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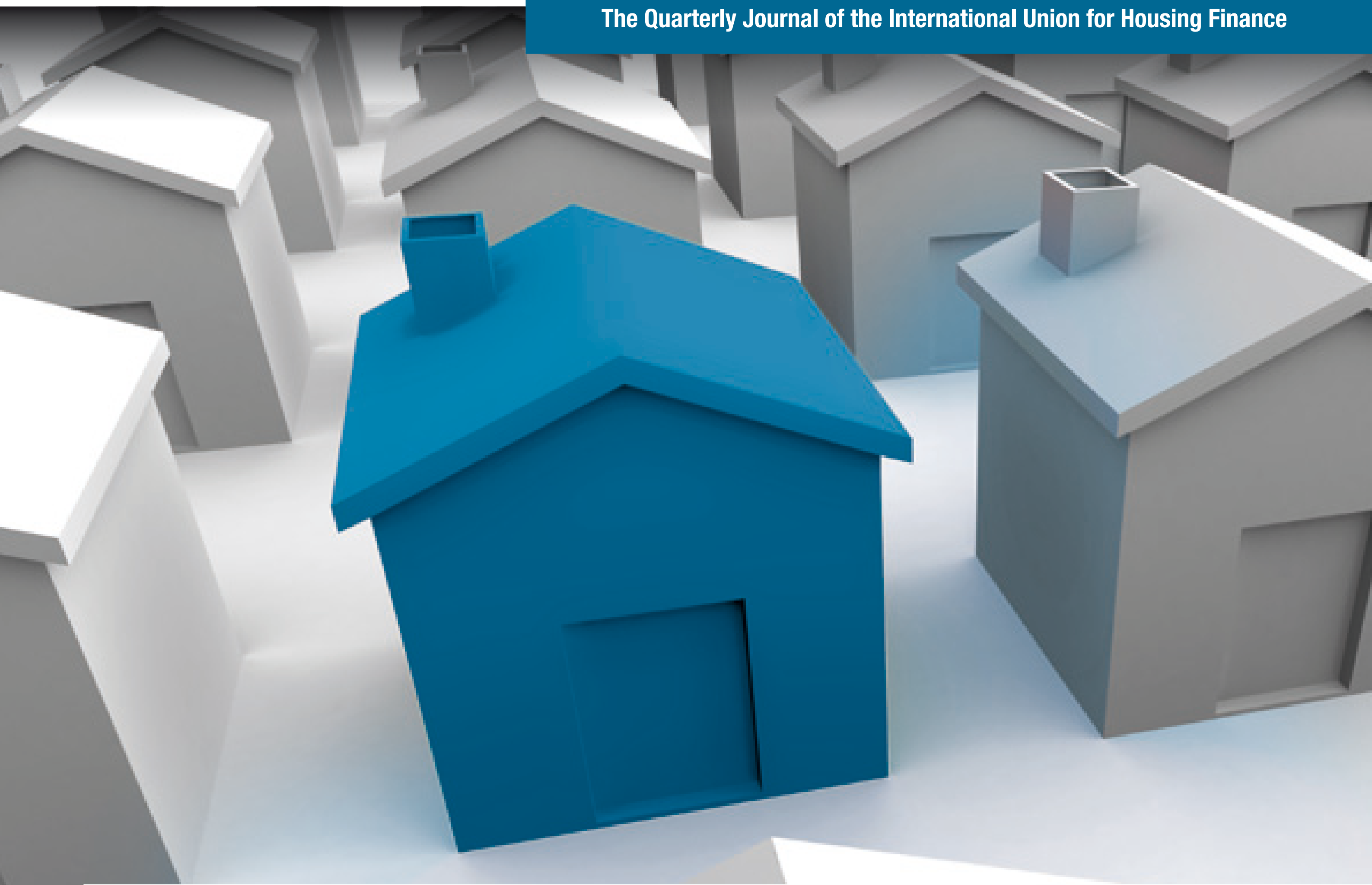

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International Union for Housing Finance

Housing Finance International

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Editor's introduction
How can we make housing affordable; new answers to an old question?

↳ **By Andrew Heywood**

Thirty years ago the provision of affordable housing, in Europe at least, was essentially a State responsibility although sometimes devolved to local or regional administrations. In the UK for instance, during the period 1950-1980 over 130,000 publicly funded homes for social rent were built each year on average. Such building utilised a combination of government grant, historic rent subsidy and 60 year amortizing loans, which sat squarely on the public balance sheet. It was a significant achievement leading to a situation where by the early 1980's over 30% of UK households lived in subsidised public housing.

It is no co-incidence that in Europe, North America and elsewhere in the world, the thirty years that followed World War II are seen as something of a golden age in economic terms. Living standards rose, unemployment remained at very low levels compared to the pre-war period and states were able and willing to sustain direct responsibility via taxation for funding a wide range of welfare services and provision, including housing. Indeed, housing expenditure was seen as an important component in the economic armoury of the state by promoting economic growth through the "multiplier" effect and helping to smooth out the highs and lows of the economic cycle.

The sustained economic growth and stability of the post-war period began to falter after the 1970's and economic thinking began increasingly to develop according to a new neo-liberal paradigm. The state began to withdraw from its direct responsibility for many aspects of welfare provision and "tax and spend" became an increasingly unfashionable concept. In the affordable housing field states like the UK increasingly moved away from direct supply-side funding of affordable housing towards reliance on rising home ownership that it was widely believed could be extended to all but the most disadvantaged. Public, or social rented housing increasingly became a "residual" tenure, housing only those with no other choices as new-build levels plummeted and then remained at historically low levels. In the UK public spending on housing shrank from over 5% of government spending in the early 1980's to just 1% by 2,000. It is currently a little over 2%.

In spite of persistent evidence that there were limits to the extension of home ownership, which eventually stalled or went into reverse in a number of countries, the revised model persisted until the banking crisis of 2007-09. For many countries the crisis has created two new sets of conditions; the first was faltering and dysfunctional private housing markets that increasingly raise questions about the ability of more vulnerable households to access home ownership in a sustainable way. The second is a huge strain on public finances that has left austerity in public spending as a reality across many countries of the EU and beyond.

The result of these two sets of conditions for many states is to pose the issue of providing affordable housing for the less affluent in a new context. In a sense the question has become how governments can intervene in housing markets without incurring unsustainable levels of strain on public finances. The conundrum has yet to be solved.

The provision of affordable housing is a theme that runs through many of the contributions to this issue of HFI. Winter 2012 sees the launch of a debate on how housing finance institutions should be regulated. RV Verma and Zaigham Rizvi discuss the relative merits of regulation by central banks or specialist regulators in an Asia Pacific context. How best to extend housing finance into the affordable sector in a sustainable way is one of the issues raised.

Kenneth Gibb also touches on the different approaches to the provision of affordable housing and of low-cost home ownership in an important article examining the implications of devolution for housing policy in Scotland since 1999. The article analyses the ways in which the Scottish Government has shaped a distinct housing policy that shows elements of both convergence and divergence from those policies developed for England by the UK Government.

Sri Lanka has received comparatively little attention from the wider housing finance world. In the current issue of HFI we go a small way to redress the balance by including an article by DLPM Rathnasingha and Professor Ali Khatibi on mortgage default in Sri Lanka. The authors examine the issue from the perspective of enabling housing finance to be extended sustainably more widely within the country. The article makes a significant contribution towards addressing a lack of data and analysis in the field of default.

Nicholas Addai Boamah will be known to readers of HFI. In this issue he addresses the impact of a range of land factors, such as problems over title, security of tenure and poor administration in inhibiting further development of the housing finance system in Ghana. The issues raised by the article will strike a chord with many.

We are particularly pleased to offer another article on Islamic housing finance models. This time, Muhammad Asghar Shahzad examines contrasting models used in Pakistan and analyses their practical impact and suitability.

In the Autumn 2012 issue of HFI Gus Freeman and Siji Sudarsanan offered a fascinating article analysing the housing markets and housing finance systems of Qatar and Bahrain. In this issue of the Journal they turn their attention to Kuwait. Their article examines how a range of financial, economic and demographic factors have shaped housing demand within the Kuwait national and expatriate communities. They analyse in particular the role of the state in meeting that demand and consider the impact of the financial crisis on existing markets and on housing policy.

HFI enters 2013 with a number of important contributions already commissioned. These include articles on Russian housing markets, on the housing finance system in Canada, on affordable housing in the US and on the role of fiscal stimulation in the Dutch housing market. Watch this space.

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Housing finance news from Africa: AUHF Annual Conference

By Kecia Rust, African Union for Housing Finance

In October, over 300 delegates from across Africa met together in Dar es Salaam for the annual conference and AGM of the African Union for Housing Finance. The focus of the conference, which was offered in partnership with the Bank of Tanzania's Housing Finance Programme, was on "Growing Housing Opportunities in Africa: Encouraging Investment and Growing the Market". Tanzania's experience in growing its mortgage market and promoting the delivery of affordable housing, while also actively addressing the market where mortgages cannot go, was showcased. The experiences in Tanzania in setting up its mortgage liquidity facility were explored.

Africa's rapidly developing economies and cities offer tremendous opportunities and challenges for housing development and investment. Urbanisation rates in Africa are the highest in the world, and positive growth over the last decade has put many countries in a position to assertively address the housing situations of their populations. While the mortgage sector remains small, developments in many countries suggest that this is changing. Housing practitioners across the continent are beginning to grapple with and understand the opportunities available and are developing precisely targeted products and projects. Their work begins to chart pathways for new entrants into the sector, and this will contribute towards the growth of the housing sector across the continent. Governments, too, are recognising the integral role of housing in overall economic growth, and are addressing the regulatory and policy constraints to housing investment, opening up further opportunities for growth. The conference showcased and promoted these opportunities, splitting the proceedings into two days, with the first considering investor interest, and the second addressing ways in which the market could be further grown.

The keynote address to the conference was delivered by Professor Paul Collier, and was based on a paper entitled "Housing and Urbanisation in Africa: Unleashing a formal market process". Dr Collier argued the importance of housing in the process of economic development and capital accumulation in rapidly urbanising Africa. He outlined five key impediments to functioning housing markets in Africa: affordability, legal rights, finance, inadequate supporting infrastructure, plus unemployment and insufficient economic opportunity. He described these as the main impediments that result in the failure of African cities. Professor Collier's recommendation for indexation as a tool to enhance housing loan affordability stimulated substantial debate among delegates.

Of course, the conference gave special emphasis to developments in Tanzania. A study into Tanzania's housing market revealed that housing supply is largely self-managed by households through incremental construction. Formal channels account for only a small proportion of housing supply. Housing finance is also largely informally supplied, with only 12.4% of the population served by the formal financial sector. Further, the study showed that urban households in Tanzania are the main providers of key onsite infrastructure services, particularly sanitation. Land and infrastructure services, finance and a low-income rental housing market were identified as key areas for reform in Tanzania. A second study on Tanzania's housing finance system focused on Housing Microfinance [HMF]. Noting that the majority of Tanzanians have volatile incomes, borrowing activity is further undermined by high interest rates and lack of collateral. However, a strong savings culture was also reflected in the findings: 90% of respondents said they save, and home construction was cited as one of the purposes for saving. Only some microfinance institutions in Tanzania offer HMF; Tanzanian banks are not active in the sector. While community banks and many Savings and Credit Co-operatives [SACCOs] are becoming more active in the sector, the current supply of HMF in Tanzania is limited; leaving a gap between demand and supply. Mr. Doce presented some financial products which may be offered in this market and provided an example of how a Housing Microfinance Fund could be structured. Further examples of HMF products were presented on the second day of the conference.

A particularly exciting presentation was given by Simon Walley, of the World Bank, as he presented on the World Bank's new initiative "Housing Finance for the Poor" or HF4P. HF4P aims to expand housing production and finance processes and support investors in creating a business model for affordable housing finance. The initiative is based on an experience in India where a multi-donor and trust fund targeting middle and lower income households is creating comprehensive projects, and bridging the gap between the financial sector and the housing sector by bringing together real estate developers, financial institutions and local/national governments.

All conference presentations are available for download on the AUHF's website: http://www.auhf.co.za/conference/2013-annual-conference/

Asia Pacific region

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

In **Bangladesh** the House Building Finance Corporation [BHBFC], the State-owned specialized housing finance institution of the country has been improving its performance over the years, both in terms of loan disbursements, loan recovery, and reduction in non-performing loans. All that has contributed to a rising trend in BHBFC's profits, states Dr. Muhammad Nurul Alam Talukder, Managing Director of BHBFC. Land is a scarce commodity in Bangladesh, more so in major metropolitan cities like Dhaka and Chittagong. Bangladesh has a population density of 1025 persons/Sq KM, whereas in Dhaka it is more than 10,000, thus making Dhaka among the most densely populated cities in the world. The rapid urbanization is simply adding to the issue of over-crowded cities. Construction of multi-storied building is a rational solution to optimize land use for housing. Since Developers are hesitant to come forward with housing projects for low-income segments of the population, promotional and supportive initiatives from the state are essential for such projects to take off. BHBFC is gearing up to play this role. It has already approached the World Bank for long term funding support for the purpose, and the International Finance Corporation [IFC] for its technical advice on how best to move forward.

Thailand is proud to have a well-developed and well-regulated housing and housing finance market. The role of the Government Housing Bank [GHB], the government owned specialized housing finance institution, is well recognized. It is a highly respected housing finance institution within the region, and even at international level. According to Mr. K.I. Woo, the Adviser to GHB, the GHB has issued its first Corporate Social Responsibility [CSR] Annual Report. CSR has become a major corporate governance element in Thailand. Many organizations have developed CSR guidelines and strategies that are integrally linked to their missions and overall objectives.

Mr. Worawit Chailimpamontri, the Bank's President said that GHB has continuously engaged in CSR initiatives that develop sustainable quality lifestyles for the general public. "The Bank operates within a principal-mission framework that is commensurate with the national housing policy and excels in providing appropriate housing credit to the public."

Thailand is developing a well-functioning Credit Bureau, as was stated by Mr. Surapol Opasatien CEO of Thailand's National Credit Bureau in a recent article published in the Asia Pacific Housing Journal.

The Thai Real Estate Association, the Housing Business Association and the Thai Condominium Association recently organized the Home & Condo Show in Bangkok attracting more than 100,000 visitors and generated Bt3 billion ($US100 million) in sales from the four-day event.

More than 1,000 residential projects worth in excess of Bt100 billion were on offer, with promotions designed to boost sales during the last quarter of the year. Meanwhile, commercial banks and the GHB are offering special mortgage packages featuring zero interest for the first one or two years.

The National Housing Authority of Thailand [NHA] intends to work with the State Railway of Thailand [SRT] and the Expressway Authority of Thailand to develop affordable housing around train stations and motorways. The first three projects with the Mass Rapid Transit Authority of Thailand [MRTA] (subway) will be condominiums at the current Lat Phrao stations and at the proposed stations at Din Daeng and at Bang Yai, Nonthaburi.

In **Afghanistan**, the Governor of the Central Bank, HE Delawari and his team on housing finance including Mr. Asad Zafari, the Advisor to the Housing Central Bank (Da Afghanistan Bank-D) are very much committed to promoting institutionalized housing finance. They have re-established contacts with OPIC of USA, the ADB and The World Bank to refresh earlier initiatives between DAB and OPIC for promoting low-income housing in the country. According to Mr. Asad Zafari, this commitment to promoting housing and housing finance is coming from the country's leadership as well. He stated that H.E. President Karzai is also committed to start mortgage lending and has asked H.E. Finance Minister Zakhilwal and H.E. Governor Delawari to allocate $100 million to jump start lending activities. Afghanistan is also active in establishing a collateral registry, and it is expected to be functional soon.

In **Pakistan**, the State Bank of Pakistan is actively pursuing the cherished goal of providing affordable housing to those at the bottom of the pyramid. For the purpose it has organized a seminar on Housing Microfinance on Sep 6th, 2012. There are 31 banks and financial institutions, including 2 Micro-Finance Institutioons-MFIs and a state owned housing finance institution [HBFCL] engaged in housing finance.

In **India** the Credit Risk Guarantee Fund Scheme for Low Income Housing was launched by Shri Ajay Maken, Honorable Union Minister for Housing & Urban Poverty Alleviation [MoHUPA] on 31st October, 2012 at New Delhi at a function organized by the National Housing Bank [NHB]. To mark the launch of the operations under the Scheme, three major lending agencies in the retail housing market, the State Bank of India, the Central bank of India and the Housing Development Finance Corporation Ltd. [HDFC] entered into an agreement with the Credit Guarantee Trust, which will be managed by the National Housing Bank.

The Credit Risk Guarantee Fund Trust for Low Income Housing was announced in the Union Budget and has been set up by the Government of India on 1st May, 2012 under the aegis of the Ministry of Housing and Urban Poverty Alleviation (MoHUPA). Under the Scheme, the Fund will provide a credit risk guarantee to the lending institutions against their housing loans up to IRs 5 lakh for new borrowers in the EWS/LIG categories of population in Urban Areas without requiring any collateral security and/or third party guarantee. The extent of Guarantee Cover to be provided under the Scheme is 90% of the amount in default in respect of loan amount up to IRs 2 lakhs and 85% of the amount in default for housing loan above IIRs 2 lakh to IRs 5 lakh.

Europe

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

On November 9, 2012, the U.S. Banking Regulators issued a press release stating that they do not expect that any of the new regulatory capital rules they had proposed to implement pursuant to Basel III will become effective on January 1, 2013.

The delay in the U.S. could also risk pushing back the start of Basel III in the European Union by several months. However, this situation may come in handy. Despite the efforts of the European Commission to make progress with Basel III/ CRD IV, the European Union is still struggling to agree on many aspects of the package, including the question of what kinds of assets can be considered liquid. Given the short time left, it seems to be a mission impossible to implement the new regulations by January 1 although officially that has not been admitted yet.

Much has happened on the regulatory front over the year but there is still a lot more to come. On October 2 the Liikanen High Level Expert Group on structural reform measures for the European banking sector revealed its recommendations. Although it is not yet clear when the European Commission will respond with new regulation (so far it has ordered only an impact assessment), the report has nevertheless fuelled the debate in Europe about reforming the banking industry.

The discussions of the Liikanen Group were influenced by the implementation of the Volcker Rule in the Dodd-Frank Act, the increased capital requirements for systemically important banks in Switzerland and the parallel discussion in the UK by the so-called Vickers Commission, which proposes not only slightly higher capital requirements than Basel III but also that British banks should have to ring fence their retail activities from their wholesale arms.

The Liikanen Group recommends a set of five measures that augment and complement the set of regulatory reforms already enacted or proposed.

The most important is the suggestion to put significant trading activities into a separate legal entity within a banking group. The report argues that "the specific objectives of separation are to ... limit a banking group's incentives and ability to take excessive risks with insured deposits" and to "prevent the coverage of losses incurred in the trading entity by the funds of the deposit bank, and hence the liability of taxpayer and the deposit insurance system". However, the threshold for putting trading activities into a separate legal entity is high and involves two stages. The trigger for the first stage would be that assets held for trading exceed € 100 billion or 15-20 per cent of total assets and at the second stage supervisors would determine the specific need for separation.

In connection with the first point the experts of the Liikanen Group support the EU Commission's Bank Recovery and Resolution Directive proposal. They specifically state that the powers granted to the resolution authority should also be used proactively if the regulators consider a bank's trading operations as particularly risky, so that the ring fence is widened in order to include more parts of the investment bank, and to better shield deposits in the event of the investment bank failing.

The report also backs the idea of bail-in debt, a mechanism to impose losses on unsecured creditors or to convert debt claims to equity in the case of a bank's bailout or collapse. These debt instruments must not be held by banks and they should also be part of the remuneration of the top management, in order to align their interests with those of creditors, not shareholders. With regard to the EU Commission's proposal on a Bank Recovery and Resolution Directive the Liikanen Group stresses the necessity "to improve the predictability of the use of the bail-in instrument" in order to avoid "congestion in the new issues market" and to allow markets to grow smoothly.

The Liikanen Group questions whether the proposed amendments to capital requirements are sufficient to keep both investment and retail banks safe and sound. It suggests that the robustness of the trading book capital requirements could be improved if either "an extra, non-risk based capital buffer requirement for all trading-book assets on top of the risk-based requirements" or a "robust floor for risk-based requirements" is introduced. Of special interest for housing finance practitioners is also the attention the Liikanen Group gives to real-estate lending. It highlights the disastrous role of reckless mortgage issuance in prompting the financial crisis and urges the European Commission to consider "further measures regarding the treatment of real estate-related lending within the capital requirement framework." A specific suggestion of the Liikanen Group is to include maximum loan-to-value and/or loan-to-income ratios in the instruments available for micro- and macro-prudential supervision.

The experts of the Liikanen Group also stress the importance of strengthening governance and control. They suggest as the following specific measures:

1)"Strengthen boards and management;

2) promote the risk management function;

3) rein in compensation for bank management and staff;

4) Improve risk disclosure and

5) Strengthen sanctioning powers."

The banking industry has of course already started to analyse the potential impact of the proposals. However, the Liikanen report is certainly not their top priority as the European policy makers' attempt to hammer out the shape of a banking union is proceeding.

North American update: U.S. and Canada at opposite ends of the cycle; The Central Bank as mortgage investor

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

North American housing markets present an interesting contrast between the U.S. and Canada.

It now appears that the U.S. has passed the bottom of its housing markets at long last. After falling for six years from the 2006 high in a terrific bust, house prices are now widely rising from their lows, and house sales are increasing. So the U.S. is starting to come up from the bottom.

Canada is at the opposite end of the cycle. Having weathered the crisis of 2007-09 far better, it looks like Canada's housing markets have just gone over the top, a top of very high house prices and household debt levels, and now are starting down.

The U.S. Federal Housing Finance Agency's house price index for the third quarter of 2012, counting house purchases financed by Fannie Mae and Freddie Mac, was up 4% over a year ago, partially reflecting a lower proportion of distressed sales. This house price index rose in 39 of the 50 states. The widely followed S&P/Case-Shiller National House Price Index was up 3.6% year-over-year in September. Since the American Consumer Price Index rose 2% during this period, this represents a 1.6% real increase. The Wall Street Journal recently opined that "an improving housing market is buoying consumers' spirits."

As is well known, the U.S. situation partially reflects manipulation of the bond market by the Federal Reserve, with its intention of driving down interest rates on long-term mortgages. In this the Fed has succeeded, with mortgage interest rates having arrived at record lows: 3.3% for 30-year, freely prepayable, fixed rate mortgages; and 2.6% for 15-year, freely prepayable, fixed rate mortgages. These rates must inevitably rise sometime, but no one knows just when.

Meanwhile, Canadians are debating "Canada's housing market: Is it a cooling? Is it a crash?" as the Canadian news magazine, Maclean's, recently put it, adding that "virtually everyone – from the Bank of Canada and the Finance Department [the banking regulator] through Canada's banks to the IMF and independent analysts – agrees that housing is losing steam."

House sales are falling and house prices are down a little on average and 11% in inflated Vancouver. One analyst has estimated Canada's house prices are 10% overvalued, another has predicted a 10%-15% drop in average prices and another as much as a 25% drop—of course, nobody really knows. Moody's bond rating service has discussed its concerns about "elevated housing prices."

The Governor of the Bank of Canada, before long to be the Governor of the Bank of England, Mark Carney, has issued renewed warnings about the high levels of household debt in Canada. Mortgage delinquencies are low—but they are always low in a housing boom. The question, needless to say, is what happens to them after the boom stops.

Canada, which has a major government exposure to mortgage credit risk, has made very sensible moves to reduce allowable loan-to-value ratios in government-insured mortgages. This is consistent with one of the most important ideas in housing finance: countercyclical credit policies.

In general, as house prices rapidly rise over their trend line, the price is growing riskier, and the amount lent against the current price should be reduced, with the required down payment correspondingly increased. This will help moderate the booms. What Canada did in this respect is admirable and directionally correct, but was it enough and soon enough? We will see.

Back in the U.S., the effects of the collapsed bubble continue, in spite of the recent market improvements. The government's Federal Housing Administration (FHA), which insures mortgage loans with the Treasury's credit, recently announced that it is insolvent by $16 billion. My AEI colleague, Ed Pinto, calculates that if the FHA had to keep its books like a private mortgage insurance company, its net worth would be a negative $25 billion. He further calculates that the present value of all projected cash flows of the FHA is negative $34 billion. The FHA has publicly tried to downplay the importance of its expected losses exceeding its resources. What a surprise that a government agency would react that way!

Another continuing effect of the collapsed U.S. housing bubble, when combined with the onerous mortgage regulation mandated by the Dodd-Frank Act, is that the private mortgage securitization business remains moribund. Almost all mortgage securitization is being done by Fannie Mae and Freddie Mac, both insolvent and now owned and managed by the government, and Ginnie Mae, a government corporation.

Pointing out the regulatory preference given to Fannie and Freddie, their financial travails notwithstanding, one securities firm has concluded that "the return of meaningful private securitization is extremely unlikely." A central policy question for the U.S. in the wake of the housing bubble, is how to reduce the government dominance of the housing finance sector?

Another effect of the collapsed bubble is the remarkable transformation of the balance sheet of the American central bank, the Federal Reserve. If you add the 12 Federal Reserve Banks together, the assets of the Fed have inflated to $2.9 trillion (up $2 trillion from the pre-crisis level). The combined capital of the Fed is $55 billion. In the Fed's new world, it now owns $900 billion, or 16 times its capital, of mortgage-backed securities. One way of looking at this is that the Fed has become the biggest savings and loan in the world. It owns more mortgage assets in portfolio that either Fannie or Freddie do.

Does the interest rate risk of owning a massive portfolio of long-term fixed rate mortgages matter if you are a central bank? It's not so clear: Reader, what do you think? It is clear that the Fed in the wake of the bubble is now in new and uncharted waters with its balance sheet. In addition to the long-term mortgages, it owns $1.6 trillion of long-term government bonds. If interest rates rose, as it seems they ultimately must, by a mere 2%, the loss in market value of the Fed's portfolio would be about $315 billion against its capital of $55 billion. No previous Chairman of the Fed, going back to its creation in 1913, has ever had to think about this kind of problem.

In short, while we in the U.S. have passed the bottom of the cycle, things remain highly interesting.

How's housing finance in 2012 in Latin America…?

By Ronald Sánchez Castro, Technical Adviser, Inter-American Housing Union

The year 2011 certainly was a good year for Latin America. In Argentina, housing finance in 2011 performed well, with 46.2% growth in the granting of mortgage loans. In Brazil, lending grew by around 42%, Chile, in 2011 ended the period with purchase-sale of homes up by $170 million; this represented an increase of 70% over the previous year. Colombia ended 2011 with more than 6 trillion dollars in housing loans granted, of these, 50% were for social housing. Ecuador, at the end of 2011 showed a level of mortgage loans of $1.461 million, of which 52.5% were delivered by the Bank BIESS. In Mexico 2011 ended with the portfolio of mortgage loans growing by about 15%, highlighting Infonavit[1] placements for more than 501,292 mortgage credits, exceeding 500,000 for the first time in a year of financing. In Peru, 2011 ended with a level of mortgage credit growth of 25%.

For the year 2012 in Argentina, housing finance continued with a good dynamic until January 2012, but in the following months purchase and sale transactions fell 22% between June 2011 and June 2012, also rental housing increased by 30 - 35%. These changes in trend were due to an increase in existing restrictions on the purchase of dollars from the government, in the context of the high dollarization of the Argentine real estate market. In July 2012, the Argentine government launched the first tranche of the Argentine Credit Program (FATHER), with which they have benefited more than 59,000 families so far this year and aim to benefit 400,000 families by 2013. It is expected that it will boost construction in the medium term. Construction levels fell in July and August by 0.4 and 8.1% over the same period last year.

In Brazil, during the first half of 2012 housing finance presented a very dynamic picture; the housing finance system placed 6.3 million Reais in May, up 11% compared to the same period in 2011. A fall in loans for the acquisition and construction of properties was recorded of 13% from June. However, lending recovered in August with a growth in funding of 28% over July.

In Chile, for the first quarter of 2012, there was a deepening of financing provision with amendments to the subsidy "Solidarity Fund of Housing Choice (DS-49)", which led to the delivery of 600,000 million pesos. This managed to increase sales by about 25% in the first quarter and 35% in the second quarter, a situation which also boosted construction so the Monthly Index of Construction Activity (Imacon) grew over 11% in June 2012. In July 2012 loans for house purchase showed an increase of 8.9% annually.

In Colombia in February, approved credit levels were 698,000 million pesos, an increase of over 76% over the same period last year. However, the most important fact so far this year in Colombia is the government program to provide free housing for 100,000 households, of which some 17 thousand have already been started in parts of Colombia and the capital.

In Ecuador in 2012 BIESS has been positioning itself as one of the major funders of housing in Ecuador. During the first quarter it funded about $437 million in mortgage loans. This represented an increase of 16% over the same period last year. Also the introduction of a Bond for the construction of housing, contributes to increase housing funding. An important event for the industry was the delivery by the Inter-American Development Bank (IDB) of a loan of 100 million dollars to support housing schemes for the poor in Ecuador.

In Mexico, in the first quarter of 2012 mortgage lending levels remained positive, also mortgage lending of Infonavit, grew 24% over the same period in the previous year. In the second quarter the momentum of funding continued, coupled with the introduction of a program for second credit for housing established by Infonavit[2], and also through more dynamism in the construction sector, which grew 4.6% from January to August 2012 compared to the same period the previous year.

In Peru, during the first quarter of 2012, the housing market remained dynamic. February was a record month for mortgage lending at S/.19, 788, i.e. a 23.95% increase over the same period last year. Although delinquencies in the mortgage portfolio increased from 0.89% to 1.62% in the period February to March, they are still one of the lowest in the region. During the second quarter housing finance continued to grow, growing nearly 23% in August. On the other hand, the construction sector continued to be one of the main drivers of the economy and grew more than 20% in the second quarter.

In Venezuela, the public program Great Mission Housing Venezuela (GMVV) promotes public investment in housing, so much so that for the second quarter of 2012, the government approved the provision of 1,200 million bolivars for direct housing subsidies. While the construction sector is growing about 20% per year, it is driven by public investment; however private construction has been cut by 10% and 14% during the first and second quarters of 2012 respectively. By September 2012 the GMVV program had achieved 71% of the target of 350 thousand housing units to be built between 2011 and 2012.

In Central America, Costa Rica stands out because of the creation of a trust by the National Institute of Housing and Urban Development to fund about a thousand homes for middle-income families.

In El Salvador, the Social Housing Fund raised the maximum amount of individual credit for home purchase to $125,000 by borrower. Also the Department of Housing and Urban Development was scheduled to divert $25 million of the total loan for $70 million from the Inter-American Development Bank (IDB) into housing.

In Guatemala, a national housing plan was announced which aims to provide 18,000 housing subsidies and another 6,000 for the program "Floor Safe[3]" A housing subsidy program for public officials and credit lines for private employees were also announced.

[1] By its Spanish acronym "Instituto del Fondo Nacional de la Vivienda para los Trabajadores"

[2] Second Credit Infonavit, offers the opportunity to borrowers to get a loan to buy a second property through a new financing Infonavit. Previously Infonavit only granted first loans and did not allow second loans.

[3] Federal program designed to provide cement to homes with dirt floors.

In Honduras, it was reported that the construction industry had lost about 16,000 jobs in the past two years, while the Honduran Bank for Production and Housing (Banhprovi) had funded the construction of 2,000 units of decent housing having a value of 438,000 lempiras. However, to meet the demand of Hondurans would require about 2,500 million lempiras.

In Nicaragua, with support from the IDB and the Spanish Cooperation, the Government announced a plan for social housing, and the program aims to rehabilitate 4,250 housing units, formalize 5,000 houses with land titles and improve basic services for 4,000 families. Housing Program and Habitat Improvement Integral (Prohabitat) will provide direct subsidies to families with incomes of up to $370 (8,700 cordobas) and will be implemented by the Nicaraguan Institute for Urban and Rural Housing (Invur). Also the Central American Bank for Economic Integration (BCIE) granted a loan of $9 million to support optimizing housing conditions for about 4133 poor families.

In Panama, loans for house purchase in September reported an increase of 3.4% over the same period of 2011. Also it was reported that the balance of the mortgage portfolio grew by 15.4%, compared with 2011.

In the Dominican Republic, the Government created the Permanent Commission of the State Land Titling, which will work to provide titles to (formalization) land and housing in this country. In addition, the IDB provided a loan of US$25 million with which the Dominican Republic will improve water services to 329,000 inhabitants in the metropolitan area of Santiago de los Caballeros.

It is likely that Latin America as a region will end 2012 with a positive picture of housing finance, but many countries still have difficulties in boosting the financing and construction of decent housing for low-income families, regenerating urban land and promoting sustainable cities. These will be the great challenges for 2013.

DEBATE

This debate focuses on the question of who should regulate housing finance institutions. Following the financial crisis of 2007, there has been much discussion about the role of mortgage lending in fostering the crisis and latterly on the broader impact of housing finance on economic development and financial stability.

In this broad context a particular question has been whether housing finance providers should be regulated by central banks or whether the task can better be undertaken by a specialist regulator.

In the following two articles Mr. R.V. Verma and Zaigham M. Rizvi put the case for and against a specialist regulator for housing finance institutions. Both authors make the case in the context of the Asia Pacific region and consider the regulatory role of the National Housing Bank of India. However, they also draw on evidence from various parts of the global financial system in order to take a considered and nuanced view of a complex question.

Regulation of specialized housing finance institutions - the case for an independent regulator

By R. V. Verma

1. Introduction

Housing finance, or mortgage lending, is among the key segments of the financial system in most economies, developed as well as developing. Home ownership has emerged as an important index of a country's socio-economic development. Moreover, housing investments also impact the broader economy as housing construction directly impacts economic growth and provides a boost to numerous upstream and downstream sectors in manufacturing and services. Thus, mortgage lending can act as a major catalyst for economic growth by boosting demand for houses through the creation of additional purchasing power for the prospective buyers of residential property.

2. The Indian experience

In the Indian context, the housing finance system has been rapidly evolving. The sector is largely driven by the aspirations of people in all income segments who desire to own a house early in their lives. The capacity of the lending institutions has grown over the years as the mortgage segment has proved to be promising and profitable and increasingly bankable. The market is big and growing on account of factors such as rapid urbanization and the resultant population migration to urban centres, and demographic composition. The growth and evolution of the sector are marked by challenges and opportunities for the various stakeholders. While the financial sector (demand side) is fairly unified under the governance of a central regulator, the construction activities and land resources (supply side, or the real economy) and their governance are decentralized and somewhat fragmented. This has thrown up regulatory challenges often resulting in excessive regulation. This tends to affect the efficiency of the market, while inducing some unintended distortions that limit the market potential. However, it is widely recognized that the Indian mortgage finance market has withstood the stress and pressures resulting from the ongoing global crisis. This is evidenced by the sustained robust growth of the sector despite recessionary trends in several quarters of the domestic economy. The quality of assets in the housing sector has been consistently good, as reflected in low a level of non-performing loans, though the coverage of financing has progressively expanded across the population and geographical regions. While the market has become more engaging for the lenders, the need for a good balance between regulation and development cannot be overemphasized in the larger context of the economic imperatives and the national priorities of the government.

The 1990s have been very eventful for India, more particularly in terms of the financial sector reforms that paved the way for better play of 'market forces' as the economy made the transition from a controlled and regulated regime to a liberalized and open regime. The Government's progressive 'hands off' approach has led to a greater role for market forces in the economy. The changes have been path-breaking and have involved institutions, policies, systems and practices. This has not been an easy transition as the developmental objectives of the Government needed to be addressed through the market mechanism. This in itself has been a challenge which has involved prioritization in terms of social needs and market capabilities.

The evolution of the housing finance system in India amid this broader transition in the economy has had to be carefully and diligently guided through these difficult years. 'Housing' has historically been a social priority next only to food and clothing. The social connotation of the housing sector also had to undergo a transformation to reflect the spirit and potential of a liberalized and market oriented system. As the national policies do not always seek a long-term solution and are often inspired by short-term objectives, such interventions do result in unexpected distortions in the market that may invite further corrections. The distortions in the housing market (more particularly the supply side), which are often a result of inadequate or incorrect policy interventions, bring about huge inefficiencies in the system. The cost has to be met eventually by the market. With appropriate care and responsive regulations, the tension between 'regulation' and 'development' can be considerably eased to enable the market to deliver optimum results.

3. The need for regulation

The Indian housing finance system has, over the years, become highly demand driven, competitive, specialized and innovative, as it progressively proceeds on the path to becoming fully market-oriented. Amid this open and competitive environment for various categories of institutions (banks, housing finance institutions, cooperative sector institutions, non-banking finance companies, regional rural banks, micro finance institutions, etc.), the need to ensure orderly growth and systemic stability is of paramount importance. To reflect this concern and philosophy, National Housing Bank NHB, India has a stated vision of 'promoting inclusive expansion with stability in the housing finance market' and a corresponding mission to ' harness and promote the market potential to serve the housing needs of all segments of the population with the focus on low and moderate income housing'.

The Indian housing finance market is today among the more robust and vibrant segments of the Indian economy. The Indian housing finance market has developed only in the past three decades or so, as prior to the late 1980s there was virtually no housing finance market to speak of. In the past three decades, particularly the period post-1988 (i.e. after establishment of the National Housing Bank), the housing finance market in India has grown phenomenally, enjoying double digit year-on-year growth and achieving vibrancy in terms of a larger number of players and products to serve different segments of the market. During these years, the regulatory philosophies of the National Housing Bank and the Reserve Bank of India (the central bank of India and regulator of all banks operating in the country) have been constantly changing and evolving as per the needs of the sector and market environment, domestic and global.

During the early days of the evolution of the housing finance market in India, there were only a handful of dedicated housing finance institutions in existence, and though the country had a thriving banking sector, banks did not then view mortgage lending as a viable product line, though this had more to do with perception than fact. At that time, the regulatory policies of the National Housing Bank and the Reserve Bank of India were directed towards promoting and developing the sector from its nascent stage to a matured state. The National Housing Bank, through a consultative process involving the Reserve Bank of India and the banking industry, played a lead advocacy role for promoting mortgage lending in the country. These initial efforts were targeted at motivating and incentivizing the lenders to undertake mortgage business. One of the steps taken by the Reserve Bank of India at the behest of the National Housing Bank was to require all banks to deploy at least 1.5% of their incremental deposits towards housing finance activities. This was later enhanced to 3% of incremental deposits. This directive made it necessary for the banks to extend housing loans and resulted in expansion of their housing loan portfolio. Gradually, as the banks extended more housing loans, they came to recognize the obvious benefits of mortgage lending in the form of low levels of bad loans, full security coverage of the loans and the opportunity to cross-sell on account of long term relationships with the customers. Banks today are major lenders to the housing sector, accounting for nearly 67% of the market. As a result of all the efforts towards championing the cause of housing finance by the NHB banks now have much larger housing loan portfolios and are quite bullish on this product segment.

4. Contribution of regulation to the growth of the housing finance market in India

That India has a healthy and vibrant housing finance market can to a large extent be attributed to the transparent and responsive regulatory regime in the country. Maintenance of stability with constant growth orientation has always been the goal of Indian regulatory policies across all components of the financial sector, be they housing finance, banking, insurance or capital markets. The regulatory bodies in India have always been alive to the fact that while growth is important, unbridled growth and excessive innovation can undo several years' of market development through irresponsible behaviour and lack of regulatory controls and supervision. 'Stability with growth' has been the centrepiece of National Housing Bank's regulatory approach and strategy from inception to the present.

When the National Housing Bank started operations in 1988, the housing finance system in India was in a nascent stage, with only a few institutions extending retail housing loans. Thus, one of the earliest responsibilities of the Bank was to oversee and catalyze the growth in the number of players in the market and thereby add depth to the market. However, when the earliest market players were still taking their first baby steps, the Indian economy began its transition, in 1991, from a controlled system to a liberalized, competitive and market driven economy. This put pressure not only on the newly established institutions but also on the regulator to ensure that the market participants not only survived but also thrived in the rapidly changing market. With support from the Government of India and the Reserve Bank of India, the National Housing Bank was able to carry out this onerous responsibility. Ensuring healthy competition in the marketplace through regulatory prescriptions and guided developments aimed at discouraging monopolistic tendencies, cartelization, restrictive trade practices, opacity in operations, etc. has been a priority for the Bank. Participative and responsive regulation in tandem with the growing market orientation and consumer-led growth in the sector has been the basic premise for the Bank's regulatory philosophy.

Apart from its regulatory role, the National Housing Bank, which is a statutory body formed by an Act of the Parliament of India, has the mandate of promoting, developing and nurturing a healthy housing finance market in the country. To serve its mandate, the Bank undertakes a varied mix of activities involving wholesale financing to the lending institutions, developing new products, supporting the design and implementation of various schemes and programmes including formulation of the housing and housing finance policies, capacity building in the sector for various stakeholders, advisory support to the Central and State Governments, including inter alia for legislations conducive to the growth of the sector. The Bank, through its multiple activities, has sought to ensure growth of the mortgage industry along sound and sustainable lines. Information collection and their collation and dissemination are important contributors to the overall growth and development of the housing sector, and the NHB works actively to improve information flow so as to benefit all the stakeholders appropriately, including the policymakers and other regulators.

5. The need for multiple regulators

The debate on the topic of single vs. multiple regulators is not a new one. In fact, ever since the financial markets witnessed segmentation on the basis of products and services, opinions have been divided as to whether a single regulator is more efficient or multiple regulators are required for effective regulation of different market segments. Countries such as the United Kingdom, which briefly courted the idea of a single regulator, are returning to the original structure of having multiple regulators, while economies like USA and India have ardently pursued the multiple-regulator model, and justifiably so.

The topic of the debate centres around mortgage lending by specialized institutions and whether there is need for a specialized Regulator. The Indian financial system has different regulators for different segments of the financial services market, such as for banks (Reserve Bank of India), specialized housing finance companies (National Housing Bank), capital market (Securities and Exchange Board of India), insurance (Insurance Regulatory and Development Authority) and pension funds (Pension Funds Regulatory Authority of India). Additionally, there is the Competition Commission (earlier known as the Monopolies and Restrictive Trade Practices Commission) which looks after competition-related issues across all sectors, with a consumer focus. The advantage of having a different regulatory body for each market segment is that each regulatory body is able to develop the requisite expertise in its respective area of operations. The example of the National Housing Bank in the Indian context has to be analyzed against the background of the broader growth process in the Indian economy and the financial market. As far as the mortgage industry is concerned, regulations have to deal with multiple scenarios depicting multiple nuances of long term lending for an asset which also has multiple dimensions. The central banks pursue their primary policy objectives of controlling and regulating the flow of money and credit in the economy and maintaining the internal and external value of the currency. Such policy objective is too broad and overarching to be able to address the specific distinctive features of the mortgage market and that of the specialized lending institutions.

While multiple regulators for different lines of activities may not provide comfort to the central monetary authority of the country in terms of the impact and efficient transmission of its policies, the need for a specialized regulator to oversee the role and activities of specialized housing finance institutions cannot be overemphasized. The potential gaps or discomfort for the monetary authority can be addressed through an efficient mechanism of information and data sharing and a process of regular consultation among the regulators.

While the regulatory turfs of the various regulatory bodies are defined by law and are by-and-large independent of each other, there are some instances of overlap where the jurisdictional lines are not very clear (such as in the case of Unit Linked Insurance Plans, which combine features of mutual funds and insurance products). In such cases, the concerned regulatory bodies work with each other under guidance from the Government of India to sort out the jurisdictional issues. Such coordination assumes greater importance in the era of increasing sophistication of financial products. The institutions engaged in housing finance in India fall under the regulatory jurisdiction of one or more regulators depending upon the scope of their activities. For instance, commercial banks are regulated by the Reserve Bank of India, and also by the Securities and Exchange Board of India if they are listed entities. Similarly, listed housing finance companies are regulated by the National Housing Bank and the Securities and Exchange Board of India. In cases where individual entities are part of a financial conglomerate, joint consultations of all concerned regulators are held periodically to iron out any outstanding regulatory issues.

The idea of having a single regulator for the entire financial sector has its own set of merits, such as an integrated approach which is particularly useful in this era of financial conglomerates. However, this model is also fraught with the risk that crucial details and critical granular trends may sometimes be lost in pursuit of the larger picture. The multiple regulatory body structure has the benefit of providing a customized approach to each business segment depending on specific characteristics and needs of the segment, thereby optimizing the regulatory outcome. The multiple regulatory structure has borne positive results in the past as the financial markets have evolved, and there is certainly a case for having multiple regulators in the financial sector. The case for multiple regulators should also be viewed against the background of likely regulatory failure at the macro level. In other words, while one super regulator will have the advantage of a complete and full oversight over the entire spectrum across the financial system, it will also embody the risk emanating from concentration of regulatory power / function in one body and the likely failure of such a regulatory regime or of any critical regulatory policy with its cascading impact on the entire market. Such arrangement may also suffer from lack of cushion or absorption capacity for such failures arising from information gaps, lack of consultation and coordination and absence of a viable alternative backup arrangement.

6. Conclusion

Based on the nature of the mortgage industry, the trends across the globe and the role played by the specialized mortgage lenders and their potential to serve the market efficiently through customized products and services, the case for a specialized regulator for the housing finance industry should merit consideration.

Regulatory regimes and business models in Asia

By Zaigham M. Rizvi

1. Financial regulation of banks and financial institutions

The regulation of financial institutions/banks is a form of regulation and supervision, which subjects financial institutions [FIs] to certain requirements, restrictions and guidelines. This aims at maintaining the integrity of the financial system. The laws, rules and banking laws in a country lay down rules for banks/FIs which they have to observe and comply with when they are being established, and also during their operational phases while carrying on their business. These rules are designed to prevent unwelcome developments that might disrupt the smooth functioning of the banking and financial system, thus ensuring a strong and efficient banking system. All this calls for a surveillance and supervisory role for a regulator.

A regulator has multiple roles to perform besides doing the primary role of the regulator. For effective regulation, the guiding principles and rules of business have to be defined at the earliest stage before granting regulatory permission to a financial body such as a housing finance institution. A report on community housing of Victoria comments:

"...appropriate regulation can make a big difference to the entry of financial institutions into low cost residential housing." [1]

There will be no simple way for the Government and/or a regulator to intervene and change policy, once a sector has matured and has assembled an existing network of partners and stakeholders. In other words, the governments/regulators will want to see that mortgage providers are set up in the "right way" right from the start. This requires regulatory arrangements to be:[2]

- *Proportionate: Regulators should only intervene when necessary. Remedies should be appropriate to the risk posed, and costs identified and minimized.*
- *Accountable: Regulators must be able to justify decisions, and be subject to public scrutiny.*
- *Consistent: Government rules and standards must be joined up and implemented fairly.*
- *Transparent: Regulators should be open, and keep regulations simple and user friendly.*
- *Targeted: Regulation should be focused on the problem, and minimize side effects.*

2. The housing finance regulatory mechanism and its evolutionary phases

Housing finance has been around for many decades in some form or the other, though in the recent past it has assumed a fresh momentum due to renewed interest of governments and stakeholders. This is all the more true for the countries of the Asia-Pacific region, the Middle East and Africa, where along with the growth of institutionalized housing finance, the residential mortgage industry has gained quite a visible recognition from policy makers in the governments and amongst stakeholders at large. Housing has become an important component of political sloganising around the globe and more so in the Asia-Pacific region. The governments in the Asia-Pacific region are announcing mega projects and programs in housing, particularly for the low-income segment of the population. Even in the Arab World, as a consequence of recent political turmoil, the governments in the Middle East and North Africa [MENA Region] have realized that with all the prosperity and economic affluence they have given to their people, they have yet to deliver on affordable housing to low-income segments of the population. Afghanistan has been facing a unique challenge, which has been aggravated by more than three decades of infighting whereby in major cities like Kabul, a large proportion of the housing is either partially or totally destroyed. The only specialized housing finance institution, which existed in Afghanistan in the pre-Taliban era, was closed down and has not yet been revived. The commercial banks in Afghanistan are reluctant to go into housing finance due to the absence of any regulatory regime and the unavailability of long term funding for housing loans. The central bank of the country, Da Afghanistan Bank is struggling to initiate a regulatory regime for housing, and seemingly will need to start from scratch.

While heavy budgets are being allocated for the purpose of delivery, as is seen in some countries of the MENA region alongside the announcement of many ambitious projects, there is a realization that this will not be possible without having established an institutional framework for housing finance, setting up of specialized housing finance institutions and incentivizing commercial banks, through regulatory measures, to allocate credit to the housing sector. There is a need for mortgage specific prudential regulations, mortgage guidelines, default management, foreclosure laws and rules/regulations for setting up specialized housing finance institutions. The question then arises as to which institution should lead as housing regulator.

3. Who should regulate housing finance sector?

Consequently one sees the role of the country's central banks as initiating the process by setting up a function of mortgage regulation

[1] Financial Regulation of Community Housing Organizations a report of Community Housing Federation of Vistoria-2010, p-5

[2] Housing Finance Policy in Emerging markets by Loic Chiquier and Michael Lea, World Bank-2009

within those central banks. Europe, the USA and some countries of Latin America have gone through a similar phase in the history of their mortgage industry, and now are at a higher level of maturity. That does not mean that they have overcome all the challenges of housing regulation, since regulatory processes evolve in a dynamic way. During the sub-prime crisis of 2008, the world saw the failure of regulatory mechanisms in Europe and America. Different countries from the developed world have faced the sub-prime crisis in different ways, with different intensity. While the USA appeared to have been more vulnerable, the Canadian Mortgage market had proved to be more disciplined and better regulated.

The World Bank publication "Housing: Enabling Markets to Work-1993"[3] elaborated on the important role of housing in the economy. While stressing the significance of housing policy and the strong role and contribution of housing and the housing finance sector in the economic development of a country, the report discussed guidelines on how best to design policy to create efficient housing markets. That demonstrated the concern that while housing finance is essential from a socio-economic angle, the need for sound policy and regulation is equally important for protecting the financial system from a potential disaster. Developed economies have done a lot of work on housing finance, institution building, and developing housing policy and regulatory mechanisms etc. This is evident through numerous publications and forums. However, very few such publications describe how the challenges of developing housing finance are being handled in emerging markets.[4]

The penetration of housing finance in an economy, as measured by the outstanding residential mortgage debt to GDP ratio, has grown over the years. The pace and extent of penetration is different in developed economies compared to emerging economies. Since the mid-nineties the penetration of housing finance has increased dramatically in developed economies. In USA, Europe, Australia, and Japan the size of outstanding mortgage debt represents between 50-100% of gross GDP. It is also showing a rising trend in emerging economies, though at a slower pace. For example in a few middle-income countries (like Korea, South Africa, Malaysia, Chile etc.) it is in the range of 20-35% and in several other countries termed as "latecomers" in institutionalized housing finance (e.g., China, India, Thailand, Mexico, Morocco, Jordan, Brazil, Turkey, Kazakhstan etc. and some EU countries) it ranges between 6-17%. Therefore the challenges of housing policy and the promotion of institutionalized housing finance and regulation are at different levels and are of a different nature.

While regulatory challenges have emerged both on the supply side and demand side of housing, this paper has a focus on demand side regulation. Just as the housing finance systems and their institutional frameworks were developed over the decades, so has the need for regulation and for institutional arrangements to support it. Regulatory mechanisms and institutional frameworks have therefore gone through an evolutionary process.

As one can see from the penetration level of mortgage finance in different countries of the Asia-Pacific and African regions, the challenges of institutionalized housing finance and regulations are different. When reviewing the gradual evolution of housing finance in these regions, it is evident that in almost all these countries housing finance has started through a government initiative in establishing a specialized housing finance institution [HFI] in the public sector. One may observe the very limited role of Housing Finance Companies [HFCs] in the private sector. The entry of commercial banks into the housing finance market is also a recent phenomenon in these regions. This means that the regulator not only has to perform a regulatory role, it has also a role as the promoter of institutionalized housing finance as well. That seems to be one reason that the role of housing regulator in these countries has been initiated by the central banks, which have expanded this role over the years.

This paper is part of a debate on who should regulate the demand side of housing. This paper takes the view that housing finance regulation would be undertaken by the central banks (e.g., Bank Negara, Malaysia).

This author is of the opinion that, like the gradual expansion of the housing finance market, the regulatory function also goes through an evolutionary process, starting from within, as a sub-set of the central bank of the country and eventually expanding to levels and volumes, which would call for an exclusive and expanded regulatory function either within the central bank or spun off as an independent regulatory regime. The following sections will discuss the factors supporting the above proposition.

4. Regulatory agency for housing finance

In order to develop the housing finance market, and then to manage its size and complexity, the Governments and the stakeholders feel the need for a regulatory agency that would ensure the disciplined growth of the industry in a viable and sustainable manner. The demand side of housing and housing finance comes under the scrutiny of financial regulation. A housing finance regulator overseeing the development and growth of housing finance is expected to play the following roles:

- Regulation for risk management of housing finance institutions.
- Promote access to finance through housing finance delivery channels (through HFCs in the public sector and commercial banks etc. in the private sector).
- Promote product diversification to ensure that housing finance is available to different clienteles as per their risk profile and income.
- Ensure financial inclusion through credit allocation and regulatory incentives in commercial banks.
- To bring housing finance stakeholders on board to ensure that other agencies like fiscal authorities, rating agencies, capital markets etc. operate in unison to ensure that the system facilitates access to housing finance and affordability.

4.1 Regulation for risk management

Lending operations carry a variety of risks that must be recognized and then allocated, managed, and priced, but the long lending terms in housing finance; 10-30 year maturities, offer unique risks. During such long terms, the sustainability of a borrower's income and his/her capacity to repay, the financial and legal scenario, institutional liquidity and capital adequacy, as well as pricing and marketability of the asset under lien could vary significantly. Any such cyclical variation would directly or indirectly expose financial institutions to unique risks. Such risks could, on one side, adversely impact the health of a financial institution, and on the other could shatter the

[3] Housing: Enabling Markets to Work- 1993, World Bank publication

[4] Housing Finance Policy in Emerging markets by Loic Chiquier and Michael Lea, World Bank-2009, P-175

confidence of the providers of funds/liquidity to that institution. In view of this it is essential that risk-taking by lenders and investors be regulated and supervised, by both the shareholders and regulatory authorities.

The principal risks associated with financial intermediation are: credit, market, liquidity, exchange fluctuation, operations or business and political or environmental risks.[5]

Mortgage finance risks include fluctuations in the value of mortgaged property, interest rate movements, and the degree of efficiency and effectiveness of foreclosure laws. In addition to product specific issues, mortgage finance can also be a source of systemic risk, as banking and real estate crises are frequently correlated. Emerging markets generally lack in publicly available housing market information, long term liquidity facilities and enforcement of liens. This can lead the lenders and regulators to restrict the flow of credit to housing. For commercial banks, housing is one asset class, alongside many other assets the banks could choose and attract through their product and service-mix. Thus at times they could decide to stay away from housing finance and just not include it within their asset-mix. That is the primary reason that the emerging economies mostly initiate housing finance by setting up a specialized housing finance institution owned by the Government.

5. Regulatory failures and challenges in historical perspective

We have seen disastrous consequences from the failure of institutional regulation in America at various times in history. It once happened in the 1890s when homeownership efforts were gaining ground as part of the "American Dream". Then major issues came in 1930s, and after that it occurred in 1950s, then 1960s and lastly in 2008, which is known to most of us; some of us might even have suffered at its hand. One thing was mostly common to these events, and that was the failure of the regulatory system in place to sound warnings against loose underwriting and to understand the growing risk factors. Had the central bank, or any central regulatory authority been doing the regulatory business of keeping check on loose underwriting standards, then the situations might have been quite a bit different.

The sensors for political and systemic risks are difficult and complex to understand and install. The classic example of that is the East Asian crisis of 1997. The financial contagion that swept East Asia in mid-1997 was the result of economic and institutional failures. This crisis was not a direct outcome of a weak legal and regulatory framework[6]. One cannot ignore the fact that central banks are the ultimate regulator of foreign direct investment [FDI], trade balances and Forex reserves and credit allocation plus the lending terms and exchange fluctuation risks of FDIs. Nevertheless they failed to prevent short-term FDIs going into long term real estate assets, one of the primary reasons for the crisis.

The above history of financial crisis clearly makes the point that financial markets, over the years, not only grow in size, but also in complexity and that they become more inter-dependent with the overall political and financial system. That calls for more specific expertise, continuing education and continued evaluation of the institutional framework, regulation and surveillance mechanisms etc. The housing markets of the Asia-Pacific region, the Middle East and Africa are just going through the evolutionary phase. Many countries in these regions have just started to realize the importance of institutionalized housing finance, leading to wake-up calls to the Governments and the central banks to put in place regulatory and surveillance mechanisms before it goes out of control. There is very little in-house expertise available to develop rules/guidelines for establishing housing finance institutions, mortgage guidelines, prudential regulations, and risk management etc. The World Bank/International Finance Corporation [IFC] and Asian Development Bank [ADB] are already active in assisting some of these countries in developing and enriching their regulatory regimes.

The central banks of these countries do have mechanisms to regulate banks and other financial institutions, though not necessarily in relation to mortgage finance. Therefore, till such time as the mortgage industry grows in size and complexity, the safest way would be to install some regulatory mechanism for housing finance within the central bank. To begin with it may be a part of some other function, so as to develop some in-house expertise, policies and procedures in the area of mortgage finance. Apparently that is the main reason that we see that in some countries the central banks have initiated a regulatory regime for mortgage finance within the function and regulatory platform of consumer finance. The central bank of Pakistan (the State Bank of Pakistan [SBP]) has followed this path. Once the function was developed, a separate department in the name of Housing and Infrastructure was established. When the regulator feels it has developed enough expertise in the area and the mortgage industry attains sufficient volumes, an independent function for regulation of the mortgage industry could be set up. The next stage would logically be either to continue strengthening the regulatory function within the central bank or to have an independent agency for regulation and supervision of the mortgage industry. Even in that case, the commercial banks would logically remain under the regulatory control of the central bank of the country. In countries where the government has a significant role in housing and housing finance as in Thailand, Indonesia, Singapore etc., there is a definite regulatory role for the ministry of finance alongside the main regulatory mechanism of the central bank.

India with a population of 1.2 billion plus people spread over 28 states and 7 union territories, had its own challenges in the field of mortgage finance. In order to ensure financial inclusion, it had to have a much expanded outreach of delivery channels, offering mortgage finance through diversified products to different market segments. After having realized that the Government alone could not be the solo player in housing finance (in India, land and thus housing is a provincial or state activity and not a central government activity), it moved towards the policy of promoting housing finance companies in the private sector. In 1978 HDFC India was already established as a specialized HFC in the private sector with equity participation from IFC and the Aga Khan Foundation of Switzerland. It started making very impressive progress right from its inception, and by 1983 HDFC had issued its owned bond to raise funding from the market. Today it is the leading housing finance institution in India. With the success of HDFC it became obvious to the planners and policy makers that India needed to promote the role of HFCs in the private sector. In 1988, the National Housing Bank of India [NHB] was established as a wholly owned subsidiary of the Reserve Bank of India

[5] Housing Finance Policy in Emerging markets by Loic Chiquier and Michael Lea, World Bank-2009, P-176

[6] Building the Legal and Regulatory Framework by John L. Walker-USA, p-33

[RBI], to serve as a specific regulator for housing finance companies-HFCs in the private sector. Till then mortgage finance was being regulated by the RBI. Still the RBI has the role and responsibility of regulating mortgage finance by commercial banks. The NHB also serves as a long term liquidity facility institution for HFCs and the banks, through issuance of bonds and mortgage-backed securities [MBS]. India has a population challenge coupled with the need to promote financial inclusion, which could only be met through the active participation of housing finance institutions in the private sector. The regulatory model India presents has indeed served its purpose. However, the evolutionary process, as we see in India, will not end there. As the industry grows further, it will become more specialized in terms of business, product line, and market segment to be served. The expansion and diversification of the mortgage sector may necessitate other specific regulatory regimes for housing microfinance, community based housing etc.

This paper is neither advocating nor opposing either of the two regulatory models i.e. housing regulation by the central bank or by an independent regulatory agency. It just warns against considering a separate and independent regulatory body as a starting point or an ultimate goal. Based on the discussion above, the author would like to suggest that housing finance regulatory regimes may go through the following evolutionary stages.

Stage 1: Establishment of the housing finance regulatory function within the central bank as part of a regulatory regime of consumer finance, whereby already existing prudential regulations say for consumer finance would be amended and improved to cover housing finance as well.

Stage 2: Separating the function of housing finance regulation from a sub-set of another function to become an independent function within the central bank. The function will develop specific mortgage regulations, mortgage guidelines, developer finance regulations, laws for the realization of security in case of default (foreclosure laws) and guidelines for setting up of specialized housing finance institutions; HFIs or HFCs.

Stage 3: This stage will offer two options. Either the central bank will continue strengthening the mortgage regulatory regime within the central bank to attain higher level of advancement and maturity. The Singapore Monetary Authority, Bank Negara Malaysia, the Bank of Thailand etc. represent this regulatory model where mortgage regulatory function is well advanced and mature, and is still being retained at the central bank. NHB India presents an alternative regulatory model, which involves partial spinning of the housing finance regulatory function from the central bank to a separate and independent entity. Even in this case, the housing finance operations of commercial banks remain with the central bank.

A review of the regulatory regimes in nine select countries of the Asia-Pacific region reveals that except in India, in all other countries the central banks are the primary regulators of housing finance. In Afghanistan, where housing finance market is just in its infancy stage, the central bank of the country is busy in establishing a housing regulatory function at the central bank. In countries like Pakistan, Sri-Lanka, Bangladesh, Indonesia and Thailand, where the housing markets are well established at various stages of development, it is the central bank again that plays an active regulatory role with varying stages of success. Even in the well-advanced and mature housing markets of Singapore and Hong Kong, housing finance regulations are the primary role and responsibility of the country's central banks. Even in India the RBI is continuing to play the regulatory function for the commercial banks, and regulation of HFCs is being done by the NHB, a wholly owned subsidiary of RBI. Here again both NHB and RBI work with a shared wisdom on the regulatory function for housing finance.

6. Conclusions

As can be seen from the discussions above, the normal business model for regulation of housing finance is through the central bank. However any decision on a proper regulatory regime for a country will depend upon factors such as the size of the population to be served for housing, the geographical spread of the population, the issue of financial inclusion, the role the state is willing to take and is capable of taking both on the supply and demand side of housing provision, the complexity and maturity of the financial sector, the regulatory business model for having a separate and independent regulatory authority etc. Depending upon the size and complexity of the housing finance market, more than one regulatory regime could be developed in due course of time. What is needed, from the perspective of the Asia-Pacific region, is to keep learning from the experience of others and keep reviewing the regulatory model that is currently in place.

Is Scottish housing policy diverging from policy in England? The complexity of devolution in practice

By Kenneth Gibb

1. Introduction

The devolution of Scotland came into force in 1999. Housing was among the areas of policy devolved to the newly-created Scottish Parliament. Although there has been housing legislation passed in Holyrood and a number of aspects of housing policy are substantively different in Scotland compared with south of the border, important aspects of policy that shape housing are reserved to the UK Parliament in London and operate UK-wide – in particular, taxation and social security, financial regulation and public finance accounting rules. Moreover, the UK is the appropriate level to consider the market context and policy framework for the mortgage market.

Prior to 1999 there was administrative devolution of housing within the Scottish Office and hence a tradition of varying the degree and nuance of the Scottish manifestation of UK policies (e.g. higher grant rates for social housing in Scotland throughout the period since 1988). Path dependence therefore plays a role in the route taken by Scottish housing policy since 1999. Nonetheless, more than a decade of devolution has produced both examples of important divergence from English policy and some examples of lagged convergence or the nuanced local development of English-originating policies in Scotland (see, also: Maclennan and O'Sullivan, 2008; Wilcox, et al, 2010).

In this paper we seek to make sense of the way in which Scottish housing policy has evolved, diverged and changed post-devolution, and consider the implications of these shifts in terms of their impacts on various constituencies in the housing system. Part 2 of the paper considers a simple framework to help organise our thinking. Part 3 of the paper sets the recent history of housing policy in Scotland in a wider context. Part 4 outlines the key policy issues of interest. Part 5 discusses the reasons behind these policy developments and their impacts on consumers, providers and others in the housing system. The 6th part of the paper summarises and concludes.

2. Convergence, divergence and devolution

The housing studies literature has been much concerned with the impact of broader processes of convergence on national housing systems and policies. This approach viewed housing through a lens of national welfare regimes and it argued that the sector was being shaped by globalisation and commodification. However, many writers also argue that national systems display elements of path dependency and that national context, institutional features and other rigidities may both impede convergence and may even sustain elements of policy divergence (Doling and Ford, 2003; Hayden, et al (2010). What this means is that although, for instance, different Scandinavian countries may operate housing systems and policy frameworks for housing that look broadly similar, these may nonetheless be being modified by general global processes (i.e. weakening their regional definition or uniqueness). The process of convergence has been argued (op. Cit.) to be characterised typically by: deregulation and marketization, an expansion of home ownership and market renting alongside reduced subsidies to non-market housing and more reliance on targeted demand-side subsidy.

While not wanting to get into the critique of these sorts of high-level models of comparative housing and international housing trajectories, the natural question for this paper is whether these national-level forces of convergence, divergence and path dependency speak to examples of fundamental constitutional change within a nation state such as that created by 14 years of substantive devolution of housing policy to Scotland? Fundamentally, devolution should offer the opportunity for policy to diverge because it reflects local preferences and political demands in ways that unitary Government could not. These locally generated policies may also, however, provide lessons for other parts of the UK's housing sector.

There are different reasons why this may be a fruitful way of looking at the problem. First, the existence of a shared set of institutions (e.g. the civil service), a broadly common set of policies from pre-devolution, and a shared macroeconomic and fiscal context – all lend themselves to comparative analysis of the different nations post-devolution by providing a common starting point. Second, there is considerable interest in learning from policy experimentation in different parts of the UK (and this has been greatly enhanced as a result of the shared fiscal crisis and deep cuts in public housing spending). One of the lessons of the policy transfer literature is the danger of unintended consequences and lack of institutional embedded shared features that allow policies to be transplanted – arguably there would be relatively greater scope for such lesson-learning and transfer in the post-1999 devolved UK setting.

However, one should proceed with caution. Policy does not exist in a vacuum and emerge from a rational decision-making process or cycle of issue identification, design, implementation, evaluation and modification. The real world is complicated by party and governmental politics, by incrementalism, by lags in implementation, by wider shocks to the policy process (such as the Global Financial Crisis [GFC], as well as the different governments within the UK learning by doing, including their inter-governmental relations (see Cairney, 2011). Arguably, all of these features have applied post-2007 with different political parties in power in Westminster and Edinburgh, austerity, plus important market failures in both the credit market and on the housing supply side.

The pragmatic position taken here is to focus on a sub-set of important distinctive post-1998 Scottish housing policies. These are considered in terms of convergence, divergence and path dependence but we would not expect to fully understand what has been going on without due regard first to political and other relevant contextual factors.

3. Policy and other drivers of a distinct Scottish housing policy

The Scottish housing sector has traditionally been different from England but many important 'real' aspects of that separateness have declined over time. Until only recently, Scotland was much less of a home owning country (see Table 1) but this has changed as a result of income growth, the right to buy and the backwash of UK-wide policies such as mortgage deregulation and dis-investment in public housing (as well as decline in home ownership in the other home nations). The later but proportionately large growth in the sector has had wider effects – Scotland largely missed the late 1980s and early 1990s boom and bust but was much more exposed to the GFC in 2007 and thereafter.

Table 1: Housing tenure in Scotland and England 1971-2009 (dwellings, %)

England	Owner-occupation	Private Rented Sector (PRS)	Housing Association	Local Authority
1971	52.5	19.3	[in PRS figure]	28.3
1981	59.8	11.3	2.3	26.6
1991	68.1	9.0	3.1	19.8
2001	70.0	10.1	6.7	13.3
2009	68.2	13.9	9.8	8.1
Scotland	**Owner-occupation**	**PRS**	**Housing Association**	**Local Authority**
1971	31.2	16.7	[in PRS figure]	52.0
1981	36.4	9.7	1.8	52.1
1992	52.4	7.1	2.6	39.8
2001	62.7	7.3	6.0	24.6
2009	65.3	10.7	10.9	13.2

Source: UK Housing Review Website (www.york.ac.uk/res/ukhr)

Note: No Scottish figures for 1991 – hence use of 1992

Note: figures for 1971 show combined housing association and PRS tenure shares

As elsewhere, in the period after 1980 and especially after 1988, investment in the Scottish social housing sector was dominated by housing associations. The distinctive features of housing associations in Scotland included the large number of community-led neighbourhood level associations (particularly in and around Glasgow) and the growth of the sector by stock transfer, mainly as a result of the selling off of Scottish Homes stock rather than whole council stock transfer (excepting the largest UK transfer in Glasgow in 2003, as one of only 6 out of a possible 32 councils who transferred). The sector is dominated by a large number of smaller general needs associations, a number of stock transfer associations, Scottish-wide providers and a few English associations who have subsidiaries or other operations in Scotland.

Prior to devolution, the administrative discretion afforded to housing policy operated through distinct structures. The national agency Scottish Homes, and its successor Communities Scotland, regulated and funded housing associations as well as playing a wider role in developing housing strategy and needs analysis, among other things. Scottish Homes was a non-departmental body [NDPB], also known as a 'quango', with a board and a degree of independence from Government (like its broad English equivalent – the Housing Corporation). Communities Scotland, however, was an executive agency of Government and had correspondingly less independence from Government. The Scottish Government went further and created an NDPB Scottish Housing Regulator but took funding of social housing directly into Government. Grant levels per unit remained much higher in Scotland (and indeed remain so albeit that grant levels fell sharply in 2011 from an average of more than £65,000 to £40,000). The Scottish Office also pursued innovative subsidy-based policies such as GRO (Grants for Rent and Ownership) aimed at housing deficit subsidy to assist supply to tackle market failure, urban regeneration, mixed tenure development and rural housing market failure).

Second, the environment facing council housing has been significantly different in that the English 1989 system[1] was never introduced and Scottish councils retained various freedoms to invest surpluses and council house sale receipts and enjoy discretion over rent-setting. Some of this was restricted in 1997 when the incoming Labour Government obliged receipts to be directed towards repaying debt (following English practice of a decade) but this was in practice overtaken by subsequent policies to increase stock quality and encourage transfer. An echo of this relatively favourable treatment for councils is apparent in the much more positive role given to councils including new build at scale encouraged by the SNP government after 2007 (discussed further below)[2].

A further critical driver has been public spending. In Scotland, prior to devolution, there was comparatively tight spending control (although relatively benign compared to recent years) manifested in the overall size of the programme offered each year for new social housing development. Post-devolution, and in a context of rising real levels of public spending for the Scottish block as a whole and sustained economic growth (if debt-fuelled), housing programmes grew in size and assumptions about further growth were undoubtedly made by many if not all stakeholders. This has now been completely reversed and while spending cuts have not been as deep as for the Department of Communities and Local Government (DCLG) they still represent a 45% cash terms cut in capital spending for affordable housing comparing the current three year spending review period with the last one (see

[1] The 1989 English council housing finance system introduced ring-fencing of council housing finance, greater central control over rents via subsidy and expenditure assumptions, as well as taking any surpluses and using them to offset rent rebate housing benefit costs. Although the system thereafter became more complex until its recent reform and simplification, Scotland always retained the '1980' system allowing them some discretion over rent setting and investment decisions and the use of surpluses (but see text for periods where debts had to be reduced by capital receipts).

[2] English councils now have more freedoms to invest and borrow under the new English council housing finance system but they are still, currently, subject to overall borrowing ceilings dictated from Whitehall.

Table 2). Policy, long based on assumptions of real spending growth now has to develop in an environment of expected long-term reductions in resources – hence the demand for experimentation and innovation, lesson learning and policy transfer.

Table 2: Public spending on affordable housing, Scotland

	2009-10 to 2011-12	2012-13 to 2014-15
Spending in review period	£1.39 billion	£0.770 billion
Social and affordable units completed	22,205	Target: 18,000
Social units completed	15,690	Target: 12,000

Source: Shelter Scotland written evidence to Scottish Parliament Infrastructure and Capital Investment Committee, October 2012.

Note: these figures do not include in-year spending revisions as a result of Barnett Consequentials and other spending redistributions vired between headings

4. The primary elements of policy divergence and convergence

In this section we selectively describe policies distinctive to devolved Scotland but not in any exhaustive or comprehensive manner. The section looks at four types of policy clusters that are directly or indirectly related to the financial sphere of policy. First, we consider those policies introduced in England but not pursued in Scotland. Second, there is a set of policies followed in Scotland with a lag or slightly differently to England. Third, we identify distinctively Scottish policies that originated north of the border since 1999. Finally, we look forward to likely future divergent policy.

4.1 English policies: negative divergence

A negative form of devolution is to choose actively not to pursue specific policies initiated south of the border. The Labour / Liberal Democrat Scottish Executive chose not to give councils the options to set up Arms-Length Management Organisations (ALMOs) or Private Finance Initiatives [PFI] models as alternatives to council housing as mechanisms to fund investment to secure statutory housing standards. This was justified in public finance and more political terms but it meant that the options for councils were essentially stock transfer to housing associations or retention. Second, Scotland, despite research and policy development, has never yet embarked on rent convergence or national rent policies meaning that councils retain considerable discretion over rent levels and differentials (and housing associations have not faced the challenges of controls found in England). By the same token, Scottish local authorities avoided the complex revenue and capital controls, benefit cross-subsidy and all the other elements that were recently dismantled in the English Housing Revenue Account (HRA) system. They have instead retained simpler systems and more discretion over a long period of time.

More recently, Scotland has shown no appetite for the distinctive elements of the English housing association Affordable Homes Programme[3]. In particular, while Scotland has cut grant rates, the SNP Government still expects 2/3 of its affordable housing supply programme to consist of traditional social renting. There is no fixed term tenancy, or rents set at up to 80% of local market rents (except for explicitly mid market affordable rent products) or the use of higher rents on reletting to cross subsidise development. That is not to say that a wider offering of tenancies may not yet appear but it is currently not part of the policy narrative.

4.2 Lagged convergence

There are examples of housing policies originating in England which have been explicitly imitated by Scottish ministers, with more or less local variation in response to a different context or set of circumstances. This has in some cases followed England with a lag or with specific amendments for implementation in Scotland. There was innovation in stock transfer policy concerning area-based partial transfers (e.g. community based housing organisations on peripheral estates in Glasgow) and the parcelling out of Scottish Homes stock into more than 100 transfers (Gibb, et al, 2005), as well as new town development corporations transfers. But it was only after the 2001 Housing (Scotland) Act that local authority large scale voluntary transfer (LSVT) was enabled (there had been one council transfer – in the Scottish Borders - prior to this point). The legislation gave tenants new protections (e.g. the Scottish Secure Tenancy) and allied to the need to achieve the Scottish Social Housing Standard (similar to the Decent Homes Standard in England); this set in train a series of ballots. Six were successful, most notably the heavily subsidised and controversial transfer in Glasgow in 2002 but mainly in rural authorities. Several, including Edinburgh and Stirling voted against transfer.

Although Scottish housing association grant rates remain considerably higher than in England, they have in recent years followed the same path down to much lower levels. Indeed, the Scottish Government was actively looking in 2007 to find ways to cut grants and development costs which did seem to be relatively high north of the border However, it was only after the 2010 spending review that pressure crystallized to reduce grant rates and supply programmes significantly. Scotland also followed England at this point by shifting to grant payment at completion rather than in stages from approval.

The Scottish Government has also long followed a similar but distinctive path supporting entry to home ownership through local versions of shared ownership, new and off the shelf shared equity and now via indemnities to help first time buyers meet the requirements of higher loan to value mortgages (similar programmes are known as NewBuy and FirstBuy in England). However, these programmes are much smaller in relative terms to those in England. Perhaps more significant in the long run, Scotland was slow to embrace the possibilities of affordable housing agreements (S.106 planning agreements in England are known as S.75 of the equivalent Scottish planning legislation). The use of these agreements was only starting to become established as mainstream policy when the market collapsed but the working assumption is that for Scottish

[3] In 2010, the English housing association development programme was replaced with a multi-year programme (the Affordable Homes Programme) based on lower grant rates (£20,000 per unit), higher rents (up to 80% of market rents) and cross subsidy from agreements that participating social providers could increase the rents of existing properties in their portfolio on relet. Typically, a new unit might require three further existing units to increase their rents to 'affordable' levels. The programme was over-subscribed and Government expects 80,000 units to be built between 2011-15 (see: Public Accounts Committee (2012)).

Ministers it remains a key plank of affordable housing in Scotland for the foreseeable future.

4.3 Divergent Scottish policies

There have been several pieces of specific devolved housing legislation that have taken Scotland off in a different direction from the rest of the UK. Here we stress just five specific policy areas. The most well known is the Scottish homelessness legislation which extends priority need to all cases of (a wider definition of) unintentional homelessness by the end of 2012 (Wilcox et al, 2010). While the policy has been lauded internationally and there is consensual support for the policy, it is also widely recognised that it brings with it many challenges not least resourcing its implementation, the management-time and staffing input particularly from councils, the need for joined up multi-sector partnership and co-ordination (including from the private rented sector).

Table 4: House building in Scotland 2001-2011 (completions by sector)

Year	Private	Housing Association	Local Authority
2001	22,392	4,252	72
2002	23,147	3,979	51
2003	23,657	3,474	53
2004	24,973	3,097	-
2005	25,288	4,649	-
2006	25,287	3,941	6
2007	25,741	4,034	28
2008	22,018	4,109	195
2009	17,664	5,809	476
2010	16,914	5,149	561
2011	15,112	4,391	866

Source: Scottish Government housing statistics website: (www.Scotland.gov.uk/Topics/statistics/browse/Housing-Regeneration)

A second distinctive area has been the Right to Buy (see Table 3). This goes back to the 2001 Act which introduced a 'modernised' Right to Buy [RTB] which, ostensibly about extending sales to part of the housing association sector, also allowed high pressured markets to suspend sales for 10 years and featured reduced discounts. This led to quite a complex mosaic of rights for tenants depending on their landlord and when they became tenants, where they lived, if they had been in a stock transfer and if they were in a charitable housing association. In 2007, and in a context of declining sales, the new minority SNP Government piloted legislation (the Housing (Scotland) Act 2010) to abolish the RTB for new build social housing essentially to incentivise councils to build homes free of the fear of subsequent loss through sales. The Act also banned the RTB for new tenants and increased the flexibility with which pressured area designation could be used to suspend the RTB.

Table 3: Public Spending on Affordable Housing, Scotland

Period	Number of Sales
1980-85	72,639
1986-90	134,374
1990-95	103,766
1996-2000	74,502
2001-2005	80,372
2006-2009	26,121
Total	**491,774**

Source: as Table 1

Note – only four years covered in 2006-2009

More recently, as the UK Coalition Government has been seeking to encourage a new wave of sales, the Scottish Government is now proposing to outlaw the Right to Buy entirely. It carried out a consultation in the second half of 2012 and the evidence suggests widespread support for an outright ban and several councils are seeking unilaterally to suspend the right. The direction of travel seems clear.

Council build has also become important in Scotland in recent years (Table 4). As a result of (a) the new build RTB abolition (b) a grant averaging £25-30,000 per unit and (c) the ability to borrow cheaply on a prudential basis and use their own land – councils have been building at volume for several years (Gibb, 2011). A key point is that while the Scottish Government has limited borrowing powers in its own right (and this is still the case despite reforms in the 2012 Scotland Act), this is not true of local authority borrowing in Scotland, which is outside of the borrowing caps currently facing English councils.

A novel, evolving Scottish housing policy involves joint venture partnerships of councils (and now also housing associations) alongside private developers to bring forward mid-market rent affordable housing supply. The National Housing Trust [NHT], established by the Scottish Futures Trust, provides a state-backed loan guarantee to protect the council/housing association against the risk of void loss and capital loss when loans are repaid after 5-10 years when the properties are disposed of (Gibb, 2011). The first round of NHT produced more than 600 units across Scotland and the second round now underway is likely to produce examples of different models including properties reverting to more social provision in the longer term. The Scottish commitment to the use of guarantees is now also finding purchase in England.

The current affordable housing programme is set for the life of the Parliament and seeks to develop 30,000 social and affordable homes over the five years. What is distinctive is that 2/3 of these properties are to be socially rented and 5,000 of the total (at least) will come from the council new build programme. The first three years of the programme is aligned both with the spending review period and a new three year multi-year planning programme that allows councils to plan approvals for social and affordable housing and to link these to their housing strategy and local needs estimates. This builds on several years of providing development funding to Glasgow and Edinburgh devolving the allocation of capital spend to housing associations (known as the Transfer of the Management of Development Funding).

While the development of multi-year planning (known as Resource Planning Assumptions) is not without practical problems, it does represent an effort to work both in partnership and to move away significantly from inefficient single year programmes for capital spend.

4.4 The horizon

Assuming no further constitutional change, there are further Scottish housing policy reforms ahead of us. As part of the 2012 Scotland Act, a number of additional powers have been granted to Scotland such as limited borrowing powers, a larger revenue collection role for income taxation and the devolution of specific taxes, one of which is Stamp Duty Land Tax. The Scottish Government has recently completed a consultation exercise and has tabled a Parliamentary Bill (November 29 2012) for its own form of Land and Buildings Transactions Tax, which may have repercussions for the housing market, for property development and even for progress with policies such as real estate investment trusts.

The Scottish Government and the Scottish Executive pursued distinctive policies on private renting and its regulation involving mandatory licensing of Houses in Multiple Occupation [HMOs], landlord registration and the development of a repairing standard[4]. Currently, and following the Private Rented Housing (Scotland) Act 2011, the Government through a sector taskforce is exploring mechanisms for redress between landlord and tenant such as tribunals (as well as refreshing existing policy and inter alia establishing a tenant deposit scheme[5] and tenants' information pack). This follows earlier distinctive legislation on HMOs and licensing.

Finally, and more speculatively, in their 2011 Manifesto, the SNP committed to devolving housing benefit in response to the proposed coalition government welfare benefit reforms. While this now looks like it will not happen, there remains considerable interest in long term reform of Housing Benefit alongside social security more broadly (as they are intimately connected) and this is a live issue whether Scotland becomes independent or even if more powers around the principles of fiscal autonomy are the ultimate result of the 2014 referendum (Gibb and Stephens, 2012).

5. Discussion

The emerging picture of examples of continuity, imitation and divergence that add up to a distinctive Scottish housing policy can be understood, arguably, on a series of different levels. First of all, there was an important political cleavage in 2007 where for the first time (and thereafter); different political parties were in power in Edinburgh and London. Second, the UK and Scottish Governments have responded differently to the fiscal crisis and its aftermath and this is reflected in strategies and in the accompanying policy frameworks. Third, however, there remain significant forces that suggest convergence will remain as important an inhibitor of local variation in policy in Scotland as it has in the past. A fourth aspect concerns actual outcomes of policy and their evaluation - what is the evidence?

In the period up to 2007, while there were significant expressions of local policy development in the 2001 Housing (Scotland) Act and the 2003 Homelessness, Etc. (Scotland) Act, new policy directions reflected both UK and Scottish considerations e.g. stock transfer but also the collective view of sector stakeholders (e.g. the 'big tent' consensus that produced the homelessness legislation). In a context of growing spending resources (and a number of Scottish Executive and Scottish Government initiated universalist social policies funded by the Spending Block in Scotland) and the bedding in of new institutions, there was certainly little appetite to move radically away from the shared direction of broad housing policy. Policy continued to drift apart (e.g. social housing rents, council housing finance, and social housing development) rather than proactively follow different roads.

Much more significant change followed the election of the SNP in 2007 and their surprise majority victory in 2011, while at the UK level Labour was replaced by the Coalition in Westminster in 2010. Although they initially had less realistic policies from opposition days to ditch (e.g. a grant for first time buyers and the policy to replace the council tax with a form of income tax), over time the SNP Government has developed a number of distinctive policies in terms, for instance, of the RTB, council house building and the National Housing Trust. In the previous spending review period the Government accelerated expenditure to maintain social house building for economic multiplier reasons and then they embarked on a series of strategic discussions in 2010 and into 2011, which led to a long term strategy focused on 'anything that works' to support more social and affordable housing and in particular they sought to find new channels for for-profit investment to become involved in non-market housing (Scottish Government, 2010; 2011).

There are currently strongly expressed political differences as to the course of social policy and housing developments. This is probably most evident in terms of the completely different positions on the RTB, the Scottish Government's trenchant criticisms of welfare benefit reform, the broader calls to slow down the fiscal deficit reduction and to use public resources to fund infrastructure, including housing. However, one needs to make the qualification that there are basic party politics at play in the run-up to the independence referendum and, at the same time, many of the key goals of housing policy remain the same on both sides of the border – although interestingly, despite the desire to sustain high levels of home ownership in Scotland, the 2010 Scottish Government policy document identified the dangers of volatile house prices and household exposure to housing-originating risk. A further reason is the re-emergence of the negative divergence argument – Scottish ministers for instance were critical of important dimensions of the affordable rent programme and the return of the active promotion of the RTB in England.

In some respects it is easier for policy innovation to emerge and be piloted and implemented in Scotland where the lines of communication are shorter, professional networks and policy communities are much smaller and tighter and consequently policy diffusion can occur perhaps more easily than in England. In 2010-11, the Scottish Government supported an innovation fund that supported more than 30 small-scale projects with low levels of grant (Field, et al, 2012) and at the same time allowed discussion with specific bidding partners to work up larger projects (e.g. a partnership involving Clyde Valley Housing Association and Savills that led to several hundred new mixed tenure units in Lanarkshire).

Divergence may be expected to become embedded for these reasons but there will remain countervailing factors that in the absence of further constitutional change will constrain developments in this direction. This includes the same national policy, finance and economic forces discussed earlier that constrain the UK and Scottish housing systems because they operate at the larger rather than Scottish levels. Public accounting rules also remain (generally) binding constraints. It is not surprising therefore that the main spaces where policy divergence have occurred are in social and affordable housing (where policy levers are much more apparent) and much less so in the market sphere which is much more to do with UK-level and global market drivers.

[4] England also has mandatory HMO licensing under the Housing Act 2004 though there are important differences.

[5] Also in England – at least one TDS company is running both sides of the border.

A reasonable question is to ask whether the Scottish policies have had a demonstrable effect on housing outcomes and the performance of the housing system more broadly in Scotland? It is of course difficult if not impossible to construct a meaningful counter-factual or 'policy-off' position (i.e. what would have happened if there had not been specific policy innovations) either with respect to Scotland over time or in comparison to England. The policy to build 6,000 social and affordable units per annum over achieved in its first year (although this in part was the result of more generous subsidy feeding through from earlier years and the consequence of moving to count completions rather than approvals). But it is quite possible, because of limited financial capacity in the housing association sector, that the commitment will be met by relatively more council housing and perhaps more intermediate housing than the current 2/3 (social, including council) to 1/3 (affordable) ratio set by Scottish Ministers (at least in the current spending review period). However, answers on meeting need, improving housing quality, and measuring outcomes against lower order policies to do with regeneration, land use, rural housing and the like must wait for a clear evaluative framework against which to assess these policies (this is of course just as true in England – see the Public Accounts Committee 2012 investigation of the affordable rent programme).

A comprehensive and conceptually coherent and evidence-supported evaluation of housing policy outcome would be highly valuable in all the UK's nations – but we are a long way from such a scenario. It might be argued that the Scottish Government is only in the second year of a programme and faces the uncertainties of another spending review next year – but it is these very considerations of value for money when resources are so scarce that suggests proper evaluation is essential (and overdue). The NHT has been closely reviewed by the Scottish Futures Trust and Audit Scotland are currently looking at housing policy as a whole but it is disappointing that the council building programme and indeed the housing association development programme has not had proper evaluation since the middle of the last decade (Satsangi, et al, 2005).

6. Conclusions

Scotland's first First Minister, Donald Dewar, described devolution as a 'process rather an event'. While this has become something of a cliché, it does capture the tentative and cumulative ways in which policies in selected devolved areas like housing, health and higher education exhibit divergence, examples of convergence and lagged limitation, but also local innovation. In recent years we have seen that this in part can be explained by fundamental differences in philosophy (and political opportunism) but it has also in part reflected genuine experimentation generated by response to fiscal crisis.

While in the earlier part of the post-1999 period, policy makers tried to create the circumstances where UK policies like stock transfer could be more acceptable in Scotland, it is clear that more recent innovation is more likely to originate north of the border and be focused on local objectives. The strongest sense one has of the success of this experimentation is its imitation elsewhere (i.e. reverse convergence). It is clear that policies announced this summer in England to use state-backed guarantees to support £10 billion of housing association investment, as well as rumours that English councils will shortly have greater capital borrowing freedom for house building – can reasonably be argued to be policies that originated in Scotland.

The one definite prediction about the future is that the relationship between Scotland and the UK will change in the years to come. If the independence vote in 2014 is 'no', this will not reduce the demand for the transfer of further financial powers, which will undoubtedly impact on housing policy and housing markets. If the vote is 'yes', the Scottish Government will control housing policy and welfare benefits, as well as the tax treatment of home ownership and private renting. Either way, the process set off by devolution in 1999 will continue to provide a fascinating case study of the divergence and convergence of housing policy.

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How demographics contribute to mortgage default: using binary logistic regression to draw inferences

By DLPM Rathnasingha and Ali Khatibi

1. Introduction

Housing is an indispensable human need. It is predictable as a basic need for shelter. It is apparent that habitable housing contributes to the health, efficiency, positive social behavior and general welfare of the populace, which uplift the living conditions of the community. In present society, housing has a value beyond the essential need for human shelter. As an upshot many agencies have moved to work in this field. This has made for a rapid transformation in the household sector in Sri Lanka. Recent studies expressed concern that substantial numbers of bank customers, who enter into complicated financial contracts such as mortgages, are financially illiterate and fail to understand crucial factors in decision-making, Engin (2011). Further, for most governments the availability of sufficient but basic housing for all is often stated as a priority for enhancing the social needs of the society. For a typical house-owner, the house is a major asset in his portfolio and for many households the purchase of a house represents the largest (and often only) lifelong investment and a store of wealth, Goodman (1989). Housing represents a large proportion of a household's expenditure and takes up a substantial proportion of lifetime incomes. It has been noted by Rose (2011) that for most Americans, the purchase of a home is the greatest and most important financial decision made during their life time.

A central purpose of financial markets is to redistribute risk in an optimal manner. However, external influences such as local currency depreciation, oil and gold price increases plus some internal factors, including higher levels of interest rates, have made the financing of housing a major challenge for the country. It needs attention at a policy level. The provision of housing services depends mostly upon a well-functioning and affordable housing finance system. The housing finance process is very complicated and the beneficiary has to meet a set of difficult criteria which make it harder to meet the requirements for a housing loan. Further, the interest rates on loans are unaffordable for the general working class of people and they went up to nearly 20% per annum in the recent past. This rate has shown vast fluctuations from 20% to 12% in the period 2009-2012 indicating the instability of the market. This rate fluctuation creates a number of issues for lenders and for borrowers in relation to their financial management. It has been mentioned by Vandell et al. (1985) that understanding the forces that drive mortgage default is a necessary prerequisite to appropriate pricing of default in the mortgage market. This study is focused on the demography of defaulting borrowers and provides valuable insight into the demography of mortgage borrowers.

2. Current mortgage loan environment

Sri Lanka has a population over 20.2 million and the density of population is 326 persons per square kilometer. However, annual housing demand for new houses is estimated at around 80,000 to 100,000 units in the country. The size of the housing finance sector in the country is 6% of Gross Domestic Product (GDP) though there are no records on a substantial number of owner-occupied and self constructed houses. Empirical research on housing finance in Sri Lanka is scarce due to the paucity and cost of relevant data. The mortgage default problem has been looked at by a number of researchers from different angles but mainly in Europe, although the United States has experienced a tremendous wave of residential mortgage foreclosure in recent years W. Scott (2010). One must look for indicators of risk for the housing finance sector in Sri Lanka. It was reported in some of the industry reports such as the Lanka property web on 14/06/2012 that the Sri Lanka overall house sale price is 17.11 million following a 4.61% down turn in price. A recent precipitous fall in the market value of the housing stock has created an ongoing sub-prime crisis in the sector. It was pointed out by Kim (1997), Manda et al. (2011) that in the absence of a well-functioning housing finance system, market-based provision of housing would therefore be lacking. This focuses the attention of researchers, policy makers and government decisions makers on addressing this situation to create affordable housing finance solutions for the country that go beyond lucrative business opportunities. Despite several attempts by the government of Sri Lanka to address this state of affairs, there are no approaches that have achieved sufficient scale and hundreds of thousands remain in need. How successful the housing finance system in Sri Lanka becomes will depend to a significant extent on how well it is integrated with, and forms part of, the overall financial sector. Under present conditions this is questionable as there is no secondary market for mortgage-backed securities in the country.

Demographic changes such as the growing number of working women, the expansion of nuclear families and a growing urban population are driving housing demand in the country. In societies like Sri Lanka, where social housing is on the priority list of government, housing affordability would have to be looked at from several angles, including the point of view of an individual's ability to raise the money needed to meet the cost of their housing needs. In the recent past several institutions have made efforts to improve access to loan financing for housing in the country. However, it is believed that there is an enormous unmet demand for housing finance from the low-income segment of the society.

The first source of funding for housing for many individuals is the proceeds of their income. This is often the cheapest source because there is no payment of extra cost in the form of interest and no other requirements to fulfill such as documents, guarantees etc. The second funding source is financial arrangements such as mortgage finance. It can be observed that there are government, private and non-government organizations providing finance facilities for housing in the country. Banks in Sri Lanka have being playing a vital role in providing credit to the housing sector for a few decades. However, Piyasiri (2006) states that the mortgage payment collection ratio for housing finance institutions in Sri Lanka is estimated to be in the range 80 to 95%. Further he identified that in certain cases the proportion of non-performing loans is around 20%. This is a major problem for finance suppliers to the sector although they have security and guarantees.

The two main players in the housing finance sector in Sri Lanka are the National Savings Bank (NSB), fully owned by the Government and the Housing Development Finance Corporation (HDFC) which is a listed company although the main share holder (51%) is the Government. During the year 2010, NSB granted housing and property loan balances of 33,011,819 (Rs' 000) which represents an increase over the 2009 balance of 28,339,675. This is equivalent to a 16.48% increase in housing and property lending by the institution. Comparatively the loan loss provision balance on total loans at the beginning of the year 2010 was 542,807 which had increased to 646,176 at the year end. However, at the beginning of year 2009 loan loss provision was only 365,907 Rs making a 19.94 % of increase year-on-year. Importantly the balance of loan loss provision at the beginning of 2008 was only 180,161. (NSB Annual Report 2010, 2009)

As per the District-wide summary of HDFC at April 2012, there were 70,380 loans granted amounting to Rs. 14,215,015,566.58 and 36,713 of these loans were under EPF[1] security which is 52.16% of the total housing loan portfolio, with a balance of 33,667 loans under other security types. There were a total of 24,178 loans making 34.35% of total loans which had been identified as in default and out of them 19, 588 loans in default were granted under EPF security amounting to 81.01% of total loans in default. There were only 4,590 default loans out of non EPF security loans granted by HDFC. At the branch level, for the total number of loans disbursed the minimum default rate was 0.16% while the maximum was 57.57% which indicates a huge variation between branches. However, excluding EPF security loans this range is only between 1.22% at the minimum and 19.91% at the maximum. Out of the total housing loans contracted 52% were allocated to the western province and 11% to the central province while other provinces reported less than 10% each.

3. Model of risk assessment

In this study, six independent variables are used: age, gender, marital status, number of dependants, employment status and credit period. Age is specified by the number of years, while gender is specified as male or female, marital status as married, unmarried or other, number of dependents as the number, employment status as government, private or other, and credit period as the total number of monthly installments to pay for the period of the loan. The dependant variable, default, was assigned dummy values equal to 0 if the loan defaulted and 1 otherwise. A number of techniques have been used to estimate the likelihood of default over time, Dennis et.al (2005). The final Binary Logistic regression model [BLR] is expected to yield a prediction of the probability of default on loan repayments, Wilson (2003). In this study BLR has been employed to gauge the probability of default and this can be used when the dependent variable is a dichotomy/division of some kind into two groups.

4. Survey of mortgage loan customers

Understanding of the determinants of default has been severely constrained by the non-availability of suitable data, Campbell at el. (1983). Today there are no publicly available databases in relation to individual outstanding mortgages and default in Sri Lanka. As a result this researcher requested access to data compiled by one major player in the market. This institution[2], under government ownership seeks the following requirements if prospective borrowers are to be eligible for a mortgage house finance facility. They include both qualitative and quantitative factors to evaluate the credit worthiness of their customers when evaluating the loan application. The applicant has to be a permanent employee or a tax payer and only a maximum 64% of monthly salary/income can be used for monthly loan settlement. The original data set of the institution included information on the above-mentioned variables for 4,237 borrowers. However, it was observed there were some missing variables in many cases and it was able to provide complete data on 1,000 loan holders, out of which 500 from the total database are borrowers in default, for analysis. All the above loans were for housing and information on mortgages for other purposes, such as commercial loans, has not been entered into the database.

5. Descriptive statistics on the data base

The mean age of the sample is 45.33 years (appendix 01) with a minimum age of 20 years and a maximum of 70 years. There are 649 males making 64.9% of the total sample and 351 females. Married individuals in the sample are 957 which comprise 95.7% of the total and unmarried 43. With regard to employment status, 950 individuals which are 95% of the sample are government workers with only 36 private sector individuals making 3.6% of the sample with 14 individuals (1.4%) under other employment categories. The number of dependents was a minimum of 0 and the maximum is 5 with a mean of 1.40 which is treated as one dependant. However, 30% of the sample does not have dependents while 19.3% have only one dependant and 35.1% had 2 dependents at the time when the mortgage loan application was approved. Among 295 of loan holders with 0 dependants the mean credit period is 165.11 months (nearly 15 years) with a minimum of 18 months and a maximum of 360 months. The average loan term is 164.15 months which is equivalent to nearly 15 years, and there are only 160 loans out of total sample with a term of less than five years.

According to gender and default cross tabulation (Table 01:A.), 53.6% of males defaulted while only 43.3% of females defaulted. Based

[1] EPF is the abbreviation for Employees Provident Fund. Its primary aim is to provide a measure of security for old age retirement to its members. Employer and employee contribute to the fund as per the directions of the labor commissioner.

[2] The researcher is not at liberty to mention the name of the institution for reasons of confidentiality.

[3] The odds ratio is a relative measure of risk, telling us how much more likely it is that someone who is exposed to the factor under study will develop the outcome as compared to someone who is not exposed.

on the odd ratio[3], the males are 1.5 times more likely to default compared to females. Among those government employees who defaulted 55% were males and 43.3% were females but in the private sector male and female borrowers do not show a difference in the rate of default. Conversely, in the "other" sector no males have defaulted on their mortgage loan while 66.7% females have defaulted and 17.9% of unmarried males and 40% unmarried males have defaulted.

However, comparison between default and marital status to see how likely married borrowers are to default with use of an odds ratio[4] of 2.938 indicates that married loan holders are almost three times more likely to default compared to unmarried loan holders While among married borrowers 51.1% (Table 01: B.) have defaulted, and only 25.6% of unmarried borrowers have defaulted on their loans. Further, among defaulted borrowers 55.2% (Table 01: E.) were married males while 43.5% of married female have defaulted their loans. The Pearson's chi-square[5] value of 10.71 (appendix 06) on default and marital status with a p-vale 0.001 and minimum expected count of 21.50 indicates that there is an association between marital status and default.

Cross tabulation on the number of dependants and default (Table 01: C.) shows a gradual increase in default amongst those with higher numbers of dependants. Among the total sample 46% of defaulting borrowers had 0 dependants while default levels were 46.1%, 51.4%, 55.7%, 76.5% and 100% for borrowers with 1,2,3,4 and 5 dependants respectively. There were only 4 loan holders with 5 dependants and they all defaulted on their loans but one cannot apply further analysis as the numbers are too small to be statistically valid. The Pearson's chi-square statistic on default and number of dependants is 13.39 (appendix 07) with a p-value of 0.02, hence there is an association between default and the number of dependants.

The data on the employment status of loan holders shows (Table 01:D.) that among government sector loan holders 50.9% has defaulted on their loan while only 38.9% of private sector loan holders have experienced default of their loan and among other sector loan holders only 14.3% have defaulted on the loan. Chi-square statistics on default and employment status 9.26 (appendix 08) under a p-value of 0.01, show there is an association between employment status and default.

6. Explanation of the risk assessment model

The output of the model (BLR) $Z = \alpha + \beta_1 I_1 + \beta_2 I_2 + \ldots\ldots + \mu I$ is expected to yield the prediction of the probability of default on housing loan repayments. Values for the independent variables (factors of default) can be substituted in the formula to calculate an estimation of the likelihood of default. Then, using the estimated equation calculating the observed value for Z, the value of the Logit model is transformed using a link function to obtain the probability of the event (default) occurring[6]. The BLR model can work by applying β values (Table 02) of independent variables for default risk in this study and it is not necessary to discuss deeply the statistical/mathematical procedure of BLR involved.

Equation Z = -5.011 + 0.005(Age) + 0.566(Gender) + 1.203(Marital status) - 0.129(Number of Dependants) + 0.729(Employment Status) + 0.013(Credit Period) + µ.

The results of the BLR model show that marital status is most significant (β = 1.203 and p = 0.00) among the variables and another influencing factor for defaulting is employment status (β = 0.7293 and p = 0.00) while gender (β = 0.566 and p = 0.00) also has a considerable weight. One other contributing factor is the number of dependants (β = -0.129 and p = 0.03). Age and credit term is indicated to be least important for default on loans and age is not significant as the p-value is more than 0.05.

With insertion of values on independent variables one can apply the model and the following demonstrate application of them to two cases in the sample.

$$Z = -5.011+0.005 * (45) + 0.566 * (1) + 1.203 * (1) - 0.129 * (0) + 0.729 * (1) + 0.013 * (120)$$
$$Z = -0.728$$

Table 1: E. Gender * Default * Marital status cross tabulation

Marital status				Default	
				Yes	No
Married	Gender	Male	Count	343(55.2%)	278(44.8%)
		Female	Count	292(43.5%)	380(56.5%)
Unmarried	Gender	Male	Count	5(17.9%)	23(82.1%)
		Female	Count	12(40.0%)	18(60.0%)

Table 2: Results of BLR

		β	S.E.	Wald	Sig.[7]
Step 1[a]	Age	.005	.005	1.085	.297
	Gender	.566	.145	15.313	.000
	Marital status	1.203	.376	10.218	.001
	No of dependants	-.129	.062	4.319	.038
	Employment status	.729	.266	7.489	.006
	Credit period	.013	.001	99.653	.000
	Constant	-5.010	.647	59.959	.000

a. Variable(s) entered on step 1: Age, Gender, Marital status, No of dependants, Employment status, and Credit period.

[4] "The odds" is the ratio of the probability that the event of interest occurs to the probability that it does not. This is often estimated by the ratio of the number of times that the event of interest occurs to the number of times that it does not.

[5] The chi-square test of association is used to discover if there is a relationship between two categorical variables. A large chi-square, indicated by a small p-value, is taken as an evidence of association.

[6] The link function is as follows: $P[event] = \frac{e^z}{1+e^z}$

[7] S.E. – Standard Error, Wald –Wald statistics , Sig. - Significance

Next the above Z value is applied to the link function and one obtains the probability of the event (default) occurring as shown below.

$$P\,[event] = \frac{e^{-0.728}}{1+e^{-0.728}} = 0.3256$$

By applying the link function and assuming a 50:50 of cutoff is used, the probability of this respondent's loan defaulting is 33% (0.3256 ≈ 33%).

The following is the second case which applies values for independent variables from the sample.

Z = -5.011 + 0.005*(59) + 0.566*(1) + 1.203*(1) - 0.129*(0) + 0.729*(1) + 0.013*(249)
Z = 0.902

And then apply link function.

$$P\,[event] = \frac{e^{0.902}}{1+e^{0.902}} = 0.7113$$

Using the BLR model the probability of this respondent's loan default is 71% (0.7113 ≈ 71%). Then in the first scenario it has a less chance of getting default the loan. However, in the second scenario the possibility of default is high. The accuracy level of the model is crucial and so it was applied to the model for the whole base of the sample and produced results for prediction accuracy as shown in table 03 below.

The accuracy of prediction (Table 03) is at an acceptable level which is better than a random prediction with an overall accuracy level of 67.5% and therefore this model provides improved explanations on predicting the probability of a housing loan being in default using six independent variables.

7. Observations

The current mortgage market is becoming full of challenges with new practices and rapid changes of customer demographics which make for continuous transformation of the mortgage industry. However, within these changes, the sample in this study shows that the number of dependants is not a decisive factor in default as the majority of the sample does not have dependants at the moment of obtaining the mortgage facility though this possibly will change over the term of the loan as borrowers are blest with children. In addition, householders may borrow too much at a high rate without realizing the future risks. This indicates the need for updated data on the age of the mortgage applicant (the age at which they default) as a determinant of mortgage loan default. Virtually four fifths of the sample is made up by males, indicating that males are more likely to engage in housing finance facility arrangements in the market.

The large majority of the sample is made up of state of government workers, proving that a large proportion of mortgage loans granted are obtained by them. On the other side this highlights the difficulty of obtaining housing finance facilities for people working in other sectors or in meeting the criteria to gain access to a mortgage loan facility in the current market. The difficulty of meeting mortgage criteria hinders access to credit by low-income citizens. It implies that it is hard for other sector individuals to obtain a mortgage facility. More importantly, there are no government programs relevant to urban residents working in the informal sector who have low incomes and who are unable to apply for loans from the formal sector. This is suggests another market segment for microfinance market players to provide housing finance facilities though the current scale of their activities is very small.

The BLR model developed and tested here is a useful tool for lenders in the industry to gauge the risks of default and implement necessary strategies to minimize the risks. The accuracy level of the predictions with the model as developed is acceptable. However, it is realized that there are a few more factors such as economic and location factors to be incorporated into the model and tested in relation to the level of default to make estimating the level of default risk more reliable.

Table 3: Default observed * Default predicted cross tabulation

Count				
		Default Predicted		Percentage correct
		YES	NO	
Default observed	Yes	363	137	72.6
	No	188	312	62.4
Overall Percentage				67.5

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Appendices

SPSS Analysis output tables

Descriptive overview of data base

	Minimum	Maximum	Mean
Age	20	70	45.33
No of dependants	0	5	1.40
Credit term	18	360	164.15
Default	0	1	.50

Gender

	Frequency	Percent
Male	649	64.9
Female	351	35.1
Total	**1000**	**100.0**

Marital status

	Frequency	Percent
Married	957	95.7
Unmarried	43	4.3
Total	**1000**	**100.0**

Employment status

	Frequency	Percent
Government	950	95.0
Private	36	3.6
Other	14	1.4
Total	**1000**	**100.0**

Number of dependants

	Frequency	Percent
0	295	29.5
1	193	19.3
2	351	35.1
3	140	14.0
4	17	1.7
5	4	.4
Total	**1000**	**100.0**

Pearson Chi-Square on default and marital status

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	10.717[a]	1	.001
Likelihood Ratio	11.169	1	.001
N of Valid Cases	1000		

a. 0 cells (0.0%) have expected count less than 5. The minimum expected count is 21.50.

Chi-Square on default and number of dependants

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	13.394[a]	5	.020
Likelihood Ratio	15.197	5	.010
Linear-by-Linear Association	8.407	1	.004
N of Valid Cases	1000		

a. 2 cells (16.7%) have expected count less than 5. The minimum expected count is 2.00.

Chi-Square tests on default and employment status

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	9.262[a]	2	.010
Likelihood Ratio	10.059	2	.007
Linear-by-Linear Association	8.910	1	.003
N of Valid Cases	1000		

a. 0 cells (0.0%) have expected count less than 5. The minimum expected count is 7.00.

Land factors and their impact on the housing finance market in Ghana

By Nicholas Addai Boamah

1. Introduction

Housing and its mode of financing is of great importance to both households and the economy in general. Investment in housing typically constitutes 2 to 8 percent of GDP, 15 to 30 percent of fixed capital formation, and comprises an enormous component of the stores of wealth of nations (Buckley and Mayo, 1989). The mortgage market may affect the monetary transmission process (Wolswijk, 2005). Stimulus measures via the real estate sector may be used to revive an economy during cyclical economic downturns. For instance, Chanond (2009) suggests that the recovery of the housing finance sector was a key catalyst for Thailand's successful economic recovery from the 1997 crisis. It is therefore essential for every nation to formulate and execute programmes and policies that will ensure adequate housing delivery to its citizens.

Adequate housing however, cannot be provided for the citizens of a nation without first establishing a sustainable housing finance regime. Housing finance is a vital component of a well-functioning housing system (Warnock and Warnock, 2008). A well-functioning housing finance market is a catalyst for sustained delivery of housing funds to homebuyers (Boamah, 2009). Households are able to consume adequate housing if a sustainable housing finance market exists. Correctly structured housing finance systems may deliver improved housing to households in a country (Renaud, 1999). A secure land ownership system and a reliable system of land titling are some of the essential requirements for the creation of a sustainable housing finance market. The land factors such as the rights in land and the mechanism for protecting those rights, the property registering system, and the land transfer system are particularly important (Needham and Louw, 2006). Security of tenure and effective and efficient land administration systems are necessary for the development of housing finance markets.

Unfortunately, the Ghanaian land sector is bedevilled by a mirage of problems such as indeterminate boundaries between adjourning landowners, indiscipline in the land market, insecurity of tenure and a weak land administration system. The most serious problem confronting the country's land sector is multiple land sales by some devious land dealers (Antwi, 2002). The uncertainties surrounding land transactions have made land increasingly unreliable as a source of dependable collateral. Consequently, there is a highly underdeveloped, ineffective and unsustainable system of financing housing in Ghana. The housing sector has long been isolated from the formal financial institutions in the country (Boamah, 2010a). The formal finance institutions have provided very few housing loans to homebuyers in the country. For instance, in 2001 the total mortgages originated in Ghana were approximately US$5.2 million (Home Finance Company (HFC, now HFC Bank, 2005). In 2001 and 2007 only 7% and 11% respectively of bank loans were granted to the housing and construction sectors, of which housing is only a small component (Ametefe et al, 2011). The financial institutions have attached little importance to mortgages as an investment opportunity (Boamah, 2009).

The housing finance market in Ghana is vastly underdeveloped. This paper argues that tenure insecurity in the country may be responsible for that. It hypothesises that land factors have made landed properties unattractive for collateralization and partly constrained the country's housing finance market. The paper examines the land ownership, acquisition, and documentation procedures in Ghana. It examines the impact of the land factors on the housing finance systems in the country. The performance of the housing finance system is subsequently evaluated. The paper relies on secondary data from the literature and authorized sources such as the HFC Bank, the Ministry of Land and Natural Resources (MLNR), and the Ministry of Works and Housing (MWH). Data was assembled chiefly through mail shots and a review of archives and certified documents.

2. Pre-requisites for housing finance market development

The development of sustainable housing finance markets depends on the existence of some fundamentals. Information on the credit worthiness of potential borrowers, macroeconomic stability, property rights, monetary policy, risk assessment tools, income distribution and effective demand, the size of the financial sector, urban planning policies, and land titling and use policies are fundamental requirements for the success of housing finance markets (Warnock and Warnock, 2008, and Butler et al, 2009). A well-developed regulatory environment also enhances housing credits market development. Less developed regulatory and legal frameworks for contract enforcement expand the credit risk of mortgage lenders (Tesfaye, 2007). A weak regulatory environment is partly responsible for the underdeveloped state of the Ghanaian mortgage market (Boamah, 2011b). The macro-economic environment affects the housing finance market development in a significant manner. An adverse macro-economic environment may increase the likelihood of default and foreclosure if it leads to a reduction in property values. Property prices correlate with default and foreclosure (Ambrose and Capone, 1998).

A reduced probability of default and foreclosure promotes the development of housing credit markets. Mortgage lenders advance loans only when they are convinced that the prospective borrower is capable of repaying the loan (Nyasulu and Cloete, 2007). Lenders will normally not grant loans to prospective mortgagors who are deemed to have a high default risk potential. The state of a country's economic development, growth rate and income levels will also impact on mortgage market development. A stable and growing economy and growth in households' income and wealth will promote the growth of housing finance markets (Buckley et al, 2009). A slow growing economy may therefore undermine the expansion of housing finance markets. Low levels of economic development have constraining effects on mortgage market growth. Low income households do not have effective demand for housing credit. Income volatility correlates positively with mortgage delinquency risk (Diaz-Serrano, 2005).

3. Land factors and the development of housing finance markets

Land title and security of tenure provide incentives for households and institutions to invest in landed property. Security of tenure induces investment in land related activities (Deininger, 2003). The procedures for accessing land, security of tenure, and the land documentation mechanisms may either induce or hinder land investment (Abdulai and Ndekugri, 2007). Prospective investors may not invest in land-based activities unless they are assured of unchallenged rights to their landed properties or adequate protection when their land rights are contested (Abdulai and Hammond, 2010). Land disputes, delays in land titling, and unclear legal rights hindered housing development in Indonesia (Ferguson and Hoffman, 1993). Secured property rights and an effective land titling system will facilitate land transactions and make it easy for landed properties to be used as collateral.

The availability of dependable collateral is an important requirement for the development of a formal housing finance market. Security of tenure is a key element in the transfer of the defined bundles of ownership rights in the mortgaged property from borrowers to lenders (Miceli et al, 2000). Land rights and security are important determinants of the depth of a country's housing finance market (Butler et al, 2009). Land titling systems 'enable' land markets and improve households' access to bank credit (De Soto, 2000). The lenders' security interest cannot be effectively enforced if clear title to the collateralized property is non-existent. Legal property titles have a positive effect on property values (Lanjouw and Levi, 2002). The estimated value of a legal title ranges between 39% and 138% of the total value of the property (Mendez, 2006). The registration of land makes it easy for the ownership and encumbrances on each individual property to be determined.

4. Land ownership in Ghana

There is a dual land ownership system in Ghana - public and customary (non-state) lands. The public and customary land holdings respectively constitute 22% (state lands, 20% and vested lands, 2%) and 78% of land in Ghana (Kasanga, 2008).

4.1 Customary land[1]

The allodial title, which is the highest interest in land, is held by stools/skins (customary sector); the stool constitutes the spiritual and physical embodiment of the people. Traditional authority is inseparable from ownership of land and the stool holds the allodial title in land (Mahama and Baffour, 2009). Land ownership under Ghanaian customary tenure is based on absolute "allodial" or paramount title from which all other lesser titles, interests and rights in land are derived (Arko-Adjei, 2005). These lesser interests include sub-paramount title, usufractuary, or determinable title. Customary lands have their allodial or paramount interest traceable to a Stool, Skin, clan or family. Customary lands are vested in Stool occupants in the Akan areas, in the occupants of Skins in the Northern regions, and in clan/family heads in some parts of the Greater Accra and Volta regions in trust for the people. "All stool lands in Ghana shall be vested in the appropriate stool on behalf of and in trust for the subjects of the stool in accordance with customary law and usage" (1992 Constitution Article, 267(1)). The occupant of the stool/skin or the head of clan/family exercises administrative and managerial functions over customary lands in accordance with the customs and traditions of the land owning group. Ghana's laws recognize the concept of trusteeship in customary landholding and impose on the custodians the responsibility for managing the land in the wider interest of the land owning group. Thus article 36(8) of the 1992 Constitution states that "the State shall recognize that the ownership and possession of land carry a social obligation to serve the larger community and in particular, the State shall recognize that the managers of public, stool, skin and family lands are fiduciaries charged with obligation to discharge their functions for the benefit respectively of the people of Ghana, the stool, skin or family concerned, and are accountable as fiduciaries in this regard".

There is communal ownership of customary land; the dead, the living, and the yet unborn all have stake in it. Customary land belongs to a vast family of whom many are dead, a few are living and countless hosts are still unborn (Ollenu, 1962). Customary land can therefore not be sold outright under the customs and traditions of Ghana. The land cannot be alienated and the living must use the land in a manner that does not jeopardize the interest of unborn generations. Land is sacred, hence the obligation is that it should be used judiciously by ensuring that the present and future well-being of the communities are met and promoted (Kasanga, 2008). Custodians of customary lands have the right to release land for development but the grant must conform to customary law and usage. However, for a grant of customary land to be effective it must receive the concurrence of the Regional Lands Commission of the region in which the land is situated (Article 267(3)) of the 1992 constitution). This legal restriction ensures that trustees of customary lands deal with it responsibly.

4.2 Public lands

Public lands are acquired by the state via various statutory provisions- the State Lands Act, 1962, Act 125; and sections 7 and 10 of the Administration of Lands Act, 1962, Act 123. The Act 125 gives compulsory acquisition powers to the State to acquire land in the public interest subject to the payment of adequate compensation to the expropriated owners. Section 7 of Act 123 empowers the State to vest land in the President in trust for the allodial owners; there is no payment of compensation since the land is only vested in the President. This is a trust with the President and the allodial owners holding the legal and beneficiary interests respectively. The "allodial" owners are therefore entitled to receive rent from the land when the land is released by the State for development. Also, the section 10 of the Act 123 empowers the State to occupy and use land in the public interest; annual rent is paid

[1] Stools and Skins are symbols of traditional authority correspondingly in the southern and northern parts of Ghana. The occupant of the stool or skin is a traditional ruler.

by the State to the stool lands account. Public lands are entrusted to the care and management of the Lands Commission. Article 258(1) of the 1992 constitution of Ghana provides that the Lands Commission shall on behalf of government manage public lands and any lands vested in the President by the constitution of Ghana or by any other law or any lands vested in the commission.

5. Land acquisition procedures in Ghana

The procedure for acquiring public land varies from what pertains in the customary land sector. Also, the procedure for acquiring land from both the public and customary land sectors in the post 2008 era varies from the pre 2008 era. This is as a result of the enactment of the Lands Commission Act 2008 (Act 767). The Act 767 has brought together the land sector agencies under one umbrella. This has influenced the land acquisition processes in the country. The public land acquisition procedure is as shown in Figure 1. The Lands Commission is responsible for the demarcation and allocation of public lands to members of the public upon application. The developer submits his application to the Regional Lands Commission [RLC]. The RLC then verifies at the Town and Country Planning Department [TCPD] to ascertain whether the proposed development conforms to the development plans for the area before the RLC approves the application. The necessary lease is prepared if the commission approves the application. The waiting period and transaction costs for acquiring public lands are uncertain and unknown to land seekers at the beginning of the process. Public lands are mostly available to the rich, the powerful and the political elites. The State land sector agencies became the medium for appropriating land for the bureaucratic elites and their close business associates (Amanor, 1998). The beneficiaries of State managed lands in Accra mainly are the rich and the powerful (Larbi, 1994). The masses may struggle to acquire developable land if the state is in full control of land. The State land sector appears to be a mechanism to further enrich the rich and to further deprive the poor.

Figure 1 Acquisition of public land in Ghana

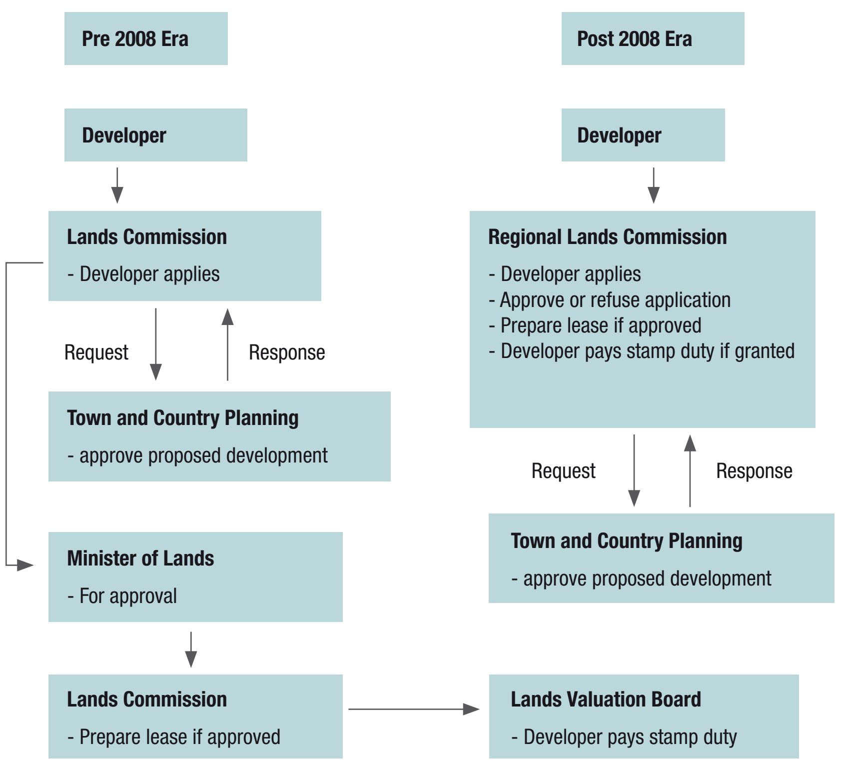


Figure 2 shows the procedure for acquiring customary land in Ghana. The developer has to first and foremost contact the caretaker chief (in stool/skin land areas) or Tendama (in the Upper East and West Regions) or clan/family heads (in clan/family land areas); the parties then negotiate for acceptable "drink money". The "drink money" is "ambiguous concept"; at one level, it is a token payment to a traditional head upon a visit, at the other level it could be huge sums of money, sometimes equivalent to the open market value of the land (Kasanga, 2008). The "drink money" is no longer a token but a huge source of revenue to customary landholders (Mahama and Baffour, 2009). A plot or parcel of land is allocated to the developer once the parties agree on the "drink money". In stool land areas such allocations must always be counter signed by the occupant of the stool for it to be effective. Irrespective of the amount of "drink money" paid, acquirers also incur another transaction cost by way of payment to the Stool's occupant before the counter signing can be done. With the allocation note duly signed and the land properly acquired, the applicant then prepares his lease which must be signed by both the caretaker chief and the occupant of the stool. In addition to incurring the cost of lease preparation, the applicant would also have to pay the Stool before the occupant of the Stool could append his signature to the lease. The signed lease, allocation note and the approved site plans are then sent to the Regional Lands Commission for concurrence.

Land acquisition in the customary land sector is associated with high transaction costs and in some parts of the country title uncertainty. The title uncertainty has been caused by chieftaincy disputes and indeterminate boundaries between adjourning customary lands. The State bureaucracy charged to give concurrence to customary land disposals is partly to blame for the high transaction costs. The costs and duration for the concurrence are unknown to applicants at the start of the process. Unofficial fees which are sometimes in multiples of the officially approved fees may have to be paid during the concurrence process. It is not uncommon for applicants for concurrence to be told that their leases prepared by qualified legal practitioners are invalid and that a new lease must be prepared for them from within the Commission. Such leases are mostly not substantially different from the applicant's submitted lease except that it has been prepared by a staff member of the Commission whose responsibility is to process concurrence applications and not to prepare leases. This is just a strategy to charge unofficial fees and illegally increases the transaction cost. It is also not uncommon for an applicant to be told that his transaction files are missing at the Commission. Such applicants would therefore have to pay for the services of the Commission's staff who will trace the transaction file. The problems in acquiring customary lands have in large measure been caused by State bureaucracy charged with the responsibility of streamlining transactions in the customary land sector.

6. Land and title registration in Ghana

The registration of land title constitutes a warranty of title in the person registered as proprietor and a bar to adverse claims (Kasanga, 2008). The Land Title Registry [LTR] is responsible for the final registration of title to land whether state or customary. The Land Title Registration Law 1986 (PNDCL 152) was promulgated in 1986 to replace the Land Registry Act (Act 122) and thereby address the shortcomings of Act 122. Figure 3 depicts the title registration process prior to and after December, 2008. The Act 767, 2008 is expected to streamline the land title registration procedures in the country. It has in principle abridged the stages for and duration of title registration, reduced the uncertainty associated with the title registration system, and minimised the possibility of multiple title registrations of the same parcel of land by relying on cadastral maps. The land title registration process in the post 2008 era is a major improvement over the pre 2008 era. The full benefit of the new land title registration process is however, yet to be realised as the Act 767, 2008 is at the initial stages of its implementation.

Figure 2 Acquisition of customary land in Ghana

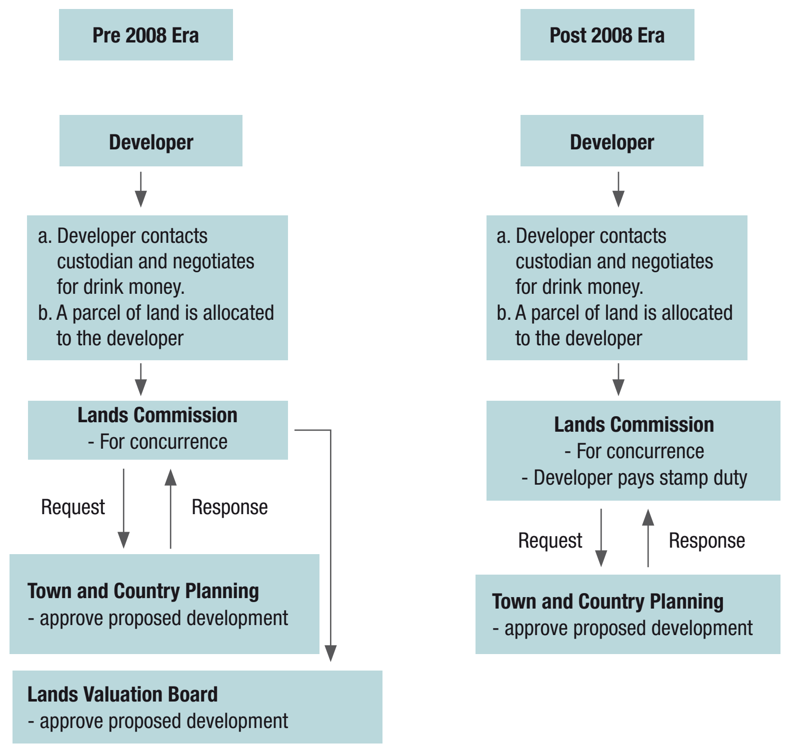
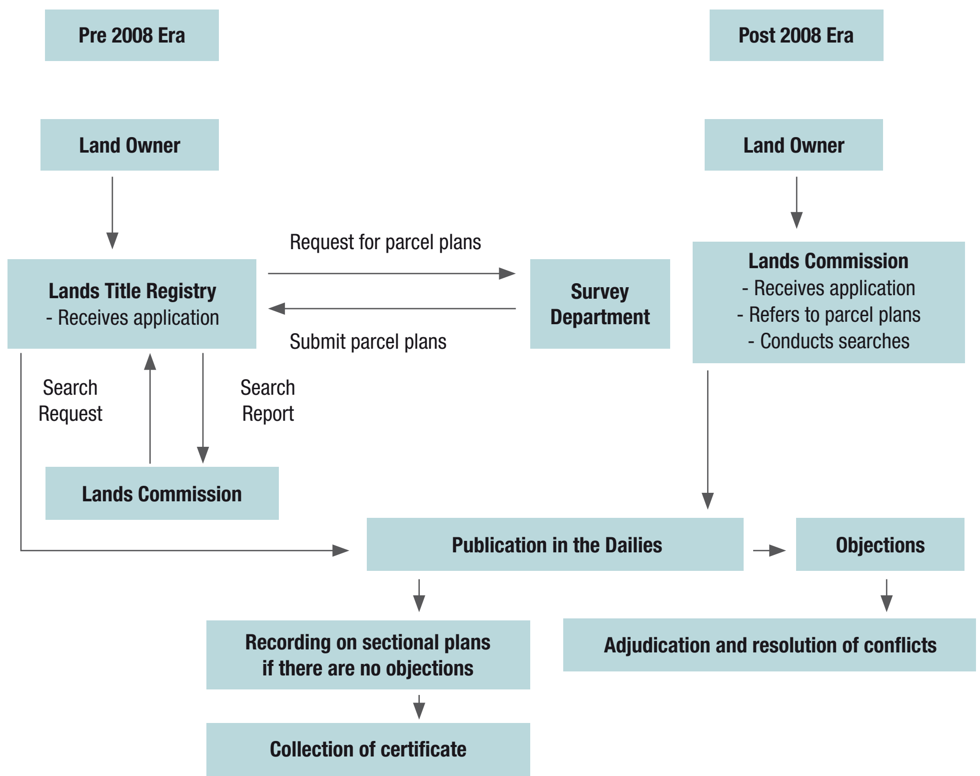


Figure 3 Land title registration procedures in Ghana



7. The effects of the land factors on the development of the housing finance market in Ghana

A major characteristic of the Ghanaian housing system is housing insufficiency (Boamah, 2010b). The housing deficit in the country stood at approximately 1,000,000 units in 2000 (GSS, 2002). The annual housing demand is estimated to be 199,000 units but actual delivery is only between 25,000 to 30,000 units and is mostly through informal processes (Ametefe et al, 2011). The housing shortage in the country may be as a result of low housing delivery relative to households' growth. The demand for housing in Ghana is high leading to an increasing demand for housing finance. Despite this huge demand for housing its financing is mostly done by individual households through informal processes. The formal real estate sector delivers only 2,500 units of the annual housing production of 30,000 (Akuffo, 2006). The formal finance institutions have failed to develop the housing finance market in the country. This may mean that mortgages are not an attractive form of investment to them. This may be due to the risk imposed by the land factors such as insecurity of tenure and an inefficient land titling regime leading to inadequate collateralization. These factors are important if sustainable housing finance is to be attained in Ghana. They affect the security of the investment, riskiness of the mortgage investment, and loan affordability.

There are institutional weaknesses in relation to real estate property rights and land markets in Ghana. These constitute a major barrier to the development of the housing finance market in the country. The sporadic and uncoordinated registration of title under PNDCL 152 has robbed the system of its potential to achieve greater certainty and security of title in the country (Kasanga, 2008). The land title registration system in Ghana (prior to 2008) was ineffective, time consuming, burdensome, costly and frustrating. The registration procedures and costs were unclear. Title applicants had to move from one agency to the other to complete various stages of the registration process with their associated financial obligations and frustrations. The land title registration process in Ghana involves 6 agencies and takes 382 days to complete (World Bank, 2005). The complexity of the title registration procedures prior to December 2008 led to delays and uncertainties; increased transaction costs; frustrations; and more chances for officials to demand informal fees, as every encounter between the title applicant and officials is an opportunity for corruption. This discouraged most property owners from perfecting their land titles thereby losing the collateral value of their fixed assets.

The land title registration process was extremely slow thereby leading to a huge backlog of unprocessed title applications. The Land Title Registry in Accra alone had a backlog of 30,000 title applications in 2001; the estimated annual increase was at least 3,000 applications (Gambrah, 2001). The accumulation of land title applications in the Land Title Registry is partly responsible for the increasing phenomenon of multiple land sales in the country. The land market is therefore ineffective and incapable of shoring-up the development of the country's housing finance market. A large proportion of properties in Ghana lack proper legal title because of the complex and inefficient land title registration regime. Only 5 (1.2%) out of 408 private properties and none of the 266 government properties surveyed in the Kumasi metropolis had title certificates (Addai et al, 2011). Only 38% of respondents in the Wa municipality had title to their lands (Boamah, 2010b). Most Ghanaians are unable to use their houses as collateral as a result of the lack of proper legal title to them. This has seriously constrained the development of the housing finance market in the country. The collateral inadequacy has acted as a barrier to housing ownership by limiting the number of individuals who can access housing credit and the maximum amount of funds that an individual can borrow. Until the quandary of land titling is resolved it will be tremendously difficult to develop a sustainable housing finance market in Ghana.

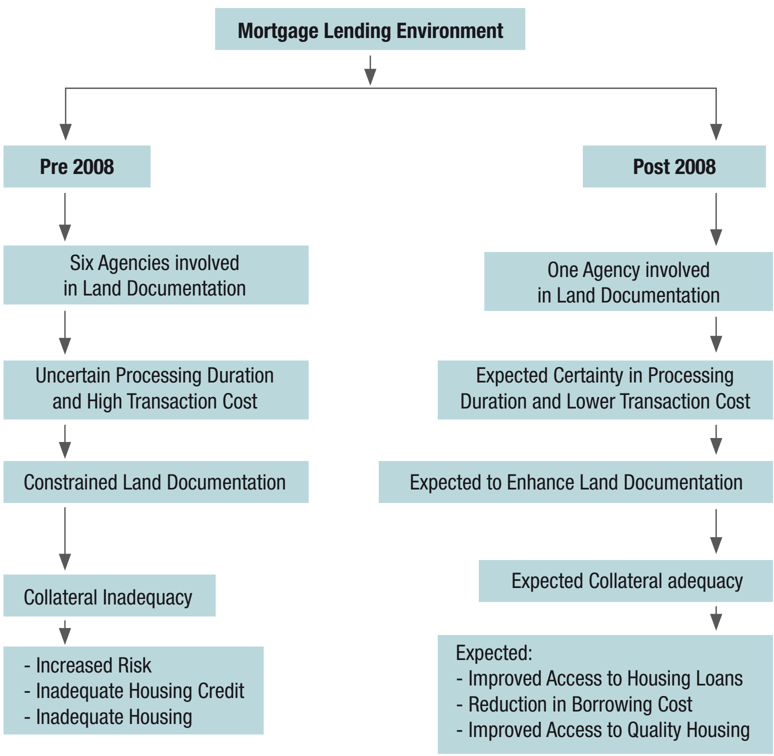
Problems such as indeterminate boundaries of land and chieftaincy disputes have engulfed the customary land sector in Ghana. These problems affect the purchaser's security of tenure and hence the dependability of land as collateral for mortgage lending in the country. The communal ownership of land has also promoted land market indiscipline such as multiple sales of land. Some members of the landholding groups in exercising their land rights sometimes sell land without consultation with other family members. In consequence, the same land parcel may be sold to different persons. This usually creates ground for competition, "land guarding", property defacement, litigation and uncertainty of tenure. Land related disputes account for about 45-50% of the total cases pending in Ghanaian courts (Crook, 2004). There are currently over fifteen thousand land related cases in the Greater Accra Region alone (Alhassan, 2004). 52.7%, 17.7%, and 12.8% of land litigations in the Ghanaian courts are the outcomes of family disputes, boundary disputes, and unauthorised disposition of land by a chief or stranger respectively (Crook, 2004). The tenure insecurity in the customary land sector has made the use of real estate as collateral almost impossible in Ghana. It does not create a secured lending environment for mortgagees and it is a knotty problem for most borrowers to use land as collateral and to qualify for mortgages in Ghana. Unfortunately, the law courts are slow, expensive, and associated with unnecessary adjournments in addressing land related conflicts. It takes five to eight years to resolve land cases before the courts (Kasanga, 2008). The slow adjudication of land disputes by the courts have further advanced the land market indiscipline particularly "land guarding" and vandalism and hence tenure insecurity.

8. Realizing the collateral value of land in Ghana

A sustainable housing finance market cannot be attained without an adequate property rights regime and a strong institutional infrastructure for property transfers. Security of tenure is of the utmost importance for the success of any housing finance market. State policy interventions are germane in addressing the land related constraints to mortgage market development in Ghana. It is important for Ghana to create and maintain a strong and an efficient system for registering land titles. An efficient land title registration procedure will promote collateralized lending in Ghana. There is therefore the need to improve the property rights regime in the country. It is expected that the full implementation of the Lands Commission Act (Act 767), 2008 will streamline the title registration process, reduce the delays and frustration in land registration, cut down land documentation costs and time, and enable land owners to acquire proper legal title to their lands. As figure 4 shows, the quality of land as mortgage collateral was reduced in the pre-Act 767 era. This increased lenders' default risk exposure and made the mortgage market unattractive to them. The resulting effect was higher borrowing costs, reduced household access to housing credit, and housing insufficiency in the country. The expected improvement in the land documentation process with the passage of Act 767 however, is expected to reduce mortgage lending risk, improve the attractiveness of the mortgage market to lenders, increase the supply of housing credit, reduce borrowing cost, and improve households' access to quality housing in the country.

It is important that the full implementation of Act 767, 2008 is not frustrated, destabilized, or dumped by the country's political elite; abandoning important legislation by successive governments is a common occurrence in Ghana's political history. The availability of an efficient land titling or land acquisition regime alone will not promote collateralized lending in Ghana. The aptitude of the country's judicial system to swiftly deal with land related disputes and foreclosure cases brought before it is essential in enhancing the acceptability of and improving the value of properties as mortgage collateral. It is imperative that the country's legal system is strengthened to buttress the development of the housing finance market. Merely putting together all the land sector agencies under one umbrella by the Act 767 will not fully address the problems in the land acquisition and documentation process. It will only provide a one stop shop for processing land transactions. However, the wilfully created delays, the additional transaction costs imposed on applicants as a result of unofficial fees, and the uncertainty in the duration for processing land transactions cannot be addressed by this. Strong administrative procedures, rules and regulations, and sanctions must be instituted and enforced by the Commission. The Commission must show responsibility to Ghanaians by sanctioning undisciplined and corrupt officials. They must purge the land documentation process of perceived corruption and win public confidence in the Commission. One of the major obstacles to the success of Act 767 is perceived corruption and negative attitudes of the Commission's officials. Public distrust of the Commission would lead to an unsuccessful outcome from the Act 767.

Figure 4 Land factors and the housing finance market in Ghana



State policy intervention must aim at supporting the customary land sector to surmount its inherent problems. The efficiency of the customary land sector could be attained through improved documentation of land transactions. This will help in curbing the state of multiple land allocations in the sector. Enhanced land documentation mechanisms in the customary land sector will ensure a more transparent and dispute-free land transactions, security of tenure, and avoid costly litigation and conflicts. It will help eliminate or reduce irresponsible dealings in the customary land sector. This will make land and properties readily acceptable as mortgage collateral and thus facilitate the development of the housing finance market in the country. The Land Title Registration Law 1986 (PNDCL 152) provides an adequate framework for controlling land transactions and documentation in the customary land sector. The most important thing is for the PNDCL 152 to be made fully operational. Policy makers must therefore make the enforcement of the PNDCL 152 and Act 767 their focus. The Act 767, 2008 if fully implemented is expected to make PNDCL 152 more efficient.

Conscious efforts must be made immediately to stamp out land market unruliness. "Land guarding" must be outlawed and the perpetrators punished adequately to stem the surge of vandalism of properties and the destruction of precious human lives as a result of land sentinel. Land vendors who are alleged to have been involved in multiple land sales must be expeditiously prosecuted and if found culpable punished severely. This fraudulent and irresponsible act necessitates no tolerance if land is to serve as effective collateral for lenders. Instilling discipline in the land market will ensure effective security of tenure and make land more easily accepted as collateral for housing loans. Adequate collateral will not only encourage more lending activities in the mortgage market but will also reduce the risk exposure of lenders. Borrowers will benefit from lenders' low risk exposure via lower mortgage costs.

Factors such as the macro-economic environment; the legal and regulatory framework; credit and real estate information sharing; existence of risk buffers and insurance instruments; availability of refinancing mechanisms; adequate income levels and stability, financial sector development; and the existence of credit bureaus all influence the development of sustainable mortgage markets. These issues are however, not addressed in this paper since prior Ghanaian studies have adequately treated them.

9. Conclusion

The Ghanaian housing finance market is hugely undersized. The country's housing finance structure is inefficient and unsustainable. The absence of reliable land acquisition and documentation procedures, and land market indiscipline may be to blame. The housing finance market has been constrained by an exceptional number of administrative encumbrances in the land acquisition and documentation processes. The housing finance market has therefore been rendered uninviting to lenders and borrowers alike. The insecurity of tenure has mired the utilization of property as effective collateral in Ghana. Most financial institutions have therefore deserted housing credit as an investment opportunity. It is indispensable for policy makers to create the facilitating milieu for the development of a strong, sound and animated mortgage market by addressing the land problem. That is, efficient land acquisition and registration procedures must be created to encourage mortgage market development in the country.

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Models of Islamic housing finance for the renovation of houses in Pakistan

By Muhammad Asghar Shahzad

1. Introduction

Every asset needs maintenance with the passage of time; in the same way a house will need some maintenance and repairs as time passes. Renovation does not involve construction of a new house but it involves repairing or maintaining a house to its original condition. In Pakistan clients normally apply for renovation finance if they want to add some facilities e.g. fit a bath or repair floor etc. The financing limit and repayment period in a renovation case is normally less as compared to construction or buying.

Normally people don't have sufficient funds to fulfill these requirements. In Pakistan Islamic banks provide finance for four categories of house, construction of a new house, buying a house, balance transfer and renovation.

This research will focus on Islamic house finance for renovation purposes, and will also discuss whether the current practice is suitable for financing or not, and alternative products will be discussed.

2. Concept of diminishing Musharakah in Islamic house financing

Diminishing *Musharakah* (*Musharakah Mutanaqisa*) is a combination of three contracts which are: *sharikah* (Partnership), *Ijarahh* (Lease) and Bay (Sale).[1] In this contract the Islamic Financial Institution [IFI] and the customer participate in the joint ownership of a property or equipment on the basis of *Sharikah tul Milk*. The share of the financier is divided into a number of units and the customer purchases those units one by one periodically. The customer purchases units from IFI until the customers become the sole owner of the property.[2] The customer pays rent to IFI for using resources of the IFI. As the customer purchases units from the IFI his payable amount of rent decreases. Finally the payable amount of rent becomes zero. This mode of financing is normally used by the Islamic financial institutions of Pakistan for house financing.[3]

3. Diminishing *Musharakah* for house renovation

IFI's provide financing for renovation through diminishing *Musharakah*. Under this contract the IFI purchases some portion of the client's house and leases back to the customer at an agreed rate of profit. During the agreed period of financing the client purchases units of the IFI's share[4] and pays the rent on the remaining units. Suppose a client needs financing for renovation of their house from Meezan Bank Limited amounting to Rs. 500,000 for ten years at 15%. The monthly payment schedule will be as follows (see Table 1).[5]

4. The concept of *MURABAHAH LIL-AMIRI BI-AL-SHIRA* in Islamic house financing

Murabahah lil-amiri bi-al-shirais is, a term of Islamic Law that refers to a particular kind of sale. Most of the Islamic banks and financial institutions use this transaction as an Islamic mode of financing.[6] *Murabahah lil-amiri bi-al-shira* is a sale of goods at a price covering the purchase price plus a profit margin agreed upon between the contracting parties. In this type of sale the seller discloses the cost of commodity and profit on the sold commodity.[7] The legitimacy of the *murabahah lil-amiri bi-al-shira* contract is based on the Quran, the Sunnah, the consensus of the Muslim jurists and the analogy (qiyas). In the Qur'an, Allah says: "*Allah has permitted trade and prohibited Riba*"[8]. The Prophet Muhammad (peace be upon him) says: "*The best earning is what man earns with his own hands and from a permissible trade*".[9] According to scholars there is a general principle of Islamic law that everything is permissible as long as there is no violation of specific rules of Sharia'h. Furthermore, the consensus of the Muslim jurists can be traced in classical Islamic jurisprudence which shows their permission for *murabahah lil-amiri bi-al-shira* contract. Its legitimacy is also proved by analogy, since the Prophet (peace be upon him) has approved the *tawliyah* sale which is similar to *murabahah*[10], Islamic financial institutions also use this mode of finance for financing. In Malaysia,

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[1] Abdullah, Noor Mohammad Osmani & Md. Farukh. (July 2010). MusharakahMutnaqisah House Financing: A review of Literatures & Practices of islamic Banks in Malysia. international Review of Business Research Papers,, (pp. Vol: 6 272-282). P. 273.

[2] Usmani, M. M. (2000). Introduction to Islamic Finance. Karachi: IDARATUL MA'ARIF, KARACHI PAKISTAN, P. 82, - OIC, F. A. (n.d.). Fatawa. Retrieved Oct 21, 2011, from ISRA: ttp://www.isra.my/fatwas/topics/commercial-banking/financing/musharakah/item/324-al-musharakah-al-mutanaqisah-and-its-shari%E2%80%99ah-rules-resolution-no-136-15/2-2004-by-the-international-council-of-fiqh-academy.html#startOfPageId324, Usmani, D. M. (2002). MeezanBank's Guide to Islamic Banking. Karachi: DARUL-ISHAAT URDU BAZAR KARACHI-I PAKISTAN., P. 115, - Usmani, D. M. (2005). Shirkat O Muzarbat Asre Hazar Main (Urdu). Karachi: Idaratul Ma'arif.,p. 415 - Usmani, M. M. (1996). Fiqhi Muqalat (Research Papers in Islamic Law). Karachi: Maiman Islamic Publishers, P. 231 - Ayub, M. (2002). Islamic Banking and Finance theory and Practice. Karachi: State Bank of Pakistan, P. 75

[3] SBP. (2008, March 25). www.sbp.org.pk/ibd/2008/Annex-c2-1.pdf. Retrieved Oct 22, 2011.

[4] Share of Islamic financial Institution which IFI purchased from customer.

[5] The payments through Diminishing Musharakah calculated through these formulas. calculation of units=Investment Amout No.of Months or Duration of investment and calculation of rent= MBL's Share X Rate

[6] Usmani, M. M. (2000). Introduction to Islamic Finance. Karachi: IDARATUL MA'ARIF, KARACHI PAKISTAN.P. 95

[7] Mansoori, D. M. (2005). Islamic Law of Contracts and Business Transactions. Islamabad: Shai'ah Academy, International Islamic University, P. 214

[8] Al-Qur'an, al-Baqarah: 275.

[9] Narrated by Hakim

[10] Tawliyah is a sale based on cost price.

Indonesia and Baronai Daru Salam IFI's provide house financing on the basis of *murabahah lil-amiri bi-al-shira/ Bay bithaman al ajil*. According to the scholars, this contract is not suitable for house financing because of the pricing issue: i.e. a contract of *Murabahah lil-amiri bi-al-shira* (for house financing) is for long term financing and IFI cannot charge an extra amount during the period of contract, as a result it becomes costly for the customer. Through this scheme in Malaysia an Islamic financing facility is provided for the purchase of a residential property on a deferred payment basis which is based on the *Shari'ah* concept[11]. The Islamic banking institution earns a profit by purchasing the asset and subsequently sells it back to the customer at a marked-up price on a deferred payment basis.

5. *Murabahah lil-amiri bi-al-shira* for house renovation

This product can be used as a mode of financing for house renovation. This mode of financing was introduced for financing house renovation, by the House Building Finance Corporation Limited[12] in 2003 and named the "*Shandar Ghar Scheme*". This product was based on *Murabahah lil-amiri bi-al-shira*, even though there were many Shariah problems in the practical application of this product. But this product was certainly very simple and practical.

The *Murabahah lil-amiri bi-al-shira* can be use in a very simple way e.g. a client wants to re-plaster his house and approaches the IFI. The IFI purchases the required materials e.g. cement, paint etc. and can sell these to the client on a deferred payment basis.

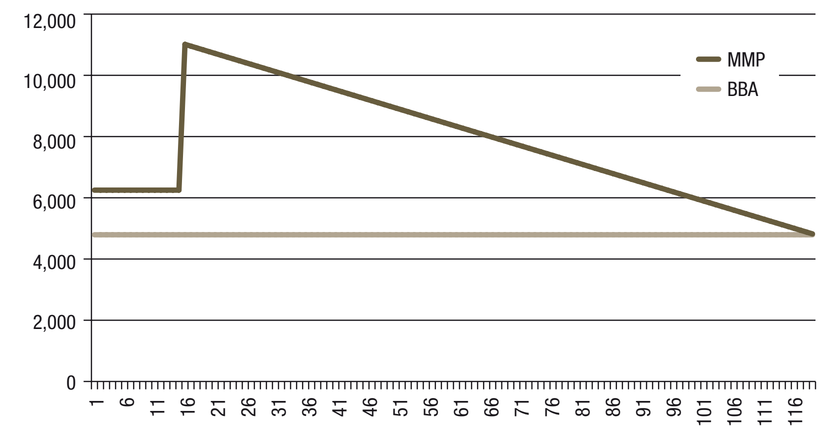
6. Comparison between *murabahah lil-amiri bi-al-shira* and diminishing *Musharakah* for house financing

For comparison we will discuss an example. Suppose an IFI provides finance for renovation of a house through diminishing *Musharakah* amounting to Rs. 500,000 for ten years at 15% and the same amount, period and rate through murabahah lil-amiri bi-al-shira the total payments will be as follows (see Table 2).

Table 1: Payment Schedule through diminishing *Musharakah*

Months	Rent	Unit Price	Monthly Payment	Balance Unit Price
0		Renovation Period		500,000
1	6,250			500,000
2	6,250		6,250	500,000
3	6,250		6,250	500,000
4	6,250		6,250	500,000
5	6,250		6,250	500,000
6	6,250		6,250	500,000
7	6,250		6,250	500,000
8	6,250		6,250	500,000
9	6,250		6,250	500,000
10	6,250		6,250	500,000
11	6,250		6,250	500,000
12	6,250		6,250	500,000
13	6,250		6,250	500,000
14	6,250		6,250	500,000
15	6,250		6,250	500,000
-	-	-	-	-
116	298	4,762	5,060	19,048
117	238	4,762	5,000	14,286
118	179	4,762	4,940	9,524
119	119	4,762	4,881	4,762
120	60	4,762	4,821	0
Total Payable amount	425,000	-	925,000	-

Figure 1 **Comparison of *Murabahah Lil-Amiri Bi-Al-Shira* and diminishing *Musharkah***



[11] Murabahah lil-amiri bi-al-shira is Shariah Compliant product but some scholars are against to use this product for long term financing.

[12] The House Building Finance Corporation was established in 1952 under an act of the Parliament of Pakistan. The House Building Finance Corporation Limited is the oldest housing finance institution in Pakistan. HBFCL is a Government designated financial institution.

Figure 1 illustrates that if one financial institution provides financing for the renovation of a house through *Murabahah Lil-Amiri Bi-Al-Shira* and another through Diminishing *Musharkah* at same rate and amount, the payable amount is different.

Table 2: Comparison of *Murabahah Lil-Amiri Bi-Al-Shira* and diminishing *Musharkah*

Months	*Murabahah Lil-Amiri Bi-Al-Shira*	Diminishing *Musharakah*
1	4791.666667	6,250
2	4791.666667	6,250
3	4791.666667	6,250
4	4791.666667	6,250
5	4791.666667	6,250
6	4791.666667	6,250
7	4791.666667	6,250
8	4791.666667	6,250
9	4791.666667	6,250
10	4791.666667	6,250
11	4791.666667	6,250
12	4791.666667	6,250
13	4791.666667	6,250
14	4791.666667	6,250
15	4791.666667	6,250
116	4791.666667	5,060
117	4791.666667	5,000
118	4791.666667	4,940
119	4791.666667	4,881
120	4791.666667	4,821
Total Payment	575000	925,000

7. Conclusion

From this discussion we can conclude that both the products are Shariah based. But Murabahah Lil-Amiri Bi-Al-Shira is very simple, and practical as compared to diminishing Musharkah. The diminishing Musharkah based product is very expensive as compared to Murabahah Lil-Amiri Bi-Al-Shira as discussed in Table no. 2. The diminishing Musharkah based product could be controversial among some scholars as it involves lease back agreements.

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Impact of the financial crisis on the housing finance system of Kuwait

↳ By Gus Freeman and Siji Sudarsanan

1. Introduction

Kuwait, a member of the Gulf Cooperation Council [GCC], was the most highly impacted of the six GCC states by the financial crisis and is still managing some of the fallout at the end of 2012. Towards the end of 2011 Kuwait witnessed the tremors of the Arab Spring as its government resigned on 28 November 2011 in response to social protests. The on-going Eurozone crisis forms a back drop to macro-management of the Kuwaiti economy through these times. The ensuing sections of this paper will provide a clear picture of whether and to what extent these crises have affected the housing finance sector in Kuwait. Section 2 outlines the main features of the housing system in Kuwait. Section 3 describes the housing finance system before Section 4 evaluates the impact of these crises on the financial sector in general and housing finance in particular. Section 5 concludes.

Figure 1 Location of Kuwait

2. Housing system overview

2.1 Population

Kuwait is the third largest GCC country in terms of population after Saudi Arabia and the UAE. The Kuwaiti population stood at 3.69 million in 2011 (Public Authority for Civil Information, Kuwait) and grew at a rate of 3.2% in 2011 against 2010. The country's total population is comprised mostly of expatriates with 32% of the total population being Kuwaiti nationals. The national population is entering the Demographic Window, where the bulging age cohorts entering working age outweigh dependent children and retirees. This provides Kuwait with an opportunity to shift the level of wealth generation upwards. The conversion of this opportunity into a demographic dividend requires that the working age population has jobs (unemployment is measured at 2.1% in 2011[1]), is housed and is healthy; otherwise the society can tend towards social unrest. The expanding national population exerts strong demand on the housing system in Kuwait.

So also does the expatriate population. Not only is the expatriate population the majority but it grows in bursts during times of economic expansion. For example, in 2007 the expatriate population grew 8.6%. This can exert very strong pressure on the national housing system. Most of the commercial activities are centered in Kuwait City Capital Area. With 98% of the population being urban, the need for residential space and related utilities of electricity, water, sewage and other amenities poses a challenge to urban development.

2.2 Households

Not all the expatriate population lives in private households, which feed into the housing market of Kuwait City. Only 55% of expatriates were

[1] Central Statistical Office, Ministry of Planning, Kuwait – Report 'Unemployment in Kuwait'

living in private households, while 30% were living in Collective Households, where housing is provided by respective employers in work camps. 15% of expatriates were living in nationals' households as domestic staff. Even though only 55% of expatriate households are in private households, they still form the majority of private households as they have a smaller average household size at 4 per household compared to 8.6 per national household. The outcome is that Kuwait has an estimated 490,000 private households in 2010 (Table 1) of which Kuwaiti national households are the minority at 33%.

Kuwait is part of the oil and gas producing Gulf Cooperation Council of [GCC] which gives them high levels of GDP, which, relative to the small populations, results in higher levels of GDP per capita income. The GDP per capita of Kuwait as of 2011 was US$ 47,982.

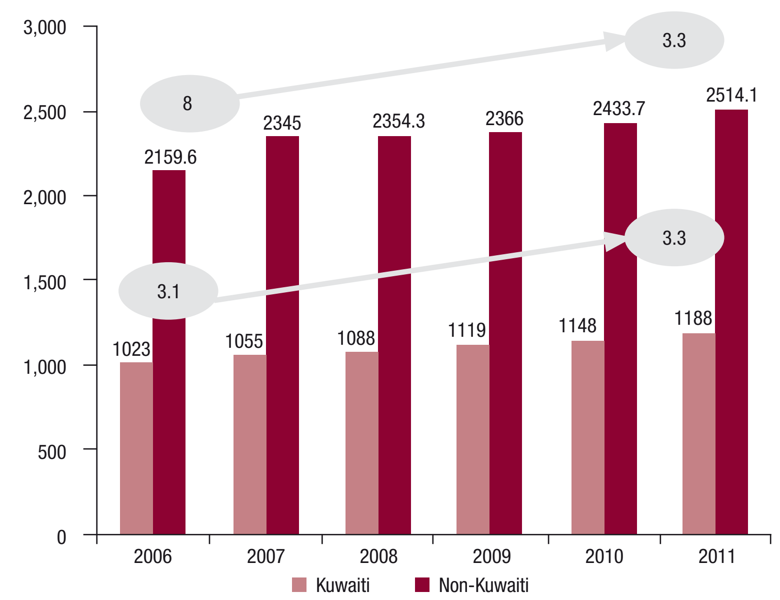
2.3. Housing system

The Kuwaiti government is obliged to provide housing for nationals, under the social contract, giving both free land and interest free housing loans to nationals and constructing houses for some. Currently the demand for government-built housing from bulging age cohorts entering working age far outstrips supply, constrained by the Public Authority for Housing Welfare's capacity to deliver. The housing loan subsidized by the government at USD 251,799 (KD 70,000) has become insufficient to buy land and build housing during the 2004 to 2008 boom years as land prices increased rapidly

The growing expatriate population has posed a challenge to the Kuwaiti authorities. Ownership of land and housing has been restricted to nationals. However, this is beginning to be relaxed with expatriates who have spent more than ten years in the country, being allowed to own property while they live in Kuwait. They are required to sell the property before they leave the country permanently.

The rental sector forms a large part of the housing sector, housing all the expatriate households as well as some of the Kuwait national households. Vacancy rates, which have remained steady from 2008 to 2009, increased in 2010 due to the downturn in the economy and a number of staff layoffs in the private sector. By 2011, demand for residential real estate increased due to demand from both expatriates and Kuwaiti nationals, causing rental rates to increase. By Q1 2012 the occupancy rate of rental homes was back in the range of 90-95%. The average apartment rent in the different areas of Kuwait City ranges from KD 2.5 to 4.5 per m^2.

Figure 2 Population distribution by nationality in 2010, (000's)



Source: National Bank of Kuwait and Public Authority for Civil Information

Note: Numbers in ellipses are the growth rates in that year

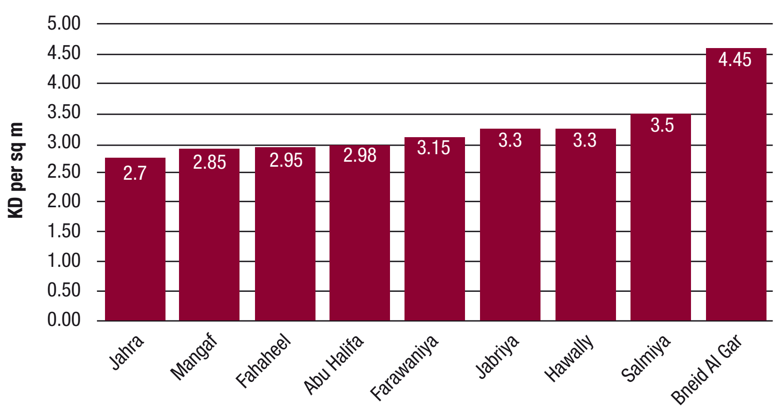
Table 1: Private households in Kuwait, 2010

	National households	Average household size	Expatriate households	Average household size	Total private households
Kuwait	160,000	8.6	330,000	4.0	490,000

Sources: Population Census, 2010 and Household Expenditure and Income Survey 2006/07, Central Informatics Organisation. Central Statistical Office, Ministry of Planning, Kuwait.

Note 1: Kuwait household numbers are the author's analysis, average household size from Census 2005 applied to 2010 population data

Figure 3 Apartment rents in Kuwait City, March 2012



Source: Kuwait Finance House

The average apartment rent ranged between KD 145 to 240 for one bedroom; KD170 to KD280 for two bedrooms; KD 200 to KD 350 for two bedrooms; and KD 260 to KD 550 for three bedrooms (Kuwait Financial House, March 2012).

3. Kuwait: housing finance system overview

3.1 Housing policy

The country has used its housing policy goal to provide a decent house for every Kuwaiti household as a way of redistributing oil wealth amongst citizens. The role of government in Kuwait's housing system has been particularly large with two government organizations implementing the housing policy. The Public Authority for Housing Welfare [PAHW] is the institution responsible for carrying out the government's mandate of providing housing for all Kuwaiti citizens, managing the distribution of land plots and construction of government housing.

The Savings and Credit Bank [SCB] of Kuwait, which was established in 1965, plays a dominant role in Kuwait's housing finance system providing subsidized credit to Kuwaiti citizens for the purchase, construction and renovation of private and government houses. According to the rules and regulations set forth by the SCB, all Kuwaiti nationals are entitled to a maximum onetime USD 251,799 (KD 70,000) interest-free loan with a repayment period of up to 60 years in equal monthly installments for either of the following:

- Purchase of property that has already been developed by private builder
- Building on a land plot distributed by the government
- Building on a land plot that has already been purchased by an eligible citizen

The loan amount is USD 17,986 (KD 5,000) higher if the household has a handicapped member and USD 35,971 (KD 10,000) higher if there are two or more handicapped members.

The SCB also provides a one-time interest free loan for the restoration of a home for all eligible Kuwaiti nationals of USD 89,9289 (KD 25,000) for those in a government provided house or USD 107914 (KD 30,000) for those in a dwelling bought or built privately.

For housing policy purposes a Kuwaiti household is defined as a married couple where the husband is Kuwaiti and there are children. Upon marriage a Kuwaiti male will most probably apply for a 100% granted house built by the Public Authority for Housing Welfare [PAHW]. In 2009, there were 90,330 applications awaiting a house. Approximately 36% of Kuwaiti males aged 19 years or more were among the applicants waiting for housing. The household has a number of options, the main ones of which are:

- Wait for the PAHW to build and deliver a 100% granted dwelling. The question is how long this will take. In 1999 the waiting list had 48,000 applicants which was the equivalent to a 12 year waiting period (National Bank of Kuwait, 1997). At the same rate of supply this would suggest it would take 22 years to clear the list. The average production rate of dwellings by PAHW has been less than 800 dwellings per year between 1996 and 2010 whilst the average number of applications over the same period is 7,300.
- Whilst waiting the household either remains in the parent's home as a 'concealed' household or forms a separate household by renting in the private rented sector. If they elect to rent the government support them with a Rent Allowance of up to USD 719 (KD 200) per month. The value of this Rent Allowance has not increased with rental inflation.
- Take a plot of vacant but serviced land from the PAHW and build their own house. In this case households can apply to the SCB for the USD 251,799 (KD 70,000) loan.
- Buy a plot of land privately, using own funds or a commercial bank loan and apply to the SCB for a loan to build.
- Buy an existing house with the SCB loan.

In parts of Kuwait City, however, USD 251,800 (KD 70,000) has long been insufficient for the needs of an average Kuwait household of 8.6 members. A family villa today ordinarily costs between USD 719,424 (KD 200,000) to USD 1,079,137 (KD 300,000) and began to exceed USD 251,800 at the end of the 1990s. This provided a demand driver for the commercial banks to start housing finance product development, which they did at the end of the 1990s. These products are used in addition to top up the SCB loans.

The Central Bank of Kuwait (CBK) has placed a maximum borrowing capacity of USD 251,800 for all the banks in Kuwait for all loans except the SCB loan which is treated separately. As a result, a borrower's total credit card and consumer loan may not surpass the USD 251,800 limit. The loan must be repaid over a maximum period of 15 years. In March 2008, the CBK also implemented a legislation, which requires that the total installment on loans relative to income should not exceed 40%.

3.2 Commercial bank housing finance

The banks are only able to obtain the borrower's salary as collateral. The law does not allow for a bank to take a person's house as collateral. As such there are no mortgages offered in Kuwait. Historically the SCB has been the dominant provider but the increase in land and house prices has driven demand for additional housing finance over and above SCB loans. This acted as a stimulant for the commercial banks to provide housing loans for construction, land or house purchase. The commercial banks provide termed Installment Loans which tend to be Islamic finance products under the Murabaha or Ijara contracts. Their tenure does not exceed 15 years and are a part of the CBK ruling capping borrowing to USD 251,800. The commercial banks are currently providing the vast majority of new housing finance in Kuwait. The commercial banks have provided about 75% of new housing finance[3] since 2007. This housing finance market is completely for Kuwaiti nationals until 2010 as expatriates were not allowed to own real estate. Hence, expatriate households could be a significant driver in fueling the housing finance market in Kuwait upon the relaxation of legislation on ownership of housing.

Banks in Kuwait are calling for reform of mortgage regulations in order to liberalize the housing finance market. Among other things, while Islamic banks offer home loans, conventional banks are in many cases unable to do so, although some have analogous products. Foreclosure remains a problem with the laws currently not allowing lenders to evict borrowers. Further, bank lending rates from conventional banks cannot exceed the CBK's discount rate by more than three percentage points and they must be fixed for at least five years and the re-setting has to take place within a 5% band.

[2] Census 2005 shows there were 248,910 Kuwait1 males aged 15 years or more which approximates to the number in 2009 of Kuwait males aged 19 years or more. 90,330 waiting listed Kuwaitis.

[3] CBK data for Installment Loans allow the calculation of additional outstanding credit since 2007, which equals KD 2.08 billion. This is a net figure. The SCB has disbursed KD 0.75 billion of new loans in the same period (NBK Real Estate Bulletins). This is a gross figure. Whilst net and gross figures are not directly comparable and Installment Loans may include a proportion of non housing finance, the estimate shows that commercial banks provide the major share of new housing finance.

3.3 Housing market supply and demand

The growth of the housing market is constrained by a supply-demand imbalance. The demand for housing is high – both from Kuwaiti population and from expatriates for rented accommodation. However, supply has not kept up with surging demand, pushing prices upward.

The supply of residential property in Kuwait is constrained. Law 8 of the planning system states that only 3-4% of Kuwait's total area is designated for private housing. Kuwait Finance House [KFH] estimates that less than 2.5% of the total area of Kuwait accounts for developed real estate, and licenses are withheld and building is restricted in areas where long term infrastructure projects are pending. Another binding constraint on the development of residential real estate is the lack of primary infrastructure development of the land allocated for residential purposes. Together these factors mean that the supply of housing is limited.

Demand for housing, on the other hand, is booming. There are two main sources of demand impacting the housing market – consumption demand and investment demand. As of June 2010, there is a waiting list in excess of 90,000 nationals for grants of government provided housing. Strong demographic growth from both nationals' natural increase and expatriate immigration is the prime factor putting upward pressure on demand.

Housing and the land it is built upon is an asset for which there is investment demand. In Kuwait this works principally through the trading of land and the development of housing for rental, where owners of capital buy land hoping for capital gain. Investment demand was strong during the 2005 to 2008 economic boom period but land prices fell between 25-35% in 2009 from the peak levels of 2008 (DTZ, 2010). In 2011 there has been some recovery in land prices especially in new areas as the Kuwait government has granted construction permits.

A number of government regulations and budget allocation to housing have been implemented or are in the pipeline to ease the supply constraint in the residential sector. The major initiatives include:

1. In February 2008, Parliament passed a law taxing large undeveloped land plots. This is thought to have caused several developers holding land banks to sell some of their land to avoid the tax, which would make more land available for active development (Soloiman, 2012).
2. Parliament has given its approval for the first phase of the Kuwait Development Plan [KDP] which was on hold due to political reasons. The first phase of the plan extends till 2014. The government of Kuwait is planning to build 70,000 new homes by 2015 under the plan, some of which will be in 6 New Town developments, such as the North West Sulaibikhat Development in the Al-Assimah area of Kuwait city which is planned to have 1,736 residential units when completed and the Sabah al-Ahmad development is located 50 kilometers south of Kuwait City. When completed, Sabah al-Ahmad will comprise 9,000 housing units for Kuwaiti nationals.
3. A significant number of projects in the KDP will operate on Build-Operate-Transfer (BOT) model, which is governed by Law No. 7/2008. Under the BOT model, the private sector would be involved in the development of these units, though the government would retain the long term ownership. PAHW awarded in December 2011 two contracts worth a total of KD53.8m ($194.5m) for housing and infrastructure contracts on large housing developments (Meed, 2011).
4. Kuwait Real Estate Clearing Company became operational in 2010. The company was formed to improve the transparency of transactions, real estate prices, and efficiency of the market.

Equally two initiatives announced by the government will stimulate further the demand for housing and add to the supply crunch. These are:

- Laws entitling women to loans from the savings and credit bank are being contemplated by the government. This increased supply of credit is likely to significantly increase the demand for housing.
- Kuwait has not permitted foreign ownership of real estate in the past but in 2010 government passed a law allowing expatriates to buy an apartment of up to 350 m2 if they have lived in the country for more than ten years.

4. Impact of financial crisis on the housing finance sector

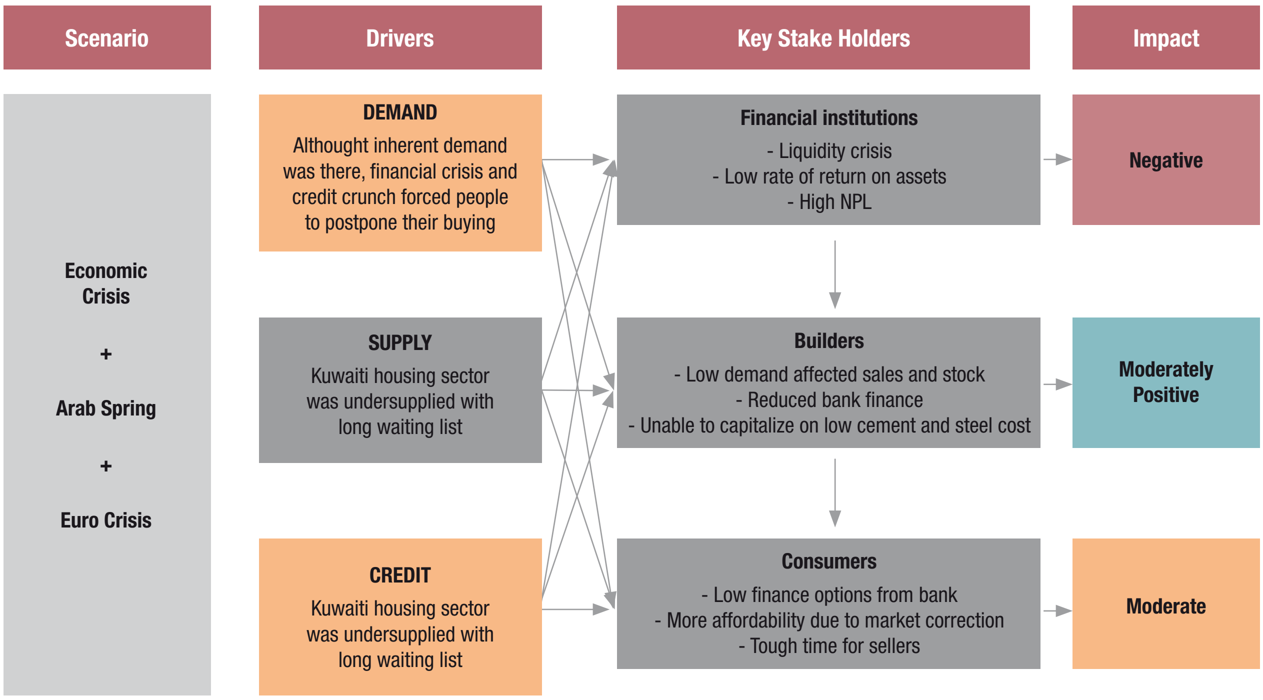
Major financial institutions around the world had invested heavily in US subprime mortgage-backed securities [MBS] during a period of higher global economic growth and housing asset price increases. When US house prices started to fall many of these financial institutions reported significant losses. The bankruptcy of Lehman Brothers Inc. in September 2008 confirmed the world was in the worst financial crisis since the Great Depression of the 1930s. The profit performance of the banking sectors in Kuwait was heavily impacted during the aftermath of the crisis. Prompt and forceful policy action by the governments of these countries helped in containing what impact of the financial crisis there was on their banking systems.

Kuwait was the worst hit economy of the whole Middle East by the financial crisis in terms of the impact on real GDP growth which declined -7.2% in 2009 (Central Statistical Bureau, State of Kuwait 2012). This was largely the result of falling oil production as part of the OPEC agreement to help raise the falling crude oil price together with the declining performance of the investment sector. Investment companies form a significant part of the financial sector in Kuwait, investing domestically and abroad. There are around a hundred such companies, including 51 that are publicly listed—almost half the total number of listed investment companies in the GCC as a whole. The sector has performed poorly recently, with the listed companies making aggregate losses of US$3.9bn in 2008 and US$3.1bn in 2009 (Qatar National Bank, 2011). This is reflected in the negative growth of the financial sector (banking, investment and insurance) value add in 2008 at -13.8% in real terms and by - 22.3% in 2009. 2010 saw the sector return to positive growth of 15% (Figure 4).

In 2009, the average return on equity improved slightly and banks made some profits owing partly to the indirect support provided by the authorities' $5.2 billion economic stimulus package launched in 2009. However, profits were depressed in 2008 and 2009 with the return on equity 6.5% and 6.1% respectively, much lower than 24.3% in 2007 (Table 3). In 2009, the Non Performing Loan [NPL] ratio to total loans rose to 11.5%, reflecting banks' exposure to the Kuwait real estate, investment and construction sectors that were adversely affected by the global recession. These three sectors combined accounted for 45% of total bank credit in 2009.

Banks are also exposed indirectly to the collapse in the local stock market. Lending to the retail sector ("personal facilities"), which also contributes significantly to the total bank credit, continues to face difficulties on loans or overdraft facilities used to invest in the local stock market during the boom period. While this exposure is troubling, the potential damage to banks is likely to be limited as credit is largely extended to salaried workers and as there is an opportunity for some distressed borrowers to access some financing from an official hardship fund.

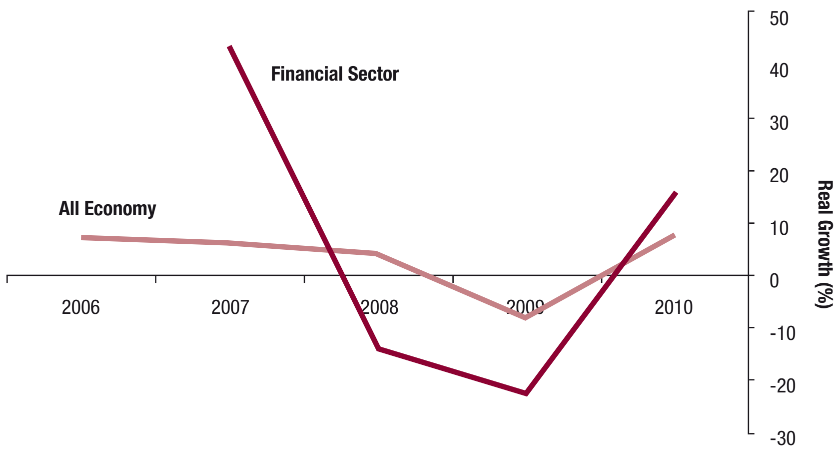
Table 2: Kuwait housing – impact analysis



A major source of weakness has been banks' exposure to local investment companies. Bank lending to investment companies grew steadily to a peak of 13% of total bank credit (KD2.86 billion, $9.9 billion) by mid-2008 before declining slightly thereafter. Bank credit to investment companies contracted sharply in 2009 following a major slowdown in 2010. The two largest companies Global Financial House and Aref Investment Group had to restructure their debt obligations, resulting in heavy losses. However, many companies with high bank and market debt, which are largely privately owned and family-controlled, have not restructured their debt. Owners have so far avoided disclosure and have continued to service the outstanding debt from private wealth, while banks have exercised forbearance as Kuwaiti commercial law prevents banks from unilaterally forcing these companies into liquidation. Until these firms are restructured or liquidated, the true condition of many banks' balance sheets will not be known publicly.

The authorities' actions to promote financial stability were focused on the banking system. It extended a significant level of support to banks from late 2008 onwards, including guaranteeing deposits in local and foreign banks, a US$5.2 billion Financial Stabilization law, and a USD 14 billion (KD4 billion) government guarantee of 50% of new loans extended by banks to local firms over two years. Investment companies on the

Figure 4 Real economic and financial sector growth in Kuwait 2006-10, (%)



Source: Central Bank of Kuwait

Table 3: Kuwaiti bank performance indicators

Percent	2007	2008	2009	2010
Capital Adequacy	19.3	15.6	16.7	18.9
NPLs/Total Loans	3.8	6.8	11.5	8.9
Loan provisions to NPLs	47.2	29.0	38.3	33.9
Return on Average Assets	3.3	0.8	0.7	1.2
Return on Average Equity	24.3	6.5	6.1	9.1
Loans/Customer deposits	103.1	109.0	113.0	116.5

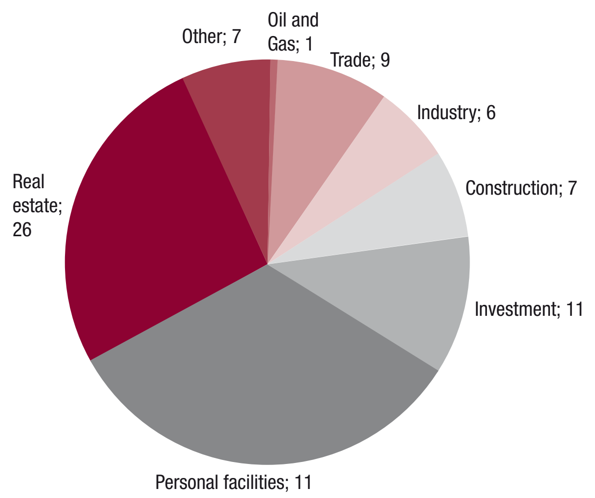
Source: Central Bank of Kuwait

other hand have received no financial support, although they are regulated by the CBK. One of the key strengths of most banks' is their strong financial positions during the pre-crisis period. Moreover, with central bank and government support, capital adequacy levels have been shored up by several percentage points and remain well above the 12% regulatory minimum requirement.

The effect of all this on commercial banks' ability to lend has been highly constraining for total credit, which slowed down from the heights of 35% year on year growth in Q1 2008 to 0.4% by the end of 2010. During that period Installment Loans, which are predominantly used for restoring or purchasing housing (Central Bank of Kuwait, 2012), maintained positive year on year growth, outgrowing the total credit to individuals which includes Installment Loans, Purchase of Securities and Consumer Loans (Chart 15). Indeed Installment Loans were 57% of all lending to individuals at the end of 2010 and the majority of additional outstanding credit to individuals over the period 2009 to the present with the exception of Q3 2010 to Q1 2011 (Figure 6). There are concerns that a large number of Kuwaiti nationals have become overburdened by debt. The National Assembly has argued that the government should buy up the consumer debt owed by Kuwaiti nationals. The government has so far resisted this because of both the cost and the moral hazard involved (Qatar National Bank, 2011 ibid).

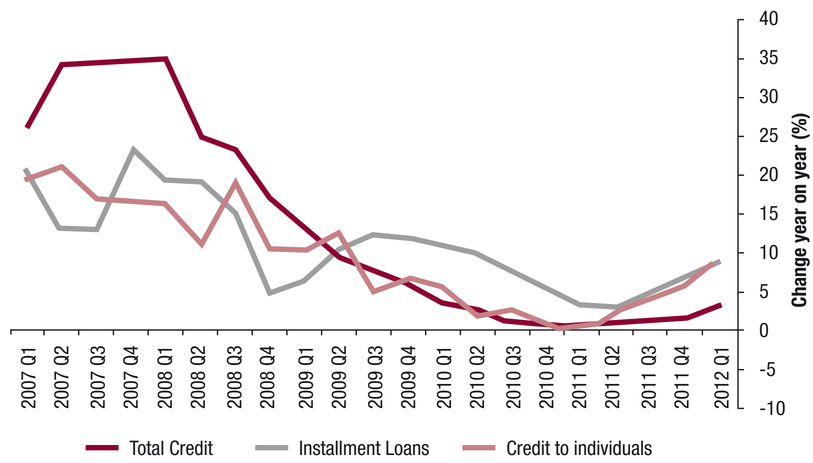
The consistent lending by the SCB has also been affected by the financial crisis but not to the same extent as the commercial banks. The bank has averaged USD 119 million (KD 33 million) of lending per quarter since Q4 2008. Generally this has been a minor share of all housing finance with the commercial bank lending (non-mortgaged) for construction and house purchase being the dominant share. When commercial bank lending for housing came to a halt between Q3 2010 and Q1 2011, the SCB was the only lender. However the level of SCB has decreased by 10.6% in 2010 over 2009 and again 27.2% in 2011, suggesting that government budget finances are constrained to rise to the growing demand.

Figure 5 Distribution of credit by commercial banks, 2009, (% of total credit)



Source: Central Bank of Kuwait

Figure 6 Credit growth by commercial banks, (year on year change %)



5. Conclusion

The financial crisis has had a major impact on the economy of Kuwait and on the financial sector in the country, but demand side housing finance to households has been only mildly impacted. The commercial banking sector has not been able to meet the credit needs of the economy as a whole, with credit barely growing at 3% year on year in Q1 2012. Yet lending to individuals for housing under the category 'Installment Loans' has returned to strong growth at 9% year on year in Q1 2012, similar to the growth in 2008 to 2009. There was only a period of three Quarters in the second half of 2010 and the first Quarter of 2011 when commercial bank lending to housing stalled.

This is the picture for demand side housing finance from the commercial banks. Government Savings and Credit Bank lending for housing remained positive but also impacted by the crises with lower amounts of credit released in 2010 and 2011. Indeed, whilst the commercial banks have returned to strong levels of credit supply for housing the Savings and Credit Bank lending is in decline. This presents the Government of Kuwait with an opportunity to reconsider how demand side housing finance is provided in the future and how the commercial banking sector could be engaged to grow its role as the dominant provider.

The demand for housing loans can be expected to increase in Kuwait as the constraints on housing supply are released and as expatriates are able to purchase or build housing in the market. The Kuwaiti housing finance system has responded well to the crises that hit Kuwait since 2008. It will need to innovate if it is to be in a strong position to meet the growing demand for housing finance that is looming with the bulging age cohorts set to reach working age within the next ten years.

The views expressed in this article represent the authors' personal views and not those of Ernst & Young.

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Figure 7 **Growth of personal credit lines by commercial banks, (year on year change %)**

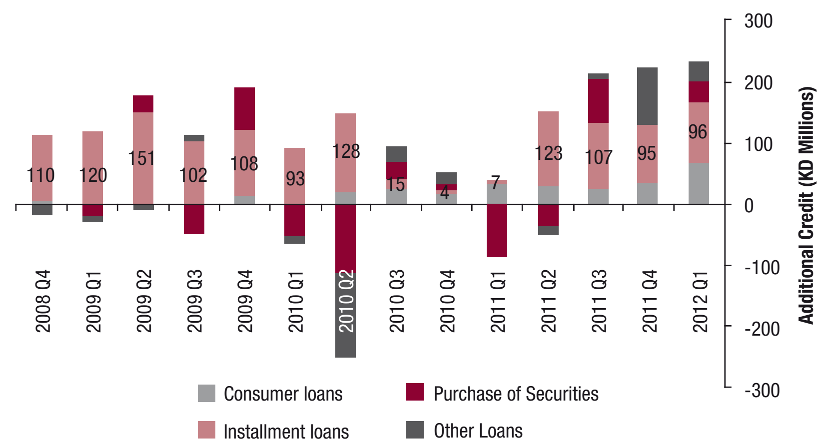

Figure 8 **Growth of additional housing finance by commercial banks and savings and credit bank, (KD millions)**