

HOUSING FINANCE INTERNATIONAL

The Quarterly Journal of the International Union for Housing Finance



- ➔ **Impact of the financial crisis on the housing finance systems of Bahrain and Qatar**
- ➔ **European Union opts to regulate mortgage credit**
- ➔ **“Orthodox” and “unorthodox” Hungarian political measures to alleviate the situation faced by foreign currency mortgage debtors**
- ➔ **From owning to renting; tenure trends in England, 1993 to 2025**
- ➔ **Housing subsidy policy in Brazil: an overview of the last five decades**
- ➔ **Housing finance in developing countries**

International Union for Housing Finance

Housing Finance International

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Those old post-banking crisis blues

↳ By Andrew Heywood

The publication date of this autumn issue of HFI corresponds closely with the five year anniversary of the bank run on Northern Rock which was subsequently followed by a takeover by the UK Government. This is seen by many as the first manifestation of the Banking Crisis that was to sweep the world and to reach its nadir with the collapse of Lehmann Brothers in 2008.

The consequences of that crisis are still with us. The Eurozone crisis is, of course a further symptom. Like previous financial crises, the Banking Crisis precipitated a global economic slowdown that has proved more persistent than many commentators believed likely two or three years ago. Government stimulus measures such as those of the UK until 2010 and the efforts of the Obama administration in the US did not produce the results hoped for, and the UK is only one of the economies currently facing a double dip recession. The all-important news from China implies slowing economic growth and a degree of political instability.

The effects of the crisis on mortgage and housing markets around the world have been documented in this journal and elsewhere. Although there are some signs in the UK that the precipitate decline in mortgage lending may have begun to reverse slightly, and Alex Pollock offers evidence that the US housing market may finally have bottomed out in terms of prices (see his regional news round-up in this issue), the general picture remains one of restricted lending, higher delinquencies and uncertain demand. Few believe that this position is going to change fundamentally anytime soon.

Four of the articles in this issue offer perspectives on how mortgage and housing markets have reacted to post-Banking Crisis conditions and/or how governments and legislators have responded to perceived problems in those markets.

In a fascinating article Gus Freeman analyses the housing finance systems of Qatar and Bahrain. In these states (as in the United Arab Emirates) housing is an important conduit to transfer oil and other sovereign wealth to the national population. Mr. Freeman examines the role of the state in promoting homes for nationals and also examines the parallel housing markets (predominantly rental) for the large-non national populations of these countries. He also analyses how these markets have been affected by the fallout from the banking crisis and how the governments and other players have responded. This groundbreaking piece will be followed by a further article examining the housing finance system in Kuwait in our winter 2012 issue.

Those of us with long memories can look back at over a decade of discussion and negotiation centred on the introduction of European retail mortgage regulation by the EU Commission. In the heady pre-crisis days such regulation was justified on the basis of creating a single European mortgage market that would fuel economic growth by fostering increased mortgage debt across the EU. Since 2007 aspirations have sobered, with the emphasis of regulatory policy shifting towards consumer protection and the promotion of financial stability. Christian König has for many years been an active participant in the consultation processes surrounding the development of legislation to introduce European mortgage regulation and his article presents a comprehensive overview of the Commission proposals, which are now in what is likely to be something close to their final form.

Hungary is one of the countries whose post-Banking Crisis difficulties have helped to make the case for, and to shape, European legislation on mortgage regulation. Andras Botos offers an industry perspective on the evolving issues surrounding the use of foreign currency denomi-

nated mortgages in Hungary, and the subsequent responses by the Hungarian Government.

The UK has for many years been seen as a flagship for housing policy promoting home ownership to its households whose aspirations to become home owners are often seen as exceptionally strong. Yet home ownership has been falling in the UK for eight years and the signs that the seemingly inexorable rise of owner occupation may have limits can be traced much further back. In this issue of HFI Peter Williams presents new research that distinguishes longer term tenure trends from the impact of the Banking Crisis and draws on data spanning two housing market cycles in order to project possible future trends in UK housing tenure. This research represents key reading for anyone interested in the inter-relationship between housing tenure, economic performance and housing policy.

As affordability places constraints on home ownership levels in an increasing number of markets, analysis of past efforts to promote affordable home ownership is timely. Claudia Eloy and colleagues present a probing assessment of the outcomes of successive policies to promote affordable home ownership in Brazil over a fifty year period. The article raises important issues for others to take forward, including how such efforts can be effectively targeted and the consequences of government intervention to cap or subsidise mortgage interest rates.

In our final article in this issue Monika Löfmark continues our series of articles on global housing finance policy issues by offering her perspective on the need to increase access to housing finance in developing countries. Ms Löfmark analyses the factors that tend to militate against access to finance, such as the high incidence of informal settlements, and discusses possible ways to improve the situation.

Correction: Summer 2012 issue

Pierre Venter has informed us that some data was inadvertently stated incorrectly in his article *Basel III to deliver a further blow to "financial inclusion" for South African mortgagors*. On page 33 the article stated: "Mortgages account for 61% of total bank loans." Mr Venter informs us that mortgages in fact represent 33% of total bank loans and 63% of total consumer loans.

Contributors' biographies

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Housing finance news from Africa: innovation to tackle affordability

↳ By Kecia Rust, African Union for Housing Finance

Chinese investment in urban development in Africa has grown significantly in recent years and promises to be a major force shaping the growth of African cities into the future. A workshop held in early August in Nairobi, Kenya, explored the implications of the level and nature of this investment, and considered opportunities for directing it towards pro-poor objectives. The workshop, co-organised by the Mazingira Institute (a Kenyan-based development NGO), the Centre for African Studies at Peking University, and Development Workshop (an Angolan-based NGO) was supported by the Bill and Melinda Gates Foundation, and brought together a diverse range of urban development practitioners from China and Africa.

The rationale behind the workshop was simple: to establish mechanisms and pilot interventions that might enhance thoughtful and developmental investment by the Chinese government and Chinese companies in Africa. The two regions are strikingly similar: both China and Africa are the most rapidly urbanizing regions in the world, and in both, the relationship between urbanization and economic growth is clear. In Africa, the urban proportion of the population has grown from about 20 percent in 1960 to just under 40 percent in 2005, while GDP per capita has also risen. China's urban population has also grown from about 20 percent to about 40 percent in the period, and its GDP per capita has risen accordingly, reflecting a trend seen across the globe (UN Habitat, 2008). But while the growth trajectories have been similar, the progress of poverty has been vastly different. In Africa, the percent of the population who have remained in poverty earning less than \$1.25 a day has hovered around 50-55 percent between 1981 and 2005, coming down slightly to rest at about 50 percent in 2005. In Asia, the percent of the population earning less than \$1.25 a day has dropped dramatically, from 80 percent in 1981, down to just under 20 percent in 2005. A key difference is the structure of economic growth in the two regions: China's growth has been broad based, engaging the population in agriculture, manufacturing and other job-rich activities, while Africa's growth has been narrow, supported by the value of and demand for commodities and more recently, oil.

For all of China's success in managing its own urban growth and in reducing poverty, however, the innovations and best practice being realized in China are not yet reflected in the Chinese-sponsored urban development projects in Africa. The workshop organisers suggested two gaps – Chinese architects, urban designers and project implementers have little local knowledge of the African context and the particular issues being faced from one country compared to another, and there is little interaction between urban development professionals in China and Africa. The workshop was therefore a first step towards better interaction between practitioners.

Chinese investment in Africa is already significant. Allan Cain, the Director of Development Workshop in Angola, noted that in Angola alone, Chinese-Angolan economic cooperation is estimated to be about US\$25 billion over the last decade, and much of Angola's post-war reconstruction has been financed by Chinese credit lines. Angola is China's principal African trading partner and 25% of China's African commerce is with Angola. Fifteen percent of China's petroleum imports are from Angola. A presentation by Dr Shelly Mao Xiaojing from the Chinese Ministry of Commerce highlighted that China's investment in and aid to the continent started in 1956. By the end of 2010, China had offered aid to 51 countries, completed 933 development projects, dispatched 18,000 medical workers and 353 young volunteers, provided training to 3,2350 Africans, and forgiven 320 debts worth 19 billion Yuan for 35 of the most indebted, least-developed nations. Dr Zhao Changhui, the Chief Country Risk Analyst from China's export import bank, China Exim Bank, added that investment in housing and urban development was a serious priority for both the Chinese government and Chinese companies. Exim Bank was created in 1994, and has rapidly grown to being the dominant lender to Africa, with \$67.2 billion in loans between 2001 and 2010. This is significantly more than the World Bank's \$54.7 billion over the same period.

In July, at the Forum on China-Africa Cooperation in Beijing, the Chinese government pledged \$20 billion in new loans over the next three-year

period to 2015. A key target of this investment is likely to be in infrastructure – not only large scale projects, however, but also smaller scale infrastructural and real estate investments.

Illustrative is the so-called “ghost town” built in Kilamba, Angola by the China International Trust and Investment Corporation at a cost of \$3.5 billion. Financed with a Chinese credit line which Angola is repaying in oil, the development is one of the largest new-build developments on the continent. In July, a BBC report noted that less than ten percent of the 2,800 unit development had sold, however. Covering 5,000 hectares about thirty kilometers out of Angola's capital City, Luanda, the residential development includes 750 eight-story apartment buildings as well as schools and retail units to serve the expected population. When Angolan President dos Santos spoke of the development, he said that it exemplified the Angolan social housing policy. It is one of a several new “satellite cities” being constructed by Chinese companies in Angola. Flats in the complex are far too expensive for the target market, however. At between \$120, 000 - \$200, 000 per unit, the housing is far from affordable for the vast majority of Angolans, 70 percent of who fall below the international poverty line of earning less than US\$60 per month. Although the local school opened six months ago, it has had to bus its pupils in from other areas because there are no children within the development to attend. The BBC report describes the commute of a student who spends three hours travelling to and from classes in Kilamba.

The Kilamba project failed to link the ideal of a quality social housing project with the affordability realities of the target market. A further constraint highlighted by some critics is the limited availability of mortgage finance in Angola. Even those with adequate incomes are unable to purchase the units because they cannot access mortgage finance. While a new legal framework has been developed to facilitate the growth of a mortgage markets, levels of savings are such that few Angolans would manage to secure the deposit required to access the credit. In response to the problem, the government has

recently announced that some of the units in Kilamba will be defined as “social housing” and offered to qualifying beneficiaries at subsidized rentals. The policy arrangements for this are not clear, however. Nor is it clear whether this subsidy would be extended to the housing in other satellite towns, and whether it could be sustainably applied to the full, low-income population in Angola.

The Kilamba housing development is indicative of both the power and capacity of Chinese investment – especially when supported by the oil economy that dominates so many African countries – and the critical need for such investment to be carefully managed in such a way that promotes local development objectives and meets local development needs.

At the Nairobi workshop on pro-poor urban development, Chinese and African practitioners both expressed commitment to realizing positive development and investment interventions that contributed towards a pro-poor development agenda, reducing poverty while stimulating growth and investment in the region. Looking towards the future, five working groups have been established to consider a land and housing finance research agenda, to promote a pro-poor African urban road project, to develop academic and vocational training for Chinese and African practitioners in urban development initiatives, to consider Corporate Social Responsibility approaches, and to explore affordable clean technology transfer.

For a copy of the workshop report and further information on this work, please feel free to contact Kecia Rust on kecia@housingfinanceafrica.org.

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Asia Pacific region

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

The APUHF has formalized its association with HOFINET through an MOU [Memorandum of Understanding] to support each other for the common cause. HOFINET is indeed a unique and a very rich platform for data/information sharing among researchers and practitioners in housing. The members of APUHF and HOFINET will benefit immensely from this association. Through this association APUHF will seek to broaden the base of the information supply network in an environment of growing global integration.

The APUHF and the Asia Pacific Ministerial Conference on Housing and Urban Development [APMCHUD] have been in discussions about a possible collaboration between the two bodies. APMCHUD is an inter-ministerial body of the Asia Pacific countries, set up under the aegis of UN-HABITAT and is represented by ministers of housing and urban development of Asia Pacific countries as its members. The APMCHUD envisages addressing the challenges of urbanization, housing and habitat management, millennium development goals, urban poverty and slum improvement etc. Considering the common goals and objectives of both the networks, and the Ministerial representation of various countries on the APMCHUD, the partnership would be fruitful and will benefit all member countries and institutions. An MOU in this regard is expected to be signed soon.

Afghanistan has its unique challenges in many social and-economic sectors, and housing is no exception. Due to decades of war and infighting, a large segment of housing has been either

damaged or totally destroyed. According to a study by the World Bank (2006-07), nearly \$ 2.5 Billion was needed to repair and rehabilitate the housing sector in Kabul only. The housing finance industry has also been damaged with the disappearance of the only specialized housing finance institution. The Central Bank [Da Afghanistan Bank-DAB] has been taking many initiatives to revive and rehabilitate housing and housing finance in the country. One major challenge before it as a regulator is to develop and implement a regulatory regime for housing finance. Being predominantly an Islamic country, the Housing Finance Institutions and Products have to be Sharia-Compatible. The Governor of DAB, H.E. Noorullah Delawari is taking concrete steps for the purpose in association with APUHF and other agencies. Mr. Asad Zafari, with two decades of experience in financial/housing sector, has been recently appointed as Senior Advisor to DAB on Housing and has been given the task of working closely with APUHF, ADB and the World Bank for possible technical assistance in different areas. Mr. Asad is being assisted by Mr. Wahid Arefi Dy. Director and Ms. Geeti Maryam. The DAB Team on Housing is also working with the Attorney general/Judiciary to streamline default and foreclosure procedures. They are also working with an international firm having expertise in Valuation to develop property valuation standards, procedures and training for the purpose. Since Afghanistan's financial market is short of long term liquidity, the DAB is also exploring a long-term credit line with some multilateral agencies.

In Pakistan, the State Bank of Pakistan-SBP [Central Bank] is now in the advanced stages of developing and enforcing housing specific prudential regulations and mortgage guidelines. Until now housing finance is being regulated under PRs [Prudential regulations] for consumer finance. The SBP is taking very positive steps in strengthening the Association of Mortgage Bankers in Pakistan-AMB (current Chairman, Mr. Abrar Amin) and keeps an active liaison with them for exchanging insights into housing finance. In Pakistan, the Islamic Banks are playing an active role in providing Sharia-compatible housing finance and their share of overall housing finance is on the increase. The SBP is also planning to conduct a market survey on housing demand and the backlog in supply for different income segments and in different Provinces/Districts.

In India, NHB is holding a national conference on Rural Housing and Housing Finance on Sept 8, 2012 at Bengaluru. It will be attended by a large number of practitioners, policy makers and regulators. The conference will deliberate on a number of issues relating to the promotion and development of rural housing in the country. NHB is also very active in advancing on various initiatives such as Green Housing, which it has recently taken under leadership of Mr. Verma CMD.

The housing markets in Thailand, Indonesia, Philippine and Mongolia are growing in size and sophistication and these countries will be covered in more details in next issue of HFI

Europe: a shifting regulatory landscape

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

Europe continues to come out with new regulatory ideas for the financial industry. While it is getting more and more unlikely that CRD IV legislation, which implements Basel III in Europe, will enter into force on January 1 2013, the European institutions have developed further proposals that might significantly impact financial institutions all over Europe.

On June 6 the European Commission proposed a framework for bank recovery and resolution. The proposal requires that every credit institution has to draw up recovery plans setting out measures that would kick in in the event of a deterioration of their financial situation, in order to restore their viability. However, not only the firms but also the national supervisory authorities have to prepare resolution plans for every credit institution with options for dealing with banks in a critical condition, which are no longer viable. If authorities identify obstacles to resolvability in the course of this planning process, they can require a bank to take appropriate measures including changes to corporate and legal structures.

This element of **preparation and prevention** is complemented by the possibility of **early intervention** by the authorities if the financial situation of a company deteriorates. The European Commission proposes to expand the powers of authorities so that they can require the weak institution to implement any measures set out in the recovery plan, require them to draw up a reform and restructuring programme, and appoint a special manager for a limited time period.

The proposal provides also for **credible resolution tools**. According to the plans of the Commission these tools include not only the power to sell or merge the business, or to separate good assets from bad ones but also the so called "bail-in" tool. This tool would allow for the recapitalisation of firms with shareholders wiped out or diluted, and creditors would have their claims reduced or converted to shares.

Clearly, to be effective, the resolution tools will require a certain amount of funding. Therefore, the proposal suggests that all countries should have to create specialised resolution funds which will raise contributions from banks pro-

portionate to their liabilities and risk profiles. The funds will have to build up sufficient capacity to reach 1% of covered deposits in their respective markets within 10 years. Furthermore, national banking resolution funds will have an obligation to grant loans to other banking resolution funds in the Union, if those are in financial distress. Institutional deposit guarantee funds which do not only secure deposits but also finance resolution measures will then also be liable for banking resolution funds in other EU member states if they are in financial difficulties.

The proposal of the European Commission follows international developments in this area; it especially builds on the ideas of the Dodd-Frank Act in the United States. But there are two very significant differences between what the EU is proposing and the US approach: first, the Dodd-Frank Act is meant only for systemic systemically important financial institutions (and not for all), and second, it does not allow for the "bail-in" tool proposed by the European Commission.

The Bank Recovery and Resolution proposal fits perfectly with the Commission's announcement of 30 May 2012 on moving towards a banking union, as a comprehensive banking union would comprise of, at a minimum, four elements:

- A single rule book, establishing materially uniform rules,
- Pan-European banking supervision,
- A pan-European resolution regime including an EU resolution fund, and
- Harmonised deposit guarantee schemes (DGS).

It is therefore no surprise that the summit of euro area heads of state and governments on June 28 has decided that the Commission will work out proposals for a single European supervisory mechanism, also involving the European Central Bank. It was also agreed that, once the single European supervisory authority is created, the European Stability Mechanism (ESM) could get the powers to recapitalise banks directly.

Regarding the harmonization of the DGS it is still unclear how the very different schemes can be brought together and how the proposed Directive will be able to fit together with the

other proposals relating to the establishment of a Banking Union. The most recent legislative proposal concerning the DGS is currently blocked by the EU member states although it has already moved away from the more ambitious initial approach.

As if this is not enough, the relevant EU-Commissioner for the creation of the internal market, Michel Barnier, established an expert group chaired by Erkki Liikanen and mandated it to bring forward ideas on the structural reform of the European banking sector. One of the major issues being discussed by this group is whether and how a separation of investment and commercial banks could be made feasible. Examples for such rules are the Glass-Steagall-Act that had been enacted in the United States 1933 as a response to the causes of the Great Depression or the Vickers report in the UK that suggests ring-fencing (but not completely separating) UK retail banks from investment banks. In this context, the group also discussed the Volcker rule, which has been included in the Dodd-Frank Act, limiting proprietary trading by commercial banks.

It is quite certain that the European financial industry will soon be confronted with new substantial regulatory rules although it is not yet certain what the rules will really look like. While the European legislative tries to establish a truly single European market for financial services the credit institutions turning in a different direction due to the Euro crisis. They increasingly finance their operations locally, the flow of money across borders has dried-up, cross-border lending among euro-zone banks is steadily declining. In addition to scaling back their loans to companies and financial institutions in other European countries, some banks are even severing connections with their own subsidiaries abroad.

The creation of a Banking Union is a very ambitious task that can contribute to re-establishing the trust in the stability and integrity of the financial system so crucial for the effective functioning of financial markets. However this project should not be rushed, but be pursued steadily and diligently in order to really get a framework that brings stability and not the contrary.

North America – after six long years, the U.S. housing market bottoms

↳ By Alex J. Pollock, Resident Fellow at the American Enterprise Institute

Six years ago, in September, 2006, the IUHF World Congress in Vancouver, Canada, began with a discussion of whether we were in a housing bubble. As reported by Adrian Coles, IUHF Secretary General at the time (and now Executive Committee member):

"The keynote opening session of the [2006] Congress was on the question of whether recent rapid increases in house prices represented a housing bubble which was about to burst with calamitous consequences...or whether current house price levels are a natural economic reaction to long-term expectations of low interest rates."

With the advantage of hindsight, of course we know the right answer. A number of countries were celebrating the first decade of the 21st century with house price bubbles. With hindsight, we also know that U.S. house prices had reached their bubble peak in the second quarter of 2006, just before the Congress opened. Then came the calamitous consequences of the bust, accompanied by a constant new question: How long can this disastrous housing bust last?

Six long years later, the U.S. housing market is finally bottoming. Interestingly, six years is the international, historical average duration of the housing bust which inevitably follows a mortgage credit and house price bubble, as calculated by Carmen Reinhart and Kenneth Rogoff in their book, *This Time is Different* (2009).

As shown in Chart 1, average U.S. house prices, after falling about 34%, are moving generally sideways, and are slightly above their level of a year ago. As also shown on the chart, they have fallen below their trend line, and have returned to the levels of 2003. One 2012 survey found house prices rising in about 40% of the 384 U.S. metropolitan areas it covered and observed that "It is now cheaper to buy than to rent in many U.S. markets." In recent months, the number of house sales has increased and inventory-to-sales ratios, price-to-rent ratios, and price-to-income ratios have all improved.

Chart 1: The U.S. Housing Bubble: Case-Shiller National Home Price Index Values 1987-2012

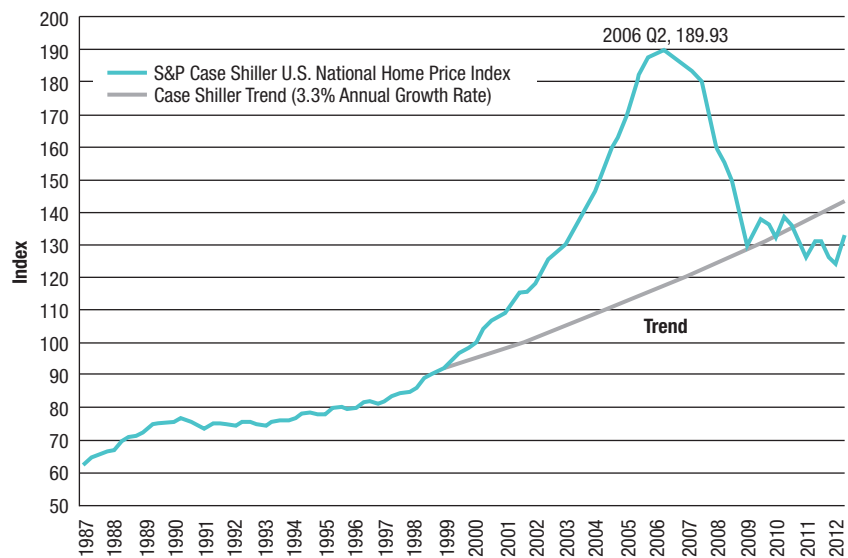


Chart 2: The U.S. Housing Bubble: Inflation-Adjusted Case-Shiller Index (1996 dollars)

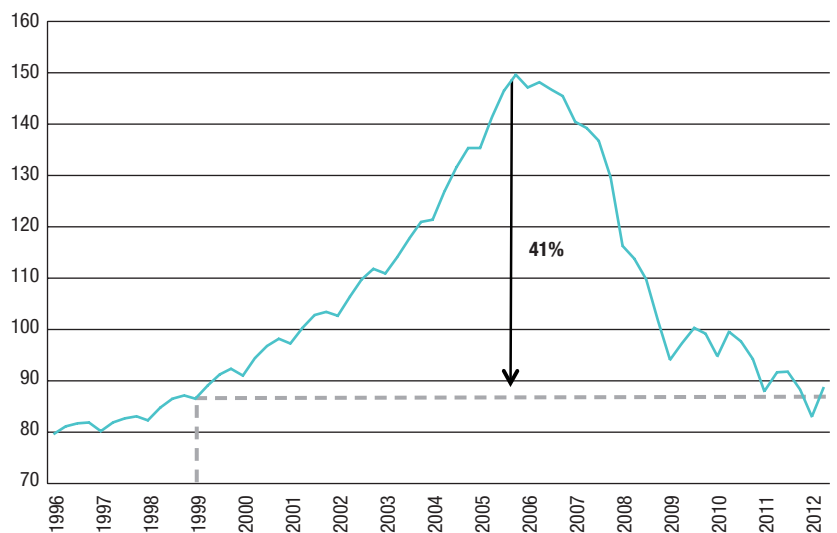
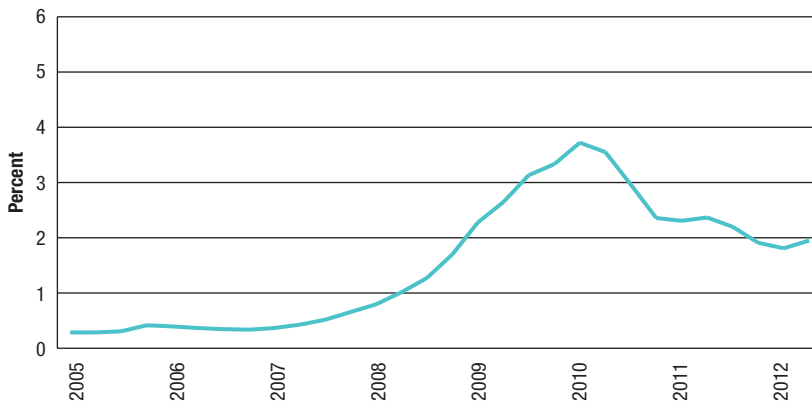
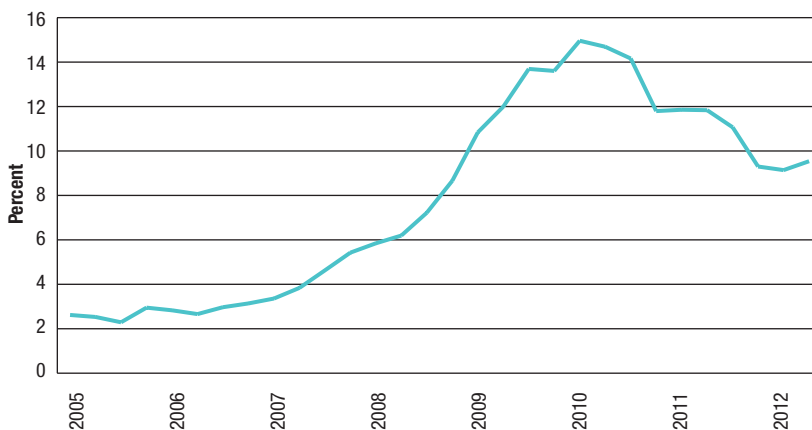


Chart 3: Percentage of Prime U.S. Mortgages 90 days past due

Source: Mortgage Bankers Association, National Delinquency Survey, Q2 2012, Data as of June 30, 2012

The extent of the house price correction and the probability of having reached a bottom are even more evident if we measure house prices in real, or inflation-adjusted terms, as shown in Chart 2. In inflation-adjusted terms, U.S. house prices have fallen not 34%, but 41% and are all the way back to the level of 1999, thirteen years ago. In other words, looked at in inflation-adjusted terms, *the entire house price bubble has been reversed.*

Consistent with these thoughts, a July, 2012 Deutsche Bank study, "Global Home Prices," considers the relationships of house prices-to-rents and house prices-to-household income. It concludes that U.S. house prices have become undervalued on fundamentals by 10%. Indeed, we would expect fundamental undervaluation, as well as having fallen below the trend line, at a market bottom.

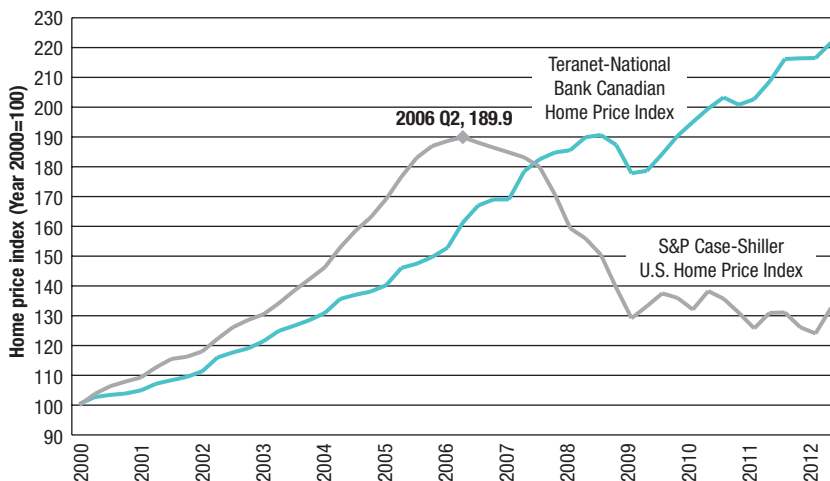
Chart 4: Percentage of Subprime U.S. Mortgages 90 days past due

Source: Mortgage Bankers Association, National Delinquency Survey, Q2 2012, Data as of June 30, 2012

Delinquencies on U.S. mortgage loans, while still at high levels, have significantly decreased. They are bad, but much less bad than before. Chart 3 shows the percentage of prime mortgage loans 90 days or more delinquent, according to the Mortgage Bankers Association quarterly survey.

Similarly with subprime mortgage delinquencies: still bad, but less bad, as shown in Chart 4.

The RE/MAX National Housing Report suggests that "2012 has become the year of the housing recovery" for the U.S. Trying to put all the factors together, it seems to me this is a little optimistic. We can say that 2012 seems to be the year the U.S. housing market has bottomed at long last. It seems likely that 2013 will be the year a cyclical recovery gets under way. We can discuss whether this is proving correct at the IUHF World Congress in Vienna in June, 2013!

Chart 5: Housing Contrast: Case-Shiller U.S. Home Price Index versus Teranet-National Bank Canadian Home Price Index

Also at the Vienna World Congress, we should consider a quite fascinating development in North America. Take a look at the vivid contrast between Canadian and U.S. house prices, as shown in Chart 5.

Relative to the year 2000, Canadian house prices have moved far above the levels reached in the U.S. at the top of its bubble. After an eight-year run-up and then a brief correction in 2009, Canada's house prices have been rapidly inflating for three more years, giving rise to anxiety about whether this is yet another house price-mortgage credit bubble. So the key question posed at the 2006 World Congress is again being debated in Canada.

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Housing for America: we will require 50 million houses until 2020

↳ By Ronald A. Sanchez Castro

The XLVII Inter-American Housing Conference was held from 19 to 22 August in Mexico City, Mexico, and aimed to analyze and discuss various experiences, policies, implementation strategies and public and private initiatives to promote savings, housing finance and the development of cities. It also aimed to explore the opportunities for modernization of housing finance institutions and for investment in large-scale housing projects in Latin America.

This event was attended as speakers to presidents and senior executives from the construction industry and housing development in Brazil, Chile, the Dominican Republic and Mexico. Also attending were the presidents of the financial and mortgage banking associations of Colombia, Brazil and Mexico. The European Federation of Building Societies participated also, as did ministers and senior officials dealing with housing policy in Brazil, Mexico and Peru. In addition the most senior executives of the largest American mortgage institution - Fannie Mae from United States, the National Institute of Housing Funds for Workers [INFONAVIT] from Mexico and the Federal Economic Bank of Brazil also attended.

During the proceedings of the Conference Dr. Jorge Yarza Garrido, President of the Inter-American Housing Union [UNIAPRAVI] noted that the major challenge for the Americas is to build 50 million homes by 2020, which will require investment of about US\$ 1.3 trillion dollars. To achieve this goal also required three strategic aims:

- Create competitive and sustainable cities, which involves raising sufficient funding for urban development and infrastructure and creating land reserves and developing urban macro-projects,
- Provide subsidies and care for families on low incomes, provide resources and encourage savings schemes and housing micro-finance,
- Promote economic growth and the development of the domestic market, plus the integration of

the private and public sectors and ensure an appropriate legal and regulatory framework.

Key findings

The Inter-American Conference highlighted the need for adequate regulation, in the light of the outbreak of the subprime mortgage crisis, which has already led to greater supervision and regulation of financial systems. However we must avoid falling into excessive regulation, because this limits the dynamism of housing finance. It is important to share experiences on regulatory and legal issues that are based on best governance practices rather than on excessive regulation.

Moreover, among the experiences presented at the Conference, it was highlighted constantly that to develop our cities it is very important to coordinate public-private sectors with a vision of long-term, joint actions and policies at all levels. This would include central and local government, and the financial, construction and real estate business sectors plus the civil community.

Another challenge for Latin America is to have proper planning and ensure the financing of urban development to generate competitive cities. This involves promoting orderly urban development, improving the quality of life for the inhabitants of the cities with provision of adequate equipment and services, and promoting sustainability in the economic, environmental and social sectors.

Latin America presents a favorable economic environment and a challenge would be to sustain this growth over the long term, maintain and/or improve high levels of employment and supervise household debt and credit quality.

It is important to have housing subsidy programs to link the production of housing, with appropriate allocation of subsidy to build household wealth and also ensure the availability of these resources in the long term.

Housing public policy should not be only a reactive measure to boost the economy and create jobs. It is also an essential tool to alleviate poverty and inequality, and generate social welfare.

In the current context of investment opportunities in the housing sector, the development banks should play a stronger role in housing finance and urban development.

Another important element is the strengthening of the domestic market. It is essential to develop the value chain within industry and eliminate bottlenecks, develop primary and secondary markets for mortgages, as well as developing tools and mechanisms to obtain greater long-term financing.

It is necessary to think about and address the customer, and also to make schemes Win/Win in relation to meeting housing demand. That means that these schemes have to be beneficial for all stakeholders including private, public and families.

Another important conclusion concerns the need for implementation of the ABCD model¹ on housing finance. That involves promoting savings, supplemented by bonds or subsidy, the granting of credit and the re-use of funding to ensure future funding for new families.

Objectives in Latin America for 2020

The main objectives for the year 2020 in Latin America, submitted to the XLVII Inter-American Housing Conference of UNIAPRAVI were:

1. Organize the housing sector with efficient public-private coordination.
2. Increase the value of the market (the volume of homes sold) and expand housing finance.
3. Use the industry as a tool to create jobs and fight poverty.
4. Build cities using housing investment to improve the quality of the urban environment and its infrastructure.

¹ ABCD scheme, by its Spanish acronym: ABCD= Ahorro + Bono + Crédito + Devolución

Impact of the financial crisis on the housing finance systems of Bahrain and Qatar

By Gus Freeman and Siji Sudarsanan

1. Introduction

This paper looks at the impact of the financial crisis on the housing finance systems of the Arabian Gulf countries Bahrain and Qatar, which share the western shore of the Arabian Gulf. These two countries are members of the Gulf Cooperation Council (GCC) along with Saudi Arabia, the UAE, Kuwait and Oman. The reader might be forgiven for asking 'Which crisis?' since these two countries, along with the rest of the Middle East and North African (MENA) region, are currently working through the combined effects of three crises. The first was the global financial crisis with its epicenter around the 15 September 2008 bankruptcy of Lehman Brothers Holdings Inc.; second is the ongoing socio-political transformation in the Arab World and third the current unfolding Eurozone crisis, a relative of the first. This paper attempts to examine the effects of these crises on the housing finance systems of these two countries, within the wider macro-economic context.

The Gulf States have some unique characteristics which distinguish their housing systems from the rest of the world. HFI readership may not be aware of these so to give context, Section 2 outlines the main features of first the housing systems and then Section 3 describes each of the countries' housing finance systems in turn.

Section 4 looks at the impact of the crises on the economies of Qatar and Bahrain and their housing and housing finance systems. Section 5 concludes.

2. Housing system overview

2.1 Population

Bahrain and Qatar are dynamic countries with distinct identities and an influence on the world stage that goes beyond their population size. Qatar has the larger population of the two coun-

Figure 1 Location of Bahrain and Qatar



tries at 1.69 million and Bahrain at 1.2 million in 2010. A remarkable characteristic of these populations is that nationals represent a minority; 46% in Bahrain and 15% in Qatar (Figure 2). Amongst the GCC only Oman and Saudi Arabia have nationals as the majority of the population. This has a significant impact on the structure of the housing systems in these two countries as ownership of land and housing is restricted to nationals. Only nationals have been able to own residential property. This foreign ownership law has begun to change at the margin for high end housing but essentially expatriates are restricted to the rental tenures.

2.2 Households

Another noteworthy characteristic of these countries is that not all the expatriate population feeds into private household formation. In Bahrain and Qatar a minority of the expatriate population in 2010 were living in private households at 24% and 32% respectively (Table 1). The majority of the expatriate populations in Bahrain and Qatar were living in Collective Households, which is accommodation provided by the employers for workers in manual trades such as construction and contracting, with a

smaller proportion living in nationals' households as domestic staff. Whilst these expatriates exert significant demand for space in the urban landscape, consume residential utilities of electricity, water, sewage and waste disposal, their impact on residential rental markets, where private households alone are the units of demand, is clearly less than if the whole expatriate population were living in private households.

The outcome is that Bahrain and Qatar have a similar number of private households to one another at 140,000 and 135,000 respectively (Table 2). National average household sizes are larger than expatriate households, ranging from 7 per household in Bahrain to 9.4 in Qatar (including expatriate domestic staff), compared to 3.5 to 4.6 per expatriate households (also including domestic staff where they live in the same dwelling). The effect is that in Bahrain national households are the 67% majority of all private households whilst in Qatar national households are the minority of all private households in their countries at 25% (Table 3).

The two countries are part of the oil and gas producing GCC which gives them high levels of GDP, which, relative to the small populations, results in higher levels of GDP per capita income. Qatar has the highest GDP per capita in the world at US\$ 102,891 in 2011, which is approximately four times that of Bahrain at US\$ 27,368 GDP per capita.

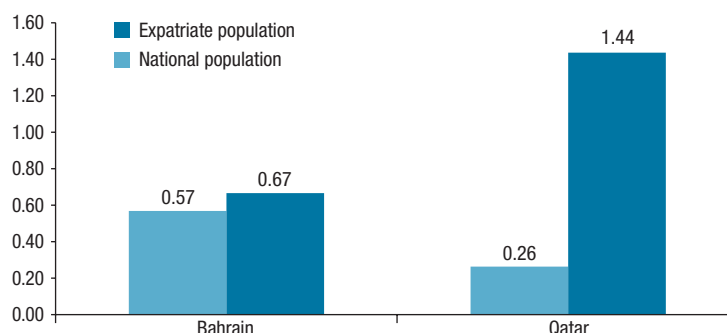
Bahrain and Qatar are city states, highly urbanized with at least 89% of the population in 2010 living in the one capital city that constitutes the country (Table 4).

2.3 Housing tenure

The restriction on foreign ownership of land and housing in Bahrain and Qatar has produced distinct housing tenure outcomes. The rate of owner-occupation amongst all private households in 2010 was 63% in Bahrain and 25% in Qatar according to the national statistical organizations in those countries (Table 5). The difference in the owner-occupation rate for the overall population is largely determined by the share of the total population that are expatriates and the proportions of these expatriates that live in private households as opposed to living in collective or nationals' households.

Amongst nationals the share that own the house they live in is very similar; 80% for Qatari households and 82% for Bahraini households. The difference in the overall owner-occupation rate for the whole population is more a function of the number of expatriate households that dilute the nationals' rate as almost all expatriates are renters.

Figure 2: Population Distribution by Nationality in 2010, Millions



Sources: Central Informatics Organisation. Bahrain, Qatar Statistics Authority

Table 1: Expatriate Population by Household Type in Bahrain and Qatar, 2010 (% of Expatriate Households)

	Private households	in Nationals' households	Collective households	Total
Bahrain	24%	13%	62%	100%
Qatar	32%	3%	64%	100%

Table 2: Private Households in Bahrain and Qatar, 2010

	National households	Average household size	Expatriate households	Average household size	Total private households
Bahrain	93,653	7.0	46,554	3.5	140,207
Qatar	33,322	9.4	101,347	4.6	134,669

Sources: Population Census, 2010 and Household Expenditure and Income Survey 2006/07, Central Informatics Organisation. Bahrain; Population Census 2010 and Household Expenditure and Income Survey 2006/07, Qatar Statistics Authority

Table 3: Private Households by Nationality in Bahrain and Qatar, 2010 (% of Private Households)

	National households	Expatriate households	Total private households
Bahrain	67%	33%	100%
Qatar	25%	75%	100%

Table 4: Demographic Characteristics of Bahrain and Qatar

	GDP per capita International \$ (2011)	Urban population (2010)
Bahrain	27,368	89%
Eurozone	33,818	
Kuwait	40,740	98%
USA	48,147	
Qatar	102,891	96%

Source: IMF WEO Database, UN Habitat

This situation may change in the future as governments relax the foreign ownership laws by permitting expatriates to own houses in certain designated areas. Restrictions have been in place to protect national populations from being crowded out of their own countries but are being relaxed in specially designated zones as their economies have liberalized to foreign investment. In 2011, Qatar enacted a law allowing foreigners to own real estate and acquire residency permits in the country. Similarly, Bahrain has liberalized the foreign ownership of housing since 2001. In January 2001, Decree 2 of 2001 was passed permitting foreign firms and GCC nationals to own land in the country, limited to certain areas and dependent on the intended use by the proposed buyer. In 2003, Bahrain enacted further legislation to enable non-Bahrainis to own real estate on a freehold basis in areas designated for foreign ownership. The recent update in 2006 to this decree allowed foreigners to own residential units of certain types anywhere in Bahrain. This is significant for the housing finance market as these expatriate segments, although small in number, can become high value segments for housing loans.

The rates of owner-occupation amongst Bahraini and Qatari households in 2010 were very high internationally (Scanlon and Whitehead, 2004). In spite of high home-ownership levels amongst nationals in these countries, there exists a shortage in housing stock for nationals in the affordable low or middle income housing, attributable largely to land supply constraints. In Bahrain and Qatar, the supply gaps are significant, primarily for the low to middle-income households.

In contrast, excess supply exists in the luxury market. After the 2008 economic downturn, the housing industry underwent a lateral change. Initially, developers were focused in the residential segment on luxury high prestige projects. However, with the current oversupply of high-end product throughout the market, companies are realigning their business models to focus on the affordable housing segment.

3. Housing finance system overview

3.1 Bahrain

3.1.1 Housing policy

The Government of Bahrain aims to ensure that all Bahraini citizens have adequate housing. Housing in the Gulf region is seen as a major vehicle for oil wealth re-distribution from the ruling family to citizens (Grimes 1976, Haywood

Table 5: Housing Tenure Pattern for Bahrain and Qatar, 2010
(% of Private Households)

Percent	Owned	Rented	Government housing	Employer Provided	All
Qatari	80%	13%	6%	1%	100%
Expatriate	0.2%	65%	17%	18%	100%
All Private Households in Qatar	25%	49%	14%	13%	100%
Bahraini	82%	14%	3%	1%	100%
Expatriate	1%	76%	0.3%	22%	100%
All Private Households in Bahrain	63%	29%	2%	6%	100%

Sources: 2005/06 Household Income and Expenditure Survey and 2010 Census, CIO Bahrain; 2006/07 Household Expenditure and Income Survey, 2010 Census, Qatar Statistics Agency

1989). The higher the oil revenue of a Gulf country, the more the housing policy has been used as means of redistributing oil wealth amongst national populations. Within the GCC Bahrain has the lowest oil revenues and so their government housing subsidy program is relatively smaller than Qatar. Where Bahraini households have an income of less than BD 400 (USD 1,060) per month they become eligible to apply for housing from the government.

In 1975, the Ministry of Housing was formed to provide housing facilities to the Bahraini families that could not afford to pay for a home of their own. In 2002, the Ministry was again made an independent entity to highlight the commitment of the government to provide housing for its citizens. The Ministry of Housing will build a house for the applicant. As with many government subsidized housing schemes in the Gulf region the waiting list of applicants far exceeds the Ministry of Housing's capacity to build houses with the waiting list standing at 50,000 people in 2011, growing at the rate of 4,000 per year, with less than 3000 dwellings being constructed by the Ministry each year. Around 80% of Bahrain's national population comes within the definition of low-income population. Hence, there is a huge demand for affordable housing as well as social housing subsidized by the Government of Bahrain. Whilst Bahrainis nationals are waiting for their government provided house they are supported in the rental sector with a rental payment for each household, capped at 25% of the household income.

Considering the rapid growth in the number of Bahraini households coupled with the current shortfall in suitable housing, the demand for housing by nationals is likely to remain a decisive issue for Bahrain over the next two decades. In Bahrain, the total demand for housing by the nationals is projected to grow from 124,065 in

2010, to 173,069 in 2020 and 225,131 in 2030 (Economic Development Board, Bahrain 2011), such that Bahrain needs to build about 40,000 homes to satisfy the current unmet demand, an additional 65,817 housing units by 2020 and 77,281 by 2030 to satisfy Bahraini households' housing demand. The Economic Development Board estimates that about 51,000 households will qualify for social housing by 2020 and 60,000 by 2030, in addition to the existing waiting list.

Whilst the Government of Bahrain has developed detailed programs to provide affordable housing finance for the middle market and lower income segments in the form of the Mortgage Guarantee System and the Social Housing Fund, these have not yet been implemented as the focus of government housing policy has been to focus on developing more housing supply. In 2010 The Ministry of Housing decided to adopt the Public Private Partnership (PPP) model as a tool to help them deal with the issues of volume, quality and timely delivery of housing. The Bahrain Housing PPP project includes a mix of housing for rental, housing for sale, retail and commercial property. The Ministry of Housing requested the private sector bidders to develop a master plan for the land and to include a requirement of 3,100 houses for the Ministry of Housing to allocate to the people on the housing list who were eligible for the rent to own scheme. The developer could then develop the rest of the land in the way that it saw fit, however this included the development of 1,400 affordable housing units that will be sold to those Bahraini nationals at the higher end of the Ministry of Housing affordable housing list (with an income of BD1,200 per month) together with commercial property for sale into the open market.

The social housing requirement of 3,100 units would be paid for by the government through a monthly payment to the developer for the period

of the contract from the availability of the houses. The Ministry of Housing would place people from the housing waiting list into these houses and recoup up to 25% of the tenants' income as rental for the property over the life of the contract, at which point the tenants become owner-occupiers of the property.

The Government of Bahrain subsidized the PPP project by putting government land and the cost of the development of primary infrastructure into the deal. This significantly reduced the cost burden to the developer and therefore the overall price paid by the Ministry of Housing to the private sector.

The developer also cross subsidized the cost of developing the social housing through the profit made by the development and sale of the affordable housing and the commercial property. This cross subsidy is one of the cornerstones of the project making housing more affordable to Bahraini citizens in Bahrain and reducing the cost of the project to the Ministry of Housing. The Ministry of Housing selected and signed a contract in early 2012 with the developer Naseej PSC to develop the housing.

One of the structural issues in Bahrain's housing system is the regulation prohibiting nationals to sell the house they have been given making it their first and only home. This causes Bahraini households to go for large villas as opposed to smaller villas or apartments as they want to get a dwelling that will accommodate the larger future size of their household, rather than settling for a smaller dwelling now as they form their household and then moving later to a larger dwelling as their household size increases.

The demand for housing from the expatriate population is likely to increase from an estimated 61,117 housing units today to 90,467 in 2020 and 121,581 in 2030 (Economic Development Board, Bahrain 2011), considering the expected level of immigration to fuel economic growth, notwithstanding the government policy of nationalizing the workforce.

3.1.2 Housing finance

Housing finance in Bahrain was initiated by the Ministry of Housing under a special scheme established in 1979 to provide housing loans on preferential terms to citizens. This was restructured in 2005 into the government-owned Eskan Bank, offering loans with subsidized interest rate. In 2012 Q1 Eskan Bank's mortgage interest rate stood at 3.5% against market rates ranging from 6.5 to 8.5%.

As land prices increased during the economic boom period 2005 to 2008, the loan amount offered was insufficient to cover the cost of building or buying a house. In response Eskan Bank increased 50% its maximum subsidized loan amount from USD 106,382 (BD40,000) to USD 159,574 (BD60,000). Additionally, it extended the maximum term of the mortgage from 25 year to 30 years, holding the maximum loan to value ratio at 80%.

Eskan Bank launched Bahrain's first Residential Mortgage Backed Securitization 'RMBS' transaction in 2007 in a move to broaden the landscape of the country's debt capital markets and provided finance for Eskan Bank's lending and investment activities. This transaction involves the issuance of USD 80 million (BD30 million) worth of conventional Residential Mortgage Backed Securities backed by a pool of social mortgage loans disbursed by Eskan Bank to eligible Bahraini citizens. A special purpose vehicle, Eskan RMBS Company BSC (Closed) has been incorporated as a wholly owned subsidiary of Eskan Bank to act as the Issuer of the RMBS Bonds. In this transaction, Eskan Bank shall transfer a pool of mortgage loans valued at approximately USD 266 million (BD100 million) to Eskan RMBS on a true sale basis. Eskan RMBS will issue RMBS Bonds to investors to raise the funds required to purchase the mortgage loans. Collections from the mortgage loans shall be used by Eskan RMBS to service interest and redeem the RMBS Bonds upon maturity. This first RMBS, a pioneer securitization of mortgage loans in the region, is a prelude to more RMBS transactions that are expected in the operation and structure of a Mortgage Guarantee

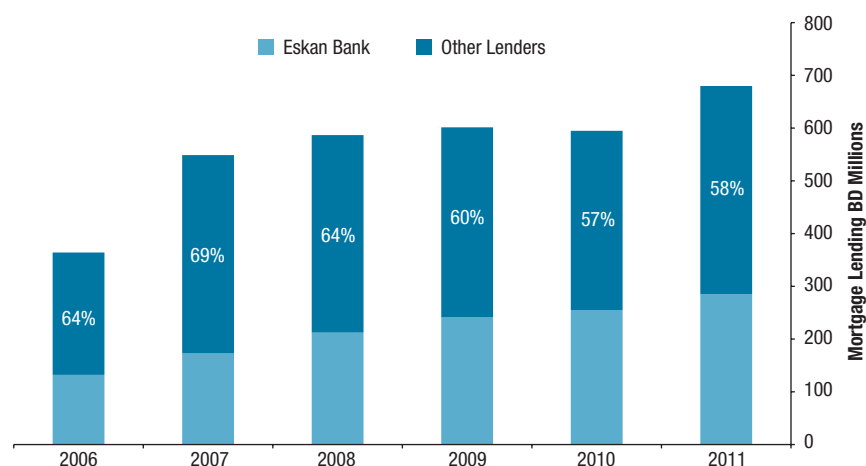
System, which the bank has developed, but awaits approval by the government.

The Central Bank of Bahrain gave license in 2006 to Sakana to operate as a specialised mortgage finance provider. In the same year they licensed commercial banks to provide housing loans. By 2012 a total of 12 banks were providing housing loans, including Eskan Bank and Sakana, foreign banks like BMI, HSBC and Standard Chartered and local banks such as National Bank of Bahrain and Khaleeji Bank. The growth in commercial bank lending was in response to the new high value segment created by the liberalization of the foreign ownership laws as non Bahrainis became able to buy dwellings in the high end residential developments like Amwaj Islands and Durrat Al Bahrain. The limited incomes of the majority of Bahraini nationals, the prominent role of Eskan Bank with its subsidized loans and the fact that government provided houses cannot be sold, limits the demand for housing loans from commercial banks from Bahrain citizens. Greater liberalization and innovation of the housing and finance system by government in concert with private sector stakeholders (banks and developers) will be needed to enable the financial resources of the banking sector to connect with the demand for housing from citizens.

3.2 Qatar

Housing issues for nationals were handled by the Ministry of Civil Service Affairs and Housing until 2007 when this Ministry was closed down and replaced by the Ministry of Labour and Social Affairs (MLSA), which handles the areas

Figure 3: Outstanding Loans Secured by a Property Mortgage, Bahrain



Source: Central Bank of Bahrain, Eskan Bank Annual Reports

of employment, providing support to those who are without income for whatever reason, the largest component of which is housing. The MLSA is responsible for developing housing policies to ensure suitable housing for every Qatari citizen. These responsibilities include:

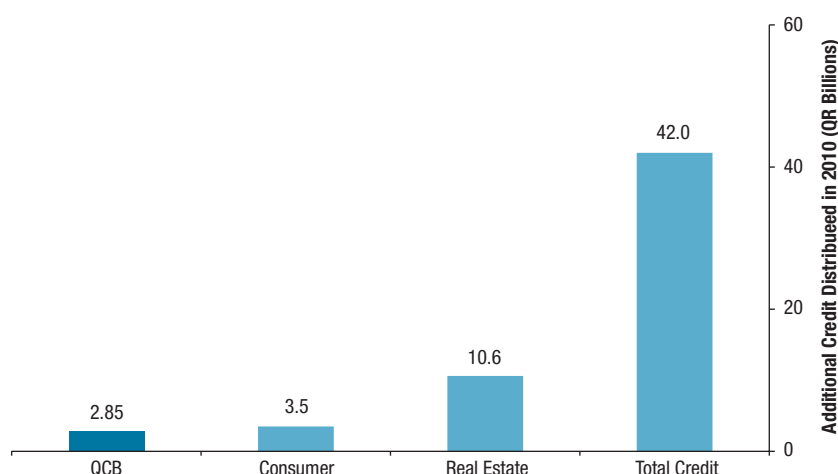
1. developing housing projects for low income, elderly and orphans,
2. coordinating housing policy with other government organizations and banks and
3. reviewing applications for housing system benefits

In March 2009 the MLSA had 7,014 Qataris receiving social welfare of USD 687 (QR 2,500) to about USD 1,236 (QR 4,500) per month depending on family composition to cover non-housing costs (General Secretariat for Development Planning, 2009). If the welfare recipients were renting their housing they received a Rent Allowance of USD 1,099 (QR 4,000) to USD 1,786 (QR 6,500) per month. The fact that the Rental Allowance was larger than the main welfare payment is testament to the high market rent levels in 2009. Only about 30% of welfare recipients were renters, the remainder owning the house they lived in.

Qatari nationals approved by the MLSA become eligible for housing loans from Qatar Development Bank (QDB). QDB was originally set up in 1997 as Qatar Industrial Development Bank to support SMEs. It has since broadened its remit to include the government-funded housing loans mandate as part of the social development targets of the 2030 vision. The government sharply increased QDB's capital from USD 55 million (QAR200 million) to USD 2.75 billion (QAR10 billion) in 2008 to fund all its programs. QDB offered approved Qatari nationals a zero-interest loan of USD 164,835 (QAR 600,000). In 2011 the ceiling of the loans was doubled to USD 0.33 million (QAR1.2 million) and the repayment period extended to 37 years. This caps the monthly payment for the maximum loan size to USD 742 (QAR 2,700). QDB disbursed USD 783 million (QR 2.85 billion) in housing loans to 3,000 nationals in 2010 (QDB, 2010) and the government allocated USD 1.43 billion (QAR5.2 billion) to housing loans in the 2011-12 budget. The 2010 loan disbursement figure is significant given it represents about 9% of the total 33,322 Qatari households and was similar to the total additional consumer credit given by all commercial banks in Qatar.

The Qatari housing market was opened up to expatriates in 2004 and mortgage products are widely available. As in Bahrain, the expatriate and foreign investor segment has been a

Figure 4: Loans Disbursed by Qatar Development Bank Housing Loan Program Relative to Consumer, Real Estate and Total Domestic Credit Disbursed, 2011 (QR Billions)



Source: Qatar Central Bank, Quarterly Statistical Bulletin, Table 25, Qatar Development Bank 2010 Annual Report

strong driver of the growing housing loan book in Qatar. Law 17 of 2004 allowed foreigners to acquire both freehold and leasehold interests in certain designated areas of Qatar (including the Pearl-Qatar, West Bay Lagoon and Al Khor Resort Project). As per the cabinet decision No. 5 and 6 made during February 2006, GCC citizens can own land in three designated areas (Losail, Al Kharaij and Jebel Thiyab), while foreign nationals and expatriates can lease properties for a period of 99 years in 18 designated areas. Recently in 2011, Qatar enacted a law allowing foreigners to own real estate and acquire residency permits in the country, which is expected to act as catalyst for FDI in the residential and construction sectors.

Qatar now has three freehold offerings available for foreign ownership – West Bay Lagoon, The Pearl and Urjuan (Al Khor) – and 18 additional areas where foreigners can buy properties on a leasehold basis. The freehold market is currently made up primarily of the offerings at The Pearl. While the current market conditions are challenging, the liberalization of the sector should bring greater development of the housing finance system in the medium term.

4. Impact of financial crisis on the housing finance sector

Major financial institutions around the world had invested heavily in US subprime mortgage-backed securities (MBS) during a period of higher global economic growth and housing asset price

increases. When US house prices started to fall many of these financial institutions reported significant losses. The bankruptcy of Lehman Brothers Inc in September 2008 confirmed the world was in the worst financial crisis since the Great Depression of the 1930s. GCC banks were less affected by the crisis than counterparts in developed economies largely due to limited exposure to these sub-prime assets. The banks in the region are generally focused on traditional lending and savings mobilization and are less integrated with the global financial markets. The profit performance of the banking sectors in Bahrain and Qatar was impacted during the aftermath of the crisis. Prompt and forceful policy action by the governments of these countries helped in containing what impact there was from the financial crisis on their banking systems.

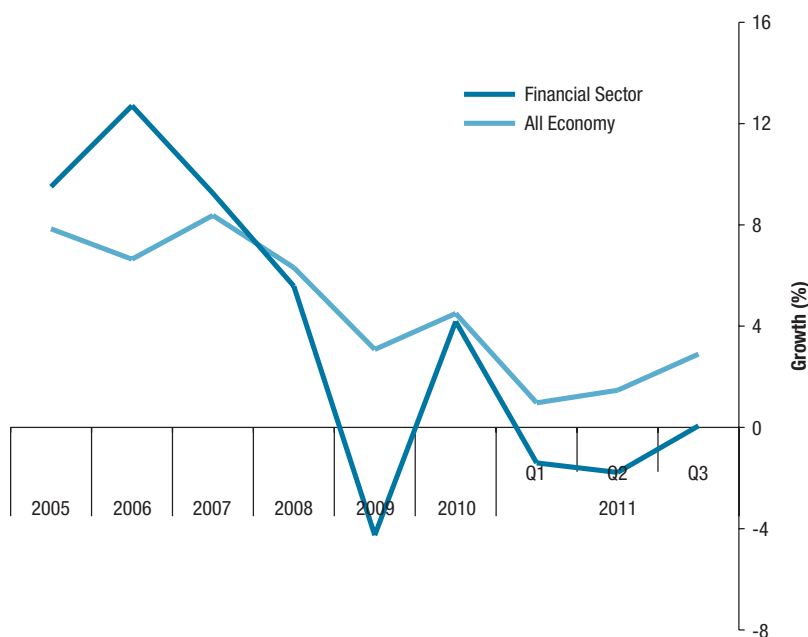
4.1 Bahrain

The financial service sector dominates the economy of Bahrain in terms of both employment and contribution to the economy, at 24.7% of real GDP in 2009, making it the largest single economic sector (CIO, 2011) and significantly larger in relative terms than the financial sector in Qatar (12.3% of real GDP) in the same year. The financial crisis coupled with other regional developments like the downturn in the real estate market, particularly in Dubai, and financial trouble at two large Saudi conglomerates (Saad and Al Ghosabi), resulted in a halving of real GDP growth from 6.3% in 2008 to 3.1% in 2009 (Figure 5). 2010 saw a rebound to real growth

at 4.2%, evidence of some recovery from the financial crisis but then growth slowed down again in 2011 to 1.8% for the first 9 months. The social-political dialogue that started in Q1 2011 in Bahrain and is ongoing has had a greater impact on the economy than the financial crisis.

The impact of the financial crisis on Bahrain's financial sector was more severe than the economy as a whole with a decline of -4.2% in real financial sector growth in 2009 compared to positive growth for the economy at 3.1% (Figure 5). The financial sector in Bahrain consists of the financial institutions, offshore financial institutions (banks and investment companies) and insurance companies. It was the offshore financial institutions that were worst impacted by the financial crisis. In 2009 they made a negative 2.5 percentage point contribution to the 3.1% real GDP growth in Bahrain (Figure 6), whilst financial institutions made only a -0.2 percentage contribution and the insurance sector contributed positively 1.6 percentage points of the 3.1% real GDP growth (Figure 6). Construction and real estate were amongst the other negative contributors to real GDP growth in 2009.

Figure 5: Real Economic and Financial Sector Growth in Bahrain 2005-11, (%)



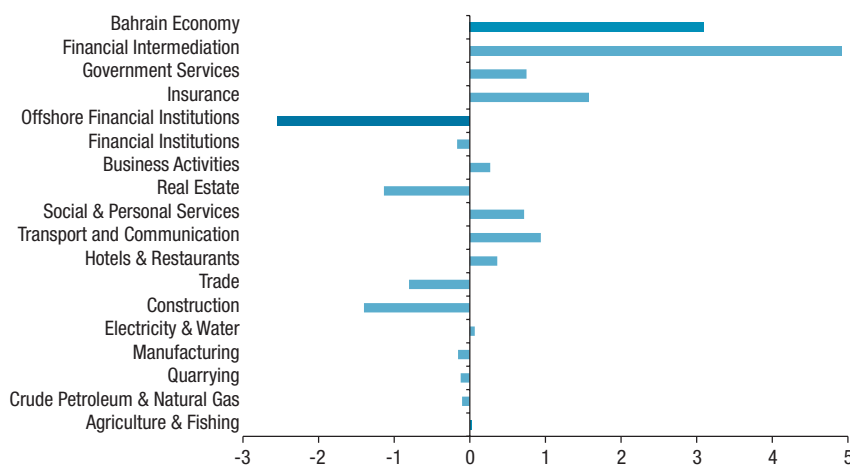
Source: Central Bank of Bahrain, Ernst & Young Analysis

Total assets in the banking system fell sharply from US\$251.5 billion in 2008 to US\$221.8 billion in 2010, down by 12.1%, largely driven by the decline in the assets of wholesale banks. The wholesale banks are generally the investment banks and offshore banking units and they represent about 71% of the total banking assets. As a result of financial crisis, the foreign assets declined by US\$21.1 billion in 2009 to reach US\$148.9 billion against US\$170 billion in 2008. At the same time, the assets of the retail banks remained broadly unchanged. By 2010 banks were not able to get their assets back to pre-crisis levels.

Due to the subprime crisis, the wholesale banks had to write off its exposures to US real estate securities. Also, the downturn in the global equity markets followed by the crisis further impacted their profitability. Domestic investments were affected by the burst of the real estate asset price bubble in Dubai. By the end of 2009, bank earnings were weak and the asset quality deteriorated.

The conventional Wholesale banks experienced losses in September 2009 with a positive Return on Assets (ROA) of 0.1% for the local banks, offset by the negative ROA of 0.7% by the overseas banks. However, the earnings improved marginally by Q1 2010 with a positive ROA of 0.3% and 0.1% for local and overseas banks respectively. The figures also indicate the rise in provisions to accommodate the increase in

Figure 6: Contribution to Real Economic Growth in 2009, Percentage Points



Source: National Accounts, Central Informatics Organisation, Bahrain, Ernst & Young Analysis

Non Performing Loans (NPLs) in Q3 2009 and Q1 2010. The Islamic banks fared no better with a negative ROA of 0.3%.

The retail banking segment where housing loans are originated was not affected as much as the wholesale and Islamic banks by the global financial crisis. The key financial soundness (Table 12) indicators given below show they

performed reasonably well. In the period Q3 2008 to Q1 2009, earnings fell sharply for both the local and the overseas banks but an increase in the net interest income in Q3 2009 helped the earnings to recover, though unable to maintain the momentum thereafter. The deterioration in the asset quality is evident from the increase in the NPL ratio from 3.7% in Q3 2008 to 6.2% in Q3 2009. However, in Q1 2010 the NPL ratio

Table 9: Asset distribution of wholesale banks and retail banks

Assets (US\$, billion)	2006	2007	2008	2009	2010
Wholesale Bank					
Domestic	13.1	16.2	18.9	13.2	11
Foreign	151.2	180.1	170.0	148.9	145.8
All	164.3	196.3	188.9	161.1	156.8
Retail Bank					
Domestic	14.4	21.0	29.2	28.8	34.6
Foreign	8.5	27.6	33.4	30.7	30.4
All	22.9	48.6	62.6	59.5	65.0
Grand Total	187.2	244.9	251.5	220.6	221.8

Source: Central Bank of Bahrain

Table 10: Financial Soundness Indicators – Conventional Wholesale Banks (%)

	March 2009	September 2009	March 2010
Non Performing Loans/Gross Loans	1.6	4.5	6.4
Return on Assets for Local Banks	0.5	0.1	0.3
Return on Assets for Overseas Banks	0.03	-0.7	0.1

Source: Central Bank of Bahrain

Table 11: Financial Soundness Indicators – Islamic Wholesale Banks (%)

	March 2009	September 2009	March 2010
NPLs/Gross Loans	5.3	10.7	8.1
ROA	-0.2	-0.3	-1.3
ROE	-1.0	-1.2	-5.5

Source: Central Bank of Bahrain

Table 12: Financial Soundness Indicators – Conventional Retail Banks (%)

	September 2008	March 2009	September 2009	March 2010
NPLs/Gross Loans	3.7	5.4	6.2	5.9
ROA Local banks	1.1	0.4	0.9	0.3
ROA overseas banks	1.2	0.6	1.3	0.4

Source: Central Bank of Bahrain

improved slightly to 5.9% following the pick-up of economic activities coupled with a fall in the impaired loan ratio for real estate/ construction from 3.7% in Q3 2009 to 2.3% in Q1 2010.

Whilst the retail banks that originate housing loans were still profitable and in better shape than the wholesale banks of Bahrain, the financial crisis had an impact on the ability of these banks to lend mortgage backed housing loans. During the years of the 2005-2008 economic boom, commercial bank lending of housing loans backed by mortgages grew strongly by

USD 223 million (BD 84 million) in 2006 and USD 383 million (BD 144 million) in 2007 (Figure 7), taking the total outstanding loan amount to USD 1,000 million (BD 376 million) (Central Bank of Bahrain, Statistical Bulletins, Table 18). During 2008 the total outstanding loan amount secured by mortgages peaked at USD 1,718 million (BD 646 million) in Q2 2008, a 72% increase from the end of 2007, but by the end of 2008 the total outstanding loan amount had fallen back to the end of 2007 level, leaving the year with a net change of zero (Figure 7).

The early point at which Bahrain liberalised its foreign ownership law for land has meant GCC investors and expatriates wanting to own instead of rent the house they live in when working in Bahrain, have been strong drivers of demand for housing loans. That the outstanding loan amount for mortgage finance in Bahrain was able to increase and decrease so much in 2008 before and after the Lehman Bros Inc liquidation, suggests investment demand was a major component of demand for these loans. The dramatic decline in outstanding loans came from the rapid sale of properties by investor owners who do not live in the residential units purchased.

The outstanding amount of commercial bank housing loans backed by mortgages declined by USD 37 million (BD 14 million) and USD 53 million (BD 20 million) in 2009 and 2010 respectively but saw growth of USD 146 million (BD 55 million) in 2011. This is noteworthy given that 2011 saw significant social protest that would offer a disincentive to the investor segment. It may be that the commercial banks have broadened their focus to the owner-occupier segment. A reason for commercial banks not to focus on the Bahraini owner-occupier segment is the majority presence of Eskin Bank in the housing finance market. Eskin Bank's lending has been growing throughout the period of the financial crisis, Arab Spring dialogue and Eurozone crisis, as it caters more for the lower income segments of Bahraini housing demand (Figure 7). There was a slowdown in the growth in 2009 and 2010, which has picked up again in 2011. Eskin Bank receives interest rate subsidy from the Ministry of Finance and as such is sponsored by the government, which protects it to some extent from the movements of housing asset prices. Eskin Bank serves squarely the national owner-occupier segment with long term commitment to Bahrain. The commercial bank lending serves this segment but also the segments of GCC and foreign investor demand and expatriate owner-occupiers, which is why their lending activity has been more volatile and more affected by the financial crisis.

4.2 Qatar

The impact of the global financial crisis was felt less severely in Qatar than other parts of the Gulf such as Kuwait and the UAE. The government's early action helped avert a crisis and formed an impetus for an improvement in the 2009 performance indicators. Many banks entered the crisis in 2008 with lax operating procedures that had developed during the lending boom, highlighted by inadequate risk management, all of which eroded loan portfolio quality and raised credit risk.

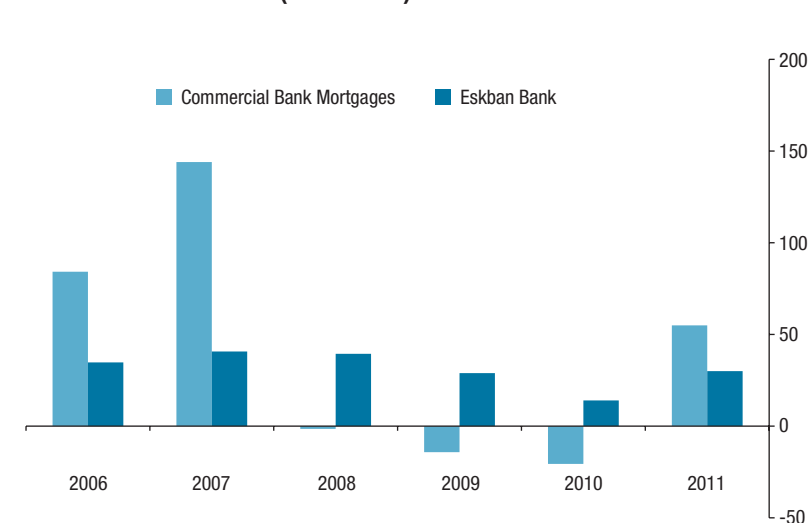
The government injected funds worth of US\$7.22 billion (equivalent to 6.1% of the GDP – Table 14) to support the banking sector. The opening policy support provided by the authorities at the end of 2008 was an equity injection into most banks, equivalent to around 10% of total assets. However, not all banks have participated. Initially, the support was provided to help stabilize banks during the early phase of the global crisis, once the magnitude of banks' balance sheets strains became apparent, the level of support was increased significantly in March and June 2009 (see Table 14). The support took the form of the complete purchase at par value of all banks' loans for local equity and real estate, along with equity injections in most banks. In exchange for these loan portfolios, banks received a mixture of cash and 10- year government bonds with a fixed coupon of 6.5 percent per year as payment. Banks were given the option to repurchase all or some of their respective portfolios within the 10-year period. In December 2009, the Qatar Investment Authority purchased a total of \$0.74 billion of equity in several banks listed on the local stock exchange (equivalent to 5% of each bank's equity).

With the government support, the banks were able to maintain their capital adequacy ratio above the central bank's minimum required level of 10% at 16.1% in 2010. Similarly, government's purchase of banks' local equity and real estate loan portfolios helped keep the NPL ratio low at 1.7% in 2009 and 2% in 2010, the lowest level in the GCC. Despite the global financial crisis, the banks were able to register a positive ROA of 2.6% in 2009 and 2010 (Table 13).

During the period 2004-2008, Qatar's financial sector experienced strong growth across the board, driven by robust domestic demand that in turn was stimulated by growing levels of government consumption and expenditure. The construction and real estate boom was supported by the strong credit growth. Private sector credit growth averaged 47% a year during 2004-2008.

A significant portion of the growth in credit was financed by foreign borrowing by Qatari banks, including short-term foreign deposits, exacerbating maturity mismatches and creating liquidity risks. These developments made the banking system more vulnerable to reversals in asset prices and availability of foreign financing. The reversals of short-term inflows linked to exchange rate speculation, combined with global deleveraging and widening emerging market spreads, resulted in significant liquidity pressures and increased funding costs for commercial banks.

Figure 7: Additional Outstanding Mortgage Loans by Commercial Banks and Eskban Bank (BD Millions)



Source: Central Bank of Bahrain Bulletins, Table 18, Eskban Bank Annual Reports

Table 13: Qatari Commercial Bank Performance Indicators

Percent	2006	2007	2008	2009	2010
Capital Adequacy	13.5	13.5	11	11.5	11.1
NPLs/Total Loans	2.2	1.5	1.2	1.7	2
Loan provisions to NPLs	94	91	83.2	84.5	85.1
Return on Assets	3.7	3.6	2.9	2.6	2.6
Return on equity	27.2	30.4	21.5	19.3	19.9
Loans/Customer deposits	85.2	96.1	114.2	109.6	102.5
Customer deposit growth	41.1	38.8	27.1	16.2	24.3

Source: Central Bank of Qatar

Table 14: Government Support to Commercial Banks in Qatar

Government Initiative	Timeline	Financial support (US\$ billion)
Equity injection	Dec. 2008	0.71
Purchase of local equity portfolios	Mar. 2009	1.79
Purchase of local real estate portfolios	Jun. 2009	3.98
Equity injections	Dec. 2009	0.74
Total		7.22

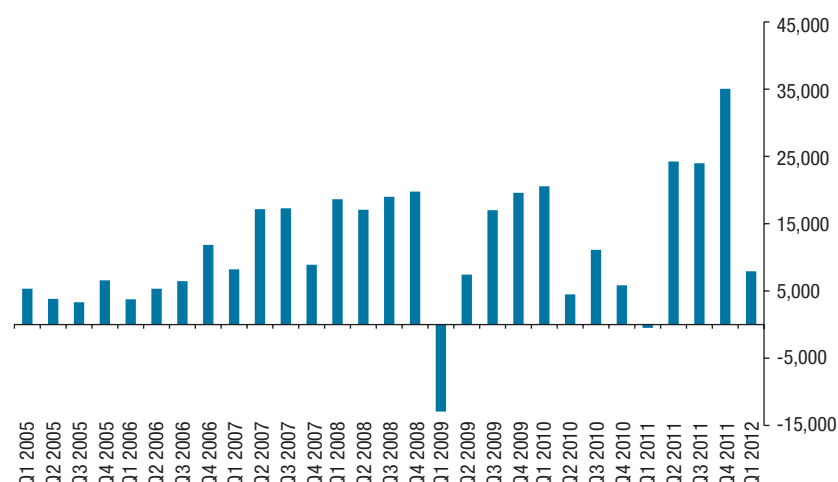
Source: Qatar National Bank 2011b

A combination of rising funding constraints, banks' increasing risk aversion, and a fall in demand for credit as local firms retrenched and re-evaluated business plans, resulted in a collapse in credit growth to the private sector and nonfinancial public enterprises from 48% per annum at end of 2008 to 2% at end of 2009. It has subsequently picked up to around 30% in February 2010 following capital replenish-

ment through government support and a modest recovery in public sector demand.

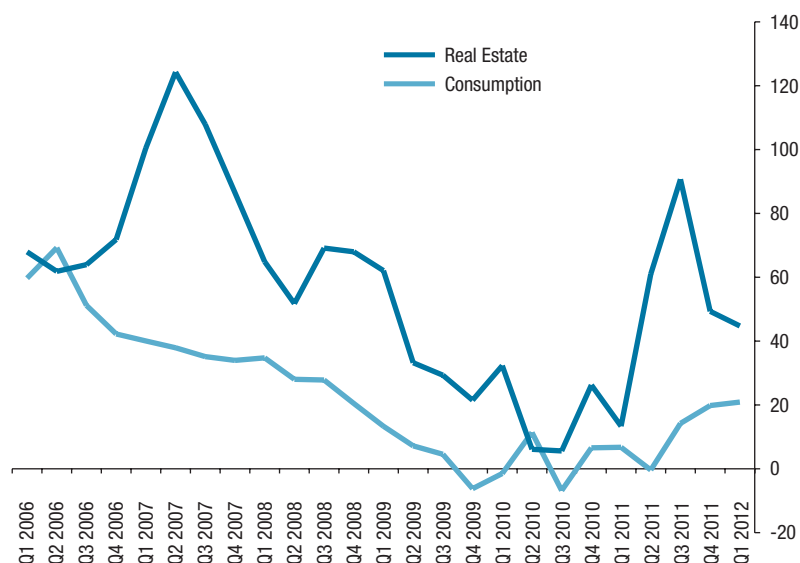
The authorities' capital injections and portfolio purchases with the commercial banks took effect and credit growth has been strong throughout the period of the financial crisis. Only in two quarters has the amount of total credit from commercial banks dropped, that

Figure 8: Growth of Additional Credit by Commercial Banks and, (QR Millions)



Source: Central Bank of Qatar, Quarterly Bulletin, Table 18

Figure 9: Growth of Credit to Consumption and Real Estate by Commercial Banks and, (Year on Year Change %)



Source: Central Bank of Qatar, Quarterly Bulletin, Table 18, Ernst & Young Analysis

was Q1 2009 and Q1 2011. Otherwise the availability of credit has been at levels as high and even higher – see Q4 2011 – than during the boom period (Figure 8).

Most of the growth in credit is explained by the sharp increase in lending to public enterprises, which accounted for 37% of total credit to the economy at the end of 2011. Growth in public

enterprise credit is projected to remain high given the level of spending by government on infrastructure, real estate, and related activities.

The emerging housing finance loan segment lies somewhere between consumption loans and lending for real estate. Consumption lending fell from the 20% to 50% growth rates during the boom years, coming to a halt in

Q4 2008, and not growing at all through the period of financial crisis until the second half of 2011 when positive growth returned (Figure 9). Real estate lending which includes lending to real estate companies and households has remained more buoyant throughout the period of the crisis, albeit dropping from the very high growth rates of the boom period to a low of 5% year-on-year in Q2 2010. The fact that credit growth remained positive and strong throughout the period suggests that real estate activity levels are high. Where this activity is lending to households for housing, it is likely to be borrowing for the high end market from nationals and GCC nationals for investment as well as expatriates for owner-occupation.

5. Conclusion

This paper has looked at the impact of the financial crisis on the housing finance systems of Bahrain and Qatar. It first introduced the reader to the particular structure and characteristics of the housing and housing finance systems in these two countries, distinguishing between national and expatriate segments of demand for housing finance. The financial crisis has had an impact on the banking sectors of both countries, which were performing very strongly during the boom period 2004-2008. The impact was not as severe as in the more mature markets of the world. The retail banks in both countries that originate housing loans to households saw an abrupt slow down in their amount of lending during 2009 and 2010, after very high growth during the boom period. By 2011 housing finance lending had picked up again in both countries, in part with the help of government finance. In Qatar, the government injected US\$ 7.2 billion to the banking sector at large during the 12 months immediately after the collapse of Lehman Brothers Inc. Bahrain's Eskin Bank, a 100% mortgage lender, receives finance from the government, which enabled it to maintain its lending throughout the period of the crisis.

The housing challenges in Bahrain and Qatar are not amongst the greatest in the region. Iraq and Saudi Arabia have housing need in millions of dwellings. Yet the mortgage markets of Bahrain and Qatar, which are still in the early stages of development, can grow further providing profitable lending opportunities for banks and affordable housing finance for households.

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European Union opts to regulate mortgage credit; new legal regime for 27 Member States

→ By Christian König

1. Introduction

The legislative process in Europe is different to other parts of the world. Banking supervisory rules as well as major consumer protection rules are decided at the European Union level, proposed by the European Commission and amended by the European Parliament and the Council, a kind of the chamber of representatives of Member States. Once the respective Draft Directives are amended and in the end agreed by the different EU institutions, Member States have to transpose these general rules into national law. National Parliaments have in general very limited discretion to deviate from the harmonized European law.

The European Commission proposed on 31st March 2010 the Directive on Credit Agreements Relating to Residential Property [CARP]¹. This proposed Directive is intended to strengthen the Internal Market for mortgage credit as a legislative answer to the financial crisis. The proposed Directive contained measures focusing on the process leading to the signing of mortgage credit agreements, such as advertising, information provision, creditworthiness assessment, advice and measures providing for a sound regulatory framework for market actors involved in the granting of credit, such as credit intermediaries and other mortgage lenders that are not credit institutions.

On 7th June the relevant Committee² of the European Parliament voted for substantial amendments in order to start the internal discussions³ with representatives from the Council

and the European Commission in order to reach an agreement in first reading before the end of 2012.

2. Justification for common rules for mortgage credit within Europe

Even though legal traditions of the 27 Member States in Europe are completely different, common law versus codification, Roman law codification in southern Europe versus German principle-based rules, the European Union has as its goal the creation of an internal market and therefore harmonizes contractual and consumer protection rules. The subprime crisis in the United Kingdom and in Ireland, problems with foreign currency lending in Romania, Austria and Hungary as well as the banking crisis and the oversupply of housing and lending in Spain have been the justification for the European Commission to propose common rules on housing loans within Europe.

After long and controversial debates within the European Parliament, the ECON Committee eventually voted on 7 June 2012 on the draft report on the proposed Directive on Credit Agreements relating to Residential Property. The vote had been postponed several times on account of the difficulty in finding a compromise between the rapporteur⁴ and the shadow rapporteurs. Under the influence of the shadow rapporteurs and the vote in the Committee on

the Internal Market and Consumer Protection [IMCO] key improvements have occurred.

In summary, the original ideas of the rapporteur, a Spanish Member of the European Parliament, were to create national mortgage registers and a mortgage key identifier, as well as aiming to introduce the total flexibility of the mortgage credit agreement to the disadvantage of creditors plus the obligation to obtain a property valuation by an external independent appraiser. These did not obtain a majority.

3. Financial education

A new principle⁵ on financial education has been included, according to which the Member States, together with stakeholders, have to devote more attention to financial education and the creation of information documents for first time property buyers. These documents should also include information regarding further assistance provided by consumer organizations and national supervisory bodies. Member States have to ensure that at national level measures are in place in order to support the education of consumers in relation to responsible borrowing and debt management. The stakeholders at national level should be involved in the design and development of these measures. Probably, the credit sector associations together with consumer organizations and the regulator will develop and draft new brochures in the future in order to fulfill these obligations.

¹ COM(2011) 142 final - COD 2011/0062 Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property

² The so called ECON (Economic and Monetary Affairs Committee of the European Parliament)

³ These internal discussions between the three institutions are called "trilog"

⁴ Under the rules of procedure of the European Parliament, the Committee selects a specific Member of the European Parliament who will be in charge of drafting a report (raport in French) with proposed amendments to the Directive. The "rapporteur" is responsible for running the proposed legal act through Parliament and defends the Parliament's position toward the European Commission and the Council within the so called trilog discussions.

⁵ Art. 4a of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

4. General rules on the conduct of business

The general rules for the conduct of business⁶ by mortgage lenders have been amended so that creditors and credit intermediaries do not always have to act in the best interests of the consumer, but merely have to consider the interests of the consumer. It is now also provided that Member States must ensure that the remuneration structure for creditors' staff and for credit intermediaries should have no impact on their ability to give objective advice or an objective recommendation.⁷ This also includes the specification of concrete sales targets.

5. Minimum qualification requirements

The ECON Committee amended the original Commission proposal to the effect that creditors' staff and intermediaries must possess relevant qualifications and knowledge about the products marketed.⁸ The details are set out in a new Annex III to the Directive, which regulates in outline the content of the training requirements. The specific rules are to be left to the Member States. Another innovation is that the relevant persons are to be required to undertake further training on a regular basis to brush up their knowledge and competence.⁹

6. Product tying

For the first time ever the European Union proposes rules on the prohibition of certain cross-selling practices in relation to mortgage credit. Until now, cross selling of financial products has not been restricted on a general European level but limitations in some EU Member States already exist.¹⁰ The relevant Committee of the European Parliament wants to prohibit the tying of products to the mortgage credit agreement. However, Member States may permit the link with a current account, insurance or a savings product if these products serve to repay the credit in whole or in part.¹¹ Product

tying in the context of this Directive means the offering of one or more ancillary services with the credit agreement in a package where the credit agreement is not made available to the consumer separately.¹²

The intention to prohibit certain forms of tying has been extended by the European Commission currently in the proposed reform of the Insurance Mediation Directive.¹³ The European Commission believes that certain forms of cross-selling practices or products, namely tying practices where two or more financial services are sold together in a package and at least one of those services or products is not available separately, can distort competition and negatively affect consumers' mobility between providers and their ability to make informed choices. Therefore it is proposed that when an insurance service or product is offered together with another service or product as a package, the insurance undertaking or, where applicable, the insurance intermediary shall inform the customer that it is possible to buy the components of the package separately and offer them and shall provide information on the costs and charges of each component of the package that may be bought through or from it separately.¹⁴

7. Pre-contractual information obligations and reflection period

Originally the European Commission suggested a period of reflection i.e. a cooling off period for the consumer in the pre-contractual phase. According to the proposal, Member States had to ensure that the credit agreement could be concluded until the consumer had had sufficient time to compare the offers, assess their implications and take an informed decision on whether to accept an offer, regardless of the means of conclusion of the contract.¹⁵ The European law maker did not want to introduce a European wide 14 days withdrawal period similar to that under German law,¹⁶ or a minimum binding period for the creditor's offer of 30 days like in France.¹⁷

But the proposed rules by the Commission would have created legal uncertainty for creditors since with the proposed wording a consumer could always have the chance to withdraw from the contract, if he were to claim in court that due to lack of experience and understanding the individual should have been granted a longer period for reflection.

In the end, the relevant Committee found a wise solution to this issue. Now, the creditor must provide the consumer with the pre-contractual information sheet in good time before the conclusion of the agreement.¹⁸ Under the Consumer Credit Directive¹⁹ the consumer must be given the standardized pre-contractual information sheet in good time before the consumer is bound by any credit agreement or offer.

The ECON Committee rejected an amendment, which had the support of the British Members of the European Parliament, which would have allowed Member States the possibility of providing information sheets other than the European Standardized Information Sheet (ESIS). Following the ECON vote, there is now to be a standard pre-contractual information sheet for housing and mortgage loans Europe-wide. This should allow consumers to compare credit offers from lenders all around Europe.

With regard to the reflection period, it is now provided²⁰ that the consumer must in all cases have 14 days to compare offers. Member States can then regulate whether this period is granted as a 14-day pre-contractual period for reflection or as a 14-day withdrawal period following the conclusion of the contract. The pre-contractual period for reflection is to ensure that the creditor's offer must remain valid for at least 14 days. Contrary to the original proposals, which corresponded to French law, the consumer can now waive the 14-day period of reflection by accepting the offer.

Member States may provide that the right of withdrawal shall be reduced or cease to apply where the consumer undertakes any action which under national law results in the creation or the transfer of a right in a property connected to or using funds obtained under the credit

⁶ Art. 5 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

⁷ Art. 5(2b) of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

⁸ Art. 6(1) of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

⁹ Art. 6(2b) of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

¹⁰ E.g. within the French Code monétaire et financier in Art. L312-1-2 or in the Belgian Consumer Credit Act which does not apply on mortgage credit, Art. 31 of the Loi relative au crédit à la consommation

¹¹ Art. 8a of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

¹² Art. 3 rd) of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

¹³ 2002/92/EC

¹⁴ Art. 21 of the Commission's proposal on insurance mediation, COM(2012) 360/2 2012/0175 (COD)

¹⁵ Art. 11 Commission's proposal for a Directive on credit agreement relating to residential property, COM/2011/0142 final

¹⁶ Art. 495 German Civil Code (BGB)

¹⁷ Art. L312-10 of the French Code de la Consommation

¹⁸ Art. 9a of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

¹⁹ Art. 5 of the Directive on credit agreements for consumers and 2008/48/EC

²⁰ Art. 9a par. 3 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

agreement or in the cases where the credit agreement is, in accordance with the law of Member State, established through a system involving a public office-holder or agent who has a statutory obligation to be independent and impartial and who must ensure, by providing to the consumer personalized and comprehensive contractual and legal information, that the consumer only concludes the agreement on the basis of careful legal consideration and with knowledge of its legal scope.²¹

8. Credit intermediaries

In addition to the credit intermediaries' general obligations to provide information concerning their status and for whom they are acting, as in the Insurance Mediation Directive²², credit intermediaries who are not tied and also brokers must provide information on remuneration paid by the creditor.²³ In good time before the conclusion of a contract on the provision of services by a credit intermediary he or she now shall provide the consumer with at least the following information on paper or on another durable medium;

- the identity and the geographical address of the credit intermediary,
- the register in which he has been included, as well as the registration number, where applicable, and the means for verifying that he has been registered,
- if he is a tied intermediary (in this context it means to be tied to one or more creditors), he or she shall identify himself as such and provide the names of the creditor(s) for which he or she is acting,
- the intermediary also has to inform the consumer, if he offers as a service,
- the fee, where applicable, payable by the consumer to the credit intermediary or creditor for his services or the basis on which the fee will be calculated,
- the procedures allowing consumers and other interested parties to register complaints internally and the means by which recourse to out-of-court complaint and redress procedures can be sought,

- If the credit intermediary charges a fee and also receives a commission from the creditor, he or she has to explain to the consumer whether or not the commission will be fully or partially offset against the fee.

The Directive also regulates minimum qualification requirements the intermediary needs to fulfill in the future. Details will be regulated by the relevant Member State. The Directive also foresees that intermediaries will be registered in a national intermediary register and supervised by national authorities. In order to start in business as an intermediary he or she must file the register application according to national law and has to prove that he or she has signed an indemnity insurance agreement or has a comparable guarantee. He must also provide the qualification certificate or proof of his professional experience and evidence of his good reputation.²⁴

9. Advice and obligation to provide explanations

The compulsory carrying out of a market comparison proposed by the European Commission if the creditor offers advisory services was also amended, so that Article 17 now stipulates that the consumer must be informed in advance whether or not advice is provided. Creditors and tied intermediaries then only have to recommend the most suitable product in their product range, whereas brokers and intermediaries, who are not tied, are required to examine a sufficiently large number of products available on the market.²⁵ If advice is provided, the result of this advice must be supplied to the consumer on a sustainable medium.

Member States are required to prohibit use of the terms 'advice', 'adviser', 'independent adviser', etc. if the broker or intermediary receives commission from the creditor.²⁶ Through this, the first step has been taken at EU level towards creating fee-only financial advisers.

The obligations to provide explanations on the pre-contractual information and linked transactions, provided for by the European Commission,²⁷ is now consistent with the

wording of the Consumer Credit Directive. Now creditors and, where applicable, credit intermediaries have to provide adequate explanations to the consumer on the proposed credit agreement and any ancillary service. This is in order to place the consumer in a position enabling him to assess whether the proposed credit agreements and ancillary services are adapted to his needs and to his financial situation. These explanations shall include the pre-contractual information including the ESIS, the essential characteristics of the products proposed and the specific effects they may have on the consumer. They shall also include the consequences of payment default by the consumer and, where ancillary services are bundled with a credit agreement, whether each component can be terminated separately and the conditions for doing so.²⁸

10. Annual percentage rate of charge

From the point of view of the creditors, the clarification in recital 23 is to be welcomed in that according to the vote of ECON Committee, in addition to the notary fees, also the mortgage registration fees are not part of the total cost of credit and therefore do not have to be included in the annual percentage rate of charge. Moreover, the ECON Committee followed the amendments proposed by the Green Party and has now agreed, pursuant to Article 12(4)(b) and (c), that in the case of variable interest agreements, the creditor must inform the consumer of the highest and lowest interest rates that applied during the previous 20 years. In the case of foreign currency loans, it is necessary in addition – also via the proposal of the Greens – to indicate an interest rate which considers a possible depreciation of the national currency of 20% in comparison to the currency of the loan.

11. Creditworthiness assessment

The earlier proposal that the duty of the creditor would be to refuse credit where the results of the creditworthiness assessment were negative, on the grounds of negative credit worthiness, was deleted.²⁹ The duty of creditworthiness assessment still exists and the borrower's expenses are to be

²¹ Art. 9a par. 2 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

²² Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation

²³ Art. 10 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

²⁴ Art. 19 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

²⁵ Art. 17 par. 3 (b) and (c) of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

²⁶ Art. 17 par. 4 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

²⁷ Art. 11 Commission's proposal for a Directive on credit agreement relating to residential property, COM/2011/0142 final

²⁸ Art. 11 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

²⁹ Art. 15 par. 1 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

considered and where appropriate, databases consulted. Any future increase in price of the property, however, cannot be considered in this respect.

Regarding the duty to inform the consumer of the consultation of any relevant database, reference is made to the provisions of the Consumer Credit Directive. Under this Directive a consumer has a right to be informed immediately and free of charge, of the result of a database consultation carried out for the purposes of assessing his credit-worthiness.³⁰ If the credit application is rejected on the basis of consultation of a database, the creditor shall inform the consumer immediately and without charge of the result of such consultation and of the particulars of the database consulted.³¹

12. Property valuation

The original proposals on external property valuation by the Spanish rapporteur were also watered down. The new rule now provides only that Member States shall ensure that sound valuation practices are applied in accordance with international standards and methods. The importance of sound regulation and oversight of appraisers is also recognized. According to the vote of the Committee of the European Parliament Member States shall also require that internal and external appraisers carrying out such valuations are professionally competent and sufficiently independent to provide an impartial and objective valuation. This should be documented on a durable medium and the lender should keep a record of it.³²

Member States must provide for the corresponding specifications regarding property valuation and that the valuation can be carried out by appraisers employed by the creditor or appoint external appraisers. This valuation must be documented and retained by the credit institution. The European Banking Authority (EBA) will now have to lay down corresponding European wide supervisory standards in this respect.

13. Variable-interest agreements and foreign currency loans

In the context of the current foreign currency lending crisis in some EU Member States, the

Members of the European Parliament brought forward some measures in order to protect consumers. The European Commission had identified foreign currency lending as an activity requiring consumer protection but had not proposed any measures. The Parliament has been more ambitious.

The ECON Committee has therefore also drawn up a new article on variable-interest rate agreements and foreign currency loans,³³ which entitles the consumer, under certain conditions, to change the currency. In the case of variable rate loans, new information obligations have been introduced in relation to the consumer. For example, the reference interest rate of the past 14 years must be made available by the lender.

14. Early repayment

Probably one of the major issues for creditors and consumer representatives at EU level has been the rules on a right to repay the loan earlier and the limits on early repayment compensation. Some EU Member States recognize a right to repay early and limit the compensation for early repayment to a certain amount of the outstanding debt or a certain limit with regard to the interest rate.

Other countries do not oblige creditors to accept the early repayment of a loan and if a creditor accepts the early repayment of a fixed interest rate credit agreement, he has a right to compensation.³⁴

According to the vote of the ECON Committee,³⁵ the consumer is in principle granted a right to early repay in whole or in part. In such cases, creditors may not impose any penalties, but are granted a right to compensation. But, Member States may restrict the right of early repayment for credit with long term fixed interest rate agreements.³⁶ The compensation of the creditor may not exceed the economic loss. The consumer must be informed in a transparent manner and before the conclusion of the agreement of the method used to calculate the compensation for early repayment or the corresponding amount of the compensation for early repayment. Member States are authorized to introduce or maintain corresponding restrictions of the compensation for early repayment.³⁷

15. Next steps

The next step within the so called co-decision procedure is that the European Parliament, European Commission and Council agree on compromise wordings in order to prevent a painful second reading. In the EU jargons the exercise of finding a compromise is called trilog meetings; these informal meetings take place behind closed doors until a compromise is found. These trilog meetings have been invented by the EU institutions without having any justification under the EU treaty in order to prevent a second reading which, to be successful, requires by the Parliament an absolute majority of their Members which is usually difficult to organize.

According to the time table of the European Parliament the vote in the plenary is scheduled for the 10th December 2012, which means that this Directive could then be published in the official journal of the EU early 2013. Member States would then have two years in order to transpose these rules into national law, probably until spring 2015.

³⁰ Art. 6 par. 1j of the Consumer Credit Directive 2008/48/EC

³¹ Art. 9 par. 2 of the Consumer Credit Directive 2008/48/EC

³² Art. 14a of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

³³ Art. 18a of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

³⁴ Art. 488 par. 1 no 2 of the German BGB

³⁵ Art. 18 par. 1 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

³⁶ Art. 18 par. 3 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

³⁷ Art. 18 par. 4 of the proposed Directive after the ECON vote, Doc No. A7-0202/2012

“Orthodox” and “unorthodox” Hungarian political measures to alleviate the situation faced by foreign currency mortgage debtors – and the consequences for the Hungarian banking sector

↪ By András Gábor Botos

1. Introduction

Shockwaves from the Eurozone crisis have hit Hungary particularly hard. Besides the high ratio of Government indebtedness (approx. 78% of the GDP – mainly foreign currency {FX} denominated) also the high volume of households' FX denominated mortgage loans - prior to the forced early prepayment scheme of the Government in 2011 when 23% of all residential FX mortgage loans were prepaid; equivalent to around 30% of GDP- contribute to the high vulnerability of the Hungarian economy. Recent depreciation of our national currency – the Hungarian Forint {HUF} – against the Euro and Swiss Franc resulted immediately in growing debt burdens both in the case of the State budget and in the case of families redeeming FX mortgages.

Debt service costs for holders of Swiss Franc loans (90% of all FX mortgages) have indeed increased sharply. 70% of CHF household debt was incurred at HUF/CHF levels of 145–165 compared to current levels of around 230–240, implying a 60% increase due to the weaker exchange rate alone. In fact, 93% of Swiss Franc denominated mortgages were granted below the 175 HUF/CHF exchange rate.

As a matter of fact, the 145–165 HUF/CHF exchange rate period was not that long ago. Almost all FX mortgages were granted from

the beginning of 2004 until August 2010, as FX mortgages overhauled the role of HUF mortgages immediately after the abolition in December 2003 of the generous state subsidy system introduced in 2001 - due to its enormous budgetary costs. In order to reduce the systemic risk caused by foreign currency indebtedness of households, the legislator entirely banned FX mortgage lending in August 2010. Since July 2011 only those who have a foreign currency monthly income at least 15 times higher than the minimum wage are eligible to take out retail FX mortgage loans. While CHF mortgages were provided prior to the outbreak of the crisis in 2008, EUR denominated mortgages were rather popular in 2009 and in 2010. A relatively small proportion of FX mortgages are Japanese Yen (JPY) denominated.

2. Situation of FX indebted households

To give an example of the increasing financial burdens and the overall situation of households taking out FX mortgage loans, let us make a comparison first by comparing the current monthly instalment on a CHF denominated mortgage loan taken out in September 2007 compared to the same loan denominated in EUR, JPY and HUF available that time. The monthly instalment of the CHF loan is now 82% higher

than at the beginning of the term because of the depreciation of the HUF. Should the borrower have taken out a JPY denominated mortgage, the increase in the instalment would be 90%, 26 percent in case of a EUR mortgage loan - and 4% only, if the mortgage had been denominated in HUF. However, the nominal rise in the monthly instalments is not the only aspect; if the original monthly instalment was not too high, the household may still be able to cope with the increased monthly instalments in spite of the rise.

If we take also interest rates into consideration (approx. CHF: 4%; EUR: 6%; JPY: 2%; HUF: 10% on an average year-on-year basis in September 2007) besides the FX volatility, it turns out that currently the overall monthly instalment is the highest in the case of the CHF denominated loan, and the lowest in the case of the EUR denominated loan among our sample loans from 2007 – as interest rate differences affect substantially the monthly payment burden.

Yet we have another result if we compare the total payment burden of the above mortgages for the period from the first instalment until now. Due to lower interest rates it is still the JPY borrowers, who have paid the least during the whole lifetime of the mortgage loan until now – despite the recent enormous decrease of the HUF rate against JPY. They are followed by the EUR-borrowers, and then by the CHF-borrowers

– and it is the HUF borrowers who have paid the most until now.

Naturally, we cannot say currently, who made the better choice – this will only be clear at the end of the repayment period. However, the shock absorbing capacity of households indebted in foreign currencies has been tested substantially since the beginning of the crisis. Thus critics of the former FX-lending practice keep saying that the financial intermediary system has simply transferred FX-risk into credit risk, leaving households without any protection against the depreciation of the national currency. The banking sector could plead on the other hand that statistics do not prove an unambiguous correlation between the non-performing mortgages and their funding currency, i.e. those households where the family income has not decreased to a large extent can still cope with their payment obligation despite depreciation of the HUF against the funding currency. It is much more the increasing rate of unemployment which seems to be a driver of non-performance (The unemployment rate has risen by approx. 4% to roughly 12% since the beginning of 2008). Mortgage lenders could also plead that in the period 2004–2008 – when we could observe the dynamic rise in the residential FX mortgage portfolio – all politicians agreed that our entry to the Eurozone was imminent and unquestionable – . The accession to the Eurozone would have naturally eliminated FX risk in case of EUR mortgages, and minimized it with respect to CHF mortgages.

3. Saving Hungarians from "debt slavery"

Prime Minister Viktor Orbán said in October 2011 that banks that have in the past made big profits from foreign currency mortgages in Hungary must now bear two-thirds of the costs of reducing the stock of such loans, to save Hungarians from "debt slavery". "I do not want to live in a country... and as people decided to elect me as one of the leaders of this country, I will not ...live in a country where one million people must face debt slavery ... I will change this." Orbán said this one month after the Hungarian Parliament adopted the "Act on the Amendment of Certain Acts Concerning Home Protection" on Monday, 19th September 2011, shortly after Antal Rogán MP filed the proposal on Friday, 16th September 2011 offering a prepayment option to mortgage debtors at preferential exchange rates.

The idea of granting a prepayment option for foreign currency (FX) residential mortgage borrowers at preferential FX rates was first raised in public by the majority leader János Lázár MP on

the 9th of September 2011, after the weekend session of the governing parties, which aimed to "find a solution" for indebted households. The announcement shocked the Hungarian banking sector and came as a complete surprise to Hungarian mortgage lenders, particularly as all costs and losses resulting from this prepayment option and the conversion of FX loans into HUF loans would have to be borne by the lenders. Although the banking community, analysts and the media raised significant concerns alongside the National Bank of Hungary (NBH), the Government was reluctant to start negotiations, and after the rapid publication of the Act in the Official Gazette, three days later on the 29th of September 2011, mortgage lenders had to start offering the conversion option to customers.

The "solution" suggested was to introduce an option for households with foreign currency mortgage loans to repay their loans at a fixed exchange rate of HUF/CHF 180, HUF/EUR 250 and HUF/100YPN 200, bearing in mind that the spot rates were at that time HUF/CHF 239, HUF/EUR 296 and HUF/100YPN 288. Even though borrowers had until the end of 2011 to take advantage of the option, the full amount of the FX loan had to be prepaid, and there was a lack of incentive among large lenders to grant HUF loans to their own borrowers, or to refinance each other's borrowers, due to the then very weak forint rates. The early repayment option has resulted in at least 25% loss on the loan principal for the banks and other lenders. We should mention that the HUF has depreciated already because of the introduction of the programme; causing even higher losses to lenders.

Finally, approx. 170 thousand households out of 796 thousand have prepaid their FX mortgage loans at a preferential exchange rate – 23% of the original number of contracts, however, over 24% if we look at the value. Indeed, it has probably not been the most struggling households who have prepaid, as only 21% of the prepaying debtors have taken out a HUF loan to refinance their previous FX mortgage loan. As a consequence of the programme, a relatively small proportion of families, whose financial situation was well above the average anyway, have used the prepayment option to get rid of FX-risk and to reduce the outstanding balance due on their mortgage. The non-prepaying several hundred thousand borrowers were either reluctant to convert their cheap FX mortgages (APR: 6–7%) to HUF denominated loans (APR: 11–13%), or were not eligible for a new HUF loan because of the high LTV of their loan.

Unfortunately, negative effects outnumber the positive ones at the end.

Fitch Ratings noted that "this measure, together with the bank tax introduced last year and the Hungarian authorities' generally quite aggressive policy stance with respect to the banking system could make it less likely that parent banks will put more capital and funding into the Hungarian banking system in the future. This could restrict future credit and economic growth, and also, in Fitch's view, sets a dangerous precedent for other Central and Eastern European countries with high foreign currency lending" (Statement by Fitch Ratings, 28 September, 2011).

"Forcing market participants to take enormous losses on their books through legally decreed prices and exchange rates is not acceptable practice in a market economy, and is in contravention of all expectations an investor may have in a functioning market economy and democracy," Austrian Federal Minister of Finance Maria Fekter wrote to her Hungarian counterpart, György Matolcsy, as shares of Erste Group Bank AG and Raiffeisen Bank International AG began to drop on the adoption of the law. (Unfortunately, investors and mother companies of Hungarian daughter companies had to face several measures, like special industrial taxes and further State intervention into private relationships, which has reminding them ever since undermined predictability and legal certainty in Hungary.)

In general, FX risk hasn't disappeared from the system with respect to the early prepayment option, and the implementation of the monetary policy of the National Bank of Hungary hasn't become more effective either – to have achieved a significant change in the structure of households' debt a much higher level of conversion of FX mortgages into HUF would have been needed.

On the other hand, the measure has caused losses as high as 1.2 billion EUR to the banking sector, reducing its ability to support economic growth at the same time. In November 2011 the total aggregated balance sheet of the banking sector in Hungary was HUF 30,050 billion, equivalent to EUR 100.84 billion. Based on the agreement of the Government and the banking sector in December, 2011, however, one third of such losses could be deducted from the special banking tax.

As it was a performing portfolio with good margins, which was repaid, lenders have now to face deteriorating profitability and an increasing ratio of non-performing loans.

The increasing sovereign risk and the deteriorating forint exchange rate has led to an increase in interest rates, causing an increase in the funding

costs of national debt and a rise in corporate and retail lending rates. This has already adversely affected millions of Hungarian corporate and retail debtors with forint and FX loans also.

In the view of the lending industry, the prepayment option granted to Hungarian households at preferential exchange rates has given clear evidence of the fact that there is no immediate, legislative solution for helping heavily indebted households.

4. Better solutions suggested by the banking sector

In October 2011, the Hungarian Parliament also formed a special committee to investigate who was responsible for the particularly high proportion of foreign currency denominated retail loans, which led to considerable vulnerability at the outbreak of the financial crisis in 2008. This committee stated in its final report that previous governments, the National Bank, the financial supervisory authorities, the financial intermediary system and borrowers were equally responsible.

Taking seriously the idea that equal responsibility requires an equal sharing of the costs of solutions to remedy the problems caused by foreign currency denominated loans, particularly after the burden of 2011 September's early prepayment scheme, the banking sector elaborated its own proposals in November 2011. An agreement was signed on the 15th of December 2011 between the Minister for the National Economy on behalf of the Government of Hungary and the Banking Association. The industry believes that this agreement on the necessary measures reflects a much fairer approach than the early repayment scheme.

4.1 Exchange rate protection scheme

As there is no one-size-fits-all solution, the Banking Association proposed differing solutions to the problems of different groups of borrowers. The Banking Association proposed first of all a revised "bridging loan" concept to alleviate the situation of FX mortgage holders whose loans are in good standing.

The concept of the new exchange rate protection scheme does not differ fundamentally from the previous scheme adopted in May 2011: a bridging loan is available to those mortgage loan borrowers who have a Swiss Franc (CHF), Euro (EUR) or Japanese Yen (JPY) denominated loan, which is either in good standing or for which payments are less than 90 days overdue. Borrowers shall pay their monthly instalments

calculated according to the lowest values of the ranges of CHF/HUF 180-270, EUR/HUF 250-340 and JPY/HUF 2.5-3.3. It should be noted that the new scheme does not offer anything to those who have already benefited from the previous preferential prepayment option scheme.

The main difference compared to the earlier scheme is that now monthly instalments will be divided into a principal and an interest component. For the interest part, the difference between the lower end of the exchange rate range and the spot rate will be borne 50-50 by the lender and the State. Should the actual exchange rates exceed the low-est values of the ranges cited above, the principal repayment element of the monthly instalment shall be borne and repaid after 2017 by the borrower in compliance with the effective buffer account regulations; in turn, 50% of the interest payments above the cap shall be borne by the financial institutions and 50% by the State. In the event of exchange rate levels exceeding the CHF/HUF 270, EUR/HUF 340 and JPY/HUF 3.3 cap, the excess costs – both with respect to the capital and to the interest rate – are to be borne entirely by the State. Due to the annuity structures, the new scheme provides more assistance to those borrowers who are at an early stage of amortisation. Thus, this measure effectively provides more relief to those borrowers who took out FX loans in recent years, when the national currency was in a much stronger position than it is today against the CHF, EUR and JPY.

Accordingly, the new scheme should offer an escape route for many FX-indebted households and it appears to be a more attractive alternative than the previous prepayment option. Under the new rules, provided that payments are not overdue, all borrowers having a foreign currency denominated mortgage loan are eligible for the new "exchange rate protection scheme".

Although the new "exchange rate protection scheme" is quite costly – the National Bank presumes that there will be a 1% loss in margins in general – now it seems to be popular among borrowers and definitely reduces the risk costs of lenders. Up to September, 2012 out of approx. 530 thousand eligible FX debtors 71 thousand have already signed the application – banks expect that by this year's end, i.e. at the end of the application period, 60-70% of all eligible households will be protected by the new exchange rate protection scheme.

4.2 Borrowers with FX mortgages 90 days past due

In addition to the new "exchange rate protection scheme", the agreement also covers the segment

of FX mortgage debtors delinquent for more than 90 days, by offering a 30% tax deduction possibility from the special banking tax to financial institutions who write off 25% of such loans, on the condition that subsequently the FX mortgage loan will be converted to an HUF loan (in general, the elimination of FX-risk or at least its successful handling has been an important goal of all stakeholders). The proportion of non-performing mortgage loans {NPL-ratio} on 30 September, 2011 amounted to 12.5% (in Q1 2008: 6%).

Actually, while on the one hand cooperative debtors in distressed situations have had their mortgages rescheduled previously, and due to this reason do not qualify as eligible (they are not 90 days past due), on the other hand, many debtors, who could have applied, have already broken off all of their connections to their lenders, and are less willing or sometimes unable to make any payment.

4.3 Interest rate subsidies

The Government has also undertaken to supplement its decree adopted in September 2011 on the Home Ownership Enhancement Subsidy Scheme, so that it will provide a gradually decreasing interest rate subsidy to clients who have converted their loans into HUF, as long as the property securing the loan is the debtor's main dwelling and registered address. A further condition of the interest rate subsidy scheme is that at the conclusion of the contract, the value of the property does not exceed a certain limit, and, furthermore, there should be at least one minor in the household. The interest rate subsidy – in line with the interest rate subsidy scheme already adopted by the Government – shall be in place for five years, equalling 50% of the benchmark yield of Government bonds, decreasing annually by five percentage points. In addition to this new interest rate subsidy scheme, some of the former ones might provide for significant help to borrowers facing financial difficulties. Interest rate subsidy can be either granted for the purchase of a residential property encumbered with a delinquent or a cancelled mortgage loan or is available to clients in default, given that they are ready to move to a smaller home.

4.4 National Asset Management Company

As for those who do not qualify for any of the above schemes, the Government undertook in the agreement to grant enough resources to the National Asset Management Company so that the Company shall be able to purchase 25,000 properties by the end of 2014.

5. Outlook

It would be good to be able to conclude by saying that the new measures seem to provide a predictable solution for both FX mortgage borrowers and their lenders. Unfortunately this is not the case – at least not in respect of mortgage lenders.

After having had a three day session of the governing parties which took place in the countryside – almost exactly 1 year after the one making the decision on the prepayment option - the successor to the majority leader, MP János Lázár declared on 7th September 2012, that mortgage debtors can rely further on the help of the Government – a message that could sound distressing to lenders and make debtors uncertain whether or not to wait rather for even better programs, instead of taking part in the current ones.

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From owning to renting; tenure trends in England 1993 to 2025

↪ By Peter Williams

1. Introduction

In many countries across the globe, home ownership has come under pressure as a consequence of the financial crisis of the late 2000s –with varying combinations of falling house prices, rising default and re-possession rates and falling levels of home ownership, all despite interventions aimed at helping stabilise markets and protect individual home owners. This has put pressure back on state budgets and brought to a halt, at least for the present, the onward march of home ownership, not simply as a tenure of choice but also as a practical reality. As a consequence there has been an increased demand for private renting and of course for the provision of affordable homes whether in the public or private sectors.

The UK has not been immune from these pressures and the housing market in England has experienced considerable difficulties since 2008, albeit it is clear that the home ownership sector was under increasing strain from the early 2000s onwards, with the proportion of owner-occupiers declining from the early 2000s while at the same time there was a steady rise in the private rented sector. This was a response to long term structural shifts (Williams, 2007; Miles, 2012, Savills, 2011, Whitehead and Williams, 2011) though without doubt all of this was given added momentum by the global financial crisis and its aftermath. Constrained balance sheets, tighter regulation and more demanding capital requirements as well as economic recession have all followed and the upshot has been reduced mortgage availability, tighter credit standards and more expensive loans as well as more uncertain demand.

The government has estimated there are now over 1 million households who have been excluded from home ownership in recent years. Taken together with cutbacks in funding for social housing and continued growth in household numbers there has been an almost inevitable increase in private renting. The rate of change is slow on an annual basis but it becomes much more evident when viewed over a longer period and then projected forward. Indeed recent evidence suggests (Resolution Foundation, 2012) there has been a radical shift for low to middle income households (10th to 50th percentile in the income distribution) with the under 35s group finding it particularly difficult to access home ownership. 34% were owners in 2009/10 as compared to over 51% ten years earlier while the proportion renting privately had tripled from 14% in the late 1980s to 47% in 2009/10.

This article draws upon recent research by the author and colleagues at the Cambridge Centre for Housing and Planning Research at Cambridge University for the Resolution Foundation and Shelter¹. The aim of the research was to look back at tenure patterns as far as the detailed data would allow and to look forward to 2025. This article focusses on the main findings for England with brief comments on London where appropriate.

2. Methodology

There were two core elements of the research – looking back and looking forward,

Looking back included a detailed analysis of the government's Survey of English Housing/English Housing Survey from 1993/94 to 2009/10 –

some 17 years and through parts of two housing cycles. Our analysis concentrated on the four main tenures; ownership with and without a mortgage, social renting and private renting. As with any sample data, especially when broken down by a number of variables, there are caveats as to the validity of sample sizes on which generalisations are then drawn. We were cautious in the breakdowns used as a consequence. In particular we pooled two years together (e.g. 1993 and 1994 are treated as one and so on throughout the period) to increase the sample size in the English Housing Survey analysis.

The second core element of the research involved detailed projections of housing tenure trends through to 2025. These are built around a set of assumptions and obviously different assumptions produce different results. Our starting point was the Office of National Statistics household projections to provide the basic information on household types and proportions. We then looked at three economic scenarios for the period to 2025: a cautious central scenario by which the economy moves towards a return to the 2000 – 2009 average growth pattern from 2015, reaching this average by 2020 and then remaining stable; a weak scenario building from negative to zero growth with continuing constraints on mortgage availability; and a robust/optimistic scenario where there is both economic growth and available but higher cost housing finance. Table 1 provides a summary of the macro economic assumptions for England. In addition we also analyse a number of scenarios for the social sector, also shown in the table.

The four economic variables we have used to define these scenarios are: mortgage interest

¹ The full report can be viewed at <http://www.cchpr.landecon.cam.ac.uk/Downloads/RF%20Shelter%20Final%20Report%20May%2031%202012%20rev.pdf>

Table 1: England: Modelled assumptions

	Weak	Cautious	Robust
Standard variable mortgage interest rate (%)			
Reference level drawn from 2000 to 2009	4.0 (lowest rate)	6.2 (average over period)	7.6 (highest rate)
Range	4.0 to 4.1	4.1 to 6.2	4.4 to 7.6
Phasing	4.1 to 2017 then 4.0	4.1 to 2015 then annual rise to 2024	Annual increase
First Time Buyer LTV (%)			
Reference level drawn from 2000 to 2009	75 (lowest)	88 (average over period)	90 (highest)
Range	75 to 70	76 to 85	78 to 90
Phasing	Phased decline over period.	76 to 2015 then steady rise to 2025.	Annual increase.
Real income growth (%; 3 year moving average)			
Reference level drawn from 2000 to 2009	-1.4 (lowest)	0.6 (average over period)	2.3 (highest)
Range	-1.0 to 0.0	-1.0 to 0.4	0.0 to 2.3
Phasing	Annual increase from negative to zero by 2015 then static at 0.0%.	Steady increase over period from negative to real growth of 0.4% at end of period.	Steady increase over period from zero to real growth of 2.3% at end of period.
Building completions in private sector			
Reference level drawn from 2000 to 2009	89,540 (lowest)	125,965 (average over period)	145,680 (highest)
Range	82,988 to 89,540	82,988 to 125,965	90,473 to 145,680
Phasing	From the beginning, steady annual increase.	From the beginning, steady annual increase.	From the beginning, steady annual increase.
Constraint on social rented housing stock (4 cases for each scenario)			
a. constant	Remaining at the 2010 level of stock (4,108,653 units) through the observation period.		
b. decrease – 2 cases	Decreasing by 50,000 units per annum throughout the period. (i) all excess demand going to private renting and (ii) half going to owner-occupation		
c. increase	Increasing by 50,000 units per annum throughout the period.		

rates and loan to value ratios for first time buyers which reflect the cost of borrowing and deposit constraints; real income growth which is the main determinant of demand; and finally housing completions used here only as a measure of housing market conditions and general expectations. The scenario evidence thus provides an analysis of how projected demand for housing might be translated into tenure mix under different market conditions reflected in these the four variables.

The weak scenario is generally rather less optimistic than some other short term forecasts in that it assumes negative real income growth to 2015 and then zero real income growth thereafter. The cautious scenario is more in line with current macro forecasts except to the extent that it assumes improvement but no real income growth until 2018. It is more positive in that it expects mortgage deposit requirements to decline slowly from 2015 but with commensurate rises in mortgage interest rates. Housing investment is seen to increase

very slowly from current low levels of activity. As such the cautious scenario reflects a slow overall improvement in the economy – but no signs of the sort of bounce back that has occurred after past recessions. To address this possibility, the robust/optimistic scenario assumes positive and increasing growth rates after 2015 up to 2.5% by 2025. While this may look over-optimistic in the current depressed environment, it is not out of line with past behaviour – especially given the sharp declines experienced in the last few years. Indeed until last year when GDP started to flat line it might have been regarded as the most likely as long as the world economy returned to trend levels of growth.

One issue of particular importance in projecting the future is what assumptions to make about the availability of social rented housing. The scale of the sector has remained fairly constant over the last few years after a period of fairly rapid decline. Most unconstrained projections would show it

increasing as the demand from households, who on past trends would have been located in the sector, feeds through. However the general expectation is that growth in this sector is unlikely to be significant even if the currently planned output of 170,000 units to 2015 is delivered. Going forward from 2015 it is unclear that the new affordable housing programme will go into a second round to take supply beyond that date. The evidence from housing associations is that their capacity will be severely constrained without additional grant or other funding solutions.

Because of these uncertainties we included four social sector scenarios;

- where the number remains constant over the whole period to 2025;
- where the sector declines consistently over the period with 50,000 units per annum transferring out of the sector nationally and an equivalent reduction of about 10,000 per annum in London – with all excess demand going into the private rented sector.
- with the same decline but half going into owner-occupation with a mortgage and half into the private rented sector; and
- where the social housing stock increases by 50,000 per annum in England and by a comparable proportion in London.

An important point to reiterate with respect to the projections is that there is an implicit assumption that the projected numbers of households will be allowed to form, i.e., overall demand will be met in numerical terms. However within the social rented sector the numbers of households accommodated in the sector is constrained to meet the supply under the different scenarios – excess demand is then allocated to the private rented sector or half to the owner-occupied sector.

Prior to the turn of the century supply did indeed keep pace with household formation across the country – and over a thirteen year period that trend might return. However continuing and worsening supply constraints may prevent households being able to form in the future. This would affect the total number of households rather more than the tenure proportions which are central to this analysis. Thus, almost certainly, the trajectories identified in this report will remain the same.

3. Tenure change in England: looking back, looking forward

A number of key findings stand out from our analysis of the data and projections of trends based on the three scenarios. These are mainly based

on the weak and cautious recovery scenarios partly because they reflect current expectations most clearly and also point to the difficulties that will be encountered were the economy not to bounce back strongly – thus highlighting the need to develop policy in ways that can make the housing system more resilient.

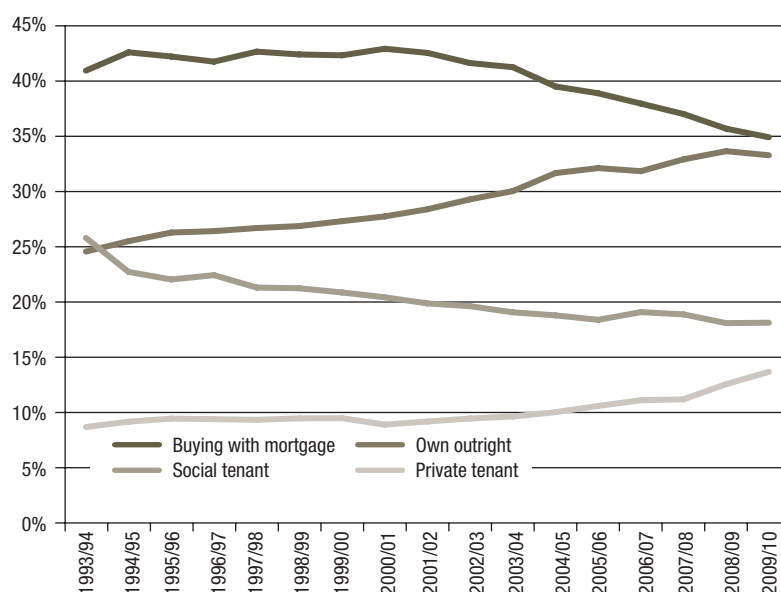
As will become evident a serious tenure transformation has been underway for some time, reflecting not only the costs of housing and difficulties of access but also the impact of an ageing population and past housing policies. This is working its way across household groups but differs significantly between London and the rest of the country as well as between income groups and age cohorts. The big question of course is whether this restructuring is a temporary or permanent transformation and, as we show in the projections, this depends very much on the forward trajectory of the economy.

3.1 The changing balance of tenure in England

We began by considering the changing balance of tenures in England over the period 1993–2010, the period over which this English Housing Survey data is available. Figure 1 gives an overview based on four categories of tenure, owner-occupation split into owned outright and buying with a mortgage; renting split into social and private. While buying with a mortgage has remained the largest sector it has been falling away particularly in the last few years and declined from 41% to 35% over the seventeen year period. Outright ownership on the other hand steadily moved upwards from 25% to 33%. Social housing declined fairly consistently in proportional terms while private renting was rising – and more rapidly since the mid-2000s. In terms of owning versus renting the proportions were around 68% owner-occupation and 32% renting near the end of the decade. However we should also note that renting from a local authority (council housing) moved from being the third most important tenure to one of the least important, while the core private renting nearly doubled from 9% to 14% (with the trend being particularly strong over the last few years).

In London, the trajectories are not dissimilar but renting, and especially social renting is far more important as compared to the country as a whole. London has experienced a steady decline in buying with a mortgage after 2002 while outright ownership has slowly risen over the period. Social renting has declined from around 30% to 23% while private renting has risen strongly from 12% to 19%. Overall owner-occupation is running at around 58% while renting accounts for about 42% of all.

Figure 1 Total Mortgage loan book as % of GDP



Source: survey of English housing/English Housing Survey

Looking in more detail at the rental split, it is clear that within social housing, council housing is much more important in London than in England. Even so, the decline in council provision has been of the order of 7% of all households in London and by 2009 it had been overtaken by private renting. Housing association renting showed growth over the period but less than elsewhere in the country. But most importantly private renting in London has been rising more rapidly than in England, growing particularly strongly from 2000.

3.2 Projecting tenure forward in England and London

As mentioned earlier the analysis has been based on three distinct economic scenarios – weak, where there is no real growth over the whole period to 2025 if anything, worsening credit conditions and a very slow recovery in the housing market; a cautious recovery scenario where only by 2018 is there real economic growth and some improvement in both the mortgage and housing markets – which might be regarded as the currently most likely; and a robust recovery after 2015 rising to 2.3% real growth in 2025. For the most part we concentrate on the first two scenarios which recent evidence suggests are the most likely.

As discussed, the analysis is based on assumptions about what might happen to the provision

of social rented housing (SR; which includes the government's affordable renting programme). The captions to the figures make clear which economic and social sector scenarios are depicted.

Figure 2 sets out what is currently perhaps the expected scenario – a continuing weak economy in England. Mortgaged ownership falls away from 31% in 2012 to 28% in 2025, while outright ownership continues to grow (from around 33% to 35%). Overall ownership falls from 64% to 62%. This is in line with many current commentators' predictions. Private renting rises from 18% to 22%. The social rented stock is held constant in numbers terms and therefore falls from 18% to 16%.

Figure 3 uses the slightly more optimistic but still cautious view of economic recovery. Then we see mortgaged home ownership, stabilising and expanding modestly from 2014 back to 33% at the end the period. Outright ownership is now above mortgaged ownership and remains roughly stable to end at 32%, initially this is higher than mortgaged homeownership but by the end of the period it is very slightly below. Overall ownership levels rise very slightly from 64% to 66% over the period. Private renting runs roughly comparable to social renting until 2012 and then overtakes social housing as the proportion of social housing falls (remembering it is constrained). Basically, it flat lines to the end of the period when it accounts for 18% of all households. So a cautious scenario suggests a picture of little change from the current depressed conditions. But there is still

suppressed demand so better macro-economic conditions would generate higher levels of mortgaged ownership.

In London, the picture is far more dramatic given the different balance between tenures at the beginning of the period. In the weak scenario with social housing maintained in numbers terms even by 2012 it is the private rented sector that is powering ahead and continues to increase from 30% of households to around 37% by 2025. Mortgaged home ownership falls away to 19% (from 23% in 2012) while outright ownership remains constant. London becomes a city of renters².

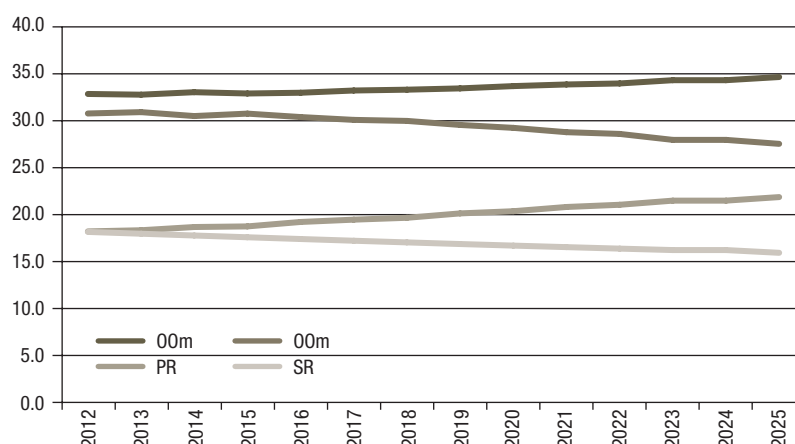
It must be remembered that these are scenarios. What will actually happen will lie somewhere within the extremes and policy and other structural factors will change in response to such massive pressures. But the trajectories are clear. Unless the economy picks up, England and particularly London will be more and more dependent on rented housing. Equally, the worse the economy the more likely it is that this rented housing will be in the private sector.

3.3 Household type

Over the period, the mix of household types has remained surprisingly static across England over the period except to the extent that the proportion of families with children (and within this perhaps even of lone parents forming separate households) has fallen and, in the survey, accounts for fewer than one in three households. In London however, the proportion of both families with children and lone parents has remained fairly stable over the period and is now higher than in the rest of the country. This reflects three main demographic trends in London: (i) fewer older households in proportional terms remain in London after decades of outmigration to other regions; (ii) far more households, proportionately, of child bearing age, in part as a result of past immigration; and (iii) a decline especially in the late 2000s in the outmigration of families from London.

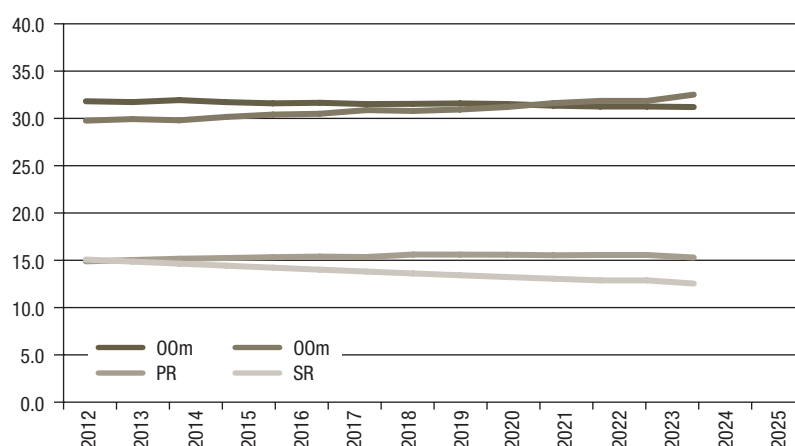
Table 2 shows how the majority tenure in England and London varies between household types and the proportions of each household in that tenure. Owning outright dominates among single households and couples without children – because these groups are themselves concentrated among older households. The majority of couples with children are buying with a mortgage – although in London it is only just in the majority, at 53%, as compared to 2 in 3 in England overall. For lone parents, social renting is the

Figure 2 Household projections by tenure (%): England



(Scenario: weak economic recovery; social rented stock: constant; excess SR demand: all to PR)

Figure 3 Household projections by tenure (%): England



(Scenario: cautious recovery; social rented stock: constant; excess SR demand: all to PR)

most important tenure, especially in London.

Looking particularly at the trends in buying with a mortgage we again find very different patterns between household types (Table 3). In England as a whole the proportion of couples with children buying with a mortgage has remained surprisingly constant over the period – while in London it has fallen. On the other hand, the proportion of couples without children who are buying has declined right across the country – reflecting both the growth in outright ownership and difficulties in buying. In this context, the shift from mortgaged to owned outright over the period is far more an outcome of tenure shift among

older households rather than any increase in the proportion of older households in the population. Indeed the proportion of older households has remained stable over the whole period.

3.4 The decline of mortgaged home ownership by age band

The evidence suggests an age cohort effect. In Figure 4 we therefore look at the change in tenure by age band over the 17 year period. We can see that the level of mortgaged ownership in each age band has changed in very different ways with some remaining stable and others declining

² See the full report for details on London and other analyses.

Table 2: Dominant tenure by household type 2008/09

Household type	Dominant tenure	Proportion in the tenure England, %	Proportion in the tenure London, %
All households	Buying with mortgage	36	31
Single person	Owning outright	40	32
Couple with no children	Owning outright	50	40
Couple with children	Buying with a mortgage	66	53
Lone parent	Social renting	44	56

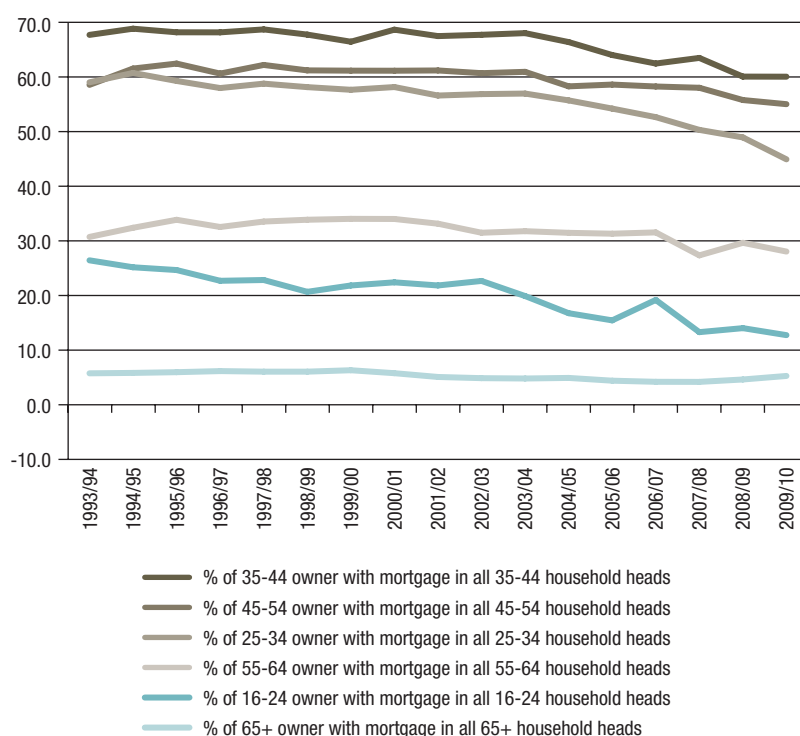
Source: SEH/ EHS

Table 3: Buying with a mortgage by household type

Household type	England %		London %	
	1994/95	2008/09	1994/95	2008/09
Single person	21	20	25	23
Couple no children	40	33	42	31
Couple with children	66	66	60	53
Lone parent	28	26	23	18
All households	43	36	39	31

Source: SEH/ EHS

Figure 4 Household heads, owning with mortgage, by age group (%), England 1993/94 to 2009/10



Source: SEH/ EHS

sharply. The biggest falls are in the 35-44 age band (down from a peak of 69% to 60%), and particularly 25-34 year olds (down from a peak of 61% to 45%) and 16-24 year olds (down from a peak of 27% to 13%). These are very significant shifts in a 17 year period and, given the age bands involved – the three youngest groups, this has implications going forward as to the level of home ownership overall. Two further points to stress – first this refers to England as a whole rather than a particular region which reinforces the significance of the finding and second, while it is possible for mortgaged home ownership rates to recover (NHPAU, 2009), tightening access to credit might mean that such a catch up is never achieved by this or subsequent generations.

3.5 The erosion of the role of social renting

Mention has already been made of the decline of social renting across the country. However, in London, social, and particularly council, renting is still very important. Social housing has accommodated around 60% of London households in the lower quartile of the income range and still provides for almost half of all such households (Figure 5). This compares with around 1 in 3 such households in England as a whole. One reason for this is that poorer households in London tend to be younger – so, as we have already noted, there are far fewer outright owners, a sector which elsewhere in the country includes larger numbers of poorer households.

Social renting is a key factor in London's competitive position and not least in relation to its very substantial service based sector. Its role has been very different dependent on investment in social provision and on the state of the economy. In particular, were social housing to decline and all households who might have been housed there had to be accommodated in the private rented sector, then the impact on both sectors would be very considerable.

Policy makers have tended to see social housing as a problem rather than a solution. But the much higher rents in London's private rented sector will impact on both wages and competitiveness as well as on the housing benefit bill. The question here is what might the consequences of the projected decline be and if social housing is as important as we suggest what might be done to sustain its role?

3.6 Families with dependent children

Helping hard working families sits at the heart of the government's stated policy aims. This group includes couples and lone parents with

dependent children but also multi-adult households where there are one or more dependent children. In Figure 6 under the weak scenario, we look ahead to see how families with dependent children might fare over time in England.

In England, mortgaged home ownership among families falls away from just under 50% to 46% and private renting edges into second place over social renting. In London as the full report shows we see a sharp decline in mortgaged home ownership – from 32% to 27% and a sharp rise in private renting from 25% to 33%. London thus sees the beginning of a tenure transformation for this group of households.

In Figure 7 we see the impact of the rather more positive but still cautious central scenario – and where half of the excess social demand goes to owner-occupation, probably a more likely outcome given the government's emphasis on supporting this tenure. Under this scenario owner-occupation with a mortgage grows relatively rapidly in England back up to nearly 60%. This is consistent with the evidence over the last decade when mortgaged ownership held up relatively well among family households. Using the same scenario in London we see moves back into owner-occupation and declining social renting leading to a quite rapid reversal of the decline in mortgaged ownership.

3.7 Low to middle income households

Of particular importance in tenure restructuring is how those in the lower part of the income spectrum are faring. Using the Resolution Foundation's grouping of 10% to 50% of income as constituting low to middle income households (LMI), it is clear from Figure 8 that, in England, social housing was extremely important to this group of households at the start of the period. However, by the 2000s this dominant position was under 'challenge' from outright ownership. Here we can see the impact of the Right to Buy in driving up outright ownership (and conversely bringing down social renting). Buying with a mortgage remains stable at around 22/23% but renting from private landlords shows a slow rise, accelerating in the second half of the 2000s. In London social housing remains crucial for LMI households and is the dominant tenure.

Projecting these trends forward, in a weak economic scenario in both England and London and holding social renting constant, the social rented sector continues to play an important role for LMI households, while mortgaged home ownership falls away. The private rented sector in England shows little growth over the period in proportion-

Figure 5 Housing tenure of lower quartile income households, London

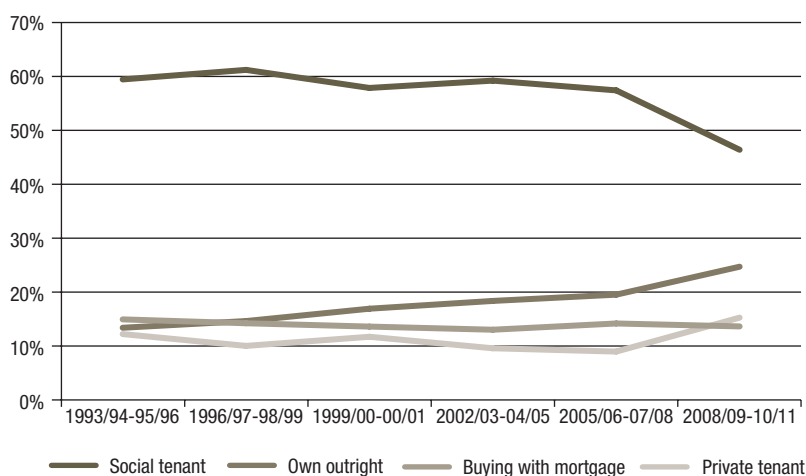
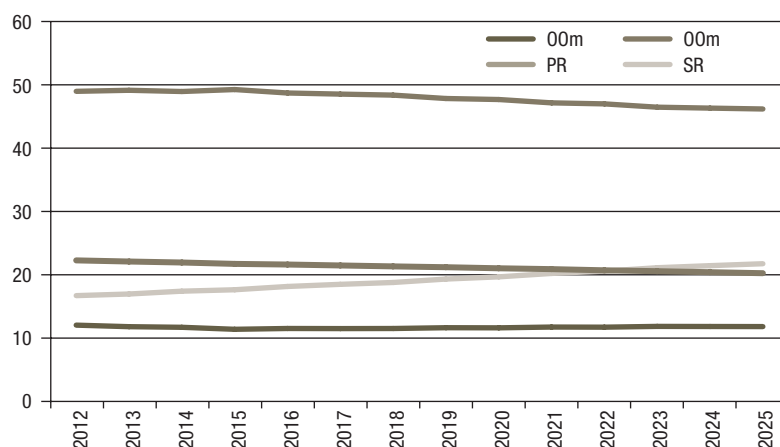


Figure 6 Household projections by tenure (%): Families with dependent children; England



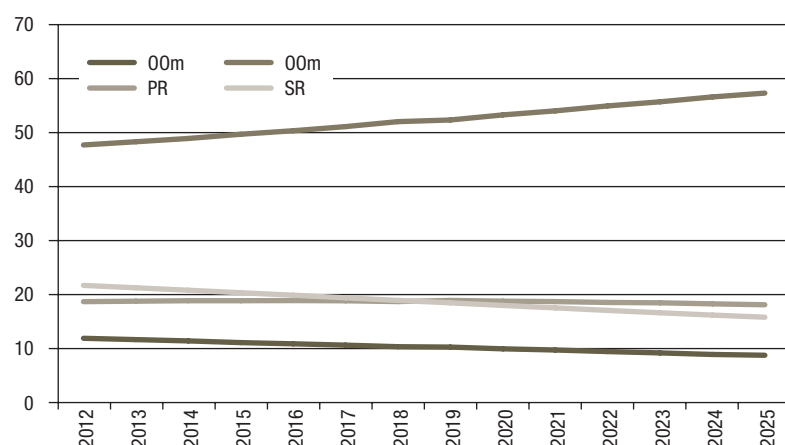
(Scenario: weak; social rented stock: constant; excess SR demand: all to PR)

ate terms, while owning outright rises as a result of built in cohort effects to become the largest sector for this group. Social renting is almost stable. In London the role of the social sector in housing around 45% of all LMI households is maintained. Those who would have expected to buy with a mortgage are mainly in the private rented sector.

As is clear, much turns on the path of any economic recovery. Figure 9 illustrates that with a weak scenario and declining social renting in England, the private rented sector increases, most notably after 2017, to around 27% in 2025. Outright ownership holds up but mortgaged ownership falls away from 20% to only 17% of all households. However, in Figure 10

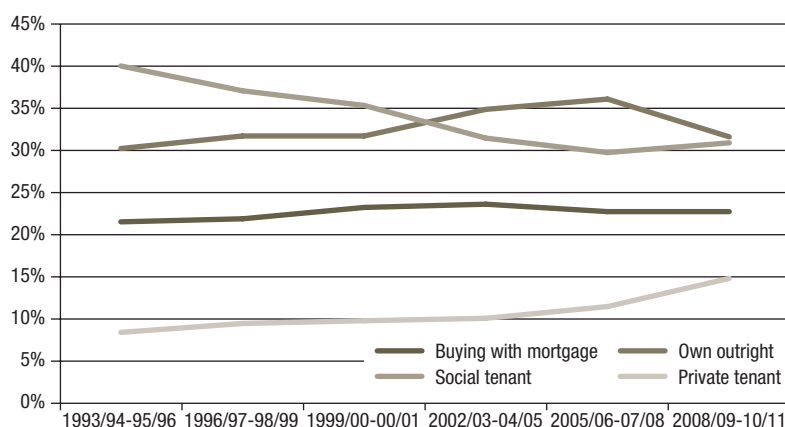
with a relaxation of the assumption regarding social renting and instead allowing for an increase (although this might imply a change of political regime, the current government has now announced a further housing market package which boosts funding for both private rented and social housing as an economic stimulus), we can see a sustained social rented sector and a reduction in the growth of the PRS especially later in the period. In London, we see a similar fall in mortgaged home ownership and a dramatic rise in private renting but even with social housing in decline it still remains the largest tenure until 2025 – although probably not for much longer. By then private renting accommodates over 35% of all LMI households in London.

Figure 7 Household projections by tenure (%): Family with dependent children; England



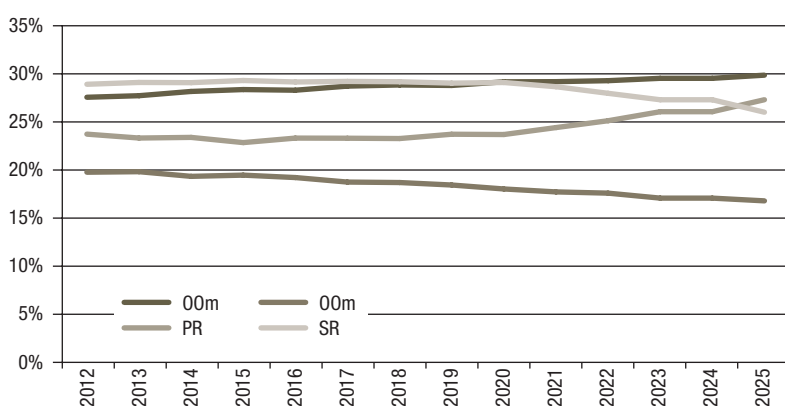
(Scenario: cautious; social rented stock: decline; excess SR demand: half each to PR and 00m)

Figure 8 Tenure of LMI households, England



Source: SEH/EHS

Figure 9 Household projections by tenure (%): LMI households; England



(Scenario: weak; social rented stock: decline; excess SR demand: all to PR)

3.8 A different view?

Even under our cautious scenario which is still modestly gloomy compared to some forecasts, the decline in buying with a mortgage and the increase in private renting starts to reverse as the economy 'improves' towards the end of the period. Under the robust scenario by which real income growth starts to kick in at the end of the decade, owner-occupation with a mortgage returns to centre stage. Equally if we assume that the social rented sector declines, some households who would otherwise have been social tenants become owner-occupiers (for instance through Right to Buy) this changes the picture with respect to tenure mix.

If we assume some transfer to owner-occupation instead of assuming that all excess social housing demand moves into private renting, under the cautious scenario we see significant growth in mortgaged ownership back above levels observed in the late 2000s while private renting falls slowly back to 17% in England.

Under the robust economic scenario these trends are reinforced. In England 44% of households become mortgaged owners, resulting in a historically high overall owner-occupation rate of 72% – although this is still well below that predicted by government in the mid-2000s. Private renting is then neck and neck with social renting, at 14% of households in both tenures.

These scenarios clarify how much tenure structure depends on two distinct factors – the state of the economy (and through that wages/taxes and much else) and housing policy. If the government emphasises owner-occupation through a range of policy measures and these policies are underpinned by a robust economic recovery owner-occupation could return to more 'normal' levels even if credit remains tighter than in the past (although easier than at the present time). But a resilient housing policy, i.e., one which would be sustainable through the economic cycle, would place most emphasis on ensuring that a decent affordable home can be found in all tenures at all times for all households.

4. Implications and conclusions

While projections are inherently just that – projections of past trends based on data which themselves are by no means perfect – the trajectories set out here appear to be quite robust under a range of economic scenarios which are neither unduly optimistic or pessimistic. This article and the underlying report raise some important questions which are summarised below.

First, perhaps the most immediate issue for England lies with the growth of the private rented sector as mainstream housing provision. Historically this sector had moved from being the main source of homes in 1900 when probably 90% of English households rented from a private landlord to a small residual sector in 2000 when around 9% of households were in that sector. There are political, social and economic issues to confront and whether or not current growth will be maintained – or even stabilised – depends as much on what happens in the owner occupied sector as it does on returns to landlords.

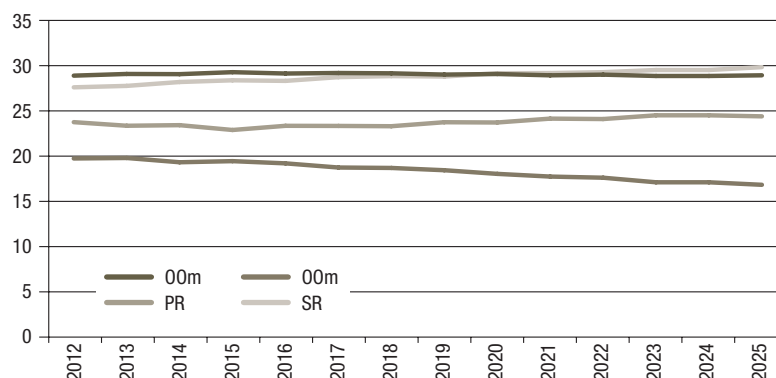
A second issue is the continuing role of social housing in providing homes for lower income households and not least in London where a higher proportion of lower income and family households are accommodated in social and affordable housing. Were the availability of social housing to decline further there could be major implications for the service sector in London and England.

Third, the expansion of home ownership has been at the centre of policy for several decades. This is now being challenged. Mortgaged home ownership is declining and there are real policy choices about what to do about this – wait for a recovery or support the tenure with additional subsidy or loans? The government has made modest gestures in the latter direction but these are modest given the scale of pent up demand. It is clear that people do want to buy and that if the economy improves and funding is easier there will be massive pressure to enter owner-occupation. One option might be a much bigger intermediate ownership programme – but to date with only around 250,000 homes provided since 1980 by this route, it is a relatively small base to build upon. If we assume that home ownership in the future will be more restricted because of controls on access to mortgages, tighter credit assessment and continued stretched affordability then this intermediate market needs to become much bigger.

The evidence suggests important generational shifts – with the future for home ownership not being like the past at least for a substantial number of the current younger generation who must expect to rent, although even under the cautious and certainly under the robust case a home ownership recovery does begin almost immediately and could be quite rapid in the latter.

The projections highlight the strengthening of trends over time. If the economy were to remain weak this would put increasing pressure on government to embrace a more sustainable PRS future. Yet this is not where most people want to be. It puts even higher priority on the cautious and robust scenarios being secured – and of taking

Figure 10 Household projections by tenure (%) LMI Households; England



(Scenario: weak; social rented stock : increase; Excess SR demand (if projected): all to PR)

account of the implications of policy on growth potential as well as housing market outcomes when determining housing policy.

Those on low to middle incomes are clearly under pressure. Their housing opportunities have changed greatly – and mainly for the worse – over the last decade and this is likely to continue. Under the weak economic scenario there is a big rise in the PRS for such households and this will not feel like a reward for hard work; anything but. In London social renting dominates but outright ownership is becoming more important. So under these scenarios London moves to being a more market dominated city compared to what it was in the past. This might be seen as a plus – but it does pose challenges to the London economy, especially if income distribution does not improve.

Among families with dependent children in England home ownership and increasingly the PRS dominates, especially in scenarios where social renting is constrained. In London, social renting still dominates for such households, especially among those on low incomes. Everywhere there are larger numbers of family households in the private rented sector. This will almost certainly continue, and for those who miss out on other options there is the prospect of private renting into old age – something that is unlikely to be welcomed.

England is experiencing a re-working of tenure choices and expectations. Government has choices as to whether it responds to the possible outcomes set out or whether it waits to see what happens. A new housing policy is to be announced in November 2012 and we now wait to see what substance that offers.

Acknowledgements

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Housing subsidy policy in Brazil: an overview of the last five decades

↳ By Claudia Magalhães Eloy, Fernanda Costa and Rossella Rossetto

1. Introduction

Housing policy and housing subsidy policy started in Brazil in 1964, during the military government, when the Housing Finance System [HFS] was established and the National Housing Bank [NHB] was created. At its start, HFS encompassed two sources of funding based on deposits: *Fundo de Garantia por Tempo de Serviço* [FGTS], a provident fund of compulsory deposits and SBPE, the Brazilian savings and loans system, both regulated at below market interest rates. Mortgage contracts signed in the early 70's - at fixed rates plus indexation for up to 25 year terms - lasted through diverse periods of the country's economic and political history. Thus, important changes in the economy and at the institutional level have shaped the way housing has been subsidized in Brazil. Yet, over these almost five decades, subsidies have been exclusively attached to the acquisition of homes and, until recently, to financing as well, while FGTS and SBPE remain as the main sources of funds for housing finance in the country.

This study aims to draw an overview of Brazilian housing subsidy policy, focused on federal level policies, from 1964 to the present time. It does so by trying to identify all types of subsidy employed. However, it focuses solely on FGTS and excludes SBPE, due to the lack of a database for mortgages and to the fact that SBPE is generally referred to as¹ a non-subsidized source of funds, in spite of the fact that its deposits are tax-exempt, backed

by governmental guarantee, earn below market interest rates and while part of its balance of funds must be used for mortgage lending (earmarking rules) at below market rates.

This analysis has revealed four distinct phases throughout the entire period. The first and longest one, from 1964 to 1986, when, under NHB coordination, housing financing and production reached impressive levels compared to previous periods – almost 2.7 million of units financed by FGTS and 1.9 million by SBPE² – can be characterized by huge hidden subsidies, not targeted to the neediest and used mostly to cover up inflation impacts on mortgages. The second phase starts with the end of NHB and lasts until 1995. It is characterized by the fight against inflation with a series of economic plans, severe cuts in housing finance and related subsidies. From a housing and subsidy policy stand point it is a period of institutional dismantling and inadequate provision or none at all. Nevertheless, around the end of this period, in 1994, comes the “Real Plan”, the one that managed to reduce inflation from hyperinflation levels and stabilize the currency, thus creating basic macroeconomic conditions to facilitate housing finance and subsidies in the following periods. Next, from 1995 to 2003, comes a period of important restructuring measures regarding first the accumulated deficit of the Wage Variation Compensation Fund [FCSV], responsible for outstanding balances at the end of NHB's contracts, and second, severe default problems of FGTS under the management of

CAIXA, the state owned bank that succeeded the NHB. It is also a phase during which housing finance is restored with newly designed programs that nonetheless fail to reach those in the lower income brackets. Less than a decade ago, in 2003, the creation of the Ministry of Cities and the start of a housing finance boom inaugurates the fourth period. During this period, subsidies are finally formally recognized as a fundamental component of Brazil's housing strategy targeting low and moderate income groups, which form the core of the country's housing needs. Such recognition is recently translated into a significant increase in the public housing subsidy budget, through a large scale housing program named *Minha Casa Minha Vida* [My House My Life] that encompasses almost all previously existing programs, coupling budget allocations with subsidies embedded in FGTS.

The income distribution pattern in Brazil makes the issue of subsidization of critical importance for the country's housing policy, in order to expand access to housing and housing finance. According to Brazil's most recent census of 2010, there are 57.3 million households, 85% located in urban areas³, while researches indicate that a portion of those units need to be replaced and also that there is a need to increase the total number of units to accommodate the accumulated housing shortage. The overall deficit is estimated to have reached 5.57 million units in 2009⁴, highly concentrated among the lower income brackets of the population – 98% is composed of families with monthly

¹ By government officials, developers and banks.

² ARAGÃO, José M. *Sistema Financeiro da Habitação: Uma análise sociojurídica da gênese, desenvolvimento e crise do Sistema*. Curitiba, Juruá: 2007. p. 150 e 192

³ The population, according to 2010 Census, totals 190.7 million.

⁴ MAGALHÃES ELOY, Claudia; PAIVA, Henrique. Paving the Way to Extend Mortgage Lending to Lower Income Groups in Brazil: The Case of the French System. Housing Finance International.

Autumn 2011. Disponível em <http://www.housingfinance.org>. They calculated the housing deficit following Fundação João Pinheiro (FJP) methodology. The deficit is conceived as the sum of replacement and increment. It includes precarious units that need to be replaced and the need to expand the housing stock – families sharing a home unwillingly, high rent costs (over 30% of household income), high density and use of unit inappropriate for housing purpose. FJP, *Déficit Habitacional no Brasil 2008*, at <http://www.fjp.gov.br/index.php/servicos/81-servicos-cei/70-deficit-habitacional-no-brasil>.

incomes below 5 Minimum Wages [MWs]⁵ – living in metropolitan regions of the country. Nonetheless, the challenge to promote housing access is even greater, for it encompasses not only the existing deficit, but also the new demand generated, estimated to be of 1.8 million units per year⁶. Studies developed within the National Housing Plan [PLANHAB]⁷ predict that, between 2009 and 2023, this new demand will also be highly concentrated in the metropolitan regions of the country. Yet, there will be significant growth in some small towns, due to economic growth patterns. Moreover, recent favorable macroeconomic conditions, have translated into real income growth, reducing the gap between rich and poor. According to Neri (2012)⁸ from 1993 to 2011, the number of middle incomers (“C” class, from BRL\$1,200.00 to BRL\$5,174.00 monthly⁹) significantly grew, from 45.6 million to 105.4 million Brazilians and the upper income brackets (A and B) also increased from 8.8 million to 22.5 million, while lower ones (D and E) diminished from 92.8 million to 63.5 million. That means 29.3 million Brazilians ascended from the basis of the income pyramid in the last 18 years. This trend is expected to continue, thus expanding the number of families that can afford to make a long term loan.

This article is organised into four sections. The first one describes, in more detail, the evolution of the subsidy policy throughout these almost five decades. The second assesses the changes, highlighting observed improvements, while the third identifies important issues still to be addressed. The last section presents the concluding remarks.

2. The housing subsidy policy from 1964 to 2012

2.1. First period: 1964 to 1986

This first and long period encompasses two very distinct economic phases: first, steep expansion

of the economy – “the Brazilian miracle” – with a GDP average growth annual rate of 11.1% between 1968 and 1973, followed by the debt crisis and escalating inflation which quickly turned into hyperinflation that continued in the following period¹⁰.

In 1964, under the military government and amidst the reform of the country’s financing system, when indexation was introduced to allow savings and long term loans¹¹, the Housing Finance System [HFS]¹² was established, together with the National Housing Bank [NHB]. Two funding sources based on deposits were set up soon afterwards¹³: a voluntary savings and loans scheme, named SBPE (generally known as “*poupança*”) and a provident fund that comprises compulsory deposits from workers – Fundo de Garantia por Tempo de Serviço, usually referred to as FGTS¹⁴. Both pay below-market interest rates on deposits and offer housing finance loans at below market rates as well, thus offering a hidden subsidy to those who receive a loan.

While most formal sector workers are required to participate in the FGTS savings scheme, loans have always been provided for any family that qualifies, regardless of being savers. The same is true for SBPE. However, even with below market rates, housing finance was not accessible to low and moderate income families and direct subsidies for housing with tax payers’ money faced strong political opposition, as Aragão (1999) observes. The solution to expanding finance to lower income groups was a cross-subsidy scheme – larger loans were charged higher interest rates¹⁵. This mechanism was thought to be sustainable, thus unlikely to impair the financial soundness of the system.

NHB roles included regulating and monitoring the system; serving as a liquidity facility; managing FGTS and operating as a second tier bank; coordinating housing investments and defining

credit parameters for borrowers. While the bank centralized policy making, financing was the responsibility of a diverse set of agents, segmented by target income groups – *Sociedades de Crédito Imobiliário* (SCIs), *Associações de Poupança e Empréstimos* [APEs] and *Caixas Econômicas* served the middle income families, while Cohabs [sub-national government housing companies] focused on lower income families¹⁶, frequently including local subsidies such as land and infrastructure in the subsidy package. Private builders and in many instances Cohabs undertook the production of units, while construction finance was provided by NHB.

Loans were made at fixed rates plus indexation. In order to protect borrowers¹⁷, in 1967, BNH established the Wage Equalization Plan [PES], limiting HFS adjustments on installments to mortgagors’ wage increases. Yet, wages were adjusted at below inflation rates, and therefore so were installments, while mortgage balances evolved tied to price indexes. Also, since wages were readjusted yearly, it altered the timing of installments’ adjustments in disregard of balances which were readjusted every three months, causing a greater mismatch. The Wage Variation Compensation Fund [FCVS]¹⁸ was created to cover debt balances that would arise due to differences in timing and adjustment indices between mortgage contracts and salaries. Since monthly payments might not cover full amortization, the outstanding amount was added to the loan balance. After 1972, as interest rates paid on FGTS deposits were reduced, so were the interest rates charged on mortgages, keeping the cross subsidization rationale however. Still, to reduce the indexation effect over installments, in 1974 a new subsidy was added: a discount equivalent to 12% of all installments paid in the previous year.

As the crisis worsened, it reduced the ability of borrowers to keep up with the payment of installments, even though these had been reduced,

⁵ The Minimum Wage was instituted in Brazil in 1936, (Law 185/36), and as of January, 2012 is BRL \$ 622.00. According to PME/IBGE, in Jan/2012, the median income of occupied workers was BRL \$1,011.57.

⁶ This study projected population in each state of the country, using data related to mortality, migration and was adopted by the National Housing Plan. Cedeplar/UFMG. *Projeção da demanda demográfica habitacional, o déficit habitacional e assentamentos subnormais*. 2007.

⁷ Plano Nacional de Habitação.

⁸ NERI, Marcelo. “Os Emergentes dos Emergentes”, Fundação Getúlio Vargas (FGV), August, 2012.

⁹ Equivalent to around 2.3 to 9.5 MWs.

¹⁰ The annual inflation rate reached 77.2% in 1979, 1,972% in 1989 and 2,477% in 1993.

¹¹ Negative real interest rates eroded savings and prevented long term loans. Not only was housing financing unavailable, but the industrialization process had slowed down also due to lack of long term credit.

¹² It can be assumed that the establishment of the HFS was part of the legitimization strategy of the dictatorship, an attempt to reduce the impact of repressive measures undertaken by the government by fostering low skilled job creation and making housing more accessible.

¹³ Until December 1966, BNH operated with grants, but resources allocated were only 20% of estimates.

¹⁴ Created in 1967, it collected monthly contributions equivalent to 8% of formal workers’ salaries.

¹⁵ Interest rates charged ranged from 2% to 10% depending on loan size.

¹⁶ Later on, around 1975, Cohabs would also turn to finance moderate income groups (around 5 MWs).

¹⁷ According to Martins (et al, 2011, p.7) “because of high and unpredictable inflation, a comprehensive system of indexing wages and debts was created throughout the economy. However, there was a risk to borrowers that the index used to adjust debt balances might not be the same as that used to adjust their wages, and more important, the timing of the two adjustments might not coincide, leaving them at risk of facing a sudden rise in loan obligations as a percentage of wages. Mortgage payment increases were therefore limited so that the obligation could not rise as a percentage of salary. This meant that in some months the outstanding principal increased.” MARTINS, Bruno; LUNDBERG, Eduardo; TAKEDA, Tony. *Housing Finance in Brazil: Institutional Improvements and Recent Developments*. IDB Working Paper Series, No.269, September, 2011.

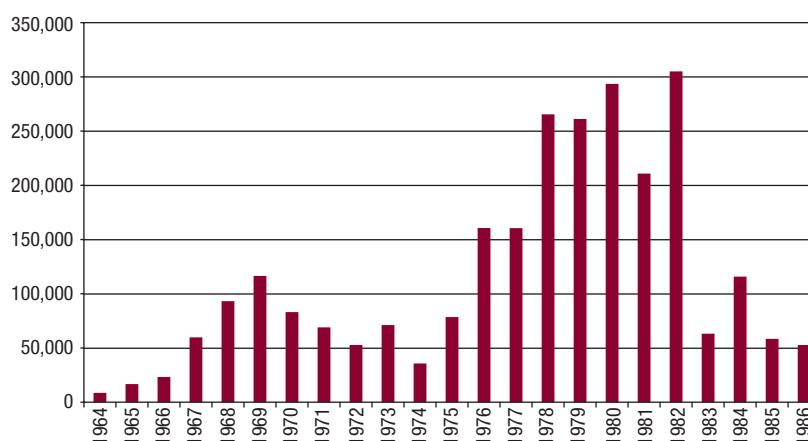
¹⁸ Created in 1967, FCVS received monthly contributions from borrowers and financial agents and constituted a guarantee that there would be no residues at the end of financing term.

causing default to explode. In 1984, 54.6% of HFS' contracts were in arrears by at least one month payment¹⁹. As Santos (1999)²⁰ points out, as inflation reached 100%, in 1980, and then 200%, in 1983, HFS' situation became unsustainable. The sub-adjustments allowed borrowers to end up paying very small installments, equivalent to 5% to 10% of corresponding rents, which were inadequate to repay the remaining debt, i.e., a case of negative amortization.

Also, the cost of money under hyperinflation was much higher than real estate price increases. While affecting all contracts, this was especially true for affordable, poorly located and lower quality units. The outstanding loans ended up much higher than the market values of the underlying properties for the vast majority of contracts. The solution, once more, came in the form of extra subsidies: discounts on the remaining balance were offered, as an incentive to pay off the debt, starting at around 25% and eventually reaching almost 100%. Again, FCVS took responsibility for a continuously increasing discrepancy between loan balances and payments for the outstanding mortgage portfolio, compromising resources way above its assets and cash flow would allow. This debt is currently estimated at BRL170 billion.

In sum, during this first period, that lasted until November, 1986, when NHB was closed down²¹, subsidies were initially indirect, comprised of below market interest rates originated from FGTS low cost funds, as well as crossed-subsidies among mortgagors. Then, as inflation outpaced wages and pressure from borrowers grew, especially from middle income groups, new subsidies were introduced and kept growing, as did inflation, the wage squeeze and unemployment. Yet, new subsidies employed did not promote new credit access or new housing production. They rather were meant to avoid a greater crisis in the HFS, in the real estate market and the entire economy, as they allowed families to keep their houses and somehow come to term with their contracts. Nonetheless, the focus on low and moderate incomes announced at the creation of the System was buried by a pile of subsidies offered indiscriminately to all mortgage holders,

Figure 1 Number of Units Financed by the NHB



Source: Aragão (2007), p.151. It does not include units financed by SBPE.

regressively benefiting those that had larger loans – middle and upper middle class families²². In order to serve families with monthly incomes below or at 3 MWs, some special programs had been introduced – self-help (João de Barro), slum upgrading (Pro-Morar) and serviced plots (Profilurb) – but altogether they produced less than 300 thousand loans²³.

The aggregate results obtained by HFS throughout the NHB years are shown on the following graph and represent a boom, when compared to periods before the creation of the system, peaking from 1976 to 1982.

2.2. Second period – 1986 to 1995

Between 1986 and 1995 the Brazilian government launched seven economic plans in an effort to control inflation and stabilize the economy. Only the Real Plan in 1994 succeeded.

Caixa Econômica Federal [CAIXA], a state owned bank, had taken on NHB's responsibility for FGTS management while also working as a 1st tier bank, a financing agent itself. The National Monetary Council [NMC or CMN in Brazil] became the

regulator of HFS/SBPE while the Central Bank was responsible for supervising credit agents. The other HFS agents, such as Cohabs, either survived and carried on its financing portfolios or were shut down, and its obligations transferred to municipalities or state governments.

In 1992 the Wage Equalization Plan [PES], from the BNH period, was substituted by the Wage Commitment Plan [PCR], establishing the use of housing loans under the system, but assuring mortgagors the right for annual contract revisions to keep installments equivalent to the original percentage of their incomes. After that, FCVS guarantee of debt remainders was suspended. Soon afterwards, in 1993, the Reference Rate [TR]²⁴ became the index for HFS – applied on deposits and loans.

During this second phase, national housing policy suffered from severe institutional instability, discontinuity and total absence of an agenda, as it wandered through various ministries. This dismantling process probably allowed for greater vulnerability to political pressure. Indeed CAIXA's approval of a significant number of loans based on political criteria resulted in around 200 thousand units with serious problems such as – lack

¹⁹ GONÇALVES, J. P. *Acesso ao financiamento para a moradia pelos extratos de média e baixa renda: a experiência recente*. CEPAL, 1997. (Série: Financiamento del Desarrollo).

²⁰ SANTOS, Claudio. *Políticas Federais de Habitação no Brasil: 1964/1998*. IPEA, Série Textos para discussão No.654. Jul/1999. At http://www.ipea.gov.br/pub/td/td_99/td_654.pdf

²¹ Decreto-lei nº 2.291, de 21 de novembro de 1986. <http://www.jusbrasil.com.br/legislacao/125755/decreto-lei-2291-86..>

²² See AZEVEDO, Sérgio. *Vinte e dois anos de política de habitação popular (1964-1986): criação, trajetória e extinção do BNH*. Revista de Administração Pública, Rio de Janeiro, v.22, n. 4, p. 107-119, out./dez. 1988. FERREIRA, Thais. *A Concessão de Subsídios por meio do Sistema Financeiro de Habitação*. 2003. Dissertação (Mestrado em Economia) – Fac. de Economia, Pontifícia Univ. Católica do Rio de Janeiro, RJ, 2003..

²³ See ROSSETO, Rossella. *Organismos Internacionais e a auto-construção: análise e refl exões sobre as políticas de habitação para população de baixa renda*. 1993. and ROYER, Luciana. *Financeirização da política habitacional: Limites e perspectivas*. 2009.

²⁴ The TR is still used as indexation for all deposits and loans under HFS, but no longer represents a price index, having become a rate that is added to interest charged/accrued. i.e., in 2011, Consumer Price Index in Brazil reached 6.5% while the TR was set at 1.2%.

of adequate infrastructure, low quality, unfinished construction and related abandonment – not to mention that they went over budget. The units that were finalized faced sale difficulties and were frequently occupied by other households than the original buyers, causing default to reach high levels. Discounts – applied either on prices or interest rates – were combined with alternative amortization schemes and loan extensions, which squeezed FGTS' funding ability, leading to the suspension of all new lending operations from 1991 to mid 1995.

Beyond that the economic recession of the 80s significantly reduced deposits, impairing SFH's capacity to provide housing loans. In 1993, FGTS net revenues were half of that of 1982²⁵. Even right after the Real Plan, when the flow of deposits grew, high withdrawal levels provoked by unemployment kept FGTS net flows negative until 1999. Some special programs from the previous period were kept and others were created, such as the National *Mutirões*²⁶ Program, in order to serve families with monthly incomes up to 3 MWs with public grants, but very little was actually achieved.

It must be stated though, that the dismantling of the federal housing policy did not mean that at the state and municipal levels nothing was being done. On the contrary, many pilot programs and new initiatives were undertaken at the local level in many places throughout the country, bringing about creative approaches to the affordable housing issue²⁷. In some instances, new funding sources were also created, as was the case of São Paulo, in 1989, which raised its local tax (*Imposto sobre Circulação de Mercadorias e Serviços*, ICMS) by 1% and dedicated its revenues to housing production, thus creating a stable flow of resources. Nevertheless, not all innovation turned into regular programs, especially since many were designed to deal with specific and emergent social demands.

2.3. Third period – 1995 to 2003

The adoption of the Real Plan finally brought about a less volatile more favorable environment for long term credit growth. Yet, it did not

happen immediately, but incrementally, requiring macroeconomic and institutional improvements. International as well as domestic economic uncertainties – currency devaluation, change to inflation targets and in the exchange regime, erosion of international reserves and high interest rates – characterized this period, during which overall credit grew much faster than housing finance.

After mid 1995, housing finance started again parsimoniously after several changes were made in FGTS regulation and programs, showing a tendency towards decentralizing to municipalities, fostering local initiatives and the creation of local agendas. On the other hand, access to financial resources was tightened.

The housing issue was then under the Secretary of Urban Policy, linked to the Ministry of Planning and Budget. In 1996 a new National Housing Policy was instituted, establishing three main strategies:

- Upgrading schemes for slum areas²⁸, that included the replacement and provision of housing units through financing to States and Municipalities – Promoradia [FGTS] – or grants – Habitar Brasil (HBB, a mix of resources from the public federal budget²⁹ and the Interamerican Development Bank);
- Housing finance directed to families with monthly incomes up to 12 MWs – “Carta de Crédito” – including construction material loans;
- Finance for housing production in the private sector – “Apoio à Produção.”

Carta de Crédito, operated by CAIXA, stood out as the main program in terms of the number of units and volume of resources contracted directly to families to promote home acquisition. Subsidies, in this case, were restricted to below market interest rates, still provided by lower rates earned by FGTS deposits. Only incomes above 5 MWs could access mortgage finance, while families with lower earnings generally just qualified for small construction material loans.

In 1999 a “lease with option to purchase” program was created: Programa de Arrendamento

Residencial [PAR]. Although it was also funded mainly by FGTS³⁰, it introduced an alternative to the traditional loans, thus offering a more flexible scheme, suitable especially to families with informal or irregular earnings. Later it could be used to rehab old buildings in central areas (PAR Reforma). Yet, out of 10 loan applications, one would qualify and it was accessible only to families with monthly incomes between 4 and 6 MWs and in some cities, such as São Paulo, mostly from 5 to 6 MWs. High maintenance costs and high default in condominium fees' payment were among its major issues³¹.

During this period, important institutional changes took place in the housing policy realm. The 1988 Federal Constitution was a benchmark in that it made housing policy a shared responsibility amongst the three federative entities – federal, state and municipal governments. Later, under the Constitutional Amendment No.26/2000 housing was first included as a “social right”. This new constitutional status emphasized the role of the federal government in the promotion of affordable housing, without, however, making it exactly mandatory to provide homes for all. In 2001, the Cities Statute³² put emphasis on housing as a fundamental part in the development of urban areas and paved the way for the creation of the Ministry of Cities a bit later, in 2003. Moreover, a series of regulatory improvements was undertaken to encourage private sector participation in mortgage lending, consolidated further in 2004³³. The introduction of the Trust Deed to substitute for traditional mortgages is probably the most important one. The Real Estate Financing System [Sistema de Financiamento Imobiliário – SFI] was created in 1997 with the purpose of integrating the capital and real estate markets, allowing for the issuance of securities and mortgage bonds. Until 2003, its development was extremely weak, however, especially with regard to housing, since SFI operations are mostly tailored to suit commercial properties. Market interest rates in this period were much higher than those typically offered under FGTS and SBPE, making this new system even less accessible to low and moderate income families and thus, those original deposit systems remained the main source of funds for housing finance in the country.

²⁵ ARRETCHÉ, M. *Estado federativo e políticas sociais: determinantes da descentralização*. Rio de Janeiro: Revan; São Paulo: FAPESP, 2000. pg 87

²⁶ Construction undertaken by families in a collective effort (task force).

²⁷ See BONDUKI, Nabil. (org) *Habitat: As práticas bem sucedidas em habitação, meio ambiente e gestão urbana das cidades brasileiras*. Studio Nobel, São Paulo, 1996.

²⁸ Provision of roads, electricity, sewage, etc., which, almost always requires relocation of part of the self built housing units, either within the same area or to another location.

²⁹ Orçamento Geral da União (OGU).

³⁰ Through loans to a specific new Fund – Fundo de Arrendamento Residencial (FAR), later used by the MCMV Program to receive federal grants.

³¹ The unit remained the property of CAIXA, and was maintained by hired private companies, until tenant exercised the purchase option, which could be as late as 15 years. Some maintenance costs included in the rent plus condominium fees made it inaccessible to lower incomes. A research conducted by Débora Sanches (2008, p.88) in two PAR projects in São Paulo, showed condominium fees equivalent to 25% and 53% of a minimum wage.

³² Estatuto das Cidades, Law 10,257/2001.

³³ Laws 9154/1997 and 10.931/2004. Others include a legal device to ringfence real estate development projects called equity separation (*Patrimônio de Afetação*) and another to assure that in the event of a lawsuit, only disputed balances' payments may be suspended while undisputed balances must be paid under contracted terms (Lei do Incontroverso).

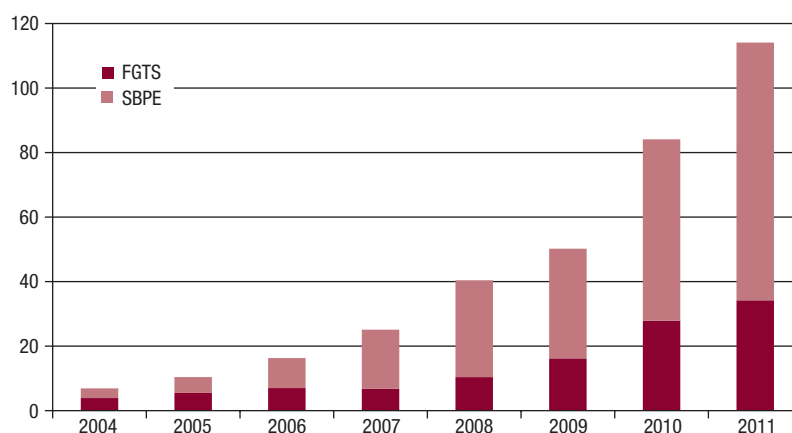
Together with the pursuit of macroeconomic stability this period was also marked by important reforms. First, the accumulated debt obligations of FCVS were securitized through the issuance of government bonds. Banks used their FCVS credits at the Program for Restructuring and Strengthening the National Financing System [PROER] as well as to comply with SBPE earmarking rules.

The Fiscal Responsibility Law enacted in 2000 imposed on states and municipalities rigid controls on expenditures and borrowings. Local public bodies – COHABs – that had acted as financing agents, began to work as promotion agents, since their capacity to take loans from FGTS was drastically restricted³⁴.

In 2001, CAIXA was cleaned up and governance improvements were instituted to assure sound credit portfolios, such as the creation of a credit risk system [SIRIC]. The asset management company EMGEA was created to receive 874,887 mortgage contracts from the pre 1991 period considered “toxic”, estimated to be worth BRL 26.6 billion, as a means of improving CAIXA's credit portfolio and of allowing it to comply with Basel rules for capital requirements. With the remaining credits, valued BRL 4.9 billion, CAIXA could proceed to issue new finance³⁵.

All this was part of an effort to reorganize the system. It is also important to emphasize that after 1995, when FGTS mortgage loans started again, they were channeled to borrowers – *Carta de Crédito* Program – instead of developers. This was a major change that has lasted throughout the following period. However, during this period, access to financing was much more limited and inaccessible to lower income families. The package of housing programs designed produced only BRL 600 million in contracts up to 1997. Small federal budgets coupled with the restricted borrowing capacity of municipal and state governments contributed to the meager housing outputs obtained, even though the overall economic environment had already improved considerably. Also, FGTS expanded its limits of maximum borrower income from 12 MWs to 20 MWs, favoring higher income segments.³⁶

Figure 2 HFS financing from 2004 to 2012 in BRL billion



Source: Abecip (2012)

According to Bonduki (2008, p.80)³⁷ between 1995 and 2003, nearly 79% of FGTS mortgages were taken by families with monthly incomes above 5 MWs. Subsidy attached to financing, maintained the regressive logic, benefiting only those who could get credit and in a direct proportion to the amount financed.

2.4. Fourth period – 2003 to 2012

Despite the change in government in 2002, the main economic policy's fundamentals from the previous period have been maintained and, so far, have allowed the country to cope with the first years of the international crisis³⁸. The consolidation of macroeconomic stability, real income growth and very low unemployment rates, together with important advances in the regulatory framework have promoted a boom in housing credit and production, as the next graph illustrates³⁹.

The creation of the Ministry of Cities⁴⁰ in 2003 rescued the status of housing as a public policy issue. The new National Housing Policy [NHP], elaborated in 2004, recognized that the absence of subsidy policy to fill the gap between lower incomes and

housing costs had historically conducted the available financing solely to upper middle income segments of the population⁴¹. Focus was set on low and moderate income families, aiming for universal housing access and establishing that urban housing provision must occur in serviced urban areas⁴². Moreover it established that subsidy must come from the federal budget rather than through FGTS funds only and suggested the creation of the Affordable Housing Fund [*Fundo Nacional de Habitação de Interesse Social* – FNHIS] to receive those funds. The long and harsh process for approving this Fund, that only happened after changes to its original design severely reduced its importance, revealed that the subsidy policy still faced some resistance.

New subsidy schemes were introduced in 2004:

- Resolution CCFGTS 460 enabled that part of net revenues obtained by FGTS – equal to the difference between interest earned on financial investments (on treasury bonds, debentures etc.) and interest paid on deposits – be used to provide subsidies attached to housing finance. This subsidy was to be given both directly to families to comple-

³⁴ The outstanding debts of those agents remain unpaid.

³⁵ IPEA. Série: Políticas Sociais: acompanhamento e análise. 14.02 2012.

³⁶ MARICATO, Erminia. *Política urbana e de habitação social: Um assunto pouco importante para o governo FHC*. Julho de 1998. Em http://www.usp.br/fau/deprojeto/labhab/biblioteca/textos/maricato_politicaurbanafhc.pdf

³⁷ BONDUKI, Nabil. *Política habitacional e inclusão social no Brasil: revisão histórica e novas perspectivas no governo Lula*. 2008. Disponível em http://www.usjt.br/arq.urb/numero_01/artigo_05_180908.pdf.

³⁸ The country has been experiencing growth, with the GDP growth rate over 5% in 2004, 2007, 2008 and 2010, when it reached 7.5%. Inflation has been somewhat erratic, but except for 2003, when it peaked at 9.3%, it has been kept under control floating around 5.5%. Interest rates (Selic) have also been reduced from as high as 18.2% in 2005 down to 7.5% now.

³⁹ In recent years housing finance has grown faster than total finance in the country: the expansion of housing credit was 50.9% from June, 2009 to May, 2010, while total credit grew by 19.7% in the same period.

⁴⁰ The new ministry encompasses the areas of housing, sewage, territory planning and urban mobility.

⁴¹ <http://www.cidades.gov.br/images/stories/ArquivosSNH/ArquivosPDF/4PoliticaNacionalHabitacao.pdf>

⁴² This is to say that financing and subsidies should not promote development in areas not served with utilities and other urban services, so distant and disconnected that they could be considered rural. In Brazilian larger cities, affluent suburbs have not been developed the same way as in other countries and low and moderate income housing tend to be developed in the periphery, since land in inner cities is much more expensive.

ment down payments, and indirectly, to the financing agent, to cover for the spread and other administrative fees. These subsidies accumulated with the below market rate one. Between 2005 and 2007, Resolution 460 provided BRL 4 million to subsidize borrowers, which represented around 15% of net revenues obtained by the Fund during the same period, despite the fact that net FGTS revenues are, as a rule, not distributed amongst depositors.

■ The Housing Subsidy Program (*Programa de Subsídio à Habitação de Interesse Social* - PSH), combined a mix of federal and local (state and municipal) budget money, targeting families with monthly incomes up to 3 MWs. PSH offered direct subsidies to complement construction costs and to pay financing agents' fees for offering credit. With that approach it attracted a lot of small financing agents, and made up for the absence of *Cohabs* at the local level. The PSH program did reach small municipalities – 67% of units produced were located in cities with less than 20 thousand inhabitants – however the original intention of using subsidies to leverage housing finance was not achieved, because of misuse and lack of oversight – families' incomes were under stated to capture the maximum subsidy amount which, in the end, would cover the entire cost of a house rather than using credit.

■ The Solidarity Credit Program (*Programa de Crédito Solidário* - PCS), financed construction, renovation or, simply, construction materials. Funds came from a different source, the Social Development Fund (FDS), setting diverse conditions than those offered by Carta de Crédito FGTS or PSH: maximum 20 year term, no interest rate loans. Subsidization, under PCS, consisted on the interest rate exempt, but its results have been much limited due to the small size and exhaustion of its funding.

Upgrading of slums was strengthened during this period, under the Growth Acceleration Program [*Programa de Aceleração do Crescimento* – PAC]. Its housing component – the provision of new homes in cases of relocation – is entirely subsidized and has received federal investments totaling BRL 15.2 billion from 2007 to 2009 and more BRL 8.2 billion since 2010⁴³. The stated objective is to provide over 800 thousand units between 2010 and 2014.

In 2008, the National Housing Plan [PLANHAB] was elaborated and identified three groups of families regarding their financing ability – those whose incomes cannot afford long term loans at any level; those that can access long term financing as long as some level of subsidy is involved (broken up into three groups according to the level of subsidy needed), and those that can get housing finance on market terms and conditions. This Plan proposed a mix of federal budget money [*Orçamento Geral da União*, OGU] and FGTS to fund the subsidy scheme, to solve the housing shortage and meet new demand. This strategy was then included in the 1 million housing program, launched by the Federal Government, in 2009, as part of a counter-cyclical strategy – to rapidly foster the creation of new jobs and reduce possible negative effects of the international crisis – named “My house, my life” [*Minha Casa Minha Vida* – PMCMV]⁴⁴. Inspired by Planhab, it offers both direct and indirect subsidies funded by the federal budget (OGU) and Res.460/FGTS, and sets a Guarantee Fund. However, instead of the more diverse range of solutions proposed by Planhab, MCMV encompasses only two basic approaches:

■ Finished housing units, targeting families with monthly incomes up to 3 MWs, funded solely by OGU grants. As a counterpart, families were first asked to pay installments of 10% of their monthly income, now down to 5% of their monthly income,⁴⁵ for 120 months, regardless of the cost of the unit. Developers produce the units while municipalities select beneficiaries. Alternatively, this scheme can be organised

through cooperatives or housing associations (PMCMV-E, a modality similar to PCS), as well as in small towns, through public bidding by small financing agents (similar to PSH);

■ Subsidized finance for families with incomes up to 10 MWs, to acquire market units. Financing comes from FGTS⁴⁶ while subsidies – funded by a mix of OGU and FGTS (Res460) resources and available to families with monthly incomes up to 6 MWs – are provided both directly to complement down payments and indirectly to pay for financing agents' spread and administrative fees. More subsidies, provided to all that qualify are the usual below market interest rates on FGTS loans plus new ones: coverage by the Guarantee Fund, reduced insurance premiums⁴⁷ and notary fees.

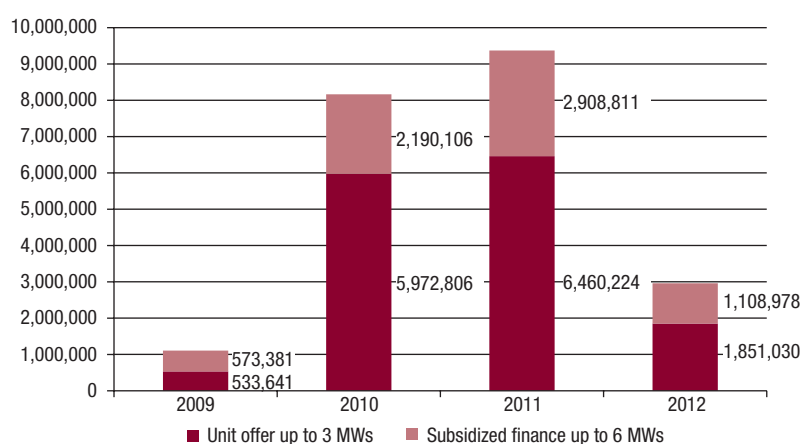
Now in its second phase, which extends the Program until 2014, PMCMV adds a new target of 2 million housing units. According to CAIXA, up to the 14th of May, 2012, out of the expected 3 million units (sum of PMCMV phases I and II), a total of 1.7 million have already been contracted, of which:

■ 40% in the 1st segment - units offered to selected families with monthly incomes up to 3 MWs;

■ 48% in the 2nd segment - subsidized financing to families with monthly incomes up to 6 MWs;

■ 12% in the 3rd segment - families with monthly incomes from 6 to 10 MWs.

Figure 3 PMCMV - Phases I and II - subsidies provided in BRL thousands



Source: CAIXA (2012)

⁴³ At http://www.planejamento.gov.br/PAC2/3balanco/pdf/PAC2_ANO1_09-MCMV.pdf

⁴⁴ Law 11.977/09.

⁴⁵ This change came up as this article was being finalised, on August, 27th, instituted by a presidential decree (# 7.795/2012).

⁴⁶ Before PMCMV, FGTS budget allowances for housing finance were always much behind the fund potential, restricted basically to the returns of existing credit portfolio, as demonstrated by PLANHAB. OGU subsidies introduced by PMCMV significantly expanded budgets afterwards.

⁴⁷ Death and disability (MIP) and Physical Damage (DFI).

Table 1

Organization/ Institution	Period	Subsidy	Source	Objective	Result
NHB	1964 - 1986	Below market interest rates	FGTS	Increase employment and boost economy	Production and housing finance boom
		Cross subsidies	Mortgagors	Expand accessibility	
		Sub-readjustment of installments	FCVS	Reduce default	Production and housing finance boom
		Discounts on outstanding debt		Reduce losses and mitigate social pressure	
CAIXA & Ministries	1986	Below market interest rates	FGTS	Political use, disregarding technical criteria	Financing suspended
	1995	Grants to "mutirões"	OGU	Serve lower income fam	Poor
CAIXA & Sepurb/MPO	1995	Below market interest rates	FGTS	Retake housing finance to families	Benefited families with monthly incomes over 5 MWs. Lower incomes only in slum areas or thru const material loans
	2003	Grants to slum urbanization projects w/ housing provision	OGU	Face the expansion of slums	
CAIXA & Ministry of Cities	2003 - 2012	Below market interest rates	FGTS	Increase employment and boost economy; focus on families with incomes below 6 MWs; provide housing to families with incomes below 3 MWs, improve slum areas	Expansion of housing finance; expansion of accessibility; housing provision
		Indirect: financing costs	FGTS + OGU		
		Direct: comp down pmt			
		Other expenses	OGU		
		Housing provision	OGU		
Grants to slum urbanization projects w/ housing provision					

So far, of this total, 780 thousand units have been finalized and received by the families. Subsidies provided yearly by segment are shown in Figure 3.

On both first and second segments municipal and state governments are stimulated to provide counterpart subsidies, which generally take the form of land or infrastructure provision, but additional direct subsidies may be offered. Especially in capital cities and metropolitan regions, where land is scarce and more expensive and subject to higher speculation, counterparts are critical to make it feasible to build housing for the up to 3MW.

The present housing subsidy policy, consolidated under PMCMV and PAC, can be characterized by the following elements:

- A focus on families with monthly incomes below 6 MWs;
- Subsidy not linked to finance for families with monthly incomes up to 3 MWs as well as finance linked subsidies to families that can access housing loans at some level;
- The supply of finished units as the sole approach for the housing issue and home-ownership as the exclusive tenure choice.

3. Assessment of housing policy changes

Table 1 summarizes the four periods described in the previous section, and serves as a reference to briefly analyse the evolution of housing subsidy policy in Brazil.

The fundamental aspect of the present stage is the emphasis given to subsidies as a crucial element of housing policy. As intended by the National Housing Policy, subsidy now is better aligned with the income distribution of the housing deficit. Moreover, significant resources from the federal budget have been added, allowing for the provision of subsidies in significant amounts and not necessarily attached to mortgages in order to serve lower income families that could not access finance. Improvements observed involve:

- Focus: subsidy policy is much better focused on low and moderate income families, with different approaches to different income segments. As Figure 4 shows, in the second phase of the Program, quantitative targets are also better aligned with the deficit – at least 60% of units for the 1st segment of the

Program, families with monthly incomes up to 3 MWs, while in the previous phase it was 40%. It is important to emphasize again that the move down market has been made feasible by the macro-economic stability, real income growth and interest rate decline.

Yet, the difficulties of achieving targets for the first segment, especially in larger cities, have not been overcome – out of the 53% overall unit target (phases I and II) to families with monthly incomes up to 3 MWs, only around 41% of all units contracted are designated for this segment, and less than half of it built so far.

- Harmonization of subsidy levels across income groups: promoted by the reduction in the number of housing program menu options independently operated. The previous diversity allowed families with similar socioeconomic situations to receive different levels of subsidies, producing inequality. In 2006, Hoek-Smit⁴⁸ analysed the various subsidy programs and concluded that subsidies provided by Res.460FGTS/Carta de Crédito could be as high as 64.7% of the housing price but down to 42.7% if the family financed it through PSH. This disparity observed by

⁴⁸ HOEK-SMIT, Marja. Framing a Subsidy Policy for Brazil. International Housing Finance Program, Wharton Real Estate Center. 2006.

Hoek-Smit was worsened by the families' lack of information regarding the options available. PMCMV has reduced those disparities. Nonetheless, families with incomes up to 3 MWs can acquire a home paying just 5% of their monthly income for 10 years if they are selected by the municipality or, at the market, with subsidized finance if they qualify, in this case paying higher proportions of their incomes for longer periods, but acquiring units that may differ in location and amenities from those offered for the first segment. That may still allow for different levels of subsidy for similar incomes, possibly creating inequality issues to some extent, but that hypothesis requires further analysis;

- **Information:** the use of a unified database that registers information regarding all beneficiaries of housing subsidies – *Cadastro Nacional de Beneficiários* [Cadúnico], allows for improved management and control.

- **Attention to vulnerable groups:** priority has been established for households headed by women and families with disabled people.

4. Issues still to be addressed by the Brazilian subsidy policy

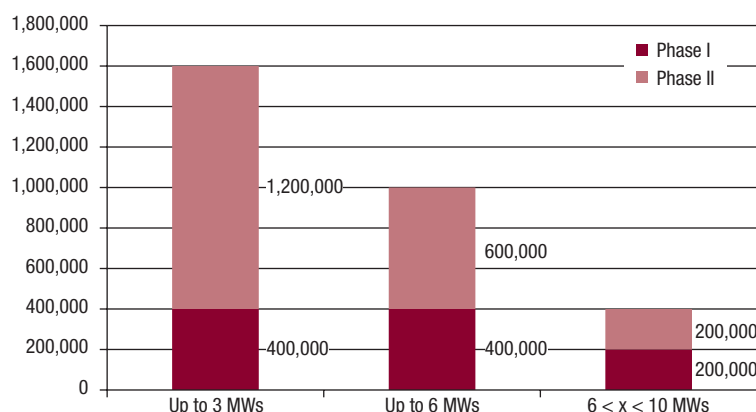
Despite the important improvements already identified, some issues remain to be addressed.

- **Tenure:** a fundamental one is the exclusive support for homeownership by the subsidy policy, despite the fact that 39% of the estimated housing shortage is comprised of families that spend over 30% of their gross income on rent. Although computed as deficit, they consist of a case of financial burden, in contrast with the rest of the deficit that actually calls for production of units.

- **Lack of diverse and customized solutions:** only finished units are subsidized, preventing the development of alternative schemes, such as those designed under the National Housing Plan.

- **Sustainability:** there have been significant expansions of subsidized unit price limits. In the first segment of PMCMV, an average of 31% increase from phase I (2009) to phase II (2011) – while the accumulated construction inflation rate [INCC] in the period⁴⁹ was 16.7% (or 13.2% for the Consumer Price Index - IPCA). As this article was being finalised, another increase in price limits of up to 33% was announced by the government⁵⁰, as

Figure 4 PMCMV Targets (number of units) - Phases I and II



Source: Ministry of Cities

a response to developers' pressure and considering that, so far, out of the 1.6 million unit target, just a little over 760 thousand units have been contracted. In the second segment, price limits have also been raised in the second phase of the Program, in a range between 30% and 50% depending on the region. While those increases may be partially credited to improvements in the housing units, they seem to be mainly explained by developers' pressures to accommodate escalating costs, due, in some part, to land speculation. This imposes threats to the continuity of the subsidy policy and causes important impacts on the housing market, reducing affordability. Another aspect of the sustainability issue is that the subsidy policy is now channeled through PMCMV, with OGU funds and targets set until 2014, leaving households, financing agents and developers without any indication of what will happen afterwards.

- **Centralization:** the huge centralization on CAIXA combined with the challenging quantitative goals established have produced much standardization of rules, projects and solutions, hindering creativity amongst the array of agents involved. The recent intervention of Banco do Brasil in HFS loans, another public bank with a tradition of granting agricultural loans, may provide a more competitive environment, favoring innovation and lower costs. This major concentration of housing loans in CAIXA – around 74% of market share – and its related risks may also be a source of concern.

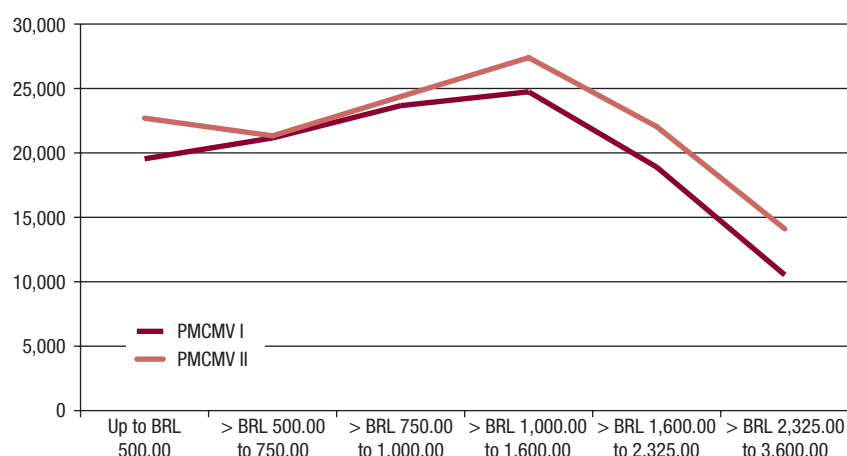
- **Subsidized Finance – FGTS hidden subsidies** of below market rate loans are provided beyond the target population of families with monthly incomes up to 6 MWs. Also, direct subsidies provided to families with incomes up to 6 MWs are calibrated in such a way that they remain constant in BRL value for families up to 3 MWs and are reduced as incomes grow from 3 up to 6 MWs. Indirect subsidies, on the other hand, vary according to the size of the loan but are capped. Yet, families with monthly incomes below 3 MWs can and have been participating in this scheme, as long as they qualify according to the financing agent criteria. That produces a situation, shown in the graph below, where for monthly incomes below 3 MWs (around BRL 1,600.00) subsidies received are smaller than at the 3 MW level.

It can be argued that those families can, or even should, be served by the 1st segment scheme, where no financing is imposed and installments represent only 5% of their incomes for 10 years. However, that would probably imply substituting their financing capacity and handing out more subsidies than those families actually need, since they only qualify for finance if they show some long term payment capacity. Also not only the units produced under the different schemes may have relevant location differences, data suggests that the first segment scheme faces implementation difficulties in some larger cities, thus leaving no other option for most of the below 3 MW

⁴⁹ From April, 2009, after the launch of PMCMV to May 2011, when the second phase was announced and new price limits were established.

⁵⁰ Portaria Ministério das Cidades Nº 435, August 28th, 2012.

Figure 4 PMCMV Targets (number of units) - Phases I and II



Source: CAIXA (2012).

Note: Subsidies do not include the below market interest rates. If it did, the curves would be inflexed at the fifth income bracket (from BRL 1,600.00 to 2,325.00).

Acknowledgement

The authors would like to thank Dr. Marja Hoek-Smit for her valuable contributions to this article.

However, the findings, interpretations, and conclusions stated here are the sole responsibility of the authors.

demand, than to apply for subsidized finance. It would be advisable to review the range of subsidization attached to finance, expanding the allowance for families between 2 and 3 MWs. Coupling greater subsidies with the amounts some families with incomes below 3 MWs can finance could help expand accessibility for families with lower incomes and possibly reduce the overall amount of subsidy needed.

5. Conclusion

This overview shows that housing subsidy policy in Brazil has gone through very different phases since 1964, influenced by the macro economy as well as institutional changes. Some continuity can also be observed, notably the hidden subsidized finance at below market rates and the exclusive emphasis on home ownership. In the present period, the subsidy policy has been significantly strengthened by the addition of federal budget resources, becoming a fundamental strategy of the housing policy. That suggests that the Brazilian society might have come to terms with the fact that subsidies are indeed needed in order to promote housing access. Accordingly, subsidies can now be provided in a more direct and transparent way.

Subsidy policy has also shown improvement in aligning with the affordability gap expressed by

the housing deficit focusing on moderate and low income segments of the population. The fact that subsidies are now provided unattached to credit for lower income groups must be pointed out, for it recognizes that in the very low income segments, some families just cannot afford long term financing.

On the negative side, important issues still remain to be addressed. Lack of diversity is a fundamental one, whether in terms of tenure choice, standardized solutions and participating financing agents, with important implications for efficiency. Sustainability should also be a major focus of concern and properly tackled in policy redesign.

Finally, it must be mentioned that although so important, a sound subsidy policy is just not enough to deal with the housing issue in Brazilian urban areas. The complexities involved, especially on large scale housing supply, require immense orchestrated efforts, among which stand out the integration of land, urban and environmental policies. If we fail to take such a comprehensive approach, financial resources employed may be insufficient to meet needs or, even worse, they may aggravate existing social, economic and environmental problems for, as Ferreira (2012) concludes, when considered on a large scale, building houses is also building cities.

⁵¹ See FERREIRA, João (coordenação). *Produzir casas ou construir cidades? Desafios para um novo Brasil urbano*. São Paulo: FUPAM, 2012.

Housing finance in developing countries

↳ By Monika Hjets Löfmark

1. Introduction

Many developing countries with growing cities cannot meet the needs of their inhabitants. There are simply not adequate houses and good enough infrastructure for people to work, produce and live in a healthy and safe way. It is hard to find reliable household data in many developing countries, especially in slum areas, but it is estimated that around a billion people live in slums around the globe, and the number is growing by the minute. It is not only difficult for the poorest to find a place to live; also middle income households are affected. Moreover, it is not only a problem for those who migrated recently; many slum dwellers are second generation inhabitants. In addition, to live in a slum is not cheap; slum dwellers often end up paying relatively large sums for a low quality home. In the rapidly growing megacities, there is no free land. Squatters often occupy land with relatively little value; in between roads, on landslide prone mountain slopes, brown field sites with major sanitary problems, garbage sites, roof tops and river banks. Places too dangerous to live if you can afford not to.

According to figures from 2003, 72% of the urban population in Africa South of the Sahara lives in slums. In South and Central Asia the figure is 59%.¹ UN-Habitat estimates that cities in developing countries will grow by another two billion people in the next 25 years. Hence, to construct houses for all demands radical changes and improvements. Apart from poverty, inequality, a very thin financial market and rapid urbanization, developing countries are characterized by a very large informal sector, lack of land and by incremental building. The lack of land and finance brings about costly and deficient houses. But even worse, it brings about homes that are unsafe to live in plus a constant fear of being evicted. By extending financial markets to more households, houses can become safer and economies can develop and grow.

In many developed countries, the housing finance sector plays a major role when it comes to wealth and bank lending. The housing finance market also affects consumption, investment and savings. Moreover, a well functioning housing finance market contributes to a well functioning housing market. And having a home matters; it increases comfort, safety, and contributes to better health. It may also give an extra income. For society, housing plays a macro economic role as it affects growth, labour markets, technical innovations and savings as well as financial markets.

However, to develop a smooth and well functioning housing finance system is difficult and time consuming, especially in developing countries marked by poverty, a volatile environment, lack of institutions and financial infrastructure; countries where it is difficult to obtain mortgages and other loans. Nevertheless, it is important to bring back housing finance onto the agenda. Personal residences account for 75-90% of household wealth in emerging countries. Investment in housing accounts for 15 to 35% of aggregated investment worldwide and housing construction supports approximately 10% of the labour force worldwide. In other words: housing finance matters.

Naturally, housing markets are affected by supply and demand. For the first time in history, a majority of people live in urban areas. The urbanization process is especially rapid in many developing countries. Cities are drivers of growth. However, they have also contributed to increased inequality and extremely poor living conditions. These large inequalities have attracted attention as a problem in itself, but also because large differences in living conditions hamper growth and development.

When it comes to development and aid, there has been shift of paradigm from the earlier top-down approach, provided by most developed countries, to a focus on bottom-up perspectives. As an example, The Swedish Politics for Global

Development [PGU] underlines that people are not to be regarded as passive receivers of aid; people and countries must lead in their own way. There are several studies finding that active and local participation provides long lasting results and it is important to highlight that numerous slum dwellers already improve their living conditions on a daily basis. As regards international aid, housing and slums are generally not prime targets. Donors want rapid results and housing improvements are often long term projects.² These projects are also often quite complicated, as they run into difficulties regarding land, political intricacies and conflicts between actors at different levels. It has also been claimed that local actors in developing countries may not wish to focus on cities, but rather on rural improvements to avoid further urbanization. Nevertheless, the Millennium Development Goals includes a target of improving the lives of 100 million slum dwellers.³

The paper will describe the way housing finance is affected by informal markets and issues related to land. Thereafter, a brief description of various forms of informal and formal housing finance will be provided. The focus in this paper is mainly on informal finance and lower income solutions. Finally an approach to promote action will be presented; the land administration chain. However, this concept can be applied also to achieve formal improvements. The paper aims to provide an overview. The situation differs between regions, countries, and areas. To provide more detailed information and suggestions one has to focus on a single country/area.

2. Informal markets

The formal institutions of developed countries cannot be set up directly in developing countries. Large parts of the economies in developing countries are "informal", i.e. unregulated; people work and live in informal markets. An informal

¹ Cited in Ferguson B., (2008).

³ UN Habitat (2003).

² Shea M., (2008).

house is not registered and it is often built incrementally, sometimes without the permission of the land owner. The costs and possibilities of obtaining formally registered property rights for land or houses vary heavily both within and between countries. Laws and institutional deficits limit the possibilities of formal ownership in many countries. In informal economies it is difficult to value assets and solvency and it may also be challenging to gain access to public contributions based on formal income; income from taxes is generally low in economies where only a minority work and live formally. Small and volatile income from taxes generates a lack of long term capital. Lack of long term capital hinders development of long term investments, such as houses and infrastructure. Informal income and housing markets also create difficulties for banks when performing credit assessments. Hence, informal markets inhibit formal lending.

Informal markets, however, succeed in providing what only few formal markets can: Homes and jobs for the poor. To build formally is complicated in many developing countries, as it is difficult to obtain land and building materials at a reasonable cost. Lack of formal housing finance brings about expensive and informal loans. Lack of capital also contributes to the habit of building step by step. Many low and middle income households cannot finance more than a small part at a time. An incremental process is often initiated by the informal purchase of land. The acquisition is not registered and it generally only provides limited access to the land.

To build step-wise is flexible and lowers up-front payment. It often provides a home close to the labour market. But to build incrementally is an inefficient and costly process; often several times more expensive than building a house formally.⁴ This is due to low quality materials, poor design, small scale and lack of knowledge. Lack of long term planning leads to many and costly reparations and often these incremental improvements are torn down when expanding the house later on.⁵ Moreover, if these informal houses and areas are formalized afterwards, for example by formal development of new permanent houses, the original investments are destroyed by new roads, official infrastructure, etc.⁶

The costs of water and electricity are high in slum areas.⁷ There is a line of house- and infra-

structure entrepreneurs who collect money and split it into different pockets. Hence, altogether, poor people may end up paying large sums for a simple home. Congested, poorly maintained slums are often more profitable per square foot than other types of real estate investment.⁸ An UN researcher points out that: *fifty-seven per cent of the dwellings in one Nairobi slum are owned by politicians and civil servants and the shacks are the most profitable in the city.*⁹

Slums and slum landlordism is not a new phenomena. Slums in London have been well described in the literature and by historians as a vicious circle of housing demolition, rising rents, overcrowding and disease where the really high profits were from rack-renting. Hence, what is new about slums today is not that they exist and that people make money from them, but their size and the immense speed at which they are growing. Slum areas with over a million inhabitants exist in several Third World cities.¹⁰

3. Land and tenure

Lack of formal land tenure and housing finance hold back the construction of new homes. Unclear ownership makes it difficult to lend money using land and house as collateral. Different forms of tenure involve different laws concerning land use and ownership. Some users have full rights. Others may use the land although they do not own it. Many have the right to live, but not to sell. Hence, tenure is a graduated matter where the most unsafe form is connected with daily threats of eviction. In some countries, these different types of rights complement and compete with each other. In other countries various kinds of ownership and tenure overlap.¹¹

As an example, in parts of Africa colonialism brought about complexities regarding land issues; different borders and regulations were introduced. In some countries, after colonialism, land was returned to the state. In other countries, private property rights were delivered.¹² Both solutions have turned out to be problematic; those who turned to market solutions have experienced obstacles due to lack of institutional prerequisites. Those who went for public ownership often experienced slow and corrupt handling.

Land may also be owned traditionally. Traditionally owned land is owned by a tribe and this is quite common in Africa South of the Sahara. The tribes decide how to use their land, but these decisions are seldom written down; one has to be locally based to obtain knowledge about ownership and user rights. To some groups, private property rights can be quite unfamiliar.¹³

De Soto (2000), underlines that well defined property rights would solve a great deal of the poverty problems; formal ownership provides a basis for tax collection which, for example, may be used to construct better and cheaper infrastructure. Moreover, properties can be used as collateral when lending. By focusing on formal ownership, problems in relation to informal systems and land issues have been highlighted.

However, it is difficult to introduce formal title and property rights in many developing countries.¹⁴ In part this is because it has become apparent that the poorest move away after a formal ownership process; they are often bought out of the area. Some researchers state that informal renting is the most alarming area in developing countries. Tenants are often poor and non-organized and they seldom get more security when land/housing markets are formalized. On the contrary, they risk a higher cost of living (due to the formalization costs) and must move away.¹⁵ In some parts of the world, tenants are in the majority. As an example, in Nairobi, 92% of slum dwellers rent their homes. Contracts are verbal and tenants feel quite secure as long as they pay their rents.¹⁶

Another difficulty regarding title is when several people claim they own the land; formalization processes may trigger conflicts. As most poor and informal households are illegal, they have to return the land, or property owners have to give away their land to those who live on it. It is problematic to focus on the importance of ownership and give away land simultaneously.

Hence, to secure ownership will not necessarily lead to any improvements for the poor in developing countries. Hence, ownership must be introduced in coherence with the particular circumstances in an area, often gradually and together with other reforms. It is central to make living as secure as possible, but this is not necessarily always the same as ownership.

⁴ Ferguson B., (2008).

⁵ UN Habitat (2005).

⁶ Ferguson B., (2008).

⁷ Berner E., (2007).

⁸ Davis M., (2006).

⁹ As cited in Davis M., (2006).

¹⁰ As cited in Davis M., (2006).

¹¹ Cited in Tomlinson M., R., (2007).

¹² Groves R., (2004).

¹³ Cited in Tomlinson M., R., (2007).

¹⁴ See e.g. UN-Habitat (2005).

¹⁵ Durand-Lasserve A., and Selod H., (2007).

¹⁶ Gulyani S., och Talukdar D., (2006).

4. Housing finance

Formal financial institutions reach only a minority in developing countries. Also when formal property rights have been introduced in extensive programs, very little lending occurs: Banks still do not want to lend and only few house owners use their property as collateral. Prices of land are high in urban areas and incomes are informal, irregular and low. To borrow is expensive and to borrow for a house normally involves a long term agreement. In countries where inflation is high and the macroeconomic situation is volatile, there is very little long term capital.¹⁷

Macroeconomic stability and well functioning laws are prerequisites for formal mortgages. In many developing countries, interest rates are high and volatile and the macroeconomic situation is unstable with a high risk of inflation. Moreover, the financial infrastructure is often poorly developed; legal systems, housing market regulations, credit bureaus, insurance, valuations and staff capacity may all be inadequate.

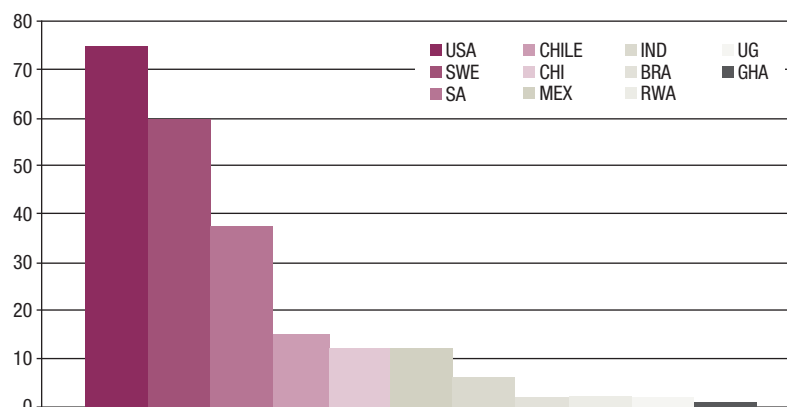
For a bank to offer loans with decent terms and conditions the institutional framework must function; the legal system must be trustworthy and transparent. Mortgages are only provided to those regarded as solvent, but in informal economies solvency is hard to determine. Apart from being expensive, most products are also badly tailored for most people as terms and conditions may be hard to understand/read and banks may be far away. Small savings are seldom accepted and the collateral needed may be extremely high.¹⁸

Naturally, the situation differs between and within countries. In large parts of Asia and also in Latin America there are financial systems established, operating to varying extents. But also in these parts of the world, a large portion of the population is excluded from financial markets.¹⁹ Africa is the region with least banking in the world. In the table below, formal mortgages as a percentage of GDP in some selected countries are presented.

As can be seen in Figure 1, mortgage finance as a percentage of GDP is low in several countries; revealing that few households have access to formal loans.

Where formal institutions do not function, informal institutions will expand. The limited access

Figure 1 Mortgages, % GDP



Source: Chiquier L., and Lea M., (2009)

to formal housing finance is compensated for, to some extent, by micro finance, individual and local savings and through informal lending. In some countries remittances are important and contribute a large part of GDP. Below, various formal and informal methods are described;

- Public action
- Guarantees
- Savings
- Micro finance
- Community based organizations
- Remittances

4.1 Public action

Governments may affect housing markets through subsidies, taxes, regulations, urban planning, infrastructure, laws and institutions. Wider access to housing finance has a large impact on construction, economic growth and urban development etc. Housing finance also plays a key role in many financial markets. Therefore one way for the state to encourage investment and growth, is to increase the access to, and the functional ability of the housing finance sector.

The trend around the globe is to leave public housing solutions behind and turn to the market. In fact, a researcher indicated that: *To date states have been far more effective in the destruction of mass housing than its construc-*

*tion.*²⁰ This contains more than an element of truth. Apart from larger evictions, often due to a particular event like IMF-World Bank meetings, Olympic Games, evictions of communities by the public and private actors are a daily threat in most slums.²¹

It is vital that urban planning is emphasized when it comes to the role of governments, because if access to finance is increased without any improvements in access to housing, this will only fuel prices. It is also important that urban planning is adapted to economic realities and with a focus also on the low-income population. This is both to encourage production of affordable housing and to avoid the destruction of existing housing. Hence, governments ought not only to strive to improve the lives of existing slum dwellers, but also plan adequate alternatives for future urban growth.

Closely related to urban planning is the provision of a reliable infrastructure and a public transport system. Simplification of access to community contracts in areas where it is possible to commute safely and inexpensively to labor markets, may be important tools in poorer areas. Infrastructure however also includes services such as sanitation, electricity, water, garbage collection etc. Experience shows that if these are provided under pure market conditions, some areas will be neglected. Hence, here is a role for governments. However, a Nairobi slum dweller describes the action of the state in relation to these services, in the following way: *The*

¹⁷ UN Habitat (2005).

¹⁹ UN Habitat (2005).

²¹ Davis M., (2006).

¹⁸ Fernando N., A., (2007).

²⁰ As cited in Davis M., (2006).

*state does nothing here. It provides no water, no schools, no sanitation, no roads, no hospitals.*²²

Other ways to increase the stock of houses is to reduce cumbersome rules. It is difficult and time consuming to buy land, to register property rights, get access to use land and build houses. Developers who work formally have difficulties in competing with informal labour. Only few are able to obtain credit and go through all the procedures connected with building houses in several developing countries. Hence, state actions that remove some of the most inhibiting regulations may improve the market for all. Planned houses often include infrastructure from the start. Moreover, in many developing countries it is difficult for developers to obtain finance as their investments are considered too risky and long term. Some developers may de facto act as small financial institutions and finance their clients, as they know that they cannot obtain loans.²³

States that are able to provide predictable and reliable legal institutions give incentives to investors, entrepreneurs and citizens to interact. A proper legal system, together with sound financial infrastructure, encourages responsible and transparent lending and investment. However, regulations must be developed with care. Partly because they are often unfair to the poor, but also because financial liberalization has been one of the fundamental factors for financial growth in several developing countries. Hence, when regulations are very strict, they may also restrict access to finance. Moreover, when no one cares about the written word, laws and regulations are more or less useless, be they pro-poor or not. Developing formal institutions includes considering why informal institutions are in place.

Another way for states to intervene is by providing direct subsidies. Subsidies are meant to correct for market failures and initiate possibilities that would not be feasible without them. Unfortunately, it has been established that subsidies do not always reach the households most in need. To improve systems in order to support the poorest demands detailed knowledge, both about subsidies and local conditions. It is difficult to provide subsidies in non-transparent societies where the information/data about communities and their inhabitants are poorly mapped.²⁴

4.2 Loan guarantees

One way to increase finance for housing and open up access to credit also for poorer people is by introducing loan guarantees. A mortgage guarantee implies that potential losses affecting the lender are covered, partly or fully, by a guarantee. Hence, the basic idea is to make it safer to lend. When it is safer to lend, banks may dare to provide new types of customers with mortgages, also those without formal collateral and/or income. Thereby, a guarantee may correct for one of the greatest market failures that exist in many developing countries; the fact that there are potential borrowers who would repay properly, but they cannot get any loans. Guarantees can be provided by donors, NGOs, governments, but also by commercial lenders.

Guarantees are often mentioned as a potential instrument to link traditional lenders with a wider part of the population and bridge formal and informal markets. If guarantees are able to work as a bridge this may contribute to cheaper loans, as the loans poorer people take often include very high interest rates. Information asymmetry is significant in developing countries and a guarantee can decrease this asymmetry by enabling working with new clients and learning from other kinds of institutions acting in the same field. By enlarging the group of clients, lending institutions learn more about credit and risk valuation and thereby they may expand.²⁵

Guarantees are also helpful when timing is imprecise; building involves many processes and actors, a guarantee may overcome uncertainties.²⁶ They are used to create demonstration projects and to inspire other banks to broaden their lending.²⁷

However, working with guarantees also entails risks and difficulties. Someone has to take the risk in a financial system not working very well. Guarantees may bring about market distortions; breach of contracts, loans that are not repaid and clients that are not inclined to pay back, etc.²⁸ Lending institutions may relax their underwriting rules because they know they cannot lose. It is crucial that guarantees are formed to correct market failures and not bring about new ones. Moreover, guarantees must produce long term changes, to be worth the effort.

4.3 Savings

In many countries, saving (own savings or savings by family and relatives) is the most common form of housing finance. Savings contribute to sustainability in finance systems and a larger autonomy for those who save. To save prepares households to make regular payments and it reveals that households are able to spare a certain sum of money.²⁹

Saving often precedes lending and poor people frequently save, especially if they have access to a local savings program. To open up a traditional bank account is generally too costly and cumbersome. Therefore, many communities organize group savings. Also, some people take part in micro finance affairs only to be able to save.³⁰ Saving cooperatives are also rather frequent, so called ROSCAs (Rotating saving and credit associations) and ASCAs (Accumulating savings and credit associations etc.).³¹ They are mainly used by women as women have even less access to formal markets than do men.³²

In ROSCA there are around 10-30 members who save regularly, sometimes daily. After a certain period of saving, one member at a time empties the pot. When all savers have received their share, the organization dissolves. This is a cheap and simple form of saving. The drawback is that the money is not necessarily delivered when needed. Nevertheless, these types of organized savings are common and cooperatives have more members than do micro finance institutions.

ASCA is another form of saving institution. In these cooperative one can save as much as one like, hence also rather poorer people can use them. Members also have the possibility of withdrawing their savings at more appropriate times. Hence, this system demands more careful book keeping and it is less transparent than the ROSCAs.³³

Other informal solutions exist: In, for example West Africa so called "mobile bankers", informal "banks" who walk around and collect small savings, are common. They charge around 10 percent of the savings to keep the money safe. These mobile bankers also lend money, and even if the fees for saving and lending are high, they are often used by poor people. Even if they charge very high interest rates, they may have a good reputation. For example, in South Africa,

²² As cited in Davis M., (2006).

²³ Chiquier L., (2009).

²⁴ UN Habitat (2005).

²⁵ Freedman P., L. (2004).

²⁶ Acumen fund (2007).

²⁷ Freedman P., L., (2004).

²⁸ Ibid.

²⁹ UN Habitat (2005).

³⁰ Cited in Mittle D., (2007).

³¹ Helmore K., (2009).

³² See eg Gordon A., (1999).

³³ Helmore K., (2009).

mobile money lenders are regarded as a part of the legitimate system.³⁴

Savings are often connected with micro finance or community based organizations.

4.4 Micro finance

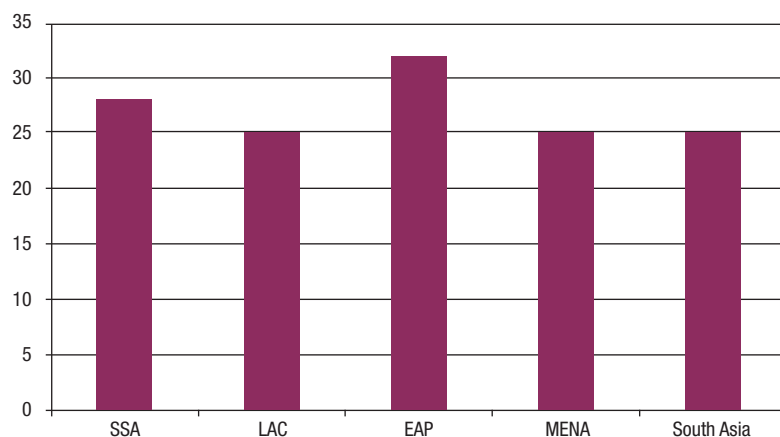
Micro financial loans are generally small, the repayment period is short and no formal collateral is needed. Initially, micro finance primarily reached small scale entrepreneurs, but now several institutions also offer loans for houses and even consumption. Thus, they have prerequisites to reach low- and middle income households, who build step by step and cannot obtain traditional bank loans. The supply of micro finance is growing. As regards micro finance in total (i.e. not only housing micro finance) there are around 200 million borrowers, growing by around 20 percent yearly. In 2007, total sum lent was 2, 5 billion US\$. Default rates are relatively low.³⁵

As micro finance loans are small they are not suitable to use when building a whole house. As these loans often are connected with savings they manage to collect credits outside the formal systems.³⁶ As regards collateral, these institutions may accept future income, previous savings, personal/group guarantees or previous repayment capacity. Property rights, in general, are not used as collateral; most poor people do not want to risk losing their home. Moreover, documents at hand may be of low quality and unclear, they simply will not do as collateral.³⁷

One hindrance to growth is that lenders often have a relationship with the borrower, institutions are reluctant to lend if they do not know their clients. As mentioned above, guarantees may be used to overcome such obstacles. Researchers, however, point to other challenges than scaling up; the transparency is often low, the costs are high, links to formal systems are often limited. Moreover, the interest rates are high. The table below shows median interest rates in Sub Saharan [SSA] Latin American countries [LAC], East Asia and the Pacific, [EAP] in Middle Eastern and North African countries [MENA] and in South Asia.

As can be seen, interest rates are high. Naturally it is quite expensive for lenders to handle all these small loans. Micro finance is generally provided by NGOs, cooperatives, state owned banks or public programs. Many micro financial

Figure 2 Median Interest Rates, micro finance



Source: Rosenberg R., Gonzales A., and Narain S., (2009).

organizations are supported by donors. Some try to grow and become sustainable, but they are often hindered by lack of formal banking knowledge.⁴⁰ Only 3-5 percent of the microfinance institutions are financially sustainable. In fact, USAID (2008) commented:

In order for financial institutions to reach economies of scale in Housing Micro Finance, they must have access to sophisticated physical, financial, and human resources – resources which Micro Finance Institutions typically do not have.

As with other kinds of financial institutions, they vary substantially around the globe. Africa has been described as the last frontier of micro-finance. The financial infrastructure is poor, especially south of the Sahara, and finance is expensive.⁴¹ In 2008, a project, Access Africa, was launched by the British organization CARE in order to create access to financial services for over 30 million people in the south of Africa. In contrast, in Peru micro finance is quite developed. The largest institution, Mibanco, has a special department for housing and may lend up to 5000\$. The yearly interest rate is very high though, 55%. Usually people borrow serially, i.e. the take many small loans, one after another.⁴²

Some micro finance institutions are purely financial and reach middle income people. Others offer technical assistance and/or social commitment. There is no water-tight border between

micro finance institutions and community based organizations. But in general, micro finance loans are individual whereas community based solutions are collective.

4.5 Community based organizations, CBO's

Collective solutions take as a starting point that poor people and their institutional habits are valuable assets and should therefore take part in or lead the process. As decisions are made by those who will be affected by them, problems with information asymmetry may be reduced. Most group lending is initiated by savings and they often reach very poor people. Group credits are often used to buy/secure land/tenure, or to build new or repair existing houses.

CBO's have many advantages; people work together, they buy land and invest in projects that would not have been possible for a single household to finance. CBO's are generally established in stable areas and demand a relatively strong local organization.⁴³ CBO's and mutual loans often improve social capital in a community. High levels of social capital have been connected with growth, less crime and corruption, better health and better institutional environments.

However, social capital theories have been criticized for ignoring that there are different kinds of networks and different roles within networks; all networking does not necessarily

³⁴ Ibid.

³⁵ Lerpold L., (2009).

³⁶ Tomlinson M., R., (2007).

³⁷ UN Habitat (2005).

³⁸ Mesarina N., and Stickney C., (2007).

³⁹ Senbet L. W., and Otchere I., (2005).

⁴⁰ Tomlinson M., R., (2007).

⁴¹ Helmore K., (2009).

⁴² Lea M., (2005).

⁴³ Mitlin D., (2007).

lead to progress as development within networks also depends on power, income, gender etc. Research has revealed that some aid projects entail large profits to local representatives. Misuse of power and corruption are prevalent in many developing countries, the correlation between GDP per capita and corruption is relatively high around the globe, also within housing finance. Also, it has been argued that the focus from donors and NGO's on poor self help groups caused governments to withdraw even more, and decrease their public interventions and support.⁴⁴

CBO's become more and more influential. SPARC is one example, working as an umbrella for many local groups. Slum/Shack Dwellers International, SDI, is another example, linking people from over 30 countries. Both of these organizations are based on decision making by the poor for the poor. By saving, the communities learn to plan their infrastructure, their housing situation and their entire future. Different groups in these networks learn from each other; they teach each other in financial matters, use of building materials etc. The repayment figures reported are impressive, especially when considering the extreme poverty most of the borrowers experience.⁴⁵ Even more impressive are their efforts to build public and private partnerships.

Research suggests that bottom up projects have potential; CBO's can lead to long lasting results, but support, networking and education are needed to sustain these effects. Egalitarian and transparent preferences are necessary prerequisites to create efficient and just allocation. Moreover, to scale up and establish long term results, it is important to connect these communities even more closely with private and public actors.

4.6 Remittances

Many emigrants and guest workers re-invest their salary in their original home countries. Remittances can be anything from some few coins carried in their pockets, to large sums sent by informal or formal channels to one's country of origin. The money is often sent to family or relatives and generally most remittances are sent during the first 10 years abroad.⁴⁶

The countries receiving the largest shares of their GDP are Tajikistan, Tonga and Moldavia.

However countries receiving the largest sums are India, China and Mexico. In the 19 countries that receive the most, remittances add up to more than 10% of their GDP. Around the globe, remittances are more than 3 times larger than official development aid; around 400 billion \$ per year. The flows are relatively stable and mainly informal.

Remittances have a price though; people must migrate, poor countries loose human capital. They may affect economies negatively if countries choose to wait for remittances rather than lead the way towards development; remittances cannot by themselves develop countries, they must be supported by good policies.⁴⁷

The number of formal mortgages based on remittances as collateral is low. Remittances are rather used to fund small improvements than for a whole house. Moreover, remittances meant for housing are reported to be used on other things as it may be difficult to decide ownership and/or obtain further loans. But there are examples of organizations that provide mortgages and insurance in order to complement remittances. Also a few micro finance organizations work with remittances as payment for houses.⁴⁸ To open up and use remittances as collateral and/or income can increase access to housing credits in developing markets.

5. A way forward

There are countless papers about development and growth. Parameters that are constantly repeated are various forms of capital; human, physical and social. Development is often driven by innovations and technological progress; results of a combination of capital. Studies also point to the importance of infrastructure. Stable economic circumstances and access to credit are important too, whereas large inequalities in wealth may worsen the situation. Studies reveal that institutions, i.e. structures and mechanisms that promote social order and cooperation, are major ingredients for success. Hence, it is relatively clear that some factors are correlated with growth and development. The ways ahead are nevertheless less straight forward. There is no straight macro-strategy for alleviating urban poverty.

Moreover, different factors and various forms of capital are often linked: To build a proper housing finance market, human, social and physical capital, good institutions, functioning infrastructure,

technological progress and stable credits are all needed. But, to find a recipe to improve social capital and promote prosperous institutions that lead to improved trust in and functioning of legal systems often seems to be complicated. Research points to good results from small and gradual changes that are grounded in institutions and behavior already existing locally.

Developing countries often suffer from a lack of several parameters and links that may lead to growth. A productive way to start an improvement is to map country specific difficulties such as the performance of governments, financial infrastructures, the legal system, as well as land markets. Next, the market for low and middle income households, those who cannot be reached by formal finance even if proper institutions are in place, can be analysed. As parameters differ between countries it is rather difficult to point to simple solutions, but some few common factors can be mentioned.

Several studies point to general institutional improvements, for example of the legal system, and more stringent roles and overview mechanisms.⁴⁹ Several actors suggest that improvement to state regulation is an important way forward; institutional reforms such as improved housing politics may make a difference. A common obstacle in many housing markets is the presence of laws and regulation that further worsen the situation.

When it comes to finance, housing and land, land registration may lead to improved formal finance and land markets. This may generate income from taxation, which can be used to improve services and infrastructure. To identify both formal and informal land may also improve land administration and make it more transparent and protect the poorest from eviction.

To gradually formalize informal land administration and informal finance may lead to long lasting effects. Market based finance must, both in formal and informal systems, be developed with care and together with land and housing markets. On the one hand, if financial support is provided in areas where housing supply is limited it will lead to increased house prices. On the other hand, if houses/ land are provided in areas where there is no access to financial support, poor people may need to sell the land and move to another area. Thus, housing and finance markets must be developed together.

⁴⁴ See Davis M., (2006).

⁴⁶ IMF (2009).

⁴⁸ Ibid.

⁴⁵ UN Habitat (2005).

⁴⁷ Saenz M., R., (2007).

⁴⁹ Cited in Tomlinson M., R., (2007).

5.1 Land administration chain

For a housing market to work, not only each specific area, but also the links between them must function smoothly. Therefore, the Swedish cadastral service, Lantmäteriet, and the Swedish National Housing Guarantee Board, BKN, have identified a Chain of Links – the *Land Administration Chain*. The chain includes mapping, planning, security of tenure, cadastral services, valuation and access to finance.

A program built on the elements in the Land Administration Chain is founded on the prerequisite of well functioning housing markets and it may provide a broad and workable plan for the future.

By analysing the parts of the chain, in informal and formal set ups, actors are able to map local settings, diagnose present institutions, and create tools and goals to analyse their own country and its challenges. The purpose is an improved recognition of the degree of functionality of the domestic structures and an increased understanding of the consequences of formal and informal systems. Thereafter actors can create country specific analyses, activities and goals based on the land administration chain. This will be achieved by mapping a specific country or locality.

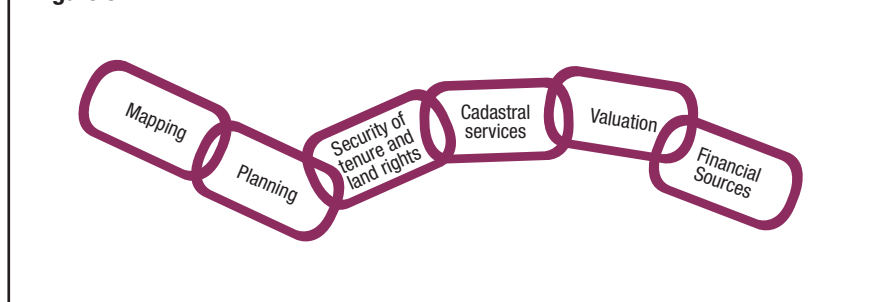
As a point of departure, different countries have different problems, goals and levels of cooperation. In some areas, remittances may be a promising tool to develop. In other areas, guarantees can play a larger role, etc. Finally, whatever way forward one chooses to take, it must include several players and markets.

6. Conclusion

For the first time in history, a majority of people live in urban areas. The urbanization process is especially rapid in many developing countries. Many growing cities cannot meet the needs of their inhabitants. To develop a well functioning housing finance system is difficult and time consuming, especially in developing countries marked by poverty, inequality, lack of institutions, good governance and financial infrastructure; countries where it is difficult to obtain mortgages and other loans. It is important to bring back housing finance onto the agenda. Having a home matters, both for individuals and to societies.

Due to lack of proper formal institutions, informal markets have developed. To gradually formalize informal markets in close coherence with existing institutions is one way forward. Land and housing markets are closely con-

Figure 3



nected and to obtain long lasting results, they should be developed together. Therefore two Swedish agencies provide a program aiming at creating better housing markets in developing countries.

The Millennium Development Goals include a target for improving the lives of 100 million slum Dwellers. To improve and construct that many homes demands radical changes and improvements. However the types of challenges differ between countries and regions. To map and analyse the functional ability of formal and informal systems already in place, the consequences of their operational approach and to perform systematic analyses of how to improve them, are important ways forward. To be able to map, it is vital not only to include public and private institutions, but also the poor who live in the slums. Across countries and regions around the world, the voices of those in need are often ignored or simply not listened to.

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