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HOUSING FINANCE INTERNATIONAL

The Quarterly Journal of the International Union for Housing Finance

- Housing bubbles and macro-prudential supervision: a case study from Japan in the 1980's and 90's
- Detecting house price bubbles: the UBS Swiss real estate bubble index
- Emerging issues in Bangladesh's housing sector
- The importance of ancillary services for residential mortgage borrowers in default in Sri Lanka
- Housing finance in Latin America: demographic and economic drivers
- Institutional challenges for lending organisations in the West African housing finance system

International Union for Housing Finance

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Editor's introduction

Double, double toil and trouble[1]

By Andrew Heywood

"London 'bubble' tested by £5 million price tag for seized flat in high-profile block."(Financial Times 11 September 2013). This front-page story in the UK's premier business newspaper is a timely reminder that the London housing market continues to diverge from that of the country as a whole. Between September 2007 when Northern Rock collapsed and June 2013 house prices in England and Wales fell 10.2% overall in spite of some recent gains. In London, by contrast, prices rose by 10.9% over the same period. The average house price in England and Wales is £163,000. The average price in London is £384,000.

The Financial Times story concerns the prestigious One Hyde Park development, where apartments fetch anything up to £140 million. The "entry level" flat was owned by a bankrupt Irish property developer and is expected to reach its full market value of around £5 million as a result of a sale caused by repossession.

The story is a reminder that fears of a property bubble in London have been growing of late and have been closely associated with the activity of overseas investors in the London residential market. Such buyers are believed to have invested over £7 billion in London in 2012. This sum is equivalent to 38% of the value of all mortgage loans for house purchase in London during that year.

Even leaving London aside the UK property market has been characterised by volatility for over 40 years, with peaks and troughs in prices in 1972-4, 1979-81, 1988-93 and peaked most recently in 2007, immediately before the onset of the banking crisis. The underlying cause of such volatility is a chronic shortage of new housing supply but immediate causes have included buyers reacting to planned changes to mortgage tax relief and an overheated mortgage market.

The UK is not alone in suffering the effects of market volatility. In the last decade Spain and Ireland have seen unsustainable price rises followed by steep falls. Taiwan introduced a tax to curb speculation in 2011 and China has very recently introduced a 20% tax on capital gains on residential property. Many other recent examples could be cited.

It is therefore timely that there are two articles concerned with house price bubbles in the current issue of HFI. Masahiro Kobayashi, offers a fascinating insight into the volatility of the Japanese housing market over three decades. His narrative begins in the 1980`s with the widespread popular perception that Japanese land prices could not decline because land was a scarce commodity. It culminates in the 15 year fall in prices that set in after 1990, which led to a collapse in confidence in land as an asset class. Kobayashi examines the responses of the US and Japanese prudential authorities to volatility in their respective jurisdictions and draws some important conclusions.

Switzerland does not feature frequently in the pages of HFI so it is particularly welcome that Matthias Holzhey of UBS has drawn on Swiss experience in his important article. Holzhey defines and characterises speculative behaviour and "bubbles" and goes on to set out the key features of the UBS Swiss real estate bubble index, which is intended to assess the likelihood of a housing bubble and which has generated significant interest inside and outside Switzerland. His analysis confirms the risk of a price correction in Switzerland and he goes on to outline some of the measures that the Swiss authorities have taken to address that risk.

Bangladesh is a country that suffers from a shortage of homes but which is simultaneously beset by a shortage of land for both agricultural and development purposes, creating a real risk that excessive low-density development could erode the capacity of the country to produce sufficient food. Dr Nurul Alam Talukder offers an excellent account of the development of the housing market in Bangladesh and provides an insightful analysis of the formidable challenges facing different stakeholders in that market.

As in Bangladesh, the majority of households in Sri Lanka have only very limited access to conventional housing finance institutions and there is a large informal sector within the housing market. There is also a large self-build sector funded by mortgage finance. DLPM Rathnasingha and Ali Khatabi, return to the pages of HFI to examine how mortgage lenders might assist self-build households to achieve success in building quality homes on time and within budget and help their own recovery rates in the process. After presenting some harrowing case studies, their conclusion is that lenders should extend their customer care beyond the simple provision of loans and be prepared to offer a range of ancillary services to borrowers that would, among other things, help them to build their financial capacity and achieve greater success in their self-build endeavours.

Latin America as a region has a population of around 500 million and 120 million inhabited homes. Its countries face major challenges in building enough homes for a population that has increased by 1.7 times in the last 30 years. In this issue of HFI Dr. Jorge Yarza offers an overview of the economic and social factors that drive the expansion of housing finance in the region. He analyses country initiatives aimed at building long-term institutions, developing the importance of housing and housing finance in the economy, using the housing sector as a driver for economic growth and promoting the development of competitive cities.

Finally the focus shifts to Africa. In their important article *institutional challenges for lending organisations in the West African housing finance system*, Basirat Oyalowo and Timothy Nubi examine the economic and institutional factors that constrain the activities of formal mortgage lenders in the West African region. They then go on to look at the conditions that would be necessary for an expansion of activity by those lending institutions.

All in all, this Autumn edition contains some fascinating and challenging articles that we hope many readers will find timely and relevant. Looking ahead, the Winter edition will include articles on Egypt, the private rented sector in Shanghai and housing privatisation in Europe.

[1] William Shakespeare, *Macbeth*

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Housing finance news from Africa: the AUHF conference in Mauritius

↳ By Oscar Mgaya, Secretary, African Union for Housing Finance

The African Union for Housing Finance held its 29th Conference and Annual General Meeting at the Sugar Beach Resort in Flic-en-Flac, Mauritius, from 11-13 September 2013. Hosted by AUHF member, the Mauritius Housing Company, the meeting attracted over one hundred delegates from over 20 countries across Africa and Europe. The theme of the conference was "Mobilising Capital for Housing Finance" – a key issue faced by housing finance practitioners across the continent. Conference presentations are available on the AUHF website: http://www.auhf.co.za/conference/mobilising-capital-for-housing-finance/

Africa's housing need is growing quickly, and demands much greater attention than it receives from policy makers and investors. UN Habitat reports that 46 African cities are now larger than one million people, and 17 of the world's 100 fastest growing cities are in Africa. These new urban residents all need housing, and as economies and incomes grow, there is a real business proposition in responding to this demand. Yet investment in housing remains limited compared with other forms of infrastructural investment, comprising only 9.6% of total capital invested in African infrastructure projects up to February 2013, and only 1.5% of total projects. Not only is housing investment dwarfed by investment in large-scale infrastructure projects such as energy production, transport and logistics, it also falls behind investment in commercial construction.

The Secretary of Finance in the Mauritian government, Mr Ali Mansoor, in his opening address, sketched the facilitative role government can play in unlocking housing development. He stressed that government should create the enabling environment for the private sector to play an optimal role in housing development and finance. He indicated that essential parts of such enabling environment are land rights, protection of property, provision of bulk infrastructure, and the development of appropriate underwriting mechanisms to address affordability and access.

Keynote speaker Richard Tait of Afrasia Corporate Finance estimated that if 20 million households in Sub Saharan Africa might afford at least a $50 000 mortgage, this could suggest a market potential of $1 trillion. Clearly, there is room for growth in Africa's mortgage markets.

The conference identified five areas where governments, the private sector, and development finance institutions should urgently focus, to enhance the performance of Africa's housing markets and improve their investment grade:

1. **Clarity of legal rights:** the investment of capital in housing markets depends on legal frameworks that confirm ownership or tenancy rights, and allow property to be used as collateral for access to credit. Sound planning frameworks that promote the growth of sustainable human settlements are a critical part of the enabling environment on which investment depends. Governments across Africa should streamline and prioritise their land titling and ownership legal frameworks in favour of effective housing markets.

2. **Serviced land for housing:** a key constraint facing housing developers in the delivery of housing at scale is access to serviced land for housing. Government can facilitate increased construction by making serviced land available to developers for specific target markets.

3. **Partnerships:** the complexity of the housing process makes partnerships a necessity. These need to be well structured, however, with each player taking a role appropriate to its own capacity. The role of government is to set an appropriate and enabling legal and regulatory framework, and to lead in the provision of serviced land for housing. Government can also provide legislative innovation and budgetary support for specific development objectives in the housing sector, such as VAT relief on newly constructed units sold to target market households. Full subsidization is not required, however, as financial institutions have the capacity and appetite to provide development capital, risk mitigation products and end user finance. Development Finance Institutions can provide additional capital, technical assistance and targeted risk sharing mechanisms. With the legal and financial framework in hand, developers can then drive the initiative with their development expertise, also taking part of the risk. Lastly, households themselves, have a variety of capacities to contribute towards the realization of their housing needs – whether financially or with their labour. Public private partnership arrangements are risk-sharing arrangements in which parties bring together their resources and use these collectively to realize the objectives of the project and effectively manage its risks.

4. **Affordability of formal housing:** with the majority of housing demand across Africa being expressed by first-time home seekers without equity, and with low incomes, only a fraction of households can afford the housing currently being delivered by the private sector. Innovative building systems, new technologies, and incremental construction approaches are all ways in which the cost of the housing product can be reduced to accommodate consumers in terms of affordability.

5. **Financial innovation:** the growth of the housing sector in Africa demands greater financial innovation that increases the capital available, whether for lenders, developers, or households themselves. Our capital markets are shallow and secondary markets are ineffective. A critical issue for attention by policy makers is the creation of an environment conducive to long term funding. For low income households, housing microfinance offers an important opportunity to finance housing on an incremental basis.

A further area of debate, relevant at a global level, was the impact of Basel 3 on mortgage lending in Africa. Mortgage markets in many African countries are in their infancy, and the bulk of demand is in the entry-level, lower value market. Lending is critical to the growth of sustainable human settlements, and also as a mechanism to control rising levels of inequality. The tighter capital and liquidity regulations imposed by Basel 3 could adversely affect economic growth and suppress the supply of mortgage loans, just at the time when housing finance is critically needed to support the sustainable and inclusive growth of African cities. It was agreed that international regulation must be responsive to local contexts, promoting growth, innovation and inclusive markets, while supporting long-term stability and consumer protection.

At its AGM, following the conference, the members of the AUHF confirmed their commitment to the development of sustainable housing finance markets that address the broad spectrum of needs in the countries and regions of Africa. The AUHF is keen to engage with national governments on both micro and macro-economic issues, including interest rates, tax and monetary policy, and housing and land policy as it influences the growth and performance of our housing markets.

HFI Editorial comment: the Winter 2013 issue of Housing Finance International will include articles based on presentations made at the AUHF conference as part of our drive to improve coverage of African housing finance markets within the journal.

Asia Pacific region: news update Q3, 2013

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

Afghanistan

The Central Bank of Afghanistan [DAB] is in the process of overseeing the establishment of a Credit Bureau with foreign technical assistance. It is hoped to have credit reporting live by end of October 2013. All commercial banks are involved in the process, and this initiative is welcomed in financial circles.

With IFC assistance Shore Bank Int'l, USA is preparing a comprehensive study of housing finance in Afghanistan. The study is expected to present a comprehensive overview of the sector, its challenges and the way-forward.

Progress is being made in setting up a collateral registry. Afghanistan appears to be the first country in the region to move in this direction, as was recognized recently at the IFC sponsored conference in Jordan.

An Appraisal Services Programme is also underway and it is hoped to start the training on property appraisal by end of current year.

The DAB is active in promoting Islamic banking in Afghanistan and is in the process of selecting a Sharia board for the purpose. On housing supply, the construction boom continues in Afghanistan, though currently serving high end buyers and focused mainly in Kabul.

India

Housing Price Index: NHB-Residex and RBI-HPI, besides providing a cross-check on house prices, facilitate a comparison between final market prices and registration prices. The latest NHB RESIDEX for the quarter January-March 2013 covers 26 cities, with the base year as 2007. The coverage of the cities is being gradually expanded to develop a representative all-India urban house price index.

To promote low income housing, India has introduced the Credit Risk Guarantee Trust for Low Income Housing [CRGTFLIH], which is being administered by the National Housing Bank [NHB]. The Reserve Bank of India [RBI] has taken some regulatory initiatives, which cover relaxed risk Weighting and provisioning requirements. Now loans for residential housing falling within commercial real estate projects will attract lower provisioning of 0.75% against 1% earlier as per an RBI directive on 21st June, 2013.

The Indian construction industry, which includes housing and townships, is continuing to receive foreign direct investment [FDI]. The FDI inflow into the construction sector, during the last quarter April-June 2013 was IRs 13. 3 billion, while for the whole year it was IRs 72.5 billion. The cumulative FDI inflow under this category since year 2000 is IRS 1,735 Billion.

The RBI eased norms for External Commercial Borrowings [ECBs] for affordable housing projects on 24th June, 2013. Developers and Builders with three years experience in undertaking residential projects will be eligible to raise funds through ECB route.

NHB, in partnership with KfW, Germany, is promoting energy efficiency in the housing sector. The Bank, in 2010-11, launched the Energy Efficient Housing Refinance Scheme [EEHRS], aimed at encouraging energy efficiency in the residential sector. The refinance assistance under the scheme is expected to improve the demand for energy efficient residential units. Since its launch in 2011, a total of IRs 2.3 billion has been disbursed under the programme.

The NHB also launched a Refinance Scheme for Installation of Solar Water Heating and Solar Lighting Equipment in Homes, to promote the use of solar energy. The newly launched scheme for is for solar equipment finance, and covers retail loans up to IRs 50,000.

As on June 30, 2013, the total number of Housing Finance Companies [HFCs] registered with the NHB stood at 57, of which 39 companies have been granted a certificate of registration without permission to accept public deposits. The NHB has advised HFCs to obtain a document containing the most important terms and conditions of a housing loan in all cases. This document will be in addition to the existing loan and security documents being obtained by the HFCs.

The Golden Jubilee Rural Housing Finance Scheme has been conceptualized to address the problem of rural housing through improved access to housing credit. It will enable an individual to build a modest new house or to improve or add to his old dwelling in rural areas. For the year 2013-2014, an annual target to finance 450,000 dwelling units has been fixed.

Some important events in the first quarter of 2013-14 were:

- The NHB-APMCHUD-APUHF International Conference from 11th-12th April, 2013 at New Delhi.
- The 35th CEOs' Conference for CEOs of HFCs, Senior Officials of Public Sector Banks [PSBs] and select Regional Rural Banks [RRBs] was held on 31st May, 2013 at New Delhi.
- The 1st stakeholders' meeting with respect to the New Energy Efficient Residential Housing Programme in collaboration with KfW was held on 6th May, 2013 at New Delhi.

- A national seminar on "Co-operative Housing: Problems and Prospects" was held on 14th June, 2013 at New Delhi.

Thailand

The Thai property market remains upbeat as the number of newly registered housing units continues to skyrocket. Another 125,000 new housing registrations are expected this year, a 15-year high. Amid concerns about a real estate glut, the Bank of Thailand recently cautioned developers to beware of over-supply, particularly of condominiums along sky train routes, and potential mortgage defaults by homebuyers.

To celebrate its 60th anniversary, GH Bank is conducting many Corporate Social Responsibility [CSR] activities and offering special financial products. Home buyers with 10 per cent down payments can now purchase non-performing assets [NPAs] from the Bank with zero per cent interest rate loans for one year. After the first year, they will be offered normal bank loan rates and terms. To encourage a wider-range of buyers, the Bank is also offering special loan programs for buyers who don't have enough ready-cash for down payments. This program especially helps middle-and-low income home buyers who haven't been able to save enough for down payments. These home-buyers will be able to pay the ten per cent down payment in 12 equally monthly payments during the first year after they buy the properties. No interest will be charged on loan payments or down payments during the first year.

Pakistan

During the last quarter, the housing finance market in Pakistan did not show any improvement in terms of the value of outstanding mortgage debt and the total number of borrowers.

The Central Bank of Pakistan [SBP] has set up a Housing Consultative Group, having representation from provincial governments, financial institutions and other key stakeholders. The objective of the group is to identify the impediments in the way of housing finance and their resolution. The first meeting of the group was held in April 2013.

The new Government, to follow up on its commitment to provide shelter to the homeless poor, has announced construction of at least, 1,000 clusters of 500 houses each for low-income families. These clusters will be developed through public-private partnership. These housing units will be developed on land to be provided by the Government, and plot size will be 100 square yards each. To facilitate this ambitious program a new five-year National Housing Policy is in the final stages of being drafted.

Bangladesh

The state-owned specialized housing finance institution, Bangladesh House Building Finance Corporation [BHBFC] is actively expanding its outreach to cover more districts in areas not yet served by BHBFC. A World Bank/IFC delegation has recently visited Bangladesh to explore expansion of its role in the housing sector of Bangladesh. Alongside meeting with concerned government officials, the delegation held meetings with financial institutions engaged in housing finance including BHBFC.

Europe: a shifting regulatory landscape

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

In mid-July, the European district in Brussels closes down for the summer. The European nerve-centre adapts to its host country Belgium during the ensuing period. Not only did the Parliament and Commission take a break but the European Court of Justice also gave its last judgment in mid-July. However, the quiet of summer should not obscure the fact that a hot autumn for the housing finance community is coming up.

This autumn the European Court of Justice will deal with a case (C-280/13) whether Spain's mortgage law is incompatible with a European directive on abusive practices in consumer contracts. It is indeed not only a Spanish affair because the judgement of the court might have an effect on well-established practices in almost every EU-country. In a nutshell, the court case discusses whether the lender's recovery in the case of a borrowers default is limited to the collateral at current value and the borrower has no additional liability if the bank acquires the property through foreclosure at a much lower price than that determined by the mortgage valuation.

If the European Court of Justice makes a judgement in favour of the borrower this might mean the introduction of the so called *datio in solutum* through the backdoor – for the whole European Union and not only for Spain. *Datio in solutum* refers to the mechanism of non-recourse mortgage loans, according to which the return of the property is sufficient to satisfy the outstanding debt, regardless of any shortfall between the value of the property and amount of the debt. Non-recourse loans are common practice in the United States, but they are typically not a feature of EU mortgage markets.

Policymakers in Europe seem to be keen to avoid foreclosures – an understandable desire given the drama of evictions in Spain which is playing out in public. The Financial Services User Group of the European Commission commissioned a study conducted by London Economics which examines potential solutions for this issue. The authors of the study suggest that *datio in solutum* might be a useful instrument – especially in countries where no, or no well-developed, debt cancellation system is in place. So far, this issue is still in the research phase but the political will is quite clear and the study is only one of a number of precursors to a proposal for either soft or hard law in the area of over-indebtedness at some future point.

However, it is very doubtful that a legal right to *datio in solutum* for mortgage credit is the "silver bullet" to handle the issue. Non-recourse loans at least contributed to the crisis in the United States and would have significant repercussions for lenders and inevitably potential borrowers. The latter can expect to see higher interest rate charges in place than would otherwise be the case and spreading the risk across the whole community of mortgage purchasers might encourage freeloading and create moral hazard on the side of the borrowers.

The European housing finance community will need to watch out for new developments in this area as there really is the potential for a sudden legislative shake-up that could undermine or even endanger the viability of the housing finance industry.

Another and even more current issue is the attempt of the European institutions to transfer the powers of the Single Supervisory Mechanism [SSM] to the European Central Bank [ECB] on the basis of Subsection 6 of Article 127 of the EU Treaty, although this article was not intended and is also not sufficient to serve as a legal basis for the transfer of banking supervision in the euro area to the ECB. In this context, it is worrisome that the ECB's Governing Council shall not only be responsible for monetary policy but also for critical supervisory decisions. It is difficult not to see a conflict of interest here as long as a dissociative identity disorder is not a necessary element of European Central Bankers' requirement profiles.

In addition to the SSM another cornerstone of the euro zone's banking union, the framework for a bank recovery and resolution mechanism, is gaining shape. Council, Commission and Parliament still need to come to terms but all proposals see the need to set up a Bank Resolution Fund [BRF] which will be built up by bank contributions over the course of 10 years. Although building up the BRF means that all credit institutions have to bear costs, there is some good news for specialised mortgage lenders. The proposal of the European Parliament recognises particular safe business models and requires that specialised and tightly supervised credit institutions make lower contributions to the BRF than those required of universal banks with riskier business models.

Now that the summer break has ended, negotiations and discussions will quickly return to their former level. Autumn is hotting up.

The U.S. considers life without Fannie and Freddie

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

The summer of 2013 has brought the U.S. two Bills in the Congress, one in the House and one in the Senate, at last addressing the long-festering problem of what to do with Fannie Mae and Freddie Mac: both propose an American housing finance sector without them. This would be a big change, since Fannie and Freddie are involved with about $5 trillion of the $10 trillion of U.S. first mortgage loans.

The Senate Bill, called after Senators Corker and Warner, who introduced it, is self-consciously bi-partisan, and sets out with impressive success to give the maximum number of relevant interest groups something they want. The House Bill, passed by the Financial Services Committee with almost all Republicans voting for and all Democrats voting against, focuses on bringing much more robust private markets to American housing finance.

The historical context of these Bills is critical: the American housing finance system has collapsed in disgrace twice in three decades, in the 1980s and again in the 2000s. This is a terrible record for the world's largest economy and largest housing finance market.

That we have perhaps learned something from these remarkable failures of former housing finance structures is suggested by the number of essential provisions that the two bills have in common:

1. Both Bills would end Fannie Mae and Freddie Mac as government-sponsored enterprises or "GSEs". Both have concluded that the fundamental GSE model, which means trying to pretend that you are simultaneously a private company and part of the government, and which results in privatized profits and socialized losses, is insidious and needs to be definitively terminated.

2. Both also understand that this large change must be phased in, so they phase out Fannie and Freddie over five to seven years.

3. Both understand that we must have much more private capital bearing the credit risk of the mortgage market, that is, more private "skin in the game" or "SITG". Both go in the same direction here, although the House Bill is better in that it goes further. I estimate that the House Bill would take the U.S. to a housing finance sector which would be about 80% private and 20% government—about the optimal mix, in my opinion. But both Bills unambiguously recognize that to have built a huge government-guaranteed system with so little SITG, as the U.S. did in the 1990s and then inflated into the bubble, was really stupid.

4. Both would end the "affordable housing goals" of the GSE system, and recognize that these "goals," actually lending quotas, were a mistake, just as the fundamental GSE structure was a mistake.

5. Both Bills propose, sensibly in my view, to use the Federal Home Loan Banks [FHLBs] as mortgage aggregators and securitizers for the small and mid-sized banks and credit unions, which in the U.S. banking system, number in the thousands. These institutions in general originate the highest credit quality mortgage loans. (I must confess that as the inventor of the FHLBs' mortgage programs, which are built on emphasizing originator SITG, I have a sentimental preference here.)

6. Neither of the Bills has the least interest in having the hedge funds, which have become speculative investors in the old preferred stock of Fannie and Freddie, rewarded by political action. As put in the form of a sharp-pointed rhetorical question by Senator Corker: Who would pay Fannie or Freddie a penny of fee to guarantee mortgages based on Fannie or Freddie's own financial merit, if the government were not completely propping them up? Correct answer: Nobody–not one penny.

A critical shortcoming of both Bills is that *neither* reflects an essential lesson of the housing bubble and collapse: the need for counter-cyclical standards which constrain the overleveraging of real estate in bubbly markets. The most efficient way to do this is by having counter-cyclical loan-to-value limits [CCLTVs], so that as house prices soar to unsustainable levels, the allowable leverage is reduced. CCLTVs will moderate both bubbles and busts, and both Bills would benefit from having this core concept added.

The most prominent difference between the two Bills is that the Senate Bill includes a full faith and credit government guarantee of mortgage-backed securities by a "Federal Mortgage Insurance Corporation". We can agree, as most observers do, that an explicit government guarantee with an explicit price is better than the implicit, but real, guarantee Fannie and Freddie got for free. So this proposal is better than and, in particular, more honest than, the former foolish claims that Fannie and Freddie were not really guaranteed by the government. But the taxpayer guarantee is still, in my opinion, unwise and unnecessary.

Proponents of the Bill argue for putting in this taxpayer risk as "balanced"–by which they mean it makes happy many parties who enjoy subsidies from such guarantees. Proponents also say the government guarantee is only for "catastrophes"–and point out the Bill's requirement that credit losses up to the first 10% of principal must be covered by private capital. This 10% SITG requirement is distinctly better than Fannie and Freddie. Nonetheless, the existence of such a government guarantee will cause excess debt and excess leverage to flow to real estate. It will create a lot of creditors who do not care if they are financing increased asset price inflation and increased systemic risk. It will thereby make the very catastrophes it is supposed to protect against instead more likely to occur.

Catastrophes in financial markets are not outside, exogenous events that just happen, beyond any human control, like hurricanes or earthquakes. Financial catastrophes are caused by human financial behavior–they are endogenous to the financial system. That is why so-called "100-year floods" in financial markets happen about once every ten years. The much discussed "tail risk" of financial markets is not an objective, stable parameter: it is created by optimistic financial behavior. As any credit-driven bubble inflates, the "tail risk" of a collapse finally becomes 100%. In short, government guarantees encourage catastrophe-causing financial behavior and increase the tail risk.

A second key difference between the Bills is that the House bill addresses the government's Federal Housing Administration [FHA], now struggling with possible insolvency, as a central part of the problem. It proposes the excellent idea of removing the FHA from the control of the political Department of Housing and Urban Development, and making it into a separate government financial corporation, with an arm's-length regulator.

The House Bill also provides for establishing the legal framework for an American covered bond market. Covered bonds would give the banking sector an additional alternative for long-term financing of mortgages, on a 100% SITG basis.

Overall, at this point we can say that in the intense politics of American housing finance, it is a good start to have Bills in both the House and Senate which agree on the main point of ending the disastrous political experiment of Fannie and Freddie.

Housing bubbles and macro-prudential supervision: a case study from Japan in 1980's and 90's[1]

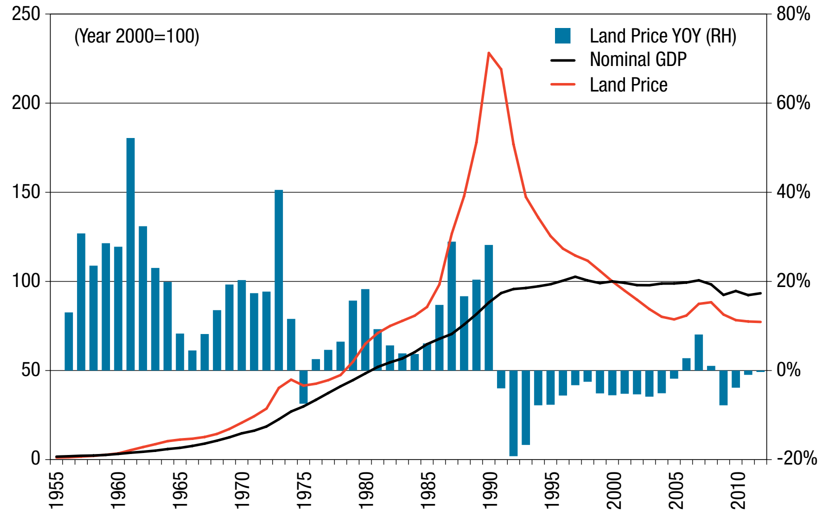
By Masahiro Kobayashi[2]

1. Introduction

There was a property bubble in Japan in the late 1980's to the early 1990's. Before the collapse of the bubble, people believed that land prices in Japan would not decline as land was a scarce resource. After the collapse of the bubble, people lost confidence in this asset class and the Japanese economy experienced "lost decades". (See Figure 1)

The trajectory of the US housing bubble from 2000 on seems to be almost identical to that of Japan from 1985 on. Some of the indicators, such as per square meter price of Condominium in Tokyo Metropolitan Area or land prices in 6 major cities in Japan, measured from 1985 on, show a similar trend as the housing prices in the US from 2000 on. Question: Will the US face "lost decades" like Japan? Or if not, what makes the difference? (See Figure 2)

Figure 1 Nominal GDP, Land Price and its year-over-year changes



Source: Cabinet Office, Japan Real Estate Institute

2. Monetary policy

Apparently, there seems to be some differences in the reaction of the two countries. The first point is the different monetary policy reaction to the bubbles. Before the bubble formation stage, the Bank of Japan [BOJ] kept the then-lowest policy rate twice as long as the Federal Reserve [Fed] in the early 2000's. The horizontal axis in Figure 3 represents days elapsed since the beginning of the monetary accommodation both in Japan and the US. In contrast to that, monetary easing by the BOJ was not as rapid as by the Fed after the collapse of asset bubbles. Monetary accommodation by the Fed was more aggressive than the BOJ because the US learned a lot from Japanese experience.

The BOJ maintained the discount rate at 2.50% from February 1987 to May 1989 because:

1) there was a need to take an accommodative monetary policy after the rapid appreciation of the Japanese Yen against the US Dollar initiated by Plaza Accord in 1985 and,

2) The Consumer Price Index [CPI] remained stable during that period and there was no fear of inflation. There was a plea from the export industries for the BOJ to take actions to alleviate their pains. The value of the Japanese Yen almost doubled relative to the US Dollar within 3 years. (See Figure 4)

[1] As prepared for 28th IUHF World Congress on June 6, 2013 in Vienna.

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

While the BOJ maintained the discount rate at 2.50% until May 1989, stock prices increased. The stock market recorded its peak in Dec 1989, but house prices continued to rise through 1991. Despite the stock market crash after 1990, the BOJ maintained the discount rate at 6.00% until Jul 1991 to curb housing bubble. (See Figure 5)

3. Not affordable, but available

Why did house prices continue to rise even after the raising of the discount rate? It was because monetary conditions were still accommodative in term of quantity. As for the exit strategy from monetary accommodation, the consensus of today is first to contract the balance sheet and then raise the policy interest rate. But the BOJ in those days did the opposite.

While the BOJ started to raise the discount rate in May 1989, the BOJ continued to increase the monetary base. The annual growth rate of the monetary base remained in double digit percentage points through mid-1990. In a sense, money to speculate was not affordable anymore, but it was available. (See Figure 6)

The policy reaction by the BOJ was retroactive rather than proactive. We often hear the phrase, "in retrospect", but our experience tells the importance of forward looking policy formation.

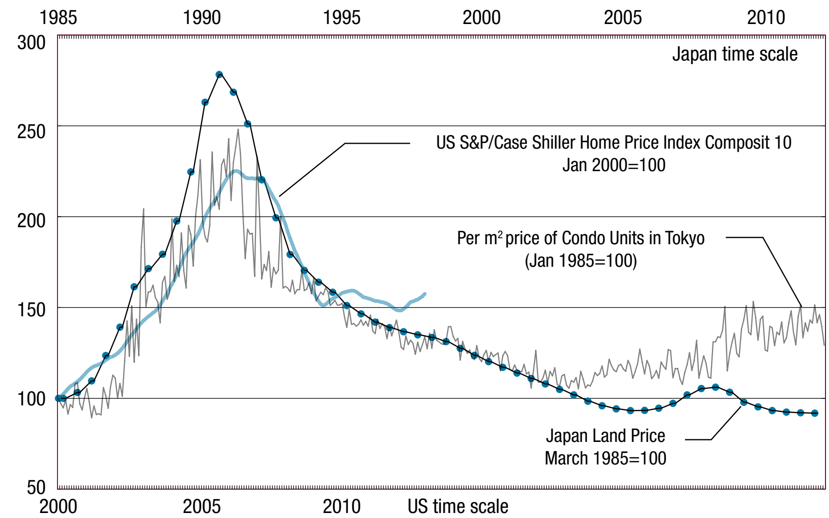
So, availability, rather than affordability, of funds seems to matter in the formation of housing bubbles. US housing bubble grew even after Fed raised Federal Fund Rate in 2004.

Then, who provided liquidity to mortgage markets? Chairman Bernanke attributed the cause of the US housing bubble to international capital flow. He blamed global imbalance as one of the causes of the U.S. housing bubble. He mentioned that countries in which current accounts worsened and capital inflows rose had greater house price appreciation. (See Figure 7) In the Japan of the late 1980's, however, the current account was in surplus during the bubble economy. The "global savings glut" hypothesis does not work here. (See Figure 8)

The housing bubble and the involvement of government financial institutions [GFIs] are also often discussed. This is very controversial topic.

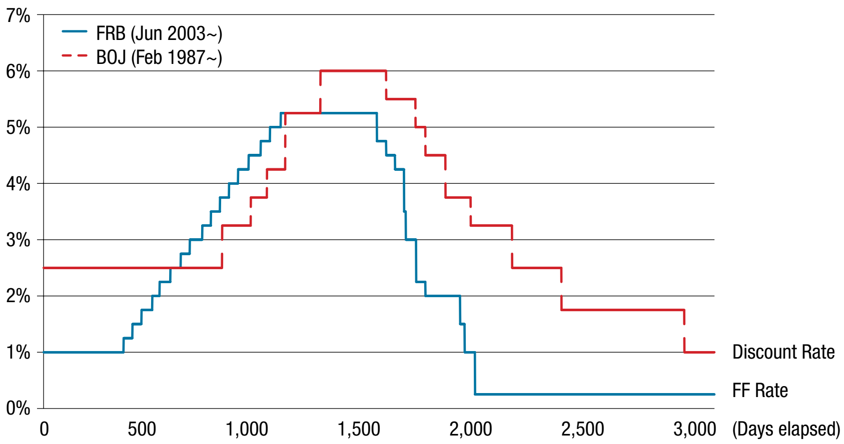
In the US, the share of agency and GSE's (Fannie Mae, Freddie Mac, Ginnie Mae and FHLB combined) in the mortgage market declined during the boom period of the mid 2000's. (See Figure 9) The same was the case for GHLC of Japan in late 1980's. (See Figure 10) The share of these agencies increased after the collapse of the housing bubble. They addressed housing market corrections and acted counter-cyclically, rather than pro-cyclically.

Figure 2 Bubbles in Japan (Starting 1985) and US (Starting 2000)



Source: Standard and Poor's, Real Estate Economic Institute, Co. Ltd, Japan Real Estate Institute

Figure 3 Policy rate in Japan and US



Source: Federal Reserve, Bank of Japan

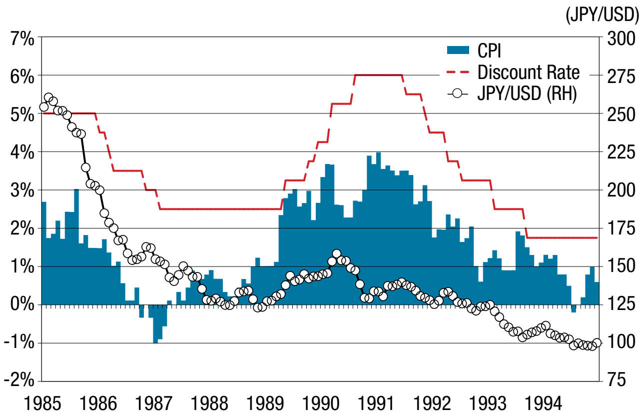
Next, what type of financial instruments contributed to the formation of housing bubbles? Deviation of mortgage debt growth from historical trend is one of the factors indicating a housing bubble from a macro-prudential perspective.

In the US, there was a rapid credit expansion during the housing bubble in the early 2000's. There was no similar movement in Japan during the bubble in the 1980's so far as mortgage debt is concerned. (See Figure 11) However, there is a strong correlation between bank lending and real land price. This is so because the bubble in Japan was initiated by speculation by non-financial corporations, to which banks extended commercial loans, not mortgages. (See Figure 12)

4. Demographics

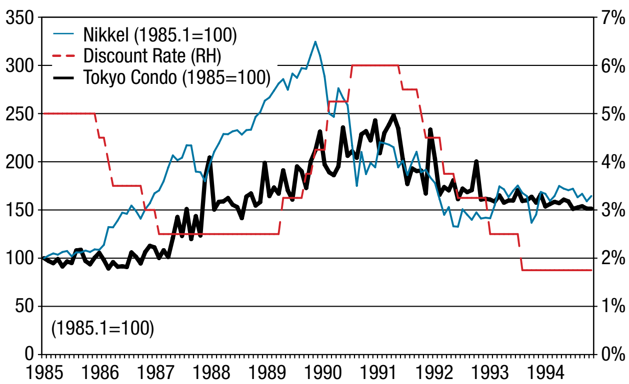
Another important factor affecting housing markets is demographics. Especially in Japan,

Figure 4 Discount rate, CPI and foreign exchange rate



Source: FRB, BOJ, Ministry of Internal Affairs and Communications

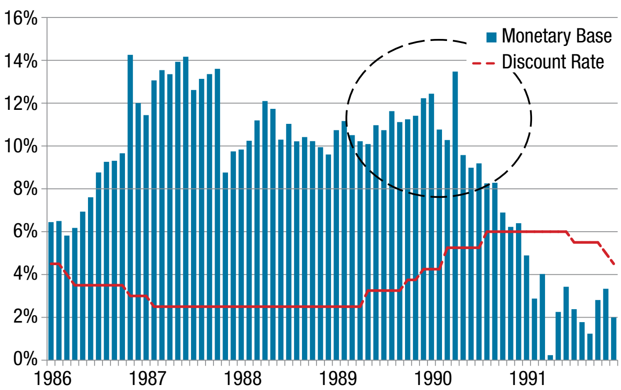
Figure 5 Discount Rate, stock bubble and housing bubble



1983/10/22	5.00%	**1989/5/31**	3.25%
1986/1/30	4.50%	**1989/10/11**	3.75%
1986/3/10	4.00%	**1989/12/25**	4.25%
1986/4/21	3.50%	**1990/3/20**	5.25%
1986/11/1	3.00%	**1990/8/30**	6.00%
1987/2/23	2.50%	**1991/7/1**	5.50%

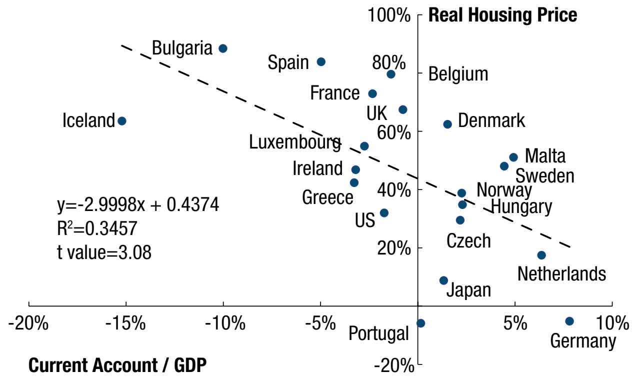
Source: Nikkei, Real Estate Economic Institute, Co. Ltd, BOJ

Figure 6 Discount rate and monetary base growth (YoY)



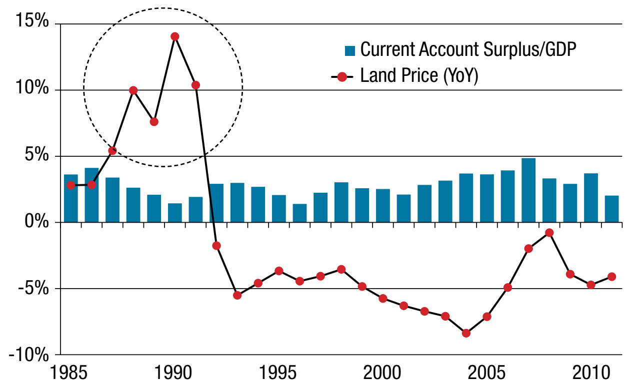
Source: BOJ

Figure 7 Current Account /GDP and real House prices (2000-2006)



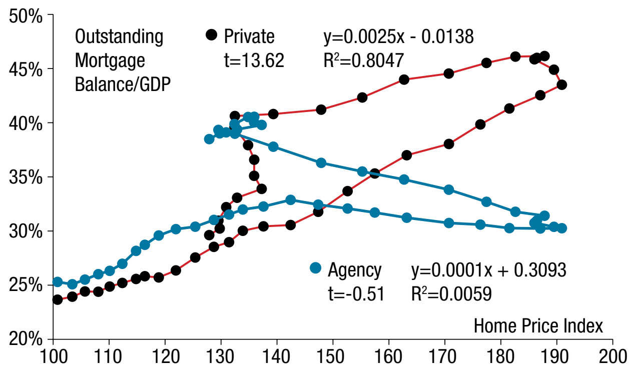
Source: European Mortgage Federation, IMF, FHFA and Real Estate Economic Institute, Co, Ltd.

Figure 8 Current accounts /GDP and land prices in Japan



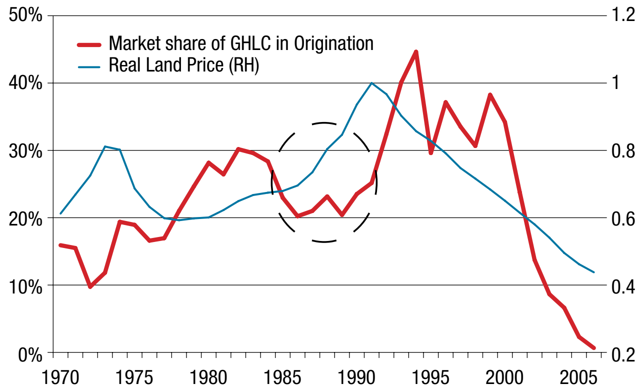
Source: Ministry of Finance, Cabinet Office, and Japan Real Estate Institute

Figure 9 US house prices and mortgage balances



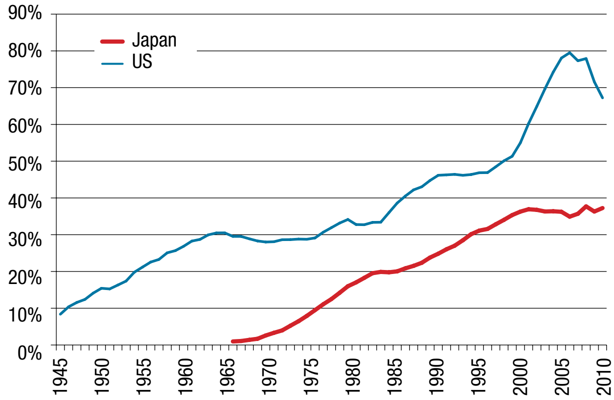
Source: Standard and Poor's, FRB

Figure 10 Japanese land price and mortgage activity



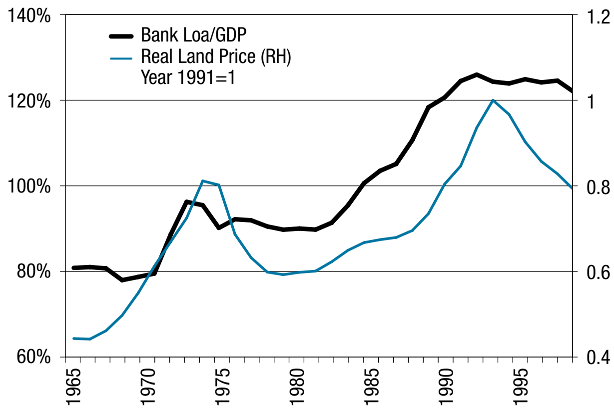
Source: Japan Real Estate Institute, GHLC and JHF

Figure 11 Mortgage Debt Outstanding as percentage of Nominal GDP



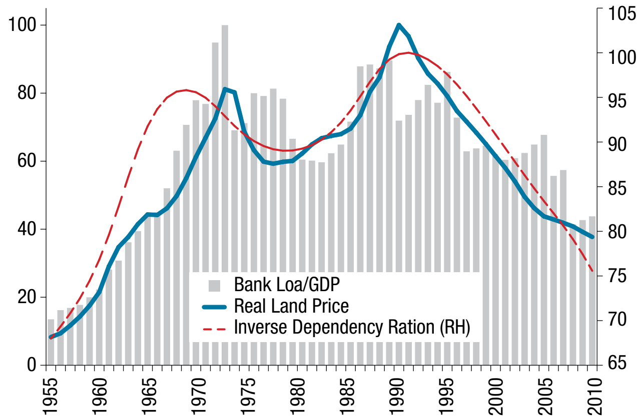
Source: FRB, US Department of Commerce, Cabinet Office and JHF

Figure 12 Bank lending outstanding as percentage of nominal GDP and real land Prices in Japan



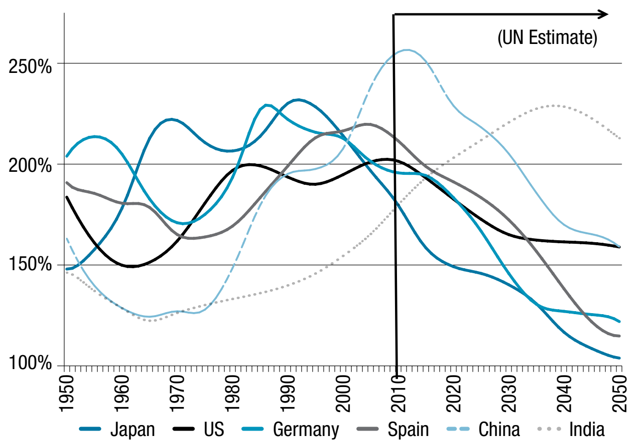
Source: Bank of Japan, Cabinet Office

Figure 13 Number of housing starts, real land prices and inverse dependency ratio (Highest level for each is indexed to be 100)



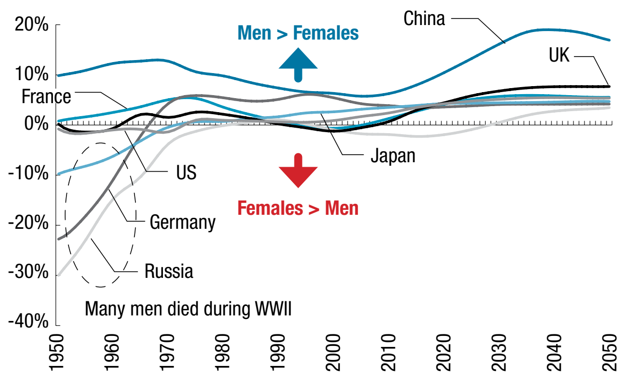
Source: Ministry of Land, Infrastructure, Transport and Tourism, Ministry of Internal Affairs and Communications, Japan Real Estate Institute, and United Nations, Department of Economic and Social Affairs, Population Division. World Population Prospects: The 2010 Revision (June 2011)

Figure 14 Inverse dependency ratio in several major economies



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

Figure 15 Percentage of men less females aged 20-44



Source: As Chart 11

the inverse dependency ratio (population aged 15-64 divided by dependent age population) has a strong correlation with housing prices and with the number of housing starts. The peaks of the inverse dependency ratio, or population bonus period, coincide with the housing boom in Japan. The Japanese population is declining and aging, a trend of which it seems to be almost impossible to change. (See Figure 13)

Japanese people were very pessimistic on the future of their housing markets and economy as a whole, until last year.

If the population bonus was the strongest driver of housing bubbles, we would not have to discuss housing bubbles in many countries. The inverse dependency ratio is expected to decline in many major economies. (See Figure 14) Does this mean that there will be no property bubbles in those countries? Maybe the answer is "NO".

China introduced the one child policy in 1979 which has impacted on the demographic composition not only in terms of generation but also in term of gender. Some of the negative impact may be partly offset by traditional, cultural factors, but we are not sure. We have to closely monitor the development of these imbalances. (See Figure 15)

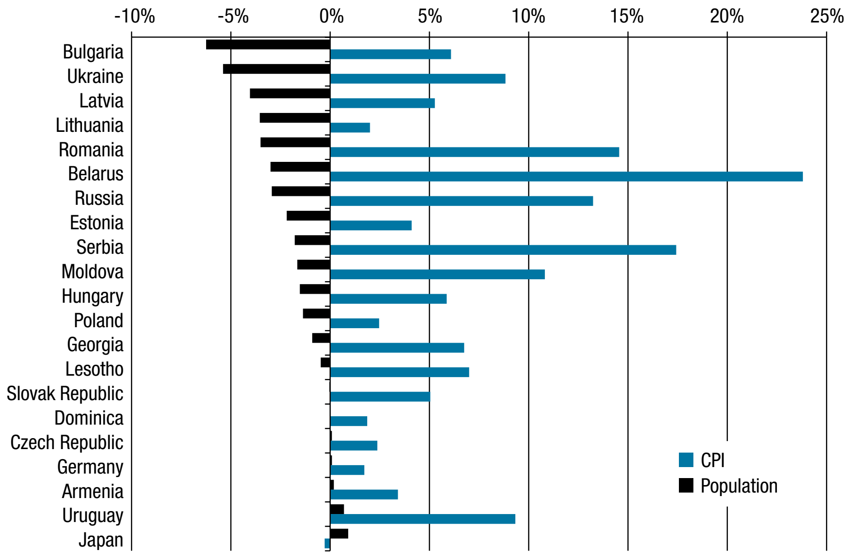
Although there is no doubt that demographics are one of the major fundamentals in the housing market, we should not overestimate their impact, but not underestimate it either. Many people in Japan believe that deflation is the result of declining population, but international comparison reveals that such a belief is wrong.

There are 20 countries whose population growth rate from 2000 to 2007 (before the financial crisis) was lower than in Japan, 15 of which had negative growth. None of them recorded negative growth in the CPI during the same period. (See Figure 16)

Japan recorded the largest decline in inverse dependency ratio during 2000 to 2007. However, there are 18 other countries which recorded negative growth in the same index, none of which faced deflation. (See Figure 17)

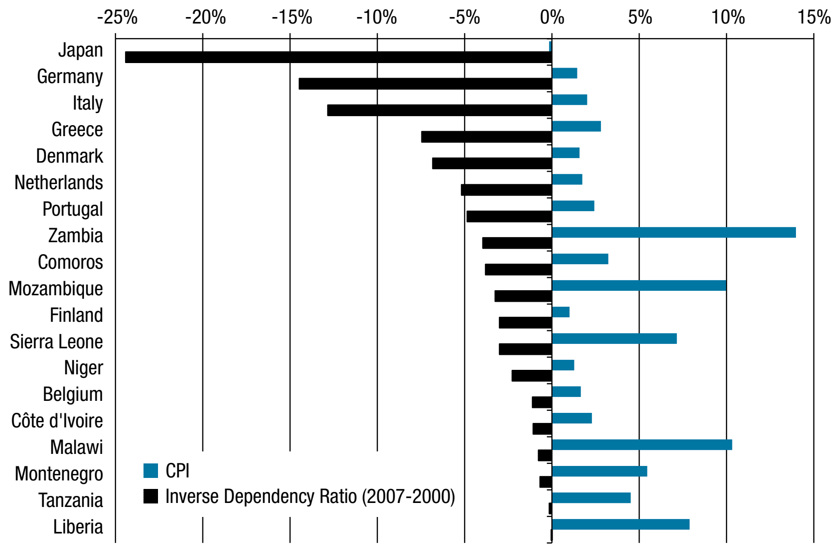
Japan is undertaking a social experiment to judge if the major cause of the deflation is demographic factors or monetary policy. On April 4, 2013, the BOJ announced the introduction of the "Quantitative and Qualitative Monetary Easing" to double the monetary base as well as to double the average remaining maturity of Japanese Government Bond [JGB] purchases in two years.

Figure 16 Annualized growth rate of population and CPI (2000-2007)



Source: Standard and Poor's, Real Estate Economic Institute, Co. Ltd, Japan Real Estate Institute

Figure 17 Inverse Dependency Ratio and CPI (2000-2007)



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

Compared to the level just before the Lehman Collapse, the BOJ is likely to catch up the pace of the FRB. (See Figure 18)

With an expectation that Japan will finally get out of deflation, capital markets have been picking up. Even before the announcement of the BOJ's new policy, the stock market and foreign exchange market started to rally, but the rally was accelerated because of the unexpectedly aggressive stance of the BOJ to get out of deflation. So far, this rally is thought to be an adjustment to the depressed prices rather than a bubble. (See Figure 19 and Figure 20)

In these couple of weeks, Abenomics is facing some turbulence in the market. As the largest issuer of MBS in Japan, we are closely monitoring the market conditions.

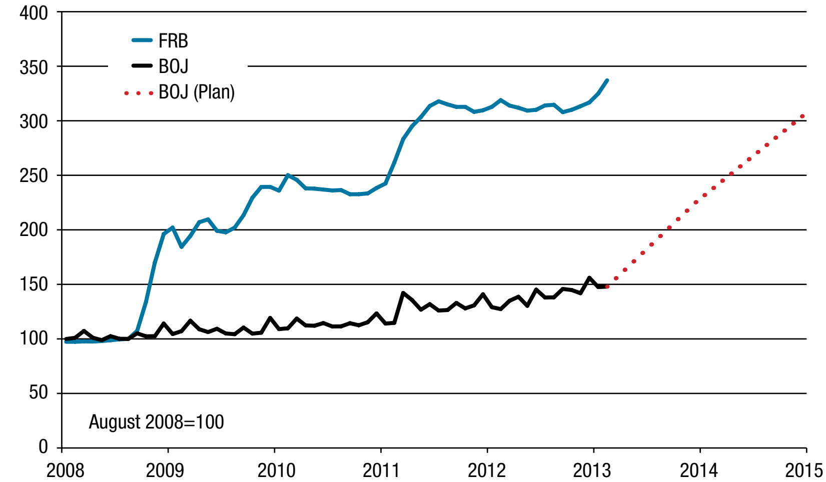
5. Conclusion

1. It is not easy to detect bubbles in real time. Even if there were some indications, there is no threshold to judge if it is a bubble or just froth. The development of a comparative house price database at an international level would be helpful to statistically measure the deviation from the norm, but local nature of housing markets makes it a challenging undertaking.

2. The primary objective of monetary policy is price stability in many jurisdictions. However, considering the aftermath of collapsing bubbles in property markets, more attention should be paid to the property markets. Policy reaction to property bubbles tends to be delayed as was the case both in Japan and the US. Policy makers should take proactive approaches rather than retroactive approaches. In order to enhance the accuracy of macro-prudential policy, the collaboration of the mortgage industry with central bankers and other regulators should be encouraged.

3. Housing bubbles may be accompanied by bubbles in other markets, including the stock market. If there are separate movements in house prices and stock prices, it remains debatable which market the policy makers should focus on. Also, it is to be noted that monetary policy tools which address property bubbles need to be clearly identified. If various tools move in different directions, it might confuse the market participants and result in unintended consequences. In my view, quantity (availability) of funds matters more than quality (affordability) of funds.

Figure 18 Monetary base in the US and Japan after the Lehman shock



Source: BOJ, FRB

Figure 19 Foreign exchange rate (JPY/USD)

Source: FRB

Figure 20 Stock market (Nikkei 225)

Source: Nikkei

Detecting house price bubbles: the UBS Swiss real estate bubble index

By Matthias Holzhey

1. Introduction

Real estate bubbles pose a substantial risk for national economies. In recent history Spain and Ireland provide the most dramatic examples. In both countries house prices more than doubled in real terms since 1996, with double-digit yearly growth rates being the norm rather than the exception.

In 2006 it became evident that those housing markets were overvalued. The bubble burst as a consequence in 2007 and prices have declined on average more than 30% since then, with severe consequences for households, banks and the construction sector. In both countries strong economic fundamentals triggered the real estate price boom. But at some point price expectations of market participants became over-optimistic, which led to the formation of a bubble. The same pattern has been seen repeatedly.

In the 19th century, fear of increasing scarcity of land in Southern California prompted a real estate price boom followed by a bubble. What the low interest rate environment and the European common market were for Ireland and Spain, the completion of a new transcontinental railroad line and other infrastructure projects were for Southern California. Those fuelled the local labor market and attracted immigrants (see [Guinn 1890] for an account of the period). Given that California had only 864,000 inhabitants in 1880 and today close to fifty times as many, the land shortage story sounds a bit far-fetched. Nevertheless both periods can serve as examples of how difficult it is to distinguish between fundamentally justified (supported by economic fundamentals) and speculatively driven price changes. It is therefore not surprising that most price bubbles in history were not detected until after they burst.

Switzerland has exhibited increasing real estate prices since 1998, although the country did not participate in the excessive price boom from 2003 to 2007. Consequently, Switzerland did not face any price correction, but instead has had among the strongest growth in prices of all European countries since 2008. Demand was strongly stimulated by high numbers of immigrants – free movement of persons agreed with the European Union came into force in 2007 – and interest rates falling close to zero. As a result residential real estate prices have more than doubled in many areas within a decade. Given the recent experience of bursting housing bubbles, such price growth gave cause for concern. The Swiss National Bank started worrying that in the wake of fundamentally driven price growth a real estate bubble might develop. Due to high uncertainty about the situation of the real estate market, UBS CIO Wealth Management Research developed the UBS Swiss Real Estate Bubble Index in May 2011 to quantify the risk of a real estate bubble.

2. Definitions

There is no comprehensive and operational definition of price bubbles in economics.

There are purely descriptive definitions such as that of Kindleberger [1996], "… a bubble is an upward price movement over an extended range that then implodes." Other more analytic approaches include Stiglitz [1990], "… when fundamental factors do not seem to justify such a price – then a bubble exists." Or Smith and Smith [2006] similarly, "What truly defines a bubble is that market prices are not justified by assets' anticipated cash flows." In general, real estate bubbles develop out of unsustainable price behavior expectations on the part of market participants. Over-optimistic or speculative attitudes regarding market fundamentals play a role. As purely chart-technical views are only empirical statements about a price movement, bubbles are defined from an analytical point of view as a deviation of the market price from the fundamental value of an investment driven by speculative demand.

To identify the bubble it is therefore necessary to estimate the fundamental price level and to differentiate between speculative and non-speculative demand. Given the complexity of the phenomenon, the term "speculative" should be interpreted rather broadly. In my view the three most important elements contributing to speculative demand and acting as catalysts for price bubbles are:

- The first element is what is called "monkey see, monkey do" behavior of market participants. Herd behavior and greater fool thinking – buying something, with the assumption of being able to sell it later to "a greater fool" - are well documented phenomena in the economic literature. Their impact on stock market and housing bubbles are extensively described by Shiller [2005]. Typical signs are increased transaction frequencies and a surge of market entrants participating in the market at a late stage of the boom.
- A second element is money illusion. Money illusion can generate house price changes without changes in economic fundamentals. Money illusion is defined as the missing distinction between nominal and real interest rates. For example, if people attribute a decrease in inflation to a decline in real interest rates, they underestimate the real future mortgage costs. . Simply put, people forget that inflation helps them to reduce their debt. Hence, a reduction in inflation can result in higher housing demand. Brunnermeier and Julliard [2007] showed that inflation

and nominal interest rates (instead of real interest rates) explained a large share of the time series variation of the mispricing in the UK real estate market. They emphasized that the phenomenon is of special importance in times of low inflation. During high inflation periods people are more attentive to the costs of inflation. In the current environment of low inflation and depressed interest rates, money illusion seems to be an important contribution to the development of mispricing and price bubbles.

- A third element for the formation of a price bubble is a prior period of increased uncertainty about the fundamental value of the real estate investment. Such uncertainty can arise through structural change in market conditions, e.g. a surge of immigration, new tax regimes or persistently improved credit availability. As short selling constraints prohibit pessimists from correcting mispricing, the optimists gain the upper hand and prices increase more strongly than fundamentally justified.

Even though these elements are not conclusive, necessary conditions for the formation of mispricing, they played a central role in the formation of price bubbles in the past and should be taken into account for their detection.

3. Detecting housing bubbles

The easiest way to identify a bubble is when it bursts, which is obviously not a useful approach for regulators or most market participants. Unfortunately it is hard to identify a real estate bubble in its early stages, but there are numerous approaches to identifying a price bubble. Methods [Rombus 2011] can be grouped as follows:

- The first approach is to look at bubble formation from a purely chart-technical perspective. The concept is to identify the bubble through its price path, i.e. exponential price growth would be a typical sign of a bubble.
- The second approach looks for differences between the actual and the fundamental price level. The fundamental price level is thereby usually identified by looking at long-term averages of price-to-rent or price-to-income ratios or by estimating the deviation from the equilibrium value using error correction models.
- The third approach is to focus on behavioral aspects – speculative behavior and over-optimistic expectations – of a price bubble. A behavioral study of market participants usually relies on survey data. As the availability of such data is rather limited, such studies are not very common.

In practice most studies focus on the second approach, i.e. try to identify a bubble from a fundamental perspective.

3.1 Does fundamental analysis work?

The Economic Outlook 2005 [OECD 2005] from the OECD gave an extensive literature review of the empirical housing-bubble literature. I summarized the findings for each country to give a qualitative assessment of the results taking into account the ambiguity of the studies for each country. Accordingly the countries are grouped for the year 2005 in three categories: not overvalued[1], weakly overvalued[2] and strongly overvalued[3].

If the studies indicated that a real estate market was not overvalued, then in most cases prices increased further or remained stable. Only in Italy and Japan were real estate prices lower in real terms in 2012 than in 2005 (minus 8% for Italy, minus 12% for Japan). If the studies showed that a market was weakly overvalued (also in the sense that results were not unambiguous), then the predictions were on average not reliable to forecast the price path in the following years. In the US the market was more strongly overvalued than predicted (resulting in a price decline of 17%), while in Norway and Sweden real estate markets continued their boom with real price growth between 30% and 40% since 2005. Finally, markets which were indicated as being clearly overvalued in 2005 experienced, in most cases, strong price declines in the following years. For example, Ireland was already clearly overvalued in 2005. Although prices increased another 21% before the market collapsed in 2008, prices dropped 37% up to 2012. The only exception is Australia, where real estate prices did not decline, but increased another 17% overall.

Table 1

Analysed countries	Bewertung in OECD 2005*	Real price development		Ex-post analysis
		till peak	Since peak	
USA		8.7%	-25.4%	X
Japan		-1.1%	-12.1%	X
Germany		-0.4%	-3.9%	V
France		20.9%	-3.5%	V
Italy		9.4%	-17.0%	X
UK		13.8%	-16.5%	V
Canada		46.6%	0.0%	V
Australia		25.3%	-8.3%	X
Denmark		33.6%	-28.5%	X
Finland		14.7%	-5.5%	V
Ireland		21.6%	-36.9%	V
Korea		13.8%	-1.3%	V
Netherlands		7.9%	-16.4%	V
Norway		41.0%	0.0%	X
New Zealand		23.3%	-12.3%	V
Spain		12.7%	-29.5%	V
Sweden		34.2%	-5.7%	X
Switzerland		25.0%	0.0%	V

Not overvalued Slightly overvalued Significantly overvalued X: Miss V: Hit

[1] Germany, France, Italy, Japan, Switzerland, Canada, Denmark, Finland, Korea, New Zealand.
[2] US, Norway, Sweden.
[3] Britain, Australia, Ireland, Spain and Netherlands

Overall the findings confirm the assumption that it is difficult to find economic fundamentals that enable prediction of whether a boom will turn into a bust or not. But studies based on economic fundamentals could at least forecast correctly the bust of the two most severe housing bubbles in Ireland and Spain. Note that the approach seems to fail in cases where the real estate market is accompanied by strong and ongoing growth in fundamentals, notably in Sweden and in Norway.

Table 2: Indicator system of the UBS Swiss Real Estate Bubble Index

Owner-occupied housing prices in consumer prices
Ratio owner-occupied housing prices and rental costs
Ratio owner-occupied housing prices and household income
Loan applications (UBS) for buy-to-let properties
Outstanding mortgages to income
Construction volume to GDP

4. The UBS Swiss Real Estate Bubble Index

UBS CIO Wealth Management Research launched the Swiss Real Estate Bubble Index in May 2011. The index is designed to measure and transparently quantify the risk of a real estate bubble in Switzerland.

Given the mixed results in the empirical literature regarding purely fundamental bubble analysis in economically comparable countries such as Norway and Sweden, we used a broader indicator-based approach: The UBS Swiss Real Estate Bubble Index is comprised of six sub-indicators, so that each sub-indicator tracks deviations from the long-term norm for the Swiss real estate market. In line with above arguments the sub-indicators identify a bubble either from a chart-technical, fundamental or behavioral perspective. The sub-indicators are summarized in table 2.

The rationale of the first sub-indicator – owner-occupied house prices relative to consumer prices – is that from a chart technical perspective a bubble is characterized by exponential growth in real house prices. At the same time there is strong evidence [Eichholtz 1997] that in the very long run real estate appreciates only marginally in value. Price levels above the long-term trend are therefore always a first indication of a price bubble.

The ratios of price-to-household incomes and to annual rents directly measure the deviation of prices from their fundamental value. Both are widely accepted measures of mispricing on the housing market. Nevertheless it is important to be aware, that both measures have to be carefully interpreted on a standalone basis. The price-to-rent ratio can be distorted because of the peculiarities of the rental law, e.g. in Switzerland rents are linked to the nominal interest rate level. And the price-to-income ratio is problematic as its equilibrium (or fair) value can change over time. Hence, the empirical link between income and house prices is rather weak and can be misleading. For example, Gallin [2003] rejects the hypothesis of co-integration of income and prices using panel data of US regions.

In addition the behavioral perspective is also taken into account. We measure the change of credit applications for residential income property. This sub-indicator tracks demand for real estate as an investment and serves as a proxy for speculative demand.

Those four direct indicators are supplemented by more indirect measures. So we look at the construction volume-to-GDP and at outstanding mortgage volumes-to-disposable household income ratios. Both are measures which typically display strong increases in times of real estate bubbles and give an indication of the risks of a bubble to the overall economy.

The index calculation starts in 1980. We assume that sub-indicators are mean reverting in the long run. The indicators are consequently interpreted relative to their long-term average. The weights of the sub-indicators in the bubble index are given by a principal component analysis. As a test exercise, the bubble index successfully identified the Swiss real estate bubble at the end of the 1980s.

Despite – or perhaps because of – the complexity of the question, the UBS Swiss Real Estate Bubble Index utilizes a very simple risk-based level system. For values below –1, the market is in the slump-zone, for values between –1 and 0 in the balance-zone, for values between 0 and 1 in the boom-zone, between 1 and 2 in the risk-zone and for values bigger 2 in the bubble-zone. At current levels the index stands at 1.2 standard deviations above the mean in the risk zone, indicating an elevated risk of a Switzerland wide correction.

5. Cautionary measures in Switzerland

As a consequence of unabated house price increases and the ever higher mortgage indebtedness of households, Switzerland experienced several regulatory interventions in the housing market. The regulations were mostly designed to make the banking system more resilient in case of a strong price correction. Most notable on the one hand, are new guidelines regarding minimum requirements for mortgage lending introduced in July 2012, and on the other, a countercyclical capital buffer which is valid from October 2013. The new guidelines determine (1) a minimum share of own equity on the collateral value of 10%, which is not allowed to come from pension funds savings and, (2) that the mortgage debt must be reduced in at least 20 years to 2/3 of the initial collateral value. Especially the first rule is a binding constraint for low-wealth households according to widespread market rumors.

In addition the banks are obliged to hold a counter-cyclical capital buffer amounting to 1% of their risk-weighted, direct or indirect mortgage-backed positions secured by residential property in Switzerland. As a result, the banking industry will need to hold additional equity capital in the amount of roughly CHF 2 billion. At a constant return on equity, new mortgages will become more expensive by 3–5 basis points. Hence it seems doubtful if the buffer will have a significant cooling effect on the housing market. But it may make banks more risk aware, as well as making new exception-to-policy lending less profitable.

These measures are not sufficient to prevent the formation of a housing bubble but are in general seen as a step in the right direction. An underestimated issue is the lack of transparency in the housing market. For example, there is no official transaction based price index in Switzerland; a shortcoming given the role of uncertainty about the true price level in the formation of mispricing in the housing market. In that regard, the UBS Swiss Real Estate Bubble Index can be seen as a piece in the jigsaw to improve market transparency and to avoid a speculative housing bubble.

6. Conclusion

In principle the concept of the UBS Swiss Real Estate Bubble Index is transferable to other countries. But for any replication, country specific peculiarities – political interventions, economic history – have to be taken into account. Regarding data, figures to calculate fundamental and chart technical indicators are easily available for most countries. A measure of behavioral aspects would be a plus but is not a necessary condition. But it is an important requirement that the data span a full real estate cycle. Otherwise the estimation of the fair or fundamental value may generate misleading results. Furthermore it is desirable that the country experienced the formation of a real estate bubble in the past in order to perform some retrospective testing.

In Switzerland the UBS Swiss Real Estate Bubble Index has become a benchmark for market assessment. The index meets with national and international media interest and is used intensely by internal and external risk boards and client advisers at UBS. In our view there are three factors behind the success of the product. First, the index gives a clear and intuitively understandable assessment of the current market situation. Second, the index is based upon a transparent and easily comprehensible methodology, making it possible to follow and verify the conclusions. And third, the index came at the right time. The dramatic headlines of the sovereign debt crisis in Europe and ongoing warnings of the Swiss National Bank made everybody aware of the huge costs of housing bubbles. The bubble index successfully filled this niche for more transparency in the real estate market.

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Emerging Issues in Bangladesh's Housing Sector

By Nurul Alam Talukder [1]

1. Introduction

The history of housing in Bangladesh has undergone noticeable changes in three major phases since the 19th Century. First of all, the pattern of housing changed as urbanization commenced, and then the use of brick, cement, iron and concrete was initiated. Secondly, rental housing emerged as a popular mode of accommodation as large numbers of people had left their homeland and were obliged to settle in different places within the country for the sake of jobs or business. Thirdly, and rather recently, commercialization of the housing sector took place as real estate companies came into existence to build houses for sale to people aspiring to own a house or flat. Concomitantly, housing finance also emerged to facilitate investment in this sector.

Bangladesh has a rather rudimentary housing finance system. Although the House Building Finance Corporation, an entirely governmental initiative, was established as early as 1952 as of 2012, the formal housing finance system provides mortgage loans only for a small proportion of newly constructed houses and home purchase. More than 95% of households have to finance housing from accumulated family savings. But the self-financing capacity is limited for most households. Financial constraints lead to incremental building of the house. Also, a lower standard of quality results from self-design and untrained self-supervision. Under self-finance single story building is the predominant choice for most of the households.

The 1980s witnessed an emphasis on professional house building as well as commercialization of the housing sector. A rise in people's purchasing power, the choice to own a flat instead of a house and also the preference for a professionally built home were changes recorded on the demand side. Meanwhile on the supply side, investment in the housing sector proved to be profitable and a number of entrepreneurs emerged who chose to take up real estate as a promising business opportunity. All these factors led to the formation of a commercial housing sector that flourished at a quick pace. By the year of 2000, the housing sector had established itself as a quite sizable business sector within the economy.

While Bangladesh can boast of a booming housing sector today, a number of problems and issues have been noticed in different areas. Some of them are related to the housing sector itself, while others are related to the health of the economy. In general the objective of this article is to present an overview of the housing sector of Bangladesh and, at the same time, document major issues facing different stakeholders. While house finance remains a major constraint, other issues need to be addressed on a priority basis too, so that optimal growth of the sector can be ensured. (Sarker et al, 2008)

2. The era of modern housing and the economy

A decade into the third millennium, more than half of the housing units of Bangladesh remain traditional in nature. These are essentially low cost housing units made of temporary materials like bamboo, wood, straw, mud and corrugated iron sheet. The era of modern housing began in the nineteenth century around government and business establishments. The landlord and affluent people followed suit. These were predominantly single-story brick-built houses constructed without any professional design or architecture. As yet, one third of houses in urban areas have been constructed outside of the formal regulatory system that requires certain standards to be followed. It is since the 1980s that multi-family units have become the predominant house type in the main urban areas of the country. The House Building Finance Corporation effectively popularized the option of four story building for living and for rent. Fast urbanization and emergence of a broad-based middle class with investible saving fuelled the growth of the housing sector at a fast pace. Also, a significant portion of people's illegal and unearned income found its way into house building. (Barua et al, 2010)

However, household saving remains the principal mode of house finance to date. For many, household saving is limited and such home-

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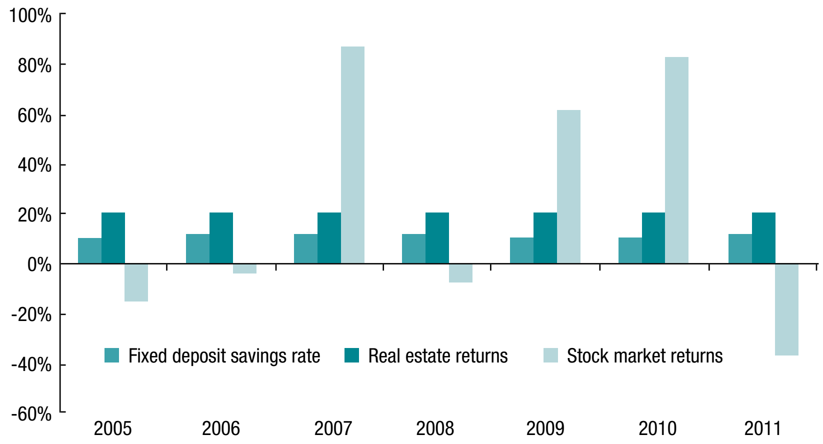
buyers often have to settle for a low standard and resort to self-construction and incremental building. Upfront finance that would allow them to purchase a higher quality home and pay for it over a longer period is often either unaffordable or inaccessible. Reasons why formal finance is inaccessible for many households include high interest rates, a lack of land and housing options for middle and low income households that are acceptable as collateral to banks, stringent formalities and the prohibitive nature of loan documentation and insecure and undocumented incomes. It is also not a negligible fact that commercial banks often show reluctance to work with small clients such as home-buyers.

The situation dramatically changed with commercialization of the housing sector in the 1980s that allowed people to buy flats or apartments by paying in installments. By the turn of the second millennium, the housing sector established itself as one of the principal drivers of economic growth of Bangladesh. In 2011, the housing sector contributed 16% of the country's gross domestic product [GDP]. In the same year, annual turnover in the commercial housing sector stood in the range of BDT 300 crore ($38.46 million). Directly and indirectly, the housing sector employed nearly 2.5 million people of the country. Hundreds of ancillary industries grew and flourished in consonance with the rapid growth of the housing sector. As indicated by strong demand and supply factors, it appears that the housing industry has the potential to continue to grow rapidly for several decades to come. (Sarker et al, 2008)

The urban population is estimated at 30 million which is around 20% of the total population of the country. These people are accommodated in an estimated 4.5 million housing units. The demand for modern housing in urban areas is growing at a steady rate due to continuous migration of well-to-do people from peri-urban to major urban centers and owing to a significant rise in people's purchasing power. Property seemed to be the only form of investment to people with unearned income. To build a four story house with eight flats, live in one and rent out seven others became quite fashionable. Also, very ordinary people entered the formal housing market by dint of remittance sent from relatives working abroad, especially in Middle-Eastern countries. A traditionally weak stock market and Islamic bank policy on consumption of interest-income also encouraged people to invest in real estate. (Chowdhury, 2012).

Figure 1 **Level and stability of return on investment from the housing sector compared with bank-saving and stock-market**



Source: Nofel Wahid (2012), "Property Prices in Dhaka – the next accident waiting to happen", 2012.

3. The housing market

Since its emergence in the 1980s, the housing market has grown and thrived well owing to strong demand and high profitability. High profits have allowed accumulation of capital. At the same time the market has drawn investment from various quarters. Being demand driven, the housing market has grown with a high concentration around Dhaka city (between 80 to 90%).

Traditionally, the housing market has proved to be a quantity clearing market where quality is not a significant factor. High profitability has encouraged the establishment of firms which lack professionalism. Quality assurance is absent by and large. The regulatory frame-work and enforcement of the same has been weak. Buyers of low purchasing capability are obliged to compromise on quality. All companies work with short-term and small scale projects. Even big companies have yet to come up with long term plans. The most common feature is flats in five to six storey buildings, side by side with sporadic high-rise buildings. Critics feel that the Real Estate Agencies are contributing towards building high-rise slums all around Dhaka city.

The housing market is characterized by wild heterogeneity. There is so much variation in terms of quality of locality, quality of construction, size and amenities that it is difficult to apply as a common denominator. In reality, there is nothing that can be termed an "average housing unit" except size. However, this is favourably matched by a heterogeneous client profile with wide range of purchasing power, and thus, the market can function smoothly.

The urban residential housing sector of Bangladesh is characterized essentially by a three-tier market. The first tier are those households with the high disposable income and savings, who constitute about 3% of the housing market, who are able to afford high-quality housing in fully serviced neighborhoods, and who are able to utilize bank financing or specialized housing finance institutions. [Rahman, 2005]

The second tier is the relatively narrow stratum of middle-income households that represent 12 to 15% of the housing market. They are the main users of specialized housing financial institutions such as the Bangladesh House Building Finance Corporation [BHBFC].

The third and largest tier is low-income households, for which housing is provided largely by the private sector real estate companies that have flourished in the recent decades. Many of these houses are built under illegal and unsatisfactory site conditions, without proper authorised design or quality masonry.

Starting in the 1960s, the government has played an important role by developing land for the sole purpose of housing. Although, the government plays no direct role in the housing market, its contribution in terms of building accommodation for public sector officials is not negligible at all.

4. The supply gap

Experts have assessed that there continues to be a supply gap in the housing market despite the fact that the formal housing sector has been flourishing since the late 1990s. It has been estimated (2008) that the annual demand for new housing was at least 300,000 units, which far exceeded the quantum of supply. The estimate is largely based on permanent migration of people from other areas to Dhaka and other major cities and people's exploding preference to switch from a rental residence to their own home. (Chowdhury, 2012)

A continuous supply gap not only drives up the average price and narrows the consumer surplus, but also compels purchasers to settle for less than a satisfactory product. It has been estimated that the annual requirement for housing in urban areas will be in the range of 300,000 to 550,000 units for at least the next two decades. A planned approach and additional drive are necessary to keep the supply gap narrow.

4.1 High price of land

Bangladesh is a very small country with a huge population. As many as 160 million people live on an area of 1, 47,570 square kilometers. Thirty million people live in an urban area of 3,370 square kilometers. Population density is very high in the urban area, being in the range of 8,870 persons per square kilometer, whereas in the rural areas the figure is 700 persons per square kilometer. On the other hand, the country remains largely an agricultural country with direct dependence on cultivable land for food and employment. Shortage of land poses a challenge to the country's food security.

Since the middle of the twentieth century, a big chunk of agricultural land has been taken up (grabbed) for road construction and for setting up factories and offices. Land scarcity became acute towards the end of the century which is reflected in the price of land in villages as well as towns and cities. The inevitable consequence of rapid expansion of the housing sector was land prices shooting up disproportionately. It has been reported that land prices in certain areas of Dhaka city, particularly Gulshan, are higher than in New York City.

The high price of land is a major impediment to the smooth and continuous flourishing of the housing sector. In recent times, bigger cities like Dhaka and Chittagong have witnessed prema-

Figure 2 Rise in the price of land in Dhaka (2000-2007)

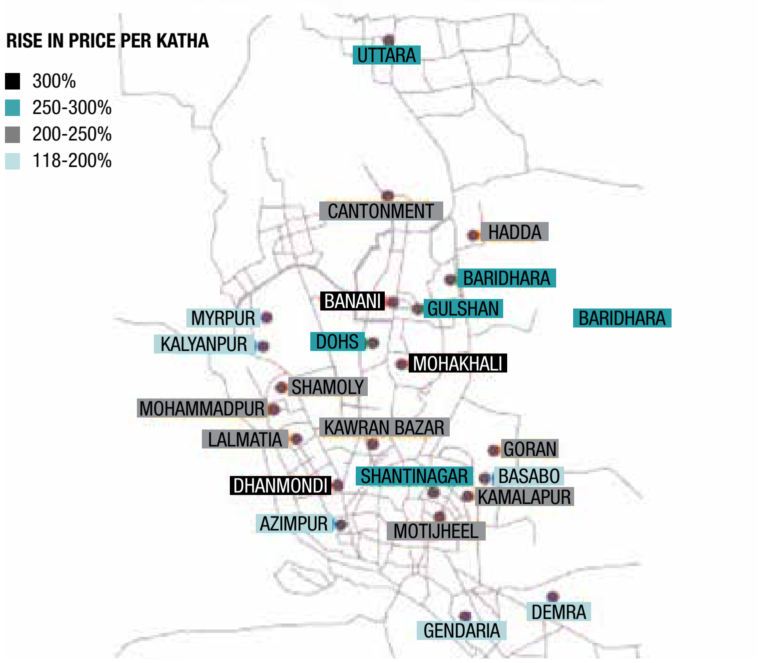


Table 1: Rise in price of land in different parts of Dhaka city since 1975

Area	PRICE OF LAND (TAKA/KATHA[2])				% Increase in price over the past two decades	
	Year				Between 1990-2000	Between 2000-2010
	2000	2007	2008	2009		
Baridhara	25,000	600,000	5,000,000	40,000,000	733%	700%
Gulshan	25,000	600,000	2,200,000	25,000,000	267%	1036%
Banani	25,000	600,000	2,000,000	15,000,000	233%	650%
Mahakhali	25,000	600,000	1,800,000	12,000,000	200%	567%
Dhanmondi	25,000	600,000	2,200,000	20,000,000	267%	809%
Lalmatia	20,000	600,000	1,800,000	15,000,000	200%	733%
Azimpur	175,000	600,000	1,600,000	5,500,000	167%	244%
Mohammadpur	25,000	500,000	1,200,000	7,000,000	140%	483%
Shantinagar	20,000	500,000	1,500,000	10,000,000	200%	567%
Shamoli	17,500	300,000	1,000,000	4,500,000	233%	350%
Uttara	20,000	300,000	1,000,000	7,500,000	233%	650%
Cantonment	20,000	400,000	1,000,000	7,500,000	150%	650%
Komlapur	17,500	400,000	800,000	4,000,000	100%	400%
Gendaria	10,000	400,000	700,000	3,500,000	75%	400%
Basabo	2,000	300,000	800,000	3,500,000	167%	338%
Kalyanpur	17,500	300,000	800,000	3,200,000	167%	300%
Mirpur	10,000	200,000	700,000	4,000,000	250%	471%
Badda	4,000	200,000	600,000	3,000,000	200%	400%
Goran	4,000	200,000	600,000	2,600,000	200%	333%
Demra	4,000	200,000	600,000	18,000,000	200%	2900%
Motijheel	50,000	1,200,000	3,500,000	20,000,000	192%	471%
KawranBazzar	41,500	1,000,000	2,500,000	15,000,000	150%	500%

[1] 20 katha = 1 bigha.

ture knock-down of many one or two-storied buildings in order to make room for multi-storied buildings. Evidently, land scarcity is a major obstacle in developing planned townships or residential neighborhoods.

4.2 Claim on agricultural land

According to the estimate by Quasem (2009), agricultural land is being converted in Bangladesh at a rate of 0.56% per year. It has been estimated that during nine years between 1996 and 2005 as much as 72,000 hectares of agricultural land was converted for non-agricultural use. A big chunk of the same goes to construction. It has also been estimated that 54.80% of converted land has been used for house construction. Based on the current estimated rate of conversion (0.56% per year), the annual loss of rice production amounts to 0.23 million tons or 0.86% of the country's annual rice production.

The trade-off is a threat to national food security. Given that there is a limit to the rise in agricultural productivity, use of agricultural land for housing cannot continue forever. It is time that planning of new housing is undertaken in order to build more high-rise apartment buildings to economize on the use of land.

4.3 Commercial house building

As already noted, from a modest start in the early 1980s, Bangladesh has experienced the growth of a robust housing sector in the last two decades. The growth has been led by private investors. In fact the commercial housing sector grew almost simultaneously with the ready-made garments sector of the country and proved to be one of the major sources of economic growth.

In this connection, it may be recalled that a large scale commercial housing project was implemented by Eastern Housing Ltd. before the independence of Bangladesh in 1971. Established in 1965, this company built up 700 single story houses in the Pallabi area of Dhaka towards the end of the 1960s. (Chowdhury, 2012). However, the initiative was not replicated in the following decades. In reality, scope of a housing project is essentially defined by the area of the land available. No wonder that subsequent commercial house building initiatives are characterized by small projects. Because of the shortage of land, a single story (or two storied) single unit building has been replaced with a multi-story building with five to ten home units in most cases. Larger sized land sites come through what is known as 'land development'. However, save for a few projects like Bashundhara, Banasri and Aftab Nagar, these are located rather in peri-urban areas and people in general are yet to be enthusiastic to own a housing unit in such projects because of bad traffic connections. Unavailability of low cost funds is another factor that is responsible for the absence of large scale projects.

In most cases, development of home units for ready-made sale is not the prominent mode of marketing. Real Estate Agents develop lands and collect fund by way of an 'advance' from intending home buyers. This mitigates financial constraints to a large extent. However, home buyers often complain late implementation and late delivery.

Also, small Real Estate Agents show little respect for customer satisfaction. Quality assurance is absent and home buyers often suffer from bad masonry and low quality fittings, fixtures and gadgets. All these point to the need for a regime of governance in the housing sector of Bangladesh.

5. Government initiatives

In Bangladesh, several public agencies are involved in the construction of housing and in residential infrastructure projects. These include the National Housing Authority [NHA], Capital Development Authority for Dhaka [RAJUK], Chittagong Development Authority [CDA], Khulna Development Authority [KDA] and the Public Works Department [PWD] of the Ministry of Housing and Public Works, etc. These agencies are developing residential subdivisions for lease to upper- and upper-middle income households, plus resettlement programmes and site-and-services schemes for lower-to-middle-income groups.

It has always been difficult to reach lower-income households with the site-and-services projects and the size of the combined public housing programmes has remained extremely small in relation to housing requirements and new construction. In sum, the public sector has contributed around 6,000 units per year, which is tantamount to approximately 1–2% of total urban residential land and housing requirements in recent times.

In this connection, it may be put on record that the government has initiated in recent times a construction program for the rural areas called Asrayan. This project is designed to provide barrack-type houses for low income people residing in the villages.

6. Urban bias

The commercial housing sector has recorded a clear bias for urban projects since inception. Most of the housing projects have been undertaken around the central business districts of different cities. Apparently, urban bias as such derived from customer preference: all people try to find an accommodation as close to their work-place as possible. This has caused extreme crowding in many city areas including Dhaka. It is often regretted that the real estate agencies have replaced a garden like modern Dhaka with a high-rise shanty town. (Chowdhury, 2012)

One key to remove this urban bias is to develop reliable road connections and utility infrastructure so that people's preference for city-centers discontinues. However, it will be a fatal remedy to suggest relocation of housing projects from cities to villages. It has already been outlined above how the use of agricultural land for housing purposes is growing into a threat to the country's food security. What is needed is economical use of land so that more accommodation can be arranged on the same area.

Table 2: Construction by the public sector

Major areas	Unit	Position June, 90	Position June, 97
Housing			
Rehabilitation of Squatter families	Nos	6860	10260
Distribution of site and services plots for low and middle income group people	Nos	13918	22398
Government flats and offices	Nos	14500	20528
Construction of flats	Nos	17408	1245
Construction of office building	Nos	1065	2983
Construction/Reconstruction of union Tahsil offices	Nos	2033	423

Source: Sixth Five Year Plan, Planning Division, Ministry of Planning. Government of Bangladesh

In this regard there is perhaps no alternative to high-rise building. A planned approach will require direct government intervention because land in large chunks is necessary to build up large high-rise residential blocks or townships. Also, adequate physical infrastructure like good road links and gas, water and electricity supply have to be ensured before occupation.

7. Affordable housing

The housing sector of Bangladesh has proved pretty profitable to the investors of the country. It has been noticed that the real estate companies build houses aiming for relatively high profit at low risk. In a bid to achieve quick turnover, they target the middle income sector which is persistently showing excessive demand powered by new earned affluence. As a result, the price of an average flat or apartment is pretty high and remains out of the reach of ordinary people. It is important to consider what proportion of the urban population can afford to buy a flat as normally offered by the real estate companies.

The capital city Dhaka has a population over 12 million which constitutes more than 70% of the urban population of the country. There are gross inequalities in the socio-economic conditions of people living here. Most of the poor people cannot manage to meet their minimum basic needs with their personal income. It is unthinkable to afford any kind of modern housing with this level of income. However, Dhaka cannot run its normal life without the existence and continual support of the poor section of the population. Poor people constitute an indispensable part of the economic and social fabric. However, there is no project or initiative to provider modern accommodation for these people.

In fact, nearly 70% of the population residing in Dhaka belongs to the 'low income' segment. Their lifetime saving is far less than the price of the cheapest flat or apartment currently made and offered by the real estate companies. The conclusion is: despite impressive growth in the past decades, the commercial housing sector has not considered the housing needs of the lower income people living in town and cities.

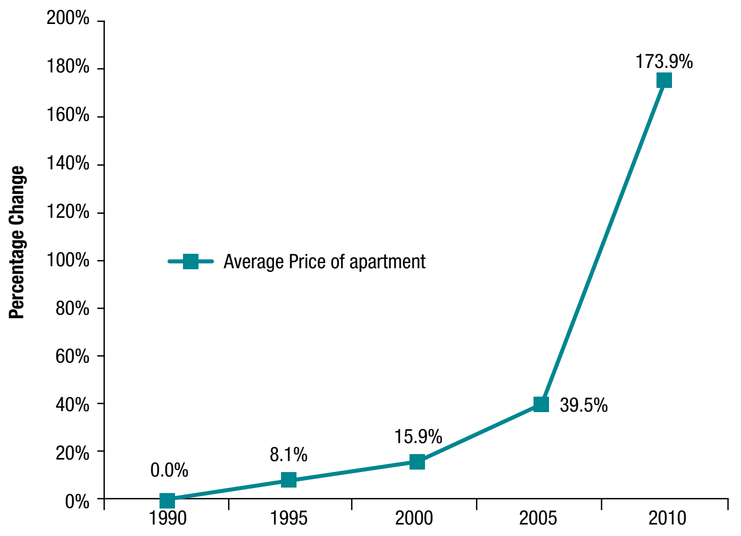
Affordable housing remains a myth as far as Bangladesh is concerned. The need to build 'affordable housing' to address the requirements of the low income people should be put on the public agenda. Apart from this, innovative ideas are required so that the cost of building a modern house can be brought down to affordable levels. (Khanam, 2004)

It has been suggested that an affordable modern housing unit should not cost more than BDT 5lacs as of 2010 (Chowdhury 2012). This will require cheap land and high rise building with a number of small size flats under the same terrace. The Government of Bangladesh initiated such a project in 2004 which came to be known as the Bashantek[3] Rehabilitation Project [BRP]. The government allotted about 150 bighas[4] of land in Dhamalkot and Lalasarai mouzas[5] of Bhashantek in Mirpur(Section-15) in Dhaka city for BRP. The goal was to build up a township for low-income people at a total cost of Tk. 347 crore ($44.49 million). It was planned to build a total of 15,024 small-sized flats of which 9,024 for slum dwellers and remaining 6000for low income people like office assistants. A price of BDT 3 lac[6] 55 thousand was fixed for each flat. A private

Table 3: Average price of apartments in different parts of Dhaka city (Taka/ Sq. feet, from 1990 to 2010)

Area	AVERAGE PRICE OF APARTMENTS (TAKA/SQ. FEET)					% Increase in price over the past two decades	
	Year					Between 1990-2000	Between 2000-2010
	1990	1995	2000	2005	2010		
Dhanmondi	2150	2200	2400	3300	14000	12%	483%
Gulshan	2115	2080	2450	4500	14000	16%	471%
Banani	1750	1950	2200	3100	12500	26%	468%
Baridhara	1850	1950	2150	4000	20000	16%	830%
Mirpur	1250	1300	1500	2500	5500	20%	267%
Uttara	1650	1750	2000	2700	5300	21%	165%
Malibag	1600	1850	2250	2500	7000	41%	211%
Mohammadpur	1450	1600	1800	3500	4500	24%	150%
Shamoli	1350	1500	1600	2100	7000	19%	338%
Monipuripara	1850	2000	2250	3300	5500	22%	144%
Green Road	1600	1700	2000	2500	5500	25%	175%
SegunBagicha	1450	1550	1900	2500	6000	31%	216%

Figure 3 **The following graph shows how the price of flats/apartment's have shot up in Dhaka in the recent time**



[3] Bhashantek is an sub-urban area in the northern part of Dhaka metropolitan city.

[4] One acre = 3 bigha land.

[5] A mouza is a block of land identified in course of survey.

[6] 10 Lac = 1 million

construction company, namely, North South Property Development Limited [(NSPDL] was assigned to build the township. Unfortunately, NSPDL resorted to the delay-dally and did not deliver in time. Eventually the government took over the project. The project is yet to be completed in full. (Chowdhury 2012).

8. Quality control & governance problems

One disturbing feature of the housing sector of Bangladesh is the lack of quality awareness. On one hand, there are a host of self-building house owners who proceed to build houses under self-supervision without proper design and architecture. On the other, the commercial builders resort to illegitimate cost-cutting measures in a bid to raise their margin. A glaring example is six-storey buildings without lifts, hundreds of which have been built in last ten years. Home owners often complain about unsuitable design, poor masonry, sub-standard fittings and lack of ancillary facilities including that for garbage disposal. This is rampant on small home units built by unknown or new real estate companies.

All these call for a good governance scheme for the burgeoning housing sector of the country. A number of government and local-governmental agencies are involved in the regulatory functions including the Public Works Department of the Ministry of Housing and Public Works, Local Government Engineering Departments, and City Corporations and Municipalities. Their combined role is inadequate both because of lack of a complete and comprehensive building code and lack of the capability to enforce rule-compliance. The good thing to notice is that public awareness is rising in favour of properly habitable housing units.

In this connection it may be noted that the National Housing Authority [NHA] was set up in 2001 to regulate and promote the housing sector of the country. It has, in the meanwhile, developed a National Housing Policy the main objectives of which are as follows:

- Ensuring housing for all with particular emphasis on the disadvantaged, destitute, the shelter less poor and the low and middle-income group of people.
- Making available suitable land for housing at an affordable price.
- Developing mechanisms to discourage formation of slums and squatter settlements, unauthorized constructions and encroachments.
- Mobilizing resources for housing through personal saving and financial institutions.
- Developing an institutional and legal framework for facilitating housing.
- Providing encouragement to universities, research institutions and research centers for housing orientated research.

9. Housing finance

Currently, Bangladesh is in the transition from self-finance to institutional financing. Self-financing is the traditional and as yet the principal mode of investment in the housing sector. The age-old culture is that people build their own house on their own land to live there permanently. Building housing units with a loan from institutional sources or for renting out to tenants is a relatively recent trend. (Chowdhury, 2012)

Institutional housing finance remains by and large under-developed although a government agency, namely the House Building Finance Corporation was established in this region as early as 1952. Today, the formal housing finance sector comprises several categories of organizations, namely, the private banking sector, the state-owned banking sector, specialized house finance institutions and NGOs.

The formal housing finance system of the country provides mortgage loans for only a small proportion of newly constructed houses and home purchases. As of June 2012, the amount of formal borrowing by the country's housing sector from banks and financial institutions stood at around BDT 3251($416.80 million) crore. This is about 8.6% of all loans to the private sector. The amount of institutional borrowing by the housing sector was BDT 2167 ($277.82 million) crore in FY 2009-10 and BDT 3521 crore in FY 2011-12. The annual growth rate was 27.48% on average during the period.

Apart from the fact that the rate of growth of house finance from the banks and financial institutions is substantial in the recent years, it can be observed that significant changes are taking place in institutional housing finance. First, the private commercial banks [PCB] and financial institutions have been expanding their operations in the housing sector. From BDT 1624 ($208.21 million) crore in FY 2009-10, their lending to the housing sector increased to BDT 2868 ($367.69 million) crore in 2011-12 indicating more than 38% annual growth in the meantime. This can be observed from the Table-4 below.

It can also be observed that the contribution of the private commercial banks to housing finance alone registered a growth of 93.73% between 2009-10 and 2011-12. They lent out BDT 990 ($126.92 million) crore in 2009-10 which increased to BDT 1918 ($245.90 million) crore by the end of 2011-12. The state

Table 4: Sources of formal lending to the housing sector

Financing Sources	Outstanding as of end June (Crore Taka)		
	FY2009-10	FY2010-11	FY2011-12
a. Banks	162.4	220.6	286.8
i) PCB[7]s	99.0	147.6	191.8
ii) SCBs	48.1	53.0	63.4
iii) Other banks (foreign and specialized)	15.3	20.0	31.6
b. Specialized housing finance providers	45.9	48.3	51.5
i) HBFC	25.1	25.1	26.0
ii) Delta-Brac Housing Finance	17.4	20.7	23.1
iii) National Housing Finance	2.4	2.5	2.4
c. Other financial institutions	9.2	11.3	13.8
d. Microcredit lenders and Grameen Bank	0.2	0.1	0.1
Total	**216.7**	**280.8**	**352.1**

Source: Annual Report of Bangladesh Bank, Year 2012-13.

[7] PCB is private commercial bank

owned commercial banks [SCB] lent out BDT 481 ($61.67 million) crore in 2009-10 which increased to BDT 634 ($81.28 million) crore in 2011-12. Other banking institutions, including foreign banks, registered significant growth during the same period.

There are two specialized housing finance companies in the private sector, namely Delta-Brac Housing Finance and National Housing Finance. Together they lent out an amount of BDT 198 ($25.38 million) crore in 2009-10 which increased to BDT 255 ($32.69 million) crore in 2011-12. During the same period the contribution by Bangladesh Housing Finance Corporation (BHBFC) increased from 251 ($32.18 million) crore to 260 ($33.33 million) crore.

Grameen Bank, as well as some other non-government organizations (NGO) lends money for home-building in rural areas. However, the contribution of NGOs is yet to reach any significant level.

BHBFC pioneered house building finance in the country, and until mid-1990, was the principal source of institutional housing finance in Bangladesh. BHBFC's main source of fund is subsidized debentures. Outstanding debentures are Tk. 12.2 billion ($1.56 million) at an average cost of around 6 per cent per annum. They are subsidized 75% by the Bangladesh Bank and 25% by financial institutions. It may be noted here that there is no active secondary market for these debentures.

BHBFC has so far disbursed only BDT 43,930 million to help construct 1.8 million housing units. Needless to say, this not a very encouraging figure given the potential of the sector and need for decent modern housing.

To be honest, the relative importance of the House Building Finance Corporation [BHBFC], which traditionally dominated the housing finance sector, is declining. This is because, on the one hand, other competitors have appeared and, on the other hand, its capacity to service the housing finance market has not been enhanced in any significant way. However, BHBFC's lending module is popular in the country. As can be seen from Table-5 below, BHBFC is the cheapest source of housing finance in recent times.

The right-most column of Table-5 above records the diversity in the cost of borrowing fund for the housing sector. The range of annual interest rate is from 8.18% to 14.53%. It is intriguing that a specialized housing finance organization like Delta Brac is charging significantly higher than the commercial banks.

Growth of the housing sector may be boosted by bringing down interest rates. The central bank of the country can intervene in this regard. In the public sector, the government can enhance the lending capacity of BHBFC. However, government has funding constraints, and converting BHBFC into a 'housing bank' may be a way off.

For the public sector, government can create a special fund for high-rise building, townships and such other desirable housing projects. The government can even borrow funds from abroad at a low cost (say, 4%) through State-owned Commercial Banks [SCBs] and offer the same to other commercial banks for expanding their activity in the housing sector in a planned manner.

In this regard it may be mentioned that government has created "Grihayan Tahbil" (housing funds) to facilitate housing finance in the rural areas via the NGOs. The Grihayan Tahbil provides housing fund to the NGOs at the rate of 2.0% simple interest which in turn provide housing loans to the rural poor at the rate of 6.0% simple interest. As of June 2012 the Grihayan Tahbil has released Taka 13 crore against an allocation of Taka 24 crore ($3.08 million) through 523 NGOs for the rural housing programme. The rural housing programme that covers 450 upazilas[9] in 64 districts of the country, has already contributed towards construction 51685 houses for the rural people.

9.1 Developing housing finance market

Despite its considerable economic and social potential, housing finance remains underdeveloped in Bangladesh. A well-developed house finance market can enable a family to buy their own home early rather than towards retirement with life-time saving. Buying one's own home at the prime time instead of near retirement will constitute a 'paradigm shift' for the people of Bangladesh (Chowdhury, 2013). This will require lower house prices matched with low cost of funding. Compared with most countries the cost of funds is excessively high in Bangladesh.

Regardless of the demand side, affordable housing remains scarce. Most mortgages are small, unaffordable, and only available from a few institutions. Modern methods of mortgage processing and risk assessment are starting to attract interest, but are still not widely used. As a result, housing finance is expensive and rationed in favour of salaried employees of the private sector with relatively high incomes, or those who can offer adequate land as collateral.

Housing lenders also face tight funding, because savings within the banking system are small, and there are few long-term savings intermediaries. This severely constricts the capacity of the capital market to generate long term loans as necessary for the housing sector. On the demand side, the legal, regulatory, and taxation frameworks are not enabling housing finance market development, and home-buyers who can afford it prefer to pay for their home in cash instead of taking out a mortgage loan (Marja C. Hoek-Smit, 1998).

Housing finance is required to reach a wider population group at a lower cost. Access to housing in turn contributes to a wide range of economic benefits, from preventing slum proliferation to promoting savings, construction, employment, and consumption. Housing finance development plays a role in boosting equitable economic growth and reducing poverty

Table 5: Housing finance in Bangladesh - fiscal year[8] 2011-12 (Taka in Crore)

Source of Fund	Total Lending Budget in 2012	Percent of Total	Cost of Fund to the borrower
BHBFC	320.00	35.56%	8.18%
Delta BRAC Housing	236.00	26.23%	11.07%
National Housing	15.40	1.71%	14.53%
Janata Bank Ltd.	131.20	14.58%	9.21%
Agrani Bank Ltd.	189.90	21.11%	9.30%
Rupali BankLtd.	7.30	0.81%	9.00%
Total	**899.80**	**100%**	

[8] Fiscal year in Bangladesh runs from 1st July of the current year to 30th June of the next year.

[9] Upazilla = a sub-district administrative unit in Bangladesh. There are 485 upazillas under 64 districts. (Zilla=District, Upa=Sub)

through helping households build assets and improve living conditions, as well as empowering the middle and lower income population and strengthening communities.

The upshot is that developing the market-based housing finance system should be set as an important goal to be vigorously pursued in years to come. The nation faces the challenge of providing appropriate housing for this growing portion of the population, whose needs are not adequately met by the existing funding channels. Some promising policy options which will help achieve this goal includes strategies to increase the capacity of the House Building Finance Corporation, to create liquidity in the market, to promote savings for home-buyers, as well as to support and promote other aspects of the housing finance markets.(Ahmed et al, 2004)

10. Concluding remarks

The formal housing sector of Bangladesh has emerged as a major pillar of the economy since its inception in the early 1980s. This sector has national importance from both demand and supply side perspectives. All stakeholders including the government, financial institutions and regulatory authorities need to work out a comprehensive mechanism for facilitating growth of the sector at a higher rate so as to cater to the growing needs of the prospective homeowners. However, there is need for correcting the trend and setting the right path.

Faster growth of the housing sector will call for development of a modern housing finance system. At the same time governance issues which are pretty serious already must be addressed without further delay. In a country of acute land scarcity, government has to play a key role in planning and coordinating the housing programmes. Small housing projects cannot solve the problem. Also, mere land development projects like Uttara, Nikunja, Purbachal or Jhilimili for individual houses are no longer very desirable schemes. What Bangladesh badly needs today is well-designed high-rise townships to be planned by government and implemented by real estate companies under strict and professional supervision. We have to provide affordable housing, with saving land.

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The importance of ancillary services for residential mortgage borrowers in default in Sri Lanka

By DLPM Rathnasingha and Ali Khatibi

1. Introduction

The demand for housing and housing finance is high and this basic need should be addressed by society. This study aims to provide insights into the loan customer's use of ancillary services in relation to mortgage loans and the effects of the use of ancillary services on loan default in the Sri Lankan residential mortgage market. In general housing loan customers may not be fully aware of related matters such as financial, legal, technical, social and economic factors. The broader objective of this study is to be aware of loan customers' perceptions of the ancillary services offered by mortgage loan suppliers and the implications of taking up these services for mortgage default. Further, it aims to identify the importance of the mortgage loan counseling service for the mortgage market in Sri Lanka.

Typically, banks and other financial institutions assess the risks of housing loans on the basis of loan features (term to maturity, interest rate, size of down-payment), borrower financial characteristics (income, total debt, credit limit), and the value of the property pledged as collateral. These are all important measures affecting the probability of recovery of mortgage loans granted by lenders. Further, there are some other measures which are important and contribute to timely loan servicing by the customers. The financial abilities of customers are relevant influencing factors in relation to servicing a housing loan which is usually a long-term transaction. Further, customers have to have competence to cope with economic and political changes and with managing day to day activities while loan obligations are met. Unfortunately, there are currently no studies being conducted of mortgage counseling specifically designed to meet these needs Lind, (2011).

In the local mortgage market, one can notice large variations in interest rates within the last few years and further considerable rate variations between loan suppliers in the market. In the beginning of 2009 market interest rates on mortgage loans were at around 19.5% and varied over the period up to 2013 down to 12.5% at bottom. This is an immense change to interest rates for transactions of this nature. However, the prevailing interest rate is still high when comparing it with other mortgage rates in the region; around 10% in India, around 7.5% in China, and around 5% in Malaysia.

This study has focused on one important pillar of the housing finance market in Sri Lanka. This follows a survey of borrowers in order to examine their views on ancillary services provided by mortgage lenders before and after loan disbursement. While housing finance is a vital component of a finance system of a country, there has not been a systematic analysis of loan counseling across the country. Among others the ratio of average value of a house and the time it would take a borrower to pay that full value out of their irregular earnings is an important measure of their ability to afford a mortgage loan in the market. Analysis of the labor force also reveals that only around 20% of the population is in regular employment. Among existing low-income loan holders, poor recovery rates have been a major problem.

Default on a housing loan is usually a result of a significant and unexpected event which ultimately affects both the financial institution/loan provider and the borrower. The borrower may not have the capability to manage such incidents but financial institutions should take more responsibility in counseling/guiding customers and supporting them in relation to the issues they are facing. This should cover the financial, insurance, legal and technical/engineering aspects of house construction under mortgage arrangements and therefore the loan provider has to play a wider role beyond only acting as a financial institution that provides a loan. On the other hand in practice it is not easy to evict borrowers and realize collateral, given the social and cultural values of the society although loan providers have all legal powers for recovery of losses through insurance or foreclosure. As a result of this situation, lenders must think twice about the implementation of parate rights (that is, the ability of a lender to foreclose and sell a property where the mortgage loan is in default, without going to court). This was mentioned by Ahmed et al.(2007). As yet the effectiveness of foreclosure is hampered for most lenders by weak eviction powers. In this situation a pre-planned loan counseling service may help to minimize default by building links between borrowers and their lenders. It might help to cultivate financial literacy/discipline among loan customers and to find solutions to other issues/problems they may have, if they work together to identify potential solutions to problems arising for borrowers when a loan payment is due.

2. The mortgaged housing sector in Sri Lanka

Niriella, (2011) identified 28 housing financial institutions in Sri Lanka in 2009. All these financial institutions play an important role in the residential mortgage market in the country and most of them offer many other services in addition to mortgage loan disbursement. One can obtain mortgage loans to purchase land, for the purchase of a house, or the construction of a house, for an apartment/condominium, to cover any land purchase related expenses, for a home extension such as constructing an annex or extra rooms, for home improvements, to build a second home, for renovation, for landscaping, for furnishing, etc. An effective system of housing finance provides key economic benefits and positively affects savings, investment, and household wealth. Beyond this, a functional mortgage market is a key factor in supporting the urbanizing trend in society, in meeting demographic challenges in terms of growing housing demand and in preventing slum proliferation.

The Sri Lankan housing market and the financing of housing has been strongly supported by government agencies for a long period under a number of programs but in future further state sponsored funding is at its minimum level. As a result of government recognition of the need for a self- sustaining housing market in the country, it has already implemented some initiatives to promote housing finance via the mortgage market while continuing with a few state sponsored housing programs. However, Ahmed et al. (2007) has mentioned that many middle and lower-income households have no access to housing finance in Sri Lanka and have identified that the bulk of commercial bank housing lending is for personal housing construction and purchases.

The relative dearth of housing finance options for middle- and low-income households means that these households often build their own housing over time, creating a form of equity (house ownership) finance which is a hurdle in their life for a long period. "Newspapers are full of real estate classified ads for both rental and purchase properties. At the same time, more than 80% of the households in Sri Lanka have no access to housing finance, and about 7% are lacking homes. One third live in semi-permanent housing and 6% live in line room (very small houses with minimum facilities for tea estate workers) estates and shanties," it says in a report on housing finance, The Sunday Times (2010). "The census reveals that Sri Lanka has been successful in managing the national housing backlog, which was approximately 350,000 units in 2001. However, a shortage still prevails within the low and lower middle income sector particularly because of the natural expansion of housing need. It is believed that a sizeable portion of the existing units are substandard hence require substantial improvement and upgrading", Pathirathna (2012). The above two citations provide evidence that the real unmet need for mortgage loans is among lower and impermanent income earners in society. The non-availability of a mortgage loan scheme for impermanent income earners in the formal mortgage market is a big issue.

Housing mortgage loans are inherently different from other types of loan products as for most individuals investment in a house is only undertaken once in their life time. Mortgage finance arrangements for housing in Sri Lanka do not have much history but there are milestones for the development of the industry since the mortgage commission appointed in 1945, which recommended major changes to the common law (http://www.fjgdesaram.com/history.htm). The gap in housing finance provision in Sri Lanka potentially includes up to half of the Sri Lankan population, Ahmed et al. (2007). This section of the population may be capable of servicing a mortgage loan but has no access to finance and may not have sufficient financial literacy. This segment of society might benefit significantly from ancillary services in the mortgage market. This allows us to reasonably estimate the net benefits to investors/lenders, borrowers and in general to society of offering mortgage loan counseling to distressed borrowers.

3. Residential mortgage default in Sri Lanka

It is important to answer the question 'What are the key triggers and causes of mortgage default' Berry M. et al. (2010). The terms and conditions laid down by the banks and other financial institutions for customers clearly indicate that for the poorer section of society it is not easy to get approval for a loan, or to afford a housing loan from a financial institution, to make their dream home a reality Niriella, (2011). Piyasiri (2006) has mentioned that collection ratios for housing finance institutions in Sri Lanka are estimated to range between 80 and 95% and Karnad (2004) recognized this as a continuing issue. Further she identified that in certain instances the Non Performing Loans [NPL] ratio is around 20%. Ahmed et al.(2007) mentioned that State-owned banks continue to have some problems with NPLs, particularly the State Mortgage and Investment Bank with 25%.

In 2011, the National Savings Bank [NSB] originated housing and property loans of 36,839,073 (Rs' 000). In 2010 it was 33,011,819 which showed an increase over the 2009 balance of 28,339,675. This makes an increase of housing and property loan of 16.48% in 2010 and 11.59% in 2011. Comparatively, loan loss provision on housing and property loans at the end of 2011 were 2,592, 254 and the balance at the end of 2010 was 2,046,181 compared to 2,290,968 at the beginning of 2010. However, suspended interest payments on housing and property loans were 170,346 (Rs' 000) in 2009, 202,706 in 2010 and 254,787 in 2011 showing a rising trend (NSB, Annual Report, 2009, 2010, and 2011). The above figures indicate a 16% and 11% increase in loan balances in 2010 and 2011 respectively and show suspension of housing and property loan interest payments increasing by 19% and 26% increase in the same years which is a much higher increase than the increase of value of loans granted.

The State Mortgage & Investment Bank (SMIB) with its vision 'To be the Leader in Housing and Development Finance in Sri Lanka' indicates in their annual reports 41.28%, 37.11% and 34.06% of NPL for years 2009, 2010 and 2011 respectively. Further, income from interest on loans and advances has slightly come down from 2,362,259 (Rs' 000) in 2010 to 2,307,130 in 2011.

The District-wide summary of the Housing Development Finance Corporation [HDFC] (April 2012) shows that there were 70,380 loans granted and out of this 36,713 were under Employee Provident Fund [EPF] security which was 52.16% of total loans granted with the balance of 33,667 loans under other types of securities. There were 24,178 loans making 34.35% of the total loans which were identified as in default and out of them 19, 588 loans in default had been granted under the EPF security amounting to 81.01% of the total of loans in default. There were 4,590 loans in default out of the non EPF security loans.

In the light of the above facts mortgage lending will remain confined to the top income groups, and it will continue to rely on regular salary income and other assurances of palpable monetary value Ahmed et al. (2007), so that lenders can ensure repayments. This underpinned with 95% of the sample made up of government workers Rathnasingha et.al (2012).

4. Ancillary services in the mortgage market

Lind, (2011) has identified that one of the major challenges faced today by mortgage investors and servicers is the inability to contact distressed borrowers with payments due who do not have adequate communication with their lenders. Ahmad et. al, (2012) has mentioned that 'In the absence of the formal arrangements between the housing developers/real estate agents etc and financial institutions, the protection of individual purchasers remains limited as the market is dominated by cash transactions with limited availability of systematic information in a transparent manner'. However, Lind, (2011) has listed diagnosis of a consumer's payment problems, updated borrower status and financial information, review of income and expenditures resulting in the creation of a budget, prioritization of all debt, developing repayment strategies, including mortgage modification, establishing a "trust" relationship with the consumer, and helping the consumer qualify for a mortgage modification through reduced overall consumer debt and lifestyle spending as features of consumer credit counseling. Further, Hartarska et.al (2001) presents empirical evidence to support the hypothesis that, when properly designed, the innovation of credit counseling reduces the incidence of default on low-income mortgage loans.

In the Sri Lankan mortgage market, a mortgage applicant has to submit a list of documents and these include an approved plan of construction, title, title report, pedigree insurance etc. Submission of these is not easy for the type of person who is in most need of a mortgage loan in Sri Lanka. Even after the submission of those documents, there is a critical need for financial, legal, and technical/engineering knowledge on the construction of a house as house construction or its supervision has to be carried out by the owner and most houses are self-build or involve the house owner, with support from relatives, hiring individuals to undertake work. Most households build their own housing over a long period, facing a range of hurdles. In this situation excellent ancillary services connected to the mortgage market spur the development of that mortgage market. House developers are not yet popular in many parts of the country and few of such service providers are available in city areas. Against this background, this study has considered financial, legal and technical/engineering advice services provided by mortgages suppliers.

4.1 Financial advice

Financial education and counseling hold the promise of improving financial knowledge and facilitating behavior change, Collins et.al (2010). They mention that it is quite clear that better studies are needed to refine how financial education and counseling strategies are designed and implemented. Credit counseling should reduce the number of distressed borrowers. In the current financial market financial literacy is a critically important issue among many potential mortgage borrowers. This is recognized as an issue even in developed economies. A significant number of Americans, including many highly educated people, seem to understand very little about residential mortgage finance decision-making and how their personal financial circumstances can determine whether their mortgage loan is approved, the interest rate, settlement fees, and the overall costs of mortgage financing, Rose (2011). This provides an important clue as to the need for loan counseling services in local markets as well. Such counselors typically concern themselves with counseling borrowers on behavior and actions they can take that can help them avoid future financial difficulties.

4.2 Legal advice

The Mortgage Act with amendments is a document of more than 38 pages using technical jargon which can only be understood by an expert in the field of law. Beyond that there are many other legal requirements relating to insurance, debt recovery, deed, stamp duty etc. The mass of mortgage holders are not aware about the content and provisions of the Mortgage Act. There are legal experts working for accepted/registered mortgage loan suppliers. Their work is a part of the mortgage loan supply process but it is only to fulfill the legal requirements of the loan supplier. All legal requirements of the borrower have to be arranged by them, which is a critical barrier and which has a high cost. Further, most mortgage customers do not clearly understand about the legal arrangements and the importance of them for their security.

4.3 Technical advice

In countries like Sri Lanka, almost all income groups partially or fully construct their own houses but their technical and engineering capabilities are not at an acceptable level to manage such works. However, in this environment it is still accepted that much of the existing stock of houses has been self-constructed by the house owner. In relation to technical or engineering skills, there are technical experts in mortgage loan supply institutions to evaluate the house or work plans submitted under the mortgage loan application. However, their services do not extend beyond the mortgage loan approval although construction works may be ongoing. This may create issues for the house owner in terms of extra costs, the inability to complete works as planned and so forth. This failure may cause a number of other issues and those issues may finally put the lender in difficulty.

5. Methodology

This article will use examples mainly from individuals who have experienced mortgage default. Information was gathered on the ancillary services provided by mortgage lenders with structured interviews conducted with borrowers in default. This study was not intended to provide a quantitative statistical analysis of the sample of mortgage lending institutions in the market. Face-to-face interviews with borrowers were held and conducted without any intervention by the lender in the discussions. Each borrower was asked specific questions relating to their satisfaction with the ancillary services provided. The information provided by the loan holders on existing mortgage loan ancillary services included loan counseling, legal advice and technical advice offered by their lending institutions. In order to ensure the privacy and confidentiality of the information provided by each loan holder they were informed that only aggregate summary data would be reported. The total number of borrowers interviewed was 30 and face-to-face interviews were held from December 2012 to February 2013.

Discussions with borrowers

Case Study 1

X is a 34 year old man who resides in Kottawa. After three years of his marriage he started to construct a house for his family with financial assistance from a mortgage loan. The plot of land was bought previously with a mortgage arranged by the same organization. By this time there were three members in the family including their child. At the beginning of the second mortgage agreement he had to pay 30% of monthly salary earned for the first mortgage installment and the interest rate on the mortgage was 19.5%. However, after 5 years he was paying 80% of his salary on loan installments while he has not been able to complete construction works on the house as he had planned previously. He disclosed that he had submitted some documents to show extra income though actually he did not have such income at the time of applying for the mortgage loan. While he was shouldering these commitments a second child came into the family. By now he had lost the capacity to meet both his family needs and to meet the payments on his mortgage loan. As a result he had entered several informal financial arrangements with known third parties in the course of making an effort to manage. All these efforts had increased his difficulties but he had not discussed his inability to meet payments on his mortgage loan with the mortgage supplier.

This case illustrates the need for increased financial capability to enable individuals to handle their income and expenditure. If this person had received guidance and explanation on how to overcome his issues, the level of risk he could afford, and what options were available to him, he might have overcome his problems. For instance, he could have obtained advice on loan rescheduling, on how to gain a grace period on payments, the danger of informal financial arrangements etc.

Case Study 2

Y is a 38 year old unmarried woman who works as a nurse at a government hospital located far away from the capital city. She was dreaming of a house and bought a plot of land with 6 perches (1 acre = 160 perches) for 400,000 LKR out of a 1,000,000 LKR loan obtained from a bank to construct a house. In the process of purchasing the plot of land she looked for guidance and help with the legal and administrative requirements from a number of third parties known to her but she had to go to a lawyer a number of times because of errors in the legal documentations. After obtaining the loan, she started construction work with verbal guidance from third parties known to her, trusting their words. Construction work was carried out by individuals living close to the area. After completing some work she was uncertain about the accuracy of measurements, the mix of materials, and so on. She questioned the workers about her doubts and this created a tense situation among them while she feared that they had committed misconduct. Finally, the work stopped as she could not continue. Then, she approached some other workers and requested them to carry out the balance of works. They informed her that the previous workers had committed some serious mistakes which they would have to rectify. Since then she has been stuck for more than two years without completing the walls of the house. She has said that she has not the financial capacity to complete the balance of works as she had to bear unexpected costs for rectification. Further, current prices of construction materials are much higher than at the time she planned and started the work.

She frankly explained the difficulties faced by her because of her lack of technical/engineering knowledge on house construction. More importantly she referred to her inability to supervise construction works as she is not confident in this area. She had consulted many individuals but they had no formal and systematic knowledge on those areas and she failed to gain access to services from formal and trustable professionals. This had resulted in unexpected issues such as quarrels with workers and the extra cost of rectification.

Case Study 3

Y is an unmarried 49 year old woman residing in Miriswatta. She worked as a music teacher for a government school. She spent the last 30 years with her sister but when some issues arose she had to leave the place. Thereafter, she had made a temporary shelter on land belonging to her which had been bought with her savings about 7 years previously. She started to construct a house for herself with financial assistance under a mortgage on her land four years back. While implementing construction works she was cheated by a number of people. One person/ contractor had promised to start works and obtained money in advance for materials and other expenses but did not come to do the work. Then, she tried with another contractor but she realized that he was over-charging her halfway through the work. Following that experience she tried to continue construction of the house by assigning part of the work to individuals under her supervision. She retired early from her job as she was unable to manage this with her job responsibilities. However, only the walls of the house have been completed over the last three years and she has no financial capacity to pay for the balance of the work to complete her house. As a result she has become disillusioned and has advertised to sell the land with a half-constructed house. She referred to the pressure of loan repayments and her inability to cover the cost of construction work even though land has been sold.

Usually, a music teacher does not have the necessary capability and knowledge of construction and engineering. She was facing the difficulty of finding a good service provider for construction works. If she had had a good builder, she would have been able to manage her job and the completion of the construction work even though she had financial difficulties.

Knowledge and awareness about financial arrangements, or the financial ability to deal with lenders are both crucial elements. Out of the total of respondents the majority did not know how to decide or calculate loan repayment installments or what information is used to calculate them while only very few respondents had gained financial management education or training. Further, 91% of them did not know whether early settlement of a loan would be economically advantageous or disadvantageous for them in their current situation other than saying if they had money they would settle the loan and get relief from the liability. More importantly 68% of respondents had not evaluated market interest rates before selecting the lender. They had selected the lender on the recommendation of known third parties or because the lenders were government establishments. It was indicated that 34% of respondents had not been able to meet the completion of works as they planned with the amount they received from the mortgage loan. All the above indicates that mortgage customers have insufficient awareness and knowledge in relation to financial management or financial capability.

The documents containing the legal requirements are drawn up by the loan supplier and it is the customer's responsibility to complete and submit them. Out of the 30 interviews, 65% claimed that all legal documents were submitted by them as per the requirement and all of them were completed at their own cost and using their own legal arrangements. The balance of 35% mentioned that the loan provider gave guidance on how to obtain these legal arrangements but the total cost and effort was their own. Further, 41% of respondents did not have awareness of the terms and consequences of those legal documents and they had not even read them before the loan agreement was approved and signed. Some respondents (32%) knew what the documents were by name but had not clearly understood why those were needed and the content of them before signing the mortgage agreement. Further, 89% of respondents did not know that there is a mortgage law covering the country.

The loan supplier will make a requirement that the borrower must submit a house plan approved by the relevant government administrative body (local government) as a condition of obtaining a housing loan. In relation to the technical or engineering support rendered by the loan provider, the majority of respondents discussed an overall limitation to the bill of quantity [BOQ] and housing plan. Out of the mortgage loan holders surveyed 79% had not received any technical or engineering advice on their construction works from the mortgage loan suppler. Some of the respondents stated that technical and engineering support was limited to a BOQ and after getting the approval for BOQ, all discussion in relation to the construction work was over. 82% of respondents had paid for professional consultancy on technical and engineering work services prior to the commencement of their house construction work. 27% of respondents mentioned that there were no such professionals to get technical or engineering consultancy from in the mortgage loan supplying office.

6. Findings and conclusions

If the mortgage loan supplier does not meet the service requirements of customers it can cause a failure to fulfill expectations. Customers have to bear additional costs and there may be dissatisfaction over many issues. Finally default on the mortgage loan may occur. Many interviewed borrowers in default did not have a clear awareness of mortgage procedure and their long term commitments and responsibilities. The majority of respondents took on the responsibility of construction of their home or they built it themselves even though they did not have minimum technical and engineering knowhow on house construction. More than half of the sample had contacted separate individuals for each piece of work such as one for the foundations, one for concreting, one for masonry works on walls, another for plastering, another mason for tiling, one for doors and windows, one for roofing etc. As a result they spent more than the average time on construction of a house. They expressed their dissatisfaction with organizing and arranging these works, with the unnecessary cost they incurred and with the poor quality of work.

None of the respondents claimed that they defaulted on their mortgage loan intentionally or defaulted because the default option was financially advantageous. They had not been able to cope with changes in costs and additional items of expense including increases in construction costs, restitution, and unexpected experiences. These indicate the need for all related services to be obtained from one service provider who they can trust and who is convenient for them to use. All the above indicates the need for a well arranged counseling and support service for borrowers before and after signing the mortgage agreement. This should include a property construction inspection service. Mostly lenders can overcome those issues by arranging along with housing loans multi service (complementary - inclusive of financial, legal, and engineering/construction) counseling instead of simply granting loans and letting borrowers make their arrangements for the rest of the works and meet the responsibility of repaying the loan.

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Housing finance in Latin America: demographic and economic drivers

By Jorge Yarza

1. Introduction

Latin America is one of the fastest growing regions in the world. With over 500 million people and more than 120 million houses inhabited. The region had an important population expansion in the last three decades, and its population grew 1.7 times in the last 30 years. This growth in population and an intensive migration from rural areas to the urban communities, created an expansion of the urban areas and housing construction.

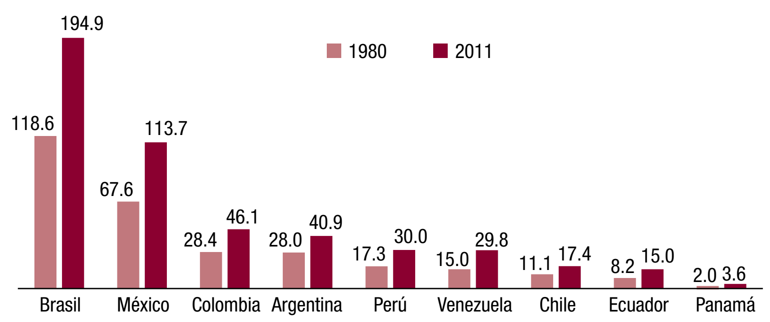
Latin America is a young region with an average age of 23 years. This means that the population demands education, job opportunities and spaces to develop their lives. A high percentage of the population is still studying and is not yet part of the workforce. We are in the process of the Latin America *baby boom*. The driving force in housing demand is the formation of new families and households. The growth of the population is a secondary driver and it is more related to the use of space and characteristics of the dwellings, than the demand for brand new houses.

During the next years (2014 to 2025), the number of new households in Latin America will increase by nearly 50 million - and they will demand over 40 million new houses in the middle sized and large cities. The quality and conditions of the houses will depend on a series of factors, but if the trends continue, a high percentage will be produced as informally built houses.

The major challenge is to plan, finance and develop over 20 million formal houses in the largest 35 cities in Latin America by the year 2025. This will require investments in infrastructure, housing and mortgages with a value of more than 1.3 trillion USD.

UNIAPRAVI was founded on 1964, and it is an international private non-profit organisation that is part of the advisory Committee of the Economic and Social Council of the United Nations. It has over 150 participants and 27 member countries in the American continent. Its mission is to create the conditions for the exchange of knowledge and organise events that promote the exchange of ideas, identifying the best practice that enables policy making in the region.

Figure 1 Population growth in selected countries 1980-2011



In the past four years, UNIAPRAVI has worked together with the United Nations [CEPAL], Ministries of housing and the leading private sector institutions, to create a common vision and a framework to exchange best practice in the American continent. The participants in this process have identified four strategic lines to enhance the situation of the housing and mortgage sector.

1. Public and Private co-ordination that promotes the creation of long-term institutions
2. Develop a stronger real estate market and a deeper financial system, in order to reach 4% of GNP per year
3. Use the Housing sector as a driving force for economic and social development
4. Promote the development of competitive cities with urban design that creates wealth, employment and sustainable growth

2. Public and private co-ordination

In the Latin American region, a key element for better urban development is the formulation of public and private long-term policies.

The role of the Government is very important. For it creates the conditions for new developments and city planning. The Government also channels resources to the housing sector through subsidies and development banks.

Governments are also responsible for the introduction and development of infrastructure – water, sewage, roads and electricity – in most of Latin America these activities remains under government control. One of the challenges facing urban development is the financing of city and municipalities who require investments in the present, with a long-term recovery scheme. The quality of cities is directly related to the availability of long term financing.

There have been interesting initiatives in Brazil and Mexico where the Ministries responsible for Housing and urban development have integrated housing, infrastructure and land use in a single entity, thus facilitating the process of coordination and decision making under one office.

Urban development requires the coordination of different activities and stakeholders. In Brazil and Mexico, Ministries have advisory boards with members from the federal government, local authorities, private sector and experts. This allows a more democratic and participative scheme, which facilitates implementation and helps to keep a long-term vision of the development of cities. In the Latin American region, a key element for better urban development is the formulation of public and private long-term policies.

The participation of the public and private sectors is essential to keep a long-term vision and sets the framework for economic and social development, as the key driving force.

As an example, the functions of the Brazilian Ministry of City Development are illustrated below.

3. Develop a real estate market in order to reach 4% of GNP per year

Housing and Real Estate are important elements in the economic process of every country. The value of the housing inventory in some countries in the Latin American region represents more than 1.5 times GNP (Mexico & Chile).

The housing sector has a positive effect on the value chain of the industries that are connected to the production of houses. Building is a process that requires labour and materials that are, in most cases, regional. This promotes employment and local economies.

The challenge that Latin American countries face today is a balance between the growth in the housing inventory and the quality of the dwellings.

Every year the housing stock of Latin America grows by over 4 million houses. Of these houses, it is estimated that over 30% are informal houses

Figure 2 Ministry of city development (Brazil)

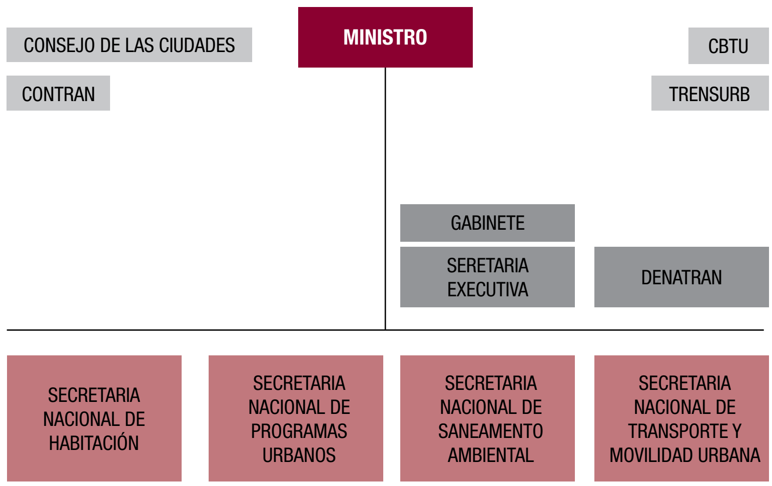


Figure 3 Labour informality in Latin America

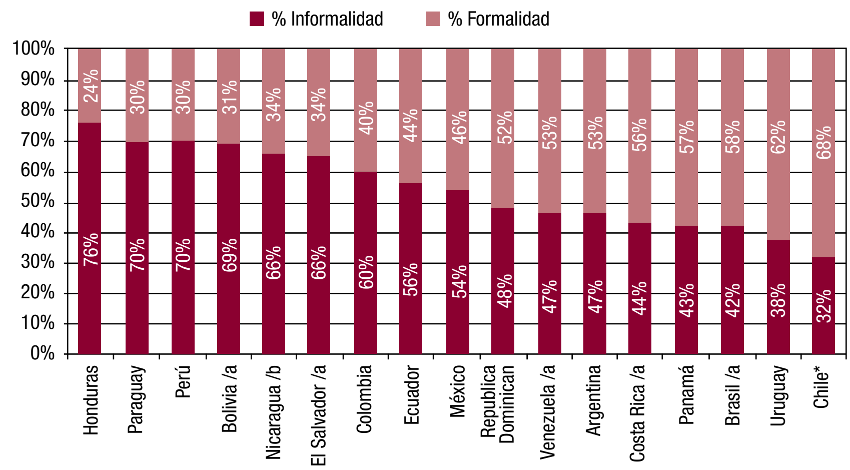
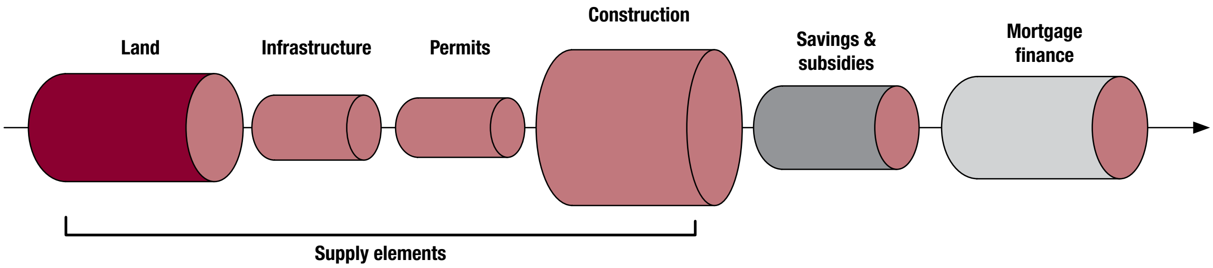


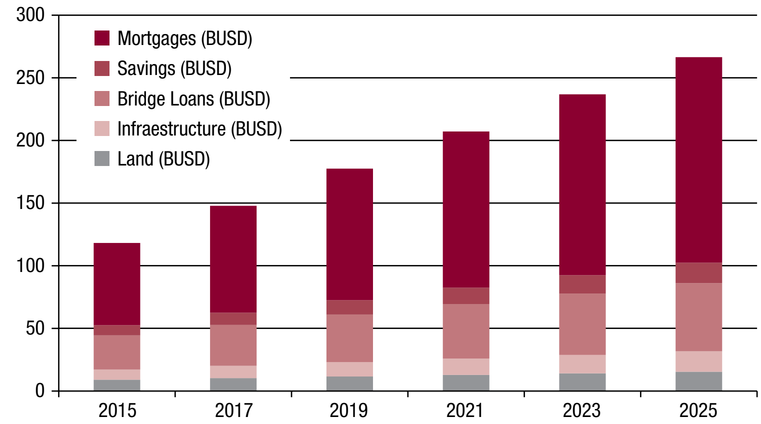
Figure 4 The housing sector value chain or pipeline



that do not comply with the legal requirements, property title, building conditions and public services that in theory should be met. Informality is part of the social and economic reality of the continent and housing and labour informality are facts of life.

Figure 5 Formal and informal housing (Mexico)

Figure 6 Investments in housing in Latin America (2015-2025)



Housing and labour informality are closely related. As informality is reduced, people have access to mortgage credit and banking services, thus they can have the option of formal housing.

One of the key questions is: How can we produce and finance better housing?

Housing is a process that can be illustrated as a value chain or pipeline.

The pipeline shows that we have different capacities and bottlenecks in the process. In order to increase the output of housing production, a balance must be achieved and the bottlenecks should be removed.

Therefore a series of actions must be taken at each stage of the process to increase the throughput capacity of the pipeline.

1. Urban development - formal and Informal improvement of present conditions
2. Urban planning for new communities
3. Financing the municipal services and utilities
4. Government sponsored entities and development banks
5. Savings, subsidies and mortgages for the households
6. Capital investment in all the stages of the process

In the majority of countries, land availability is not a restricted; the restrictions tend to be more in terms of the introduction of infrastructure and services.

Paperwork and permit compliance is also a bottleneck for formal production. As one can imagine, the stages of the process where capacity is limited, tend to create informal solutions with sub-optimal results in terms of legality, ecological effects and wealth formation.

Construction capacity is not in general a restriction and most of Latin-American countries have the building and civil engineering capabilities to supply houses.

The combination of savings, subsidies and mortgages is a major bottleneck. Savings are limited and often informal, so many families opt for solutions where they can have shelter and self-built houses.

It appears that the options are either industrial housing production or the disordered use of land with informal built dwelling.

The positive combination of the public and private sectors seems to be the solution to better housing. Urban development is a long-term process so the policies need to be consistent over long periods of time.

The development of the value chain will have a wealth creation process in respect of two important objectives.

1. It creates value, employment and triggers the production of materials. This contributes to the National Product.

2. Formal housing becomes part of the family equity and can be financed, inherited or sold. It is legal and complies with local requirements. Formal housing has a lower negative impact on resources and promotes sustainability and ecological measures.

The objective the private sector pursues is to develop a bigger sector with more economic capacity over all the stages of the housing pipeline. Today formal housing accounts for about 2% of the GNP in Latin America, whereas in more developed economies this figure is closer to 6%.

The opportunity to develop better housing and a stronger internal market in the next ten years is a major issue on the agenda of the Latin American countries. Softec, a leading Mexican consultancy firm, has estimated that the region will require investments in the region of 1.3 trillion US dollars. The estimation of resources, on a yearly basis, will grow from 130 billion US dollars to over 260 billion US dollars by 2025.

4. Use the housing sector as a driving force in economic and social development

Housing and Real Estate have two dimensions in the perceptions of policy makers. One of these is the social implications of housing for the well being of people and families. The other is the economic dimension of the housing development process.

The social perception of housing is a major political theme on the agenda. Demand for better housing for those with fewer resources is of concern in relation to social equality and opportunities. In the case of Latin America, where the growth of houses, both formal and informal, is a key topic, some initiatives have been taken in three directions.

First, a series of initiatives have been put forward in order to overcome present conditions. The objective is to reduce the deficient conditions of an important percentage of substandard housing (Softec estimates are that 30% of houses in countries like Mexico are substandard). The organization of urban regeneration has been more on a project-by-project basis. The improvement of the inventory quality will take many years of sustained effort and fiscal resources throughout the region.

The Second objective is to provide accessibility to those segments of the population with fewer resources. The mechanism most frequently used has been subsidised homes or direct subsidies to families who acquire a house. Subsidies are often linked with a savings programme.

The third line of action has to do with the process of formality and upward mobility of the families. In almost every country in the Latin American region there has been an increase in the consumption capacity, capital formation and purchase of automobiles, utilities and houses. These constitute the process of creating a bigger middle class.

The perceptions and expectations are also an issue to consider. The socio-demographics in Latin America are changing. People are more informed, they use digital tools to compare their different options. Families are moving out of the traditional patterns and are considering other lifestyles. All these elements will have an influence on the houses that will be required in the future.

The economic outlook in general is positive, and the economy is expected to continue to grow in the future throughout Latin America.

The basic economic condition of families is improving and in the next ten years we will see an upward mobility of the families in Latin America. This means that the economic dimension at an individual and family level will improve.

Figure 7 Systemic view of competitive cities

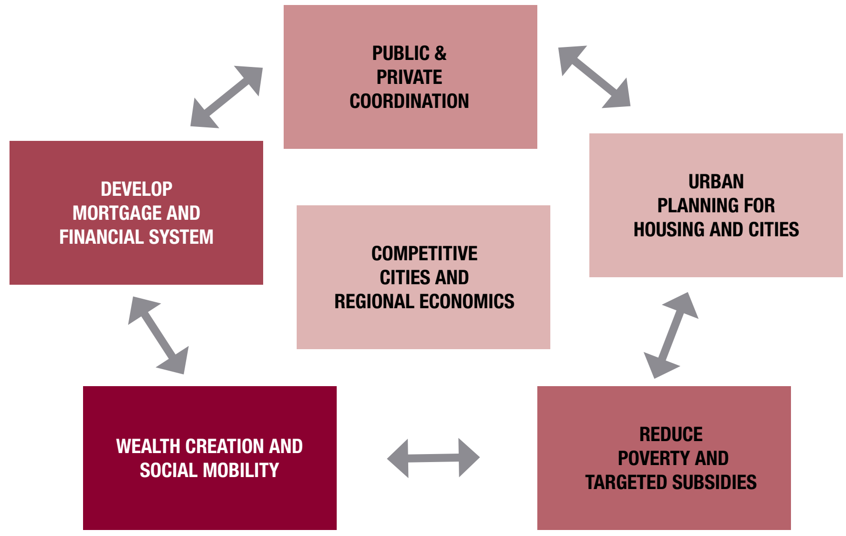
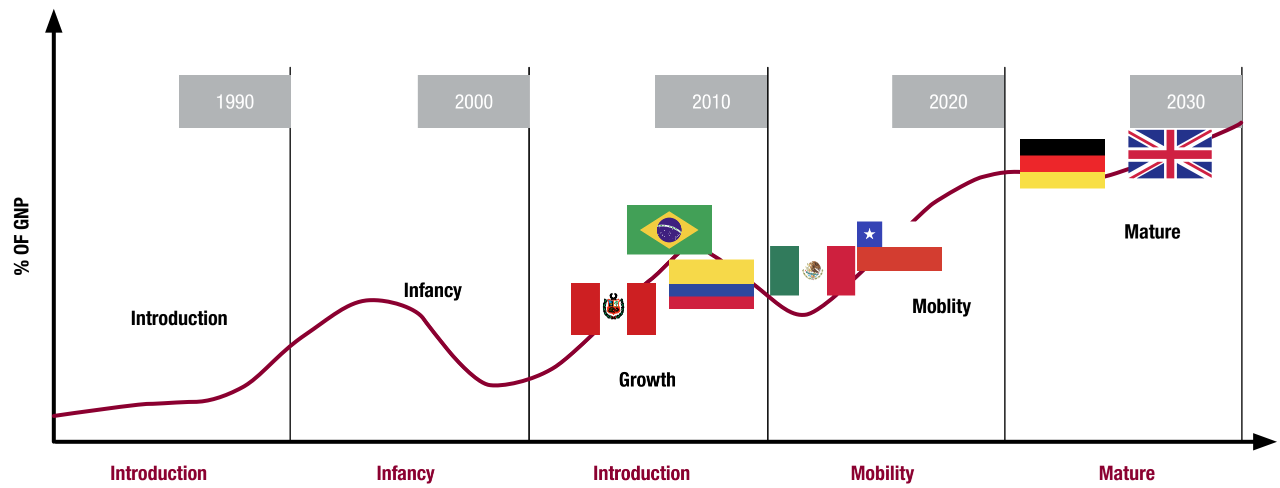


Figure 8 Life cycle of the housing and mortgage market



Given that housing is the major asset of a family, the expectation is for a growing market for houses. Upward mobility will also be related to the formation of new jobs and commercial activities.

In the next ten years urban development, including offices, commercial centres, factories and services, will be the major driver in the development of the cities in the region.

5. Promote the development of competitive cities with urban design, which creates wealth, employment and sustainable growth

The development of competitive cities with planned solutions for housing and real estate is the key driving idea in regional development in Latin America. Brazil and Mexico are among the six leading countries in developing and producing houses in the world.

The view of urban development promoted by UNIAPRAVI and its associates is a systemic model that considers competitiveness as the key element.

Under this systemic view, six elements interact and have a mutually re-enforcing effect. The focus is the creation of value, quality of life and economic activities in the major cities.

Long term planning with the involvement of all the stakeholders (public and private) is another element that is essential in the process as discussed before.

The recognition of the actual conditions of the different segments of the population and the agenda to reduce poverty and promote constructive upper social mobility that creates a growing middle class, are also important elements in the system.

Long term financing and mortgages are the catalysts of the whole process. The whole financial system needs to be developed, including the saving and pension fund schemes. The role of development banks and government-sponsored institutions will be critical in the next 20 years in the Latin American region. The stage of development at this moment require measures similar to the ones that where taken in Europe or the United States 50 yeas ago.

Different countries are in specific stages of development in terms of urban planning, the economic importance of the housing and real estate markets and the mortgage system.

We can understand better the specific conditions and challenges when we identify the evolutionary nature of mortgage markets.

Latin America is at this moment an area of opportunity. New companies and schemes will emerge and those who understand the momentum and trends will be in an excellent position to be part of the development of those markets.

Institutional challenges for lending organizations in the West African housing finance system

By Basirat Oyalowo and Timothy Gbenga Nubi

1. Introduction

The functions that lending organizations perform in the housing market are generally broad and impact on national development, especially where the mortgage market is embedded in the macro-economic financial policy. Major functions include the mobilization of household savings, allocation of funds for lending to loan seekers, allocation of domestic and international funds to the local housing sector, differentiated loan product design and also, integration of the housing system into the local and global financial markets (Forrest, 2008; Renaud, 1985). As most of these functions can be achieved through policy liaisons with government regulatory agencies, the effectiveness of lending organizations rests on the policy environment in which they operate. However, some institutional factors act to constrain the ability of lending organizations to carry out lending activities. Institutional factors are here defined as the macro-economic and financial infrastructures acting on the capacity- and willingness- of fund suppliers to provide accessible (to the borrowers) and profitable (for themselves) housing funds across various income groups. Without a cohesive framework that integrates the profit seeking motives of formal lending organizations with the social obligation of the government, the general housing sector might become dysfunctional. This could account for the informality inherent in the housing finance sector in developing countries, where the contribution of formal lending organizations to the market has been minimal (Chiqiuer et al., 2004; Erbas and Nothaft, 2005; Nubi, 2010). Across emerging economies, the scale of residential lending is small, expensive and thus poorly accessible, with lenders being exposed to several risks- credit, liquidity and interest rate risks (Chiquier et al., 2004). Further, in Africa, a shortage of homes for sale in the open market has led to widespread adoption -by all income classes-of self-build options, with finance sourced from informal means (Centre for Affordable Housing Finance in Africa CAHFA, 2011). The limitations affecting the participation of formal lending organizations in the housing sector could also be a contributory factor to this state of affairs. The aim of this study is therefore to examine the institutional constraints acting on the ability of lenders to carry out loan mobilization functions in the West African region. Loan mobilization in this context, relates to the ability of the formal lenders to gather sufficient funds from borrowers through the savings and mortgages they (borrowers) make in the formal sector. The study is therefore limited to studying constraints on the supply side, from which inferences about the necessary and sufficient criteria for their enhanced participation in the market can then be drawn.

In subsequent sections, the institutional conditions necessary for the mobilization of housing finance by formal lending organizations are examined. Next, these conditions are highlighted in relation to the West African context. The study methodology is thereafter presented; followed by a discussion and concluding remarks.

2. Institutional conditions for market-based housing finance systems

The influence of institutional factors on housing finance mobilization has been studied in varying depths in a number of studies. However, there is a dearth of comparative research focused on the West African region. For instance, Erbas & Nothaft (2005) presented a case for the introduction of mortgage suppliers in five Middle East and North African countries. Djankov, McLeish & Shleifer (2006) investigated cross-country determinants of private credit using data on legal rights and private and public credit registries in 129 countries between 1978 and 2003. They found that legal creditors' rights and existence of information sharing institutions are statistically significant in the private credit development of these countries.

Chiquier et al. (2004) focused on emerging countries spread across Latin America, Asia, Eastern Europe and the Middle East. The study examined the experience in developing mortgage securities development in emerging countries with case-studies of eight emerging economies. They argue that a country must have sufficient legal, regulatory and primary market infrastructure to be able to tap into more formalized sources of finance such as mortgage securities.

Renaud (2004 in Warnock and Warnock, 2008) examined the constraints on mortgage finance in emerging economies and noted that macro-economic stability, property registration and development of modern mortgage laws are a pre-requisite for the development and growth of mortgage markets, which is the foundation of formal housing finance.

More recently, Warnock & Warnock (2008) examined the determinants of housing finance in sixty two countries which included one West African country (Ghana). However, the authors concluded that a stable macro-economic condition, strength of legal rights for borrowers and lenders, and deep credit information systems contribute to deeper housing finance systems.

Similarly, Butler, Kravkova and Safavian (2009) examined the regulatory efficiency in the mortgage registration and title transfer process as well as ease of foreclosure in 42 countries. They concluded that the size of housing finance markets depends on land rights, income distribution, macro-economic stability, financial market depth, urban planning policies and the availability of other sources of long-term finance. They also reiterated the need for ease of mortgage registration, title transfer and ease of foreclosure processes as conditions necessary for the development of housing finance markets. More recently, Adams & Fuss (2010) determined the impact of macro-economic variables on house prices. Using panel data on macroeconomics and housing markets for 15 countries over 30 years; they found that interest rates and construction costs had significant average long-term impacts on house prices in the 15 OECD countries studied.

While providing significant insights into the factors underpinning the performance of housing markets in several developed countries; none of these studies presented targeted and detailed analyses of the constraints acting against developing countries-such as in Sub-Saharan Africa-as a whole, despite the increasing potential of the region as a possible property investment destination (Centre for Affordable Housing Finance in Africa CAHFA 2011). In filling this gap, the most prominent institutional factors identified in the literatures (with consideration for availability of data) are selected and analyzed in relation to the West African region.

2.1 The current situation in West Africa

A number of factors have been identified in the literature as being integral to the development of mortgage finance, which has become synonymous with formal housing finance for developing countries (see Chiquier and Lea 2009).

The strength of mortgage lending in a country is enhanced by the ability of financial institutions to gather loans from savings and thereafter disburse effectively across all geographical locations of the country (Renaud, 1985). This requires stable macroeconomic conditions where inflation rates are low and stable over time, with a balanced distribution of income and single digit interest rates. Apart from this, the quality of access to credit information by lenders is also important, as it facilitates the development of various loan structures to suit the needs of borrowers; while also ensuring that lenders can carry out objective verification of the ability of potential borrowers to repay the loans and also ascertain the soundness of their collateral (The World Bank, 2009). This information could be accessed from private credit bureaus or public registries or both.

Lending activity is enhanced by the ability of lenders to foreclose on defaulters' properties quickly and easily. Ease of foreclosure has been found to be a significant factor in regulatory efficiency in housing finance systems (Butler et al., 2009).

The legal powers of lenders are also enhanced by the quality of the country's property registration system, which should be quick, relatively cheap and not bureaucratic. Thus, these factors: strength of mortgage lending, stable macro-economic conditions, access to credit information networks, legal power of lenders and property registration systems, are examined in this paper as integral conditions to mobilizing funds from the market.

2.1.1. Strength of mortgage lending

The ratio of mortgage lending to GDP is the measure of the financial resources provided by the private sector in the form of mortgages. It is a direct measure of mortgage lending in a country. Available data (CAHFA, 2011) shows that this data is available for only a few West African States. As at 2009, Nigeria has 0.4%, Ghana has 0.2% and Senegal 2% mortgage lending to GDP ratios. The small size across the three available countries where data is available is an indicator that the fund disbursement from the market to prospective home-owners is also low in the region.

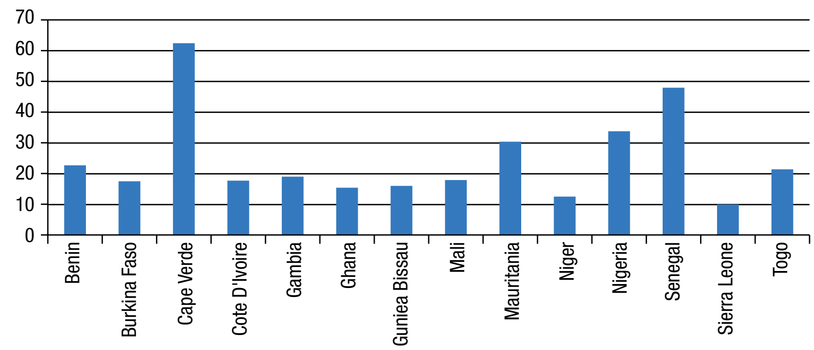
The absence of data for other West African countries is an indication of either its non-existence, or lack of measurement and probable insignificance to the national economy. In view of this, a more widely available indicator of the ratio of private credit to GDP- is used as a proxy for the depth of mortgage lending to GDP. The private credit to GDP ratio captures all the private sector debts in the market: of which mortgage debts are a component. It would therefore give an insight into the upper limit of the potential size of the mortgage market and its contribution to the national GDP.

Figure 1 below shows average private credit to GDP ratios for 2009 and 2010 for 14 West African countries as available from the World Bank (2011) data base. It shows that Cape Verde (at 62%) and Senegal at (48%) are two countries where the private credit ratio appears significant. It is therefore probable that the mortgage credit component of this ratio in comparison with the GDP is accordingly low.

2.1.2 Macro-economic stability

For the purpose of this study, inflation rates and GDP are utilized as the indicators of macroeconomic stability. Inflation figures are gathered for all 16 West African countries from the database of the African Economic Outlook for the 2009 to 2012 period. Fig.2 shows the average inflation rates between 2009 and 2012. Due to lack of access to uniform datasets in each country, inflation rates for some years were projected in the original data source (Africa Economic Outlook report). Inflation rates across West Africa are currently in the single digit range and with the exception of countries like Liberia, Niger and Senegal, inflation rates have actually been declining within the past three years. Despite this, there is need to be con-

Figure 1 Average private credit to GDP ratios (2009-2010) in West Africa



Source: Adapted from The World Bank (2011) cerned about inflation changes in the region in the years to come; as increases in inflation could affect sound macro-economic management and stability in the region. As West African countries do not generally have social security systems to cushion macro-economic fluctuations; increases in the price of basic consumer goods and social services would further reduce savings and investment, reducing the pool of funds available for lending in the market.

In terms of economic growth as measured by increases in GDP in the region, the trend had been positive. West African countries such as Senegal, and Guinea Bissau saw accelerated growth in the 2007-2008 period. Good climatic conditions had aided agricultural performance, and high commodity prices increased the region's GDP from 4.6% in 2006 to 5.1% in 2007 ((ECA, AU & ADBG, 2010). However by 2009, the effects of the global recession had resulted in growth stagnation across most of the West African countries. For instance, Guinea recorded 0% growth and Ghana witnessed a 4.5% increase. By 2010, growth had rebounded across a number of countries such as Nigeria and Cape Verde as a result of increased domestic demand and status as an oil exporting country (Economic Report for Africa, ERA 2011).

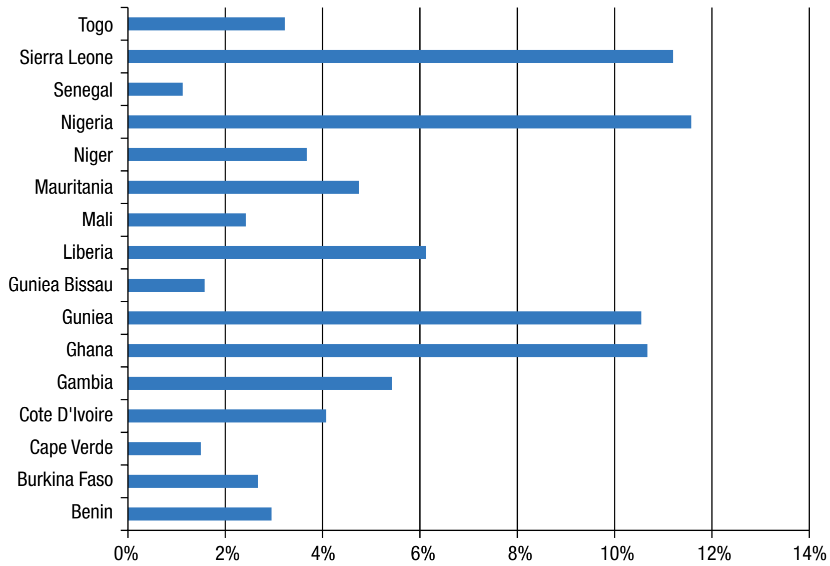
2.1.3 Access to credit information

Three indicators: the depth of credit information index, public registry coverage and private bureau coverage were collected from the Doing Business report's credit information section to determine whether financial institutions had access to information to determine the credit worthiness of potential borrowers. Data was collected for four years; between 2009 and 2012. The data showed that private registry coverage is virtually non-existent in West Africa. Ghana is the only country that has adult population coverage in private credit bureaus in the region, with average of 6% coverage over the four years measured. Although Nigeria recently (2nd quarter 2010) incorporated three private credit bureaus, their performance in terms of coverage is yet to be integrated in the Doing Business reports. As shown in fig 4 below, with over 20% coverage, Cape Verde has the highest public credit information bureau coverage in West Africa. Other countries such as Benin, Mali and Senegal have public bureau coverage, but have not achieved up to 15% coverage over the period measured. Across all the regions of the world, the Economic Community of West Africa States (ECOWAS) region has the lowest depth of credit information.

2.1.4 Ease of registration of property

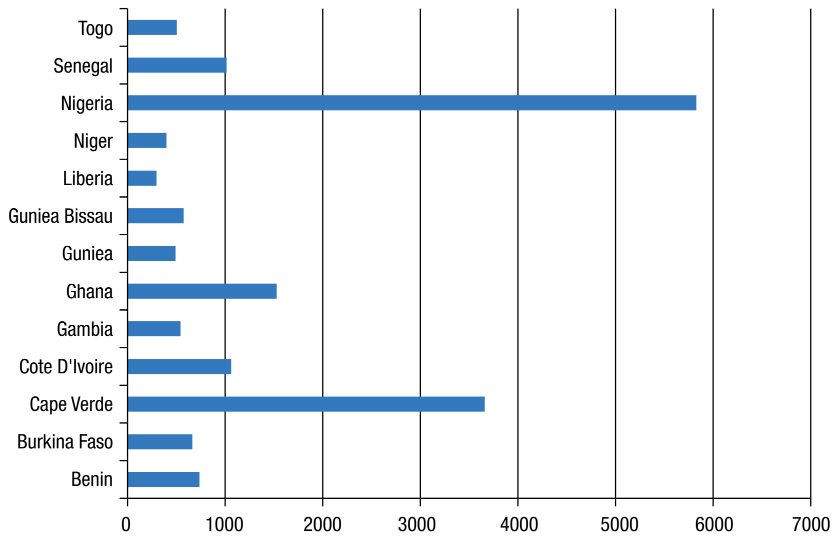
To test the quality of the institutional structures necessary to register properties in the region, data was gathered from the Doing Business reports (registering property section) for four years (2009-2012). In this period, at least one West African country was at the bottom of the rating schedule in each of the three indicators measured; on a global scale. The indicators, shown in tables 1, 2 and 3 are: number of procedures necessary to transfer property title, time to register property measured in days and cost to complete registration measured as a percentage of property value. At 13 stages, Nigeria has one of the highest numbers of procedures to register properties globally-although reforms are being carried out in the sector

Figure 2 Average percentage inflation 2009-2012 (projected) across West Africa



Source: www.tradingeconomies.com; African Economic Outlook Database (2012).

Figure 3 GDP per capita (USD) across West Africa (2011)



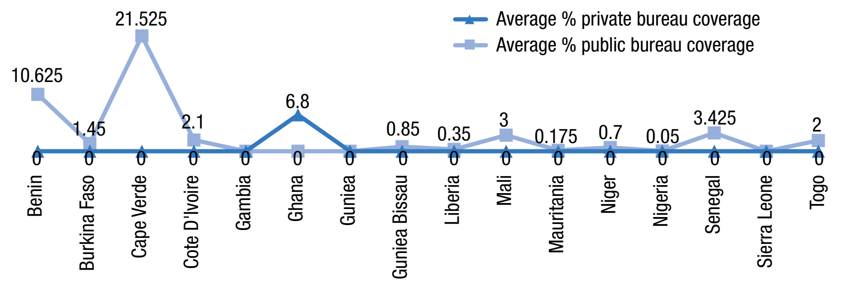
Source: African Economic Outlook Database (2012) through the introduction of GIS mapping and computerized registration systems in several states of the country; the effect of this reform is yet to be measured. Four West African Countries –Guinea Bissau, Sierra Leone, Togo and The Gambia were amongst the slowest countries in which to have a property registered (table 2). Globally, the cost of registering properties is highest in several West African States: Cote d'Ivoire, Guinea, Mali, Senegal, and Nigeria. However, in Burkina Faso, new regulations were made to recognize the land registry and establish statutory time limits for registration procedures. The Doing Business reports therefore present Burkina Faso as a global best practice country.

2.1.5 Ability to secure collateral by lenders

Data is gathered for the years 2009 to 2012 from the World Bank's Doing Business reports to test the extent of the legal powers of lenders. The legal right index ranges from 0 (weak legal rights) to 10 (strong legal rights).

Fig. 5 shows that across West Africa, Nigeria, Gambia, Ghana and Sierra Leone ranked above average in the legal strength of lenders' ranking. The ability of lenders in the region to seize properties used as collateral in the case of default is therefore generally not strong. Since loan recovery is hinged on successful foreclosures; lenders might not be encouraged to participate in loan disbursement in the face of weak legal rights.

Figure 4 Average % adult coverage on public and private credit information bureau across West Africa 2009-2012



Source: World Bank's Doing Business West Afican Regional Reports 2009, 2010, 2011 & 2012)

Table 1: Number of procedures to register property (2009-2012)

COUNTRIES	PROCEDURES TO REGISTER				AVERAGE
	2009	2010	2011	2012	2009-2012
Benin	3	4	4	4	3.8
Burkina Faso	8	6	4	4	5.5
Cape Verde	6	6	6	6	6.0
Cote d'Ivoire	7	6	6	6	6.25
Gambia	5	5	5	5	5.0
Ghana	5	5	5	5	5.0
Guinea	6	6	6	6	6.0
G/ Bissau	9	9	9	8	8.8
Liberia	13	13	10	10	11.5
Mali	5	5	5	5	5
Mauritania	4	4	4	4	4
Niger	5	4	4	4	4.3
Nigeria	14	14	13	13	13.5
Senegal	6	6	6	6	6
Sierra Leone	8	7	7	7	7.3
Togo	5	5	5	5	5

Source: World Bank Doing Business West Africa Regional Reports 2009, 2010, 2011

Table 2: Time to register property (2009-2012)

COUNTRIES	TIME TO REGISTER PROPERTY (DAYS)				AVERAGE
	2009	2010	2011	2012	2009-2012
Benin	11.8	120	120	120	93
Burkina Faso	12	136	59	59	67
Cape Verde	73	73	73	31	63
Cote d'Ivoire	62	62	62	62	62
Gambia	371	371	66	66	219
Ghana	34	34	34	34	34
Guinea	104	104	104	59	67
G/ Bissau	211	211	211	210	210
Liberia	50	50	50	50	50
Mali	29	29	29	29	29
Mauritania	49	49	49	49	49
Niger	32	35	35	35	34
Nigeria	82	82	82	82	82
Senegal	114	124	122	122	121
Sierra Leone	235	86	86	86	123
Togo	295	295	295	295	295

Source: World Bank Doing Business West Africa Regional Reports 2009, 2010, 2011 & 2012

Table 3: Cost to register across West Africa (2009-2012)

COUNTRIES	COST TO REGISTER PROPERTY (% OF PROPERTY VALUES)				AVERAGE
	2009	2010	2011	2012	2009-2012
Benin	11.4	11.9	11.8	11.8	46.9
Burkina Faso	12.2	10.2	13.1	12.8	12.1
Cape Verde	7.7	7.6	3.9	3.9	5.8
Cote d'Ivoire	16.9	13.90	13.9	13.9	14.7
Gambia	7.6	4.6	7.6	7.7	7.0
Ghana	1.3	1.2	1.0	0.7	1.0
Guinea	15.3	13.90	14.0	14.4	14.4
G/ Bissau	5.4	5.4	6.1	10.6	6.9
Liberia	14.9	14.7	13.2	13.1	13.9
Mali	21.2	20.30	11.9	12.1	35.7
Mauritania	5.2	5.2	5.2	4.7	5.0
Niger	9.0	11.0	11.0	11.0	10.5
Nigeria	22.2	21.9	20.9	20.8	21.4
Senegal	19.5	20.60	20.6	20.3	20.3
Sierra Leone	14.9	12.90	12.2	11.8	12.9
Togo	13.9	13.40	13	13	53.3

Source: World Bank Doing Business West Africa Regional Reports 2009, 2010, 2011

3. Method

Data was gathered in respect to the variables discussed in the previous section for16 West African countries over the short-term (4 years from 2009-2012) period. These were averaged to allow the computation using bootstrap regression method. However, as shown in the previous section, not all data was available for all countries across all variables. For instance, it should be noted that due to limited data, the private credit to GDP ratio is adopted as a proxy for the mortgage credit to GDP ratio and serves as the dependent variable. While it is recognized that the mortgage credit to GDP ratio is a more appropriate measure of nation's formal housing finance depth (Chiquier and Lea, 2009); this strategy was adopted due to lack of data on the mortgage credit to GDP across several West African countries (data was available for only three countries). In addition, the private credit to GDP ratio captures all the private sector debts in the market: of which mortgage debts are a component. Its use as a proxy also provides an indication of the upper limit of the potential size of the mortgage market. Independent variables for the study are inflation, depth of credit information systems (measured by percentage of adults covered by either a private or public credit bureau), property registration index (measured by three variables: time to register property, cost of registering property and number of procedures needed to register a property), and finally, depth of legal strength. The use of secondary data from a number of institutional sources (the World Bank, International Monetary Fund, African Development Bank, Economic Commission for Africa and Africa Economic Outlook) was necessary due to lack of a single, concise database on housing finance for the region. It is therefore noted that this study is limited to the extent of the accuracy of the data from these sources. Having obtained secondary data, for each of the dependent and independent variables, 'bootstrap regression analysis' was utilized to determine which of these institutional factors present(s) the most significant challenges to the participation of lenders in the West African region.

The descriptive statistics shown in table 4 below indicate that the average depth of credit to GDP in West Africa over the four years studied was 23%. Inflation averaged 4.5%; while the average depth of the credit information systems ranking was 3.6. The mean ranking on the registration of property index and strength of legal rights were 6.6 and 3.9 respectively.

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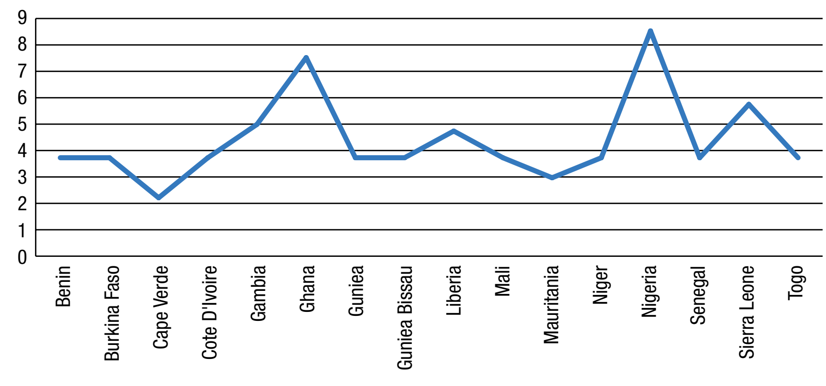
In order to ascertain which of these factors presents the most significant challenge to lending organizations in the West Africa region, the data presented above were subjected to statistical analysis, which is presented in the next section.

Pearson correlation was then used to determine the degree of association between the variables-Private credit to GDP as the dependent variable; and inflation, depth of credit information systems, ranking on property registration and strength of legal rights as independent variables. It was determined that at 0.726 (p value<0.05), there is a significant, positive relationship between the strength of information systems and the depth of private credit to GDP. This is the only institutional factor that has a positive significant relationship with the private credit to GDP ratio. It can be inferred from this that if the credit information system across West African countries is deepened to allow access to credit information on loan seekers; the volume of private credit to GDP may increase.

The reliability of the data set in reaching this conclusion is ascertained in a number of ways. First, by the calculation of the multiple coefficient of determination R2, which measures the degree of fitness of the regression to the data by determining the average correlation and percentage of variation of the dependent variable (depth of private credit to GDP) explained by the independent variables (inflation, depth of credit information systems, ranking on property registration and strength of legal rights). This is found to be 0.785% for West Africa. The adjusted multiple coefficient of determination R-2 is further determined as 55%. It is adjudged that at 55%, the regression model somewhat fits adequately with the data, and that the independent variables

Figure 5 Average rating on powers of lenders across West Africa (2009-2012)



Source: World Bank Doing Business West African Regional reports 2009,2010, 2011 & 2012

Table 4: Pearson correlations and descriptive statistics

		Depth of credit to GDP	Inflation	Strength of credit information systems	Registration of property index	Strength of legal rights index	Mean	Std.	N
WEST AFRICA	Depth of private credit to GDP	1					23.396	15.230	28
	Inflation	-.203	1				4.559	4.351	28
	Strength of credit information systems	.726***	-.358	1			3.657	6.000	28
	Registration of property index	.005	.501***	-.249	1		6.61	2.885	28
	Strength of legal rights index	-.089	.733***	-.416***	.512***	1	3.96	1.796	28

***. Correlation is significant at the 0.05 level (2-tailed). Bootstrap results are based on 1000 bootstrap samples. West Africa: R = 0.785. Adjusted R Square = 0.550.

somewhat explain the dependent variable. As the adjusted R2 shows the multiple coefficient of determination corrected for degrees of freedom, similar results across the two tests would imply fitness of the data to the regression. The two results, at 0.785 and 0.55 are adjudged to be closely fit. The reliability of the result is also supported by the Analysis of Variance test. The ANOVA table (table 5) shows that the F ratio for the regression across West African states is 9.259 with P-value <0.05. The F ratio is the ratio of the average variability in the dependent variable that a given model can explain. Since the values for West Africa are a significant, the independent variables are adequate for the regression analysis.

Third, the variance inflation factor Variance Inflation Factor (VIF) is utilized to determine the existence of multi-collinearity in the data set. The Bootstrap regression co-efficient in table 3 shows that the VIF for all independent variable across both West African states is not up to 5 thereby showing little or no existence of multi-collinearity in the regression models. This further increases the reliability of the dataset and the independent variables adopted for the study.

The result of the Bootstrap Regression Analysis in table 6 below indicates that only the credit information system has a significant effect on the private credit to GDP ratio (significant at 0.000 with p-value<0.05). The standard coefficient (beta) also shows that strength of information systems has the highest effect followed by inflation and legal rights. It can therefore be concluded that the strength of credit information has a direct effect on the depth of private credit to GDP in West Africa.

3.1 Discussion

Unlike previous studies such as Warnock and Warnock (2008) and Butler et al. (2009) which showed that across developed countries, the variation in the strength of the legal rights accounted for the depth of the housing finance system, the bootstrap regression analysis shows that strength of credit information systems is the most significant institutional factor affecting the participation of lenders in housing fund supply in West Africa. The implication of these findings is that should West African countries provide better mechanisms for efficiently capturing credit history information on fund seekers; there is a possibility of increased interest in lending activities generally, which could spill-over into the mortgage market. This therefore forms the most important criteria for fund mobilization in the region. However, government support is crucial to achieve this objective.

The documentation of borrowers' income is necessary and should form the basis of objective assessment of capacity to repay loans. Similarly, an objective assessment of a borrower's credit history assures increased capacities to take informed risks and hence the development of alternative finance products for various classes of lenders (IMF, 2008). However in West Africa, most incomes are earned in the informal sector where documentation is rare. The government can intervene by establishing a formal relationship with thrift and credit societies that are traditional local savings outlets for this category of people. This could be achieved by strengthening them through local capacity development efforts and then introducing them to modern financial records management that could feed back into the formal credit information system. In this way, the local thrift and credit societies could be gradually formalized and utilized by more sophisticated credit information bureaus.

The establishment of public credit information bureaus and promotion of private credit information bureaus are very important roles governments can play in creating an 'enabling' environment for formal fund suppliers (Butler et al, 2009; Genworth Financial, 2008) while fund suppliers themselves should be equipped with the capacities to evaluate credit risks. As already happens in countries with higher ratings in the credit information index, these credit bureaus should be ready to share collected (positive and negative) credit information with other lenders and also allow borrowers to check their credit records.

Further, to ensure that access to funds by low income groups is protected; governments would have to provide guarantees for lending to certain target groups. These state guarantees ensure that the challenge to provide housing finance to subprime lenders can be tackled by the private sector. Further, the cost of capital for housing finance should not be left wholly to the operations of the market, but could be tailored toward the affordability of the people they are meant to serve. South Africa for instance, has developed housing finance mobilization and housing market stabilization policies to achieve this (Gardner, 2008).

Housing markets are susceptible to national policies relating to land-use and construction laws, price controls, and governance of institutions, allocation policies, taxation and savings mobilization (Forest, 2008). Thus, another critical role of the government is to ensure that the macro-economic and most importantly, the political-economy structure is stable and conducive for the operations of formal housing finance providers.

All these could be accommodated in a framework aimed at sustainable financial development, which would span from establishment of macro-

Table 5: Analysis of variance (ANOVA)

Split	Model	Sum of squares	df.	Mean Square	F	Sig.
West-African Countries	Regression	3863.572	4	965.893	9.259	0.000
	Residual	2399.377	23	104.321		
	Total	6262.950	27			

Table 6: Bootstrap regression coefficients

Split model	Unstandardized coefficients		Standardized coefficients	t.	Sig.	Correlations			Co-linearity statistics	
	B	Std. Error	Beta			Zero-order	Partial	Part	Tolerance	VIF
(constant)	2.463	6.738		.366	.718					
Inflation	-.853	.683	-2.44	-1.251	.223	-.203	-.252	-.162	.439	2.279
Strength of credit information systems	2.091	.362	.824	5,782	.000	.726	.770	.746	.820	1.219
Registration of property index	.792	.813	.150	.974	.3440	.005	.199	.126	.703	1.423
Strength of legal rights index	3.013	1.706	.355	1.767	.091	.089	.346	.228	.412	2.425

****. Correlation is significant at the 0.05 level (2-tailed). Bootstrap results are based on 1000 bootstrap samples. West Africa: R = 0.785. Adjusted R Square = 0.550.*

economic policies, to the development of financial infrastructures, upgrading of human capital, the development and deepening of appropriate institutions and finally, the development of capital markets and other institutions.

4. Conclusion

The effectiveness of formal lending organizations in performing their functions in the housing market rests on the policy environment in which they operate. Further, several institutional factors have been identified as criteria needed for the effective performance of these functions. This study examined the institutional constraints acting on the ability of lenders to carry out loan mobilization functions in the West African region, and finds that the limited effectiveness of the credit information systems (as a result of lack of credit information bureaus) is a major constraint. Against the backdrop of previous studies in developed countries, this finding appears significant. Previous studies have identified several criteria for fund mobilization in developed countries to range from strong legal rights of lenders, to information sharing institutions, adequate legal, tax and accounting framework, macro-economic stability, property registration systems, urban planning policies and financial market depth. However, studies that have empirically tested for the strength of these criteria in the development of market processes have identified legal rights of lenders and existence of credit information institutions as the two most pertinent criteria. The result of the bootstrap regression analysis utilized in this paper shows that similar criteria are required in the West African region as are found in developed countries.

The lack of credit information bureaus in the region challenges the private sector to enter the housing finance sector by establishing private credit information bureaus. On the other hand, the need to set up credit information systems through public information bureaus by the government itself, or the facilitation of private sector credit information companies becomes urgent. However, current attempts at neo-liberalism across West Africa might negatively influence direct participation of government in these areas. It should be noted that in developed countries, an integration of government participation in the housing finance market has been achieved, with resultant increase in the sector's contribution to the GDP and improved access to housing finance for the people. The facilitation of governments in converting informal credit information from informal organizations to formal records is also necessary in the region. It is therefore argued that in realizing the criteria necessary for housing finance development in the region, the governments of West Africa should focus on the provision of direct, indirect and regulatory interventions to facilitate market-based forms of provision, rather than to take a completely passive policy of withdrawal and non-participation.

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