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Editor's introduction
What a difference a day makes

By Andrew Heywood

The UK General election in May 2015 was certainly not the only piece of electoral news that was discussed around the world this year but it received a fair amount of international coverage. This was largely due to the possibility that the United Kingdom Independence Party [UKIP] might win enough seats to give a significant boost to those aiming to take the UK out of the EU in a referendum scheduled for 2017.

In the event, UKIP won 12.6% of the vote to become the third largest party but obtained only one seat. The Conservatives won the election with an overall majority and the opinion polls are now suggesting that a majority of voters wish to remain in Europe.

Election Day made a difference in the housing world too. A Conservative victory has meant that their recently announced policy to extend the Right to Buy their homes to tenants of housing associations is now firmly on the government agenda. A Bill will be introduced later in the year.

Selling off social rented housing is no longer either new nor uniquely a UK phenomenon. Social housing has been sold in the Netherlands also, to offer one example. However, the Right to Buy, introduced by the Thatcher Government in 1981 was seen as symbolic of a move away from the European welfare policies of the post-war period towards a neo-liberal policy environment, in which home ownership was acknowledged as the tenure of choice and the role of the state in the provision of housing was to be progressively reduced. By 2013-14, in England alone, Right to Buy had resulted in 1.9 million local authority homes being sold to tenants at a discount. Housing associations have been beneficiaries of government's desire to divest itself of public housing. Well over one million homes have been transferred from local authorities to housing associations via Large Scale Voluntary Stock Transfer [LSVT]. However, the Right to Buy was not extended to housing association tenants. The Government had moved funding of new social housing from the public sector balance sheet to rely on private finance in the form of long-term secured loans to housing associations- bodies independent of the state. To depreciate core housing association assets by selling homes to tenants at a large discount thus made little sense to government, housing associations or to lenders.

However, circumstances change cases, at least for Government. In spite of the efforts of successive governments, the UK has experienced more than a decade of falling home ownership. If Right to Buy were taken out of the equation home ownership would be back to the levels of the 1980's. The Coalition had in 2012 already increased discounts for tenants of local authorities wishing to buy their homes. With a General Election looming, offering the Right to Buy to the 2.4 million housing association households (subject to a minimum residence requirement) was potentially a politically popular option. Three weeks before Election Day the policy was announced. Homelessness in England is on the rise, and the development of social rented housing is already at totally inadequate levels to meet demand. Housing affordability is a major problem, particularly in London. There is a real risk that extension of Right to Buy will lead to a further net loss of social housing and an erosion of new affordable housing development. Whether extension of the Right to Buy is ultimately seen as a victory of political expediency over sound housing policy, or as a far-sighted move to re-invigorate homeownership, remains to be seen. As the song says: "What a difference a day makes"

The development of UK affordable housing policy is one of the themes of this issue of HFI. Christine Whitehead and Peter Williams, trace changing social housing policy over a thirty year period, examining the move from provision via local authorities to the present pre-eminence of housing associations and the all-important move from development, funded via the public sector, to reliance on private finance. They examine the current position of the affordable housing sector and ask what the future may bring in terms of policy and practice.

In China too, the state has reassessed its role in the provision of housing over the past twenty years. In a welcome return to this journal, Jie Chen analyses housing policy in post reform urban China. She points out that Chinese housing policy is operating in the context of rapid industrialisation and urbanisation and that while there have been major improvements in housing provision and a rapid rise in home ownership, significant problems continue to require a housing policy response.

The EU does not have legislative powers in the housing field. Nevertheless, as Christian König demonstrates in a fascinating article, it has been a subject for discussion both in the European Commission and amongst MEPs. Mr König also shows how decisions taken by the European Court of Justice, notably over state aid and the provision of social housing, can have an impact at national level. The article will be of interest to all those who wish to follow national housing policy developments in Europe within an EU context.

Mayanmar has not recently been featured in the journal, so the article by Josie McVitty offering a valuable overview of the country and its housing is extremely helpful. McVitty points out that while Myanmar is undergoing a major political and economic transformation it remains a country with much poverty, with a large informal housing sector and with rapidly rising prices. An underdeveloped financial system means there is very limited availability of housing finance. McVitty traces the efforts of the Government to address the major challenges in the housing field.

With a population of 119 million and rising and with 46% of that population under 25, Mexico is a country of both challenges and opportunities. In his fascinating article *Understanding Mexico's housing market*, Jose Luis Romero Hicks examines housing demand and housing policy in this rapidly developing country.

It is good to have an update on the situation in Sweden in this issue. Alexandra Leonhard examines the incentives to become a home owner in Sweden and the relationship between rising house prices, household debt and low interest rates. This article offers readers an excellent analytical overview.

Finally, those who would have liked to see an article on South America in this issue can make up the deficit by registering for the Joint Congress of the IUHF and UNIAPRAVI in Rio de Janeiro in September. More details on the IUHF website.

Contributors' biographies

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José Luis Romero Hicks is a Mexican Attorney and a US trained economist and political scientist. He was a diplomat stationed in India and Japan, a PEMEX Board Director and CEO of Mexico's Foreign Trade Bank – BANCOMEXT. He is a university professor, a legal economic and financial consultant.

Masahiro Kobayashi is the Director General at Japan Housing Finance Agency. He graduated from University of Tokyo in 1988 with bachelor of law and joined Government Housing Loan Corporation. He worked with Overseas Economic Cooperation Fund, Japan Bank for International Cooperation and seconded to Fannie Mae. He Serves as Advisory Board Member for Asia Pacific Union for Housing Finance. He can be contacted at Kobayashi.0rh@ihf.go.jp

Christian König works as Head of Legal Affairs for the Association of Private Bausparkassen in Berlin and is responsible for all German and European legal affairs dealing and affecting the business of Bausparkassen and other credit institutes financing home ownership. The scope of his work includes the evaluation of legislative proposals of the European and German Institutions, dealing with banking, contract and consumer protection law. He is currently involved in the discussions of the consumer and mortgage credit legislation on the European level.

Chung Chee Leong has been the President/Chief Executive Officer and an Executive Director of Cagamas Berhad, Malaysia's national mortgage corporation, since 1 April 2012. Mr. Chung is also a member of the Small Debt Resolution Committee; established by Bank Negara Malaysia to support the resolution of non-performing loans of Small and Medium Enterprises, and a member of the Advisory Board of the Asia Pacific Union for Housing Finance (APUHF). He has 29 years of experience in central banking focusing mainly on financial system stability and the financial sector.

Alexandra Leonhard is an economist at the Ministry of Finance in Sweden and holds a Doctoral degree in Economics from the Universität Duisburg-Essen. She is a specialist on the Swedish housing and credit market, having worked as an analyst at the Swedish National Board of Housing, Building and Planning and other government agencies.

Josephine McVitty is an urban development and housing specialist. Her work is focused on strengthening urban management, improving access to basic services and provision of affordable housing in cities. Over the past year, she has worked with the World Bank on comprehensive housing sector assessments and advisory on housing policy reform in Indonesia and Vietnam.

Alex J. Pollock is a resident fellow at the American Enterprise Institute, Washington DC, USA. He was President and CEO of the Federal Home Loan Bank of Chicago 1991-2004, and President of the IUHF 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. Email: zaigham2r@yahoo.com

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

Christine Whitehead is emeritus professor of housing economics at the London School of Economics. She works mainly in the fields of housing economics, finance and policy. She has worked with a wide range of international agencies as well as regularly for the UK government and Parliament.

Peter Williams is Executive Director of the Intermediary Mortgage Lenders Association and a Departmental Fellow, Department of Land Economy, University of Cambridge. He was previously Director of the Cambridge Centre for Housing and Planning Research, Deputy Director General of the Council of Mortgage Lenders and Professor of Housing at the University of Wales, Cardiff. He is currently on the board of The National Housing Federation.

Asia-Pacific Union for Housing Finance: News Update

↳ By Zaigham Mahmood Rizvi, Secretary General, Asia-Pacific Union for Housing Finance

Pakistan

During the current quarter, an increase of Rs 0.8 billion was witnessed in gross outstanding lending (1.49%). The continued growth in the housing finance portfolio is an encouraging sign. Overall the housing finance portfolio currently stands at Rs. 54.5 Billion. The House Building Finance Company Ltd. [HBFCL] remained the largest shareholder, in terms of gross outstanding lending, with the overall market share of 24%.

Furthermore, a major chunk of the total outstanding remained directed towards the "outright purchase" category as 63.97% of total outstanding was used to finance "outright purchase" housing loans. It was followed by "construction" and "renovation" products with 24.77% and 11.24% respectively.

Notwithstanding the growth in housing finance during the last two quarters, housing finance in fact started picking up after 2008. It is expected that the State Bank of Pakistan's [SBP] recent stance of reducing the policy rate will further help in enhancing affordability and demand for housing finance in Pakistan. All this will be instrumental to increase economic growth through positive changes in 40 industries allied to the housing sector.

Government to extend more incentives towards housing sector
The Government is working on more attractive fiscal incentives to promote housing finance schemes in Pakistan including a proposed income tax exemption/tax incentive on income earned from such projects, income tax relaxation for long term finance and reduction in capital value tax [CVT], stamp duty and the registration fee to make house sale/ purchase transactions more affordable, especially in case of low value properties.

State Bank amends prudential regulations to finance solar system
The SBP amended prudential regulations to allow banks and development institutions to finance solar systems for residential use of up to ten years. Previously, financial institutions were extending finance for solar systems under the heading of personal loan for a maximum tenure of five years.

SECP to promote housing finance in Pakistan
The Securities and Exchange Commission of Pakistan [SECP] has approved substantial amendments to the regulatory framework for the non-bank financial [NBF] sector. The SECP intends to promote housing finance and enable NBFIs to play a key role in the development of the formal housing finance sector.

PM to inaugurate Low Cost Housing Scheme soon
The Federal Minister for Housing and Works, has said that the Prime Minister would soon inaugurate the Low Cost Housing Scheme for low income people. The minister said that 500,000 housing units would be constructed across the country which would be provided to low income people on easy monthly installments.

Bangladesh

According to geological experts, Bangladesh is extremely vulnerable to seismic attack. Very recent back-to-back occurrences of earthquakes have made planners think and put emphasis on this issue. Bangladesh is one of the most populated countries, and more than 85% of its population live in rural areas. The matter of deep concern is that while the earthquake-resistant building design and construction codes are not being followed properly in metropolitan area, their implementation at the local level is practically non-existent. Consequently, the risk of a devastating impact from an earthquake is very high in rural areas as well. In rural areas, people are used to constructing their houses with local materials and local construction techniques without any engineering evaluation. A survey indicates that new technology for building earthquake resistant houses in rural areas has to be formulated.

Recently, there have been back-to-back earthquakes in Nepal on 25th April and 12th May (Richter scale 7.5 and 7.8), shocks which were also felt in Bangladesh (Richter scale 4.5). That was another warning signal. Dhaka, the capital city of Bangladesh and a city with a very high population density and land scarcity, is moving toward high rise apartment buildings, with not much assurance that construction will conform to Richter scale standards as specified.

It is high time to think prudently and take pragmatic steps. From this perspective, the Bangladesh House Building Finance Corporation [BHBFC] is extending its home loan coverage to rural areas aimed at developing planned and modern housing in villages while protecting cropland from indiscriminate use. The state-owned BHBFC will offer cheaper loans for construction of 385 four-storied buildings in 22 rural areas across the country involving Tk 3.13 billion taka. The 385 apartment buildings will contain 3000 flats, providing around 18,000 people with comfortable and affordable accommodation while cropland would be protected from misuse.

Thailand

Listed Thai developers launching new promotions after disappointing first quarter
The Stock Exchange of Thailand listed property companies recently told *The Nation* that they will boost revenues and net profits in Q2 2015 by offering new promotions after lower than expected first-quarter earnings. During the first quarter of 2015, 11 of the 20 Thai Stock Exchange listed developers reported year-on-year revenue increases but only seven reported net profit increases. Facing rising land and construction-material costs during a tough period, the companies could not raise sales prices despite rising marketing expenditures. Bank of Thailand policy rate cuts of 50 basis points during Q1 also failed to drive market growth. Several listed developers are now launching promotions with local banks to offer special home-loan interest rates. Other developers are

shifting their target markets from the middle-income market to upper-income markets where home buyer demand is still relatively strong. They are also stepping-up overseas roadshows to compensate for lower domestic sales.

Thai builders offering home buyers no installment payment promotions

In an effort to boost lagging sales, Thai developers are offering "no-monthly payment" promotions for new home buyers. "The Nation" reported that Pruksa Real Estate Plc's new home buyers are being offered new homes with no monthly payment installments in the first year. At the same time, Sansiri Plc's "Now or Never" campaign offers homebuyers no monthly payments for two years and discounts of up to Bt1 million ($US 31,250) on many of its 40 nationwide projects. In addition, Sena Development Plc is reducing down payments by 50% and offering home buyers no payments for 15 months at its new single Sena Ville Ramindara and Sena Town Ramindra family home and townhouse projects. Pruksa's Prasert said the cost of providing one or two years of free stays is not more than five per cent of a unit's price. Although developers have to shoulder high costs to run these promos, it's better than having to carry more inventory that doesn't generate income for them, he said.

GH Bank participates in 15th MONEY EXPO 2015

Government Housing Bank President, Angkana Pilun-Owad Chaimanat welcomed M.R. Pridiyathorn Devakula, Deputy Prime Minister and Prasarn Trairatvorakul, Governor of the Bank of Thailand at the 15th MONEY EXPO 2015. At the event, the Bank offered a complete range of financial products including special housing loans at 0% interest for six months. The Bank required no loan application fees and charged only Bt 1,500 ($US 46) for collateral appraisals. The Bank also offered "five month savings deposits" with 2.50% interest per annum for five months. Good quality and well-located non-performing assets (NPAs) in Bangkok and surrounding areas (starting at Bt 140,000) ($US 43,750)) were offered with discounts as high as 30%. Customers purchasing NPAs received 12 month zero per cent interest rate mortgages.

GH Bank announces first quarter 2015 operating profits of Bt 2,474 million

Angkana Pilun-Owad Chaimanat, GH Bank's President announced first quarter 2015 operating profits (as of March 31, 2015) of Bt 2,474 million ($US 77 million), increasing 6.78% from the same period last year. During the first quarter, the Bank issued new loans of Bt 31,647 million ($US 959 million), increasing 7.80% from the same period last year. The Bank's first-quarter total outstanding loans increased 1.35% (from the end of last year) to Bt 804,992 million ($US 25.2 billion) while first quarter total assets increased 3.41% to Bt 853,102 million ($US26.6 billion). Total deposits were Bt 677,339 million ($US 21.2 billion), increasing 3.83% from the end of last year. Non-performing-assets (NPAs) were Bt 44,411 million ($US 1.38 billion) or 5.52% of total loans outstanding – decreasing 0.77% (6.29% of total loans) when compared with same period last year but increased 5.36% from the end of last year.

Annual Meeting of the Asia-Pacific Union for Housing Finance [APUHF]

The APUHF held its Annual Meeting in Islamabad, Pakistan on May 28, 2015.

The meeting was chaired by its new Chairperson Mr. Saeed Ahmad, the Dy. Governor of State Bank of Pakistan-SBP (the central bank of the country). On a proposal presented by Mr. Zaigham M. Rizvi, the Secretary General of APUHF, the meeting passed a resolution to pay tribute to the outgoing Chairperson, Mr. R.V. Verma, Ex-Chairman National Housing Bank (NHB) of India and to confer upon Mr. Verma the Honorary Membership of the APUHF. The Housing Development and Finance Corporation of India [HDFC], represented by Ms. Renu Karnad was also inducted as member of the APUHF Advisory Board. The Secretariat of APUHF will now be functioning at the State Bank of Pakistan, through the office of Chairperson of the APUHF. The HDFC of India has offered to be the host of the next mid-term meeting of the APUHF.

Recent housing markets in Japan

By Masahiro Kobayashi[1]

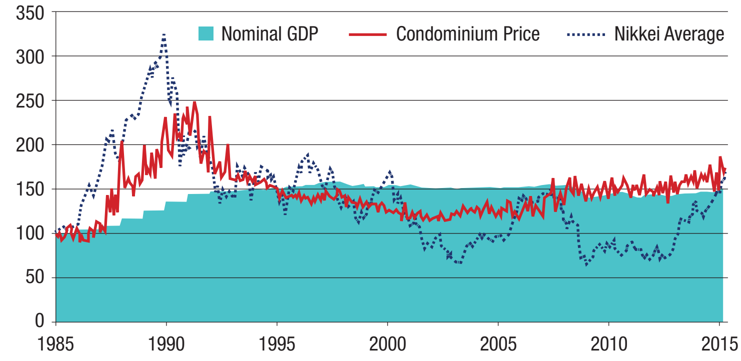
As I wrote in my previous article , Japan experienced a housing bubble and subsequent stagnation of the overall economy, known as the "lost decades", accompanied by persistent deflation. The level of nominal GDP as of 2015Q1 is almost the same as 20 years ago, although real GDP grew moderately because there was deflation.

There is no national home price index in Japan similar to FHFA Home Price Index or the S&P Case Shiller Home Price Index in the US. However, the vast majority of the value of home is considered to be the value of land in Japan, and the value of the national aggregate of residential land continued to decline until 2013 when the newest statistics by SNA became available.

However, property market conditions started to improve in urban areas ahead of rural areas and the per square meter price of a condominium unit in Tokyo Metropolitan Region had already started to pick up in the early 2000's. Another asset class, the stock market, also experienced a significant bubble and this burst in the late 20th century. The Nikkei Average, the most popular stock price index, started to recover from late 2012 and the recovery was reinforced by the strong commitment of Bank of Japan to implement an extraordinary monetary accommodation named QQE "Quantitative and Qualitative Monetary Easing" along with a sharp depreciation of the Japanese Yen. By May 2015, the Nikkei Average recovered 20,000 points since 2000 and had experienced 12 consecutive business day rises since 1988.

What is interesting is that the levels of these asset prices have recovered to the comparable level of the real economy [Figure 1]. Although the growth of nominal GDP has almost stagnated for 20 years, the level is 50% above that of 1985 when the Japanese economy started to experience turbulence amidst sharp appreciation of the Japanese Yen after the so-called "Plaza Accord" [Figure 2]. The annualized growth rates of housing prices and stock prices are both 1.8% while that of nominal GDP is 1.4%.

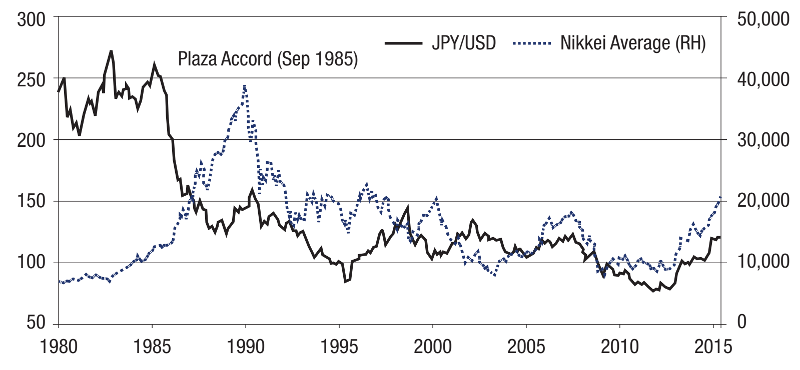
Figure 1 Housing, stock price and GDP (Jan 1985 = 100)



Note: The "Condominium Price" represents the per square meter price of a condominium unit in Tokyo Metropolitan Region. The current series of "Nominal GDP" starts from 1994 and the figure here is the seasonally adjusted annual rate at quarterly base. Figures before 1993 are the author's estimates of annual value by using the previous series. The "Nikkei Average" is the value at the end of month except for May 2015.

Source: Nikkei, Cabinet Office of Government of Japan, Real Estate Economic Institute Co.,Ltd.

Figure 2 Foreign exchange rate and stock price



Source: FRB, Nikkei

Some people warn that the recent appreciation of asset prices is nothing but a bubble triggered by the extraordinary monetary accommodation and insist that the Bank of Japan should consider an exit strategy or normalization of monetary policy, but the Governor of the Bank of Japan has stated that there is no bubble at this time. We have to closely monitor developments in housing and financial markets.

[1] The views and opinions expressed in this article are the author's own and do not represent those of the JHF or the Government of Japan.

[2] Masahiro Kobayashi "Housing bubbles and macro-prudential supervision: a case study from Japan in 1980's and 90's", Housing Finance International Autumn 2013.

[3] An agreement among G7 countries to adjust the over-valued US dollar against the Japanese Yen and other major currencies concluded at the Plaza Hotel, New York.

Goods and Services Tax: How will it impact the residential property sector in Malaysia

By Chung Chee Leong – President/Chief Executive Officer, Cagamas Berhad

Malaysia's government recently rolled out the new Goods & Services Tax [GST] on 1 April 2015. GST which is also known as VAT or Value Added Tax in many countries is a multi-stage consumption tax on goods and services. GST is levied on the supply of goods and services at each stage of the supply chain from the supplier up to the retail stage of the distribution. Even though GST is imposed at each level of the supply chain, the tax element does not become part of the cost of the product because GST paid on the business inputs is claimable.

Type of GST scheme

There will be three categories under the GST scheme: standard-rated category, zero-rated category and exempt-rated category.

1. Standard-rated Category
   In the standard-rated category, local supply of goods and services, supply of land and building for commercial, administration or industrial purposes, and construction of all types of buildings will be subject to GST of 6%. The tax will be billed and collected by businesses and paid to the government. Every party, except the final consumer, can claim back credits on the GST that they have paid. This is called input tax.

2. Zero-rated Category
   Goods and services under the zero-rated category will be charged a zero per cent GST rate. This means that GST is not charged to the final consumer but businesses can claim back credits on their input tax. This is applicable for export sales, international services, basic foodstuff (meat, fish, and cooking oil) and agricultural supplies.

3. Exempt-rated Category
   Exempt-rated category are goods and services that are non-taxable nor are subject to GST at the output stage. This means that GST is not charged to the final consumer. In this context, businesses do not collect any GST on their supplies and are not entitled to claim credit on their business inputs. Examples of goods and services in this category are transport, toll or highway, certain financial services, sales, lease of residential land, **residential properties**, private healthcare and education. In the real estate sector, although residential properties fall under the exempt-rated basket of goods, GST will be applicable for commercial property purchases as they are standard-rated.

Table 1 Residential and commercial properties – previous tax scheme

Supply chain	Cost	Final cost after tax claims	Profit Margin	Sales Price	Sales Tax	Cost Collected	Total Collected
Construction materials First schedule goods	100,000	100,000	20%	120,000	0%	0	120,000
Second schedule goods	100,000	100,000	20%	120,000	5%	6,000	126,000
Construction & Development Construction contractor	**246,000**	246,000	50%	369,000	0%	0	**246,000** 369,000
Developer	369,000	369,000	50%	553,000	0%	0	553,500
						Final cost to consumer	**553,500**

Table 2 Residential properties – GST

Supply chain	Cost	Final cost after tax claims	Profit Margin	Sales Price	Sales Tax	Cost Collected	Total Collected
Construction materials Standard rated goods	200,000	200,000	20%	240,000	6%	14,400	**254,400**
Construction & Development Construction contractor	**254,400**	240,000	50%	360,000	6%	21,600	381,600
Developer	381,600	381,600	50%	572,400	0%	0	572,400
						Final cost to consumer	**572,400**

Source: Royal Malaysian Customs Department; 1gst Malaysia; PropertyGuru Malaysia; www.gst.com.my

Pre and post GST system to property sectors

Based on the previous tax system (Sales Tax Act of 1972), basic building materials like bricks, cement and floor tiles come under **First Schedule Goods**. This means they are not subject to a sales tax, while all other construction materials incur a sales tax of 5% as they fall under **Second Schedule Goods**.

The tables show a comparison between the cost of a new property before and after GST. Certain taxes and costs leading up to the sale to the final consumer have been simplified for this purpose. Also, an assumption is made that developers are able to transfer 100% of all incurred tax costs to the consumer via the sale price.

The example above shows a price increase of 3.41% for new residential properties post-GST implementation. However, new residential properties may register a lower overall increase in tax compared to commercial properties that are standard-rated. This is because developers may only transfer some and not all of their tax cost increases to the final retail price.

Conclusion

There is no doubt that the GST will result in an overall price increase in light of the higher cost of construction materials and necessary building services, but the impact should be minimal on the residential segment and more on the commercial properties. Nevertheless, prices in the secondary residential market may also trend upward to mirror the higher cost of new homes.

Europe: Encouraging private capital investment to promote energy efficiency

By Mark Weinrich

The EU has set itself a 20% energy savings target by 2020 when compared to the projected use of energy in 2020. Furthermore, at an EU summit in October 2014, EU countries agreed on a new energy efficiency target of 27% or greater by 2030.

Buildings cause a significant amount of greenhouse gas emissions. In the European Union they are responsible for approximately 40% of energy consumption and 36% of $CO2$ emissions. By improving the energy efficiency of buildings, EU energy consumption could be reduced by 5% to 6% and $CO2$ emissions lowered by about 5% – a considerable contribution to the energy savings targets.

It is therefore no surpise that the EU has introduced legislation to ensure that buildings consume less energy. A key part of this legislation is the Energy Performance of Buildings Directive, first published in 2002 and recast in 2010. The recast Directive attracted a great deal of attention as it introduced, in Article 9, "nearly Zero-Energy Buildings" [nZEB] as a future requirement to be implemented from 2019 onwards for public buildings and from 2021 onwards for all new buildings. However, as currently about 35% of the EU's buildings are over 50 years old, it is more important that the Directive gives priority to the renovation of the existing housing stock by demanding a long term strategy for the energy efficiency of the existing building stock.

In relation to the objectives laid out in the National Energy Efficiency Action Plans [NEEAPs] which must be drawn up by the Member States every three years, a considerable investment gap for the energy-efficient modernisation of houses is usually apparent. This is also the case in Germany which for many years has provided sizable subsidies in the form of low-interest loans for the energy-efficient refurbishment of older residential buildings.

This has raised the question of whether alternative funding strategies could be able to attract more private capital for energy-efficiency investments. Investments in building energy efficiency do not only require a long investment horizon but bear also particular risks. First, there are *technological risks* which result from unprofessional refurbishment and give rise to uncertainty in respect to the expected energy savings. *Energy price risks* are due to the uncertainty of the development of prices for energy which determine to a large extent the return on energy efficiency investments. There are also *housing market risks* that reflect the ability and/or willingness of renters or investors to pay for the energy efficiency of a building; investment costs might therefore be passed on only partly. Furthermore, there are also *financing risks* which are due to the special character of energy-efficient investments. First, the probability of default is tied to a specific investment project and, second, it is usually not the financial return from the project that counts in obtaining financing but the creditworthiness of the borrower and the property value.

The technical complexity, the particular risks and the long duration of investments in energy efficiency make them less attractive for the classical loan business, despite for some specialists like the German Bausparkassen which disburse loans for energy efficient refurbishment at favourable rates – however, only for private owner-occupiers.

Therefore, governments of many countries support investments in building energy-efficiency with subsidized loans or a financing guarantee – very often in combination with some direct investment subsidy. However, government-supported loans are also structured like traditional mortgage loans so that the loan collateral and creditworthiness of the borrower are of prime importance for the approval of the loan. That is why this type of programme might not reach all investors; Germany is not the only country where despite a sizable government-supported loan programme investment in building energy efficiency falls short of national goals.

This is where alternative funding strategies come into the discussion – could they attract more private capital for energy-efficiency investments? And which alternative might work best?

Given the current low-interest rate period, institutional investors look for safe and long-term investment options. First attempts to tap into pools of private-sector wealth to fund energy efficiency projects include **Green Bonds** or Climate Bonds. As Green Bonds can provide long-term and secure returns, they are an attractive option for investors who appreciate the risks and investment opportunities related to climate change and strive to diversify their portfolio in this regard. Green bonds were first issued by the European Investment Bank and the World Bank in 2007 and 2008, followed by private issuers like GDF Suez, Unilever and the Bank of America. Green Bonds are used so far mostly in order to fund renewable energies. Investments in building energy efficiency are uncommon which can be explained by the smallness of the respective loans. In order to reach the typical issuing volume in a three-digit million range many small loans would need to be bundled which makes the quality assessment costly and implies high risk premiums. At the moment, a direct aggregation of loans to building owners for energy efficiency purposes to Green Bonds seems to very unlikely – at least without government support.

Pay-as-you-save programmes try to overcome different investment horizons and motivate the beneficiaries of the investments to meet the energy savings targets. The UK is the first country which introduced with the so called Green Deal in 2013 such a programme on a national level. The Green Deal helps meet the upfront and funding costs of making energy saving improvements. The key aspect is that the loan repayments match the potential savings on the energy bills from the measure(s) installed. The potential savings are calculated using a formula provided by the government – the Golden Rule – which also defines the maximum loan amount. The loan remains with the property, so that the repayment obligation is passed on to new owners or renters; a feature which makes the Green Deal attractive also for renters. Loan provision is therefore not tied to the creditworthiness of the owner or the property value but only to the returns from the energy efficiency investments. However, there has only so far been low demand for the Green Deal in the UK.

Energy Savings Performance Contracting [ESPC] is a way to attract equity capital for investments in energy efficiency. The contracting partner provides the energy efficiency measures and usually bears most of the financing, operating and project risks. The remuneration for these services is directly tied to the savings achieved by the reduced energy consumption as the contracting partner gets only an amount up to the saved energy costs during the contract period. The ESPC is a service primarily used in the public, commercial and industrial sectors and focused on heating, cooling or electricity; thermal insulation is usually not an issue. While ESPC might be still applicable for larger residential complexes, it is unlikely that owner-occupied houses are an attractive business option for contracting partners.

An **energy efficiency fund** could be another way to provide equity capital for investments in building energy efficiency. Such a fund would collect capital from investors and invest the money in energy efficiency projects. There are two different options for the fund to do so: First, it could either act directly as contracting partner or invest equity capital in businesses of existing contracting partners. As this option is similar to the ESPC, it is first of all attractive for the public and commercial sectors but it has potential to reach out to the residential sector and even private home owners. In contrast to normal contracting partners, the large size of such a fund offers the possibility for better risk diversification, so that also small projects could be considered. However, it is likely that such a fund would invest only in projects that can be highly standardized. Alternatively, such a fund could provide capital for Green Deal projects, but it is questionable whether this would offer any advantage to existing funding sources.

The debate about alternative funding instruments for investments in building energy efficiency gained in importance due to the great investment needs and pressures. Government support through subsidised loans or guarantees works quite well and is used in many countries, but still falls short of the need as the German example shows.

An energy efficiency fund that operates according to the pay-as-you-save-principal could be an interesting funding alternative that is able to attract private capital and to reach out to the private residential sector. Due to its larger size it is in a superior position to diversify its portfolio and to develop a better risk profile than a small private contracting partner. However, the complexity of the issue will make it unlikely that such a fund will be operational within a short time. It should therefore also be considered whether to support systems and specialists already in place who disburse loans for the energy efficient refurbishment of buildings at favourable rates – like the Bausparkassen which operate in several European countries.

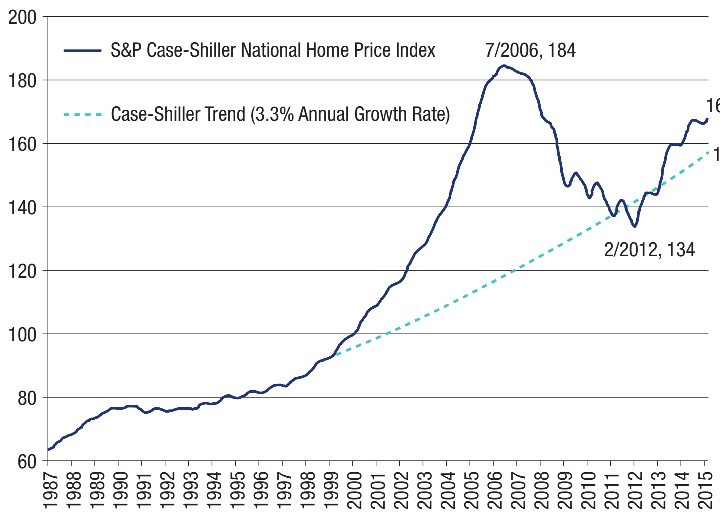
Cycles, pro-cyclicality, counter-cyclicality in housing finance

↳ By Alex J. Pollock

Cycles in housing finance, as in finance and economics in general, are inevitable. The 1960s pipe dream that business cycles could be prevented by macroeconomic "fine tuning" (as the term was then), which was to be guided by Keynesian government economists playing Platonic guardians, was shown to be a delusion soon thereafter. After the wild financial cycles of the 1970s, 1980s, 1990s and 2000s, how silly now seems the title of this 1969 economics book: Is the Business Cycle Obsolete?

But it is certainly no sillier than the much more recent notion which led central bankers, right up to the beginning of the 2007 crisis, to congratulate themselves on having masterminded the so-called "Great Moderation." Belatedly, they found out that it was actually the Great Leveraging, which led to a series of Great Busts, most of which are now cycling back up again (Greece is a notable exception).

The U.S. Housing Bubble:
Case-Shiller National Price Index Values – 1987-2015



In the United States in particular, it is now six years since the bottom of the financial crisis and panic in the spring of 2009. The stock market has reached all-time highs. Sub-prime automobile lending is in full swing. The government is moving to lower down payments for government-sponsored mortgage loans. Fannie Mae and Freddie Mac are again profitable, although 79.9% owned and 100% controlled by the government. House prices started recovering in 2012 and have risen again smartly. The profits of house flipping have again appeared on television. Since 2012, house prices are up on national average about 25%, and in some once again hot markets much more, according to the S&P/Case-Shiller index. This puts national average house prices back over their long-term trend, as shown in the accompanying chart.

The inflation in asset prices, including house prices, is still being promoted by the Federal Reserve, as it insists on maintaining near-zero nominal short-term rates and negative real short-term interest rates, crushing savers to make leverage cheap. The house price inflation makes it harder for first-time home buyers to afford a house, but is good for home builders, realtors, mortgagees, and dealers in mortgage securities. The Fed is the biggest speculator in long-term mortgage securities, owning $1.7 trillion of them. What could go wrong?

A lot of factors are pro-cyclical. That is why we have cycles. These include the group psychology of confidence, which affects all financial actors, private and government alike. This leads to optimistic over-leveraging in the boom, by government as well as private lending programs, which precedes the panicked scramble for cash and safety of the bust.

"All people are most credulous when they are most happy," wrote the great banking thinker, Walter Bagehot, in 1873 – as they all were happy again in 2006. Consider how in the 21st century housing bubbles, the ever-rising house prices seemed to be confirmed by success on all sides. As long as prices were rising, everybody – borrowers and lenders, brokers and mortgage investors, speculators and condo flippers, home builders and home buyers, bond rating agencies and bond salesmen, realtors with rising commissions and municipalities with rising property tax rolls, and very importantly, politicians promoting rising home ownership and loose credit standards – all were or seemed to be winning. Not to be forgotten in the list of winners were the bank regulators proudly announcing there were no bank failures and capital ratios looked good.

Key cyclical factors include the pro-cyclical behavior of financial regulation – a problem well known to the theoreticians of banking and regulation.

This is true in the up phase of the cycle, marked by cognitive herding which led regulators, for example, to promote belief in the Great

Moderation, the idea that there was a global liquidity glut, the use of complex financial risk models, the theories of risk-based capital requirements imbedded in the now-discredited but then-internationally standard Basel II theories, belief in the apparently strong bank performance created by the illusory profits of the bubble, and belief in the booming wealth of households, also an illusion of the bubble.

Regulatory pro-cyclicality is even more important in the down phase of the cycle, as the post-bubble years amply demonstrate. Reacting to the disastrous losses and recriminations of the bust, regulators are afraid of being criticized themselves, afraid of making further mistakes, are trying to rebuild their diminished or insolvent deposit insurance fund, which in the U.S. had shrunk to negative net worth, and trying to re-establish their political credibility. Reacting to mistakes now in the past, they clamp down with great and unforgiving fervor. This contracts credit even further than the crisis already has. Thus it multiplies the downward forces. In the U.S., this pattern is best symbolized by the Dodd-Frank Act of 2010, written in the immediate aftermath of the bust, which created a stifling bureaucratic expansion.

Amidst so much that is pro-cyclical, can counter-cyclical forces be created, which could moderate the inevitable cycles? In theory, they certainly can, however difficult the practice may be. A well-known proponent of this position was William McChesney Martin, longtime Chairman of the Federal Reserve Board (1951-1970). Martin said that "the idea that the business cycle can be altogether abolished seems to me…fanciful." Nonetheless, "something can be done about moderating excessive swings." What that something to do was he described in 1955 in the classic metaphor of the countercyclical idea. This was:

> "To order the punch bowl removed just when the party is really warming up."

What, in literal terms, is the punch bowl, and when is the party warming up? The punch bowl is leverage, and what warms up the party is rising asset prices. Martin's countercyclical principle thus reduces in financial language to:

> Reduce leverage as asset prices rise above their trend.

Leverage can and should be reduced in two places: the balance sheet of the borrowers, and the balance sheet of the lenders. In short, for housing finance: as house prices rise above their trend, reduce the allowable loan-to-value ratios and increase required down payments, and put heavier capital requirements on the mortgage loans of lenders.

Is this hard in practice and in the details? Of course. Would those enjoying the asset price inflation and the credit inflation like it? As Martin's famous metaphor suggests, of course not. But the principle is clear, and in my view, unimpeachable.

Financing affordable social housing in the UK; building on success?

↳ By Peter Williams and Christine Whitehead

1. Introduction

Housing associations [HAs] now provide some 10% of the total housing stock in England and have become the majority providers, overtaking local authorities, in the last few years in terms of both total number of homes and the scale of new development. They are non-profit organisations, usually with a mission to provide affordable housing for lower income and other vulnerable households. They have existed in one form or another for at least two centuries. However, they became important in housing provision only in the 1970s when the UK government began to offer considerable capital subsidies so that they could expand their levels of investment using their own capital and government finance.

Thereafter the next big change came in 1988 when the Conservative Government moved to restrict borrowing by local authorities and decided only to support new investment by HAs within a new funding regime. This involved enabling HAs to set their rents to cover costs and at least balance their budgets and then to borrow on the private finance market against these rents. Capital grants were provided to ensure that rents remained affordable and building was concentrated in areas of need – but increasingly associations had to compete for that grant by offering more for less. Over time the rate of grant from government has fallen from over 90% and sometimes higher before 1988 to usually well below 25% now. Indeed new HA building now often involves no direct government subsidy at all but is funded from HA reserves and private borrowing.

The regime put in place in 1988 had a number of safeguards including strengthening the regulatory framework to control standards and meet prudential targets. Most importantly income related housing allowances, now called Housing Benefit, provided a safety net for tenants and made the income stream for landlords secure. Although there have been many policy changes over the succeeding decades, as well as increasing complexities in financing mechanisms, this framework has fundamentally remained in place to this day.

A very different part of the market also set in place in the mid-1980s was the 'privatisation' of local authority housing through large scale voluntary transfers of their housing stock[1]. Under this regime local authorities could propose a transfer to a new organisation (usually a housing association and normally created from the local authority housing department) 100% funded by private finance. The price of the transfer was based on the projected income stream – taking account of projected rents and tenants' preserved right to buy offset by the costs necessary to bring the housing stock up to a decent standard. Tenants had the casting vote about such transfers based on rents and other conditions set for the first five years. This transfer process enabled the improvement of the stock which had often become run down during the previous decades and it usually involved a positive cash transfer to the Treasury.

Thus the mid-1980s saw the Government put in place a financing and regulatory regime which potentially involved much reduced direct government subsidy while at the same time achieving large programmes of investment both in new-build and the existing stock. This was made possible by developments in the private debt finance market.

In this article Peter Williams and Christine Whitehead look back at the use of private finance to support social housing provision in the UK (and mainly England[2]) since 1988 and discuss how this market might evolve in coming years. Part of this discussion derives from the findings of regular seminars hosted at the London School of Economics on an annual basis from 1989 to 1999 where stakeholders discussed the evolution and development of the private finance regime to the point where funding affordable housing had become a mainstream activity. It draws in particular on the presentations and discussion at two later seminars, one in September 2009 when the global financial crisis was still at its height and the other in September 2014 when the system was beginning to move towards the 'new normal' both in terms of housing policy and financial regulation.

2. The evolution of the private finance regime

Over the 26 years since 1988 it is clear that the private finance regime has evolved from an infant industry which had to be nurtured by government to one which is very much in the mainstream with credit rated housing associations and intermediaries raising bond and debt finance at historically low rates of interest for a wide range of activities that support the provision of social and affordable housing.

In the early days HAs were reliant almost entirely on retail borrowing. In addition the government and regulator funded (with £7 capital) an intermediary – The Housing Finance Corporation [THFC] – which could act as an aggregator to raise bond finance mainly for larger associations. However because of the organisation's extremely limited capitalisation this could initially only operate at a small scale.

[1] As distinct from the Right to Buy introduced in 1980 which allowed individual local authority tenants to buy their homes at a discount. Around 2.5 million homes across the UK have been sold under this policy.

[2] The regimes for English and Welsh associations were very similar, albeit of a different scale. The regimes in Scotland and Northern Ireland were somewhat different.

The debates at the regular LSE seminar in the early years were almost entirely around the question of whether the debt finance was in actuality guaranteed by government. The legal position was straightforward – there was no guarantee. However the Housing Corporation – which acted both as the provider of government funding (technically in the form of a loan) and as the regulator, took only a second charge – protecting the private finance providers from most of the risks associated with lending to the sector. In addition the Corporation as regulator was in a position to restructure associations if problems did occur. Finally, income-related subsidies in the form of housing benefit provided a large proportion of the rental stream. In reality therefore this was a pretty low risk market (Pryke and Whitehead, 1991, 1994, 1995; Bramley in Turner and Whitehead, 1993).

Even so, in the early years the interest rates charged were some points above the LIBOR rate so the system appeared quite costly. However rents were enabled to rise in such a way that reserves were built up (Chaplin et al, 1995) and experience grew to the point that ten years later interest rates for private loans were comparable to those found in the only other major social housing finance market which was fully guaranteed by government, the Netherlands (Priemus, 1999). These rates were sometimes as low as 30 basis points above LIBOR and showed very little variation between associations whatever their scale of operation, financial strength and level of borrowing (Whitehead, 1999).

Thus, over the first decade the market grew rapidly and clearly became an important and healthy segment of the UK housing finance market. This position only started to change with the global financial crisis and the austerity and financial restructuring packages brought in under the Coalition government (Whitehead and Williams, 2011).

The development of the social housing finance market remains the biggest privatisation in the UK with total funding now in the region of £59 billion in England alone with funding forecast to grow by a further £25 billion to 2019, up £14 billion in net terms (see the annual Global Accounts[3] produced by the regulator the Homes and Communities Agency – the successor body to the Housing Corporation).

Since 2008 the debt market has changed considerably with a number of mergers and withdrawals from the sector. The number of large active lenders is now down to 5 with a further 10 lenders active in the market (and a total of 28 lenders having lent to the sector).

Importantly, many bank loans from the late 2000s are now unprofitable resulting in a pressure from lenders to re-price when opportunities arise. Loan terms have shortened from 30 years to 10 years and the interest charge has risen from 25-50 basis points (bps) plus LIBOR to 130 to 200 bps. As the HCA report notes with respect to housing associations in England (HCA, 2015);

> 'Increasingly, providers are using revolving credit facilities for short-term needs, combined with capital market funding for the longer term. These facilities add extra flexibility in terms of cost and security use to the relationship benefits of bank funding. However, the bank market is not in most cases meeting larger providers' need for longer term funding. As a result, the basic treasury model of the sector is changing, introducing new tiers of short- (overdraft and revolving) and medium-term facilities to long-dated debt from existing bank facilities and the capital markets. This will in turn increase the refinancing needs of the sector in the next 10 years as both new and existing loans expire together'

This evolution has gone further with associations raising finance via private placements with insurers, retail bonds issued and now crowd funding being deployed. It is clear that the era of bank debt dominance at least in terms of new funding is over and that the landscape is now much more diverse. Because of the very large back book, bank debt will continue to be the largest source of funding at least for some years but that position will evolve especially in the light of growing dependence on bond finance.

Bond market issuance via the capital markets is now the resurgent source of funding. In 2013/14 some £2.9 billion of bonds was issued by associations in the debt capital markets, exceeding the £2.5 billion raised via bank debt. The first private finance was via the bond market in 1987 and this market is now growing and evolving too. An increased range of institutions are buying paper and via a variety of instruments and structures. Typically there are pension and life funds looking to match long-dated liabilities with an index-related income stream. A further £500 million was raised through private placements. The size of the bond issuance has reduced. The smallest issue in the year at £25 million had an all-in cost only slightly higher than larger issues. There were 2 benchmark issues of £250million or more and a further ten of over £100 million. Pricing of these issues was between 95bps and 140bps over gilts (Government bonds) with terms mainly between 30 and 35 years. This relatively narrow range is also reflected in provider credit ratings, which are all between A and Aa3. There were some 'club' issues where a group of associations combine their funding needs.

There continue to be debates as to the advantages and disadvantages of bank debt or bond finance with some arguing that bond financing lacks flexibility, is more complex and more costly in terms of expensive arrangement processes and higher exit costs. However the pricing can be attractive, funds are available and the loan terms are long, which gives associations considerable certainty with respect to their funding costs. Ultimately most large to medium sized associations seek to have a balanced portfolio of loans – short and long term, fixed and variable rate and bank debt and bond

During the last 3 years the Government in England has embraced the concept of loans and guarantees as distinct from grant. Driven by a shortage of public money and the fact that loans and guarantees score differently than grant in public expenditure terms, 2013/14 saw the first government guaranteed debt made available to providers under the Affordable Homes Guarantee Programme through a subsidiary of THFC. The guarantee backed a £500 million loan from the European Investment Bank [EIB] for on-lending to providers. This subsidiary has subsequently issued its own bonds. The combination of the government guarantee and EIB's AAA rating resulted in very low on-lending rates to providers, at around 40bps over gilts. This funding source is only available for new development.

The sector remains an attractive lending prospect for both banks and capital markets, with a strong asset base, predictable income streams and government support through Housing Benefit and regulation combining to produce favourable pricing. Despite the changes discussed earlier, the availability of debt through capital market finance has continued into 2014/15, with the fall in the gilt rate triggering further reductions in the cost. Over half of new debt raised was via this route. The Guarantee Programme referred

[3] See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/414362/Global_Accounts_2014_Full.pdf.

to above was a new departure for government-linked financing to the sector, while a small number of local authorities have on-lent from their Public Works Loan Board facilities.

3. Looking back

As is clear from the discussion above, by the end of the first decade after 1988 the market was pretty mature. The actors understood the nature of the product and the risks – and there was little point in regular discussion around a well operating system. Although there have been a number of 'incidents' over the years, the decade from 1999 was mainly one of steady growth with the only major concerns being how to expand social sector housing output and to substitute for declining grant. The market had experienced minimal losses and there had been only one insolvency. Lenders had to work hard on occasions to defend their interests and government had taken a long while fully to engage with the reality of having strong private sector partners in the shape of lenders. But the system seemed strong and functional.

3.1 The position in 2009

Then everything changed. The seminar in September 2009 was convened in an environment of massive financial uncertainty – where the worst initial effects of the Global Financial Crisis [GFC] had been addressed but most borrowing markets remained fundamentally closed.

When the seminar was convened in 2009 we concluded in our report (see footnote below[4]) that a new era was emerging in contrast to the picture of almost continuous growth over the decades from 1988. We drew parallels with the situation in 1988 citing the following;

- Low levels of activity; rising grant rates;
- Limited capacity for leverage with few lenders with an appetite for lending;
- A growing interest in bonds as a means of funding rather than debt;
- A discussion of the potential for equity investment;
- A government that cut back heavily on public expenditure once the economy recovers and interest rates move back to 200 bp above LIBOR.

We noted that the number of lenders active in the sector had declined – there were fewer than 10 lenders (with a strong regional lender in both Scotland and Wales) with market conditions working against major new entrants and product innovation. Equity investment in associations has been rejected by government as a way forward, although individual associations were setting up joint ventures with the private sector. We also noted the important changes taking place in both the investment and regulatory frameworks which in the end proved short-lived – the Tenant Service Authority set up in 2008 to take over the regulatory functions of the Housing Corporation. These were then transferred to the Homes and Communities Agency (which had taken over the Corporation's investment functions in 2008) in 2012 when regulation was also scaled back to focus only on finance and governance.

The credit crunch had significantly affected the situation. The shortage of funds had changed the dynamics of the market place with associations in a more vulnerable position than they had been previously, given the falls that had taken place in property prices and sales. In particular a number of associations were exposed to the near closure of the private housing sales market because of their involvement in shared ownership (a part rent/part buy product) which was used by them to provide cash flow and build reserves to expand investment. Some of these problems were being addressed by the Kickstart programme bringing forward capital grants and so enabling investment activity to be maintained – but that in itself puts further pressure on borrowing.

Overall the risks were higher and the demand for funding was less predictable. In our assessment there was a discussion about associations refocussing on social rented provision secured with higher grant. In reality that did not happen, indeed the government stepped back from the provision of social housing and introduced 'affordable rents' – pressuring associations to move to develop these homes with less grant and higher rents (80% of market rather than 40% of market which is what social rents are). The government's focus was on getting associations to be part of the process of helping restart the housebuilding industry after the downturn.

So in 2009 we had some understanding of the issues that were likely to impact on price and availability of social housing finance but very little about how much would be required and the extent to which subsidy would be available. However the fundamentals remained. Associations who were in the market for borrowing (remembering that this was a small minority of the total number, i.e. those with an active development programme) still had strong balance sheets which would in normal times make borrowing relatively easy. Housing benefit remained available for all tenants on low incomes and because of the emphasis on accommodating vulnerable households this meant government was providing around half of all rental income to associations. There was plenty of leeway to increase rents if necessary in most areas. The regulator still acted to ensure stability in the market and to address specific difficulties such as arose from certain more sophisticated financial instruments (interest rate swaps to cover fixed rate borrowing) and government subsidy remained a second charge. Overall, there was a great deal of uncertainty but also some optimism.

3.2 The position in 2014

At the seminar in September 2014 some of these uncertainties had been resolved but others had emerged significantly because of the reduction in capital grants; the move towards affordable (80% of market) rents and welfare reform. The coalition government cut grant funding for the period from 2010 to 2015 to £4.5 billion from which they expected some 170,000 units based on a new affordable rents policy which would require rents to be set at up to 80% of market levels. This had significant impact on HA development programmes and plans (CCHPR, 2013)

They also, for the first time, implemented welfare policies which (at the margin) removed the certainty that social rents would be covered by housing benefit. A welfare cap was introduced which limited the maximum an individual household could claim to roughly the median earned income (£500 per month for a family). This has had very little impact on rental income but has generated additional costs in supporting the small number of social tenants affected. More importantly from the point of view of rental income and management of the stock tenants are now 'charged' for bedrooms above the number deemed appropriate for their household size and structure (DWP Select Committee, 2014).

In combination these have impacted upon associations in a variety of ways depending in part on the markets they are serving. Overall capital funding to the sector has been cut by 50%. Although the take up of the 'affordable' rent programme is increasing (the number of new affordable rent homes rose from 928 in 2011/12 to 40,636 in 2014/15, it is at best a partial and

[4] See http://www.thfcorp.com/docs/news/LSE%20Development%20and%20Change%20back-ground%20paper-%2029%206%2009.pdf.

limited solution. Rather ominously new homes built for social rent fell from 36,713 in 2010/11 to 6,192 in 2014/15 – although there will be a very large one-off increase in 2015/16.

As one of the speakers at the seminar (a finance director) highlighted, the prudent approach adopted at his association included a sensible debt service ratio, no reliance on sales to meet obligations, an active asset management strategy and a forward funding programme. He questioned the tensions between the new affordability regime and the social purpose of the association but recognised the need to balance out competing objectives around social purpose, affordability, welfare dependency and increasing supply. A second speaker, a funding advisor, reminded us of the successes of the private finance regime along with what he called the minor misdemeanours around stand-alone and structured derivatives, both of which were in the process of being worked out of the system. More critically from his point of view was the reliance on bank debt which was now unprofitable but which was also constraining associations via covenants and the banks' unwillingness to allow HAs to refinance. He also highlighted some of the problems with regulation. It had led to a lack of credit differentiation (and the survival of mediocre associations), strong credit ratings unduly reliant on regulation and regulation had induced passivity on the part of HA boards. The implicit guarantee provided by regulation also meant lenders were unlikely to face default and repossession because a transfer of engagements would take place. He asked why HAs need the current form of regulation.

A third speaker who was involved at the outset of the private finance regime in the UK took up this point. She put considerable stress in her closing remarks on the continued importance of regulation to get secure low margins (and ensure access for all sizes of HA from the full range of funders). She reflected that in the late 1980s long-term finance from banks was not envisaged, and this led to the creation of THFC to give access to the bond market and longer term finance. This is a role THFC has continued to play (along with helping ensure access to smaller long-term fixed rate loans from the bond market). She was not persuaded that equity investment made sense given housing providers want long-term ownership of properties. A 2003 study had demonstrated there was a deep market for revolving credit facilities (borrowers pay a fee to secure access to funds as and when they need it) of up to 10 years from banks and long-term bonds, albeit it was several years before the demand for this emerged (Joseph and Terry, 1997).

She asked what might provide the equity/subsidy to enable social housing development in the absence of government support. She highlighted good treasury management and the issue of good timing for the drawdown of loans (a £250m bond with saving of 10bps gives £¼m saving per annum) along with the right balance of fixed and variable loans plus appropriate use of hedging instruments. She also laid considerable stress on good asset management to strengthen the balance sheet. She set out 3 areas where she thought new capacity could be found:

1. If associations could exploit planning gain with government requiring 50% of the increase in land values to be used to support social housing
2. The potential for infill development on local authority-owned land which would remain in LA hands and be financed by an increase in LA borrowing capacity and, finally;
3. She felt that tax breaks specifically for institutional investment in social housing should be introduced.

She concluded that private finance is not the problem, finding subsidy for the core business of social housing is.

4. The current position and looking to the future

4.1 The policy environment

The election of a majority Conservative government in 2015 means that in some ways there is greater certainty than under any other outcome but in others the future is far less clear.

On the certainty side the scale of funding is already set. The Government's 2015-2018 Affordable Homes Programme is aiming to produce 165,000 homes from £1.7bn as compared to the 170,000 plus from triple that amount over the five years from 2010-2015. This is to be achieved by the continuation of the affordable rents regime and the guarantee scheme which reduces the costs of borrowing together with much greater emphasis on bringing forward public land for housing. This will provide additional subsidy in kind to the extent that the land is provided in partnership between the owners and housing providers and from the results of negotiations with respect to planning obligations to provide affordable housing. However it will also undoubtedly use up HA reserves and there are concerns among some that there is inadequate balance sheet strength available.

One response to the increased funding requirement and to the needs of households who in the past would have become owner-occupiers but currently are not able to do so, has been to become increasingly involved in market housing provision. HAs are helping to build for the owner-occupied market, especially for shared ownership and shared equity products and also to build for market and intermediate rent products. This approach can increase profits which can be recycled into additional investment, provide for a range of households no longer able fully to fund themselves and diversify HA activities into the management of mixed tenure developments (Williams et al, 2012).

One of the most significant factors on the uncertainty side is the impact of further welfare reforms. The new regime for HA rents sets maximum increases at Consumer Price Index [CPI] plus 1% but welfare payments are to be held constant for 2 years and will then rise only with CPI while housing benefit also rises with CPI not with actual rents. The expectation is therefore that HAs will not always be able to increase rents by the maximum as tenants will not always be able to pay such increases. More fundamental is the announced reduction of the welfare cap to £23,000 per annum. The cap is also likely to be further reduced during the current Parliament to £21,000. At that level many mainstream families, especially single parents with 2 children, who are wholly dependent on welfare payments will not have all of their rent paid. These changes and others that could be introduced will have three main impacts on HAs – their rental income will no longer be as secure, they will have to use additional resources to deal with the shortfall in rental income and they will have to support their tenants in the more difficult environment (NHF, 2014; Grant Thornton, 2015; Clarke et al, 2015 forthcoming).

A longer term concern lies in the government's commitment to move to a Universal Credit regime within which housing benefit is no longer directly identified and tenants pay their own rents. The potential for large increases in rent arrears arising from this regime is recognised as an important problem. However, the most immediate uncertainty however arises from the Manifesto policy to give HA tenants the Right to Buy their property (extending earlier legislation on the Right to Acquire and the preserved Right to Buy for tenants in place when Local Authority dwellings were transferred to LSVT HAs. We discuss this in more detail below.

4.2 Financial developments

As touched upon earlier, associations have now moved into a new era where the 'terms of trade' are being substantially rewritten on a continuing basis (usefully discussed in KPMG, 2011, Standard and Poor, 2102; Chevin, 2013). Over the five years to 2015 this triggered much reflection on where associations might go in terms of funding and role (see, for example, the series of papers prepared by a major London association, London and Quadrant in conjunction with PWC (2010-2012) and the view of the ratings agencies; Moody (2013 and 2014). With reduced government finance, associations were under considerable pressure to diversify their activities to include more profitable but more risky private sector initiatives which might produce profits and thus a stream of income which could be used to cross-subsidise their social rented development. Clearly not all associations could or would do this. Some (typically smaller) associations simply reduced activity to reflect new circumstances. Others set up subsidiaries which undertook housebuilding, employment services, private renting and indeed functions outside of housing altogether such as provision of leisure facilities. Some associations resolved to sell stock on a regular basis to balance their books. The diversification that has taken place is still modest in relation to the stock as a whole but is indicative of the tensions that exist.

These developments have prompted a continuing debate as to ways ahead regarding funding. Some have asked whether institutional investors would become major players in the affordable housing market by for example, buying freeholds and leasing homes back to associations (JLL, 2014) or the creation of a social equity fund (PWC and L&Q, 2012). Equally government could take equity stakes (Walker, 2014). Alternatives have also included moving to market rents (PWC and L&Q, 2012) and the creation of a new regime of 'living ' rents linked to local incomes (JRF and NHF, 2015) as well, of course of restoring grant funding (Capital Economics, 2015).

It is not evident that the Government is willing to embrace any of these suggestions. For the moment it has settled on continuing their policy of realising assets by selling HA homes to their tenants (see below). This aims to secure the dual objectives of enhancing home ownership and generating receipts for new building topped up by a requirement that local authorities sell their most expensive housing stock, the practicalities of which have been challenged by many (eg, Kerslake, 2015).

5. Conclusions

It is evident from this review that over a quarter of a century the private finance regime for social housing in the UK has been a successful initiative. However it has not been unchanging nor unproblematic. The market has shown a degree of volatility arising from both policy and market conditions. In retail debt funding terms it is undoubtedly currently in a contraction phase. Initiatives looking to increase equity finance have as yet been relatively small and confined to new mixed tenure developments.

Current concerns are exacerbated by a number of outstanding issues around the future strength of the association sector and its regulatory and financial environment. These will undoubtedly be condition lender appetite going forward. However there have been many times in the past when HAs and the financial institutions have rung warning bells but there has generally been relatively little subsequent negative impact.

Most recently the new government has set out its intention to introduce a Right to Buy policy for all tenants of housing associations in England. While some existing association tenants have enshrined rights (both preserved Right to Buy as stock transfer tenants and Right to Acquire for tenants in homes built post 1997 – probably in excess of 1.2 million tenants -around half of the total number of HA tenants) higher discounts and shorter 'waiting' period mean that take up is likely to increase. An important issue is that the new policy might threaten the HA sector's status as private bodies and ultimately whether the private finance they have raised will count instead as public debt. This would be so much of an own goal for government that it is probable that the policy will be developed so this is not the case – the fact that the discounts are paid for from sales of more expensive local authority properties rather than the HA is part of this story. However there are currently clear concerns not just about the status of the sector's debt but also with respect to the value for money for associations in continuing development programmes which might simply generate sales.

At this stage there is no real evidence on the financial impact of such a sales policy nor on the flow of receipts that might be generated to enable additional building. However it highlights the policy risks that still surround this sector, driven by both its continued reliance on public subsidy (if not grant then housing benefit and ultimately un-hypothecated Universal Credit) and the underlying drive by the government to promote home ownership (especially given the decline of that tenure in the last decade).

At the same time the HA sector has shown considerable resilience and has now built up a significant asset base with a substantial rental flow. This gives the sector the capacity to ride out some of the storms that come its way. Associations have shown a considerable capacity to adapt to new circumstances although in so doing some have reduced their role in relation to the poorest households and most are looking to strengthen their activity in the middle ground of the housing market. Most recently the Chair of the Communities and Local Government Select Committee has announced his intention to ask the Committee to examine how housing associations use their surpluses with a focus on whether more could be done (Inside Housing, 2015). In 2013/14 the sector in England generated a surplus of £2.4bn although it is important to note that cumulative reserves are taken into account by lenders and so affect the terms available.

One important issue tied up with the regulatory regime and the capacity to fund their own investment is that of mergers and take-overs. Even though there has been considerable restructuring it is still not unusual for a local authority to have to work with dozens of HAs, some large, some small, generating high costs for both groups. More generally it means that scale economies are not being realised. The regulator has in the past called for more systematic restructuring of the sector and this call is likely to be reiterated in the new environment.

This issue of industry structure is one element of a much more fundamental problem. The regime set up in 1988 offered few incentives to HAs to reduce their costs and to operate more efficiently. Bidding for grant put some limited pressure on new-build efficiency but more generally higher costs could be covered by higher rents with the government taking the strain through higher housing benefit payments. Changes in the welfare system are beginning to put some pressure on associations to increase efficiency but there is a long way to go. The means by which government might address this issue are as yet unclear – but they could significantly increase risks for financial institutions, highlighting once again the constraints of policy imposed by putting in place a private finance regime.

The private finance regime for housing associations in England and the UK is recognised as having been one of the biggest success stories of the era of privatisation. It allowed government significantly to reduce grant funding and to bring a new commercialism to the sector. That process has continued to evolve, with associations as not for profit social businesses now setting out plans substantially to increase housing output both for renting and owner-occupation – subject of course to government not damaging their capacity to do so. Without doubt there is the potential for the sector to do more and it is evident there is a continued appetite from funders to support their activities. Now the challenge for the HA sector is to absorb the impact of welfare reform and government cutbacks while fulfilling its evident potential to be a major contributor to solving the housing crisis in England.

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Housing policy in post-reform urban China

By Jie Chen[1]

1. Introduction

This paper demonstrates that the latest developments in the Chinese housing system are closely connected to the adoption of the "harmonious society" development ideology of 2006 as well as the new urbanization strategy formally launched in 2013, which is essentially a reorientation of the development strategy of the Chinese economy (World Bank and DRC 2013). In its focus, the recent public housing program serves as a driving force to promote provision of permanent accommodation for millions of low-income migrants in cities under the new urbanization strategy. Interestingly, the literature suggests that housing practices in China at the moment are actually not very different from those in western countries if one takes the stage of development of urbanization in China into consideration (Chen, Stephens, et al. 2014). In many western countries, public housing was developed at a similar stage of rapid industrialization to accommodate industrial workers (Malpass & Murie 1999; Chen, Stephens, et al. 2014). From this perspective, one may conclude that governments across the world are adopting "similar strategies" to address similar housing issues when facing the pressures of rapid urbanization (Chen, Stephens, et al. 2014). However, the Chinese experience of achieving a balance between economic prosperity and housing affordability during the rapid urbanization process is still unique and thus may carry wide policy implications.

2. The Chinese post-reform housing system

Since 1998, the system of housing provision in urban China has evolved gradually with economic development and the urbanization process. The shift in the responsibility for provision of urban housing from work units to the market has made rural-to-urban migration and labor mobility much easier than before. However, the housing market boom has also been accompanied by a rapid increase in house prices, making home purchase increasingly unaffordable for low- and middle-income households and, in particular, for young workers and migrants (Chen et al. 2010; Yang & Shen 2008). The housing market is thus polarizing property wealth between different tenures and different socioeconomic and demographic cohorts (Logan et al. 2010; Man 2011). Meanwhile, the lack of affordable housing provision has produced severe obstacles for the sustainability of urbanization in China. The Chinese central government has over time reached a consensus that the imbalance between the housing sector and socioeconomic development can be largely attributed to the insufficiency and inefficiency of the state provision of housing (Qi 2009; MOHURD 2011; Li 2011).

2.1 Housing stock

An overwhelming majority of the public housing stock was quickly privatized within a few years after 1998. It is estimated that the size of the privatized public urban housing stock at the end of the 20th century was 2.5 million sq. m (roughly 70% of total public housing stock) and associated with an implicit market value of approximately RMB 2.5 trillion, or approximately 32% of China's GDP in 1998 (Adams 2009). Privatization has helped raise home ownership levels among the permanent urban population to approximately 90% (cf. Table 1). It is estimated that 40% of (permanent) urban residents live in privatized housing. Enjoying a form of 'state legacy welfare', they are protected from the rising costs of housing in the market sector (Chen et al. 2010).

In tandem with the massive construction boom since the 1998 reforms, the improvement in housing conditions in urban China is substantial. According to the sixth national census (2010) (NBSC 2012), the total area of the occupied housing stock in urban China doubled from 10.3 billion

Table 1 Tenure Distribution of Housing in Urban China, 2011

Tenure type	Description	Share (%)
Owner-occupied		89.3
Owned Private housing	Self-built after 1949 or old private housing built before 1949	11.2
Owned Market housing	Bought through the market and built by developers	38.0
Privatized Public housing	Bought during the 1980-2000 housing reforms	40.1
Rental lease	Including both private and public rental housing	10.7

Source: NBSC (2011)

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sq. m in 2000 to 20.3 billion sq. m in 2010, and the average housing space per person in urban China was subject to a 35.6% growth over the same period (22.36 sq. m vs. 30.33 sq. m).

However, the improvement in housing conditions in urban China is substantially uneven across regions. The housing conditions are generally quite good in the developed eastern region, but much poorer in the underdeveloped western area (cf. Figure 1). Further, there are vast variations in housing conditions across cities of different sizes. Generally speaking, the prevalence of housing overcrowding is still high in large cities where the migrant population grows fast, for instance, Shanghai and Beijing.

2.2 Housing provision system

The market-oriented housing reform in 1998 aimed to shift responsibility for provision of housing from the state to the market. Nevertheless, the state did not plan to withdraw completely from housing provision. A two-tier public housing system consisting of Cheap Rental Housing [CRH] and Economic Comfortable Housing [ECH] was introduced in 1998. The CRH program is targeted at accommodating lowest-income households at a nominal rent rate, playing a residual role as in the U.S. and other western countries (Chen, Yang, et al. 2014). The ECH program is expected to promote homeownership within low-to-medium income households who could not afford buying home at market price.

While the policies and mandates are set by the central government, the responsibility of producing and distributing ECH is placed on the shoulders of local governments. However, local governments usually assign state-owned land to real estate developers at zero or very low prices and then direct them to take responsibility for the finance and construction of ECH. The profits for real estate developers are capped at around 3%, so as to keep the price of ECH at a level that is affordable for most low-income households. To get ECH, individuals need to apply to the local housing authority and pass the qualification check that includes a local residence permit *(hukou)*, asset, income and living space requirement.

ECH was officially designed as the predominant form of post-reform housing provision in the milestone document of the 1998 housing reform (SC [1998] No.23). In recent years, several new forms of public housing have been developed in urban China. The SOH [shared ownership housing], which has been launched since 2010 in Shanghai, resembles very much ECH [economic comfortable housing). However, SOH clearly requires that about half of the capital gain when selling the housing should be returned to the government while ECH does not explicitly have such a regulation. The PRH (public rental housing) is the only type of public housing that is accessible to migrants (residents without local *hukou*) and its rent is generally only slightly lower than the market rate. In 2010, the PRH was promoted by the Ministry of Housing and Urban-Rural Development [MOHURD] as a favored national mode of public housing (MOHURD [2010] No.87). Since 2014, the CRH has been merged with PRH where CRH is treated as a special segment of PRH (MOHURD [2013] No.178).

2.3 Housing affordability pressures

Since 1999, housing prices in urban China have maintained a strong upward trend, with the exception of a slight downward price adjustment in 2008 due to the shock of the global financial crisis. Clearly, rapid urbanization is one of the fundamental driving forces behind the recent developments in the urban housing market in China (World Bank and DRC, 2013). At the national level, the mean housing price in 2014 was approximately 3.15 times that in 1999 and 1.6 times that in 2008. In large cities such as Beijing and Shanghai, housing prices have risen much higher than the national average. A persistent increase in housing prices, particularly in China's major cities after 2008, affects both the sustainability of the property market and social stability (Yang & Chen 2014). Nonetheless, Chinese households' incomes have also grown substantially since the 1998 housing reform. At national level, it appears that the housing affordability index has not worsened much since 1999, and recent research confirms this point (Chen et al. 2010). However, households' purchasing power varies significantly across regions, and widening differences in regional housing markets have created a volatile context for local housing affordability.

While the marketization of housing provision has greatly helped facilitate rural-to-urban migration and also created millions of job opportunities for migrants, the upsurge in housing prices also makes decent housing accommodation increasingly unaffordable for migrants (Chen et al. 2010; Yang & Shen 2008). Over time, the lack of affordable housing provision has posed severe challenges for the sustainability of urbanization in China. Despite rapid urbanization, migration in China is still subject to many institutional restraints. The *hukou* system, the urban registration system that was introduced in 1958 (although it had precedents), has been promulgated as an official tool to control the free movement of people between urban and rural areas (Chan & Buckingham 2008). Administrative regulations issued in 1982 known as "custody and repatriation" (C&R) authorized the police to detain migrants if they did not have a local residence permit *(hukou)* or temporary living permit in the city and repatriate these "illegal migrants" to the settlements where their permanent *hukous* were issued (Chan & Buckingham 2008). Although the C&R law was formally abolished in 2003, the *hukou* system remains in force today and continues to constrain population mobility. Under the *hukou* system, migrants are largely excluded from the welfare package reserved for local residents, including unemployment insurance, health care, pension, housing benefits and even their children's right to enter local schools (PFPC 2012).

The *hukou* system has been constantly noted as a major constraint on the housing consumption of migrants (Wu 2004; Sato 2006). At the national level, an official survey indicates that the homeownership ratio among migrants was around just 10% in 2010 (PFPC 2012), which is in sharp contrast with the figure of 89% among permanent urban residents (NBSC 2011). The exclusion of migrants from the local housing welfare system further exacerbates migrants' difficulties in the Chinese urban housing market (Sato 2006).

2.4 Housing policy reformulations

The priority of Chinese urban housing policy in the first decade of 2000 was exclusively to develop for-profit property development that could help generate enormous taxes and increase land revenue. The housing affordability issue of low-income disadvantaged groups, particularly rural-to-urban migrants, has been largely neglected in the Chinese urban housing policy so far. This mode of housing regime is clearly unsustainable because it has produced too many social conflicts and even threats to political stability (Chen, Yang, et al. 2014). Heavy reliance on the real estate sector also makes the Chinese urban economy too susceptible to the risks of property cycles. In addition, the Chinese banking system has accumulated undue risks from investing too much credit in mortgages and other forms of real estate loans (People's Bank of China 2014). This model also hinders urbanization in China by not only making the costs of decent accommodation increasingly unaffordable for migrants but also pushing up local wages, deterring labor mobility, hampering large cities from achieving the full potential of the agglomeration effect and reducing the competiveness of these cities. For example, a recent study notes that the severe constraint of land supply in the east is a key reason housing prices, and consequently wages, have increased in these cities, which has damaged the competitiveness of the Chinese urban economy (Lu et al. 2014).

From these perspectives, the Chinese housing policy is no longer subordinated to economic policy, but is rather an integrated part of economic policy. Nonetheless, the Chinese housing system is still undergoing drastic transformations, and it is obviously too early to draw any definite conclusion. Further research is needed to identify whether and how the Chinese housing system has shifted from "productivism" to "developmentalism". However, because the switch in the housing regime is already an important part of this macro political and economic transition, the recent transformations of the Chinese urban housing system must be understood within the overall transformation of China's development ideology from "productivism welfare" to "developmental welfare" (Chen, Yang, et al. 2014).

3. Conclusions: Lessons from the Chinese post-reform housing policy

The Chinese experience regarding the interaction between the housing system and urbanization is unique, but it clearly indicates that an effective housing system that can responsively provide sufficient affordable housing is an essential component to the success of inclusive and equitable urbanization. Below we offer some policy recommendations for establishing an affordable housing system that is more supportive to urbanization.

It is true that the housing policy may need to meet several policy objectives, but ensuring affordability should always be the primary priority. The massive public housing program is designed to help balance economic growth and provide stability in light of the increasingly short supply of low-cost housing, high levels of inflation and a growing wealth gap. Fortunately, the new urbanization strategy has openly put accommodating low-income migrants in the cities as a central target, and various solutions, including developing massive-scale public housing, have been attempted. The current national prioritization of public housing in China signals a sharp change in the housing policy of previous decades, addressing negative externalities and inefficiencies in China's short-lived post-housing reforms period. To make the affordable housing movement sustainable, there is a need to promote the UN-honored concept of "housing rights", where adequate housing is considered a basic human right and is be protected not only by governmental measures but also laws (UN-HCHR 2009). However, housing sector complexities can never be totally coordinated by a central authority, and a legal system that ensures the delivery of sufficient affordable housing should be established.

The conflict between affordability concerns and the objective of economic growth within the Chinese housing system is largely due to the local state's heavy reliance on land-based urban financing, which is contingent on housing market booms. Land and housing policies are among the Chinese government's most important tools for fine-tuning the economy. A housing policy that addresses the needs of the majority is critical for any government during the transition. Today the government is looking at a long-term land allocation plan oriented toward economic restructuring as a tool to control economic cycles. Nonetheless, to promote human-based urbanization rather than "land urbanization", the state needs to restructure the central-local fiscal relationship, reform the tax system of local states and encourage experimental innovations in urban infrastructure financing, i.e., new forms of PPP [public–private partnership]. For example, several hybrid arrangements of PPP between local governments and private investors have emerged in the last decade (ADB 2008). However, an enabling formulation of the regulatory and policy arrangements is a precondition to the success of any type of PPP project. Meanwhile, there is a need for concerted attempts to develop the Chinese municipal bond market.

The current plan to rapidly increase investment and construction in public housing may result in an increased supply of affordable housing for needy families. However, we believe that the establishment of a finance system for such affordable housing is at least equally important. The Chinese government should promote the use of a variety of financing tools and instruments to attract social capital to public housing investment and lower the cost of borrowing for low- and middle-income families. A well-functioning housing finance system will contribute to the expansion of home ownership (Chen & Deng 2014), the development of housing markets and employment, economic growth and wealth accumulation, and social and political stability.

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National Housing Policy; an issue for prohibited state aid

↳ By Christian König

1. Introduction: how European Union law restricts national supportive measures for housing[1]

Housing Policy is no longer a focus of the EU, even though, it has previously been a policy issue for the European Commission. The European Union does not have legislative powers in the area of housing. Housing policy is still an exclusive issue for Member States. But in the past the EU has tried to influence national housing policy and even social housing policy by both direct and indirect means.

2. Activities of the European Parliament

The creation of so called inter-parliamentary groups by the European Parliament is an evident proof of the fact that the Members of the European Parliament [EP] wish to make their mark in the area of housing policy at EU level, even though according to the EU treaty, the EU is not competent to regulate this matter. Nevertheless, already in 2005 the Members of the European Parliament founded the so called Inter Group Urban & Logement[2] in order to become more involved in the area of housing policy. The name of this group changed after the last election in 2014 to Urban, the other part of the name "logement", which in French means "housing", was deleted.

The work of the URBAN Intergroup focuses now on a number of subjects linked to sustainable development of urban areas such as environment and energy efficiency, urban transport, housing social aspects (social exclusion, migration, ageing of the population), services of general interest, local public finances and the impact of the financial and economic crisis on cities. The main objectives of the URBAN Intergroup are to monitor the legislative and non-legislative work of EP's committees on urban related issues, to work on common EU strategies, to put urban needs on the agenda in terms of EU policies, to be actively involved in the preparation of EU legislation, to constantly stay in contact with partners and practitioners and to provide information about realization of EU policies on the ground. Usually, the members of this group of gather once a month in Strasbourg.

But the European Parliament[3] in the past also generally raised its voice and claimed that access to housing is a fundamental right that can be seen as a precondition to the exercise of, and access to, other fundamental rights and to a dignified life. Furthermore the Parliament has stressed that guaranteeing access to decent and adequate housing is an international obligation incumbent on the Member States, to which the Union must have regard, given that the right of access to housing and to housing assistance is recognized in Article 34 of the Charter of Fundamental Rights of the European Union, Articles 30, and 31 of the revised European Social Charter adopted by the Council of Europe and Article 25 of the Universal Declaration of Human rights, as well as in many Member States constitutions.

According to the European Parliament, national, regional and local authorities in the Member States have a right, as well as a duty, to define their own housing policy and to take the steps required to ensure that this fundamental right is upheld on their respective housing markets, in accordance with the needs of their inhabitants, with the aim of providing universal access to decent, affordable housing.

Concerning social housing, the European Parliament stated that Member States, in line with the principle of subsidiarity, have an essential role to play, and a wide discretion, in providing, commissioning and organizing the provision of social housing in parallel with, and in addition to, the unplanned, market-based housing supply. The provisions of social housing should fulfil a high level of quality, safety and affordability, and promote equal treatment and user rights.

If there is a shortage of social housing facilities, and an increasing need for affordable housing, which is the case in most EU Member States, new social factors in order to entitle citizens to benefit from social housing should be identified so that the Member States, and their respective local and regional authorities, can define a range of housing strategies that more closely match actual circumstances.

According to the European Parliament, social housing policy is an integral aspect of services of general economic interest. It helps to meet housing needs, facilitates access to property, promotes the quality of living space in new dwellings, improves existing living space and adapts housing expenditure to the family situation and resources of the occupiers, while leaving scope for effort on their part. Social housing should be characterized by a good relationship between quality and purchase price or rent, permit energy savings, be located in an environment which includes green spaces, and be suitable for different generations, with account taken of the specific needs of children and older persons.

So far so good, this report expressed the political wish by the European Parliament to take housing into consideration, but concrete actions in the

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[2] http://urban-intergroup.eu/about-us/

[3] Report on social housing in the European Union (2012/2293(INI)), Committee on Employment and Social Affairs of the European Parliament from 30. April 2013.

area of housing policy have never been voted by the European Parliament.

3. Housing policy developed by the European Commission

Despite the clear political demand by the European Parliament the European Commission has never proposed any concrete policy measures to promote action in the area of housing.[4] Only in the area of social policy and fighting homelessness has the Commission published a so called Commissions Staff Working Document Confronting Homelessness in the European Union.[5] Even in this document the Commission stressed the point that the primary responsibility for tackling homelessness lies with EU Member States and their regional or local authorities, the European Union only complements and supports their efforts.

Therefore it is clear that the European Union will not take the initiative by regulating or proposing measures in the area of housing or social housing policy directly.

But, indirectly the European Union influences housing and social housing policies by regulating mortgage credit[6] and by bringing EU Member States to the European Court of Justice, challenging individual rules in national law which affect social housing and housing policy.

4. EU case law affecting housing policies

The European Commission took the initiative to rule out some Member States policies which supported housing finance or tax advantages for self-owned housing. These two older examples show that even national tax law incentives have been under scrutiny.

a) Case C-152/05 Judgment of the ECJ of 17 January 2008: Commission of the European Communities v Federal Republic of Germany

On 17 January 2008, the ECJ ruled that the Federal Republic of Germany, with the Act on subsidies for owner-occupied dwellings (EigZulG), which in the meantime had been repealed, infringed the fundamental freedoms under the EC Treaty. The European Commission had pursued its action brought on 5 April 2005 despite the repeal of the EigZulG on 1 January 2006 and did not withdraw it. In his judgment, the judge largely followed the Opinion of French Advocate-General Yves Bot.

The ECJ argues that the EigZulG has a discriminatory effect especially for frontier workers, since it denies the subsidy to persons taxable in Germany who acquire a home of their own elsewhere in the EU. The Act therefore infringes the freedom of movement for workers according to Article 39 of the EC Treaty and the freedom of establishment according to Article 43 of the EC Treaty. The ECJ explains that it is true that in principle such intervention could be justified by an overriding reason in the public interest – here the promotion of housing. However, the measures would have to be an appropriate way of ensuring that the objective pursued is achieved. The aim of meeting the demand for housing could however also have been achieved if the subsidy is received by a taxable person in Germany deciding to reside in another EU Member State.

A few years later the German government abolished this supportive measure for housing entirely for budget reasons.

b) Case C-269/07 Judgment of the ECJ of 10 September 2009 in the Treaty infringement proceedings: Commission of the European Communities v Federal Republic of Germany

The ECJ ruled that, by introducing and maintaining the provisions for complementary pensions in paragraphs 79-99 of the Income Tax Act, the Federal Republic of Germany has failed to fulfil its obligations under Article 39 EC and Article 7(2) of Regulation (EEC) No 1612/68 of the Council on freedom of movement for workers within the Community and Article 18 EC. It is therefore to be seen as an infringement that the Income Tax Act denies cross-border workers and their spouses the right to the savings pension bonus, unless they are fully subject to tax in Germany. A second infringement exists since, according to these provisions, cross-border workers are prohibited from using the subsidised capital for the acquisition or construction of an owner-occupied dwelling unless the property is situated in Germany. Thirdly, also the rule that provides that the bonus be reimbursed on termination of full liability to tax in Germany is in conflict with Community law. In their judgment, the judges followed the opinion of Slovak Advocate-General Ján Mazák and thereby granted the order sought by the European Commission in full. The ECJ explains on this subject that this is indirect discrimination on the grounds of nationality which cannot be justified by coherence of the fiscal system, since this would be ensured by bilateral conventions to prevent double taxation concluded by the Federal Republic with other Member States. According to the ECJ, the risk of a conflict with the housing policies of other States or of jeopardising the national social security system is not sufficiently established to justify the indirect discrimination found. The ECJ explains that the fact that Germany cannot tax the later payments on account of the retirement provision agreement if the worker leaves the territory of the Federal Republic again is not a relevant argument on account of the existence of bilateral tax conventions.

c) Cases C-132/12 P Stichting Woonpunt and C-133/12 P Stichting Woonlinie

These two cases Stichting Woonpunt and Stichting Woonlinie at the European Court of Justice did not deal with social housing policy and state aid law as such, since the Court had to decide on the procedural right of plaintiffs, which were not addressed directly by decisions of the European Commission, but which were affected by the implementation of a state aid decision.

But the background of these rulings was that the European Commission had interfered with social housing policy of the Netherlands by using the sharp tool of EU state aid law in the year 2009. As a general principle in EU law,[7] any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favoring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market. But there is an exemption for state aid which is compatible with the Internal Market of the EU, if this aid has a social character, granted to individual consumers, provided

[4] Social Housing in the EU, Report by the European Commission Employment and Monetary Affairs, 2013, which give a good overview of social housing state of play within the 28 EU Member States.

[5] Commissions Staff Working Document Confronting Homelessness in the European Union accompanying the document Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions "Towards Social Investment for Growth and Cohesion – including implementing the European Social Fund" 2014-2020/* SWD/2013/042 final */

[6] For more details on the EU regulation of mortgage credits, König, "European Union opts to regulate mortgage credit", Housing Finance International 2012 , König in Svenska institutet för europapolitiska studier, "The creation of an internal market for mortgage loans: A never ending story" or König, "Latest ideas on the structural reform of the banking market and its effect on housing finance", Housing Finance International 2013.

[7] Art. 107 TEU

that such aid is granted without discrimination related to the origin of the products concerned.

Already in 2002 the Dutch authorities notified the Commission of the general state aid scheme for so called wocos, (Stichting Woonpunt, Stichting Havensteder (formerly Stichting Com.wonen), Woningstichting Haag Wonen and Stichting Woonbedrijf SWS.Hhvl). Since the Commission found that the funding measures for wocos could be classified as existing aid, the Dutch authorities subsequently withdrew their notification. Wocos are Dutch not-for-profit organizations. Their basic mission is to acquire, build and let out dwellings mainly for disadvantaged citizens and socially less advantaged groups. They are engaged in other activities such as construction and renting out apartments of higher value, construction of apartments for sale, construct and let out of public purpose buildings such as cultural and health centres, construct and let out commercial premises, construct and maintain parks and other local infrastructure. They are also involved in supporting social services such as family coaching, financial advice to households and integration of immigrants.

On 14 July 2005, the Commission sent a letter to the Dutch authorities under Article 17 of Council Regulation (EC) No 659/1999 classifying the general scheme of State aid provided in favour of wocos as existing aid and expressing doubts as to the compatibility of that aid with the common market. First, the Commission pointed out that the Netherlands authorities had to amend the public service mission entrusted to wocos, in such a way that social housing would be earmarked for a clearly defined target group of underprivileged individuals or socially disadvantaged groups. It stated that all commercial activities of wocos had to be carried out in accordance with market conditions and should not benefit from State aid. Finally, it stated that the offer of social housing had to be adapted to the requirements of underprivileged individuals and socially disadvantaged groups.

According to the European Commission at that time there have been 7.1 million dwellings in the Netherlands, of which 2.4 million (33%) were owned by wocos. In the rental market wocos were the biggest player with a 77% share of all rental dwellings. Of this stock 98% are let under a regulated rent regime. Wocos virtually alone rent out public purpose buildings such as community centres, youth centres, sports facilities etc. In addition, wocos are also active in the market of construction of owner-occupied homes where they had a 14% share of new constructions in 2007.

Due to state aid they received, private competitors claimed to suffer from unfair competition.[8]

These woco's received state guarantees for loans granted by the Guarantee Fund for the construction of social housing, state aid from the Central Housing Fund, project-based aid or aid for rationalisation in the form of loans at preferential rates or direct subsidies, the sale by municipal authorities of land at prices below market value and had the right to obtain loans from the Bank Nederlandse Gemeenten.

The European Commission classified each of those measures as constituting State aid and took the view that the Dutch scheme for financing social housing constituted existing aid, as that scheme had been created before the EC Treaty entered into force in the Netherlands and the subsequent reforms did not bring about any fundamental change. The Dutch government then made commitments to amend the functioning of wocos and the measures favouring them. For several of the planned changes the Netherlands authorities have submitted draft rules to the Commission. These newly proposed rules have then been cleared by the European Commission to compatible with the Treaty of the European Union.[9]

5. Conclusion

As a conclusion of the whole procedure one can draw the following borderline for housing policy by EU Member States in order to be compatible with EU state aid rules.

Social housing needs to be targeted at a clearly defined group of disadvantaged citizens or socially less advantaged groups. Any commercial activities by market participants, which get an advantageous public treatment, like cheaper funding costs due to implicit state guarantees for example, should be carried out on market terms and should not benefit from state aid. Finally, the offer of social housing should be adapted to the demand from disadvantaged citizens or socially less advantaged groups.

Previously, the European Commission had already stressed in respect of social housing and state aid,[10] that Member States shall carry out regular checks, or ensure that such checks are carried out, at the level of each social housing undertakings, to ensure that the undertaking concerned is not receiving any overcompensation for their service.

Undertakings in charge of social housing which are entrusted with tasks involving services of general economic interest have specific characteristics that need to be taken into consideration. In particular, account should be taken of the fact that at the current stage of development of the internal market, the intensity of distortion of competition in those sectors is not necessarily proportionate to the level of turnover and compensation. Accordingly, undertakings in charge of social housing providing housing for disadvantaged citizens or socially less advantaged groups, which due to financial constraints are unable to afford to obtain housing in the market, should benefit from the exemption from notification to the European Commission if the public service compensation granted to undertakings with an average annual turnover before tax, all activities included, of less than EUR 100 million during the two financial years preceding that in which the service of general economic interest was assigned, which receive annual compensation for the service in question of less than EUR 30 million.[11]

Coming back to the Dutch example, as a result of this whole procedure the Dutch government will grant aid to the wocos in the sense that the target group of socially disadvantaged households will be defined as individuals with an income not exceeding EUR 33,000. This definition covers approximately 43% of the Dutch population. The ceiling will be indexed every year. The maximum rent in social housing will amount to EUR 647.53. This ceiling is subject to annual indexation as well. It will be ensured that 90% of the dwellings in each woco are allocated to individuals belonging to the target group at the moment of allocation. This decision has clear implications for social housing providers who wish to offer housing to an economic cross-section of the population in order to promote mixed communities rather than communities containing a concentration of poor households which is believed by some to lead to a range of social problems.

[8] More details on this with a comparison with the Swedish rental system can be found at Marja Elsinga and Hans Lind in „The effect of EU-legislation on rental systems in Sweden and the Netherlands".

[9] Article 106(2) TFEU

[10] Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest C(2005) 2673).

[11] Art. 2 of the Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation C(2005) 2673).

An overview of the housing sector in Myanmar; a country in transformation

By Josie McVitty

1. Introduction

Myanmar is undergoing a rapid political, economic and social transformation as it emerges from 50 years of authoritarian military rule and shifts from a centrally-planned to market-oriented economy. This transition is expected to have major impacts on the structure of employment, urban development patterns and the housing sector. Property prices have already skyrocketed as the need for office space and housing in major cities multiplies. Meanwhile, Myanmar remains a poor country with a high level of informality and has one of the most undeveloped financial sectors in the world. There are many constraints on the supply and on access to housing, including limited availability of suitable financial instruments.

Through the reforms, government policy is now focusing on new tools to stimulate affordable housing development, particularly in urban and peri-urban areas, in order to support national development objectives, including economic growth and poverty reduction. Preparation of a National Housing Policy and a proposed law for Urban Development, that are both currently in formulation, aims to facilitate migration to cities, to support the transition of workers into higher-productivity jobs, and to ensure that urban development is well-managed. Yet, much still needs to be done in order to build out the infrastructure and systems that will enable long-term development of the housing sector and ensure that there are affordable and adequate housing solutions accessible for each subset of the population.

2. Country context

A new constitution, adopted in 2008, laid the foundations for political and economic changes and the first democratic elections that put in place Myanmar's civilian government in 2011, led by President Thein Sein. Although the military still retain a quarter of seats in parliament, the government has been proactive in developing an ambitious program of reforms to open up and integrate the economy into world markets and stimulate growth. These deep reforms have led to an easing of international sanctions, a rapid inflow of foreign investment and a period of major social and economic change for this South-East Asian country of approximately 52 million people.

Reforms are driving new activity in the service and manufacturing export sectors, as well as interest from international companies and investors. Government relaxed import restrictions, abolished export taxes and floated the exchange rate in 2012, lifting the official rate from 6.4 kyat to the US dollar, to 818 kyat, which has now further increased to 1090 Myanmar kyat [MMK], as of June 2015. Foreign Direct Investment [FDI] has surged, almost doubling year-on-year from US$4.1 billion in the 2013-14 fiscal year, to US$8.1 billion in the 2014-15 fiscal year, which ended in March. This is 25 times the US$330 million received in 2009-10 and compares well with other South-East Asian nations, with an estimated US$11.8 billion of disbursed FDI last year in Thailand, US$12.3 billion in Vietnam and US$4 billion in Cambodia[1]. These structural reforms have resulted in strong growth in Myanmar's gross domestic product estimated at 7.7% in 2014 and expected to accelerate to 8.3% in FY2015[2].

Investor interest has been driven by the low wages and high volume of Myanmar's young labor force, estimated at around 34 million people. The monthly minimum wage in Myanmar was set at US$32 in 2013, which is much lower than neighboring Thailand or Vietnam, at US$253 and US$96, respectively[3]. Building off these strengths and inspired by the development approach in other Asian countries, the government launched the National Export Strategy [NES] in March 2015. This Strategy outlines a five year roadmap until 2020, aimed at strengthening smaller companies, expanding exports and supporting trade diversification. The NES articulates targets to increase production and promote value-addition in priority sectors, which include agricultural industries, textiles and tourism.

Strong investment in services and manufacturing sectors is expected to create new job opportunities in cities and peri-urban industrial areas. Agriculture, hunting and forestry is still by far the biggest employer in Myanmar accounting for over half of total employment, compared to only 6% of the economically active population that are employed in manufacturing[4]. Although Myanmar remains a largely rural-oriented economy, with an estimated 70 percent of the population residing in rural areas, the share of agriculture to total GDP has declined from around 60% of GDP in 2000 to around 38% in 2013, while the share of services and industry has been increasing (to 42 and 20% of GDP respectively in 2013)[5]. These changes in the

1 OECD (2015). Foreign Direct Investment Statistics.

2 Asian Development Bank (2015). Myanmar: Economy. Accessed at http://www.adb.org/countries/myanmar/economy.

3 New Crossroads Asia (2014). Sector Brief. Labour Market. Accessed at http://www.newcrossroadsasia.com/series/myanmar-all-that-matters/.

4 UNDP (2011). Integrated Household Living Conditions Survey in Myanmar: 2009-2010. Poverty Profile.

5 CIA. World Factbook. 2014.

structure of employment are expected to have a significant impact on spatial growth patterns and the rate of urbanization, which has been modest relative to Myanmar's neighbors, at around 3% per annum over the past decade.

Meanwhile, much of the population in Myanmar remains in poverty. Over 95% of adults earn less than US$10 per day, with around 25% of the population living in poverty[6]. Although poverty rates have fallen by 6 percentage points since 2005, food poverty still afflicts around 5% of the population, as of 2013. Rural areas account for almost 85% of total poverty, with poverty incidence twice as high compared with urban areas (at 29% and 15% percent respectively)[7]. Informality also remains high. Around 7.5 million adults are classified as informal consumers earning an average of US$66 per month, compared with only 1.7 million that are formal with an average monthly income of US$128. Meanwhile, 4.7 million adults work in informal enterprises earning US$133 per month, compared to 2.5 million that work in formal enterprises with a monthly income of US$224. As reforms in Myanmar advance, increasing the level of formality and supporting urbanization as tools to accelerate poverty reduction and economic growth are quickly becoming important policy focal points[8].

3. Property market dynamics

The boost in economic activity and entrance of international companies has resulted in significant inflation of property prices in cities in the past three years. Demand for office space has increased substantially, with an estimated 810,000 m^2 needed in 2013 and only 56,000 m^2 available[9]. Prices of existing office blocks have risen exponentially since 2012 and are now the highest in the Association of South Eastern Asian Nations [ASEAN] region and above those in New York or Singapore, with top tier office space going for US$78/m^2 per month, compared to US$50/m2 in New York or US$27/m^2 in Bangkok[10]. For residential housing, increases in the cost of land, the rising cost of construction and limits on new supply have also multiplied prices. One developer reported that the sale prices for apartment units of around 40m^2 in Yangon had increased from K16.5 million (US$15,000) to K70 million (US$64,000) since 2012, while another real estate actor calculated that average prices for apartments rose 600% over the past decade to an average of US$250 per square foot[11]. Such rapid increases are beyond the reach of most Burmese and threaten to make formal housing solutions inaccessible, particularly for the urban poor and new migrants to cities.

The construction sector is reaping the rewards of elevated demand and increased business confidence. For Myanmar as a whole, the construction sector has been growing at an exponential rate with a compound annual growth rate of 20% between 2012 and 2014, which is expected to continue to expand at an annual rate of at least 8% over the next five years. The construction sector has been valued at US$3 billion, with the residential segment responsible for 49% of the sector, while infrastructure makes up 28% of construction activities, 14% are industrial and 6% are commercial[12].

Nevertheless, new housing supply is limited by a number of constraints. In 2013, the Department of Human Settlements and Housing Development [DHSHD] reported that only 7,000 houses were being built compared to annual demand of 20,000 units. Actual demand is likely to be substantially higher considering the average rate of urbanization, which indicates around 100,000 new units per year are required in cities, and the need to replace or improve poor quality housing stock. Private developers struggle to access land on which to build, particularly in the major cities of Yangon and Mandalay, or to access development finance for construction. With such rapid increases in property prices and increased interest from foreigners, new construction tends to be for luxury units, such as serviced apartments, that are well beyond the price range of most Burmese. Another challenge is the lengthy approval processes for new developments, where construction permits require 13 procedures, taking an average of 128 days and costing 10% the value of the property (Myanmar is ranked 130th of 189 countries), while registering property takes 6 steps, 113 days and costs 7.2% the value of the property (ranked 159th of 189 countries)[13].

Official figures on the number of households living in poor conditions are low. In Yangon, only 2.6% of the total population of 5,209,000 are recorded as living in slums. This accounts for 37,000 informal housing units of the 1.296 million units in the city[14]. The largest informal settlement are on the outskirts of the city and on railway-owned land or near waterways, where one can find permanent homes of 2 or 3 levels and no record of ownership, even though some households have resided there for more than 20 years. A survey of 4641 households residing in 45 townships around the Yangon region, conducted by DHSHD in 2014, has provided more information on the state of existing housing stock. Around 81% of households have registration of land tenure and the construction materials used are predominantly wood, brick and zinc sheet roofing, with 58.2% of households residing in a wooden house, 15.3% in brick and wooden units and 19.4% living in multi-storey apartments[15]. This survey also found that 12% of units had more than one household, 26% of units were rental, 68% were self-owned and 38% of households were migrants from other cities or rural areas. Demand for rental and low-cost apartments is expected to rise even further with an increase in urbanization rate and investment in new industrial zones in peri-urban areas.

New supply for low and middle-income households tends to be built incrementally by households, by government or alternatively, by entrepreneurs that find innovative solutions to finance development. For the private sector, a common model for development is for an investor to make an agreement with a land-owner to develop their site and offer back a certain number of the complete units to the land-owner for their use or sale, while using the other portion, at least half, to cover their own costs and profits. Many of these developments are narrow 5-storey walk-ups with 2 to 4 units per level. A lot of construction is financed using pre-sales, where a purchaser pays in installments in line with construction progress, usually over a period of around 12 months. Or if developers

[6] UNDP (2011). Integrated Household Living Conditions Survey in Myanmar: 2009-2010. Poverty Profile

[7] *Ibid.* 2014.

[8] Government of Myanmar. Myanmar: Financial Inclusion Roadmap. 2014-2020. Making Access Possible. 2014.

[9] International Development Group: Building and Construction Authority (2013). Country Report Myanmar – 2013.

[10] *Ibid.* 2013.

[11] Fuller, T. (2015). Profits of Drug Trade Drive Economic Boom in Myanmar. New York Times. Published on 5 June 2015.

[12] International Development Group: Building and Construction Authority (2013). Country Report Myanmar.

[13] IFC (2015). Doing Business 2015: Going Beyond Efficiency. Economy Profile 2015. Myanmar.

[14] Interview with Yangon City Development Corporation.

[15] Ministry of Construction (2014). Report on Housing Survey of Yangon Region by Department of Human Settlements and Housing Development Department, Ministry of Construction in cooperation with International Myanmar Research Company Limited.

are unable to offload stock, they can offer informal lease-purchase agreements as a means to make stock affordable to prospective customers. This popular model is resulting in incremental transformation of low-rise neighborhoods into medium-rise apartments, on an *ad hoc* basis, often without adequate infrastructure in place.

Meanwhile, government policy focused on industrialization will push new housing demand into urban and peri-urban areas. Myanmar's average rate of urban expansion has been one of the lowest in the region from 2000 to 2010, at below 1 percent per annum, with urban land area increasing from 760 km^2 to 830 km^2. This has resulted in a steep climb in urban density (an additional 1,347 people per km^2), to absorb the urban population growth for this period[16]. The government has plans for approximately 20 industrial zones in large tracts of land surrounding Yangon, Mandalay and other major cities, offering tax exemptions and other incentives to international companies. These initiatives are attracting businesses and creating new sources of employment and drivers for internal migration. To date, 21 foreign firms have signed to operate out of Myanmar's first industrial zone, the Thilawa Special Economic Zone, with the majority of interest coming from medium and light industries. This industrial expansion is expected to shift employment to cities. A 2013 McKinsey report estimated that an additional 10 million people would be added to Myanmar's large cities by 2030 and that around a quarter of the total investment of US$650 billion needed to support growth would be in residential and commercial real estate[17].

4. Financial sector development

Development of the financial sector is still in its early stages. Myanmar still operates as a largely cash-based and informal economy. Financial reform started in the 1990s with the passing of the Central Bank of Myanmar Law and the Financial Institutions Law of Myanmar, which allowed a private sector to emerge. A period of rapid expansion of financial services continued until a banking crisis in 2003, which resulted in heavy state intervention. Today, the financial system remains one of the least developed in the world. In 2015, Myanmar ranked 169th for obtaining finance in the 2015 IFC Doing Business report, legal rights achieved a score of 2 (out of 12), and there is not yet credit information, no credit registry, nor credit bureaus. There is lingering public distrust of the banking and financial services industry due to periods of high inflation, bank runs and insider lending. It is estimated that less than 10% of citizens in Myanmar have access to an account and less than 0.1% are active in the credit market[18]. Major challenges include building out good banking governance and the competencies of lenders, as well as educating consumers.

There are a growing number of financial actors and diversity of financial products. The Central Bank of Myanmar was established in 1990 and there are 4 other state-owned banks and 19 domestic private banks. Foreign banks have been permitted to open representative offices, and as of the first quarter of 2015, 32 foreign banks had set up their offices in Myanmar in anticipation of future legal and market liberalization. Around four of these international banks are now permitted to commence operations. Meanwhile, in 2013, there were around 153 MFIs serving 0.7 million, 7562 cooperatives serving 0.9 million customers, 13 insurance providers for 1.3 million users, and 2026 pawnshops for 3.1 million users[19].

However, the level of financial inclusion is still relatively low, at an overall average of 30% of adults, where only 6% have used more than one financial service. Farmers have the highest level of financial inclusion (around 43% formal, 16% informal, and only 14% are entirely excluded). In terms of credit access, around one-third of agricultural households received a formal or informal loan for agricultural activities in 2009, compared to 11% of non-agricultural households to finance business activities. Half of this finance is sourced informally, while informal consumers, particularly those on low-incomes in urban areas, tend to be worst served, with only 15% with formal financial access and 23% excluded entirely.

There is also a high level of informality in financial access. An estimated 9.2 million adults have accessed a loan from an unregulated financial services provider, with total outstanding debt as high as US$5.7 billion and debt from unregulated money-lenders estimated at US$3.9 billion. Remittance companies, both licensed and unlicensed, also remain popular. This compares with the outstanding loans of the commercial banking sector of US$5 billion and only 60,000 credit clients. Other challenges include limited diversification of products to suit different needs, with limited availability of insurance or savings products, a challenging legal and regulatory environment and scarcity of capital, given the lack of development of secondary markets and short-term nature of deposits funding loan portfolios.

5. Availability of housing finance

As a result, there are very limited instruments for financing housing. Loans and advances accounted for nearly 38% of total assets, with government securities and cash still the dominant forms of assets. Overall credit to the economy is low, with the ratio of outstanding loans to GDP at 7.1% and deposits to GDP at 15.5% in 2013[20]. Commercial loans are limited by law to a maximum of one year, with possibility of extension, and construction credit can be provided for up to 3 years. The banking sector is still heavily controlled by regulations and there are limits on interest rates, with the maximum lending rate set at 13% per annum and a minimum interest rate on deposits at 8% per annum, which creates tight margins given that inflation has averaged 6.5% over the last four years. Mortgage finance is not yet available, as there is no legal basis to define mortgage rights or to allow recourse in cases of default. Banks also struggle to access funds for developing longer-term financial products. Several larger banks offer products where housing can be bought on a hire-purchase basis, over a period of up to 4 years, whereby title is only transferred once all the installment payments have been completed. Yet, these products are largely only accessible to households with formal income and households still prefer to pay the full purchase amount in cash, if they are able.

The Ministry of Construction established a Construction and Housing Development [CHD] Bank in January 2014 to support the development of housing finance. The mandate of the CHD Bank is primarily to support new housing construction and to assist low and middle-income families into home ownership through development of suitable financial products. Initial capital to establish CHD Bank was provided by both the Government and a majority share by SOE and private investors. CHD Bank currently has four offices, two in Yangon, one in

[16] World Bank (2015). East Asia's Changing Urban Landscape: Measuring a Decade of Spatial Growth. Urban Development Series.

[17] McKinsey Global Institute (2013). Myanmar's moment: Unique opportunities, major challenges.

[18] Government of Myanmar (2014). Myanmar: Financial Inclusion Roadmap. 2014-2020. Making Access Possible.

[19] *Ibid.* 2014.

[20] Oxford Business Group (2014). The Report: Myanmar.

Mandalay and one in the capital, Nay Pyi Taw, although there are plans to extend a network of branches around the country. Initial products include construction finance for developers of residential housing for up to 36 months at 13% per annum, and consumer financing for households that qualify to purchase government-built housing, which will be offered for 8 years, also at 13% per annum, with a 70% loan-to-value ratio and maximum monthly payment of K100,000 (around US$92).

In time, CHD Bank hopes to spearhead innovations in housing finance in Myanmar and to access alternative sources of funding to enable them to offer financial products that are longer-term and more affordable to low-income households. However, there still needs to be important legal advances to allow CHD Bank to use property as collateral and CHD Bank will also need to invest in building awareness and creating demand from potential customers. The DHSHD survey in 2014 found that only 1.3% of households were interested in bank loans for home purchase, while 92.1% preferred to purchase on an installment basis directly from developers and 6.6% would like to pay in full upfront. Meanwhile, 95.1% would elect to use their own budget, rather than accessing financing from banks or other sources. CHD Bank are also currently exploring the development of new products, including setting up a savings-for-housing product or support for the development of housing microfinance to enhance financial inclusion, promote a savings culture and ensure that the lowest income has access to finance for home improvement or incremental construction.

6. Government housing policy

As Myanmar carries out reforms, the Government has identified housing and urban development as important areas of national development. The presidential advisor called for more focus on urban planning, zoning and infrastructural development, including in industrial zones in 2013. A series of initiatives were quickly launched, including the announcement of a new target for the Ministry of Construction to develop one million houses across the country over a period of 20 years (50,000 units annually), as well as a National Workshop on Urban and Housing Policy and Planning in November 2014, hosted by the Department of Human Settlements and Housing Development and attended by the President. The Ministry is also currently convening stakeholders through a process to formulate a National Housing Policy that is due to be drafted this year, in addition to the bill for Urban Development, which is in the preliminary stages of review.

Myanmar already has a long history of active intervention in the housing market and urban development. Following independence in 1948, the new Government launched a large-scale reconstruction program that sought to replace destroyed or damaged housing stock. Along with education and health, housing was addressed in the provisions of the welfare state as a subsidized social service for all. Since then, there have been several waves of large-scale site-and-service projects, starting in 1958, when the Government created three satellite towns, South Okkalapa, North Okkalapa and Tharketa, on the outskirts of Yangon, and relocated slum-dwellers to around 60,000 plots measuring 40 by 60 feet. Many sites were subdivided by poor households and then subdivided again, to give either 20 feet or 10 feet street frontages. Some projects incorporated core units that were built with labor contributions from beneficiary households and have since been incrementally expanded. However, home improvements in these projects over the past 50 years have been limited due to increases in prices of quality building materials, limited construction knowledge and lack of access to finance. Meanwhile, many of these townships still have very poor drainage, no piped water supply, sanitation or solid waste collection, as the Government has not invested heavily in upgrading services, apart from roads.

Another wave of resettlement projects started in the late 1980s when the Government initiated a 'beautification' program in Yangon and other major cities. Law No. 11 in 1990 vested Yangon City Development Committee [YCDC] with the authority to convert Yangon into an international city. Public housing and new site-and-service projects were carried out for both the low and middle-income in new satellite towns. In one 12 month period (1988-1989), an estimated 260,000 squatter residents were evicted from central Yangon and provided plots and some services at their new locations on the urban peripheries[21]. In addition, DHDHS estimates to have built 55,000 housing units on government land surrounding Yangon in the 20 years up to 2010, with vast areas of Yangon being developed into apartment buildings, private towers and condominiums. Many subdivisions of government land were also sold off in joint ventures with private sector to higher-income households that have held these plots for speculative purposes or to build large homes, some of which are in gated communities.

In 2014, the Government started preparing a new set of public housing programs to reorient support toward the lower-income groups, increase supply of affordable units in the market and achieve production targets. Last year, plans were developed to construct 30,000 low-cost affordable units in townships on the outskirts of Yangon. The Ministry has engaged with 51 private companies as contractors and provided the design for most buildings to be built as four storey walk-ups with 4 units on each level of around 40m^2 each. The first phase of the program is targeted at housing delivery to civil servants and middle-income families with formal salaries. The construction period for these units takes around 8 to 9 months and is financed by a government revolving fund that is managed by DHSHD. Complete units are intended to be sold to eligible end-users, with finance being provided to them by CHD Bank. Eligible households must have formal incomes of between MMK300,000 and MMK700,000 (US$274 to US$640), and units will be sold at the cost for both construction and infrastructure connections, with a long-term land lease being provided on a concessionary basis by the government. Prices of units range from MMK10 million to a maximum of 12.5 million (or US$9,100 to US$11,500, at current exchange rates).

This new public housing program faces high demand, yet several major hurdles. Around 3000 units around Yangon were nearing completion as of April 2015 and were being prepared for sale to selected applicants. In order to be selected to purchase government-built affordable housing, households must complete an arduous application process with the local housing department and hope to be selected in a lottery. The first round was heavily over-subscribed with over 70,000 applicants. Lottery winners were selected by local governments in March and were given three months to gather the 30% down payment to confirm their home purchase, yet most have struggled to come up with this amount. Furthermore, there have been challenges restoring public trust in Government initiatives, with DHSHD coming under a lot of pressure for more competitive and transparent tender processes, due to a history of graft. Finally, some fundamental laws to allow this program to work and to scale up are still not in place. For example, the condominium law to allow sectional title of buildings is still in preparation and there is no clear legal basis

[21] UN-HABITAT (1991). Human Settlements Sector Review Union of Myanmar. Nairobi. Kenya.

on which CHD Bank could evict or foreclose on non-paying households. Nevertheless, a new set of tenders were being prepared for Phase II of the program.

Other policy initiatives to support affordable housing have included the introduction of a new property tax system in an attempt to temper speculation, lower costs for low-income households and promote higher levels of registration of property transfers. The draft law, which was being reviewed by parliament in April, would revise the 2012 system, where buyers were required to pay a flat 37% rate on property transfers, into a progressive system. Here, a 3% tax rate would be charged for buyers of property valued below 50 million kyat (around US$46,000), 10% for properties under 150 million kyat (US$140,000), and 30% for real estate worth more than 300 million kyat (above US$275,000), while all sellers would pay a flat 10% tax. There is also consideration around the introduction of a vacant land tax to be incorporated into new regulations related to land use and land management, although this measure is not likely to be adopted soon.

Meanwhile, some larger cities are also initiating their own projects. Both Yangon and Mandalay have developed their own revolving funds to construct housing projects, with the intention of selling at the cost of construction to help temper speculation in the market. There were reports that Yangon City Development Committee [YCDC] had set aside K100 billion (US$92 million) to build 10 affordable housing projects or 18,000 affordable units in the 2015-16 fiscal year, in joint partnership with private companies. Yet, these supply-side programs will also likely face difficulties, due to the lack of suitable financial products to allow low or middle-income households to purchase completed units.

7. The outlook for the housing sector

Change is happening rapidly in Myanmar. In 2011, there were no ATMs in the country, only 1 percent of the population had access to the Internet and SIM cards were traded on the black-market for several hundred US dollars. By the end of 2014, there were more than 2,000 ATMs nationwide, the number of mobile phone users has increased from around one million in 2012 to more than 18 million[22], with SIM cards being sold on the streets for US$1.50, just a fraction of former prices. The number of foreign tourists has increased from 790,000 visitors in 2010, to 2.04 million in 2013 and 3.05 million tourists in 2014. These few elements are indicative of the substantial economic and social changes that are taking place. Yet, despite these changes, Myanmar is still one of the poorest countries in South-East Asia and the business environment is still very challenging. Per capita income was approximately US$1221 in 2014[23], while Myanmar ranked 177th for the ease of doing business in 2015 (an improvement by one place from 2014) and the lowest ranking in East Asia & Pacific, where Malaysia and Thailand are ranked 18th and 26th respectively. Much still needs to be done to ensure growth is well-managed and equitable and translates into increases in incomes and poverty reduction, for which affordable housing in well-serviced neighborhoods close to employment opportunities, can play an important role.

There are a number of current developments that will have an impact on affordable housing supply and the housing finance sector. Financial sector development and stabilization is one of the Government's primary priorities in the reform process. There are a number of major activities in the financial sector including preparation of a new Banking and Financial Institutions Law to enhance the regulatory and supervisory framework for the banking sector, as well as regulations to govern the business of leasing, factoring, credit token and money services and a regulation to enable licensing, oversight and supervision of the credit bureaus, all of which will have an impact on the advancement of housing finance activities. The Microfinance Law was also put in place in 2011, as well as the Making Access Possible initiative that set out a detailed roadmap for the next 5 years to enhance financial inclusion. Though progress in development of capital markets is expected to be slow, the planned opening of the Yangon Stock Exchange later this year is hoped to take some steam out of real estate speculation and help to advance the development of longer-term housing finance, as it will provide another avenue for investors and give banks alternative options for funding.

Finally, the preparation of the National Housing Policy, and the laws related to land use management, as well as urban development, will play an important role in determining how the housing sector develops. These policies will set the foundations for legislative and regulatory reforms, as well as direct public investments and the prospects for private sector participation in the housing sector. Areas of priority for government include greater measures to temper speculation and runaway prices in cities, as well as to increase the supply of affordable housing solutions that meet the needs of different households in urban areas, including home improvement and self-built housing, rental housing for workers, and multi-family apartments. Finally, strengthening the financial sector's capability to build out suitable financial instruments that support the low-income groups in accessing housing across these options are also recognized as essential components of inclusive growth as Myanmar looks to draw lessons from its neighbors, including India, Thailand and Malaysia, that have already developed sophisticated housing systems. Creating effective policies to manage housing and settlements, which address both supply and demand-side solutions for the low-income groups, is becoming increasingly urgent for Myanmar as this emerging country works to ensure that there is adequate housing to support its rapid structural transformation and can maximize the potential for sustained economic development, poverty reduction and regional competitiveness.

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Understanding Mexico's housing market

↳ By José Luis Romero Hicks

1. Introduction

Every year Mexico's housing stock grows by a million dwellings. In a country with a population of 119 million this sounds like good news; especially because 55.2 million are under the age of 25 (46% of total). The population under 25 years of age represents an important "demographic bonus" that will propel Mexico into a prosperous future. The figure is quite significant and is comparable to South Africa's total population (54.8 million), to that of Italy (60.9 million) or that of South Korea (50.6 million).

On the other hand Mexico's population will continue to grow well into the middle of the 21st century. Its fertility rate stands at 2.2 children per woman, higher than that of the US (1.8) or Canada (1.6) and according to Mexico's National Population Council (Consejo Nacional de Población) by 2030 the country will reach a population of 137.5 million: of which 53.7 million will be under 25 years of age (39%). Unfortunately, this is not necessarily all good news. Of the million dwellings built every year, about 40% are "irregular" dwellings that are built without construction licenses (squatters in many cases), have no architectural project or design, are financed by personal savings, friends and family, are of very poor quality and have questionable contribution to families' equity. Their resale value is unknown; their "irregular" status prevents them from being used as collateral for a future buyer's mortgage-backed transaction.

Mexico's yearly household formations run at about 830 thousand per year. This means that roughly 12.8 million new households will require a house between 2014 and 2030. When this figure is added to current unmet housing needs of 9.04 million it implies potential housing demand of 21.84 million homes that will require some type of housing investment (new homes plus significant home improvements. In Mexico 78% of the population live in urban centers[1].

These population and housing needs scenarios underline the complexity of understanding Mexico's housing and urban development challenges and constraints.

In order to attempt to understand Mexico's housing market and urban development trends this presentation will describe Mexico's government and territory, and address the economic conditions, recent structural reforms that will stimulate future growth, current housing policy, the housing market structure and housing supply and demand.

2. Government and territory

Mexico is a Federal Republic with 32 subnational "states" spread across 2 million square kilometers. Land area varies widely among states and so does their economic contribution to the country's Gross Domestic Product ($1.2876 trillion USD in 2014).

There are 59 regions that are regarded as metropolitan zones that host 57% of Mexico's population. Metropolitan zones are composed of several municipalities with high population density and common economic activity.

Urban zones include several city governments and that occasionally are located within the territorial boundaries of two or more states. A good example is the "Metropolitan Zone of the Mexico Valley" – also known as "Mexico City." It is the biggest in the country and includes land from the Federal District plus the states of Mexico, Morelos and Hidalgo.

Given the complexity inherent to a metropolitan zone in terms of different aspects that influence quality of life (such as employment, safety, water services, environmental management and other public services), housing policy requires a global vision than can coordinate and determine investment and infrastructure decisions in metropolitan areas.

3. Economic conditions

In short, Mexico has the fifteenth largest economy in the world (World Bank) and has enjoyed government commitment to preserve macroeconomic stability for over two decades. Such stability is a result of maintaining low levels of gross financing needs and a relatively low level of debt with extended average maturity. This fiscal discipline has produced declining interest rates on its foreign debt that now stands at a historical minimum level in terms of the moderate current account deficit which is combined with historical high levels of international reserves ($195 + billion USD).

In sum, macroeconomic fundamentals explain reduced inflation rates, a manageable public debt, a low current account deficit (well financed by foreign direct investment) and a solid banking sector.

4. Structural reforms

Since 1997 and due to political limitations, where no single political party held a majority in the national Congress, Mexico postponed needed changes that impaired its potential to be competitive. The result has been meager GDP growth rates and a stagnated per capita income growth.

1 INEGI. 2010 Population and Housing Census.

Innovative political maneuvering and negotiations led by the current Federal Administration, before taking office on December 1st, 2012, produced inter party agreements on several structural issues that have been successfully implemented through major constitutional and legal reforms. They cover strategic sectors of the economy including better quality education, more flexible labor, open telecoms to more players and competition, more financial options especially to small business and the end of state-owned energy monopolies in oil, gas and electricity production. The reforms are historical and can only have positive impacts on the economy. They are large and bold, confronting traditional power holders, both entrenched government and union interests and private companies, especially in the telecom sector.

5. Housing policy

The Ministry for Agrarian, Territorial and Urban Development [SEDATU] jointly coordinates housing policy together with the National Housing Commission [CONAVI], a Federal Government Agency.

The housing policy promotes four strategies:

1. Achieve greater and better coordination among institutions.
2. Move towards a sustainable and intelligent urban development model.
3. Diminish the housing deficit.
4. Provide better quality housing

Housing policy has become an ideal "vehicle" in terms of economic, environmental and social public policies to better families' health, education and safety conditions.

As mentioned, Mexico has achieved macroeconomic stability for over 20 years. Country risk levels (170 basis points), public finance management, low fiscal deficits and competitive interest rates are all good indicators of such stability. Nevertheless there is plenty of room for improvement, as shown by low credit penetration and the population's uneven income.

Low industrial credit acts as constraint for housing development companies. This scenario provides a "Kafkian" paradigm for Mexico: sufficient mortgage finance to support strong and steady buyer housing demand in a country with inexplicably low working capital and bridging loan finance available to build houses. In the last two years, Mexico's Federal Mortgage Agency [SHF] has had to offer construction loans for companies due to private bank's lack of appetite, despite sufficient mortgage financing provided by INFONAVIT, FOVISSSTE, and the private banking sector, plus federal buyer subsidies administered by CONAVI.

6. The Housing Market

6.1 Housing supply and urban policies

Housing activities heavily contracted in 2013. The new Federal Government's Housing and Urban Development policies announced future urban zoning restrictions combined with vertical and higher density housing complexes, plus the financial restructuring of three large public housing companies (GEO, HOMEX and URBI). These had jointly produced 129 thousand units in 2012 and this reduced housing supply significantly. In addition, a higher revenue oriented tax reform affected consumer spending expectations.

The new tax, territorial and urban policies were simultaneously implemented, but were complemented by higher federal subsidies to low income home buyers that softened the impact of policy change effects. In fact, Mexico's Congress appropriated in 2013 USD 540 million and in 2014 USD 830 million for new and second hand house buyers, self-built houses, plus home improvement benefits, that benefitted 162 thousand and 248 thousand families, respectively.

Home buyer oriented subsidies have proven effective under the current Federal Administration. In 2014 house production increased by 35.4%. Government records indicate 412 thousand new homes were built in 2014.

CONAVI has designed and implanted a scoring system to determine a buyer's subsidy amount at time of purchase. The scoring system takes into account four criteria: House location, urban infrastructure available, amount of densification, and competitiveness.

In essence, the subsidies program is used to benefit home buyers, but also as an instrument of urban policy implementation, since these are spent exclusively for the purchase of homes located in specific urban areas. As such, zoning areas are used to contain vertical urban growth to diminish land overuse and avoid high costs of urban infrastructure. Also, subsidies are used to stimulate the use of environmental friendly building materials and house equipment (solar water heating and efficient water saving devices in bathrooms). As a result, housing policies and subsidies are governmental policies used to support other poverty alleviation programs. The government agency in charge of measuring poverty (CONEVAL) estimates that 45% of the population is poor. In this context, housing policies are used to improve family living standards and equity formation.

INEGI's (National Statistics and Geography Institute) announced a new housing satellite account under which the housing sector contributes 5.9% of GDP[2]. There are around 1, 200 active home developers in Mexico that are affiliated to the housing guild (Cámara Nacional de Vivienda – CANADEVI).

Keeping statistical track of Mexico's housing supply is becoming easier since the establishment in 2004 of the Housing Single Registry [RUV]; a quasi-government an institution that registers by location each home that will require a buyer's mortgage and provides information for quality verification and home value.

The Housing Single Registry has played a strategic role in understanding Mexico's housing problems and solutions. The public nature of the information helps companies plan ahead with better knowledge of market conditions and provides consumers with a better understanding of available home quality, supply and price.

In some countries "housing starts" provide useful measurements of current and future economic activity. Since "housing starts" information is not available in Mexico, the National Housing Registry is beginning to assume the role of an "economic activity" thermometer, combined with other information provided by INEGI[3].

Current public policies underline government intentions of using housing policies to build competitive cities throughout the country. Government programs correctly argue the need for higher density urban centers that are less costly, with better mobility options that cut transportation costs and reduce workers' opportunity costs for less time spent in getting to work and back home. On the private sector's side, over the last few years, studies have been

[2] The amount considers industrially built, self-built and third party built homes, plus rented dwellings and real estate and financing services, among other related activities. Without taking into account the rental value that would be paid on the market for a similar house than that owned (imputed rent), under with which the value would be 14.1% of GDP.

[3] Two of INEGI's indexes that monitor economic activity in Mexico are the Monthly Construction Index (Índice Mensual de Edificación) and the Global Index of Economic Activity (Índice Global de la Actividad Económica (IGAE).

making the case for more social inclusion, better health services, economic stability and good government as inter related requirements that benefit from higher urban density and better quality housing[4].

6.2 Housing demand

Housing real demand determines the amount and price of units offered on the market. Consumer access to mortgages assumes that the buyer is part of the "formal sector" – holds a bank account and pays taxes. Unfortunately, most consumers in Mexico are not in the "formal sector"; a situation that inhibits their access to mortgage financing and home ownership.

Through long term tax breaks and benefits – including mortgage access- the government has successfully increased the "formal sector" – measured by people who have now enrolled for future tax payments. This has been good news for the housing market. These are future clients that will exercise mortgage benefits through INFONAVIT, a quasi-mutual fund for private sector workers.

In Mexico, private sector workers contribute to a housing mortgage fund [INFONAVIT] through a compulsory 5% payroll contribution. Federal workers have a parallel scheme that contributes with 5% of government pay roll contribution to another mortgage fund [FOVISSSTE]. Between these two mortgage funds, every year there are around 600 thousand mortgage facilities available for the purchase of new and second hand homes.

As of May of this year, the combined portfolios of INFONAVIT and FOVISSSTE were worth 63 billion USD[5]; 85% of which belong to INFONAVIT.

INFONAVIT and FOVISSSTE offer workers direct or private bank co-financed loans for home buying -new and second hand-, home building in a worker's property, home improvement, creditor debt restructuring, rent guarantees against a worker's fund deposit balance, among other products.

The Mexican population will reach 137.4 million by 2030 and 150.8 million by 2050. The number of potential buyers will significantly increase in the coming years. Potential buyers are a reflection of working age potential clients. Well, Mexico has a population of 120 million, of which 78 million falls under the working age group (15-64 years). By 2030, the number of people within the working age group will increase by 16%, totaling 90.8 million, representing 66% of the total population. Mexico's society is constantly changing and an important challenge for real estate and mortgage markets in the next few years (2014-2030) will be to promote mobility and increasingly provide segmented and flexible housing products for nuclear families (mother, father and children), extended families (nuclear plus relatives), one person dwelling, co resident partners and composite families (two or more families).

Another positive development is the recent growth in the "formal" housing market has been accompanied by better quality housing that should provide not only for home dwellers' life quality, but also in better equity value for families. In Mexico, an average family holds only one mortgage throughout their working life. This will change in future years as work mobility and more flexible mortgage products are developed.

7. Final remarks

Low per capita income in Mexico defines the characteristics of what is considered an affordable home and as such limits the size and scope of the housing market. Family income strongly determines access to a home and to a better home. In other words, family income in part determines the type of home that can be purchased at market rates.

The question then is what types of homes can Mexican families buy?

It's a standard analytical tool in Mexico to classify the types of homes by their price, that is indexed to "x" times the Mexico City monthly minimum wage (TMCMM).

There are six commonly used types of dwellings[6]:

1. Economy home: up to 118 TMCMW ($ 17, 342 USD)
2. Popular home: up to 200 TMCMW ($ 29, 393 USD)
3. Traditional home: up to 350 TMCMW ($ 51, 439 USD)
4. Middle class home: up to 750 TMCMW ($ 110, 226 USD)
5. Residential home: up to 1, 500 TMCMW ($ 220, 452 USD)
6. Residential plus home: over 1, 500 TMCMW ($ 220, 452 USD)

According to the latest National survey of household income and expenditures, four family income brackets can be identified:

- 28% of families earn every month up to 3 times the minimum wage ($ 441 USD),
- 33% of families earn every month between 3 and 6 times the minimum wage ($ 882 USD),
- 13% earn every month between 6 and 8 times the minimum wage ($ 1, 175 USD),
- 26% earn every month more than 8 times the minimum wage ($ 1, 175 USD).

Families that fall under the first income bracket can purchase an economy home; those within the second income bracket can afford a popular house; those within the third income bracket can afford a traditional home; and those included in the last income bracket can aspire to purchase a middle class or residential home.

Housing supply is determined by housing "real" demand; understanding that real housing demand is a potential purchasing desire backed by a financially sustainable purchasing scheme. On the other hand we find social housing demand that actually refers to "housing needs," regardless of the actual purchasing possibility to fulfill such need.

Within this context, the housing market will continue to grow in years to come. The speed of yearly household formation and the demographic bonus, plus the historical deficit (estimated at two new million units plus seven million that require significant improvements), all underline strong market demand towards the future.

With the structural reforms in place, Mexico's economy can only go north and at a faster rate. Increased per capita income combined with more social and worker mobility will undoubtedly produce a more mature housing market in the near future.

The greatest challenge to Mexico's housing market is to provide "formal" housing alternatives to the million plus families that every year establish a dwelling in Mexico. As long as Mexico's policies fail to provide a legally "formal" alternative to the million families that each year increase the housing stock, Mexico's housing policy will not be assessed as successful.

These are exciting times to be in Mexico, full of accomplishments and challenges; a scenario that can only improve in the future.

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[4] These attributes are used in the Urban Competitiveness Index of the Mexican Competitiveness Institute [IMCO].

[5] Exchange rate of 14.50 pesos per USD.

[6] Exchange rate of 14.50 pesos per USD.

The Swedish mortgage and housing market

↳ By Alexandra Leonhard

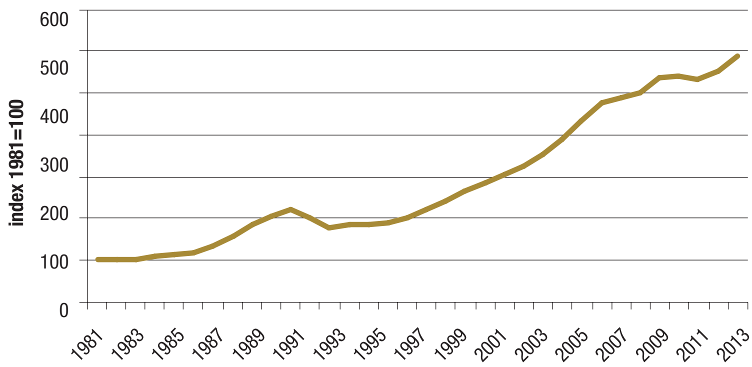
1. Introduction

Debt allows us to enjoy economic growth by letting households smooth their consumption over time and firms invest. In this sense the financial markets have led to increased productivity and wealth. But there are side effects if an economy becomes too focussed on leverage. If debt quickly grows too large, it can cause economic crashes and prolong the time of recovery.

2. House prices and household debt are closely interlinked...

House prices in Sweden have increased every year since 1996. The global financial crisis did not lead to more than a sneeze; while it gave many other countries' housing markets the flu.

House price development in Sweden, nominal prices



Source: Statistics Sweden

Note: the time series only includes small houses, prices on owner-occupied apartments are only available from 2005. They are presented below per region.

The drivers behind house price development are increased incomes, decreasing mortgage interest rates, generous credit and backward-looking expectations amongst consumers. In the three largest cities (Stockholm, Göteborg and Malmö) low housing construction, increasing population, easy access to credit and backward-looking expectations are important drivers for house prices. The regulated rental market leads to apartments being under-priced in the centre of Göteborg and Stockholm. In Malmö regulation is more lax and rents therefore better reflect people's willingness to pay more to live in the city centre. In Stockholm it may take up to 30 years to find an apartment in preferred areas. The shortest waiting list is naturally found in less attractive areas. But here one still has to wait around 3 years, on average, to get a rental apartment. This of course has negative effects on mobility and on the labour market. Firms can sometimes not find skilled labour as there are no rental apartments. For example, a foreign friend, works at one of the embassies in Stockholm and he has had to move 8 times in the last 4.5 years. He has been renting an apartment through subletting. There is usually the possibility of renting apartments for shorter time periods by subletting. If a person owning or renting an apartment moves away temporarily (for reasons such as studies or work in a different location) he or she can sublet their apartment, but this is only allowed for short periods and is not a long-term solution as this friend has found. The second hand market is characterised by uncertainty, the presence of swindlers and significantly higher rents. Sometimes deposits are not repaid by landlords. Sometimes the landlord has not agreed to the subletting of the apartment, which means that one can get evicted at very short notice. For people who do not want to participate in this market, the only option left is to buy a home. The high demand for owner-occupied housing is reflected in the movement of prices in the three city-regions.

The population is growing in the big cities, especially in Stockholm. A report by Boverket (2013) shows that more than 20% of the increase in house prices can be explained by increased population[1]. Some of the remainder is explained by lower interest rates and income growth, but as much as 1/3rd cannot be accounted for. The unexplained factors may derive from beliefs that house prices will continue to rise since they rose yesterday (backward-looking expectations). Akerlof and Shiller (2009) explain how buyers tend to believe that house prices (or any other asset prices) will continue to rise if they have risen previously[2]. These expectations explain how asset price bubbles develop and thrive. However, the real problems arise when assets are bought with borrowed money[3]. One should therefore look at the mortgage credit market.

[1] Boverket (2013), "Are house prices driven by housing shortage?" *Market report February 2013.*

[2] Akerlof, G. A. and J. R. Shiller (2009), *Animal Spirits: How human psychology drives the economy, and why it matters for global capitalism*, Princeton University.

3. ...but increasing debts depend on the credit market...

Household debt is made up of consumption loans and mortgages. In Sweden consumption loans have accounted for 40% of households' disposable income since the 1990's. It is the increase of mortgages that has led to the high debt ratio (debt/disposable income). In the mid 1990's the debt ratio was around 90%, today it is 175%. In the chart below is the rise in debt in comparison to disposable income and house price development in Sweden. It is clear that debt has increased faster than house prices.

The indebtedness can partly be explained by the liberalisation of the mortgage market. Since the 1990's mortgage interest rate costs have decreased as a proportion of households' disposable income, interest-only loans have become common, high loan to value ratios are permitted, and the market valuations of residential properties allow for households to withdraw equity from their homes as market prices increase.

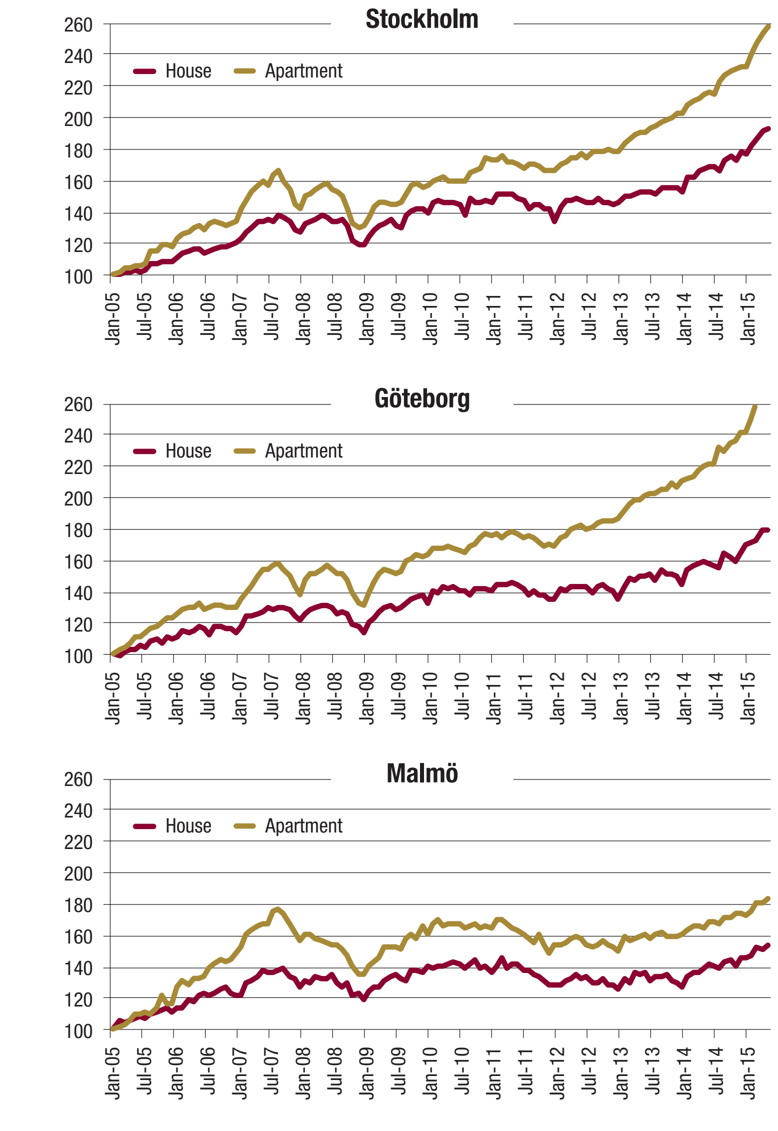
4. Decreasing interest rates have made mortgages "cheaper"

The mortgage interest rates have decreased over the past 25 years. In 1990 interest payments on mortgages amounted to almost 16 per cent of disposable income. Since then they have decreased and from 2000 until 2012 they have varied around 5 per cent, despite the fact that total debt has increased by 400 per cent.

Household debt has increased significantly, but at the same time total interest payments make up a decreasing proportion of disposable income.

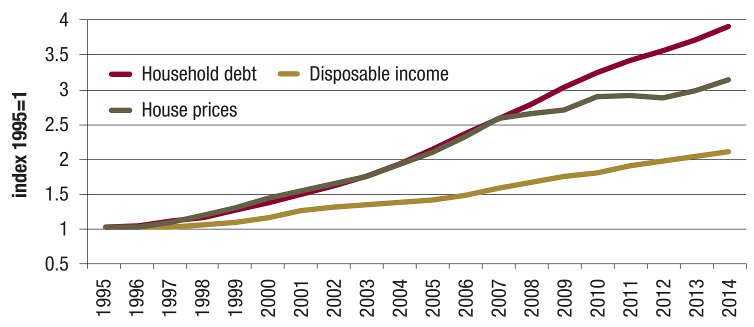
In addition to this, Swedish borrowers are able to deduct interest costs from their taxable capital gains or their income. Unique to Sweden is that there is no ceiling on the amount of interest costs that are tax-deductible. Most other countries, such as Denmark, Finland and the USA, which allow interest costs to be deducted, have a ceiling on the amount of interest costs that can be deducted on personal income. In Sweden, the interest cost deduction is 30% for interest costs up to 100 000 SEK, after which the interest cost deduction rate falls to 21%, but there is no limit and all borrowers thus receive a tax subsidy, whatever the size of their interest costs. This

Movement of prices on houses and owner-occupied apartments, nominal prices



Source: Valueguard HOX-index

Development of house hold debt, disposable income and house prices



Source: Statistics Sweden

[3] Credit crises normally affect the real economy more than stock market crashes.

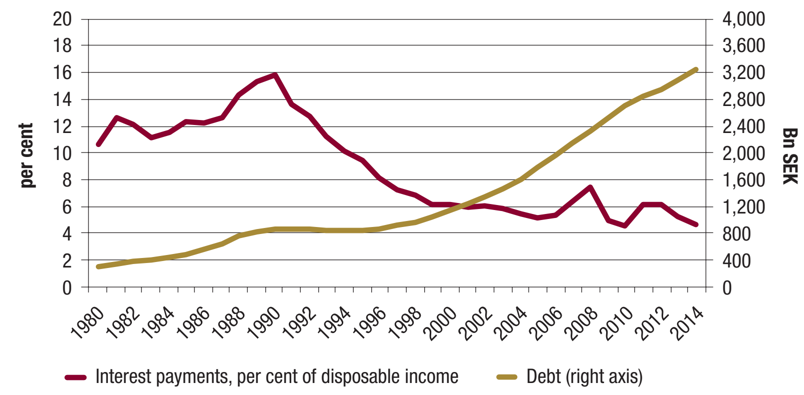
naturally encourages a high debt ratio. Other countries with similar regulations (Netherlands and Denmark) began to decrease the deductibility after the financial crisis.

5. High loan-to-value mortgages and low willingness to repay

The Swedish mortgage market can be characterised as having high loan to value (LTV)-ratios and a low willingness to repay. The value of a property commonly equals the market price. Until 2010 it was possible to take out mortgages with an LTV ratio of up to 100%. At the end of 2010 a ceiling on the LTV ratio was introduced and set at 85%. However, if one does not have 15% equity, one may qualify for an unsecured loan paying a somewhat higher interest rate than the normal mortgage rate. The Swedish Financial Supervisory Authority has found that around 1% of the new mortgages taken out after 2010 are accompanied by unsecured loans[4]. For those that do not qualify for an unsecured loan a further option is available. That is the so called "bank of Mum and Dad". Parents with houses that have increased in value can easily increase the LTV ratio on their house in order to help their children with the 15% equity. This creates losers and winners among young households, depending on their parents or relatives.

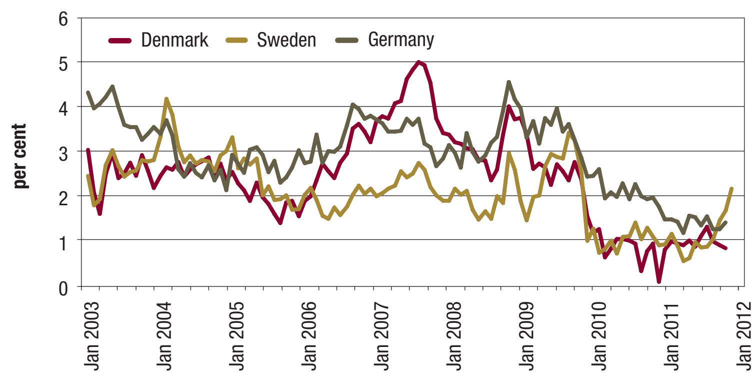
The second reason for the increasing stock of mortgages is the low willingness to repay. In order to enhance the willingness for borrowers to repay the Swedish bankers' association has recommended their members to encourage households to repay their mortgages in order to reach an LTV of 75%. After that the bankers argue that it is unnecessary to repay further. They, instead, offer borrowers the opportunity to invest in their mutual funds. In this way they charge the costumer the mortgage interest rate and a management fees for their mutual funds. Swedish banks have never experienced substantial losses on mortgages. The credit and real estate crash of 1990-1992 was the result of extended lending on commercial real estate. The banks' internal risk models therefore give extremely low risk weights to mortgage lending. In an attempt to dampen the growth of mortgages, risk weight floors of 15% were imposed in 2013 and further increased to 25% in 2014.

The willingness to repay has decreased, as house prices have risen quickly since 1996 and the



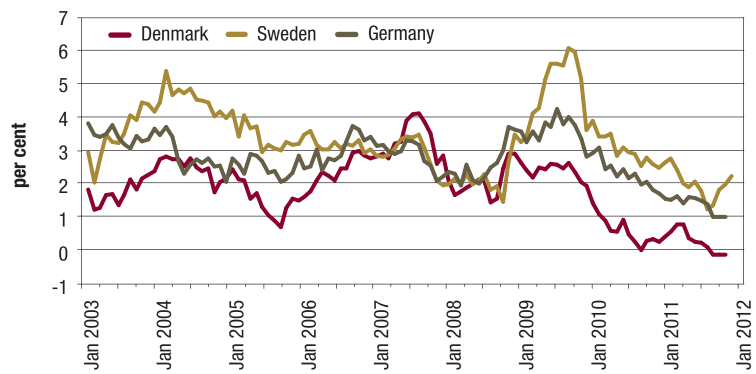
Source: Statistics Sweden

Flexible real mortgage rates in Sweden, Germany and Denmark



Source: Macrobond and Eurostat

5-year real mortgage rates in Sweden, Germany and Denmark



Source: Macrobond and Eurostat

[4] The Swedish Financial Supervisory Authority's mortgage market survey, *Den svenska bolånemarknaden*, published yearly, www.fi.se.

banks value homes according to the market price. For example, if one borrowed 100% of the market value to buy an apartment in Stockholm in 2006 at a cost of 1 million SEK. By 2014 the market value would have increased to 1.7 million SEK (according to Valueguard's price index for apartments in Stockholm). Hence, purely because of the increase in market value, the LTV has decreased from 100 per cent to 58% over 8 years. When people recognise this development and the banks do not require them to repay their mortgage, it is hard to motivate them to repay. Instead it makes households and banks happy to borrow and lend money for consumption. When the value of homes increases, it is possible to borrow more money from the bank as the LTV ratio has fallen. Hence, borrowing to replace the old kitchen or to buy a new car can be done by taking out a new loan with your home as security.

There are currently talks on how to impose a repayment requirement. The Swedish Financial Supervisory Authority proposed a regulation that would require borrowers to pay back their mortgage until they reach a 50% LTV. The valuation of the property would then equal a combination of the purchasing price and the market value over the last 5 years.

The regulation was announced but its legal basis was questioned and therefore the proposal was withdrawn[5]. The government is currently investigating its options and how a repayment requirement can be introduced in Sweden. International organisations and experts argue that it would be beneficial for Sweden to introduce a cap on the tax-deductibility of interest rate costs as well.

Another risk for the Swedish mortgage market is that most mortgages have flexible interest rates. Currently around 70% per cent of mortgages have flexible 3-months interest rates. The rest are fixed for one to two years. Hardly any mortgages have interest rates fixed for more than five years. A study by Boverket (2012a) shows that Swedish banks offer their customers the lowest flexible rates and the most expensive rates on 5-year fixed mortgage rates[6].

The figures above explain why Swedish households tend to choose flexible mortgage rates to a larger extent than households in Denmark and Germany. Flexible rates create an additional risk for households. Should interest rates increase, they will quickly be affected by higher monthly costs.

6. Structural problems on the housing market lead to insufficient housing supply and high prices

As mentioned above the regulation of the rental market, keeps rents from increasing too fast. It is a system that came into effect after WW II; it then changed in the late 1960's. It changed from rental regulation to regulated rental negotiations, which implies that rents still cannot be set freely. They are negotiated between the property owners' and the renters' associations. The system protects the tenants but discourages from the development of rental apartments as rents cannot be set rents freely. As the market value of these apartment houses increase, it makes more sense for the tenants to form tenant owned cooperatives that buy the houses and thereby may profit from further price increases. This has led to rental apartment houses in the city centres (especially in Stockholm) being transformed into tenant owned housing corporations. Even though some rental apartments have been built, the number of rental apartments decreased from 250 000 to 199 000 between 2000 and 2010 in Stockholm. In Malmö and Göteborg the decrease was not as dramatic, but instead of seeing an increase, which one would expect as the population increases – the number of rental apartments is dropping. Assar Lindbeck (2012), a famous Swedish economist writes in his memoirs that Swedish rental regulation is a 70 year old housing policy disaster[7]. He proposed the abolition of the regulation in the 1960's. Since then, many economists including international organizations such as the IMF and OECD have found that the lack of rental apartments is dampening economic growth and welfare in Sweden as it hinders labour mobility. Boverket (2012b) estimated that the regulation has led to a lack of up to 163 000 rental apartments[8].

The low rents also lead to "over-consumption" in the rental market. Some households live in apartments that are larger than they need, some keep their apartments without living there since it is so cheap and because the waiting lists are so long that one might not get a rental apartment if one needed one in the future. This situation has of course allowed a black market to develop, where rental contracts are traded. Indicators show that this is a growing market and prices of the contracts are increasing and reaching prices of several hundred thousand SEK (EUR/SEK ≈9.3).

Experts working on how to solve the situation in the rental market and how to deregulate it have concluded that Sweden could learn much by looking at the German regulation of the rental market.

Another major problem with the housing market is the property gains tax. In Sweden gains tax on properties is 22% (capital gains tax is 30%). In most European countries a residential property is converted from an investment to a consumption good and thereby the gains tax does not have to be paid after a period of ownership. In contrast the property gains tax in Sweden has to be paid no matter how long the house has been owned by the same household. Since house prices have increased rapidly over the past 20 years, taxes that have to be paid on selling a house have increased as well. This keeps many households from moving. Older households where the children have moved out, are especially likely to stay on in houses larger than they need because of the property gains tax.

Further problems with the housing market, are the slow process of planning and building. The municipalities and regional governments are responsible for planning and giving building permission. The planning process takes at least 3 years. Since it takes so long smaller building companies cannot compete with the larger ones and therefore the large building companies have an oligopoly position. Their return on equity indicates that they are doing very well- even better than our profitable banks.

In addition the market for building materials is also characterized by lack of competition. This all leads to high production prices. The rate of development of houses and apartments is slow in Sweden compared to other European countries. The slow rate of supply in combination with generous conditions on the credit market makes prices increase.

[5] The Swedish Financial Supervisory Authority was assigned the responsibility for Sweden's macro prudential policy in 2014. However, the legal framework that regulates their control of financial institutions was not extended to include other sectors that may affect macroeconomic stability. This made it questionable whether they are allowed to impose repayment requirements that directly affect households.

[6] Boverket (2012a), "The era of cheap mortgages is at an end", *Market report February 2012.*

[7] Lindbeck, A. (2012), *Ekonomi är att välja*, Albert Bonniers förlag.

[8] Boverket (2012b), *Bostadsbristen ur ett marknadsperspektiv*, Rapport 2012:18, Regeringsuppdrag.

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