

Caribbean developments in housing finance

The Caribbean Association of Building Societies and Housing Finance Institutions (CABSHFI) held its annual meeting in Port of Spain, Trinidad, on 7 November 1988. The meeting was followed by a two day conference with the theme of financing low income housing in small economies.

This article reports on the annual meeting and then summarises some of the major papers presented at the conference.

CABSHFI annual meeting

The executive committee of CABSHFI met in Tobago on 5 November 1988 and the Annual Meeting followed in Trinidad on 7 November. In his chairman's report Freddy Reyes-Perez (Dominican Republic) reported that membership of the Association totalled 49 institutions from 14 countries. The Caribbean Development Bank has 'observer' status. During the year the Banque De L'Union Haitienne became an associate member. It is hoped to expand membership further.

The chairman reported that during the year the Association had maintained its role as a "clearing house", providing member institutions with information on developments in the establishment of housing finance systems.

The Association has devoted major efforts to training and human resource development with the support in particular of the Federal Home Loan Bank of New York. Several member institutions in Trinidad and Tobago, Barbados, Cayman, the Dominican Republic and Jamaica had benefited from the Sister Institutions Programme which had provided invaluable training opportunities. Also, several members benefited

from the Bank's School of Education training programme.

Following the 1987 annual meeting in the Dominican Republic a housing finance conference had been held in Puerto Plata and a conference had been arranged following the AGM.

The Association was maintaining its efforts to establish a bank of information on its members.

The Association had maintained international relationships with a number of organisations including the United States Agency for International Development, the Federal Home Loan Bank Board, the United Nations Commission on Human Settlements, and the United States League of Savings Institutions. The Association had been represented at the Inter-American Housing Union meetings in Mexico City in March, the

'Major effort on training'

British Building Societies Association Annual Conference in May, the Inter-American Housing Conference in Quito in June and the IUBSSA meetings in Cannes, France, in October.

The newsletter had kept members informed of developments in the Association and it reported on relevant developments.

The executive committee had held three meetings during the year. A meeting in March in Coral Gables, Florida, had been attended by the IUBSSA president and secretary-general and had been followed by a meeting of the IUBSSA review group. A second meeting had been held in July in Nassau in the Bahamas with

the third meeting being held immediately before the AGM.

The executive committee

The executive committee of the Association was re-elected. It comprises:

Chairman:

Dr Freddy Reyes-Perez
(Dominican Republic)

Vice-Chairman:

Carlton Robinson
(Trinidad & Tobago)

Juan Bermudez

(Puerto Rico)

Leonard Ebanks

(Cayman Islands)

Hugh Hamlett

(St Vincent)

Rupert Martyr

(St Lucia)

Harcourt Niles

(Barbados)

Lancelot Reynolds

(Jamaica)

Joe Bailey (Jamaica) is secretary-general of the Association and Eric Carlson (IUBSSA senior consultant) is special advisor.

Housing in Trinidad

The Caribbean Conference began with a message from the Honourable Pamela Nicholson, Minister of Settlements and Public Utilities for Trinidad. She stressed that governments were now taking cognisance of the fact that their more effective role was that of enabler and facilitator and that co-operation and collaboration between the public and private sectors was critical to the achievement of the national goal of shelter for all.

The opening address to the conference was given by Arthur Sanderson, the acting Minister of Settlements and Public Utilities. He said that the government which had assumed office in December 1986 had adopted

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an approach to housing on the following principles:

- (a) Human settlements range from capital cities down to isolated farmsteads. Settlement policy is multi-sectoral and should be developed within the framework of economic and social planning processes at national, regional and local levels.
- (b) There is an acute housing problem in the country with an estimated housing need of between 7,000 and 9,000 units annually to the year 2000.
- (c) Housing need at the low income level is particularly urgent.
- (d) Housing and home ownership constitute a stabilising force in society.
- (e) A land distribution policy is essential to the shelter solution.
- (f) Measures employed to solve the shelter problem could also be stimulants to economic activity.
- (g) The private sector must be an active partner in the settlements thrust.

Accordingly, housing strategy must embrace land development and distribution, squatter regularisation, regulatory support mechanisms, financial support mechanisms and a psychological turnaround of the dependency syndrome.

Mr Sanderson invited the conference to consider the following issues:

- (a) Does affordability result in a dichotomy between the provision of mortgage housing and rental accommodation and the provision of sites and services, self-help and incremental housing?
- (b) Is it a question of segmenting the market with different solutions applied to the peculiarities of the segments?
- (c) It seems necessary to offer incentives to the financial sector and to developers for the development of settlements and the provision of shelter. One hears the argument that incentives are misplaced when applied to home ownership.
- (d) Are subsidies akin to incentives, and how should they be applied?
- (e) Affordability must be related to an acceptable and habitable product. There is the issue of minimum stan-

dards regardless of target group and sector of the market. Should building standards be uniform or relaxed for those on low income?

(f) What role is there for research and who is to carry it out?

(g) The plethora of regulatory agencies increases the time and cost of providing shelter. Is a one-stop approval agency the solution?

(h) It is desirable that low cost solutions be pursued, but this raises the question of cost recovery.

(i) Is self-help and incremental housing the solution? If so, what are the basics in terms of sites, services, etc that must form the core of this solution?

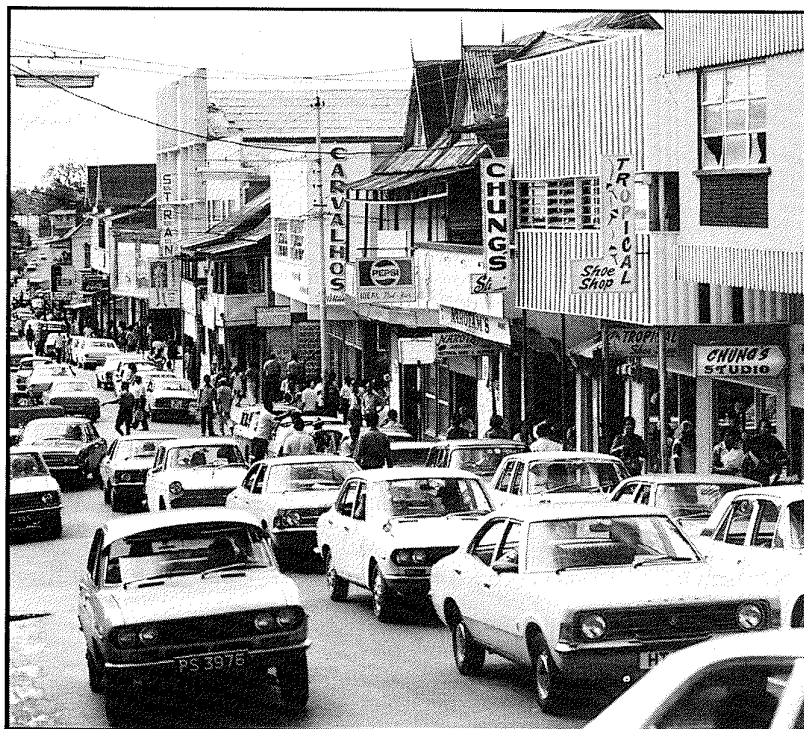
(j) The financial environment is important if the private sector is to be a partner. How can entrepreneurs find it rewarding to assist in the settlements effort?

Subsequently, Cynthia Bishop, permanent secretary at the Ministry of Settlements and Public Utilities, gave a paper on the settlements and housing policy of the Government of Trinidad and Tobago.

She said that the basic strategy to be pursued by the Government would be directed at: (a) reducing the cost of housing; (b) reducing the role of the public sector in direct house construction; (c) stimulating the flow of resources from the private sector towards satisfying the housing needs of all income earners; (d) maximising the use of existing resources; (e) rural development.

It is recognised that the financing of shelter cannot be achieved without participation of the private sector. Under the Finance Act 1988, provision is made to declare willing financial institutions "Approved Mortgage Companies" and thereby access a portion of their financial resources for

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Street scene in San Fernando, Trinidad.

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providing mortgage funds to lower income groups.

Agreements will be entered into with these companies to provide for exemption from corporation tax of any income or profits of the company deriving from its business of providing mortgage loans to purchase existing dwelling houses, construction of which commenced after December 1957, or mortgage loans granted for the construction of dwelling houses, up to a maximum of TT\$250,000 (TT\$7.95 to the £ at 5 December 1988) and at interest rates between 8% and 9%. The agreement provides that a certain percentage of the portfolio must be applied to low income housing.

Other tax incentives are available in the housing sector relating to gains or profits derived from the initial sale of new houses, premiums and rents derived from the letting of new houses and interest on mortgage loans.

An important aspect of the Government's new policy is the shift from the provision of finished housing units to the provision of sites and services, with a basic shelter core to be expanded and improved upon at a later stage by the beneficiaries.

A major thrust of the housing policy is the Squatter Regularisation Programme which commenced in July 1987. The previous policy was legalistic in approach and provided for individuals to seek regularisation through a legal process. It failed to take into consideration the social and technical dimensions of the problem, arising from the fact that squatter communities had developed and any strategy for regularisation had to be based on an approach to the community as a whole.

Under the new policy there is a comprehensive approach based on two principal concepts — rationalisation and settlement. The community is involved at all stages.

The major objectives of the programme are the rehabilitation of squatter communities where practicable, the resettlement of squatters

where regularisation is not practical, the regularisation of tenure on tenanted estates, and the containment of spontaneous development.

Substantial financial resources need to be channelled to the housing sector. Direct public investment will concentrate primarily on the provision of shelter for lower income families. Innovative mechanisms for the mobilisation of funds are required. The Ministry is interested in the development of community-based finance institutions such as credit unions, housing co-operatives and local building societies.

'Exemption from corporation tax'

Lending to low income populations

The United States Agency for International Development (USAID) has a long history of involvement in housing and housing finance in the Caribbean. Dr Albert Greve, of the Regional Housing and Urban Development Office of USAID in Kingston, Jamaica, gave a paper entitled "Positive Experiences in Lending to Low Income Populations". Dr Greve's speech concentrated on loans for home improvement as for many people their income is such that they have no alternative but to improve and expand on what they have.

The office in Kingston had collaborated with the Jamaican churches and credit unions to find innovative ways of addressing the problem. A pilot project to provide low income households with greater ease of access to home improvement loans for upgrading the quality of their dwellings had been developed by the Moravian Church Synod and the Moravian Church in the rural town of Mizpah in co-operation with the local branch of the Regional Parish Credit Union and with technical assistance from USAID.

The project was conceived as a means of closing the gap between financial institutions and low income households who often do not qualify for institutional credit or who are afraid to approach a bank or building society or other institution for a loan because of their perception of what would be required. The idea emerged of using a church group or other community group to provide the organisational focus which would benefit the loan recipients and the participating financial institutions.

The Moravian Church Parish in Mizpah has traditionally played a very active role in community development. It initiated a savings club for its members to familiarise them with the concept of savings to encourage them to save on a regular basis. It invested the proceeds to start a variety of income-generating projects in the community. It was well placed to work on the new project. The programme was designed to function around the principle of community involvement and the use of peer pressure to ensure timely loan repayments.

The Church set up a committee to oversee the project at local level with functions including pre-selecting potential programme applicants, providing a skilled building inspector from within the community, providing training and basic financial management and assisting the credit union by assuming some field activities. The Church would also exercise moral authority to encourage timely repayment of loans and it agreed that the savings accounts of beneficiaries would be transferred to the credit union. The credit union agreed to offer immediate membership and immediate availability of credit to the new participants.

The most innovative aspect of the programme was the decision to secure the loans by having each participant co-make each other's loans. Loans were funded in groups of five individuals. These five would co-make each other's loans. Extension of the credit to the next group of five individuals would be contingent on

the first group having made at least two full and timely repayments. This peer pressure is important given the lack of traditional guarantees such as title documents to land, property, etc.

The lesson that has emerged from the project is that poor people do repay loans and in many cases do so better than their more fortunate counterparts. One of the reasons for success was the constant guidance and supervision provided by the Church and the strength of the peer pressure in the community.

The first loans were made at the end of 1987 and were disbursed on a voucher system through participating hardware stores in the community. In order to ensure that work costs were reduced and the work completed in a timely manner, the beneficiaries worked on each other's homes.

Based on this experience, not only does the local credit union stand ready to fund more applicants from the same locality, but the main parish office is now planning to expand the programme to other areas within the parish, with the co-operation of the church. Other church groups in the same parish have contacted the credit union to enquire about initiating similar schemes.

There is an opportunity for banks, building societies and other financial institutions to become involved in such projects.

Interest rate policy and low income housing

Compton Bourne, Professor of Economics at the University of the West Indies, St Augustine, Trinidad and Tobago, presented a paper on interest rate policy and low income housing. Professor Bourne commented that unattractive deposit rates would discourage deposit growth even if not engendering a reduction in deposit levels. The dampening effect of low nominal deposit rates would be greater in the inflationary environment since real rates of interest would be even lower and would tend to be negative. With negative real rates of interest, the

asset value of financial capital is eroded.

The importance of appropriate interest rate policies for the supply of finance for low income housing is emphasised by the depressing influence of economic recession and unemployment on the share of contractual and quasi-fiscal savings in total personal sector savings. A small reliance has to be placed on increasing the voluntary savings effort of employed persons and other income recipients within the household sector.

The unintended consequence of artificially low interest rates may well be reduced lending capacity and a lower volume of lending in the face of expanded loan demands stimulated by the particular interest rate régime.

'Some degree of tax relief'

There was usually the presumption that mortgage rates of interest accurately measured the financial burden of mortgage financed home ownership. However, the fiscal system in all Commonwealth Caribbean countries provides some degree of income tax relief on mortgage interest payments. Using tax discounted mortgage interest rates as the true measure of interest costs it is by no means clear that current interest rates are unaffordable or disadvantageous to low income households.

However, the fiscal system does confer disproportionate benefits on high income households. It is a pertinent question as to whether more attention should not be directed towards converting those fiscal benefits or implicit mortgage rate subsidies into more direct and certain provision of low income housing than to the questionable pursuit of low mortgage rates as such.

A further consideration is the fact that there is a real rate of return on

home ownership. The indices for Barbados, Jamaica and Trinidad and Tobago all suggest substantial capital gains and increases in imputed rental values.

Explicit consideration of interest costs in relation to the returns on home ownership improves the formulation of interest rate policy for two reasons:

- (a) it forces recognition of the fact that house acquisition is an investment;
- (b) it raises questions of why investors in housing should be subsidised by other investors.

The Sou Sou land approach

Ivan Laughlin gave a paper on the Sou Sou land approach. Mr Laughlin was formerly chairman of the National Housing Authority of Trinidad and Tobago and in that position he had responsibility to lead the planning and implementation of the housing policy based on the Sou Sou land concept. Today he works with a number of small community-based organisations on settlements. The Sou Sou concept attempts to capture the essence of a people centred approach to the creation of viable community settlements. The framework embraces the following fundamental factors:

- (a) Recognition of the creative energies in the informal sector. Sou Sou is based on a traditional form of banking within villages through which a fixed number of participants pool their savings, with each participant at appropriate intervals being able to draw the lump sum. Under the Sou Sou land initiative the individual invests money with the Sou Sou land company in affordable instalments, the company purchases the estates and develops them in a process involving the investors, and at the end of the exercise the investor receives his parcel of land.
- (b) Village revitalisation both in the urban and rural environments.
- (c) Small-scale farming, identified

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as homesteading. This provides an intermediate land use between residential and farmsteading. It provides for the basics of shelter and food to be available and for surpluses to be marketed in a village co-operative endeavour.

(d) The assertion of smallness as a distinct advantage.

(e) Research and experimentation.

After three-and-a-half years' experimentation, 1,200 hectares of land had been purchased in over 13 projects involving the investment of approximately TT\$18 million provided by 10,000 participants. At this stage the Government and the planning authorities were in conflict with Sou Sou Land Ltd.

The new Government, elected in December 1986, provided an opportunity to extend the Sou Sou concept. This was a major plank in the governing party's election campaign. Because the Sou Sou land concept was based on the participation of people in the overall development process, the implementation of the policy demanded sensitivity and patience.

The NHA set in train a number of strategies that had to take account of the limited resource capability of the Authority for such an enterprise. The Authority was politically emasculated. It had not been allowed the opportunity of developing its own managerial techniques and approaches to the issues confronting shelter and development. There were huge arrears owed on rentals and mortgage loans, and also innumerable problems related to personnel.

The first strategy had to be the reorganisation of the NHA and this required a long timespan. That activity was pursued by the introduction of collaborative mechanisms with staff and management. The lesson that was learnt was that once the focus was turned inwards and people realised that their participation mattered in the context of an exciting development initiative there was a tremendous amount of goodwill forthcoming.

The second strategy had to deal

with the anomalies created by previous NHA policies. It revolved around two major areas. The first was the existing housing estates, especially those built since 1979. There was much concern about the quality of the housing and the high level of mortgage payments. Residents were encouraged to institute organisational machinery to negotiate with the NHA on issues of mortgage revaluation and community upgrading. The result was comprehensive revaluation agreements. A remedial works programme was also initiated.

The second area in this strategy were the rental estates where there was an excess of expenditure for maintenance over income of TT\$24 million per annum. The strategy was based on the involvement of the resident communities, who responded with a high level of responsibility and commitment.

The third strategy had to deal with the new settlements thrust. This strategy, based on the Sou Sou land concept, acknowledged the internationally accepted view that governments build shelter at five times the price of the individual and that what is necessary is to provide the land base in a context of community participation and to create mechanisms in the financial sector to allow people to undertake their own housing construction.

The thrust had five elements:

- (a) Village expansion.
- (b) Comprehensive development.
- (c) Squatter regularisation.
- (d) Urban renewal and revival.
- (e) Financing.

An investment programme was put into effect whereby the participants invested funds in incremental amounts and became eligible for their land once they satisfied specific criteria. The investment programme was structured to create a funding potential to generate a cash flow for the project to be initiated. Because it afforded people in the low income bracket the opportunity for invest-

ment in land, it opened up opportunities for the generation of revenue from previously untapped sources. One such source had to do with the repatriation of funds from hard currency areas since investment in land is always attractive and family connections encourage that activity.

The fourth strategy had to deal with the way in which the resource capability of NHA would be expanded without increasing the current expenditure. This was undertaken by three initiatives:

(a) Mobilisation of private sector professional and contractor organisations.

(b) Mobilisation of the financial community. The Minister of Finance, in his 1988 Budget, indicated that special arrangements would be formulated to allow mortgage companies in particular to be able to operate a funding component under special conditions that would assist participants in the programme. The Trinidad and Tobago Mortgage Finance Co was designated to be the agency in the forefront of this activity.

(c) The strengthening of the technical capability of the NHA in particular with regard to this issue of land title.

That, then, was the quantum leap. It was creating confidence, a basis for survival, providing a wide range of opportunities for participants, encouraging the professionals involved in the programme to understand the importance of collaboration with the communities and at the same time allowing the communities to exercise their responsibilities, thereby engendering a new culture of participation and responsibility.

Process and flexibility are the critical dimensions. There are no overnight solutions. The seeds of a new approach have to be sown in the knowledge that rigid perceptions exist at all levels and allow people the time to respond positively in an atmosphere of perceived accomplishments. ■

Work on housing finance by UNCHS (Habitat)

The United Nations Centre for Human Settlements (Habitat), better known as UNCHS (Habitat), is one of the smaller agencies of the United Nations. It is also a relatively new organisation, having been established only in 1978. It had its origins in the 1976 United Nations Conference on Human Settlements held in Vancouver, Canada. The member states concluded that there was a need for a United Nations organisation to assist governments with their national programmes on human settlements development. UNCHS (Habitat) was created to meet that need under the control of a 58-member governing body, the Commission on Human Settlements.

UNCHS (Habitat) combines in one organisation activities that formerly were scattered among various departments and organisations within the United Nations system. It has its headquarters just outside Nairobi in Kenya. The Centre receives policy guidance from the Commission on Human Settlements which meets annually. The UNCHS (Habitat) secretariat is headed by an under-secretary-general of the United Nations, designated the executive director. The current executive director is Dr Arcot Ramachandran.

UNCHS (Habitat) was the organising and co-ordinating body for the International Year of Shelter for the Homeless and subsequently has prepared the Global Strategy for Shelter to the Year 2000.

This article briefly reviews recent work of UNCHS (Habitat) with particular emphasis on housing finance.

International Year of Shelter for the Homeless

In 1982 the United Nations General

Assembly declared 1987 as the International Year of Shelter for the Homeless. Responsibility for organising and co-ordinating the activities for the year was entrusted to the Commission on Human Settlements at the inter-governmental level and UNCHS (Habitat) at the secretariat level. At the 11th session of the Commission on Human Settlements held in New Delhi, India, in April 1988 the executive director presented a report on activities and achievements of the International Year. The report lists the following achievements of the year—

(a) Improving the shelter in neighbourhoods of some of the poor and disadvantaged by 1987. IYSH related activities and specific projects benefited a large number of the poor, though it was small in comparison with the scale of the need.

(b) Demonstrating ways and means of improving shelter and neighbourhoods of the poor and disadvantaged by the year 2000. The long term objective of the year was to "demonstrate by the year 2000 ways and means of improving the shelter in neighbourhoods of the poor and disadvantaged". More than 600 demonstration projects and over 100 countries were designated as IYSH projects and a substantial body of practical and technical knowledge has been accumulated.

(c) Securing renewed political commitment by the international community. Governments have shown their new commitment to improving shelter conditions of the poor by adopting new revised shelter strategies.

(d) Consolidating and sharing all new and existing knowledge and relevant experience to provide a full range of tested and practical alternatives for

improvement of shelter and neighbourhoods. IYSH sub-regional meetings with participation of more than 100 member-states served as the most suitable for a sharing of experiences.

(e) Developing and demonstrating new approaches and methods in order to provide a basis for new national policies and strategies. Among the 130 countries having advanced programmes towards the achievement of the objectives of the year, 55 have established new strategies, 11 have started preparatory activities for new strategies, and the rest have made at least one significant policy change.

(f) Exchanging experience and providing support among countries to meet the objectives of the year. A high level of exchange of experience among countries was achieved in conferences, seminars and workshops. UNCHS (Habitat) published two books, more than 10 special topic publications, 15 monographs and 12 IYSH Bulletins.

The report concludes that in spite of severe economic conditions for the majority of developing countries, the reports of the activities of national governments show hopeful signs. After six years of experimentation there is now a clear focus on a number of issues which relate the improvement of shelter to the overall development efforts and efficient resource utilisation—

(a) The impact of national macro-economic policies on urbanisation, settlement patterns and shelter.

(b) The integration and co-ordination of public and private sector activities in the field of shelter and services.

(c) The recognition of the vast

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energies and resources of individuals and communities that can be tapped and reinforced to produce more and improve the conditions of shelter and services.

(d) The recognition of a wider range of public sector potentials for participation in improving the conditions of shelter and services by the adoption of a variety of enabling and facilitating measures.

It was on reviewing these emerging ideas and concepts that the Commission on Human Settlements, at its 1987 meeting, asked the executive director to prepare a Global Strategy for Shelter to the Year 2000.

The report includes a specific section on financing shelter for the poor. This is set out in full in the accompanying box.

Report of the executive director for 1986-87

The executive director of UNCHS (Habitat) presented a progress report to the Commission on Human Settlements at its meeting in New Delhi in April 1988. Among the eight sub-programmes described is sub-programme seven which is the mobilisation of financial resources for human settlements development. The overall objective of this is to provide support to the development of effective human settlement finance systems.

During 1987 work continued on the preparation of case studies on the integration of employment generating activities with housing projects and other human settlements development programmes. The studies will cover Chile, India, Nigeria, the Philippines, Sri Lanka and Zambia.

The findings will be published in the form of guidelines and recommendations to governments and local authorities on support systems, legal and institutional frameworks, advisory services, credit facilities, training assistance and other areas conducive to the development of opportunities for self employment and promotion of small enterprises.

Research in housing finance sys-

Financing shelter for the poor

THE range of actions reported on improving the availability of finance to the poor including the setting up of housing finance institutions, mobilisation of new sources of funds, improving access of the poor to finance, and cost recovery.

(a) New financial institutions

In Lesotho, Nepal and Papua New Guinea feasibility studies have been undertaken for setting up a housing finance institution. Other countries considering setting up a national housing bank are Costa Rica and El Salvador. In the Comoros a national building society is envisaged with contributions amounting to CFAF 80 million and a grant of \$US600,000. In India plans are advanced for the setting up of a three-tier new housing finance system. At the apex level, a national housing bank will be set up, with regional institutions at the second tier and local grassroots institutions, mutual savings and thrift associations at the third tier. In Djibouti Credit Habitat has been set up, with 600 loans already issued for the improvement of the poorest dwellings. To ensure continuity of the programme an urban development fund has been created for recovery of costs, budgetary grants and external aid.

(b) Improving access of finance to the poor

Existing housing finance institutions are being strengthened to reach the poor in Cyprus, the Dominican Republic, Indonesia, Kenya and Thailand. In Argentina, the National Mortgage Bank has undertaken a new

scheme called "Plan Techno" geared towards providing funds to low-income families for the construction of roofs. In Barbados a wholesaling financing agency, the Housing Credit Fund, has been established to channel funds to low-income groups through mortgage companies, commercial banks and credit unions. In Cameroon, Credit Foncier has embarked on a set of new financial packages addressed to the poor. In Malaysia, the building societies have received new directives to reach low-income groups. In Sierra Leone and Togo savings and credit systems have been developed to assist the poor. In Zimbabwe the building societies have extended their lending to low-income people directly or through the employers. In Jamaica a system of gradual repayments has been instituted for increasing access to housing finance by the poor.

(c) Mobilisation of funds

In many countries, mobilisation of funds for housing has been undertaken as a matter of priority. In Turkey, the National Housing Fund was created in accordance with the National Housing Law of 1984. The sources of the Fund consist of a surtax of 10% on petroleum products, 5% on other liquid fuels, 30% on tobacco and other state monopoly products, varying surtaxes on imports, and a levy of \$US100 on trips abroad. The fund is available to housing co-operatives, individual buyers, and private contractors (to purchase construction machinery and installations) as well as to manufacturers producing construction materials and equipment.

tems is concentrated on the mobilisation of savings with a view to disseminating information on suitable instruments to increase the flow of funds to the housing finance sector.

Publications

The principal regular publication of UNCHS is *Habitat News* which is published quarterly. This contains

articles on UNCHS (Habitat) activities, technical co-operation, research and development, information initiatives, regional news and events.

NGO News is an insert to *Habitat News*. It is a forum for non-governmental organisations concerned with issues related to human settlements at the international and national level.

INTERNATIONAL AGENCIES

A second regular publication is the *UNCHS Shelter Bulletin*. The most recent issue, published in July 1988, reviews the Global Strategy for Shelter to the Year 2000, includes an article on housing finance, mechanisms and economic adjustment, and has country news and United Nations news.

Global Strategy for Shelter to the Year 2000

Before the International Year of Shelter for the Homeless came to a close, the General Assembly of the United Nations concluded that the year should be followed by a longer term implementation-orientated effort that could capitalise on the interest and momentum generated by the year, and decided to launch a Global Strategy for Shelter to the Year 2000.

The Commission on Human Settlements, at its meeting in New Delhi in April 1988, recommended the adoption of the Global Strategy as the framework for national and international action.

It is estimated that the inadequate shelter conditions of an estimated one billion people are a cause of grave concern to governments and the international community. If current trends hold, cities in developing countries, which will already have enormous slum and squatter settlement populations, will have to accommodate a further 750 million people by the turn of the century.

There are three important reasons why a global level strategy is warranted—

- (a) No country can claim to have solved all of its shelter problems and therefore all countries should make a commitment to meeting shelter needs.
- (b) All countries have successful experience to share with others, and global exchange of knowledge is essential to solving national shelter problems.
- (c) The sheer scale of shelter demand calls for a global effort based on the support of all nations.

It is suggested that the right to adequate shelter requires governments to make basic changes to their existing policies on shelter.

The practicality of a national strategy should be ensured by the full participation of all actors involved in the shelter production process. The role of the state will vary. In some cases it should play a leading role without precluding private sector participation, while in others, the private sector will take the leading role with only broad policy making and institutional support from government.

Attention will have to be given to rental housing. In view of the importance of rental housing in the total housing stock, particularly to low income settlements, governments will have to come to some decision as to the promotion of rental housing as an effective way of expanding production options for shelter.

The unaided private market will not be able to solve the fundamental problems of squatters and other occupants of informal or illegal housing. Overcoming these problems is dependent on the introduction of new government procedures.

National shelter strategies will need to contain four complementary parts—

- (a) Definition of clear and measurable objectives.
- (b) Gradual mobilisation of the shelter sector.
- (c) Mobilisation and distribution of financial resources in the sector.
- (d) Equal emphasis on improving the management of land, expanding the supply of infrastructure, and increasing the capacity of the construction industry.

International action is crucial for the success of the strategy. The strategy can be re-inforced by technical co-operation between developing countries, and there will also be a need for external assistance to developing countries from developed countries.

UNCHS (Habitat) will act as the co-ordinating and monitoring agency for the implementation of the strategy. The Centre will also prepare a reporting format to facilitate monitoring of progress by the Commission on Human Settlements.

The strategy includes a section on financing for housing which makes the following five key points—

- (a) Shelter finance reform will have to be seen as part of a broad effort to develop and reform the financial sector.
- (b) Shelter development will require a steady flow of long term finance.
- (c) Governmental physical and credit policy should be orientated to ensuring that the shelter sector is allowed to compete fairly for financing and that the costs of financial intermediation are minimised.
- (d) Given the substantial and growing demand for rental housing, particularly in the rapidly growing urban settlements of developing countries, financing will have to be mobilised and made available for the production of shelter for rental purposes for all income groups.
- (e) Lending for individual housing mortgages cannot be sustained without significant improvements in recovering loans and reducing loan default rates.

Main points of the section on financing of housing are shown below.

Financing for housing

Shelter-finance reform will have to be seen as part of a broad effort to develop and reform the financial sector

A key component of a shelter strategy is in the area of housing finance, where it is clear that governments have an obligation to ensure that an appropriate environment is created for the mobilisation of funds. The development or reform of institutions engaged in financing housing

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should be part of an overall effort to strengthen and develop the financial system of a country. The objectives of such an effort are to promote and mobilise savings, reduce the cost and improve the efficiency of financial intermediation, and promote the free movement of capital throughout the national economy.

Shelter development will require a steady flow of long-term finance

Strategies for financing investment in shelter have to address the central issue of mobilising a steady flow of long-term finance. Housing requires a longer term than some other types of investment, because housing costs are usually a large multiple of household incomes, making amortisation of loans over a long period necessary. Several sources of finance need to be considered, including not only savings by households in financial institutions but also funds from the sale of housing bonds (which may be backed by mortgages as security) and funds accumulated in compulsory savings schemes, such as provident or pension funds, life insurance and other social security systems.

Governmental fiscal and credit policies should be oriented to ensuring that the shelter sector is allowed to compete fairly for financing and that the costs of financial intermediation are minimised

Governmental policies regarding investment priorities and availability and pricing of credit can have a strong impact on the ability of any sector of the economy to compete for investment resources. In recent years, Governments have often made it difficult for the housing sector to compete for funds by establishing policies that have directed credit to sectors of the economy that were held to be more productive than housing or by establishing interest rate restrictions on deposits or lending rates of housing finance institutions that made such institutions financially unviable, unable to com-

pete for funds and unable to continue to make loans.

Shelter strategies need to examine closely the continuing rationale for such policies and, when it appears warranted, seek the elimination or restructuring of governmental credit-allocation procedures, the establishment of deposit rates at housing-finance institutions that will mobilise additional savings, the fixing of lending rates that will ensure financial viability and the approval of new types of mortgage instruments, such as adjustable or graduated payment mortgages, that will permit housing finance institutions to respond flexibly to changing macro-economic conditions.

Governments should avoid using housing finance institutions as vehicles for housing subsidies, since there are almost always more equitable and efficient subsidy mechanisms available which do not threaten the financial integrity of lending institutions. One objective in any country should be to reduce the cost of housing finance to the lowest possible level that is consistent with sound financial and economic principles.

Given the substantial and growing demand for rental housing, particularly in the rapidly growing urban settlements of developing countries, financing will have to be mobilised and made available for the production of shelter for rental purposes for all income groups

In all countries, rental housing contributes a substantial portion of the existing urban housing stock. In some centrally planned economies, the majority of the urban housing stock is built by State enterprises and rented at extremely low rates. In market economies, the growing demand for rental housing concerns all income groups and is determined by the modernisation processes taking place in those societies. Many households, regardless of their income

level, are not necessarily interested in buying a house. There are many reasons for this — expected mobility, reluctance to invest a disproportionate share of income or resources in a fixed asset or, simply, unaffordability. Low-income groups in developing countries are often interested in renting decent and affordable accommodation close to the location of their income-generation activities.

The production of new housing units for rental purposes is often hampered by the unintended results of social legislation designed to help the weak groups of society, e.g., rent controls over the urban housing stock, which, particularly in times of high inflation, often crystallise with time into unfair privileges for consolidated tenants and the exclusion of deserving households. A review of rent control legislation, in line with the general principles of the strategy on subsidy policy — compassion, equity, and efficiency — will have to be undertaken in all countries.

Lending for individual housing mortgages cannot be sustained without significant improvements in recovering loans and reducing loan-default rates

Many housing loan arrangements, by financial institutions, governmental agencies and community-based credit unions and co-operatives, suffer from high rates of default. Beneficiaries of such loans are one-time borrowers who may not be significantly threatened by reneging on their commitments. Evicting them from their houses for failing to pay is in direct contradiction with the effort to house them properly and, in many cases, difficult, if not impossible. The recovery of loans will need to be attended to at the community level, on a regular daily, weekly or bi-weekly basis, by people who remain close to the borrowers. There will be a need to devise collection systems that reduce the risk of lending to the poor and, possibly, to supplement them with special welfare funds to assist those unable to pay in times of dire need. ■

The World Bank reviews its housing finance operations

DURING the past five years World Bank lending for urban development has expanded considerably. In the fiscal year 1988 urban lending was \$2,016 million compared with \$1,324 million in the previous year and as little as \$385 million in 1985. Urban lending accounted for 10.3% of total Bank and International Development Association lending. A total of 19 loans and credits were approved, of which 11 were by the Bank and eight by the International Development Association.

Four projects accounted for half of the total lending — the Tamil Nadu Urban Development Project in Sri Lanka (\$300 million), the Housing Development Finance Project in India (\$250 million), the Mexico Housing Finance Project (\$300 million), and the Rio Emergency Flood Reconstruction Project in Brazil (\$175 million).

Policy towards urban projects has moved away from sporadic traditional interventions to broader policy and institutional issues of greater importance for national economies and the productivity of cities. Special attention has been placed on:

- (a) Urban administration and municipal finance through devolution of resource mobilisation and investment planning to local authorities.
- (b) Land management and regulatory environments to stimulate private initiatives and investment, especially in housing, land development and urban transport.
- (c) Housing, not only as a basic human need, but also as a potential contributor to domestic

IN OCTOBER 1988 the Infrastructure and Urban Development Department of the World Bank published the *FY88 Annual Sector Review — Urban*, which briefly reviews the Bank's urban operations. This particular report focuses on the most dynamic sub-sector of urban lending, housing finance, for an in-depth assessment.

This article summarises the report, dealing first with urban lending in general and then in detail with the review of housing finance operations.

resource mobilisation and financial developments.

The Bank's urban development lending has concentrated on the following areas:

- (a) *Municipal development.* Rapid urbanisation has outstripped most governments' ability to cope with the demand for even the most basic services. The Bank has responded by expanding lending for general municipal infrastructure and giving more attention to the overall process of urban management, especially to the need to delegate more responsibilities to local governments. In the fiscal year 1988 there were nine operations that concentrated on municipal development. These addressed the basic objectives of improving the efficiency of public sector management at the state and municipal levels, increasing the local capacity for revenue generation, and improving financing and delivery mechanisms for municipal investments. All nine projects include an institutional strengthening component. Improving local taxation systems has also

emerged as a crucial issue, as has improving financing mechanisms for urban investments.

- (b) *Urban infrastructure.* In the fiscal year 1988 the Bank approved five urban water sanitation projects (\$535 million), two urban transport projects (\$180 million) and 13 projects providing a wide range of urban infrastructure facilities (\$780 million). A striking feature of the Bank's finance for general urban infrastructure is the heavy reliance on financial intermediaries. The urban infrastructure projects have maintained an increasing concern for operation and maintenance, cost recovery targets for the services, and improving the investment planning process.

- (c) *Emergency loans.* Lending for reconstruction activities in the fiscal year 1988 accounted for 16% of total urban lending (\$318 million). The three projects responded to different kinds of emergencies: flooding and landslides in Rio de Janeiro in Brazil, an earthquake in El Salvador and civil strife in Sri Lanka.

- (d) *Land management.* Over half of the Bank's shelter projects have suffered delays due to land acquisition problems. An increasing number of projects address land acquisition issues directly. Of greater concern is the poor functioning of urban land markets in developing countries. The focus of the Bank's interventions is now broader and land management issues are very important elements in sector work and policy dialogue. The Bank is also expanding its lending support for land management projects in Brazil and Sri Lanka, including

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studies on land tenure and registration issues. Land information and mapping components were included in five 1988 projects.

(e) *Housing*. In the fiscal year 1988, the Bank lent, through 15 projects, approximately \$1 billion for housing, helping to finance investments costing \$3.2 billion. Free standing housing finance components or projects accounted for 64% of the total lending volume for shelter. The steady increase in lending for housing finance has justified the selection of housing finance as the special topic for the review of urban operations.

(f) *Poverty alleviation and environmental concerns*. Most of the 1988 urban loans are focused on policies and programmes that support economic adjustment efforts that enable the resumption of economic growth. The renewed emphasis on urban productivity rather than urban poverty does not, however, imply a reduced concern for the urban poor. Twelve of the 19 loans provide a significant portion of their resources directly to the urban poor. Rather, it reflects the fact that the basic cause of urban poverty is not lack of employment opportunities but the low productivity of many of the jobs that the urban poor hold and also the fact that the urban poor are the ones who suffer most from distortions in the land, housing and financial markets and from the general shortage of public investment opportunities.

Overview of the Bank's housing finance portfolio

Housing investments typically amount to between 3% and 8% of GNP in developing countries and

between 15% and 25% of gross capital formation. Housing is an economic good and also a basic human need. The link between health and housing conditions, for example, is well established. Housing is also the main user of urban land. Finally, housing is a long-lived and costly asset which is heavily dependent on people's ability to borrow.

The housing sector represents an opportunity for the Bank because housing is one of the simplest and safest assets in the economy. Market-rate housing finance can be a very basic part of the Bank's effort to encourage private savings and support a process of financial deepening in the economy.

On the other hand, it is clear that housing finance assistance is fraught with many dangers. After 16 years of Bank experience, and 99 shelter projects in 50 countries, it is fair to say that squatter upgrading and sites-and-services programmes have been a considerable improvement over the public shelter programmes that preceded them. They have provided unquestionable evidence that production of affordable and adequate housing for the poor is possible.

In the six years since the Bank's first housing finance project, 17 projects focusing on housing finance or including major free standing components have been approved totalling \$1.5 billion. Table 1 shows the growth in the bank's housing finance lending.

Table 2 shows details of the projects.

Some 13 of the 17 housing finance

projects were channelled to financial intermediaries rather than to non-financial public sector housing authorities. In addition, in the cases in which projects relied on government housing programmes, the central objective was a refocusing of the public sector authorities so that the financial sector could more actively participate in the mortgage market. Most of the institutions that have received housing finance loans have either been created in the past 11 years or considerably refocused.

Most of the loans have a number of policy objectives. There have been three broad motivating rationales:

- (a) Financial sector reforms.
- (b) Broader fiscal policy initiatives.
- (c) Housing sector concerns.

The early housing finance projects

'Fraught with dangers'

were primarily concerned with increasing the access to adequate housing for the poor and with controlling or reducing and better targeting housing subsidies. As the macro-economic role of housing finance has become better understood, these projects are increasingly aimed at supporting financial sector reform.

An assessment of the effectiveness of housing finance operations

Performance in respect of financial sector objectives has been as follows:

(a) *Resource mobilisation*. More than 40% of the housing finance institutions that receive bank loans have been able to mobilise most of their resources domestically. In most cases interest rates paid by the institutions have been positive. Positive interest rates are essential to provide long-term financial integrity to the intermediation process.

(b) *Risk exposure and contingent liabilities*. In 12 of the 17 housing

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Table 1: World Bank Housing Finance Lending

| <i>Fiscal Year</i> | <i>Number of Operations</i> | <i>Lending (\$m)</i> | <i>Lending as Percentage of Total Urban Lending</i> |
|--------------------|-----------------------------|----------------------|---|
| 1983 | 1 | 60 | 11 |
| 1984 | 1 | 5 | 1 |
| 1985 | 2 | 90 | 23 |
| 1986 | 4 | 466 | 30 |
| 1987 | 3 | 199 | 15 |
| 1988 | 6 | 672 | 39 |

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Table 2: World Bank Housing Finance Lending (\$m)

| Year | Bank Lending | | Bank Urban Lending | | | Bank Lending for Housing Finance | | | | | |
|----------------|--------------|-----------------|--------------------|----------------------|-----------------|----------------------------------|----------------------------|--------------------|--------------------------------|-------------------------|--------------------|
| | Total Amount | No. of Projects | Total Costs | Bank Contribution | No. of Projects | Title | Total Projected Cost (TPC) | Share of TPC to HF | Total Loan Amount (LA) | Share of LA to HF | % of Urban Lending |
| FY83 | 14,479.0 | 14 | 1,279.0 | 537.2 | 1 | – Morocco I Hsng. Loan to CIH | 209.5 | 209.5 | 60.0 | 60.0 | 11.2 |
| FY84 | 15,524.2 | 16 | 1,080.0 | 497.0 | 1 | – Zimbabwe Urban Project I | 112.6 | 47.2 | 43.0 | 4.5 | |
| FY85 | 14,406.0 | 10 | 1,255.9 | 384.6 | 2 | – Chile Public Sector Hsng. | 576.5 | 576.5 | 80.0 | 80.0 | |
| | | | | | | – Malawi Urban Project I | 18.2 | 13.0 | 15.0 | 10.0 | |
| Total | | | | | | | | | | 90.0 | 23.0 |
| FY86 | 16,318.2 | 17 | 4,763.0 | 1,540.1 ^a | 4 | – Mexico Low-Income Hsng. | 300.0 | 300.0 | 150.0 | 150.0 | |
| | | | | | | – Indonesia Hsng. Sector | 846.5 | 846.5 | 275.0 | 275.0 | |
| | | | | | | – Portugal Hsng. Finance | 56.6 | 56.6 | 25.0 | 25.0 | |
| | | | | | | – Nigeria Urban Devel. II | 85.0 | 23.4 | 53.0 | 16.3 | |
| Total | | | | | | | | | | 466.3 | 30.0 |
| FY87 | 17,674.0 | 13 | 4,695.0 | 1,324.1 | 3 | – Korea Hsng. Finance | 1,442.5 | 1,442.5 | 150.0 | 150.0 | |
| | | | | | | – Thailand III Shelter | 72.4 | 35.8 | 21.0 | 10.0 | |
| | | | | | | – Ivory Coast Urban Dev. III | 304.2 | 136.2 | 126.0 | 38.5 | |
| Total | | | | | | | | | | 198.5 | 15.0 |
| FY88 | 19,220.7 | 19 | 5,114.4 | 2,016.3 ^b | 6 | – Senegal Hsng. & Mun. Devel. | 78.3 | 13.5 | 46.0 | 21.7 | |
| | | | | | | | | Loan to BHS | | IDA finances 100% of HL | |
| | | | | | | – India Hsng. Devel. Corp. | 840.8 | 840.8 | 250.0 | 250.0 | |
| | | | | | | – Philippines Hsng. Sector | 325.0 | | 160.0 | 80.0 | |
| | | | | | | | | | 80 million for const. industry | | |
| | | | | | | – Ecuador National Hsng. II | 85.7 | 24.0 | 60.0 | 20.0 | |
| | | | | | | | | Home Impvt. Loans | 30% for Hsng. Fin. | | |
| | | | | | | – Mexico Hsng. Finance | 1,576.0 | 1,576.0 | 300.0 | 300.0 | |
| | | | | | | – Lesotho Urban Sector Reorient. | 42.2 | 14.0 | 20.4 | 8.0 | |
| Total | | | | | | | | | | 680.0 | 33.7 ^c |
| FY83-88 Totals | | | | 6,299.3 | 17 | | | | | 1,510.0 | 23.8 |

(a) Includes US\$400 million Emergency Reconstruction Loan to Mexico.

(b) Includes two Urban Transport Projects.

Includes Mexico Housing Finance Project.

Includes three emergency loans totalling US\$318 million.

(c) Would be 44% if emergency loans were not included.

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projects the government's contingent liability was reduced.

(c) *Arrears.* The average percentage of portfolio arrears reported for projects funded by the Bank is about 12%. However, there has been tremendous variation between the projects. For example, the rate reported on the Indian housing finance loan has been less than 1%.

(d) *Interest rates.* Few of the projects involve funds being on-lent at negative inflation adjusted interest rates.

With respect to fiscal policy concerns, the following have been noted:

(a) *Subsidies and target beneficiaries.* The target beneficiaries of housing finance projects are "below the median income" households rather than the very poor. A number of the institutions that have been supported by housing finance projects provide access to concessional finance for very expensive housing even if the projects themselves do not. In a number of projects the average borrowing rate has been implicitly subsidised by the lender. Subsidy targeting has therefore been a concern and an equally important concern has been the efficiency with which housing transfers are mobilised.

(b) *Foreign exchange risk.* In only one case was the foreign exchange risk imposed on the borrowing intermediary.

'Growing demand for housing'

Housing sector concerns have been the most frequent rationale for housing finance projects. These concerns arise because of the inability of most housing production and delivery mechanisms to accommodate the large and growing demand for housing. In many countries the informal sector plays the dominant role not only in the provision of housing services but also in housing finance. Policy objectives have been to demonstrate that many low income

households can afford to repay market rate finance and to give greater emphasis to the private sector in providing both housing and housing finance services.

Lessons learned

One lesson learned has been in respect of linkages between housing finance and overall financial sector strategies. The housing finance project in Morocco centred on the Crédit Immobilier et Hotelier and shifted in focus to provide explicitly for improving the competitiveness and ability of the institution to mobilise resources so that it can ultimately operate without any government assistance in a fully mobilised financial system. The project has permitted the Bank to engage in a discussion of what types of deposit instruments can best serve these purposes.

The experience of the World Bank is that housing finance loans can be made at positive real rates of interest with reasonable expectation of satisfactory cost recovery and reliance on domestic resources. However, the development of more competitive sound financial practices is a long-term objective. They may not be achievable in one project.

In every country the housing sector receives a significant share of government transfers. Credit policies and regulatory controls generate large and unmeasured transfers to the sector and as the scale of these transfers increases this aspect of housing finance policy needs more emphasis. Transfers to the sector need to and can be reduced by better targeted, more transparent transfers. Developing housing finance institutions that minimise these subsidies will be central to the agenda.

The Bank's understanding of the broader effects of the implicit subsidies due to financial policies has increased significantly. For example, the shelter study of Pakistan attempts to identify and rank the factors that hinder the effective and more spon-

taneous development of the housing market. In Pakistan many of the impediments are in the regulation of the housing and land markets; others are in the housing finance system. Housing finance policies are an important source of implicit subsidies to upper-income borrowers but nevertheless are of less importance than basic land management issues.

The Bank is still in a transition from a traditional housing sector analysis which looked at housing needs to a broader analysis that puts housing and the government's housing policies in a broader macro-economic perspective. However, the transition away from sites-and-services and upgrading projects to housing finance operations will not occur rapidly, nor, in many countries, should it occur at all for the near term.

In most of the low income countries the sites-and-services approach remains the appropriate strategy today. In many respects, housing

'Second generation approach'

finance projects represent a "second generation" approach that should not be of the foremost priority for many of the Bank's borrowers.

Generally, some regional specialisation of basic housing finance strategies will almost certainly occur. For example, in many higher inflation countries better mortgage and taxation systems may be essential to make housing affordable, to reduce transfers and to help mobilise financial resources. In such an economy housing finance interventions should be of a relatively high level.

On the other hand, if a high inflation country also has a low level of economic and financial development, declining real income and a weak land recordation system, there are many more important sectoral policy issues before indexation is introduced or discussed. ■

US agency aims to meet challenge of urban growth

UNDER the dual pressures of rapid population growth and unprecedented rates of urbanisation, developing countries are experiencing profound changes in their social and economic structures. By early in the next century, urban population will exceed rural population, and more than half the poor in developing countries will reside in cities. By the year 2000, more than six cities in less developed countries will have populations greater than 15 million. Equally important is the growth occurring in

secondary cities and smaller towns (see charts).

Although the rapid pace of urbanisation creates problems, it can also present opportunities for social and economic development. Cities are the locus of off-farm employment and the centres in which innovation and the restructuring of the economy must occur. Cities in developing countries already generate more than 50% of their country's Gross Domestic Product (GDP), a percentage predicted to rise over the next decade. Just as agricultural produc-

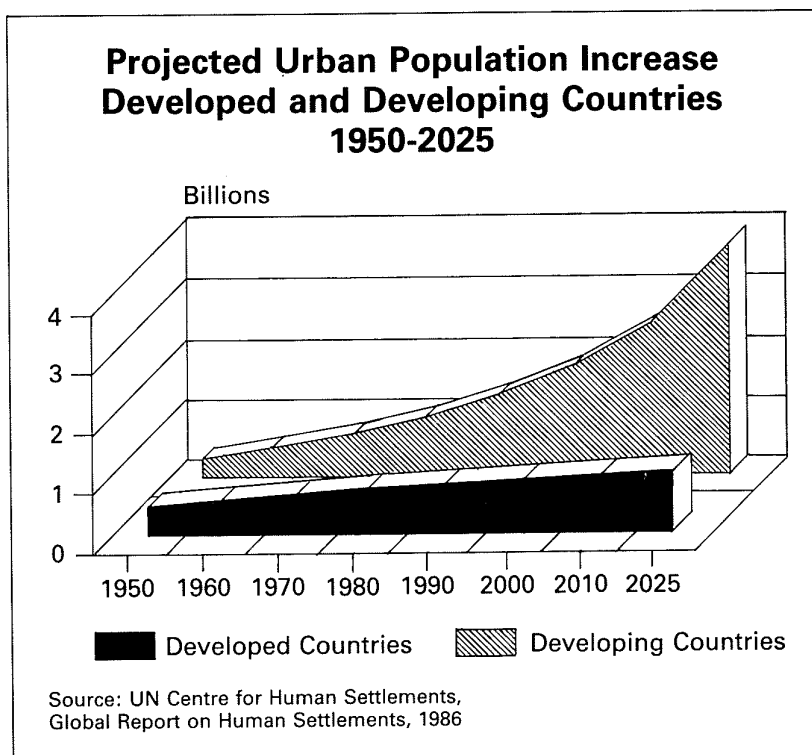
tivity has increased in the last decades, the productivity of urban economic activities must now grow to absorb the surplus and under-utilised labour force streaming into the LDC cities. The efficiency of urban management and financial markets are some of the key factors affecting economic development in the 1990s.

Since its creation in 1961, the Agency for International Development (AID) has addressed the shelter problem in developing countries, and, for the last 25 years, the Office of Housing and Urban Programs has been the Agency's principal vehicle for shelter and urban development assistance.

In the 1980s, the Office has expanded its agenda to address a wider range of problems which have been exacerbated by increased urbanisation. The Office has concluded that urbanisation can be managed and that adequate minimal shelter can be made available for all in a reasonable period of time if the right policies are pursued.

Conversely, however, the problem is not solvable and will grow worse if the wrong policies are followed. The right policies rely on individual initiative, market forces and the private sector to produce housing, with the government playing a vital role providing the policy framework conducive to development and access to the basic infrastructure such as water, sewerage and roads.

Availability of resources in a fair market, appropriate and affordable development standards, and decentralisation of authority are essential for the creation of a self-sustaining system of shelter provision capable of meeting the demand of the grow-



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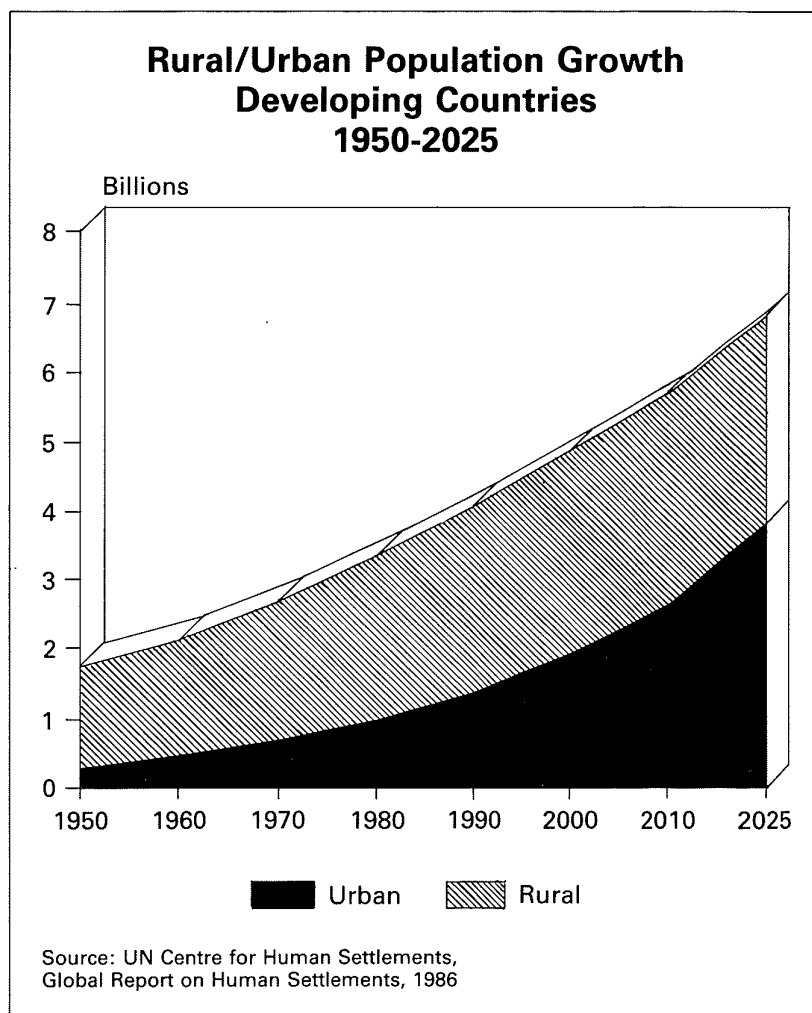
ing urban populations. Governments must also provide the "safety net" of municipal services for the truly needy.

Under the Housing Guaranty (HG) programme, private US lenders make loans available to developing countries for shelter-related activities approved by AID. The US Government guarantees repayment of these loans. Through fiscal year 1988, the total authority remained at \$2.18 billion; of this, the amount under contract (funds actually allocated to specific project implementation) amounted to \$1.65 billion in 164 projects in more than 40 countries. During the past year, a total of \$125 million was authorised for new projects and amendments.

The Office of Housing approaches its responsibility for AID's urban development activities by "assessing broadly but investing narrowly." In the past the Office has concentrated its resources on a limited number of areas which have been defined over time as land, infrastructure, credit and municipal management; each is a major constraint to the shelter and urban development.

The Office uses its resources to develop innovative and capable institutions in the developing countries. In the area of housing finance, the Office in 1981 began an HG programme with the Housing Development Finance Corporation (HDFC) of India. The HDFC has since earned the support of other members of the donor community. The initial HG loan was for \$30 million, for a programme with the following objectives:

- construction of 6,000 units for below median income households at a cost of \$20 million;
- increased institutional capacity in HDFC to raise the level of lending and to attract and absorb higher level of borrowing and deposits;
- expansion of HDFC operations in terms of geographic area, income levels served, type of shelter financed, and the variety and source of debt obligations obtained, as well as its contribution to a functioning country-wide



housing finance system.

Since AID's initial intervention, HDFC's original range of services has expanded to include home improvement loans, infrastructure financing in low income communities, and encouragement of private investment in urban services. The institutional strengthening of HDFC resulted in the expansion of its branch network and a replication of the HDFC model country-wide through the establishment of a multi-lender housing finance system. Currently the Housing Guaranty Program in India is providing \$50 million over

the next few years to support the continued expansion of the market-oriented housing finance system.

An example of AID's municipal finance programme is a five-year \$100 million Housing Guaranty in Indonesia. This programme is based on the belief that urban infrastructure will increasingly need to be financed principally by domestic investment capital and that municipal governments need assistance to mobilise these resources through the development of linkages between the municipal finance system and private sec-

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tor capital markets. The programme has three objectives:

- establishing increased private sector participation in providing and financing urban infrastructure and services;
- improving the role of central government in funding urban infrastructure and services affordable to low income households via a system of grants and loans that encourage local resource mobilisation;
- strengthening the institutional capacity of the local governmental finance system and local government's capacity to manage resources.

Governments must capitalise on the energies of the informal sector, and can help support the informal processes to be more efficient and productive. Governments can adopt development standards at levels that are appropriate to the capacity of the economy and the resources of the people. By providing infrastructure in strategic locations, governments can assure that minimal service levels are maintained and help guide the growth of cities. They can also pursue economic policies assuring the availability of credit at reasonable terms. The provision of clear land title or less formal rights of occupancy will give low-income families security of tenure, collateral for home improvement loans, and encouragement to invest in their housing. This will foster their sense of community and promote greater social and political stability.

In addition to relying on the private sector and individual initiative, appropriate policies in the land, infrastructure and credit sub-sectors are likely to be the most effective if the government places the responsibility and authority for developing and implementing urbanisation and shelter programmes as close as possible to the people who are most affected by them.

To meet its responsibility of assisting developing countries to manage urban growth, AID's Office of Hous-

ing operates through seven Regional Housing and Urban Development Offices (RHUDOs). Located around the world, the RHUDOs act as advisers to all interested AID Missions. The principal capital resource available is the Housing Guaranty (HG), under which about \$125 million is made available annually. The Office also manages \$5 million in centrally funded grant and technical assistance, research and training.

Through these programmes, the Office engages in policy dialogue with LDC governments on key issues and works to strengthen institutions in the relevant sectors. Major emphasis is placed on training counterparts in these public and private sector organisations. The Office's programmes are developing a cadre of policy makers and programme implementers who are able to improve a country's capacity to address its shelter and urban development needs.

The Office recognises that development issues created by rapid urbanisation demand a more fundamental response from donors than can be achieved through individual capital projects. Thus, for the past five years the Office has been moving toward policy-oriented lending. A major emphasis is now placed on supporting the Office's redirection toward sectorial programming, the goal being to use technical and capital assistance programmes to achieve systemic policy and institutional changes.

The intent is to work with countries to identify the systematic impediments to enhanced housing production and to assist in alleviating them. The Office believes that this sectorial orientation will help its client countries to develop strategies that are more appropriate to their needs.

The programme pursues a mutually determined policy agenda which removes institutional, technical and policy-related constraints to the above objectives. This agenda will form a basis for pro-

gramme-related actions undertaken by the Government of Indonesia over the life of the project.

In Jamaica, part of the ongoing Housing Guaranty Program has been a \$10 million initiative to encourage private sector financial institutions and developers to build and finance shelter solutions for low-income households. Under this programme, the Caribbean Housing Finance Corporation provided loans to private banks, building societies and credit unions for affordable onlending to low-income borrowers. The lower cost of funds has made it more attractive for private sector developers to produce affordable housing.

In Tunisia, the sectorial approach is helping to transform the National Housing Finance Fund from financing public sector production and mortgaging housing units into a housing finance bank helping prospective homeowners and private sector developers acquire land and build housing. Such institutional reform is being supported by a \$15 million Housing Guaranty Program.

The Office of Housing's activities in Jordan include a \$35 million Housing Guaranty Program that provides financing to the National Housing Bank to stimulate the production of low-cost housing by private developers and to support mortgage financing for low-income households.

As the Office looks toward the next decade, it sees its role growing to meet the challenge of urban growth. To realise its goal of helping to steer the process of urbanisation in the direction of economic growth and equitable development, both guaranty and other development resources must be deployed strategically and with the maximum impact. AID and the Office of Housing and Urban Programs, in co-operation with the US Congress, is currently engaged in a thorough review of its strategies and programmes which, combined with its 25 years of experience, will help provide the foundation for the Agency's activities into the next century. ■

Developments in Europe

By Peter Birch

It is important to ask why specialist lenders should concern themselves with Europe. I believe there are four main reasons.

(a) Competition in the UK is such that we have many European-based institutions competing on equal terms in the mortgage market. Some of the more recent additions are French, such as UCB (providing mortgage finance through Prudential Insurance); Credit Agricole (through M&G); Societe Generale (through the Skipton Building Society); and Banque Nationale de Paris (through acquiring the mortgage subsidiary of Chemical Bank). Some of these entrants to the UK market have provided services with a lower rate of interest, or more generous status requirements, than the UK-based distributor has been offering. It is therefore worthwhile looking at the home markets of some of these institutions to see if the battle cannot be carried forward into their own territory.

(b) Looking at housing tenure statistics, there are markets in Europe where home ownership is not nearly as well developed as it is in the UK. A simple analysis suggests that there are opportunities for selling mortgages in these markets.

(c) For UK-based institutions such as building societies, involvement in Europe gives any such lender the opportunity to spread its risk across more than one market.

(d) Also, there is the scheduled opening of the EC market in 1992. This would mean that UK mortgage providers should (if the objective of the 1992 single market is followed to its logical conclusion) be thinking much more in terms of a market with more than 300 million potential customers, instead of the 60 million in the UK. Looking at it another way, a major UK mortgage provider post-1992 could

THIS paper compares the wider European market with the UK market, looks at what 1992 could mean for building societies, and examines the opportunities that exist in the wider European market.

well become no more than a large regional institution in part of Europe.

Building societies have come fairly late to the opportunities offered in other member states of the EC. This is because legislative restrictions have only been lifted since January 1988 to allow these institutions to operate in Europe. It is worth remembering, and perhaps this is a fifth reason for further concentration on Europe by UK building societies, that Europe is the only market opened up to societies by these changes in controlling legislation; markets elsewhere in the world remain closed to UK building societies.

Having said that, the major UK clearing banks, which have not experienced such legal restraints, have made slow progress in entering the retail markets in Europe so far, with the one exception of Spain, whilst at the same time they have had no competition from their home base to date.

It has clearly been difficult for the banks to penetrate these markets and so it can be argued that it will be equally difficult for specialist lenders. I suspect, however, that until recently, the banks have not considered the retail market particularly worthwhile in Europe. In addition, despite all the talk of 1992, it is still true that housing finance institutions have to deal with peculiarly national markets, where very different conditions exist in individual member states.

Unlike banking, where chequeing accounts, personal loans and credit

cards are basically similar everywhere, housing finance systems are much more idiosyncratic. In the European market we find different tax régimes, capital gains taxation on house transfers, larger rented sectors than in the UK and higher levels of regulation in systems as in Germany and France.

Home ownership trends in Europe

A simple analysis of housing tenure statistics for Europe could suggest that there are opportunities for selling mortgage products in those markets where owner-occupation is at a lower level. In fact, the picture is less straightforward. The availability of rented accommodation plays a significant role in determining the level of owner-occupation in a market, together with the level of prosperity for the country in question. The figures here tend to suggest that the more prosperous a country, the more important the rented sector will be, with a correspondingly lower level of home ownership.

As an example of this, Switzerland has an owner-occupation level of only 30%, whilst in West Germany the level is some 40%. This theme should not be taken too far, however, as looking at levels of owner-occupation on their own can prove to be misleading. Switzerland, despite having a low level of owner-occupation, has one of the higher levels of outstanding mortgage debt.

In the UK, the privately rented sector is much less significant than in most of the other European countries. Thus we see that the privately rented sector in the UK accounts for only some 12% of the market. By comparison, in France the figure is 26%, in Belgium it is 31% and in

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the Netherlands 47%.

In addition, some member states of Europe are under political and economic pressure to maintain housing construction programmes whilst, at the same time, they find themselves increasingly unable to fund such programmes. There is no doubt that this situation creates opportunities for mortgage lending not necessarily indigenous to these individual markets.

An example of this is West Germany, where it is official government policy to encourage and increase the level of owner-occupation, with a target of 50% ownership — a substantial increase on the present low level of 40%.

In Spain, the government attaches particular importance to housing construction and has gone out of its way in recent years to encourage more liberal means of housing finance. Hence its decision in 1982 to allow the setting up of mortgage loan companies, under more generous banking co-efficients than those applicable to the banks themselves.

The 1992 target date is also offering prospects in other markets, to those institutions in states which have enjoyed a closed market. It is therefore encouraging these states, of necessity, to open up their own markets to foreign competition.

Differences by country

At this stage I would like to look at some of the reasons why the markets are so different. First, as mentioned previously, in most European countries there is a much larger privately rented sector than in the UK.

Secondly, house prices in other member states of the Community have not enjoyed the steady rise in value that we have seen in the UK over the last decade. Whilst, during the early 1980s, the UK suffered the same economic problems as other EC countries, namely sharp increases in mortgage interest rates, high unemployment and general uncertainty over job prospects, other countries did not enjoy the generous tax relief

on mortgage interest, absence of capital gains tax on house sales and social security payments that covered mortgage interest repayments which were available in Britain.

Because of this, any British institution looking at the European markets must do so understanding that they are much more volatile markets, where home ownership is not seen as the safe investment it is in the UK and where it is not given quite the high priority that borrowers tend to give it in this country.

It is worth recalling that in the early 1980s the then independent Dutch mortgage banks virtually disappeared from the market, having become involved in commercial and residential property development at a time when property prices had started to fall dramatically.

It is also worth noting that in Europe generally the costs of acquiring a home are more substantial than they are in the UK. In Belgium, legal costs are some 17% of the value of the home whilst the European average is between 7% and 8%, compared with some 2.7% in the UK.

It is said that in Belgium a family will probably move three times in its life — initially to rent a flat when husband and wife are married, thereafter to buy a family house when they have children, and lastly to sell that and buy a smaller house when they retire. That does not provide institutions with the average mortgage life of five or six years that we see in the UK. With capital gains tax payable on each transaction in Belgium, plus VAT of some 16% on the acquisition of a new house, one can begin to see that some of the European markets are not particularly attractive.

Having offered a fairly cautionary picture on the reality of some European markets, it is also worth recalling the extent to which state intervention encroaches on housing finance compared with the UK. This can be found in two areas, first in

housing markets and secondly in the financial markets.

In France, for instance, not only would a mortgage lender find itself competing against some of the state institutions such as *Crédit Foncier* and the *Caisse Nationale d'Épargne*, but also with the major banking groups, a number of which are still nationalised. That does not take into account *Crédit Agricole*, which claims to be one of the largest banks in the world. In France alone it has some 5,600 branches and a substantial share of the domestic mortgage market. France also provides further obstacles in the shape of controls on the rates of interest for savings products and on the ability of an institution to raise money on the wholesale markets.

Similarly, in Belgium, whilst there is not exactly control of interest rates, the central bank provides "guidance" on interest rates being offered on deposits and there is still doubt in Belgium as to the legality of charging a variable interest rate on mortgages.

In West Germany only the *Bausparkassen*, which are somewhat similar to UK building societies, enjoy special tax advantages attached to their form of operation. This gives them an advantage in the market that would be difficult to match for any newcomer.

The room to manoeuvre provided for an institution, and more particularly for any new foreign entrant into some of the European markets, is therefore considerably lower than is the case for, say, a new foreign entrant into the UK, where for nearly a decade institutions, particularly building societies, have been facing strong competition in their home market.

Implications of 1992

Undoubtedly the opportunities in those markets would be made a lot easier if some of the predictions being made for 1992 were to come true. It is therefore perhaps worth looking at this stage at what that magic date could mean for UK mortgage players.

THE EUROPEAN MARKET

Three pieces of community legislation lead the way in this market: the Second Banking Co-ordination Directive, the Proposal for a Directive on Mortgage Credit and the Proposal for a Directive on the Harmonisation of the Conditions for the Issue of Mortgage Bonds.

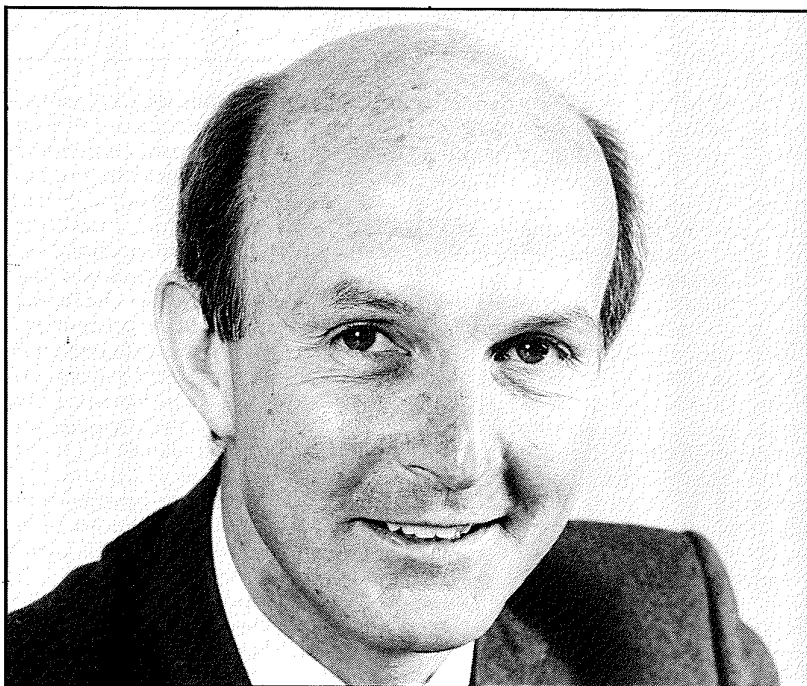
In essence, what these three pieces of legislation mean if enacted is that if an institution is authorised to operate in its home member state, then that is evidence to a host state that an institution is a fit and proper one to conduct or establish its business there and, in effect, institutions will have a single licence applicable across the EC. This would, of course, be very significant to banks from countries outside the EC established in one of the member states.

The mortgage credit legislation aims to abolish obstacles faced by specialist mortgage institutions in undertaking mortgage business throughout the Community. I have some doubts about whether this directive will ever be agreed, since what it originally aimed to achieve was to allow import of foreign funding techniques into host states.

So, for instance, a UK institution would be able to set up in, say, France or West Germany and demand of the authorities there that as the institution intends to operate a variable rate mortgage (which works in the UK with the flexibility of funding in retail and wholesale markets), then the authorities in the host state should provide conditions similar to those prevailing in the UK. To my mind that seems unlikely and this directive, having been in existence since 1984, is now being amended and could be under discussion into the 1990s.

The mortgage bond directive will operate on a system of mutual recognition for such bonds issued in individual member states. This would be a useful piece of legislation in allowing for greater flexibility in funding and may well become legislation before the mortgage credit directive.

However, I note recent fears expressed in the German mortgage market over the idea of mutual



Peter Birch: 1992 is already seen as a cut-off date.

recognition of mortgage bonds. The Germans claim that their mortgage backed securities are superior in quality to those elsewhere and that the opening of the market could threaten the existence of the German mortgage banks.

I think that there is little doubt that the second banking directive will come into force and will assist institutions wishing to set up retail operations in other member states. Perhaps the most important element of the 1992 target at present is not the speed with which matters go forward in Brussels, nor the fact that we may be talking about 1995 or 1997 before much of this legislation becomes law, but that a majority of member states and most institutions are already seeing 1992 as a cut-off date. In effect, they expect, prior to that date, to have completed or be near completing whatever strategy they have for what will become a common European market.

Hence the wide-ranging activity we are seeing in the French insurance

market in terms of takeovers and defensive alliances. Likewise the moves we are seeing between Spanish and French banks and the recent alliances between the Dutch Amro and Belgian Generale bank, and the Royal Bank of Scotland and Banco Santander. Cross-border alliances seem set to continue and to increase in pace over the next four years as specialist lenders also start to form alliances, as one sees with the French savings banks and Caixa de Barcelona, the biggest Spanish savings bank.

Nevertheless, the financial restrictions that exist in many member states do constitute a real brake on opening the market. For example, exchange control restrictions on financing long and medium term loans at fixed rates in Italy, Spain and Portugal. Further, the special rights accorded to the West German mortgage banks on marketing mortgage bonds and the control on retail deposits in France all inhibit entry by foreign specialist institutions. 24 →

Likely trends

Without a doubt, the Second Banking Directive and the Directive on Mortgage Bonds, if drafted widely enough, will go some way to removing or at least easing some of these obstacles; but the fear must remain as to whether these legislative proposals will move fast enough to make a real difference.

The difficulties of penetrating the European market for the specialist lenders can be contrasted with the way in which the UK banks have developed their presence in Europe. The UK banks have concentrated on serving corporate customers through the wholesale markets. They have not attempted, in general, to tackle the local retail markets in the EC which require the establishment of extensive branch networks.

Not only can corporate and wholesale banking operations work from a comparatively lower number of offices, but, in general, the nature of the business attracts less restrictions than a retail savings or housing finance operation would.

Furthermore, banks will open an office specifically to serve some of their home base customers that have already moved to the country in question. In addition, banks may be able to serve some European-based companies with whom they are already doing business at home.

As stated earlier, there are a few examples of foreign banks which have developed a retail presence. Chief among those which have are Citibank and Barclays. In both cases they have done this through acquisitions.

Impact on major lenders

Prospects in Europe are therefore mixed. I am, of course, not going to point to individual member states where the markets offer opportunities for housing finance institutions. I would not seek for a moment to argue that any mortgage lender is going to find a vast market out there in Europe.

However, for the large and small specialist lender there are niche

market opportunities where borrowers have been restricted in their choice of mortgage products over the years. Those markets need to be carefully researched as to method of distribution, type of product, marketing strategy and, of course, profitability.

It is essential to understand the local market and the problems associated with it. The present EC legislation is going to create opportunities but the most that legislation can do is to remove some of the more intractable legal and regulatory obstacles to a new institution operating in an EC market. If Community legislation is to make any progress in the European housing finance market, it would therefore be in overcoming these obstacles.

With a population of some 300 million plus, 50% of whom are not yet owner-occupiers, the potential in the common market is considerable and specialist institutions in the Community are being presented with a very real market opportunity.

In the past few years there has been a change in the attitudes of some governments in member states towards their financial markets and the movement of capital across frontiers. States that were regarded as closed to outside specialist institutions are beginning to change. Lenders will inevitably move towards the most attractive markets for housing finance.

If an institution is to attempt to penetrate some of the continental European markets and establish a local presence, then it faces two main options as to how this may be achieved: the acquisition of an existing operator or the start-up of a completely new operation.

With acquisitions, new entrants have faced a number of problems.

At this time, institutions looking to make an acquisition are coming to the market relatively late in the day. Over the past few years many of the smaller independent institutions have already been taken over by

larger groups. Further, a number of the more attractive targets in Europe, such as the savings banks, are public in the sense of being owned by the state or by their regional governments. They are not, therefore, available for acquisition.

For building societies, still working within the limitations of restrictive legislation, many of the activities at present being carried on by some of those possible acquisition targets are outside the powers allowed to building societies, even when operating in Europe. Further, what is available for acquisition is very often not worth buying. Local supervisors can sometimes add to this picture by making the price of entry into their market the acquisition of the most troubled institution in their state.

Institutions choosing the second method of entry, the start-up of a new operation, can face serious limitations placed by national supervisory authorities on the opening of offices, and as I mentioned earlier, on the means of funding. It is often the case that regulatory authorities are not prepared to grant consent for the opening of offices on the scale and at the pace necessary to allow a new operation to become profitable in a reasonable period of time.

The opportunities

At Abbey National our strategy has been more opportunist, with our approach reflecting the need for profit and the need to gain experience and understanding of what to us are "foreign markets." To prepare for 1992 we researched the European member states thoroughly and identified those where start-up operations looked possible against the following criteria:

A relatively modest capital injection.

A welcoming attitude by the authorities.

A free market susceptible to innovation.

Wider margins than available in the UK.

The capacity to generate fee income.

Competitors with problems.

Avoidance of exchange risks (which we cannot legally accept and would not want to do prudentially anyway).

Against these criteria many European markets are, at present, not of interest. The level of regulation and state involvement combine with a low level of opportunity and attraction for the new entrant. As a generalisation, the more mature and regulated markets are in the north, whilst the more exciting prospects are in the south.

Since the societies' power to lend in Europe came into force on January 1, 1988, Abbey National has opened its doors in three locations outside the UK:

Abbey National (Overseas) Ltd based in Jersey.

Abbeycor Nacional Hipotecario in Madrid.

Abbey National (Gibraltar) Ltd in Gibraltar.

Dealing with our first venture into a major EC economy, Abbey National identified Spain as a clear-cut opportunity because:

1. The Spanish Government was deregulating the financial system relatively quickly.
2. The Spanish economy was seen as buoyant in the long term with benefits flowing from recent admission to the EC.
3. New statutes had created a new corporate format — the mortgage credit company, whose constitution fitted a UK building society's legal powers under our new act.
4. Contact with the authorities was encouraging.
5. An acquisition was not necessary.
6. Wide margins were available in the short term.

Further, the existing mortgage loan operators in many cases belonged to groups, particularly the domestic banks, whose widespread branch networks (with more branches *per capita* than anywhere else in Europe) gave them cost problems.

From this analysis, identifying the opportunity at the macro level, we

proceeded to deal with the more difficult and complex aspect of progressing the development of this project through an implementation strategy to operations, which began in February 1988. The product of all this work was Abbeycor Nacional Hipotecario, which is a partnership of three widely different companies:

- Grupo Cor, a financial services company with some mortgage market experience, skilled management and ambitions to grow faster in the mortgage market.
- Winterthur, the Swiss insurance company, a worldwide operator

'Waiting for 1992 will be too late'

with a very successful Spanish subsidiary whose management saw opportunities in the mortgage market and whose distribution network of branches and agents could support a wider product range — including mortgage products.

- Finally, Abbey National, a major UK mortgage lender, with capital, a strong credit rating and experience of a highly developed and competitive mortgage market; the majority shareholder in the new company.

For both our partners there were distinct opportunities provided by the formation of the new company. For Grupo Cor the chance to develop a bigger presence more quickly than their own resources could support. For Winterthur the chance to generate more income from their network, to sell more products along with the new mortgage product and, perhaps most interestingly, to be the supplier of the endowment policy for the endowment mortgage product for Abbeycor Nacional.

The endowment mortgage product

offered by Abbeycor Nacional has been a major element in building our new company's market position as an innovative, efficient, streamlined new lender.

Conclusion

From these last comments it is clear that, despite the cautionary doom and gloom in the earlier sections of this paper, I have not been saying that there are no opportunities for mortgage lenders in Europe.

Certainly, as member states become more affluent, particularly the newly joined members, and as competition increases in some of the major EC states such as France and Germany, so potential borrowers will begin to realise that whilst their own system has remained somewhat rigid and complex, new and more flexible mortgage products have become available in other countries; particularly in the UK. Inevitably, some of these products can be marketed elsewhere in Europe and can provide niche markets for those operators willing to look for the opportunities.

It has been said by some institutions that with the advent of 1992, lending in Europe will become easier and that prospects for mortgage lenders will increase. Despite all this talk of open markets, we are a very long way from being able to market a single mortgage product across Europe. Indeed, we may probably never reach that stage and the one message I hope I have managed to convey is that we are dealing with a series of individual markets which must be approached as such.

Nevertheless, any major mortgage lender wishing to get into Europe and who is contemplating waiting for 1992 to see if things will be easier will have missed the opportunities. Our friends across the channel have not and are not going to wait. ■

PETER BIRCH is chief executive of the Abbey National Building Society. This paper was given at the International Housing Finance Conference in London in November 1988.

Freddie Mac — a key player in the secondary mortgage market

By Leland C. Brendsel

In simple terms, Freddie Mac (the Federal Home Loan Mortgage Corporation) was created by the US Congress to improve the flow of capital to conventional residential mortgages, thereby improving the efficiency of the housing finance system.

Its role has contributed positively to the profound changes that have taken place in the primary and secondary mortgage markets in recent years. These developments have affected loan originations, exchanges of mortgage loans, the transformation of mortgage cashflows, and investor groups holding various mortgage and mortgage-related assets in their portfolios.

Background

Freddie Mac has a primary obligation to fulfil the statutory purposes for which it was created. It links mort-

'Close links with thrift industry'

gage lenders and capital markets through its purchase and sales functions. It buys conventional single family (one-to-four units) fixed rate and adjustable rate loans, government-backed fixed rate loans, plus multi-family, seconds and graduated payment loans.

Freddie Mac purchases these loans from savings and loan institutions, mortgage bankers, and commercial banks. Freddie Mac uses a range of

financing alternatives to accomplish its objectives. It finances most of its mortgage purchases through mortgage-backed security (Mortgage Participation Certificates, or PC) sales.

The Corporation creates liquidity in the conventional loan market by purchasing quality loans and by attaching its own agency guarantee to the mortgage-backed securities issued. Freddie Mac unconditionally guarantees the timely payment of interest at the PC coupon rate and the ultimate collection of principal on all underlying mortgages.

The guarantee is supported by its own financial position. Freddie Mac PCs are considered eligible as collateral for structured financings rated AAA by the rating agencies.

The Corporation can also finance its operations through the issue of debt obligations, long-term discount notes, PC reverse repurchase agreements, and lines of credit obtained from commercial banks.

PCs are accounted for as a sale of assets. Accordingly, the mortgage loans sold are excluded from the Corporation's retained mortgage portfolio. The mortgages sold, in securitised form, are reflected on Freddie Mac's balance sheets as contingent liabilities.

Since its inception, the Corporation has purchased more than \$360 billion in mortgage loans, which amounts to more than seven million homes. Freddie Mac's mortgage securities outstanding at the close of 1988 stood in excess of \$225 billion. These securities are freely traded daily among investors on a worldwide basis.

Organisation

Freddie Mac was initially capitalised for \$100 million through the subscription of non-voting common stock by the 12 Federal Home Loan Banks (FHLBs). The FHLBs are the central banks for the nation's thrift industry, principally savings and loan institutions. As a result, the Corporation has had a close relationship with the thrift industry.

The Federal Home Loan Bank Board (FHLBB) supervises the operation of the FHLBs and regulates member institutions. The FHLBB consists of three presidentially-appointed members. These three members also

'Securities are freely traded'

serve, in a separate capacity, as Freddie Mac's board of directors.

In December 1984, the Corporation distributed 15 million shares of newly created non-voting participating preferred stock. The stock was distributed to the FHLBs in proportion to their respective holdings of the Corporation's common stock. The banks in turn distributed the participating preferred stock in their member savings institutions. The distribution reflected the growth of Freddie Mac from its creation in 1970.

Prior to 1989, trading of the participating preferred stock was limited to members of the FHLBs. In July 1988, the board of directors removed the

SECONDARY MORTGAGE MARKET

trading limitation with effect from January 1, 1989. In a subsequent exchange offer, 99% of the restricted shares outstanding were tendered on the basis of one restricted share for four shares of non-restricted stock.

Removing the trading restriction significantly increased the market value of Freddie Mac preferred stock, with most of it being realized by thrift institutions. Market value increased from about \$60 a share in June, prior to the Board's announcement, to the equivalent of nearly \$200 per share on a pre-split basis in initial trading. Another stock restriction remains. Investors may hold a maximum of 4%, or 2.4 million shares, of Freddie Mac non-voting participating preferred stock.

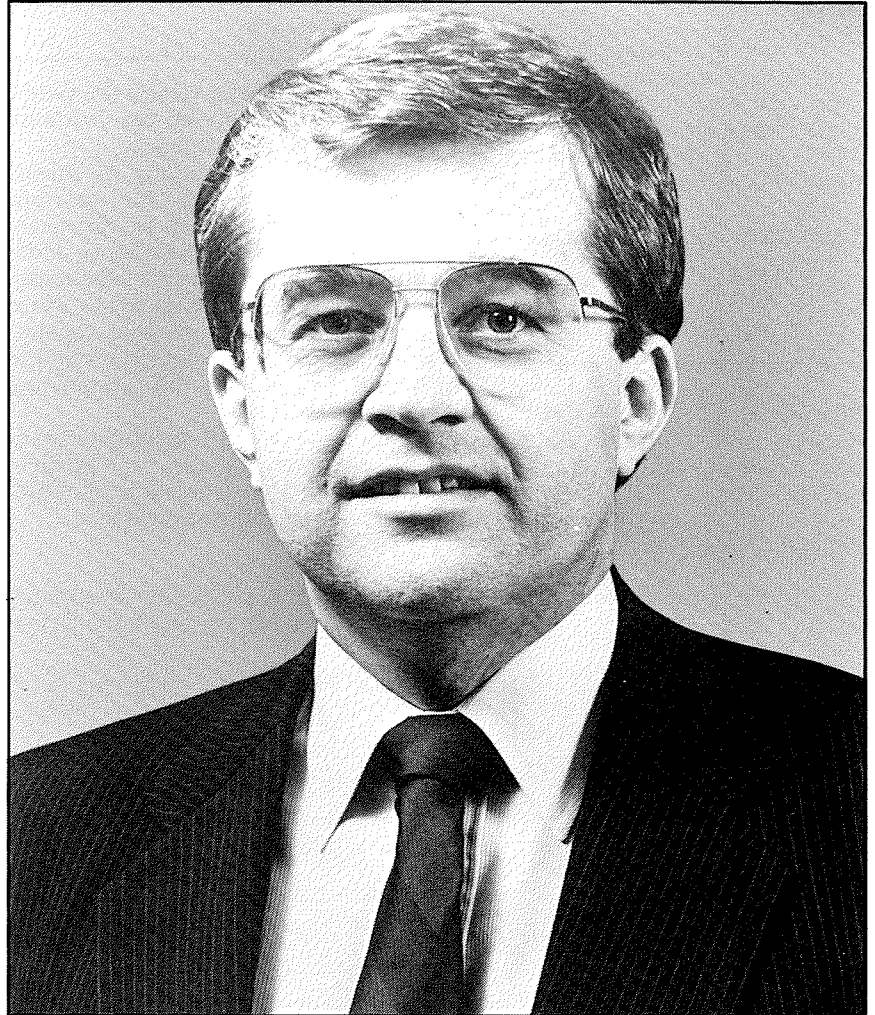
'Investor base broadened'

Operations

Structurally, Freddie Mac has five regional offices, with its home office in Reston, Va. Operationally, the Corporation has six divisions — Marketing and Sales, Risk and Property Management, Operations, Finance, Corporate Relations and Information Systems Services.

Freddie Mac performs a number of important roles for the mortgage market:

It provides liquidity to the mortgage market. The Corporation encourages the use of standard loan documents and uniform underwriting criteria. Any residual credit risk is allayed by the guarantee of timely payment of interest and principal, thus reducing investor fear of default. Packaging mortgages in securities saves investors the costs of gathering information needed to invest in mortgage loans. Investors do not have to be concerned with servicing the loans that back the securities. Volume issuance and homogeneity assure efficient markets for trading such securities.



It acts as a secondary market conduit between mortgage originators and investors. By providing a mechanism to intermediate between mortgage markets and capital markets, Freddie Mac integrates mortgage markets into a national market that allows pooling of mortgages, local servicing, and distribution of principal and interest cash flows to a wide variety of investor groups. Mortgage cashflows may be tailored or managed to meet the specific requirements of different investor groups. As a conduit, Freddie Mac has expanded and stabilised the supply of residential mortgage funds.

It attracts new capital market

sources of funds for the mortgage market. New financial instruments and customer securities have broadened the investor base to pension funds, insurance companies, and investors in Europe and Japan.

It provides flexibility to lenders to develop business strategies to compete in a deregulated, highly automated and increasingly competitive mortgage market. Freddie Mac buys mortgages under two programmes. One is its cash programme, in which Freddie Mac purchases loans daily from lenders. During the morning, the Corporation quotes by telephone to lenders a number of yields for each

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kind of loan that it buys. In the afternoon, the Corporation sells mortgage-backed securities to a Wall Street dealer group.

The other means of acquiring mortgages is through the Guarantor

'S&Ls' flexibility increased'

Programme. First, instead of receiving cash for mortgages, lenders receive Freddie Mac PCs. In effect, the lenders swap their mortgage for the certificates which represent an undivided interest in the same loans.

Second, instead of being posted by Freddie Mac, the required yields are determined by the lender according

to a formula that correlates the yields of the certificates with the yields of the underlying mortgages.

The increased liquidity of assets provides a balance for savings deposit liabilities, most of which can be withdrawn from the S&L as additional backing of Freddie Mac make the PCs a valuable asset to the S&Ls and other institutions that receive them. In fact, PCs may command a higher price than the underlying loans themselves.

A well-developed secondary market has greatly increased the flexibility of savings and loan associations to manage their mortgage assets.

Looking to the future

Clearly, the secondary mortgage market will be an important tool in the

future of the thrift industry, which is now in a state of transition. In mortgage finance, a market-driven environment has all but replaced the highly regulated, specialised network of S&Ls that dominated mortgage lending over the past decades.

Computer and telecommunications development have altered the mortgage finance field. These conditions have opened the mortgage lending door to anyone with access to capital who wants to make a residential mortgage, be it a mortgage banker, commercial bank or an S&L.

The key to a lender competing successfully in a less restricted mortgage lending market is access to capital and an ability to manage risks. Such a formula fits well with the strengths of the secondary market. That market, through its public and private conduits, lets market users take advantage of the increased sophistication of financial markets that have come

AGENCY ISSUES OF MORTGAGE-BACKED PASS-THROUGH SECURITIES (In millions of dollars)

| | Freddie Mac | Fannie Mae | Total |
|-----------------|-------------|------------|--------|
| 1980 | 2,526 | | 20,647 |
| 1981 | 3,529 | 717 | 14,257 |
| 1982 | 24,169 | 13,970 | 16,011 |
| 1983 | 21,376 | 13,340 | 50,496 |
| 1984 | 20,489 | 13,546 | 27,857 |
| 1985 | 41,453 | 23,649 | 45,868 |
| 1986 | 102,431 | 60,365 | 98,169 |
| 1987 | 75,018 | 63,229 | 96,983 |
| 1988 through Q3 | 26,361 | 39,266 | 41,967 |

Sources: Freddie Mac, Fannie Mae and Ginnie Mae.

AGENCY PURCHASES OF MORTGAGE LOANS (In millions of dollars)

| | Freddie Mac | Fannie Mae |
|-----------------|-------------|------------|
| 1980 | 3,690 | 8,101 |
| 1981 | 3,744 | 6,830 |
| 1982 | 23,671 | 25,936 |
| 1983 | 22,952 | 26,475 |
| 1984 | 21,885 | 29,288 |
| 1985 | 44,012 | 43,841 |
| 1986 | 103,474 | 79,712 |
| 1987 | 76,840 | 77,609 |
| 1988 through Q3 | 30,087 | 53,808 |

Sources: Freddie Mac and Fannie Mae.

'Innovation a key theme'

to understand mortgage securities. By the end of 1988, mortgage securities outstanding in the aggregate topped \$700 billion, second in size to U.S. Treasuries in the fixed-income market.

The secondary market also helps lenders manage interest-rate risk by selling or trading their mortgage-backed securities. And it offers ways for lenders to manage credit risk through diversified mortgage portfolios.

Moreover, the market has attracted new investors to housing finance. It has been able to do this because leaders in the market have been innovative in developing new mortgage products that meet a wider range of investor needs. And that will be a key to its future. Innovation will be a key theme in that marketplace. Mortgage-related securities have historically offered higher yields than

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corporate issues of a comparable maturity and quality because of their cash-flow uncertainties.

In 1983, Freddie Mac offered the first multi-class security, which reallocated prepayment uncertainty, creating bond-like instruments in classes with expected maturities in short, intermediate and long ranges. This breakthrough has led to a new generation of mortgage securities that has attained many of the desirable qualities of high-grade corporate bonds while preserving some of the yield advantage.

The maturation of the multi-class security, including the more favour-

able tax treatment through REMICs (Real Estate Mortgage Investment Conduits), has forged a strong link between the previously isolated mortgage sector and international capital markets. This link will grow even stronger in the future.

An immediate challenge for the secondary market leaders is to create a more liquid market for adjustable-rate mortgages (ARMs). Freddie Mac estimates that some \$450 billion in ARMs are outstanding, roughly a quarter of total home ownership

debt. Less than 10% of those loans exist in the form of mortgage-backed securities. One key to faster growth in ARM securitisation will be attracting new investors. Pension funds and insurance companies tend to look for longer-term investments.

In the final analysis, to sustain its overall support of housing finance in the years ahead, Freddie Mac and others active in the secondary mortgage market must continue to satisfy a broad investor base for mortgages and mortgage-related securities. ■

LELAND BRENDSEL is president at Freddie Mac.

MORTGAGE ORIGINATIONS BY TYPE OF LENDER
(In millions of dollars)
Originations of conventional 1-4 family mortgage loans

| | Thrifts | Commercial banks | Mortgage banks | Life insurance companies | Pension funds | Federal credit agencies | State & local credit agencies | Total |
|-----------------|---------|------------------|----------------|--------------------------|---------------|-------------------------|-------------------------------|----------------------|
| 1980 | 63,534 | 27,037 | 7,691 | 1,415 | 273 | 4,378 | 2,343 | 106,704 ^a |
| 1981 | 44,209 | 20,449 | 9,178 | 281 | 138 | 4,464 | 1,396 | 80,141 ^a |
| 1982 | 37,843 | 23,268 | 12,029 | 279 | 56 | 3,504 | 803 | 77,782 |
| 1983 | 88,489 | 38,566 | 22,678 | 297 | 13 | 3,180 | 1,006 | 154,229 |
| 1984 | 105,699 | 37,927 | 26,504 | 573 | 13 | 3,223 | 1,143 | 175,082 |
| 1985 | 113,976 | 50,928 | 28,717 | 951 | 12 | 3,154 | 1,320 | 199,058 |
| 1986 | 201,839 | 100,922 | 52,502 | 3,196 | 104 | 2,676 | 887 | 362,126 |
| 1987 | 200,287 | 112,380 | 57,578 | 2,726 | 23 | 2,890 | 557 | 376,441 |
| 1988:Q1 | 31,374 | 16,070 | 11,632 | 200 | 6 | 697 | 225 | 60,204 |
| 1988:Q2 | 49,279 | 24,726 | 15,218 | 789 | 30 | 759 | 249 | 91,050 |
| 1988:Q3 | 54,088 | 26,472 | 16,583 | 964 | 9 | 728 | 274 | 99,118 |
| 1988 through Q3 | 134,741 | 67,268 | 43,433 | 1,953 | 45 | 2,184 | 748 | 250,372 |

a. Totals for 1980 and 1981 include \$33 million and \$26 million, respectively, of origination, by private mortgage-backed conduits; such originations have been zero ever since.

Source: US Department of Housing & Urban Development.

SECURITISED MORTGAGE DEBT OUTSTANDING
(As of September 30, 1988)

| | 1-4 Family | | | Multifamily | | |
|---|------------|--------------|--------|-------------|--------------|-----|
| | Total | Conventional | FHA/VA | Total | Conventional | FHA |
| Per cent of debt securitised | 34 | 22 | 84 | 7 | 5 | 18 |
| Amount securitised (\$ billions) | 701 | 364 | 337 | 20 | 12 | 8 |
| Amount not securitised (\$ billions) | 1,379 | 1,315 | 64 | 267 | 231 | 36 |
| Total mortgage Debt Outstanding (\$ billions) | 2,080 | 1,679 | 401 | 287 | 243 | 44 |

Sources: Federal Reserve Board, US Department of Housing and Urban Development, Veterans Administration, Freddie Mac. Excludes mortgage debt held in conventional mortgage-related securities.

Loan systems for the international market

By Alastair Taylor

There are practical examples of successful business solutions being applied internationally. However, is this experience germane to housing finance? Is there something about this business environment which requires consistent international applications for common systems to succeed? As is often the case, the answers are not all black and white.

Of course, the more a business area is recognised as consistent on an international basis the greater the likelihood of success. Wholesale banking, for example, is an area of business where some international banks insist on a common system world-wide. While the advantage of consistent reporting is ensured, there exists the burden of providing multi-lingual software and satisfying the reporting for the differing legislative bodies. Thus there are some important mechanisms to understand before deciding on whether an international housing finance system is a practical proposition.

First, no such system has existed thus far except in cases where the markets are based on the same historical foundation, for example the UK and Australia. However, in the very rigid nature of the problem lies the solution, at least for Europe. As the European Community intends to introduce mutual recognition of techniques, if this is the case — and my argument depends on it — then at one stroke an international housing finance information system does become a practical proposition, since the rules by which we would build

THIS paper discusses whether or not it is practical to consider an international housing finance system, and, if so, what design goals such a system have, how the system might be produced and what role expert systems will play in the delivery of such a system through the chosen distribution channels.

and maintain such a system are at least known to us, because they are largely our own. The remaining obstacles are then largely "at home", for example, building societies in the UK can operate in the EC only through a subsidiary by UK law.

Design goals for the international markets

If we are to design a system to meet the needs of the UK and/or international markets, I believe there are three fundamental design goals.

The first is that it must be a customer based system so that we can at all times view our total relationship with a customer and target the market accordingly.

The next goal — design for change — reflects the need to respond to the market with new or innovative products and also to react to legislative changes.

Tom Peters' new book suggests that as deregulation ensues in most markets the new competitive environment will bring chaos. It is the ability to thrive on that chaos which will determine success or failure as opposed to the organisation which

will see it as something to be controlled or handled, not grasping change as an opportunity.

We can be sure that unpredictability will stay with us and we can be absolutely certain of experiencing rapid change. But what kind of development environment is required?

Extensive use of the concepts of modular systems and parameterisation will be required to provide greater flexibility which is essential to meet the varying requirements in the market, both legislative and competitive. For example, products must be defined in this manner to allow multiple types of mortgage product such as capital repayment, endowment, and so on, which can be defined and made specific by applying an associated policy or set of business rules, and, of course, within each primary product variations should be allowed for. The definition of a new product should be entered into the system by way of parameters via a visual display unit. It should not be necessary to change computer programs to incorporate new products.

Another example of parameterisation is in the area of securitisation whereby you will require the flexibility to describe the rules and selection criteria associated with a particular mortgage backed security.

Finally, the system should interface to existing and future branch systems, not just the counter positions but the whole area of administration, electronic mail, external facilities like Videotext for insurance quotations, ATMs and expert sys-

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tems. From the outset the design must have flexibility as its key goal.

Computer systems for international operations

How do we provide computer systems to ensure that they will support the international or pan European marketing, production and distribution initiatives?

The currently accepted way is to seek "systems liaisons" in the countries in which you wish to do business, bureaux being the most used at the moment. However these systems provide the nationalistic (language) and legal requirements but not necessarily the customer-based marketing systems required for sustained competitive edge.

The paper now covers the options as if we were only in one country and then returns to the international implications. There is only one cost effective way forward.

The prerequisite for tomorrow's system is that it should be customer-based and that, obviously, it should be flexible enough to cope with the inevitable change we, or government(s) may require of it. We know that the vast majority of financial systems today are not customer based and are certainly inflexible.

The most graphic example of international systems I can think of is the world's airlines' reservation systems where some years ago the IATA community got together to consider how to rebuild their 20-year-old systems to meet today's requirements in a deregulated world.

The agreed that no one country or airline could do the job of some tens of thousand of man years — and hence, born out of that, we have seen international consortia building Amadeus and Gallileo, two huge computer systems that will take years to build and will be possible only through shared international cost. The aim of these systems is to become more customer orientated so that you can book more easily for several legs of your journey and include hotel bookings, car hire, etc, across the world.



One of the supposed implications will be to squeeze severely the travel agents and obtain the margin currently enjoyed by those agents. Of course the distribution channel is a problem, so initially I see them focusing on the large international corporate customers for their competitive advantage in search of the "high net worth (travel) customer".

But closer to home we are not yet faced with such daunting propositions for international housing finance. Instead of trying to introduce a special mortgage finance directive for 1992 the Commission is likely to link its legislation on housing finance to its recently completed Second Banking Co-ordination Directive. This will not try to harmonise national

mortgage systems but will introduce mutual recognition of techniques, so that operators may work outside their home base in the European Community as if they were working at home.

It is my contention that since harmonisation has proved to be impossibly complex in the case of the mortgage market, it is this ruling that really makes international systems a cost effective proposition. Thus a customer-based system that is flexible and allows us to work "as if we were at home" is a good starting point. At first sight the answer may seem simple — buy a package. It does what we want and is specially designed for our problem.

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But is it? Is it not just someone else's version of your "old" system with all the attendant problems of inflexibility and high maintenance costs? Are not the same costs and delays involved in tailoring it to suit your needs as packaged systems generally provide only a 65% fit, and can force significant compromise to fit in with its constraints?

Fourth generation languages

There may be an alternative — fourth generation languages. These are designed to accelerate development of new applications and this they do very effectively. The term "fourth generation languages", or 4GL, is one of the most misused or misunderstood descriptions in the industry. It is used as an all encompassing title for many different types of language. There exist basically two different types of fourth generation language.

In developing any new system there are three basic elements which make up the complete system: the communications and message control system, the application programs, and the database management system. Someone has to define and develop codes to handle all these elements. The first type of 4GL handles only the application programs. In other words it is only a programmer productivity aid. The complex business of communications and database still have to be handled by very experienced and expensive people and therefore the entire development, while faster, is still limited.

The second type is the total systems generator that does the entire job, also avoiding those expensive personnel who are increasingly difficult to find. It takes business specifications and automatically translates them into entire applications systems.

The claims made here for such systems are, for example, a three year development being reduced to anything from four months to one year. These results were achieved with *system generators* and there are many other examples including a

major UK bank, which dropped its package approach after three difficult years in favour of this systems generator approach last year.

It may be worth covering why these benefits exist:

(a) *The 4GL picture.* With the growth of computing needs there was no way that conventional programming techniques were going to keep up with the advancing demand for solid yet flexible information systems. The arrival of systems generators was timely — but it is important to note that it was born out of frustration, the frustration that arises out of following the unnatural processes of translating user requirements into computerese, from following a rigid sequential process to an evolutionary problem, and from both of these producing the all too common unrecognisable result, two or three years after the problem was articulated. By then the world had moved on; business requirements had changed. Of course this is no one's fault, it just reflects the traditional business of program development under so-called 3GL languages.

(b) *Productivity.* The speed of construction and the easy maintenance possible with 4GLs creates huge productivity gains and so application backlogs can be substantially reduced.

(c) *Evolution.* The evolutionary nature allows a cohesive whole to be maintained despite change through time, providing a new foundation for systems. This changed forever the linear view of development previously popular. Systems generator products recognise that users' views of requirements may "clarify" over time and will change as the system is "used". This is an interactive development process. Life is therefore not regarded as static. It changes over time.

(d) *Information systems foundation.* Much has been written about the need for management to pay greater regard to the information resources within their organisation. Systems

generators provide a means by which information systems rather than data processing systems can be successfully constructed within a company.

Resistance to change

The DP executive should no longer feel squeezed by demand for new applications on the one hand and maintenance of existing applications on the other. Despite the fact that 4GLs or systems generators have been in existence for years, and major organisations are reaping significant benefits, there are still many that have not moved to this arena yet, although the take-up is fast accelerating. There are several reasons but ultimately there is only one reason — the fear of change or resistance to change.

The commonly heard reasons include:

- (1) we cannot change now, we still have two years to go on re-writing investments;
- (2) that solution will not run on our hardware;
- (3) converting our old systems will take hundreds of man years;
- (4) 4GLs are good but 5GLs are just around the corner — perhaps we should wait;
- (5) the programmers and analysts will not like it and many may depart and leave us exposed;
- (6) we are locked into one supplier; and
- (7) 4GLs are slow.

Acceptance of these is to misunderstand fundamentally the technology. For example, locked into one supplier — it is a fallacy to suggest that if you use COBOL you have total independence of supplier. That is an argument which had its place when everyone was developing batch systems.

The sophistication of systems today requires complex communications and database management facilities. It is that software which "locks" you in. COBOL is only a small part of the 3GL environment.

Because the time taken to develop systems using a 4GL approach is dramatically reduced, the replacement costs are significantly smaller and the time period required is

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shorter. The "locked in" scenario has to be significantly less than when using 3GL techniques.

4GLs are too slow and cannot be as efficient and are therefore only suited to small systems — of the total systems generators there are two basic types, those which are interpretive and those which produce source code like COBOL for compilation. The former do have an overhead and as long as you are prepared to spend additional investment in horsepower, this can be justified in most cases, in terms of balancing the total cost of the computing equation. Make sure however, that the range of hardware you choose has the capacity to increase significantly within the same compatible environment.

The latter, which produces source code, eg COBOL, is a code that the computer would normally execute if using a 3GL development environment and hence executes the codes as efficiently. In fact evidence suggests that the code produced is

superior to the COBOL programmer. Therefore, in answer to the question "Are 4GLs slow?", if you choose the type which produce source code they operate as efficiently, if not better.

It is true that change will be required — but surely it is our responsibility to manage change and encourage it where it supports an overall improvement in our ability to compete.

Aspects of change

I would like now to comment on some of the aspects of change that are required.

(a) **Existing applications.** Often the most difficult adaptation required to newcomers to 4GL is to swallow the bitter pill that the value of existing applications has been dramatically devalued overnight. If we can now provide productivity gains of up to 20 to 1 then a portfolio of applications

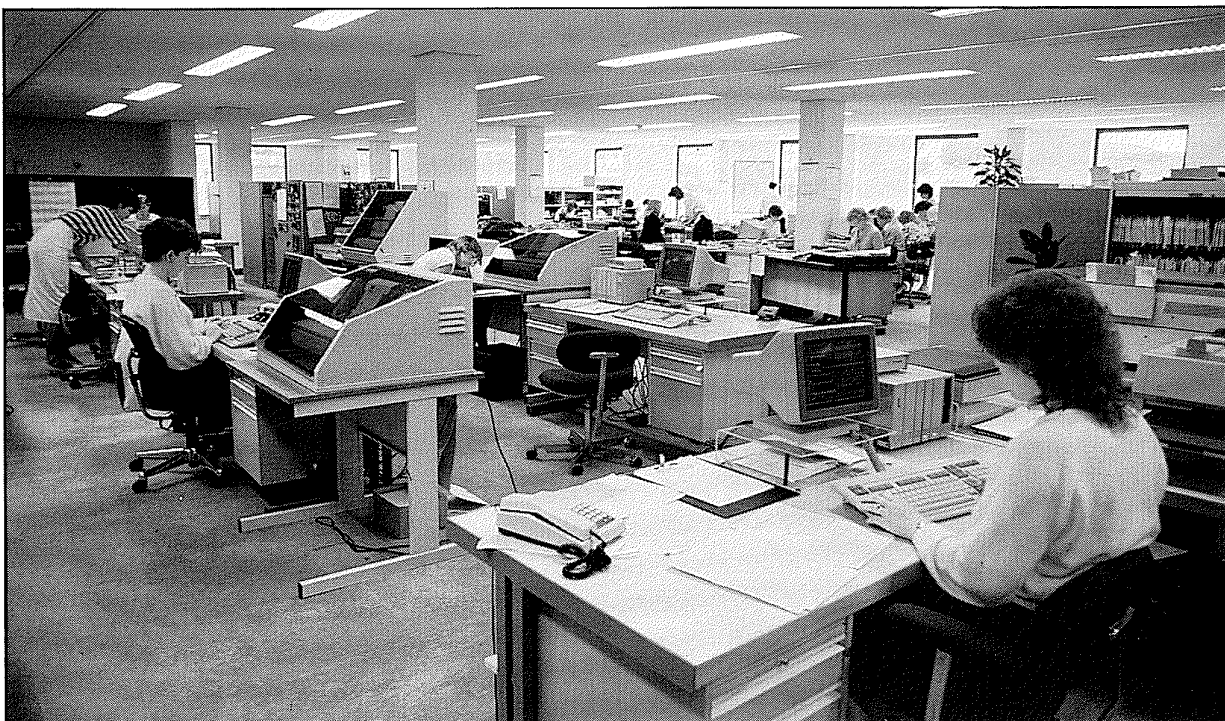
that costs £100,000 (in salary costs) to build can be replaced by an expenditure of just £5,000.

Many companies today rightly feel they have so much invested in their existing systems that they cannot contemplate replacement. It needs a clear objective assessment to be able to discard past involvements and face the reality of today and the next five or 10 years. Judgment is required to be based on replacement, not historic cost. Organisationally, this can be a culture shock. Frequently those closest to the applications in DP are the slowest to change. In this respect all the old values associated with the resistance to change questions listed earlier have to be unlearned.

(b) **Productivity.** Culturally it takes time to adjust to the acceptance of production gains in the order of 10 or 20 fold.

For instance, does this not imply smaller DP staff numbers? The answer, of course, is yes. However,

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Major systems development utilising LINC at the head office of the Skipton Building Society in the UK.

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some DP managers, especially those who value the empire over which they preside, do not volunteer to move to systems generator solutions — unless perhaps they are enlightened or selfless enough to look beyond their immediate surrounds to see the new path as possibly creating opportunities.

DP lives have for years been tied up with technologies that they have known were difficult to hold together. Suddenly life is becoming easier. Attention can be diverted to the ends not the means. Another culture shock has arrived.

(c) **Closing the user DP gap.** Another aspect of the 4GL environment is that communication channels are shortened. Users and DP staff work more closely together than ever before.

Enormous benefits flow by directly putting user knowledge into systems construction without having to pass through such arduous analysis techniques as were required under 3GL. Time taken from specification to systems production is dramatically compressed as earlier examples have shown. So user supplied systems information is rapidly validated by construction and testing. Incorrect initial definitions can be equally rapidly rebuilt into the correct systems shape. Action and reaction follow closer, the reaction coming whilst the subject is still fresh in mind.

The whole process becomes more enjoyable and productive as users

can at last see systems created (almost) before their eyes. There are plusses here for improved relations and the capturing of enthusiasm. From enthusiasm flows determination. From determination flows a new responsibility for the whole subject of information systems. This is exactly what results in those departments which have made the change.

(d) **Evolutionary systems design.** With 4GL the development allows for evolutionary design of systems from the input of business plan. Whilst 3GL systems get progressively more unmanageable under change, 4GLs respond unphased by extensive change. Also, unlike the bolt on approach of the 3GL systems, 4GLs produce a single cohesive "whole" system, an enterprise model.

(e) **No information power broking.** We have all seen those bureaucrats who retain power by keeping information to themselves? The advent of 4GLs and their database has the power to provide immediate access to information by all who need it — directly. No longer the separate storage of information by each user for his or her own use. Under 4GL systems generators a single consistent source of data provides the organisation with solid, clear data signals. Intermediary processing of data is eliminated. The original data entry is

the only update to the system: no overnight updates except by choice. As a result a more open organisation is provided where the traditional walls between departments disappear. But this is not an unbridled advance. Of course, there is the need to have strong access control and systems security. The focus is on the culture of the organisation when we talk about more openness.

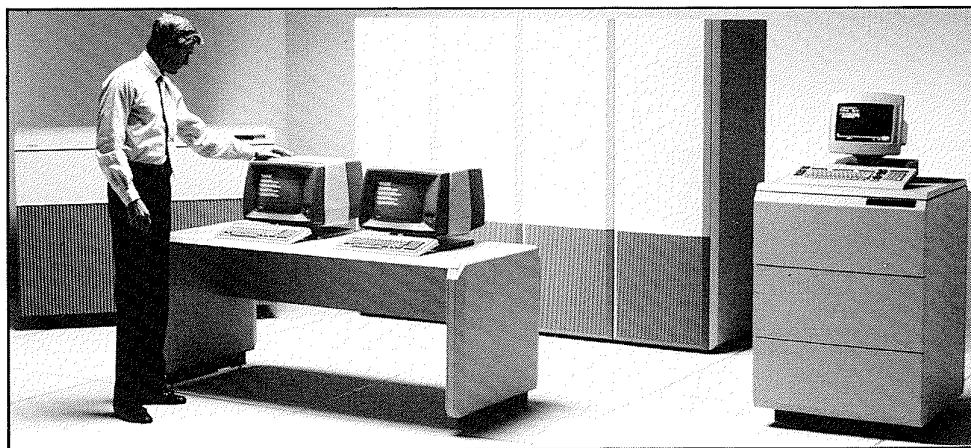
(f) **DP taken into the organisation.** So many organisations these days have developed DP departments behind closed doors that the outside world, the user organisation, rarely sees the occupants. By corollary, nor do users greatly encourage contact with DP. Under these conditions, it is not surprising that mumbblings grow quickly to grievances and then to outright intolerance when communications remain closed. By their very nature the arrival of 4GLs closes the distance between users and DP.

4GL packages

There are now packages on the market which are written with 4GLs. The qualities of flexibility and malleability can be exploited using such a package, even if you have to tailor it a little to fulfil your precise needs. This is just not practical under 3GL packages without creating an "orphan".

4GL packages have been developed in a number of the more common application areas, including housing finance, and there could well be advantage in examining whether

The Unisys A17, designed for very large data processing applications.



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part or all of your needs for the future may not be more easily satisfied with such solutions.

As a side benefit, many of the standards required by legislation are incorporated in such software, so it will be possible for you to adopt these in organisations rather than invent your own or go into the business of adopting orphans.

National issues

Obviously if, as I have suggested, it is practical to build systems that serve organisations in achieving their goals, and legislation allows us to work "as if we were at home," then presenting these systems either in a distributed or networked environment in different countries is generally limited by the language barrier.

Here, a common problem has a common solution. Our own international experience over the years led us to conclude that international systems could be created from common logic platforms, i.e. while processing of the data was provided for by a given application, within the computer, it was only the presentation that needed to be customised, and so our own systems generator or 4GL does allow for an application to handle multiple copies of the same screen format.

In this way we can "connect" multiple users to the same system where the screen format is in the local language of any one user. And indeed, countries where more than one language is standard, like Belgium and South Africa, now have a method of operating the same system in the language most applicable to the user. I believe that this now removes the final barrier from developing international systems for housing finance.

Artificial intelligence

What are expert systems and where might they be used? There are many definitions, but in simple terms: expert systems summarise an expert's knowledge and the reasoning procedures used to arrive at certain conclusions.

Thus, the view is that by under-

standing the rules by which the most accomplished advisors conclude on, say, product advice — that same "expertise" may be available to the less accomplished staff members. We only need to look at our own organisations in finance to realise that in front of our most valuable asset, the customer, we tend to put our least experienced, lowest earning, youngest people! What potential could be realised if these people possessed the "expertise" of our more able staff.

However, while the need is clear, the practice is so far disappointing. In a survey conducted by Ovum Ltd earlier this year across Europe, entitled *Expert Systems in Banking and Securities*, only 15% of UK institutions were active in this area. The most active country was Switzerland, but still with a disappointing 33% of institutions. More disappointing still, those active institutions had very few operational systems; most were confined to the "laboratory". Among the reasons given for the figures:

- immaturity of expert systems technology;
- conservatism of some users;
- exaggerated claims; and
- secrecy on what was being done.

The biggest problem was seen as the lack of operational systems.

Well, if the results to date are disappointing, should we give up? I suggest not. While there is still much we need to do as technologists to help managers, the potential benefits provide a compelling argument to proceed. Tapping the knowledge of our best people so that all can perform closer to those heights must have direct beneficial impact for organisations in areas like:

- product advice — mortgages, investments, loans;
- cross-selling of products;
- personal financial planning;
- loan risk assessment;
- credit assessment;
- business plan evaluation;

- letters of credit;
- share price monitoring; and
- foreign exchange advice.

Finally, on this subject we started with some disappointing statistics from the Ovum survey in Europe. However, that same survey showed a growth rate of 30% for AI, which is at twice the rate of more conventional computing systems.

However, you should not wait for expert systems to mature further before harnessing the competitive power that is available in today's branch systems. Outside of expert systems today there is a wealth of capability provided to aid the counselling sessions and integrate the needs of the customer from one screen to gather information, conduct interviews, perform product simulations and what-if calculations, gather external quotations for, say, insurance on Prestel or Infoview, and produce quality output of mortgage certificates or application forms.

We have certainly experienced a wealth of activity in this arena in the past two years, in fact, enough to keep you busy until expert systems mature to develop to their full potential.

A final point is that branch systems, including expert systems, should obviously be capable of interfacing to the 4GL systems talked of earlier and, indeed, that is a practical proposition today, from at least one supplier!

Systems for international housing finance is a practical proposition. The tools in the form of 4GLs or 4GL packages are in existence which include addressing the language issues. The growing momentum for expert systems will ensure their success in an integrated environment to provide international competitive edge. ■

ALISTAIR TAYLOR is director and general manager, Financial Systems Division, UK and Ireland, of Unisys Ltd. This is a shortened version of the paper which Mr Taylor gave at the IUBSSA International Housing Finance Conference on 21 November 1988.

Role of housing finance in global retail banking

By Robert D. Horner

IN looking at the housing finance industry and, more specifically, Citicorp's role as a global retail banker, one can make two general observations: there is plenty of opportunity ahead for all institutions, and making the most of the opportunity is going to become an increasingly difficult proposition.

Citicorp's approach to housing finance

Citicorp is the United States' largest financial institution, with more than \$210 billion in assets, and operations in 36 American states and 92 countries around the world.

A growing part of that worldwide operation is Citicorp Mortgage Inc, which is responsible for driving the mortgage banking business throughout the US. We have been in the mortgage business for more than 20 years, although our real focus began only as recently as 1981. Today, Citicorp is the largest mortgage lender in the US. We originated more than \$13 billion in housing loans in 1987, and expect to achieve similar numbers in 1988.

We are also the largest servicer of mortgages, by a wide margin. We currently service nearly 600,000 loan customers with an estimated servicing portfolio of \$46 billion. Our goal is to grow that part of the business to more than one million accounts in the next five years.

Clearly, housing finance plays a strong role in our consumer banking business in the US. Outside the US, Citicorp has consumer operations in 40 countries across the globe. In 26 of these countries we are involved in housing finance to some degree.

We have thousands of mortgage customers outside the United States,

from Asia to Europe to Latin America. We operate as full service banks in some countries, as consumer finance operations in others, and as savings banks in still others.

We are extremely pleased with our progress in this business, especially as we only began actively pursuing our international consumer business in 1975. In many countries, we made acquisitions and began sourcing home loans less than five years ago.

Our growth to date and in the future will result from two factors. First, we recognise that the housing finance business requires local presence and management. We can't expect to do business the same way in France as we do in Chile. Nor do we do business exactly the same way in New York as we do in California. We set up our mortgage operations to be locally managed and stay flexible to the needs of the market place. The second factor is that we also realise that there are many aspects of housing finance that are very similar, where processes and systems can be duplicated and savings and improvements achieved.

So we are moving slowly but surely towards a more standardised approach wherever possible. One thing that is already standardised around the world is Citicorp's commitment to the housing finance business.

We see this commitment to housing finance becoming even larger over the next decade. The mortgage business is a key part of Citicorp's consumer strategy both today and as we approach the year 2000.

In the United States, we have set our sights on continuing to grow our portfolio at the annual rate of \$12-\$20

billion in new loans. We have mortgage operations in two-thirds of the States and a growing consumer awareness brought on by the use of national advertising, strategic acquisitions and erosion of many of the legal and regulatory barriers which have constrained us for many years.

Outside the US, the picture is just as bright. Our mortgage portfolios are growing significantly in a number of countries. We expect this trend to continue as we expand our markets and refine our operations. As a result, we are confident that the mortgage business will continue to be a major contributor to Citicorp's half billion dollars in consumer earnings each year.

Housing finance and global strategy

In looking at these optimistic projections, three questions come to mind. First, why is housing finance such an important part of Citicorp's global consumer strategy? Second, what advantages do we have, as a global retail bank, in the competitive market place? And finally, what issues and obstacles must we overcome if we are to succeed?

The answer to the first question is easy. Housing finance is important to our global strategy because housing is important to the consumers we are trying to serve around the world.

Citicorp's chairman, John Reed, laid out our basic consumer business strategy back in 1975. "A well-served consumer," he said very simply, "is a good business proposition." That concept is still viable today in 1988 and it will be just as viable in 1998. We believe that success in the consumer

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financial services business is a matter of finding out what the customer wants and then finding ways to give it to him efficiently and profitably.

Our research has shown that owning a home is still at the top of the consumer's list of wants. Thus, we feel that by meeting this basic consumer need, we will form the basis for a long-term relationship with that consumer. This strategy is as true and relevant in Spain as it is in Japan or Great Britain or the US.

The second reason housing is so important to us is that the size of the opportunity is so huge. The mortgage market in the United States alone is in the order of \$250-\$350 billion each year. As the largest lender in the country, Citicorp still has less than a 4% share of that market. Thus, a 1% increase in our share points would result in \$3-\$4 billion per year in new business. Worldwide, the numbers are just as inviting.

Our market share, even in our most established international markets, is still small by any measurement, so there is tremendous opportunity for us to grow the business in many countries by leveraging our strengths and focusing resources in this area.

What are the strengths of a global retail bank in this business? Ironically, the answer most of us would immediately jump at is not the correct one. Global size and scope — the ability to do business across national borders and achieve economies that the smaller players cannot — is not necessarily true in this business.

The reality of the market place is that the housing finance business is very different from one country to another. So, while we would like to think that we can standardise our product offerings, our delivery mechanisms and even our treasury and servicing support functions to achieve these economies, the truth is that we are not there yet. Local laws and customs continue to slow our efforts, and everyone else's, to make the most of the opportunities that are waiting for us.

In Germany, for example, there is

no secondary market to speak of today, so our ability to grow in large part is based on our ability to attract new deposits in our German bank. In Taiwan, we have had to put into place special credit controls to protect ourselves in a market where 50% of the workforce is self-employed and credit checking is difficult at best. In Hong Kong, our business is impacted by the uncertainty of the 1997 lease issue and the effect of that impending change on home ownership on the island.

There are, however, a number of areas where our size and global reach can pay dividends.

Lessons for international operations

We have attained the position as the largest mortgage lender in the United States. Along the way we have learned a number of valuable lessons about this business which we feel can be exported to our operations in other countries.

Perhaps the most important of these lessons is that we look at the mortgage business in a fundamentally different way than most other lenders. We look at the mortgage business as a service business rather than as a financial commodity. We have made service our key point of differentiation with consumers across the globe.

We have learned with all our products that price and terms are not as important to the consumer as service, information and dependability. Customers value service above everything else. It is the basis upon which they will build a long-term relationship with an institution.

We see this information as an advantage for Citicorp because we have been working for many years to make selling service the primary focus of our consumer strategy. We have also learned that selling a service is not something that one masters overnight. In a complex business such as housing finance there

are hundreds, even thousands, of opportunities to deliver on our service promise to the customer... or to drop the ball.

For example, if we make a loan to a customer in New York and deliver the best service in the business, we have set up that customer's expectations. If our national servicing centre in St Louis then loses that customer's payment, or fails to meet that customer's expectations in any way, then we have failed.

Customers tend to judge a service provider very harshly, and rightly so. They also tend to reward a good provider of service with their loyalty and their willingness to come back to that provider again and again.

Becoming the largest housing lender is an easy task compared to achieving the position of "best provider of service". We think we have learned the formula and are already seeing it work in other countries.

Being a global bank also means that you don't always have to recreate the wheel every time you need to respond to a customer's needs. For instance, our primary distribution of mortgages in the US is through a programme we call MortgagePower. MortgagePower offers a package of products and services to consumers that is accessed through real estate agents and brokers. In the US we rely heavily on those agents to refer their home buyers to us. MortgagePower is our promise to them that we will treat their customers the way they would treat them themselves. It is our guarantee of quality service and value.

When we began to export the service concept to our housing finance businesses in other countries, we found that the MortgagePower concept has application in many lands. Of course, each time we have had to modify it to meet local customs and practices. But the basic, underlying philosophy of MortgagePower is just as applicable in all of our banks.

That is why, in Australia or some of the other Pacific Rim countries, our consumer loan business advertises a

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MortgagePower revolving credit first mortgage product. In England, in a Citibank Savings branch, MortgagePower loans are all the talk because we've capped the rate until March 1989 to help consumers get past recent increases in interest rates.

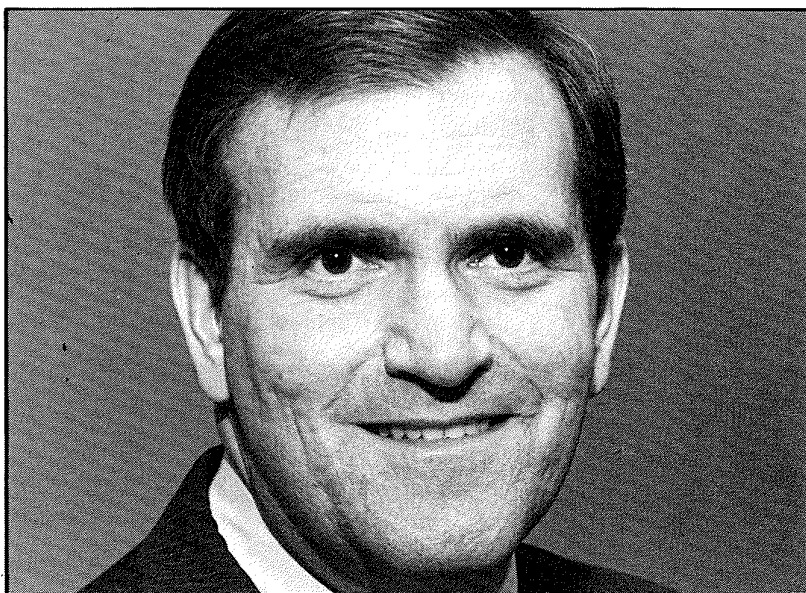
The point is that, regardless of what the local product parameters are, we have managed to develop and export on a wide scale a philosophy that makes sense in any language service. And that has put us ahead of our competition and well on the road to achieving those opportunities that are waiting.

We also have the advantage, as a global bank, of our experience and our presence as a commercial bank in many different countries. That presence has given us insight and access to markets, investors and strategies. In the past year, for example, we have worked closely with our Citicorp colleagues to make presentations on our US private label mortgage-backed securities to potential Japanese and Arab investors.

We see other opportunities to share our experiences and our successes across the globe. We are currently working in the US to consolidate all of our processing and servicing of loans into a single one or two locations. We have avoided many of the pitfalls in this process thanks to lessons we learned from our Citicorp Bank Cards division when they underwent similar restructuring a few years ago.

We have taken their experience and have added our own to it. And there will come a time, just as there was when Citicorp rolled out ATMs, when that experience, not to mention the technology and the process management, will be used by our European counterparts or our South American friends to streamline their own operations.

Productivity is another area where our international experiences give us an advantage. Despite all of the differences in our business across the world, one thing is the same: you make money in this business by keeping your costs as low as possible and



Robert D. Horner: seeking better productivity.

by giving your customers value for their money.

One of our main focuses over the past few years and into the 1990s is to seek better productivity in all aspects of our operation. What we are trying in the US and what we have learned has ready application to our mortgage operations everywhere.

International issues

You might say that our mortgage business in the US is, in many ways, a test market for the rest of the world. It is. But those of us in the US also look to our overseas colleagues for their lessons and their advice. Because, when you break the mortgage business down to its most basic premise — meeting the consumer's needs — we have learned that there are more similarities than differences.

There are, of course, a number of issues which face all of us as we approach the end of the century — or perhaps challenges would be a better word. I believe there are three primary ones.

First, we need to recognise that our world is shrinking all the time. We no longer operate in isolation, because what we do in the mortgage business

in the US today has implications for the rest of the world and vice versa.

Nowhere is this more apparent than in the capital markets. I have mentioned some of our efforts to seek international markets for our US mortgage-backed securities. That is but one small step in what is going to become an international financial market place.

We must seek out ways to internationalise the secondary markets which exist today. And we must pursue the expansion of those markets into new countries and new sources of capital. We must work toward the point where that loan that we make in Texas is originally funded with Eurodollars and eventually sold to investors in a Japanese secondary market.

Our second challenge is how we will respond, as an industry, to the changes and the opportunities which will open up as regulatory and national borders come down. The most obvious example of this is the European Common Market in 1992.

I believe that those who want to profit from this opportunity would do well to study the US mortgage busi-

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ness. In the US, the mortgage business is a national one. Unlike many other aspects of the financial industry which are restricted by state and national legislation, the mortgage business is unfettered by artificial borders.

As a result, our national approach to the mortgage business in the US has given us a huge business opportunity, and I sense a similar situation being created in Europe. The ability to do business without many of the differences and constraints which we have had is a tremendous opportunity. It gives us a chance to evolve to a common product set, resulting in productivity gains in product development, operations, marketing and more.

Around the world, we are seeing more and more opportunities opening up for those who are prepared to compete on a level playing field. We must continue to seek out any opportunity that will allow us to create efficiencies and economies of scale which allow us to provide affordable housing finance products in all markets.

Our final challenge is one for which neither I nor Citicorp has a definitive

answer. It is the question of housing affordability and availability. In the United States, we are faced with two growing problems. Our young people are beginning to find that they can no longer afford to buy and, in many cases, rent the home they desire. And we seem unable to find a way to house all of our people.

Affordability of housing is a critical

'Barriers to trade will come down'

issue in all countries. In many cases, especially in some of the smaller countries, there is simply no more room to build. We have a special role to play in this issue because experience has taught us that the mortgage industry plays a key role in facilitating home ownership. This is true in the US and I daresay it is true in other countries as well.

The US mortgage market is the most developed, most sophisticated, in the world. The rate of home owner-

ship in the US is a result of our conscientious past efforts to keep funds available and to encourage young people to buy homes. As a result, we have in the US a level of economic stability that, over the long run, is among the best anywhere. Housing stability breeds economic stability, and economic stability makes any market a better place to do business.

The basis of our consumer banking strategy is that a home is a fundamental need and want of every consumer. If we cannot find a way to insure that consumers have the opportunity to achieve this dream, then we will not succeed in our plans.

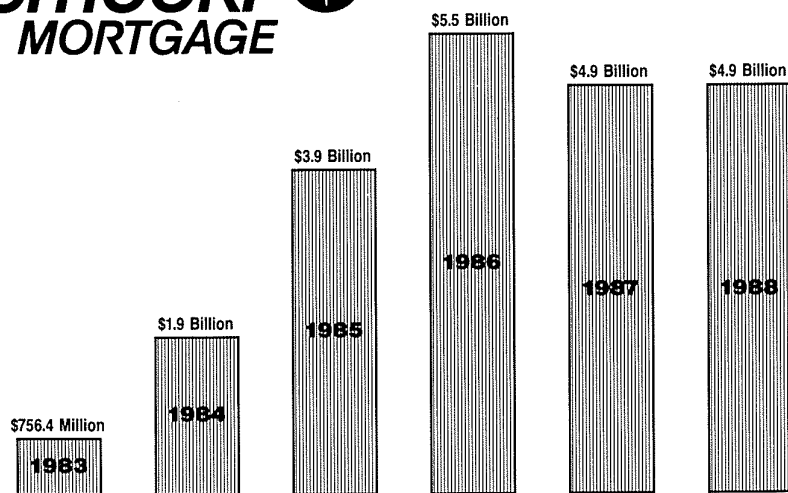
In summary, we at Citicorp are excited about the challenges and the opportunities which face us as we head towards the 21st century. We see the barriers to fair trade and competition coming down in many areas and we are encouraged by that. We know that success is possible in the housing finance business, as long as you are cost-conscious, creative and willing to take the right risks. We welcome the creation of world markets which will provide new sources of funds to make our businesses grow. We look forward to dealing with the issues that face us as we seek to keep the consumer's dream of home ownership alive.

Above all, we welcome the opportunity to grow our business in new markets and new countries, to find ways to translate lessons learned from one country to another, to take advantage of the opportunities which we have.

The role of housing finance in our global retail bank has never been stronger. And I believe that the best is yet to come. ■

ROBERT D. HORNER is chairman and division executive of Citicorp Mortgage Inc, Citicorp's Mortgage Division, based in St Louis, Missouri. This paper was given at the IUBSSA International Housing Finance Conference, held in London on 21 and 22 November 1988.

CITICORP **MORTGAGE**



MORTGAGE ORIGINATIONS

European Community and the mortgage market

THE European Community has published a study, *The Economics of 1992*, which is described as an assessment of the potential economic effects of completing the internal market of the Community.

One section of the report comprises service case studies, with financial services being among the areas selected for study. It is noted that the financial services sector is of growing importance to the Community in terms of output produced (6.5% of total value added) and number of people employed (3% of total employment).

It is noted that in each Community country there is freedom of establishment for foreign banks, but the conditions under which this may be done differ markedly from country to country. It is argued that what is needed is for such freedoms which are already enjoyed, sometimes on a rather tenuous basis, to be secured, and for the full scope of freedom to provide services to be made generally available so that the competitive marketing of these services can take place.

The Commission aims to achieve this through the proposed Second Council Directive on Credit Institutions. This will be supported by four technical directives which between

them will establish a single banking licence valid for both establishment and freedom of services throughout the Community not later than 1992.

The report considers possible reductions in the cost of financial services as a result of the integration of financial markets, using a study undertaken by the consultants, Price Waterhouse. The study was based on the prices for 16 financial products or services, seven banking services, five insurance services and four brokering or securities services. For each of the products current prices were estimated on the basis of surveying a sample of market participants. The average of the four lowest prices was

Estimation of Potential Falls in Mortgage Prices as a Result of Completing the Internal Market

| Country | % differences in prices of mortgages compared with the average of the four lowest observations |
|-------------|--|
| Spain | 118 |
| France | 78 |
| Germany | 57 |
| Belgium | 31 |
| Ireland | -4 |
| Netherlands | -6 |
| UK | -20 |

taken to represent a low competitive price.

The extent to which financial product prices exceed this level is indicated in a number of tables. Spain comes out as the country where there is the greatest theoretical scope for price reductions (34%), with the Netherlands, the United Kingdom and Luxembourg being at the other end of the scale.

The variations between the countries in respect of mortgage finance are among the most striking. These are shown in the table.

It is important to note that these figures do not relate to mortgage rates but, rather, to the cost of intermediation. If the methodology used is correct, then this would imply that the mortgage market with potentially the greatest profit for new operators would be Spain, with the United Kingdom at the other end of the spectrum. ■

The Economics of 1992, an assessment of the potential economic effects of completing the internal market of the European Community, was published by the Commission of the European Communities in 1988.

Financing of rural housing: the Malawi experience

By G. Woldeyesus

Experience has shown that it has always been painful for decision-makers in Africa to allocate funds for housing development in general and rural housing in particular, where the affordability in quantified terms does not appear attractive. However, in most cases of the developing countries, the majority of the population (over 80%) constitutes the rural people who contribute not less than 45% to the GDP. This traditional fear of tackling the rural housing problem has been dramatically overcome by the Government and people of Malawi with the successful launching and implementation of the Rural Low-Cost Housing Project (RHP).

As reflected by its title, this paper tries to highlight the major features of Malawi's experience in the rural housing finance component — policy and operational strategies. The credit system is still in its development phase — a process of refinement and strengthening based on the necessary feed-back being received from the beneficiaries as well as the RHP field officers, particularly the Community Development Assistants (CDAs).

Project background and objectives

The Rural Housing Project (RHP) initially started operations on an experimental basis with its immediate objectives being to improve indigenous building materials, and introduce simple house designs and construction methods, providing

demonstration/model houses so that people would view and apply them in the rural areas. The focus was on the development of building technology — building materials and construction techniques including identification and training of artisans. The financing system was introduced at a relatively later stage.

The first (experimental) phase came to a successful completion by the end of 1983, leading to the launching of phase two in 1984, which focused on extending the project services to the rural families to help them improve their housing conditions and sanitary facilities. During this phase, the UNCDF joined the two UN agencies to supplement the Government efforts in the implementation of the project.

The project had to extend its services to the rural people through the establishment of regional (three) and district (24) housing centres in the rural areas, and in order to promote the technology and make it accessible to people, the Government had to introduce a rural housing credit system which also necessitated the creation of a revolving fund.

The credit system and its objectives

One of the major features of the Rural Housing Project is the financing mechanism featured by the introduction of the credit system and creation of a revolving fund to form the basis of self-supporting financing institutional machinery. In order to supple-

ment and strengthen the self-help efforts of the rural people in construction/rehabilitation of their houses, the project extends medium-term credits to households which are recommended and supported by their respective Village Housing Committees, established by the villagers themselves.

The main objectives of the credit scheme are:

- (a) to facilitate construction/renovation of houses for the rural household;
- (b) to provide material loans at easy terms and conditions for the low-income rural people; and
- (c) to encourage and assist through training and short-term credit village entrepreneurs such as building contractors, carpenters and building material producers.

The Project's target groups constitute in broad terms the low-income farmers and the artisans (small scale business entrepreneurs) operating in the rural areas. Although it has been difficult to define the target groups in quantified terms by way of income range in the rural areas, the Project experience shows that the beneficiaries and artisans so far served appear to be in the annual income range of K300 to K2000 (£75-500).

The cost of houses and the related credits have to be affordable to the target groups. Hence, the policy underlines economical houses which would require the minimum amount of credit. The principal guiding factor

HOUSING IN MALAWI

is the concept, "the house that grows"; beneficiaries are encouraged to start with modest house designs (one or two roomed) which can be easily extended later, as and when their economic means improve.

Terms and conditions of the scheme

The Project demonstrates and encourages economical house development through maximum self-help inputs and use of indigenous building materials. Meanwhile, after assessing and evaluating the credit worthiness of the applicant, in consultation with the Village Housing Committee, a material loan worth up to K1,000 (£250) is issued to the approved beneficiary. Normally, this loan covers essential building components such as sisal-sand roofing sheets, door and window frames, APC flat sheets, nails, window vents (or glasses) and ant poison.

The beneficiary is expected to arrange for his/her affordables — materials and components such as mud blocks, roofing poles and labour. In all cases, the beneficiary is provided with advice and technical assistance by the RHP Housing Team with a technical training and expertise available at each Project Centre.

The loan, at 12% interest, is normally payable annually. Borrowers are given the options to pay quarterly or monthly as they choose over a ten-year period including one year grace.

Artisan loans and independent house developers

In order to expand its impact and popularise the services among the broad section of the rural population, the Project extends small-scale business loans in the form of equipment and tools to materials producers (roofing sheet/tile makers) and house builders including bricklayers, carpenters and tin-smiths. The loan limit extends up to K1800 to be repaid at 12% interest over five years with six months grace period.

The Rural Housing Project also

Rural Low Cost Housing Conference

AS PART of its contribution to the International Year of Shelter for the Homeless, the Building and Social Housing Foundation initiated the Habitat Awards. These Awards are designed to identify human settlement projects in both developed and developing countries which offer sustainable futures to the residents and which present practical and imaginative solutions to current problems.

The Rural Housing Programme, instigated by the Government of Malawi with United Nations support, was identified by the Building and Social Housing Foundation as a highly successful project in the developing world and was awarded the Habitat Award for 1986. The Award was presented to the Malawi Government on World Habitat Day 1987 by Hon Ranasinghe Premadasa, Prime Minister of Sri Lanka, in the presence of the United Nations Secretary General, Senor Javier Perez de Cuellar, at the United Nations Headquarters in New York.

A conference on Rural Low Cost Housing, entitled *The House That Grows*, was held in Malawi from 1-6 August, 1988, in order that this highly successful project could be made known to all developing countries. Over 100 delegates from 25 different countries attended this extremely successful conference and were able

to share their own ideas and experiences as well as learning at first hand about the Malawian Rural Housing Project.

The conference proceedings* have been published by The Building and Social Foundation. This paper, one of 16 presented to the conference, deals specially with housing finance.

The Building and Social Foundation is a research and education institute based in Coalville, Leicestershire. It is an independent and non-political organisation which has been endowed with funds by a building organisation formed by a group of homeless and penniless ex-servicemen just after World War Two. The Foundation carries out research into all aspects of housing, concerning itself with the immediate and practical problems of housing today as well as attempting to look to the future in a progressive and imaginative way. Of particular interest is the need to identify a sustainable and viable way of life for the future in both developed and developing countries.

**The House That Grows*, Proceedings of the International Conference on Rural Low Cost Housing, Building and Social Foundation, Memorial Square, Coalville, Leicestershire LE6 4EU, UK.

assists independent/private house developers in rural areas who show interest to utilise the RHP materials and construction techniques in their house development and that they are able and ready to meet all other costs for their house development including:

- cost of all materials for their house construction;
- cost of labour
- cost of transporting their materials from the sources to the building sites;
- reimbursement to the RHP some of the costs for drawings and supervision as may be found necessary by the Project.

Linkage with POSB

The mode of repayment has been facilitated by arranging with the Post Office Savings Bank (POSB) for beneficiaries to make repayments at its postal agency in the village concerned. There is already an effective linkage with POSB whereby throughout its country-wide counter facilities it accepts loan repayments from RHP borrowers. Thus, borrowers can make repayments at their nearest branch of the Post Office, which records details in the loan passbook of the borrower concerned and issues the receipts. Then POSB communicates with RHP, providing it with monthly repayments. 46 →

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At the end of each quarter, the POSB issues a cheque to the RHP covering loan repayments money for the preceding quarter. The repayment mechanism also provides that each RHP Centre makes repayment follow-ups, to establish "who has paid and who has failed to meet his or her obligation". Hence, each centre maintains proper payment records on each borrower to determine loan servicing performance. So far, POSB working relations have proved workable; however, there is a need for strengthening the follow-up on the part of the centre's staff.

Collateral security

Unlike conventional housing loans, the Project credit system does not require the beneficiaries/borrowers to pledge or mortgage the houses financed with the loan proceeds. The main reason is that by law, rural houses in Malawi cannot be sold, and hence cannot be pledged.

However, borrowers are required to declare their assets during the credit screening; the credit system places reliance on the discipline of the borrowers in meeting their repayment obligations as well as the high sense of responsibility demonstrated by the Village Housing Committees and village elders in supporting and recommending the creditworthiness of the beneficiaries. The Committee is also expected to act as a guarantor for them, ensuring proper recovery of the loans.

Meanwhile, the 10% deposit funds, which also serve as savings/capital formation, as well as the chattels consisting of domestic animals, furniture, ox-carts, bicycles and other properties, form an integral part of the collateral securities for the loans made out.

A group loan protection insurance policy is also being set up which would contribute to the strengthening of loan repayments. This insurance scheme was introduced for the mutual benefit of the lender and heir(s) to the borrowers in case of death; the outstanding balance of

indebtedness is to be settled by the insurance company (now the life and pensions department of NICO).

In summary, these direct and indirect securities, self-discipline and Village Housing Committee and 10% deposit Trust Funds and Group Insurance Scheme, should serve as sufficient cover/guarantee for the loan repayment in case of default for any reason.

The revolving fund — establishment and performance

It is a well known fact that financial resources in any developing country are scarce and difficult to obtain, especially for housing. In order to overcome this constraint, the Government of Malawi in collaboration with UNDP, UNCDF and UNCHS (Habitat) created the Credit Revolving Fund to serve as a continuous source of funds for the rural housing credits.

The Revolving Fund mechanism constitutes an annual contribution by the Government to the tune of K72,000 through budget allocations. This has been supplemented by funds inputs (grants) from UNCDF, and all loan repayments including principal and interest go into the Revolving fund account for recycling into new credits.

The following summary of data may serve as an indicator of the trend of performance in the financing/credit sector as at 30 June, 1988:

| | |
|---|-------------|
| No of beneficiaries/artisans served ... | 895 |
| Loans advanced | |
| (Committed & disbursed) ... | K537,443 |
| Deposits received | K51,790 |
| Repayments made | K9,250 |
| Government contributions | K328,000 |
| UNCDF inputs (2 releases) ... | K208,034.71 |
| Demand for 1988/89 | |
| (1550 applicants) | K1,267,299 |
| External Funding Required — as per | |
| Projection (1988/89 through | |
| 1994/5): | K9,038,312 |

So far, the credit capital mobilised from internal and external sources amounts to nearly K536,000, the major part of which came from Government. The external sources' fund-

ing assistance is expected to reach a level of K9.0 million (£2.5 million) during 1988/89 through to 1994/95, which will enable the Rural Housing Programme to operate on a self-sustaining basis as reflected in the annexed cash flow and credit funds projection exercise.

Although the projection might appear over ambitious when considering the present low implementation capacity, demand for rural house consolidation would justify efforts for its implementation.

The main objective of the exercise is to enable the Government and the donor agency (UNDP) to see the funding resources required and provide the capacity to serve annually a defined number of beneficiaries over a 12 year period to the year 2000 under the Rural Housing Development Programme of Malawi. Some of the major assumptions and conclusions drawn are noted as follows:

(i) A total of 32,000 beneficiaries for home loans and 1,080 artisans for small-scale business are to be served from 1988/89 through 1992/2000. It is anticipated that demand as quantified in the number of loans issued each year, as well as the implementation capacity would be available.

(ii) The credit funds required would be mobilised from internal and external sources including inputs to a tune of £2.25 million to be utilised over a seven-year period from 1988/89 through 1994/95.

(iii) The Government contribution would continue until the break-even point is reached in 1995/96. It is also assumed that the Credit Revolving Fund would have to be reinforced with additional external funds from UNDP/UNCDF or other donor agencies.

(iv) Interestingly, the analysis shows that if the plan is effectively/strictly implemented, the Housing Programme would attain self-sustained operations at the end of 1994/95; in the ensuing period to the year 2000, a total of K8.8 million (£2.2 million) inflow would be realised from the housing investments (credits) and this would be available for further

HOUSING IN MALAWI

financing of rural housing development.

(v) It should be noted that the higher the number of beneficiaries, the higher the required funds and the higher the repayments inflow; repayments collection on any given loan is based on 80% recovery, assuming the 20% would cover the contingencies including defaults due to crop failure, sickness, negligence, etc.

(vi) During the projected surplus period from 1995/96 onwards, given a stronger implementation capacity and the anticipated increasing demand, the Housing Programme would intensify its investments employing the surplus funds, thereby serving more beneficiaries annually than the projected figures; or the option would be to make the Credit Institution a self-supporting entity.

Village Housing Committees — catalysts for housing co-ops

The RHP deploys Community Development Assistants (CDAs) at each centre and through them carries out extensive community development/education and self-help promotion; they are in constant contact with villagers and conduct orientation/education of borrowers as well as addresses at public gatherings, elaborating on the Project objectives and operations and also on the building technology and credit mechanism.

In each village within the area (about 20 km radius) served by the RHP Centre, residents assisted by the Project staff create a Village Housing Committee comprising 10 to 15 members. The major duties of the committee include:

- (a) organising and co-ordinating the village efforts and to liaise with the RHP Housing Team on behalf of the villagers;
- (b) grouping together families interested in receiving assistance to construct/improve their houses and arrange meetings between these families and the RHP officers;
- (c) assisting the RHP Housing Team in evaluating each

family's ability to repay the amount of credit that is being considered;

- (d) ensuring that each borrower pays back regularly and in case of default to arrange settlement of the outstanding loan.

At this initial stage of the credit operations, the Village Housing Committees have great responsibilities and act as "Pre-Housing Co-operatives" which may soon be converted to full-fledged "Housing Groups or Co-operatives" with full power to manage the credits including selection of beneficiaries, determination of loan amounts within the limit and monitoring/controlling the recovery of the loans.

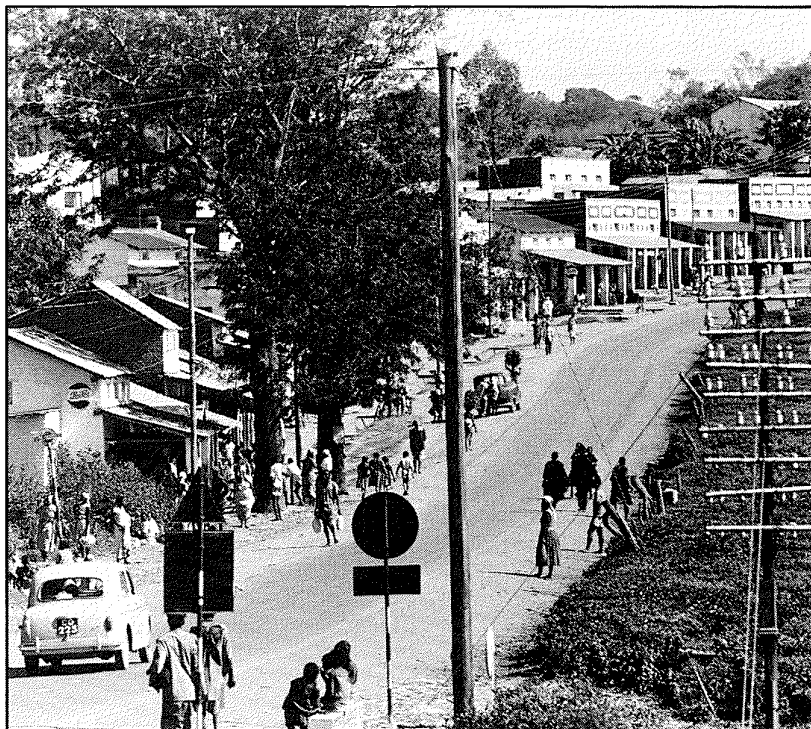
In line with the future expansion of rural housing credit services to the rural population of Malawi, studies

have shown that there is a pressing need for group lending *vis-à-vis* individual loans. Hence, the Village Housing Committees can serve as effective catalysts in enhancing the establishment of legally constituted association or "housing co-operatives" which the Project Management is now seriously pursuing with its field officers to examine and investigate how best these could be speedily achieved.

Staff development

As regards the staffing constraints in the Project implementation, the Malawi experience is not much different from most other countries in Africa. The need for trained and high-calibre personnel is crucial to achieve the desired output, especially in the area of loan processing and servicing. Thus staff development is one of the major challenges at present faced

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The town of Blantyre in Malawi.

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by management. Efforts have not been spared in initiating and undertaking in-house and outside training for RHP staff, particularly in the construction technology as well as the financing mechanism including the credit policies and operations.

Some useful in-house training courses conducted for field staff include a recent week-long training workshop on "Community Services and Credit Operations" which was carried out in each Regional Centre. All in all, 76 participants — 30 in the south, 27 in the central area and 19 in the north — benefited from the training. The workshop was organised in such a way that the training needs of all stores clerks, Community Development Assistants (CDAs) and the District Officers (DOs) were fully addressed, elaborating on the integrated management of materials delivery, community services (promotion, motivation and education) and the co-ordination role of the District Centre Officers.

One of the major outcomes was that there was a great need for team spirit and co-ordinated action by the incumbents of stores, CDAs and the DOs; the participants further stressed the usefulness of similar workshops on community services promotion strategies and credit operations. It was also the opinion of the course organisers and resource personnel that in-house training was essential for the success of the Project implementation in general and the credit operations in particular.

As the existing staff, especially at the field centres, did not have adequate training and experience, especially in financial activities, the continued training should focus on equipping the field officers with full knowledge of community education, applicants' screening, credit approvals, processing of loan agreements, materials disbursement and the loan servicing.

Public co-operation

The long-term success of the Credit Scheme greatly depends on the co-

operation and understanding of the public, mainly the rural population which is the major beneficiary. The Village Housing Committees have vital roles to play in monitoring the proper usage and regular servicing of the credits by all borrowers who are recommended members of the village community as well as responsible citizens of the country. It is the regular repayments inflow that can reinforce the Revolving Fund from which other Malawians on the waiting list are to obtain loans to build or renovate their houses.

'Lessons for other countries'

Therefore, a high sense of responsibility and maximum co-operation is expected from the beneficiaries as well as the members of the Housing Committees, so that the Programme can soon become self-sustaining, thereby ensuring continued credit services to as many rural people as possible. It is in this way that the public would demonstrate its readiness and determination to be rallying behind the Life President, His Excellency Dr H. Kamuzu Banda, in implementing one of his cardinal principles of "decent houses for all — houses that do not leak when it is raining."

Lessons learnt

The Credit System is still in its development stage. It is being refined and strengthened with the help of the useful feedback being received from the beneficiaries and the community leaders. Despite the visible implementation constraints, the RHP Financing System, including its Revolving Fund and the Credit Scheme, has a great potential for success provided it is properly implemented and monitored. Hence, the need for a well-trained staff, parti-

cularly the District Officers and the Community Development Assistants, is of paramount importance. The already tested construction technology as well as the materials credit mechanism can be effected and adopted in any rural setting of a developing country.

Another important housing development policy lesson for other developing countries to underline is the exemplary attention given to the rural housing sector by the Government of Malawi. His Excellency the Life President himself not only initiated the Rural Housing Project, which won the Building and Social Housing Foundation 1986 International Year of Shelter for the Homeless (IYSH) award, but also closely monitors its progress through constant briefing by the Office of the President and Cabinet; such an action-oriented recognition encourages and motivates the planners as well as implementers to give the rural human settlements sector its due share of the financial resource allocations.

Therefore, in conclusion, it is the Malawi Government's view that, although the Credit System is still gaining momentum, the experience gained in financing rural housing can be usefully replicated in other developing countries. The various lessons learnt from the Project experience and implementation process can help minimise, if not eliminate, the constraints encountered in the process and adopt effective strategies with better and more encouraging results, thereby enhancing accelerated rural housing development, the goal of every rational government. ■

MR G. WOLDEYESUS is the Housing Finance Management Adviser for UNCHS/RHP in Malawi.