the 2000-2001 banking crisis) with the risks of the housing-construction sector.

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