Housing finance in the USA in the 1990s

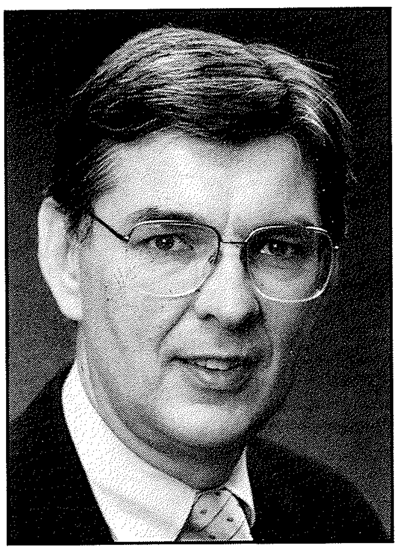
By Warren Lasko

IN recent years, the American mortgage market has been beset by high and volatile interest rates, the fallout effects of deregulation, excess capacity, huge default and foreclosure losses, intense price competition and the evaporation of profits. There has been a shift from fixed rate financing towards adjustable rate and other forms of "creative" financing, and there has been a sweeping trend towards securitisation and increased reliance on the secondary market.

Taking the longer, broader view, we recognise we now have a well-developed secondary market that assures the availability of mortgages in bad times as well as good. The secondary market, through Fannie Mae, Freddie Mac and Ginnie Mae, and through a number of private conduits, has proven a remarkably efficient engine for channelling capital for housing from the national and global credit markets into local housing markets.

The marvels of near instant worldwide communications and the ability with computers to transform mortgages into a wide variety of rateable-tradable high grade securities has made the mortgage market one of the most efficient and competitive marketplaces in existence. Housing consumers have been the beneficiaries as they can compete for housing finance on nearly equal terms with giant corporations and obtain credit at rates only 150 basis points or so above the U.S. Government's costs of borrowing.

Yet housing affordability has suffered even as the mortgage market has become more efficient. House prices in much of the country have risen faster than incomes and faster than consumer prices. Young people trying to buy their first home are most affected, as they struggle to accumulate a down payment and to achieve sufficient income to make a monthly mortgage payment that requires an income out of reach to increasing numbers of them.



THIS paper sets out ranges of possibilities for the future of the housing finance market. It points out that while there will be a growing market for real estate finance for the forseeable future, the housing finance business will be leaner in the 1990s than it has been in the 1980s.

Among households headed by persons aged 25 to 34, the home ownership rate has dropped to about 45%, an eight percentage point drop from a decade earlier. The typical home in the late 1980s absorbs half again as much family income as it did two decades earlier.

The affordability of rental housing is similarly distressing. Higher financing and other costs of owning and operating rental housing have pulled rents up faster than the modest incomes of most renters.

As we look towards the future in our capitalist, free market system, the ultimate driving forces, as in the past, will be profits and returns on investments. The future of real estate finance will be shaped by the traditional interwoven forces of entrepreneurship, human ingenuity, and technology; armed with capital; in pursuit of material gain; guided and restrained by public policy and regulation.

The way we finance housing and other real estate in the 21st century will almost certainly provide better mortgage products, more efficiently, at lower real costs. The competitive forces of the free marketplace over the long term work inexorably toward innovation and greater efficiency. Our business, like most, will do thousands of little things a little bit better, and once in a while a very few things a whole lot better.

Basic demand for mortgage finance

There will be a large and growing market for real estate finance for as far into the future as we can imagine. But it will be leaner, less ebullient business than in the 1980s.

There will always be a need, and therefore demand, for housing, office and other commercial space, and for the financing of it. But the rate of growth in demand has reached a plateau and will even slacken during the 1990s. Chart 1 shows net new household formations declining from an annual average of 1.6 million in the 1980s to 1.2 million in the 1990s. This will translate into an average annual need for some 1.4 million housing unit starts, which in turn suggests fewer new home sales and sharply lower multifamily construction.

Interestingly, existing home sales will rise gradually. Though the absolute number of additional homes will be declining, the total stock of housing will be rising and so too will the number of existing units sold each year.

This less than effervescent housing market and related employment and commercial activity will in turn generate only slowly growing and still cyclical needs for mortgage credit. We anticipate that home mortgage originations during the 1990s will average a bit over $500 billion a year. Thus we will indeed see the day when the phenomenal lending levels of 1986-87 are reached again. But it will take until the middle of the decade to reach such levels.

In contrast, loan servicing grows year in and year out. By the year 2000, home mortgage debt will likely reach $6 trillion. This is far more than double its level at the start of the 1990s (Chart 2).

Demographics could play a beneficial role in lowering mortgage and other interest rates in the 1990s. As the bulge in the U.S. population grows older, it will shift over the next decade from credit-using, non-saving young people to credit-supplying net savers. This could prove a powerful shift that lowers demand for consumer durables and housing, slows credit growth relative to employment and income, and raises the national savings rate. Federal policy success in containing inflation through reduced budget deficits and lower international imbalance will, of course, also play a vital role in determining interest rates.

6 →

Chart 1

Housing Markets in the 1990s

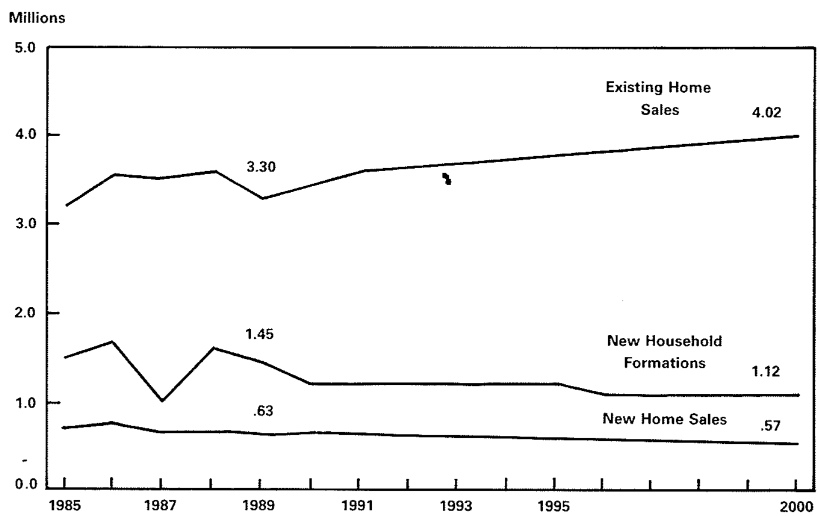
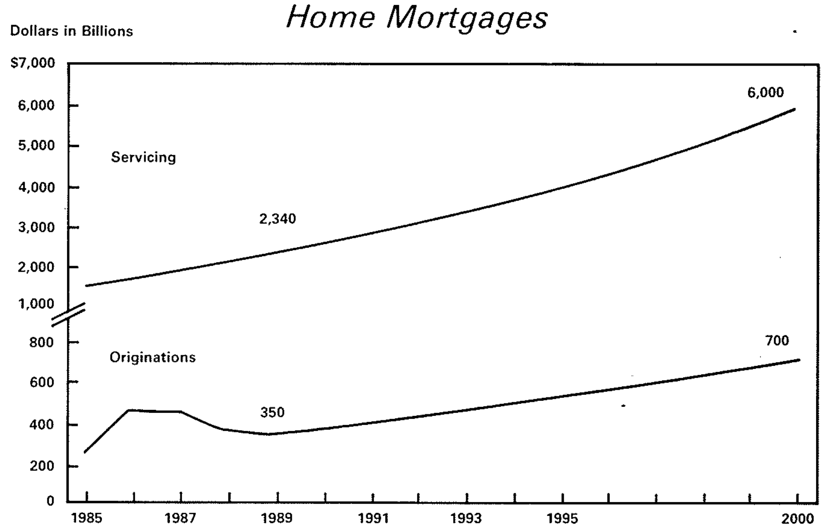


Chart 2

Mortgage Finance in the 1990s

Home Mortgages



←5

This population shift almost certainly will be accompanied by diminished market share for first-time home buyers and the use of low down payment, conventional, government-insured mortgages. The move up-market for housing and mortgages will grow in importance, suggesting comparatively strong demand for high balance conventional nonconforming financing.

Taken together, these demographic and market phenomena could well also weaken the political support for pro-housing issues.

Structure of the real estate finance industry

Who will make, service and hold mortgage debt? As we enter the 1990s, the entire financial services industry, and especially the mortgage delivery system, is going through a period of fundamental restructuring.

Consider first who will hold mortgages as the ultimate investors. Where will mortgage money come from? It used to be, at the beginning of the 1980s, that savings institutions and banks provided most of it. Indeed, the thrift industry alone held about half of all mortgage debt then. But, as the decade ends, thrifts hold a much lower portion of the total, and their share is declining (Table 1).

Meanwhile, banks, pension and insurance funds and foreign institutions are becoming far more important as ultimate sources of mortgage funds, and this trend will accelerate. Pension funds will without doubt grow in importance. As our population ages, a growing proportion of its financial assets will be held in "forced savings" in retirement funds. Pension funds also benefit from low operating costs, hence ability to survive on lower spreads over their cost of funds, and greater predictability of liabilities compared with thrifts.

How will these funds, these savings, find their way into the mortgage market? Just because the resources are held in big banks, thrifts and retirement funds does not mean those institutions will necessarily create and service the assets — the mortgages — that they hold. Large institutional investors become essentially asset managers, handlers of huge portfolios, with their top management trained and skilled at optimising yields. This is a very different set of skills and orientation compared with that of a producer of a product.

In terms of who does what in the mortgage market in the years ahead, there is a paradox evolving. At one time there is underway an homogenisation of institutions on a global scale, but also a growing specialisation of functions within firms. If we can look beyond the day-to-day vagaries, crises and pitfalls, the long-term trend is inexorably towards a global and more level playing field.

Borrowers of all sorts will gain increasing access to capital more efficiently, through more firms, more quickly across the continent and around the world. At the same time, within the mortgage delivery business, market forces are shaping and will continue to shape more efficient and more specialised ways to finance housing and commercial facilities.

In the centuries-old process of progress through specialisation and division of labour, we envisage the mortgage business becoming divided into separate, more efficient entities, specialising in:

Originating (or making) mortgages, including underwriting and quality control.

Aggregating (or pooling) and warehousing mortgages, making them ready for delivery into the secondary market.

Marketing and risk management prior to delivery to investors.

Wholesale distribution to the investment community, and subsequent trading, along with the reconfiguration of cash flows into derivative products.

Mortgage loan administration.

Table 1
Who Makes, Services and Holds Home Mortgage Debt?

(Dollars in billions)

	1980		1988	
	Amount	*Per cent*	*Amount*	*Per cent*
Mortgage Originations				
Thrifts	$ 66.5	49.7%	$ 186.2	49.7%
Mortgage companies	29.4	22.0	85.3	22.8
Commercial banks	28.8	21.5	95.5	22.5
All others	9.1	6.8	7.4	2.0
Total	$133.8	100.0%	$ 374.4	100.0%
Mortgage Servicing				
Thrifts	$482.0	50.4%	$ 823.8	38.9%
Mortgage companies	195.0	20.4	748.8	35.4
Commercial banks	179.1	18.7	402.2	19.0
All others	100.2	10.5	140.4	6.7
Total	$956.3	100.0%	$2,115.2	100.0%
*Mortgage Holdings**				
Thrifts	$512.0	53.5%	$ 924.8	43.7%
Commercial banks	196.6	20.6	482.5	22.8
Pension and retirement funds	27.3	2.9	135.9	6.4
Federally-chartered agencies	38.0	4.0	131.8	6.2
Insurance companies	28.2	2.9	143.0	6.8
All others	154.2	16.1	297.2	14.1
Total	$956.3	100.0%	$2,115.2	100.0%

*Including mortgage-backed securities.

Mortgage insurance and other credit enhancement functions.
Holding mortgages and related securities as investors.

These functions will often be carried out within the same firm, but they need not be. Banks and thrifts that hold uninsured conventional loans in their portfolios carry out all of these activities in-house. But low-cost/high-efficiency specialists will increasingly take on the individual functions.

The making and servicing of mortgages will continue to be the province of mortgage companies, banks and "thrift" institutions. Mortgage companies will succeed when they can take advantage of their absolute specialisation in mortgages, their agility and their ingenuity to be the low-cost providers and servicers of mortgage products.

It is likely that thrifts and banks will converge, and will fall into two — perhaps three — categories. Some will remain small scale, essentially consumer lenders. These will have a special role emphasising mortgages in towns and communities where personal relationships remain important and price is not the most determining factor in consumer decisions.

Other thrifts and banks will look more like the mid-sized commercial banks looked in the late 1980s. They will make mortgages, but also provide a full range of commercial and business loan functions, offer a range of deposit and other liability services, and provide access to mutual funds, annuities, trusts, credit card and other financial services.

At the extreme, some institutions will be so huge as to be almost impossible to define: Citicorp and American Express come to mind. They will have large market shares in the mortgage arena, but also in investment banking, credit cards, foreign exchange trading and in other services. Their success in the mortgage arena will be augmented by their name, scale and corporate presence, but a more vital ingredient will be whether they can muster the ability to motivate and maintain entrepreneurial autonomy in a separate, mortgage-specialised subsidiary within the overall corporate structure.

Consider now the possibilities in the key traditional functions of mortgage finance — making, marketing and servicing mortgages.

The origination function

Nowhere in the mortgage market is competition keener than in loan production. It will remain so. The business of producing mortgages will face the continuing challenges of: gaining access efficiently to the consumer — the borrower — both directly and through real estate agents, a very labour-intensive person-to-person business, while at the same time controlling costs and adapting automation and other new technology to speed and simplify mortgage lending, a capital intensive process. Coupled with the ease of entry into the business and tendency towards over-capacity, these forces will keep pressure on loan pricing for the foreseeable future.

In the 1980s the most successful firms were those which controlled costs most effectively. With demographics weakening and capacity excessive, intense price competition will mean that successful firms will be leaner and still more tightly managed in the years ahead.

Economies of scale exist to a far lesser extent in loan production than in loan servicing. The annual volume of loan production needed for profitability in a well-run firm is likely to remain low. Indeed, diseconomies may set above fairly modest production levels. So, relatively small, well-managed firms can prosper, particularly in so-called niche markets with niche products. For all originations, though, there will be continuing moves toward reduced branch office overhead, "shirt-sleeve" rather than "managerial" employees, controls on excessive compensation packages, and consistently sound underwriting and overall quality controls.

The 1990s could well witness the emergence of the loan originating correspondent firm, rather than the branch office network, as the predominant organ of loan originations. Independent correspondents can be so efficient, move so fast, operate with such low overheads and enter or leave a volatile market so easily ("they pop up like mushrooms after a rain-storm") that they may render traditional branch offices competitively obsolete in cost-price competitive markets. Risk management and quality control will be keys to long-term success among wholesale purchasers from such correspondents.

Expect at the same time in the decade ahead a trend towards global standardisation in mortgage products. Consumer desires and preferences all over the world are becoming more homogeneous. In new industries, such as compact discs and fibre optics, we have global standards from day one. In older industries we are moving towards global standards in consumer goods ranging from cars to televisions to watches and soft drinks. We can expect similar conformity in the mortgage market.

The marketing function

The heart of mortgage banking is the process of delivering, or marketing, mortgages into the secondary market. This function almost without doubt will become even more integral to the business of mortgage lending in the decade ahead.

And at the heart of the marketing function is profit optimisation in a framework of risk management. This will be as true in the future as in the past; we may not be able to forecast the level of interest rates, but we know they will be volatile.

We can anticipate a continued search for better hedging vehicles — with both futures and options pro-

8 →

←7

ducts, and attempts to shorten further the period from loan application to delivery. There will almost certainly be advances in securitising adjustable rate loans, and these will become more readily accepted in the investor community. Other new products will probably involve securities with global appeal — LIBOR (and other indexes)-based floaters, with strip features and advances in reducing exchange rate risk.

Whilst there well may be some further refinement in mortgage securities structures, there is only a limited likelihood of any further quantum leaps in the technology of rearranging mortgage cash flows. Certainly the marketing function, more than any other part of the mortgage business, will be heavily dependent on computers, information processing and electronic communications. And it will be driven by intense competition based on price, not on personal relationships. Indeed, this may be the single biggest revolution over the past two decades in the way the mortgage business is conducted.

Loan originators and servicers will relate to the marketing function in different ways, based mainly on their size. Small firms will deliver to wholesalers, which in turn will aggregate loans and perform most of the risk management and marketing functions. The very largest servicers will increasingly issue securities directly, while most firms will continue to rely on the federal agencies and private conduits for the securitisation of their loans. Even the large private issuers will be constrained by the capacity of their corporate parents to carry the contingent liability of huge volumes of mortgage-backed securities.

Chart 3 shows our projection that by the year 2000 home mortgage sales into the secondary market will reach about $560 billion. This will represent about 80% of loan originations. Mortgage bankers can be expected to be the principal players in delivering new mortgages into the secondary market.

If they do no more than maintain their current market share of 45%, they will be selling over $250 billion in loans by the beginning of the 21st century. It is not unreasonable, however, to project a 60% market share — or annual sales exceeding $300 billion.

The servicing function

In loan administration, technological advances coupled with competitive forces will move the break-even level of real costs ever lower. The minimum volume of residential servicing needed for sustained profitability, probably in the 30,000 to 50,000 loan range in the late 1980s, will continue to rise.

Hence the minimally optimal servicing operation is likely to be far larger than the concomitant scale of an efficient production operation. As a result, various forms of bulk servicing purchases will become a routine, institutionalised part of the mortgage business.

Over the course of the 1980s, the point at which most dramatic economies of scale set in shifted from perhaps as low as 10,000 loans early in the decade to the 50,000 loan range late in the decade. Though we can never know in advance what technical marvels will arise in the future, history leads us to expect that progress will continue to be made.

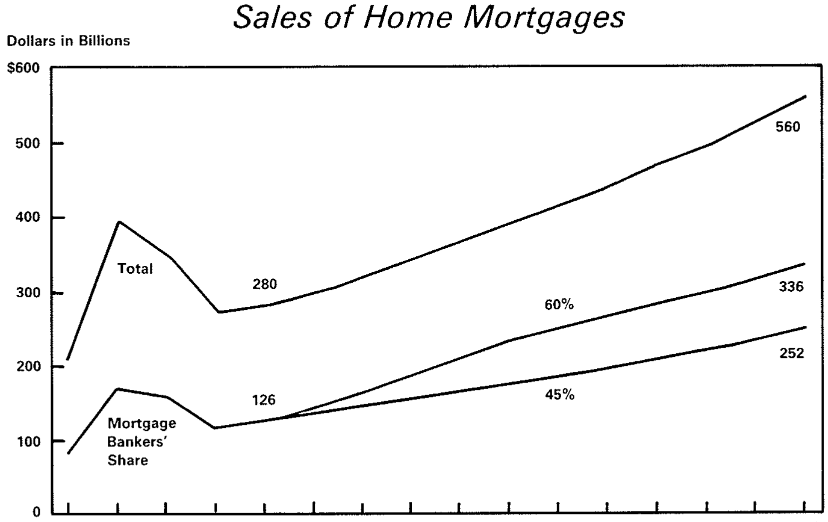
As direct servicing costs — people, data processing and the like — are brought down to their technically feasible limits, the 1990s will see a growing emphasis on controlling credit losses and contingent liabilities that are becoming more and more a part of the mortgage business. ■

WARREN LASKO is executive vice-president of the Mortgage Bankers Association of America. This article is extracted from a long report which will be published by the Association later this year.

Chart 3

Secondary Market Activity in the 1990s

Sales of Home Mortgages



The US mortgage market: a statistical overview

OVER the past few years analysis of the American mortgage market has concentrated predominantly on the precarious position of the thrift institutions. However, notwithstanding the thrift problem the market has continued to evolve with activity at a very high level, although with a downturn in 1988.

This article briefly presents a number of statistical tables which show the size of the American mortgage market, the principal participants in that market, and the evolution of the market. The tables are all drawn from *A Statistical Summary of Housing and Mortgage Finance Activities, 1970-1988,* published by Fannie Mae, one of the quasi-government secondary market institutions. The primary sources for the tables are a number of government agencies, in particular the Department of Housing and Urban Development and the Federal Reserve Board.

Lenders and holders of mortgage loans

Table 1 shows the breakdown of loan originations in 1970 and 1988.

Perhaps the remarkable feature of this table is the relative stability in shares of mortgage originations. There are three principal institutional groups:

(a) Savings associations or savings and loans. These are specialist housing finance institutions, which traditionally funded themselves on the retail deposit market, but which increasingly in recent years have been using other sources of finance, in particular the secondary mortgage market.

(b) The commercial banks.

(c) Mortgage companies. These originate loans which they immediately sell to an institutional investor rather than hold on their own balance sheet.

While shares of mortgage lending may have remained relatively unchanged there have been very significant changes in holdings of residential mortgage debt. Table 2 shows the position.

It will be seen that the share of mortgage loans held by savings associations has fallen sharply and that there has been an even more significant fall in the share held by mutual savings banks. These "portfolio lenders" have been replaced by holders of mortgage back securities issued by three government agencies:

(a) FNMA or Fannie Mae, a private company, albeit created by Congress and with Government backing. Fannie Mae's traditional role

10 →

Table 1. Origination of Residential Mortgage Loans

Institution	*1970*		*1988*	
	$bn	*%*	*$bn*	*%*
Savings associations	17	39	178	43
Mutual savings banks	3	7	28	7
Commercial banks	8	18	103	25
Federal credit agencies	2	5	4	1
Mortgage companies	10	23	90	22
Other	3	7	9	2
Total	44	100	412	100

Table 2. Residential Mortgage Debt Outstanding by Investor/Guarantor

Institution	*1970*		*1988*	
	$bn	*%*	*$bn*	*%*
Savings associations	139	40	650	29
Mutual savings banks	50	14	112	5
Commercial banks	50	14	348	16
Life insurance companies	47	14	47	2
State and local credit agencies	4	1	92	4
Fannie Mae	16	5	103	5
Other federal credit agencies	18	5	59	3
Mortgage backed securities:				
Fannie Mae	—	—	178	8
Ginnie Mae	—	—	341	15
Freddie Mac	—	—	225	10
Other	21	6	96	4
Total	345	100	2,249	100

← 9

is as a purchaser of mortgage loans, which it held on its balance sheet, but more recently it has been purchasing loans and issuing corresponding mortgage back securities.

(b) GNMA, or Ginnie Mae, which is a Government entity operated within the Department of Housing and Urban Development. This buys mortgage loans, especially those insured by government agencies, and sells securities backed by the loans.

(c) FLHMC, or Freddie Mac, which buys mortgage loans not insured by government agencies and sells securities backed by them.

The table shows that holders of mortgage-backed securities (typically institutional investors, such as insurance companies and pension funds, but also savings associations and banks) held 33% of residential mortgage debt at the end of 1988, whereas this instrument did not exist in 1970.

Secondary mortgage market

The secondary market is a key part of the mortgage market in America. The market operates either by lenders originating loans which they then sell to institutional investors, or more commonly by lenders originating loans which they sell to a government agency (and to a lesser extent private agencies) which then issues securities backed by those loans. In the case of Freddie Mac, Fannie Mae and Ginnie Mae, the securities have an implicit government guarantee, which makes them particularly marketable. Table 3 shows secondary market purchases in 1988.

It will be seen that savings associations were significant purchasers of loans as were other mortgage lending institutions. However, the volume of direct purchases was swamped by agency purchases for mortgage pools.

The changing nature of the secondary market is shown in Table 4.

The main trend between 1978 and 1988 was the sharp decline in purchases by the federal agencies of loans for their own portfolios. Correspondingly, there has been a sharp increase in purchases for mortgage pools. This largely reflects a changing role for Fannie Mae from being a holder of mortgage loans to an issuer of mortgage-backed securities.

The bottom half of the table reflects this. Ginnie Mae was the only issuer of mortgage-backed securities in 1978. More recently it has been joined by the other two agencies.

Summary

In the United States the principal originators of mortgage loans are savings associations, commercial banks and mortgage companies. The distinguishing feature of the American mortgage market is the huge size of the secondary market with some two-thirds of new loans now being securitised. The secondary market now largely takes the form of purchases of mortgage loans by quasi-governmental agencies and the issuing of mortgage-backed securities backed by those loans. The ultimate beneficial owners of many mortgage loans are now a variety of institutional investors who can take advantage of the secondary market by being able to hold an asset which has all of the desirable attributes of mortgage loans, that is a good yield and security, but without the work involved in originating and processing loans. ■

Table 3. Secondary Market Purchases, 1-4 Family Mortgage Loans, 1988

Institution	*$bn*	*%*
Institutional direct purchasers:		
Savings associations	49.7	16
Commercial banks	21.9	7
Mutual savings banks	3.2	1
Mortgage companies	35.8	11
Other	2.9	1
Agency portfolio purchasers:		
Federal agencies	25.1	9
State and local agencies	6.1	2
Purchasers for mortgage pools:		
Agency	192.8	45
Other	23.4	7
Total	313.9	100

Table 4. Secondary Market Activity in 1-4 Family Mortgage Loans

Institution	*1978*		*1986*		*1988*	
	$bn	*%*	*$bn*	*%*	*$bn*	*%*
Institutional direct purchasers	6.1	46	132.2	30	112.5	36
Agency portfolio purchasers	5.4	41	41.1	9	35.2	11
Purchasers for mortgage pools	1.8	14	269.7	61	166.2	53
Total	13.3	100	443.0	100	313.9	100
Federal agency activities:						
Portfolio purchases	3.4	55	22.3	8	16.9	11
Mortgage backed securities issues:						
Fannie Mae	—	—	59.0	22	50.4	31
Freddie Mac	0.1	2	94.8	35	39.6	25
Ginnie Mae	2.7	44	95.8	36	53.6	33
Total	6.2	100	271.9	100	160.5	100

Recent developments in Indian housing finance

By Nasser M. Munjee

HOUSING policy in India during the country's first six economic development plans (1947-85) remained largely implicit: housing was seen to be a social sector and therefore not a major part of economic development. In preparation for the Seventh Plan (1985-90), the Planning Commission set up a series of Task Forces to enquire into the issues and policy alternatives for the shelter and urban sector in India. The reports produced by these Task Forces[1] remain today to be the major documents analysing the state of housing development in India.

As a consequence of these reports, a number of initiatives were undertaken in 1988 — the penultimate year of the Seventh Plan — which will be reported subsequently. This article provides a brief summary of the evolution of the housing finance system in India, describes some recent developments, places the recently established National Housing Bank in perspective, and concludes with some issues that remain to be addressed by future policy.

India's progress towards a strategy for housing development may be measured by institutional processes that began in the 1970s. Initially, the concern for the lowest income urban households (less than the 40th percentile of the distribution of income) resulted in the establishment of a network of State level Housing Boards entrusted with the task of parcelling and harnessing available publicly owned land resources for the development of residential housing for these target households. An apex financial institution, the Housing and Urban Development Corporation (HUDCO), was entrusted with financing these efforts through a techno-financial link with these various house building agencies.

The second pillar of the initial strategy was the co-operative movement catering largely to the private sector. Households were encouraged to form co-operative societies, invest initial capital for land purchase and then were financed through State level Apex Co-operative Housing Finance Societies. These societies, in turn, were funded through the Life Insurance Corporation which set aside for this purpose a particular quantum of the resources they had available for investment.

The third pillar comprised the House Building Advances made to employees of public sector corporations and financial institutions as well as to civil servants. Capital formation in housing for the rest of the private sector was left almost entirely to market forces. Chart I (overleaf) illustrates the flow of funds to the housing sector.

It is estimated (very roughly) that about Rs7,000 crores ($US4,516 million) has been the total formal sector's finance for housing which, after netting out inter-sectoral flows, works out to roughly half the gross figure, ie Rs3,500 crores ($US2,258 million). A schematic representation of the flow of funds to housing through a select network of major financial institutions is indicated in Chart I. Table I illustrates in more detail the flow of funds through public institutions.

Housing finance, as a financial intermediation process, commenced only in 1978, with the establishment of Housing Development Finance Corporation (HDFC) as a specialised lender to households and corporate entities specifically for housing purposes. Since then, the sector has grown to encompass three major regional institutions with the promise of a further seven in the near future. Table II illustrates the institutional growth of the sector during the 1980s and Table III summarises the performance of the major operating specialised housing finance institutions in the country.

Some recent developments

Spurred by the United Nations declaration of 1987 as the International Year of Shelter, combined with the resolve of the Government of India to initiate processes which would reallocate resources to housing and urban development, a number of initiatives were taken, all to emerge in 1988, to create a policy framework for the sector. These could be listed as follows:

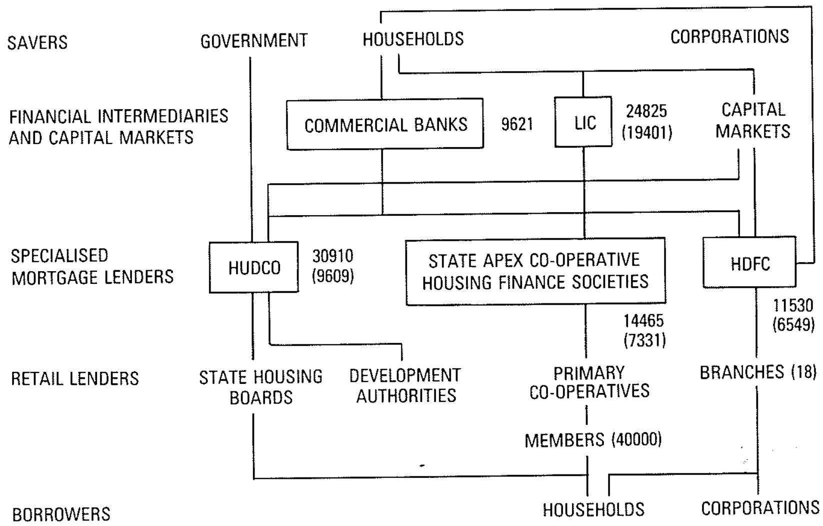
(1) The formulation of a National Housing Policy Document.
(2) The publication of the final report of the National Commission on Urbanisation.
(3) The establishment of the National Housing Bank as a wholly owned subsidiary of the Reserve Bank of India.

Despite these initiatives, the future role of the public and private sectors, the constraints faced at present and an operational strategy for the future have not been tackled analytically for

12 ⟶

Chart 1

Schematic Representation of Formal Housing Financial Intermediation in India as of March 1988

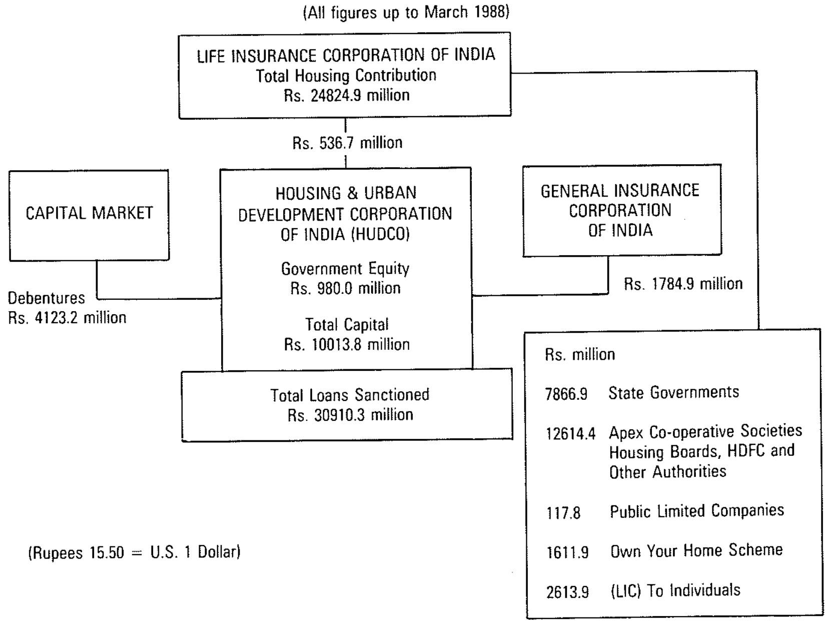


1. All figures in Rs. millions.
2. Figures indicate cumulative approvals as of March 31, 1989.
3. Figures in parentheses represent outstanding housing loans.

Table 1

Public Institutions Financing Housing

(All figures up to March 1988)



(Rupees 15.50 = U.S. 1 Dollar)

← 11

the sector as a whole. The National Housing Policy Document makes only two references to this issue, one in the preamble:

"There is obviously a need to recognise and rely on a multiplicity of actors including the Government in the production and improvement of housing on the scale required. Government will need to devise and implement coherent and well-set-out shelter strategies which will enable all the various actors to complement one another and to ensure most efficient utilisation of resources."

and the other in the objective statement:

"To create an enabling environment by eliminating constraints and developing an efficient and accessible system for the delivery of inputs to maximise housing efforts."

The document does not illustrate how this might be achieved. The creation of the National Housing Bank ostensibly to "be the principal agency to promote housing finance institutions and provide financial and other support to them" will be of great operational significance to the future growth and development of the emerging housing finance system as it evolves in the years ahead.

The National Housing Bank

One of the key recommendations of the Task Force on Housing in 1985 was to establish two key institutions: a Housing Bank and an Urban Infrastructure Finance Bank. The Government accepted the first to be implemented in the Seventh Plan period and, as a consequence, the National Housing Bank (NHB) was established in July 1988.

NHB's main objective was to ensure the development of a viable and accessible institutional system for the provision of housing finance. The NHB was established by Statute under the National Housing Bank Act (1988) and was capitalised by the Reserve Bank of India with an initial capital of Rs100 crores ($58 million).

The NHB views its role as an "Apex" housing finance institution which has a regulatory, promotional and refinance role for other institutions that have appeared or have been operational in the field.

In its initial year, the NHB has taken a number of steps to operationalise its objectives:

(i) In November 1988, NHB announced the role that it envisages for the commercial banking system in housing finance. Commercial banks had hitherto allocated a certain quantum of funds each year, under guidelines issued by the Reserve Bank of India, for both direct as well as indirect lending for housing finance. The new guidelines indicated the terms and conditions on which banks could finance individuals, institutions, Housing Boards and private developers. The terms for individual households were comparative to those currently offered by HDFC.

(ii) In March 1989, NHB announced detailed guidelines for a Home Loan Account Scheme that would be offered and operated by banks through their branch network. A household would be able to save under the scheme for a minimum period of five years at a rate on return of 10% per annum, after which the saver would be eligible for a housing loan of a multiple of the total savings subject to a ceiling of Rs300,000 ($17,500), as well as some restrictions on the size of the unit to be financed. The scheme is to be a national scheme which would replace all other products, if any, offered by the banks.

(iii) In April 1989, the NHB announced its refinance guidelines to existing housing finance institutions, aimed at refinancing these institutions, especially for loans made to lower income households and loans made for renovation or for upgrading of low cost housing. Refinance is available up to Rs50,000 ($3,000) per household and loans made for purchase or Rs30,000 ($1,700) per household for renovation or upgrading of an existing unit. The rate of interest varies from 10.5% to 13% per annum depending upon the size of the loan with a slight difference of ½% for rural housing.

(iv) In June 1989, NHB also announced guidelines for acceptance of deposits by housing finance institutions. The major feature of these guidelines is that housing finance institutions cannot now accept deposits for a period of less than 24 months.

(v) Finally, NHB has also issued guidelines for the promotion of Housing Finance Institutions in private or joint participation which would be applicable if these institutions expect financial support from NHB. The guidelines, *inter alia,* include paid-up capital requirements, gearing ratios, acceptance of deposits rules, and terms and conditions offered by these institutions for housing finance. *(See Annex I.)*

Table II

Existing Housing Finance Institutions	
Institution	*Head Office Location in India*
1. Housing Development Finance Corporation Ltd	Bombay
2. Gujarat Rural Housing Finance Corporation Ltd (GRUH)	Ahmedabad
3. Housing Promotion & Finance Corporation Ltd (HPFC)	Calcutta
4. Can Fin Homes Ltd	Bangalore
Proposed Housing Finance Institutions	
Promoted by:	
1. General Insurance Corporation of India (Subsidiary)	Bombay
2. Life Insurance Corporation of India (Subsidiary)	Bombay
3. Bank of India	Bombay
4. Central Bank of India	Bhopal
5. Punjab National Bank (PNB) Housing Finance Ltd	New Delhi
6. United Commercial Bank (for rural housing)	Orissa
7. UP Rural Housing Finance Corporation Ltd (for rural housing)	Uttar Pradesh

There are about 40 other minor housing finance institutions spread throughout India.

Table III

Rs Crores

		HDFC	*CAN FIN HOMES*	*GRUH*	*HPFC*
CUMULATIVE LOANS	Approved	1,500	41.4	6.86	5.47
	Disbursed	1,100	27.6	2.51	1.19
LOANS OUTSTANDING		850	29.69	2.49	1.18
RESOURCES	Net Worth	65	10.52	2.23	4.43
	Loans	500	—	2.00	—
	Deposits	485	32.80	—	—
FUNDS EMPLOYED		1,050	43.32	4.23	4.43
PROFIT BEFORE TAX		17.2	0.43	0.18	0.15

Housing Finance: the issues

With formal institutional finance for home purchase being in its infancy in India, the major objectives of a future strategy would seem to be the following:

(1) To enhance the loan origina-

14 ⟶

← 13

tion process for housing throughout the country.

(2) To develop an institutional network that would facilitate this origination process.

(3) To identify a potential resource base for the system as a whole.

(4) To codify and simplify the legal system with respect to risk management of housing finance institutions (liquidity, interest rates and default risks in particular).

(5) To rationalise and reorient the fiscal system to reallocate funds to the housing sector by providing incentives for household thrift as well as institutional growth.

(6) To link formal networks with informal networks which are the major source of financial and economic activity for the rural and urban poor.

The current debate for policy formulation attempts to resolve the vexing question of how the loan origination process can be expanded in the short run with a combined strategy for institutional development and resource mobilisation in the long run. In this respect, recent developments in the sector include the following:

(a) A major entry by the Life Insurance Corporation of India in *direct* household mortgage loan origination. Until 1988, LIC's total direct loan originations for housing under its Own Your Own Home Scheme were 37,730 loans (Rs161 crores) ($US95 million). During 1988 alone, 4,525 loans were originated (Rs33 crores) ($20 million) and 15,000 loans are expected to be originated (approximately Rs150 crores ($88 million) during 1988-89. These are likely to rise to 75,000 loans in 1989-90. LIC is also likely to establish a subsidiary company exclusively to undertake housing finance activities.

(b) A major initiative by the National Housing Bank to include the commercial banking system in the direct loan origination process through its 55,000 branches throughout the country.

(c) Major initiatives by the commercial banks to create housing finance subsidiaries either jointly with existing housing finance institutions or on their own.

(d) Entry of the General Insurance Corporation of India into home loan origination through a subsidiary company.

Supply constraints

While the loan origination process will be considerably strengthened by these recent developments, little attempt has been made, at present, to identify the *long-term* strategic issues posed by the supply constraints of housing in the years to come. These issues include the following:

(a) While housing finance availability is critical to household effective demand for housing, how will housing supply responses cope with this additional demand?

(b) Land parcelling and servicing is the critical constraint on urban housing development largely as a result of the Urban Land Ceiling Act (which limits permissible land holdings in urban areas and freezes the remainder) as well as the inability of the judicial system to expedite cases involving land disputes.

(c) The House Price to Household Income Ratio in India on average is 6.2, well above the average for developing countries of about 5.25, indicating that housing remains expensive thus limiting the affordability of market-related housing finance.

(d) The Housing Delivery System is characterised by relatively small "builders" rather than large-scale construction companies, limiting the benefits that might be derived from economies of scale, modular construction and industrialised techniques.

As a result of these constraints, the input costs of housing development (especially land) are extraordinarily high. Housing for the poor can, therefore, be limited only to areas where land is either Government owned or acquired by Government for the purpose.

While private developers are the major suppliers of housing in most major urban centres, housing for the poor remains largely outside the formal private delivery system. Much remains to be done in designing and financing low income housing. A recent evaluation of sites and services projects by the World Bank[2] concluded that, while the concept was a valid one, replicability remained elusive largely owing to erroneous judgements on appropriate affordability estimates.

This would seem to highlight the need to link low income housing or shelter projects much more closely to the perceived needs of the beneficiaries backed by their willingness to pay for the service stream of benefits over time. Links between formal financial institutions and informal local level networks would seem to be critical to future policy in this area.

Our experience in India is that the potential for these links can be extremely effective in understanding local problems and designing specific approaches for their solution. HDFC recently promoted the Gujarat Rural Housing Finance Corporation (GRUH) specifically to deal with some of these issues. GRUH finances the acquisition or upgrading of housing in rural areas and small towns with a population below 50,000.

GRUH reaches out to local level networks in order to administer and disseminate housing finance — eg dairy and cotton co-operatives, nongovernment organisations — and those networks in turn have positive incentives to utilise GRUH's financial services. GRUH is experimenting with new methods of credit appraisal and training programmes are planned jointly with GRUH staff as well as local level organisations to help jointly administer operating systems more effectively.

Resource mobilisation and efficient intermediation have become the key ingredients of an effective financial system. The rationale for specialised institutions lies precisely in the development of specialised human resources, technological systems and managerial techniques to deal with very specific forms of activity in the most efficient (cost effective) manner possible.

India is now fortunate that these skills have been gradually developed and are being embodied in the emerging housing finance system. Their future evolution, however, will require a framework which will permit these institutions to fit into the financial system at large. As the Honourable Minister for Urban Development of the Indian Government recently emphasised: "Housing finance would need to be integrated into the financial system as a whole if it is to assume the proportions that will be required to finance projected needs."

The initial basic requirement for an emerging structure would be access to a resource base. The narrower the base, the fiercer the competition for available resources, which would result in enhancing costs. It would seem, therefore, that Government policy would need to define the savings base and the capital market base for housing finance institutions fairly carefully, keeping in mind the critical role of the price of housing credit. An institutional development strategy would demand that new institutions transform themselves from mortgage banks in their initial operations (wholesale borrowing and retail lending) to savings institutions (retail borrowing and retail lending) as they establish themselves in their respective market segments.

A future system would need to ensure that it was designed to be sufficiently robust to generate its own resources from within the system as well as contribute to financial deepening and institutional diversification of the financial system at large. It is this aspect — the sound structure of institutions within an evolving financial system — that will prove to have the most lasting impact on the real development of housing activity in developing economies. ■

NASSER MUNJEE is general manager, human resources, of the Housing Development Finance Corporation.

NOTES

1. Task Force Reports, Planning Commission of India, 1985.
   (i) Planning and Development
   (ii) Financing of Urban Development
   (iii) Management of Urban Development
   (iv) Shelter for the Urban Poor and Slum Improvement.
2. Stephen K. Mayo and David J. Gross, "Sites and Services — and Subsidies: The Economics of Low-Cost Housing in Developing Countries", *The World Bank Economic Review,* Volume 1, No 2, January 1987.

Annex I

SUMMARY GUIDELINES FOR HFIs ISSUED BY NATIONAL HOUSING BANK

1. Main Object:	The business of providing long-term finance for construction or purchase of houses in India for residential purposes	
2. Minimum Paid-Up Capital:	Rs1 crore (approx $US600,000)	
Minimum Promoters' Contribution:	30%	
Minimum Government/ Approved HFIs:	20%	
3. Gearing:	Net Owned Funds	Total Borrowing
	Up to Rs10 crores	10 times
	Rs10-20 crores	12.5 times
	Over Rs20 crores	15.0 times
4. Lending Rates:	Up to Rs20,000	12.5%
	Rs 20,000-Rs 50,000	13.5%
	Rs 50,000-Rs 1,000,000	14.0%
	Above Rs1,000,000	14.5-16%
5. Front End Charges:	Should not exceed 2% of the loan	

6. Tax Concessions:
   a) A public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes can create a special reserve within an amount not exceeding 40% of the total income; such a reserve is admissible as a deduction in computing income chargeable to Income Tax.
   b) Investments in the new equity shares of such companies are an eligible deduction up to 50% of the cost of such shares.
   c) Deposits with or investments in any bonds issued by such companies from income derived from property held under trust wholly for charitable or religious purposes qualifies as an eligible mode of investment.
   d) Interest on deposits with such companies qualifies for deduction from tax.
   e) Repayment of the amount borrowed from any such company for housing purposes is eligible for deduction from tax up to the limit of Rs10,000.
   f) Deposits made with such companies are exempt from Wealth Tax.

While these initial activities are gradually formalising the role of housing finance in the Indian Financial system, some significant policy issues remain for the future.

Major role for India's Housing Development Finance Corporation

THE Housing Development Finance Corporation (HDFC) is a private sector specialist housing finance institution. It was established in 1977 on the initiative of the Industrial Credit and Investment Corporation of India (ICCI). The International Finance Corporation, which provided 5% of the initial share capital, maintains an involvement in HDFC. HDFC's 12th annual report (which, because of a change of year end, covers only the nine months to 31 March, 1989) shows that the corporation has continued to make sound progress, and it now plays a major part in the development of an efficient housing finance system in India. This article briefly summarises the annual report.

THE Housing Development Finance Corporation does not obtain its funds from the retail deposit market. The liabilities side of its balance sheet shows that 39% of liabilities were accounted for by the Certificate of Deposits Scheme. There is a modest home savings plan on the lines of the German Bausparkasse contract, and over 5,400 new account holders joined the plan during the period covered by the report. Efforts at marketing the plan to employees and the corporate sector have met with significant success.

The terms of the plan were changed during the year, such that the savings contribution required is 30% of the planned sum. The maximum repayment term of the loan (which carries a preferential rate of interest) was increased from 12 to 15 years. Bank loans provide a significant proportion of HDFC's finance. It also obtains funding from insurance companies, in particular the giant Life Insurance Corporation of India.

'HDFC lending increases'

A significant feature of HDFC's funding is the use made of World Bank and United States Agency for International Development loans. In the previous year the World Bank had approved a loan equivalent to US$250 million to HDFC against a Government of India guarantee. During the year there was a draw down of this of 1,250 million rupees (US$84 million).

In the financial year HDFC raised US$35 million in the United States capital markets under the USAID Housing Guaranty Program. The Bank of India takes the exchange risk. With this tranche HDFC has raised a total of US$125 million under the USAID Housing Guaranty Program over the past five years, the funds being used to finance low income households.

Lending

HDFC's lending has continued to increase year-by-year as the table showing the progress of the institution illustrates. Some 71% of the loans made during the year were for individual home ownership. Households with family incomes less than the urban median income accounted for 65% of the number of dwelling units financed. HDFC has introduced a number of new loan products — a step-up repayment facility, a telescopic loan plan, and a short-term bridging loan. These facilities have helped younger borrowers whose repayment capacity at the time of taking out a loan is not very high.

'Helping the younger borrowers'

Financial performance

One of the problems with housing finance institutions in developing countries has been their viability. Many have been operated in a manner such as to cause significant losses and a number are technically insolvent. HDFC can boast an excellent record on profitability. Its post tax profit has increased year-by-year, and in the nine-month financial year 1988/89 was 145 million rupees, compared with 131 million rupees in the full year 1987/88. Shareholders' funds stood at a comfortable 6·1% of assets at 31 March, 1989.

Policy points

The chairman's statement at the beginning of the annual report usefully reviews major policy issues. It refers to the three major policy initiatives —

(a) The formal adoption of a national housing policy document.

(b) The publication of the final report on the National Committee on Housing.

(c) The creation of a National Housing Bank, a wholly-owned subsidiary of the Reserve Bank of India.

The chairman identifies a number of supply constraints —

(a) How will housing supply responses cope with additional demand?

(b) Land parcelling and servicing is a critical constraint on housing development, largely as a result of the Urban Land Ceiling Act (which limits permissible land holdings in urban areas, and freezes the remainder), as well as the inability of the judicial system to expedite cases involving land disputes.

(c) The house price to household income ratio in India is on average 6.2, well above the average for developing countries of about 5.25, indicating that housing remains expensive.

(d) The housing delivery system is characterised by relatively small builders. ■

HDFC Progress

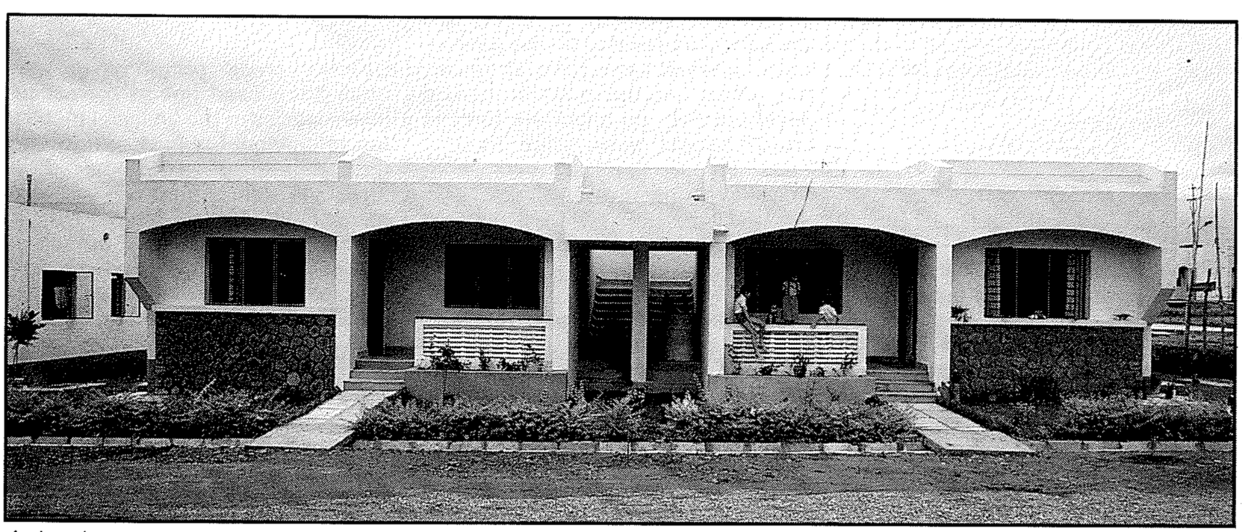
Year	Loan Approvals Number	Amount Rupees m	£m	Balance, End Period Deposits Rupees m	£m	Housing Loans Rupees m	£m
1984-85	27,645	1,345	52	1,776	68	2,347	90
1985-86	40,848	1,864	72	2,528	97	3,518	135
1986-87	46,023	2,375	91	3,422	132	4,842	186
1987-88	55,156	3,050	117	4,242	163	6,549	252
1988-89	66,200	4,440	171	4,832	186	8,449	325

Notes: 1. Until 1987-88, financial years ended on 30 June; from 1988-89 the financial year ended on 31 March. The 1988-89 figures for approvals are for nine months at an annual rate.

2. Sterling equivalent figures are calculated at 26 rupees to the pound.

HDFC Balance Sheet, 31 March, 1989

Liabilities	Rupees m	%	Assets	Rupees m	%
Certificate of Deposit Scheme	4,143	39	Housing loans		
Cumulative interest scheme	584	6	Individuals	6,242	59
Loan linked deposit	38	—	Corporate bodies	1,784	17
Home savings plan	66	1	Other	421	4
Bank loans	1,197	11	Investments	1,354	12
Insurance company loans	610	4	Net current assets	497	5
AID funds	1,020	10	Fixed assets	225	2
World Bank	1,250	12	Advances in respect of fixed assets	38	—
International Finance Corporation	10	—			
Bonds	997	9			
Share capital	200	2			
Reserves and surplus	446	4			
Total	10,562	100	Total	10,562	100



A development financed by HDFC.

World Development Report 1989

THIS report is the 12th in the annual World Bank series assessing major development issues. Like its predecessors, the report includes the world development indicators, which provide selected social and economic data for more than 100 countries. Chapter 1 of the report reviews recent trends in the world economy and their implications for the future prospects of developing countries. Each year the report concentrates on a specific topic. In the 1989 report the topic is the role of financial systems in development. Eight chapters cover the subject, probably in more depth than is covered in any other single publication.

In his foreword to the report, Barber Conable, president of the World Bank, comments that policies followed in the 1970s and 1980s, together with the economic shocks in the 1980s, have left many developing countries' financial institutions insolvent. However, many institutions have continued to lend to their most impaired customers and to accrue unpaid interest. Restructuring the financial system is providing a unique opportunity to consider the sorts of institutions which will be best suited to the economic enviroment of the 1990s. Greater emphasis than in the past should be placed on ensuring the availability of a broader array of financial services. It is specifically suggested that contractual saving systems should be developed.

'Institutions insolvent'

This article summarises the *World Development Report 1989*, concentrating on those issues of most relevance to housing finance.

Why does finance matter?

Chapter 2 introduces the main body of the report and examines the role of finance in development. It argues that finance matters in more ways than might be immediately apparent. Efficient financial systems help to allocate resources to their best uses and are indispensible in complex modern economies. In many developing countries the financial sector is in urgent need of reform.

The role of savings is particularly important. On average the more rapidly growing developing countries have had higher savings rates than the slower growing countries. Many factors influence the saving rate including the rate of income growth, the age composition of the population, attitudes to thrift, and the services provided by the government. Interest rates have an uncertain effect on the amount people save, but they do affect the form in which people save. High interest rates favour financial over non-financial forms of saving.

Financial sector issues in developing countries

Developing country governments have played a large role in credit allocation. For example, in Pakistan in 1986, 70% of new lending by the national banks was targeted by government. In Yugoslavia in 1986, 58% of short-term loans were directed credits. Many such regimes have been very complicated. At one point Korea had 221 formal directed credit programmes. These programmes usually have targeted industry, state-owned enterprises, agriculture, small and medium scale firms, and to a lesser extent housing and exports. In under-developed countries, interventions have largely comprised lending requirements imposed on banks, refinance schemes, loans at preferential interest rates, and loans by development finance institutions.

Individual sectors have benefited from directed credit, but the overall effect on growth is hard to gauge. Credit programmes can be useful when used to tackle inadequacies of the market. However, even well designed controls tend to lose effectiveness if maintained too long.

'Reform needed urgently'

Directed credit programmes have often been used not to correct the inadequacies of the financial markets but to channel funds to priority sectors, regardless of whether these were the more productive investments.

The interest rates charged on directed credits have deviated substantially from market rates. Subsidised credit often failed to reach its intended beneficiaries.

It is clear that directed credit programmes have damaged financial systems. Many directed credits have become non-performing loans. In a sample of 18 industrial development finance institutions, on average nearly 50% of their loans by value were in arrears and accumulated arrears were equivalent to 17% of the portfolio value.

Housing finance institutions have had problems and several have been closed but on the whole they have fared better than industrial and agricultural finance institutions. They have had more success in mobilising resources, although funding in some cases has come from compulsory savings schemes. The better housing banks view themselves as household sector banks and offer a range of services. They also tend to be located in countries with legal systems that make it possible to enforce collateral arrangements.

Some housing intermediaries, pressured to behave like social agencies rather than bankers, have lent on excessively high loan to value or loan to income ratios, which has caused losses and poor recovery from collateral. Where fixed rates were charged on mortgages but inflation and short-term deposit rates were rising, housing banks which depended on short-term deposits were badly hurt.

In some countries macroeconomic instability has compounded the difficulties that financial institutions now face. Government borrowing and inflation have been particular problems. Interest rate controls and inflation have set back financial development in many countries. In countries that have maintained low and stable inflation, financial sector growth has been rapid even where interest rates have been moderately regulated, Japan and Malaysia being examples. By contrast, Argentina has suffered high and variable inflation and its financial system has retarded as a result. Artificially low interest rates also cause excess demand for credit and force financial institutions to ration their landing.

Financial systems in distress

Not since the 1930s have so many firms in developing countries been unable to service their debts. Their difficulties are rooted in the international shocks of the 1980s. In Chile in 1981 the Chilean Government liquidated three commercial banks, four finance companies and a development bank, which together accounted for more than a third of all loans made by financial institutions. Fourteen months later the authorities placed eight institutions which accounted for nearly half of all loans under central bank management and extended financial support to all but one of the remaining commercial banks. In the USA more than a thousand saving and loan associations were closed or merged between 1980 and 1988. By early 1989 600 savings and loans were still thought to be insolvent and the loss to the insurance fund was expected to be at least $120 billion.

Explanations of firms' financial difficulties can be grouped under three headings — macroeconomic conditions, industrial and financial policy, and debtor and creditor behaviour. The importance of macroeconomic factors is clearest in the countries with large external debt burdens. Mismanagement and speculative behaviour persist because prudential regulation and supervision are inadequate in many countries. Four types of mismanagement commonly occur in the absence of effective regulation and supervision:

'Interest rate setbacks'

(a) *Technical mismanagement.* Poor lending policies are the most common form of technical mismanagement and are usually a consequence of deficient internal controls, inadequate credit analysis or political pressures. Poor lending policies often lead to excessive risk concentration. Mismatching assets and liabilities in terms of currencies, interest rates or maturities is another form of technical mismanagement.

(b) *Cosmetic mismanagement.* Strong supervision with a good board of directors should ensure that losses are reported and corrective measures taken. Without these bankers may try to hide the past and current losses, for example, by keeping dividends up in spite of poorer earnings or resorting to accounting measures that increase net profits on paper, even if more tax can be paid as a result.

(c) *Desperate management.* When losses are too large to be concealed bankers may adopt more desperate strategies including lending to risky projects at higher loan rates and speculating in stock and real estate markets.

(d) *Fraud.* This sometimes causes the initial losses, but once illiquidity appears inevitable fraud becomes common. Bankers are tempted to grant themselves loans which they are unlikely to repay.

The case of the United States savings and loan associations is given as an example of moral hazard and is shown in the box on the following page.

Foundations of financial systems

If financial systems are to be efficient and robust they must be set within a suitable legal and regulatory framework.

Lenders must have appropriate assurances of repayment. Lenders have traditionally made extensive use of collateral (mortgages, floating charges, liens and so forth) and personal guarantees to reduce the probability and cost of default. Consequently, annual loan losses of commercial banks in industrial countries have typically been less than 1% of outstanding balances and in turn this helps to keep total intermediation costs at less than 4%. Non-performing loans in many developing countries are now 20% of total loans. Profitable lending becomes

20 →

The US savings and loan crisis: the lessons of moral hazard

MORE than 500 of the 3,000 savings and loan associations in the United States were insolvent at the beginning of 1989. The cost to the Federal Savings and Loan Insurance Corporation (FSLIC) of restructuring the S&L industry through liquidations, consolidations and assisted mergers was, as of early 1989, estimated to be roughly $80 billion in terms of present value. Because its own assets were insufficient to meet the potential obligations, FSLIC had been unable to close or otherwise dispose of many insolvent institutions, and so loss-making S&Ls were allowed to remain in operation. In early 1989 the US government announced its intention to cover the FSLIC shortfall through a combination of government funding and higher deposit insurance premiums to be paid by S&Ls.

The difficulties of the S&L industry began in the late 1970s. S&Ls had traditionally lent funds on 20- to 30-year mortgages at fixed rates and funded themselves with short-term deposits. Higher inflation rates in the late 1970s and early 1980s and the correspondingly higher interest rates that S&Ls had to pay on deposits sharply depressed earnings.

The response of the US Congress and several state legislatures was to authorise S&Ls to take on a wider range of lending and borrowing. Ceilings on deposit rates were phased out, and the maximum size of an insured deposit went up from $40,000 to $100,000. Unfortunately, lawmakers paid less attention to strengthening the system of prudential regulation and supervision. Increased lending and borrowing powers gave S&Ls new opportunities for loss as well as profit. They were required to risk little of their own capital; any losses beyond those amounts would be absorbed by FSLIC. This gave them strong incentives to take greater risks, since they would enjoy all the gains but suffer only some of the losses. In addition, deposit insurance premiums were levied at a flat rate per dollar of deposit, so the premium structure did not discourage risk taking. Insurance experts and economists use the term "moral hazard" to describe this situation of distorted incentives.

Although only a minority of S&Ls fell prey to moral hazard, they did so with gusto. Their losses were compounded by changes in the tax law that made real estate (in which many of these S&Ls had invested) a less attractive investment; by a severe economic downturn in oil-producing areas, particularly Texas; by delays in the imposition of remedial prudential regulations; by delays in the closure of insolvent S&Ls; and by an accounting system that used historical cost-based values rather than current market values to determine income and solvency.

Valuable (albeit costly) lessons have been learned from this experience. Appropriate prudential regulation must accompany the economic deregulation of deposit-taking institutions that are explicitly or implicitly insured by the government. Adequate capital levels, preferably related to risks undertaken, are vital. Risk-related insurance premiums can help. Strong supervisory and examination powers, enforced by well-trained and well-paid personnel, are important. Market value accounting systems are indispensable. Finally, if an institution falters towards insolvency, early regulatory intervention is necessary to prevent small problems from exploding into costly horrors.

← 19

almost impossible at these default rates.

The development of legal rules governing the economic rights and obligations of different agents should go hand-in-hand with economic and financial development. Most developing countries have legal systems which were imposed during colonial rule which were often at odds with local custom. This has happened in India and Indonesia. By contrast Korea and Thailand have imported and adapted foreign legal systems on their own initiative.

The legal recognition of property rights, that is, rights of exclusive use and control over particular resources, gives owners an incentive to use resources efficiently. For example, without the right to exclude others from their land, farmers have no incentive to plough, sow, weed, and harvest. China's recent economic reforms consisted mainly of restoring land tenure to households.

The assignment and transferability of property rights promotes economic efficiency by directly creating new incentives, but it also assists by making financial intermediation possible by allowing borrowers to offer security in the form of mortgages over real estate or other collateral. Immobile assets such as real estate have very desirable properties as they cannot easily be misappropriated and can be quickly sold for an amount close to the purchase price.

When taking collateral the lender is mainly interested in the efficient transfer of property rights because the security is invoked only in the case of default and may deteriorate or disappear if too much time elapses before he can take possession. In most countries real estate accounts for between half and three-quarters of national wealth and if ownership is widely dispersed, tenure is secure and title transfer is easy, real estate can be a good collateral for any type of lending. The accompanying box shows the position in Thailand.

However, in developing countries the land distribution is often skewed, tenure (if any) insecure and title transfer cumbersome. A key to smoothly functioning systems of land tenure is land registers supported by cadastral surveys. In many countries these are inadequate or missing altogether.

Often real estate is used as collateral for commercial ventures. However, if an entrepreneur has no suitable collateral the risks to the lender increase dramatically.

Legal systems in developing countries often favour the borrower by making it hard for the lender to foreclose on collateral. Originally, the intention was to protect small borrowers against unscrupulous money lenders, but today such laws may adversely affect the ability of state-owned commercial banks to collect on loans. This raises the cost of intermediation and weakens bank portfolios. In many countries in Southern Asia creditors have to sue the defaulting debtor for payment which can take several years. Cumbersome recovery procedure has led to new lending arrangements but redresses the balance to favour the creditor, for example, hire purchase and leasing.

'Prudential supervision

Prudential supervision by government authorities is needed for banks and other financial institutions and markets. In many countries bank supervisors concentrate on compliance with monetary policy regulations, foreign exchange controls, and economic policy regulations, rather than prudential aspects of financial monitoring. The goal of bank supervision should be to promote safe, stable and efficient financial system.

Among the points that need examination are:

(a) *Organisation.* Off-site supervision cannot assess risk adequately. Off-site supervisors should analyse reports periodically submitted by banks and on-site inspectors should verify their accuracy.

(b) *Licensing.* The purpose of licensing should be to ensure adequate capitalisation and sound management, not to limit entry or restrict competition.

(c) *Capital adequacy.* Banks need capital to absorb unusual losses. Standards of capital adequacy can take account of different degrees of risk. The recent agreement among major industrial countries on standards of capital adequacy uses risk weights and might serve as a model for others.

(d) *Asset classification and provisioning.* Banks should be required to make appropriate provisions for loan losses, to write off uncollectable assets and to suspend interest on non-performing loans.

(e) *Liquidity.* Liquidity ratio requirements are more often used for monetary policy purposes than as a prudential measure. Liquidity risk arises because banks borrow money at short maturities and lend it long-term.

(f) *Portfolio concentration.* Limits on lending as a percentage of a bank's capital are necessary to prevent concentration of risk in a single borrower, a group of

Financial and economic effects of land tenure in Thailand

THAILAND has a relatively efficient system of land tenure, title transfer and use of collateral. In 1901 the government introduced the Torrens system in which land titles are based on cadastral land surveys and registered with central land record offices. The use of land as collateral increased significantly, but land registration was concentrated in the more heavily populated areas. In the early 1960s half of the land area of Thailand was designated as national forest reserve, including land that was already being farmed. Most farmers in the forest reserve have no transferable title to their land, but the government has enforced the forest reserve policy flexibly and has not evicted farmers. About one-fifth of the farmed land does not have secure and transferable title.

Although uncertainty about continued possession does not seem to worry untitled farmers, lack of titled ownership affects their access to institutional credit. Untitled farmers cannot provide collateral and are limited to borrowing on the basis of personal or group guarantees or from money lenders. (Money lenders charge interest rates of 40-50%, compared with about 15% for loans from financial institutions.) In a sample study of matched groups of titled and untitled farmers, titled farmers were able to borrow on average three times more per acre of land. Secure land title not only affected the ability to obtain mortgage credit (which accounted for half of all credit among titled farmers) but also doubled access to unsecured credit.

Thanks to easier access to credit, titled farmers made significantly more land improvements and used significantly more machinery and other inputs. As a result they enjoyed 12-20% higher farm revenues and 12-17% higher productivity than untitled farmers in similar regions. The government has recently taken steps to improve land tenure for untitled farmers.

← 21
related borrowers or a particular industry.

(g) *Enforcement powers.* In many countries supervisors can do little to address unsafe and unsound banking practices.

(h) *Restructuring.* If supervisors are to dispose of insolvent banks quickly they must have authority to close a bank, to replace its management and directors, to dissolve existing shareholders' interest, to sell or transfer bad assets, and to merge, restructure or liquidate as necessary.

(i) *Audits.* Minimum audit standards should be set and the form and the content of the related financial disclosure should be prescribed.

(j) *Policy priorities and political will.* Prudential regulation must be backed by a political commitment to supervision and enforcement.

(k) *Developing financial systems.* There are pressures that are leading most developing countries to rethink the shape of their financial systems. These include the effort to apply some of the lessons learnt from past intervention and the need to adapt to the decline in foreign capital inflows. A third factor is rapid changes in financial technology and banking practice. The net flow of foreign capital to most developing countries is likely to be relatively small in the years immediately ahead. Developing countries will therefore have to rely primarily on domestic savings. Unless countries develop their financial systems, potential investors will have to rely primarily on retained earnings.

Demographic trends will affect the financial systems of developing countries. As the share of the population living in urban areas increases and as incomes rise, more people will live apart from the rest of their family. This combines with the fact that in urban areas people are required to buy or build a house, whereas in rural areas, typically, the owner builds his own house.

'Rethinking of financial systems'

Some governments provide concessional finance for housing to preferred borrowers, often civil servants. But others discourage mortgage lending so as to free resources for investment in industry. As urbanisation increases it will be important for governments to recognise the scale of housing investment, to improve laws concerning using housing as collateral, and to integrate housing finance on a non-preferential basis with the remainder of the financial system (see the accompanying box).

As more people will wish to make provision for retirement there should be an opportunity to develop contractual savings institutions such as life assurance companies and pension funds.

Commercial banks hold between 50% and 90% of the assets of all financial intermediaries in most developing countries and will continue to be at the heart of their financial markets for the foreseeable future. Often markets are dominated by a few large banks as a result of restrictions on interest rates, product

Housing finance

THE formal financial sector in most developing countries finances only a small share of housing investment. Mortgage credit from the formal sector was 28% of all housing investment in a sample of eleven developing countries, compared with more than 60% in OECD countries. The difference partly reflects the shallowness of financial systems in developing countries. Years of financial repression not only have minimised the role of the formal sector in housing finance, but have raised housing prices because negative real interest rates favoured investments in real assets. In another sample of eleven developing countries the average ratio of house value to annual household income was 5.5, compared with 3.0 in five high-income countries.

Several other factors explain the lack of smoothly functioning markets for housing finance in developing countries. Countries have often given little priority to housing finance. Because housing is a large investment, it requires long-term finance and in many countries inflation, interest rate controls and the instability of financial markets have deterred long-term lending of any kind. Inadequate legal systems diminish the value of housing as collateral and hence also diminish lenders' willingness to provide mortgage finance. And policymakers have been concerned that increased finance for housing might drive the cost of housing even higher.

Shelter is a basic human need. Secure ownership of a house can raise the welfare of the household that lives in it. Moreover, when a house is purchased through a mortgage, the buyer becomes, in effect, a contractual saver: the buyer is paying the lender for the right to live in the house while saving for its purchase. And when the title to a house can be easily transferred, the household gains a relatively riskless form of collateral. Furthermore, a housing loan, which is fungible with other household resources, may provide the funds that would permit the household to undertake a productive investment.

innovation, branching and the entry of new institutions. Greater freedom for banks to respond to market signals, to choose their own customers, to set interest rates, and to determine the location of branches will stimulate greater competition. The creation of new banks and other institutions should be stimulated by prudential requirements.

In small economies it may not be possible to ensure a competitive market for every financial product. A few commercial banks, supplemented by a postal savings bank, may be all a small economy can support.

Poor management has contributed to banks' difficulties in many countries. Improvements must be made in the skills of management and the banks' internal systems.

Issues in informal finance

The non-corporate sector accounts for between 30% and 70% of the labour force in some developing countries. A formal financial arrangement is not often well suited for the needs of the non-corporate sector, partly because of the sums of money involved. Also, non-corporate borrowers rarely have the collateral acceptable to banks.

The popular view of informal finance is that of powerful money lenders who exploit the poor through usurous interest and unfair seizure of collateral. In fact, informal finance is both extensive and diverse. Informal financial arrangement reduce transaction costs and risks in ways denied to formal institutions. Money lenders, for example, can operate out of their own homes and the services they provide are outside the control of the monetary authorities. Freedom from regulation allows informal agents greater flexibility and they must rely on local knowledge.

'Problem of poor management'

Not much long-term finance is provided through informal arrangements and where it does exist it is generally for housing finance. One example is key money as in Korea. A home buyer can lease his house in exchange for payment; after an agreed period the house and the money are re-exchanged. The interest that could have been earned on the money is the rental value of the house. The recipient of the key money may use it to finance a business venture or the purchase of the house, thus circumventing the lack of conventional mortgage finance.

Informal financial arrangements are limited. They do not move funds

24 →

The Grameen Bank: an alternative approach to noncorporate finance in Bangladesh

WHILE the government struggled to create a viable rural banking system in Bangladesh, a small private initiative was started in 1976 to help the landless without normal bank collateral to obtain credit. This programme has become the Grameen (Rural) Bank. The unique operating procedures of the Grameen Bank grew out of several earlier attempts to reach the rural poor and were a sharp departure from traditional banking. The bank's customers, who are restricted to the very poor, are organised into five-person groups, and each group member must establish a regular pattern of weekly saving before seeking a loan. The first two borrowers in a group must make several regular weekly payments on their loans before other group members can borrow. Most loans are to finance trading and the purchase of livestock.

By February 1987 the Grameen Bank was operating 300 branches covering 5,400 villages. Nearly 250,000 persons were participating, among them an increasing number of women, who accounted for about 75% of the total. The membership included about 13% of households with less than half an acre of land in the areas in which the bank was operating. Loans are small — on average, about 3,000 taka ($100) in 1985. By the end of 1986 about Tk1.5 billion had been disbursed, of which almost Tk1.2 billion had been recovered. Outstanding loans were thus about Tk300 million, with almost 70% held by women borrowers.

In sharp contrast to the Bangladesh commercial banking system, the Grameen Bank has experienced excellent loan recovery. As of February 1987 about 97% of loans had been recovered within one year after disbursement and almost 99% within two years. This good performance is reportedly attributable to a combination of factors: close supervision of field operations, dedicated service by bank staff, borrowing for purposes that generate regular income, solidarity within groups, and repayment in weekly installments. Another factor which encourages repayment is the borrower's knowledge that the availability of future loans depends on the repayment of borrowed funds.

Bank staff meet weekly with groups to disburse loans, collect savings deposits and loan payments, and provide training in financial responsibility. This means high operating costs. The ratio of expenses to loans rose from 9% in 1984 to 18% in 1986. These high costs have been partially offset by low-cost funds from international agencies.

← 23

over large distances and they segment local from national markets. However, the limitations do not call for completely new institutions. Indeed, formal intermediaries have often failed where informal arrangements have prospered. Formal institutions and policy makers might learn about the markets by studying informal arrangements more closely. The essential features are that transactions are undertaken by mutual consent, transaction costs are kept to a minimum, and lenders are able to reduce risk by using knowledge that they have already gathered from other social or business dealings.

Group lending schemes and co-

'Success of informal finance'

operative finance try to overcome the limitations of informal finance for the non-corporate sector.

There are various ways in which finance for the non-corporate sector can be improved:

(a) *Improving the legal environment.* Legal reforms could make it easier for small enterprises with relatively large financial needs to use formal services; such reforms include better definition and enforcement of property rights. Squatters and small farmers with clear land titles would then have an acceptable form of collateral. Laws meant to protect borrowers have often made loan contracts harder to enforce and have therefore raised the risk of lending.

(b) *Links between informal and formal finance.* This is becoming increasingly common in Africa.

(c) *Formal intermediation for the non-corporate sector.* Formal institutions can be encouraged to serve the non-corporate sector by various means including low cost rediscount facilities for targetted lending through commercial banks, mandatory lending targets and state supported lending institutions. These policies have created weak institutions and have retarded the development of an efficient financial sector. However, government supported credit programmes for the non-corporate sector can work.

Towards more liberal and open financial systems

A number of countries have taken steps to liberalise their financial systems. Interest rates have been liberalised in Argentina, Indonesia, Korea, Malaysia, Nigeria, the Philippines, Sri Lanka, Turkey and Uruguay. In other countries, such as Thailand and Yugoslavia, interest rate ceilings have been managed more flexibly. Several countries, such as Korea and Chile, have privatised commercial banks. Directed credit programmes have been reduced in Argentina, Chile, Pakistan and Turkey, and interest rate subsidies have been reduced or abolished in Korea and the Phillippines.

'Commercial banks privatised'

However, it is difficult to disentangle the effects of financial reform from those of other reforms that were taking place at the same time. Generally though, it seems that financial liberalisation has helped to mobilise resources through the formal financial system.

The attempts at financial sector reform point to certain pitfalls, although the longer-term benefits are considerable. The clearest lesson is that reforms carried out against an unstable macroeconomic background can make the instability worse. In contrast, countries with reasonable macroeconomic stability have been able to avoid the pitfalls of high real interest rates, fluctuations in the real exchange rate, and insolvency among firms and banks. A second lesson is that where prices are distorted owing to protection or price controls, financial liberalisation may not improve the allocation of resources. The third lesson is that direct intervention in finance must be replaced by an adequate if less invasive system of laws and regulations. A fourth lesson is that the authorities must anticipate how

'Liberalisation of interest rates'

reforms will change relative prices and how these changes will affect different groups. Many developing countries will be unable to liberalise as extensively as some of the high income countries.

Reforms should start by getting the fiscal deficit under control and establishing macroeconomic stability. Directed credit programmes can then be scaled down and the level and pattern of interest rates adjusted to bring them in line with inflation and other market forces. The foundations of finance, that is the accounting and legal systems, procedures for the enforcement of contracts, disclosure requirements, and the structure of prudential regulation and supervision should also be improved. In the next stage financial reforms should seek to promote the development of a greater variety of markets and institutions and to foster competition. The government can then move to the final stage, full liberalisation of interest rates, the elimination of the remaining credit programmes, the relaxation of capital controls, and the removal of restrictions on foreign institutions. ■

World Development Report 1989 is published for the World Bank by Oxford University Press, 1989.

Valuation of properties in Europe

THE European Community Mortgage Federation has published a study in comparative law, *Study on the Valuation of Property in the EC countries,* based on a meeting held in Munich, West Germany, in January 1988.

At that meeting national experts noted that they all used three methods of valuation, either individually or in a complementary fashion—

(a) *The comparative value procedure.* This involves finding the greatest possible number of examples of recent sales of property comparable to that valued, and taking a common measure between those comparable properties and the one to be valued. This method is applied predominantly to residential properties.

(b) *The real value procedure, or historic method or estimate of land and building.* The property is considered as a durable good, and the value comprises the costs of the basic elements, that is, land value, building costs and cost of renovation.

(c) *The value of yield procedure.* The property is considered as a capital good, and the value is the current value of the income stream in the future after deduction of financing costs. This method is used principally for industrial and commercial buildings.

The experts agreed to recommend to the European Commission a definition of the "lasting market value", which is important for granting long-term credit —

"The lasting market value is determined by the price which could be obtained at the time to which the valuation refers, in the context of normal business transactions, according to the current legal provisions, the individual characteristics, the general condition and the situation of the real property (market value). Appropriate deductions are to be made if characteristics determining the value of the real property are not lastingly ensured or its yield, in the case of proper management by any occupant, cannot be obtained on a permanent basis."

They also recommend that the valuing of properties be described in a concise document using three valuation methods —

'The lasting market value'

(a) An estimate by comparison (sufficient if a standard property is involved which is not rented out, and for which there is a substantial demand).
(b) An indication of the cost price, separating the cost of the land and the cost of the building.
(c) An estimate based on the current rent or the normal rental value.

The book largely comprises chapters covering the 10 countries studied: Belgium, Germany, Denmark, Spain, France, United Kingdom, Greece, Italy, the Netherlands and Portugal. The country studies have a common format, thus facilitating comparison between countries. Following is a brief summary of the sections of the report dealing with the application of valuation procedures to one-family houses.

In *Belgium* the comparative value procedure and real value procedure are used. However, the property is only one element among others which contribute to the assessment of the credit. Consideration is currently being given to the use of credit scoring techniques. A valuation is mandatory —

(a) For tax purposes where the purchase or construction of a first home is involved in order to be able to determine whether the housing is low cost housing, which enables the capital repaid to be deducted in full for tax purposes, or middle class housing, which enables only partial deduction of the capital repaid for tax purposes.
(b) For the purposes of determining the proportion of a building to be used for professional purposes where a loan is involved which is the subject of interest subsidies.

Mortgage companies can grant loans of up to 100%, but where loans exceed the normal loan to value ratio (60% to 80%) they will require additional guarantees.

In *Germany,* one-family houses are valued primarily according to the real value procedure. The value of the yield is used as a control. However, older one-family houses, especially larger ones, are subject to substantial depreciation if their design and equipment no longer fully correspond to current requirements. In such cases there will be a corresponding abatement in the real value. Owner-occupied flats are judged and valued roughly according to comparative values (that is, the value per square metre of useful area). The value of the yield is more important for the valuation of owner-occupied flats than for one-family houses. In less desirable areas it corresponds to the market value. Here, owner-occupied flats are traded at 10 to 14 times the gross annual rate, whereas in better areas the multiple is between 18 and 28.

In *Denmark* the valuation of newly built owner-occupied houses cannot exceed the stated actual construction costs, including site costs and other costs, unless own work is included in the valuation. Where houses are built with a view to sale the valuation cannot exceed the expected price, including sale costs. The valuation of a newly built house has to be within a reasonable original price for which the institution estimates such a house can be built using rational construction methods.

In *Spain,* for one-family houses the market value is calculated as the value of the capitalised yield (in the case of housing being rented), and the maximum legal value (if the house comes under the system of official protection). For houses in the process of being built it is possible to calculate future value according to the time needed to complete the work and the market trend.

In *France* the comparative value procedure and the real value procedure are preferred for one-family houses. Under the comparison procedure examples of recent sales are looked at in relation to the house under consideration. The registered sale prices are converted either into a figure per square metre of habitable or surface area, or into a figure per square metre of the external dimensions of the developed surface area, where it is appropriate. Under the real value procedure the cost price is taken for a similar or comparable house to the one to be valued.

In the *United Kingdom* the comparative basis of valuation is generally used for residential property. In times when the property market is stable, and as long as there is sufficient turnover across the range of property to allow hard evidence to be collected, the method is straightforward. The problem in England and Wales is that there is no open public record of prices achieved on property sales. In an unstable market the position is different and valuation can become an art rather than a science.

In *Greece,* one-family houses have assigned to them a lending value which is computed by multiplying the total payable rent per month by an index ranging from 140 to 220. Monthly rents are determined by considering information about rents paid for smaller properties in the same area.

In *Italy* the position is complicated. In the case of loans for house purchase the valuation of the property is based on research of the most likely market value being performed by a synthetic comparative estimation (unit value per square metre or for each room, etc) which must be based on the best updated market-derived data. This has to be confirmed by the addition of the various items which contribute to form the final sale price.

In the *Netherlands,* the definition of the lending value is the price that the property will fetch at an auction. Proceeds from selling by auction are always lower than a sale in normal market conditions because buying and selling by auction is costly, and the buyer does not have the same guarantees concerning the property as with a normal transaction. The lending value is of importance for the supervision by the Dutch central bank of the solvency of the lending institution.

In *Portugal* the comparative value procedure is used. ■

Study on the Valuation of Property in the EC Countries, English, German and French editions, can be obtained at the price of BEF450 per copy (postage included) from ECMF, Avenue de la Joyeuse Entrée, 14/2, B-1040 Brussels, Belgium.

Nearing completion . . . but how will it be valued?

Recent developments for Canadian 'near banks'

By Philip F. Bartholomew

CANADIAN depositories experienced difficulties in the early 1980s not unlike those experienced by banks and thrifts in the United States. Because of these problems, regulators of depositories were restructured. Near banks (thrifts) emerged as viable competitors.

Depository institutions, which were quite stable and prosperous in the years following Word War II, began to run into difficulties in the late 1970s. Failures mounted as economic conditions changed, rates rose and mismanagement occurred. The national deposit insurance corporation started running deficits; the government studied matters in an effort to cope.

Is this a description of the U.S. thrift industry? Yes, but it is also a description of the Canadian financial services industry. While Canadian depositories experienced problems similar to those in the United States, the difficulties for Canadian depository institutions appear to be past. The chartered bank industry has consolidated to a few very healthy institutions (although the chartered banks' exposure to the debt of Third World countries is still not fully addressed).

The trust and loan and mortgage loan companies have also consolidated. Canada's co-operative societies suffered similar problems to those experienced by other depositories, but they continue to adapt to a changing financial environment and remain an important competitor for retail financial services.

Chartered banks

Until recently, the Canadian banking, insurance and securities industries were kept separate. There are four types of financial institutions — chartered banks, near banks, insurance companies and securities dealers — known popularly as the four pillars. Although the distinctions among the four types are eroding, many traditional and legal differences persist, and Canadians remain generally opposed to the commingling of financial with non-financial institutions.

Because of Canada's geography, the chartered banking business, the largest of the four financial industries, was allowed to become highly concentrated. As of the end of 1987, there were only 11 domestically owned chartered banks, of which six are very large institutions that operate extensive branching networks.

To counterbalance the negative aspects of such concentration, Canada has two important legal restrictions. First, chartered banks must obtain their charters through an Act of Parliament. Second, domestically owned chartered banks must be widely held (no more than 10% may be owned by a single individual or organisation).

The notions of chartering and wide ownership are crucial to understanding Canadian preferences in the trade-off of efficiency, safety and competition as it applies to financial institutions. Canadians prefer to regulate, and to administer regulations, more through the honour system than through active supervision. But because of recent difficulties in the depository institutions' industry, and because of a market-driven trend toward commingling of financial institutions, Canadians are reluctantly being forced into creating a system that requires more active supervision.

Domestically owned chartered banks are called Schedule A banks, and foreign-owned chartered banks are called Schedule B banks. (Currently, the only Schedule B banks operating are subsidiaries of foreign banks.) Foreign banks were permitted entry in 1980, but are subject to special capital and asset regulations that are more restrictive than those for Schedule A banks. At the end of the third quarter of 1988, there were 58 Schedule B banks controlling almost 12% of bank assets.

Near banks

There are three other types of Canadian depository institutions besides the chartered commercial bank. These are collectively referred to as near banks, and they resemble US thrifts. The three types are trust and loan companies, mortgage loan companies (also known as loan companies) and co-operative societies (credit unions and *caisses populaires*).

Although chartered banks appear to dominate Canadian depositories in assets (66% of the industry total in 1988), examination of the deposit market better reflects the importance of the near banks. In 1988, chartered banks held 52% and near banks held 48% of total deposits (*Table 1*). In comparison US commercial banks held 57% of the nation's deposits in 1988. Other US depositories (thrifts and credit unions) held 43%.

Canadian near banks developed to satisfy the demand for consumer savings and mortgage lending services, which chartered banks had traditionally ignored. After World War II, chartered banks began to concern themselves more with consumer financial services.

Trust and loans were closely associated with chartered banks until the Bank Act of 1967 limited chartered bank ownership of a trust company to 10% of the voting shares. Since the 1960s, trust and loans have been providing consumer savings and mortgage credit. By the 1970s trust and loans had become a major competitor of the chartered banks for consumer financial services.

Mortgage loan companies were originally patterned after British building societies (as were US savings and loan associations), but they have evolved into mortgage lending subsidiaries (either wholly or jointly owned) of chartered banks, trust and loans, and other financial institutions.

Table 1
CANADIAN DEPOSITORY INSTITUTIONS
(Third Quarter 1988)

Depository Institution	*Total Deposits (Millions of C$)*	*Percentage of Total*	*Total Assets (Millions of C$)*	*Percentage of Total*
Chartered Banks	233,693	52.4	490,994	66.1
Trust & Loan Companies	90,093	20.2	101,487	13.7
Mortgage Loan Companies	71,262	16.0	90,832	12.2
Co-operative Societies	50,891	11.4	59,864	8.1
TOTAL	445,939	100.0	743,177	100.0

Source: Chartered bank and co-operative society data from Bank of Canada. Trust & Loan and Mortgage Loan data from Statistics Canada.
Note: Canada also has a system of small federal and provincial government savings institutions. In 1986, these institutions held $5 billion or 2% of all deposits in Canada.

The Canadian co-operative society movement was strongly influenced by the US credit union movement. This movement (and the now non-existent savings bank industry) started in French-speaking Canada — primarily in Quebec. *Caisses populaires* were organised along parish lines and were established principally to foster savings. Credit unions developed as non-French-speaking co-operative societies and were formed to serve the needs of small borrowers.

Residential mortgage market

In 1988, depository institutions held 87% of outstanding residential mortgages (*Table 2*). Life insurance companies and other non-depository financial institutions held the remaining share. The depository-institution share of this market has been increasing since the 1950s (in 1978, their share was 75%). This increasing penetration was due primarily to increased mortgage activity by chartered banks.

Before 1954, chartered banks were prohibited from making mortgage loans. As a result of the Bank Act of 1954, and revisions of the National Housing Act (NHA), chartered banks were permitted to hold NHA mortgages. The Bank Act of 1967 permitted chartered banks to make conventional residential mortgages, but in an amount not greater than 10% of their holdings of domestic deposits. This restriction still applies and is the principal reason for the chartered banks' use of subsidiary mortgage loan companies. The Bank Act of 1980 forced all mortgage loan company subsidiaries of chartered banks to become wholly owned subsidiaries of the parent banks.

Mortgage instruments

There are two types of residential mortgage in Canada — conventional and NHA (government-guaranteed)

30 →

Table 2
CANADIAN RESIDENTIAL MORTGAGE MARKET
(Thousands of Canadian dollars)

Type of Institution	*1978 Outstanding Residential Mortgages*	*1978 Per cent of Total*	*1988 Outstanding Residential Mortgages*	*1988 Per cent of Total*
Chartered Banks (Note 1)	18,438	27.7	75,218	40.8
Trust & Loan and Mortgage Loan Companies	21,590	32.4	57,340	31.1
Co-operative Societies	9,888	14.8	26,896	14.6
Life Insurance Companies	7,086	10.6	12,997	7.0
Other Financial Institutions	9,622	14.4	11,938	6.5
TOTAL	66,624	100.0	184,389	100.0

Source: Bank of Canada
Note: Totals may not add properly due to rounding
Note 1: Includes mortgages held by bank mortgage loan company subsidiaries

← 29

mortgages. Currently, there is no well-developed secondary market for residential mortgages; however, the government is trying to nurture one.

The Canada Mortgage and Housing Corporation (CMHC) is a Crown corporation charged with administration of the NHA. It both directly issues mortgages and governs and insures NHA mortgages made by qualified financial institutions. In 1961 the CMHC was ordered to sell a portion of its directly issued NHA mortgages to foster the development of a secondary mortgage market; however, few mortgages were sold even though CMHC was authorised to be a lender of last resort to institutional holders of NHA mortgages. In December 1986 CMHC successfully introduced a mortgage-backed securities programme. These securities have been well-received by securities dealers and investors; a secondary mortgage market may now develop. Also the introduction of these mortgage-backed securities may foster the offering of longer-term mortgages.

Mortgage instruments in Canada, unlike those in the United States, are short term. In the 1970s the term to renewal averaged five years, although the amortisation was for a longer period. At the end of the term to renewal of the mortgage, the borrower could pay off or refinance the remaining principal. These "roll-over" mortgages were, in effect, adjustable-rate mortgages. However, the rate and other conditions of the loan could be amended at the end of the term to renewal.

In the early 1980s additional versions of the rollover mortgages were introduced to address higher interest-rate levels and rapidly increasing property values. A graduated-payment mortgage was developed that allowed the monthly payment to be initially low and increase over the amortised life of the loan.

Changes were made to the rollover mortgage so that renewable-term mortgages could have rollover terms as short as six months. Variable-rate mortgages were also created that had fixed monthly payments and regular adjustments to outstanding principal based upon interest rate fluctuations.

Table 3
ASSET AND LIABILITY STRUCTURES
(Third Quarter 1988)

	Trust and Loan Companies		*Mortgage Loan Companies*	
Liabilities	*Millions of Canadian Dollars*	*Per cent of Assets*	*Millions of Canadian Dollars*	*Per cent of Total*
Savings Deposits:				
Checking	9,153	9.0	19,772	21.8
Other	13,768	13.6	6,187	6.8
Total Savings Deposits	22,921	22.6	25,959	28.6
Term Deposits:				
Less Than 1 Year	8,016	7.9	3,180	3.5
1-5 Years	39,593	39.0	41,804	46.0
More Than 5 Years	150	0.1	9	0.0
Other	19,413	19.1	311	0.3
Total Term Deposits	67,172	66.2	45,304	49.9
Bank & Other Loans:	1,441	1.4	3,395	3.7
Other Liabilities:	5,119	5.0	12,428	13.7
Total Liabilities	96,653	95.2	87,086	95.9
Shareholders' Equity:	4,834	4.8	3,746	4.1
Total Liabilities and Equity	101,487	100.0	90,832	100.0

Source: Statistics Canada

Performance of loan companies

Trust and loan and mortgage loan companies are similar in their asset and liability structures (*Table 3*). Trust and loans hold a higher percentage of assets in liquid and security forms than mortgage loan companies, which are typically associated with other financial institutions. This explains the higher holdings of mortgage loans relative to other assets by mortgage loan companies. Both types of institution engage in non-mortgage lending, but mortgage loan companies are prohibited from extending business loans unless they finance real estate.

Mortgage loan companies receive a high percentage of funds from non-deposit sources — principally, loans from banks and other institutions associated with the companies. Both types of institution hold about the same percentage of term deposits relative to total assets. Trust and loans have developed extensive checking and regular savings services.

Near bank regulation

Near banks are regulated by either federal or provincial agencies or by both. For example, federally chartered trust and loan and mortgage loan companies are supervised by the Office of the Superintendent of Financial Institutions (OSFI), which was created in 1987 through the merger of the Office of the Inspector General of Banks, or OIGB (which supervised chartered banks), and the Department of Insurance (which supervised federally chartered trust and loan, mortgage loan, and insurance companies). Provincially chartered institutions are supervised by the provinces in which they are incorporated.

Federal and non-Quebec provincial institutions subscribe to deposit insurance from the Canada Deposit Insurance Corporation (CDIC), which was established in 1967. The CDIC insures deposits up to C$60,000 per depositor (increased in 1983 from C$20,000). Trust and loan and mortgage loan companies incorporated in Quebec have Quebec deposits insured by the Quebec Deposit Insurance Board (QDIB).

In addition to providing deposit insurance, the CBIC and QDIB provide liquidity to insured institutions. Eligible institutions have either direct or indirect access to the Canadian Payments Association (CPA) for cheque clearing. Currently, all institutions that offer "chequable" deposits must maintain reserves against these balances in accordance with Bank of Canada regulations. These reserve requirements will probably be phased out for both near and chartered banks, but clearing balances will still be required by the CPA.

Recent failures

As in the United States, depository institutions in Canada were highly stable in the post-World War II period. Difficulties began in 1979; between then and 1985 some 30 trust and loan and mortgage loan companies experienced severe financial difficulties. Despite the problems, not all institutions were closed. Between 1980 and 1987, 15 of these institutions were closed or placed in a form of receivership and merged with other institutions or liquidated. Some chartered banks subsequently suffered similar problems.

There were two principal reasons for the problems that developed in the trust and loan and mortgage loan industry. One was general Canadian economic conditions. The other was misbehaviour and the mismanagement of some institutions.

Beginning in the 1960s, regulations were relaxed on trust and loan and mortgage loan companies. In 1961 the loan-to-value ratio for residential mortgages was increased from 60% to 66.6%, and further increased to 75% in 1975. Within the same period, the same institutions had their capital-to-asset ratio requirements reduced: from 8% to 6.67% in 1965 (a change in leverage ratio from 12.5 to 15) and then to 5% — in 1970 for trust and loans and in 1974 for mortgage loan companies — bringing the leverage ratio to 20.

Higher interest rates between 1979 and 1982 caused some institutions to have a mismatch of asset yields and liability expenses. Property values rapidly escalated between 1975 and 1982 — as certain regions benefited from higher world energy prices — but later paralleled the collapse of world energy prices. Because of the high interest rates, some government assistance was provided to those refinancing their mortgages. This assistance and the nature of Canadian mortgage instruments are considered to be the reasons most mortgage lending institutions weathered the high interest rates. However, the collapse of western real estate prices, especially in energy-rich Alberta, caused some institutions to close their doors.

In addition to the problems associated with general economic conditions, some trust and loan and mortgage loan companies experienced poor managerial judgment or explicit malfeasance, according to Helmut H. Binhammer, dean of arts at the Royal Military College of Canada. In his book, *Money, Banking and the Canadian Financial System,* Professor Binhammer notes that during the 1970s and early 1980s, many trust and loan and mortgage loan companies were formed or acquired by persons who did not live up to the standards of conduct and responsibility usually associated with chartered financial institutions.

"Some . . . failed because . . . [of] fraudulent practices", he wrote. "Many failed because of self-dealing . . . abuses. In nearly all cases of failure, there was inappropriate portfolio diversification." Binhammer also places part of the blame on an antiquated regulatory system and lax enforcement of existing regulations.

The problems experienced by near banks were subsequently experienced by smaller regional chartered banks. These institutions had been established during the 1970s and were located mostly in the western provinces. Two of the regional chartered banks failed and most of the others were merged or sold through arrangements with the bank regulators. The domestically owned banking industry consolidated from 15 banks in 1984 to eight banks in 1986.

Regulatory restructuring

Problems with the regulatory system's structure and the system's traditional methods of operation may have contributed to the costs associated with the chartered and near bank failures of the early 1980s. Different agencies have performed non-overlapping regulatory functions. This has created some difficulties.

The former Office of the Inspector General of Banks (OIGB) provided examination information on chartered banks to the CDIC and the Bank of Canada, enabling them to carry out their respective functions of deposit insurer and lender of last resort. On-site bank examination, however, was not carried out by the inspector general's office because of manpower limitations. Rather, each chartered bank employed two accounting firms to examine the books regularly.

The chartered bank's auditors were responsible for self-examination. These auditors and the outside accounting firms reported their findings to the bank's board of directors, who in turn submitted the reports to the inspector general (who could, and did, consult the external accounting firms independently). The OIGB did conduct on-site "visitations" with each of the chartered banks. These visits were typically with the senior management, and the topics for discussion were capitalisation, operation, and performance.

The Estey Commission, formed to

32 →

← 31

examine the failures of two chartered banks, criticised this examination process, which is popularly known as a "wink and nod" system. The OIGB had not considered itself responsible for conducting audits that would determine misbehaviour, which was a task considered to be the responsibility of internal audits. The OIGB also did not consider itself responsible for ascertaining that the books were correct or for asset classification, which were considered to be the responsibilities of the external auditors. Unfortunately, the external auditors did not consider their responsibility to include asset classification. It appears that the OIGB was unaware that the external auditors were not classifying assets rigorously (if at all).

The OIGB was aware that certain chartered banks were experiencing difficulties. Unfortunately, the only disciplinary power held by the chief bank supervisor — the inspector general — was the recommendation to the minister of finance that the bank in question have its charter revoked. This was considered to be too extreme a measure. The inspector general did effectively use moral suasion, but the circumstances of the early 1980s were more than moral suasion could address. Because the inspector general did not know the full extent of the troubled bank difficulties and because the inspector general used traditional disciplinary practices, the troubled banks were not closed quickly.

Near bank examinations

In contrast to the examination process for chartered banks, the Department of Insurance (DOI), the former near bank federal supervisor, conducted on-site examinations of federally chartered trust and loan and mortgage loan companies. However, its manpower, while considerably greater than that of the OIGB, was small relative to the problems it encountered.

When problem chartered or near banks were identified as such, a number of regulatory actions were available. Institutions could be kept open through arrangement of liquidity loans (actually, they turned out to be solvency loans) from the CDIC, the Bank of Canada, or through loan packages from the large chartered banks co-ordinated by the OIGB, the DOI, the minister of finance, the CDIC and the Bank of Canada.

Unfortunately, these efforts only prolonged and deepened the problem. Moreover, institutions that were deemed to be in difficulty were not always placed in formal receivership; thus, the original management maintained control.

The CDIC preferred not to close immediately an institution that had been determined to be insolvent. (The CDIC also had only a few employees.) Rather, the CDIC arranged with other institutions, through agency and operating agreements, to administer the insolvent institution during a winding-down period. During the winding down, the CDIC advanced or guaranteed funds that the agent used to meet depositors' claims. In so doing, the CDIC, in effect, paid off on both insured and uninsured deposits.

In 1985, the government announced that all depositors would be protected during the liquidations of two chartered banks. It would appear that this was the CDIC policy that was in effect for all institutions that the CDIC closed or wound down between 1979 and 1987. After 1985, the CDIC changed its method of dealing with insolvent institutions; it no longer gave preference to the winding-down approach.

The CDIC also did not have the power to issue cease-and-desist orders. It could assess a special surcharge to institutions that the CDIC deemed to be non-compliant with CDIC bylaws, especially those that pertain to standards of sound business and financial practice. This was found to be a useful disciplinary tool for normal operations, but completely valueless in application to institutions that were destined for closure.

Insurance Fund deficit

The CDIC's insurance fund has been in deficit since 1983. In 1987, the deficit was $1.1 billion, down from $1.2 billion in 1986. These figures understate the extent of losses to the public from the chartered and near bank failures. The insurance fund deficit does not account for loans that will never be repaid, which had been made to now-failed institutions by the Bank of Canada, provincial governments and the largest chartered banks.

The problems of the CDIC were examined by a federal committee (the Wyman Committee) and several other provincial and federal government inquiries. The chartered bank failures of 1985 were the subject of inquiry by the Estey Commission. Several changes were initiated as a result of all of the government inquiries. The OIGB and DOI were merged into the OSFI. The OSFI has taken an active stand to develop on-site examinations of all federal depository institutions.

A group of retired bankers has been employed as a consultant group to the OSFI to conduct intensive examinations of identified problem institutions. The OSFI and CDIC have been granted powers to issue cease-and-desist orders. The manpower of both the OSFI and CDIC have been dramatically increased.

Considering the proximity of Canada to the United States and the large and increasing trade relationship between the two countries, the Canadian regulatory policies affecting depository institutions should be of continuing interest to U.S. depository institutions and their regulators. ■

PHILIP BARTHOLOMEW is financial economist with the Federal Home Loan Bank Board (USA).

Impact of technological change in the Australian financial sector

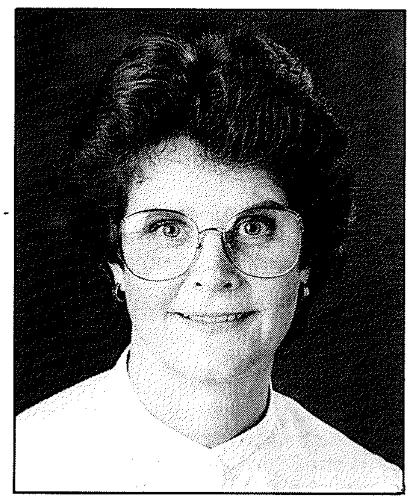
By Germaine Kennedy

AUSTRALIA'S financial sector is in a state of rapid change; and technological change is a potent force fast revolutionising the working world for both men and women. Technology has transmogrified the Australian financial institution socially, culturally, politically and economically.

With the de-regulation of the banking system and the introduction of computerisation, the speed and accuracy with which business must now be conducted in order to gain competitive advantage makes more critical than ever before the need to have the logistics of information handling properly sorted out.

The financial organisation's performance invariably depends on this, and to remain competitive institutions look closely at any developments that may occur within the entire financial sector. In fact, Australia's financial sector has been one of the most progressive in adopting new and modern technology.

Industry competition can be likened to a war between nations, with warlike "games" played and new products, techniques, strategies and the like playing the role of "weapons", with technical innovation being analogous to the processes and problems of technical innovations in a nation's military functions. Banks, building societies and credit unions compete for funds in a like manner. Technological innovation thus threatens the hierarchy of power and prestige upon which the financial institutional system of power is built, for political structure is tied to an



established technology and a radical technological shift disrupts the organisational structure.

The latest technological introduction of a universal electronic banking card has set up a three-way electronic banking contest between Westpac, the Commonwealth Bank and those in the latest Bankcard deal, with non-bank financial institutions on the periphery of using the banks' "Gateway" or "Shared Common Access" systems. Not to be outmanoeuvred, building societies have their own national hook-up system.

In the 1960s technological change in computerisation provided a tool for gathering data and processing information through a single data bank, thus allowing senior managers to retain centralised control, despite organisational growth and rapid branch development. Consequently, the first impact of the computer was to support growth in organisational size and complexity, and to consolidate centralised control rather than foster delegation and decentralised decision making.

Those institutions which failed to keep abreast of technological developments were gradually absorbed through amalgamations, mergers and transfer of engagements into other larger organisations. Such rationalisation projects were successful in achieving savings through economies of scale in advertising, stationery and printing, and in computerisation, the latter leading to a rapid diversification and integration of services.

To a far greater extent than is generally realised, the Australian financial sector provides objectives, formal and informal rules, values, styles of personal behaviour and a language of its own as it shapes the identities of its members, drawing on resources of emotional energy in the same manner as do other non-corporate societies such as family and church. Technological change within the financial sector was the catalyst which altered the cultural and social composition of individual organisations.

First, changes occurred in the distribution of responsibility — the relatively small number of technicians needed to programme and debug the equipment and to carry out preventive maintenance were often able to hold an inordinate level of power because of their intimate knowledge

34 →

← 33

of the technology. *Secondly,* there is a marked alteration in the divisions in time spent on tasks, and this change in job content has resulted in a consequent contraction of career paths and limited job opportunities. *Thirdly,* there has been a change in relationships within the organisation, from an interaction between people to an interaction of people with machines.

In one investigation, Friedlander and Brown found that what job changes were made, and how they were carried out, were dependent in important ways on which technology was involved. They point out that in a continuous process technology, such as the advanced information technology introduced by financial institutions — banks, building societies and credit unions — it may be nearly impossible to design jobs with high task identity.

Thus, technological changes have profoundly affected the nature of clerical, professional and managerial work, created a new "elite", and altered the distribution of the sexes within the office environment.

While there has grown a small group of "elite" personnel, such as the programmer, analyst and trainer, these areas remain heavily male-dominated. At the same time, there has been a reduction in the need for a flexible, broadly-trained clerical workforce as lowgrade clerical, key-board, word-processing and teller or "manual" duties replace tasks which took innate ability and experience to master.

The computer's capacity to process vast amounts of information has increased the demand for data, on the assumption that more data results in more rational, better-informed decisions, and the introduction of the computer has not reduced the size of the clerical staff.

However, while technological change has meant that new skilled jobs, such as programming, are created as well as routine jobs such as transporting deck tapes and key-punching, clerks are rarely upgraded to fill these new jobs. Instead, professional and technical workers, recruited direct from outside an organisation, form a new, higher-status group within the office hierarchy. The mass of low-level clerical jobs has been filled by an increasing female component, with the managerial or "task design" elements remaining the male preserve in the distribution of responsibilities.

In its social impact, technological change in the financial sector has required a willingness to adapt to change by all employees. Managers, professional and clerical personnel are all required to interact directly with computer terminals, often an integral part of their duties or responsibilities. Because the system is on-line, the relationship between the user and the system is more immediate, and therefore has the potential to affect more employees than ever before.

At the clerical level, eye and finger co-ordination, speed and dexterity become important job requirements as mental skill and knowledge are made technologically obsolete. This has resulted in an increase in operator fatigue and tension exacerbated by change in interdepartmental patterns of accountability for errors and the creation of more tedious routine requirements.

Certainly, computerisation has allowed the concentration of information under close scrutiny in the hands of top management. However, because of its immediacy, communication patterns at higher executive levels have been altered to allow vertical and horizontal communications, and the decision-making processes to become fraught with stress. For top management, the cumulative effects of all these changes in the institution may be overwhelming.

At middle-management level, there has also been an unforeseen social impact from technological change with the financial sector. As the system increases specialisation and separates the speciality from interdependent activities, many middle managers find themselves becoming isolated and unable to obtain performance feedback. Thus, they "lose touch" with other areas and become physically and informationally isolated from other steps in the process. Often they cannot respond to customers and make autonomous decisions, or must provide them with meaningless promises about the situation.

This has resulted in tension and mutual fault finding between customer service and data processing personnel. Socially and culturally, then, technological change has been a mixed blessing. The technology was the easy bit, for with planning and co-ordination it worked.

Some results of technological change in the past decade in the financial sector have been very positive. Because of the generally higher educational levels being achieved by promising younger staff and their growing familiarity with the technology, their view of their market ability is increasing and thus they tend to change jobs more frequently as economic conditions permit.

This has increased contact with technologies in other organisations, and, although research and technological innovation is, in the main, exogenous to a particular system, inter-organisational exchanges of ideas have on the whole been most positive.

Australia may not have the largest banks, building societies or credit unions in the world, but it does have some of the most progressive. It is imperative, in terms of national cost-benefit analysis, that, rather than allow the technology to remain unexploited, every organisation to which it is relevant should be brought together to act co-operatively so as to realise its potential benefits.

This has become a feature of the Australian financial sector, with agreement between such banks as

Westpac Banking Corp and The Commonwealth Banking Corp to share each other's electronic funds transfer (EFT), point-of-sale (POS) and automatic teller (ATM) network; credit union use of the National Australia Bank's ATM network; and the national hook-up of the building societies' switch.

The impetus for cost-saving ideas can come from technologies operating elsewhere in the industry, and an operating process in which equipment is purchased from a vendor may be modified, adapted and developed to suit particular internal requirements until the "bugs" are worked out, but this co-operation is a positive aspect of technological change in the financial sector, and one in which continued acceleration in the future appears inevitable.

Naturally, many innovations are designed to overcome specific operating problems: an equipment breakdown, a change in the process and the like, and these components have to be considered as economic costs in estimating the benefits of technological change. Capital costs of installation, general maintenance cost, staff training, operating wages bills, output per unit of operating time, materials consumption and wastage, and repair costs are taken into account by management before the introduction of the technology.

However, there are many "hidden" costs which are overlooked. These include those occasioned through loss of productivity while training staff to use new equipment, staff attending workshops, industry association meetings, inter-firm visits, schools of administration and the like. It would be anticipated that such involvement would originate cost-saving ideas which would balance involvement costs.

Other "hidden" costs would include delay costs occasioned by lack of skilled technicians to effect repairs to terminals or printers, and cost of adjustment while the public accept new services such as industry plastic cards and automatic teller machines.

Politically, technological change has also been beneficial to financial institutions in Australia. Both State and Federal legislation as envisaged in the Martin and Campbell Reports has given organisations the ability to diversify their services further, and this has been a tremendous stimulus for the financial sector to introduce the latest technology. For instance, electronic funds transfer (EFT) and point-of-sale (POS) dispense with the paperwork traditionally associated with transfering money from bank to bank and account to account, with all transactions carried out electronically.

Institutions benefit with a reduction in the amount of paper which they would otherwise have to produce; customers benefit from delay-free transactions for direct crediting of salaries and dividends or for payment of amounts owing for accounts, insurance premiums, subscriptions and the like.

Of course, efficiency in handling information processing does not always translate directly to profits, even if it does make operational environment changes and alterations to the social and cultural aspect of working life. Nevertheless, there has been little agitation within the financial sector in industrial relations as a result of technological changes. One report which examined the experience of selected Australian industries over the past 20 years found that the financial sector had increased its employment, despite rapid introduction of technology.

There is little trade union literature so far available or concerned with electronic data processing in Australia, possibly because, as the Federated Clerks Union reported to an ACTU seminar, "Our experience has been that, with some notable exceptions, nobody has been retrenched because of the introduction of computers."

Also, while regulation of pay and physical working conditions of organised labour have concerned Australian trade unions, the issue of employment security has attracted little interest until recently and unions generally have not sought to infringe upon management's prerogative to introduce new technology or retrench labour.

Nevertheless, marked changes in both the labour market and the cost competitiveness of computer technology in recent years have forced trade unions to adopt a more aggressive stance on the issue of redundancy protection.

Australia has always been progressive in its approach to technological changes which are widely perceived as a means of generating a higher standard of living by maximising the benefit to be gained from Australia's resources and by minimising natural obstacles. This has meant acceptance by the public of electronic services to a greater degree than overseas. Financial institutions will continue to forge the path ahead in technological changes in the face of rising costs of maintaining staff, shorter working hours, greater job mobility and heightened expectations of employees of the organisation with which they work.

A combination of cost reduction and competitive pressures are forcing Australia's financial institutions to discontinue services that do not contribute directly to achievement of organisational goals, with managerial expectation of staff increasing. In effect, it is people who are really the key to the success or failure of a computing project or of technological change; acceptance by both society, employees and the general public.

It is of the utmost importance that Australia's financial institutions continue to consider the people side of projects in the applications system development environment of technological change. ■

GERMAINE KENNEDY is assistant to the managing director of Wide Bay Capricorn Building Society, Queensland, Australia.

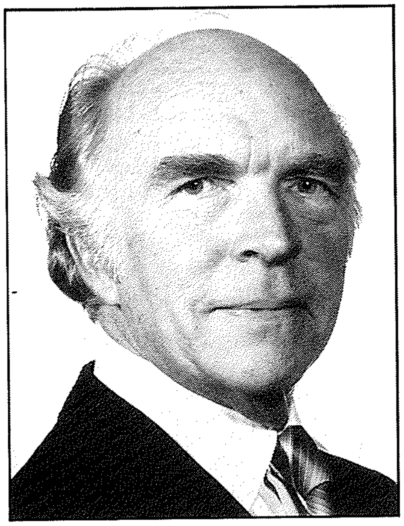
Inter-American Housing Conference in Guatemala

By Eric Carlson

HOUSING and Development was the central theme of the stimulating and productive annual conference of the Inter-American Housing Union held in Guatemala City from May 8 to 12 and attended by more than 300 participants from most countries of the region. The conference has taken place without interruption for 27 years, and brings together representatives of the majority of institutions related to the financing of housing in the Americas. The Guatemalan host was the Mortgage Insurance Institute (Institute de Fomento de Hipotecas Aseguradas, known by its initials, FHA), which is in the process of expanding and modernising its activities.

Considerable achievements were reported during the conference, which is also traditionally the time and place for the board meeting and general assembly of BIAPE, the Inter-American Bank for Savings and Loans. Conference delegates were welcomed at the National Place of Guatemala, and the vice-president of the country participated and spoke at the closing assembly.

The conference featured eight plenary sessions: the papers and conclusions will be available in English and Spanish later this year from the headquarters of the Inter-American Housing Union in Lima, Peru. Among the major papers presented was one entitled "Housing Finance and Savings Banks: The Spanish Experience." This discussed Spain's experience with its $45 billion finance and credit system for housing, 51% of which is accounted for by lending from savings banks, 21% by the Mortgage Bank of Spain, 22% from the private banking sector and 6% by Societies for Mortgage Credit. This appeared to offer a model of interest for some Latin American housing finance institutions which are currently in transition and considering new directions for their future policies.



The International Union of Housing Finance Institutions was represented by Norman Strunk, World Congress secretary and former secretary general, and Eric Carlson, senior consultant, who were the principals at two plenary sessions.

'Considerable achievements'

Mr Strunk presented an in-depth analysis on the topic "Deregulation and Savings and Loan Associations in the USA" in which he reviewed the reasons for the thrift institution decline in the housing finance system and the changes which are currently taking place. Mr Carlson presented an overview of significant housing finance progress and developments in the Asia-Pacific region where there is no standardised system or model in the different countries but where housing finance policy and financing is achieving considerable success and higher priority in public-private sector planning.

Another plenary session reported on the steps taken to establish a Caribbean and Latin American Network of Housing and Urban Development Institutions. This growing network has involved the collaboration and participation of many public and private sector organisations which now feel the need for stronger constituency-building and lobbying efforts on behalf of shelter and housing development generally.

Representatives from Costa Rica, Mexico and Chile were the main presenters on "Subsidies and Housing Finance", reporting on the different approaches in each country. Other sessions dealt with the concepts and technologies for "Banking in the Future", and "Perspectives for Housing Finance in Latin America by the year 2000".

The Conference also featured a commemorative session for the XXVth anniversary of UNIAPRAVI, which was founded in Caracas, Venezuela, on November 12, 1964. Medals were awarded to the founding members who were present. The new President of UNIAPRAVI for the period 1989-90, Alvaro Alberto

INTER-AMERICAN CONFERENCE

Barreto of Brazil, assumed office with a stirring statement of faith and confidence that the housing finance institutions represented in UNIAPRAVI would develop viable new policies and directions for accomplishment of their prime missions. Succeeding annual conferences will be held in Rio de Janeiro, Santiago de Chile and the Dominican Republic. Freddy Reyes Perez, chairman of the Caribbean Association of Building Societies and Housing Finance Institutions (CABSHFI), was named first vice-president of UNIAPRAVI.

Despite the severe economic difficulties still prevailing in many countries of Latin America, a region where overall GNP per capita declined by 1.5% in 1988, and inflation has doubled, some housing finance institutions have been able to operate in compliance with their social objectives. There are success stories in countries such as Colombia, Chile, Bolivia, Costa Rica, Ecuador and the Caribbean islands, including the Dominican Republic. But the transference of capital out of the region was $29 billion in 1988, more than

'Meeting social objectives'

15% above the prior year. The debt crisis, the lack of external credit for the region, and the difficulty of capital recovery are all making it essential to redefine and redesign existing housing finance institutions and their operational forms.

UNIAPRAVI and its allied financial entity BIAPE have now positioned themselves to assist this process. UNIAPRAVI is in a strong growth and activation mode after its first 25 years of experience. Among its recent activities are the following:

1. Establishment of CELEH, the Latin American Center of Housing Statistics. This regional project assisted by funding from US-AID operates from the headquarters of UNIAPRAVI. It is providing comparable and updated statistical data to assess the housing finance situation in Latin America, and the contribution of housing finance institutions for resource mobilisation. A system of corresponding institutions has been established, a bulletin of housing statistics is being published, and the Center's First Statistics Report has been issued. A computerised databank operates closely with CELEH.

2. Latin American Forum. These will be regional technical meetings for the analysis of a wide range of issues regarding housing finance policies in Latin America. The first forum was held in Cartagena, Colombia, in July and dealt with the role of public and private sectors in housing development and finance.

3. Promotion of Latin American and Caribbean Network of Housing and Urban Development Institutions. The first meeting of institutional founders of this network was held in Quito, Ecuador, in February. It included the Inter-American Federation of the Construction Industry, the International Union of Local Authorities, the Inter-American Association of Housing Co-operatives, the World Federation of Credit Unions, the National Association of Realtors (NAR-USA), the Carvajal Foundation (Colombia), the Co-operative Housing Foundation (USA), the Regional Housing and Urban Development Office (US-AID) and UNIAPRAVI. A memorandum of understanding for Declaration of Principles for this network was signed in Guatemala City on May 11.

4. Recognition of UNIAPRAVI as a Non-Governmental Organisation, Category II, by the United Nations Economic and Social Council. This will permit it a voice in appropriate UN body deliberations.

5. Expanded services. During its existence UNIAPRAVI has supplied training through the development of 117 sector and national seminars, in different cities in 16 countries, attended by 9,500 people. It has provided 50 technical assistance missions and programmes to central bodies and to national housing savings and loan systems in Argentina, Bolivia, Chile, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Nicaragua, Paraguay and Peru, with assistance and support from US-AID. UNIAPRAVI's publication programme has expanded to include a Thesaurus, directory (Vade-mecum), bulletins and news-

'Expanding services'

letters, special papers (Cuadernos), of which 138 have been published, annals of the conferences, annual reports and new descriptive brochures.

As for BIAPE, member shareholders voted full approval of the report and recommendations presented by executive president Iari M. R. de Andrade at the 14th annual meeting held in Guatemala City on May 9. Andrade reported that BIAPE's net profit before reserves in 1988 was $1,540,667, which exceeded by 67% that of 1987, and represented an interest return on capital of 6%. The increase had been achieved through intensive efforts to regularise loan repayments, establishing a package of credit to assist with repayment flows, and cancelling some loans.

BIAPE has now opened a representative office in New York, at Rockefeller Center, in order to be closer to financial centres and the capital markets. An objective is to secure linkage of BIAPE and BIAPE International Bank with another financial institution. Steps are also being taken to develop BIAPE as a support vehicle for financial institutions linked to or promoted by BIAPE members in their respective countries. The fact that BIAPE is now in a comfortable liquidity position will help in restructuring and expansion plans for its member institutions. ■

ERIC CARLSON is the International Union's senior consultant.

A housing finance strategy evolves in Saint Lucia

By Orlando Martyr

PRIOR to 1968, there were no specialist housing finance institutions operating in Saint Lucia — commercial bank loans, when available, were usually short-term (five years or less), and for amounts not exceeding 50% of the cost of the property, and guarantors, life insurance policies or other additional securities were often mandatory.

In 1968, in an effort to increase home ownership, the Government of Saint Lucia established the St. Lucia Mortgage Finance Company Limited (SMFC) to provide loans for the purchase or construction of dwelling houses. SMFC provides loans of up to 90% of value on the security of a first charge over the property; the maximum loan term is 20 years.

As a substitute for mortgage insurance, SMFC creates its own reserve fund in respect of loans exceeding 80% of value. Under the terms of the agreement establishing SMFC, its maximum loan and interest rate are controlled by the Government.

Initially incorporated as a wholly-owned and funded subsidiary of the Commonwealth Development Corporation (CDC), SMFC has grown with support and funding provided also by the Government of Saint Lucia and the National Insurance Board (NIB). (A National Insurance Fund was established under the National Insurance Act No 10 of 1978 to provide retirement and other relevant benefits to employees; the proceeds of the Fund are vested in the National Insurance Board.)

Mortgage disbursements by SMFC from inception to 31 December, 1988, total almost EC$50 million and percentage investments by way of shares and long-term loans are stated below:

SHARES		LONG-TERM LOANS	
CDC	51%	CDC	45%
GOVT	49%	NIB	55%

SMFC's lending procedures and practices contain features similar to UK building society models — this is hardly surprising since its senior consultants, Reginald Howard and F. G. Weaver (both now retired from CDC), "grew up" with the building society movement. Of course, appropriate adaptations and amendments have had to be made in the light of local practices and the land laws which are based on the Quebec Code (Code Napoleon!).

SMFC does not accept deposits from the public. The population of Saint Lucia is about 140,000 and the savings market has always been well serviced by the commercial banks.

'Credit union established'

Current tax legislation provides for interest earned on deposits at commercial banks to be free from income tax. Consequently, four foreign and two local (one Government-owned) banks compete aggressively for small savings.

In this climate, no building society has emerged, although a credit union movement is well established and gaining momentum in the rural areas.

Since December 1983 there has been substantial growth in deposits at commercial banks. The table below is extracted from quarterly statistics supplied by the East Caribbean Central Bank:

PERIOD ENDED DECEMBER 31st	TOTAL DEPOSITS (000's) EC$
1982	219,654
1983	244,811
1984	270,192
1985	324,074
1986	404,712
1987	467,886
1988	586,103

This phenomenal growth in deposits has been attributed to prudent management of the economy supported by good performances in the agricultural and tourism sectors and a stable currency.

The liquidity at the commercial banks prompted their increased activity in mortgage lending. Interest rates have also been reduced and today all six commercial banks provide long-term (20-year) mortgage facilities at rates not exceeding 12% per annum. Most of this mortgage lending is in the form of refinancing and consolidation of existing loans (home-equity mortgages) and advances seldom exceed 75% of value.

SMFC has utilised the liquidity to introduce a number of policy amendments aimed at making housing more easily available. These include:-

i) Provision of loans for the extension of dwelling houses.
ii) Provision of loans to purchase land (on condition that houses are built within 5 years of purchase).
iii) Increase in the maximum loan available to EC$200,000.

iv) Provision of a special low-budget facility at 6% pa to persons of moderate incomes in respect of houses costing EC$75,000 or less. (This facility has been made available through the kind co-operation of the National Insurance Board.)

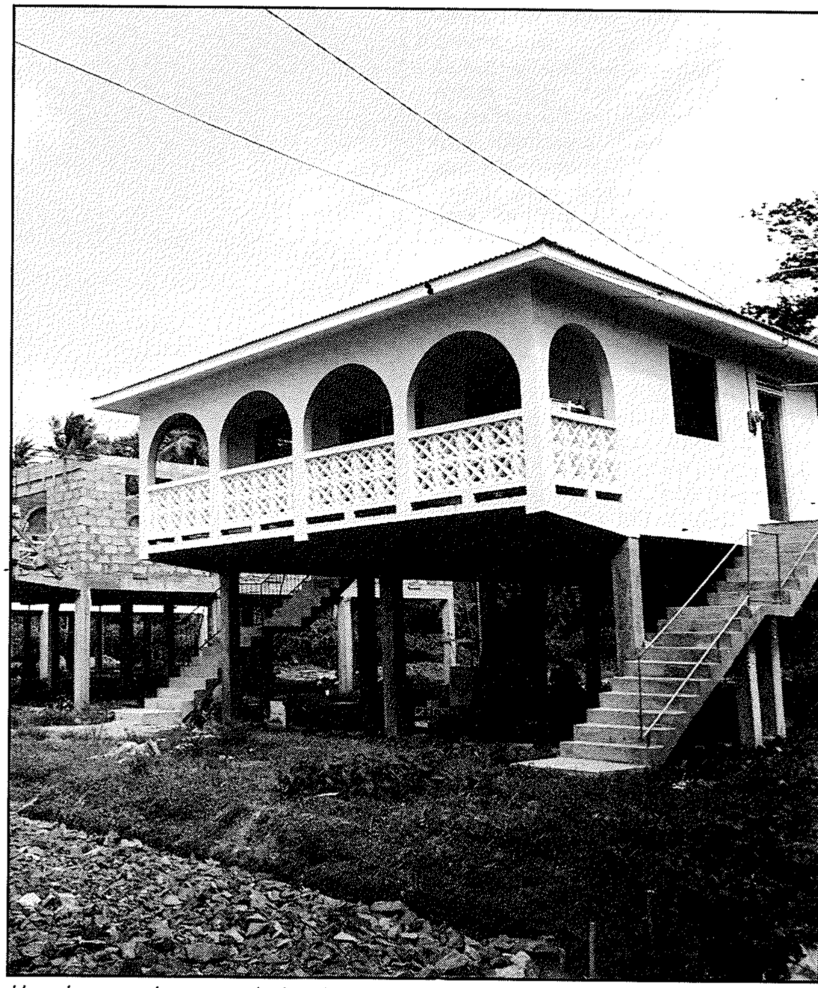
Liquidity and buoyancy are not the only factors influencing increased investment in home mortgages. Over the last two decades, there have been incremental but significant legislative and administrative efforts implemented by the Government of Saint Lucia to facilitate a housing delivery system based on public-private co-operation, for example:

1971 — Housing & Urban Development Corporation Act — under this legislation the UDC is charged with "the duty of promoting the development of housing and undertaking the planning and development of land." Responsibility for the UDC has recently been vested in the Minister of Housing and it is expected that efforts will be concentrated on the delivery of sites and services.

1972 — Establishment of Housing Development Bank to provide loans where the security of mortgages could not be offered. This bank has been superseded by the creation of the St. Lucia Development Bank in 1980.

1973 &
1975 — Consolidation of Aliens (Land Holding Regulations) Act to provide, *inter alia*, that approved lending agencies, development aliens or other foreign investors may, with the approval of Cabinet, hold land for the purposes of development.

1976 — Condominium Act 1976 — legislation to facilitate the division of property into parts to be owned individually and parts to be owned in common and to provide for the use and management of such property.



Housing nearing completion in Saint Lucia.

1978 — Establishment of National Insurance Fund — Employers match deductions from the wages of employees and the fund is invested to provide retirement and other benefits. The National Insurance Board has supported SMFC's lending programme, thus reducing its dependence on foreign currency loans. The NIB has also invested in public buildings, easing the shortage of office space in Castries and other towns.

1980 — Establishment of Saint Lucia Development Bank — Act No 22 of 1980.

1981 — Establishment of National Commercial Bank.

1984 — The Land Adjudication Act and Land Registration Act provided for the adjudication of rights and interests in land and their subsequent registration and dealings

40 ⟶

← 39 therewith. Under this comprehensive programme which was funded by USAID and covered the entire Island, over 34,000 parcels of land were identified and registered, each with its unique parcel and block number. The project was completed in 1987 and a separate Land Registry opened. The records have been fully computerised, facilitating prompt searches, transfers and mortgages.

1986 — Amendment of the Succession Duty Ordinance to exclude duties on the matrimonial home.

1988 — Amendment to Civil Code to reduce the age of majority (minimum age at which one can enter into contract) from 21 to 18.
Amendment to Code of Civil Procedure to up-date the law relating to the conduct of public auction sales, thus improving the remedies available to a lender.

1989 — Income Tax Act 1/89. This recent legislation revised and consolidated the law relating to income tax; among its provisions intended to stimulate housing development are:

i) Increased allowances to individuals and a reduction in the top rate to 30%, thus increasing disposable income;

ii) mortgage interest *and* expenses reasonably incurred in the up-keep and maintenance of an owner-occupied dwelling house are deductible;

iii) gains from the sale or rental of residential property (costing EC$150,000 or less) within 10 years from the date of construction shall be exempted from tax;

iv) the income derived from the initial sale of not less than 10 newly constructed houses by a builder shall be exempted from tax;

v) the income from loans to purchase, construct or reconstruct dwelling houses (where the mortgage does not exceed EC$150,000 and the rate does not exceed 11% pa) shall be exempted from tax.

Public buildings in Saint Lucia.

The policy amendments by SMFC, the new thrust by the commercial banks and the continued efforts of the Government, especially the incentives contained in the new Tax Act, are all expected to impact favourably on the housing market. But the market is changing and practitioners of the "art" of housing finance must anticipate the changes.

The proposed political union between members of the Organisation of East Caribbean States (OECS) countries will present fresh challenges in the 1990s. Housing must, therefore, be seen not only in terms of bricks, mortar, land or money but rather in terms of people — the needs of a growing population will not permit policies to remain static. ■

ORLANDO MARTYR is the chief executive of SMFC. He has also managed finance companies in Barbados, Dominica and St. Vincent. Mr Martyr is a former vice-chairman of the Housing and Urban Development Corporation and is currently a director of Rodney Bay Mortgage Finance Company Limited. He is also a member of the executive committee of CABSHFI.

UN Commission on Human Settlements focuses on global strategy for 2000

By Eric Carlson

THE twelfth session of the UN Commission on Human Settlements was convened in Colombia, at the Convention Center of Cartagena, from April 24 to May 3, with the participation of 350 delegates from 82 countries. The Commission devoted the bulk of its time to examining questions concerned with implementation of the Global Strategy for Shelter adopted by the UN General Assembly in 1988. Special attention was directed to how national policies and action formulated in accordance with this strategy should be monitored on a systematic basis.

Each country is to adopt its own timetable for reorganisation of its shelter sector in the following suggested sequence:

1989-1991 Establishment of national policies and strategies and design of new institutional arrangements.

1992-1994 Introduction of new institutional arrangements, and strengthening of existing national programmes.

1995-2000 Full-scale operation of national programmes and progressive strengthening of institutions for activities beyond 2000.

'Mobilising resources for housing'

The major feature of the Global Shelter Strategy is to facilitate adequate shelter for all by the year 2000, with particular focus on the poor and disadvantaged. The operational focus is for action at the national level. A fundamental premise is that governments should not carry the entire burden of shelter production and distribution but should adopt "enabling" strategies.

The strategy is to be a framework for integrating and advancing national economic and social development objectives. It recognises the contribution of women as income-earners, home-makers and heads of households in the development of housing policies, programmes and projects. The public sector has the responsibility of creating incentives and facilitating measures for housing action by other entities, particularly as represented in the private sector by non-governmental and community-based organisations.

Governments are expected to encourage the mobilisation of resources for housing and for infrastructure and to ensure that the shelter sector is allowed to compete fairly for domestic financing. They should also stimulate the flow of sufficient serviced land to meet shelter needs, to expand the provision of basic infrastructure as well as urban road and transport networks, and to support the expansion of indigenous building materials production.

The Global Shelter Strategy is, therefore, an impressive international mandate for action. The monitoring guidelines for national governments are being developed by the UN Center for Human Settlements in Nairobi. Governments are urged to prepare annual progress reports on their national shelter strategies and to target these for release and presentation on the annual Habitat Day, the first Monday in October.

Bi-annual reporting to the Commission, however, will take on more importance, as henceforth the UNCHS will meet only every two years. The 13th session of the Commission will be held in Harare, Zimbabwe, in 1991, at which there will be a review of the Global Strategy and the results of monitoring involved in the first biennial reports prepared by governments.

'Stimulating flow of land'

The Commission's session in Cartagena was inaugurated by Colombian President Dr. Virgilio Barco Vargas, who endorsed the new approach represented by the Global Strategy, and saw it as an avenue towards eradication of poverty while achieving development objectives. He reported that the Colombian Government has approved legislation designed to promote rural and urban land

46 →

← 44

reform, and to give broad autonomy to local governments.

The Commission considered two special theme papers, the first on The Role, Responsibilities and Capabilities of Governmental and Non-Governmental Sectors in the Field of Human Settlements, and the second on The Maintenance of Buildings and Infrastructure and Its Financing and Cost Recovery. On the first subject the Commission approved a resolution requesting priorities in the Global Strategy work programme

'Debt equity conversion'

and the medium-term plan for 1992 to 1997 as follows:

(a) Strengthening the management and implementation capacities of local government through support for such measures as devolution and decentralisation, appropriate financial capability and training.

(b) Defining relationships between government and the private sector in such areas as the supply of urban services, housing and land, etc.

(c) Encouraging effective community participation at all levels in human settlements programmes, especially those designed to combat urban poverty through training and emphasis on self-reliance and self-help.

(d) Urging governments to promote co-ordination between public agencies and to engage in dialogue with private and community sectors.

(e) Requesting national governments to accord local government authorities a substantial role and corresponding responsibilities for the management and development of human settlements.

On the second subject, maintenance of buildings and infrastructure was seen as complementary to new capital investment in public works. In many developing countries, and in times of financial stringency, maintenance could be the most economical means of sustaining services essential to economic growth and social improvement. The Commission adopted a resolution on this subject providing guidelines for government consideration.

Papers on Financing the Global Strategy for Shelter to the Year 2000, and Assistance Provided To and Among Developing Countries on Human Settlements were also reviewed by the Commission. The reports raised fundamental issues about the need for governments to put into place national finance systems for addressing shelter development on a sustainable basis and at the required scale. The issue of financing shelter and urban infrastructure was seen as an opportunity for domestic resource mobilisation, and in light of the need for private capital formation and employment generation.

The difficulties of achieving a sound financial system were recognised, especially in times of economic recession, external debts, high inflation and cuts in public investment. At present the housing and shelter sector receives only about 2% of international aid assistance across the board. The Global Strategy paper on Shelter Finance suggested new possibilities that might become available through debt-equity conversion arrangements which are beginning to be employed in several countries.

The representative of the International Union presented a statement endorsing further action to investigate debt-equity conversions and other arrangements to facilitate capital flow to developing countries, and their potential for assistance to the industries and services involved in housing, building and construction. He suggested that a special task force or working party be established regarding this matter, which might also help in reviewing the need for a new international financial services entity for assistance to countries in need of shelter and housing development. Excerpts from the statement of IUBSSA's senior consultant, Eric Carlson, appear in the accompanying box.

The Commission accepted the work programme of the Center for Human Settlements (Habitat) for the biennium 1990-1991, which will focus on the Global Strategy for Shelter and the "enabling" concept. The Center was requested to give more weight to the following issues: roles of governmental and non-governmental sectors, municipal management, finance, training, land policies, urban and regional planning, comprehensive urban development, and the link between shelter and related environmental issues. The 1992-1997 programme for the Center's future work was also

'Global strategy launched'

accepted by the Commission, and, after adoption by the UN General Assembly, will form an integral part of the UN Medium-Term Plan for the same period.

During the Commission's session in Cartagena a special meeting was held of the 60 participating Parliamentarians to discuss the legislative and institutional changes necessary to launch action at national and local levels. The Global Strategy itself has been launched with some ceremony, including a special meeting held at UN Headquarters on 16 February, 1989, attended by the executive heads of other relevant UN agencies or departments, the World Bank and several non-governmental organisations (NGOs). A consultative meeting on the strategy of 12 organisations and agencies of the UN system was held in Geneva in July 1989.

A number of countries are already participating in preparatory work for their national shelter programmes, with support from both bilateral and

48 →

IUHFI STATEMENT TO TWELFTH SESSION OF UNITED NATIONS COMMISSION ON HUMAN SETTLEMENTS

THE International Union of Housing Finance Institutions has followed since 1965 the work of the United Nations on housing and shelter finance and the mobilisation of resources for this sector.

The executive director's report on Financing of Shelter and Infrastructure is an excellent concise statement. The Union is in substantial agreement with the findings and recommended approaches. However, more work is needed if the report is to be an adequate and sufficiently specific response to the Commission's resolution. The financial constraints and needs of the developing countries should be more sharply identified and quantified. Also required is rigorous analysis and realistic consideration of possible solutions for obtaining the funds required. The level of United Nations commitment for work in this field should also be indicated, including regular staff, consultant and adviser services.

To follow up some aspects of the report, such as paras 80 to 82 on debt equity conversions, a special task force or working party should be established.

Such a dedicated group action for financing of human settlements should expand the stock of information available within the UN system and elsewhere on individual country conditions and needs as well as evaluate the relative merits of actual programmes. It would explore and work through various possibilities for new funding from both public and private sectors. It would focus on practical measures of value to the majority of countries, drawing upon the best of existing experience in mobilising savings and financing in both urban and rural communities and townships. It would analyse the trends towards globalisation of financial services and technologies, and their implications for shelter, housing and human settlements development.

The International Union would be pleased to co-operate with such an undertaking, and is sure that in today's conditions it could produce new directions useful to the entire international community.

In addressing the Commission on several occasions, the Prime Minister of Sri Lanka has proposed study of a "Global Housing and Shelter Bank". There seems to have been little follow-up to this proposal. But the need remains for international focus on housing finance, and for a service institution to devise means to harness credit for settlements and to help mobilise domestic savings and resources along the policy guidelines of the Executive Director's report. Such an institution would provide seed capital and technical assistance and help governments to modernise their housing finance structures.

Feasibility studies for such an entity, fund or financial institution should be pursued as part of the essential global strategy for human settlement development to the Year 2000. Assistance for such a project should be sought from UNDP and its Capital Development fund, the World Bank, other multi/bilateral financial bodies, and national and international NGOs concerned with this sector. At its World Congress in 1968 in Sydney, Australia, the International Union endorsed and supported United Nations' initiatives in this direction and it stands ready to collaborate with a project of this type, if one should be agreed to.

In addition to its own projects, the United Nations should conduct a review of worldwide experience of non-conventional funding and organisation for housing and human settlements: eg the use of credit unions in Central America for housing improvement loans; the extensive involvement of community-based organisations for housing in Colombia; the Nehemiah Plan of Brooklyn, New York; new methods of funding for rural villages. Special attention should be directed to relevant experience of long-term investment and funding for housing through pension, social security, postal savings, and insurance funds. An international research project on current experience with mobilisation of private sector funding and investment for human settlements could provide tools for developing new partnerships and approaches, especially for involvement in low-income and rural/urban poor communities. United Nations support will be required for a network of regional training and research centres on financing, management, technology and education for human settlements.

The International Union is pleased to collaborate with the Commission in the development of an international shelter strategy. Attention will be given to these efforts at the Union's World Congress to be held in Washington DC, September 17 to 20. The Union is also a co-sponsor of the Third International Shelter Conference to be held in 1990.

← 46

multilateral agencies. These include Bolivia, Burundi, Colombia, Costa Rica, Djibouti, Indonesia, Jamaica, Jordan, Kenya, Mozambique, Nicaragua, Oman, the Philippines, Tunisia, Turks and Caicos Islands, Uganda, Vanuatu and Zimbabwe. At regional and international levels also, projects, workshops and training activities related to Shelter Strategies are under way or programmed.

It seems clear that this new panorama of national shelter strategy development and implementation around the world will require additional resources if it is to succeed and also be sustainable. The UNCHS (Habitat) is already overloaded with a menu of projects and activities under eight different programmes in addition to many technical co-operation projects financed by the UN Development Programme for which the Center acts as executing agent for an overhead fee of 13%. It is subject to the overall UN budgetary restrictions of "no-growth" in recent years. Its limited regular budget allocations have been supplemented by extra-budgetary funds available for personnel, services and projects from the UN, Habitat and Human Settlements Foundation.

'Donor community reluctant'

But despite the stated support for the Global Strategy and other allied follow-up resulting from the International Year of Shelter for the Homeless (1987), the international donor community has been reluctant to step up its contributions and assistance to the Foundation for the use of the Habitat Center. At the Cartagena session, for example, only an additional $1.5 million was pledged, from the following countries: Burkina Faso, France, The Federal Republic of Germany, Kenya, Papua New Guinea, Sweden and the United States of America. An additional $2.9 million had been pledged at the UN pledging conference in New York in November 1988. The total is not impressive for the tasks which are ahead in mobilising a new world programme of action for shelter and housing.

The NGO role

Non-governmental organisations (NGOs) and community-based organisations are counted on for a major role in implementing the Global Shelter Strategy, but only a handful were present at the Commission session in Cartagena. The Habitat International Coalition (HIC) did, however, present several constructive statements to the Commission regarding its agenda topics and the importance of involvement of NGOs and community-based organisations as partners in housing and shelter sector development. The HIC is a federation of over 200 organisations from all over the world which was founded in 1978, and in 1987 undertook a reorganisation of its constitution, structure and programme, including the promotion of new regional groupings.

The HIC's objectives are expressed in the following paragraph from its new policy statement:

> "It is HIC's belief that the problem of housing is neither a localised problem nor one only of particular sections of society such as the poor, nor can it be seen in isolation from other social issues. Rather it is a structural issue, interlinked with issues of domination by market and state and the inhibition of local initiative, of global resource degradation and it is the collective responsibility of all peoples to address this problem. HIC believes that it must not only be seen as the problem of individuals nor can it be tackled by projects alone but rather through the creation of conditions by which all people can gain and retain adequate housing. Accordingly, it directs its efforts towards support for the struggle for the right to housing and the promotion of enabling policies in the field of housing and human settlements."

'Creating the right conditions'

The HIC held a workshop before the UNCHS session and adopted a first draft of a Declaration of Housing Rights. This will be discussed among its members and other NGOs and CBOs as part of a Global Campaign for Housing Rights, leading to the formulation of an international Convention on Housing Rights, and action by the UN in this context. The new president of the HIC is Hans van Putten, who was its former secretary and also former secretary general of the International Union of Local Authorities in The Hague. He succeeds David Hall, executive director, Town and Country Planning Association, London. HIC's recently appointed executive director, Enrique Ortiz, continues to serve from the Mexico City office of HIC.

Although few international NGOs participated in the UNCHS session, Colombian professional and civic groups, with the support of Cartagena municipality, organised in the historic walled city an unusual event titled I Colombia Habitat Festival. It was a five-day feast of stimulating discussions, round tables and cultural events held in different historic sites. Present and former officials of leading Colombian housing sector institutions participated, as did many professionals and civic leaders from universities, NGOs and communities. Their experience and viewpoints gave witness to Colombia's long-standing work in the housing field. Invited visitors from other Latin American countries presented additional perspectives. ■