Secondary mortgage markets — national or international?

Mark Boleat concludes that there is only limited scope for international secondary mortgage market operations

A MAJOR financial trend is the tendency towards the globalisation of the capital markets. Leading financial and commercial companies now raise funds in a number of financial centres, and the markets in London and Tokyo are competitive with that in New York. Partly, this reflects the fact that many businesses now operate on an international scale, but it also reflects the deregulation of the financial markets generally. The bond market is now international, and equity markets are increasingly becoming international. Not surprisingly, therefore, the possibility of mortgage markets becoming international is being seriously considered. To some this seems a natural follow-on from the development of secondary market activity in the US, and already a number of American institutions have successfully sold mortgage-backed securities on the international financial markets.

This article considers the theoretical aspects of secondary mortgage market operations, briefly describes the huge American secondary market and the emerging British secondary market, and finally discusses the possibility of international secondary mortgage market operations, and their relevance to developing countries.

Theoretical issues

Traditionally, in most countries, the same institutions have made, serviced and held mortgage loans. That is, a building society, savings bank or mortgage bank makes a loan to a house-buyer, handling all the administrative arrangements; collects the regular repayments, dealing with any repayment difficulties; and holds the loan in its own portfolio, financing it by retail deposits or wholesale market funding.

Where the lending institution is not a deposit-taking body, for example, a mortgage bank, it will probably not have the branch network and customer contact with which to obtain new mortgage business directly and therefore may obtain its business through introductions, perhaps from banks or from brokers. In some cases the introducing agent may actually do some of the initial work in setting up the loan, while in other cases a mortgage bank may obtain business from related institutions in a group. For example, the public mortgage banks in West Germany obtain their business partly through introductions from the savings banks which collectively own the parent institutions of the mortgage banks, the landesbankes.

Once a loan has been set up it has been normal for the lending institution to continue servicing it; in most countries the possibility of the lender selling part or all of a loan portfolio has not been seriously considered. Theoretically, however, there is no reason why the processes of making loans, servicing them and holding them should be integrated. The qualities needed for each type of activity are not identical. In order to make loans, one needs regular contact with consumers and this is likely to mean high street branches and a large number of customers or, alternatively, contact with customers at the time they are purchasing a house, for

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example, through house-builders or real estate agents.

To hold loans, the main requirement is access to the cheapest source of long-term finance. In some countries, deposit-taking institutions may be in this position, while in others institutions which obtain their funds on the wholesale markets may be better placed. There is no particular reason why an institution which is well placed to obtain mortgage business should necessarily be well placed to hold long-term mortgage loans.

Servicing mortgage loans is, relatively speaking, a mechanical operation open to almost any institution with a reasonable computer facility.

One major trend in housing finance markets has been towards diversifying sources of funds. Deposit-taking institutions, such as savings associations and building societies, have increasingly used the wholesale markets as this has offered them, in many cases, cheaper funds than the retail markets and certainly more stable long-term funds. However, tapping long-term sources of funds in this way does not imply a secondary market.

As mortgage markets have become more competitive so financial institutions which traditionally have not held mortgage loans have been increasingly attracted to them. Mortgages generally offer a premium over other investment opportunities but the obstacle to institutions such as insurance companies and pension funds holding mortgage loans has been the difficulty of dealing with a large number of customers and handling the regular monthly repayments.

There are several ways in which financial institutions, with access to large sources of funds, can fund the housing market:

(a) By direct lending to house-buyers, the method used predominantly by banks.

(b) By direct lending to housing finance institutions.

(c) By purchasing marketable securities such as certificates of deposit or Eurobonds issued by housing finance institutions.

(d) By purchasing loans or securities backed by mortgages.

Each of these four options achieves roughly the same result, but only one of them involves a secondary market. Here it is important to recognise that a secondary market is only a means to an end. It is a method of channelling institutional funds into the housing market, and any such method is likely to improve the competitiveness of the mortgage market, generally to the benefit of consumers.

It is necessary to consider the four methods of institutional funding of the housing market to illustrate the role of secondary market operations.

Direct lending to house buyers is for the most part attractive only to retail financial institutions such as building societies, savings associations, savings banks and commercial banks. Such institutions already have a large customer base and have the computer and other facilities capable of handling the rather messy business of making long-term mortgage loans and receiving the monthly repayments.

Direct loans from institutional investors to housing finance institutions is an alternative method of operation. This system is already used in many countries, particularly by linked institutions. For example, in the Netherlands the Rabobank makes loans to its subsidiary mortgage bank, and in France the Compagnie Bancaire makes direct loans to one of its subsidiaries, the Union de Crédit pour le Bâtiment.

With the increasing trend towards securitisation it has become more attractive to both housing finance institutions and institutional investors for the latter to fund the former by purchasing marketable unsecured securities rather than by making direct loans. These give liquidity to the institutional investor, while providing a steady source of funds to the lender. Many mortgage banks operate in this way while building societies and savings institutions have increasingly raised funds through certificates of deposit and Eurobonds.

Secondary market operations can be seen as a special case of housing finance institutions obtaining their funds through issuing securities, the refinement being that the funds raised are backed by mortgage loans or result from the sale of such loans. It is inevitable that in any portfolio of mortgage loans there will be some bad loans, so the institutional investor will want the loans to be insured. He will also require a higher rate of interest than, for example, on government securities to compensate for the fact that the loans are likely to be prepaid prematurely.

For a housing finance institution, the motives for raising funds through the secondary mortgage market can vary. For many institutions it may be possible to obtain funds at a cheaper rate by using the secondary mortgage market than by raising funds on an unsecured basis. More importantly, perhaps, all financial institutions have to maintain capital and if assets can be got off the balance sheet for capital adequacy purposes then a given amount of capital can be used to fund a greater amount of activity. If a housing finance institution can make loans and sell them it has the opportunity to earn fee income from making the loans, it may be able to sell the loans at a premium and if it continues to service the loans it will also earn fee income.

The secondary market in the United States

The US is the only country which has a significant secondary mortgage market, and that market has grown rapidly in recent years. The original rationale for the American secondary market was to overcome regional imbalances caused by restrictive legislation. The bulk of savings were raised in the long established centres on the East coast, while the demand for funds was predominantly in the developing areas of the South and West of the country. Banks and savings associations were largely confined to operating within individual states and a secondary market was needed to switch funds between parts of the country.

The secondary market in America then developed further partly because of the activities of a number of government and quasi-government agencies. They helped to establish two important variables which are essential if secondary mortgage market activity is to be achieved:

(a) Uniform lending criteria. The secondary market in America has led to the adoption of standard criteria and also standard forms for mortgage applications and appraisals. Government bodies which purchase mortgage loans or guarantee them have effectively determined the criteria for mortgage loans which may subsequently be used as security for mortgage-backed securities.

(b) Insurance of mortgage loans.

The American secondary market was given a considerable impetus in the late 1970s and early 1980s as a result of the financial crisis which affected the American savings institutions. They had been forced to borrow short and lend long, which inevitably caused problems when interest rates rose rapidly. The institutions simply did not have access to long-term sources of finance at fixed rates of interest, yet they had been forced to lend long-term at fixed rates. By selling mortgages they were effectively laying-off the interest rate risk, and the institutions which bought mortgages could fund them through long-term fixed rate financings.

The extent of the secondary market in America is shown in the accompanying table. The principal originators of mortgage loans are thrift institutions, that is, savings associations and savings banks, commercial banks and mortgage banks. The latter institutions originate and service loans and do not hold them long term in their portfolio. Mortgage banks effectively sell all the mortgage loans which they originate, but increasingly thrift institutions also sell a high proportion, in particular those made at fixed rates of interest. Purchasers of mortgage loans include thrift institutions (which may well purchase mortgage backed securities backed by loans which they themselves have made) and the federal agencies which then fund their operations by issuing mortgage backed securities which are purchased by a variety of institutional investors.

A number of government or quasi-government agencies effectively make the secondary mortgage market work.

The *Government National Mortgage Association* (GNMA) operates within the Department of Housing and Urban Development and works through the mortgage backed securities programme by which privately issued securities backed by mortgages insured by the Federal Housing Administration, the Veterans Administration and the Farmers Housing Administration are guaranteed. The initial lender markets and administers these securities and GNMA earns its income through charging a guarantee fee.

The *Federal National Mortgage Association* (FNMA) purchases mortgage loans, holding them in its own portfolio, and financing these by a variety of funding instruments. More recently, FNMA has begun to sell mortgage backed securities backed by its own loans.

The *Federal Home Loan Mortgage Corporation* (FHLMC) purchases mortgage loans and then re-sells them by means of mortgage participation certificates.

The importance of these institutions is that not only is the institutional investor purchasing mortgage backed securities: generally there is

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USA Residential Mortgages, 1985

Institution	Originations		Sales		Purchases		Net Acquisitions		Net Acquisitions of Mortgage Related Securities		Total Source of New Housing Credit	
	$m	%	$m	%	$m	%	$m	%	$m	%	$m	%
Thrifts	143,753	50	102,566	52	55,145	25	96,332	62	7,856	5	104,188	34
Commercial banks	56,622	20	18,154	9	5,828	3	44,296	29	11,693	8	55,989	18
Life insurance companies and pension funds	4,176	1	1,655	1	964	—	3,485	2	26,886	17	30,371	10
Federal agencies	5,154	2	884	—	133,540	60						
State and local agencies	4,870	2	0	0	6,005	3						
Builders	4,053	1										
Mortgage banks	66,201	23	75,505	38	20,997	9						
Others							10,625	7	107,370	70	117,995	38
Total	284,829	100	198,764	100	222,479	100	154,738	100	153,805	100	308,543	100

Source: Freddie Mac, *Secondary Mortgage Markets,* Summer 1986.

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some form of government backing as well.

Many countries look to the American experience to see if it is applicable to their countries. In considering this the following points need to be noted:

(a) The American secondary market grew in response to the peculiar American situtation, in particular, restrictions on interstate activity and regulations which effectively forced the housing finance institutions to borrow short-term at variable rates and lend long-term at fixed rates.

(b) The American secondary market is dependent on the activity of the governmental agencies which transform mortgage backed securities into government backed securities.

The British secondary market

Britain has a very sophisticated financial system and has a housing finance system which in principle is not dissimilar to that of the US. Nevertheless, there is only a tiny amount of secondary mortgage market activity in Britain. Building societies, the principal lenders, have traditionally raised their funds through short-term retail deposits. Over the past few years they have seen a necessity to diversify their sources of funds and have raised substantial amounts from the wholesale markets, through certificates of deposit, Eurobonds, bank loans, tender facilities and other instruments. However, societies have not had to pledge any of their mortgages as security for this form of financing and have not, as yet, issued any form of mortgage-backed securities.

This partly reflects the fact that British building societies are mutual institutions and the holders of unsecured wholesale deposits or Eurobonds rank before their ordinary investors who provide most of their funds. However, building societies do have capital requirements and they are also subject to a limit of 20% on funds which they may raise from wholesale sources. There is provision for this limit to be increased but to no more than 40%. If building societies start bumping up against this limit then they may well be attracted to using the secondary market as a method of increasing their mortgage business while staying within the limit for wholesale funding.

However, an embryonic secondary mortgage market is beginning to emerge. The British mortgage market has now become much more competitive and mortgage rates have settled down at an attractive premium over money market rates. The mortgage loan is therefore now an attractive investment for institutional investors and five mortgage companies have been established by institutional investors to take advantage of this. These institutions are all funded from the wholesale markets and obtain their mortgage business through introductions from estate agents and insurance companies. Three of the companies have now made issues of mortgage backed securities. However, the cost of the funds generated in this way is higher than the cost of the wholesale funds which building societies are able to raise unsecured from the wholesale markets.

'Mortgage loan an attractive investment'

The extent to which the secondary market in the UK will develop, will depend to a large extent on how building societies react to the new market position. If they continue to be restricted in the extent to which they can raise wholesale funds then the secondary market may well grow considerably as this will be an attractive method of funding for societies. If, however, they are allowed to raise more funds on their balance sheet then most would probably prefer to continue their funding on the balance sheet as long as they can do so within their capital adequacy requirements.

International secondary market operations

Mortgage backed securities issued by American institutions have been sold in the international financial markets and the same applies to the three issues of mortgage backed securities by British institutions. In deciding whether to purchase these securities, an international investor will first consider in what currency he wishes to hold securities. If he wishes to hold dollars then that decision is taken first and the various dollar instruments are considered. The high yield on mortgage backed securities will be an advantage but the uncertain prepayment pattern will be a disadvantage and the investor will have to make his own decision. The same would apply to anyone purchasing a mortgage backed security denominated in sterling. The initial decision to take is what currency does the institutional investor wish to invest in, and then the mortgage backed securities are examined against other investment opportunities.

It follows that an international secondary market is simply not realistic as a means of increasing the flow of mortgage funds to countries which are unable to attract international funds because of the exchange rate risk. In some cases a central bank or commercial bank may be willing and able to take the exchange risk and where this is the case, foreign funding for mortgage institutions, through a secondary market or more conventional loans, can be achieved. However, for most countries this is simply not feasible.

In many countries, there is perceived to be a shortage of funds for house purchase and naturally one is inclined to look to the secondary market, national or international, as a method of raising more funds. While in some countries this may be

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appropriate, it is important not to see a secondary market as a panacea. The first critical point is that a secondary market can operate only where the yield on mortgages is higher than the yield on, for example, government securities, which, by definition, offer better security, greater liquidity and a definite repayment date.

The differential between the rate on mortgage backed securities and that on government securities will depend on the sophistication of the secondary market. In America that differential is quite low because the secondary market is very sophisticated; in other countries the premium would be much higher, perhaps as high as five percentage points depending on such factors as the default rate and any government insurance of the mortgage loans.

It follows that in any country where the mortgage rate is not at an attractive premium over the rate on government securities, a secondary market could not be established and, of course, it is in precisely such countries where there is likely to be a

'Shortage of mortgage funds in many countries'

perceived shortage of mortgage funds. Such a shortage, by definition, must be caused by the price being too low. A necessary condition for establishing a secondary market is for the mortgage rate to be at the appropriate market level and that this in itself would generate more funds into housing finance regardless of the secondary market aspect.

The secondary mortgage market cannot be seen as an easy solution to problems which, in fact, are caused by the mortgage rate being held, for whatever reason, at below the proper level. Similarly, a secondary mortgage market is not going to lead to more funds going into the housing market if the general problem is the shortage of funds.

In most developing countries, therefore, a secondary market is likely to be of little benefit as the problems they face are not those that can properly be addressed by a secondary market. However, there is scope in both industrialised and developing countries for secondary market or quasi-secondary market activity to develop where there is a mismatch between institutions' abilities to originate and service and to hold loans.

It has been found in developing countries that mortgage lending is a far from easy task and most general financial institutions shy away from it. Accordingly, the major lenders are specialist institutions which develop the necessary expertise in mortgage lending. However, these institutions often find difficulty in raising the funds which they need and permanently have to ration their mortgage loans. If in such countries there are other institutions which would find investing in mortgages an attractive proposition were it not for their

'Scope in developing countries for secondary market'

inability to originate and hold loans, then the two sets of institutions can be brought together.

This can be done in one of the various ways described earlier in this article; for example, loans to be sold

A modern residential home . . . . but which institution is servicing the loan that is helping to buy it?

on the pattern of the secondary market in America. A simpler option is for the institutions which are specialists in originating and servicing loans to originate those loans directly onto the balance sheet of the institution which wishes to hold them. In either case the investing institution needs to be satisfied about the quality of its investment, and experience suggests that such satisfaction will derive from examining a number of factors:

(a) Appraisal — it is necessary for the property in question to be appraised according to accepted standards, possibly by people in certain professional bodies and possibly on a standard form.

(b) Lending criteria must be realistic, acceptable to the investing institution, and rigidly adhered to. Typically, such criteria will cover the loan to value ratio and the income multiple.

(c) The originating and servicing institution must have a sound policy for dealing with arrears, and, moreover, a policy which it adheres to. Obviously, this is something which can be tested only over time and hence a track record is important.

(d) Insurance may be desirable, particularly in the case of high percentage loans. Such insurance can be granted either by a commercial insurance company or by a governmental or quasi-governmental agency.

'Need for sound policy on arrears'

In industrialised countries the task of producing acceptable mortgage backed securities is in some ways eased by the activities of rating agencies such as Moody's and Standard and Poors as they use the experience which they have gained in the United States to rate securities in that country and increasingly to rate securities in other countries as well. Among the major factors that such agencies look at are those listed above.

It follows, therefore, that if lending institutions are constrained simply by inability to raise funds themselves, then they do have an opportunity to develop either secondary market activity (selling loans) or quasi-secondary market activity (originating loans for other institutions in this case) and in either case such activity is likely to develop and become more sophisticated over time. The sooner the opportunity is taken to produce policies which are acceptable to institutional investors in respect of appraisal, lending criteria, management of arrears and mortgage insurance, the more likely it is that fruitful working relationships can be developed and the amount of finance going into housing can be increased.

'Mortgage lenders diversifying their sources of funds'

Summary

(a) A major financial trend is the tendency towards the globalisation of capital markets; logically this might be expected to lead to the globalisation of the mortgage markets.

(b) Traditionally, most institutions which make mortgage loans continued to service and hold them throughout their life. However, there is no logical reason why the act of originating loans should be linked with that of holding them.

(c) Mortgage lenders have increasingly been diversifying their sources of funds; even those which have traditionally relied predominantly on retail deposits have been obtaining finance from the wholesale money markets.

(d) There are a number of ways in which institutional investors can fund the mortgage market — direct lending to house buyers, direct lending to housing finance institutions, purchasing marketable securities issued by housing finance institutions and, finally, the secondary mortgage market, that is, purchasing loans or securities backed by mortgages.

(e) America has a huge secondary market which has developed largely because of the special circumstances of that country, in particular, the limits on inter-state banking activity and the savings associations being forced to borrow short and lend long.

(f) A limited secondary market is developing in a number of other countries such as Britain.

(g) The secondary mortgage market is not a way of overcoming mortgage market problems caused by interest rates being held at too low a level. Within countries the secondary market can increase the flow of funds into the housing market only where the problem is that the institutions which can make and originate loans do not have the capacity to hold them, but where mortgage interest rates are at an attractive level to institutional investors.

'Limited scope for international operations'

(h) Where this problem exists it can best be overcome by the mortgage loan originators developing acceptable appraisal techniques, lending criteria, management of mortgages and, where necessary mortgage insurance. This will make investing in residential mortgages attractive to institutional investors.

(i) There is only limited scope for international secondary mortgage market operations. The first decision of an institutional investor is the currency in which he wishes to invest and mortgage backed securities or mortgages have to take their place alongside other investment opportunities. ■

UK building societies and international capital markets

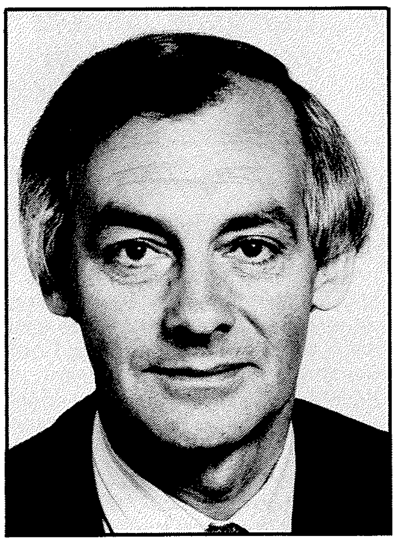
Brian Phillips examines how societies are developing their funding strategies from a widening variety of sources

IN the first issue of *Housing Finance International* I outlined how and why building societies had entered the Eurobond market and discussed the type and volume of issues that had been made. Now, a year later, I would like to examine how societies are continuing to develop their funding strategies against the ever-increasing sources of funds which are available in the international capital markets.

Building societies' funding

The use that societies make of capital markets depends not only upon the opportunities available, but also upon their funding requirements. During 1986 societies' gross mortgage lending totalled £36.6 billion compared with £26.5 billion in 1985. Net receipts from retail investors declined from £7.5 billion to £6.6 billion and the use of capital markets increased from £3.1 billion to £6.1 billion. This included the funds raised from the domestic markets by way of Sterling Certificates of Deposit, Time Deposits, bank loans and index-linked securities.

However, during the first five months of 1987 societies raised only a further £1.3 billion from the capital markets. This may sound surprising as mortgage demand continued at a high level and the cost of capital market funding was extremely attractive compared with retail funding. In fact, the decline reflected the regulatory restrictions under which societies now operate.



'Societies closely monitored by supervisory body'

Prudential supervision

The Building Societies Act 1986 provided that a body of Commissioners, called the Building Societies Commission, be established whose members are appointed by the Treasury. The general functions of the Commission are:

(a) to promote the protection by each building society of the investments of its shareholders and depositors;

(b) to promote the financial stability of building societies generally;

(c) to secure that the principal purpose of building societies remains that of raising, primarily from members, funds for making advances to members secured upon land for their residential use;

(d) to administer the system of regulation of building societies provided for by or under the Building Societies Act 1986; and

(e) to advise and make recommendations to the Treasury or other government departments on any matter relating to building societies.

The Commission has the power to do anything which is calculated to facilitate the discharge of its functions. It is clear, therefore, that societies are very closely monitored by their supervisory body, the Commission. This adds to the excellent security afforded to investors and is an important factor in promoting international interest in building societies' bond issues.

Nevertheless, the Commission's powers may, as we shall see, act as a restraining influence on building societies in a way which can affect their competitive position compared with other lenders in the mortgage market.

The capital markets funding limit

The Act empowers the Building

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Societies Commission to lay regulations before Parliament which fix a limit on the amount of wholesale (capital market) funds which societies are allowed to raise. This limit has initially been set at 20% of total interest bearing liabilities and an upper limit of 40% is laid down in the Act.

The sharp increase in capital market activity in 1986 caused a number of societies' holdings of capital market funds to rise towards the 20% limit. The desire to maintain some headroom, and the lack of any immediate indication that the initial limit would be raised, therefore caused those societies to slow down their capital market funding whilst they began actively to lobby for some relaxation by the authorities.

'Wider access to capital markets vital'

All societies have now agreed that it is vital that they should be allowed wider access to the capital markets in order to remain competitive with the new lenders that have entered the mortgage market. These comprise banks and specialist mortgage finance houses which are financed almost exclusively from the capital markets without similar supervisory restraint.

This matter is now being pursued by The Building Societies Association, which is in the process of making a detailed submission to the Building Societies Commission and hopefully through them to the Treasury.

Sources of funds

The sources of funds available to societies in the domestic market tend to be short term except for syndicated bank loans and index-linked securities. An improved capital structure will therefore dictate that societies continue to maximise their international funding opportunities.

Building Society Funding

Date	Society	Initial Amount	Term Years	L/F*	Lead Bank
Eurosterling Issues		*£m*			
1986					
June	Abbey National	200	7	L	Samuel Montagu
	Nationwide	250	10	L	Baring Bros
	Alliance & Leicester	300	8	L	Morgan Guaranty
July	Alliance & Leicester	75	5	F	Citicorp
	Halifax	100	7	F	Morgan Grenfell
August	Britannia	150	10	L	Hambros
	Abbey National	500	5	L	Samuel Montagu
September	Halifax	150	10	L	Credit Suisse First Boston
	Halifax	150	10	L	Credit Suisse First Boston
	Anglia	150	10	L	SG Warburg
	Nationwide	300	10	L	Baring Bros
1987					
February	Halifax	100	10	F	Morgan Grenfell
	Alliance & Leicester	40	5	F	Bankers Trust
March	Cheltenham & Gloucester	50	5	F	Union Bank of Switzerland
	Leeds Permanent	50	5	F	Baring Bros
	Woolwich	50	5	F	Chase Investment Bank
May	Halifax	50	5	F/L	Morgan Grenfell
Eurodollar Issues		*$m*			
1987					
January	Halifax	150	5	F	Credit Suisse First Boston
	Abbey National	200	5	F	Morgan Grenfell
February	Woolwich	150	7	F	County Nat West

*L: LIBOR related. F: Fixed rate.
Source: *Building Society News* and press reports.

The table shows that during the summer months of 1986 building society activity in the Euromarkets was heavily weighted towards the issue of Floating Rate Notes. Furthermore, most issues were tied to the three-month interbank rate until investor demand enabled issues to be priced relative to the one- and six-month rates.

'Diversification into the foreign currency market'

The table also shows that 1987 began with an early move towards diversification into the foreign currency market by both the Halifax and Abbey National societies. On 6 January both societies took advantage of the powers in the new Act which enabled societies to tap the foreign currency markets.

The proceeds of the issues of $150 million and $200 million were both swapped into attractively priced variable rate sterling at close to the London Interbank Offered Rate (LIBOR). These issues were followed by a similar issue of $150 million by the Woolwich Building Society on 13 February.

The most interesting factor shown by the table is that there have been no Floating Rate Note issues since September last year. This has reflected the increases in yields that have occurred in the Floating Rate
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Note markets, a subject I shall refer to later, and the indigestion caused by the amount of building society paper issued in such a short time.

Against this background societies have raised £340 million so far in 1987 from the fixed rate Eurosterling market. This equates approximately to the sterling value of the three US dollar issues. In addition to these bond issues, a number of societies have taken steps to raise foreign currency funds from the shorter-term Eurodollar markets.

'Huge market that has not yet been tapped'

They have done this by announcing programmes to issue Certificates of Deposit (CDs). These, when issued, will trade in the commercial paper market and, in addition to providing a useful source of funds, the costs may be favourable compared with the sterling CD market.

Future strategy

The speed at which societies have built up capital market funding has demonstrated the enthusiastic manner in which a wide range of domestic and international investors, who understand building societies and the UK housing market, have responded to the attractions of the investments offered. This supportive group has, however, largely represented organisations whose knowledge results from their presence in London.

There remains a huge market that has not yet been tapped. This is made up of overseas private and institutional investors who invest in those names that have already established a well-known international name. A great deal of promotional work remains to be done by societies to promote their name not only to overseas investors but also with those who distribute investments to the investors.

This process was commenced by the two building society delegations that visited Europe and Japan following the launch of societies into the Euromarkets. Since then a number of societies have made individual trips to Europe, America and the Far East. It remains clear, however, that a significant increase in such activity will be required if building society paper is to acquire a more varied investor base.

Credit rating

Credit rating is becoming an increasingly important qualification for the international fund-raising institution as it enables the investor to rely on a professional agency to evaluate credit standing rather than to become involved in his own detailed assessment. However, many investors continue to be attracted by the name of an investor and its type of business.

This is reflected from time to time by those with slightly lower credit rating obtaining superior terms in the dollar market. To date, British building societies have not needed credit ratings, but as new techniques are adopted and as societies tap new markets such ratings could be of advantage in the future.

'More assured source of funds'

Future activity

As societies broaden their appeal to a wider range of investors they will gain many advantages from being able to raise funds on an international basis. The process will ensure that a wide base gives them a more assured source of funds and that they will be able to choose only those funds that are cost-efficient.

Opportunities may also occur to switch out of some existing sources of funds into newer cost-effective funds and this could become an ongoing process in the effective management process. Furthermore, such a process will add considerable strength to societies' funding base which could be of great future importance as a particular source of funds may, on occasion, dry up.

Recent developments in the international markets

Probably the most significant development in the past year has been the problems that have occurred in the dollar-based perpetual bond market. This deterioration occurred because the paper was widely held by trading houses and resulted from policy decisions to reduce the size of the trading books concerned. The ripple effects have spread through to both dollar and sterling Floating Rate Notes.

'Need for truly international presence'

The other striking feature has been the sharp reduction in dollar denominated issues. This has reflected the extreme weakness of the dollar. There has, however, been a corresponding increase in yen, Deutschmark, ECU and Australian dollar issues. This underlines the importance for institutions to develop a truly international presence to ensure access to funds at all times.

Undoubtedly British building societies will watch developments in these markets with keen interest in order to capitalise on the success which they have enjoyed to date. ■

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Shelter, Settlement and Development

A major new work which deals comprehensively with housing issues in developing countries

Much valuable research has been conducted into housing issues in developing countries in recent years, but a great deal of it has not been easily accessible. Much unpublished work lays relatively hidden within international aid agencies and national governments, and a high proportion of academic work remains unread other than by academics. Ther has been a critical need for a major volume which deals comprehensively with all aspects of housing problems in developing countries.

Shelter, Settlement & Development represents such a volume, and should become the bible for all of those concerned with housing issues in developing countries. The book results directly from the declaration by the General Assembly of the United Nations of 1987 as the International Year of Shelter for the Homeless. The year provides an opportunity to assess policy and to decide on new directions and approaches for national polices and strategies. Towards this end the United National Centre for Human Settlements commissioned a group of eminent academics and practitioners to put together an analysis of the past efforts and to identify the critical areas requiring urgent action.

The resultant publication comprises 15 papers and two appendices by those experts. The papers were subject to detailed review by all the authors at a seminar held in New York, and, although differences of emphasis have inevitably remained, the authors adopt a fairly consistent approach. The volume is edited by Professor Lloyd Rodwin, director of the Special Programme for Urban and Regional Studies of Developing Areas (SPURS) at the Massachusetts Institute of Technology, who directed the study.

Overview

An overview chapter by Lloyd Rodwin and Bishwapriya Sanyal usefully sets out the overall conclusions of the study. They draw a number of lessons from the past:

(a) Third world countries have tried to re-direct urbanisation through planning policy, but such strategies proved difficult to implement. Big cities have continued to grow and have continued to provide significant economic, social, infrastructure and other opportunities for their population.

'Mistakes have been made in shelter programmes'

(b) Mistakes have been made in previous thinking and programmes relating to shelter. It used to be argued that housing is consumption rather than a productive investment. But, today, a new point of view is that housing investment makes particular sense in third world countries because it demands less of scarce resources such as highly skilled labour, capital and foreign exchange. Government has responded to housing shortages by building public housing, but the number of units provided has been constrained by high standards and rents have had to be subsidised. However well intended, public housing has been tiny in volume, exorbitant in cost, and inefficient in administration. The previous belief that housing standards should be high has now turned into a consensus that high standards are one of the major barriers blocking the provision of shelter for low income families. Shanty towns were previously decried and often destroyed, but now it is recognised that they provide shelter for owners and contribute significantly to the rental stock.

(c) Third world countries have suffered administrative over-centralisation, combined with weak local government.

Rodwin and Sanyal conclude that the present crunch position can be seen both as a crisis and as an opportunity. Third world countries are constrained by several trends including the debt financing problem and low incomes, as well as continuing rapid rates of population growth. The largest pressure for shelter will be from low and moderate income households, with limited ability to pay for shelter and related services. Access to peripheral land is increasingly restricted.

However, austerity measures could put pressure on governments to improve the efficiency of their operations through more selective use of their resources. There could be a fresh look at subsidies, which may be regressive and drain governmental resources, and capital intensive projects for spacious planning will be discouraged. The cuts will curtail expensive large-scale public housing projects and probably curb initiation of new projects. Local government will have to become more efficient in collecting charges and taxes, and will put a premium on shelter policies which facilitate access of the maximum number of households to jobs and service facilities.

Policy guidelines
Rodwin and Sanyal suggest that third world countries might explore the following policy guidelines:

(a) *Settlement policy.* Government should not create programmes that might unjustifiably increase the attractiveness of large cities, for example, by subsidised urban infrastructure. The promotion of secondary cities has had virtually no impact on countering the primacy of the large urban units, but the strategy might be more viable if the aims and scope were more limited and the methods more realistic. Broadly based rural development programmes could yield substantial savings in shelter and service costs by retaining population outside of the major urban centres.

'Local government will have to be more efficient'

(b) *Shelter policy.* The only way the bulk of the poor are now sheltered in third world countries is through incremental house building by the urban poor themselves. Incremental building must be seen as an efficient component of the shelter delivery system. It is no longer possible to deny or ignore extra-legal building processes and one of the tasks of shelter policy is to prepare a process well in advance of the future growth of population that can utilise the tremendous energies embodied in incremental building and incorporate them more effectively and equitably in the productive structure of the urban system.

(c) *Land and tenure.* To encourage investment in shelter by the urban poor, rules for establishing provisional as well as long-term property rights must be firmly established. Self-builders invest substantially only in an asset they perceive to be secure. The cities of the developing world now have one advantage, which is the high incidence of *de facto* home ownership among people with relatively low incomes. Policy makers must try to hold on to the existence and the advantage of ownership as much as possible. This involves land policies which will have to deal with a particular version of the "standards" issue. However, there is evidence that legalising the tenure of land formerly held by irregular arrangements outside the legal system raises the price. Each group of policy makers must experiment with different ways of managing these conflicts.

(d) *Finance.* Low income households rely on informal financing methods, but these services are limited, and the problem is how to create better alternatives. Housing finance institutions have played only a modest role in financing housing and construction in third world countries, but in the longer term they must play a more important role which requires them to mobilise the savings of the people who will eventually receive loans. There is agreement on a number of basic matters: that housing finance policies are severely handicapped without macro-economic policies favouring price stability, that if financial institutions wish to mobilise funds they must keep their interest rates close to the market cost of funds, and that on the lending side it might be better to experiment with more flexible lending arrangements, adjusted to different market segments and household needs. Finally, there is increasing evidence that even low income households shrewdly change their financial strategies to improve their shelter when they can count on affordable standards, miminal infrastructure and public services and some reasonable security of tenure.

(e) *The construction industry and building materials.* Most governments have tended to support large firms on the grounds that they provide economies of scale. However, small-scale firms offer benefits that are particularly significant for developing countries, for example, lower overhead costs, and they are more likely to reflect relative factor prices. Governments can encourage small firms and the use of indigenous building materials but the re-formulation of standards for materials, zoning and building design. They can also augment sources of finance for small-scale builders and producers, allocate low rent plots for informal enterprises and be sensitive to the needs of small builders when distributing raw materials.

'Governments can encourage small firms'

Housing finance
Two of the papers deal particularly with housing finance matters. Mark Boleat, secretary-general of IUBBSA, provides the chapter on housing finance institutions. The main points he makes are;

a) In developing countries, even when there are projects to provide affordable housing units, progress may be frustrated because of inadequate housing finance mechanisms.

b) Housing finance is largely provided without the intermediation of financial institutions, and where there is such intermediation it is generally by institutions working on the mortgage bank principle.

c) Home ownership is a powerful

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incentive to save, and people will make sacrifices to purchase their homes.

d) Informal systems of housing finance work because they are suited to conditions in which they operate. However, informal systems are not efficient and cannot provide long-term loans.

e) Governments should not try to prevent the informal system working but rather should encourage formal institutions to provide competition to it. Formal institutions are more likely to be efficient where they are allowed to lend as well as raise deposits, where there is political and economic stability, where there are no artificial constraints on interest rates, and where institutions which raise retail deposits are not subject to credit controls on how they lend those funds.

f) Formal institutions can increase their housing finance activity and mobilisation of savings by various measures, including promoting savings schemes linked to house purchase, establishing branches, establishing links with informal institutions, and using innovative methods of assessing income and recovering repayments.

'Cost recovery the mirror image of subsidies'

g) In the past expectations in respect of housing finance have been too high. If institutions are forced to lend to lower income people who cannot afford owner-occupation then their own viability is threatened.

h) The provision of informal rented housing is an important source of supply of affordable housing and can help finance improvements and house purchase by owner-occupiers.

i) The learning system in housing finance is deficient, in particular there is an inadequate dissemination of information.

Bertrand Renaud of the World Bank contributes a paper on financing shelter. He analyses the lessons from experience of housing delivery systems in third world countries and notes the typical three-tier structure of housing markets with a legal private sector, coping with the top end of the income scale, a narrowly subsidised market of middle class salaried workers, and finally, the large and private incremental housing market.

Renaud lists a number of non-financial constraints affecting housing supply, including poor land administration and institutions, excessively high standards and building costs, lack of major infrastructure and rent control legislation.

On the more specific question of finance, he suggests that experience has shown the limits of public budgets which could not accommodate large, but rapidly growing, urban populations and of the implementing capacity of public institutions. Developing countries have found that conventional subsidised public housing is not the answer to providing shelter for large, low-income populations and that public agencies should focus their activities on the provision of infrastructure, move away from the direct production of housing units, and strive to facilitate private housing construction at all income levels.

From a financial viewpoint two issues are of vital importance: subsidies and cost recovery. If governments want to have housing programmes that are sustainable over time, then they should clarify their use of subsidies and contain them. In housing programmes which include an element of subsidy it should be confined to the lowest income groups and should focus most heavily on infrastructure.

Cost recovery is the mirror image of subsidies. There has been a failure in cost recovery in the past, caused by inadequate legislation, poorly organised and supervised collection procedures, difficulties with land tenure and the transfer of titles, weak administration or unwillingness to adjust tariffs and user charges for inflation and the true cost of providing services, and sometimes the plain unwillingness to pay on the part of the beneficiaries. The failure to recover costs provides a windfall to those who have been served and threatens the viability of public programmes.

'Mortgage rate should be close to market rate'

Renaud concludes that the primary requirement for successful housing finance policy consists of macro-economic policies inducive to price stability and increased domestic savings. Generally, the volume of direct government subsidies and the scope for their misallocation is in direct proportion to the level of inflation. Heavy subsidies provided though housing finance, insolvent public sector agencies and continuing attempts at financing public activities through inflation have been a major cause of financial instability in a number of countries.

The strategic variable for the expansion of housing finance systems is the mortgage interest rate level, and financial institutions should keep this rate close to the market cost of funds in order to pay appropriate rates on deposits and mobilise funds.

Legislative frameworks limiting the flexibility of housing finance institutions should be reviewed to permit them to experiment with more varied mortgage instruments. Financial institutions should develop their project appraisal capacities with respect to their financial, technical and commercial characteristics of the projects submitted to them for financing. ■

Shelter Settlement and Development, edited by Lloyd Rodwin, is published by Allen & Unwin at £30.00.

Urban housing finance report completed by OECD

THE Organisation for Economic Co-operation and Development (OECD), which comprises the major industrial nations, ran an Urban Affairs Programme from 1982 to 1986. This new report brings together the results of the work of the project group on urban housing finance which is one component of the programme.

The report is based on information prepared by 16 member countries and on two special studies, one on tax policies and the urban housing markets and the other on housing maintenance and modernisation policies.

The urban housing finance project was charged specifically with examining housing finance policies in OECD countries with a view to identifying the objectives of major housing policies and programmes, examining the role of housing finance policies as an instrument for the regeneration of urban areas, reviewing taxation policies and financing mechanisms with regard to investment in housing, and advising

'Concern over housing affordability'

governments on policies and programmes for urban housing finance.

The report begins with an examination of housing markets and housing policies. It is noted that in most OECD countries concern about the overall supply of housing has now been either supplemented or replaced by questions concerning maintenance and modernisation, neighbourhood quality and housing affordability.

New concerns have emerged such as the reappraisal of the balance between public and private provision of finance, changing of responsibilities between central and local governments and the introduction of new techniques of housing management.

The report notes that most OECD countries have experienced the process of urban decline and that governments have developed specific urban regeneration programmes, although in most countries these are still in their infancy. Certain common policy directions are observed, in particular that greater decentralisation of functions and responsibilities and greater public participation will improve the operation of housing markets.

The report notes that most governments have sought to encourage owner-occupation through tax concessions to home owners, low-interest loans and the encouragement of innovation by loan financing institutions. Tax expenditures (that is, relief from taxation) are a major source of housing subsidy, but it is argued that there are drawbacks in that they do not always appear in public expenditure accounts and therefore escape the scrutiny to which specific subsidies are subjected.

Also, it is argued that they are inefficient, inequitable and have adverse effects on urban housing markets. It is suggested that many of the adverse effects of subsidy programmes could be reduced if they were more carefully targeted.

Chapter IV deals specifically with housing loan finance. This notes that housing finance systems were subject to considerable pressures during the 1970s through inflation, interest rate volatility and fluctuations in the supply of funds. Inflation causes "front end loading" and various loan instruments have been devised to deal with this, including deferred payment mortgages, index-linked mortgages and equity or shared appreciation mortgages.

However, it is noted that despite the wide availability of such instruments they are rarely used extensively, even in times of rapid inflation. This is partly attributed to lack of

'Subsidies' adverse effect on housing markets'

publicity for such schemes and consumer caution.

The problem of greater interest rate volatility has been dealt with partly by the more widespread adoption of adjustable rate mortgages, suggesting that they are a necessary form of loan finance instrument in those countries where lending institutions borrow short and lend long and where interest rates fluctuate significantly.

Various methods of increasing the supply of funds from institutional

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investors to the housing market are considered, including direct loans to housing finance institutions, the purchase by institutional investors of marketable unsecured securities issued by housing finance institutions and secondary mortgage markets. The huge expansion of secondary mortgage market activity in the US is described.

It is suggested that there is no longer a major problem of shortage in the supply of mortgage credit as housing finance markets are now more closely integrated into general financial markets. From a borrower's point of view it is argued that, although the supply of mortgage credit will be increased, cost and availability will also be expected to increase and this poses the potential problem of affordability for marginal and first-time buyers.

In the policy conclusions (set out in full below) it is suggested that in those countries seeking to achieve greater owner-occupation, special mortgage instruments, such as deferred payment loans, may have a greater role to play, and that governments may wish to consider methods of improving the targeting of subsidies to home-owners to contain their costs and reduce the other negative aspects.

[1]Urban Housing Finance, Final Report of the OECD Project Group on Urban Housing Finance, OECD, 1987.

Conclusions of the OECD report

THERE are wide variations in the housing systems and policies in OECD member countries, but most of them have experienced difficulties in achieving the basic housing objectives of efficiency and equity. In particular, historical development of housing finance and tax systems has led to a pattern of subsidies which obscures the real cost of housing.

Many countries are in the process of reassessing their housing policies. The first task is to determine the appropriate role of central and local government in housing. Within their fiscal restrictions governments may wish to produce a more cohesive and consistent housing strategy to cover all tenures. This might be primarily designed to meet housing objectives rather than as a subsidiary component of other policies, for example, employment or regional policies.

New priorities

Rising incomes and changes in demographic composition have led to increased aspirations for smaller but higher quality dwellings in many OECD countries. There is an increasing trend for this to be met by the private market through new construction and adjustments to the existing stock.

Concern is shifting in many countries away from the provision of new dwellings and towards maintenance, repair and improvement of existing dwellings. Governments may wish to consider whether their housing policies emphasise sufficiently both this need and the necessary stock adjustments. In countries still experiencing migration into urban areas and higher population growth, however, policies are likely to continue to focus on new construction.

Most housing policies are nationally-based, yet housing conditions and problems can differ significantly between regions within a country. Governments may wish to consider whether their systems offer sufficient flexibility to deal with the variety of regional problems encountered.

'Revitalisation of urban areas an increasing concern'

Urban regeneration

Revitalisation of urban areas is an increasing concern in many countries. Governments may wish to consider the extent to which the required reinvestment can be initiated by housing activities. Also, attention may need to be devoted to the relative roles to be played by the public and private sectors, in partnership, in reviving confidence in an urban area.

Successful urban regeneration encompasses non-housing as well as housing reinvestment; this needs to be spatially concentrated in well-defined neighbourhoods. It is also desirable to decentralise public services. It is important that housing policies are consistent with these aspects, and that they are supported by other activities, such as social and environmental improvement programmes, which allow for comprehensive area improvement.

Pricing

In order to develop efficient housing policies governments have to be aware of the real cost of housing and aim towards a pricing structure which in general reflects these costs. In the social housing sector, too, rent structures need to correspond more closely to the value of housing services provided by dwellings.

However, housing is an expensive commodity and most countries will wish to continue to limit the level of cost borne by consumers. Some countries will wish to maintain a broad-based support system, while others may prefer a greater degree of targeting and selectivity. They may consider adapting their policies to achieve greater targeting in terms of some of the following criteria:

Households on low incomes.

Households wishing to enter or

having recently entered the housing market such as first-time buyers, new entrants to the rental sector, etc.

Households with special needs, eg people with handicaps, mental disabilities etc.

Household expenditure on specific aspects of housing for which the social benefit is greater than the private benefit, eg energy saving features.

Households moving into or improving dwellings in areas undergoing revitalisation where the social benefit is greater than the private benefit.

Tenure choice

It may be the case that the expansion of a particular tenure is the most efficient way of achieving a general housing or social objective. But countries may wish to consider whether there is a case for greater emphasis on tenure neutral approaches.

Owner occupation

In those countries seeking to achieve growth of owner occupation, special mortgage instruments such as deferred payment, index-linked and equity sharing mortgages can help to reduce the outlay of home owners in the first years and may have a greater role to play than they

'Improving the targeting of subsidies'

have to date. They will be of special help to families with modest incomes and help to defray the transaction costs associated with movement.

Some governments may wish to consider methods to improve the targeting of subsidies to home owners to contain their costs and reduce their other negative aspects. These could include restricting them to first-time buyers; introducing a ceiling on tax relief; restricting the period of time over which it is available; introducing tax credits; or directing aid to home owners on low incomes.

The rental sector

Some countries are concerned to encourage the growth, or maintain the size, of their rental sectors because of the advantages they offer by providing a tenure suitable to some households' circumstances and facilitating mobility.

The Private Rental Sector. In the private rental sector this may best be achieved by the gradual decontrol of rents, for example, decontrolling new lettings at a pace which allows the supply of housing to adjust and thereby avoids the incidence of windfall capital gains. This must not jeopardise security of tenure and may need to be supported by housing allowances. This strategy is most likely to achieve the necessary broad political consensus. Rent decontrol may also lessen the problems of disrepair and maintenance. Within the private rental sector, arrangements which enable tenants to be consulted about the ways in which their housing is managed can also contribute to maintaining the quality of this housing.

The Public Rental Sector. In seeking to encourage the public rental sector, some countries may wish to adopt initiatives that are already under way elsewhere which aim to improve management, and introduce more flexibility in setting rents and improving housing conditions, especially on large scale estates. In response to criticisms of over-centralised and bureaucratic management practices — which do not respond sufficiently to tenants' preferences — a number of countries are developing new management systems. These involve the decentralisation of functions, responsibilities and budgeting, and may incorporate a greater degree of tenant participation in decision making. In some countries poor housing conditions and social problems are particularly acute in the large tracts of post war social housing. These may require a greater level of maintenance and reinvestment than is presently taking place. Countries may consider how best to achieve a more balanced mix of tenants on these estates. One means of integrating public housing tenants into the life of the city, in a way that spatial segregation does not permit, is to build public housing in small-scale developments at locations throughout the urban area. Another could be building or converting dwellings for private ownership on existing estates.

The Non-Profit Rental Sector. In countries where non-profit organisations have developed into large-scale operations, their division into smaller units is favoured as a means of improving efficiency and accountability. Elsewhere, small-scale non-profit organisations may offer an attractive alternative tenure in the rental sector. They have a number of features such as relative autonomy, using a combination of public and private finance, often decentralised management structures, and frequently incorporating tenant participation. This may make them particularly suited to the changing housing situation.

'Ensuring an acceptable quality of life'

Concluding remarks

Many aspects of housing finance and tax systems have direct implications for urban development. Although there is a tendency for governments to decentralise responsibilities, there is nonetheless a continuing need for national governments to ensure consistency between housing policy and their objectives for cities. Due attention to these linkages is a necessary prerequisite of successful urban regeneration strategies and for ensuring an acceptable quality of life for people in urban areas. ■

Role of the International Finance Corporation

Eric Carlson, IUBSSA Senior Consultant, profiles the market orientated international aid agency

THE International Finance Corporation, which celebrated its 30th anniversary in 1986, has an impressive record of activities and achievements. It is the world's largest organisation providing financial assistance in the form of loans and equity, without government guarantees, to the private sector in developing countries.

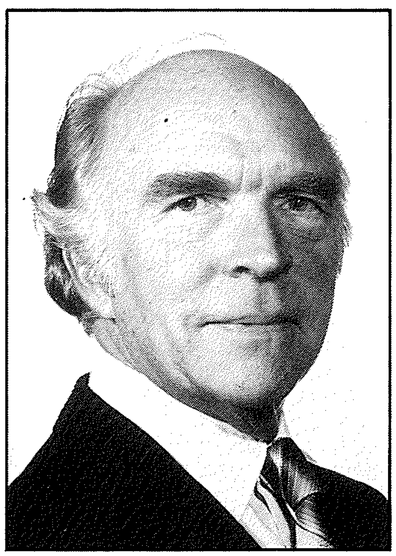
IFC is affiliated to the World Bank, but operates largely with a separate staff and funding. IFC has 128 member nations countries, more than 100 of them comprising developing countries.

IFC's fundamental purpose is to promote the economic development of its developing member countries through the support of the private sector. This includes housing finance. To date, IFC has provided advice on organisational policy and operational aspects of housing finance and secondary mortgage markets in 16 countries. However, this particular

'Support for the private sector'

activity, centred in the IFC's Capital Markets Department, has been limited and the record is patchy, especially when compared with the volume and effectiveness of its work elsewhere.

Since it began operations in 1956, IFC has been associated with more than 2,000 companies and financial



institutions in supporting over 800 business ventures in more than 80 countries, with a total capital cost amounting to more than $30 billion.

IFC's authorised capital is $1·3 billion. The resources available to it consist of its paid-in capital, provided by member countries, of $602 million at the end of fiscal 1986; accumulated earnings of $284 million; and repayments and sales to others of IFC investments. IFC can borrow from the World Bank and other sources up to four times the amount of its unimpaired subscribed capital and accumulated earnings — about $3.2 billion. In 1986, it borrowed the equivalent of $350 million in this manner, compared with $130 million in the previous year. This borrowing policy provides IFC with flexibility in its activities, and allows it to take advantage of lower market interest rates and thus offer lower rates to its clients.

There is no standard form of application for IFC financing, although certain basic preliminary information is required to enable it to decide whether an investment proposal warrants consideration. Generally, IFC will assist a project only if there is a benefit to the economy of the host country, if there is a prospect that the venture will earn a profit, if there is a provision for immediate or eventual local participation, and if the host government does not object.

IFC never invests alone — it expects to supplement and mobilise private capital, not replace it. IFC will make investments in a wide variety of

'Lower rates offered to IFC clients'

sectors — manufacturing, mining, tourism, agribusiness, financial institutions, and others, but will not invest in such activities as land speculation, trading companies and luxury goods. It invests for its own account generally no more than 25% of the project cost. Normally, its investments are in the $1-50 million range.

IFC loans are usually for terms of 7-12 years and are made at fixed or variable rates. Depending on a project's need, IFC can invest in equity, make loans, underwrite securities' offerings, provide stand-by financing, and organise syndications of commercial bank financing as participators in IFC's loans.

To attract more equity investment to developing countries, IFC recently introduced the Guaranteed Recovery of Investment Principal Program (GRIP). Through a combination of standard financial devices, GRIP will guarantee the investor's principal in an equity investment made through IFC, with participation in dividend income and capital gains over an agreed period. IFC may invest in "mixed" government/private enterprise projects when they contribute to private sector developments.

'Staff drawn for more than 70 countries'

IFC frequently provides specific technical assistance while appraising and monitoring individual projects. Its international staff — drawn from more than 70 countries — has accumulated much financial, legal and technical expertise and, moreover, can draw upon the World Bank's wide experience, as well as on its own contacts with financial institutions and development agencies. The Foreign Investment Advisory Service (FIAS) is a recent innovation developed by IFC to assist developing countries' governments in creating the framework of policies and institutions necessary to attract and regulate direct foreign investment.

IFC, together with the World Bank, makes a special effort to encourage the establishment and development of capital markets. It helps local investors, and often serves as a bridge between the international capital markets and the local businessmen and financial institutions in a developing country. Over the years they have supplied more than half the financing for ventures assisted by IFC.

The Corporation's capital markets programme has three objectives:

(a) Supporting and financing of specialised financial institutions, including housing finance banks.

(b) Providing technical services and advice on capital markets policy and regulatory matters to governments and financial institutions to help them strengthen the private sector.

(c) Increasing international investors' awareness of emerging securities markets and major private sector companies in developing countries in order to facilitate the entry of the companies into the international money, bond and equity markets.

An important recent example of IFC's growing role in the promotion of portfolio investment in developing countries is the Emerging Markets Growth Fund. The fund will invest in publicly listed shares in certain developing countries, and was established with the participation of a group of large institutional investors from the United States, Western Europe and the Middle East.

'Providing advice on capital markets policy'

The board of IFC comprises six directors and six alternates representing individual countries — China, France, West Germany, Japan, United Kingdom and United States. There are 15 other directors and 15 alternates who are elected by groups of countries. All projects are submitted to the board of directors for approval. The president of the World Bank also serves as president of IFC. The management of IFC is the responsibility of Sir William Ryrie, executive vice-president since 1984.

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IFC involvement in housing finance

Advice on organisational, policy and operational aspects of housing finance and secondary mortgage markets in 16 countries: Indonesia, Tunisia, the Philippines, Lebanon, Thailand, Costa Rica, Colombia, Bolivia, India, Senegal, Trinidad and Tobago, the Bahamas, Panama, Chile, Haiti and Portugal.

Approved investments in housing finance companies have been made as follows:

Lebanon (1974): Bank of the Near East (BNE)	
IFC equity (sold 1981)	20%
Colombia (1974): Corporacion Colombiana de Ahorro y Vivienda (DAVIVIENDA). IFC equity (sold 1976)	15%
Bolivia (1976): Banco Hipotecario Nacional (BHN).	
IFC equity (sold 1978)	15%
India (1978): Housing Development Finance Co Ltd (HDFC)	
IFC equity	5%
IFC equity underwriting	5%
IFC loan	$4 million
Indonesia (1980): P.T. Papan Sejahtera (PAPAN)	
IFC equity	15%
IFC loan	$4 million
Senegal (1980): Banque de l'Habitat du Senegal (BHS)	
IFC equity	9%
Trinidad and Tobago (1984): The Home Mortgage Bank (HMB) a secondary mortgage market company	
IFC equity	10%
India (1985) Gujarat Rural Housing Finance Development Corp	
IFC equity	12.5%

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In 1986, IFC approved 85 projects in 39 countries for a total approved investment of $1,156 million. Thirty-three projects with a total value of $245 million were located in countries with an annual per capita income of less than $800. Capital markets projects accounted for 12 investments totalling $85 million.

A wide range of sectors was represented by IFC investments in fiscal 1986, but housing banks and housing finance institutions were not included during this period. More recently, progress in this field has been developing in Trinidad and Tobago with the establishment, by legislation in 1986, of the Home Mortgage Bank; the establishment in India in 1985 of the Gujarat Rural Housing Finance and Development Corp; and negotiations with Nepal regarding the possible establishment of a Housing Development Finance Corporation (HDFC), patterned on the model in India, profiled in *Housing Finance International* no 3.

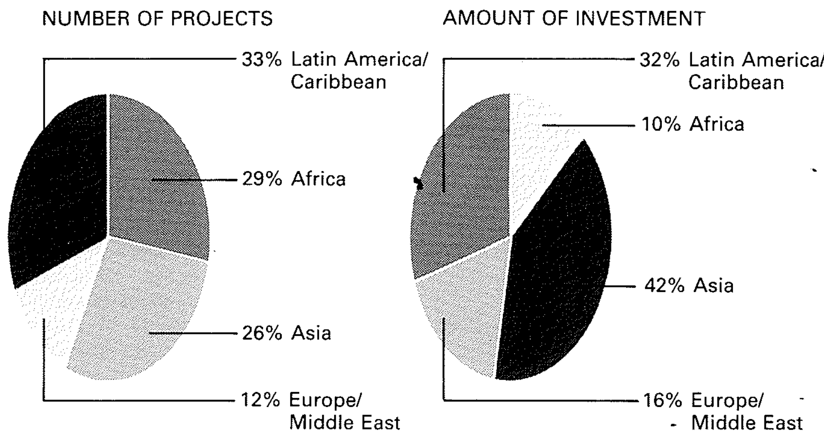
The HDFC is probably the crown jewel of IFC's involvement in the housing finance field. The Colombian Corporation for Savings and Housing (DAVIVIENDA) is also an outstandingly successful operation. It had some IFC equity participation in its very early years, but this was "sold back" to IFC in 1976.

The full record of IFC's activity in housing finance is shown in the table on page 33 from the IFC publication, *Capital Markets — Mobilising Resources for Development.*

Although in recent years housing investment has not been given priority by many countries in the weak global economic scene, assistance provided through the IFC, with its new approaches and instruments, could become an increasingly important factor in the remainder of the decade. ■

Further information about the IFC, including the Annual Report 1986, *is available from the Corporation at its headquarters address: 1818 H Street NW, Washington DC 20433, USA.*

Regional Distribution of IFC Investments: Fiscal 1986



IFC activity in the past 10 years
(US$ millions)

Fiscal Years	**1977**	**1978**	**1979**	**1980**	**1981**	**1982**	**1983**	**1984**	**1985**	**1986**
Operations										
Approved Investments:										
number of projects	34	41	48	55	56	65	58	62	75	85
number of countries	21	31	33	30	34	31	36	37	38	39
amount (gross $)	259	338	425	681	811	612	845	696	937	1,156
total project cost	1,228	1,872	1,714	2,377	3,340	2,936	2,894	2,473	2,768	3,588
Cumulative Approvals:										
number of projects	388	429	477	532	588	653	711	773	848	933
amount (gross $)	1,808	2,146	2,571	3,242	4,063	4,675	5,520	6,216	7,153	8,309
total project costs	9,190	11,062	12,776	15,153	18,493	21,429	24,323	26,796	29,564	33,152
syndications	548	688	890	1,157	1,559	1,747	2,166	2,471	3,125	3,571
Investment Held										
number of firms	200	225	253	288	314	333	341	349	366	377
loans	704	799	889	1,159	1,374	1,551	1,588	1,644	1,748	2,001
equity	160	184	223	245	273	284	294	346	368	386
total	864	983	1,112	1,404	1,647	1,835	1,882	1,990	2,116	2,387
Resources and Income										
Capitalisation										
borrowings	445	462	455	438	509	531	536	582	825	1,223
paid-in capital	108	144	229	307	392	497	544	544	546	602
accumulated earnings	87	100	119	140	159	181	204	230	258	284
Earnings										
net income	8.9	12.5	19.2	20.7	19.5	21.6	23.0	26.3	28.3	25.4

African institutions adopt recommendations on shelter and urban development

HELD in Vienna, Austria, in September 1986, the second International Shelter Conference was a private sector effort to support the International Year of Shelter. The objective was to produce an authoritative private sector statement which would define the principles and action steps necessary to address the problem of shelter and urban development at the national level.

The Conference produced the Vienna Recommendations which have been widely circulated and reported in an earlier issue of this journal. These recommendations were considered at a workshop in Mangochi, Malawi, at the end of March 1987 by representatives of the public and private sectors drawn from six countries in Africa and were amended to meet African needs.

The amended recommendations form the basis for further dialogue

'Basis for further dialogue'

between the public and private sectors and will be distributed to interested parties.

The recommendations note the urbanisation trends in world population and examine the experience with shelter and urban development over recent years. The need for economic growth with equity is stressed.

The partnership for a new action agenda is seen to be the recognition of the necessity to foster co-operation between the public and private sectors. The public sector has specific responsibility for appropriate macro-economic policies, the encouragement of the mobilisation of domestic financial resources, supporting efficient pricing policies, emphasising efficiency in urban management and infrastructure provision and also land policy, and defining its activities and those which can best be done by the private sector.

The private sector's responsibilities are to balance the essential need for operating profits with a response to social needs for all income groups, to mobilise investment capital for housing and urban development, to accept prudent business risks, competitive principles and market results, and to develop entrepreneurship and innovation.

It is recommended that regional, public and private sector coalitions be established for Northern Africa, West and Central Africa, and East and Southern Africa.

A series of recommendations was adopted covering shelter and urban policy formulation, urban management and planning, urban land policies and procedures, infrastructure services, housing production and finance, and finally housing finance.

The recommendations in respect of housing finance are set out in full below:

RECOMMENDATION VI
HOUSING FINANCE

1. The lack of housing finance resources is a major constraint to the housing market in most developing countries. While in many countries it may be necessary to protect and favour the housing finance system to foster its development, housing finance should enjoy equal priority with other national needs, have full access to national capital and savings markets.

'Lack of finance a major constraint'

The financial services necessary to support housing development include finance for land acquisition, on- and off-site infrastructure, construction, and long-term mortgages for the ultimate purchaser. The sources of these financial services are likely to involve a variety of institutions in the public and private sectors as well as informal networks. Each of these financing entities must mobilise its funds from the four main sources of gross savings: the household sector, business sector, government, or international transfers.

Housing finance policy must address the needs of all target groups. In few countries are the finance institutions developed to the point that adequate sources of funding are mobilised and allocated effectively to support the needs of housing among all the

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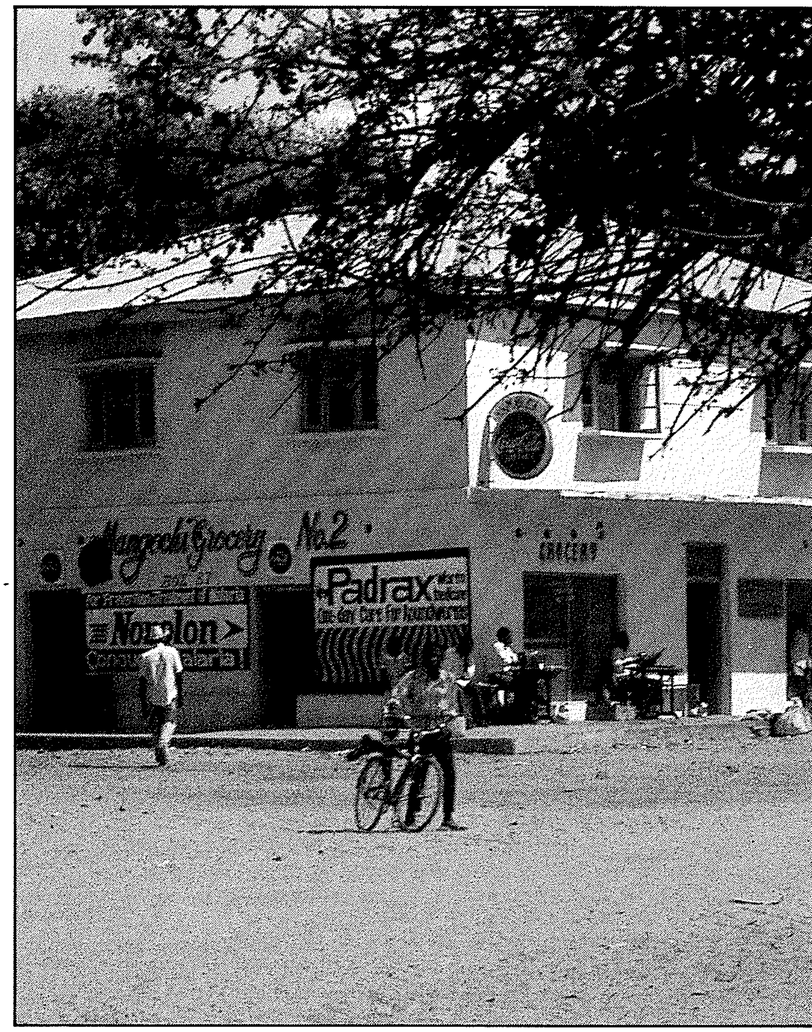
income groups. Typically, there are three-tiered housing markets: a small, well-financed upper-income market supplied entirely by the private sector; a small subsidised market of civil servants and middle-class salaried workers supported by public sector housing activities; and a large informal housing market serving the poor.

2. All countries should seek to develop housing finance policies and institutions which are integrated into their capital markets, which maximise the mobilisation of savings, and seek solutions that stress affordability, general application and cost recovery.
3. Housing finance institutions and policies.
   a) The development of the housing finance sector is a joint responsibility of the government and the private sector. In this co-operation, the contributions of the government should be made in a manner consistent with market principles and economic efficiency. The contributions should be done in a way that will promote the long-term growth, development and viability of the housing finance system.
   b) The development of housing finance institutions should be a national objective with the rate and scale determined by the demand associated with increasing levels of GDP and the growth of the capital market.
   c) The full range of potential public/private partnerships in housing finance institutional development should be explored. The government should support and encourage the establishment of housing finance institutions by private groups, and, if such groups do not emerge, the government should consider establishing the institution itself.
   d) Governments should provide a regulatory climate conducive to the establishment of private specialised housing finance institutions by allowing them to compete effectively for savings and respond to market demand for loan rates.
   e) Housing finance institutions should be allowed the flexibility to conduct their business in a manner consistent with long-term profitability. This includes the ability to develop products and services suited to the various borrowing needs of its customers and its own needs to raise funds; the ability to locate operations in the neighbourhoods it serves, subject to management capacity; and access to technical assistance and training.
   f) There should be efforts to link the informal housing finance mechanisms found in most countries to the formal housing finance system. ■



The town of Mangochi, Malawi, where the Vienna Recommendations were discussed and amended.

Housing policy and practice in Asia

THIS book is another welcome addition to the growing volume of literature on comparative studies in housing. It is edited by Seong-Kyu Ha, Assistant Professor of Urban and Regional Planning at Chung-Ang University, Seoul, Korea, and comprises seven country studies together with an introductory chapter by the editor.

The introductory chapter notes that after the Second World War the housing situation in Asia was chaotic because of war damage, and also because low priority was given to housing problems. The rapid growth of urbanisation has significantly affected the development of housing policy.

Another factor has been the high cost of housing and the income distribution which has meant that significant sections of the population have been unable, without assistance, to afford the full economic price of decent accommodation.

The chapter concludes with a comment on state intervention, noting that governments simply cannot afford to subsidise many of the poorest people. The author concludes that the most important argument for state intervention is to compensate for poverty and inequality in the distribution of income in capitalist societies. However, he suggests that targetted minimum standards should be directly relevant to the housing conditions and aspirations of the mass of peasants and urban poor rather than geared to the position in western countries.

The chapter on *Hong Kong* by Peter Fong and Anthony Yeh notes that over 44% of the population live in public housing. The Government has adopted an interventionist policy but simultaneously has operated a land policy which sells land to the highest bidder and, as a result of high land prices, many low income families do not yet enjoy public housing.

Hong Kong's public housing programme is regarded as being successful, with the territory being second only to Singapore in terms of the percentage of population now living in public housing. However, the authors comment that one may argue that Hong Kong has a public housing programme and no real housing policy. It is suggested that the Government should broaden its policy options to increase production of private housing and to improve the housing stock.

P. S. A. Sunderam contributes the chapter on *India.* The Indian housing problem is accentuated by the rapid rise in population and the even more rapid rise in the urban population. A range of housing programmes exists but there has been no consistency of approach over various planning periods.

'Significant effect of growth of urbanisation'

A variety of housing policy instruments has been used. The role of the specialist Housing Development Finance Corporation is briefly noted, but it is argued that there are many inadequacies in the present system of financial intermediation for housing, with the specialised agencies touching only a fraction of the people. The author concludes that the prospect of low income housing is quite bright in terms of policy thrust to the Government and various initiatives.

Korea has had one of the most dynamic economies in the world in recent years. Seong-Kyu Ha, the editor of the volume, also contributes to the chapter on Korea. As in other Asian countries, the growth of urban population has been particularly marked, the proportion of the population living in urban areas rising from 47% in 1970 to 65% in 1985. Seven housing problems are identified:

(a) The growing shortage of housing.
(b) The Government attitude that sub-standard settlements should be removed.
(c) Low income house ownership has been encouraged but low income tenant households have found themselves less able to obtain decent accommodation.
(d) Housing has not been a priority.
(e) The role of municipal housing has been significantly weakened.
(f) The poorly developed financial sector has failed to provide better investment opportunities in land and real estate.
(g) Government policies have restricted the conversion of agricultural and other land to residential use.

The chapter considers the evolution of housing policy, noting the role of the specialist housing finance lender, the Korea Housing Bank, and then goes on to explain the apparatus of housing administration and the Government response to sub-standard urban settlements.

The section on housing policy instruments deals with the financial system, dominated by the Korea Housing Bank, including its administration of the National Housing Fund. Various comments are made on the KHB activities:

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(a) It combines the roles of private deposit institution and an ordinary Government mortgage institution, having a hand in the financing of over 60% of all new housing units. It is argued that in the medium term the KHB should limit its role to that of a true Government mortgage institution financed by Government consolidated funds.
(b) Procedures for obtaining loans are time-consuming.
(c) There is little difference between the KHB's loans and the NFH loans in terms of interest rate and loan terms.
(d) The NFH's clients are more likely to be middle income groups than lower income groups.
(f) There is no well-developed private mortgage market. The author's own work suggests that in 1983 about 58% of home purchase funds were buyers' own funds, with the remaining 42% of funds being borrowed.

The chapter on *Japan* by Kazuo Hayakawa notes that, despite rapid economic growth, living conditions are poor. The chapter charts the development of housing policy and concentrates on a number of areas of concern:

(a) Housing policy has promoted discrimination by dividing people by class according to their income and gathering them together in one place.
(b) The recent introduction of a points system for public housing has led to a large increase in applications for public housing amongst households receiving welfare payments.
(c) Those living in the low income strata are discriminated against by their neighbours.
(d) There are strong pressures for people to move out of the inner city, but many, because of their jobs, are not able to do this.
(e) There is a shortage of public rental housing and high rents.
(f) High land prices make it very difficult for people to own their own homes.

The author concludes that all aspects in everyday life in Japan the most backward is housing.

The chapter on *Indonesia* by Johan Silas concentrates on the development of housing policy and housing policy instruments and then describes the various Government and quasi-Government institutions involved in the housing programme.

The chapter on *Vietnam* by Lars Reuterswärd notes that Vietnam's housing policy has undergone a revolutionary change since the early 1980s. There has been a shift in responsibility for construction from the state to individual entrepreneurs and a de-centralisation of physical planning.

Finally, the chapter on *Thailand* by Warin Wonghanchao emphasizes the role of the National Housing Authority (NHA) which was established in 1973 and explains the role of housing in various national social and economic development plans. In the current six-year plan, the Government chastises the NHA for bad short-term loan management and not using its funds effectively and recommends that in future it obtains loans from internal loans sources, especially the Government Housing Bank, which would become the NHA central financial institution. ■

"Housing Policy and Practice in Asia," edited by Seong-Kyu Ha, 197 pages, hardback, published by Croom Helm at £25.

Australian fact book

THE 1987 edition of the Australian Association's *Fact Book* provides up-to-date statistics and information on the Australian building society industry. A background section sets out the historical origins of the industry and the legislative framework in each state before going on to describe briefly the National Deposit Insurance Corporation and Mortgage Insurance.

The remainder of the book comprises key statistics and commentary. Among the areas covered are:
(a) The number of societies by state — the total number fell from 178 at June 1975 to 71 at June 1985.
(b) ATMs — the number grew from 26 in 1982 to 603 in 1987.
(c) Assets on a state basis.
(d) Asset concentration — the share of the largest eight societies increased from 47.4% in 1975/76 to 54.7% in 1984/85.
(e) Market share of building societies — societies' share of the assets of financial institutions rose from 5.3% in 1975 to 7.1% in 1979 before falling to 5.7% in 1985.
(f) Housing tenure — owner-occupation increased from 53.4% in 1947 to 71.4% in 1966, before falling to 68.4% in 1976 and then increasing to 70.1% in 1981.
(g) The structure of assets and liabilities — at end June 1985 total assets were $A20,543 million, of which loans accounted for 70.9%. Withdrawable shares accounted for 51.4% of liabilities and deposits for 40.1%.
(h) Income and expenditure.
(i) Savings flows.
(j) Loans — loan commitments to individuals peaked at 85,700 in 1984/85 but had fallen to 52,500 in 1985/86.
(k) The housing finance market.

Building Society Fact Book 1987, 29 pages in English, published by the Australian Association of Permanent Building Societies, 8 Thesiger Court, Deakin ACT 2600, Australia.

Tenure conversion

IN many industrialised countries, there has been a shift in housing tenure away from renting and towards owner-occupation. *Housing Policy and Equality* by Lennard Lundqvist, a senior research associate at the National Swedish Institute of Building Research, examines the change in the pattern of housing tenure in three countries, the United States, Britain and West Germany. The book actually covers a narrower area than its title suggests, concentrating on the conversion of rental units into owner-occupied units.

The book begins with a theoretical analysis of the conversion controversy and sets out the central purpose of the study as being to evaluate the validity of arguments for and against tenure conversion and to establish under what conditions they seem valid.

The chapter on the US considers the conversion of rental units into condominiums and the effect of this practice. Lundqvist argues that conversions occurred as a spontaneous market phenomenon and were not backed by government policy. Increases in the prices of owner-occupied homes, the reduced attractiveness of rented housing as an investment and changes in tax regulations all served to open up a new type of housing market. However, Lundqvist suggests that conversion was likely to be concentrated in higher quality dwellings and that the final result of conversions has been a greater inequality of outcome.

The chapter on Britain concentrates on the sale of public sector houses. Lundqvist suggests that the policy was part of a conscious government housing policy to spread home ownership and reduce direct subsidies to the housing sector, especially the public rented part of it. He notes that the part of the stock sold was largely attractive houses in attractive areas and that few flats have been sold. Consequently, he doubts that council house sales have so far led to a wider distribution of home ownership in socio-economic or demographic terms.

He argues that remaining tenants have become the losers, not only because they have higher costs to pay as a result of the government policy of reducing housing subsidies, but also they lose out in terms of their future freedom of choice to move into another rented unit.

Generally, he concludes that the effect of sales did not lead to greater equality in housing but rather to make differences between tenures and households more pronounced on the grounds that those actually buying are very similar to owner-occupiers rather than to the generality of tenants.

The chapter on West Germany suggests that the change of policy from tenancy to owner-occupation was a result of both conscious governmental policy and market developments. It is suggested that West German tenure conversions are unique in that several landlord categories are operating. Compared with the US the German tenant is in a strong position because of security of tenure. Lundqvist concludes that the effects of conversions are dependent on the strategies used by individual sellers.

Again, Lundqvist concludes that the outcome is one of more inequality in that those who have a good ability to pay and can afford to buy enjoy favourable growth of wealth.

The concluding chapter suggests that the general pattern to emerge is that conversions are concentrated in housing of good quality in attractive areas and that households with good ability to pay are over-represented among buyers while those with less ability are under-represented. The long-term development is generally seen as being more favourable to buyers than to continuing renters, with the overall result that there is a redistribution of housing quality and economic wealth towards better off households.

Lundqvist examines various lessons which can be learnt from the conversion process and suggests that the most important lesson is that although tenure conversions in some cases involve selling out publicly owned and/or supported housing, this need not necessarily imply decreasing governmental involvement in the housing sector.

The book contains valuable research and is a useful addition to the somewhat sparse literature on comparative studies of housing. It is clearly written from a certain point of view and in respect of Britain at least, the sources used would inevitably suggest the conclusions that the author has duly reached. Arguably, the book looks at too narrow an area and fails to take full account of the policy context. Probably, in few countries has the sale of public sector housing been designed as a policy to promote housing equality and indeed few countries explicitly accept housing equality as a valid policy anyway.

Certainly, in Britain no one has suggested that selling council housing is supposed to promote housing equality. Rather, the motive of the central government has been to allow a greater element of choice to the one-third of the households who, in 1979, were public sector tenants. There will inevitably be winners and losers in any such policy and those who have taken advantage of the opportunity to purchase their own homes have been winners. ■

Housing Policy and Equality: A Comparative Study of Tenure Conversions and their Effects, by Lennard J. Lundqvist, Croom Helm, 1987.

Mobilising small-scale savings

There has recently been growing interest in programmes aimed at increasing financial savings, especially through the expansion of branch office networks and other services, into relatively poor rural and urban areas. The notion that the poor are unable to save has increasingly been challenged. Although there are growing numbers of successful savings mobilisation programmes in developing countries, there had been no systematic analysis of such programmes.

In this study*, Robert Vogel of the American University in Washington DC, and Paul Burkett of the University of Miami, both consultants to the World Bank, attempt to develop a framework for analysing the benefits and costs of programmes to mobilise deposits from non-wealthy households. The framework distinguishes between the flow of new savings and savings as a stock of wealth.

The study concludes that non-wealthy households benefit from improved savings facilities provided by safe, liquid, interest-bearing deposits that allow households to earn a positive income on their savings balances and avoid the erosion of these balances by inflation.

This facilitates the accumulation and withdrawal of funds, for lump sum investment in physical capital and for the funding of cashflows associated with consumption and the operating costs of capital. Also, the greater use of the financial system generates social efficiencies through the pooling of risks and through information economies in the allocation of funds for investment.

The success of deposit mobilisation programmes aimed at small savers is held to depend on competition in the financial sector and the regulatory environment — the most efficient means of improving deposit opportunities are the removal of regulatory constraints and the promotion of competition.

This study suggests that reciprocity, that is, whether financial institutions make loans to their depositors, is an important issue in small saver programmes. A comparison of the experience of postal savings banks, credit unions, informal savings and credit associations, and other institutions, suggests that access to credit and confidence in the viability of financial intermediaries are important determinants of the decision to save in financial forms.

The extent to which financial intermediaries lend to the same people from whom deposits are obtained affects the success of small savers' schemes. Institutions that provide both deposits and lending facilities to the same customers also enjoy significant cost advantages compared to those which do not. However, these must be balanced against possible losses of specialisation.

The study examines lending activities of three types of deposit taking institutions: postal savings facilities, rotating savings and credit associations and credit unions. There are also three case studies: the expansion of bank offices in India, the potential for savings mobilisation in Nigeria, and savings mobilisation by BANCOOP (the National Co-operative Bank in Peru).

The case studies suggest that the cost of small savers' programmes need not be large. They also indicate the crucial role of financial innovation and reciprocity in determining the viability of branch office expansion as a tool for improving deposit opportunities in developing countries. ■

**Mobilising Small-Scale Savings,* Approaches, Costs and Benefits, by Robert C. Vogel and Paul Burkett, World Bank Industry and Finance Series, Volume 15 (obtainable free of charge from the Publication Sales Unit, Department T, The World Bank, 1818 H Street, NW Washington DC 20433, USA or from the European Office of the Bank, The World Bank, 66 avenue d'léna, 75116 Paris, France.