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Editor's introduction
What price homeownership?

In the UK, the post-Brexit Government of Theresa May has moved away from her predecessor's almost exclusive focus on raising the level of homeownership. At the Conservative Party conference in October 2016, Mrs May declared that *"We simply need to build more homes"*. and distanced herself from those who appeared committed to promoting homeownership even at the cost of maximising new housing supply. The UK government has since announced that grant for new affordable housing will be allocated more flexibly to allow housing associations to build homes for rent as well as for sale.

A cynic might argue that shifting the political ground in this way was little more than a quiet recognition of the fact that successive Conservative housing ministers had presided over falling homeownership since 2010 and that homeownership levels have in fact been falling since they peaked at over 69% in 2004, reaching a new low of 62.9% announced in March 2017.

UK homeownership is now at a lower level than in the USA where the latest figure of 63.7% was announced by the Census Bureau in January 2017, only days after the inauguration of President Trump. The latter figure is well below the peak.

Those who expected the incoming Trump administration to announce a raft of measures to assist beleaguered and aspiring homeowners were surprised that one of Trump's first acts was to reverse a 0.25% reduction in the cost of mortgage guarantees issued by the Federal Housing Administration. This move, expected to significantly affect mortgaged homeowners, including first-time buyers, could be taken to signal that intervening to sort out the dysfunctional US housing finance system is now a higher priority than promoting homeownership; time will tell whether populist aspiration or the desire to reduce taxpayer liability will ultimately gain the upper hand.

The UK and US are not isolated instances of stagnant or falling homeownership levels. Europe tells its own story, with homeownership levels now below their peak in a number of countries including the Netherlands, Spain and Finland, moving towards the Pacific, homeownership in Australia at 67%, is well below its peak of 71%.

Falling homeownership has been noted as a phenomenon by several commentators, particularly in the wake of the Global Financial Crisis. The cause is often cited as affordability, which in the UK is seen as a result of a chronic shortage of new housing supply and to an extent as a consequence of stricter lending criteria. While such factors are clearly important, are there other underlying trends at work? It is no accident that the most sustained rises in homeownership levels in many countries took place in the post-war period when governments were, in many cases, prepared to intervene to ensure full and stable employment and to underpin that with high levels of welfare benefits. In addition, there was a willingness by many governments to intervene directly to ensure that housing supply was adequate to meet need. While economic liberalisation during the past quarter century may have produced benefits in terms of GDP it has been at a price. That price has often been less stable jobs, higher unemployment, poorer welfare provision and less promotion of new housing supply. Public housing is increasingly seen as a feature of the past. Arguably, this has undermined the social foundations on which rising homeownership was built. Ironically, those worst hit have frequently been those who have fuelled pro-BREXIT sentiment and propelled President Trump to power. Housing finance pundits must now analyse whether there are real prospects for a revival in homeownership where it is in decline, or whether the decline will continue and result in a re-shaping of traditional housing finance markets.

So far, housing and housing finance have not been major discussion topics for observers of the new Trump administration. Yet, for housing finance professionals the likely policy stance of the administration in these areas is of great importance. This issue of HFI takes the discussion forward with thoughtful articles by Alex Pollock and Jay Brinkman, both US citizens with long experience of the vicissitudes of housing finance systems. While the two articles reflect the individual stances of their authors, both focus on the key tasks facing the new administration and they are agreed that reform of the housing finance system underpinned by the two agencies Freddie Mac and Fannie Mae should be the focus for change.

Brazil's housing finance system has had its problems also. In a fascinating article, Claudia Magalhães Eloy looks at attempts that have been made to increase the role of the capital markets in funding mortgage lending. Eloy shows how the existing deposit-based system, characterised by significant government intervention, has proved surprisingly resilient.

In an important article on housing subsidy programmes in Mexico, Arthur Acolin and Haim Kichik examine the provision of mortgage finance for households on low and moderate incomes and the provision of grants by the National Housing Commission (CONAVI). The article focusses particularly on the introduction on location criteria for eligibility for the above subsidies, in order to combat default and high vacancy rates.

When homeownership is unattainable or impractical, then households rent. In Nigeria, 85% of urban households rent their homes. In a valuable article, Ben Okusu analyses the rental sector in Nigeria, in an article that discusses supply, market fundamentals and their interaction with investment. He also touches on the relevance of the concept of rent-to-own.

An important outcome of the United Nations Habitat III conference in Quito in 2016 was the New Urban Agenda. It is predicted that by 2050, 70% of the world's population will live in urban areas, making the Agenda of particular interest with ecological sustainability, urban resilience and inclusion forming key focal points. In their article, Sandra Jurasszovich and Wolfgang Amann set out the contents of the New Urban Agenda, and assess its strengths, weaknesses and possible impact.

Contributors' biographies

Arthur Acolin is a PhD student in the Price School of Public Policy at the University of Southern California. His research focuses on housing strategies designed to deliver adequate and affordable homes in different contexts, with a particular interest in the structure of housing finance systems.

Wolfgang Amann, Director of IIBW, the Institute of Real Estate Construction and Housing Ltd., Vienna/Austria has executed some 300 research and consulting projects on housing finance, housing policy, and housing legislation. He is consultant to the UN and World and teaches real estate economics on several graduate programmes in Austria.
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Jay Brinkmann is the retired Chief Economist of the Mortgage Bankers Association and spent decades working in the fields of real estate finance and financial institution regulation. He currently resides in New Orleans where he is involved in historic preservation and public safety issues.

Sandra Jurasszovich works as a research assistant focusing on the analysis of housing markets, housing subsidy schemes and spatial planning. She holds two master's degrees, one in Spatial Planning from Vienna University of Technology and one in Urban Studies (4Cities Programme).
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Haim Kichik is an urban economist from Mexico [UNAM] with more than 7 seven years' experience in housing public policy and in developments issues in his country. He currently works as a private consultant.

Claudia Magalhães Eloy is a consultant on housing finance and subsidy policy in Brazil, who has worked for FIPE [Fundação Instituto de Pesquisas Econômicas] and for the World Bank [TA] and for the Brazilian Ministry of Cities and Companhia de Desenvolvimento Urbano e Habitacional of São Paulo [CDHU]. Claudia has also participated in the development of the National Housing Plan, in the analysis of the Housing Finance System. She holds a PHD in Urban Planning at the University of São Paulo [USP], a Master in City Planning at the University of Pennsylvania, a Master in Public Administration at Bahia's Federal University [UFBA] and a BA in Architecture and Urban Planning [UFBA], with a specialization in Real Estate Finance at the Brazilian Economists Order [OEB]. She also attended Wharton's International Housing Finance Program.

Ben Okuzu was a Senior Banker with Citigroup Inc. in New York. At Citi, he led a team that underwrote underlying real estate assets as the basis for revenue bonds issued to fund affordable housing production. He is currently a consultant in Nigeria providing advisory services on housing policy and finance.

Alex J. Pollock is a distinguished senior fellow at the R Street Institute in Washington DC. He was President and CEO of the Federal Home Loan Bank of Chicago 1991-2004, and President of the International Union for Housing Finance 1999-2001.

Zaigham M. Rizvi is currently serving as Secretary General of the Asia-Pacific Union of Housing Finance and is an expert consultant on housing and housing finance to international agencies including the World Bank/IFC. He is a career development finance banker with extensive experience in the field of housing and housing finance spread over more than 25 countries in Africa, the Middle-East, South-Asia, East-Asia and the Pacific. He has a passion for low-cost affordable housing for economically weaker sections of society, with a regional focus on Asia-Pacific and MENA.
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Kecia Rust is the Executive Director of the Centre for Affordable Housing Finance in Africa, and manages the Secretariat of the African Union for Housing Finance. She is a housing policy specialist and is particularly interested in access to housing finance and the functioning of affordable property markets. Kecia holds a Masters of Management degree (1998), earned from the Graduate School of Public and Development Management, University of the Witwatersrand. She lives in Johannesburg, South Africa.

Mark Weinrich holds graduate degrees in political science and economics from the University of Freiburg, Germany. He is the General Secretary of the International Union for Housing Finance and the manager for international public affairs at the Association of Private German Bausparkassen.

Housing Finance News from Africa

↳ By Kecia Rust

Investor interest offers an opportunity to overcome value chain weaknesses

Across Africa, the residential investment opportunity is increasingly driving conversations about economic growth. While the definition of who is middle class and how many such households there are continue, the fact of Africa's rising population and rapid urbanization is palpable in its cities where the inadequate housing conditions of the majority are obvious. In many places and in many projects, investors are responding. In the process, they are identifying, and in some cases, resolving, value chain weaknesses that have been constraining the sector.

For example, International Housing Solutions [IHS], a private equity investor that has mobilized investors including the Overseas Private Investment Corporation [OPIC], KfW [Kreditanstalt für Wiederaufbau], the International Finance Corporation [IFC], WDB Investment Holdings, and the South African Eskom Pension and Provident Fund into two funds, focusing on the development of affordable housing in sub-Saharan Africa. In their first fund, IHS facilitated the delivery of 28,000 affordable housing units, partnering with 19 property companies in 35 housing projects in South Africa. It is well understood that they contributed substantially to the broadening of South Africa's residential construction sector – highlighting market opportunities to be found in the development of workforce housing. Based on capital invested, the weighted average internal rate of return of the exited deals is 25.2%, with an average multiple of 2.47, demonstrating the viability of this market niche. With the closing of their second fund (US$180 million capital raised to date, and including a green investment facility), IHS is now focusing on investments in Namibia, Botswana, and Zambia, in addition to further projects in South Africa.

Phatisa's Pan African Housing Fund [PAHF] was established in 2012, and closed at the end of the third quarter of 2014 at US$41.95 million. Like IHS, the fund provides equity to developers for real estate projects on a joint-venture basis, working closely with selected developers to build technical and financial capacity to operate at scale. The PAHF is currently involved in five developments, comprising about 1,000 units and targeted at middle income earners in Zambia, Rwanda and Kenya.

One of the investors in the PAHF is CDC, which committed US$20 million to the fund in December 2012. CDC is currently seeking further equity investment opportunities in the residential real estate and financial sectors, having identified housing as an important contributor to job creation and economic growth.

All of these initiatives have had to face serious constraints on the supply side, most significantly the absence of developers with the technical and financial capacity to deliver affordable housing at scale. To address this, the IFC, launched a US$300 million investment platform to provide long-term capital to develop 30,000 units over the next five years in various countries throughout Africa. The initiative draws in Chinese multinational construction and engineering company CITIC Construction, which has the capacity for large scale projects. In Angola, CITIC founded the CITIC BN Vocational School in Angola, which works with young people to train them towards being able to operate effectively in the sector. IFC hopes that CITIC's engineering experience and delivery capability will be transferred to local suppliers, building capacity across Africa through the delivery plans of this programme.

Some funds are targeting niche segments of the housing value chain. Sofala Capital's investment in Zambian Home Loans, and its support for the iBuild initiative in Tanzania, Kenya and South Africa, is interesting in its engagement with the owner-builder housing process that is so common across the continent. Sitting somewhere between housing microfinance approaches and mortgage finance, Zambia Home Loans' experience will offer Sofala a track record to then explore in other countries. The iBuild initiative links housing microfinance into a supply chain of providers that are connected with an app.

Another impact investor, Goodwell Investments, is based in the Netherlands. Their Goodwell III fund (with target capital of EUR 20 million, of which EUR 10 million will be invested in financial inclusion) makes investments, providing risk capital and technical support, to commercially viable solutions that enable financial inclusion, including for housing. The technical support component, offered by Goodwell Advisory Services, is an important offering, as few projects and initiatives are investor-ready. Goodwell seeks to support what look like promising projects get to the stage where they might be able to receive investments.

A key challenge with foreign-denominated investments is currency risk. The African Local Currency Bond Fund [ALCB] was set up in 2012 by KfW on behalf of the German Federal Ministry for Economic Cooperation and Development, with a mission to promote the development of African capital markets. Managed by Lions Head Global Partners, the fund promotes the participation of local capital markets in developmental sectors, through anchor investments and technical assistance for bond programmes. It has a strong focus on housing. ALCB has acted as anchor investor for various micro lenders offering housing microfinance in Botswana, Kenya, Zambia and Ghana. In 2016-17, further deals are likely to include a bond issuance from a mortgage provider in Ghana; a commercial paper programme from a mortgage warehousing vehicle in Nigeria; bond deals for a micro-lender offering incremental housing finance in Malawi, Lesotho, and Swaziland; a mortgage covered bond for a building society in Zimbabwe; and a parastatal housing developer in Kenya. In its focus on local capital markets, the ALCB is strengthening the connection between domestic economic growth and housing, and contributing to stronger financial markets in Africa that include housing as a key asset class.

Recently, the Centre for Affordable Housing Finance in Africa commissioned a study into residential Real Estate Investment Trusts [REITS] and their relevance for supporting affordable housing in Africa. The structure and tax benefits of REITs are internationally recognized, and offer an interesting investment target for both local and international investors. In very many countries, pension fund legislation requires the fund to invest a certain proportion of its capital in domestic targets. Historically, housing has not been considered a viable investment target for the more conservative pension funds; this notwithstanding their favourable term requirements which align with the longer-term nature of housing investments. The study found that possibly the most significant constraint to REITs in the affordable housing market, however, related to weaknesses in the housing value chains in the various countries. REITs require a number of enabling conditions to be in place. For example, the institutional strength of local property markets, including the existence and efficiency of the deeds registry system, the reliability of property valuations and property market transparency. Within the legislative and regulatory environment, appropriate rental market legislation is critical. Institutional capacity – whether on the construction side or in terms of longer term property management, is also fundamental to the ability of REITs to attract investor attention.

These are all issues that will be the subject of the next AUHF Annual Conference, which is being held in Uganda in October 2017. At that meeting, AUHF members and the wider housing sector will identify mechanisms for better collaboration between the public and private sectors in housing. The conference will explore public private partnerships as one such mechanism, and will also consider the role of housing policy in stimulating private sector participation in affordable housing. For more information, or to propose a topic for delivery at the conference, please contact the AUHF Coordinator, Noluthando Ntshanga on *Noluthando@housingfinanceafrica.org.*

http://housingfinanceafrica.org/documents/residential-real-estate-investment-trusts-reits-and-their-potential-to-increase-investment-in-and-access-to-affordable-housing-in-africa/

Asia Pacific region

↳ By Zaigham M. Rizvi

India - renewed thrust on housing

Against the backdrop of an overall slowdown in global growth, India has remained amongst the fastest growing major economies. India is a domestic, consumption-driven economy. Its favourable demographics, rising income levels, rapid urbanisation and increased aspirations of its people for a better quality of life characterise the economy.

The real estate sector in India is the second largest employment generator after agriculture. Housing and the economy are inextricably linked with housing having strong backward and forward linkages with several industries. India continues to face an acute shortage of adequate housing. Further, the mortgage to GPD ratio at 9% is extremely low compared to its peer countries.

Given the strong demand in India, the scope to grow mortgage finance is immense. The Indian mortgage market is dominated by a few large banks and housing finance companies who have a pan-India presence. Yet interestingly, over the last few years, many new housing finance companies have been set up, with the objective of capitalising on the growth opportunities in this sector. Most of these mortgage financiers are small, locally-based niche players who have raised their initial capital through private equity or impact investors. The customer profile is generally low income, self-employed individuals and the average loan size is small at under US $ 22,000. The loans are mostly for self-construction, home improvement or extensions. It augurs well that a larger number of home finance players are now focusing on the housing needs of both the formal and informal sector.

Deepening the mortgage market in India calls for a greater focus on affordable housing. One of the government's flagship schemes has been *'Housing for All by 2022'*. Under this scheme, the government targets the development of 20 million new homes. The scheme also entails various interest rate subventions on housing loans. Initially, the interest subventions were exclusively for the low-income group with annual household incomes below US$ 9,000. Recently, to further encourage homeownership, the interest subvention is now being extended to middle-class borrowers as well, with incomes up to US$ 27,000. These measures will make housing more affordable.

Demonetisation – a game changer for India

On November 8, 2016, India embarked on a landmark reform wherein 86% of the currency in circulation of INR 500 and INR 1,000 currency notes was demonetised. The objective was multifold – reducing unaccounted wealth, weeding out corruption, encouraging a shift towards digitisation, eliminating counterfeit currency and ensuring a more tax compliant society. While the exercise did cause hardship to the common man and resulted in an overall slowdown across all segments of the economy, the general consensus is that there is merit in enduring short-term pain to reap gains over the long-term.

Initially, many believed that the real estate sector in India would be severely impacted by demonetisation as historically, this industry has seen a high incidence of cash transactions. There were concerns that demonetisation would lead to a free fall in real estate prices. This, however, has not been the case at all.

Sales in a few pockets of the country have slowed down, but this is largely in the high-end luxury home segment. In the case of re-sale properties in select cities, there typically was a cash component involved and post demonetisation, there has been a reduction in transactions. This could lead to a correction in prices. However, removing the cash component is a welcome measure for a customer as it makes the transaction simpler and more transparent. From a lender's perspective, it is advantageous as a higher loan amount can be offered as the actual amount being paid by the customer will be reflected in the agreement for sale.

Residential sales in the primary market are less impacted because well-established developers were already accepting cheque payments from customers. Some borrowers had deferred their decision to buy homes in the hope of lower real estate prices. However, with prices holding steady, customers are now resuming transactions. On the positive side, demonetisation has resulted in surplus liquidity within the system, which has reduced interest rates on home loans.

A housing focused budget

Recognising that housing can be a stimulus for the economy, the government in its union budget presented on February 1, 2017, has rightly focused on boosting the housing sector.

To encourage the building of more affordable housing units, the government has provided developers with a 100% tax deduction on profits for housing units with a carpet area size of up to 60 sq mtr. To avail these benefits, the projects have to be completed within 5 years.

The holding period for determining long-term capital gains on immovable property has been reduced from 3 to 2 years and the base year for indexation has also been changed. These measures will reduce the tax burden on individuals and encourage more property transactions.

There has been an increase in budgetary allocations for building low cost homes and refinancing of home loans through the housing finance regulator.

A home loan borrower now gets fiscal incentives on both, the interest and principal component of a home loan up to INR 350,000 (US$ 5,200) each year. These incentives help reduce the overall cost of a home loan.

Lastly, one of the most significant measures has been according 'infrastructure status' to the housing sector. This will enable players to get greater access to lower cost, longer tenor funding from insurance, pension and provident funds and through external commercial borrowings.

To conclude, given the daunting challenges that rapid urbanisation presents, the government is rightly focusing on encouraging smart cities and urban rejuvenation. Housing and urban infrastructure requires immense resources and thus presents a number of investment opportunities as well. In 2016, the Indian real estate attracted private equity investment in excess of US$ 6 billion. More than half of this investment was towards residential assets. Measures towards improving the ease of doing business and with the setting up real estate regulators in each state, the housing sector will become more transparent and will have the necessary checks and balances to ensure consumer protection. Nothing can be more advantageous for a country like India than building a property-owning democracy.

Malaysia

Provision of affordable housing in Malaysian 2017 budget

The Malaysian 2017 Budget was successfully tabled by the Prime Minister Dato' Sri Mohd Najib Tun Haji Abdul Razak on 21 October 2016. The budget theme was *"Ensuring Unity and Economic Growth, Inclusive Prudent Spending, Wellbeing of the Rakyat".* It saw an increase of 3.4% in the total budget allocation of RM260.8 billion compared with 2016 Budget.

The 2017 Budget underscores the Malaysian Government's commitment to exercising fiscal discipline and alleviating the concerns of the people, particularly over the provision of affordable housing, whilst not detracting from longer-term development goals. Over the last few years, various affordable housing programmes were introduced by the Government, basically to enhance affordability for first-time home buyers and to improve the supply of affordable housing.

A number of the initiatives introduced under the 2017 Budget are listed below:

Despite several challenges in ensuring sufficient supply of affordable homes for its people, the Malaysian Government will continue to introduce programmes that will increase home ownership in Malaysia.

Pakistan

Housing finance is improving, though slowly

By Dec 2016, the overall housing finance portfolio stood at Rs. 69.50 billion; an increase of 5.78% since June 2016. The House Building Finance Company [HBFC], the state-owned specialized housing finance institution remained the largest lender, in terms of the gross loan balance outstanding, with a market share of 22%. However, based on the lender category, Islamic Banks remained the largest players with a 38% share of the gross loan balance outstanding. Fresh disbursement during Jul-Dec amounted to Rs. 10.10 billion to 1,661 borrowers. Furthermore, non-performing loans [NPLs] decreased to the level of Rs 12.28 billion compared to Rs 12.75 billion in June 2016; a decrease of 3.69% over the past six months. HBFC, being the largest player in the housing finance market, accounted for 35.04% of new borrowers and contributed 11.09% to the new disbursements equivalent to Rs. 1.12 billion. Islamic banks disbursed Rs. 4.20 billion. Outright purchase of houses was 65.88% of the gross outstanding loan balance; while construction and renovation products were 23.61% and 10.51% respectively.

During the current period, Islamic and private banks remained active in extending housing finance. This rise in disbursements is a reflection of efforts to create an enabling environment for housing finance in Pakistan. This will be instrumental in increasing economic growth through positive changes in 40 industries allied to the housing sector. Keeping in view overall trends, housing finance in Pakistan is gradually growing, moreover, the shares of private banks, Islamic banks and HBFC of the gross outstanding loans were 31, 39 and 22% respectively at the end of September 2016.

World Bank shows interest in promoting housing finance

The World Bank has expressed interest in initiating projects facilitating long-term financing in Pakistan, including housing finance. During a meeting with the Finance Minister the World Bank delegation led by Country Director, Patchamuthu Illangovan reviewed the Bank's portfolio in Pakistan and also discussed housing finance in the country.

Loic Chiquier, the World Bank's Global Lead on Housing Finance, said that Pakistan should introduce soft loan schemes aimed at the less privileged strata of society for the provision of

PROGRAMMES	DESCRIPTION	2017 BUDGET INITIATIVES
My Beautiful New Home	New scheme introduced under the 2017 Budget for the B40 (bottom 40% of households with monthly incomes of RM3,900 and below).	Allocation of RM200 million to build 5,000 new housing units at a price of between RM40,000 to RM50,000 per unit, of which RM20,000 will be financed by the Government while the remainder will be paid as instalments by the owners.
People Housing Programme [PPR]	The PPR was developed to build affordable housing with adequate infrastructure and basic amenities in suitable locations. It also addresses the increasing demand for affordable homes particularly in urban areas and from lower income household with maximum income up to RM2,500 per month.	Allocation of RM710 million to build 9,850 new units and to complete 11,250 units of PPR houses. These houses will be priced between RM30,000 to RM35,000 per unit.
1Malaysia People's Friendly Home [RMR1M]	Operated by Syarikat Perumahan Negara Berhad [SPNB] to build affordable homes for lower income households with a maximum income of up to RM3,000 per month.	To build 5,000 new units of houses with a subsidy of RM20,000 per unit. These houses will be priced between RM45,000 and RM65,000 per unit.
1Malaysia Civil Servant Housing [PPA1M]	PPA1M was established to provide affordable homes with a price 20% to 30% lower than market value for civil servants with a monthly income of less than RM10,000 per month.	To build 30,000 new units of houses at a selling price between RM90,000 and RM300,000, which is 20% below market price.
1Malaysia People's Housing [PR1MA]	PR1MA was established to plan, develop, construct and maintain high-quality houses with lifestyle concepts for middle-income households in key urban areas with the house prices ranging between RM100,000 and RM400,000. Targeted buyers are households with income between RM2,500 and RM15,000 per month.	• To build 30,000 new units of houses on the Government's land at a selling price between RM150,000 to RM300,000. • Effective 1 January 2017, a new step-up end-financing scheme was introduced to provide easier financing to home buyers which allows 100% financing.

affordable housing, and take requisite action to develop a plan for the low-income segment in the future. Mr. Chiquier made these remarks during a meeting of the National Financial Inclusion Strategy Sub-Committee on Housing Finance organized by the State Bank of Pakistan [SBP] at the Association of Builders and Developers [ABAD] base in Karachi.

Thailand

Experts downplay property bubble

The Bangkok Post recently reported that although Thai condominium prices have risen significantly in the past years, the market is far from being in a bubble.

Surachet Kongcheep, Associate Director of Colliers International Thailand's Research Department said residential unit prices in Bangkok have yet to exceed homebuyers' ability to pay.

Condominium prices in Greater Bangkok during the past few years, he said, were driven up by more high-end segment units.

Developers began building high-priced units because lower priced unit sales were hampered by high mortgage-rejection rates.

Bangkok condo price rises, according to Surachet, were driven largely by land costs, which have risen about 5-6% annually while land price increases in the central business district exceeded 10% during 2015-16.

Siam Commercial Bank's Economic Intelligence Center [EIC] said that despite a surge in housing prices in Greater Bangkok, it has yet to see any grounds for concern about a possible property bubble in Thailand.

Thailand's property price increases, according to the EIC, stem mainly from a continuous rise in land prices, not from speculation as in the Singaporean and Chinese housing markets.

Government infrastructure developments to boost property developer

The Nation said that government plans to commence infrastructure project investments of Bt1.8 trillion this year ($US 50 trillion) will change the country's logistics infrastructure and boost property sales. Developers are expanding their focus from Bangkok's central business districts to suburban areas and neighboring provinces.

"Investment in public infrastructure projects will lead to the development of land around the projects into community and workplace areas," Thongma Vijitpongpun, chief executive officer of residential developer Pruksa Real Estate, told The Nation.

Many people are expected to move from their current residences to homes nearer their new workplaces. Developers are targeting more residential projects near mass-transit lines.

A Transport Ministry report said Thailand's current overall logistics costs are about 4% of gross domestic product, including 7% for transportation costs, 6% for inventory/warehousing costs (6%) and 1% for management costs. Both Malaysia and Singapore have overall logistics cost of below 10% of GDP.

Developing the country's transportation infrastructure – and the rail system will be a way reduce logistics costs.

Last year, the Thai government approved investments in 20 infrastructure projects (Bt1.79 trillion ($US50 billion)) commencing in 2017. It will include the development of a nationwide rail system from 1 meter gauge single-rail track to 1.435-meter double-rail track, which will considerably speed up rail transportation for both passenger and cargo traffic. The master plan to develop the country's infrastructure also links all major aspects of the transportation system – road, rail, marine and air – which will make it easier for businesses to manage their logistics costs, while they will also benefit from links between Thailand and other Asian countries.

GH Bank announces outstanding Q3 2016 operating results

The Government Housing Bank [GH Bank] President announced the Bank's third quarter 2016 operating results.

During this period, the Bank issued new loans of Bt 111.4 billion ($US 3.1 billion) (96,319 customers for the first nine months of 2016), an increase of 2.79% over the same period last year. Loans not exceeding Bt2 million ($US57,000) were issued to 43,395 customers. At the end of Q3 2016, the Bank's total loans outstanding increased by 5.01% to Bt 906,039 million ($US 25.9 billion) while total assets increased 9.77% to Bt 988,210 million ($US28.2 billion).

Total deposits were Bt 791,047 million ($US 22 billion) (increasing 8.89%). Non-performing loans [NPLs] decreased by 0.16% compared to Q2 2016 to 5.60% of total loans. The Bank's net profit was Bt 7,450 million ($US213 million). The Bank's BIS ratio (16.21) exceeds Bank of Thailand's Minimum Capital Requirements (8.50).

GH Bank presents flood victim relief packages

Chatchai Sirilai, GH Bank President, said the Bank is helping many southern Thailand flood victims by allocating Bt 500 million ($US14 million) to a *"2017 loan project to reduce flood victims' debts"*. The Bank is also allocating Bt1 million ($US28,000) to distribute 2,000 relief packages to customers and flood victims to provide additional comfort and build confidence. The Bank's relief packages include good quality consumer goods such as canned fish, drinking water, soap and tissue paper. All relief packages are distributed throughout flood ravaged areas. The Bank is also sending staff to survey affected areas to plan for housing rehabilitation projects after the floods recede. This project is an integral part of the Bank's CSR initiatives.

GH Bank partners with National Savings Fund

Somporn Chitpentom, Secretary General of The National Savings Fund (NSF) said that the Government Housing Bank [GH Bank] will now service people who wish to save money through the National Savings Fund [NSF]. NSF currently has three state-owned banks as partners – Krungthai Bank, Government Savings Bank and Bank for Agriculture Cooperatives to accept fund members and deposits. Although more than 25 million self-employed workers are not covered by pension funds, Social Security or Provident Funds, only 520,000 people have applied for NSF membership. GH Bank and NSF have completed working systems, process management and Bank staff training for the project. NSF fund members can now deposit funds at 3,489 Bank branches (four Banks) across the country.

Chatchai Sirilai, GH Bank President, said that the Bank will service NSF members and deposits in line with Bank policy to encourage saving discipline. NSF members can access these services at 200 GH Bank branches nationwide.

"The Bank is supporting government policy to prepare for an "Ageing Society" by enhancing self-employed workers' quality of life and savings discipline," Mr. Chatchai said. Members who joins the NSF program can access their retirement savings at age 60. Self-employed members are also invited to join the "GH Bank Financial Literacy" programme that will allow them to access bank loans in the future.

Europe: harmonisation of covered bond frameworks in the European Union

By Mark Weinrich

Active covered bond markets exist in almost all countries of the European Union [EU]. While most national frameworks adhere to the same core principles, there is also substantial diversity among the legal, regulatory and supervisory covered bond frameworks across the EU Member States. These differences are quite significant. In some European countries, for example Slovakia, the bankruptcy remoteness of the cover pool is not a given, and investors could face an acceleration of covered bonds upon the insolvency of the issuer. In others, for example Spain, the collateral provided in the cover pools might no longer comply with loan-to-value limits, as compliance is tested at origination and no cover pool revaluations based on house price development are required by law.

As part of the Capital Market Union [CMU] action plan, the European Commission wishes to develop an integrated European framework for covered bonds with a view to ensure their robustness and consistency, based on high-quality standards and best market practices in order to allow for a single, preferential regulatory capital treatment for a standardised European product.

On December 20th 2016 the European Banking Authority [EBA] published its final report on covered bonds. It is largely based on the EBA's best practices paper of 2014 and proposes a three-step approach to the harmonisation of covered bond frameworks in the European Union. With its three-step approach the EBA attempts to ensure more consistency in the definition and regulatory treatment of EU covered bonds, while building on the strengths of the existing national covered bond frameworks and maintaining the flexibility and specificities of such frameworks. The three-step approach consists of:

- an EU Covered Bonds Directive;
- amendments to the EU Capital Requirements Regulation (575/2013); and
- a voluntary convergence.

As first step, a new Covered Bond Directive should be developed to provide a definition of the covered bond and specify structural quality requirements for all regulated covered bonds in the European Union. The EBA proposes the following key features to establish a covered bond:

- a clearly defined dual-recourse principle, the clear and valid segregation of cover assets, and the bankruptcy-remoteness of the covered bond;
- the coverage principle, and special requirements with regard to liquidity risk mitigation and cover pool derivatives;
- a more clearly defined system of special public supervision and administration; and
- transparency requirements for the issuer, including specific conditions for 'soft bullet'/ conditional pass-through covered bonds.

As second step, the Capital Requirements Regulation [CRR] should be amended to strengthen conditions for those covered bonds that seek preferential capital treatment. The second step is closely related to the first one. Covered bonds that meet the requirements of the new Covered Bond Directive are not automatically eligible for preferential risk-weight treatment. As under the current applicable rules, the additional criteria for eligibility for preferential risk-weight treatment will be set out in the CRR. In addition to the existing provisions, new conditions for access to preferential risk-weight treatment of investments in covered bonds will be included. The areas that should be covered under the second step include, among other things:

- requirements for eligible cover assets and loan-to-value limits for mortgage cover assets, and limits on substitution assets; and
- requirements for minimum over-collateralisation.

The third step aims to encourage convergence of national frameworks on a voluntary basis in some areas where binding minimum harmonisation could have disruptive effects, by means of non-binding instruments to foster investor acceptance. According to the EBA, such non-binding measures should provide for additional rules on, among other things:

- the composition of cover pools;
- the treatment of cover pools with assets or obligors located in jurisdictions outside the European Economic Area[1];
- asset valuation and monitoring; and
- stress testing in relation to the coverage requirement.

Arguably, the aim of the European Commission seems to be to allow for a single, preferential regulatory capital treatment for a standardised European covered bond product. In this context and given the diversity and strengths of the existing legal, regulatory and supervisory covered bond frameworks, the three-step approach as suggested by the EBA makes sense. The minimum harmonisation principle as laid out in the three-step approach is probably the most realistic method of creating effective harmonisation that defines and preserves a quality covered bond product and justifies a preferential prudential and risk-weight treatment for EU covered bonds. It could encourage covered bond investment across borders, without the risk of surprises, although there is also the risk that it results in an underestimation of prevailing differences in risks. It is likely that the European Commission – which intends to complete the CMU mid-term review in June 2017 – will take account of the recommendations made by the EBA's report when finalising its proposals.

The report of the EBA is complemented by an assessment of the latest market trends discussing also the change in the investors'

[1] EEA parties are Members States of the EU (Croatia only provisional) with the addition of Iceland, Liechtenstein and Norway.

base. As of the end of November 2016, the European Central Bank [ECB] was the single largest covered bond investor, with holdings of more than EUR 200bn accumulated during the third covered bond purchase programme [CBPP3]. The ECB already holds 30% of eligible covered bonds on its balance sheet, up from about 18% a year ago. The ECB buying and holding such a large portion of the market is in fact a problem for the covered bond market. It has priced the investor base out of the market; investors are not able to replace maturing covered bonds as the ECB is active in primary and secondary markets. Furthermore, CBPP3 resulted in a significant spread compression between 'core' and 'peripheral' markets partially masking the different credit risk levels of the individual issuances. Clearly, the end of the covered bond purchase programme will have a significant impact on the covered bond market. There are fears that the exit of the ECB might leave a *"void of demand"* leading to a volatile period of re-pricing, and risks permanently damaging a market and its long-held reputation for safety. A well-timed and well-managed end to the purchase programme is therefore of crucial importance.

Latin America and Caribbean Round Up

By Claudia Magalhães Eloy[1]

Slum upgrading and new mass housing developments in LAC countries

> *We will implement housing and urban development programs with housing at the center of the strategy and to the extent possible, situated at the center of the city, prioritizing well-located and well-distributed housing schemes in order to avoid peripheral and isolated mass housing developments detached from urban systems, regardless of the social and economic segment for which they are developed.*
>
> (HABITAT III: DRAFT of the NEW URBAN AGENDA, 18 July 2016)

In 2014, the number of people living in slums throughout Latin America and the Caribbean countries corresponded, according to the world bank database, to an average of 21% of the region's population[2], with rates ranging from as low as 6% (Costa Rica) to as high as over 70% (Haiti and Sao Tome and Principe). Top economies (in GDP terms) still exhibit worrisome figures – Brazil with over 22% of its population living in slum areas, Peru, 34%, Argentina, nearly 17%, while Colombia and Mexico have 13% and 11% respectively.

The urban sprawl that followed rapid and poorly planned urbanization is core to the slum phenomenon that has evolved with the rise of megacities in the region. Out of its more than 600 million people, roughly 80% already live in urban areas, over 300 million are expected to live in 198 large cities in Latin America in 2025[3]. The two largest cities: Mexico City and São Paulo[4], with, respectively, 8.9 and 12 million people, have both surpassed the 20 million population mark at the metropolitan region level. In Brazil, currently 17 cities hold more than 1 million people each, encompassing, together, 20% of the entire country's population.

Slums are an urban expression of inequality, the visual segregation between rich and poor that encompasses around 120 million people throughout the LAC region. Slums result from the fact that many people still simply cannot afford the purchase of a new home within consolidated urban areas, despite strong efforts from both government (including subsidies) and families at the lower end of the market. Therefore, financing needs to accommodate a more comprehensive set of housing policies. Yet, current trends in the region seem to favor new mass housing development schemes. Building new homes for low-income families has generally proven much less complicated, and therefore more attractive for policy makers than upgrading slum areas, which is much less susceptible to scaling up, depends upon (most often troublesome) regularization of land to promote security of tenure and does not necessarily ensure full integration with the city. In addition, the former approach often produces greater city sprawl characterized by peripheral housing developments with poor or no access to urban infrastructure: education and health services, public transport, jobs, leisure, etc. It must also be noted that current peripheral developments have extremely profound urban implications in regions such as LAC where the urbanization process is already at such an advanced stage.

Brazil's large scale Minha Casa Minha Vida Program [MCMV], with its "Faixa I" nearly 674,000 units produced and delivered to low income families (between April 2009 and December 2015) is a most recent and massive example of a housing policy that has failed to respond adequately to the "urban divide" challenge. Although the massive production of new homes has managed to upgrade the intrinsic habitable conditions of those families previously living in extremely precarious dwellings, it has not addressed overcrowding or diverse needs issues, nor has it avoided problems of violence due to control by organized crime[5], or, in most instances, provided access to urban infrastructure:

> *"MCMV developments tend to form homogeneous low-income segregated areas, distant from job offers as well as leisure opportunities and social services typically offered in urbanized areas, thus densifying existing ghetto dormitory neighborhoods or producing new ones".*[6]

As financial resources for housing investments at the federal level – both budgetary and from the workers indemnity fund [FGTS] – have been raised to unprecedented levels and increasingly channeled to MCMV, investments in slum upgrading schemes[7] – that started during the 80s and gained some leverage, despite problems and limitations faced[8] in the 90s and early 2000s – have been drastically reduced throughout the past decade, particularly in the last couple of years[9].

Chile, a country that exhibits the highest mortgage loan to GDP ratio in LAC (over 20%[10]) and which has also managed to scale up housing access, still faces urban segregation and poor quality housing, with reported slum growth between 2007 and 2010 due to a reduction in affordable housing. In the Chilean 657 "campamentos", that house over 84,000 people, 91% do not have sewerage and 76% lack access to running water[11]. A UN report in 2015[12] affirmed that "persistent inequalities result in a highly segregated society, in which separate residential areas, separate schools, and separate employment markets operate to entrench privilege and stifle mobility." The Shantytown

[1] The author would like to acknowledge the valuable suggestions made by Arthur Acolin regarding the cases of Mexico and Argentina, but assumes full responsibility for views and contents expressed here.

[2] According to UN-HABITAT, 2013, the region faces a 24% rate.

[3] UN: Urban Sustainability in Latin American and the Caribbean, 2013.

[4] The city of São Paulo alone has over 12 million people in 2016, according to IBGE, while Mexico City, 9.9 million.

[5] Violence is another cruel aspect of segregated housing and while it generally reflected the absence of governmental presence in informal (slum) areas, it has appeared in new MCMV developments vulnerable – both socially and physically – to control by organized crime.

[6] IPPUR/UFRJ: Minha Casa... E a Cidade? Avaliação do Programa Minha Casa Minha Vida em seis estados Brasileiros, 2015, p.414 (translated by the author).

[7] Habitar Brasil, PASS, Pro-Moradia and Pro-Saneamento.

[8] One of the major limitations was the fact that, since the Fiscal Responsibility Law of 2001, states and municipalities must have debt capacity in order to contract loans to finance their programs and most lack that capacity. Under Brazilian law, nor can they issue bonds.

[9] Slum upgrade and related interventions received approximately BRL 15 billion in 2007, down to a little over BRL 400 million in 2012.

[10] www.hofinet.org.

[11] 2013 Techo report and 2012 Plan Integral de Campamentos.

[12] By Philip Alston, Special Rapporteur, United Nations Human Rights Council.

Integral Plan of 2012 promised a shift from individual housing to a more comprehensive social approach for those areas and from market-led to state coordinated interventions.

In Colombia, after 25 years of incentives to the housing construction and financial sectors and a "mounting housing deficit, growing expansion of slums in key secondary centers and a system of national housing grants in collapse"[13], the housing portfolio has recently seen some diversification to include innovative and promising policies, while municipalities have stepped in on land use and planning. Yet, according to IDB (2016), scaling up and transcending successful local housing initiatives in Bogota and Medellin are still needed to achieve a national policy. Since 2010, there have been urban improvement investments in more than 780 cities. Recent national production programs include "My Casa Ya" with a target of over 100,000 new subsidized (both on down payment and interest rate) units, "Vivienda para Ahorradores [VIPA] with larger subsidies for lower income families and "Vivienda Gratis", a "homes for free" program targeted at displaced families.[14]

In Argentina, housing policy is articulating slum improvement along with mortgage subsidies. A recent World Bank[15] loan will provide US $400 million for urbanization and housing in the main Argentine cities, including US $200 million for the "Integrated Habitat and Housing project" that will promote a nation-wide housing subsidy program (Línea Solución Casa Propia), together with an "urban transformation project" aimed at improving housing conditions and access to basic services and infrastructure in informal settlements in metropolitan Buenos Aires. It will also provide US $ 170 million for the urbanization of the largest informal settlement – Villa 31[16] – located just a short distance from downtown Buenos Aires. An additional US$30 million will be allocated to habitat improvements in disadvantaged neighborhoods and to strengthen the institutional capacity for urban management at the metropolitan level.

The Peruvian government has recently set a development target of 500 thousand new social housing units up to 2021, 150 thousand of them subsidized (Vivienda Nueva de Techo Propio), as part of an effort to boost construction activity, but committed to keeping the finance of water and sewage projects as an important part of the housing scheme[17]. The Municipal Housing Plan of Arequipa has recently included the creation of special housing schemes to consolidate municipal land illegally occupied prior to 2013, raising counter arguments questioning the legality of the initiative as well as the possible stimulus to the traffic of land.

In Mexico, slum upgrading schemes during the 90s include experiences such as the Manos a la Obra, the informal settlement upgrading scheme developed in Tijuana, which according to Imparato and Ruster[18] "has generated a critical mass of institutional architecture, technical knowledge, management routines, and qualified personnel". The production of new homes, that had significantly increased since early 2000s as financing options were expanded to incorporate previously-underserved markets, has significantly fallen after 2008 in regard to workers unaffiliated with Infonavit and FOVISSSTE[19]. Nonetheless, the availability of funding for home improvements, although not yet very successful in terms of performance, represents an important alternative to new construction. The 2012 Report on the Current Housing Situation in Mexico[20] recognized "the greatest challenge derived from the construction of housing developments in areas distant from urban areas, which lack services and other features, and accessibility and connectivity with the cities, which leads to the uncontrolled expansion of the cities and an increase in uninhabited housing units." Still according to that report "it is evident that the growth of urban sprawl in recent years has been uncontrolled, without considering the application of instruments of urban planning and territorial regulation." The JCHS 2012 study observed that "over the last few decades Mexico has seen the size of its urban areas grow by a factor of seven even as the population has only doubled. A complex array of factors has combined to drive new housing production in both the informal and formal sectors to far-flung locations." The Esta es tu casa program has included rules for assigning federal subsidies regarding location and connectivity to urban services. Acolin and Kichik's article published in this issue discusses the introduction of location criteria eligibility for subsidies in Mexico.

In conclusion, improving the living conditions in slum areas remains an urgent matter in LAC. Slum urbanization policies need to be part of broader housing policies that must go hand in hand with comprehensive and inclusionary urban, territorial and financing policies. Otherwise, we risk repeating past mistakes and perpetuating the pattern of urban divide, whether in the form of slums and informal settlements or new formal housing developments.

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13 IDB: Slum upgrading and Housing in Latin America, 2016.

14 According to the census of households affected by disasters: Single Registry of Displaced Population (RUPD).

15 http://www.worldbank.org/en/news/press-release/2017/02/28/housing-urban-transformation-improve-living-conditions-argentina

16 The oldest informal settlement in the Capital City, Villa 31 dates back from the 30s. Its population grew by impressive 50% between 2009 and 2013, from 27 thousand to 40 thousand inhabitants. www.infobae.com

17 El Economista, Peru, on 16.02.2017 and La Republica, 11.03.2017, both reported by Uniapravi.

18 The World Bank: Slum Upgrading and Participation, Lessons from Latin America, 2003.

19 Harvard JCHS: The State of Mexico's Housing, 2012.

20 By CIDOC and SHF.

What's next for U.S. housing finance?

↪ By Alex J. Pollock

With the new administration of President Donald Trump, and simultaneous Republican majorities in both houses of the Congress, can the U.S. look forward to meaningful reform of Fannie Mae, Freddie Mac, and American housing finance?

My view is that it is highly unlikely. The interested parties and the policy ideas are simply too fragmented for a politically energetic solution to emerge and be enacted. Many powerful interest groups are fond of the subsidies that Fannie and Freddie pass on to them from the taxpayers. At the same time, a dissonant chorus of well-intentioned theoreticians promote mutually inconsistent proposals.

The topic of the debates, the American housing finance sector, is genuinely huge, with $10.2 trillion in outstanding mortgage loans. That is a number about equal to the combined GDPs of Germany, France, the United Kingdom and Canada.

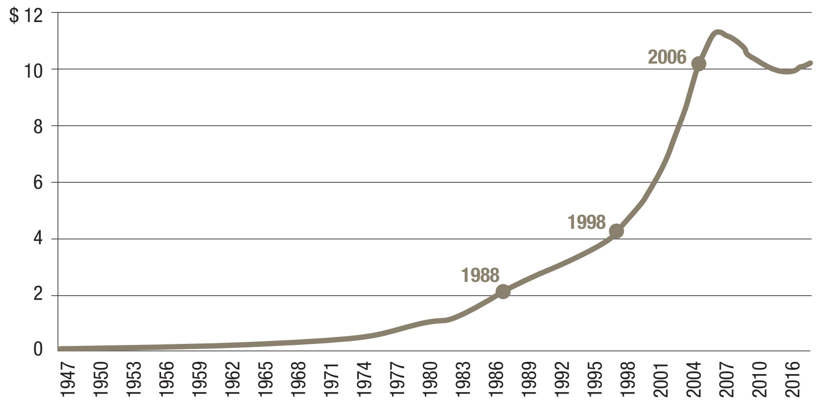
U.S. housing finance also has a troubled history. It collapsed in the 1980s, when based on the savings and loan model, and required a $150 billion taxpayer bailout. The bonds sold to finance that bailout won't be paid in full for another 13 years from now – until 2030. The 1980s U.S. housing finance scandal led to the abolition of the government's housing finance promoter and regulator of the time, the Federal Home Loan Bank Board, in 1989. One of the lessons drawn by American financial regulators at that point was that housing finance needed to focus on the securitization of mortgages, a less-than-perfect conclusion.

So, the U.S. tried again, this time with a model which featured at its core securitization and the "government-sponsored enterprises" [GSEs], Fannie Mae and Freddie Mac. Fannie and Freddie rapidly expanded mortgage credit by issuing trillions of dollars in mortgage-backed securities and debt in highly leveraged balance sheets, which always depended on the so-called "implicit" guarantee of the U.S. Government. That was a mistake, but they and the politicians who promoted them foolishly claimed that this model was "the envy of the world." Both government-sponsored and private mortgage securitization inflated. The increase in outstanding mortgage loans was remarkable, as shown in Graph 1, and was accompanied by political cheering.

Total American mortgage loans reached $2 trillion in 1988. By 2006, during the golden years of Fannie and Freddie, they had quintupled to $10 trillion. Nominal GDP increased by 2.6 times during this period, so mortgage debt was growing far faster the economy for years, a clear danger sign in retrospect. There was an acceleration after 1998, when mortgages crossed $4 trillion. Today, after the fall, total mortgage loans are at about the same level as in 2006, having gone basically sideways for a decade.

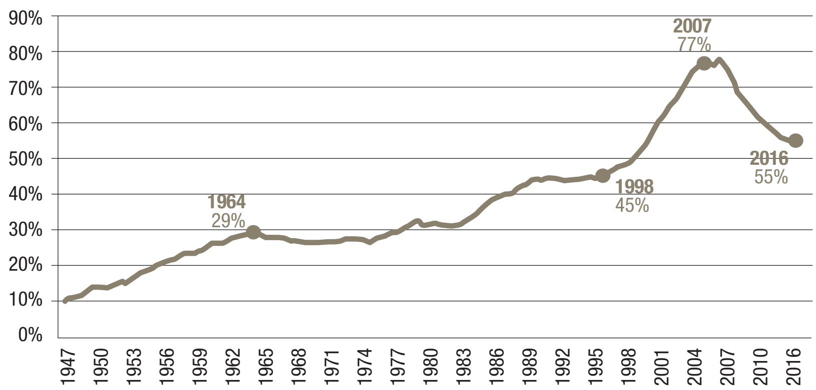
Graph 2 shifts to the long-term growth of total U.S. mortgage loans relative to the size of the

Graph 1 U.S. Outstanding Home Mortgages
1947-2016 (Trillions of Dollars)



Source: Board of Governors of the Federal Reserve, Z.1 Financial Accounts of the United States

Graph 2 Outstanding Home Mortgages as a % of GDP
1947-2016



Sources: Board of Governors of the Federal Reserve, Z.1 Financial Accounts of the United States; United States; U.S. Bureau of Economic Analysis economy, measured as a percent of GDP – and displays an instructive history.

In this graph, we see first the post-World War II U.S. mortgage credit boom which ran until 1964. Then mortgages as a percent of GDP were flat at about 30% for twenty years. They rose to 45% in the 1980s-1990s, then took off with the great mortgage bubble, reaching 77% in 2007 as disaster loomed.

At that point, as we know, the American housing finance sector with its post-1980s "improvements," had an even bigger collapse than before, including the failure of Fannie and Freddie. Among the bailouts of the time was a $189 billion crisis equity infusion in the deeply insolvent Fannie and Freddie by the taxpayers. Fannie and Freddie thus became subsidiaries of the U.S. Government. They remain so to this day, almost nine years after their humiliating failure.

Since the top of the bubble, total U.S. mortgages as a percent of GDP have fallen to 55%. This is sharply corrected from the peak, but is still a high level, historically speaking – equal to the proportion in 2002 and close to twice the level of 1964 or 1980.

Because of their government support, Fannie and Freddie remain powers in the American mortgage system. They guarantee or own $4.9 trillion of mortgage loans – or 48% of all the mortgage loans in the U.S. They have combined $5.3 trillion in total assets and $5.3 trillion in liabilities. You will readily see by arithmetic that they have no net worth to speak of.

The Treasury Department controls 79.9% of the common stock of Fannie and Freddie. Why not 80% or 100%? Because that would have forced the government to put Fannie and Freddie's $5 trillion of debt on the government's books – an outcome the government was and is desperate to avoid. Honest accounting is not going to happen, and the Treasury will continue whatever gyrations it takes to keep its Fannie and Freddie exposure as an off-balance sheet liability.

The Treasury Department also owns $189 billion of senior preferred stock in Fannie and Freddie, the bailout investment. This was the amount required to bring their net worth up to zero, where it remains. Although Fannie and Freddie are now reporting profits – a total of $20.1 billion for the year 2016 – virtually all of this is paid to the Treasury as dividends on the senior preferred stock, so there is no increase in their capital. The profits made by the government, at least for now, from owning these biggest companies in the mortgage business, and from absorbing half the country's mortgage credit risk, thus go to help reduce the annual government deficit.

At December 31, 2016, Fannie and Freddie's combined net worth was about $11 billion, compared to their assets of $5.3 trillion. This gives them a risible capital ratio of 0.2% – so close to zero that the difference doesn't matter.

Fannie and Freddie's principal business is guaranteeing mortgages. So here is an essential question: What is the value of $5 trillion in guarantees from guarantors with zero capital? Clearly the answer is that such guarantees by themselves have no value. Every bit of the value and all ability of Fannie and Freddie to report a profit comes not from themselves, but from the fact that the government truly (though not formally) guarantees their $5.3 trillion in liabilities. In this sense, it certainly seems fair that the Treasury continue to take all the profits which its guarantee creates.

The government is also involved in directly financing Fannie and Freddie's debt, for the U.S. central bank has in its investment portfolio the remarkable amount of $1.7 trillion of Fannie and Freddie's mortgage-backed securities. Thus, the Federal Reserve owns and has monetized one-third of Fannie and Freddie's liabilities and one-sixth of all the mortgages in the country. This is unorthodox central banking, to say the least. The Fed is still buying Fannie and Freddie's MBS, eight years after the 2009 end of the crisis, as they make new investments to replace any maturity or prepayment of principal. The Fed's interest rate risk position is exactly like that of a 1980s savings and loan institution: long-term, fixed rate mortgages funded short. How will that turn out? One must wonder.

In the meantime, the Fed is reporting billions of dollars of short-term profits from investing in long-term fixed-rate mortgages and funding them with floating rate deposits. The bulk of this profit it then pays to the U.S. Treasury. The scheme reduces the government deficit in the short run by speculating in the interest rate risk of mortgages guaranteed by Fannie and Freddie and in turn guaranteed by the Treasury. The financial relationships of the Federal Reserve, the Treasury Department and Fannie and Freddie make an intriguing tangle. One plausible argument is that we should view them all together as one financial entity, the intertwined Treasury-Fed-Fannie-Freddie financial combine.

Viewed from the rest of the world, the American housing finance system is not only impressively big, but odd and indeed unique. The thing that makes it most odd continues to be the role and financial structure of Fannie and Freddie. In addition to their function of guaranteeing and massively concentrating mortgage credit risk, it is clear that they are entirely wards of the state and intertwined in a very complex fashion in the government's finances.

What's next for U.S. housing finance? Will Fannie and Freddie just continue forever as subsidiaries of the government? Nobody admits to liking the status quo very much. But the status quo has tremendous inertia and has proved highly resistant to change over the last eight years.

Do Fannie and Freddie as government subsidiaries represent a good model for American housing finance? For those (like me) who believe in competitive, private markets as the superior form of allocating resources and risk, the answer is obviously No. In particular, people like me think that reinstating anything like the former disastrous Fannie and Freddie "GSE" structure would be a monumental mistake. Many people do not want to see another government bailout of a Fannie and Freddie which have eternally zero capital. Many others correctly think that private capital should bear the principal credit risk in the mortgage market. Speculators who have bought the 20.1% of Fannie and Freddie's common stock which the government does not control, or who own the old, junior preferred stock whose non-cumulative dividends have not been paid for years, hope for some political event which will generate windfall gains for them.

All these people would like change, but there is no consensus proposal. Moreover, many other interests wouldn't mind seeing the old Fannie and Freddie come back, or even the current Fannie and Freddie continue.

For example, homebuilders like having the government guarantee mortgages so it's easier to sell houses, including bigger and more expensive houses. Realtors like anything which helps sell houses faster and increases their commissions. Investment banks find it easier and more profitable to sell mortgage-backed securities around the world when they are guaranteed by the U.S. Government. Then they can be marketed as so-called "rate products" where the investors don't have to worry about credit risk. In addition, these firms can then more make money selling swaps and options to hedge the interest rate risk of Fannie and Freddie MBS. Affordable housing groups like the subsidies which Fannie and Freddie used to pass out so freely, as do left-leaning politicians looking for ways to get money for their constituents without facing a vote in Congress.

For several years after the most recent housing crisis, it seemed that Fannie and Freddie's egregious failure, and their embarrassing bailout, would surely trigger some kind of fundamental reform. But it didn't. Bills were introduced in Congress, but didn't pass. Many plans for how to reform American housing finance in general and Fannie and Freddie in particular were published, and some of them widely circulated and debated, but years went by and nothing happened.

The Trump Administration would clearly have different ideas for housing finance reform than its predecessor, but in its early months, it has not so far articulated any specific recommendations. The new Secretary of the Treasury, Steven Mnuchin, has previously said that continuing government ownership of Fannie and Freddie is unacceptable, but has not yet provided any proposed path to change it.

In my opinion, no legislative reform proposals, whether from the new administration or elsewhere, have a high probability of success in any near term. But there is one possibility we should consider as the one that makes the most sense.

This requires admitting that we cannot get rid of Fannie and Freddie, and that we cannot stop the government from making them "too big to fail" whenever they next get themselves in trouble. However, we should in the meantime take away all the special government favors and sponsorship which allowed Fannie and Freddie to so distort the gigantic American housing finance market.

I propose that Fannie and Freddie should be treated in exactly the same way as every other trillion-dollar bank—that is, exactly the same as Citigroup, JPMorgan Chase, Bank of America, Well Fargo, and the like. They should have the same capital requirements—with a minimum of 5% equity capital to total assets. They should make equivalent payments to the government for their taxpayer credit support, just as the banks do for deposit insurance. They should lose their indefensible exemption from state and local corporate income taxes. They should be clearly designated as the "Systemically Important" institutions they so obviously are and be regulated just like the other big banks under the forceful hand of the Federal Reserve.

Life under these terms would be harder for Fannie and Freddie than just living on the free guarantee from the taxpayers as a subsidiary of the government. But the American housing finance sector would be healthier, more based on private capital, and less prone to entering yet another collapse.

It this scenario possible? Yes. Is it likely? No.

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Housing and housing finance under the Trump administration

↳ By Jay Brinkmann

1. Introduction

Based on the record of its earliest days, attempting to predict anything about Trump administration is a perilous task. This is particularly true of housing. While the new President has demonstrated that, to the extent practicable, he will do exactly what he said he would do in his campaign, he was largely silent on the issue of housing and housing finance. Predictions as to the direction of housing and housing finance under the new administration, therefore, are unfettered by any facts. Nevertheless, it is possible to forecast the growth of housing based on economic and demographic fundamentals, as well as changes to the regulatory imbroglio that ensnared many mortgage lenders attempting to do business under the Obama administration.

2. Demographic outlook

Among the key demographic drivers are the aging baby boomers who are at their peak homeownership years, with the majority staying in the homes where they have lived for many years. Despite reports that aging baby boomers are moving out of the suburbs and into urban centers, or out of urban areas to less-crowded areas, or to condos on a beach or golf course, the numbers of such moves only appear large because there are many more baby boomers involved. On a percentage basis, people now reaching age 65 are making essentially the same housing choices that people reaching that age have made for decades – staying where they are.

Another key driver will be millennials finally settling down, marrying and raising families, whether due to the imperative of biological clocks or an improved economy. Despite their professed preference for urban living and their apartments, the arrival of young children is driving them to the suburbs just as it did their parents and grandparents. Finally, a number of immigrants, primarily those from the large Hispanic influx of the 1980s and 1990s, are economically now in a position to buy homes. While the homeownership rate among Hispanics will remain below the national average, the large numbers involved against which that percentage is applied results in a high absolute number of new owner-occupied homes.

3. Economic outlook

In terms of the economy, most current signs point to continued growth in the US economy. The most important factors are a healthy banking system, and the growing expectation that, with Obama out of the White House, the corporate tax system will be reformed such that the US will no longer have one of the worst corporate tax systems in the world. In its 2016 'International Tax Competitiveness Index', the US-based Tax Foundation ranked the US last among 35 OECD nations for its 35% percent corporate tax rate, and second to last for its international tax rules[1]. In addition, rapidly growing business and consumer optimism will drive increased consumer spending and business investment. While a growing economy has, and will, drive up interest rates, a rise in rates will not materially impact home buying. Interest rates impact the size and location of the home a family can afford to buy for a given income, but not whether or not to buy a home. That decision is driven by family and lifestyle choices, not interest rates. Finally, the Trump administration has put a major emphasis on increasing the number of jobs in the US, not just growing the economy. The slight difference in emphasis is important because houses are bought with paychecks, not percentage point changes in GDP.

4. Regulatory outlook

The regulatory environment for lenders should improve, largely because it would be extremely difficult for it to get worse. The Department of Justice and the Department of Housing and Urban Development have hit lenders with a steady assault of claims of racial bias in lending, largely due to flawed statistical models and a legal doctrine that does not appear to be supported by any laws actually passed by Congress. The Equal Credit Opportunity Act of 1974 prohibits lenders from discriminating in the granting and pricing of credit based on race, ethnicity, age, gender, and other factors. The law prohibits the disparate treatment of borrowers based on the characteristics. The Obama administration, however, expanded the interpretation of the law to prohibit also disparate impact, meaning that lenders would be potential liable if their lending did not match the racial or ethnic characteristics of an area in which they operated. Thus, even if lenders made sure they did not discriminate, if there were racial differences in the outcomes, the lenders could be held liable regardless of the socio-economic factors that may have caused those differences in those lending outcomes.

Compounding the problem for lenders is that they are limited to what risk-based interest rates and fees they can charge for loans, and rates and fees are subject to discrimination tests. Lenders also face jeopardy if they make loans with the types of features and structures that were commonly used for mortgage borrowers who needed time to repair their credit. In addition, major sanctions came into play if mortgage servicers did not follow a set of prescribed procedures if a borrower went into default. All of this resulted in the gallows humor among lenders that they would be sued for making a loan that properly priced in risk to a borrower in a protected racial or ethnic group, or sued for not making that loan.

All of this will most certainly change under the Trump administration. While the prohibitions against racial or ethnic discrimination will absolutely remain in place, it is likely that

[1] https://taxfoundation.org/2016-international-tax-competitiveness-index/

the Trump Justice department will not pursue the same questionable legal theories that drove some of the Obama administration's enforcement actions. Perhaps the most important changes will come with what happens with the Consumer Financial Protection Bureau [CFBP]. This agency was established in such a way as to be autonomous from Congressional and even Executive Branch oversite. Its history has been pockmarked with imposing fines on lenders who thought they were following the often ill-defined CFBP rules. Politically, the CFPB had little choice. It was staffed in many cases with individuals who were seeking to change the world but who had next to no experience with the realities of lending or running a financial institution. In the absence of the maturity and balanced judgement of established financial regulators, they had to learn as they went along, and establish a record of large fines and legal actions to prove their worth before an increasingly hostile Congress. It is entirely likely that lenders will face a new spasm of enforcement actions in the near term as the CFPB continues to try to "make its bones" as it faces legal challenges, a White House that has been openly critical of the agency, and the eventual appointment of a new director who will likely take it in a new direction.

Perhaps the biggest change for the CFPB and other regulators would come if they were forced to sit through a revival of 'The Mikado' and afterwards repeat over and over "Does the punishment fit the crime?" For example, under the Obama administration, the Department of Justice began imposing treble damages fines against lenders for even minor errors in loan documents for loans insured by the Federal Housing Administration, the agency that provides credit guarantees for mortgage borrowers with limited financial resources and/or poor credit histories. Such errors included such things as rounding errors in loan to value or debt to income ratios. The basis for the fines was an 1863 law designed to punish those who sold rancid meat to the US Army during the American Civil War. This pattern of finding fraud with even minor mistakes is part of an ongoing visceral desire to punish the mortgage industry for sins committed more than a decade ago by firms that, for the most part, no longer exist. Unable to follow the example of Charles II who dug up the bones of Oliver Cromwell twelve years after he died and posthumously executed him for beheading Charles I, the regulators instead sought to exact their revenge on the survivors in the mortgage industry, companies who survived because they were not the ones who caused the problems. Since the regulatory axe most often only fell when loans defaulted, lenders have had to build regulatory and reputational risk unto their loan decision calculus. Because losses in the event of default increased, not just due to increased severity from increased foreclosure timelines, but due to potential fines, penalties, and legal costs as well, lenders tightened credit to reduce the likelihood of default more so than in the past, just to keep their expected losses constant. All of this is likely to moderate under Trump, with a commensurate expansion of credit availability.

5. What should the Trump Administration do?

What steps should the Trump Administration and the Republican majorities in Congress take to improve housing finance? After eight years of sitzkrieg by the Obama administration, the path is wide open for the Trump administration to make fundamental changes to the housing finance system that are long overdue. In making the changes, the Trump administration should follow these general guidelines:

1) Let private capital bear as much of the housing market credit and interest rate risk as possible. American taxpayers are unnecessarily bearing trillions of dollars of housing risk because current structures discourage the deployment of private capital at a fair return.

2) Ignore any interest groups who use terms like "housing crisis" or "expanding affordability". There is no housing or housing affordability crisis by any objective measure, and affordability is more a function of incomes and lifestyle choices than a problem that financial systems can remedy. There are ongoing problems, but none rise to the level of being a crisis. Affordability can be more directly addressed though addressing constraints on supply, such as density restrictions, rather than government manipulation of the finance market.

3) Ignore those whose livelihoods depend on transactions volume. The biggest supporters of Fannie Mae, Freddie Mac, and the other governmental housing agencies over past decades have been real estate agents, home builders, mortgage brokers and others who have used their political influence to protect whatever financing structures would keep transaction volumes high regardless of the economic cycle. They enjoy the immediate transactions income but it is the taxpayers who are stuck with the long-term risk.

4) Ignore those whose business models are explicitly linked to Fannie Mae and Freddie Mac. For example, some apartment lenders have capital invested in risk-sharing models with Fannie Mae that offer certain rate, execution and earnings advantages relative to doing business with other investors. At some point, Schumpeter's creative destruction and economic Darwinism must be allowed to work without the sclerotic, permanent interference of a governmental finance system that only benefits a few.

Given the above, what should the Trump administration do? First and foremost is abolish Fannie Mae and Freddie Mac, either with the executioner's axe or market indifference once a better system is put in place. These ill-conceived systems of private gain and taxpayer risk have long-outlived whatever purpose they may have once served. The credit guarantees, technology platforms and servicing oversight can be shifted to the private capital in mortgage insurance companies, and the existing books of business can be auctioned over time as new capital comes into these businesses to support the credit risk. A new FDIC-type structure could be established to ensure the liquidity of mortgage-backed securities issued with the primary credit support of the private mortgage insurers, thus preventing disruptions in the capital market.

Second, the Trump administration should clearly define and narrow the role of the Federal Housing Administration. While the purpose of the agency is to insure loans to borrowers with credit profiles so poor that they could not obtain home loans in the market supported by Fannie, Freddie, or banks, for years it has been in a battle to protect its market share, and, using its subsidized rates, has competed away the ability of private capital to finance riskier borrowers.

Third, the Trump administration should not remove the tax deductibility of mortgage interest unless it is part of a tax plan that reduces the overall tax burden. The deductibility of mortgage interest has little to do with driving home buying, therefore the elimination of the mortgage interest deduction would have little if any impact on homeownership as long as it is part of a broader reduction in income tax rates. In addition, it is generally not used by lower income individuals who do not itemize their deductions. The Obama administration, however, spoke often of limiting or eliminating the deduction, but with the sole purpose of raising revenue. One obvious problem with that approach is that it maintained the interest deduction for those who bought homes to rent, thus tilting the economics more in favor of home rental rather than homeownership.

The much more important problem, however, is the macroeconomic problem of what would have been a massive tax increase on the middle class. The Trump administration should resist any calls for the elimination of the mortgage interest deduction unless it is more than offset by a reduction in tax rates, and combined with other items like the elimination of the deductibility of state taxes. Tax simplification would have tremendous economic benefits as it lowers compliance costs and removes tax-incented sub-optimal investments.

Finally, while the expansion of federal regulation has posed difficulties for mortgage lenders, those difficulties have been greatly multiplied by individual state regulators who are often politically ambitious and who seek to prove their mettle by looking for ways to go beyond what the federal regulators require. Adopting a set of regulations that apply and are enforced uniformly across the entire country without additional state rules would increase competition among lenders and be a major step toward reforming the complicated regulatory hodgepodge under which housing finance must currently operate.

In summary, housing under Trump should benefit from an expanding economy, favorable demographic trends, and a rationalization of the regulatory environment. However, President Trump must also use the opportunity to make fundamental and long overdue changes to housing finance, the most important being the elimination of Fannie Mae and Freddie and restoring the role of private capital.

Funding for housing finance in Brazil: regulatory and structural issues

By Claudia Magalhães Eloy[1]

1. Introduction

Many emerging market countries are trying to grow their housing finance systems by expanding funding sources for mortgages beyond savings schemes. That is the case with Brazil. Here, many efforts have been made in the last 20 years to increase capital market access for mortgage lending. Yet, housing finance is still based on a deposit system [SFH], created back in the 60's, that comprises a compulsory workers' indemnity fund [FGTS] and a savings and loans scheme [SBPE] coupled with earmarked credit obligations for financial institutions which hold those deposits.

The creation of a new system (The Real Estate Finance System – SFI), in 1997, that would connect the housing credit market to capital markets through the establishment of legal frameworks for bonds and mortgage-backed securities [MBS] was seen as a necessary substitute for the savings and loans scheme, since mortgage lending through SFH had been severely reduced during the 90s. Around the mid 2000's, as fund raising through the Brazilian stock market was on the rise and many developers launched successful initial public offerings [IPO], the belief was reaffirmed that the country's financial system was mature enough and would benefit from more market and less government intervention[2].

Yet, developments that followed contradicted expectations. Mortgage bonds and securities have taken quite a long time to become relevant investment alternatives and, most important, so far have not really become sources of funding for housing loans. The housing production and credit boom that started in 2006 was based on the traditional housing finance system with its earmarked funds and below-market regulated rates, as well as on the dominant role of public banks, particularly CAIXA – a state-owned bank that alone has around 67% of the housing credit market.

This paper intends to offer a brief overview of the development of the two systems, present an updated picture and briefly reflect on their interactions and the implications of current regulations. The underlying questions are: what makes housing credit feasible in Brazil today? and what factors limit the development of new funding and prevent a more efficient use of existing funding?

This article is composed of four sections, beside this introduction and closing remarks. The next section gives a brief overview of the traditional Housing Finance System [SFH]. The following section focuses on the SFI, reporting measures undertaken to encourage its development, especially those that relate to the SFH. The third section discusses interest rate issues and implications for the development of SFI as well as for affordability and credit expansion.

2. SFH – a traditional deposit system

The Brazilian Housing Finance System [SFH], created in the 60s, is composed of an indemnity Fund for (legally registered) workers [FGTS] and a voluntary, tax-exempt savings scheme [SBPE or "poupança"]. Deposits in SBPE have always been subject to regulation both regarding below-market interest paid on savings as well as how much banks have to channel into housing loans – a minimum of 52% of savings stock[3] –; another 13% into real estate credit at market rates; and 30% compulsorily deposited with the Central Bank[4]. As to investors, SBPE account holders receive a tax-exempt regulated interest rate up to 6%+TR[5] per year (always below market rates)[6] and deposits, up to a fixed limit (BRL 250,000), are covered by the Credit Guarantee Fund [FGC]. FGTS collects monthly compulsory deposits made by employers on behalf of their formal workers[7]. Accounts are also remunerated at below market rates (even below SBPE´s), fixed at 3% + TR per year and withdrawals can only be made if certain conditions are met[8]. Throughout its 5 decades, SFH has experienced crises and has been subject to much criticism, but it has managed to keep its ability to collect deposits.

Following a credit and production boom period in the late 70s and early 80s, as hyperinflation and a wage squeeze policy threatened to cause a real estate crisis, the solution found was to maintain inflation indexation on mortgage balances, but index installments to (much lower) wage increase rates, therefore causing a mismatch. The difference was supported by a government fund (Fundo de Compensação de Variações Salariais, FCVS)[9] that exceeded over BRL 100 billion in losses and allowed for huge

1 The author would like to acknowledge the most valuable review and comments made by Dr. Marja Hoek-Smit and thank her for contributing to this article. Nevertheless, the author assumes full responsibility for views and contents expressed here.

2 Pinheiro & Oliveira Filho, 2007.

3 The 52% may be complied with housing loans + MBSs + other types of credit. When the minimum requirement under regulation is not met, banks have to deposit the amount of unmet obligations within the Central Bank, where it is remunerated at 6%+TR (same interest paid to depositors). The 52% is calculated upon the past 12 months' average savings funds.

4 This 30% aliquot used to be split: 20% remunerated at 6%+TR and the other 10% remunerated at the reference rate (Selic). Since 2015, the 20% has been temporarily increased to 24,5% remunerated at the same interest paid to accounts, which can be lowered to around 18% in exchange for extra housing loans contracted, and the remaining 5,5% at Selic. This change has been made as an anticyclical measure, in order to stimulate credit.

5 The Reference Rate used as an index rate for the SFH since 1991 – both on interest paid savings and FGTS deposits and on mortgage debt/balances – is not a price/inflation index. It is set by a formula, defined by the Central Bank, based on average interest rates of 30-day Bank Deposit Certificates [CDBs]. Thus, it is correlated to the reference rate (Selic), although correlation is much smoothed by the calculating formula. Its positive effect is to smoothen fluctuations of Selic into the housing credit system, thus allowing for what would be considered a variable rate to become, in fact, almost fixed.

6 6%+TR per year or 70% of the Reference Rate Selic, whenever it falls below 8.5% per year.

7 The idea behind it is to constitute compulsory savings for formal workers (those subject to the CLT Law, plus, more recently, housekeepers): through contributions equivalent to 8% of the monthly salary, it composes savings equivalent to around one salary per year. It was created back in 1966 as compensation for the abolition of the 10-year stability law (after 10 years of work, an employee could not be dismissed).

8 Mainly unmotivated work dismissal, retirement, death or fatal disease and the purchase of a home. FGTS account holders can use their FGTS savings to purchase a home appraised at a maximum price of BRL 650,000, and exceptionally up to BRL 750,00 in the states of Minas Gerais, Rio de Janeiro, São Paulo and the Federal District (Resolução BCB nº 4271/2013).

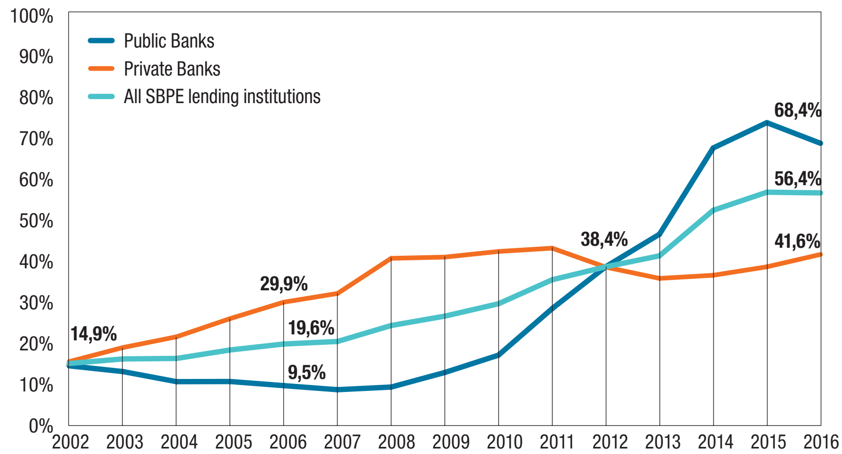
9 Created in 1967 with the purpose of covering residual remaining balances of housing finance operations under SFH – FCVS ended up with debt obligations to financing agents of over BRL 100 billion, as installments and balances were subject to different interest rates in a very high inflation context and subsidized rates were applied on installments regardless of mortgagees' actual payment capacity.

and utterly unfair indirect subsidies that benefitted mostly middle and upper income families. That episode led to the extinction of the National Housing Bank [BNH], its central implementing institution, while funding sources were maintained – SBPE, now regulated and supervised by the Central Bank and FGTS, managed by CAIXA, that took the role of a housing bank.

After a decade of meager housing credit supply, in the early 2000s, an important regulatory change within SBPE promoted the expansion of banks' mortgage portfolios inaugurating another credit and production boom period. While past regulatory flexibility had allowed banks to register FCVS credit already paid off by the government as part of their current housing loan portfolios in order to comply with the 52% obligation, the new rule mandated a gradual deduction, between 2002 and 2006, of those registered FCVS credits[10]. Up to then, banks could comply with SBPE regulation despite having outstanding housing loan portfolio levels much below requirements: just 15% of SBPE's total savings stock in 2002. This alteration constituted a major regulatory driver of the credit boom seen in SBPE since 2006.

Undoubtedly that change was made viable by much more favorable macroeconomic and legal scenarios – stability as a result of curbed inflation, allowing for the reduction of market interest rates, growth of formal employment and household income coupled with other relevant changes to the regulatory framework, mainly the introduction of trust deeds in substitution for conventional mortgages[11]. Housing loans to savings stock levels grew from a mere 15% in 2002, to 38% in 2012. In January, 2015 the SFH/SBPE housing loans portfolio exceeded, for the first time, the 52% mark since the extinction of the BNH, and in December 2016 it represented 56% of total savings/deposits stock. It must be emphasized though, as the next Figure illustrates, that overall numbers do not reveal the important performance differences between private and public banks. Since 2008, private banks have kept quite a stable housing credit to savings stock level of around 40%. During the same period, public banks (notably CAIXA), on the other hand, showed a steep rise from 9% (Dec, 2008) to 68% (Dec, 2016, while in June/2015 it had reached a peak of 76%)[12].

Figure 1 SBPE: Housing Loans X Savings Stock (%)



Data source: Central Bank of Brazil. Percentages reflect SBPE housing loans under the SFH criteria (those subject to the 52% minimum compliance requirement) in relation to the stock of savings.

The different behaviors between public and private banks date back to the early development phase of the SFH: "the takeover of big banks on SBPE, through a series of acquisitions of smaller savings and loans institutions that occurred during the 80s, brought about an increased capacity to collect savings, contrasted by a much smaller willingness to lend long term and at controlled lower rates, showing a clear preference, instead, for short term, more profitable loans" (Aragão, 2007). The last section of this article will return to this discussion.

After the 2008 global financial crisis, government intervention in the housing sector increased as part of an anticyclical policy. Amidst fears of the possible crisis' impacts on the Brazilian economy and particularly on the real estate industry, a 1 million house program (My House, My Life, PMCMV)[13] was launched, based on FGTS[14] funding coupled with budgetary resources for extra subsidies, focusing on moderate and low income families. As a result, FGTS has also significantly increased its housing finance portfolio, from 17% of total assets in 2003, to 40% in 2012, up to approximately 46% in 2015.

Between 2006 and 2014, the increase in mortgage loans and housing production within SFH – FGTS and SBPE – was such that it even aroused suspicions of a housing bubble[15]. Prices have started decreasing as the economic recession developed, but so far default rates remain low – below 2%[16].

This latest credit expansion period was again supported by the traditional deposit system, not based on capital market funding as many had predicted. Together, SBPE and FGTS currently exhibit a housing loan portfolio of over BRL 500 billion while holding around BRL $1 trillion in funds with almost equal sums of approximately BRL $500 billion each[17]. The next section will discuss the growth trajectory of SFI.

3. Creating and fostering a system based on capital market – SFI

In the 90s, as inflation was finally curbed[18] but housing credit within SFH[19] remained tightly restricted, as an aftermath of the 80s crisis, SBPE participating banks and other financing agents proposed ending earmarked credit

[10] FCVS credit had accumulated in banks' balance sheets as a result of the mismatch created during the 80s. Of credits held by banks, even those already paid off by the government, were kept registered to comply with earmarked regulation.

[11] After its enactment in 2000, the trust deed quickly substituted conventional mortgages due to the significant decrease in time and costs compared to the traditional judicial foreclosure process mortgages were subject to.

[12] Amongst SBPE banks, CAIXA held the majority of remaining FCVS' credit. Also, it received a strong governmental mandate, after 2009, as part of the anticyclical measures, to expand housing credit under both SBPE and FGTS.

[13] PMCMV soon ballooned to 3 million units up to 2016. The new government has recently announced the addition of 610 thousand units.

[14] The federal government occupies half of the seats in FGTS Trustee Committee [CCFGTS], and holds its presidency and the casting vote.

[15] See Magalhães Eloy & Cagnin, 2014, article for a discussion on the suspicion of a housing bubble in Brazil.

[16] 1.44% in December 2016. https://www3.bcb.gov.br/sgspub.

[17] BRL 501 billion in Dec.2015, under SFH's limits/criteria. BRL 288 billion from SBPE funding and BRL 213 billion from FGTS.

[18] After the "Real" Plan of 1994.

[19] While between 1980 and 1982 SBPE financed 787 thousand units (an average of 262 thousand per year), from 1983 until 2001 SBPE financed an average of 47 thousand units per year. In 2001, only 34 thousand units were financed throughout Brazil.

regulation on SBPE and creating a new system – the Real Estate Financing System [SFI] – comprising the legal framework for the creation of mortgage backed securities (here called Real Estate Certificate of Receivables, CRI) and REITs (Fundo de Investimento Imobiliário, FII). MBSs were regulated inspired by the robust American secondary market, amidst the belief that the time had come for Brazil to inaugurate a new era of real estate finance by tapping into the capital market. SFI was expected to replace, rather than complement SBPE.

Yet, although some of the analysis and proposals regarding the establishment and development of SFI recognized the necessity of a transitional phase due to difficulties involved in creating a market for real estate securities and called for measures that would mitigate risk and enhance liquidity[20], apparently, it was not foreseen how difficult it would actually be to create a market for MBSs in Brazil. Among the measures, fiscal incentives (income tax exemption) were extended to MBS [CRIs] thus levelling them, in terms of fiscal benefits, with SBPE's savings accounts for private individual investors, although interest rates paid remained diversely referenced.

Another set of stimuli for the development of the SFI were introduced within SFH's regulation as early as 1997, allowing for any type of MBSs purchased by SBPE participating banks to be counted towards meeting the 52% housing loans compliance[21]. Also, the extra 13% requirement for housing loans contracted at market rate were expanded to include any type of real estate credit (not just housing)[22].

As FCVS past credits could no longer be used for compliance purposes and private banks achieved housing loan portfolios of around 40% of SBPE's savings[23], they started purchasing MBSs to comply with the remainder to meet the 52% minimum requirement. In December 2008, private banks held around BRL 5 billion of MBS in their balance sheets. Seven years later, in September 2015, that figure had risen to BRL 34.4 billion, which was equivalent to almost a third of SFH housing loans portfolio held by private banks – at that time of BRL 92.5 billion[24] – and 57% of the total stock of MBSs then registered in the country (BRL 60.6 billion). In 2016, while the overall stock of MBSs registered amounted to 73.6 billion, SBPE banks held BRL 31.6 billion (43%) of those securities in their balance sheets, of which BRL 31.1 billion were held by private banks, as mentioned, for housing loan regulatory purposes "in lieu" of housing loans.

Banks have either bought MBS which originated from other banks within the SBPE System or have securitized their own real estate portfolios and bought them back in the form of MBS and in both cases have done so to register them to fulfill SBPE's 52% housing credit requirement. A good example of this latter strategy is a big securitization operation performed by Itaú, one of Brazil's biggest banks[25], in 2013, when BRL 4.4 billion of its credits were securitized and BRL 3.3 billion of total MBSs generated were bought back by the same Itaú. Two other big securitization operations in that year followed the same pattern (CETIP, 2016). With that type of operation, a real estate loan at market interest rate (therefore outside SFH's criteria[26]) when transformed into a MBS and bought back could be counted towards the 52% credit obligation, leaving cheap funding free for other (more profitable) loans. That is precisely how banks have kept the housing loan to SBPE savings' level below the 52% mark, and still achieved regulatory compliance. Moreover, that strategy has boosted the issuance of MBS, without really developing a market for those securities, since they are kept in SBPE's banks portfolios.

The stimulus went further: in 2005, a multiplying factor was introduced in SBPE's regulation, allowing banks to register RMBSs originated from other banks' credit portfolios for 20% more than their value. It was said that the multiplying factor would foster the issuance of Residential MBS, since only a very small portion of overall MBS were residential. Yet, it did more to enhance banks' compliance at the expense of expanding housing credit supply. The multiplying factor was extinguished in June 2015[27].

Throughout the last decade, real estate securities have filled part of private banks housing loan requirement obligations, thus reducing the potential of savings to supply new credit at regulated lower rates and promote greater expansion of the housing sector[28]. Despite having been justified by the need to stimulate the development of mortgage securities, SBPE's regulation have ended up undermining, not expanding, overall housing finance. Also, aside from helping boost the volume of issuance of MBS, they have not promoted negotiations of these securities in the Brazilian secondary market, nor have they expanded investors' base. Notwithstanding all those efforts, the growth of MBS over almost two decades remains disappointing – a stock of BRL 73.6 billion – falling quite short relative to other funding, as well as negotiations in the secondary market that amounted to BRL 8.3 billion throughout 2016[29].

The convoluted interaction with SBPE and the high volume of mortgage contracts originated which are indexed by the TR (not an inflation rate) have contradictorily limited the development of MBS. Moreover, the small size of the Brazilian secondary market contributes significantly to hamper the liquidity of those securities while the high real interest rates still paid by treasury bonds are another major factor that explains the slow and timid growth of MBS in Brazil[30]. A quick look at figures of the overall real estate security market suggests that it is still very much concentrated and under-developed[31]:

In 2015, 31% of investors of new placements were the credit providers; 70% of credit providers were developers[32]; out of 45 securitization companies that have been registered[33] since 1999, only 19 were operating in 2015, of which 5 were responsible for 82% of total MBS' issuance[34].

In 2016, out of the 18 securitization companies that issued MBS, Cibrasec was responsible

[20] Caixa/FINATEC, 2002.

[21] Later, the purchase of shares in REITs was also included as countable.

[22] Before 1997, SBPE funding was earmarked entirely for housing loans – 56% under SFH criteria and 14% at market rates, therefore channeling a total of 70% of savings to housing credit. Resolution 2458/1997 allowed for real estate mortgages to share the 14% compliance at market rates, later reduced to 13% (Resolution 3005/2002).

[23] Private banks have generally held around 50% of total SBPE's savings, lately around 47%.

[24] Public banks did not need to use the same strategy, because government, since 2009, has made them expand housing loans.

[25] Total assets of BRL 1.2 trillion in March, 2016.

[26] SFH's criteria comprehends a cap of 12% on annual interest rate and house price limits.

[27] RMBS registered up to that date can still be counted by 1.2 times its value until the end of their terms.

[28] SFH regulation established a maximum 12% per year rate on its housing credit. Please refer to Figure #3 for a comparison of interest rates amongst different types of credit.

[29] A fall from 2015, when negotiations totaled BRL 9.2 billion. Considering negotiations that took place at least 180 days after issuance. Anuário Securitização e Financiamento Imobiliário UQBAR 2017, p.114. (www.uqbar.com.br).

[30] Others include procedural issues, such as the bureaucracy of notaries and lack of standardization of contracts, but there have been improvements to those over the years. Others are more structural and remain unresolved: high real interest rates and the competition of TBs; the "low appetite" of institutional investors, as well as the origination under the SFH indexed by the TR, which is not a price index.

[31] UQBAR, 2016 (pages 94-104).

[32] Construction companies and financing institutions account for 11% and 15% respectively.

[33] At Comissão de Valores Mobiliários, CVM.

[34] RB Capital and Cibrasec together accounted for approximately 44% of total securities' placements in 2015, and for 41% of all accumulated placements.

for 65% of volume issued, 64% of real estate securities were issued at below market rates (TR) and had a single main buyer – FGTS.[35]

In addition, according to UQBAR (2016, p.90), the degree of information transparency still lack important advances in timing, form and content – quarterly reports are disclosed 1 month late, delaying for up to 4 months, information on delinquency; format imperfections hinder evolutionary temporal analysis and consolidation of data – thus also constituting an important obstacle for the development of MBS.

As banks started restricting housing credit again, the Central Bank introduced new SBPE's regulation[36] banning not only the use of the multiplying factor on RMBS but also the use of MBS for compliance purposes. From June 2015 on only RMBS purchased, which originated from loans within SFH criteria, could be counted toward meeting the 52% housing loan requirement (before that, securities backed by any type of mortgage credit were allowed). Nonetheless, MBS already in banks' balance sheets can remain counted until the end of their terms and thus will substitute the supply of housing mortgages until fully amortized[37].

It must be noted that back in 2010, SBPE's regulation was altered to forbid securities which originated from corporate rentals to be counted towards housing loan requirement obligations. Back then those types of securities represented 59% of total real estate securities, totaling BRL 4.4 billion. By 2015, they had fallen to BRL 1.5 billion, corresponding to 13% of that market and in 2016, BRL 1.7 billion or just 8.9%. Since then, MBS have prevailed, suggesting that issuance of real estate securities is much influenced by SBPE's regulation, which means that demand for them has been largely defined by banks strategic interests instead of typical market dynamism.

Therefore, the impact of the most recent regulatory restriction on the use of MBS within SBPE on the securities market is yet to be seen. Will it stimulate the issuance of RMBS? Will it reduce the issuance of other types of mortgage securities as happened with corporate rentals after 2011? ANBIMA (2015) believes that this change may, at first, lower MBS issuance levels, but it will be positive because in the long run they will resemble actual capital market instruments.

RMBS issuance had been generally limited in the Brazilian securitization market[38]: BRL 4.4 billion in 2014 out of a total of BRL 15.5 billion of mortgage securities issued (28%); BRL 1.9 billion out of a total of BRL 9.5 billion in 2015 (20%). Yet, in 2016, they prevailed in terms of volume: RMBS increased to BRL 11.4 billion out of BRL 16.1 billion in total real estate MBS issued, reaching 70% and suggesting this movement may be influenced by regulatory changes within SBPE.

Last, but not least, FGTS funding has also been channeled to the purchase of RMBS. In 2014, 89% (BRL 3.6 billion) of RMBS placements had underlying credits provided by CAIXA and roughly half of them were bought by FGTS[39]. In 2015 FGTS purchased 9% of all MBS, almost half of all RMBSs placements in that year and totaled BRL 6.3 billion of its (BRL 458 bi) assets in residential mortgage securities. In 2016, FGTS purchased another BRL 8.9 billion. It must be noted though that RMBS bought by FGTS pay much lower yields than securities priced at market rates, thus creating a diverse class of securities that will have no buyers outside this closed circuit within SFH. The following section will come back to this discussion.

In 2004, another instrument was added to the SFI: the Real Estate Credit Bonds [LCIs][40]. Issued by financing agents with short maturities (between 2 and 24 months) and remuneration close to the reference rate[41], those bonds have shown a much faster increase than MBS – from BRL 5.7 billion in October 2006 to BRL 189 billion in October 2016. Amongst fixed interest investment options, the LCI appears as the second preference amongst investors[42], with a total of 898 thousand investors and an average ticket of BRL 110,000.00[43]. The fiscal incentive (income tax exemption) as well as the coverage by the guarantee fund [FGC][44], advantages traditionally offered by "poupança" [SBPE], coupled with the fact that these bonds are issued by few very large banks and yields are referenced on the DI[45] can explain most of the steep rise of the LCIs in recent years[46]. Also, Real Estate Investment Funds have increasingly invested on LCIs.

However, despite having been created to provide an alternative funding source for the real estate credit market, analyses suggest that, in fact, notably amongst private banks, LCIs[47] have not been used to expand real estate credit portfolios. Its short term characteristics impose asset and liability mismatch risks. Additionally, despite LCIs significant growth and potential, SBPE's regulation maintains its 1997 rule earmarking a portion of savings to market rate real estate loans, funded by savings'cheap funding. This allows the real estate market to access subsidies from the housing finance system and consequently limits the expansion of mortgage bonds and securities that perform at market rates as funding for mortgages.

In January 2015[48], a national version of covered bonds, the Guaranteed Real Estate Bond [LIG] was enacted. Its underlying asset portfolio may be composed of real estate loans (minimum 80%), treasury bonds and derivatives. The dual recourse to be offered by LIGs is expected to lower yields, thus becoming a more accessible fund for mortgages, yet, the risk-adjusted returns will depend upon the level of information transparency[49]. Individual investors (foreign or national) will also benefit from tax exemption on revenues (as with LCIs and MBS). Additional regulation is still pending for LIGs to become operational and the Central Bank has just opened a public consultation to end on April 30th addressing the general characteristics of this new bond, issuance requirements and procedures and underlying asset portfolio requirements. It is estimated that BRL 280 billion in LIGs could be issued by the commercial banks[50], which represents an additional 28% in SFH's funding. However, it is hard at this point to predict how fast it will actually develop as the competition of other bonds are still much relevant, but the expected decline of interest rates suggests that the regulation of LIGs has come in a good moment.

35 UQBAR 2017.

36 Res.4410/2015, Central Bank.

37 Credit originators could deduct loans transferred to security companies at a 1/36 monthly pace. A recent Resolution (4464/2016) has speeded up deduction pace to 1/12 for credits transferred after March 2016. The registering of MBS purchased by SBPE's financing agents for compliance purposes must follow the same rule.

38 Data from www.anbima.com.br and Uqbar2017.

39 BRL 1.7 billion. CAIXA does not need to buy/keep MBSs to comply with the 52% requirement rule, because it has exceeded that mark.

40 LCIs have substituted for the existing LHs (Mortgage Bonds) as the latter only admitted mortgages as collateral while LCIs, Trust Deeds. Trust Deeds are a legal innovation that substituted the traditional mortgage, speeding up foreclosure process and reducing costs.

41 Remuneration offered by LCIs are referenced on Banks Interfinancial Deposits, close to Selic.

42 Only behind Bank Deposit Certificates.

43 Anuário UQBAR 2016.

44 Up to BRL 250,000 per investor.

45 Interfinancial Deposit/Selic.

46 According to UQBAR, 2017, throughout 2016, the issuance of LCIs decreased, signaling the lack of enough real estate credit portfolios to underpin those bonds to supply for investor's demand.

47 LCAs (Agricultural Credit Bonds) on the other hand have indeed increased the supply of new loans, expanding the rural finance market. Different from LCIs, it is subject to credit requirement obligations.

48 Law No.13097.

49 Refer to Anuário UQBAR 2017, p.51.

50 http://www.valor.com.br/financas/4860676/concorrencia-deve-limitar-nova-letra-imobiliaria.

4. Interest rates at SFH and SFI

As already mentioned, the SFH funds are regulated – both on the deposit and credit sides – at below market interest rates. That creates a diverse set of implications which must be carefully considered. On the deposit remuneration side, it may affect the long-term sustainability of these funding sources. Whereas on the credit side, it presents somewhat opposing effects. First, credit supplied at below market rates increases affordability and expands demand, which is paramount to a country such as Brazil, still characterized by inequality and high real interest rates. In the absence of those subsidized rates, demand for housing credit would significantly shrink, therefore limiting the development of the housing market. Second, the very existence of subsidized rates makes it hard to restrict access to SFH credit to families that really need it and limits the development of other sources of funding that function at market rates. The following paragraphs will consider each of these issues.

A decade ago, as the reference interest rate started decreasing in Brazil, fixed interest paid on savings was seen as a cap that limited the reduction of market interest rates. In May 2012, when the reference rate [Selic] was down to 8.5%, the rule regarding interest paid on SBPE's savings account changed[51]. It was established that whenever Selic was equal to or less than 8.5% per year, interest paid on SBPE savings accounts would be equivalent to 70% of Selic, otherwise it would remain the usual 6% +TR, thus assuring a remuneration rate always below market. At the end of that year and early 2013, Selic fell as low as 7.2%, but since then it has regained an upward curve, increasing up to 14.25% between July 2015 and October 2016, now down to 12.25%. The interest accrued by savings accounts was 7.9% in 2015, below the inflation rate of 10.7%[52] therefore producing a negative yield. In 2016, the yield was positive, at 1.9% points above inflation, but still below the real remuneration rate offered by other investment options. The lower returns coupled with the current adverse macroeconomic scenario – economic recession and rising unemployment – have hindered the growth of SBPE's stock. From January 2015 to January 2017, there has been a negative net outflow of funds[53], except for 3 months when new deposits outgrew withdrawals[54]. Nonetheless, SBPE has always been a very popular investment option that still holds an astonishing BRL 511 billion in savings[55] and data shows that since the macroeconomic stabilization (The Real Plan of 1994), SBPE's overall stock has been somewhat stable at around 7.6% of GDP. Even after the last 22 months of negative inflows, in December 2016 this ratio measured 8.2%.

If inflation continues to decrease towards the target of 4.5%, as expected for 2017 and interest rates keep a downward trend, it is reasonable to assume that as the economy picks up, SBPE will again show positive inflows, reversing this recent trend of falling real stock levels. Updated figures regarding deposits and withdrawals seem to signal that trend already – while the net outflow of the 1st semester of 2016 was BRL 34.7 billion, the 2nd semester showed a positive inflow of BRL 3.5 billion. SBPE shall certainly remain a very significant source of funding for housing finance in Brazil.

FGTS, the second pillar of SFH, is compulsory for legally employed workers and bears regulation that severely limits withdrawals, thus assuring a regular and massive accumulation of deposits. Throughout 2015 and 2016, despite the economic recession and raising unemployment, FGTS maintained positive inflows of deposits, although smaller than previous years and declining, of BRL 19.4 billion and BRL8.4 billion, respectively[56]. As mentioned, it remunerates deposits at rates below SBPE´s, of 3% + TR, almost always below inflation rates and for that FGTS has long been the subject of much criticism – it constitutes an unfair burden on account holders[57]. Organized as one fund, its growth exceeds the mere collection of deposits, since it accrues interest both on credit operations[58] and financial investments, which over time has enabled FGTS to accumulate liquid assets of BRL 90.9 billion (December 2015). At the end of 2015, FGTS had total assets of approximately BRL 458 billion.

Due to the difference in interest rates paid on deposits, FGTS allows for the supply of more accessible credit than SBPE. Thanks to income and home price limits imposed on FGTS lending since 2004, it has been able to focus on low and moderate income families and promote the expansion of housing finance at the lower end of the market. Yet, recent developments have threatened both the focus and its financial health. Since 2007, diversification of financial investments within FGTS management, traditionally concentrated on the purchase of treasury bonds, notably the creation of an investment fund (FIFGTS), a real estate investment fund (FII) and the purchase of RMBS, has produced much lower yields – negative 3.1% and positive 2% and 7.6%, respectively, in 2015 – while the reference rate was over 14%. Those opportunity-cost losses end up pressuring credit operations to raise margins, favoring higher spreads that reduce optimal affordability levels. Moreover, in the last couple of months a set of measures undertaken as part of FGTS regulation may put the Fund under stress, endangering its financial health[59]. Amongst them the significant increase in the maximum family income and upper house price limits that can be financed, thus suspending the previous focus and expanding FGTS's credit up market. That was justified by the shortage of credit supply within SBPE banks, which in turn, also justified the increase of SBPE's maximum home price limits, from BRL 750 thousand to BRL 1.5 million[60] (SBPE regulation does not impose limits for family's income).

These recent changes are the result of lobbying by real estate developers who hold high stocks of more expensive properties and are threatened by the overall tightening of SBPE credit by banks. Cheaper credit funded by FGTS is expected to stimulate sales of those units. Their argument that those changes would rapidly boost construction and employment was (again) very appealing to the government. That is somewhat cyclical since it is quite similar to what happened in the late 90s and reflects the difficulties in focusing subsidized lending in Brazil.

Altogether, SBPE and FGTS still account for the vast majority of outstanding housing credit in Brazil, with mortgages at below market rates and indexed by the TR which is not an inflation index. Consequently, they tend to produce a special segment of securities, tailored not to the market, but for specific purposes within the SFH: the demand from private banks wishing to avoid SBPE's housing loan requirements; and, the sale to FGTS. The variety of indexes and spreads amongst MBS issuances is good evidence: in 2015, mortgage securities indexed by inflation

[51] Provisional Measure #567.

[52] IPCA (IBGE).

[53] Difference between deposits and withdrawals within SBPE savings accounts in a certain period.

[54] December on both years and last November.

[55] Stock level at the end of January, 2017. In December, 2014 it was BRL522 billion. For a reflection on cultural aspects of the SBPE phenomena, see Marcos Kohler, 2009.

[56] In 2015, it corresponded to a difference of BRL 14.4 billion between regular deposits and withdrawals plus BRL 5 billion of complementary deposits (LC110). Unfortunately, FGTS' Balance Sheet of 2016 is not yet disclosed and the figure above comes from Anuário Securitização e Financiamento Imobiliário UQBAR 2017 (www.uqbar.com.br).

[57] In August 2015, a Bill was preliminarily approved by legislators (Chamber of Deputies), establishing a gradual raise to interest paid to FGTS accounts from 3% to 6% (always added by the TR), in order to level it with *Poupança*. So far, it has still not passed through the Senate.

[58] Housing, sewage and urban infrastructure loans.

[59] For an analysis on that, please refer to the Merrill Lynch report, Jan, 30th, 2016

[60] FGTS deposit holders have subsequently been allowed to make withdrawals to purchase homes up to that new price limit.

rates of over 10% (IPCA or IGPM)[61] + spreads that varied from 8 to 13% paid much higher rates than those indexed by the TR of just 1.8% + spreads between 6 and 12%[62]. Of all securities issued that year, 59% were indexed by the TR.

In 2016, the TR was 2%, still much lower than IPCA, 6.3% and IGPM, 7.2%. Of all real estate securities issued in 2016 – BRL 17.8 billion – 64.3% were indexed by TR, with a typical spread of 7.7%, paying much lower interest rates than the remaining (not indexed by the TR), most of them (24% of total) around .95% of DI[63]. FGTS was the single investor of classes "senior" and "unica" with the purchase of BRL 8.9 billion of those TR securities, composed of SBPE credits transferred by the major players – CAIXA, Banco do Brasil, Itaú and Bradesco. According to UQBAR (2017, p.98): "those CRIs are structured to the extent that FGTS can purchase them, with no intention to distribute them to the market".

In that scenario, mortgage bonds, notably LIGs, have better chances of becoming significant funding sources for housing finance. Nonetheless, while the country still faces high interest rates and middle and upper income families can benefit from subsidized credit within SFH, it is unlikely that big private commercial banks will be willing to expand their housing credit portfolios[64].

5. Final remarks

The analysis developed in this paper suggests that SFH and SFI should be looked at from a more comprehensive and complementary perspective. It is clear that the two systems need to coexist in order to expand affordability, optimize funding and increase housing credit, finally allowing the country to achieve a housing credit to GDP ratio more consistent with the size of its economy.

Together, SFH and SFI totaled, at the end of 2015, BRL 1.2 trillion in funds, which corresponded to 20% of GDP[65]. The next chart shows the growth trajectory of each funding source during the last decade. It is reasonable to expect overall funding growth as soon as the current economic recession is overcome.

As discussed here, although SBPE has suffered a real decrease in outstanding savings over the last two years, there is no reason to dispute that as soon as the economy recovers, savings accounts will exhibit positive and increasing inflows again. A poll conducted by FGV (2017) shows that the percentage of families planning to withdrawal from savings accounts in February 2017 had fallen to 2015 levels, after reaching a peak on February 2016. FGTS, after all the recent regulatory changes, must be closely monitored, but its compulsory status allows for some predictability. The rapid rise of Real Estate Bonds [LCIs] – an impressive increase of 1.700% above inflation[66] between 2006 and 2016 – indicates they could become a much more relevant source of funding for real estate finance. Yet, their short-term nature, which attracts investors, in comparison to the long-term needs of housing finance suggests that LIGs may be a better substitute if they are so well accepted by investors. Moreover, LIGs have the potential of offering cheaper funding than LCIs, but its regulation needs to be properly designed to ensure qualitative information transparency, enabling for robust evaluation and timely monitoring of its underlying assets.

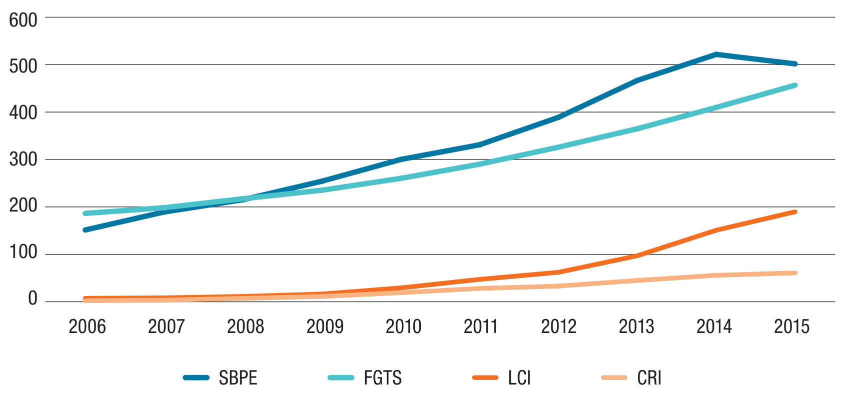
As for RMBS, their prospects are still not clear, as discussed in the previous sections. A lot of factors, beyond SFH – the relatively underdeveloped capital market being the most relevant[67] – still prevent them from playing a significant role in housing finance. Wrongly designed stimuli, notably those created as part of SFH regulation, have not fostered a market for securities or promoted their liquidity, but, instead, have created many distortions: the purchase of MBS by their own credit originators; RMBS based on subsidized, non-market-based loans (cashflows) receive lower remuneration than those underpinned by fully market-based loans; the issuance of RMBS especially tailored for the sale to SBPE banks and FGTS instead of typical capital market investors.

Interaction between systems (SFH and SFI) remains, thus, an important issue requiring properly calibrated regulation designed to avoid the negative impacts discussed in this paper: the underutilization of SFH's funding; the distortions of SFI, with the issuance of MBSs that do not truly resemble marketable securities or of mortgage bonds that do not expand funding for housing finance; as well as the channeling of subsidized credit to families that could qualify for housing finance at market rates.

Also, the interaction of funding within SFH – SBPE and FGTS – needs to be more carefully regulated. The overlapping and gaps in credit supply caused by the previously mentioned recent changes in price and income limits, impact on the overall system´s efficiency in the mid and long run.

The above notwithstanding, the actual channeling of funding into housing loan portfolios still constitutes an important challenge in Brazil. Here, the fact that banks have been able to achieve much greater profits from other types of credit, has historically undermined the supply of housing loans relative to funding potential. The next chart shows the much higher interest rates charged in other credit lines such as consumer credit, credit card and vehicle leasing, illustrating why banks (notably private

Figure 2 Funding for Real Estate Finance – in BRL billion



Source of data: Brazil's Central Bank.

[61] IPCA is the National Consumer Price Index (IBGE) and IGPM is the General Price Index (FGV).

[62] www.anbima.com.br.

[63] UQBAR 2017 (www.uqbar.com.br).

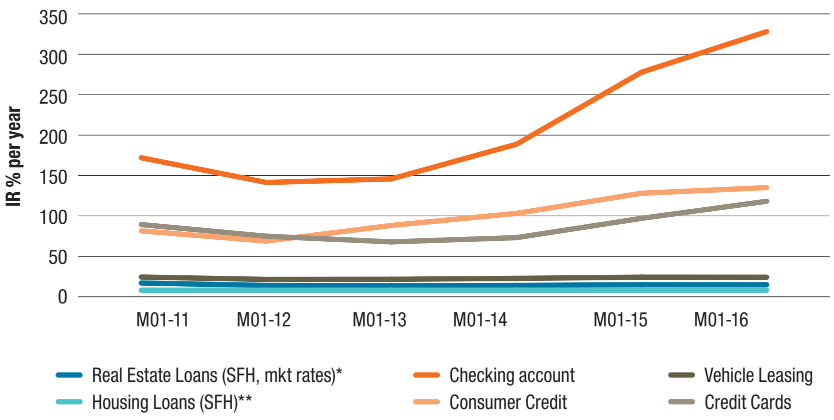
[64] In the rural credit segment, bonds (LCAs) are subject to regulation similar to that of savings that earmark funds for loans.

[65] BRL 5.9 trillion in 2015.

[66] Deflated by IPCA, Central bank.

[67] http://www1.folha.uol.com.br/mercado/2016/11/1828844-credito-caro-e-sinais-de-retomada-fazem-empresas-buscarem-a-bolsa.shtml.

Figure 3 Average Interest Rates for Personal Credit



Source of data: Brazil's Central Bank.

** Real Estate Loans made within SBPE, but contracted at market rates.*
*** Housing Loans subject to SFH rules.*

ones, since public ones are under governmental mandate), have not shown much appetite for housing finance, especially at regulated rates and have always opposed SBPE's housing loan requirements.

Biancarelli and Conti (2015, p.8) agree with that observation and state that "banks and other financial institutions tend to achieve greater profits with short term finance, leaving long term credit behind, especially when markets are deregulated". In this scenario, the interest generally aroused by mortgages as key relationship products in the banking sector is somewhat diminished in the Brazilian financial environment. Also, the concentration of the housing finance market within a small number of players[68] is another important aspect to be considered in credit supply analysis.

The prevailing issuance of MBS indexed by the TR that tend to stay within the SFH circuit (either bought and kept by banks to comply with SBPE regulation or by FGTS) causes market distortions. They inflate the stock with mortgage backed securities that do not correspond to actual capital market instruments.

On the demand side, the availability of cheaper credit within SFH – SBPE and FGTS – hinders the development of funding sources for mortgages based on capital markets and market interest rates. Higher income families, high end entrepreneurs and commercial private banks keep pressuring the government to deregulate SFH's subsidized system[69]. The recent increase in income and house price limits exemplifies this ongoing tension. Yet, on the other hand, until the reference interest rate lowers to levels found in developed countries it would be quite difficult for Brazil to manage its housing finance market without SFH funding at below-market rates – SBPE and FGTS. Not only does it still provide major funding, but also strategic funding in terms of affordability, allowing for significant credit expansion at the lower end of the market[70]. Therefore, contrary to what some have argued,[71] even if the SFI were more developed, Brazil could not, at this point, dispense with the regulated SFH without significantly shrinking demand, preventing a great proportion of families from qualifying for housing credit.

This article has tried to show that there are regulatory and structural issues that have worked against a more efficient use of SFH as well as against the development of SFI, hindering the potential offered by both systems. The issues debated here should not be left unaddressed, for they impose obstacles to the overall development of the country's housing finance market and housing sector. Brazil could most certainly benefit from improvements and adjustments that would better align its two systems. In order for that to happen, the traditional SFH and the capital market based SFI should be looked at as complementary systems. The former is key to expanding credit at the lower end of the market and the latter, to increasing overall funding and supply of real estate credit, notably through bonds.

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[68] There are 19 savings and loans agents operating in SBPE, of which only 6 are present in all 27 states (including DF) and 5 big commercial banks are the main players: the private Bradesco, Itaú and Santander; and, the public ones, CAIXA and Banco do Brasil.

[69] As mentioned previously, the income limit to access FGTS loans has just been raised to BRL 9 thousand (it was BRL 6.5 thousand) and homes which can be financed by SBPE have just had their price limit raised from BRL 750 thousand to BRL 950 thousand and soon afterwards, to BRL1.5 million.

[70] For an analysis on expansion at the lower end of the market please refer to Magalhães Eloy 2015.

[71] Arida (2005), ABECIP (2016).

Mexico's contornos: including location criteria in housing programs

↳ By Arthur Acolin and Haim Kichik

1. Introduction

In recent decades Mexico has experienced a slowdown in population growth (from 1.6% a year in the 1990s to less than 1.2% between 2010 and 2014) and has largely completed its urban transition. Nonetheless, housing needs remain pressing, particularly in urban areas. Mexico has Latin America's second largest population after Brazil and almost 80% of its more than 120 million residents live in urban areas as of 2014. This compares to less than 40% in 1960. With over 20 million residents, Mexico City metropolitan region is one of the ten largest urban agglomerations in the world and the second largest in Latin America after Sao Paulo. In addition, two metropolitan regions have more than 4 million residents and another eight more than 1 million.

The combination of a highly-urbanized population and large urban agglomerations creates specific quality and affordability housing challenges. Mexico's overall housing deficit is estimated to remain at over 10.1 million units as of 2014, representing 31% of the housing stock (MCS, ENIGH, INEGI 2014).[1] As shown in Table 1, most of the deficit is qualitative (9.3 million or 92%), as many units are made of substandard construction (lack of flooring), lack access to basic urban services (electricity, water) or don't have formal property titles.[2] A substantial number of families also live in overcrowded conditions or do not form households due to the difficulty to obtain housing, forming the 0.8 million of units that are part of the quantitative deficit.

Table 1 Component of the housing deficit

DEFICIT	CONCEPT	HOUSEHOLDS
Quantitative	More than 1 household per dwelling	559,362
	Improvised dwelling	207,611
Qualitative	Roof	642,796
	Wall	336,782
	Floor	966,417
	Overcrowded	1,622,666
	Water	2,490,306
	Sewage	1,926,718
	Electricity	246,526
	Tenure	5,733,831

According to Rojas and Medellín (2011) pp.25 here: http://bit.ly/2gxpTaA

Source: MCS, ENIGH, INEGI 2014

** Double counting*

Mexico has made substantial progress in reducing the scale of the housing deficit in recent decades. The number of households increased by over 8 million between 2000 and 2014 (a 33.8% increase) but the housing supply response was such that the housing deficit decreased as a share of the housing stock. The increase in the provision of adequate housing has been supported by the expansion of housing finance, with mortgage outstanding increasing from 6.7 to 9.7% between 2000 and 2014 (Banxico) and by active governmental support through different subsidy schemes.

Over the last two decades, Mexico's housing policy has contributed to substantive progress towards providing decent, affordable housing for all Mexicans. The development of new housing programs that combine funding for mortgages to low and moderate income households from the provident funds Infonavit and Fovissste and upfront subsidies provided by the National Housing Commission (*Comisión Nacional de Vivienda* or CONAVI) have enabled the provision of new housing units for households earning less than 5 minimum wages. Between 2007 and 2013, the upfront subsidy provided by CONAVI contributed to the financing of about 20% of the formal unit built during that period (CONAVI 2015). Several iterations of the subsidy programs have resulted in the introduction of a location criterion in the eligibility criteria for the subsidies (the contornos). This innovation took place in response to the unsustainable rates of default and vacancy experienced in previous generations of the housing programs. The recognition of the need to combine the housing program with some location criteria is of importance for subsidized housing programs internationally as many countries have struggled with delivering affordable housing in desirable locations (with access to employment, urban services such as health and education and retail). This article briefly reviews the history of affordable housing programs in Mexico and how the introduction of the contornos became a necessity. It then analyzes the implementation of this scheme, the impact it had on the subsidized housing market and how it could be transposed to other countries.

[1] This definition of the deficit is based on the concept adopted by the Interamerican Development Bank in Rojas and Medellín (2011).

[2] The main component of the quantitative deficit is the lack of title that affects 5.7 million households. Without that component, the quantitative deficit declines to 5.7 million instead of 9.3 million, and combined, the quantitative and qualitative deficit represent 20% of the stock. Land title programs have not been a priority of Mexico housing policy in recent years and the lack of titles remains a barrier to the development of mortgages for existing properties.

2. Brief history of Mexico housing policy: from supply-side to demand side subsidies

Throughout the 20th century, Mexico experienced the growth of communities built through self-construction, without permits and often with limited access to basic infrastructure (water, electricity, sanitation) and transportation. This was the result of rapid population growth concentrated in urban areas and insufficient formal construction, in part due to the unavailability of funding for housing and infrastructures. In response to these housing needs, particularly in Mexico City and other large cities, the national and local governments have developed social housing programs with a focus on providing new houses over housing improvements.

Article 123, paragraph XII of the constitution of 1917 includes a provision that companies of more than 100 employees assist them in gaining access to decent housing. Early housing programs originated with large private and public companies directly providing housing to their workers going back to the 1910s and expanding in the 1920s and 1930s (Arteaga and Martinez 1997). These programs were progressively replaced by federal and state programs, but the public entities in charge of housing maintained a focus on directly providing housing rather than developing the private sector with limited results (Peralta 2013). Peralta (2013: 38) estimates that in the 1950s, while the housing stock increased by 1.1 million, publicly funded units were only 53,600 (less than 0.42% of the total), mostly rental units built in Mexico City in the form of large housing estates of several hundred units.

Options to provide access to ownership replaced programs for social rental housing in the 1960s and 1970s. In 1963, as part of the Programa Financiero de la Vivienda [PFV], the federal government created the Fondo de Operación y Descuento Bancario a la Vivienda [Fovi] to provide funding for financial institutions. Fovi later became the Fondo de Operación y Financiamiento Bancario a la Vivienda and was incorporated into Sociedad Hipotecaria Federal [SHF] based on the 2001 law establishing SHF. Between 1961 and 1972, Peralta (2013: 40) reports that public programs were responsible for 233,400 units (124,400 financed by Fovi), representing 10.7% of the 1.9 million units built during that period.

In 1972, the Instituto del Fondo Nacional para la Vivienda de los Trabajadores [Infonavit] and the Fondo de la Vivienda del Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado [FOVISSSTE] were created. Infonavit receives contributions from employers that correspond to 5% of all formal private workers' salaries and FOVISSSTE receive the same for public workers' and the funds are allocated for financing housing. These public funds have established themselves as the primary sources of funding for mortgages with Infonavit becoming the largest housing finance institution in Latin America (Herbert, Belsy and DuBroff, 2012). Combined, Fovi and Infonavit supported about a quarter of the provision of all housing built from the 1970s to 2000. Between 1971 and 2000, the public entities (Infonavit, Fovi, FOVISSSTE and other organisms) supported the production of 5.4 million units, or about 40% of the 13.7 million houses built during that period (Peralta 2013: 47) with the rest mostly built incrementally and informally without using housing finance (Monkkonen 2011a). Infonavit alone was responsible for the construction of over 2.1 million units, 15.5% of all new housing built between 1971 and 2000 and Fovi of 1.2 million or 8.7% (Peralta 2013: 47).

Infonavit and Fovi remained the main sources of housing finance through the 2000s, despite attempts to liberalize the housing finance sector and develop private lenders in the early 1990s. This position was reinforced after the 1994 financial crisis that particularly affected private lenders. Infonavit's importance in the mortgage system was further strengthened with its evolution from building and financing the units to focusing on the provision of mortgages to households (Monkkonen 2011a).

Critics point to the fact that the housing units built through Fovi, Infonavit and FOVISSSTE, particularly during the 1990s, tended to serve mostly upper middle class households with formal income rather than low and moderate income households with informal employment (Peralta 2013; Monkonen 2009). The latter remained reliant on incremental self-building and did not have access to financing (Peralta 2013; Monkonen 2009; Monkkonen 2011a). For instance, in the 1990s, 77% of mortgages funded by Infonavit went to households earning more than twice the minimum wage (Peralta 2013).

Other programs, focused on the direct provision of housing such as the Fondo Nacional de Habitaciones Populares (Fonahapo) created in 1981 and state level programs tended to focus more on lower income households (Arteaga and Martinez 1997; Cano Soriano 2007). These programs directly built housing and delivered them to lower income households but require a high level of public funding per unit and have been prone to mismanagement and waste.

Since the early 2000s, Mexico's housing policy has evolved from acting on the supply side, with governmental entities directly funding the construction and management of housing to demand-side subsidies allocated directly to the end users, the benefiting households. This evolution was supported by World Bank funded programs and a similar evolution has been accomplished or is underway in many other countries, including a number of Latin American countries (i.e. Chile, Colombia, Brazil, Argentina) (Schwartz 2010; Monkkonen 2011a). The shift towards demand side subsidies to support access to housing was accentuated by the implementation of an upfront subsidy provided by CONAVI after 2007 for eligible households earning up to five times the minimum wage.

3. New houses and location constraints

Mexico experienced a substantial improvement in housing conditions in the 1990s and 2000s. As shown in Table 2, between 1990 and 2010,

Table 2 Share of household living in units built with durable material and access to infrastructures

	DURABLE MATERIALS* (%)	INFRASTRUCTURES** (%)	DURABLE MATERIALS AND INFRASTRUCTURES (%)
1990	60.4	44.7	37.5
2000	71.5	54.8	46.8
2010	82.0	67.9	61.5

* Durable Materials: Floor made of cement or other finished durable materials; Roof made of masonry, concrete, clay tile, or tiles of unspecified type, metal or asbestos sheets; Walls made of brick, cement, stone, metal or asbestos sheet.

** Infrastructure: Electricity; Connected to sewage system or septic tank; Access to water within unit.

Source: IPUMS

the share of households living in housing units made of durable materials and with access to basic infrastructure increased from 38 to 62%. The increase was particularly large in the 2000s increasing from 47 to 62% through combining improvements in the share of the population living in houses made of durable materials (82% in 2010) with access to infrastructure (68% in 2010) (IPUMS 2015). These improvements were made possible by a conjunction of factors including a slowdown in population growth and the recovering economy in the aftermath of the 1994 crisis. The increasing access to mortgages and the increasing share of houses built through large scale developers also certainly contributed to improving housing conditions.

The increase in mortgages issued during the 2000s and early 2010s contributed to increasing the ratio of mortgage balances outstanding to GDP from 6.7% in 2000 to 9.7% in 2014. The 2000s increase in the mortgage supply took place through Infonavit and Fovi then SHF as well as through specialized lenders that appeared in the 1990s (the Sofoles). The Sofoles played a substantial role until the financial crisis of 2008 that reduced their access to capital and resulted in the failure of a number of major Sofoles. Between 1997 and 2004, the number of retail mortgages offered by Infonavit increased from 99 thousand to 300 thousand and further increased to 396 thousand in 2015. Fovissste also experienced a substantial increase in retail mortgages offered. In total, the number of mortgages originated by Infonavit, Fovissste, the Sofoles and commercial banks almost doubled between 2004 and 2014 from 466,000 to 926,000. Infonavit remains the main source of mortgages for lower to middle income borrowers, holding 59% of all loans outstanding as of 2015. Following the decline of the Sofoles after the 2008 crisis, there has been a lack of private lenders serving that segment of the market.[3]

The mortgage markets continue to evolve, with Infonavit making the transition in 2015 from issuing mortgages indexed on minimum wages to issuing 15 to 25-year fixed rate mortgages in pesos similar to those issued by private lenders. In addition, improvement loans and mortgages for existing homes became more common during that period. Improvement loans increased from representing 14.3% of mortgages originated in 2004 to 38.4% in 2014 while mortgages for used homes went from being virtually non-existent in 2004 to representing 17.9% of origination in 2014.

In addition to the growth in the mortgage market by public and private lenders, the 2000s saw the development of new subsidy programs by CONAVI[4]. These programs aim to facilitate access to mortgages for purchase and home improvement by those with incomes up to five times the minimum wage. Between 2007 and 2015, CONAVI provided 1.7 million upfront subsidies in total (190,000 subsidies a year on average). Of that total, 62% of subsidies went to the purchase of new houses, 30% to finance improvement and 7% to purchase existing homes. Compared to previous programs that directly financed developers or built houses, CONAVI's upfront subsidy program provides the subsidy directly to the households. Based on their preferences, eligible households have the option to use subsidies for the purchase of a new or existing house, for self-construction, or improvements but they face income constraints on purchasing new housing in desirable locations. The subsidies cover on average 20% of the cost of purchases and 40% of the improvements and combined with household saving and a loan from the financial sector enable households with less than three times the minimum wage to represent about three quarters of beneficiaries (CONAVI 2016). The design of CONAVI's subsidies leverage financial sector resources to limit direct expenditure of public funds and make the program more sustainable. At the same time, the depth of the subsidies and the development of different types of subsidies enable it to reach lower income households than previous programs.

The development of the mortgage market combined the introduction of upfront subsidies by Conavi contributed to a substantial increase in the number of formal units built and to the improvement in housing condition reported above (Monkkonen 2011a). However, the production function that emerged to serve that public resulted in housing developments built on the periphery, with limited access to jobs and services and sometimes with poor construction quality.

The demand side subsidies and the development of a broader range of mortgage products available to lower and middle income households are developments that supported the production of formal housing and the improvement of existing housing. CONAVI aimed to design its subsidy as an improvement over previous programs by providing a more flexible set of solutions and enabling households to obtain housing solutions that meet their needs. However, the production system that emerged to respond to the demand generated by the conjunction of CONAVI subsidies with Infonavit mortgages had characteristics that created a number of issues and resulted in high default and vacancy rates by 2010.

The stable demand of households with the ability to purchase houses within a set price range contributed to the emergence of a concentrated real estate development industry. As of 2010, 44% of formal housing units were produced by the top 10 developers (RUV 2015). These large developers produced developments with thousands of units based on standard construction plans. Communities with homogenous designs were built across the country and represented a large share of the units produced for CONAVI/Infonavit households. The developments were planned only for residential uses and lacked retail capacity However, residents have incrementally adopted and expanded their units to accommodate commercial activities (Monkkonen 2011b) addressing one of the limits to this mass production of residential units. However, these developments were not all built according to the quality standards expected by Infonavit and due to their location, they sometimes lack connection to services (electricity, water, gas and sanitation) for months or years due to the cost of extending the trunk infrastructures (Monkkonen 2014).

The location and quality of the units contributed to elevated levels of default and vacancy. Newspaper and academic accounts (Sánchez and Salazar 2011; Monkkonen 2014; OECD 2015) provide evidence that households who purchased some of the new units never moved in or moved out after a few years due to structural issues, lack of connection to basic infrastructure or difficulty in accessing jobs and public services from the development. As of 2010, Monkkonen (2014) estimates that 16% of units in peri-urban areas were vacant and 14% overall in Mexico. The vacancy rate is high compared to an international average of 10% reported by Monkkonen. This is a particularly high rate of vacancy for areas that are mostly made up of new construction and would be expected to have above average occupancy if adequately built and well located. The vacancy rate even reaches over 20% in some of the Northern cities that have received a disproportionate number

[3] See Monkkonen (2011a) and OECD (2015) for a more detailed discussion of the role of Infonavit and Fovissste in the evolution of the Mexican mortgage market.

[4] CONAVI was create in 2001 as the Comisión Nacional de Fomento a la Vivienda (CONAFOVI) and became the Comisión Nacional de Vivienda in 2006. Originally reporting directly to the president, CONAVI is now integrated into the ministry of rural, territorial and urban development (Secretaría de Desarrollo Agrario, Territorial y Urbano or SEDATU). It is the organ in charge of housing policy and of the administration of the direct subsidy program.

of subsidies (Juarez, Nuevo Laredo, Reynosa) as reported by the OECD (2015). The CONAVI/Infonavit programs are certainly not the only ones responsible for the high vacancy rate that is also substantial in central areas (Monkkonen 2014). In addition to housing finance policy, Sánchez and Salazar (2011) identify three other factors that can contribute to the elevated vacancy rate observed in 2010: the recession that followed the 2008 financial crisis, emigration to the US and localized violence.

In addition to elevated vacancy rates, the location and quality of the units have been linked to the high level of non-performing loans in these projects. Overall, Infonavit reported 8.1% of its outstanding mortgages as being in default as of September 2016, (Infonavit 2016) and 5.7% as being in Prorroga[5]. That means that in total, 13.8% of loans are not performing. The rates are even higher among loans that were originated prior to 2011.

The OECD (2015) attributes some of the vacancy and default to the focus on providing access to mortgages for relatively low income household to the expense of the development of a robust rental sector that might serve this population well. The report also points out the role of a model of houses produced at a large scale on large land parcels *"far from city centers and disconnected from urban services and infrastructure"* (OECD 2015: 18). This situation is made worse by the fact that in many instances the contractual obligations to connect these developments to infrastructure, including water, sanitation and transportation infrastructure were not fulfilled. In response to this situation, CONAVI modified its subsidy program as discussed in the next section and Infonavit adapted its business model by offering more loans for improvements, extending financing for rental housing and encouraging developers to build multi-family projects more centrally located.

4. The introduction of location criteria: a step towards integrated housing programs

In 2011, CONAVI introduced spatial criteria that restricted eligibility for subsidies to areas included within the perimeters of concentric areas around the city center, the *Perímetros de Contención Urbana or contornos*. The contornos were a response to the high levels of vacancy in new developments partly financed with subsidies and to evidence about the cost for national and local governments of providing trunk infrastructures and services to these peripheral developments (OECD 2015; Kim and Zangerling 2016).

The introduction of location criteria in housing subsidy programs recognizes that in order to improve living conditions, providing new housing, even with minimum construction standards might not be enough. The physical characteristics of a unit matter to its residents. Studies provide robust evidence that houses built with durable roofs, walls and floors can have a series of positive effects on their residents. For instance, Cattaneo et al. (2009: 75) find that in Mexico, a housing improvement program that replaced dirt floors with cement floors had large positive effects on children's health: *"decreases in the incidence of parasitic infestations, diarrhea, and the prevalence of anemia, and an improvement in children's cognitive development."* It also contributed to improving the welfare of adults as measured by increases in satisfaction with their houses and quality of life and lower levels of depression and stress. But while building quality matters, the accessibility to infrastructure, services and employment also has important welfare implications.

The location of housing developments targeted to recipients of CONAVI subsidies and mortgages from Infonavit and other public lenders matters. Attention to location characteristics is necessary to ensure that new residents have access to opportunities and find amenities within their community, contributing to the positive economic and welfare impact of the overall housing policy. As noted above, a number of developments built beyond the existing urban boundaries were not connected to the infrastructure networks (roads, electricity, water sewage) or it took time and was costly to do so. In addition, access to jobs from these developments often requires substantial commute time and the use of an individual mode of transportation, contributing to the increase in car usage and environmental pollution (Guerra 2015). Looking at Sao Paulo Metropolitan Region in Brazil, Acolin and Green (2017) find that even in cases in which housing is affordable, the monetary and time cost of commuting can result in households spending over 45 percent of their income on housing and transportation combined.

Kim and Zangerling (2016) report estimates comparing the costs of providing infrastructures (roads, drainage, water and electricity) under different urban expansion scenarios. The estimates under a more compact urban development plan are estimated to be 67% lower for the cost of developing and maintaining infrastructures in Los Cabos and 41% lower in Merida compared to the current forms of development. There is therefore an incentive for local governments, who are in charge of financing local services, to support more compact urban forms.

Prior to 2011, the design of the CONAVI subsidy program and Infonavit business model contributed to the supply of new developments far from the city center. The flat amount of subsidies regardless of the location of the projects provided an incentive to locate projects where land costs were minimal, that is on the fringe of urban areas. The fixed administrative costs to meet the program requirement incentivize large developers and large projects to recoup the costs. The introduction of the contornos after 2011, with the definition updated in 2013, provided a substantial step to address these issues. It falls within the goals established in the 2014-2018 National Urban Development Program (Programa Nacional de Desarrollo Urbano) that call for actions to improve the environmental and economic sustainability of cities, reduce urban sprawl, and increase city compactness, mobility and connectivity.

There are three contornos that are eligible for different amounts of subsidies and areas outside the contornos are not eligible to receive subsidies. In the definition of contornos updated in 2013, the most central contorno (U1) is defined based on employment density (areas with at least 250 jobs and a higher share of jobs than residents relative to the city average). The second ring (U2), is made of areas with at least 75% of residents with access to water and sewage as a proxy for access to infrastructure and services. The last ring (U3) is defined as a buffer expanding out of U1 and U2 of 500 to 900 m depending on the size of the agglomeration. The contornos are updated yearly using objective census data for 384 urban areas with more than 15,000 residents that form the national urban system (Sistema Urbano Nacional) (SEDATU 2015).

Figure 1 shows the contornos in Mexico City and Nueva Laredo as defined in 2015. It shows the discontinuity of the urban fringe in the case of Mexico City and the impact of the border in Nuevo Laredo. The standard and objective definition of the contornos for all urban areas of more than 15,000 residents required investing in the development of a geodatabase that can provide information about the eligibility for the

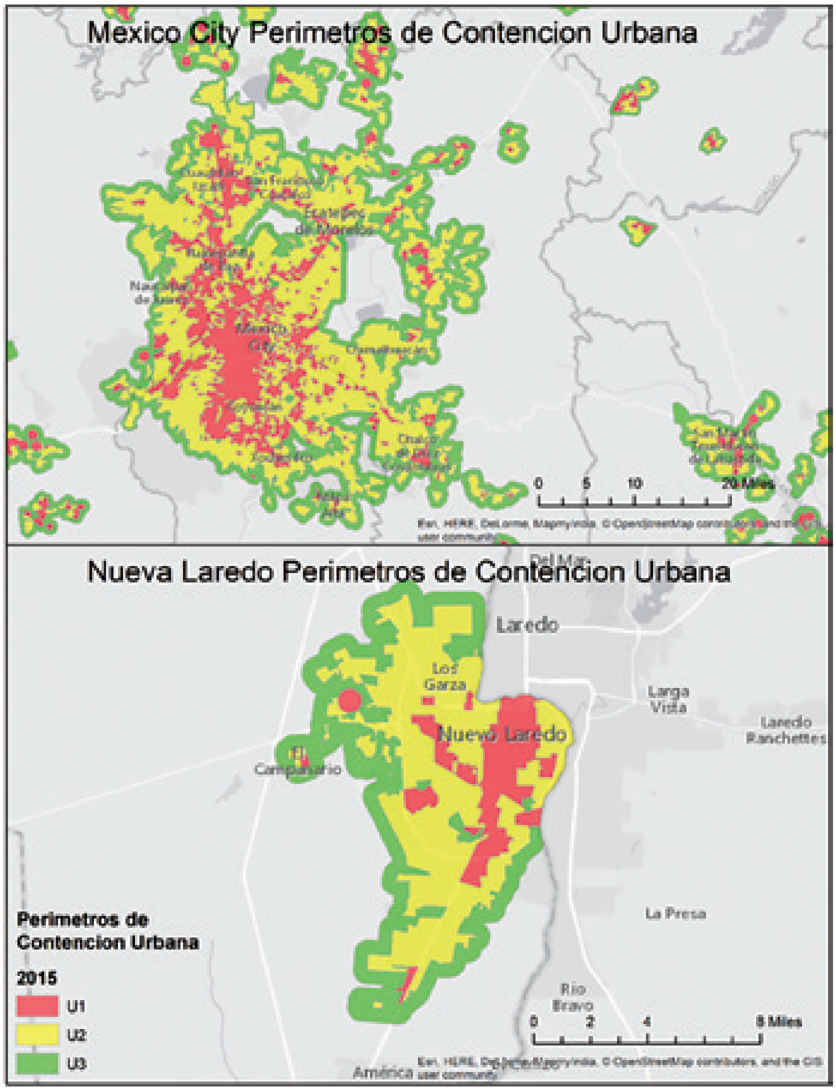
[5] Prorroga corresponds to a period of up to 24 months during which a guarantee fund can cover the difference between a household's payments and the amount due without the loan being recorded as in default. A loan exits prorroga by becoming performing again or enters default at the end of the period. Infonavit is exempt from following the regulations with regard to recording non-performing loans applied to banks by la Comisión Nacional Bancaria y de Valores, Mexico's banking regulatory institution.

subsidies of every individual parcel. The effort required was substantial, but now provides an unprecedented source of data to guide urban policy and track the evolution of cities in Mexico.

The new design of the subsidy program incentivizes developers to locate in more central locations by increasing the amount of subsidies available for projects located in areas with high employment density and access to infrastructures. It also directly prevents developments being built substantially outside the existing urbanized areas since the land outside of U3 has become ineligible for subsidies. In addition to the contornos, a system of points also add the level of subsidies for denser, more centrally located developments with access to services. Projects with a higher level of density and in proximity to health centers, schools, grocery stores, broadband infrastructure, public and non-motorized transportation and amenities (sport and community center, green areas) can receive higher subsidies. Overall, the amount of subsidy per unit can vary from 32 to 37 minimum wages depending on the contorno in which the project falls and its accessibility and design (CONAVI 2016).

The implementation of the contornos contributed to a substantial transformation of the existing development structure. A number of large developers that had invested heavily in purchasing land reserves on the outskirts of metropolitan areas faced substantial losses as these parcels became virtually worthless. The shock to the production sector resulted in an initial lower level of concentration of the industry and a slowdown in production but the number of units built rebounded after 2014.[6] It remains to be seen whether the combination of the contornos with bonuses for denser, better connected and more sustainable projects will be sufficient to reorient the production of houses for lower income households towards better locations. The current estimates from CONAVI suggest that the subsidized units are largely concentrated in U3 (CONAVI 2014). The contornos could also reduce the number of affordable units built if local land supply and regulations do not enable developers to make projects in central areas profitable despite the higher level of subsidies.

Figure 1 Mexico City and Nuevo Laredo Contornos, 2015



Source: CONAVI 2015

5. Conclusion and implications for other countries

Going back to the 1990s, Mexico has made substantial progress in improving housing conditions, with a reduction in the share of the population living in inadequate housing conditions. These improvements were the results of overall economic growth but also of housing policies that emphasized access to housing finance, demand side subsidies and a diversification away from only new construction programs toward supporting the purchase of existing houses and improvements. The combination of the market and policy changes made it possible for not only middle but also lower income households (earning less than three times the minimum wage) to access housing solutions, compared to previous programs that mostly catered to middle income households.

However, the design of the policy and the structure of the mortgage finance and construction industry resulted in undesirable outcomes with the development of large housing developments not connected to jobs and services. The goal of demand side subsidies was to make them more responsive to market forces and better meet household needs while being more fiscally sustainable. The undifferentiated subsidy amount across space and the single focus on housing production without taking location into account resulted in an allocation of resources to place with low land cost but low levels of accessibility. This pattern contributed to high levels of vacancy in some of the newly developed projects and to a substantial default rate among recipients of the subsidy programs.

The introduction by CONAVI of the contornos and the development of location criteria in the

[6] There is currently relatively a lack of analysis on the causes and effects of the restructuring of the development industry that took place in the aftermath of the financial crisis and of the changes to CONAVI and Infonavit programs. Further work on this shift is necessary.

allocation of subsidies after 2011 was a response to the development of subsidized housing targeted for lower to middle income households that were located beyond the periphery of metropolitan areas creating barriers to the connection to urban infrastructures, public services and jobs. The experience of Mexico in that regard has implications for many countries. In Latin America and other regions faced with housing deficit, national governments tend to intervene with programs that result in the mass production of new housing with limited consideration for the externalities associated with this type of urban development. This pattern is expensive for local governments, costing more than more compact development both in the upfront development of trunk infrastructures and in their maintenance. It is also expensive for residents who face substantial monetary and time costs to access jobs, health and education services, with the potential for negative outcomes on labor force participation, educational achievement and health.

The example of CONAVI's contornos and location criteria has the potential to be adapted in order to be implemented in other countries. Doing so requires establishing objective criteria to proxy for accessibility and desirable urban forms. These criteria need to be based on data that is available nationally and can be updated regularly with limited costs. The modulation of the subsidies by location needs to adequately reflect the differences in construction costs across location to make it profitable for developers to build in more desirable locations. Non-monetary incentives such as accelerated permitting, density bonus and the potential for mixed income projects also need to be considered since the difference in land cost between central and peripheral locations would likely require levels of subsidies that are not fiscally sustainable.

Further work is needed to evaluate the impact of the introduction of the contornos program. There is currently a lack of information about the effectiveness of the contornos in affecting the production and spatial distribution of subsidized units. Analysis of whether the outcomes of the new subsidized units are substantially better than under the previous version of the program is also needed (both in terms of repayment and household welfare). Overall, CONAVI's contornos and location criteria appear to be an effective mean to direct subsidies towards more desirable locations, addressing one of the limitations of the existing programs.

In addition, Mexican housing policy goes beyond the upfront subsidy program for home purchase. As discussed in this article, CONAVI also administers programs for improvement and self-construction and rental programs are also being considered. Nonetheless informally employed households or those experiencing substantial employment mobility continue to face barriers to accessing mortgages and public lenders are the main source of mortgages. In addition, the market for existing home remains underdeveloped, with most retail mortgages issued for new houses rather than existing houses.

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Rental housing: addressing the challenges of delivery in Nigeria

↳ **By Ben Okuzu**[1]

1. Introduction

Whenever housing is discussed in Africa, discussion is usually centered on home ownership, and especially so at policy level. Home ownership is important and deserving of all the attention it gets for reasons that are well known. Although the middle class is growing rapidly, African countries still have the vast majority of their populations living in poverty, and those that are not, struggle with more basic life issues such as basic shelter, food, and education for their children etc. For them, the thought of home ownership is but a distant dream. Not everyone can or wants to own a home. In Nigeria, it is estimated that the housing deficit is around 17 million units, and growing at the rate of 10% per annum, but it is inconceivable that this figure represents the demand for home ownership. Listening to the policy narrative however, might lead one to that conclusion.

Thankfully, it is increasingly being recognized that this gap in the discourse exists. The fact that rental housing is featuring as a subject matter at this conference and others before it is indicative of that recognition. In October 2014, Shelter Afrique in partnership with the French Development Agency organized an Africa Rental Housing conference themed 'Formal Rental Housing in Sub-Saharan Africa: opportunities for providing affordable rental housing for all', The White Paper issued after the conference enumerated the conclusions reached, and made recommendations on how to move the rental housing agenda forward. The conclusions validated my long-held view that the bigger issue in housing in Africa is rental housing, given the rapid rate of urbanization and the resulting pressures on available housing.

Rental housing need is enormous and should therefore be front and center in housing policy formulation. However, delivery faces a multitude of challenges, chief among them being financing. Africa does not just have a housing problem it also has a housing finance problem. This paper will focus on the economics of market-oriented production, and suggest alternative funding mechanisms that may be worthy of examination. Although it will be based on the Nigerian experience, there are parallels that can be drawn with other African countries with similar challenges, since the shortage of rental housing is essentially an urbanization issue.

2. Urbanization and effects on housing

Urban housing shortages are not unique to Africa. In fact, it is a problem that persists globally because of the rate at which the world is urbanizing. The African Development Bank estimates that by 2050, 57% of the world's population will be living in urban areas. Much of that growth is expected to come from developing nations, with African countries leading the way at an estimated annual growth rate of 3.5%. At that rate, the percentage of the African population living in urban areas currently averaging 36% is projected to rise to 50% by 2030. An explosion of population has also given rise to the growth of new urban centers thereby exacerbating the problem.

Sociologists have attributed this phenomenon in Africa to the transformation of the society from one that was principally agrarian, to one that is increasingly service oriented. With this orientation, the vast majority of opportunities become concentrated in urban areas, resulting in a steady rural to urban migration. This influx has put tremendous pressure on available infrastructure, services and housing in cities. The lack of long term planning that would have anticipated this phenomenon has left governments scrambling to deal with the effects of this explosive urban growth. The inability of governments to manage these problems can be attributed to the following:

- Policy makers tend to engage in hyperbole for political expedience. Often there is over promising and under delivering because little thought had been given to the feasibility of implementation.
- Implementation is haphazard at best, and falters in the face of difficulties. Structural issues that should have been, but were not addressed at the policy formulation stage, manifest at implementation, and governments often times lack the political will to follow through.
- African national and local governments generally lack the fiscal capacity to deal with the multitude of issues that come with rapid urbanization.

3. The rental housing market

An estimated 46% of Nigeria's 160 million people live in urban areas, and 85% of them live in rented accommodation. This high proportion of renters in urban environments is not unique to Nigeria. In fact, the more densely populated cities of the world tend to have a home ownership rate lower than the national average. For instance, New York City, which is one of the most densely populated cities in the world, and located in a country with one of the highest home ownership rates recorded a 26% home ownership rate in 2015, against a national average of 64%. Two things combine to produce this situation: One is that lower income households make up a large percentage of the population of urban centers and cannot afford home ownership, and the other is that home prices in the urban markets tend to be higher.

According to UN Habitat, there are two categories of renters:

- **Tenants by Choice:** Those who choose to rent for reasons of mobility or temporary residence, and
- **Tenants by Constraint:** Those who do not have the means to own their home.

[1] A paper presented to the Africa Union for Housing Finance Annual Conference in September 2016.

This second category makes up the majority of urban dwellers. In the face of home prices increasingly out of the reach of the average Nigerian urban dweller, the number of urban households seeking rental accommodation is expected to continue to grow exponentially if the current urban population growth rates persist. All the above therefore begs the question: With this demand, why then is the market not producing rental accommodation on a commercial scale to fill the need? To Answer that question requires an understanding of the housing dynamics in Nigerian.

4. The supply method

Delivery of rental housing can be either formal or informal. Formal delivery is structured to drive scale and is produced either by private enterprise on a commercial scale, or by government through direct production. Informal delivery on the other hand is haphazard, with individuals either renting out a part of the houses they occupy or for those that can afford one, offer their investment property for rent. Presently in Nigeria, supply of rental housing is mostly informal as described above, made up primarily of rooming houses popularly known in Nigeria as "face me I face you", interspersed with small walk-up apartment buildings, and a limited number of large-scale rental developments located mostly in highbrow areas.

To make any appreciable dent in the supply gap, policy has to provide an enabling environment for the development of rental housing on a commercial scale. Achieving this however, depends largely on the management of the elements of production- availability of land, cost of building materials, financing structures, and financing costs. While prices of building materials cannot be controlled directly, land assemblage and financing costs can be tackled through direct intervention by government. Supply to the lower income bracket should be in the form of social housing, where government provides a direct subsidy to either the project or the renter. It can also provide support for a sustainable market -driven delivery model for the middle market.

5. Market fundamentals

One of the conclusions of the Shelter Afrique white paper was that *"…underlying fundamentals are strong: There is indeed significant pent up demand for rented housing in the years up to 2020, at least"*. While the demand aspect of that conclusion holds true, there are however, other market fundamentals that produce strong headwinds for rental housing delivery in Nigeria.

There is a large disparity between prevailing rents and cost of housing such that rents are insufficient to drive investments in rental property by individuals. As a result, only a limited number of people are able to engage in supplying for the rental market. This informal method of delivery is the reason the supply gap will continue to widen.

In Nigeria, high interest rates, short tenures, and the absence of multi-family mortgages have combined to impede the delivery of rental housing on a commercial scale. Longer tenures do help reduce the periodic principal repayment, but financing costs more than anything else have the most significant impact on the viability of rental housing development, since the projects have to show a positive cash flow over and above debt service to provide a return on investment. Current interest rates are north of 20%, and are expected to trend higher as a result of the recent increase in the Monetary Policy Rate [MPR] from 12% to 14% in July 2016. These two factors, interest rates and short tenures, have plagued home loan mortgage penetration in Nigeria, and are reflected in the unavailability of multi-family mortgages as well, with the result that banks do not have the latter as a product on offer.

Nigerians blame banks for not wanting to provide long term financing for mortgages. That sentiment may be understandable. Banks have made little effort to increase mortgage lending, either for homeowners or commercial rental ventures, and often cite the Land Use Act and the lack of a formal foreclosure process as the reasons why mortgage lending is anemic. The Act governs the transfer or assignment of property title by requiring the State Governor to consent to the transaction, a process that is a lengthy and expensive.

It is a widely held view in Nigeria that banks are more favorably disposed to providing financing for trading ventures rather that mortgages. Trade finance provides a greater turnover of capital since the transactions have a shorter turnaround time. It therefore behooves governments to be the arbiter in this matter by holding banks and financial institutions to their corporate social responsibility, while recognizing their need to protect capital and turn a profit. After all, they do have a social responsibility to give back to the communities in which they make money.

- The Central Bank of Nigeria, as the regulatory body for banks and other financial institutions can make it mandatory for them to invest a percentage of their capital in housing related transactions to meet corporate social responsibilities. This has been applied successfully in the United States under the Community Reinvestment Act (CRA) that requires banks to earn social responsibility credits or face sanctions. Realizing that providing financing for affordable housing was the quickest way to accumulate substantial amounts of credits, banks began actively seeking CRA eligible housing projects to finance, allowing them to do well and do good at the same time. Efforts should be geared towards finding ways to enable private enterprise in Africa to do the same.

- Liquidity continues to be an issue. Pent-up capital in Pension funds currently standing at N5.4 trillion can be harnessed for rental house production. Pension capital with its long-term outlook is especially suited for investment in rental housing production, but pension fund managers in Nigeria are restricted in the types of assets they can invest in. Although the funds are still barred from direct investments in real estate, recent changes have broadened the investment outlets to include investments in the asset class through vehicles such as Real Estate Investment Trusts [REITS] and mortgage-backed securities. By extension therefore, they should be able to invest in revenue bonds that are underwritten on the basis of rental cash flow. Government can provide support by providing additional security in the form of guarantees or other credit enhancement. This structure is currently being employed in Swaziland, where the Swaziland Public Service Pension Fund [PSPF] is funding the institutional housing program that will provide rental housing for public employees.

- The Federal Mortgage Bank of Nigeria [FMBN] currently has N2.1 trillion in its National Housing Fund- a contributory fund that provides financing for home purchases for contributors at a subsidized interest rate and longer tenures. Their lending rate is currently 6%. This fund can be harnessed for rental housing if government expands the activities of FMBN to allow multi-family mortgages. They already provide construction loans for the development of for-sale housing that can be converted to permanent loans upon rental achievement- the break-even rental revenue needed to support the debt.

6. Equity investments

Conventional financing structures in Nigeria require equity investments that range from 30% to 50% of project costs. At such levels, available equity capital is tied up in fewer projects. Reducing the required equity could conceivably produce an increase in the number of housing projects undertaken.

Recognizing that affordable rental housing projects were unable to provide the returns that would attract equity investments in rental housing production, the United States government introduced the low-income housing tax credits [LIHTC] to provide equity capital for projects, so developers build for a fee that is part of project costs. In a nutshell, the program is a platform that allows any corporate investor to provide funding for a housing project in exchange for a dollar-for-dollar reduction in income tax, utilized over a 10-year period. Calculating the tax-credits is a complex exercise, but the concept itself is simple. In effect, it enables government to leverage its future tax collection to meet current capital needs for projects in the face of capital budget constraints. Tax-credits have been applied extensively in the US to support affordable housing development with tremendous success. It has been so successful that it spurned an entire industry that now accounts for 90% of all affordable rental housing created in the United States.

This concept is beginning to take hold in Nigeria, exemplified by the recent signing of an agreement between the Federal Government of Nigeria and the Dangote Group for the construction of concrete roads. The agreement includes an arrangement that allows Dangote to claim tax credits for executing the project, effectively reducing or eliminating any immediate capital contribution that would have been required of government. The Minister of Power, Works and Housing, Babatunde Fashola, has made it known that the government will consider proposals for similar arrangements. This is welcome news, as it will provide a conduit for corporate capital to flow into rental housing development.

7. Rent-to-own [RTO]

Recent housing discourse is starting to include RTO as a gateway to home ownership. The concept itself is not new, and is in use in countries with developed mortgage markets as a way to assist buyers who don't qualify for a mortgage either because they don't have a satisfactory credit rating, or don't have the required down payment and therefore need some time to improve their credit or save for the down-payment. It also allows the developer to commit units when the housing market softens or credit tightens. Every time the occupant pays rent, a portion accrues to the tenant as rent credit. The rent-credit is then applied to reduce what is owed on the unit or accumulated as equity to be used as down payment for the purposes of obtaining a mortgage at some point in time.

Clearly the concept of RTO as described above cannot be applied to most of Africa for the same reasons enunciated earlier as to why it has proven difficult to produce rental housing on a commercial scale- lack of multi-family mortgages, high interest rates and short tenures. Perhaps when these issues are resolved, the concept can be modified to suit, with a defined purpose such as using the rent credits to pay down the mortgage to a point where payments on a mortgage will be at par with the rent. Any modification however, has to work from a project finance perspective and address the following fundamental questions:

- Who bears the financing costs during the rental period?
- Are prevailing rents sufficient to support debt service?

8. Conclusion

South Africa is a country that has proven to be an exception in Africa in that production of rental housing is possible on a commercial scale precisely because of the things that are lacking in Nigeria and most African markets-relatively low interest rates at single digits until very recently, longer tenures, banks willing and able to provide multi-family mortgages, government commitment and financial support to social housing, and the ability of the financial markets to securitize assets. The private sector continues to produce rental housing profitably, demonstrating the critical role of financing structures in the production of rental housing. This success is replicated in South Africa's neighboring countries like Swaziland and Botswana because they have the good fortune of being connected to South Africa's sophisticated financial markets.

Finally, to echo the sentiments of an emerging thinking that housing, particularly rental housing should be classified as infrastructure. Wikipedia provides an interesting definition of infrastructure as "The physical components of interrelated systems providing commodities and services essential to enable, sustain, or enhance societal living conditions." That being the case, then housing is just as important as power, transportation, telecommunication etc., for the sustenance and enhancement of societal living. Since vast amounts of private capital are available for infrastructure projects then perhaps housing, if accepted in that space, can harness infrastructure funds with their patient, long-term outlook for sustainable rental housing production.

Habitat III – a critical review of the New Urban Agenda

↳ **By Wolfgang Amann and Sandra Jurasszovich**

The New Urban Agenda, which was decided in the United Nations Habitat III Conference in October 2016 in Quito, tries to give an answer to the massive global trend of urbanisation. Only a couple of decades ago the biggest part of the global population lived in villages. Only a few years ago, the 50 percent mark of the world's population residing in urban areas was exceeded. By 2050 it is predicted that 70% of the population will live in urban areas.

Regions are affected differently by this development. Many highly-developed countries of the northern hemisphere are already today highly urbanised, and show only small further increases in the urbanisation ratio. By contrast, the global trend becomes a paradigm shift in many less developed countries and those areas with high demographic dynamics. The biggest part of population growth in those areas will happen in cities. And it is questionable if the cities are sufficiently equipped to keep pace with this demographic pressure.

Focal areas of the New Urban Agenda are ecological sustainability, urban resilience and inclusion. The Agenda details what was decided in 2015 with the UN Sustainable Development Goals (SDG), particularly Goal 11 "Make cities and human settlements inclusive, safe, resilient and sustainable". The ambitious specific targets of SDG Goal 11 for the short period until 2030 are:

- access for all to adequate, safe and affordable housing and basic services, including slum upgrade,
- safe, affordable, accessible, sustainable and inclusive transport systems,
- universal access to safe, inclusive and accessible, green and public spaces,
- participatory, integrated and sustainable human settlement planning,
- protection of the cultural and natural heritage,
- reduced human damage caused by disasters,
- reduced environmental impact of cities, e.g. in relation to air quality and waste management,
- strengthening of national and regional development planning to improve economic, social and environmental links between urban and rural areas,
- implementation of suitable integrated policies and plans,
- support of least developed countries.

Reflecting the complexity of urban structures, the new Agenda covers a broad set of topics:

1. Responsibilities, law enforcement, good governance

The New Urban Agenda urges the leading role of national governments in the definition and implementation of inclusive and effective urban policies and legislation for sustainable urban development (para. 15). On the other hand, the equally important contributions of sub-national and local governments across administrative borders are highlighted (para. 15, 90).

The private sector is generally addressed … *to apply their creativity and innovation toward solving sustainable development challenges in urban areas, acknowledging that private business activity, investment, and innovation are major drivers of productivity, inclusive growth and job creation…* (para. 133).

Little space is given to legal issues and law enforcement. Only para 111 refers to *adequate and enforceable regulations in the housing sector* (…) resilient building codes (…) land use by-laws (…) and planning regulations, with a single focus on *combating and preventing speculation, displacement, homelessness, and arbitrary forced evictions*. To achieve effective public administrations e-government and science-policy interfaces in urban and territorial planning and policy formulation are promoted (para. 156, 157).

The term "good governance" is not mentioned in the New Urban Agenda. And only occasionally aspects of effective policy and administration are addressed, such as … expenditure control instruments … tendering processes, procurement mechanisms … preventive anti-corruption measures (para. 138). In the context of financing the proposed measures, a number of coherent recommendations are given (see section q).

Obviously, the New Urban Agenda frequently refers to other approved UN documents, such as the Rio Declaration on Environment and Development (1992), the 2030 Agenda for Sustainable Development (2015), the International Guidelines on Urban and Territorial Planning (2015) or the Sendai Framework for Disaster Risk Reduction 2015-2030 (2015). Several paragraphs are dedicated to the implementation of the Paris Agreement of November 2015, particularly regarding the support of the poorest and most vulnerable countries in climate change mitigation and adaptation (para. 142-146). In the final paragraphs (para. 128-129,165, 170-172) the Agenda defines a mandate of UN HABITAT for its future activities.

Following the provisions of the Paris Agreement (2015) the New Urban Agenda calls for support for cities in less developed countries and the development of instruments for financial transfers.

2. Urban planning

Planning can be assumed to be the bracket to include all the subsequently mentioned requirements within the New Urban Agenda. Cities are required to develop their urban planning capacities to achieve the comprehensive targets.

Paragraph 94 summarizes the approach of integrated planning *… that aims to balance short-term needs with long-term desired outcomes of a competitive economy, high quality of life, and sustainable environment.* It is about flexible plans *… in order to adjust to changing social and economic conditions over time …* by systematic evaluation and technological innovations. Paragraph 51 details the aspired urban spatial frameworks *… including urban planning and design instruments that support sustainable management and use of natural resources and land, appropriate compactness and density, polycentrism, and mixed uses, through infill or planned urban extension strategies as applicable, to trigger economies of scale and agglomeration, strengthen food system planning, enhance resource efficiency, urban resilience, and environmental sustainability. One of the following paragraphs highlights … the need to guide urban extension prioritizing urban renewal by planning for the provision of accessible and well-connected infrastructure and services, sustainable population densities, and compact design and integration of new neighbourhoods in the urban fabric, preventing urban sprawl and marginalization* (para. 52). The smart city approach is addressed, *…which makes use of opportunities from digitalization, clean energy and technologies, as well as innovative transport technologies* (para. 66). Finally, the Agenda demands participation in planning and urban decision making (para. 41, 81).

3. Regional cooperation

The Agenda requires interaction between cities, their hinterland and rural areas concerning migration, traffic, and economic development, suggesting *… long-term urban and territorial planning processes … considering the urban-rural continuum at the local and territorial scales, and including the participation of relevant stakeholders and communities* (para. 72). Inter-municipal cooperation mechanisms are promoted *… based on functional territories and urban areas as effective instruments to perform municipal and metropolitan administrative tasks …* (para. 96). Cooperation and mutual support among different scales of cities is encouraged (para. 95).

4. Inclusion, equality, gender issues, anti-discrimination, participation

Inclusion is one of the hot topics in the New Urban Agenda and mentioned not less than 36 times, with a specific focus on women and girls, children and youth, older persons and persons with disabilities, indigenous peoples and local communities. Repeatedly, the request on inclusion goes hand-in hand with the call for equal rights, anti-discrimination action and participation (e.g. para. 13, 26, 34), as well as the SDG goal 1 to *end poverty in all its forms anywhere* (para 14, 25). It is also often linked to migration, fair treatment of refugees and internally displaced persons (para 28) or informal work (para 59). Inclusion is closely linked with participation of the population in decision making processes, the New Urban Agenda intends to be *… participatory, and people-centred* (para. 16).

Some few paragraphs link the topic to housing policies (para. 32). Challenges of informal settlement upgrade is frequently cited, other more specific policies such as measures against homelessness or housing first programmes only occasionally (para. 108).

5. Youth, age, education, health

Proposed policies targeting young people are often linked to gender and age responsive measures, but with hardly any specification. Few recommendations concern *access to education and skills development* (para. 61)

The New Urban Agenda frequently refers to the challenges of an aging urban society and calls for age-sensitive inclusive policies. This also includes *age- and gender-responsive housing policies* (para. 32), but with hardly any specification concerning e.g. assisted living, provision of homes for the elderly or technological solutions such as ambient assisted living. Health issues focus on safe drinking water, sanitation, clean air and social infrastructure (e.g. para. 13, 55), but with hardly any further specification.

6. Economy, industry, prosperity

The New Urban Agenda claims prosperity for all (para. 15). It requires *… vibrant, sustainable, and inclusive urban economies, building on endogenous potential, competitive advantages, cultural heritage and local resources, as well as resource-efficient and resilient infrastructure, promoting sustainable and inclusive industrial development …* (para. 45). It calls for *… enhanced productivity* (para. 50) *… through the promotion of full and productive employment, decent work, and livelihood opportunities … by providing the labour force with access to income-earning opportunities, knowledge, skills and educational facilities that contribute to an innovative and competitive urban economy …* (para. 56).

Employers receive far less attention. The Agenda suggests an *… enabling, fair, and responsible business environment, based on the principles of environmental sustainability and inclusive prosperity, promoting investments, innovations, and entrepreneurship … businesses and enterprises in the social and solidarity economy, operating in both the formal and informal economies* (para. 58).

There is hardly any mention of large scale industries or the benefits of re-industrialisation of urban areas. The economic theory behind the Agenda seems single-sided, as it proposes *… urban economies to progressively transition to higher productivity through high-value-added sectors, promoting diversification, technological upgrading, research, and innovation, including the creation of quality, decent, and productive jobs, including through promoting cultural and creative industries, sustainable tourism, performing arts, and heritage conservation activities …* (para. 60).

7. Technical infrastructure

Technical infrastructure, i.e. roads, energy, IT technology, water, sanitation, is crucial for the functioning of urban areas. Its development, maintenance and protection against natural and man-made disasters and terrorism is therefore a focus area of the New Urban Agenda. It promotes *… adequate investments in protective, accessible, and sustainable infrastructure and service provision systems for water, sanitation, and hygiene, sewage, solid waste management, urban drainage, reduction of air pollution, and storm water management* (para. 119) and requires *… universal access to safe and affordable drinking water and sanitation, as well as equal access for all to public goods and quality services in areas such as … infrastructure, mobility and transportation, energy …* (para. 13, similar in 34). Propositions on energy infrastructure is very much focussed on renewable sources (see heading I).

8. Resilience, disaster risk reduction, security

Resilient cities may be achieved with *… disaster risk reduction and management* (para. 13, 14) *… shifting from reactive to more proactive … approaches* (para. 78), anticipating post-disaster recovery and integrating *… lessons from past disasters and new risks into future planning* (para. 78). In this context, the UN Sendai Framework for Disaster Risk Reduction 2015-2030 is cited (para. 77)

Urban safety target *… crime and violence prevention, including terrorism and violent extremism conducive to terrorism …* (para. 103).

9. Affordable and adequate housing

The commitment to *… cities for all, inclusivity, just, safe, healthy, accessible, affordable, resilient, and sustainable …* (para. 11) locates housing in the very centre as a matter of course.

The Agenda stipulates a *… right to adequate housing for all* (para. 13, 105) and *… equal access for all to … adequate and affordable housing* (para. 14, similar in para. 33), *… based on the principles of social inclusion, economic effectiveness, and environmental protection* (para. 106).

Obviously, housing policy should be people-oriented. The Agenda requires the … development of integrated and age- and gender-responsive housing policies … provision of adequate, affordable, accessible, resource efficient, safe, resilient, well-connected, and well-located housing (para. 32).

Housing policy should provide *… increased security of tenure for all … within the continuum of land and property rights …* (para. 35) and *… prevent arbitrary forced evictions, and … should … focus on the needs of the homeless, persons in vulnerable situations, low income groups, and persons with disabilities* (para. 31). In this context, the Agenda contains many references to informal settlement upgrade.

Social and affordable housing construction is promoted within urban planning strategies *… that facilitate a social mix* (para 46, 99) *… and encourage mixed-income development to promote social inclusion and cohesion* (para. 106). The Agenda encourages the development of *… policies, tools, mechanisms, and financing models that promote access to a wide range of affordable, sustainable housing options including rental and other tenure options, as well as cooperative solutions such as co-housing, community land trust, and other forms of collective tenure …* (para. 107).

Requirements on quality housing focus on *… planned urban extensions, infill, prioritizing renewal, regeneration, and retrofitting of urban areas … avoiding spatial and socio-economic segregation and gentrification* (para. 97). *Peripheral and isolated mass housing developments detached from urban systems …* should be avoided (para. 112).

10. Land use, real estate

The ecological and social function of land is valued higher than its economic functions. Sustainable land use should combine *… urban extensions with adequate densities and compactness preventing and containing urban sprawl, as well as preventing unnecessary land use change and the loss of productive land and fragile and important ecosystems* (para. 69). Populations should be served with *… equitable and affordable access to … affordable serviced land* (para. 34) and *… secure land tenure* (para. 14).

The real estate sector is invited *… to enhance coordination of their urban and rural development strategies and programmes to apply an integrated approach to sustainable urbanization* (para. 82), but at the same time there is concern about *… preventing land speculation* (para. 14).

11. Mobility, traffic

Similar to other areas of urban life, the Agenda claims mobility as a universal right (e.g. in para. 13, 50) in order to achieve *… the benefits of connectivity* (para. 54). Urban mobility should be … safe, age- and gender-responsive, affordable, accessible, and sustainable urban mobility … accessible safe, efficient, affordable, and sustainable infrastructure for public transport … (para. 114).

At the same time, there is concern about the negative effects of motorised traffic. It is pursued to reduce *… the financial, environmental, and public health costs of inefficient mobility, congestion, air pollution, urban heat island effect, and noise* (para. 54). Road safety should be enhanced (para. 113).

The Agenda pledges a better *… coordination between transport and urban and territorial planning departments* (para. 117). Financing instruments should be developed and expanded, enabling cities to improve their transport and mobility infrastructure (para. 118).

12. Energy, energy efficiency, ecological sustainability

Similar to housing and mobility, the Agenda makes a claim for a *… universal access to affordable, reliable and modern energy services* (para. 121). However, following the provisions of the Paris Agreement of 2015 all proposed measures focus on renewable sources and energy efficiency, always in the light of affordable costs (e.g. para. 34, 54, 79). Urban form, infrastructure, building design and construction modes are addressed as major drivers of resource efficiencies (para. 44, 75).

Ecological sustainability is addressed in a rather general mode, e.g. with the vision of cities and human settlements that *… protect, conserve, restore, and promote their ecosystems, water, natural habitats, and biodiversity, minimize their environmental impact, and change to sustainable consumption and production patterns* (para. 13). A little bit more specific are the provisions of paragraph 76 concerning the *… sustainable use of natural resources … resource-efficiency of raw and construction materials … development of sustainable and resilient buildings … prioritizing the usage of local, non-toxic and recycled materials* (para. 76).

13. Public space

The comprehensive functions of public space concerning ecology, social life, societal and economic development are highlighted. The Agenda calls for the *… creation and maintenance of well-connected and well-distributed networks of open, multi-purpose, safe, inclusive, accessible, green, and quality public spaces* (para. 67), *… including streets, sidewalks, and cycling lanes, squares, waterfront areas, gardens, and parks that are multi-functional areas for social interaction and inclusion, human health and well-being, economic exchange, and cultural expression and dialogue among a wide diversity of people and cultures* (para. 37), *… sustainably leveraging their potential to generate increased social and economic value, including property value, and to facilitate business, public and private investments, and livelihood opportunities for all* (para. 53), *… free from crime and violence, including sexual harassment and gender-based violence, considering the human-scale and measures that allow for the best possible commercial use of street-level floors, fostering local markets and commerce, both formal and informal, as well as not-for-profit community initiatives, bringing people into the public spaces, promoting walkability and cycling towards improving health and well-being* (para. 100).

14. Arts, architecture, cultural heritage

Hardly any provisions in the New Urban Agenda concern contemporary culture (para. 26, 124), arts or architecture. Building design is only mentioned in the context of housing costs and resource efficiencies (para. 44).

By contrast, the protection of the cultural heritage is one of the focus areas. Paragraph 38 aims to … *safeguard and promote cultural infrastructures and sites, museums, indigenous cultures and languages, as well as traditional knowledge and the arts … as a way to strengthen social participation and the exercise of citizenship*. The cultural heritage should be leveraged … *for sustainable urban development … innovative and sustainable use of architectural monuments and sites with the intention of value creation, through respectful restoration and adaptation* (para. 125)

15. Research, data-based decision-making

The contemporary saying that *you can't manage what you don't measure*, has been taken seriously in the New Urban Agenda. The requirement for … *high-quality, timely, and reliable disaggregated data* (para. 104), *statistical capacities* (para. 158/159) and … *enhancement of open, user-friendly, and participatory data platforms* (para. 160) is repeatedly addressed.

16. Implementation

The New Urban Agenda is a soft tool with no legislative power amongst the UN member states. It relies upon the willingness of global stakeholders to be implemented. The fact that the New Urban Agenda is a non-binding agreement is clearly an obstacle to its implementation, it obviously trusts the power of facts and the dynamics arising from urbanisation. The countries are requested … *to report on the progress of the implementation of the New Urban Agenda every four years* (para. 166-168), there ought to be a … *voluntary, country-led, open, inclusive, multi-level, participatory, and transparent follow-up and review of the New Urban Agenda* (para. 161/162).

17. Financing of measures

A crucial aspect of implementation is financing. The Agenda addresses both public and private sources.

Public financing includes budgetary funds and transfers from developed to less developed countries as well as fiscal measures.

One popular fiscal measure is land value capture, by mobilizing … *endogenous resources and revenues generated through the capture of benefits of urbanization, as well as the catalysing effects and maximized impact of public and private investments in order to improve the financial conditions for urban development …* (para. 132). Increasing … *land and property value generated as a result of urban development processes, infrastructure projects, and public investments …* should be captured and shared by means of … *land market regulations* (para. 137). Capacity development programmes are promoted … *on the use of legal land-based revenue and financing tools as well as on real estate market functioning for policymakers and local public officials focusing on the legal and economic foundations of value capture, including quantification, capturing, and distribution of land value increments* (para. 152).

Other recommendations on fiscal strategies seem somehow contradictory. Whereas an expansion of the public revenue base is proposed, neither … *women and girls, children and youth, older persons, persons with disabilities, indigenous peoples and local communities, and poor households …* should be … *disproportionately affected* (para. 134).

The Agenda proposes a number of measures to promote sound public finance and debt management. It recommends … *appropriate financial intermediaries for urban financing, such as regional, national, sub-national, and local development funds or development banks …* and promotes … *risk mitigation mechanisms …* to … *reduce the cost of capital and to stimulate the private sector and households to participate in sustainable urban development* (para. 139). It also proposes … *sound and transparent systems of financial transfers from national government to sub-national and local governments* (para. 135) and the … *development of vertical and horizontal models of distribution of financial resources to decrease inequalities across sub-national territories, within urban centres, and between urban and rural areas* (para. 136).

Public financing should be allocated primarily to … *affordable and sustainable housing* (para. 106) … *including rental and other tenure options* (para. 107), but obviously also to technical and social infrastructure and other public service obligations.

Addressing financing issues, the private sector comes into play, particularly concerning … *the development of appropriate and affordable housing finance products* (para. 140). The Agenda encourages … *the participation of a diverse range of multilateral financial institutions, regional development banks, and development finance institutions; cooperation agencies; private sector lenders and investors, cooperatives, money lenders, and microfinance banks to invest in affordable and incremental housing in all its forms* (para. 140, similar in para 142) … *recognizing that housing enhances capital formation, income, employment generation, and savings* (para 46).

18. What is under-represented or missing…

The comprehensive approach of the New Urban Agenda is remarkable and courageous. Nevertheless, a substantial number of white spots can be detected. Insufficient attention is awarded e.g. to the following topics:

- There are very few mentions of the effectiveness of policy making and legislation, law enforcement, public administration and compliance.
- There is hardly any consideration of democratic rules and self-organisation of people (communitarianism), which is a precondition of inclusion and for participation in political decision making processes.
- Hardly any remarks on the evolution of civil society can be found, e.g. concerning the promotion of registered or informal associations.
- There is a lot of text covering our aging society, but no concrete measures regarding accommodation and care of elderly people are proposed.
- Very few remarks concern education, and none are dedicated to higher education, universities, research and development, despite being a core competence of urban agglomerations.
- The focus on people-oriented policies seems responsible for lack of attention to the urgently needed re-industrialisation of cities and employer-oriented measures. Housing for all and mobility and infrastructure for all require first and foremost jobs for all.
- The growing energy hunger of cities is hardly mentioned. A change of energy supply to re-newable sources is desirable, but our large urban agglomerations require large-scale solutions.
- There is no consideration of the concept of sufficiency, i.e. the voluntary or directed reduction of consumption of goods and resources in order to mitigate climate change and to avoid pollution.
- Cooperation with the private sector is mentioned repeatedly. But the private sector was hardly present at the Habitat III conference. The crucial role of the real estate industry in the development of our cities, in capital formation and in providing accommodation for all is scarcely reflected.

- The promising approaches of public-private-partnerships (PPP) were widely discussed during the Habitat III conference (leading to aspirations for public-private-people-partnerships), but cannot be found in the Agenda.
- The crucial role of architecture, contemporary art and beauty for the development of urban structures, for the appearance of identity and the constitution of civil society is not at all reflected. Reference to cultural heritage is not enough. Vibrant arts are needed.
- Even though it is repeatedly stated that cities must be inclusive, targets and propositions regarding equal rights and treatment of gay, lesbian and transsexual people are never mentioned because of resistance of some very conservative countries during the long pre-paratory process of the New Urban Agenda. Also, a general "right on cities" was not enforceable.
- Although, the official title of the New Urban Agenda is "Quito Declaration on Sustainable Cities and Human Settlements for All", the focus lies strongly on cities. More than half of the world's population now lives in cities; so it makes sense that the New Urban Agenda will shape future UN agendas. Nevertheless, it would be a mistake to neglect rural areas. The crucial question is how to achieve holistic spatial development of all human settlements.

Altogether, the New Urban Agenda seems to take the well-organised cities from the Northern Hemisphere as a model for the emerging metropolises of the South. There seems to be an inherent assumption about a universal model for a city. But this model is an invention of the Northern Hemi-sphere, developed via a protracted civilising process. It is by no means certain that this model fits the present-day needs of the rapidly growing urban regions in all those emerging economies in Africa and South Asia. This approach reminds one of the presumptuous (if not neo-colonial) claim of the Western World regarding democracy and the liberal market economy as the single pre-eminent model of government, although other approaches have proved more efficient in releasing masses of people from poverty. The New Urban Agenda does not ask the question of principle, whether cities in less developed countries of the South work differently and maybe should follow different paths.

19. Conclusions

The New Urban Agenda claims for *… cities for all, inclusivity, just, safe, healthy, accessible, affordable, resilient, and sustainable cities and human settlements* (para. 11)

Put simply, the New Urban Agenda is a 22-page consensual document intending to *"guide the next twenty years of sustainable and transformative urban development worldwide"* and is based on a long and admirable participatory process.

As pointed out in the last section, the "new" of the New Urban Agenda is debatable since the answer depends on taking a vision and set of principles from one national and local context to another. For example for many European cities this vision and set of principles would already be considered as accepted (see the adoption of the Leipzig Charter on Sustainable European Cities of 2007, the Lisbon Treaty of 2009 including the notion of territorial cohesion and the Europe2020 strategy). Rather than an innovative agenda of the future, it presents a reminder of values that cities have committed themselves to.

What is going to happen next with the New Urban Agenda? As this analysis has shown, the agenda presents a comprehensive guideline what goals to pursue, but a concrete roadmap how to actually achieve these goals is missing. Such a roadmap does not necessarily have to be part of the content of the agenda as it is a political document; however, it should be tackled in follow-up processes. Strong monitoring processes will be essential to maintain commitment and engagement over time for this agenda. However, a clear schedule for structured review processes is missing. Paragraphs 161 and 162 call for a periodic review of the implementation steps, but the next Habitat conference is not planned until 2036. In view of the nature and urgency of the challenges faced, a much shorter interval between conferences is necessary. One thing is clear, all countries and cities will need to step up their commitments if the aspirations outlined in Habitat III are to be achieved.

Download New Urban Agenda: *www.habitat3.org/the-new-urban-agenda* and from *www.iibw.at*

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Established in 1914, the International Union for Housing Finance (IUHF) is a worldwide networking organisation that enables its members to keep up-to-date with the latest developments in housing finance from around the world and to learn from each other's experiences.

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The Union does this in five different ways

- The Union runs a website - www.housingfinance.org. Please pay a visit!
- The Union publishes a quarterly journal, *Housing Finance International* (HFI)
- The Union organises a World Congress every two years
- The Union actively participates in events related to key housing finance issues around the world
- The Union facilitates the exchange of information and networking opportunities between its members

For more information, please see www.housingfinance.org
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