Improving urban shelter strategies in developing countries

Housing policies in many developing countries are inefficient and inequitable and the wrong solutions are often applied to the problems, says Stephen Malpezzi

CITIES in developing countries are growing at explosive rates by historical standards — from 2% to 10% a year. By the year 2000, 20 of the world's 25 largest cities will be in developing countries and their total urban population will exceed two billion. By any definition, most of the people in these cities are poor. In terms of one specific definition of absolute poverty, in 1980 over 200 million city dwellers lived below a level satisfying basic nutritional requirements; by 2000, this number is expected to double.

Coping with rapid urban growth and widespread poverty strains the resources and imagination of even the most accomplished governments. Yet governments often hinder their ability to deal with such problems because they misunderstand the urban economy and do not employ the right policies and programmes. This is especially true of shelter. Even the most casual empiricism confirms that shelter policies in many developing countries are inefficient and inequitable.

Common problems and common solutions

Many housing problems can be stated simply, and their solutions may therefore appear simple; unfortunately, facile solutions often compound the problems.

Problem: There is a perceived shortage of housing.

Common solution: Government should build housing. This is usually the wrong solution. Housing shortages, when they exist, are the result of fast growth in demand and of impediments to the supply of housing. Governments do not, in general, respond to demand faster or more efficiently than private markets. But they can do much to mitigate or remove market imperfections, improving the private sector's response.

Problem: The quality of housing is poor.

Common solution: Raise standards through stricter building codes and better enforcement. This, too, is often the wrong solution. Many current standards, based on Western codes, have little to do with basic structural soundness or hygiene, and are simply unaffordable by the bulk of the population. Standards and codes should focus on basic requirements for safety and health. Further improvements will come as development proceeds and incomes rise, provided regulations do not actually prevent upgrading.

Problem: There are too many squatters. Many poor people live on public or private land, contravening land use controls and similar laws.

Common solution: Clear the squatter areas. For many reasons this can be the wrong solution. When people are moved off land, they go somewhere else. Slum housing represents a large part of the poor's capital stock; destroying their capital retards development. And informal housing is sometimes of surprisingly high quality. Policies can be adopted that improve conditions more cheaply and for more people than clearance programmes, even when such programmes include new public construction.

Problem: The price of housing is too high for many families.

Common solution: Control rents and the price of land and building materials. This is usually the wrong solution. When housing prices rise faster than prices in general, that is a signal to the market to produce more housing relative to other goods and services. Such price increases are transitory unless the market is prevented from adjusting because of shortages of inputs, excessive government regulation, and similar restrictions. It is far better to deal directly with the causes of rising costs, rather than try to shift the burden of adjustment to landlords, who will then reduce the quantity of housing and land for rent, thereby exacerbating the very problem controls were supposed to solve.

How housing markets work

A schematic diagram of how the housing market works is shown below. Inputs such as land, labour, finance, materials and infrastructure are combined by supply-side agents such as landlords and developers to produce housing services.

Homeowners, and to a lesser extent, renters, are also producers if they maintain and upgrade their houses. Relative prices inform producers of housing services about whether to provide more or less housing, and the input suppliers about providing more or fewer inputs.

It is not a bad approximation to treat the market for housing services as a competitive market. For the activities in the middle box, there are few barriers to entry or large economies of scale in most countries. This does not mean, of course, that anybody in a poor country can become a landlord or developer. But there are seldom so few landlords or developers that they exert significant market power, except insofar as they also control inputs that are not competitive.

The market for many inputs is not competitive, however: (a) their ownership may be so concentrated that owners can fix prices, as in some land markets; (b) large economies of scale may make the production of some inputs a natural monopoly, as with some types of infrastructure; and (c) government regulations may restrict the competitive allocation of inputs, notably finance.

The implications of this analysis are clear. Problems in housing markets are often caused by problems in the input markets. Government actions that attack these problems directly are the right ones. Rather than adopt this approach, however, many governments intervene in production (the middle box). Governments that try to fix prices — for example, by rent controls — only distort the signals being sent to the market and may exacerbate the original problem.

Role of the public sector

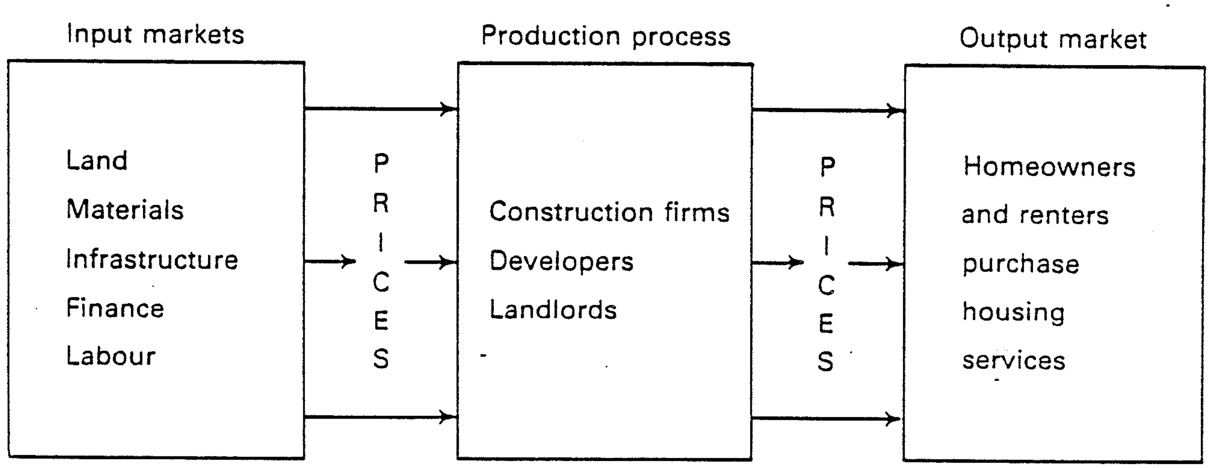
Until the early 1970s housing policies in developing countries often followed the model of many industrial nations, relying on heavily subsidised blocks of public housing. By and large, those policies did not work.

By the late 1960s and early 1970s many governments started to build on the success of informal housing. They introduced sites and services projects and slum upgrading, encouraged by the World Bank and other international organisations. These projects tried to set design standards on the basis of what people could and would pay, rather than on some arbitrary and inflated notion of "housing need."

The new approach involved two important related principles: affordability and full recovery costs. Only self-financing projects can be replicated on a large scale. Governments also tried to encourage self-help in building houses and community facilities and also in producing low-cost building materials.

Now it is increasingly recognised that even improved projects must be accompanied by fundamental changes in related government policies. New projects and policies focus even more directly on housing finance, infrastructure, and land mar-

→ 6



←5
ket imperfections rather than direct production of housing units. There is a new awareness of the important impact of government regulations — zoning, standards and codes, taxes, financial policies, rent controls, and other pricing policies.

Improving shelter strategies in developing countries

An integrated housing strategy requires a clear statement of objectives, an understanding of local conditions, a sense of how policy and programme features are linked to outcomes, and a plan for generating and applying the resources needed to implement the strategy. Even though local political and other conditions will have a strong influence on the content of a strategy in a given place, enough is known about developing-country housing markets to suggest some general strategic guidelines.

Two points in particular are worth emphasising: that general economic development is the most effective way of improving housing conditions in developing countries; and that to ensure maximum benefits, governments should promote the efficiency of the housing sector and should avoid policies that cause significant market distortions and produce counter-productive results.

Economic development

Research demonstrates that, as development proceeds, housing conditions improve more rapidly than incomes. Housing investment as a share of GNP increases rapidly, as does the fraction of income that people spend on housing.

In low-income countries, housing investment relative to GNP is only 2%; in middle-income developing countries the fraction is from 6% to 8%. Households in very low-income countries spend only 5% to 10% of their income on housing; in middle-income developing countries, the fraction may be 25% to 30%.

To a considerable degree, what is good for the economy is better for housing. Improving the performance of the shelter sector is therefore linked to appropriate policies in other sectors, and appropriate macro policies.

.... *Shelter policies in many developing countries are inefficient and inequitable* ....

While this is an encouraging long-run prescription, it does little to solve immediate housing problems. Nor does it show how the gains from economic development are most effectively channelled into improving housing conditions. These questions require a careful choice of policies and programmes by government.

Required actions

Government activities that deserve emphasis include:

The provision of infrastructure with appropriate and affordable standards. The benefits of infrastructure investments are considerable: rates of return to investment are high (often higher than in housing alone), household spending on housing is often spurred, and *de facto* security of tenure is established for many informal households. However, cost recovery is required for large-scale investment and for continued maintenance, otherwise enormous social and private economic costs result, as demonstrated by the high costs of small-scale private provision of water and electricity in Lagos, for example.

The development of land information systems and a legal and administrative framework that promotes efficiency in land markets. The costs of developing land are unnecessarily high in most developing countries, largely because of poor land information, backward systems of titling and property rights, and a cumbersome legal and administrative structure.

The reform of land tenure systems in order to promote private spending on housing. Most cities in developing countries are being built largely by the informal sector, with houses that are often illegal and with insecure tenure. Research shows that even very poor households place significant monetary premiums on security of tenure and that incentives to improve property are often dramatically increased when tenure in illegal or squatter settlements is legalised.

The development of financial markets and institutions. Development or

→8

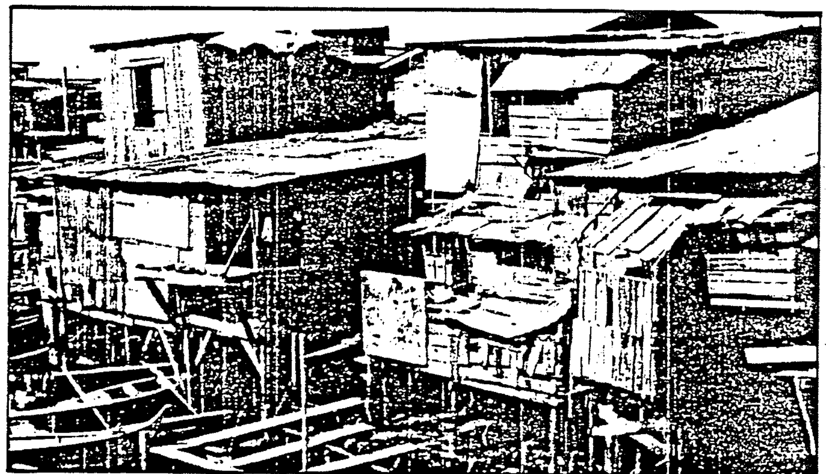
←6

reform of housing finance institutions should be a part of the overall process of financial reform and thus of promoting savings, financial intermediation, and the free movement of capital throughout the economy. The objective of a sound housing finance system is not to provide ever larger amounts of subsidised money for housing, but to facilitate required investment in a sector that is growing rapidly as development proceeds and to encourage savings.

The critical review of housing subsidies, with the goals of increasing their effectiveness, avoiding unintended side effects, minimising costs to the public and private sectors, and distributing benefits fairly in relation to need. By necessity, subsidies must be carefully targeted to groups that have a specific demonstrable need. In most developing countries, subsidy policies suffer from an almost total lack of strategic planning. The scale, distribution, and impact of subsidies are not usually known. Such evidence as exists shows that subsidies often do not reach their intended targets.

The pursuit and further improvement of sites and services and slum upgrading projects as solutions for the housing problems of low-to-moderate-income households. The best of such projects provide appropriate and affordable housing and services to low- and moderate-income groups, recover costs and minimise subsidies, target such subsidies as there are to those in greatest need, have high economic rates of return, and improve the ability to replicate projects on a broad scale. Many such projects, however, often fall short of these potential benefits in practice. Research indicates that planning assumptions are frequently incorrect, which leads to problems as the projects develop.

The promotion of private housing, including rental housing. It is worth noting that most housing policies have implicitly or explicitly focused on the owner-occupied sector, and with reason. However, the rental sector in most developing-country cities



.... Displacing slums to other areas may encourage the development of larger squatter settlements ....

is large and growing, usually comprising at least 50% and sometimes as much as 90% of the housing stock. The sector is often hampered by unfavourable treatment such as inappropriate regulation, including rent controls, and discrimination in access to finance, land and infrastructure.

Of the policies that governments should avoid, three deserve special mention:

The creation of unrealistic and costly building codes and zoning regulations. These increase costs, often without corresponding benefits, and may encourage development of illegal informal areas.

The destruction of squatter settlements. Slum removal and urban renewal programmes that simply displace the slums to other areas may encourage the development of larger and more militant squatter settlements.

The displacement of private investment by public activities. One study in the United States recently found that each 100 new units of publicly subsidised housing caused a drop of almost 85 units in private construction; other studies indicate that public housing actually has a negative economic rate of return (it is worth less than what it cost to build). Similar displacement effects and inefficiencies undoubtedly exist in many developing countries and are to be avoided at all cost.

These general guidelines are the basis for development and improvement of shelter strategies in most developing countries. Many of these principles are also of some relevance to developed countries. Detailed formulation of housing strategies must, of course, be informed by data collection, research, planning, and monitoring and evaluation of the programme involved. ■

STEPHEN MALPEZZI is an economist in the Water Supply and Urban Development Department of the World Bank. For the past five years he has analysed developing country housing markets and policies for the Bank. He holds a PhD in economics from The George Washington University, and prior to joining the Bank he was a research associate at The Urban Institute. This article is excerpted from "Shelter Strategies for the Urban Poor in Developing Countries," co-authored with Stephen K. Mayo and David J. Gross, and published in the "World Bank Research Observer" (vol 1, no 2, July 1986).

Stimulating housing development in developing countries

With the resources now available, the goal of an adequate house for every family can be achieved, says Peter Kimm

RAPID urbanisation is creating unprecedented pressure for shelter and related community services everywhere in the developing world. Governments are confronting enormous needs across all sectors of the economy with limited financial resources and shortages of technical and managerial skills to cope with the growing housing problem. Cities in developing countries, which were already starting to meet basic service needs, grew in the aggregate by 350 million people over the past decade. The future holds more of the same. The urban population of developing countries is expected to double over the next 20 years, by which time more than half the poor will be living in cities. Squatter communities, which accounted for 40% of their populations in 1981, will constitute nearly two-thirds by the year 2000.

One dramatic indicator of this urbanisation is the increase in the number of large cities. In 1950, fewer than half of the world's 76 cities with more than one million people were in developing countries; by the year 2000, they are expected to contain 284 such cities. This growth will have profound implications for the developing world. The efficiency of these urban areas, or lack thereof, will be a major determinant of the overall quality of life and economic strength of developing countries.

Over the past 25 years, the United States Agency for International

Development has been providing assistance to developing countries for housing and related urban services. AID has accumulated a wealth of experience about the nature of the shelter problem and its solutions. This experience has led it to the conclusion that individual and private initiatives are the real solution to the world's urban problems.

In AID's view, which I discuss in this article, governments have an indispensable role in providing infrastructure and secure land tenure and in creating the climate and policies that will facilitate the production of housing by individual initiative and private action. Very rarely is government an efficient producer or owner of housing.

The strategies for tackling urban shelter problems have moved dramatically since the 1960s, when the view was widely held that the key to the solution was the construction of housing at relatively high standards by the government. That approach was costly to the country and failed to produce housing units in sufficient quantity to meet the need.

In the 1970s, that strategy gave way to one of addressing basic needs by providing minimal services to a vastly larger proportion of the urban poor through sites and services, core housing projects and slum upgrading. Such projects demonstrated that poor families could be served with improved shelter and that they could become homeowners and function well within a normal credit system.

The basic needs strategy helped to re-orient the policies of developing countries to appropriate and affordable housing solutions. Many governments, however, continued to provide unrealistic and unsustainable subsidies by making land available at below market prices, providing financing at interest rates that did not reflect the true cost of money, or constructing infrastruture without making provision for cost recovery. Thus, the projects required a continuous replenishment of resources for subsidies, precluding replicability at the scale needed due to limited government and donor resources. This became dramatically more evident during the financial crunch of the 1980s.

For most countries, the solution to overcoming the limitations of government resources needed to improve shelter conditions lies within their indigenous private sectors where financial and human resources vastly exceed those available to the public sector. The private sector includes both the formal sector organisations owned by individual and institutional investors, and the informal sector, which consists of individuals and small scale enterprises that are not formally registered, do not keep proper accounts, and employ labour on a mostly casual basis.

In industrialised countries, the informal sector plays a very small role in housing. In virtually every developing country, however, the informal sector has been responsible for producing most new housing, particularly for low income people. In aggregate, informal private sector activities represent a significant investment in housing that confirms the strong desire and willingness of people, regardless of their income, to provide themselves with a decent place to live. Experience with sites and services projects, home improvement and community upgrading programmes has demonstrated that assistance to the informal sector can be an effective means of improving shelter conditions.

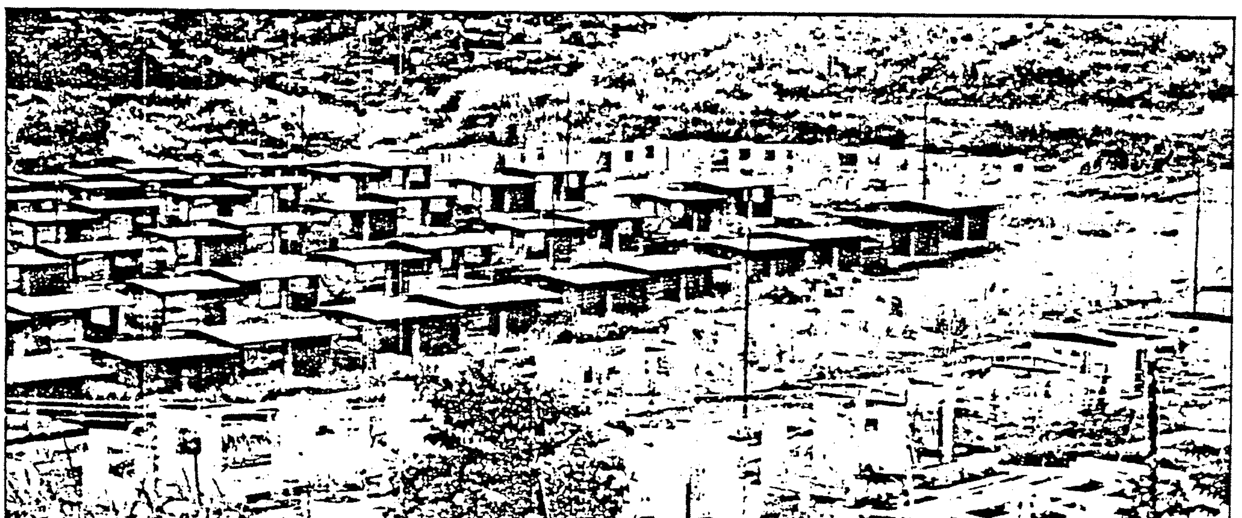
The potential for generating investment capital for shelter from individual and institutional savings far exceeds that available from public funds. The formal private sector also generally commands superior technical and managerial expertise to that found in government due to its focus on individual performance. As a result, they usually can perform a particular task more efficiently and at lower cost than a public agency.

To a large extent, however, the formal private sector has been providing generally high quality and relatively expensive shelter for a limited segment of the housing market, ignoring a broad range of unmet need among low-income households. Unlike governments, the private sector is not obligated to respond to public expectations or social need. This suggests that appropriate government action will also be required to create the climate needed to encourage additional private sector participation in the provision of shelter and to solve those problems that individuals and private sector institutions cannot solve alone. Generally, public sector efforts are required to facilitate access to land and secure tenure, to provide adequate infrastructure and to generate sufficent long term credit for housing.

AID's shelter strategy views individuals and formal and informal private sector institutions as the proven producers of housing and the government as the facilitator of increased private participation, which also undertakes those tasks that the private sector cannot accomplish. AID concentrates on working with officials from less developed countries to formulate national shelter policies and implementation strategies. It engages in a dialogue on policies and appropriate reforms that will set in motion the forces to increase the supply of housing to meet existing and future demand.

Developing countries that have most effectively met their shelter

→ 12



A housing project in Panama City financed under the AID housing guaranty programme.

← 11

needs have adopted, at least to some degree, a number of common policies that help explain their success. The substance of the dialogue between AID and developing country governments centres on six basic policy elements or objectives.

The first element is an investment policy that recognises the significance of shelter production to the national economy. Developing country governments of all political philosophies are faced with difficult decisions regarding the allocation of limited fiscal resources among different sectors of the economy. The financing of housing and urban services must compete with the investment needs of industry, agriculture, education and other sectors. In making these choices, a common misperception is that investing in shelter uses scarce capital resources without producing as many economic benefits in terms of employment and capital formation as, for example, manufacturing and agriculture.

Shelter does, however, make a significant impact on national and local economic development. Because it is labour intensive, construction creates a high level of employment per unit of investment. Housing construction supplies about 10% of all jobs in developing countries. It also generates demand for construction materials, furnishings and related goods and services which translates into jobs in the manufacturing and services sectors. On average, each construction job generates one additional housing related job.

Thus the shelter industry can play a powerful role in economic development as a creator of employment and a stimulant to investment, while also directly benefiting society through improved living conditions. This increased production does not, of course, assure equity in the distribution of shelter, and the need for some social investments will remain.

A second policy objective is a high degree of reliance on market systems and the private development of housing. Although some regulation is needed, both to protect public health and safety and to improve the efficiency of the development process, in many countries the competitiveness of the housing market is severely restricted. Governments may regulate the flow of finance, restrict the development of residential land, control rents, or subsidise housing for selected groups. These and similar market interventions are often counterproductive and hinder private sector shelter activity.

For example, credit and interest rate controls designed to modulate the money supply or to target credit resources for specific purposes often crowd low income borowers out of the credit market. As a result credit is made available only to those who already have resources and whom financial institutions consider the most creditworthy.

A third key policy thrust is cost recovery in the provision and maintenance of housing and urban services. The objective of full cost recovery is to provide revenues that cover the cost of the investment and generate resources that can be invested in additional housing. Cost recovery first and foremost requires that the bills due are collected in a timely fashion. It also argues for eliminating interest rate subsidies, charging market prices for government owned or controlled land, and establishing appropriate user charges for basic infrastructure and services.

Although the private sector must fully recover costs and make a profit in order to stay in business, government is often less concerned with recovering costs than with producing social benefits. Cost of recovery, however, is an important management tool to increase the impact of scarce government resources and produce shelter solutions at a scale adequate to meet the growing needs.

If government elects to absorb some costs, it should do so consciously, considering the budgetary impacts of the decision, and ensuring that the subsidies have been carefully targeted to the disadvantaged. Unfortunately, the housing sector is loaded with subsidies that distort decision-making, are usually inequitable, and are fiercely defended by the current beneficiaries.

A fourth key policy objective is the adoption of affordable, appropriate standards for housing, infrastructure and other urban services. Governments protect the health and safety of the public by establishing standards for land use and development densities; for the level of infrastructure and services to be provided; and for the

→ 14

Core housing project in Honduras, financed under the housing guaranty programme.

←12

design and structural qualities of the building to be constructed. Standards are a legitimate means of protecting public health and safety, but they cannot be used to improve people's living conditions above a level they can afford. While the objective may be admirable in terms of social benefit, the approach is counter-productive if people cannot afford shelter and services when they are built to official standards.

In many instances, the growth of illegal (unauthorised) settlements can be directly attributed to the existence of excessively restrictive standards. The establishment of realistic standards that conform to affordability criteria is one of the most effective actions government can take to encourage the private sector to produce serviced land and shelter for low income households.

A fifth strategic policy objective is to adopt rational administrative procedures that encourage private investment in housing and land development. The cost of housing is significantly affected by the time required to obtain approvals to proceed with construction, secure financing, close a loan, or clear some other administrative step in the long process of shelter production.

Administrative delays can deter private entrepreneurs from investing in low income shelter construction because the small margin of profit associated with such projects can quickly be absorbed by unexpected time delays. Streamlining administrative procedures can be effective in

The Office of Housing and Urban Programs of the US Agency for International Development

THE OFFICE of Housing and Urban Programs of the Agency for International Development has been providing capital and technical assistance for shelter and urban programmes for 25 years. The principal source of capital assistance has been its Housing Guaranty (HG) Program, under which AID guarantees the loans of private US banks, insurance companies, pension funds and savings and loan associations, in the long term financing of basic shelter and infrastructure for lower income families in less developed countries (LDCs). The cost to the borrowing countries is comparable to that of World Bank loans.

The central office is supported by seven Regional Housing and Urban Development Offices (RHUDOs) that are responsible for identifying, designing and managing shelter projects in their respective regions. They are located in Tegucigalpa, Kingston, Panama, Tunis, Nairobi, Abidjan and Bangkok. A relatively small Washington office provides oversight and support through its Operations Division and leadership in policy and programme development through its Policy and Urban Program Division.

The HG Program was enacted in the US Foreign Assistance Act of 1961. To date, 41 countries have received assistance under the HG Program in developing their own housing finance institutions and in mobilising savings to help meet the housing needs of their populations. At the end of fiscal year 1986, $1.5 billion was under contract in 148 projects. During fiscal year 1986, £145 million was authorised for new projects around the world.

The fundamental goal of the programme is to help achieve comprehensive, rational strategies for meeting the shelter needs of the poorer half of LDC populations. AID is convinced that the world shelter problem can be resolved in a finite time frame with existing resources if the right policies are pursued. The HG Program works with LDC leaders in designing and implementing policies that create the climate that will permit individual initiative and the private sector to produce the needed housing. Government has an essential role to play in the provision of infrastructure and in facilitating the availability of land and financing, but has not been an efficient producer of housing.

In the 1960s AID provided technical assistance and loan resources to help create private savings and loan systems throughout Latin America. These institutions have undergone significant changes in the intervening years, but most continue to flourish, mobilising resources from savers and investing them in housing. Now the HG program is worldwide and AID supports private financial institutions in countries as diverse as Barbados, Bolivia, India, and Kenya.

In Bolivia, for example, $15 million in HG funds and $1.65 million in technical assistance are programmed to strengthen the Central Savings and Loan Bank (CACEN), the privately owned regulatory and representative body for the S & Ls, as well as improve the management and financial base of its members. In Haiti, AID actively encouraged the founding of the privately held Banque de Credit Immobiliere (BCI), the first financial institution in the country to specialise in financing housing. Despite difficult ecnomic and political circumstances, BCI has generated over $2.3 million in savings and made more than 80 loans valued at $2.4 million in less than one year of operation. In addition to technical assistance, AID is lending $10 million to the Barbadan Government, which it is on-lending to commercial banks and credit unions. As a result of this project, commercial banks now lend to low-income households using their own resources. ■

SHELTER POLICIES

lowering the cost of housing generally and in stimulating greater private sector involvement in the production of low income shelter.

The final key policy objective is to develop and support efficient institutions, both public and private, that are capable of participating in the production and finance of shelter and urban development. The full benefits of private initiative can be realised only in a supportive environment in which the basic public responsibilities are executed efficiently and private sector institutions have the capacity to participate.

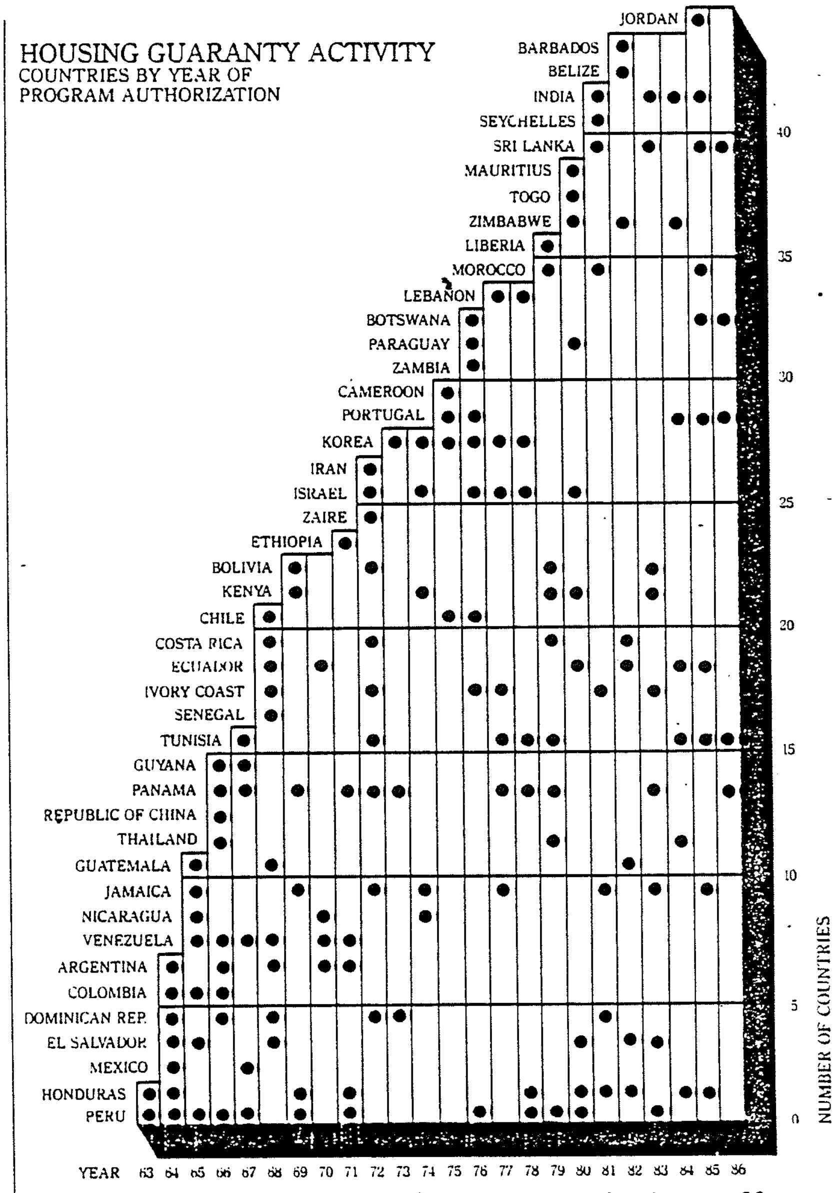
It is particularly important to support institutions that serve people at a local level, such as neighbourhood associations, and to strengthen local governments, which have the greatest ability to assess local needs and elicit individual and private sector support.

Through its Housing Guaranty Program and related assistance resources, AID works with developing countries to formulate national policies and implement projects which embody these concepts to support the resolution of the world shelter problem. AID believes that the shelter problem can be solved and that — perhaps within a single generation — with the resources now available, the goal of an adequate, basic house for every family is achievable. This will happen only if the human and financial resources of individuals and private sector enterprises can be mobilised for the task.

It is the role of government to facilitate and encourage this participation, and intervene only where the private sector cannot solve the problems. A consensus is emerging among the major donor agencies involved in shelter, including the World Bank and the United Nations Centre for Human Settlements (Habitat), that this approach has great potential for achieving the goal of providing decent, basic shelter for all.

The UN has designated 1987 as the International Year of Shelter for the Homeless. This is an appropriate opportunity for developing countries to examine their shelter policies and make renewed commitments to expand housing opportunities for the poor. ■

HOUSING GUARANTY ACTIVITY
COUNTRIES BY YEAR OF
PROGRAM AUTHORIZATION



PETER KIMM has directed the shelter and urban programmes of the United States Agency for International Development for the past 20 years. He has been directly involved in shelter and urban strategies in more than 50 countries in Latin America, the Caribbean, Africa and Asia, and has written and spoken widely on these matters. He likes to say that he has made every mistake that it is possible to make in this sector.

The financing of housing in Brazil

Luiz Eduardo Pinto Lima explains measures taken by the Brazilian authorities to improve the country's housing situation, against a background of endemic high inflation

UNTIL the establishment in 1964 of the Sistema Financeiro de Habitação (SFH), the Financial System for Housing, there was virtually no mechanism for financing the production of housing in Brazil. Only 120,000 dwellings had been produced and financed with budget resources from government and parastate departments such as caixas econômicas (savings banks) and the Institutos de Previdência (social security system). Approximately 50% of the population of 75 million, requiring around eight million dwellings, were not catered for.

The problem of the lack of popular housing in Brazil was fundamentally financial by nature. The system in force until 1964 had no defence mechanism against the inflation that, since 1940, has been endemic in the country. This discouraged both the accumulation of savings for housing and investment in housing.

The creation of the Financial System for Housing

With the accelerated and disordered process of urbanisation which occurred as a consequence of the industrial boom of the 1950s, it was necessary to create a specialised system that, besides catering to the growing needs of housing, infrastructure and basic sanitation, would handle the massive migration of manual workers to the urban areas.

In this context, SFH was conceived in 1964 to allow large segments of the population, especially those on low

incomes, to purchase their own homes, as well as promoting urban development in a rational form, assuring adequate standards of health, safety and welfare generally.

The basic condition for making the system viable was the institution of monetary correction, created with the objective of acting as an instrument of stabilising and minimising the social costs generated by inflation. Its introduction in Brazil was associated to the problem of the budget deficit.

Originally the housing system had a central department, the Banco Nacional de Habitação — BNH (National Housing Bank), which coordinated the sub-systems shown in the chart. It carried out regulatory, guidance and inspection functions.

The BNH managed resources that derived from the collecting of compulsory savings from workers, administered by companies. The collecting was done by banks and the savings earn interest at 3% a year, plus quarterly monetary correction.

Besides the compulsory savings and profit from its operations, BNH could obtain possible budget allocations from the federal government and also resources from abroad. The BNH operated in these sub-systems as a second line bank, passing on resources by means of public and private agents who were responsible for carrying out the programmes, acting as financial agents and/or promoters.

The SBPE sub-system — Sistema Brasileiro de Poupança e Empréstimo (the Brazilian System for Savings and Loans) could act as a channel for BNH resources in the housing programme intended for the low/medium income population. It is, however, a subsystem where the action of financial conglomerates predominates. With a vast network of branches, and by means of the savings account, they made the SBPE the holder of the second largest amount of nonmonetary financial assets in the country.

The organisations that make up SBPE comprise three categories: Sociedades de Crédito Imobiliário — SCI (Societies of Housing-Financing Credit), private companies organised

MONETARY CORRECTION

in the form of profit-making business corporations, and the State and Federal Savings Banks.

The SBPE's main source of funds — the savings account — gives depositors a return of 6.14% per annum, plus monetary correction, credited quarterly. Other sources of SBPE funds are housing finance notes — bonds that are totally guaranteed with a minimum maturity date of one year and interest rates of 6% per annum, as well as monetary correction — own funds, and profit.

Institutions must direct 60% of the resources obtained through savings accounts and housing financing notes to real estate investment, distributing the remaining 40% as follows:

20% collected by financial agents compulsorily so as to supply participants' possible cash needs;

20% on average maintained in liquid assets such as cash, government bonds, etc, and investments in the real estate sector, which by its characteristics of term and remuneration are more profitable, for example, financing of working capital for companies producing building materials, or commercial leasing of real estate.

In 22 years the Financial System for Housing financed approximately 4.5 million homes, an impressive figure compared with the 120,000 homes financed up to 1964. SIFHAP (the financial system for popular housing) accounted for 2.6 million units, and SBPE (the Brazilian system for savings and loans) accounted for the remaining 1.9 million. In May 1986 the resources of the total system amounted to US$32.2 billion, made up of US$9.6 billion in the Guarantee Fund for Time of Service and US$22.6 billion in the savings and loan system.

In terms of resources, voluntary savings, represented by the savings accounts, are greater than the compulsory savings represented by the FGTS and account for 31% of the non-monetary financial assets.

The basis of the economic equilibrium of the system was the principle of monetary correction. When the SFH was instituted it was established that the balances of the asset and liability operations should be corrected on the same date and in the same space of time. This principle guaranteed the full return of the amounts loaned, duly corrected, in such a way that there would be a possibility of re-investing and expanding the business.

For this, the borrowers' instalments were adjusted every quarter, accompanying the adjustments of the debt which, in turn, followed the corrections of the savings deposit.

In this spirit, the Unidade Padrão de Capital — UPC (the standard unit of capital) was conceived. It became the currency of the system and corresponded to the variation in monetary correction in each calendar quarter, always calculated on the first day of the calendar quarter. It should be noted that the model adopted was based on the hypothesis that the repayment of the loan should, when re-invested, keep its value in UPCs unaltered.

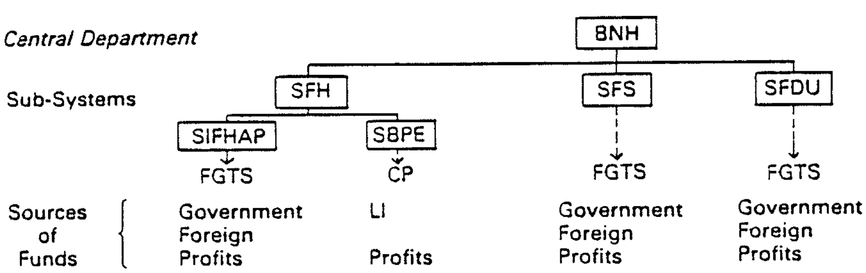
As the borrowers' salary adjustment was, in general, annual, a new plan for financing was created where instalments began to be adjusted yearly in accordance with the variation of the minimum wage. The balance of the financing was still corrected each quarter by the UPC.

Because of the unequal periodicity of the different indices adopted, for the correction of the instalments and of financing balances, once the contract maturity was reached there might still be a balance to amortise,

→ 18

Non-Monetary Financial Assets, September 1986

Category	Amount US$ bn	Percentage of total
Savings accounts	22.6	31
Federal public bonds	25.9	36
Time deposits	16.2	23
Municipal and state bonds	4.2	6
Bills of exchange	2.8	4
Totals	71.8	100



BNH — *Banco Nacional de Habitação* (National Housing Bank)
SFH — *Sistema Financeiro de Habitação* (Financial System for Housing)
SIFHAP — *Sistema Financeiro da Habitação Popular* (Financial System for Popular Housing) (Low and Low/Medium Income)
SBPE — *Sistema Brasileiro de Poupança e Empréstimo* (Brazilian System for Savings and Loans) (Medium and Medium/High Income)
SFS — *Sistema Financeiro de Saneamento* (Financial System for Sanitation)
SFDU — *Sistema Financeiro de desenvolvimento Urbano* (Financial System for Urban Development)
FGTS — *Fundo de Garantia por Tempo e Serviço* (Guarantee Fund for Time of Service) (Compulsory savings)
CP — *Caderneta de Poupança* (Savings Account) (Voluntary savings)
LI — *Letras Imobiliárias* (Housing Financing Note) (Voluntary savings)

←17

requiring an extension of the financing period.

In order to guarantee to the borrowers of these plans a time limit for amortising the debt, the Fundo de Compensação de Variações Salariais — FCVS (Fund for the Compensation of Salary Variation) was created, administered by the BNH, with resources originating from a contribution of those financed and of the financial agents. The FCVS guaranteed the borrower the entire amortisation of the debt, following an extension in the terms of financing of, at most, 50% of the initially contracted term.

Later, the Plano de Equivalência Salarial — PES (Plan for Salary Equivalence) was instituted where the quarterly corrections of the debt by the UPC and the instalments, yearly, by the variation of the minimum wage, were maintained, but a fixed number of instalments was guaranteed. If there was a residue of

'Real inflation higher than estimated'

the balance, this would remain under the responsibility of the FCVS.

The guarantee of a fixed term would, theoretically, be obtained by means of the use of a multiplier on the instalments. This multiplier was fixed, based on the estimates of future inflation, and was used to eliminate the effect of the monetary correction used at different periods on the instalments (annually) and on the balance (quarterly). This plan entailed a risk, should inflation be under-estimated. In this case the multiplier would be insufficient and the balance would not be paid within the term — in other words, there would be a residue to be paid by FCVS.

In 1977 the instalments again began to be corrected officially by the annual variation of the UPC.

In 1979, when the change in salary policy established a six-monthly adjustment, the adjustment of the instalments remained annual. If the six-monthly policy for instalments had been adopted at this time the system would have recovered the equilibrium that had been compromised by the under-sized multiplier of the instalment. Real inflation was already higher than that estimated for the multiplier.

In the period 1981 to 1984 the country was plunged into a deep recession resulting from a policy of adjustment of the economy to the needs of the foreign sector. Besides seriously increasing unemployment, the adjustment led to a squeeze on salaries.

Paradoxically, inflation was not reduced with a tight monetary policy, while the government forced the maintenance of high interest rates.

The consequences for the SBPE were serious:

a. Draining of resources from savings accounts to other assets where interest rates were flexible.

b. A squeeze on the margins of participating financial institutions.

c. Increase of the future commitments of the FCVS as a result of the acceleration of inflation, as the multiplier of the instalments to accelerate amortisation within the term of contract was designed for inflationary rates lower than those which occurred.

d. Reduction in the saving capacity of the economically active population, reducing the resources for new financing.

e. Reduction in compulsory saving by the BNH, as a result of unemployment and the reduction in real wages.

f. Contraction of the demand for housing, engendering an accumulation of stocks and threatening the solvency of builders financed by the system.

g. Reduction of real house prices, threatening the security of lending institutions.

h. Liquidation, merging or incorporation of several SBPE institutions, mainly those not associated with financial conglomerates, placing the credibility of the system at risk.

To deal with those serious problems, some remedial measures were adopted:

1. Transformation of the term of credit of the three-monthly yield of *Caderneta de Poupança* (savings accounts) to a monthly yield, to maintain the attractiveness of this instrument in face of the improvements in competitive investments. This measure stabilised the flow of the savings accounts, leading to a recovery in savings deposits, but it also had negative consequences:

Increase in operational and financial costs.

Increase in the instability of the liabilities as a result of the greater liquidity.

Imbalance in the periodicity of the monetary correction. The assets continued to be corrected every three months; the liabilities began to be corrected monthly.

2. In order to solve the problem of insolvency and consequent default of

'Concessions made to borrowers'

house purchasers financed by the SBPE, a series of concessions was made to borrowers which resulted in the reduction of the real value of the instalments owed. For example:

Concession of discounts on the value of the instalment for the period of one year.

Adjustment of the yearly instalment by the index corresponding to 80% of the variation in the minimum wage (valid for one year only).

Adjustment of the annual instalment by the index corresponding to about 50% of the annual variation in monetary correction, with the condition that the following adjustments would be six-monthly, according to the variation in the salary of the professional category to which the borrower belongs.

The adoption of these measures helped deal with the more urgent problems, but left serious difficulties for the future, the principal one being the increase of the residue of the debt existing at the end of the contract, thus increasing even more the FCVS commitment for the future.

The SBPE was affected by the substantial alteration in the normal pattern of loan payments as a significant part would be received only at the end of the contracts by means of the balance of the debt, via the FCVS. The alteration was so large that many operations began to experience negative amortisations, that is, the instalment was not sufficient to cover even the monthly interest on the financing. There was also a reduction in profitability as a result of the increase in costs and a slower asset turnover.

At the beginning of 1986, in spite of the recovery of the economy begun in the second quarter of 1984, the macroeconomic scene was worrying. The good performance in 1985 had resulted from a policy that encouraged growth and an increase in employment to the detriment of inflation. The latter threatened to run wild, severely burdening the public debt and discouraging private investment essential to the continuity of economic growth.

This was aggravated by the generalised system of indexation which hampered any gradualist policy of fighting inflation. The apparent defence of real incomes rendered the structure of relative prices rigid, in a continuous process of rekindling inflation.

The Cruzado Plan

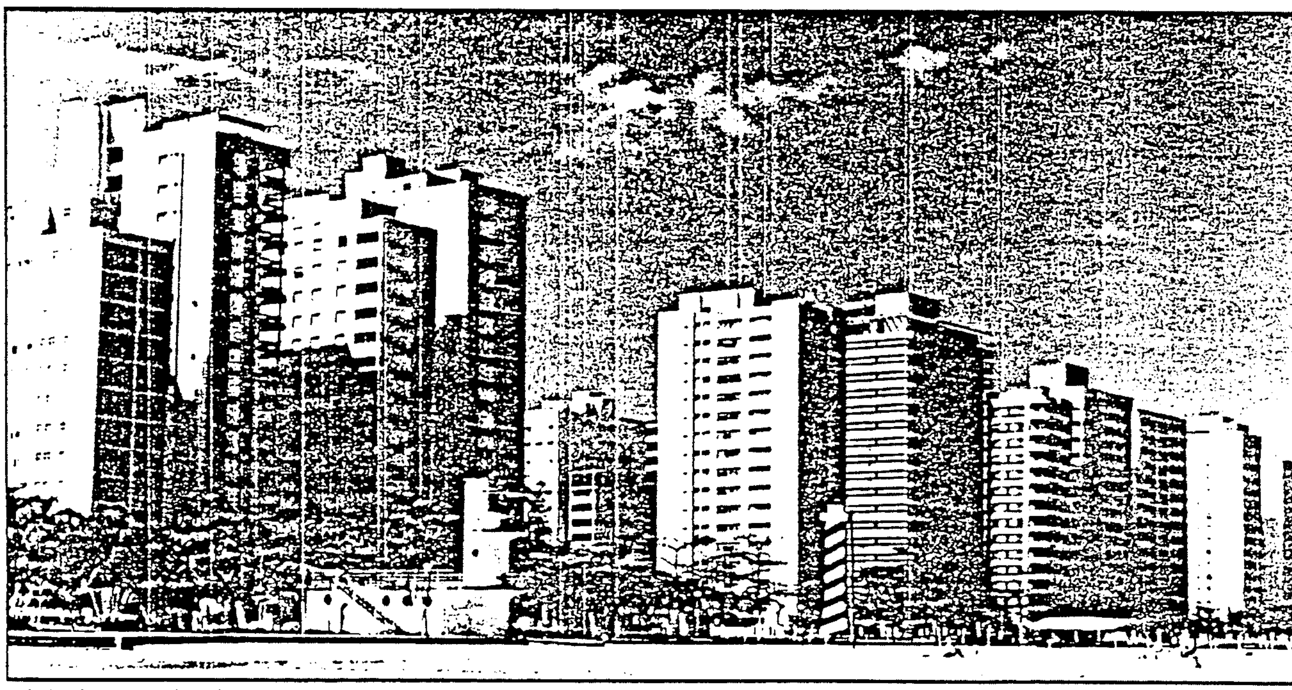
On 28 February, 1986, the government decreed the monetary reform, popularly known as the Cruzado Plan, which partially did away with monetary correction, retaining it only for savings deposits, FGTS deposits and other labour funds, and also for contracts with a term over one year. Under the plan, the exchange rate was fixed and all prices, salaries and rents were frozen.

Salaries were updated by the real average of the salaries earned in the six months before March, increased by a bonus of 8%. A guarantee of a new adjustment was established, should the accumulated inflation reach 20%.

Rents were adjusted by the same criterion as the salaries, without the additional 8%, but with differentiated indices for the calculation of the real average. Residential rents were corrected below salaries, instalments in the SFH and also below commercial rents. In the field of the SFH, a number of measures were taken:

1. Freezing loan repayments for a year, after an updating similar to salaries, but excluding the addi-

→ 20



High rise housing in Rio de Janeiro.

←19

tional 8%. Had the government included the 8% in the instalments it would have helped to rectify some of the problems which had arisen over the previous few years.

2. Interruption of the monetary correction of the debt balances for one year. During this period the correction would be applied only in the case of extra amortisation, financing transfers and anticipated discharge of the debt.

3. Change in periodicity in the credit of the yield of the savings accounts, which is once again quarterly.

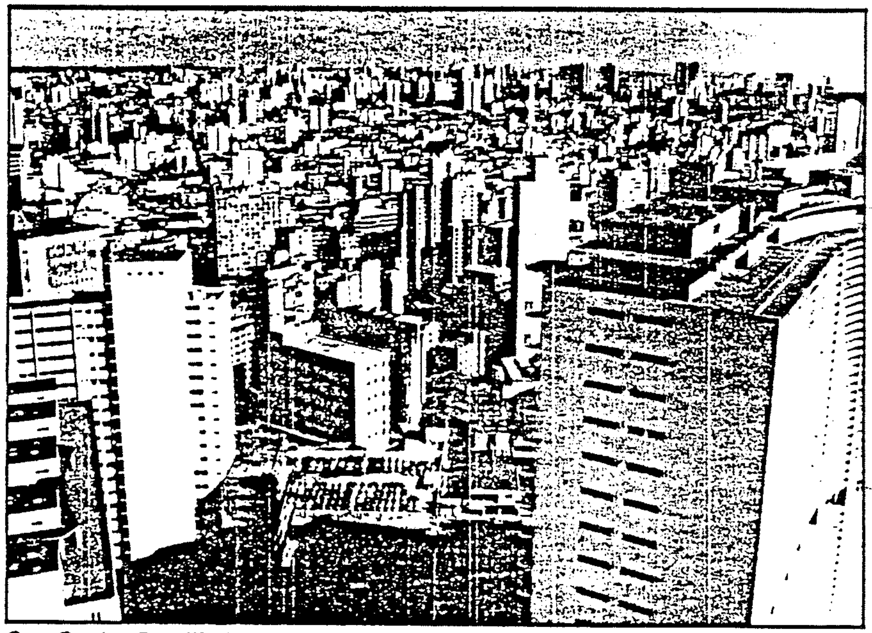
4. Maintaining the monetary correction on savings account balances.

The fact of suspending the correction of the balance of the debt for one year, and keeping it for the savings accounts, accentuated the distortion that already existed, on a lesser scale, when the savings accounts began to be remunerated monthly and the debt balances were corrected every quarter.

The monetary correction paid on the savings accounts is calculated on the average balance of the quarter. The interest is calculated on the balance of the savings account, after the correction has been added. For loans, the correction will be calculated on the balances of February 1987. During the period of the freeze the interest is being calculated on an uncorrected balance, and that is being amortised monthly. The impact of the Cruzado Plan on the SFH was intense.

In spite of the real increases in salaries and the strong growth in employment and salaries, there was a massive withdrawal of resources from the savings accounts. The savers did not immediately accept the increase in the term of redemption and the reduction of the nominal yields. They were used to high rates of monetary correction before the Cruzado Plan (the rates of the two months preceding the Plan were 16.23% and 14.36%).

High inflation afforded high nominal yields, giving rise to the so-called phenomenon of "monetary illusion." When interest was credited, the saver withdrew not only the part referring to the interest, but also that referring to monetary correction, without perceiving that they were, in fact, reducing the invested capital.



Sao Paulo, Brazil's industrial capital.

Savers preferred to direct their resources towards consumption or to assets which greatly increased in value in the new situation, such as shares and real estate. The latter experienced an unprecedented increase in value, as the importance acquired by the safety factor, in relation to the liquidity, was a function of the prospect of stability of inflation at low levels.

In the first two months following the announcement of the Cruzado Plan, losses on savings accounts came to approximately US$3.6 billion, corresponding to 16% of the overall balance of deposits, which in February were US$21.9 billion. Later, with the repressed demand relatively satisfied, with the drop in stock exchanges due to the realisation of profit and with the awareness that the real yield of the saving accounts remained unaltered, maintaining its competitiveness with other financial assets, a slow recovery of deposits began.

Even so, the year 1986 ended with a negative net increase, which had never before occurred in the history of the system.

The negative impact of the savings accounts reflected immediately on the profitability of the participating institutions. The massive withdrawals of resources affected the liquidity of the institutions, forcing the sale of short-term assets, and rendered the granting of new financing non-viable. Financing was largely confined to the construction phase. This was of no help to the great majority of the population, who saw the housing problem aggravated.

The government recently issued a series of measures to correct the distortions generated by the Cruzado Plan. The objectives were to reduce excessive demand, to encourage financial savings, to create exportable surpluses and to reduce the public debt. The path adopted was to penalise consumption via fiscal policy.

The measures included sweeping changes in the whole housing finance system:

a. The abolition of the National Housing Bank (BNH) and the transfer of its operations to the Federal Savings Bank, a department linked to the Ministry of Finance that already acted as a financial agent in the SBPE. The Federal Savings Bank has two functions. It maintains its status as an institution within the SBPE, financing housing with resources from the savings account, and it will start to give priority to catering for social housing. These latter operations will include housing finance for low income households using budgetary allocations and infrastructure and basic sanitation work with FGTS resources.

b. The guidelines for the housing policy continue to stem from the Ministry of Urban Development and the Environment.

c. SBPE regulation was transferred to the Central Bank of Brazil. The SBPE, where voluntary savings predominate, begins to cater for the middle class. Its activity will be less regulated, and its new profile will receive a more financial treatment. The new allocating structure of the resources obtained will, in principle, be in the following form:

20% — compulsory liquidity with the Central Bank.

60% — financing for housing, 50% being in operations within the traditional pattern (controlled interest rates, with ceilings and predefined term) and the remainder in freely negotiated operations with borrowers with higher financing values, at market rates of interest.

20% — other real estate operations.

d. In order to increase the competitiveness and attractiveness of the savings account, and to recover the losses suffered after the announcement of the Cruzado Plan, the period of crediting interest was changed again from quarterly to monthly.

e. The SBPE can now count on a new type of savings account known as the Peculium Account. This is the same as the traditional savings account in terms of interest rates, monetary correction periodicity and exemption from income tax on the yield. Its attraction and differentiating element is the tax benefit. The depositor may discount up to the limit of 30% of yearly income in salary, subject to taxation, US$7,087. The deposit must be for a minimum of five years. The SBPE can also obtain savings deposits at a yield of 6.14% and monetary correction, with interest taxed at 35%.

f. Another measure that will affect not only the SBPE but the whole economy is the new criterion for calculating the monetary correction. This is no longer indexed to the official rate of inflation but will be measured by the remuneration of the Letra do Banco Central — LBC (Central Bank Bonds). This is a short-term federal bond that is backed by the overnight operations.

'Savings should return to previous levels'

In this way, asset and liability SBPE operations begin to be corrected by the new index. The criterion for the correction of the instalments of financing for housing still has to be clarified. Today, it follows the variation in salaries which, in turn, follows inflation. Should this criterion remain, there will always be the risk of long-term operations with different indices of monetary correction. The applying of the correction to the balances of the financing for new housing is now with the same periodicity of payments of the instalments. For old contracts, it is still effected each quarter.

The definitive profile of the new housing system depends on additional measures and on the regulation of the measures already announced. Only then will a more accurate analysis be possible of the effect of the alterations in the SBPE.

It is important to emphasise that, to solve the great housing problem in Brazil, the guidelines of a housing policy must consider housing in its broad concept. Until today, the importance of a "house of one's own" has been emphasised, but the need for housing can be catered for much more effectively if houses for rent are encouraged as a first stage in housing. In other words, the aim should be to afford a home — but not necessarily one's own.

For SBPE, the expectations are optimistic. The recent economic policy measures should normalise demand, and savings should return to their previous levels, allowing a resumption of financing.

Within the guidelines recommended by the government, not to abandon the growth of the economy and to preserve the salary gains of the lower income classes, the SBPE and its role as a channel of resources for the area of civil construction, which has a strong multiplying effect on employment and on incomes, represents an important alternative of economic growth without inflationary pressures and without an impact on the balance of payments. ■

LUIZ EDUARDO FERREIRA PINTO LIMA is director of capital for Unibanco, the Brazilian banking group. He is managing director of four housing credit company subsidiaries of Unibanco. He is vice-president of ABECIP (the Brazilian Association of Housing Credit and Savings Agencies) and president of ACRESP (the Sao Paulo Association of Housing Credit and Savings Agencies). He is also a vice-president of IUBSSA.

A third world housing finance success story

How the Housing Development Finance Corporation is helping to tackle India's housing problem

THROUGHOUT the third world, it is now recognised that housing finance institutions can themselves contribute towards the solving of acute housing problems. However, in most developing countries, such institutions have only scratched the surface of the problem and, in some cases, institutions have been established only to wither away or to develop into more wide-ranging financial institutions. One institution which stands out against this general trend is the Housing Development Finance Corporation in India. It is one of the few purely private sector institutions, without significant government backing, which has made a significant direct contribution towards dealing with acute housing problems and, moreover, it is an institution which is dedicated to sharing its experience with others in India and outside.

The development and role of this unique organisation is described in this profile, written by the editor of Housing Finance International, *Mark Boleat.*

IT IS difficult for those in Western countries to understand the magnitude of the housing problem in a country like India. The numbers alone illustrate the size of the problem. It is estimated that in 1985 there were 135 million households but only 111 million serviceable housing units, giving a shortage of 25 million units. Furthermore, it is anticipated that the problem will get worse rather than better. Projections made by the National Buildings Organisation are that by the year 2001, the number of households will have increased to 187 million but that the number of housing units will have increased to only 148 million, resulting in a deficit of 39 million units.

The poorest people in India have nothing which can be called a home. In the major cities there are massive squatter settlements, and many other people do not even have any roof over their heads; instead, they sleep on pavements. Faced with such an enormous housing problem, it is difficult to know where to start. State governments have constructed large quantities of housing for low income people, but often this is badly built and after only a few years shows signs of serious deterioration.

Private sector institutions cannot hope to help the economically weaker sections of the community, while remaining viable institutions themselves. However, even for those who are able to afford modest housing, there has been a lack of a housing finance mechanism to help them to purchase their own homes. It is

against this background that the Housing Development Finance Corporation (HDFC) has rapidly established itself as a pioneer in housing and housing finance activities in India.

The establishment of HDFC

HDFC is the brainchild of one of the outstanding figures in finance in India, H. T. Parekh, who developed the idea of a private sector housing finance institution in the early 1970s. His idea was backed by a development bank of which he was chairman, the Industrial Credit and Investment Corporation of India. A feasibility study on the institution was presented to the World Bank, which passed it on to the International Finance Corporation which, in turn, conducted its own feasibility study.

IFC decided to back the institution with some equity capital of its own. A final partner was the Aga Khan, and these three groups each contributed 5% of the initial share capital. HDFC then made a public issue of capital in 1978, and this received overwhelming response from the public and from institutions.

HDFC is a company established under Indian company law with a widespread shareholding. In June 1986, it had over 14,000 shareholders. Companies hold 48% of the shares, banks 15%, individuals 14%, financial institutions 13%, insurance companies 3% and others 5%.

The managing director of HDFC is Deepak Parekh, a London trained accountant who was formerly with Chase Manhattan Bank. He is chairman of the Housing Finance Development Committee and a vice-president of IUBSSA. Pradip Shah, a Harvard MBA who helped set up HDFC, is general manager. Four other general managers complete the senior management team: D. M. Satwalekar (finance and planning), G. W. Kshirsagar (resources), Nasser Munjee (human resources) and T. S. Chandrasekhar (HDFC developers).

Resource mobilisation

The problem for any financial institution in developing countries is the mobilisation of resources. While people may have substantial savings, these are often held in a physical form, and there is a wariness in investing in institutions which are seen to be remote. A newly-established institution faces particular problems in this respect, especially in India where most of the banks are nationalised, and where the Government offers very attractive tax free returns on some of its own instruments. HDFC has, therefore, not been able to mobilise large amounts of personal savings.

Its main source of funds is its certificate of deposit scheme. The certificates have a mimimum denomination of 2,000 rupees (about $150), and a maturity of between six months and five years. Currently the rate of interest varies from 9.5% for six month certificates to 12% for 12 month certificates.

A slight variation of this scheme is the cumulative interest scheme, by which interest is compounded each six months rather than paid out annually. There is the same minimum denomination as for the normal certificate of deposit scheme, and maturities range from two years to five years. Current rates of interest vary from 11% for two year certificates to 12% for five year certificates.

HDFC has as yet made little progress in tapping the personal market, although it is conscious that it needs to do so to maintain its development. Its main scheme for attracting personal savings is the loan-linked deposit scheme. This is a flexible variation of the more formal contractual schemes operated, for example, in France, Germany and Austria. An initial deposit of 200 rupees must be made, and a savings period of between 18 months and five years is chosen. Savings carry an interest rate of 9%.

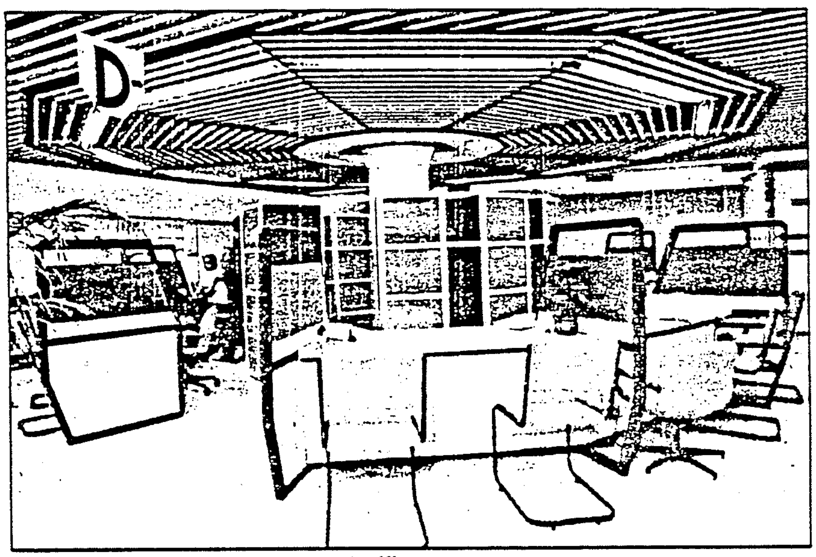
After completion of 18 months' saving, and provided there is a minimum amount in the savings account, the saver becomes eligible for a housing loan based on the amount deposited, and the repayment capacity. The maximum housing loan under the scheme is 200,000 rupees ($15,000). Interest earned on deposits up to 7,000 rupees is tax free. However, the scheme does not have to be used for housing loan, but can simply be used as an attractive savings scheme in its own right.

More recently, HDFC has introduced a formal contractual scheme in the form of the homes savings plan, which is greatly influenced by the Bausparkasse system in West Germany. Savings under this plan attract a rate of interest of 6%. At the end of the savings period a loan is available at a low rate of interest of 8.5%, and the loan must be repaid over 12 years. The scheme has only recently been introduced, and accounted for a modest 3 million rupees of deposits at the end of June 1986.

HDFC obtains much of its funds through loans and bonds. It has three outstanding 12.5% bond issues, redeemable between 1992 and 1996, and totalling 300 million rupees ($23 million). At the end of June 1986, banks had loans outstanding to HDFC of 438 million rupees ($34 million). Other sources of funds included the Army Group Insurance Fund (150 million rupees), the Life Insurance Corporation of India (100 million rupees) and the General Insurance Corporation of India (25 million rupees).

HDFC has made particular use of international sources of funds. The International Finance Corporation, in

→ 24



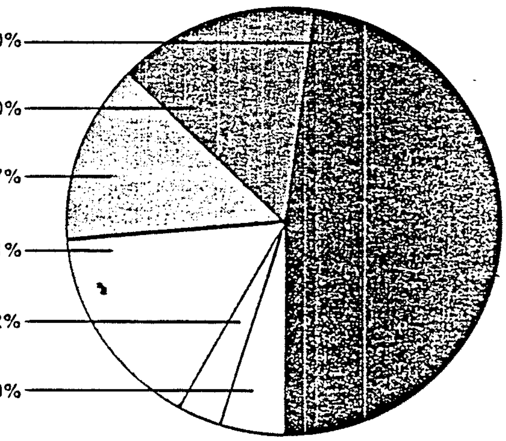
The branch in HDFC's new head office.

← 23
addition to providing equity capital, has a loan outstanding of 14 million rupees. The Corporation has raised $75 million from the US capital markets, under the housing guarantee programme of the United States Agency for International Development (AID). The funds are raised in dollars with the exchange risk being taken by the State Bank of India, the Bank of India and the Industrial Development Bank of India. The AID funds are specifically earmarked for borrowers with incomes below the median for the country.

Lending

Lending for house purchase in India is not the relatively simple matter that it is in most industrialised countries. One particular problem is the security. Such is the legislative process in India that it can take from eight to 10 years for a lending institution to gain possession of a property following the default of the borrower. Lending institutions cannot, therefore, rely on the property alone as security.

It is HDFC's policy to seek two additional guarantors. In addition, if the property is secured by an insurance policy with the Life Insurance Corporation of India (a nationalised body which has a monopoly of life insurance), then that policy must be charged to the property. Obtaining guarantors inevitably takes time, slows up the process of house purchase and is particularly difficult for the low income people which HDFC is trying to assist.

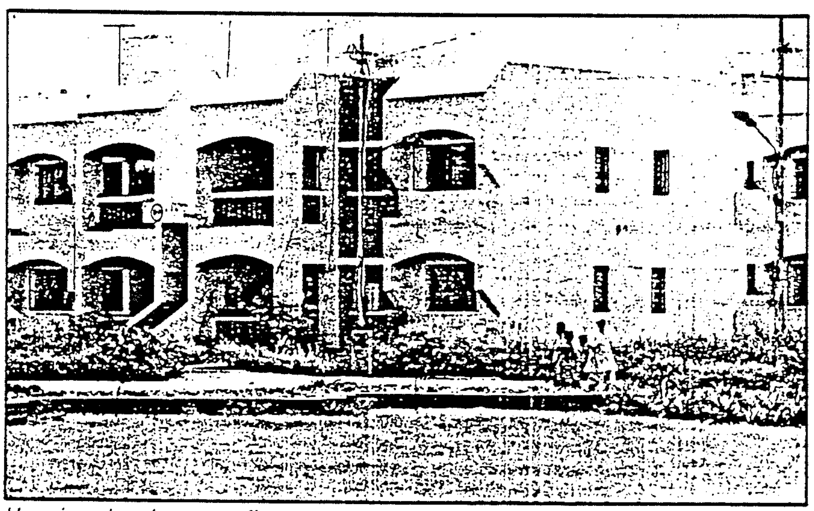


Distribution of HDFC's shareholding

The second problem, particularly related to lower income people, is that of ascertaining income. Many people in India do not have stable jobs with regular pay cheques. In the case of self employed people in particular, it may well be necessary for HDFC lending officers to spend some time ascertaining precisely what the income of the applicant is, and whether he will be able to afford the loan repayment.

HDFC lends mainly for new residential housing, anywhere in India, to individuals, associations of individuals, groups of individuals and individual members of co-operative societies. HDFC makes advances primarily to individuals whose immediate families do not own any dwelling units. Loans will not normally be for less than 7,000 rupees ($540), and the maximum loan to any individual applicant is normally 100,000 rupees ($7,700). Loans do not normally exceed 70% of the cost of the property, including the cost of land. The rate of interest varies according to the size of the loan, from 12.5% for loans below 20,000 rupees to 14.5% for those loans above 100,000 rupees. The repayment period is normally in the range from five to 15 years.

HDFC channels some of its loans through co-operatives and institutional channels. It will give loans to companies for construction or purchase of new dwelling units for the use of their employees. HDFC normally lends up to a maximum of 50% of the



Housing development financed by HDFC.

→ 26

←24
housing project, with a maximum loan per unit of 100,000 rupees ($7,700). The loan is normally repayable within five years at a set rate of interest of 14.5%.

HDFC will also enter into arrangements with companies under which it grants loans to individual employees, or groups of employees, with the company guaranteeing the loans. The rate of interest varies from 13.5% to 14.5%.

In 1985-86, 364 million rupees ($28 million) of loans were channelled through the corporate institutional sector, and 69% of the households benefiting from these schemes had incomes less than 1,000 rupees ($80) per month.

HDFC has recently been involved in a number of new lending initiatives. It has introduced a low start repayment facility, aimed at helping lower income groups and younger professionals to obtain larger individual loans than normal eligibility considerations would permit. It has also provided substantial financial assistance to low income groups, notably through the financing of 5,500 units through the rehabilitation housing scheme for the economically weaker sections affected by natural calamities in Kerala, and also financial assistance for employees of transport corporations.

In anticipation of 1987 as the International Year of Shelter for the Homeless, HDFC has already identified and approved finance, jointly with the Housing and Urban Development Corporation (HUDC), for two projects which are intended to benefit economically weaker households.

Growth

HDFC has grown spectacularly and has constantly had to revise its plans upwards. From a standing start assets passed the $100 million mark at the end of 1982 and then more than tripled by early 1986 and reached $400 million by the end of 1986. Well over 150,000 loans have already been approved. This growth is forecast to continue.

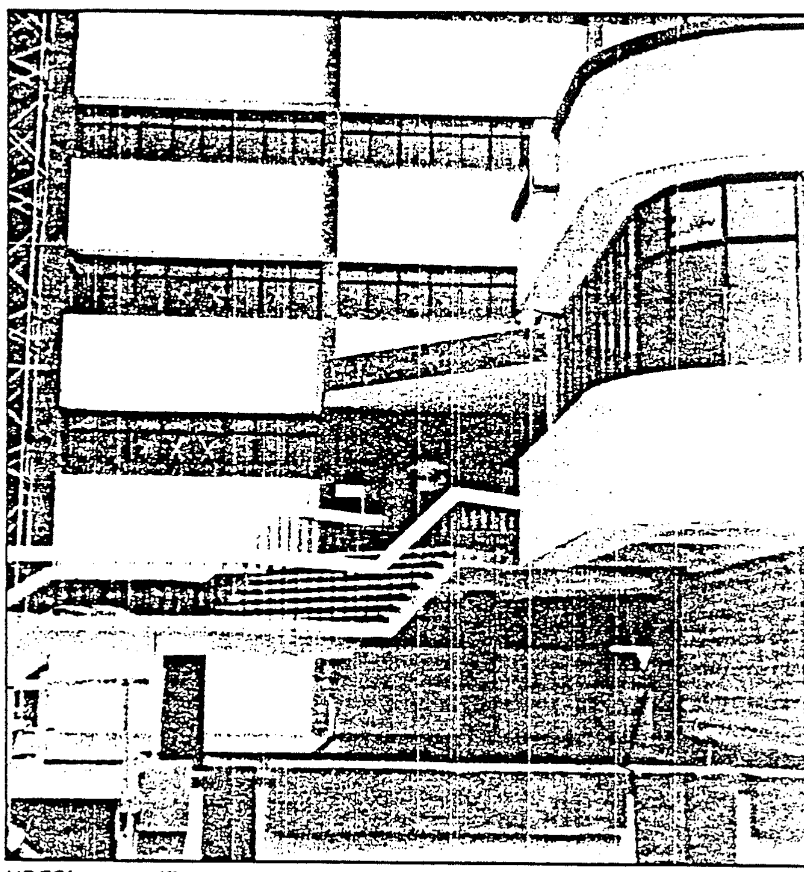
Development

It should not be thought that HDFC is simply a financial institution. It also has a subsidiary company, HDFC Developers Ltd, which aims to build good quality housing aimed at middle income people. A major project at present is for 644 units at Chinchwad Pune, and a second project involves a new office in South Bombay, together with 137 units of accommodation.

Building on experience

HDFC is now widely recognised as one of the most successful housing finance institutions in developing countries. Its senior officers have been involved in a number of consultancy projects. The United States Agency for International Development engaged HDFC as consultants for a new building construction company recently established in Nepal, and two HDFC executives conducted an operational review that covered all aspects of the company's operations. An HDFC executive also visited Nepal as a member of the team from the IFC which carried out a study on the feasibility of promoting a housing finance institution.

A senior HDFC executive has visited the Philippines, as part of a World Bank team, in order to assess and help restructure housing finance institutions in that country. Another



HDFC's new office complex at Vashi.

senior executive visited Indonesia as a member of the World Bank appraisal mission following an earlier visit, with a view to carrying out an institutional evaluation of the primary housing bank in Indonesia. Other countries where HDFC has been involved include Bhutan and Sri Lanka.

Despite its spectacular growth, HDFC recognises that it is but a small institution in the context of India, and it is able to make only a limited impact on the acute housing problems of that country. It sees one of its long-term objectives as being to help the development of an efficient housing finance system for India.

HDFC is already well respected within government circles, and is consulted on all proposals relating to housing and housing finance. It continues to press points such as the complications caused by the rent acts, and the difficulties of obtaining possession, both of which severely constrain the operation of housing finance institutions. It is anxious to help promote new institutions, perhaps including another institution like HDFC in the east of the country, and it is also willing to play its part in the promotion of building society type institutions.

For itself, HDFC wants to develop its deposit-taking base, as it cannot continue to grow simply by raising institutional funds. It also wishes to decentralise operations from head office to its 14 branches, but this is dependent on the development of the necessary skills within those branches. In the construction area it considers it necessary to develop large scale building techniques which can help deal with some of the worst housing problems.

HDFC's philosophy is well illustrated from the concluding words of the chairman's annual report for 1985-86:

"The development of a housing finance facility is not the solution to the housing problem; it merely operates on the demand side of the equation. The greater task ahead is the modernisation of the housing industry; its technical components and the method by which it is put together; in other words on the supply side of the equation. The effectiveness of housing finance or the efficiency with which it can be utilised depends crucially on the development of the housing industry as well as the manner in which the industry can control costs.

By evolving new techniques across a wide spectrum of housing needs from the modest upgrading project to middle income housing through a modern institutionalised provision of housing finance, an entire industry can be transformed. It is vital for policy planners to examine both the supply and demand side of the housing market. Now that significant developments have taken place in the Indian environment, within the housing sector, these efforts need to be supplemented by considerable public policy support.

HDFC, in its own way, has attempted to introduce a housing finance system robust enough to develop in accordance with the growth and diversification of the housing industry. In the end, the housing sector is intimately intertwined with the financial system. HDFC's own name was constituted from the three words which, when fused together, constitute the interlocking of these key areas: Housing, Finance and Development." ■

HDFC, Assets and Liabilities, 30 June, 1986

Liabilities	Rupees m	$m	Assets	Rupees m	$m
Certificates of deposit	2,472	190	Housing loans		
Loan linked deposits	22	2	Individuals	2,804	216
Cumulative interest scheme	28	2	Corporate bodies and co-operatives	609	47
Home savings plan	3	—	Staff	4	—
Loans and bonds	1,569	121	Others	41	3
Share capital	100	8	Investments	431	33
Reserves and surplus	159	12	New current assets	356	27
			Fixed assets	36	3
			Other assets	13	1
Total	4,354	335		4,354	335

Source: HDFC Ninth Annual Report, 1985-86.

HDFC Progress, 1981-82 to 1985-86

		1981-82	1982-83	1983-84	1984-85	1985-86
No. of loans approved		12,000	19,000	27,000	28,000	41,000
Loan disbursements	rupees m	298	478	749	932	1,457
	$m	23	37	58	72	112
Housing loans outstanding	rupees m	564	985	1,612	2,347	3,518
	$m	43	76	124	181	271
Total assets	rupees m	691	1,213	2,164	3,064	4,354
	$m	53	93	166	236	335

Source: HDFC Ninth Annual Report, 1985-86.

Note: The rupee figures have been converted into dollars at the November 1986 exchange rate of 13 rupees to the dollar.

Major reform of housing finance system in Sweden

Percy Bargholtz explains important changes in Sweden's housing subsidy system

COMPREHENSIVE reform of the Swedish housing finance system had been scheduled for 1986, following the setting up of a Public Commission three years earlier. The brief for the Commission, which submitted a massive report early in the year, had been to find a way to curb the spiralling cost of the system of guaranteed interest rate levels for the new and rebuilt housing.

However, problems that had been seen as critically urgent in 1982 were no longer seen as equally urgent in 1986. Price inflation had slowed and interest rates had come down by several percentage points, so that the budgetary cost of the subsidies had fallen. Given this, there was no real support for the Commission's main proposal, which was for a system of loans with partially deferred interest charges, so that the house-owner would be *borrowing* to reduce the initial cash outlays for the loan, instead of receiving outright *grants* as under the old system.

So, the important reform concerning the working of the Swedish housing finance system, that has been introduced from 1 December, 1986, is an entirely different one. Indeed, its background is really in capital market reform, rather than in housing policy considerations. Nevertheless its immediate practical effects are considerable and the potential implications quite far-reaching. To appreciate this, some knowledge of the main features of the Swedish system is required.

The Swedish system

The mainstay of Swedish housing finance is a long-term, fixed interest rate, transferable mortgage loan. The peculiar Swedish twist is that while the amortisation schedule may foresee a 30-50 year repayment period, the formal maturity of loans nowadays is much shorter. This means that a succession of shorter loans, rarely longer than 10 years and most often only five years, make up the full (theoretical) loan schedule. If the maturity is longer than five years, there is almost always a provision for periodical interest rate adjustments.

A new loan is granted automatically when the earlier one falls due for repayment, but the borrower is free to shift his source of finance if at that time he can get better offers elsewhere. During the life of each loan, however, prepayment penalties rarely make it economic to break a loan contract.

Loans of this kind covering up to 75% or sometimes 85% of the property value are given by the Urban Mortgage Bank (a mutual institution) or by one of the mortgage credit companies (all of which are currently bank-owned). These lenders in turn raise their funds in the capital market, mainly through the sale of bonds. Traditionally, major buyers of these bonds are the insurance companies and the National Pension Insurance Fund, and also the banks themselves. Households do not buy much directly, but invest indirectly through unit trusts and similar vehicles. In recent years, a number of the large industrial companies have found themselves with surplus liquid funds to invest, part of which have gone to the bond market.

For state-aided new housing construction or rebuilding (virtually all projects now have such aid), the first mortgage loan is complemented by a second loan covering the financing up to a total of 95-100% of the full cost, depending on category of housing. Funds for these loans came directly from the state budget, until mid-1985, but now the financing has been moved off-budget.

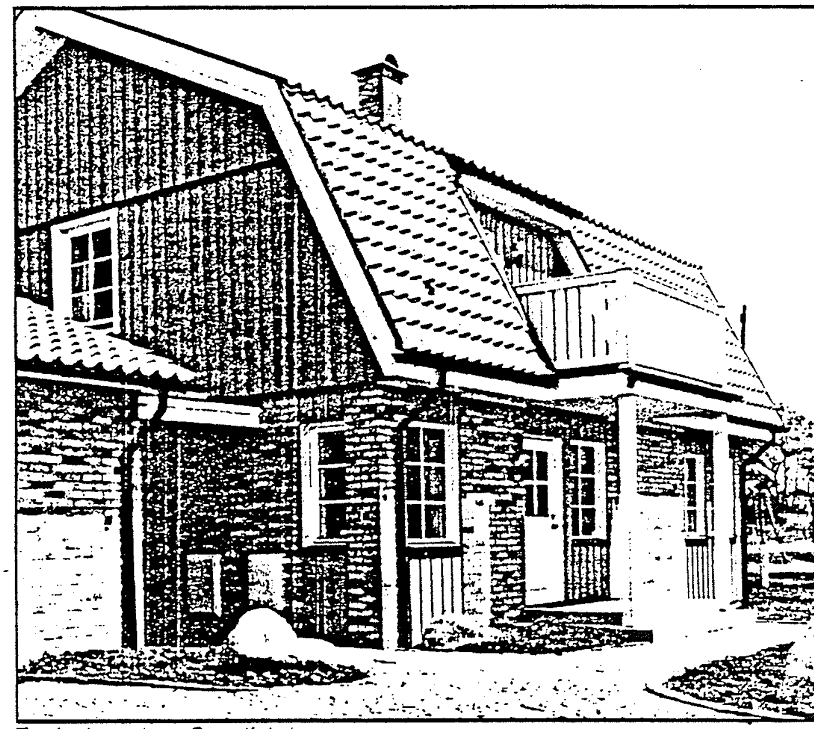
A new state-owned Housing Finance Company has been created. This issues bonds and makes fixed-term loans similar to the first mortgage loans. The interest rate subsidy covers interest both on this top loan and on the underlying first mortgage loan. It works by guaranteeing a very low first year interest cost to the house-owner, and this guaranteed level is gradually raised over time until the full rate of the loan is reached. The money for this subsidy comes from the budget, and takes the form of an outright grant.

The priority system

For many years, a fact of life in the Swedish credit market has been the division, by the regulatory agencies, between a priority sector and a non-priority one. The system initially developed as a credit rationing rule: available credit resources must primarily go to cover the financing needs of the very ambitious housing investment programme of the 1960s and early 1970s.

Banks, insurance companies and the National Pension Insurance Fund had to buy enough of the so-called priority bonds issued by the Urban Mortgage Bank or mortgage credit companies as to make available the required funds for priority lending purposes. The specialised housing finance institutions during these years were practically barred from financing purchases of secondhand homes; that was a non-priority matter and had to find its financing in other ways.

Gradually, in the late 1970s and early 1980s, the practical effect of the priority system changed. New housing investment fell, while inflationary price increases made financing of secondhand houses ever more difficult. Beginning in 1980, growing volumes of non-priority lending were then permitted for the mortgage institutions. While priority bonds and loans had interest rates and maturities determined by central bank regulation, this new non-priority business was at market terms, ie with shorter maturities and higher rates of interest.



Typical modern Swedish house.

Gradually it became clear that the capacity of the credit market was such as to make it possible to raise all the financing needed for the housing sector without any compulsion. The remaining effect of the priority system was to create a hidden tax on those institutions still obliged to buy priority bonds, and to maintain a sub-sector of the credit market practically insulated from the competitive forces that were otherwise making themselves felt.

Priority system scrapped

In November 1985, the Central Bank suddenly abolished all volume restrictions on non-priority lending. Banks, finance companies and mortgage institutions were free to lend as much as the market asked for. Combined with the falling interest rate trend this produced an enormous expansion, primarily in the non-priority business of the mortgage institutions. During 1986, this business became much larger than the stagnant remaining priority lending. Most observers concluded that it was only a matter of time before the regulations maintaining the priority system would be scrapped. The question was

→ 30

Priority and non-priority new loans from Swedish housing finance institutions. 1982 — November, 1986[1], SEK billion.

	1982	1983	1984	1985	1986 Jan-Nov
Priority[2]	21.1	26.2	26.0	31.7	27
Non-priority	5.3	6.6	17.0	12.7	48

1) Priority system ended 30 November, 1986.
2) Prior to 1 July, 1985, part of these loans came from the state budget (now State Housing Finance Company).
Note: At end-November 1986 there were SEK 14.1 to the dollar.

←29

just how the transition would be managed.

Despite this anticipation, the actual move was unexpected. On 12 September, the Government simply announced that the rules forcing certain institutions to buy priority bonds would not be prolonged beyond 30 November, 1986. The system of interest rate subsidies for new and rebuilt housing would continue, but the loan funds would have to be raised entirely at market terms. Those concerned had two-and-a-half months to prepare.

Effects in the credit market

The most immediately visible effects of the scrapping of the priority system can be seen in the credit market. Banks, insurance companies and the National Pension Insurance Fund no longer have to pay the hidden tax implied by the below-market rates of priority bonds. A rough estimate would be that the 10-year priority bonds of 1986 would have had to be discounted by some 8-10% in order to reach market yield. With a total volume of some SEK 26 billion in new priority bonds issued, that indicates a substantial monetary figure.

More important for the longer term, the institutions concerned are now free from the constraint on their portfolio composition. Not only do they not have to buy bonds at below market rates, they do not have to buy bonds at all. In practice, the alternatives are limited, but the likely effect is that the market rate for longer-term bonds will rise relative to other interest rates. This in turn will then affect the balance between the cost of financing in the short-term money markets and the long-term capital markets. The financing of real estate investments by money-market related debt instruments may well become more popular. If so, that will certainly affect the ways of the mortgage institutions also, as until now they have not been allowed to extend permanent loans except on fixed terms. One can already see the growth of various so-called temporary bridging loans for larger investment projects, with sophisticated borrowers.

For the mortgage institutions the scrapping of the priority system means more competition. Before, only the Urban Mortgage Bank and two of the mortgage credit companies were allowed to issue priority bonds, while the remaining companies had only non-priority business. Now the field is free for all of them, with no market shares being fixed by central bank allocation of issuing permits. Entry into the sector is restricted for new institutions, so there is still some protection, but compared with the old way of life it is a revolution.

The most obvious effect for the housing finance system is that the budgetary cost to the Ministry of housing will increase. As borrowers (house-owners) have been promised unchanged levels of guaranteed interest rates, the increase in the loan rates will have to be met in full by larger subsidies. The previously hidden subsidy provided by the 'tax' on bond-buying institutions will in future be visible. Given the original intention of cutting back on the budgetary cost, this may appear as a paradoxical result. Cynics conclude that it will not be long before the urge to cut reappears, thus making the future of the system as uncertain as ever.

There are also more technical, but still important, effects on how the subsidy system operates. Previously, it was always clear what the gross rate to be subsidised was. The priority interest rate was at each time set by the Central Bank. Now, the loans are extended at market rates, which may change daily and may not be precisely the same for all institutions. The government has thus felt compelled to announce for each week the highest loan rate it is prepared to subsidise, based on actual market conditions during the previous week. Obviously, it wishes to keep that rate low to minimise costs. On the other hand, it must not make the rate so low that the mortgage institutions find it impossible to provide the financing required.

Experience with this system is limited as yet, but it appears quite clear that it makes life much more complicated for the mortgage institutions and their ultimate borrowers than it was under the old system. Freedom has its price. ■

Long Term Mortgage Loans Outstanding, End 1985

Institution and ownership	Amount SEK bn	Percentage of total
Governments	84.8	22
Urban mortgage bank	133.5	34
Spintab (central bank for savings banks)	59.9	15
BOFAB (commercial banks)	50.0	14
Spafi (central bank for savings banks)	18.9	5
SKF (SEB commercial bank)	14.7	4
Sigab (Handlesbanken commercial bank)	10.3	2
Gigab (Gotabanken commercial bank)	5.0	1
PK — Kredit (PK Banken — state owned, based on post offices)	3.9	1
Agro Kredit	2.2	1
Stockholme Tomtrattskassa (Municipal)	4.0	1
Total	387.2	100

PERCY BARGHOLTZ has been with the Urban Mortgage Bank of Sweden since 1983. He is mainly involved in an advisory capacity and not in day-to-day operations. Previously, he has worked as a tax policy advisor to the Minister of the Budget and an economist at the World Bank.

Reform of subsidies for owner-occupied housing in Germany

Major changes in the tax treatment of residential property in Germany have produced far-reaching consequences, as Dr Joachim Degner explains

AT the beginning of 1987 the treatment of residential property for tax purposes changed in the Federal Republic of Germany. The Act for the New Regulation of Tax Subsidies for Owner-Occupied Property (Residential Property Subsidies Act) constitutes a genuine reform. The main emphases of the subsidies have been substantially altered, producing far-reaching consequences for financing methods as a result. Much greater importance is attached to the owner's own capital than in the past.

Deduction of mortgage interest abolished

Two points at the centre of the reform are the elimination of income tax on owner-occupied residential property and the abolition of the deduction from tax of mortgage interest, which was permitted up to the end of 1986. The subsidy is granted irrespective of the degree of indebtedness. The maximum amounts of subsidy have also been increased.

The second pillar of the subsidy system for owner-occupied housing — the building-saver subsidy — is not affected by these changes.

The previous system

Up to the end of 1986, a person's own four walls were subsidised in the context of the famous section 7b of the Income Tax Act. According to this, every owner-occupier could, for a period of eight years, deduct 5% of the construction or purchase cost of his house (up to certain maximum amounts) from his taxable income. The maximum amounts laid down for the cost of the house (excluding the cost of the site) were:

— DM200,000 for one-family houses and owner-occupied apartments and

— DM250,000 for two-family houses.

For the second and subsequent children, DM600 could additionally be deducted from the amount of tax payable, also for a period of eight years (the "children's allowance").

In addition, the so-called extended debt interest deduction was introduced in November 1982 as a temporary measure to encourage housing construction. From that time onwards, and lasting for three years, interest payments up to a maximum of DM10,000 per year could also be deducted from the taxable income in respect of newly constructed owner-occupied homes. This measure was withdrawn at the end of 1986.

Quite apart from the subsidy provisions, for over 100 years in Germany owner-occupied dwellings had also been subject to income tax; tax had to be paid on the use of it, ie a notional rent (the so-called "rental value") was calculated, which was added to the other income annually as "income from letting and leasing" and taxed. This notional rental value amounted to 1.4% of the "standard value" of the house. The standard value was, in turn, a value for tax purposes fixed in a uniform manner.

Within the framework of this tax system, however, it was also possible to charge the professional expenses; interest charges, for example, up to the equivalent of the rental value could be offset against tax. If, however, the interest charges were lower than this amount or the house was already free from debt, the difference was subject to income tax in full.

The new tax subsidy system

Specifically, the following changes have been made to the tax subsidy system for *owner-occupied* property (the system remains unchanged for rented housing):

1. Section 7b of the Income Tax Act has been replaced by a new section, 10e. The maximum amount for the real property subsidy has been increased to DM300,000 and applies uniformly to one- and two-family dwellings and owner-occupied apartments. This means that for residential property acquired or completed since 1 January 1987, 5% of the purchase or construction costs can be offset against tax annually as exceptional expenditure for a period of eight years up

→ 32

←31
to the maximum amount of DM300,000. Half of the real property costs can be included in this maximum amount (this, too, is a new feature).
2. The so-called "children's allowance" amounting to DM600 annually will in future apply from the first child onwards and not from the second onwards as hitherto.
3. The liability of owner-occupied property to income tax has been abolished. If a person has cleared his own home of debt, he will now live not only rent- and encumbrance-free but also tax-free. For many owner-occupiers this removes the obligation to file an income tax declaration.
4. Every owner-occupied dwelling is treated in the same way. It no longer makes any difference if it is a one-family dwelling, a two-family dwelling or an owner-occupied apartment. The construction of a new residence and the acquisition of second-hand property are accordingly treated in the same way.
5. For dwellings built or acquired before 1 January 1987 there is a 12-year transitional arrangement, ie nothing will change as regards the subsidy system for owner-occupiers who have hitherto paid tax on their dwelling in accordance with the so-called excess calculation (the excess of the rental value over professional or running expenses); it is not possible to change over to the new subsidy system under section 10e. The abolition of the tax on owner-occupation will nevertheless benefit this group of people, too.
6. The possibility of offsetting against tax expenditure incurred during the construction and acquisition phase — in particular the cost of raising the money — will be retained for the future. This also applies to renovation and modernisation work in second-hand houses, where this has been carried out before moving in.
7. This subsidy can be claimed once in a person's lifetime — twice for married couples for two properties — and account will be taken of any tax concession already granted under the terms of the old section 7b of the Income Tax Act.

Housing finance from all sources[1] in the Federal Republic of Germany in 1985

Source of finance	Payments for all housing construction (DM million)	(%)	New commitments for housing construction (DM million)	(%)
All bausparkassen[2]	44,406	41.3	24,741	46.9
Private bausparkassen	(29,942)	(27.8)	(16,389)	(31.0)
Public bausparkassen	(14,464)	(13.5)	(8,352)	(15.8)
All mortgage banks	28,390	26.4	12,983	24.6
Private mortgage banks	(19,284)	(17.9)	(7,885)	(14.9)
Public banks	(9,106)	(8.5)	(5,098)	(9.7)
Savings banks	29,218	27.2	12,722	24.1
Life assurance companies[3]	5,506	5.1	2,348	4.4
Funds from providers of capital	107,520	100.0	52,794	100.0

1. Excluding commercial banks and public funding.
2. Including deposited amounts.
3. Private and public sector.

Loan interest more important

In addition to the tax on owner-occupation, the deduction of interest payments for owner-occupied dwellings has also been abolished. The new subsidy system for owner-occupied housing is thus neutral as regards financing. In other words, it makes no difference whether the owner-occupied home has been financed by the owner's own capital or by outside funds.

Interest charges on outside capital and any subsequent increases in interest rates for loans must in future be met by the owner without any contribution from the tax authorities. The incentive for as high an amount of indebtedness as possible is thus removed, and financing is put on a more solid basis once again.

The importance of one's own capital is increased

Those who will profit most from the new subsidy arrangements are the middle and lower income groups who are currently on the threshold of home ownership in the Federal Republic. These people are, in fact, obliged to contribute a relatively high proportion of their own capital, as they would not otherwise be able to meet the financial burdens.

Under the interest deduction system, on the other hand, the people "rewarded" were those who financed their house purchase with as much outside capital as possible, ie the higher income groups.

The marked increase in recent years in the number of auction sales under execution of owner-occupied property in the Federal Republic is due above all to the fact that the proportion of outside finance (up to 100% in some cases!) was often too high.

The direct connection between the proportion of own capital and the risk of an auction sale under execution can be easily illustrated by the German building-savers who acquire residential property; building-savers finance their purchases with an above-average proportion of own capital (about 40%) and are at the same time involved in a much lower proportion of auction sales.

It was furthermore remarkable that virtually all leading politicians — both in the Government and in the Opposition — supported the principles of the new tax subsidy system. ■

DR JOACHIM DEGNER is managing director of the Association of Private Bausparkassen in Bonn, West Germany.

Singapore's unique housing finance system

SINGAPORE is an unusual, if not unique, economy — a small island state that occupies only 620 square kilometers with a population of a little over 2.5 million. It has a thriving economy with a GNP per capita and living standards that put it well above its neighbours in South East Asia. Indeed, if the experience of the past 10 years continues then Singapore will rapidly be joining the OECD countries in terms of wealth.

In respect of housing and housing finance, Singapore has its own distinct pattern. Where public housing and high rise housing throughout the world have often been failures they are seen as being a success in Singapore. The island has also made extensive use of social security funds to finance housing.

The Housing and Development Board

Housing in Singapore is synonymous with the Housing Development Board (HDB), a public sector body. HDB was established in 1960, and by the end of 1961 had 200,000 units housing 10% of the population of Singapore. The number of units and the proportion of the population housed has risen relentlessly since that time. By 1976 half the population were housed in HDB flats, and by March 1986 84% of the population lived in 558,000 flats.

Housing Development Board Balance Sheet, March 1986

Liabilities	$m	%	Assets	$m	%
Government loans	13,381	37	Fixed assets	18,704	51
Bank loans	62	—	Properties under construction	8,124	22
Other current liabilities	5,864	16			
Capital reserve	17,249	47	Mortgage loans to purchasers of flats	6,818	19
			Other loans	241	1
			Current assets	2,669	7
Total	36,556	100	Total	36,556	100

Residential Units under Management

Type of properties	March 82	March 83	March 84	March 85	March 86
One-room flats	64,664	65,257	60,646	60,283	60,105
Two-room flats	47,056	48,634	48,562	48,462	48,565
Three-room flats	167,283	191,063	209,714	229,759	244,635
Four-room flats	57,080	66,041	87,619	118,248	141,556
Five-room flats	21,739	26,930	32,728	40,968	45,765
Executive flats	—	—	2,333	5,484	8,722
HUDC flats	—	2,732	3,214	4,842	8,007
Other residential properties	61	61	61	257	257
Total	357,883	400,718	444,877	508,303	*557,612

*Includes 61 landed properties

HDB has continued an extensive housebuilding programme. The number of homes completed began at a modest 682 in 1960 and rose steadily to peak at 30,406 in 1977. There was then a downturn until 1981 when the figure was 16,366. Subsequently there has been a sharp increase with the figure reaching 70,345 in 1984 and 50,348 in 1985.

All HDB units are flats rather than houses and many are in high rise blocks, which seem to work successfully in contrast to the position in a number of industrialised countries.

Initially, HDB provided flats for rent, but in 1964 there was a change in policy with a home ownership scheme being introduced. The emphasis is now very much on home ownership rather than renting. In March 1986 HDB had a waiting list of 32,000 people wanting to buy with just 3,000 wanting to rent. Both figures show a marked reduction on those for March 1985.

By March 1986 HDB had sold 420,000 units so that 75% of its properties under management were in fact owner-occupied rather than rented. The Board makes loans to those buying their flats at a rate of interest which is pegged marginally above the Central Provident Fund interest rate, and which was 5.88% in 1986. The rate is reviewed half yearly.

The Board's development programme is funded by government loans, most of which are repayable over 60 years. The loans have varying rates of interest; new loans carry a rate 2% above the CPF interest rate.

The government has an overt policy of subsidising housing. In 1985-86 rental income of $73 million was less than half the expenditure on rented flats of $163 million giving a deficit of $90 million. Service and

SINGAPORE

conservancy income was $212 million while expenditure was $314 million, and a substantial deficit was also incurred on the sale of flats below cost. A total government subsidy of $1,173 million was paid to the Board.

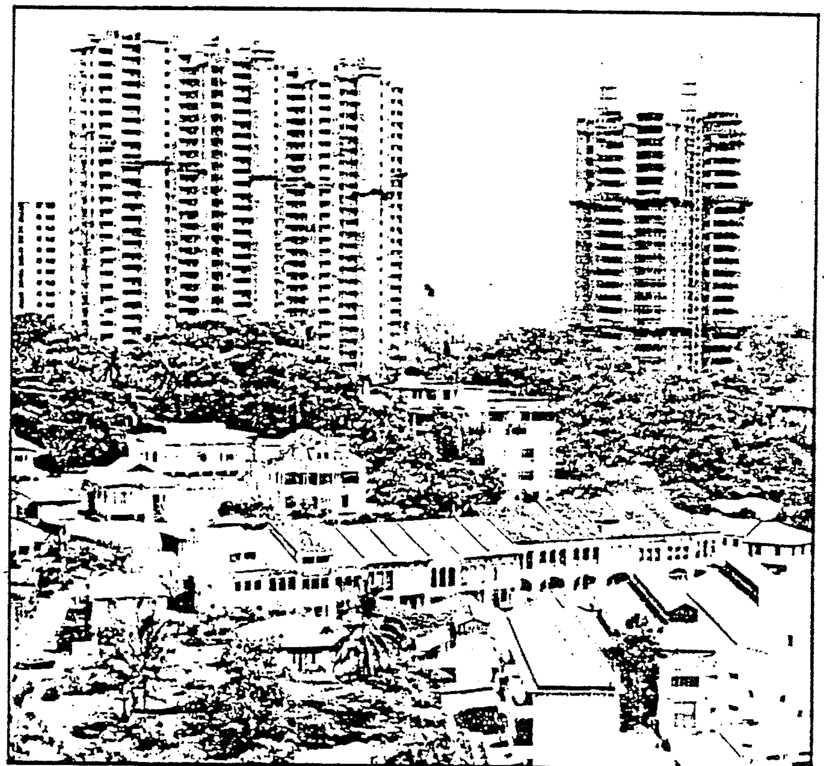
The Central Provident Fund and Home Ownership

Most HDB flats are sold in conjunction with withdrawals from the Central Provident Fund. This was established in 1955 and is a compulsory savings scheme with the objective of providing retirement benefits. At the end of 1985 it had no fewer than 1,892,000 members, and total balances of $26.83 billion, that is, some $10,700 for each person in Singapore.

The contribution rate has been a very high 25% of salaries for both employees and employer, albeit with a ceiling. However, for a two year period the employer's contribution has been reduced to 10%.

In the mid-1970s the Fund made direct loans for house purchase, but in a switch of policy people were enabled to withdraw their savings in order to pay for housing, both the initial deposit and remaining monthly instalments. Over 600,000 members have used their savings to buy their own homes. In 1985 withdrawals from the fund amounted to $3,017 million and of this total $2,204 million was withdrawn by 302,000 members to help pay for HDB flats.

Someone purchasing an HDB flat, at a discount, may well have a package made up of withdrawals from his Central Provident account and a loan from the Post Office Savings Bank, which is the major retail financial institution in Singapore, accounting for well over half of the personal sector deposits. Notwithstanding its name, it now has little to do with the Post Office, but, rather, operates through 279 branches and has 2.87 million savings accounts — more than the number of people in Singapore.



Old and new housing in the Orchard Road area of Singapore.

Conclusion

Singapore has chosen to spend much of its rapidly rising wealth on an ambitious public housing programme. It has also chosen to provide for people's retirement through the Central Provident Fund and has allowed people to draw on that fund to finance the purchase of a house which can be seen as an alternative method of saving for retirement.

Singapore is renowned for its efficiency. In many countries a combination of a public sector housing board, public sector savings bank and a government run provident fund would not make for an efficient housing or housing finance system. However, it is apparent that this unlikely combination has produced very satisfactory results in Singapore. ■

Central Provident Fund

Year	Contributions $bn	Members' balances $bn	Membership millions	Withdrawals for housing schemes $bn
1981	3.01	12.15	1.65	0.69
1982	3.90	15.66	1.73	0.80
1983	4.49	19.50	1.78	1.12
1984	5.39	22.67	1.85	2.69
1985	5.99	26.83	1.89	2.57

All figures in this article are in Singapore dollars. There are about 2.1 Singapore dollars to the US dollar and 3.1 Singapore dollars to the pound.

Mortgage servicing — the new profit centre

Peter Knight explains the advantages of an increasingly important development of the secondary mortgage market

IN William Shakespeare's "Hamlet," Polonius advised a young Laertes off on a journey into the world to "Neither a borrower nor a lender be." Had Laertes been off to a life in the mortgage lending business, Polonius could have added, "Be a servicer."

While much has been written about the US secondary mortgage markets and mortgage securitisation in particular, there has been less international attention focused on mortgage servicing. However, mortgage servicing is an important and very lucrative element of a healthy secondary marketplace.

The servicing of mortgages has become a very attractive feature to mortgage lenders in the US who are seeking profits that are somewhat insulated from interest rate risk. Newcomers to the mortgage business are also attracted to mortgage servicing for the same reasons. They include some of the largest US manufacturing, insurance and financial service conglomerates. They are aggressively operated and hope to take a major part of the business from all existing mortgage participants, mortgage bankers as well as portfolio lenders.

What is mortgage servicing?

WHAT exactly does the servicing of a mortgage entail? The Federal National Mortgage Association's *Servicers Guide* lists the following duties and responsibilities of FNMA loan servicers. Required duties for servicing will vary, but these requirements are generally consistent with the needs of most investors:

"The servicer must take whatever action that is necessary to protect our interest in the mortgaged property as long as it is authorised to do so by the terms of the mortgage. Among other things, this generally includes:

- Paying property taxes to avoid possible tax liens.
- Maintaining adequate hazard insurance to cover damage from unforeseen casualty losses.
- Establishing and maintaining accounts for the deposit of mortgagors' funds.
- Making periodic property inspections to assure that the physical condition of the property is satisfactory or to determine needed action if it is not.
- Maintaining accurate mortgage servicing and accounting records.
- Collecting and promptly remitting any and all amounts due us.
- Taking prompt and appropriate action to resolve a delinquency, including any action necessary to liquidate a defaulted mortgage.
- Managing, marketing and disposing of an acquired property.
- Advancing reasonable amounts, if necessary, to cover expenses arising in connection with any of the duties described above."

Mortgage servicing — foundation of the secondary markets

The basic ingredient for an efficient secondary mortgage market is the ability to tailor mortgage investments for new sources of capital. This has been accomplished by meeting the needs of investors who might not otherwise be interested in investing directly in mortgages.

The first thing that may cause investors to avoid mortgages is the need to manage the loans effectively themselves and to ensure that the investor's interest is protected. This function is served by the mortgage servicer. Mortgage servicing includes collection of payments, maintenance of amortisation schedules, escrow administration, and handling delinquency and other problems that may arise.

Servicing capacity is needed to assure market liquidity, since the sale of loans and securities must be free of concern about servicing quality. For that reason, the ownership of the loan, and its servicing, are often controlled by separate entities. However, the initial investor in the loan establishes the terms of the servicing agreement. Servicing agreements can and do vary. A representative one used by Fannie Mae, the largest US mortgage investor, is highlighted in the inset.

Servicing has helped the US secondary mortgage markets grow to over half a trillion dollars in outstanding mortgage-backed securities at the end of November 1986. Hunter Wolcott, president of Reserve Financial Management Corporation, based in Miami, Florida, who serves as a consultant in the servicing field, estimates that over $800 billion of mortgages are serviced for others in either whole loan or security form.

Mortgage servicing — an important source of fee income

The two main areas of fee income for mortgages are origination and servicing. In a typical mortgage sale in the secondary market, the lender making the loan receives an origination fee based on a percentage of the loan. That fee is collected immediately, and should that lender continue to service the loan, he will earn a servicing fee representing a portion of the interest income generated by the mortgage. These fees vary from ¼% to over ½%.

Servicing is one of the best profit opportunities for lenders in the mortgage process. The profits from mortgage originations vary with interest rates and/or seasons in many areas. In addition, the personnel-intensive nature of originating loans means higher overheads. The servicing of mortgages, on the other hand, is less affected by the vagaries of interest rates and lends itself to computerisation and very efficient staff operations. Computers have enhanced the attractiveness of mortgage servicing by increasing profitability. Without computers, servicing could not be the profit centre now established by so many institutions.

In addition to being a stable source of asset-based income, servicing also provides one of the few remaining sources of stable long-term deposits in the form of escrow accounts. These accounts are established to pay a mortgagor's taxes and insurance and range from between 1% and 2% of the unpaid balance of the loans being serviced. Most states do not require interest to be paid on these escrows, which is a significant attraction for servicers.

Servicing loans also gives lenders a strong relationship with the mortgagors, opening up possible new business. Many servicers attempt to cross-sell a wide range of financial products to the borrowers on the loans they service.

However, servicing is not immune to rate risk. Rather, the risk is inverse to the standard rate risk for the savings industry. As rates fall, borrowers refinance higher rate loans and mortgages prepay. Servicers that do not aggressively recapture their mortgage servicing as it refinances may see an evaporation of valuable servicing rights, some of which may have been recently purchased with a long-term expectation.

The trading of mortgage servicing rights

Finally, servicing is now a liquid commodity due to today's mortgage market standardisation of loans and procedures as well as new computer technology. The trading of servicing rights has become a multi-billion dollar market. Companies buy and sell servicing rights on existing mortgages, and the high degree of liquidity of servicing approaches the liquidity of the mortgage investments themselves. Over $100 billion of servicing rights traded hands in 1986.

In fact, the servicing market has recently gone from a sellers' to a buyers' market. Two years ago, servicing sold for more than 2% of the amount of the balance of loans to be serviced. This was more than twice what the traditional going rates were. After the wave of refinanced mortgages in the past years, these prices have fallen somewhat, but are still in the 1½% range.

In this high-priced market, it is important that buyers only seek servicing based on careful planning. Hunter Wolcott advises purchasers first to define the objectives of an acquisition programme. This analysis starts with an assessment of an institution's strengths. The purchase programme must be founded on the institution's capabilities, which include staffing, systems, procedures, capacity and other factors

→ 38

20 Largest Mortgage Servicing Organisations

	Parent	Total Volume Serviced for Others 000s	As of
1.	GMAC	$21,761,283	6/86
2.	Lomas & Nettleton	$21,600,000	12/86
3.	Citicorp	$18,239,108	6/86
4.	Fleet Financial	$17,590,000	12/86
5.	Metropolitan Life	$14,958,546	12/86
6.	Firemen's Fund	$14,792,230	6/86
7.	City Federal Savings	$14,064,826	6/86
8.	Sears	$12,800,000	12/86
9.	Mellon Bank	$11,609,260	6/86
10.	Commonwealth Savings	$11,413,223	12/86
11.	Weyerhaeuser Corp	$10,754,822	6/86
12.	First National Bank, Boston	$10,467,575	6/86
13.	FCA	$9,861,011	6/86
14.	First Union Corp	$9,830,000	12/86
15.	Goldome FSB	$9,393,822	12/86
16.	First Interstate	$9,382,000	12/86
17.	H. F. Ahmanson	$8,753,183	6/86
18.	Meritor Financial	$7,630,468	6/86
19.	Sovran Bank	$7,253,421	12/86
20.	Chemical Bank	$6,779,000	6/86
	Top 20 Total	$248,933,778	

Source: Reserve Financial Management Corp.

←37

such as geographical location of staff.

Then the institution must define the objectives for purchasing the servicings most compatible with the institution. Of course, profitability of servicing is paramount. To be profitable in servicing, an institution must reach a critical mass of mortgages being serviced to offset expenses such as new computer systems. Therefore, the volume of servicing desired must be ascertained.

Other factors also affect the profit potential of mortgages to be serviced. Location is a big factor in this equation. If all the loans are located in a similar region or state, the profitability may be higher, especially if the lender already has support personnel in the region. On the other hand, high delinquency rates in a given area can make servicing more expensive.

State and local laws must also be examined. State laws affecting foreclosure proceedings, escrow accounts and property taxes all affect servicing. For example, when California passed Proposition 13 limiting state property taxes, it also reduced the attractiveness of servicing mortgages in California since escrows for taxes would be lower.

The last major factor to be weighed, according to Mr Wolcott, is the type of servicing. Adjustable rate mortgages add new complexities such as negative amortisation, variable payments and other factors which increase the lender's servicing responsibilities and costs.

In the case of servicing for mortgage pools sold through the issuance of mortgage-backed securities, there are other important distinctions. Pass-through certificates, in which principal and interest must be advanced, are potentially more expensive to service than modified pass-throughs in which only interest must be advanced. Individual investors may also have policies that affect servicing.

For example, if an investor charges a fee to anyone who subsequently transfers servicing, this consideration should be built into the purchase price of that service.

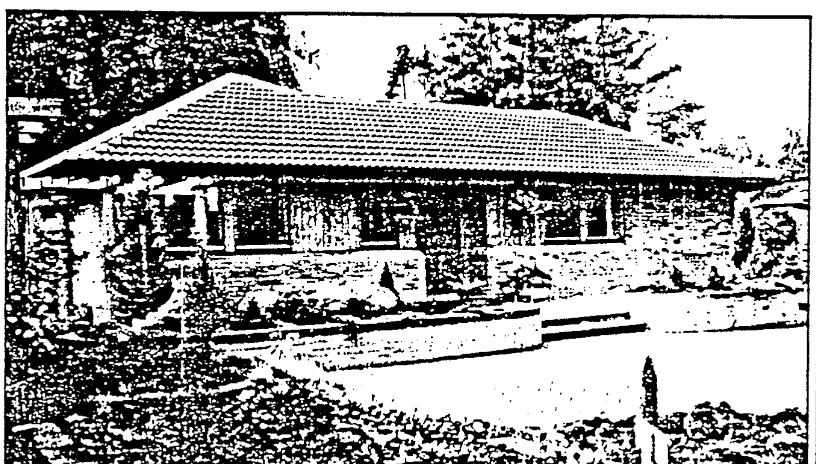
Industry consolidation

The attractiveness of servicing in terms of profitability, cross-selling opportunities and liquidity has attracted the largest US corporate names to the business. The table (page 37) lists the top 20 servicing firms, and many recognisable, non-mortgage names appear on that list, including Sears, Citibank and GMAC (General Mortgage Acceptance Corporation).

A recent study, "The Consolidation of the US Mortgage Industry," published by the SMR Research Corporation in Budd Lake, New Jersey, examines the trend to a national market with fewer, bigger players.

Stuart Feldstein, president of SMR, commented, "The largest players in the market are growing two to three times as fast as the overall market, which is symptomatic of an industry going through dramatic consolidation." The figures reflect this trend as the growth in servicing by the largest players has outpaced the growth in the volume of outstanding loans.

	1983	1984	1985
Mortgage Debt Outstanding	\$1.81 tri	\$2.02 tri	\$2.25 tri
Change from Previous Year	—	11.6%	11.4%
Portfolio of 20 Largest Mortgage Servicers	\$133.2 bn	\$152.8 bn	\$209.4 bn
Change from Previous Year	—	14.7%	37%



Servicing the mortgage on this attractive home would be a useful way of earning fee income.

Outlook for servicing market in other countries

Just as secondary markets are now spreading worldwide, it can be expected that mortgage servicing as a separate and profitable operation will develop. This will occur over time, as the markets themselves develop. Eventually, in countries with an active secondary market, mortgage servicing will provide traditional suppliers of mortgage credit with new ways to earn fee income while opening the door for additional competitors in the mortgage business. ■

PETER KNIGHT is vice-president and director of mortgage finance for the National Council of Savings Institutions.

Shelter needs and housing finance institutions' role

Eric Carlson, IUBSSA's senior consultant, looks at the challenge for housing finance institutions posed by the International Year of Shelter

THE International Year of Shelter for the Homeless (IYSH) is upon us, as declared by the United Nations General Assembly, and it remains to be seen whether this project will enhance the mobilisation of resources for investment in housing. But the Year itself is meant to be the beginning of a process to help focus world attention on the issues of shelter and housing, with emphasis on the action required at national level.

There are two immediate concerns: the assessment of shelter needs and the promotion of better understanding of the role of shelter in national development. More than 130 governments have agreed to participate in the IYSH programme and have designated focal points for this purpose. Many have developed or promoted demonstration projects of various kinds, and there will be many conferences, seminars, exhibitions and discussions bringing together public and private sector interests at national, regional and international levels.

Housing finance institutions will have ample opportunities for participation, and perhaps to help in development of recommendations, policy reforms and demonstrations of commitment and responsibility. Their public relations, publicity and advertising programmes can be useful factors in the public education effort required for action to achieve an improved shelter and housing environment.

The shelter problem

Though the disparities between levels of achievement of the industrialised and developing countries continue to grow, the housing sector contains much that is in common cause, and the fundamental human right to basic shelter is increasingly being asserted. Public opinion has been aroused at the alarming growth of the homeless in the cities of the Western world. Newspapers carry headlines such as "The homeless of Europe: a scourge of our time." Increasingly, searching articles appear such as that in *Harper's Magazine* on "Helping and hating the homeless — the struggle at the margins of America." Though there are sharp disputes as to the actual numbers of homeless, few observers and editors question the projections of continuing sharp increases. Daily television coverage on the homeless and related problems make this a key story of our times.

In the developing countries, the housing and shelter position has been exacerbated by massive debt burdens, excessive urbanisation and infrastructure costs, disincentives for savings of high inflation, speculation in land, and the need for improved municipal management and financing. This gives rise to a situation where the major and ever-increasing proportion of people lack adequate shelter and live in insanitary conditions in squatter settlements and overcrowded urban slums. The informal sector which they constitute may be responsible for building more than 50% to 80% of all shelter and housing in different countries.

Most of the world's population growth of 1.5 billion more people by the year 2000 will be in the urban areas of these already overburdened countries. The scale of construction required is comparable to building 120 cities of about the size of New York during this period.

Few governments in developing countries can claim to have housing policies and programmes that cope effectively with basic shelter needs. Within their economic and resource capabilities, good examples in this direction have been set by Colombia, Sri Lanka, South Korea, Singapore, and Jordan, and many others have developed specific approaches and projects that merit special attention. But problems persist and help is

→ 40

←39

required, especially for the support and development of savings systems which help to mobilise household resources for the improvement, construction and acquisition of shelter.

The important role of housing and shelter as a stimulus for domestic economic activity and national development can be identified from three points of view. First, investment in this field is labour intensive and improves the employment situation; second, it can stimulate the production of local building materials; third, it is an incentive to mobilise household savings by offering an attractive investment opportunity. Yet these basic factors are often completely ignored by international finance and development agencies. An example is the 1986 Report of the Inter-American Development Bank, *Economic and Social Progress in Latin America.* In this report, not a single word appears about shelter, housing or building in either rural or urban areas. Unfortunately, this "blind-side" economics is prevalent on the international scene.

For housing finance institutions in some countries this is a time of problems, difficulties, competition and transition. The justification for specialised entities in this field is being questioned as never before, and, under the competitive pressures brought about by deregulation, the trend is for these institutions to become involved in providing a full range of household financial services, rather than just offering finance for construction and mortgage loans, and related activities.

On the one hand, public opinion is being shaped by the sense of crisis exemplified in a *Bangkok Post* article on "Hard times for thrift industry," or in a *Washington Post* article, "Our S & L's are obsolete — its time to merge dying thrifts into the New World of finance."

On the other hand, the good news, such as "Thrift units reporting solid profits," based on third quarter results in the US, rarely gets much attention. Nor do articles such as "Local pressure bringing more lending in inner cities." But positive accomplishment, and results, on the local level, are still the major weapons to deal with the disseminators of "gloom and doom".

The international capital markets and housing finance

In the United States over the past 15 years there has been a vast growth in secondary mortgage markets, and in 1985 over $120 billion in securities were issued — a record volume. This market growth has been facilitated by government chartered housing finance corporations, particularly the Federal National Mortgage Association (Fannie Mae), the Government National Mortgage Association (Ginnie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac). They are among the largest issuers of debt and securities in the country. They buy and package mortgages, and create different forms of mortgage securities, such as Collateralised Mortgage Obligations (CMO's) which are sold to investors including pension funds, insurance companies and others.

'Vast growth in secondary market'

In this business of packaging and selling mortgage securities, the investment houses are playing a leading role, and all the large Wall Street firms now have large and profitable divisions dealing with mortgage securities, with some of these issues of remarkable size and complexity. Beginning with 1983, there has been a growing development of international markets for these securities. In February 1984 the Alaska Housing Finance Corporation issued the first Eurobond collateralised with mortgage securities, and several Eurobond issues by US thrift institutions soon followed. Freddie Mac and Fannie Mae have together sold in excess of $20 billion of debt in Japan and Europe, and US thrift institutions have issued approximately $5.7 billion in collateralised floating rate notes abroad.

As reported in some detail in the August issue of *Housing Finance International,* the UK building societies entered the Euromarket for the first time in October 1985, with four societies raising £600 million between them from the issue of Floating Rate Notes. Since that time more societies have raised funds in this way, totalling £3.1 billion pounds at June 1986.

The Crédit Foncier of France also decided to use the international capital markets, to help meet the demand for funds for house purchase, particularly through Government assisted programmes, and to help stabilise France's balance of payments following the negative effects of the two oil crises.

Japanese banks and financial institutions have become major factors in most international capital markets. Just five years ago, only one Japanese bank ranked among the top 10 internationally. Today, seven of the world's 10 largest commercial banks, and the top four, are Japanese. The managers of pension funds and insurance companies are increasingly dominating the capital markets, and the big new Japanese players — the trust banks and the insurers — have enormous funds to invest.

It is generally believed that recent experience with the development of markets for mortgage securities, both nationally and internationally, will lead to the interest of other countries in establishing similar types of instruments and markets. Each country will, of course, have to develop its own mortgage finance solution. One recent example is that of Canada, where the Canada Mortgage and Housing Corporation (CMHC) has now introduced its mortgage-backed securities programme, dubbed "Cannie Mae."

The major Canadian mortgage lenders — chartered banks and trust companies — fund their mortgage originations with savings deposits, but most Canadian mortgages have a maximum term of five years or less, with a balloon payment due at the end of the term. This leaves borrowers vulnerable if interest rates rise, and the development of a mortgage backed security is a response. It is expected to alleviate lenders' dependence on deposits by bringing different investor types into the mortgage market. Initially, the securities will be issued in the form of paper certificates, and any CMHC approved institution will be able to issue the

'Privatisation may have run its course'

securities. The CMHC certificates will be sold in multiples of $5,000 and up, putting them within reach of individuals as well as institutional investors. Canada therefore seems well on its way to joining the larger capital market scenario for mortgage securities.

Thus far, only a few savings and thrift institutions, the larger ones, have benefited from the sale of mortgage securities on the international markets. In the United States, three institutions are responsible for nearly one-third of the deals realised to date. Four firms, Paribas Capital Markets, Salomon Brothers, Credit Suisse First Boston and Merrill Lynch Capital Markets are responsible for the vast majority of Eurofinancings for US savings institutions.

But the relatively favourable experience to date, the receptive market and cost-effectiveness factors, indicates that in future more housing finance institutions will size up the overseas capital markets, and there will be efforts to interest investors in other forms of issues than collateralised notes and convertibles.

To what extent housing finance and thrift institutions in different countries will benefit from this increased flow of global capital will depend on many factors, particularly the economic situation and perspectives of the areas they serve. For example, the debt crisis in some Latin American countries inhibits their capabilities for providing the necessary guarantees and instruments for participation in the international markets for mortgage securities. The African countries have these and other problems, though in a few, perhaps, such as Kenya, Zimbabwe, Ivory Coast, Tunisia and Cameroon, there may be possibilities for securitisation of mortgages, and some eventual entry into the global capital market. It is the Asian countries, generally speaking, that seem particularly well-placed to foster securitisation of mortgages through their existing structures of housing banks and mortgage finance institutions.

Housing initiatives by housing finance institutions

Getting back to the basics, what are housing finance institutions doing to provide support and resources for the improvement of shelter and housing conditions of the poor and homeless?

The Committee on Economic Affairs of the US League of Savings Institutions has recognised the problem. In its new statement on "Strategic objectives for savings institutions" there is included the point that, "Savings institutions further support the judicious use of direct and indirect subsidies to assist low-income families to obtain decent shelter but seek to eliminate subsidies provided by governments and government sponsored agencies that distort or impair the functioning of the private mortgage market."

Some US housing finance entities have become involved in public-private sector partnerships to assist with provision of shelter for the homeless and housing for low income people. This is in the context of increasing discussion about the need for new housing and urban policies at local, state and national levels. There are strong views that "privatisation" may have run its course and the time has come to preserve and maintain the small public housing stock that still remains as well as to devise new programmes in this field.

In the UK the Nationwide Building Society has adopted the theme, "Putting the building back into society" as indicative of its efforts to give special attention to projects for the elderly, the disabled and first-time buyers. It set up a Housing Trust in 1982 which has made innovative loans to housing associations (of which there are over 1,000 in the UK). It has assisted in urban regeneration schemes which may include new council housing for rent and shared ownership, new housing and converted and refurbished council properties for sale. Nationwide and Halifax Building Society teamed up with a large builder to launch PROBE (Partnership Renewal of the Build Environment)

'US involvement in shelter for the homeless'

with a substantial three year budget, to find and prepare partnership schemes for local governments that lack the imagination, skill or staff to carry them out on their own. Other societies are also developing new methods to help low income families.

In Australia, the Co-operative Building Society in Adelaide embarked on several new areas of service and still shouldered important civic responsibilities. In 1986, for example, it was a principal sponsor of the World Housing and Planning Congress, held in Adelaide, which brought together 1,200 professionals from different countries, and produced a wide range of stimulating reports and presentations, including

→ 42

← 41

considerable attention to the IYSH and problems of the homeless. In 1981 the society established and endowed the Co-op Foundation, independent of the society and with its own board of directors. The Foundation has assisted projects for the handicapped, invalid and disabled, and the furnishing of homes and hostels for the underprivileged, intellectually disabled and the aged.

Housing finance institutions in the developing countries are in a quite different situation. Zimbabwe is one country where the concepts of public-private partnership for housing have made some headway, and the building societies, with guarantees from the government, have taken an active role in several projects for housing low-income groups. At the African Housing Conference held in Harare in February 1985, the Prime Minister praised the efforts of the private sector to provide resources for these projects, and expressed the hope that they were an example of new directions. "In some countries of Africa," he said, "the home finance entities or building societies have the reputation of taking the savings of the poor and investing them in housing for the rich."

In Latin America and the Caribbean the role of home financing entities with respect to the informal market requires special attention and new programmes. This was a main theme of the annual conference of the Inter-American Housing Union held in Mexico City last May. Thrift institutions were urged to promote and develop new customers and services in the informal market, both for savings and for lending. It was pointed out that this is likely to be a major growth area for home finance entities, perhaps essential for their survival and viability as instruments for resource mobilisation.

An entry point to the informal markets can be secured by providing assistance to credit unions, co-operatives, housing associations and other organised groupings at the grass-roots level. Co-operatives are important vehicles because they can organise low-income households, pool the resources of the members, and provide security for loans. They can produce building materials, construct houses, and manage properties. Local governments can help such ventures by making land and services available, as can the utility systems.

The IYSH challenge

The IYSH will undoubtedly produce heightened awareness of basic shelter problems. Housing finance and thrift institutions can be important components of the programmes which emerge. The meeting of the Habitat International Council in Nairobi this April, to be followed by the 10th session of the UN Commission for Human Settlements, will provide much information from both governmental and private sector organisations about their progress with demonstration projects and housing reform and policy measures, including those dealing with shelter finance.

'Challenge of new investment proposals'

Housing finance institutions have a most valid international cause in promoting savings to invest and build for home ownership. This is an important step in helping developing countries to mobilise and to retain domestic savings, and to reduce capital flight. Inducing or attracting such savings from the informal sector deserves high priority consideration. The provision of financing for housing and related urban investment is an important key toward accelerating economic growth and development, and thus to permit further expansion of international trade and the capital markets.

The globalisation of capital flows through private investment, including a housing finance component represented by mortgage securities, is already in full swing among industrialised market economies. This will sharply expand in the future, in part because of the continuing accumulation of capital through pension fund and insurance systems as well as the banking system generally. It can be expected that direct investment in real estate and equities in housing finance institutions will also expand, given current trends and funding indications. There is no question that international capital can be an important catalytic factor for helping to establish and to support thrift institutions and sound savings programmes in the developing countries.

Economic stagnation is a marked characteristic of much of the world's economy in spite of the fantastic development of financial technology. In some countries there is a favourable conjuncture of lower interest rates, decline of inflation and greater monetary stability. Yet there is urgent need for more housing at reasonable cost in many places. The IYSH may provide the opportunity to seek new international funding in this field, from both public and private sources. The challenge is there, to develop new investment proposals and initiatives, and to assist in a major new promotion of the future. ■

ERIC CARLSON has been senior consultant to the International Union of Building Societies and Savings Associations (IUBSSA) since 1982, following his retirement from the United Nations Secretariat. In the UN he was deputy director of the Habitat and Human Settlements Foundation in Nairobi, Kenya, for eight years, and formerly chief of housing at the UN in New York for 10 years. He is also a senior associate of the Institute of Public Administration, New York City, and currently serves as director, joint housing research project, People's Republic of China, with the China Academy of Urban Planning and Design.