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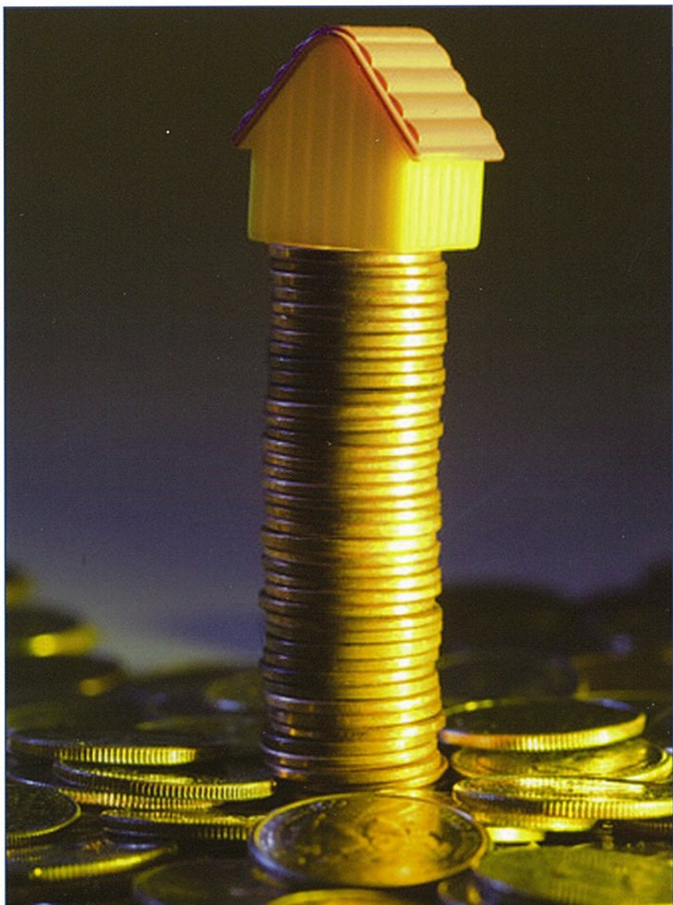

Housing Finance Systems After The Boom, Spain, Indonesia, Vietnam, Uganda, Innovative Finance and Slum Improvement

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Editor's Introduction

by Friedemann Roy

September 2008 is one of the most amazing months since I have delved into housing finance! First, the US Government took over or nationalised (though labelled "conservatorship") the housing finance giants Fannie Mae and Freddie Mac. Second, seven days later the investment bank Lehman Brothers filed for bankruptcy and another investment bank Merrill Lynch merged with Bank of America, the US's largest consumer bank. According to Lehman's filed bankruptcy papers, the bank owes USD 613 billion to 100,000 creditors all over the world, including bondholders who are owed USD 155 billion.[1] However, not only banks suffered from the mortgage meltdown. The nation's biggest insurer, American International Group (AIG) reported USD 18.5 billion in losses because of problems with its mortgage insurance business.

Nearly unnoticed, *The Economist* reported that "the 'developing world is poorer than we thought'. The number of poor was almost 1.4 billion in 2005. It was believed that this figure was about 400m less.[2]

What do all these events mean for housing finance? *The Washington Post* asks, "How much of a day-to-day role should the government and regulators take in financial markets? Should the basics of the financial world be rethought?"[3] As regards mortgage markets: did capital markets fail in such a way that we have to look for other solutions? Which role should regulators play in the future? Did we give up on sound lending practices to promote growth, which has got out of control?

This *Housing Finance International* Edition is trying to answer these questions. Our first article by Ray Forrest on "Risk, Governance and the Housing Market" provides some general thoughts. It has its roots in the Asian Pacific Network for Housing Research (APNHR) Conference of August 2007 and has been updated for this HFI edition. Ray Forrest looks at the relationship between national governments and their national housing systems. The reduction, sometimes substantial, of direct housing provision has arguably diminished state capacities to respond as effectively as in the past to the shifting housing needs and demands of populations. There is now greater reliance on indirect and regulatory interventions to facilitate market-based forms of provision. It follows from this that housing systems which are increasingly dependent on private institutions with regard to mortgage finance are inevitably more intimately connected to the global economy and potentially more vulnerable to economic and political turbulence beyond national boundaries.

The second article by Santiago Fernández de Lis and Alicia García Herrero on the Spanish securitization model and dynamic provisioning approach sheds light on the Spanish housing boom. The Spanish regulators required special purpose vehicles to consolidate under the sponsor's balance sheet. This approach has so far prevented financial institutions from plunging into great troubles, although Spain is now experiencing a sharp reduction in construction activities and a rapid increase in bad loans to developers. It will be interesting to explore how the country will deal with the credit crunch in the next months.

The third article by Raymond Struyk, Narayanasamy Kokularupan, and Nilesh Patel on "Indonesian Home Purchaser's Loan Preferences" highlights an important topic in housing finance which could also help to prevent future crises: households' knowledge of mortgage loans. The article is based on a survey to learn more about the decisions of Indonesian home purchasers to take a loan from a formal financial institution or to finance their homes otherwise. One major lesson of the article is that a customer education program in mortgage lending is crucial to more demand for mortgage loans. Families thinking about purchasing a dwelling will be much more likely to seriously consider taking out a mortgage if they have a working knowledge of the rights and responsibilities that such loans entail. In addition, such a program assists them to better understand the implied risks of this loan type.

The fourth article is by Charles Cornelis and Hanna Ruben. It reviews recent developments and opportunities to create viable housing microfinance structures in Vietnam. After describing the market for Housing Microfinance (HMF) in Vietnam, the authors identify the key Microfinance (MF), Housing Finance (HF) and HMF suppliers and their current products as well as their ideas for new products. In this context, they also evaluate the future challenges and developments in Vietnam.

Victor Agaba is the author of the fifth article. He provides an update on the Ugandan mortgage market. Although tiny in size, lenders are slowly entering the market, attracted by a stabilizing economy and rising incomes. Another driver is the expected enactment of the Mortgage Bill 2007, which will reduce legal and regulatory constraints, in particular foreclosures and rights related to titles and mortgages.

Our last article by Ann Jennervik delivers a summary of the FIG/UN HABITAT Stockholm seminar on "Improving Slum Conditions through Innovative Financing" which took place from 16 to 17 June 2008. It was organised within the annual FIG Working Week. The International Federation of Surveyors (FIG), the conference organiser, is an international, non-government organisation whose purpose is to support international collaboration for the progress of surveying in all fields and applications. The two-day seminar dealt with the main obstacles. How to improve access to land and security of tenure, and how to improve access to finance? Without security of tenure, the poor risk eviction and, in the longer term, are reluctant to invest in long-term shelter improvements. Without access to affordable finance, poor people are caught in a vicious cycle in which affordable housing is inadequate, but adequate housing is unaffordable.

I hope you will enjoy reading these articles. The next editions will provide further insights on the effects of the global credit crunch and provide you with ample ammunition so that you will be well-equipped for the next debates!

Please do not hesitate to come up with your comments and recommendations. They are more than welcome!

[1] See *The Washington Post*, "The Lehman Lesson", September 16, 2008.

[2] See *The Economist*, "The bottom 1.4 billion", August 30 2008. *The Economist* refers to a report published by the World Bank on August 26th.

[3] See *The Washington Post*, "A New Architecture for the Financial World", September 15, 2008.

Risk, Governance and the Housing Market[1]

By Ray Forrest

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Introduction

Changes in housing provision and housing finance both reflect and require new forms of governance. Governance, for the purposes of this paper, refers to the vertical and horizontal configuration of institutions and agencies which are directly or indirectly involved in the regulation and provision of housing finance. By housing market we are referring in the main to the purchase of dwellings by individuals or households for home ownership or investment.

Most contemporary commentaries on housing tend to be nationally oriented and to explore and analyse shifts in government policies which have encouraged particular forms and patterns of provision. For example, the decline of private renting or the growth of mortgaged home ownership may be attributed in great part to changes in national subsidy and taxation regimes as well as cultural and other factors. Cross national studies of trends in housing provision typically explore the extent to which there has been convergence or divergence in housing policy and provision and to seek explanations in the broader literature on the nature and evolution of welfare states and welfare regimes. For example, do countries with more market oriented housing systems display a more general pattern of market orientation? Can we understand the nature of national housing markets in terms of the more fundamental character of particular welfare states? How far do more privatised and marketised housing systems reflect and act upon a more pervasive ideology of market based individualism? (For a summary and development of these arguments see Kurz and Blossfeld, 2004.)

These kinds of analyses, however, whether national or cross national tend to be essentially state centred-despite longstanding arguments put forward by Ball and others (Ball, 1986; Ball and Harloe, 1990) that we need to take account of a wide range of actors and institutions in the housing sphere. This is not to suggest that the major players in the construction or financial sectors have been neglected in these analyses but that the housing and housing policy oriented literature has focused disproportionately on a restricted area of policy space - namely, the balance between direct and indirect intervention by governments, national and local, in housing provision.

We live, however, in a world in which the role of national governments in housing is changing. Two particular issues are relevant here. First, there has been a retreat from direct state provision, which has been paralleled by the growth of individual home ownership and, in some cases, a modest revival of private renting. Second, more market oriented housing systems, sit within a wider context of global financial integration and global competition. In the ever-expanding literature on globalisation, it is the scale and velocity of financial flows around the globe, which are among the least contested features of this new global age. Investment in real estate is a significant part of this global financial system. Zhu (2003), for example, notes that "real estate lending is one of the most important components of bank loans. In most developed countries it accounts for one third, sometimes even more than half, of total bank loans" (p.16).

The relationship between national governments and their national housing systems has therefore changed in important ways. The reduction, sometimes substantial, of direct housing provision has arguably diminished state capacities to respond as effectively as in the past to the shifting housing needs and demands of populations. There is now greater reliance on indirect and regulatory interventions to facilitate market-based forms of provision. It follows from this that housing systems which are increasingly dependent on private institutions with regard to mortgage finance are inevitably more intimately connected to the global economy and potentially more vulnerable to economic and political turbulence beyond national boundaries. The property you or I may purchase, to live in or as an investment, is thus inextricably part of global big business.

Over the last few years a geographically widespread property boom was fuelled by a combination of low interest rates, rising real incomes (for some) and less attractive investment opportunities in other sectors. With riskier stock markets and concerns over the future value and security of pension funds, both individuals and institutions turned increasingly to a property sector which, with some notable exceptions such as Japan and Germany, had seen generally inflating asset values over the last decade. Referring to this *global house price boom* (author's emphasis), *The Economist* (2005) estimated that, "the total value of

[1] A version of this article was published in Kennett,P. (2007) Globalisation, Governance and Public Policy, Cheltenham: Edward Elgar

residential property in developed economies rose by more than $30 trillion over the past five years, to over $70 trillion, an increase equivalent to 100% of those countries' combined GDPs." (p.73).

Although it may appear therefore as a parochial transaction, there is a complex and diffuse institutional architecture determining how much we can borrow, at what interest rate and for how long. Moreover, the origins of the money we borrow and who actually bears the risk if we default have evidently become less transparent. Trade in mortgage asset portfolios means that high street lenders are part of an investment chain locked into the international capital market. Indeed, if we default, or alternatively repay early, we could be part of an aggregate effect which ultimately impacts on the value of our pension fund.

Globalisation, Neo-liberalism, Risk and the Housing Market

Before focusing in more detail on the housing sector, it is appropriate to provide a broader framework in which to situate this discussion. It has already been stressed that investment in real estate, residential and commercial, represents a significant part of bank lending and therefore of global investment flows. Housing provision has become more market based and these transformations in the housing sector are symptomatic of a contemporary globalisation shaped by the imperatives of neo-liberal ideology. Processes of deregulation, re-regulation, privatisation and financial liberalisation and the changing role of government in public and social policy reflect an ideological and policy shift in the interests of corporate capitalism. It is in the financial sphere where these changes have been most evident with the development of globally integrated financial markets and significant increases in cross border financial flows.

Put simply, there is a lot more capital swilling around and the growing numbers of households in market based housing systems combined with a period of pervasive house price inflation made a significant contribution to this process. Wade (2006) observes that the post Bretton Woods financial system has seen a massive increase in world liquidity associated with the free movement of private capital, the proliferation of financial organisations and the US current account deficit. Wade makes the point that whilst much attention, particularly among anti-globalisation activists is focused on institutions such as the IMF and the World Bank, it is the operation of private pensions funds and insurance companies which has much greater impact on the world economy. "Insurance companies of developed countries have assets of roughly $14 trillion. Pension funds of developed countries have roughly $13 trillion. By way of comparison, total World Bank lending over its entire existence is below $1 trillion." (p.117). Wade argues that this "surge of liquidity" is "an inherent source of instability in the world economy" in the sense that financial markets as opposed to product markets are subject to bouts of speculative frenzy or irrational pessimism

The relevance of these observations to the concerns of this paper is straightforward enough. A less stable financial system creates greater risks for both institutions and households. Asset deflation or inflation, interest rate changes, investment flows into and out of real estate (occasioned perhaps by booms and bust in the stock market) impact on the financial health of the banking sector and on individual households. Real estate sectors are typically centre stage of financial crises, as was the case in Asia in the late 1990s. Institutional insolvency due to loans collateralised against falling real estate investments and negative equity may be the result. As Zhu (2003) notes, "Banks tend to underestimate the default probability of property-related loans in a real estate boom for various reasons, including poor risk management practices, poor data and perverse incentives linked to the safety net." He continues, "Another worrisome situation occurs when one bank or a particular type of financial institution has extremely high concentration in the real estate sector, as exemplified by the US thrift institutions and Japanese "jusen". This concentration of property-related risk turned out to be very dangerous in both cases. The collapse of property prices easily dragged down these specialised institutions, and generated systemic risk for the whole financial system." (p.17)

Past experience of such systemic shocks, the expansion of mortgage finance and the widening spectrum of populations drawn into market based housing provision has thus necessitated greater attention to internal and external monitoring and regulation of lending and accounting practices of banks and other financial institutions. Here, discussions of governance in relation to the housing market become inevitably embedded in a broader and more complex debate about global financial governance and the integrity and status of geographic borders (Sassen, 2005). Cerny (2005), for example, refers to an international financial system which is "becoming more and more multi-level and structurally complex..." (p.36) He continues, "In what is an increasingly uneven process of pluralizing the politics of finance, it empowers a range of actors operating within and through overlapping and intertwined financial 'fiefdoms', thereby not only promoting neoliberalism but also creating spaces for distinctive responses and varieties of neoliberalism".(p.37). A point made forcefully by Cerny is that the contemporary global financial system is characterised not by deregulation but increasing pro-market reregulation. The hegemony of neo-liberal financial restructuring does not involve a deregulated free for all - quite the contrary. "Although reactions are always filtered through different domestic political and social systems, especially where those systems are well-embedded and accepted by mass publics as well as elites, the 'safety and soundness' of financial systems have become the bottom line of contemporary politics in the developing world as well as in the developed world." (p.45)

Others have argued that the current phase of the reshaping of the global financial system can be seen as a universalising, top-down process which actually allows decreasing space for responses shaped by local factors and institutions - less room for domestic variations of neo-liberalism. Best (2003) sees references to a 'new financial architecture' and 'transparency' as part of a normative discourse which offers a thin technical disguise for "...a radically new kind of embedded liberalism - one that seeks to stabilise financial liberalisation by imposing new domestic norms and institutions, effectively embedding finance from the top down" (p.373). Earlier she suggests that whilst a "plurality of liberalisms" was encouraged and facilitated with the earlier post war system, "advocates of the new financial architecture seek to embed a singular global liberalism by imposing a set of Western 'universal' financial norms and institutions" (p.364).

The need for more robust governance structures involving greater scrutiny and regulation of lending practices is often presented as consumer protection but is arguably driven primarily by the need to reduce institutional risk - a need given greater urgency because of rising instability and unpredictability in the natural environment. The rapid pace of urbanisation and rural-urban migration has a strong association with coastal developments, which are themselves increasingly vulnerable to the consequences of climate change. Investment risk in the real estate sector has thus been heightened by more adverse weather conditions. Referring to the rising costs of insurance claims, Berz (1999) states that "There is absolutely no doubt that this increase in losses is due to a large, if not overwhelming extent, to mounting economic values and insured liabilities in heavily exposed metropolitan areas. In addition, natural catastrophes have shown time and again that the susceptibility of building and infrastructure has increased rather than decreased in spite of tighter building codes and technological advancement" (p285). Swiss Re's Sigma Report on natural disasters and human catastrophes (2006) referred to the "continuing upward trend in both categories"' and observed that " In 2005 property insurers worldwide registered catastrophe-related claims of $83 billion - a new dimension" (p.4-5). It is thus not surprising that participants at the 2006 International Union of Housing Finance World Congress were invited to "participate in discussion on topics like the repercussions of global warming and natural disasters on housing finance" (See, http://congress.housingfinance.org/).

We live therefore in times where major financial institutions have more capital invested in real estate, where more individual households have invested in dwellings and where the risks to those investments are at least less certain if not increasing. General confidence in the global financial system is therefore closely linked to confidence in the housing sector.

Governance and housing provision

Until relatively recently, references to housing governance would have been primarily about domestic and social policy issues. Whilst housing in most societies has been produced, if not always distributed, via the market the housing policy debate has generally pivoted around aspects of access, inequality and the extent of direct or indirect state intervention. Moreover, the discursive shift from references to housing *management* and *state provision* to housing *governance* has generally been conducted within the confines of national housing policies - albeit against a more general backcloth of anti-statism and neo-liberalism. With few exceptions, the prescription for housing reform or modernisation has been a concoction of privatisation, marketisation, de- or re-regulation and institutional fragmentation. Providers have become enablers and tenants have become customers. National and local governments in circumstances of monopoly or near monopoly provision have given way to more private and quasi-private agencies and institutions. These prescriptions to address the perceived failures of state housing provision, particularly in relation to fiscal burdens, housing quality and consumer sovereignty have been instigated at different levels. It is national, regional and local governments which have been at the forefront of these institutional and political transformations in the core capitalist countries but it is the global financial institutions such as the International Monetary Fund and the World Bank which have often been the most visible actors shaping housing reforms in the transitional societies of the former Soviet Union or in poorer developing countries.

Whatever the context, housing has been at the forefront of the so-called *modernisation* project. Selling state housing to sitting tenants, introducing market actors into the management of state housing, marketising state rental systems and reducing the overall role of direct government provision in the housing market have become familiar and pervasive policy tools of governments across a wide range of societies. Moreover, housing marketisation and privatisation have often preceded and been regarded as a prerequisite for more sweeping social and economic transformations - most notably in relation to China and the former Soviet Union.

These shifts in the housing policy environment can be traced back for at least a quarter century. Few would disagree that the Thatcherism of the early 1980s had a wide influence on policy discourse and policy direction. For example, Oizumi's (2007) account of Japan's housing transformations refers to a "developmentalist strategy [which] was strengthened by the introduction of privatisation and deregulation policies during the 1980s when the form of neo-liberalism represented by Thatcher and Reagan expanded its influence more internationally. But whatever the international extent of that influence it is evident that, as we move into the 21st century, housing provision is now more thoroughly embedded in market processes and that over the last two decades the dominant direction of change has been towards higher levels of individual home ownership. While some countries such as Finland and Denmark (and more recently the UK) have recorded modest falls in home ownership levels, the neo-liberal turn in the housing policies of the core capitalist countries, post communist housing privatisations in Eastern bloc countries, Chinese housing reforms and the general economic rise of East Asia have pushed market provision in housing decisively upwards. This trend combined with globalised financialisation has pushed the governance debate in housing beyond providing rental housing and managing tenant populations. These developments require an acknowledgement of other and often less visible institutions and regulatory bodies which sit outside the normal purview of housing policy debate.

Domestically, we have seen national governments transfer increasing amounts of responsibility for housing provision for low income groups to a range of institutions. As suggested above, it is in this area where most of the discussion of housing governance has occurred. But for majorities, the debate has a very different complexion and relates to assumptions about their personal asset worth, pension plans and consumption decisions. These assumptions, however, are made in a very uncertain environment where industry experts and the global players who shape the extent and nature of that uncertainty admit to the apparent unknowability of what the future holds. For example, Alan Greenspan, the former Chairman of the US Federal Reserve, remarked, " House prices, however, like those of many other assets, are difficult to predict, and movements in those prices can be of macroeconomic significance."(Greenspan, 2005).

Managing the Unmanageable?

The housing market is thus unpredictable and uncertain but of enormous significance for individual households and for the global economy. Housing policy, as welfare policy, remains understandably focused on issues of homelessness, slumification and the problems of those unable to access housing via the market. This is more visible terrain in discussions of partnerships, the public-private mix and new forms of governance. It is about managing the casualties of the market. But in housing the main business is elsewhere - in a world of financial flows to and from households and between institutions and in the regulatory frameworks set up to manage the risks associated with the ever expanding investment in the residential sphere.

Over the last few decades there has been growing evidence of increasing house price volatility (Kennedy and Andersen, 1994). Stephens (2003) has suggested that this greater volatility is partly at least the product of market liberalisation. He observes that, "The social and economic significance of high levels of owner-occupation is increased by the framework of a liberalised financial system. The housing market tends to be more volatile in financially deregulated countries, with periodic house price booms and busts" (p.4). Fallis (1995) similarly argued that the former stability of national housing finance systems had been compromised by these developments. For example, lending practices in deregulated environments have often involved higher loan to value ratios and thus higher risk exposure for both households and institutions.

Specific examples of an apparent increase in price volatility include Japan with house price rises of around 75 per cent between 1985 and 1990 and a fall of around 40 per cent thereafter. In Finland prices rose by more than 50 per cent 1986 to 1989 and then fell by more than 40 per cent over the next four years (OECD, 2000) More recently it was the Asian financial crisis which produced the most dramatic collapse in residential property values. In Thailand, after 1997, some condominium prices fell by up to 50 per cent (Kritayanavaj, 2002). Seoul's house price index fell from 103.5 in 1997 to 89.8 in 1998 (Blankenship, 2002) and in Hong Kong and Singapore residential prices fell by 50 and 37 per cent respectively. With admirable foresight *The Economist*'s (2005) assessment of the global house price boom suggested that it was more likely to be followed by a serious adjustment because of the particular circumstances in which the price inflation had occurred. "Indeed, a drop in nominal prices is today more likely than after previous booms for three reasons: homes are more overvalued; inflation is much lower; and many more people have been buying houses as an investment. If house prices stop rising or start to fall, owner-occupiers will largely stay put, but over-exposed investors are more likely to sell, especially if rents do not cover their interest payments. House prices will not collapse overnight like stock markets—a slow puncture is more likely. But over the next five years, several countries are likely to experience price falls of 20% or more" (p.74-75). The general analysis was correct even if it underestimated the speed of the current collapse in property values.

Shifting demographics (as well as the major environmental concerns referred to earlier) also produce new market dynamics and new uncertainties for both supply and demand in home ownership sectors. Many major economies face shrinking populations and significant societal ageing. Baby boom generations have flowed across the life course during a period of economic expansion producing strong and shifting demands for home ownership. In some countries the cohorts which are following are both smaller and more differentiated in their income and employment prospects. Factors such as longer periods in full time education and the rising costs and debts associated with this development are also important issues in this context. Dramatic falls in home ownership rates among younger households in countries such as the UK and Japan are the evident consequences of these developments signalling potentially significant new generational fissures in housing tenure patterns and property asset portfolios.

From some vantage points it would appear, therefore, that the health of the global economy is now finely balanced on the undulations of residential property markets and on the spending and savings behaviour of individual home owners (See Forrest, 2007, forthcoming for a more detailed account). Again *The Economist* (2005) pointed to the significance of rising residential property values in sustaining consumer spending. "It is surely no coincidence that Japan and Germany, the two countries where house prices have fallen for most of the past decade, have had the weakest growth in consumer spending of all developed economies over that period. Americans who believe that house prices can only go up and pose no risk to

their economy would be well advised to look overseas" (p.75). And Brenner (2004) calculated that cash outs, second mortgages and other housing related spending "accounted, in total, for no less than two-thirds of [US] GDP growth between 2000 and the first half of 2003" (p. 81). Essentially, the equity or borrowing capacity represented by residential property has grown in significance globally and can be deployed to substantial and unpredictable economic effect.

Moreover, those households with spare capital or borrowing capacity seem increasingly likely to invest in more real estate. Countries such as the UK and the US have seen a substantial expansion of second home ownership for both investment and lifestyle enhancement. Government policies in the UK specifically encouraged 'buy to let' as a means of expanding the privately rented sector. Rising affluence among those in the right skills sectors with appreciating primary residences enabled further investment in property - fuelled by less attractive rates of return in stocks and shares and a concern to create more reliable income streams for retirement. A study by the National Association of Realtors (NAR, 2005) found that 23 per cent of American houses bought in 2004 were for investment rather than for owner-occupation. A further 13 per cent were bought as second homes. Investing in 'bricks and mortar' has a new contemporary ring although the investment seems to be increasingly someone else's bricks and mortar.

Robert Schiller, the author of *Irrational Exhuberance and the New Financial Order*, observed that this kind of development was a logical means of risk spreading by individual owners and launched a new venture in futures on house prices in ten US cities. "A fundamental principle of financial theory – "diversification" or "risk spreading" – implies that interest in the new contracts will be high. People and businesses in New York, for example, are overexposed to their local real estate risks, so they should reduce this risk by selling New York home price futures. People in Tokyo will assume some of this risk by purchasing New York home price futures if the price is right. The New Yorkers still live in their own homes, but now they have spread their investment risk worldwide." (Schiller, 2006)

New Times

Housing markets remain predominantly local and national in terms of their essential makeup in the sense that national governments continue to exert a strong influence in such areas as taxation policies, price controls, land use and construction controls and regulations and policies to encourage savings. Also, households continue to shop locally or regionally for mortgages with a high degree of consumer resistance to borrowing from unfamiliar institutions. References to globalisation and integrated financial markets should therefore be used cautiously as regards implying the degree to which there is convergence in regulatory and governance arrangements and in the nature of mortgage intermediaries. Stephens (2003), for example, suggests that "Evidence from the European Single Market, combines with the *a priori* observation that terms of mortgage products are based on non-financial matters, such as the nature of valuation and foreclosure systems. Since these are nationally (and sometimes even sub-nationally) based, increased globalisation of finance should not be expected to lead to rapid convergence. This is the key tension that arises from the most mobile factor meeting the least mobile factor in the mortgage instrument" (p.1025).

Nevertheless, it is undeniable that the economic forces which are shaping local housing markets are increasingly supranational (IMF, 2005). As has been argued, the direct influence on local housing markets through direct and indirect state provision has generally diminished and private sector lenders have become larger, less specialised and increasingly embedded in international capital markets. The competitive pressures on the mortgage industry have impacted on local and regional providers in terms of pricing and product range. The most visible consequence of this process is that homeowners have had to engage with an ever-expanding array of financial products offering varying interest rates, loan repayment terms and different financial risks. In newer and expanding markets with more first time buyers the choice available may be particularly bewildering with a higher risk of making inappropriate choices. Borrowers have required a greater degree of financial sophistication in understanding the terminology and implications of capped, tracker and discounted mortgages, fixed rate or variable, negative amortization, mortgage insurance policies, equity release and drawdown schemes. Most critically, borrowers have needed to understand that cheap money now may well involve later painful adjustments. The US market, for example, saw the introduction of 50 year mortgage repayment products and a marked increase in negative amortization and interest only mortgages.

A working paper from the Committee on the Global Financial System (CGFS, 2006) referred to the introduction of these 'innovative financial products' in a number of countries. Referring to option adjustable rate mortgages (option ARMs) and other similar products it observed that "An attractive feature for the borrower is the low minimum payment in the first year, which may allow the borrower to buy a more costly house or use the monthly payment savings for other purposes." However, these kinds of mortgages typically have mechanisms for adjusting payments every 5-10 years to ensure that they are fully amortising and limits to loan to value ratios. "Both these clauses may result in a significant increase in the payments required to service the loan" (p.11).

For lenders, the pressures to expand and maintain mortgage business in more competitive markets have also drawn in more vulnerable households. Sub - prime lending, the financial sector euphemism for lending to households with lower credit rating, lower incomes and poorer credit histories, expanded. This increased the risk of bad debt and the need for government backed mortgage insurance to facilitate the securitisation of asset portfolios. The increasing involvement of state guarantees in this sphere is an important aspect of the shifting role of government in the housing sector. Whilst neo-liberal ideology suggests the need for the state to leave the stage to allow the unfettered development of market forces in the cause of a more efficient and competitive housing finance system, the reality is more nuanced. Dymski and Isenberg (1998) argued that the financial restructuring of the mortgage market has been intimately and inextricably associated with a growth rather than a diminution of government activity. The insolvencies among savings and loan institutions in the US in the 1980s required government guarantees to restore confidence. This development triggered further changes in the nature and supply of mortgage finance. "Expanded government underwriting of mortgage sales led to the rapid growth of mortgage securitization, which in turn provided the new sources of credit supply needed to replace lost thrift lending capacity. Increased mortgage securitization, in turn, required increased government (and private) underwriting of mortgage sales and the use of standardized mortgage eligibility criteria in lieu of the earlier system of "relationship" lending." (p.225). Governments have therefore been active participants in the financial restructuring of the housing sector.

This changing financial environment has required greater institutional attention to risk management to protect investors and to maintain general confidence in residential lending. There is a greater need to monitor and regulate institutional lending but with a strong market orientation. Institutions, households and indeed nation states are subjected to more extensive assessment of their risk profiles. There have been more financial institutions chasing potential mortgagors. At the same time, the expansion of mortgage lending increased the risks of default. "On the one hand, those market institutions that stand to profit from an expansion in everyday credit practices would appear likely to benefit from a deepening of credit relations to include those previously excluded from, for instance, consumer credit. On the other hand, however, such a deepening of credit relations is impeded as the previously excluded are deemed to be too 'risky' and unlikely to meet any new obligations." (Langley, 2005, p.93)

Managing the Unmanageable?

In constructing a different perspective on housing market governance we can envisage a layering and intertwining of institutional connections at different spatial scales-from the individual home owners to those global financial institutions setting frameworks and guidelines (see figure 1 for an indicative list). These governance structures involve an intermingling of regulatory and monitoring activities of various types within and between different scales – international, national, regional and local. The regulatory controls may relate to land use planning mechanisms such as residential zoning or greenbelt policies at local and regional levels; regulations concerning building materials and environmental standards which in the European situation would be a mix of European Union, national and local measures; and measures to control and minimise financial risks filtering down from the macro economic strategic planning of Basel II to the specific lending policies of particular lending institutions in particular countries.

All this is not to suggest, however, an uncomplicated top-down hierarchy of power and influence or one in which the local and the global are at opposite and mutually exclusive ends of the spatial scale. As Sassen (2005) emphasises, "processes that do not necessarily scale at the global level as such can be part of globalisation" (p.527). Referring to 'encounters' between the global and national/subnational processes and practices she suggests that such an encounter "can be a highly charged event with multiple, individual, institutional and/or structured contestations, victories and retreats on each side. Or it can be a highly specialised insertion, noticeable directly only within that specialised domain, as might be the case with some of the new standards in finance and accounting" (p.528). In other words, the boundaries between the global and the local are ambiguous and variable. In relation to the structures of housing market governance it may involve highly visible top down interventions from the IMF or the World Bank concerning the state of a particular national housing market – or it may more typically involve these 'highly specialised insertions' which more thoroughly embed local housing finance norms and practices within global rules and procedures.

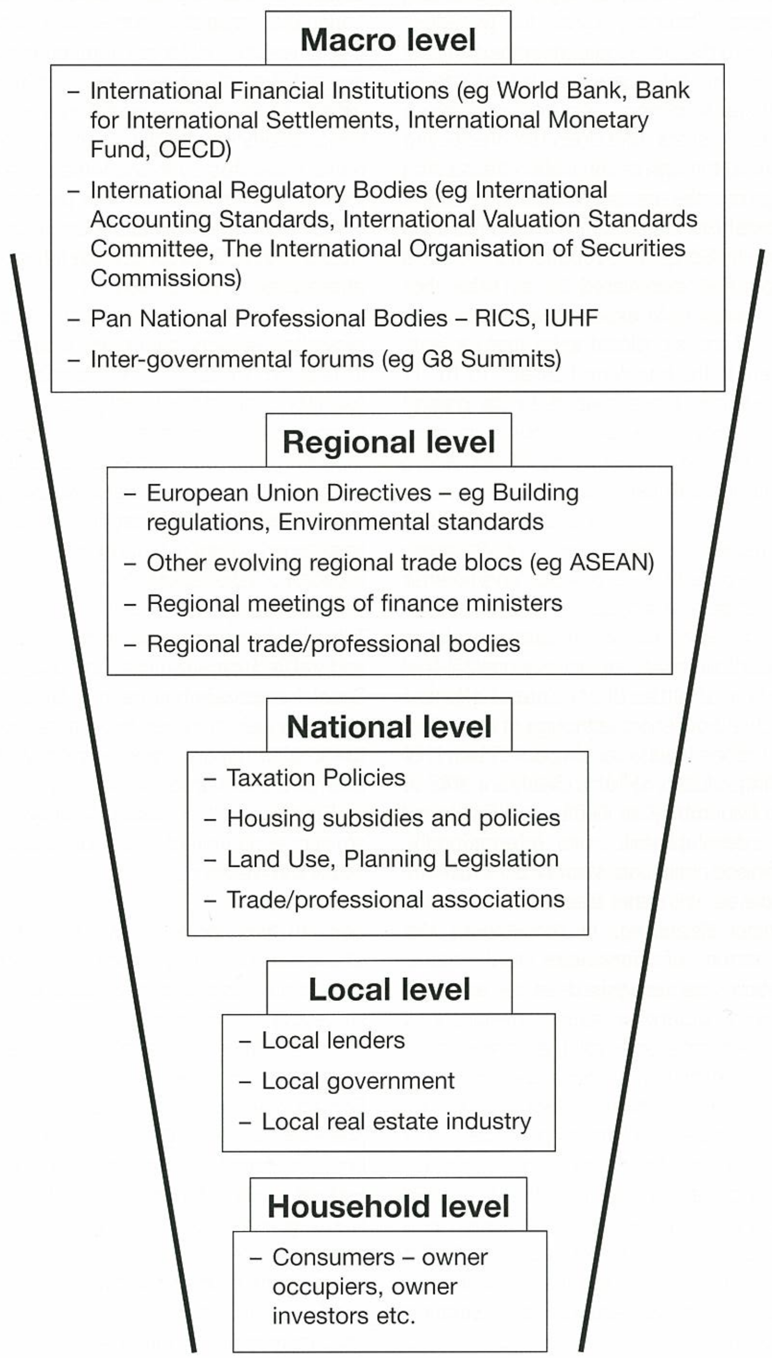
Where properties are built, the form they take, the quality of the materials, how much they cost and the loan criteria including interest rates and loan terms are shaped therefore by a combination of global/ national and subnational processes. And the evolving architecture of housing market governance is driven in part by the tension between extending the global marketplace in the housing sector and the inherent risks of lending to a wider range of consumers.

A number of interconnected global players such as the Bank for International Settlements and the International Organisation of Securities Commissions (IOSCO) provide the overall framework for the governance of the housing finance market. The Bank for International Settlements (BIS) does not have enforceable, legal powers but shapes the global financial order through its committee system. These committees include the Basel Committee on Banking Supervision and the Committee on the Global Financial System. Seabrooke, (2006) observes that the BIS "is the proverbial 'IT staff' of the global economy. Whilst other international financial institutions are highly visible, the BIS remains mostly out of the public eye while it weaves a set of rules, norms and decision-making procedures that establish governance structures for both public and private international banks"(p.141).

Other key organisations of relevance to housing market governance are the International Valuation Standards Committee (IVSC) founded in 1981 and the International Accounting Standards Committee Board (IASB) founded in 1973. The IVSC is an NGO member of the UN with links to the World Bank, OECD and the International Federation of Accountants.

IASB is a privately financed organisation set up originally through an agreement across ten national accountancy bodies. Both organisations are part of this broader project to create regulatory structures and rules appropriate to a global financial regime. Thus, to return to an earlier point, the global influences on local and regional housing markets are not simply those of increased competitiveness but involve the introduction of new and evolving international regulatory norms and procedures. For example, it involves how real assets such as dwellings are valued, how their value is recorded in institutional accounts and accountancy rules as regards assets and liabilities in relation to securitisation.

Figure 1 – Governance and the Housing Market



The significance of this should not be underestimated. Kemeny (2004), in an article in *Business Times Online*, referred to the '3000 plus page tome' which constitutes the new International Financial Reporting Standards. It "will have landed on the desks of an estimated 7,000 listed companies and will have to be read by hundreds, if not thousands, of staff." The goal she continues, "is to create one single set of accounting standards that can be applied anywhere in the world, saving millions for firms with more than one listing and allowing investors to compare the performance of businesses across geographic boundaries for the first time."

Sir David Tweedie, Chair of IASB, set out some of the background to the development of these internationally recognised accountancy standards in a speech to the US Senate Committee on Banking, Housing and Urban Affairs in 2002. "The IASB's objective was to work towards a single set of high quality international reporting standards, produced in the private sector under principles of transparency, open meetings, and full due process". There were also some very specific concerns driving these developments - namely, the collapse of Enron and what it represented in terms of corporate corruption. As Tweedie concluded at the time, " We who are on the outside learn a little more every day, but it still remains to be seen whether the financial reporting that preceded Enron's collapse was a result of flawed accounting standards, incorrect application of existing standards, auditing mistakes, or plain deceit" (p.13).

Various commentators have expressed their concerns about the adequacy of existing and evolving regulatory measures to cope with a more complex set of risks to the financial system. Zhu (2003) makes particular reference to 'real estate price dynamics' and states that "They pose important challenges for risk management, financial regulation and policy design. These issues may not be fully resolved in the future, mainly because of the complexity of the market and varieties of market functioning." (p.19). In a more general analysis of the new financial architecture, Kapstein (2006) points to a paradox which "lies at the heart of the contemporary risk environment, the combination - whether poison or elixor - of increasing bank consolidation on the one hand and risk atomisation on the other." (p.10) Risk atomisation is the trend towards the downloading of risks to other firms and individual households by large financial institutions. Kapstein remarked that their '"absorptive capacity has yet to be severely tested" (p.v). His concern with the consolidation lay with various factors. Risks may increase because large financial institutions may enjoy a 'too big to fail premium' in the sense that their may be a belief that governments would step in the event of impending crisis; that in large organisations governance diseconomies can arise and unethical or poor management may go undetected; that consolidation may not lead to a diversification of risks. With regard to the latter, Kapstein offered a particularly relevant example. "Take for example, the Basel II Accord, which adopts a lower risk weighting for mortgages than for other types of loan. Imagine a "Basel II" bank decides to specialize in mortgage lending and acquires other firms in this market segment; it would then be greatly exposed to a generalized collapse of house prices." (p.11). One might observe that recent events in the USA and the UK indicate that Kapstein`s concerns were well founded.

There also continue to be major concerns about China's financial institutions and the global ramifications of an asset bubble burst in that country (Studwell, 2003; Nolan, 2004). Nolan (2004) comments that the Chinese government's initiation of major reforms following a series of financial scandals in Guangdong Province revealed "shocking evidence about the state of corporate governance in China's main banks. In the course of the clean-up of the country's financial institutions, huge problems were found from the bottom to the top of the country's financial system" (p.52). Securitisation also raised the need for greater transparency as regard assets and liabilities. Referring back to Tweedie`s speech to the US Senate, he remarked that "Under existing accounting standards in many jurisdictions, a company which transfers assets (like loan or credit-card balances) through securitisation transaction recognises the transaction as a sale and removes the amounts from the balance sheet. Some securitisations are appropriately accounted for as sales, but many continue to expose the transferor to many of the significant risks and rewards inherent in the transferred assets" (p.10). In other words, there needed to be greater transparency in relation to who was going to carry the can in the event of significant default or a collapse in property values.

This returns us to the issue of valuation. How much is a property worth and how far can that be standardised to ensure that the value of residential assets and associated loan portfolios translate internationally? This may be of little direct interest to an individual household (although at the micro level it does have a real impact in terms of dwelling valuations) but is clearly a matter of some importance to institutional investors. The development of internationally recognised valuation standards is directly associated with the Basel II Accord on Financial Reporting. In the Accord the importance of consistent real estate valuation was recognised as an essential ingredient of any measures designed to enable comparison of the strength of different financial institutions (see Foreword, IVSC, 2005). Echoing Stephen`s (2003) earlier remarks, valuation practices have been subject to considerable variation reflecting differences in cultures and in associated differences in lending and foreclosure practices. Ndungu et. al. (2002) nicely summarise the subjective and culturally bound nature of valuation procedures.

"It is important to appreciate the fact that valuation and appraisal is not practised in a vacuum. It is subject to national legal, economic, political and cultural systems. These systems vary from country to country. The valuers/appraisers go through different educational systems which are largely determined at national levels..... Languages, societal norms and cultures give rise to differing definitions and perceptions of values." (p.3). In a more globally integrated financial world, however, this is clearly not good enough. We have to move towards internationally agreed procedures in relation to what properties or indeed any other tradeable commodity is worth. The IVSC (2006) saw the introduction of international standards as a major step in conflict avoidance and essential to facilitate cross-border transactions. More pertinently, it referred to their (IVS) contribution to "viability of an international property market by promoting transparency in financial reporting as well as the reliability of valuations performed to secure loans and mortgages, for transactions involving transfer of ownership and for settlements in litigation or tax matters" (p.7).

There is insufficient space to deal with these and related organisations in more detail. Special emphasis has been given to them because their activities are directly related to debates around globalisation and the internationalisation of property transactions and professional practices. Moreover, they are rarely mentioned in the discussions of housing governance.

Beneath these organisations sit a panoply of more familiar institutions. These would include professional bodies associated with surveying or mortgage finance which typically have national, regional (eg European) or international organisations. For example, mortgage lenders have a UK presence as the Council of Mortgage Lenders; there is also a European Mortgage Federation; and the International Union of Housing Finance has a core group of banking and housing finance trade associations from 25 countries.

An increasingly important regulatory framework in Europe is constituted by the

raft of European Union Directives and other statutory measures and voluntary agreements at Euro level concerning such issues as building standards, environmental audits, the construction industry and mortgage guarantees. Whilst housing as such is outside the competence of the European Union, these measures impact directly on housing design and thus construction and purchase costs and are becoming more significant with rising concerns about environmental sustainability and energy conservation. The European Union constitutes a layer of governance which does not currently exist in other regions of the world. However, in any national context, the location, planning and construction of residential developments will be affected by a combination of national legislation and regulatory frameworks and local bye laws and practices.

In market driven systems the key issue is the availability and cost of housing finance. As regards the governance of mortgage lending, new regulatory measures in the governance of risk (which was the primary global concern encapsulated in Basel II) translate to the local level via government and quasi-government agencies. In the UK, for example, the Financial Services Authority (FSA) is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. It is responsible to the Treasury and ultimately Parliament. It is an FSA requirement that lenders lend responsibly and responsible lending is framed by the new Basel Accord (global level) implemented by the European Union (regional level) via the Capital Requirement Directive (CRD). These institutional and governance developments inevitably vary according to national policy and institutional histories but they will impact in similar ways in relation to local institutional restructuring and the borrowing experience of consumers. Responsible lending involves closer scrutiny of customers` ability to pay. This involves greater use of affordability models and increasing use of automatic credit scoring techniques and computer based valuation procedures. New technology and the ever expanding amount of information available on individuals on databases enables greater differentiation of risk profiles. These assessments encompass credit histories, tax liabilities, utility bills, outstanding credit commitments as well as expenses such as child care, child maintenance and schooling. High quality borrowers, first time buyers, sub-prime buyers are scored and 'stress-tested' according to varying criteria creating greater market segmentation in lending practices and thus risk exposure for institutions. Applicants for loans, especially the 'high quality' candidates, can be rapidly processed through these automated systems. For example, a recent survey of UK lenders found that 38 per cent make a decision to lend in principle within five minutes of receiving the relevant information from the applicant or the intermediary (See, Van Dijk and Garga, 2006).

Easier access to mortgage finance combined with the growth in home ownership and rising property values has also produced spiralling levels of debt exposure for households. This has been a global phenomenon although its extent has varied from country to country according to local variations in lending practices, housing tenure structures, price trajectories and legislative and fiscal frameworks. For example, between 1992 and 2002 mortgage debt as a percentage of GDP grew from 43% to 87% in the Netherlands, from 45% to 58% in the US and from 53% to 64% in the UK (Zhang, 2006, p.2). Give this high debt exposure of households, there was concern that a significant fall in residential property values or a sharp rise in interest rates could be highly destabilising, locally or globally. Until recently, financial institutions appeared to be relatively relaxed about this development, mainly because low interest rates, rising real incomes and rising asset values meant that the majority of households appeared be able to service these higher debts. Indeed, Alan Greenspan, commented that "short of a period of appreciable overall economic weakness, households, with the exception of some highly leveraged sub prime borrowers, do not appear to be faced with significant financial strain. With interest rates low, debt service costs for households have been essentially stable for the past few years" (Greenspan, 2005). An assessment of the UK situation offered a similarly optimistic scenario (See Zhang, 2006). There were, however, less optimistic views (eg. *The Economist*, 2005).

This takes us back to where we came in. There may be increasingly sophisticated methods for risk assessment in mortgage lending and increasingly integrated and standardized regulatory guidelines, frameworks and institutions which link local housing markets to the global economy. But any reading of the technical, analytical or more populist commentaries on the state of residential housing markets create a strong impression of unmanageability, wishful thinking and an essential unpredictability and uncertainty about future prospects. However, the extent and novelty of the new risks associated with more market driven forms of housing provision are recognized and are reflected in the development of governance structures described here. In this new world, housing market governance is becoming more global because of the increased risks to institutions and to households of economic downturns occasioned by major conflict, natural catastrophe or some other destabilizing political or economic event or set of circumstances. Moreover, with such an occurrence, it is already evident that national governments are likely to have to play a central role as they do in other sectors in mediating between financial systems which owe little national allegiance and the local casualties, both households and institutions.

Concluding Comments

There is nothing novel about an intertwining of the local and the global in the framing of rules and practices which shape local housing markets. Most of the key global institutions have been in existence for most of the post war period. What is novel is an apparent increased drive to internationalise and universalise rules and practices. Two interconnected factors are particularly relevant to these developments in relation to housing: risk proliferation and (to slightly adapt Sassen`s phraseology) 'liquification'.

Risk proliferation associated with price volatility, environmental change and changing borrower profiles requires more scrutiny and regulation to ensure robust lending practices and adequate capital reserves. Liquification takes two forms. The conversion by households of stored equity to facilitate general consumption and the various processes which enable dwellings or loans to become tradeable financial instruments in the global economy. Financial liberalisation has acted to relentlessly extend these liquification processes which in turn increase investment risks.

The current property crisis embracing the USA, the UK and other parts of Europe, the experience of the Asian financial crisis and, prior to that, the rapid descent of the Japanese economy, highlighted the dangers of overlending on overinflated property values. The rise and international significance of the Chinese economy and continuing concerns about the probity of its banking sector have given further priority to the development of global regulatory practices and norms. At the household level (and intimately connected with these evolving global norms for risk assessment and management), technology coupled with a greater array of individual level data enable more automatic and differentiated credit rating of individuals and households. One consequence of this is a more varied experience by consumers in terms of the cost and availability of funding and in the degree to which they are protected from this higher risk environment.

The housing market and the money flows associated with it occupy an important position in terms of national and international financial stability. Whilst the dwellings themselves are immobile the financial flows which lubricate local property markets are increasingly mobile. For most households their dwelling is their primary asset and for most governments the state of the residential property market is an important bellwether of underlying consumer confidence. House price inflation may create affordability difficulties for those seeking to enter home ownership but for existing owners rising property values are a key ingredient of the 'feel good' factor. Conversely, a price bust throws a pervasive shadow of gloom over consumers and the wider economy. The extent to which residential property values are robust or vulnerable to economic shocks which can drive them sharply downward has become more significant in the context of ageing populations, rising levels of home ownership, volatile stock markets, uncertainties over pensions funds and environmental change. Moreover, our consumption oriented culture has been fuelled in great part by the increasing ease with which home owners in deregulated markets have been able to 'liquify' their dwellings - more consumer durables, cars, air travel, second home ownership and other activities which contribute in turn to the environmental consequences which pose an increasing threat to property values and market stability.

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The Housing Boom and Bust in Spain: Impact of the Securitisation Model and Dynamic Provisioning

By Santiago Fernández de Lis[1] and Alicia García Herrero[2]

Introduction

The subprime crisis initiated in the US has affected in particular those countries where the previous housing boom was most pronounced, Spain among them. In these countries the housing bubble was accompanied by a series of common traits: a credit expansion, a reduction in the saving rate and a current account deficit.

The Spanish case is interesting for several reasons: (i) the existence of a dynamic provisioning system aimed at smoothing the pro-cyclical pattern of provisions; (ii) a model of securitisation in which originators retained the exposure and where obliged to put aside capital requirements and (iii) the participation in the euro area, which implies that, as compared to previous episodes, monetary policy is no longer an adjustment tool.

In this article we explore some lessons from the Spanish housing boom and the incipient bust from the point of view of the usefulness of the regulatory approach, with particular regard to dynamic provisions and the regulatory treatment of securitisation. First, we describe the main features of the recent housing cycle. Second, we summarize the Spanish securitisation model. Third; we deal with dynamic provisions and in the last section, we present some conclusions.

The recent housing market cycle in Spain.

From the mid 1990s to 2007, Spain enjoyed an extraordinary housing boom. On average, house prices rose by 194 percent.[3] The rate of increase of house prices peaked in 2004 above 15% in annual terms and experienced a slowdown thereafter, to an only slightly positive rate in mid- 2007, when the US subprime crisis accelerated the then ongoing correction. Recent estimates show that price changes have already been in the negative territory in mid-2008, although it is widely assumed that official figures underestimate the true extent of the housing correction.

There were a number of common factors to other countries, such as the US, UK, Ireland, Australia, and others, but also some relevant and more specific factors that explain this boom for Spain: (i) Membership of the euro area implied a sharp reduction in real interest rates of around 4 percentage points, which fostered borrowing, as well as a change of regime in terms of nominal stability, all of which allowed for a substantial lengthening of maturities for mortgage borrowing (from 10 to 28 years between 1990 and 2007); (ii) demographic factors also played a role, due to the access to the market of the baby boom generation (which in Spain was delayed as compared to other EU countries) and an explosion of immigration (estimates show an entry of 4 million immigrants in the last 10 years which corresponds to 10% of the total population); the purchase of secondary homes by other EU countries' citizens, especially in the Mediterranean coast (net foreign investment in housing ranged between 0.5% and 1% of Spanish GDP for each year between 1999 and 2007).

This housing boom was reflected in a credit boom, with rates of growth that peaked above 25% in 2006, of which 15 points was related to housing, construction and property development. Credit growth decreased sharply since 2007 and is expected to reach 5% in 2008, bellow nominal growth of GDP.

Some interesting characteristics of this housing boom in Spain are (i) the coincidence of the remarkable rise in prices with a huge increase in supply. Dwellings built yearly between 2000 and 2007 averaged 600,000. This number exceeded for some years new construction in the other 4 big EU countries combined i.e. Germany, France, UK and Italy; (ii) the predominance of Adjustable Rate Mortgages (ARM), which account for around 98% of the stock of mortgages; and (iii) the relatively small incidence of home equity withdrawals, which experienced however a small increase from 2003.

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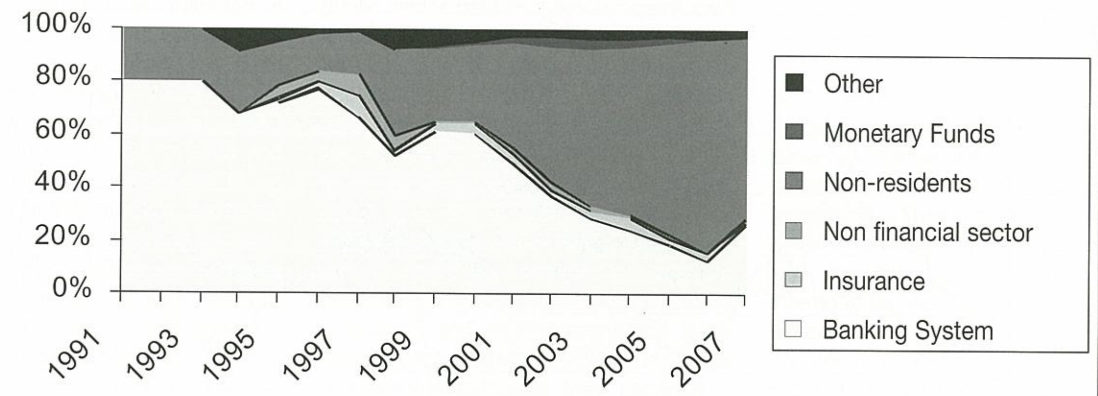
[3] See *The Economist*'s house price indicators, *The Economist*, September 13 2008, page 78.

Chart 1 - Securitised Assets: Sectoral distribution



Although the rate of growth of house prices was decreasing from 2004, the impact of the subprime crisis accelerated significantly the ongoing correction. There were 3 channels of contagion from the US to the rest of the world: (i) direct exposure to subprime losses, which in Spain were negligible, due to the very limited need of Spanish banking institutions to look for investment opportunities abroad; (ii) funding liquidity dry-up, both in the European interbank market and in the wholesale markets for MBS and other mortgage-related paper, which in Spain had a huge impact, given the high dependency of Spanish institutions on external funding (see chart 1); (iii) the expectations channel, which accelerated price corrections.

The subprime crisis forced banks to reduce loan supply, which led to a sharp reduction in construction activity. Further consequences have been a rapid increase in bad loans (especially to the property development sector) and a wave of bankruptcies in some of the main construction companies. At the time of writing this article it is difficult to assess the extent and the duration of the correction, but the macroeconomic effects (in terms of industrial production losses, unemployment and decrease in overall economic activity) are already evident.

Although the bust of the housing bubble is only incipient, it is interesting to assess to what extent the two most characteristic features of the Spanish regulatory approach to the credit and housing booms (dynamic provisions and the treatment of Off-Balance Sheet Entities) would imply a significant difference in the adjustment to the downturn phase.

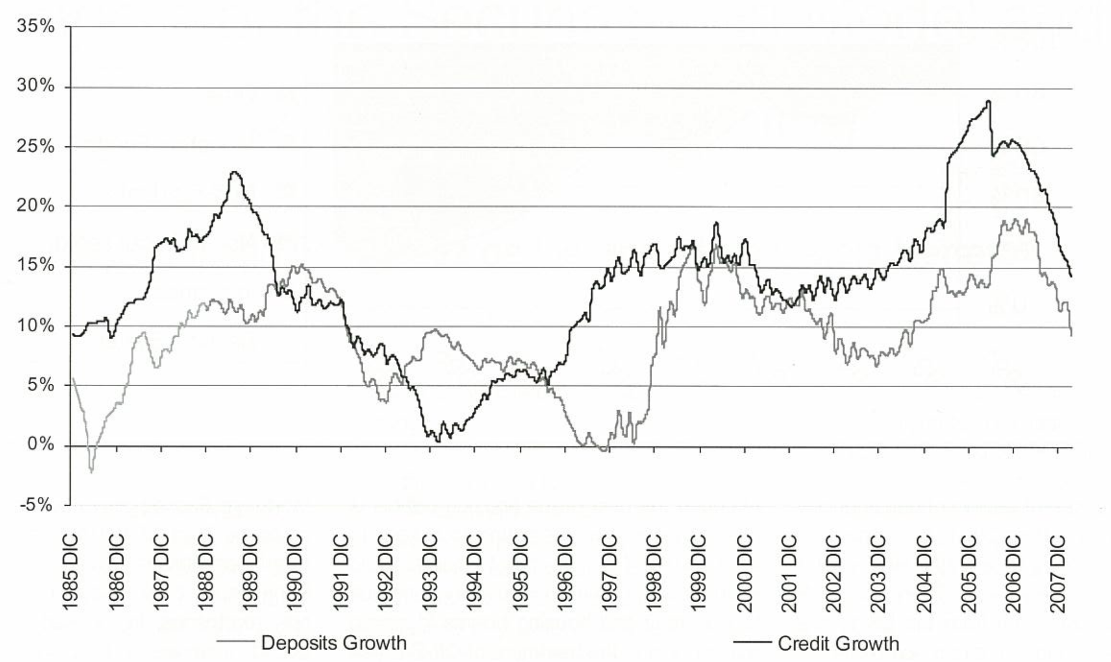
Securitisation in Spain

As opposed to other systems, where securitisation was a mechanism to transfer risk, in Spain it was related to funding purposes. As can be seen in chart 2, for a very long period (but particularly since the inception of the Euro area in 1998) the growth of credit systematically exceeded that of deposits by more than 5 percentage points during most of the period.

The regulation of securitised assets was rather conservative in Spain. The main reason has been the focus of the supervisor on consolidated accounts since the banking crisis of the late 70s and early 80s. Covered Bonds (CBs) were regulated for the first time in 1981, and for many years were the only securitisation mechanism available, which implied that traditional securitisation remained in banks' balance sheets. In 1992 Mortgage Securitisation Funds were created, with the possibility of issuing Mortgage Backed Securities, part of which could be held off-balance sheet. In 1998 Asset Securitisation Funds were allowed to issue paper backed by other assets, not only mortgages. In the early years of this decade there was an incipient trend to issue Off-Balance Sheet Securitized paper, but only until 2004. The new accounting regulation adopted then, in anticipation of International Financial Reporting Standards (IFRS), established that financial institutions that retain a significant exposure - defined in rather strict terms - to these ABS would be treated from a consolidated viewpoint by the supervisor. This approach reduced drastically the incentives for Off-Balance Sheet securitisation. The new mortgage law adopted in December 2007 allowed for more flexibility in the securitisation process, but at the same time increased the requirements for over-collateralisation.

As a result of this approach, there were no incentives to disintermediate in order to reduce capital requirements and any other kind of regulatory arbitrage. In fact, off-Balance Sheet securitisation in strict terms only accounts for about 6-7% of total securitisation in Spain. Securitisation took the form of plain vanilla instruments. Management remained in the hands of originators (which provide credit enhancements and typically keep the lower quality tranches) and the Bank of Spain focused on consolidated accounts. Most of

Chart 2 - Growth in deposits and credit by Spanish financial institutions



the securities issued were purchased by non-residents, in particular other euro-area institutions. It is important to note that this approach to a certain extent anticipated the impact of the new IFRS and Basel-II, whose combined effect will reinforce consolidated supervision.

Dynamic provisioning

The rationale behind mechanisms such as dynamic provisioning[4] is basically to reduce the inherent pro-cyclicality of the banking system. The amplification of the economic cycle by the financial sector has long been analyzed in the economic literature. The "financial instability hypothesis" developed by Kindleberger (1978) and Minsky (1982) argue that the financial system is inherently unstable due to its tendency for "excessive" accumulation of debt in times of plenty, which is corrected during recessions through deflation and economic crisis, resulting in an amplification of business cycle fluctuations. A second strand of the literature concentrates on the so-called disaster myopia, which occurs when it is impossible to assign a probability to a future shock (Guttentag and Herring, 1984)[5]. A third one is herd behaviour according to which credit mistakes are judged more leniently if they are common to the whole industry (Rajan, 1994). Fourth, the classical principal-agency problem between bank shareholders and managers can also feed excessive volatility into loan growth rates if managers' objectives are more related to credit growth – in order to increase the social presence of the bank (and its managers) or the power of managers in a continuously enlarging organisation – instead of profitability targets. Finally, Berger and Udell (2003) have developed a complementary hypothesis, called "the institutional memory", according to which as time passes since the last loan bust, loan officers become less and less skilled in order to avoid granting loans to high-risk borrowers, due to the retirement of experienced loan officers and a genuine loss of memory.

There is less consensus, however, as to how the authorities should react to the procyclicality of the financial system and, thereby, the relation between its functioning and economic collapse. Some think that booms and busts cannot be prevented (in other words, the financial system is inherently pro-cyclical because risk is pro-cyclical, and regulators cannot – or indeed should not – do much to avoid it). Others argue that regulation and supervision can improve the situation by limiting this cyclical bias (or at least avoid creating additional incentives for a pro-cyclical behaviour stemming from regulation itself). A few even give a role to monetary policy.

[4] Dynamic provisioning is understood here as any mechanism designed to smooth the contemporary negative relationship between provisions and GDP/credit growth.

[5] For more details on these different schools of thought see Fernandez de Lis, Martinez Pages and Saurina. (2000) and Jimenez and Saurina (2005).

In the case of Spain, a few additional reasons explain why regulators are especially sensitive to the risks of pro-cyclicality. First, the Spanish economy has generally been quite volatile compared to European standards. This is specially the case for bank lending, which has been subject to large swings following the economic cycle. Second, the EMU convergence process in the mid-90s and the euro adoption since 1998 led to an unprecedented credit expansion due to the reduction in real interest rates and the gains in terms of nominal stability, against which the Bank of Spain had no instruments to react, due to the loss of monetary and exchange rate policies. The fact that the Bank of Spain has traditionally been in charge of both monetary and supervisory policies explains that the approach to credit growth and bad loans (and their links to economic cycles) has been integral, implying that the loss of monetary policy (and the perception that the ECB stance in the early years of EMU was too loose for the Spanish economy's needs) was counteracted by the adoption of a more anti-cyclical regulatory approach.

All in all, the strong procyclicality of credit in Spain and its negative consequences in several instances explains the Bank of Spain decision to introduce dynamic provisioning. At that time, there was the concern that banks' loan portfolios continued to expand with very low loan loss provisions. In other words, provisions would not keep pace with potential credit losses, which were latent in new lending. The statistical probability of losses attached to any credit portfolio is incurred at the time the loan is granted although it may (or may not) materialize later. Probably, the closest example is mathematical reserves put aside by insurance companies.

The statistical provision was approved in December 1999, but came into effect in July 2000. It was added to the two previously existing provisions (generic and specific). Banks' assets were classified according to risk categories, either in a standard method (whose parameters ranked from 0% for public sector debt to 1.5% for credit card lending or current account overdrafts) or through internal methods, subject to supervisory evaluation. The statistic provision was charged quarterly, based on the difference between a calculation of latent exposure (depending on the credit stock) and the specific provisions. This implied that statistical provisions for a given period could be positive or negative, depending on credit growth (with a positive coefficient) and contemporary bad loans (with a negative coefficient). When statistical provisions accumulate they generate a Fund, with an upper limit (300% of the coefficient multiplied by the exposure).

The expected effect of the statistical provision was to smooth provisions along the cycle. Under the old system provisions were strongly procyclical, implying that provisioning efforts were higher at the recessions (for example in 1992-93, at the time of the ERM crisis[6]). The anti-cyclical behaviour of the statistical provision was expected to counterbalance this effect and result in a more evenly distributed provisioning effort along the cycle.

At the time of its introduction, most of the Spanish financial industry criticized the statistical provision on the grounds that it implied a competitive disadvantage vis-à-vis similar institutions in the single European market.

After the introduction of the statistical provision, the upper phase of the economic cycle turned out to be much stronger and longer than anticipated. This led to a rapid increase in statistical provisions, whereas specific provisions stabilised at very low levels in an environment of historically low non-performing loans. Around 2004 there was a perception that the accumulation of statistical provisions was probably excessive and that the upper limit of the statistical Fund was too high (which was initially based on very rough estimates, partly due to the lack of previous experience with this instrument).

At the same time, the Bank of Spain was being increasingly criticized by standard-setters of international accounting rules for applying a mechanism that favoured profit smoothing. Their reasoning was that dynamic provisioning is not in compliance with the "fair value" principles of the International Accounting Standards. To correct this excessive accumulation and to counter the criticisms of accountants, a new accounting regulation was adopted in 2004, which merged the statistic and the generic provisions[7]. The new system maintained most features of the old one:

The new generic provisions depended on both the stock of loans and the new loan production, with parameters alpha and beta, respectively, that increased with the riskiness of the assets[8];

- In the calculation of the new generic provision there is compensation with the specific provisions.
- New limits were established for the generic provision, between 33% and 125% of the alpha (see footnote 7).

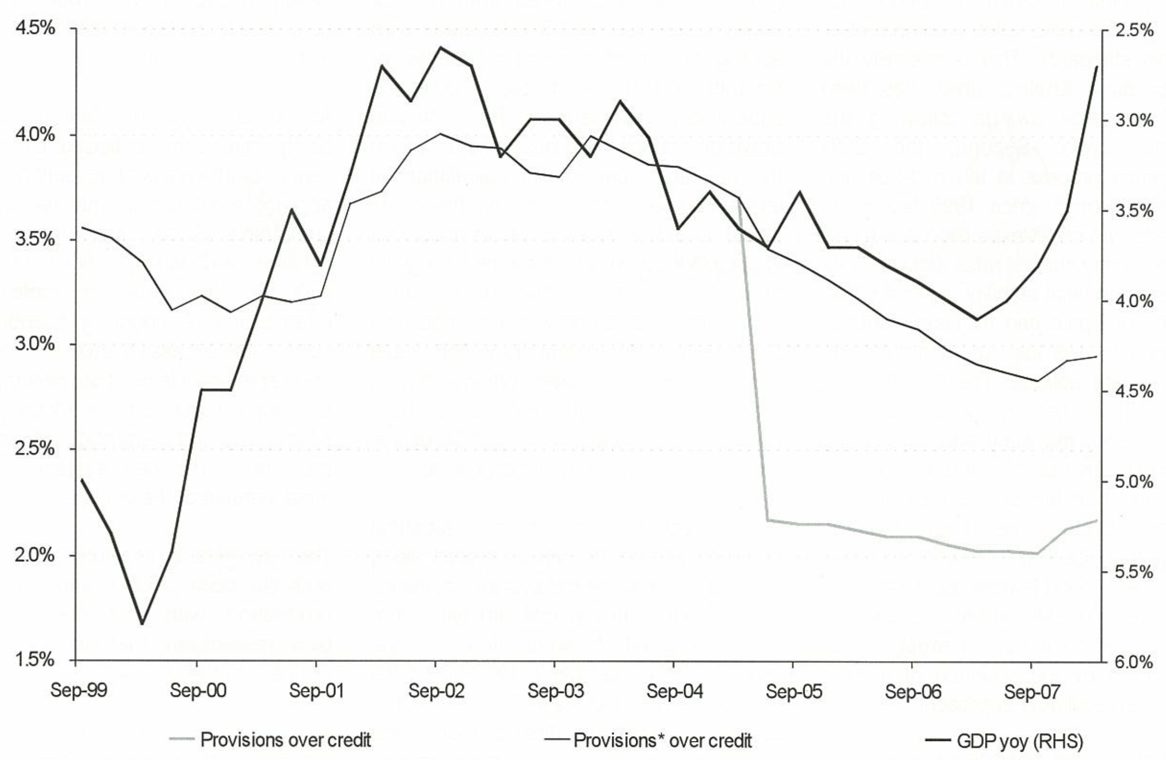
Since the upper limit was lower than the previous one, most institutions were already at the new upper limit at the time of the application of this new regulation in mid 2005, which resulted in a partial liberation of the accumulated Fund. The excess Fund, however, was not distributed to shareholders but went to banks' own resources (reserves). For comparison of the amount of the dynamic provisions, it is therefore necessary to adjust for this accounting change.

[6] After the Danish referendum that rejected the Maastricht Treaty, and in a context of deep exchange rate misalignments and divergent current account positions, the British Pound and the Italian Lira exited the ERM thus discontinuing the link with the Deutche Mark, and the Spanish Peseta was devalued 3 times between the summer of 1992 and the summer of 1993 (and a fourth time in 1995).

[7] It is important to note that this was feasible because the Bank of Spain is at the same time the banking supervisor and the accounting authority for banks, a situation quite extraordinary in the international context.

[8] Generic provisions are set according to the formula: Generic provisions = (New loan production x alpha) + (stock of loans x beta) – specific provisions

Chart 3 - Growth in provisioning and GDP



Provisions* are corrected for the impact of the new accounting regulation in 2004.

GDP growth has an inverted scale.

It is interesting to analyse how dynamic provisioning worked compared to expectations. As can be seen in chart 3, the ratio of provisions to credit decreased slightly from 1999 to 2001, increased from 2001 to 2004 and showed a declining trend thereafter, with a pattern similar to that of (inverted) GDP, but much smoother. This would indicate that the Spanish dynamic provisioning system does not eliminate procyclicality but reduces it to a considerable extent. The incipient increase of the provisions to credit ratio since September 2007 seems to confirm this pattern.

In any event, it is important to keep in mind that the upward cycle was exceptional in length. The first downturn is starting now with a rapid increase in bad loans - albeit from an extremely low level - and a sharp reduction in credit growth. These trends - very closely related to the bust of the housing bubble - imply that specific provisions are increasing, which - together with a lower credit growth - would, in principle, reduce generic provisions and, thereby, the accumulated fund.

The fact that most institutions are at the upper 125% limit implies that there is ample room for a reduction in case of need. But these limits are inherently asymmetric, in the sense that institutions are in principle free to provision above them. They may be inclined to follow this strategy for reasons of caution, although what is more appropriate for a given institution is not necessarily good from a systemic point of view. The rationale of the system suggests that if the downturn is severe enough, institutions should allow its automatic anticyclical features to operate.

Conclusions

Spain experienced from the late 1990s until 2007 a housing boom with similar features known to other economies, but with a series of idiosyncratic characteristics. Since it coincided with a massive increase in housing supply, this boom was even more impressive. There are fundamentals that explain to a certain extent the boom (EMU, demographics, demand from other EU countries), but even considering these factors an element of bubble seems to be present.

HOUSING BOOM AND BUST IN SPAIN: IMPACT OF THE SECURITISATION MODEL AND DYNAMIC PROVISIONING

The correction of the Spanish boom was already ongoing when the subprime crisis hit international financial markets in mid-2007. Apart from the impact on expectations, which probably accelerated the housing prices correction, the main effect of the international crisis was to drastically cut access to wholesale funding markets, which had been the main source of financing for credit expansion in previous years. This led to a sharp correction in bank lending.

One year after the onset of the crisis, it is difficult to assess its full impact and duration in international financial markets. The same is applicable to the Spanish real estate market and banking system. At this stage, it is interesting to assess the impact of two distinctive features of Spanish financial regulations that were addressed precisely to avoid excess credit procyclicality and perverse incentives to disintermediation that may result in an increase in systemic risks: dynamic provisioning and the treatment of Off-Balance Sheet Entities (OBSEs), respectively.

The treatment of OBSEs already did its work, to a large extent. The inclusion of these instruments in the consolidated supervision of banking groups avoided that risks were transferred to unknown segments of the financial system or to households and non-financial companies. There was no spurious disintermediation as a result of perverse incentives. The other side of the coin is that the banking system concentrated most of the risks and the impact of the housing correction, but this is natural in a banking-dominated financial system with a universal banking model, like the Spanish one. According to available data, the Spanish banking system is strong compared to other systems in the EU in terms of efficiency, profitability and solvency, which is reassuring.

As to the Spanish dynamic provisioning system, it reduced but did not eliminate the procyclicality of provisions. The way the statistical Fund was defined and the extraordinary length of the business cycle implied that most institutions reached the maximum level relatively early. This mechanism allowed Spanish banks to maintain a doubtful assets coverage ratio 3 times higher than the EU average in December 2007, which implies that when the crisis hit, the objective of counting with a buffer in terms in provisions had been reached. But it is difficult to assess whether the accumulated Fund will be sufficient.

The rationale of the system would lead to a use (depletion) of the accumulated Fund in the downturn. But will the entities use it? In principle they are allowed to provision above the minimum (although without fiscal advantages), and may be inclined to do so for the sake of caution, with a view of the very rapid increase in bad loans they are witnessing in 2008. But from a systemic point of view it might be more appropriate to allow the system to operate as initially envisaged, using the Fund in the downturn. This will contribute to smooth the credit contraction process and reduce the severity of the adjustment in the housing sector and in the overall economy.

For emerging market economies (EMEs), that are usually subject to more pronounced cyclical swings, the Spanish provisioning mechanism might be an interesting device to smooth provisioning efforts along the cycle and attenuate the financial accelerator problem. As for the treatment of Off-Balance Sheet Entities (OBSEs), the general lesson seems to be that regulation should avoid artificial incentives to disintermediation due to differences in the degree of regulatory pressure on certain segments of the financial system.

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Indonesian Home Purchasers' Loan Preferences

By Raymond J. Struyk, N. Kokularupan, and Nilesh Patel[1]

1. Introduction[2]

In industrialized countries, the ability to borrow funds to finance housing investment is generally a key determinant of whether a family can afford to become a homeowner. Formal housing finance, i.e., mortgage loans provided by regulated institutions, plays an extremely important role in actualizing potential housing demand. Competition spurs lenders to offer loan products that meet clients' preferences.[3]

In developing nations, on the other hand, while formal finance sometimes plays a significant role, it is often not the primary means of realizing adequate housing. Moreover, competition among lenders is limited, and product offerings seldom appear to result from market studies.

Rather, incremental unit construction financed through savings, or short-term borrowing, is frequently the dominant path households take to eventually obtaining a unit of minimum acceptable quality.

In Indonesia, the majority of urban housing is constructed incrementally (Struyk, Hoffman, Katsura, 1990). Formal mortgage finance has had a modest role. In 1996, outstanding mortgage debt was 3.1 percent of GDP, but lending declined sharply after the financial crisis initiated in 1997. In 2005, the ratio stood at only 1.8 percent (Hoek-Smit, 2005). This is similar to the figures for Algeria, Saudi Arabia, Pakistan, Turkey, and Ghana, and much lower than India's 5 percent (Chiquier, 2006).

In the fall of 2007, mortgage loans from commercial banks were very predominantly variable interest rate loans (VRMs), typically with the first adjustment occurring after the loan was active 1-3 years. Interest rates on these variable rate products were about 9.5 percent annually; the few fixed rate loans on offer had rates about 200 basis points higher. Maximum loan-to-value ratios (LTVs) were in the 70-80 percent range. Loan terms were as long as 15-20 years. The popularity of VRMs with lenders resulted from the losses they suffered during the 1997 financial crisis when the cost of liabilities accelerated while outstanding fixed rate mortgage loans did not reprice.[4]

The International Finance Corporation (IFC) commissioned the survey discussed here to learn more about the decisions of Indonesian home purchasers to take a loan from a formal financial institution or to otherwise finance their homes. The IFC was particularly interested in would-be borrowers' preferences for certain loan features: the length of the loan term, whether the interest rate is fixed or variable, and the loan-to-value ratio. Another area of concern was consumers' knowledge of the mortgage loan: if home purchasers are largely ignorant of the characteristics of mortgage loans, they are less likely to consider this form of finance.

To date, Indonesian mortgage lenders have had little systematic information with which to work on either would-be borrowers' loan product preferences or their knowledge of mortgages. Our study was designed to fill this void, and provide them a powerful resource for expanding lending. To our knowledge this is the first such study undertaken for a developing country.[5]

At the same time, there are significant policy issues associated with changes to current loan features. The shift from variable to fixed rate loans would require enhanced management of the attendant increased interest rate risk. Likewise, offering high LTV loans may require the introduction of mortgage default insurance to help lenders management the heightened credit risk.

This article presents information from a February-March 2008 representative household survey on the financing plans of Indonesian households who plan to purchase a dwelling in the next three years and who live in the nation's seven largest metropolitan areas. Because only households who said they were planning to purchase completed units were included, as opposed to beginning or continuing incremental construction of a dwelling, respondents were expected to be in the upper part of the income distribution.

The balance of the article is organized as follows. The next section sketches the data employed in the analysis. The third reviews respondents' general plans for financing their home purchase, focusing on population estimates of the demand for mortgage finance. The fourth section reviews findings on preferences for mortgage loan features - loan-to-value ratio (LTV), the term of the loan, and a fixed versus variable interest rate. The fifth section contains information on respondents' grasp of basic mortgage concepts. The final section offers some conclusions.

2. The Survey and Questionnaire[6]

The primary objective of the survey was to find out about the home purchase loan preferences of Indonesian families residing in the nation's seven largest metropolitan areas who intend to purchase a dwelling in the next three years. These areas include Greater Jakarta (Jakarta, Bogor, Depok, Tangerang and Bekasi), Surabaya, Medan, Makassar, Bandung, Semarang and Denpasar.

The family planning the purchase could be a whole household (led by a primary family), or a family within a household (a secondary family) who will move out when it buys a unit. It is possible that more than one family unit within a household would be planning to purchase a dwelling in the near term. The family could currently be a homeowner or a renter.

The survey had a final sample size of 1,281 families, resulting from contacting a total of 8,756 separate households, implying a combined (unweighted) eligibility and response rate of 15 percent. It is representative of families in these cities who are planning to purchase a dwelling in the next three years.

The questionnaire gathered comprehensive information on household composition so that family units within the household could be identified, and the income of each person could be properly allocated to a family. Information on the current housing situation was gathered at the household level, along with questions about how the purchase of the current dwelling was financed, if the unit was owner-occupied. For each family unit that reported it was planning to purchase a dwelling in the next three years, there were batteries of questions on the type of dwelling they wished to purchase and its location, how they intended to finance the purchase, their connection with formal financial institutions through savings or current accounts, prior loans, and credit cards; a series of questions on loan product preferences; and, questions designed to assess their knowledge of mortgage loans. The questions on loan product preferences did not explicitly ask about mortgages because there was some concern that not all those intending to borrow from a formal lender would know the term, and therefore its use could lead to confusion.

3. An Overview of Financing Plans

The survey data represents a population of 199,000 families who say they intend to purchase a dwelling in the next three years. A very important question is what percentage of these families plan to borrow to do so. As shown in Table 1, 49 percent of purchasers - 97,500 families - plan to take a loan. Thirty-six percent plan to use their own resources to pay cash for the unit. The remaining purchasers plan to pay cash with help from their employers or families and friends.

Where do those who will borrow to purchase their units plan to get their loans? Table 2 presents two types of information on this point. First, those respondents planning to borrow were asked where they were thinking of borrowing funds. They could name as many sources as they wished. The percent naming each source is recorded in the second column. Second, they were asked which would be the single most important source. The percent naming each source is in column 3.

Commercial banks are by far the most important planned source of funds, with 55 percent of borrowers citing them as one source and 52 percent citing them as the most important source. Family and friends and employers are the second and third sources, but with only 16 and 14 percent,

Table 1. Broad Plans for Financing Home Purchase

Respondent reporting that this option best describes his plans	Percent Naming This Option
Buy it with cash with my own resources	36
Buy it outright with cash with help from my family or friends	10
Buy it outright with help from my employer	5
Buy it with a combination of downpayment and a loan	49

[1] The authors are, respectively, a Senior Fellow at the National Opinion Research Center, Principal Housing Finance Specialist, East Asia and Pacific, International Finance Corporation, and a PhD student in the Sociology Department at the University of Chicago.

[2] Every large survey project requires an effective team effort to be successful. Several people and organizations made significant contributions to the results reported here. Foremost, YIPD (Yayasan Inovasi Pemerintahan Daerah) did an excellent job in carrying out the survey work and preparing the data set. Safaa Amer and Fritz Scheuren designed the sample and developed the weights. Daniella Wallace helped them with a variety of spreadsheet tasks. Throughout, Jeffrey Telgarsky gave assistance and advice on a variety of topics and matters and generally moved the project along. Marisol Ravicz gave very helpful comments on a draft. At the IFC, Nyoman Gde Satrya Wibawa efficiently dispatched the administrative tasks associated with the contract. The work reported here was carried out under contract with the International Finance Corporation. The authors are responsible for any inaccuracies in the paper.

[3] A fine example of a lender's working to position his bank to expand market share is in Knight (2006).

[4] An overview of the Indonesian housing finance sector can be found in Hoek-Smit (2005).

[5] The topic of consumer preferences for mortgages with various attributes has received significant attention in countries with highly developed mortgage markets. A very important difference between those studies and this one is that those studies use data on actual choices household made when financing their dwellings, whereas the present study is based on stated household intentions. See, for example, Breslow et al. (1996), Brueckner and Follain (1998), Follain (1990), Campbell and Cocco (2003).

[6] A full description of the sampling and weighting procedures along with basic data tabulations is provided in Struyk (2008).

INDONESIAN HOME PURCHASERS' LOAN PREFERENCES

Table 2. Where Home Purchasers Plan to Get a Loan

Loan Source	Percent Naming This as One of Possibly Multiple Sources[a]	Percent Naming This as Most Important Loan Source
Commercial bank	55	52
Cooperative	14	5
Private developer	7	5
Money lender	—	—
Family and friends	25	16
Employer	20	14
Other	8	7

a. Because multiple answers were permitted, the column entries sum to more than 100%.

respectively, naming them as the most important source.

Commercial banks and cooperatives are regulated mortgage lenders, and together they account for 57 percent of the estimated primary loans, or 55,800 loans. The other loan sources are unregulated and for some like families, friends, and employers, there may be significant non interest payment obligations associated with getting a loan; e.g., an employer may demand that the worker sign a contract to work 5 more years with the firm.

From a banker's perspective, those home purchasers who intend to take a loan from a bank or cooperative are the more interesting group since these purchasers constitute a concrete market. The balance of the report focuses on this group of purchasers. We often contrast the characteristics of these purchasers with those planning to use other forms of finance to better describe both groups.

4. Findings on Home Purchase Loans

Our findings on would be borrowers' plans and product preferences are presented in the next three sections: the expected value of the loans, down payments, and the affordability of loans borrowers plan to take; preferences expressed for three loan attributes; and, purchasers' knowledge of basic mortgage facts.

Forty-nine percent of those planning to purchase a dwelling intend to take a loan of some sort to finance it. This means that over the next three years, 97,500 households in these seven major metro areas will be looking for a loan. On average, they plan to borrow Rp.107.7 million, or $11,580, yielding a total loan volume of Rp.10.5 trillion or $1.13 billion. If we restrict the number of loans to the 55,800 for borrowers who plan financing from commercial banks and cooperatives, on average borrowing Rp.118.4 million ($12,730), then the amount is Rp.6.6 trillion ($0.71 billion). (In May, 2008, the Rupiah – USD exchange rate was about Rp.9,300 to 1USD.)

Table 3 provides a more complete overview of would-be borrowers' plans for financing their homes. Note that the sample used in the table is restricted to those who plan to borrow from a formal lender and for whom all information is available. Many respondents did not name a purchase price when asked, presumably reflecting their uncertainty about actual prices for the type of unit they are seeking.

Overall, borrowers have conservative plans. We estimate that their mortgage payment as a share of family income will be 0.20. Moreover, the house price-to-annual income ratio is a modest 2.09. On average, borrowers expect to make a downpayment of 15 percent. Of course, it is possible that prices are higher than they realize and that they will take bigger loans, which would increase both these ratios.

Table 3. Mean Values for Key Loan Characteristics: All Observations and Observations Where Respondents Provided Information on All Items[a]

Loan Feature or Borrower Income	Value (Rp are in thousands)
Computed PTI[b] based on borrower' statements	.20
Maximum monthly loan payment	935
Dwelling price	139,129
Loan amount[c]	118,401
Downpayment amount	20,728
Family income per month	5,531

a. Mean is based only on those observations where respondents provided answers for all of the items listed in the first column; n = 216.
b. PTI is payment to income ratio. The respondent was asked what was the maximum monthly payment he could make. The figure in the table is this number divided by family income computed for each household and then the mean taken of the ratios.
c. Respondents provided information on the price of the unit they were considering and the expected downpayment. The loan amount was computed as the difference.

An important result concerns how the respondents' estimate of their maximum monthly mortgage loan payment compares with the size of the loan they indicate they are seeking. Using current interest rates, we computed the size of the loan a borrower could take with a 15-year term. In other words, do borrowers appear to have a realistic idea of what their monthly payment can purchase? We found that only one-half of borrowers' anticipated monthly payments would cover at least 85 percent of their loan under a 15-year loan. Thus, a significant share of those planning to borrow has a somewhat unrealistic idea of what they can afford. On the other hand, the share of income they are planning to devote to mortgage payments is also estimated at a quite low value by international standards; so they could in principle spend more.

5. Consumers' Preferences for Selected Loan Features

This analysis employs information for all respondents rather than that for only those saying they intend to take a loan from a formal lender. This is preferred because some of those planning to use other types of finance may be discouraged from approaching formal lenders by the loan terms now being offered.

Table 4 lists two or three measures for each loan feature. The results are shown for two populations: respondents who said they plan to borrow from a bank or cooperative to finance their home purchase, and other respondents. Again, we concentrate on the first group, which is of greater interest to bankers.

Length of the loan term

Results for two questions about the length of the loan are reported in the table. Both sought to make clear the trade off between being in debt for a longer period of time and having a lower payment. Respondents were shown the difference in monthly payments on a card in each case and then asked for their preference.

- In the first case, the choices were between a 5-year and a 10-year loan. Between the two cases, 76 percent of borrowers preferred the 10-year loan.
- In the second, the choices were a 5-year, a 10-year, and a 15-year loan. A majority, 59 percent, preferred the 15-year loan.

So the pattern is for borrowers generally to want the lower monthly payments associated with the 10-year loan, but there is some reluctance to take on a debt that will run as long as 15 years, i.e., while 76 percent would take a 10-year loan only 59 percent would take the 15-year loan.

The responses on the loan term are highly consistent with the responses to another question that asked respondents which of two statements better fit them: (a) one that said he really did not like being in debt for a long time, and (b) one that said that while he disliked being in debt he would take a longer term loan to get a lower monthly payment. For those selecting the 10-year loan between the 5- and 10-year loans, 75 percent of those who selected the longer loan term answered (b); for the 10-year versus the 15-year loans, 77 percent did. In short, there is a strong and consistent preference for a loan term of at least 10-years to increase affordability through lower monthly payments.

Fixed versus Variable Interest Rate

Respondents were asked two questions on this point, and both questions offered them a lower interest rate with a variable rate loan than with a fixed rate loan. The first question inquired about the importance of knowing his monthly payment would be the same every month versus a variable payment with the initial loan interest rate being lower. The second question walked the respondent through a concrete example comparing a 10-year variable rate loan with a 9.5 percent starting interest rate and a 12-year, 11.5 percent fixed interest rate loan. (The monthly payments are essentially the same for the two.) The respondent was then asked his preference between the fixed and variable rate loans.

The results in Table 4 show a strong preference for the fixed rate loan:

- 74 percent of respondents wanted the consistent monthly payment, and
- 71 percent also chose the fixed rate 12-year, fixed interest rate loan over the 10-year, 9.5 percent variable rate loan.

These responses are highly consistent with each other. Seventy-nine percent of those who chose the fixed interest rate 12-year loan in the second question said the need for a constant monthly payment better characterized them.

Respondents were also asked to select between two statements about their expectations for the economy and inflation in the "next 2-3 years:" (a) one said that the economy would be "pretty good" and inflation will not increase much, and (b) one that said that "we may have another period of inflation and general instability." Of those giving answer (b), 62 percent prefer the fixed rate mortgage in the first question described above; and, 90 percent said they would chose the fixed rate over the lower interest variable rate mortgage in the concrete example.

In summary, there is a strong preference for fixed-rate over variable rate mortgages. Moreover, would-be borrowers' preferences for fixed rate mortgages are highly consistent, and consistent with their views regarding future economic developments.

Loan-to-Value Ratio

We noted earlier that at present commercial banks seldom make mortgage loans for more that 70-80 percent of a property's value. Some believe that this is constraining the demand for mortgage loans because families have difficulty assembling large down payments. If potential borrowers have a strong preference for higher LTV loans, then a sensible public policy response may be to encourage the development of mortgage default insurance to help banks manage the greater credit risks associated with such loans.

The survey included one direct question on preferred down payment as a percentage of the unit price, and two indirect questions designed to understand what the

Table 4. Indicators of Home Purchasers' Loan Preferences

Feature and Indicator	Those planning to take loan from bank or coop to purchase their unit	Those planning to use other ways to finance unit purchase
LTV		
LTV1 – respondent said he would have to have a higher downpayment because he could not make larger monthly payments[a] (percent giving this answer)	69	73
LTV2 – respondent's statement about the best downpayment percentage for him (downpayment as percent of purchase price)	15.0	13.4
LTV3 - respondent said he would pay an extra Rp. 22,000 per month for a higher LTV using a specific example[b] (percent giving this answer)	44	42
Loan term		
LENGTH 1 – respondent chose a 10-year repayment period over a 5-year period, after looking at a card that showed the monthly payments on a specific loan for the two periods (percent giving this answer)	76*	69
LENGTH 2 – respondent chose a 15-year repayment period over a 5- or 10-year period, after looking at a card that showed the monthly payments on a specific loan for the two periods (percent giving this answer)	59*	46
Fixed vs variable interest rate		
FIX-RATE – respondent expressed a preference for a loan with the same payment every month compared with a variable rate loan with the starting interest rate that is lower for the first 1-2 years.[c] (percent giving this answer)	74	78
FIX-PREF – respondent selected a fixed rate loan with a higher interest rate and longer term over a variable rate loan with a shorter term; the monthly payment on the two loans were essentially the same.[d] (percent giving this answer)	71*	62

* The difference in the values for FORMAL and OTHER populations is statistically significant at the .05 level or higher.

a. The specific question was: *Which of these statements better fits your thinking?*

1. It is hard for me to save for a big downpayment. So I would rather have a bigger loan (and a bigger monthly payment) than to save for a big downpayment.

2. Even though it is hard to save for a big downpayment, I think I have to do this because I cannot make bigger payments.

The figure in the table is the percent who chose the second option.

b. The Rp. 22,000 figure corresponds to the monthly premium for mortgage insurance under fairly severe default and loss rates.

c. The specific question was: *Does the first or second statement better fit your thinking?*

1. It is really important for me that the payment I make on my loan will be same every month so I can plan on it. Changes in the interest rate and monthly payments, especially an increase, would be a big problem.

2. If the interest rate on the loan is lower for the first 1-2 years (and so the monthly payments are lower, too), then I would accept that the payments could change later if in general interest rates in the market changed; my payments could go up or they could go down.

d. The specific question was: *I want to ask you about two cases with the same loan amount taken out to buy a dwelling. The dwelling costs Rp 140,000,000; the loan amount is Rp.90,000,000 [HAND CARD 2] Please compare these two cases, both with a loan amount of Rp.90,000,000.*

In Case 1, the loan has a variable interest rate. Its interest rate is 9.5% when you first get the loan, and the loan repayment period is 10 years. As you see on the card, the monthly payment for this loan at the beginning is Rp.1,145,000.

In Case 2, the loan has a fixed interest rate of 11.5%, and the loan term is 12 years. Again, as shown on the card, the monthly payment is Rp.1,125,000.

In other words, the two loans start out without much difference in the monthly payment due. The variable rate loan's payment could increase over time whereas the fixed rate loan's payment will always be the same. However, if you choose the variable rate loan, you will spend 2 years less making payments on it than you would if you choose the fixed rate loan. Also, monthly payments on the variable rate loan could decrease over time if interest rates go down. Which option would you prefer if both were offered?

INDONESIAN HOME PURCHASERS' LOAN PREFERENCES

Table 5. Indicators of Consumers' Knowledge of Mortgages

Indicator	Those planning to take loan from bank or coop to purchase their unit	Those planning to use other ways to finance unit purchase
Had no knowledge of mortgage loans (%)	27*	37
Questions asked to those with some knowledge[a]		
Knows that the borrower holds title during the loan period (%)	36	43
Knows that foreclosure is penalty for not making payments. (%)	40	40
Knows dwelling serves as collateral for the loan (%)	45	42
Knows that the seller must have title to the property to obtain a mortgage (%)	80*	86
Knows can occupy unit immediately with a mortgage rather than waiting until most or all of the loan is repaid (%)	81*	70
Sum of the number of correct responses for the previous 5 questions. (number)	2.06*	1.57

a. The base for the percentages for the five questions is the number of respondents who knew something about mortgages.
* The difference in the values for the two populations is statistically significant at the .05 level or higher.

respondent saw as his best downpayment. The average LTV based on the direct question on the borrower's preferred downpayment is 15 percent; 63 percent of respondents said they prefer a downpayment of 15 percent or less. This is consistent with 44 percent of borrowers saying that they would be willing to make a higher monthly payment (for default insurance) to get a loan with an 85-90 percent LTV.

Not so consistent with the above two observations is that 69 percent of borrowers said that they would have to save for a bigger down payment because they could not afford higher monthly payments (item LTV1 in Table 4).

Among these indicators it is reasonable to give greater weight to a question that directly asks about preferences. Here the response is clear: overall preferences are for down payments substantially lower than those now permitted by formal lenders.

6. Consumers' Knowledge of Mortgages

How knowledgeable are Indonesian home purchasers about mortgage loans? The survey asked respondents if they knew anything about a mortgage and then, for those who said they did, five additional questions about the basic features of a mortgage. These are items 2 thru 6 listed in Table 5.[7]

Item 1 in the table records the share of those who said they planned to take a loan for their unit purchase who also said that they had no knowledge about mortgages.[8] About 27 percent of those intending to take a mortgage said they really did not have knowledge of this loan instrument, and 37 percent of other would-be purchasers also acknowledged no familiarity with mortgages.

With the exception of answers to questions about whether the seller must hold title to sell a unit that will be financed by a mortgage, and when a borrower can occupy his unit, this pattern of fairly low knowledge levels is repeated in the rest of the table. This response pattern is similar to that documented in a 2007 survey of would-be home purchasers in Cairo (Struyk, 2007).

Overall, those intending to take a mortgage identified mortgage conditions more accurately significantly more often that others - 2.06 vs. 1.57 correct answers out of a possible 5. This is expected since members of this group are really planning to take such a loan.

These results point to the advisability of a broad education campaign by mortgage lenders to help generate demand. Families thinking about purchasing a dwelling will be much more likely to seriously consider taking out a mortgage if they have a working knowledge of the rights and responsibilities that such loans entail.

7. Conclusions

The 2008 Indonesia Housing Finance Survey provides bankers and policy makers with very important and statistically reliable information on the home purchase and

[7] The questions on financing the home purchase were asked before the questions on mortgage attributes and did not ask about a mortgage specifically. We were concerned that some respondents would not be familiar with the term "mortgage" and this would confuse them in responding to the loan questions.

[8] The specific question was: Have you ever heard of a mortgage loan? I mean do you have any knowledge of this type of loan?

home finance intentions of families in the nation's seven largest metropolitan areas. Few transition and developing countries have such data available to guide mortgage product design and plans for funds mobilization to meet likely mortgage demand.

The final sample size of 1,281 reflects about 199,000 families that intend to purchase a dwelling in the next three years. Forty-nine percent of those planning to purchase a dwelling intend to take a loan of some sort to finance it. This means that over the next three years, 97,500 households in these seven major metropolitan areas will be looking for a loan. On average, they plan to borrow Rp.107.7 million, yielding a total loan volume of Rp.10.5 trillion, or Rp.6.6 trillion, if we restrict the number of loans to the 55,800 for borrowers who plan financing from commercial banks and cooperatives.

The survey's primary purpose was to enable study of the mortgage loan preferences of those planning to purchase a dwelling, in particular: the length of the loan, the preference for a fixed rate loan over a variable rate loan, and the loan-to-value ratio (LTV). Preferences were identified using several questions on each loan characteristic. The broad findings are as follows:

- There is a strong preference for fixed interest rate loans over variable rate loans, even when interest rates on the fixed rate loans are 2 percentage points higher than the rate on variable rate loans.
- Borrowers have a strong preference for a 10-year loan over a 5-year loan but a less pronounced preference for a 15-year loan over a 5- or 10-year loan.
- There is a general preference for lower downpayments than those now permitted by formal lenders.

The results show quite limited knowledge levels by home purchasers about mortgage loans, with those intending to borrow knowing significantly more than others but still relatively little. Overall, the pattern points to the need for more consumer education about mortgage loan products. The fact that would-be borrowers have greater knowledge suggests that education campaigns may well generate additional borrowers.

Responding to consumers' preferences for higher LTV and fixed-rate mortgages to increase loan volumes will be challenging for lenders. In particular, they will confront the requirements of enhanced management of interest rate and credit risks. Interest rate risk will be heightened by an expected short-term surge in inflation to 11.5 percent (IMF, 2008). There are possible public policy actions in both instances that would help.

Interest rate risk could be sharply mitigated through the refinancing of loans by a refinance facility. One exists in Indonesia today (SMF). However, because its regulatory limit on on-lending activities was three years, its refinancing window was not considered attractive for lenders. The loan limit was changed to 15 years in February 2008, and SMF is preparing its first bond-issuance in the coming months to kick-start its liquidity lending.

The heightened credit risk of higher LTV loans could be addressed with mortgage default insurance, with risk shared between the lender and insurer. This would be a new area in Indonesia.

It is difficult to know the extent to which these results can be generalized to other countries with nascent mortgage markets. The consistency of the findings on consumers' limited knowledge of mortgage loans with the situation in Egypt suggests there may be some transfer. Unfortunately, it is not possible to go further until more information on preferences from other countries is available.

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Housing Microfinance in Vietnam: a mass-market still left unattended

By Charles Cornelis and Hanna Ruben[1]

Vietnam has shown remarkable growth results in recent years, lifting millions out of poverty in the past decade. This makes the question whether housing microfinance (HMF) could further contribute to Vietnam's development highly relevant.

Besides providing an updated overview of the current market situation for HMF in Vietnam, we believe our research provides several novelties. The broad theoretical and methodological approach, the detailed product derivation and dynamic setting, results in a clear overview of market opportunities and a set of recommendations for new market actors.

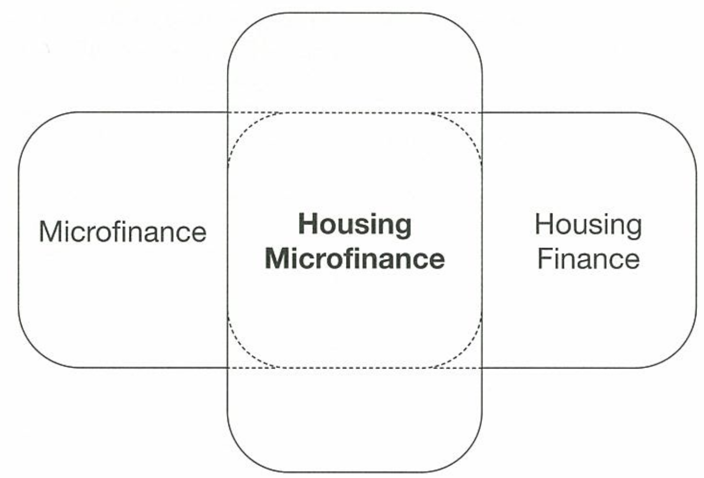
The methodological approach of this study was to collect both quantitative and qualitative data, subjected to qualitative interpretation. In the desk research relevant literature was reviewed, which included websites, articles and books on the subject. During the field research phase in Vietnam face-to-face interviews with experts of different backgrounds were conducted. These interviews in combination with the mentioned secondary data enabled us to provide a broad overview of current supply and demand of HMF in Vietnam, as well as expected future developments in the market.

1 – Housing Microfinance: A Broad Approach

Although there is no precise definition of HMF, a good start for a definition would be, for example: HMF is the application of techniques/mechanisms from the microfinance (MF) revolution to housing finance (HF solutions). Thus, in this perception HMF is the area of overlap between HF and traditional MF. This overlap applies to products (including their target clientele) as well as institutions.

A more intricate way to define HMF is a two-fold approach, namely to distinguish a product-based definition and a provider-based definition of HMF (Daphnis, 2004)[2]. The product-based definition focuses on the *distinguishing characteristics* of HMF products, rather than the type of organization offering the product. The provider-based definition focuses on microfinance institutions offering any *housing-focused financial service*. Thus, to put it in plain words, the choice of definition determines the "glasses" you wear when looking at HMF: the product-based definition leaves room for alternative institutions and the provider-based definition for alternatives products – i.e. alternative from the traditional HMF overlap-definition paradigm. So, while a great degree of overlap between HF and MF

Figure 1.1: Conceptual Model of Housing Microfinance – adapted from Daphnis & Ferguson (2004)[3]



[1] University of Groningen, The Netherlands. This article is excerpted and edited from a larger research paper, titled "Housing Microfinance in Vietnam". This research was commissioned by FMO, the Netherlands Development Finance Company, by the authors, two senior students at the University of Groningen, The Netherlands.

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[3] Daphnis, F. & Ferguson, B. (2004b), "Housing Microfinance: An Overview", Presentation for USAID, CHF International / World Bank, October 28 2004.

exists, there is also a certain degree of uniqueness to HMF. This uniqueness exists on the supply-side as well as on the demand-side. New suppliers, previously not active in either MF or HF, may add HMF-products to their portfolio. Moreover, HMF products themselves often have certain characteristics, for instance construction assistance, that are not found in MF or HF products. On the demand-side, demand may not only stem from current MF or HF clients, for whom a HMF product might better suit their needs, but also from people who before were not interested in either.

Recognizing both the overlap and the uniqueness of HMF to HF and MF, we graphically represent our theoretical concept of HMF as in Figure 1.1. Note how the HMF rectangle not only consists out of the overlap between MF and HF, but also out of a part that falls outside of these latter two, representing the part of HMF which is unique. This overlap + uniqueness view of HMF that we employ can be applied to the whole HMF market. Therefore, at the outset, we consider both existing HF and MF providers, clients and products when examining the market for HMF in Vietnam, as well as alternative ones.

2 – Institutions providing MF, HF and HMF in Vietnam

Looking at the products of the HF and MF institutions we judged whether the issuing institution could be considered as providing HMF-products. We did this by deriving in detail the characteristics that make up a HMF-product according to our conceptual model, and comparing how closely their products match. When examining these MF, HF and HMF-institutions, we segmented them on the basis of ownership (private, public) and legal form (formal, semi-formal or informal).

There is currently a broad variety of different institutions providing MF products in Vietnam. In the public sector, the largest formal player is the Vietnam Bank for Social Policies (VBSP), a state-bank, which has a vast nation-wide network and provides heavily subsidized credit both to individuals and groups. Additionally the People's Credit Fund (PCF's) network is a large formal cooperative using mobilized savings as its chief resource. The semi-formal public actors in the MF market are many, although they cover only 5-10% of the total credit market. These are Mass Organizations (MOs) such as the Vietnam Women's Union (VWU) and the People's Credit Funds (PCFs). The VWU is not a direct supplier of MF itself but owns three specialized MF funds. In the private sector more than 50 International Non-Governmental Organizations (INGOs) are involved, although they cover only 5% of the microcredit market. Many make use of the VWU's extensive network, for example Netherlands Development Organization (SNV), Save the Children, World Vision, Plan International, ActionAid and (AFAP). Finally, the informal economy also plays a significant role in MF. As part of historic cultural tradition, cash lending by families, friends, communities etc. is very common in Vietnam.

In Vietnam, three formal State Owned Commercial Banks (SOCBs) provide HF products for individual households. These banks are equitized, but a majority of shares (to be downscaled to 51%) are in government possession. The banks in question are Vietcombank, Vietinbank and the Mekong Housing Bank. In the private sector, HF products are offered by several Joint-Stock Commercial Banks (JSCBs): Asian Commercial Bank (ACB), Sacombank, Techcombank and Habubank. Additionally, several (private) international banks have entered the scene, taking only a marginal share however. In general, HF products of all these commercial banks are very much traditional mortgage products in which the land and/or property is collateralized. As a result, they are targeted at mid- to high but mostly high-income Vietnamese.

As HMF is a relatively new concept in general, this is also the case for Vietnam. It is therefore not surprising that those institutions currently providing true HMF-products are few. At the moment there is only one provider, Capital Aid fund for Employment of the Poor (CEP) that has taken HMF to a significant level. To be fair, another party that could be regarded as providing HMF, though at smaller scale, is the VBSP. They provide loans to households whom the government forced to relocate to the Mekong delta area. Additionally, the VBSP knows that some of their micro-loans are actually applied for housing purposes, but misses accurate statistics on this. More genuine HMF projects are on their way, however. Tao Yue May Fund (TYM) is very near to starting a pilot, also together with Habitat for Humanity Vietnam (HFH-V). Binminh CDC is currently still in the process of designing a suitable HMF-product, but is determined to follow through.

3 – HMF products in Vietnam

The HMF-products currently supplied as well as those that will be in the near future certainly are quite similar, although there are interesting differences in some product characteristics (see Table 1 in annex 1). Firstly consider the target clientele. All HMF-products are directed at the poorest households. As TYM is part of the VWU and as Binminh cooperates closely with the VWU too, their loans are wholly or mostly issued to women. Binhminh and the VBSP's HMF-products are available only in a specific, rural province, while TYM's are available in seven (mostly rural) Northern provinces and CEP's in both urban and rural areas all over Southern Vietnam. All (except the VBSP, which is a social-housing project) provide HMF for upgrading purposes. CEP is the only organization currently offering a HMF-product for the purpose of new construction – although these only concern a limited amount of loans. All require the applicant to demonstrate that he/she is the legal proprietor of land and structure, except for TYM.

Loan sizes for housing-upgrading vary from a minimum of around 2.5 Mln VND / 160 USD at TYM and 10 Mln VND / 625 USD at Binminh, up to a maximum of approximately 15 Mln VND / 940 USD. Corresponding loan terms are, unsurprisingly, ascending in order of loan size: 50-100 weeks, 80 weeks and 3 years / 156 weeks respectively. Interest rates of the larger and longer term loans are lower than the smaller and shorter term loans. CEP's interest is 0.6-0.8 percent per month. As CEP's loan is larger in size and longer in term than TYM's, its interest rate is lower than TYM's (0.8-1.0 percent per month). The one new-construction HMF-product of CEP concerns an amount up to 70 Mln VND / 4375 USD and a term of 10 years. VBSP is the exemption as these loans are subsidized by the government, so the interest rate is at 0.5 percent for the poor and 0.65 percent for the middle-income people[4]. All loans are issued and disbursed at once, monthly or weekly in cash by loan officers. The repayment schedule is weekly or monthly, in cash, depending on the needs of the client. Collateral is not required but upfront savings are required at Binhminh CDC and TYM (up to a maximum of 100 USD). At CEP upfront savings are not required while the VBSP does not require it, though promoting. None use joint-liability group lending, but all use group setting social control mechanisms to enhance loan security. Besides, all of the institutions provide progressive linked loans but only TYM uses linked loans for HMF, while the others provide this stand-alone[5]. CEP and TYM are already providing technical assistance with the help of Habitat for Humanity (HFH), while Binhminh CDC and VBSP are looking for partnerships. Except for Binhminh CDC all institutions provide budgeting assistance. Overall we can conclude that the biggest differences lay in the target groups mainly on the rural and/or urban side and in product specifications, mentioned before.

Given their similar backgrounds, the similarities between the products that CEP (and the VBSP) is (are) supplying and those which TYM and Binhminh will be supplying in the future are not surprising. Firstly, these institutions are similar in ownership. All are owned by public MOs (Mass organizations) except the VBSP, which of course is a public institute on its own. As a result, achieving financial sustainability let alone profit are not prioritized objectives. Emphasis within these organizations lies on their social role, thus on achieving impact (on client's welfare) and outreach (extent of poor reached, both in numbers and depth of poverty). They rely on donor funding, which makes it not imperative for them to break even on operations. However, donors do generally appreciate knowing precisely how their funding is spent, and like to have the certainty that they are directed at the very poorest. This often puts the breaks on product diversification. Current / soon-to-be HMF-providers are all (except for the VBSP) semi-formal institutions. As a result they do not have full credit-licenses, limiting their possibilities to accumulate savings, hold collateral, attract funds, etc. This restricts their options in building (diversified) products, thus puts a break on product innovation.

As noted before, HF products of both public and private commercial banks (State-Owned Commercial Banks (SOCBs)/Joint-Stock Commercial Banks (JSCBs)) are very much traditional mortgages: large loan size, long term (up to 20-25 years), market interest rates (currently 18-20% per annum), collateralized by the land and/or property. It has to be noted, however, that some SOCBs seemingly, start to realize the potential of the middle-income market and are thinking of ways to serve it. Techcom Bank is even running a pilot program for smaller sized mortgages with the Asia Development Bank (ADB), but this project has for now proven difficult to be financially sustainable.

4 – Opportunities for HMF in Vietnam

When turning to the specific opportunities for HMF on the Vietnamese market, we immediately have to acknowledge that the very limited amount of HMF-products available today stands in sharp contrast with its potential demand. While demand is huge, current consumption of HMF in Vietnam is rather marginal. Only a few thousand people are serviced, all poor households, mostly for home-upgrading purposes, and only in very specific areas (both rural and urban) – namely those in which the providers are active. What is more, traditional HF – mortgaging – is a service available only to the middle-high and high-end customer segment. Thus, while millions have been lifted out of poverty and a large middle-class is emerging, it is the same low- to middle-income mass-market that is left unattended, a fact that is exacerbated even further due to the lack of real estate that is affordable for that income group. As a result, a tremendous market opportunity to finance middle-income housing exists, one that could grow even larger if real estate developments would also start aiming more at that target group.

Within this enormous potential market, is there a sub-segment that is most attractive to serve? We propose that in Vietnam important subtleties in the nature of the market's demand emerge once introducing three segmenting characteristics: income, age, and geographical area. In general, Vietnamese of higher-income levels and of younger age will demand more HMF. Regarding the area of residence, specifically the difference between rural and urban Vietnamese, generalizations are harder to make. Rural and urban households could both be attractive. The advantages of targeting city-dwellers lie in a higher degree of formality, higher incomes, and more young (nuclear) families. Therefore, it is easier to assess creditworthiness, easier to make loans affordable, and easier to convince potential clients as attitudes towards lending will be more positive. The advantage of targeting the countryside could be that vast fine-mesh networks, which could be used for distribution, already exist. Social informal structures are tighter, which via group settings could also be utilized in HMF, as is already common in other MF. So, the answer to the question of

[4] As Vietnam still has a highly informal economy, assessing income (expectations) is a difficult exercise. Fortunately, (H)MF providers can rely on vast networks, for example that of the VWU, so that a personal relationship with the client can overcome this difficulty. Moreover, as more people open bank accounts, the formality of Vietnam's economy is on the rise.

[5] Linked lending means that a (HMF) loan can only be taken up if another loan (e.g. an income generating MF loan) is successfully paid back, while a stand-alone loan has no such condition. Progressive lending entails that increasingly larger loans can be requested, conditional on the client's previous successfully returned smaller loan.

which sub-segment is most attractive, (segmenting on income, age and geographic area) depends on the objectives MFIs have. These objectives may concern impact (on client's welfare), outreach (extent of poor reached, both in numbers and depth of poverty) and financial sustainability. Targeting one segment may better match some objectives than others. For example, targeting the very poorest may lead to difficulties in achieving sustainability.

Regarding the future of HMF in Vietnam, the coming five years, the following are the most important conclusions about the expected developments of the market (demand, supply) and its larger macro-environment.

- Firstly, not only is HMF-demand high today, there are positive signs that it will continue to be in the future. Solid growth prospects and continuous socio-cultural changes (altering traditional family ties, improving attitudes towards borrowing, etc.) lead to this belief. The shape of future GDP-growth in Vietnam is something to keep a close eye on however: equal distribution of growth is most favorable for H(M)F, as the emerging middle class is where the largest numbers lie.
- Secondly, on the supply side, institutions that become legal MFIs will be able to upscale their projects, expand their outreach and diversify their products. HMF-products are an obvious candidate-product for expansion. Institutions that are currently planning to become legal MFIs include at least: CEP, TYM and Binhminh CDC. Thanh Hoa will probably apply within a couple of years. It is no coincidence that these are the same which are currently either providing (CEP) or in the process of designing HMF products. The VSB expects an official application to become a MFI. Thirdly, once more concerning supply, current HF-providers (most notably JSCBs) might move more down-market. They recognize the size of the middle-income segment, and the potential demand that lies there. Table 2 in annex 2 provides an overview of income levels in Vietnam.
- But whilst they see the possibilities, especially for the longer term, they find it difficult to make their products more affordable to this income group and simultaneously keep them acceptable for themselves in terms of risk.
- Fourthly, the current high inflationary pressure is a worry. Inflation averaged 10% over 2007, and the VSB would currently be happy if it can keep it under 20% for 2008. Would inflation levels remain at current high levels in the longer term there could be serious macro-economic consequences, for example for the real estate market. The VSB seems to realize this, though. Interest rates were raised. Credit growth was capped at 30% for 2008.
- Finally, the turbulent boom-bust real estate market (as a consequence of wild speculation) is a short-term uncertainty. It could become long-term liability if the macro-economic situation (most notably inflation) exacerbates and real estate speculation is not curbed. Additionally, the rising interest rates to combat inflation reduce real estate demand.

5 – Recommendations for HMF in Vietnam

Finally, we turn to our recommendations on what possible paths MFIs and their funders can take in diversifying their activities in Vietnam by adding HMF-products to their portfolio. We distinguish two clearly different options. These options should be regarded as general guidelines and certainly not as stringent instructions. But the different options do represent a clearly different strategic choice and should both be realizable in the short term (i.e. within 5 years). Therefore, the decision that any MFI or financer of HMF in Vietnam on which option to take depends on the target groups it wishes to serve and its objectives in terms of intended impact, outreach and financial sustainability.

Option 1

The first option is to fund a HMF-initiative of one of the specialized MF-funds (owned by MOs) that are currently planning to become a legal MFI. The target group of such HMF-projects and -products would first and foremost be low-income households in rural areas and/or poor to low-income households in urban areas. The advantage of this option is that great impact and outreach (in terms of depth of poverty reached) are most certainly achieved. Often the rural and urban poor live under unhealthy and unsafe conditions. Therefore, those who benefit relatively the most from improving their homes or building better ones are served. The disadvantages of this option lie in the potential difficulties that may be encountered in attaining outreach (in terms of numbers of people reached) and financial sustainability. Outreach may be a problem because licenses are restricted to one province. To achieve a multi-province or even national coverage may prove cumbersome, although this has to be seen in practice. Moreover, as MOs/NGOs often rely partly on the efforts of volunteers, it might prove difficult for them to build the human resource capacity that can support rapid expansion of activities. Achieving financial sustainability may be complicated to ascertain because HMF product require a fit with the existing MFI structure which could be costly. As loans for home-upgrading purposes can be smaller than for new construction, the former would probably be an appropriate solution. Moreover, the dominant position of the very low interest-rate loans of VBSP is hard to compete with, once again threatening sustainability.

There are, however, some positive factors in view of the above mentioned disadvantages of option 1. Firstly, concerning outreach: the quality of some of the existing networks that some NGOs/MOs (thus future MFIs) have is very high. These networks are well established. Many are familiar with and have favorable attitudes towards them, as they have already been active in other MF for many years. For example, CEP makes use of the HCMC Labour Union network, and TYM of the VWU's network. Especially the latter is gigantic. As a result, perhaps human resource capacity for expansion does exist, improving outreach. Secondly, building sustainable products promises to be much

more possible under the new MF-decree. The decree increases the possibilities for MFIs to attract funds, collect savings, hold collateral, etc.

Option 2

The second option is to fund a JSCB which is willing to add HF-products that are directed significantly more down-market than is currently the case. Such a H(M)F product would be targeted at the at households with a stable job and income. It would therefore be best to focus on urban areas, where these households can be found most. Thus in terms of income we are talking about a range from the upper lower class (i.e. excluding the poor), up to the higher levels of the middle class. The emerging middle class would be the target group. Possibly, the financer of such a down-market HF-up-market HMF-product could work together with a real estate developer and local governments to ensure availability of affordable housing. This would require, however, more administrative/ management effort.

The advantages of this strategy are that more outreach (in terms of numbers of people reached) as well as a larger degree of (or even complete) sustainability can be attained. Outreach is helped because large JSCBs are active throughout the country and have greater capacity, both financially and in terms of human resources. Sustainability will be easier to achieve because of the different choice of the target group. The higher income levels and stable income situation mean that less of the traditional MF mechanisms are required to make the loan affordable. Loans could be a bit larger and of a bit longer term than under option 1, yet still smaller and shorter than traditional HF-products. Possibly, land use rights and/or property rights could even be collateralized. In option 2, the new product may seem more like a down-market variant of HF instead of an up-market variant of HMF, especially in case it is collateralized. The only differences may lie in a slightly lower loan size, lower interest rate, and shorter loan term. Additionally, such a product may not use group settings in its lending procedures. But if introducing only some MF mechanisms into HF orthodoxy would already reach the middle-class that could not attain HF before, that itself is an accomplishment.

The main disadvantages of option 2 are clear. Both impact and outreach (in terms of depth of poverty reached) are certainly less when providing such a product. Those who would benefit relatively the most from improving their housing situation are not within arm's length. One could, however, argue that these people would first be more helped with an income-generating (e.g. micro-enterprise) loan. And if such a loan is successful in increasing a household's income, they will more likely be able to successfully apply for a housing loan.

Thus, in the above two clearly different possibilities to provide HMF (or its supporting funds) in Vietnam were set out, representing two different strategies concerning desired impact, outreach and sustainability in the development of the Vietnamese economy. For any MFI and their financial supporter(s), it is the task to set priorities on these objectives first, and then choose the target group, the product, and the organizational form that suits these objectives best. After these choices are made, to discover whether success is attainable or whether adjustments need to be made, a preliminary pilot project seems to be good advice.

Annex 1

Table 1: Product characterisics of HMF products in Vietnam

A. Eligibility Requirements	TYM	Binhminh CDC	CEP	VWU	VBSP
A.1 Target Clientele					
A.1.1 Gender based	100% female (VWU)	Mostly female (97%)	Mostly female	100% female	not gender based
A.1.2 Income client	poor	poor	poor	poor	poor-middle
A.1.3 Rural/urban	mostly rural	rural	urban & rural	rural & urban	urban & rural
A.1.4 Region	7 Northern Provinces	Binh Minh Province	Southern VN	all Vietnam	all Vietnam (54 provinces)
A.2 Loan Purpose					
A.2.1 New construction	no	no	yes* (76 clients)	no	yes*, only Mekong-region
A.2.2 Upgrading	yes	yes	yes** (1492 clients)	yes	yes**
A.3 Property rights					
A.3.1 Land use rights	not required	required	required	required	required
A.3.2 Structure prop. rights	not required	required	required	required	required
B. Loan Conditions					
B.1 Loan specifications					
B.1.1 Loan size (min.)	$ 125	no minimum	no minimum	no minimum	no minimum
B.1.2 Loan size (max.)	$ 375	$ 625	$ 940* / $ 4375**	$ 1875	$ 200* / $ 4000**
B.1.3 Disbursement schedule	over weeks	at once	at once* / over months**	at once, in instalments	depends on needs
B.1.3 Disbursement method	loan officers	loan officers	loan officers	loan officers	loan officers
B.1.4 Loan term (min.)	50 weeks	10 weeks (emergencyloan)	none	1 year	3 years
B.1.5 Loan term (max)	100 weeks	80 weeks (HMF)	3 years* / 5 years**	5 years	10 years
B.1.6 Repayment schedule	weekly	monthly	weekly or monthly	monthly	monthly
B.1.7 Repayments collection	cash	cash	cash	cash	cash
B.1.8 Interest-rate (/month)	0.8-1.0%	1.6%	0.6-0.8%* / 0.6%**	0.6-0.9%	0.5 %*-0.65%**
B.1.9 Fees	none	none	none	none	
B.2 Loan Security					
B.2.1 Collateral	none	none	none	none	none
B.2.2 Savings/deposit up-front	until a max. of $1000	required	not required	required	promoted, not required
B.2.3 Group vs Individual	groups, individual liability	groups, individual liability	groups, individual liability	groups, individual liability	groups, individual liability
B.2.4 Linked vs stand alone	linked & stand-alone	linked	stand-alone	stand-alone	stand-alone
B.2.5 Progressive linkage?	yes	yes	yes, but only for upgrading	yes	yes
B.3 Loan Services					
B.3.1 Technical assistance	yes (by HFH)	considered (by HFH)	yes (by HFH, 1 project)	no	no, possibly in future (HFH)
B.3.2 Budgeting assistance	yes, directly by TYM	no	yes	no	yes, by VWU
B.3.3 Other services	life-insurance	no	Possible to combine housing with entrepreneurs-loan	No	no

A. Eligibility Requirements	MHB	Vietcombank	Techcom Bank	Sacom Bank	ACB
A.1 Target Clientele					
A.1.1 Gender based	not gender based	not gender based	not gender based	not gender based	not gender based
A.1.2 Income client	middle – high	middle – high	(low) middle – high	low – high	high
A.1.3 Rural/urban	rural & urban	rural & urban	rural & urban	rural & urban	mostly urban, also rural
A.1.4 Region	Mekong Delta region	all VN	all VN	all VN	all VN
A.2 Loan Purpose					
A.2.1 New construction	yes*	yes	yes	yes	yes
A.2.2 Upgrading	yes**	No	yes	yes	no
A.3 Property rights					
A.3.1 Land use rights	required	required	required	required	required
A.3.2 Structure prop. rights	required	required	required	required	required
B. Loan Conditions					
B.1 Loan specifications					
B.1.1 Loan size (min.)	none	none	none	none	none
B.1.2 Loan size (max.)	85%/value	70%/value	70%/value, ADB $ 3000	70%/value	70%/value
B.1.3 Disbursement schedule	mostly at once	over months	client request	client request	client request
B.1.3 Disbursement method	loan officers	branches	Branches	branches	loan officers
B.1.4 Loan term (min.)	No min.** / 180 mnths*	none	7 years, ADB 5 years	none	none
B.1.5 Loan term (max)	60 mnths** / 240 mnths*	20 years	20 years	15-25 years	15 years
B.1.6 Repayment schedule	monthly	monthly/quarterly	monthly/quarterly	monthly	monthly
B.1.7 Repayments collection		payroll deduction	bank account	bank account	cash/check
B.1.8 Interest-rate (/month)		1.8%	1.5%/mnth, ADB 0.67 %	undisclosed	1.6%
B.1.9 Fees	none	none	initial financial fee	none	none
B.2 Loan Security					
B.2.1 Collateral	yes, property rights	yes, property rights	yes, property rights	yes, property rights	yes, property rights
B.2.2 Savings/deposit up-front		not required	not required	req. only for new product	not required
B.2.3 Group vs Individual	individual	individual	individual	Individual	individual
B.2.4 Linked vs stand alon	estand alone	stand alone	linked & stand-alone	linked & stand-alone	stand alone
B.2.5 Progressive linkage?	no	no	possible	yes	no
B.3 Loan Services					
B.3.1 Technical assistance	no	no	no, planning	yes, by partner org.	no
B.3.2 Budgeting assistance	no	no	yes, by bank	yes, small scale	no
B.3.3 Other services	no	no	no	no	no

Notes: – all money-values are expressed in United States Dollars (USD) at the 01-01-2008 USD:VND (Vietnam Dong) exchange rate of 1:16000
– values with the suffix '*' indicate values loan characteristics of upgrading loans, the suffix '**' indicates these of new construction loans.
– Data on several other suppliers of MF- and/or HF- products was collected, but omitted for clarity, leaving only the most relevant data. Available on request.

Table 2: Income Groups in Vietnam (2007 estimates)

	Vietnam	(nationwide)	Vietnam	(urban areas)
	USD / yr	*VND / yr*	*USD / yr*	*VND / yr*
GDP per capita	700	11,200	5,700	91,200
GDP per capita (PPP)	2,380	38,80	19,380	31,0080
Income groups	*USD / yr*	*VND / yr*	*USD / yr*	*VND / yr*
Low (range: < ..)	350	5,600	2,400	38,400
Medium (average)	700	11,200	5,700	91,200
High (range: > ..)	1,050	16,800	9,000	144,000
Income groups (PPP)	*USD / yr*	*VND / yr*	*USD / yr*	*VND / yr*
Low (range: < ..)	1,90	19,040	8,160	130,560
Medium (average)	2,380	38,080	19,380	310,080
High (range: > ..)	3,570	57,120	30,600	489,600

Notes:

- All figures are the authors' estimates, based on statistics of the World Bank's World Development Indicators as well as on estimations by several of our interviewees and the authors' judgment on these estimates.
- All figures in VND are expressed in 1000's.
- VND:VND exchange rate is 16,000:1; PPP:absolute figures relate 3.4:1

Shrugging off the Lethargy – Trends in the Uganda Mortgage Market

By Victor Agaba[1]

Overview

Uganda's economy is in relative terms wealthier than a crude analysis of GDP per capita figures at $400 would suggest. Its population is 28 million, rising rapidly at 3.2 percent a year. There are 4.5 million dwellings, 78 percent are owner-occupied. However, owner occupation is much lower in urban areas – just 28 percent.

Mortgaging in Uganda is still limited to a few districts and is most prevalent in urban areas. Rural areas and the north are underserved. Financial intermediation and the reduction/elimination of land conflicts are pre-requisites for further geographical expansion of the mortgage market. There is a housing shortage, and existing housing in urban areas is significantly under standard and in need of replacement. The Government has estimated that there is a need for 377,000 new houses a year, largely to cater for the increase in the population, expected to reach 45 million by 2020 from the current 28 million.

The most important requirement for borrowing through a mortgage is a land title. However, more than 80 percent of Uganda's land is untitled. Systematic demarcation offers a cheaper means of gradually titling land in Uganda. The current law provides for four types of land tenure namely Freehold, Mailo land (slight variation to freehold but confined to the Buganda region), Leasehold and Customary land (held on a communal, clan or nomadic tenure and regulated by customary principles and authorities). The expected enactment of the Mortgage Bill 2007 that recognizes customary certificates as bankable instruments is urgently called for.

Interest rates on mortgages are high, severely restricting demand. Mortgage lending rates are 16 to 19 percent. The spread over the average cost of funds which is deposit based is in the 12 to15 percent range. Although the advent of competition would likely bring down the spreads and margins, increased mortgage production by individual companies would help to reduce unit costs.

Key Players

The Ugandan mortgage-lending sector is tiny. There is hardly any competition between lenders and until recently there were only two formal mortgage lenders; as of July 2008 the number has increased to four.

The Housing Finance Company of Uganda is a government parastatal and the National Social Security Fund has a major stake in the company. It has grown from a small credit institution forty years ago to a fully-fledged commercial bank this year and is accordingly changing its name from Housing Finance Company of Uganda to *Housing Finance Bank Ltd*. Commercial bank operations commenced on January 2, 2008 and involved the introduction of new products like demand deposits, forex trading and term loans. The bank is also rolling out a branch network with new branches opened to take services closer to the people and upgrading the IT system to support the new business need.

Development Finance Company of Uganda (DFCU) is primarily a development bank. It has recently been privatised with the Commonwealth Development Corporation plc (CDC) owning a majority stake of 60 percent. DFCU commenced mortgage lending in 2002 and is now a leading provider of medium and long-term finance.

The two more recent players in the Uganda mortgage market are international banks namely *Stanbic Bank* and *Standard Chartered Bank*. Stanbic Bank is the largest bank in Uganda with about 30% market share of the deposit market and 20% of loans and advances. In February 2002, Stanbic Bank of South Africa, one of the largest banks on the continent, bought 90% of the shares in Uganda Commercial Bank (UCB), a largely retail government-owned bank that operated a countrywide network of 67 branches. Stanbic launched its mortgage products in May 2007 after a pilot mortgage program was conducted in 2005. Stanbic offers mortgage loans for purchase, improvements and refinance. Mortgage loans are based on the prime rate and may reach up to 20 years in maturity. A building (construction) loan is expected to be added to their mortgage range of products by the end of 2008.

Standard Chartered Bank Uganda Limited is a member of the Standard Chartered Group. The Bank has been operating in Uganda for 95 years. As Uganda's first bank, established in 1912, it currently has a network of 7 branches. Standard Chartered Bank launched its residential mortgages facility in May 2007 with facilities ranging from USD12,000 to USD470,000 granted to

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customers and repayable within a period of 15 years at the prevailing prime or base rate.

Prospects of the mortgage sector

The sector is at take off stage. All the fundamentals are in place. Industry participants only need to get coordinated. The macroeconomic environment is conducive and there is confidence in the economy. Inflation had kept low between 5 and 7 percent until the recent world oil and food crisis. According to the Uganda Bureau of Statistics, it stands at 15.6 percent as of August 2008 but is expected to decline. Interest rates are stable though and are still expected to go down. Demographics indicate the population is growing rapidly and therefore need increased housing. A number of property developers are coming up and Government policy is positive and therefore there are good prospects for a growing mortgage sector.

The last few months have seen new entrants in the market offering new loan products to assist their customers in buying homes. With the recently announced VAT reduction from 18 to 5 percent on the sale of houses it is expected that the market will move to meet the pent up demand for residential units. This will in turn drive the demand for new home loan products, thereby further spurring the growth of the mortgage industry. Already we are witnessing more investors entering the real estate development market alongside with National Housing & Construction Company Ltd.

The Mortgage Bill 2007 conundrum

The principle objective of the Mortgage Bill 2007 is to consolidate the law relating to mortgages in Uganda, which will greatly reduce legal and regulatory constraints. Evidently the current Mortgage Act (Cap. 229), that came into force in 1974 is in need of an update to reflect current market developments and practices as well as advances in the Common Law such as the extension of mortgages to customary land. As customary land is not registered, an equitable rather than a legal mortgage is created under common law. An equitable mortgage is one which is lacking one or more formalities of legal requirements, such as stamping, filing or registration.

Terms and conditions for UGX purchase mortgage loans

	HFCU	DFCU	Stanbic	Standard Chartered
Interest rate	16%	16%	16%	18.5%
Term	≤ 20 years	≤ 15 years	≤ 20 years	≤ 15 years
Amounts	≤ 500 million	10 million +	N/A	20 - 800 million
Payment-to-income ratio	35%	40%	30%*	40%
Loan-to-value ratio	70%	70%	80%	80%
Origination fee	200,000 UGX	2%	1%	1.5%

Source: Bank marketing information and websites.

Common Law refers to a legal system that is developed through decisions of courts and tribunals, rather than through legislative statutes or executive action. It is created and refined by judges: a decision in the case currently pending depends on decisions in previous cases and affects the law to be applied in future cases. In this respect, the drafters of the Bill have to be commended. The consolidation of all the laws relating to mortgages is most welcome because the existing law is currently dotted between the Mortgage Act, the Registration of Title Act and the Land Act.

Unfortunately the Bill contains various provisions that if passed into law in their current form, will greatly and adversely affect the mortgage industry and effectively bring it to a halt. These provisions are inconsistent with the current good banking practice, and are not derived from advances in the Common Law and are generally and largely unworkable. An example is the provision granting courts general powers to grant relief to a mortgagor and re-open mortgages. No grounds are specified for the exercise of these powers and it would appear that the Court could even act out of compassion.

The recent bad experience of Tanzania following their enactment of the Land Act 2004 shows too well the dangers that the Ugandan mortgage market now faces,[2] such as the reluctance of lenders to give credit due to heavy mortgagor protection which could put in doubt the realization of the lender's security. Stipulations in the Mortgage Bill have been put forward in good will but unfortunately if they are not well thought out they may stunt the growth of the mortgage market by making it harder to access credit. Lenders will review their mortgage business and may retreat to the zero-risk government securities.

For example, Chapter X of the Tanzania Land Act, No. 4 of 1999 relating to mortgages has been of concern to bankers as its provisions tended to inhibit bankable projects especially mortgages from accessing finance. After three years of dialogue between the Government and various stakeholders, the entire Chapter X was replaced by the Land (Amendment) Act No. 5 of 2004. This Act relates to the regulation of the power to create a mortgage, mortgage of matrimonial homes, discharge of mortgages and mortgagees consent to transfer.

[2] Ugandan legislators referred to the Tanzanian Land Act when they revised their own Mortgage Bill. There are a number of similarities in both bills.

SHRUGGING OFF THE LETHARGY – TRENDS IN THE UGANDA MORTGAGE MARKET

Another example is under Clauses 33-37 in the Uganda Mortgage Bill 2007. They state that courts have general powers to grant relief to a mortgagor and reopen mortgages upon application by a mortgagor. The Court may cancel, vary, suspend or postpone the remedy sought by the mortgagee for such period as the court considers reasonable. The time for compliance with a default notice, by the mortgagor, may also be extended by the Court. No grounds are specified for the exercise of these powers and it would appear that the Court could even act out of compassion. This is reminiscent of the general powers given to the Tanzanian courts to intervene on the ground of 'hardship', which has created problems because the mortgagor is overprotected. This Tanzanian law is currently under review and Ugandan legislators must ensure that this problem is addressed right at the start to prevent the Mortgage Bill 2007 from going down the same road.

Coupled with this is the power of the Court to re-open a mortgage that has been obtained by fraud, deceit, misrepresentation of undue influence, or any other unconscionable conduct by a third party. While some of these provisions are simply restatements of the Common Law, taken together they simply throw open the doors to the courthouse for all manner of challenges to mortgages, with or without foundation. These provisions if passed into law in their current state will severely damage the banking industry, already under pressure from the Central Bank's tight loss-provisioning requirements under the Financial Institutions Act 2004.

The good news for the mortgage market, however, is that the Bill provides for extension of mortgages to cover customary land. This is a welcome development given that the bulk of the country's agricultural production occurs on land held under customary tenure. The Bill gives protection to the matrimonial home and gives every spouse security of occupancy on family land and requires prior spousal consent for any dealing with family land. It is important to note that the banks should not be held liable for proving that all the spouses are known.

This Bill also underscores the reinforcement of the equity of redemption. It criminalizes the current practice of non-bank lenders to require the execution of a transfer deed alongside a mortgage. Under current practice, most money-lenders (not regulated by the Central Bank) require the borrower to sign transfer forms or a sale agreement for the property being used as collateral for the loan. This is in contravention of already existing laws such as the Registration of Titles Act (s.116), which stipulates that a mortgage does not act as a transfer but only operates as security. The Mortgage Bill further emphasises the criminality of actions that entitle a mortgagee to foreclose the equity of redemption in mortgaged land.

Considering the impediments to mortgage finance in Uganda, getting this sector to take off stage is an uphill task but in light of the upcoming changes in legislation, the positive government policies, the steady growth of the economy, it appears that the lethargy that has shrouded the mortgage market for many years is being shrugged off and there is at last light at the end of the tunnel.

"Not just another seminar" – or What happened at the FIG/UN HABITAT Stockholm seminar on Improving Slum Conditions through Innovative Financing 16–17 June?

By Ann Jennervik[1]

Introduction

The role of Housing Finance in alleviating urban poverty is certainly an issue that needs further attention from Housing Finance actors and experts, as well as from the financial sector in general. In reality we all belong to a global, but obscure, market for financial services and for our housing. Quite a limited group of experts is involved today, still mainly working from the national level perspective. One third of the urban population has no access to these markets, and consequently no adequate housing that is affordable. It is a problem for "us", not just for "them", since well functioning cities are the engine for all our development. Housing finance for all needs to move out of the "charity corner"! The scope and actors should be broadened from "just" a donor-poor peoples concern. New perspectives should be brought forward in an inclusive and genuine dialogue.

The International Federation of Surveyor's (FIG) wants to mobilise the next generation of Land Professionals and continue to develop innovative and transitional solutions to address global inequality in land and property ownership and tenure. The annual FIG Working Week took place in Stockholm, Sweden just before the Midsummer Night and was the biggest Working Week ever held. 950 participants from 90 nations attended the event and the exhibition. In addition to the plenary sessions there were over 70 technical sessions, with almost 350 presentations, and technical tours. A strong attraction was the two-day joint FIG/UN-HABITAT Seminar on "Improving Slum Conditions through Innovative Financing", forming an integral part of the week. FIG is strongly committed to the Millennium Development Goals (MDGs) and the UN-HABITAT agenda on the Global Land Tool Network. The Seminar was therefore dedicated to adequate and affordable housing for all.

UN agencies have access to national governments and to setting the global agenda, but UN agencies will often depend on interest groups and Non Governmental Organisations (NGOs) for implementing this agenda. FIG is an international NGO that has worldwide access to national associations and individual professionals. Global partnerships are much needed for achieving the good development. This agenda includes the big challenges of the new millennium: climate change, food shortage, energy scarcity, urban growth, environmental degradation and natural disasters. All these issues relate to governance and management of land. Land governance and management is a core area for surveyors – the Land Professionals.

The seminar attracted new delegates to the FIG Working Week, broadening discussions from mere surveyors to a multi-discipline dialogue between land professionals and economists. The seminar dialogues brought together more than 120 leading actors from the public, private and non-governmental sectors working on land and housing finance issues, in vivid discussions revealing a lot of shared and common understanding on the way forward.

THE HEART OF THE MATTER

Adequate and affordable housing for all is a promise made by almost all states in the world, and it was agreed 60 years ago! The UN Universal Declaration of Human Rights 1948 stipulates: "Everyone has the right to a standard of living adequate for the health and well-being of himself and of his family, including food, clothing, housing and medical care and necessary social services". The right to housing should be seen as the right to live somewhere in security, peace and dignity. The right to housing should be ensured to all persons irrespective of income or access to economic resources.

The seminar focused on the essential elements of a just and sustainable provision of adequate shelter, embedded in coordination with land, infrastructure, legal, and financial systems.

The two days of the seminar dealt with the main current obstacles: How to improve access to land and security of tenure, and how to improve access to finance? Without security of tenure, the poor are at daily risk of eviction and, in the longer term, are reluctant to invest in long-term shelter improvements. Without access to affordable finance, poor people are caught in a vicious cycle in which affordable housing is inadequate, but adequate housing is unaffordable.

The theoretical solution to this dilemma is a well-functioning land and housing market; however, experts around the world recognize that these same markets are often dysfunctional, and arguably represent the most consistent bottleneck undermining long-term city development. Market access is built on transparency, low transaction costs, and good access to property information as well as property financing. Such information is considered to be key public goods. Facilitating efficient land markets and effective land-use management is therefore critical to sustainable urbanization.

A special emphasis was put on how these two issues are linked together. It is a fact little known outside the narrow field of land administration. Surveyors play a key role in linking functioning markets for housing and finance. That the slums represent a market is fairly unfamiliar to the formal housing finance institutions. Huge risks are perceived, while this bottom of the pyramid market in fact has a better track record in timely repayment and higher rate of return than the upper market that traditionally benefit from the current housing finance systems. Without access to functioning financial mechanisms (institutions as well as instruments), one billion people are kept from achieving an acceptable housing standard.

Support to this aim is being provided, but despite 30 years of efforts, political commitments and reiterated priority to the issue, little has been achieved. Building up the key institutions that can manage the public systems providing the key public goods is at best a slow process. The vested interests of a wide variety of stakeholders conspire to maintain the status quo.

THE FIRST DAY: *"Land Use Management and Property Rights"*

There are signs of progress, however. The seminar was structured around a practitioners' dialogue – communication across professional and institutional perspectives. A total of eight Dialogues were held in smaller groups to enable a fruitful exchange of experiences. Each set of Dialogues was prepared through sharing inputs at the interactive website www.justnsustshelter.org and through the introductory presentations at the Plenary and Presentation sessions.

The opening of the Working Week symbolically did not cut, but tied a ribbon together between the former and the coming generations of Land Professionals. The Swedish Minister for Environment, Andreas Carlgren, spoke about solving the issues of our time – where surveying is the backbone of society. In his speech, he emphasised that in Sweden land and property underpin the economy. However, he said that in developing countries legal empowerment of the poor is required to support property ownership, and transparent land information systems are needed to stop us guessing.

A just Land Use Management

Dr. Anna K. Tibaijuka, UN Under-Secretary General and Executive Director of UN-HABITAT gave the keynote address. In her speech she reminded the audience that the world is becoming more urban, and the capabilities of the newcomers themselves to develop more sustainable cities: "Cities are not prepared to welcome and receive the new influx. The challenge, therefore, is to try to guide this urbanisation process. The urban poor are potentially capable of contributing 20 billion US dollars per year to improve their own living conditions. This would leave approximately 5 billion US dollars per year to be mobilised from other sources – currently this is only 2 billion US dollars."

According to Dr. Tibaijuka only some 10 percent of land parcels in the world are registered; in many areas, land rights are based on customary rights that are not legally recognised, but socially legitimate and only some 5 percent of registered land is registered in a woman's name. Individual freehold titling is not always appropriate for a number of reasons including, the costs of adjudication, high technical standards, expensive registration and transfer fees, and literacy requirements. The development of new land tools, such as the FIG Land Administration Domain Model, will allow for the registration of customary forms of tenure and overlapping land rights and claims. UN-HABITAT has a two-year agreement with Google to collaborate on new mapping tools using modern technologies.

Property Rights

Dr. Ashraf Ghani, Chairman of the Institute for State Effectiveness (Afghanistan) presented the Commission on Legal Empowerment of the Poor and its very recent report: "Making the Law Work for Everyone". Effective means for legal empowerment in a globalizing world build on a four-pillar approach: access to justice and the rule of law, property rights, labour rights and business rights. The four key building blocks are interdependent.

One third of the world's poor – one billion people – live without any legal protection of their assets, and that poverty is a result of the failure of public policies and markets. In fact, in many countries the laws, institutions

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THE FIG/UN HABITAT SEMINAR ON IMPROVING SLUM CONDITIONS THROUGH INNOVATIVE FINANCING

and policies are a barrier to prosperity. Functioning state and markets need to be built in the 40-60 states that are the weak links of the international system.

To arrive at solutions, it is not enough to rely on aid-based approaches. Rather, it is critical to look at globalization and inclusion. Globalization is of human making but not of human design. Most of the world feels dislocated by the process of globalization. Strategies and partnerships to the BRICs (Brazil, Russia, India and China) and other emerging countries need to be tailored. Corporations must be brought into a global development compact. Invest in national, regional and international leadership and management.

Governance needs to be re-framed in a more co-ordinated way. The task is to bring states, markets, corporations, civil society and international organizations together. In the next 25 years, US$ 42-44 trillion will be invested in global infrastructure. These investments make global economic integration possible, but could also have severe negative consequences. Getting the design right is critical. Creating liveable cities is critical for the agenda of inclusive globalization. But creativity and imagination need collaboration among many actors. Information, knowledge and wisdom need to be brought together in harmony.

...in a human rights perspective

Women's rights to land and finance need particular attention and were especially addressed. Four main barriers exist: cultural or legal impediments to acquiring land through markets, inheritance or transfer; barriers created by intra-household customs and practices related to marriage; discriminatory policies at the central or local government level; and poorly drafted laws and regulations governing land and property rights. An example was given from *Sri Lanka*, having three types of land laws, and the laws are not applied consistently or coherently. The "head of household" concept is more of an administrative term than a legal one, and the household head is presumed to be the male. This had a major impact during the tsunami: in many cases, even if women had owned property before the tsunami, all houses were given to the male "head of household".

EXPERIENCES FROM VARIOUS PARTS OF THE WORLD

Four parallel regional Dialogues to Outline the Roadmap to functioning Land Use Management for all were held, focusing on an exchange of experiences within different parts of the world. The objective was to address issues specific to each region, as well as commonalities, success stories and failures, in order to gain a better understanding of how land administration systems can be improved and property rights established. There is clear evidence that sharing experiences and lessons learned advances progress.

The Dialogues were introduced by presentations from four different regional perspectives on Land Administration and its effects on poverty and slums:

Lessons learned from an overview of Land policy issues based on Lincoln Institute's experience in *Latin America* show quite poor performance, for reasons that are all basically due to weak institutional structures, and often based on vested interests. There is a strong legacy of powerful landowning interests that influence land policies to their own benefit. Most countries share poor performance when it comes to recovery of publicly generated land value increments, the delivery of urban infrastructure and services, the provision of housing alternatives for the urban poor, and appropriate land taxation. Management of existing resources is often characterized by a lack of operational capacity or unscrupulous behaviour on the part of authorities. Often information exists, but not the capacity to find, organize and interpret it. Moreover, public officials are often unable or unwilling to assimilate and translate information into operational results. Especially, there is a lack of dialogue between urban planners and public finance officials. This is reflected in planners often overlooking how projects should be financed and how urban forms affect the tax base, or the impacts of tax collection practices on land uses. But, perhaps the most severe obstacle is the discontinuity in programme implementation. Even the most popular or successful projects can be disrupted, derailed and ultimately terminated by political and administrative discontinuities. Expectation about the permanence of the rules of the game is a major component affecting how the private sector acts. Land policy should transcend party politics and promote political plurality and diversity.

The rapid population increases in *Countries in Transition* often lead to unplanned or informal development. More than 50 million people in at least 15 European countries are affected by poor land administration and cadastre systems, with a lack of clarity and transparency in land tenure and property rights. Lack of clear planning regimes or a lack of enforcement of existing plans leads to massive illegal construction in urban areas. Land policy and the four major land administration functions - land tenure, land value, land use and land development - lack an integrated approach. This may be compounded by poor management procedures that fail to deliver required services.

Informal construction has two principal and different motivations: construction by poor people for basic shelter; and construction for upgrading private real estate and for profit, usually in areas where real estate values are high. To reduce the informal settlements is registration of property rights of both formal and informal construction important for proper decision-making. Land-use planning with citizen participation is the task of government at appropriate levels. Real property taxes should be collected and reinvested locally, while citizens should recognize their responsibility to contribute to the cost of land improvement and the provision of services.

In *Kenya*, the development agenda has always avoided a serious engagement on land issues. Thousands of Kenyans were displaced by recent post-election violence, and the main cause was land. This emphasizes the importance of governance

issues with respect to land. Slum dwellers live outside the rule of law and basic legal protection, and the government is now seeking to promote tenure security issues through a number of initiatives including the land policy formulation process, the adoption of eviction guidelines, land control boards, and land dispute tribunals - all geared to helping slum dwellers have a basic level of legal protection.

The draft land policy recognizes and addresses key obstacles in the current system. The lack of security of tenure is a major challenge. It weakens the link between land administration and financial markets and impacts on other ways of using land as collateral. Too often a centralized land administration system is complex, thus compounding the problem of access to financial markets. In addition, there is a need for gender equality, a lack of which often blocks women's access to financial markets. Women are not considered fit to inherit and hold property.

The following dialogues provided and shared lessons learned from around 35 countries in Africa, Asia and Central and Eastern Europe. In the end, it was once again proven that sharing experiences and lessons learned advances progress.

HOW TO MAKE PROGRESS IN LAND USE MANAGEMENT - FOR ALL

- **Slum upgrading requires a holistic approach;** Slum upgrading and the granting of title should be conducted as vital parts of broader processes of development, and particular attention should be paid to conditions of macro-economic growth and participatory democracy.
- **Urban infrastructure investment is a driver for slum upgrading.** Facilities and services such as sewerage, water and security should not be addressed individually. Surveying and Land registration should not be undertaken on a settlement-by settlement basis, but within a broader area-based framework. Stable land policies will encourage investment in the maintenance and upgrading of newly privatized land or property in countries in transition, and in general.
- Public land administration needs to be equipped with **modern tools** such as spatial data infrastructures, cadastre, e-governance in order to be able to effectively and quickly address emerging demands arising from urbanization. Moreover, it needs to be simplified to prevent undue delays that would promote illegal construction. People are willing to respect laws if they are efficient and respond to their priorities.
- The **granting of title must be designed to benefit people equitably,** especially considering the needs of the most vulnerable, and share rights between women and men, young and old, landlords and tenants, one generation and the next. Titling should be coupled with education around the accompanying limitations and obligations.
- Ownership should be one option, and **rental and other tenure arrangements** such as group rights should be made available as viable alternatives. A shift towards a group/cooperative approach to housing development could also be advantageous. Contemporary forms of collective tenure need to be explored, and more research is needed to build our knowledge on its evolution and impacts.
- **Property rights should be enforceable** if they are to be meaningful. High incidences of dispossession of land would indicate that the prevailing system of property rights is inappropriate. Dispute resolution mechanisms that are pro-poor, straightforward and not costly.
- **Legalization** is not a panacea. It needs to be to be complemented with environmental improvements and upgrading of settlements, all of which is time-consuming and costly. Decentralized or environmental upgrading may be more appropriate to use than the term "legalization" when talking about acknowledging, in some way, the existence of "informal" construction or settlements.
- **Intermediate forms of tenure,** such as individual or group certificates, shall be more recognized. Massive land titling doesn't work; certificates work better, evolving to more mature property rights over time.
- **Decentralizing** land title processes and establishing local commissions to regulate the process with transparency, and simpler titling systems for housing was recommended. Diversity exists within each country and therefore it is important not to generalize solutions. The reasons for slum formation and development differ. Slums and informality may exist for reasons other than - or in addition to - poverty. For example, lack of transportation can lead wealthier groups to choose to build informally close to work, even if they own land in rural areas. If local governments do not have the capacity to work with slums, ultimately nothing will happen. In all cases, solutions need to be found locally, and local governments need to have the will, capacity and access to information.
- **Taxation** of property has the benefit of making money available to improve the environment for the general public. Taxation is an indispensable tool that should be used to collect revenue to be reinvested locally so that people see the immediate and local benefit. Consideration should be given to needs of the taxpayers and not simply to the legal owners. Some kind of register is needed in order to establish a taxation system, but this does not need to be land titling. Documentation and recording of property should include legal as well as illegal dimensions. Today, corruption and weak land governance results in taxation on the poor in many developing countries, while the wealthiest property owners are not taxed.

The objective of surveying and titling (or the establishment of other forms of tenure) should in the first place be **to create**

predictability and to build trust between neighbours, between residents and local authorities, between residents and politicians, etc. Security of tenure comes first, then the ability to pass on their asset to their children and then to access credit.
Creating trust between property owners (or people with other types of secure tenure) and lending institutions may be a much later development when property becomes collateral for loan finance, but it was not considered a sound initial motivation for establishing individual title, as long as the financial market does not work properly.
One of the impacts of land titling is that land value increases were significantly higher and the poor were selling it at a much lower price, with the result that the rich were capturing the majority of the land value increase due to titling. Transparent market information is missing!

THE SECOND DAY: *"Just and Sustainable Shelter Finance Systems"*

The Plenary session outlined the expansion of financial outreach for the urban poor and how the mortgage systems can channel global financial flows to the Bottom of the pyramid market.

Expanding the outreach of housing finance for the urban poor

Mr. Michael Mutter contributed with the long-term experience from UN-HABITAT. The most asked-for element in upgrading demanded by slum dwellers is access to formal credit for loans for them to construct their own houses. Existing housing finance systems are not geared to their needs. As a result, they fall prey to exploitation by loan sharks at the informal end of the market, and to the high interest rates of the formal market, both of which are linked to the perceived high degree of risk for the lender.

This 'slums investment deficit' show the appalling contrast between what poor people can do and what they need to put up with in an environment where they are not formally accommodated or sometimes even acknowledged, even though they provide the city with its base resources, namely, the labour and entrepreneurial skills that support the city economy. Currently, the 'slums investment deficit' is lop-sided. The slum dwellers are the investors in the urban economy, but lack access to financial mechanisms to support these investments. The 'authorities' and private actors on the market do not keep up with them. The slum dwellers have incredible resources, and the slums have tremendous unrealized value. To be productive they need investment.

Examples of community-led housing finance schemes in Pakistan, South Africa, the Philippines, Namibia and Thailand were presented. Commercial project loans coupled with direct repayment elements by the householders themselves on a group basis make urban development projects more successful and sustainable. Again, it is a matter of ***Linking the Land Administration Chain***. Land availability and land security - formal recognition of land security in multiple forms specifically designed around the capabilities of the urban poor is part of the due diligence required for finance. The municipalities play a key role. Their responsibility to ensure basic affordable services - road access, drainage, sanitation and water supplies, etc. may require credit facilities against the revenue generation of the entire city asset base. Understanding costs is crucial, especially keeping in check the cost of construction. Information on construction costs for various alternatives are needed at the local level for them to be a proficient purchaser.

The establishment of local finance facilities that can offer credit enhancements or guarantees to act as a stimulus for the application of loan products from local financial institutions - the commercial banks has been found by UN-HABITAT as a best approach. Acting as a local guarantee arrangement for household groups or cooperatives to take loans on a collective basis can augment community savings. A key component is the technical assistance that can package the slum dwellers' own upgrading multiple projects with the business plans for the repayment mechanisms and other finance agreements. Not only the packaging, but also providing transparent information on the agreement to both parties is an essential functioning of the finance facilities. Transparent information will link the parties together. The content and effects of the agreement need to be well understood both by the slum dwellers themselves as the 'client' and by the credit committees of the commercial banks.

Housing upgrading schemes that are based on the plans of community groups (as opposed to individuals accessing bank loans) creates greater 'due diligence' of the process leading towards the formal credit facilities. A sound methodology should result in a clearer picture of sustainable financing. It is a model that is working in practice and needs to be developed and expanded.

Channelling the Global Financial Flows

Ms. Renu Karnard, President of the International Union for Housing Finance elaborated on how the global financial flows could be linked to serve the purpose of adequate and affordable housing - for all, based on experiences from India. Housing is a critical component of the economy in India, since it is the second largest employment generator after agriculture. The sector has grown 30 percent per year over the last five years. The total investment for meeting housing requirements until 2012 (estimated at US$ 90billion) represents an enormous challenge. It is all the more imperative to seek innovative housing finance solutions from the private sector. The acute housing shortage has translated into 23 percent of the population living in slums or squatter settlements, and only 36 percent of urban households have sanitation facilities. There is a growing commitment on the part of the government to realize its goal of "Affordable Housing for All" and to partner with the private sector in order to ensure that every citizen of India has a place to call home.

THE FIG/UN HABITAT SEMINAR ON IMPROVING SLUM CONDITIONS THROUGH INNOVATIVE FINANCING

The key reason that housing remains unaffordable to a vast population is the distortion in land prices. The price of land accounts for almost half the cost of a house. Land is a state subject, and like any other emerging country, India faces a host of legal and regulatory constraints that prevents land from entering the market. Other constraints include lack of clear land titles, and lack of a rental market. The main players in housing finance today are banks and housing finance companies, which cater to the upper and middle-income segments of the population. Affordability has improved over the last decade attributed primarily to rising disposable incomes. One of the most comprehensive policy measures by the government is the National Housing Policy, which is focusing on economically weaker segments of the population. The policy encourages in situ slum housing over resettlement, where possible.

To encourage low-cost housing, there could be a stipulation that all new housing projects have a fixed percentage allotted for low-income housing, with tax relief incentives for developers. The government has recognized that free housing schemes do not reach the intended beneficiaries, and that low-income households tend to build gradually (often one room at a time), thus requiring the need for timely credit. To encourage financiers to lend for low-cost housing, there is a need for clear land titles, the introduction of mortgage insurance and better credit data.

Dr. Malcolm Childress, Sr. Land Administration specialist, then brought the World Bank vision to the broader discussion "Land Finance through Land Governance - Expanding the Discussion of Land Policy during Food Crisis, Climate Change and Rapid Urbanization". He pointed at coming needs and the following challenges: "Within 20 years, we are going to be forced to managing every square inch of the planet in a more detailed and systematic way. And we will need the institutional and governance mechanisms to do it. With the current crisis come opportunities for more interface with governments, etc. A new consideration of land governance needs the spatial dimension."

The Swedish support

Dan Ericsson, State Secretary of the Ministry of Finance, Sweden explained the Swedish engagement in land administration and housing finance. Cities in developing countries show that the paradox rings true that progress creates poverty. Poor people are forced to live in overcrowded conditions due to rising constraints on their access to land. The functioning of the Urban Land Market is arguably the most consistent bottleneck undermining long-term city development.

To change this, the Swedish State Secretary requested the powerful and proficient existing actors to the global financial markets to take its part in a comprehensive legal, political, social, and economic framework for urban land markets. A fully functioning property system should be composed of four blocks: a system of rules that defines the bundle of rights and obligations between people and assets reflecting the diversity of property systems around the world; a system of governance; a functioning market for the exchange of assets; and an instrument of social policy. When such a system fully functions, it becomes a tool for the inclusion of the poor in the formal economy, and a mechanism for upward social mobility, but when the entire system or a single component is dysfunctional, the poor are deprived or discriminated against.

The initiative to this Seminar was taken by the two responsible agencies for land and housing in Sweden - the National Land Surveying Agency and the National Housing Credit Guarantee Board[2]. These two institutions have for many decades developed a way to combat poor living conditions. Sweden will support responsible actors which aim to improve the land administration chain and contribute to a shared understanding of the way forward.

Actors' activities

The following Introductory presentations on Putting Innovative Systems for Functioning Finance into Practice reflected the development from both ends of the financial sector: the major international banks efforts and the emerging microfinance sector.

Mr. P.R. Anil Kumar, Head (Microfinance), Emerging Markets, Barclays Bank PLC, presented some innovative structures for financing slum housing and basic infrastructure.

Some innovations to make banking easier include "boarding passes" with subsequent credit cards and home and personal loans. They are not yet widely used in slum areas because there is often no proof of identity for boarding passes and no proof of address for loans. Traditional banks and housing finance companies perceive such innovations as too risky, since the transactions carry high operating costs with low value and require longer-term exposure. Microfinance institutions are wary because of the difficulty of creating groups for repayment assurance as well as the issue of the long-term context.

Some successful examples were presented, which include prerequisites as urban land that is available for rehabilitation, and a good transferable development rights market (i.e. the right to construct more for a given land area), community based responsibilities and varied forms of tenure. A *community-housing model* in India uses the government machinery to create community organizations, build capacity and thus reduce costs and risks. The bank then lends, based on its credit assessment, and the government facilitates the bank's linkages with the community. Individual loans can be taken for up to US$2,500. To date, more than 15 banks have participated in the model, with over 100,000 houses financed and with very high repayment rates. A *rental-housing* model tested in South Africa seeks to refurbish relatively older buildings and lease them to clients. The loan component comprises about 60 percent of the project cost, and the equity

[2] (Member of IUHF)

component comes as a grant. Both the loan and building maintenance are paid for from rental receivables, and rent collections have a track record of almost 100 percent.

Ms. McLeod from Emerging Markets Group then continued the exploration of the **Local Finance Facilities** concept that was started off by Mr. Mutter in the morning plenary session. They should bring together the key players: government authorities, traditional authorities, local government, civil society and market representatives. Functions include providing a means to blend different funding to maximize affordability, for example loan guarantees to facilitate access to commercial bank loans and catalytic grants to provide critical inputs for successful project planning and implementation. Technical assistance to ensure the development of bankable projects and programmes include generating data and information for planning and monitoring slum upgrading.

The establishment and operation of such facilities in Ghana, Indonesia and Sri Lanka as part of the UN-HABITAT SUF[3] pilot project has been supported by Sweden. Some of the main lessons learned were:

- Local finance facilities generate commitment and focus on city-wide slum upgrading.
- There is great potential for long-term and more complex slum upgrading initiatives to be channelled through facilities using the "Finance Plus" approach[4].
- National- and municipal-level facilities help to stimulate project ideas.
- There is a high delay and fall-out rate between project concept and implementation.
- Rising interest rates are interfering with affordability (particularly in Sri Lanka).
- Community savings and loan systems are a crucial element.

Ms Ayanthi Gurushinge, Country Coordinator for Slum Upgrading Project (PT) of UN-HABITAT in Sri Lanka, presented one of the pilots, the **Lanka Financial Services for Underserved Settlements** (LFSUS) more in detail. It is a not-for-profit company that mobilizes resources for countrywide slum upgrading activities through public-private partnership, promotes the viability of lending to low-income groups, and provides guarantees to banks to encourage lending for settlement upgrading. This facility has the longest history of the three, and experience shows that housing finance needs to be community-based and simple (minimal paper work, minimal collateral requirements, flexibility in repayment, incremental housing financing, etc.).

EXPERIENCES WERE SHARED ON VARIOUS LINKS OF THE CHAIN

Four parallel **Dialogues addressing the various Links of the Land Administration Chain** were held, again focusing on an exchange of experiences, but this time from different trades within the land professionals. The objective was to enable a crosscutting development of linking the chain. The participants made a choice between four entry points: Practices and Tools, Reinventing Planning, Linking the Financial Sources and Access to Finance. A wealth of real world experience was shared from around 30 countries. It led to the following outcome.

Conclusions regarding Land Use Management Practices and Tools:

- A lengthy and multi-faceted **discussion was held on gender**, where a number of country examples were highlighted. Many women still do not have the right to hold a title. Women are often not recognized as a *de jure* head of household even though many women are in fact the head. Female land ownership may be as low as 5 percent (and less) in some countries while it is women who mainly work on agricultural land with little benefit from the produces. Customary laws and practices often discriminate against women.
- It was concluded that **to enhance gender-responsiveness**, work is needed on many fronts at the same time. Education is critical, both for women to know and apply their rights, and for them to be able to join land professions and decision-making bodies. It was agreed that one of the most important elements is to have appropriate laws and policies in place, including the fundamental one of allowing women to own land, and to make sure that these are implemented.
- Discussions also centred on **the significance of effectively collecting municipal fees**. A number of country examples were again provided. Examples of only 20% collection were cited, while a collection rate of 90% would be financially self-sufficient. Rather than looking at other means of innovative financing, it might be more appropriate to explore means of improving collection.
- The advantages of enumeration were flagged, where land data are collected in cooperation with NGOs using forms to **record land users** linked to satellite images to collect spatial data. The need for a cadastre was also mentioned, and steps were shared on how a land information database can be set up at the municipal level, which can be monitored by the municipal assembly.
- Information required for tax collection. Scaled-down options with simpler and quicker methods for collecting information in informal settlements need to be explored. Who should have the responsibility for sufficient information – the community, local governments or landowners? In addition, back-up systems must be in place.

[3] Slum Upgrading Facility

[4] An attempt to encompass the complexity of slum upgrading, including not only finance, but also participation of various actors, project risk assessment, capacity to optimize the mixing of various financial instruments, including a link to broader development.

- Too much focus on upgrading rather than on **preparing for urbanization**. In this regard, revenues can be used to avoid new informal settlements in the future by proper and longer-term planning.

Conclusions regarding Revisiting Planning, Cutting the Costs, Involving the Rights of the Poor and Enabling Adequate Finance:

- The need to **persuade politicians that urban development is necessary and that the poor should have a share** was emphasized. The approaches needed to create successful cities are not being adopted and implemented at the scale and speed needed. One reason could be that politicians, senior administrators and the commercial elite are benefiting sufficiently from status quo, and therefore ignore the information that is available. Therefore, a major issue is **how to re-invent planning to mediate between public and market interests**, and **how to de-link land interests (of politicians/elite)** from planning.
- **The best planning is done by the slum dwellers themselves.** Mobilizing them is not difficult, and if the service needs are articulated by the people who live there, it becomes their project – they get what they want, and resources are utilized to the maximum. Less information is needed for planning by professionals, as the local people know their area. Stakeholder participation leads to local conflicts being resolved within the community. Local distribution of money to communities helps realize their locally defined goals.
- It was also pointed out that **megacities** need information for an overview, and that planning needs to be long term, for example ten years. The **link between detailed planning and large area planning** is missing.
- Development broadens the base for **property tax**, and this tax raises funds for decentralized functions. Information is needed for collecting tax and appropriate systems are required for the redistribution of resources. Taxation should also capture some of the value that is created by society. There should be systems for re-distribution of wealth, and there is a limit as to how far redistribution can go. The poor are willing to pay taxes if they see benefits.
- Taxation is democratically determined, but politics and policies do not drive development – the market does. In this regard, **transferable development rights** (TDR) are a good example of how governments can guide the market rather than fight the market.[5] Infrastructure can be financed by selling land-rights "above" the infrastructure.
- To help the poor within market economies any commercially based residential development should include low-income housing for a certain per cent of the development. This is feasible when institutional capacity is in place for enforcing the rules. The problem in many developing countries, and even more 'developed' ones like South Africa, is that **governments** are generally market-illiterate and lack an understanding of where and how much they can **influence market-based decisions**. Policy makers also overlook the fact that the poor build incrementally and not all at once.
- Two types of planning are needed: development to meet the needs of existing settlements and populations, and development to address the needs of future populations. For **existing settlements, planning/upgrading is incremental**. Confidence must be built between communities and the public sector. It requires follow-up and it must be accepted that poor people usually cannot provide input other than their labour.
- **Information** is indispensable for community-based planning. Examples were given of information kiosks or E-Centres and the concept of "m-government" (mobile) to help bridge the information divide and improve quick and easy information exchange.

Conclusions regarding Linking the Financial sources:

- **Efficient subsidies** should govern the sustainability of the market, with one-time subsidies for the connection, and additional subsidies for access to services for the use of them. Government or local subsidies are needed when it comes to Informal settlements, where often extremely poor people are living on land whose value is very low.
- The **role of the state versus the market** was a leading theme throughout the discussion. Both are intertwined and must work together. A functioning private sector is not possible if the public sector is not working. The crucial question is where the private actor will find its incentives.
- A solution given by several participants from their own examples was the **building of a more compact city**, with high-rises, and in a public-private partnership. Government provides land and the private sector provides housing. Initially the flats can be rented and after a while also available for purchase. It is a market-based approach to share the benefits of rising values. Property rights are very important.
- A good experience was presented (from Ethiopia) where the government uses two approaches: setting the rules for private participation and providing condominium houses.
- As for the development of slums in Africa, the basic problem is **corruption**. Greed and need are both root causes. The government's role should be to provide incentives for housing cooperatives and create an enabling environment for low-interest bank rates.

[5] If the right to construct more for a given land area can be traded on an open and transparent market, the upfront infrastructure investments that are needed for such development will also be put out to a fair competition creating a downward pressure on costs.

- It is still generally impossible for **local communities to mobilize** enough. It is very difficult for poor people in informal settlements to come together and invest in their infrastructure. The government (usually with a planning monopoly) needs to conduct the initial work to improve roads, water, sanitation, etc. In this way, the value of the house increases, and it then becomes possible to gain access to credit from the commercial banks.
- The dialogue concluded that the **involvement of both central and local government is needed** to minimize corruption, support infrastructure, security and title issues, and provide subsidies. This could provide incentives for the private sector to come in. All of this will need to be integrated within the planning process. The international community also has an important role to play by putting pressure on national governments when they are corrupt, especially when money is diverted. The international community could also provide the long-term financing required to address housing.

Conclusions regarding expanding the outreach of housing finance for the urban poor

The **existing banking situation** was discussed and experience on this shared in both dialogues (*Linking the financial sources* and this one). It is summarized below.

- **MFIs** are just beginning to function, partly an outflow from banking consolidation conducted in some countries. Only a few percent of the population's home construction is financed through mortgages and that financing is generally accessible only to the upper middle class, since they require a downpayment of at least 25 percent. Only people who are working or self-employed have the necessary assets to borrow. In addition, it is taken for granted borrowers will have a good title documents. It still remains unclear whether MFIs in much of Africa will invest in long-term loans.
- **Banks are slowly moving** to broaden the market base. A dramatic shift took place when banks became willing to take construction-related risks (example from India where today a monthly salary of up to US$ 500 can receive a formal loan for housing under construction). For the bank, the main concern is whether it can sell the asset to recover its investment in the event the person defaults. Mechanisms to recover their investment (foreclosure, group guarantee) are perceived to be essential for banks, not only the collateral as such. Commercial loans are available before residential. As commercial lenders became more comfortable in the market, they started to become willing to create new and different products.
- **Financing sources** could also include affordable funds, including pension funds.

A number of key messages emerged from the dialogue:

- **Macro-economic stability is critical.** The macro-economic environment is improving in many developing countries and there are more diverse opportunities for investment, including housing finance. However, in some emerging markets, inflation is rising and needs to be accommodated in the calculation of the loan interest rates. The annual inflation rate must be less than 10 percent for mortgage finance to be viable. Otherwise, loans are restricted to short-term incremental lending, and incremental construction, like home improvements.
- There is a need for **political will** to create an enabling environment for private investment in slum upgrading. Governments must practice restraint: borrowing less for their annual budget and helping to bring inflation down.
- **Mortgage-based lending instruments are not appropriate** for the urban poor living in a context of rapid urbanization, lack of land title, and inability to foreclose.
- **Secondary mortgage markets and insurance schemes** may also contribute to broadening access to finance for the poor. Large loans would be needed, and, perhaps spread over multiple countries, but there is a question of capacity in domestic banks.
- There may be a need to **create new institutions** to meet the demands of the urban poor clientele, since it is difficult to convince banks to move into new markets. One model: group lending is established; an upgrading or development project proposal is put forward, depending on government capital and never linked to the commercial financial sector.
- A **history of repayment** is more critical for the possibility to get loans than asset-based (collateral-based) lending. Often, many housing loans are small-business loans, as home-based businesses are established.
- **Groups or cooperative models** are key to accessing finance and reducing the risk perception. Groups can provide a guarantee for repayment, with members of the group able to cover an individual's instalment if one of them falls short in any given month. Over time these systems can become larger and more sophisticated and help build financial literacy. Savings are indispensable to prove creditworthiness. In this regard, groups can strengthen and leverage individual savings.
- Another option is a **shared ownership scheme**. For example, an individual pays rent on three quarters of the unit to a housing association and over time can increase his or her equity share. Such a market would require a strong regulatory framework.
- **Subsidies** have historically played a significant role in generating markets. These are not a best practice, but they do open up markets to new sources of finance. Often an incremental approach is required to build lender comfort. Commercial loans can start more quickly; loan guarantee or insurance systems are other options at the early stage to get the system functioning.

MAKING THE MARKETS WORK

To summarize the conclusions from all four Dialogues, it is all about working towards an inclusive and functioning market, governed by sound and sufficiently equipped institutions. This main conclusion is remarkable, - not in itself, but in the fact that such a large discussion with the diverse group of participants ended up with this unanimous solution.

To know where to go is one important thing, to know *how to get there* is equally important. Also here the examples, remarks and conclusions ended up in great congruence. An **incremental approach** is needed for building houses and markets. A poor person cannot simply go out today and arrange bank financing for housing.

Incremental approaches to land and finance access are needed in order to minimize market distortion and put less strain on the administrative system. In this regard, as a group, people are better positioned to withstand livelihood shocks and access credit, and certificates gain in value as individuals create a positive credit history over time. Building trust was considered paramount. As people achieve a certain level of income, they gain more confidence in the formal system, and informal systems are gradually pared down. It is critical to demonstrate that the poor have the ability to repay and to save, in order for banks to have a better understanding of their capacity. The need was also expressed to have systems that can marry access to finance to ever-improving certificates. Small loans need to be able to evolve into larger loans and then into some form of mortgage. Communities can increase their power through savings schemes or using traditional institutions.

MOVING FORWARD - A PERSONAL PERSPECTIVE

Starting up my work-engine again after the summer holidays, I begin with taking a look in the rear-view mirror:

- ❖ We succeeded in arranging a well-organized seminar with rich and instructive programme content.
- ❖ We highlighted many aspects that are contributing to improved conditions for the slum-dwellers, and thereby also contributing the development of society as a whole.
- ❖ Theory and practice from all of the world was of great benefit to us
- ❖ Participants, taking an active interest and having a high level of engagement, throughout the seminar as well as in preparing for it, yielded exchange of experiences of great benefit to us.
- ❖ We were given a more qualified and deeper understanding of the holistic approach to urban development.
- ❖ We put emphasis on the importance to create improved conditions for the victims of the informal economy, by enabling access to land and functioning markets.
- ❖ We improved our understanding of how to integrate the informal land economy in a functioning formal accessible, transparent and just formal economy.
- ❖ We gained an overall understanding of cooperation and development, providing prosperous conditions ahead.

Looking at the road ahead, I see the vehicles where we should embark, and letting go of our own specific branding of an "innovative mechanism". I see who needs to take the driver seat in the longer-term perspective, but also the ones that need to take turn in that position initially. I see the need to equip the vehicles with modern techniques for surveying, mapping, cadastres, valuation and financial products, but even sharper I see the need for paving the road and restoring all the potholes where individual greed sticks you.

Remember the words from the Swedish State Secretary: We were not there just to attend another seminar! The Dialogue formula made it possible for us all to learn from experience and share both successes and failures. We were there to listen and to learn. We will help bridge the gap between functioning land markets and functioning financial markets. This work must continue so that we can come closer to fulfilling "the dream" – or actually fulfil our promise made by almost all of us 60 years ago – the adequate and affordable housing for all. It is a goal that we all should share and work towards together!