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HOUSING FINANCE INTERNATIONAL

The Quarterly Journal of the International Union for Housing Finance

- Housing Finance in South Africa
- Preparing a Housing Finance Strategy
- Affordable Housing in New Zealand
- Facilitating Investment in Affordable Housing
- Mismatch between Homeownership and Residency in Korea
- Housing and the Financial Crisis: Causes, Consequences, Cures

International Union for Housing Finance

Housing Finance International

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Editor's Introduction

↳ **By Friedemann Roy**

With the overall economic climate slowly improving world-wide, we should be capable of further scrutinising the effects of the global financial crisis on the individual national housing markets. A recent article in the Financial Times which refers to the latest European Quality of Life Survey points out that Europe's households are apparently better protected from the ravages of the financial crisis than its banks. Only a minority of homeowners have a mortgage and, to date, only few have experienced payment difficulties.[1] Even households in Central and Eastern Europe, the part of Europe which has been particularly affected by the global recession, appear to be less affected since only 8% of all households have a mortgage.[2] However, the article does not elaborate on the extent of rising non-performing loans and their repercussions on households and banks.[3]

The following months are expected to shed more light into such issues and will provide relevant lessons learnt. This should help to develop housing markets which are more resilient to fluctuations in the economic cycle and to continue promoting access to housing finance for lower income groups without creating undue systemic risks.

Our first contribution is a note on an article which was published in the March 2009 edition (Vuyisani Moss, "Measuring the Impact of the Financial Sector Charter (FSC) with Respect to Low Income Housing in South Africa"). The author, Pierre Venter, believes that Mr Moss's contribution contains misleading statements and findings. He argues that over the past years lenders have made great efforts to provide more lending to the low income sector in South Africa. However, inefficiencies in the institutional framework have held them back.

Our second contribution is by Raymond Struyk. He delivers an excerpt from the "Guide to Preparing a Housing Finance Strategy", a report he prepared for the UN-Habitat in Nairobi. This report provides assistance to housing policy makers in the development of a housing finance strategy. This strategy is aimed at deploying the financial resources available in a given country to finance the demand for housing by the different segments of the society, in particular low and middle income groups.

The next two contributions are in close connection to Raymond Struyk's contribution since they deal with affordable housing. The first is by Patricia M. Austin and describes the attempts in New Zealand to introduce policies requiring developers to contribute to affordable housing provision in local communities. The Labour-led government introduced an Affordable Housing Act in September 2008 but, following a change in government, this is now under review. This policy transfer experience is contrasted with that of a small mountain resort community (Queenstown Lakes) that has successfully negotiated affordable housing contributions with a number of its local developers.

The second, drafted by Julie Lawson, Mike Berry, Vivienne Milligan and Judith Yates, contemplates the development of an investment model to finance affordable housing. The authors argue that unlike many other countries, Australia has not established a long term vehicle to channel institutional investment into housing, despite clearly inadequate public and private low cost supply, a situation that has been recognised by numerous reviews in the country. In their paper, the authors revisit the case for housing bond financing in Australia and supplement it with the analysis of similar, but well established, bond financed schemes operating successfully in Austria and Switzerland. This analysis provides an exploratory basis for outlining the necessary features of a bond financed model that would be appropriate for the Australian conditions in order to support the sustainable growth of social housing and the broadening of affordable housing options for low and middle income households.

Our next contribution, which is written by Jun-Hyung Kim, Mack Joong Choi and Jinsoo Ko, deals with a housing feature in Korea that has not been studied in depth so far. It is generally assumed that homeowners live in the house they own. However, homeowners may live in a rented house and lease their own home. Thus, homeownership may not necessarily imply residence. This feature is of particular importance in Korea: the Chonsei system allows homeowners to obtain a sizable upfront deposit in cases where they rent their own apartment/house to a different person. The deposit earned could be used to rent a different house or apartment without disposing of the already owned home. In their paper, the authors investigate how systematic this pattern of mismatch between homeownership and residence is and, if so, what factors contribute to it.

Our last article by Michael E. Stone provides a provocative analysis of the sub-prime crisis in the United States. In his contribution, he describes how the U.S. Housing System was constructed and how it collapsed. Following that description, he identifies a number of elements for building a different and more solid housing finance system.

I hope you will enjoy reading these articles. Please do not hesitate to come up with your comments (as Pierre Venter did) to stimulate a wider debate which will allow for a broader exchange of ideas and concepts. They are more than welcome!

Friedemann Roy[4]

[1] See Financial Times (24 July 2009), "Europe's households build finances on firmer foundations". The article is written by Chris Giles.

[2] The article does not refer to the home improvement and consumer loans taken out by many people in the region to improve their housing situation.

[3] A good insight in this issue can be found at a recent EBRD blog from 16 July 2009 ("A look at non-performing loans: the boomerang effect" by R. de Haas) and a recent paper from Deutsche Bank Research ("All about asset quality", 20 August 2009).

[4] The Findings, interpretations, statements and conclusions expressed herein are those of the editor alone and do not necessarily reflect the views of the International Bank for Reconstruction and Development/The World Bank and its affiliated organizations, or those of the Executive Directors of The World Bank.

Housing Finance in South Africa

↳ From Pierre Venter (The Banking Association South Africa)[1]

Dear Editor,

As an avid reader of your journal and as a housing practitioner employed within the banking industry, who has been intimately involved in the provision of housing finance to the Financial Sector Charter target market over the past 20 years, I feel obliged to comment on what I can only describe as a shallow article by Mr Vuyisani Moss styled "Measuring the Impact of the Financial Sector Charter (FSC) with Respect to Low Income Housing in South Africa."

Not only are there a number of omissions/misleading statements within the article, but the paper suggests that a primary challenge for private sector lenders in South Africa is the creation of suitable products to service this market segment, that there is a need to reduce their loan origination standards and that legislation, in the form of the introduction of a Community Reinvestment Act, may provide the necessary impetus for this to happen. I venture to suggest and demonstrate that these arguments are flawed.

Omissions/misleading statements within the article include amongst others:

(a) *Financial Sector Charter Council (FSCC) Annual Reports/provision of data to support lender target achievements*

Most developing countries do not have sufficient accessible data and/or the necessary data storage/extraction tools available to them for analysts to interrogate opportunities/challenges/achievements within a particular focus area at a micro level. South Africa has been no different than most developing countries in this respect. The National Credit Act (NCA), which was introduced in June 2007, provided the necessary impetus for the financial sector to upgrade its data storage and extraction facilities to the extent that the industry is now in a position to provide micro level detailed information on a demographic and income sub segmentation basis for all lending products, including housing finance. It was estimated at the time of the implementation that lenders would spend more than R2 billion to upgrade their computer systems in order to comply with this legislation, although this would ultimately be of considerable benefit to the industry.

The provision of information by financial institutions at a micro level for annual reporting purposes to the FSCC was aligned by lenders to their provision of information in terms of the National Credit Act. The FSCC therefore received detailed information at a micro level for all housing finance related loans made by lenders from 2007 onwards. The fact that the FSCC annual reports have not reflected a detailed breakdown of such loans has not been a matter which financial institutions could control, as these reports are compiled entirely independently of financial institutions.

Governance, in respect of the accuracy of the information being provided by Charter participants in regard to their achievements, has however been of a high standard since inception. Financial institutions are required to provide the Charter Council with external auditor reports which validate that the information has conformed to the interrogation process followed by auditing companies to determine, with reasonable accuracy, the integrity of the information. The recognised and registered external auditing firms used by lenders to confirm this process, interrogated the following:

- Matching the information stored within lender data warehouses with balances reflected within their general ledger accounts.
- That the computer software extraction programmes used by lenders to extract aggregated data for the FSCC reports accurately reflected their lending to the target market.
- A sample check of loans was undertaken by the auditors to validate the position.
- An unqualified report was then provided by these auditing firms to the FSCC, failing which the FSCC did not include such achievements within the Charter scorecard for that financial institution.

To suggest that achievements reported by financial institutions to the FSCC were/are "unreliable" is, I therefore believe, both misleading and groundless.

The Banking Association of South Africa (The Banking Association) has, since the inception of the Charter, proactively obtained quarterly high level Charter progress reports from its members and has made industry information available to the media, NGOs and Government. The provision of such progress reports has, however, always been qualified as the accuracy of the current year's information had not been validated in terms of the rigorous audit process as described above. The detailed achievement scorecards which individual financial institutions submit to the FSCC were/are, I believe, confidential as they contain information which would allow competitors to gain insights into competitors' organisational strategies aimed at penetrating and capturing market share within this market segment. FSCC annual reports and The Banking Association progress report releases have, therefore, only provided aggregated industry information.

[1] The Findings, interpretations, statements and conclusions expressed herein are those of the author alone and do not necessarily reflect the views of the International Bank for Reconstruction and Development/The World Bank and its affiliated organizations, or those of the Executive Directors of The World Bank or the institution the author works for or is affiliated with.

(b) *Achievements of the National Housing Finance Corporation (NHFC) within the targeted market segment as compared to that of commercial lenders*

The NHFC was established in 1996 as a Developmental Financial Institution (DFI). Part of its mandate was to provide wholesale housing finance to households with incomes below the level of those which commercial lenders believed to be commercially viable and sustainable, through leveraging off intermediaries deploying an innovative product mix. For Mr. Moss to suggest that the NHFC was, and remains, a key player within the lower income market segment is, I believe, an exaggeration if one uses the quantum of lending to this market segment as an indicator of success. The financials of the NHFC indicate that their outstanding advances to the lower income market over a twelve year period is less than R1 billion as compared to that of commercial lenders which, over the past five years alone, is expected to reach R30 billion. Further, it would appear that the leadership within the NHFC has recognised and accepted that the 'gap in the housing ladder' is not one of financial product and/or an unwillingness on the part of the private sector to make finance available to lower income households, but rather one of a supply shortage and inadequate institutional financial support for low income households, as they have shifted their focus to include households earning up to R15,000 (about USD 2,000) per month (middle income households) and are now trying to compete with the private sector for such business. There is little doubt that the NHFC is an important player, but its role should be seen in the above context.

(c) *Geographical/sub-income spread of loans*

I have a very different understanding from Mr. Moss' about the value chain and/or the role of the various stakeholders in respect of the provision of housing within a market economy. The role of the lender is to make suitable product finance available, based on demand from consumers on a non-discriminatory and responsible lending basis. It is not to try to dictate to the market (developers and consumers) either the value of and/or the location of homes to be built and/or to attempt to limit lending policy to try to artificially force such a geographical and income sub-segmentation spread. In essence, a lender anticipates consumer demand and proactively creates products to cater for such demand on a competitive basis, whilst the Government creates an enabling environment where lenders can lend. This places an onus on the Government to create viable communities which can only be premised on their providing holistic infrastructure (physical, social, economic and environmental infrastructure) to support sustainable human settlements. The writer would therefore argue that the geographic and income concentration of loans for which lenders are being criticized is, in essence, reflective of an inadequate public sector institutional framework.

(d) *Borrower Equity*

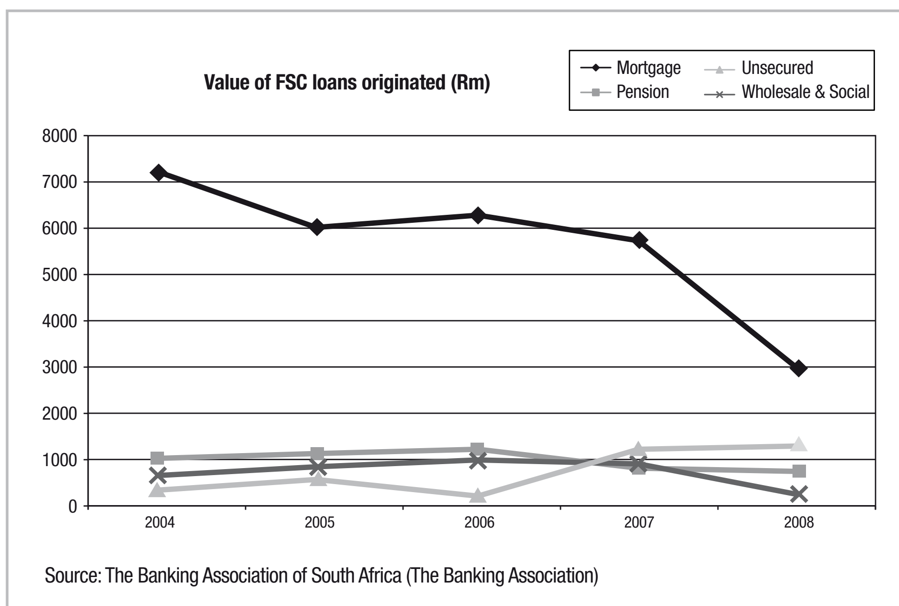
According to practices in other countries, lenders require a down payment of up to 40% of the purchase price of the home. In South Africa this has not been the norm, as competition has driven lenders over the past number of years into a position where they have provided mortgage loans without requiring an equity stake from borrowers and, in some cases, they have even capitalised the legal costs and loan origination fees associated with the purchase of the home into the mortgage loans. The sector's reaction to market pressures must, however, be seen against an appreciating residential property market where a lender's loss severity, in the event of default, was low when compared to international norms.

South Africa has, however, for the first time in 17 years slipped into a recession and one outcome of this has been a weakening in residential property prices. Whilst South African banks have reported lower profitability figures and a worsening in default and bad debt levels, South African banks remain financially stable and are well regulated, capitalised and managed (I mention that there has been no consideration or need for the "bail out" of any of the banks within South Africa by the Government). The poor economic climate, both locally and internationally, has however forced them to review the need for households to provide a cash deposit of between 5% and 20% on home purchases. Fortunately, this equity stake does not apply to the Charter target market as South Africa has a mortgage insurance company called the Home Loan Guarantee Company which underwrites losses specifically within the affordable housing market. This obviates the need for mortgage lenders to demand a cash deposit from affordable housing borrowers should they wish to avail of this "risk underpin". A "gap in the housing ladder" for first time middle income buyers is, however, evident and dependent upon the severity and magnitude of this 'gap', as well as of whether a home owner equity stake is viewed as a structural change as opposed to a temporary lender reaction to the adverse economic climate, the Government and/or insurers may wish to initiate a risk enhancer which will close the 'gap'.

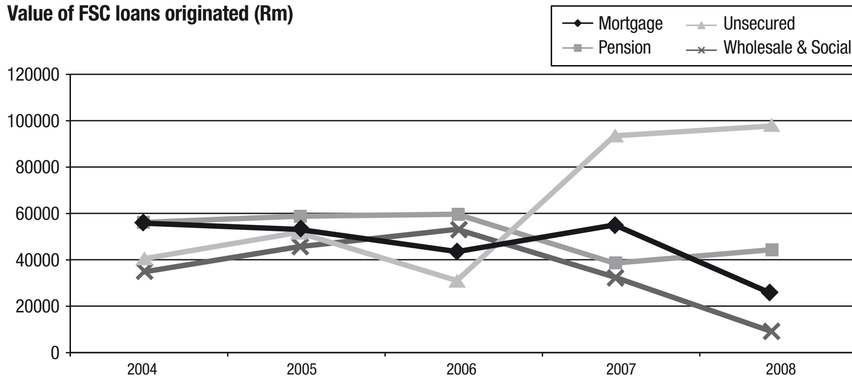
(e) *Performance of Lenders*

In assessing the performance of lenders over the first five year period which ended in 2008, the following observations are noteworthy:

- The financial sector committed itself to originate R42 billion in housing finance loans. The origination achievement of the big five lenders alone was R52.2 billion (these lenders committed themselves to an origination target of R42 billion with Government). If one were to add the achievements of the smaller lenders to this figure, we expect origination achievements to increase to approximately R55 billion (131% to target)
- The number of families who benefited from the Charter initiative is approximately 1.6

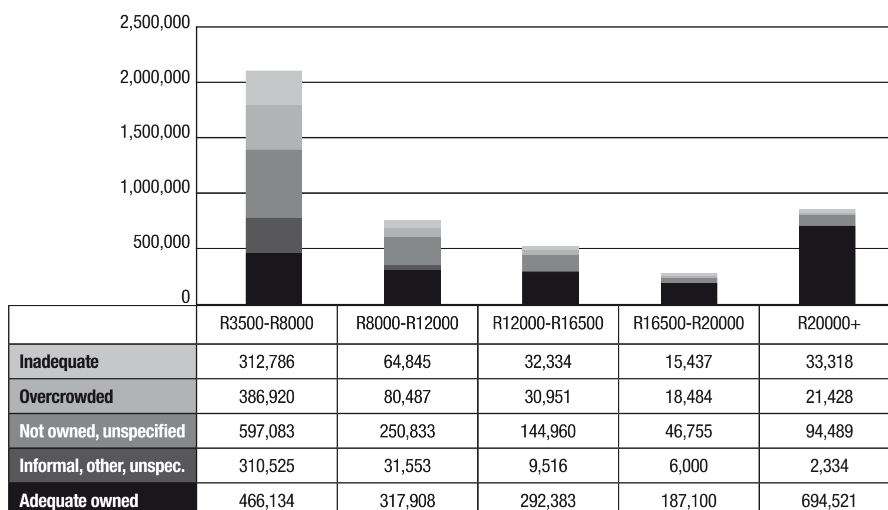


Source: The Banking Association of South Africa (The Banking Association)



Source: The Banking Association

Housing backlog in the low to medium income market



	R3500-R8000	R8000-R12000	R12000-R16500	R16500-R20000	R20000+
Inadequate	312,786	64,845	32,334	15,437	33,318
Overcrowded	386,920	80,487	30,951	18,484	21,428
Not owned, unspecified	597,083	250,833	144,960	46,755	94,489
Informal, other, unspec.	310,525	31,553	9,516	6,000	2,334
Adequate owned	466,134	317,908	292,383	187,100	694,521

Source: Finmark Trust

million families or close to 7 million citizens either through the provision of new housing or through improved housing conditions

- What is, however, disappointing and of concern is that despite lenders being willing to finance new housing opportunities, only about 95,000 new homes were built by developers within the target market over the period and it is this dearth of suitable stock which has resulted in the housing backlog within the Charter target market increasing from about 600,000 units in 2004 to approximately 800,000 units by the end 2008.

In an effort to try boost the supply of housing it is important to mention that all the major banks have created a development arm so as to acquire land and that they leverage off private developers to provide new housing within both the welfare and Charter target markets. This is certainly "business unusual" and, I believe, it demonstrates the commitment of lenders to both assisting the Government in its endeavours to "house the nation" as well as to their Charter commitments.

- Readers will note from the graphs above, the drastic decrease in the value of mortgages granted by lenders in 2008. This can be attributed to :
  - A 33% increase in interest rates during 2006 and 2007.
  - A stock shortage within the target market.
  - An overall 40% decrease in the disposable income of the average family.

Readers will also note that there was a substantial increase in the number of unsecured housing loans granted from 2006. This merely reflects the fact that some lenders were only able to distinguish such housing related loans from their unsecured loans used for other purposes, as opposed a real increase in activity.

Institutional Framework Inadequacies

Before detailing some of the major institutional framework challenges which South Africa faces, I think I would be doing an injustice to my country were I not to highlight some of the significant achievements which we have accomplished since the advent of democracy in 1994. Further, such comments will contextualise the reason for the institutional framework challenges which we face.

As South Africans, we can be proud of our achievements and I would like to suggest that South Africa is the envy of much of the African continent and other developing countries throughout the world.

Some of the significant successes we have achieved include:

- In excess of 10 million additional poor citizens (additional 22% of the population) now have access to basic services (municipal piped water, electricity and water borne sewerage).
- Over and above the provision of the above basic services, the Government has provided 2.3 million completed homes to welfare families. Such homes also include basic municipal services. The lives of an additional 10 million South Africans (22% of the population) have therefore been improved through the Government's housing subsidy programs.
- From a private sector perspective, the provision of housing finance in terms of the Charter has again improved the lives of an additional 7 million people (15.4% of the population) either through the provision of new homes or by providing finance for the improvement of homes.

Despite these remarkable achievements, the formal housing backlog in South Africa is estimated to be about 2.1 million units, with a further housing backlog of about 800,000 within the Charter target market and so, whilst we have good reason to celebrate our remarkable successes, we also need to be cognizant of the challenges that still lie ahead.

The figure above named «Housing backlog in the low to medium income market» depicts the housing backlog for households who have the propensity to repay a mortgage loan.

From the above graph it is clear that the major portion of the bondable housing backlog in South Africa is for households earning between R3,501 and R12,000. One can argue that a private sector lender strives to lend as much as possible provided such loans are profitable and sustainable. Why has the private sector not exploited this market opportunity? The writer would like to suggest that the answers lie in the following institutional framework inadequacies:

(a) *Product versus affordability gap*

In 1993 all stakeholders who had an interest in housing shaped current housing policy through collective research and debate at a forum known as the National Housing Forum. At the time, research determined that households earning up to R3,500 per month could not afford to purchase a home without financial assistance from the Government as they did not have the propensity to qualify for, or repay a home loan. Accordingly, the Government has provided such first time home owners with a free entry level home. Around fifteen years later, the Government has not yet lifted the income ceiling for qualifying for welfare households to compensate for house price increases, as its focus has been on improving the lives of the poorest South Africans first. If one were to check an inflation index or to take into consideration building cost increases over this period, then R3,500 in 1994 would equate to an equivalent household income of R9,940 (inflation adjusted) and R15,540 (building cost index adjusted) per month. See graph below.

(b) *Affordability Gap*

The minimum housing standard of the Government's welfare housing ownership programme consists of a 40m² completed home which comprises of:

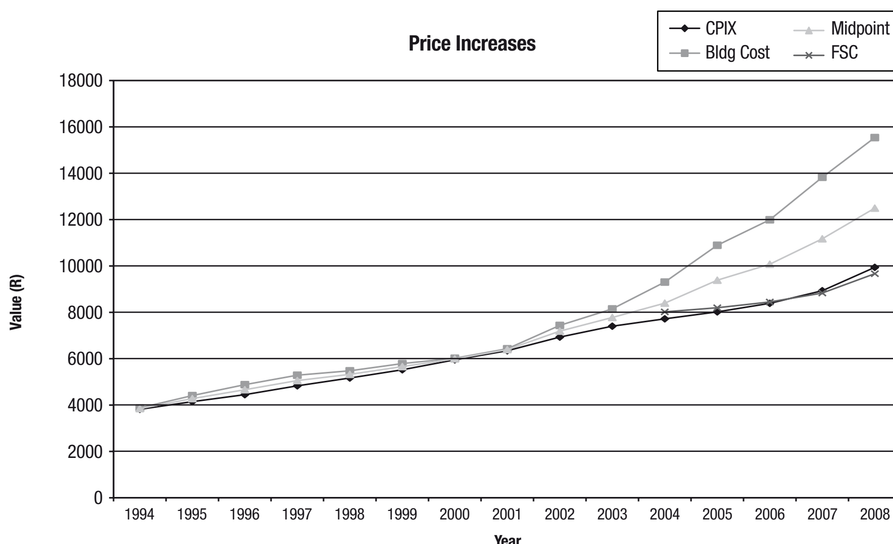
- Two bedrooms;
- A separate bathroom with a toilet, shower and hand basin;
- A combined living area/kitchen with a wash basin;
- Municipal basic services (piped water, water borne sewerage, metered electricity, roads, storm water drainage); and
- Predominantly single unit structures located on a 250m² site.

As the banking industry was concerned at the dwindling supply of homes being built within the Charter target market (lenders were advising that only about 10% of the Charter target market qualified for a home loan due to the price of entry homes coming to the market), The Banking Association undertook external research, which determined that the average cost of a welfare home is approximately R145,000. If one were to add concrete tiles, ceilings, guttering and facia boards to the unit, the price of the unit increases to approximately R178,000.

40m² welfare housing unit

40m² unit with concrete tiles, ceilings, guttering and facia boards

Source: The Banking Association



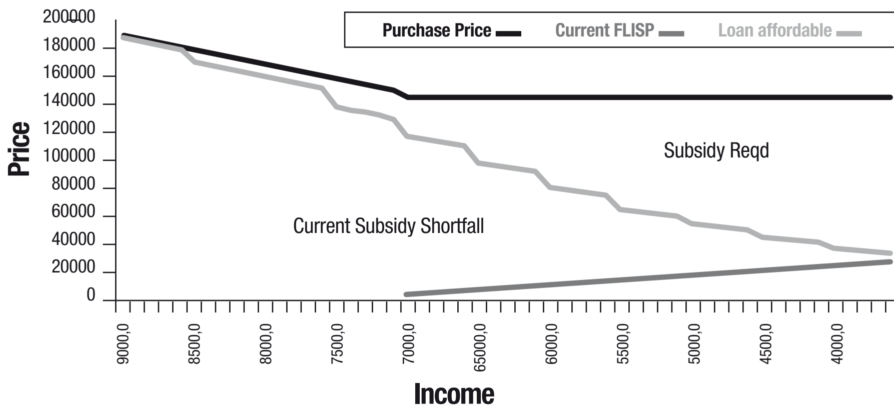
Source: The Banking Association

Even if a household were able to access a home loan at the country's current prime lending rate plus 1% over a 20 year period, we estimate that, on average, households would have to earn approximately R8,500 per month in order to be able to afford to repay a home loan on a 40m² unit with improved finishes as described above. Traditionally, households who are required to repay a home loan believe that not only should there be improved finishes within their home as compared to that of a welfare unit, but also that the home should also be bigger in size. On a general basis, developers therefore opt to build a 50m² unit with the improved finishes as described above with an average sales price of R240,000. Such a home requires a family to earn approximately R10,500 per month.

In 2005, when the banking sector entered into a Memorandum of Understanding with the Department of Housing, one of the key identified enabling enhancers sought from the Government was precisely that the Government was to provide limited financial support in the form of a partial capital subsidy to households who earned above R3,500 per month, which would allow them to access an entry home within their affordability limitations. Regrettably, this Scheme was only introduced for households earning between R3,501 and R7,000 per month. Further, the amount which such households receive, reduces progressively from R35,969 (household income of R3,501 per month) to R5,136 (household income of R7,000 per month). This Scheme therefore:

- has an upper income threshold below the level where a family can access an entry home; and
- the magnitude of the subsidy amounts provided is far less than what is required to assist families to be able to access an entry home.

Evidence of the ineffectiveness of this Scheme is that since its introduction three years ago, less than 3,000 subsidies have been accessed and currently provincial housing departments have allocated less than 5,000 subsidies towards this Scheme in their annual budgeting, simply because they do not see families being able to use this subsidy Scheme. The graph in the following page highlights the affordability gap for households earning between R3,501 and R8,500 per month in order for them to access a 40m² home with slightly better finishes than a welfare home.



From the above graph, it is clear that the "gap in the housing ladder" between welfare housing and a bondable entry home is a result of inadequate institutional support in the form of adequate subsidies. There is therefore the very real danger that the 800,000 housing backlog within the Charter target will result in these families becoming increasingly frustrated at not being able to access an entry home within their affordability constraints and that they will be forced to turn to the Government for their housing needs, thereby increasing the burden on an already stretched state to try eliminate a welfare housing backlog which would have grown from 2.1 million to 2.9 million units. Clearly, this is an untenable thought as the challenges which South Africa faces cannot be overcome by the Government on its own or, for that matter, by the private sector on its own. Mr. Moss in his article suggested that one possible solution to the housing challenges which our country faces is a meaningful partnership between the private and public sector, to which the writer and lenders fully subscribe, as big business must, and is prepared to play a meaningful role in helping to shape the future of our country.

(c) *Inadequate physical infrastructure (electricity, sewerage, piped water, roads, public transport etc.) to support new residential housing developments*

Given South Africa's success in providing basic services to an additional 20 million poor citizens (44% of our population) who, by necessity, have to receive a free minimum electricity and water quota and do not pay municipal rates and taxes, simply because they are too poor to do so, has placed a considerable financial burden on municipalities. They are not receiving sufficient additional income to maintain or fund the provision of additional physical infrastructure to support the increased number of users of these services. This has, in turn, negatively impacted on the creditworthiness of the majority of municipalities within South Africa to the extent that they are unable to borrow additional long term funding to support additional expenditure on the maintenance or provision of infrastructure from either the private sector or from developmental financial institutions. Today, both developers and lenders alike are highlighting that the biggest challenge which housing supply faces is a lack of infrastructure, with many projects having to be either delayed or scrapped due to a lack of physical infrastructure to support such residential developments.

Further, the predominance of single units on a 250m² site is resulting in considerable costs to the Government due to 'urban sprawl' and, therefore, the availability of well located and affordable land is becoming problematic. There is therefore an urgent need for an increased densification policy to be followed.

Again, this highlights a gap within the Government's institutional framework to support housing delivery.

(d) *Capacity within municipalities to process residential development applications*

From a developer perspective, time equals risk and additional costs. External research undertaken by Partners for Housing (a forum comprising of housing representatives from the major banks and the various Government entities involved in housing) two years ago indicated that, on average, it takes three years for a developer to obtain the various regulatory approvals from municipalities which will allow raw land to be converted into serviced sites. The research further highlighted that if process and monitoring improvements were implemented within municipalities, the approval process could at least be halved. Estimations are that such a time saving could reduce the cost of housing by as much as 15%. Again, this inefficiency points to an institutional framework gap.

(f) *Capacity and skills within the private sector (construction sector)*

South Africa has been fortunate to have been awarded the 2010 Football World Cup. This achievement has, however, necessitated an upgrade of South African airports, an improvement upon and erection of new stadia, hotels and roads to accommodate the additional influx of expected visitors to South Africa during this period. The capacity and skills of the construction sector has for the past few years been stretched to implement these big infrastructure projects in time for the World Cup. This has, in turn, impacted negatively on the remaining construction capacity/skills within the residential construction industry. Even if infrastructure to support housing developments and/or the government budget constraints and/or affordable well located land were not an issue, my feeling is that little or no additional capacity exists within the construction sector to accelerate the supply of housing. This again points to a temporary institutional framework inadequacy.

(g) *Government Housing Budget/Introduction of Legislation to effect increased Housing Delivery*

The Department of Housing (now called the Department of Human Settlements), has received substantial budget increases over the past five years (annual increase of 23%). For the past two years the Ministers in their annual budget speeches have however highlighted that by 2016, budget allocations will need to have increased by a further 2,100% if the housing backlog in South Africa is to be eliminated. As a developing country, where the majority of our people are poor, housing is not necessarily their most pressing need. Food, basic services, health and education are all often higher priorities, and so, if the Government were to increase its housing budget allocations, it would have to reduce its funding for other socio-economic priorities in the absence of a growing population tax base. Alternatively, it would need to raise taxation levels and to increase the risk of the flight of scarce skills from the country to more tax friendly countries in a global economy. This raises the question as to whether current housing policy is sustainable and whether current minimum housing standards are not set too high.

In 1994, the Government embraced an incremental housing policy whereby the welfare home it provided to the poor consisted of a core home of 20m^2 with basic services. The intention was that beneficiaries would improve, and, add onto their home over time (an incremental housing approach). Since then, the Government has bowed to voter pressure to improve upon this offering to the extent where we now it provides beneficiaries with a

well located, completed home of 40m², which whilst this meets the needs of beneficiaries, it is unaffordable to the country. The writer is therefore suggesting that, if housing backlogs are to be eliminated within both the welfare and affordable housing (Charter) target markets, housing delivery would need to at least triple over the next ten years and that this would require a review of current housing policy including minimum housing standards.

Mr. Moss, in his article, suggests that it is undesirable for "the free flow of market forces for public goods and services in a developing economy, as it allows markets to operate as they wish" and that "Government intervention to address impediments is essential". The writer would like to suggest that this argument is flawed if the crux of the challenge revolves around an inadequate institutional framework as opposed to reticence and/or unwillingness on the part of the private sector to play a meaningful role in supporting the Government's socio-economic imperatives. Similarly, unless an enabling framework is in place, no punitive legislation in the form of a Community Reinvestment Act, or otherwise, will increase housing delivery.

(h) *Reducing loan origination standards*

The sub-prime market crisis has proven to the world that for lenders to engineer their product offerings so as to over house families is not a desirable practice and that such lending could, perhaps, even be viewed as "predatory lending". This is certainly not in the interest of families and, if one were to ignore the financial mayhem that this has had within the first world and to focus purely on the heartache and difficulties now faced by families who have lost all their material wealth, reducing loan origination standards is certainly not part of the solution as suggested by Mr. Moss.

Fortunately within South Africa, lenders have always followed a responsible, prudent lending policy, with the result that South Africa does not have a sub-prime market. Even with the 5% interest rate increase over the past three years, coupled with similar food, fuel, electricity, and rates and taxes increases, which, at their peak reduced the disposal income of an average family by about 40%, the loan repayment performance of the affordable housing market has, despite its vulnerability to such price increases, not fared any worse than the middle income market. The writer attributes much of this to a combination of prudent loan origination, servicing standards and customer education, which is compulsory for all first time home buyers within the affordable housing market (such education is provided by lenders).

As an aside, for a lender to reduce its loan origination standards to the extent that a home owner could not afford the home loan when the loan was incepted, would in terms of the National Credit Act be deemed to be "reckless lending" on the part of the lender. Should consumers approach the courts and obtain a court ruling that a lender acted "recklessly", the court could set the debt agreement aside.

Conclusion

In closing, I hope that I have successfully demonstrated that the primary housing delivery challenges which South Africa faces are far more complex than that which the article by Mr. Moss suggests. I would also hope that readers recognise that private sector initiatives such as the Financial Sector Charter are helping to make inroads into the socio-economic challenges which all developing countries face and that initiatives such as this should be applauded rather than be superficially "trashed". Even if the housing initiative within the Financial Sector Charter helped to improve the living conditions of one family (in reality the first five years of the Charter touched the lives of more than one and a half million families), we would have added to the dignity of that family and, in the process, helped contribute towards a more equitable, inclusive and socially just society.

Over the past few years both lenders and the Government have committed considerable resources (on a partnership basis) to better understanding the market and collaborating so as to overcome the housing challenges which confront us. I have no doubt that now that we have a better understanding of precisely what these challenges are, we will continue to collaborate to overcome them. If the past 16 years achievements are anything to go by, South Africa will certainly be the country to watch.

A Guide to Preparing a Housing Finance Strategy: An Overview[1]

↳ Raymond Struyk [2]

The cold reality is that in many countries families who want to construct, purchase, or improve their housing are inhibited from doing so because they cannot borrow funds. Loans that are available are channelled to middle- and higher-income families. In these countries most families, especially the poor, improve their housing only as their savings permit, as they are unable to leverage their incomes through loans.

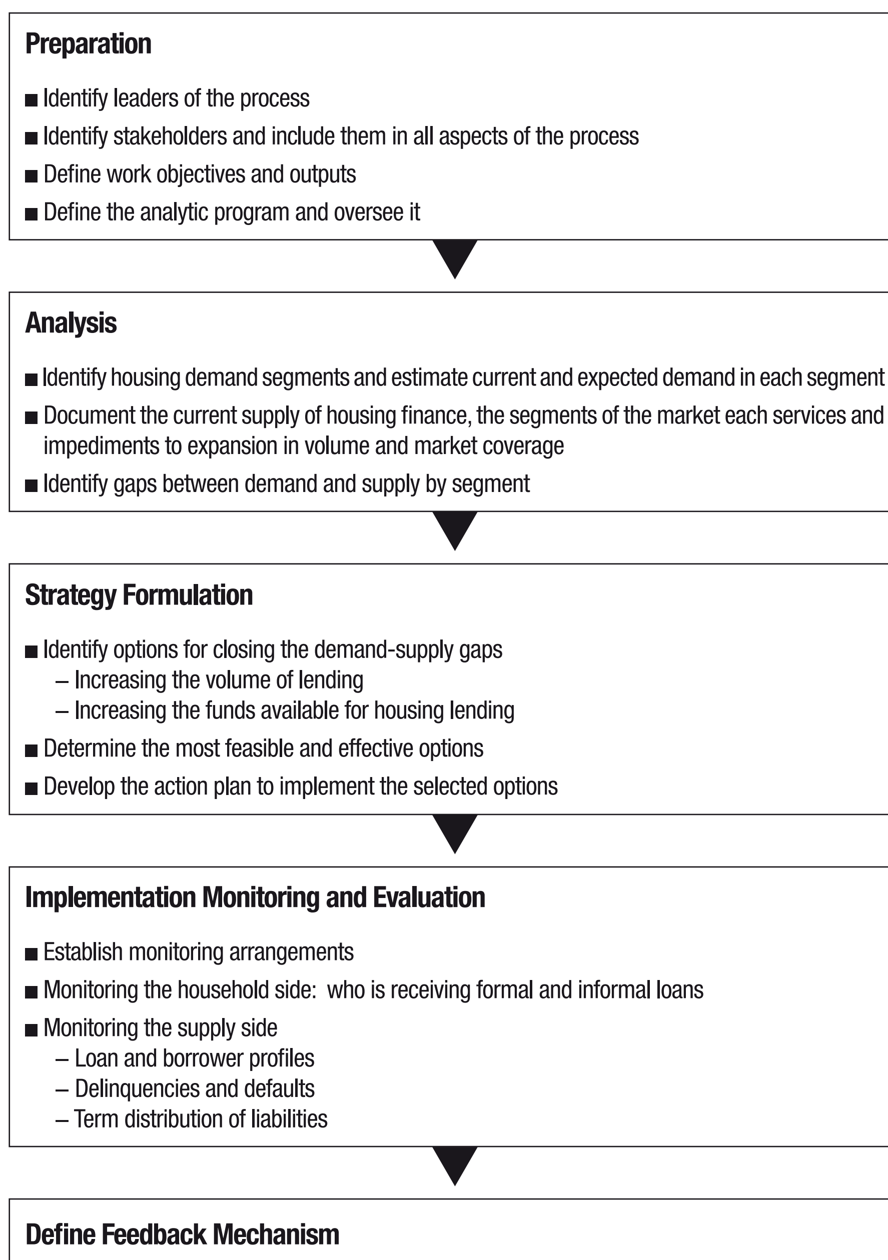
The effects of this situation, combined in some cases with extremely low-income levels, are that families in cities and in the countryside live in extremely difficult conditions characterised by poor dwelling quality and the absence of water and sewerage services that much of the world takes for granted. The rapid growth of cities and the increasing urbanisation of nations in the developing world are well-documented and make clear that this situation will only become worse in the years ahead unless addressed. The next few pages describe the preparation of a realistic plan to overcome this severe problem.

Organising a Housing Finance Strategy

A housing strategy is a plan for deploying the resources available (and if needed increasing them) to finance the demand for housing by different segments of society. A purpose of a strategy is to get the most from available resources. Preparing and implementing a strategy is a task requiring broad stakeholder involvement, a good deal of technical analysis and strong political leadership to realise.

The emphasis on stakeholder involvement and getting the process correct is clearly evident in the steps in the strategy development process shown in Figure 1. The process starts with identifying the relevant stakeholders and ensuring their active involvement, beginning with defining the strategic objectives.

Figure 1:
Overview of the Housing Finance Strategy Development Process



[1] This article is an excerpt from *Guide to Preparing a Housing Finance Strategy* (Nairobi: UN-HABITAT, 2009.) The full report can be downloaded from the HABITAT web site. This excerpt is published with permission.

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The primary technical steps in strategy formulation are, in a simplified form, the following (figure 1 serves as an illustration).

- Understand the broad housing situation in the country, including basic housing quality and related infrastructure conditions, the extent of the preference for homeownership versus renting, and other relevant factors.
- Determine effective housing demand by income class and location (urban, rural) to identify and define market segments and the volume of finance required by each segment in the planning period (note that because loan terms differ across households with different incomes, there is no simple ratio to apply to income to reach a housing finance demand estimate).
- Inventory housing finance currently available products and volumes, market coverage and lending policies (for example, treatment of different sources of income in underwriting standards, physical access, registration requirements) by market segment. This must include all sources private, both formal and micro, and government. Find out where lenders obtain their funds and the elasticity of these sources.
- Determine the gap between potential demand and current supply for each housing and loan market segment.
- Prepare a plan for closing the gap that is informed by the information developed in the prior steps.

Sounds simple? It is not, but it is clearly doable. However, the best technical analysis will be unproductive if the financial community, broadly defined, and the relevant government agencies are not fore square behind it.

Naturally, a primary question is how will the "gap be closed" or the plan fulfilled.

The Strategy Must be Comprehensive

Too often housing finance strategies address only the requirements for formal finance and then often only for a country's principal cities. Such strategies will often omit a major share of all households. This is a clear mistake.

Consider the following observations over the past decade for developing nations:

- In Mexico, self-built housing accounts for roughly half of all new building.
- An estimated 70 percent of housing investment in developing countries occurs through progressive building and therefore with little finance beyond household savings.
- Room- and unit-renters account for the principal tenure form for lower-income families in the urban areas of a number of African countries, including Kenya and Tanzania.

The situation is problematic in some transition countries as well:

- In Kyrgyzstan, in the years following the collapse of the Soviet Union, over 200,000 people migrated from the countryside to the capital, Bishkek, in search of work. They are living in very basic dwellings mostly without infrastructure services but within communities with formal layouts thanks to prompt action by the local government. Little finance is available for upgrading.
- In some of the countries of Southeastern Europe, the Caucuses and Central Asia a large share of rural households live without piped water or indoor toilets. Again, financing for housing improvement is very scarce.

These examples simply highlight that a national housing strategy must address all market segments, where segments are defined by household purchasing power, location, and tenure form. To do this requires giving micro finance a full role as a source for housing lending where it is needed.

Micro housing lending can and has permitted families to accelerate the rate at which they consolidate their dwellings. Microfinance Institutions (MFIs) make a succession of loans to families constructing their homes incrementally, beginning with quite small loans for short periods and gradually increasing the size and the loan period as borrowers demonstrate their ability to pay. Loan agreements are typically simple and the emphasis is on ability to pay rather than on pledged collateral. Techniques are available to reduce further the credit risks associated with such loans. As an example, lenders can pay suppliers directly for materials sold to borrowers to ensure the targeted use of funds.

One sometimes hears that few MFIs make loans for housing. In fact, estimates suggest that around 30 percent of MFIs' loans for business purposes are diverted to incremental housing improvements. Hence, in part the task is to formalise a type of lending that is already occurring.

How Will the Strategy be Fulfilled?

Conditions should be established so that private sector lenders, formal and micro finance, can extend credit to most market segments without taking undue risk.

As often noted, over the past twenty years there has been a gradual but fairly pervasive shift toward market provision of housing. In some cases this is due to the poor performance of public institutions charged with constructing housing or acting as lenders. But probably more important is that in many countries governments have helped set the necessary conditions that permit private lenders to prosper and serve most of the market.

It is worth spending another moment on the government's role. Governments, specifically, are in a unique position to execute two critical functions. The first is to set enabling conditions in which private lenders are able to operate successfully. These are discussed further in the next section. Suffice for now to note that it is often not a matter of an absolute shortage of funds but rather the terms used by lenders in making lending decisions. Banks in Africa, for example, are often quite liquid, but they do not lend because they employ archaic underwriting standards or believe the associated risks to be too great. Table 1 gives two of many examples of actions that government agencies could take to promote increased lending by banks and micro lenders.

Table 1: Examples of Mortgage Finance Inhibitors and Possible Government Steps to Resolve Them

Problem	Possible Solution
There is a mismatch between formal lenders' underwriting standards and many borrowers' qualifications. Banks are lending only to salaried employees and have high minimum loan sizes.	The Central Bank and the Bankers' Association agree to press for lower loan sizes and for lending to those with less easily documented incomes. It is recognised that this will make lending more costly and should be reflected in the interest rate charged.
MFIs are short of lendable funds for housing. One option is larger lines of credit from commercial banks. Banks are concerned that the risk of such credit lines is significant because MFIs are not strongly supervised.	The Government moves supervisory responsibility for MFIs from a social ministry to the Central Bank. The Central Bank will develop alternative standards for MFIs compared with commercial banks but supervision will definitely be stronger for MFIs than it is now. The risk level perceived by commercial banks in extending lines of credits to MFIs will be reduced and the funds should flow.

Second, governments are in the unique position to facilitate market development through three channels:

1) Legal framework and related supervision for MFIs: mature MFIs need the authority to attract funds as depositories and they need strong supervision to give confidence to lenders who can provide mid-term funding to them that is suitable for multi-year housing loans.

2) Insurance: Risk sharing between the government and private lenders, with government taking the risk of exceptional events, e.g., loss rates beyond *ex ante* careful estimates. Examples include mortgage default insurance and insurance to commercial banks in extending lines of credit for housing loans to micro lenders.

3) Creation of facilities critical to mortgage market development that are too risky for the private sector to undertake at the current stage of market development. These might include a secondary mortgage facility, or a credit rating agency. They are risky in the short-run because of the large up-front investment required and the relatively low volume of initial activity. When such organisations are more mature, they can be privatised.

In summary, a housing finance strategy requires a clear statement of objectives, an understanding of local conditions, a sense of how policy and program features are linked to outcomes, and a plan for generating and applying the resources needed to implement the strategy. Defining objectives at the start of the planning process is necessary to help guide it, but the final objectives will be informed by the results of the analysis undertaken in strategy preparation. In short, objectives setting will be an iterative process.

The Guide covers both the technical steps and organisational requirements in considerable detail. The Guide realises that the technical analysis underpinning decisions will often have to be indicative rather than definitive. It is more important to develop goals and a realistic plan to begin achieving them than to hold out for state-of-the-art analytic results.

The Affordable Housing:
Enabling Territorial Authorities Act 2008 – When Policy Transfer Fails

By Patricia M. Austin[1]

Introduction

The Affordable Housing: Enabling Territorial Authorities Act passed into law in New Zealand in September 2008. Under this legislation, local councils can adopt an affordable housing policy requiring developers to make an affordable housing contribution. However, in November 2008 another National-led government was elected and, a few months later, the Minister of Housing announced a review of the legislation. This paper traces the evolution of New Zealand's approach to affordable housing contributions. Some of the complexities of the Act are then discussed and critically evaluated with regard to policy "fit" for local councils and in comparison to similar initiatives in the UK and the USA.

Policy Transfer

New Zealand, because of its size and inherent openness to overseas ideas and experiences, draws extensively on overseas policies. Selecting the 'best' policies from overseas and transferring them to address identified emerging problems is not only a New Zealand phenomena. Policy transfer is routinely used between countries in Europe, between OECD countries, between the USA and Britain, and between developed and developing countries. Successful policy transfer is likely to involve understanding the operation (and effectiveness) of the policy in its home country; local institutional factors, structures and processes in both the originating and recipient countries; the role of agents, be they politicians or policy staff, in championing the policy transfer; and (re-)designing the policy to "fit" the local context and still meet desired objectives.

Policy Design

According to Rose (2005) there are alternative ways of drawing lessons from overseas policies ranging from photocopying (with changes only to institutional names, places and dates) to selective imitation (utilising the attractive parts of other policies and programmes whilst leaving out the, possibly essential, difficult bits). In the middle of this spectrum are hybrid policies (drawing on programmes with similar objectives found in several countries and combining them to develop a policy that "fits" the local political and statutory context); synthesis (combining familiar elements of programmes in different countries in a novel way); and disciplined inspiration (the policy draws on some elements of the overseas policies and is not inconsistent with them) (Rose, 2005). The New Zealand experience with the design of policy for affordable housing contributions ranges across this spectrum.

Affordable housing contributions – policy implementation in the USA and the UK

A number of overseas jurisdictions implement housing policies which require developers of both residential and commercial development to contribute to the provision of affordable housing. In the USA, the first inclusionary zoning programmes (requiring residential development to include some affordable housing) appeared in the early 1970s in the more affluent communities in California and around Washington DC. California, Massachusetts and New Jersey state laws, in particular, have supported the production of affordable housing through inclusionary zoning: for example, under Californian state law municipalities are allowed to require up to 15% affordable housing. For the most part, inclusionary zoning is treated as part of a community's land-use regulations – designed to meet a sound stated public purpose (such as desiring a mixed-income community); not excessively limit the owner's ability to use the property; and be applied to all similarly situated properties.

Linkage zoning, requiring developers of commercial (and other employment generating) developments to contribute to the provision of affordable housing appeared in the 1980s in the USA. Following decisions of the USA Supreme Court, a clear relationship (or rational nexus) has to be established between the impact of the development and the affordable housing contribution required.[2] A nexus study predicting the number of lower-income households that will need housing as a result of a proposed development is required in some states.

In the UK, affordable housing contributions are negotiated with developers under Section 106 of the Town and Country Planning Act, along with other development contributions. Mixed-income communities are seen as significant and necessary in planning for "sustainable communities", this being a strong central government objective. Desired local community outcomes; the level of Social Housing Grant (funded from central government); and the ability of the developer to make the level of contribution required, whilst still receiving an accepted profit from the development; are all factors used to determine the amount of the affordable housing contribution.

The emerging housing contributions policy in New Zealand

Planning legislation in New Zealand was reformed in 1991 with the passing of the Resource Management Act (RMA). This legislation, with its focus on the sustainable management of natural and physical resources, is arguably the product of an uneasy alliance between neo-liberalism and environmentalism. (Grundy and Gleeson, 1996). Whilst the legislation attempts to address biophysical sustainability, "…the neo-liberal attempts to remove socio-economic considerations from resource management decisions and the failure to recognise the urban environment as a locus of complex socio-economic and cultural

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[2] *Nollan v. California Coastal Commission 483 US 825* (1987) and *Dolan v. City of Tigard, 512 US 687* (1994) US Supreme Court Cases.

interactions raise the possibility of regressive socio-economic outcomes." (Grundy and Gleeson, 1996). Clearly affordable housing is one such "socio-economic consideration". The legislation did not directly acknowledge the impact of planning or development on land values and housing markets and, as a result, opportunities for using planning to address the provision of affordable housing appeared to be non-existent.

In 1996, the Auckland Regional Growth Forum was formed from an alliance of all of the regional, city and district councils in metropolitan Auckland, to develop an agreed response to growth pressures. The *Auckland Regional Growth Strategy* identified "… improved housing choice and affordability throughout the region …" as a desired outcome. (ARGF, 1999). A study of the need for affordable housing in the region and possible local government responses drew on overseas planning experience and noted both inclusionary zoning and linkage zoning as potential policy solutions, requiring further development to overcome any potential legal constraints (such as the RMA) for implementation in Auckland. (ARGF, 1998).

In 2003, all the councils in the region signed up to the *Auckland Regional Affordable Housing Strategy* (ARAHS). This strategy presented a strategic framework within which individual city and district councils could adopt a local affordable housing plan and provided a discussion of appropriate methods and mechanisms, including both inclusionary and linkage zoning. Whilst concerns were raised about the legality of using such mechanisms under the RMA, the ARAHS did not require the local councils to develop an affordable housing plan or to respond to affordable housing needs. Without any requirements only limited progress has been made on any affordable housing plans in the Auckland region since 2003 and, hence, the legal standing of any one mechanism has not been a significant issue.

In the early 2000s, Queenstown Lakes District Council (a mountain resort community on the South Island of New Zealand, with strong development pressures and a growing housing affordability problem) entered into an agreement with the developer of an area known as Jacks Point. This voluntary agreement required the developer to give the council 5% of all residential sites created by the development to be used solely for affordable housing provision. This agreement was not determined under the RMA (and therefore its legality was not subject to challenge in the Environment Court). However, it was seen as the first example of voluntary inclusionary zoning in New Zealand. Central government considered this development in *Building the Future: The New Zealand Housing Strategy* (Housing New Zealand Corporation, 2005) noting that, "There is potential for planning mechanisms like inclusionary zoning to address local shortages of affordable housing, by requiring developers to make some provision for affordable housing".

Queenstown Lakes District Council adopted the *Housing Our People in our Environment (HOPE) Strategy* in 2005. This strategy consisted of 32 actions to increase the supply of quality affordable housing integrated into the local community. Voluntary agreements with developers to provide affordable housing as part of developments were to be made whenever possible. In addition, affordable housing was to be integrated into district plan policies (under the RMA) to ensure that affordable housing would become a relevant matter when consent applications or plan changes were considered, so that the impacts on affordability would be addressed. (QLDC, 2005).

The Council notified a district plan change in 2007, requiring new developments that exceed permitted thresholds under the district plan to prepare an Affordable Housing Impact and Mitigation Statement (AHIMS). (QLDC, 2007). The AHIMS determines the extent of affordable housing demands generated by the proposed development, over and above that allowed under the district plan, and the range of actions to be taken to mitigate the demand identified. This is an example of linkage zoning, using a *rational nexus* approach to determine the amount of additional low-income employment generated by the proposed development and its likely effects in terms of additional affordable housing needed. This district plan change brings socio-economic considerations directly into the resource management decision arena, based on an understanding of sustainability that recognises environmental and socio-economic interdependencies. The district plan change was adopted by the Council in January 2009 and is currently under appeal to the Environment Court.

The Affordable Housing Enabling Territorial Authorities Act

In September 2008, The Affordable Housing: Enabling Territorial Authorities Act (hereafter referred to as the Affordable Housing Act) was passed into law, by the then Labour-led government.

"The purposes of this Act are to

a) enable a territorial authority, in consultation with its community, to require persons doing developments to facilitate the provision of affordable housing

   I. for the purposes of meeting a need for affordable housing that the authority has identified by doing a housing needs assessment;

   II. in a manner that takes account of the desirability of the community having a variety of housing sizes, tenures and costs …"

The Affordable Housing Act is not mandatory. It enables a council to adopt an affordable housing policy requiring developers to contribute towards the provision of affordable housing.

However, the Bill (and the most significant problems associated with the Bill have been carried through into the Affordable Housing Act) was strongly criticised by the Local Government New Zealand (LGNZ). LGNZ supported the intent of the Bill, but opposed its substance.

"The necessary clarification and legislative mandate (to use regulatory tools for affordable housing) is not provided in the Bill. The processes in the Bill are complex, open ended and involve unacceptable risk and cost. The Bill does not provide the mechanisms territorial authorities need to implement affordable housing policies… rather it duplicates and complicates policy processes that already exist for local government. … we consider that this Bill will result in no additional affordable housing units. Furthermore the Bill may actually place at risk those housing policies and initiatives currently in development by territorial authorities …" (LGNZ, 2008).

LGNZ submitted an alternative Bill that was streamlined and simple, and attempted to be much less costly and risky to local councils to implement and be more closely aligned with existing policies and procedures. LGNZ's alternative Bill can be seen as an example of *disciplined inspiration* in policy transfer - "responding to the stimulus of a programme's inspiration elsewhere by creating a novel programme not inconsistent with foreign examples." (Rose, 2005). The alternative Bill was designed so as to bed the intent of the new policy into existing local council operating practices (for example, by adding the "need for affordable housing" to the section of the RMA listing "matters to be considered") with the unique New Zealand twist that the Governor General was to play a similar role to the State of California, by "… specify(ing) characteristics or thresholds of affordable housing … which apply either nationally or in respect of any area or areas." (LGNZ, 2008).

The Process of Transfer

Evans (2009) identifies three sets of inter-acting variables that can serve as obstacles to policy transfer: "cognitive" obstacles in the pre-decision phase; "environmental" obstacles in the implementation phase; and public opinion. These variables can be usefully applied to assess the

policy transfer involved in developing the affordable housing contributions policy. Cognitive obstacles include "the recognition and understanding of policy problems" and of alternative policy options. (Evans, 2009). Various government work streams, including that of the House Prices Unit (established within the Department of the Prime Minister and Cabinet) and the Centre for Housing Research Aotearoa New Zealand, attempted to develop a deeper understanding of the operation of housing markets. However, there was no comparable level of research effort on the limitations of growth management planning under the RMA (the potential for "regressive socio-economic outcomes" identified by Grundy and Gleeson [1996]) or on local policy interventions, including planning instruments, to increase the supply of affordable housing. Neither the policy problem nor the alternative policy options were adequately 'recognised or understood' (Evans, 2009) by the politicians and the senior policy advisors in the relevant ministries and central government agencies.

The Affordable Housing Act was not a home-grown policy. The Act was the product of design by selective imitation, utilising the attractive parts of other policies whilst omitting the essential, and difficult, bits. (Rose, 2005). The policy design borrowed from the programmes in the USA and the UK, but there is little in the wording of the Affordable Housing Act to suggest a detailed understanding of the planning practices in those countries. Whilst there is a requirement to establish a level of affordable housing need before implementing an affordable housing plan, the Affordable Housing Act provides no guidance as to the appropriate level of affordable housing contribution that a local council can require. The level of contribution is not linked to an appropriate percentage of dwellings (as in Californian inclusionary zoning), or to the affordable housing needs of employees (as in linkage zoning), or to government objectives for mixed income communities (as in the UK). Presumably this omission was one of the politically "too difficult bits". (Rose, 2005). As a result, the Affordable Housing Act lacks a central justificatory argument and that leaves any affordable housing policy developed under the Act open to challenge.

Does the policy transfer in the form of the Affordable Housing Act overcome the environmental obstacles (structural constraints and technical implementation constraints) identified by Evans? (2009) The Affordable Housing Act was a product of a top-down approach, driven by central government agencies and politicians, with limited experience or understanding of affordable housing contributions policies in relevant overseas jurisdictions and with limited knowledge of local government planning processes in New Zealand. (LGNZ, 2008). The costs and risks imposed on local councils at the policy and legislative interfaces indicate that structural constraints were not fully understood or addressed. (LGNZ, 2008).

Critically, the Affordable Housing Act and its supporting policy advice did not adequately take into account implementation constraints, such as staff capacity, technical support and appropriate resources. The development and implementation of affordable housing policy has never been a central function of New Zealand's local councils, and the introduction of the RMA in 1991 broke the relationship between land use planning and community planning in many councils. Without direct statutory responsibility or strong local political commitment, council staff were unlikely to have detailed understanding of the impacts of planning on housing markets, or experience in developing housing policies linked to district planning processes. Drawing up a housing needs assessment would be beyond the skills, expertise and available time of policy staff in many smaller councils in New Zealand. Under the Affordable Housing Act, this assessment is required before adopting an affordable housing policy, which, in turn, leads to more complex processes of policy implementation.

Unlike the UK policy, the Affordable Housing Act did not include a central government subsidy per affordable dwelling, relying on the landowners, the developers and the council to fund the housing. Inevitably, this led to concerns about developers or ratepayers bearing the costs of affordable housing. LGNZ raised concerns that resource availability had not been given sufficient consideration. For example, the Affordable Housing Act proposed that local councils provide incentives to developers to participate, including reductions in rates (local taxes) or in other development contributions, which would have to be balanced by increasing the rates taken from all other ratepayers and / or by borrowing to pay for the necessary infrastructure. (LGNZ, 2008).

Public opinion (including bureaucratic, constituency and media opinion) was the third obstacle for policy transfer. (Evans, 2009). Clearly the opinion of LGNZ was a significant obstacle. Attempts to respond to the submissions of LGNZ and others were limited, perhaps due to the restricted time available to get the legislation to parliament. The opinion of constituency groups varied from strong support from the Human Rights Commission through to strong opposition by the Property Council and some business groups. The Business New Zealand submission (2008) stated that "... the Bill as drafted represents a taking of property rights off land developers without compensation" and went on to assert that "there might be little discipline for territorial authorities to fully investigate alternatives to ensure greater affordability of housing as confiscation of developer's land and money would be an easy option." Coverage in the New Zealand Herald (Auckland's daily paper) was limited and for the most part negative. The paper announced the introduction of the Bill with the heading "Affordable-housing bill 'perverse'" and went on to write in the opening sentence of the article: "The Property Council says that the Government's solution to boost cheap houses for first-home buyers would push up the price of other houses as developers try to offset cuts in their profits." (Trevett, 2007).

The Affordable Housing Act did become legislation in 2008, but would the policy transfer (embodied in the Act) be successful? Rose (2005) suggests the following conditions increase the likelihood of successful implementation: a clearly defined objective; a single goal; a simple design based on tested social, political and technical knowledge; flexibility in relating the elements of the policy; and committed political leaders. The Affordable Housing Act fails to meet these conditions. For example, the design is far from simple in terms of its own policy structure and its interaction with existing legislation. The Affordable Housing Act does not appear to have been based on the technical knowledge that supports inclusionary and linkage zoning in the USA, or on the residual value approach commonly used to support Section 106 contribution requirements in the UK.

The Affordable Housing Act does not encourage councils to be flexible; indeed one "flexible decision" could result in an appeal to the Environment Court, on the basis that the affordable housing policy should be applied to all similar situations equally. In any complex resource consent application, there are likely to be significant tradeoffs between various social, economic and environmental factors. The LGNZ alternative Bill attempted to acknowledge this complexity by introducing "the need for affordable housing" into the list of matters to be considered. However, none of the wording or reasoning in this alternative Bill found its way into the Affordable Housing Act.

Importantly, political leaders were not committed to the policy. The Labour government included the Act in a package of legislative measures passed just before the 2008 election. The Labour Minister of Housing, speaking at an Australasian Housing Institute event in Auckland in the month before the election, complained that LGNZ had not supported the Affordable Housing Bill in its submissions to the Select Committee. The Minister went on to state that the Government had only proceeded with the Affordable Housing Bill because local government had asked for it. This lack of proactive support from a Minister for his government's own legislation suggests low commitment, at the very least. The change of

government in October 2008 signalled a future change in policy direction, followed by the announcement of a review of the legislation by the new National Housing Minister.

Does the Queenstown Lakes District Council (QLDC) model meet these principles of policy transfer?

The policy model developed and implemented by Queenstown Lakes District Council is a *synthesis* (Rose, 2005), drawing on elements from similar programmes in mountain resort communities in the USA and Canada, and combining them with elements of local programmes. The synthesis emerged from a relatively complex process involving technical reports; steering groups with members drawn from the public and private sectors (including developers and employers) and local non-governmental organisations; community-stakeholder workshops and stakeholder discussions; community consultation processes; and formal council meetings. How were the cognitive, environmental and public opinion obstacles identified by Evans (2009) addressed? With regard to cognitive obstacles, the Queenstown Lakes District Council recognised the extent and diversity of the impacts of housing affordability needed a significantly diverse response. A number of policy options were identified and assessed, and the affordable housing strategy included 32 actions in total, of which only two directly concerned affordable housing contributions from developers.

Environmental obstacles include both structural constraints and technical implementation constraints. (Evans, 2009). Following consideration of alternative policy options, the Council recognised that the originally preferred policy (based on inclusionary zoning) was likely to face legal challenges and would be difficult to robustly support in an effects-based resource management focused planning system. The ability of the Council to move to a linkage zoning approach (with its supporting nexus study) was directly attributable to the capacity and knowledge of the policy staff at the Council and the availability of external technical expertise.

For the most part, public opinion has not been an obstacle for the policy; indeed many of the submissions on the district plan change were strongly supportive. This can be attributed to the small size of the community (a permanent resident population of approximately 20,500 in 2006) and the extensive formal and informal consultation processes. Despite focus group meetings and stakeholder discussions with the local developers appearing to reach agreement that as long as the policy applied to all in a similar manner it would be acceptable, a number of developers have appealed the council's decision to the Environment Court. Whether the district plan change withstands this appeal, waits to be seen.

If the policy is successful in the Environment Court, there is a strong likelihood of successful implementation based on meeting conditions identified by Rose (2005). In particular, it has clearly defined objectives and a simple design based on well-tested and established knowledge base. The Council is small, flexible and innovative. The Mayor (constant through three political terms) exerts firm political leadership and strongly supports policy implementation to address housing affordability in the district. And the policy staff has the required capacity, skills and expertise for policy implementation. This level of staff expertise in affordable housing policies is uncommon in New Zealand's local councils.

In conclusion

Transferring an affordable housing contributions policy faces particular challenges that are as much ideological as technical. These challenges were compounded in the case of the Affordable Housing Act, as central government was unwilling to recognise the essential (but politically difficult) components of a contributions policy; and local government was wary of adopting new roles and responsibilities without sound legislation and adequate resourcing. Whilst obstacles were overcome to legislate the Affordable Housing Act, the likelihood of successful implementation would have been low, even without the change in government following the election. However, if the Queenstown Lakes district plan change survives the appeal to the Environment Court, the likelihood of successful implementation is high. In this case, an innovative council sought out opportunities and adopted creative approaches to deliver more affordable housing. Arguably the skills and resources required to produce affordable housing for local communities are the same skills and resources that are needed to implement the Affordable Housing Act. Those local councils, that lack the necessary skills and resources, will need more than an Affordable Housing Act to achieve affordable and sustainable housing outcomes.

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Facilitating Investment in Affordable Housing – Towards an Australian Model

By Julie Lawson, Mike Berry, Vivienne Milligan and Judith Yates[1]

Introduction

This paper concerns the financing of affordable housing in order to respond to what is now a well documented need in Australia and many other countries. It explores the potential of a bond-based model, which channels low cost investment towards the non-profit housing sector and provides progressive tax incentives to investors.

Recent research shows that of the 7.6 million households in Australia, under 1.2 million (16 per cent of all households) paid 30 per cent or more of gross household income to meet their housing costs. Of these, 862,000 were lower-income households, defined as being in housing stress[2]. A further 164,000 were moderate-income households (Yates and Milligan, 2007:19). In its first State of Supply report, the National Housing Supply Council (NHSC) showed there was a need for an additional 251,000 rental dwellings affordable and available for lower income households (Australian Government, 2009: 98).

In the last year, the Australian Government has made welcome moves to address this shortfall. Two substantial initiatives have been a $6.4billion social housing stimulus package to increase the supply of social rental dwellings by 20,000 over three years, and a Commonwealth contribution of $623million[3] towards the National Rental Affordability Scheme (NRAS), which when combined with state government outlays and private equity investment, aims to add 50,000 dwellings to the affordable rental stock over four years. These initiatives represent a significant turnaround in the funding of rental housing in Australia. However, their impact is unlikely to be adequate to meet the already considerable and rising need.[4]

This paper explores the proposition that what is missing in these initiatives is the establishment of a financial intermediary and funding instrument which builds on them and is designed to channel much more substantial levels of low cost investment towards social and affordable housing[5]. While overseas efforts in the field of private finance for affordable housing accelerated in the 1990s (Berry et al, 2004; Whitehead, 2003), Australian policy has continued to rely on government funding and sporadic innovative programs that, with the notable exception of the new initiatives, have only provided for low levels of activity and have not been robust for the longer term.

Inadequate funding strategies have persisted despite recommendations for change put forward by the research community and housing interest groups, and numerous proposals outlining alternative strategies, including tax credits and bond financed approaches. In their 2009 assessment of what is needed to enable emerging non-profit housing developers or similar organisations to make larger scale contributions to the provision of affordable housing in Australia, Milligan et al (2009:151) argued that growth in affordable housing necessarily required a long term investment path involving a substantial commitment of dedicated public funds coupled to forms of cost-effective private financing. A recurring feature of past proposals has been the use of long term, low risk and low interest bonds for this purpose. For a range of reasons, discussed in this paper, these proposals were not implemented. However, during the same period two countries did employ such models with a high degree of success, not only in terms of the volume of supply but also outcomes for tenants and positive impacts in the wider housing system (for example, containing house prices).

The next section of this paper begins with an overview of the current arrangements for funding social housing to provide general background information. This is followed by a summary of several of the unsuccessful previous proposals in Australia, focussing specifically on the rationale given for these proposals. The third section provides an overview of schemes that have been implemented in Austria and Switzerland. These schemes show how a financial intermediary and "fit for purpose" funding instruments can be used successfully to channel substantial levels of low cost private investment funds into affordable housing. The paper concludes by drawing out the lessons from current policies, past proposals and this international experience to support its argument that there is a missing piece in current policies that could be remedied by adoption of a Housing Supply Bonds (HSB) model. This model is loosely based on key characteristics of past proposals and the Austrian and Swiss schemes described in this paper, and builds on policy and funding initiatives already in place in Australia.

Current arrangements for funding social housing[6]

To date, the financing of social and affordable housing in Australia can be categorised into three models, which have generated what is

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[2] Housing stress is defined by a household in the lowest 40 per cent of the income distribution having housing costs of at least 30 per cent of their household income. For detailed results and technical notes see Yates and Milligan (2007).

[3] For the first four years of its operation until the end of 2011-12.

[4] Steps have also been taken to assist new home purchasers accumulate a deposit, via a matched saving scheme for first home buyers. Individuals can divert up to 10% of their income into First Home Savings Accounts (FHSA). Interest on these accounts will be taxed at a favourable 15% by the Australian Tax Office. The Commonwealth will contribute 17% of annual contributions, to a maximum of $850.00 per year. Other initiatives that have been introduced are less relevant for this paper.

[5] In the Australian context, social housing refers to deeply subsidised public and community managed housing that is allocated predominantly to low income households and those with special needs. Affordable housing refers to a wider range of low cost housing options provided by non government agencies using diverse forms of government and private funding.

[6] These arrangements do not cover funding arrangements under the new National Affordable Housing Agreement (NAHA) that commenced on 1 January 2009. See Milligan (2009) for an overview.

known as public housing, community housing and most recently affordable rental housing. These models are outlined in the paragraphs below, followed by a review of the issues that they raise for developing more sustainable approaches to the supply of low rent housing.

Public housing funding has evolved since 1945 from a combination of discounted Commonwealth and state matching loans that were later replaced by grants because of the insufficient capacity of state housing authorities to service debt. Alongside, there has been a major shift in rent policy from historic cost rents to market rents accompanied by income related rebates. Shifts in demand towards smaller, lower income households and allocation policies that have increasingly targetted those with high or complex needs have reduced rental income and increased operating costs, and providers have had to rely on annual grant funds to meet deepening operating shortfalls. However, declining grant levels have left little or no capacity for growth (Hall and Berry, 2007), and even resulted in significant sales in some states. By 2008, there were around 351,000 units of public housing remaining in Australia, less than 5% of all dwellings (AIHW, 2009a and 2009b).

Community housing has been funded by a variety of programs as outlined in a recent review (Jones et al, 2008). Implementation of these programs has varied across states and territories. For example, Victoria and South Australia had debt-financed schemes backed by government subsidies in the 1980s but these have not been expanded. Other populous states (NSW and Queensland) have relied on grants to fund supply, supplemented by head leasing of private housing. Some community housing providers have restructured their rent setting policy to draw in Commonwealth Rent Assistance (CRA), which it is paid directly to many of their tenants[7], with the aim of generating additional cash flows to leverage and service debt finance. However, the portfolios of most providers are too small to generate significant surpluses. These fragmented and low-level funding arrangements have generated approximately 36,000 dwellings, most of which, while managed in the non-profit sector, are owned by state housing authorities (AIHW, 2009c)[8].

Affordable rental housing has been funded, until recently, mainly by state and local government initiatives that have been designed to demonstrate new models. The small-scale and experimental nature of these schemes has produced about 7,000 additional dwellings (Milligan et al, 2009; 2004). Prospectively, much more affordable rental housing will be delivered through the National Rental Affordability Scheme (NRAS). This scheme offers financial incentives to encourage private investors, developers and non-profit organisations to construct additional dwellings for rent. Specifically, it offers a $6,000 Commonwealth refundable tax offset (or grant to registered charities) plus a $2,000 state grant (or equivalent) per dwelling, indexed, for ten years. Dwellings must be allocated to eligible low and moderate income households at rents no higher than 80% of the local market level for 10 years. There are no restrictions on the use of the dwellings produced after the expiry of the 10-year tax credit period. NRAS guidelines encourage private developers and investors participating in the scheme to use regulated non-profit housing organisations as tenancy managers. This strategy aims to promote the expansion of non-profits and to ensure good tenant outcomes. The target output for the initial funding allocation is 50,000 dwellings[9]. There have been indications from the national government that the scheme will be expanded by a further 50,000 dwellings, if it is successful.

Past approaches to funding housing using non-profit organisations have been insufficient to generate a strong and sustainable third sector in Australia. Consequently, while there is clear potential to expand the contribution of non-profit organisations, especially through appropriate funding, regulation and capacity building, this sector remains small and under utilised (Milligan et al, 2009). In the past decade, considerable growth in community housing was insufficient to offset the decline in public housing and thus the absolute size of the social housing sector in Australia declined (Australian Government, 2009:135).

Attracting large scale institutional investment towards affordable rental housing has been an important goal for a non-profit housing sector with ambitions to emerge from under the control of state housing authorities. In principle, NRAS has the potential to attract larger volumes of private investment that could be channelled to this sector. While the infancy of that scheme makes it premature to assess its impacts, it is not designed presently to secure a long-term stock of affordable dwellings. Thus it runs counter to the mission of many non-profit organisations to provide *and* preserve affordable housing. There have also been teething problems with the Australian Tax Office (ATO) challenging whether the scheme's provisions to house a range of low to moderate income households meet their rules for alleviating poverty that govern the charitable status of these organisations, which in turn contributes to their cost effectiveness.

The shortage of affordable housing in Australia[10] has meant that most low income households rely on a volatile private rental market with potential for sizeable rent rises when conditions are tight (as is the case in the current economic environment) to meet their need for housing. However, there is longitudinal evidence to show that increases in the stock of private rental dwellings occur mainly at the top end of the market and that the stock of low cost rental dwellings has declined steadily (Yates and Wulff, 2005; 2000 and Australian Government, 2009). Historically, the private rental sector in Australia has been dominated by individual "mums and dads" investors holding small portfolios (one or two dwellings typically). They are motivated by a variety of factors but especially expectations of capital gain (Seelig et al, 2009). When coupled to a strong first home buyer market, this has resulted in security for long term tenants in the private rental sector being weak.

This situation suggests that market shortages of affordable housing have structural causes and, therefore, calls for policies that can promote sustainable provision of housing affordable by lower income households. Given public funding constraints, such policies must rely in part on stimulating an expanding supply of low cost finance that is fit for purpose and tap into major innovations in financial markets that have occurred over the past two decades. Some suggestions along these lines are presented in the following sections of this paper.

The new model of funding under the National Affordable Housing Agreement (NAHA) provides funding that should be adequate to ensure retention of the existing stock of public housing but does not provide funds for growth beyond two years (Milligan, 2009). Thus suggestions for expansion of the supply of funds to seed growth in an affordable housing sector will need to build on the important new NRAS initiative for the foreseeable future.

NRAS has considerable strengths in that it has committed a considerable and predictable volume of Commonwealth and State funds to the supply of additional affordable housing over a

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[7] Tenants of state owned public and community housing are eligible for Commonwealth Rent Assistance (CRA). Private tenants who receive social security payments are eligible for an additional cash payment called rent assistance (RA), if their rent exceeds a floor amount. There is a set maximum payment of RA, which is uniform across Australia.

[8] There is also an Indigenous community housing sector and some community managed housing provided by other non government organisations such as disability and welfare groups and aged care providers. These groups in total are estimated to manage /own a similar number of dwellings to the mainstream community housing sector.

[9] http://www.fahcsia.gov.au/sa/housing/progserv/affordability/nras/Pages/default.aspx

[10] In what follows, the term affordable housing will be used generically, to encompass public and community (social) rental housing as well as any other form of subsidised rental housing.

10-year period. As an on-going recurrent subsidy, the funds available through NRAS provide affordable housing providers with the capacity to service significant debt burdens for this period. The scheme has also served to indicate to the private sector the potential for investment in the affordable rental sector and has helped to educate them both about the opportunities for, and benefits of, doing so. Early funding rounds have attracted a considerable number of applications from a diverse range of would-be providers.

There are, however, a number of weaknesses of NRAS, as it is designed or operating currently. First, the flat rate subsidy is likely to be inadequate to ensure that affordable housing projects in high cost areas are viable on an on-going basis. Rather than being satisfied on the basis of the rental income alone, investors in such areas are likely to look to returns from capital growth (and, consequently, to the sale of dwellings) at the end of the designated 10-year period. Thus, in high cost areas, the current scheme is unlikely to contribute to development of a sustainable affordable housing sector. Second, the prevailing subsidy levels, structure and current design of demand assistance (CRA) are not sufficient to achieve affordable rents for special needs households or those on low and very low incomes or in high cost locations. Such households will need additional ('top-up') recurrent subsidies. Finally, as with any new financial initiative at present, the current economic climate raises considerable uncertainties about the capacity of a scheme to attract private investors.

Progress towards affordable housing financing using housing bonds

Identifying ways of achieving sustainable private investment in the provision of additional affordable housing has been an explicit concern of past Australian governments but not acted on (COAG, 2003; HPLGM, 2005) and under the new Rudd government, there appears to be renewed interest.

In this context, it is pertinent to revisit proposals concerning the use of long term investment bonds as a vehicle for investment in social housing (inc. Yates, 1994; Hall et al, 2001; Lawson and Milligan, 2007). Bonds are a proven mechanism for raising private capital, used by both the public and private sectors and have been used for housing purposes in Austria, US, Switzerland, the UK and many other countries to achieve housing supply targets. The proposals of Australian housing researchers have included the "equity bonds" model, developed for the National Housing Strategy more than a decade ago (Yates, 1994) and the "Consortium Model" involving sale of wholesale bonds, developed by the Affordable Housing National Research Consortium (Hall et al, 2001).

The "Equity Bonds Model" proposed the establishment of a single independent corporation or trust to issue standardised equity bonds indexed to changes in house prices (Yates 1994:192). Finance raised would be used by non-profit organisations to provide dwellings at market rents to low income renters, who would also be assisted by an adequate and secure rent allowance. This proposal aimed to provide a tradeable bond linked to actual price movements in the housing portfolio and suitable for large-scale investors. The bonds were to provide investors in social rental housing with the same return on their equity as was available (on average) to investors in tax-advantaged, owner-occupied housing. The proposal to establish an independent corporation was a response to the inefficiencies that arose from the complex and costly administrative structures that had been used previously to raise off-budget finance for social housing in Australia. A special purpose corporation would address the uncertainties about tax rulings that plagued past financing initiatives (available only on an ad hoc basis after the proposal has been fully developed). A single corporation also increases the possibility that there is adequate financial and legal expertise available to ensure financing arrangements are effective. An additional proposal that the government guaranteed continuation of existing rental assistance schemes as a means of guaranteeing the rental return on investment provided a source of public-private risk sharing and a form of credit enhancement that would help to reduce the costs of raising finance capital.

A number of factors might explain why this proposal was not successful. At the time it was proposed, house price derivatives did not exist and there was no suitable house price index to which equity bonds could be linked, although work was underway to develop such an index. Indexes now exist. Responsibility for different aspects of the proposal resided in different government departments or instrumentalities. The (then) Commonwealth Department of Health, Housing and Community Services was responsible for housing policy but responsibility for procuring and delivering social housing lay with the State Housing Authorities. Treasury was responsible for developing tax policy but the Australian Tax Office has responsibility for implementing this. The proposal, therefore, required a significant degree of coordination both within and across different levels of government. A third factor arose from the fact that the institutional investors who were the target for the proposed equity bonds were adamant that they did not want to be involved with the day-to-day management of social housing. Public sector management of housing developed with private sector funds was seen as insufficiently independent and the management capacity in the existing (then marginal) community sector was inadequate at the time and there was no regulatory framework that could provide investors with the comfort that proposed managers were accredited and therefore, competent. Removal of, or reduction in, such capacity constraints and management risks is well advanced (Milligan et al, 2009).

The so-called "Consortium Model" was proposed as a debt instrument involving the sale of fixed interest state government bonds to institutional investors with a 20-year term at market rates, with the aim of tapping into burgeoning superannuation funds. Funds raised would be used by state housing authorities (or allocated to other regulated providers) to acquire dwellings, which would be rented to low to moderate income tenants at rents set to 25% of income. The Commonwealth Government would provide outlay subsidies to housing providers for the difference between rents and the full cost of provision, including the cost of loan funds. Regular bond issues would be limited by the amount of funding made available by the Commonwealth. Properties would be turned over after 20 years to retire the debt, or new bonds could be issued (Allen Consulting Group, 2001; Berry, 2003, 2002; Hall et al., 2001).

The main policy advantage of the consortium model is the degree of leverage achieved; initial modelling suggested that for every dollar of government subsidy, AU$4.50 of housing would be provided. From the Commonwealth Government's point of view, a major advantage is that its financial exposure is capped at the agreed upfront subsidy level for each tranche of support. Institutional investors can satisfy their requirements for scale, liquidity and risk adjusted returns by purchasing (state) government bonds in the normal way, while avoiding any reputation risk associated with financing social housing. Most of the financial and operating risks would be borne by and must be managed by state government treasuries and public housing agencies.

However, this also points to a major disadvantage of the model: viz. the unwillingness of state governments to assume these risks or endanger their credit ratings by expanding public borrowings. Constraints imposed by the Australian Loan Council also reduced the attractiveness of this approach; applying public borrowing to social housing reduced the capacity of governments to apply loan funds to other priority areas of social and economic infrastructure. Another disadvantage of the model was the need to sell off the stock to redeem debt and thereby manage re-housing of sitting tenants. The Consortium Model assumes dwellings required to house social housing tenants are initially purchased from the proceeds of a bond issuance and that as time goes on the proceeds of sales of the dwellings is used to repatriate the principal owed on the

bonds and to provide for any operational shortfalls (Hall et al, 2001:26). This could be avoided by the Commonwealth Government committing a new round of funding to support a replacement round of state bonds. Alternatively, either or both levels of government could replace the loan funding with government equity.

These disadvantages largely explain why the model was not taken up earlier this decade. However, as with equity bonds, inter-government and within-government bureaucratic factors were also obstacles. For example, central agencies at both levels were generally not convinced that declining housing affordability represented a long term structural problem or that expanding the supply of affordable housing provision was a high priority (in preference to providing rent assistance, for example. In the current environment, the impact of the global financial crisis on house prices in many countries (though apparently not Australia) is likely to mean that, at least in the immediate future, institutional investors will be wary of investments that involve house price risk. While the Consortium Model avoids this, it replaces it with a policy and political risk to the sustainable supply of affordable housing.

Illustrations of bond financed affordable housing systems

Given the issues raised above and the current interest in models which can use public funds to lever private investment, this section describes how bonds are used to support the growth of social housing in Austria and Switzerland. The concluding section discusses the possible relevance of these approaches in the Australian context and suggests what changes might be required to address the missing link in current policies.

The Austrian 'Housing Construction Convertible Bond' model

The Austrian bonds model is relatively straightforward. It does not rely on derivatives nor does it require the turn over of social housing stock. Commercial finance is simply raised via the sale of bonds to low risk investors, promoted via tax incentives and secured by public loans and grants. These are used to fund a well regulated and broadly accessible social housing sector. Delivery is via a mix of regulated limited profit housing companies and private providers.

In principle, affordability in the Austrian system is promoted by cost efficient, limited profit housing providers assisted by "bricks and mortar" subsidies in the form of discounted land, public loans and grants and tax relief. Initial rents are based on a rental cost per square metre, which can be increased each year with the consumer price index (CPI). Rent revenues are intended to be sufficient to repay the annuity of the capital loan, as well as the interest on the public loan (Neuwirth, 2004:1). Typically rents are fixed annually and balanced at the end of the year, with tenants either receiving a return or making additional payments to cover financing and operating costs. Where a tenant's income falls below that needed to pay for decent housing, they can draw upon rent assistance, which is provided by regional governments.

In summary, Austrian social housing is financed via capital market loans (30 to 50%); public loans (30 to 40%); equity of the developer (around 10%, mostly land); additional subsidies and sometimes the equity of future tenants (0 to 10%) (Amann and Mundt 2006; Lawson and Nieboer, 2009). Private mortgage finance, comprising up to 50%, is largely raised through the sale of bonds via private Housing Banks.

In 1993 the Austrian Government passed the Housing Construction Subsidy Act to create a special circuit of capital involving the sale of bonds via Housing Banks in order to channel investment into new affordable housing. The Austrian Tax Office offers progressive incentives for purchasers of Housing Construction Convertible Bonds (HCCB) and requires that any funds raised by Housing Banks through the sale of bonds have to be used to finance approved limited profit housing projects by registered social landlords.

This national legislation enabled several major banks to create subsidiaries, called Housing Banks, with preferential underwriting criteria (first-lien loans with 62% maximum loan to valuation ratio similar to the classic mortgage loan, whereby only 4% of the risk exposure had to be covered by asset holdings instead of the usual 8% according to the Basel accord). With that allowance, the Housing Banks could operate with lower transaction costs (of around 65 basis points).

Purchasers of HCCB coupons are required to hold them for a minimum of 10 years. Both fixed-interest securities as well as securities with variable interest rates offer a double tax privilege to private investors: the annual dividend coupon is exempt from capital gains tax up to 4% and the initial purchase price is progressively tax deductible for income tax purposes as part of the blanket allowance for special expenses. This tax-deductibility for income tax purposes specifically benefits low and medium-income groups. The return can thus amount to an additional 1.5%. Housings bonds have a fixed interest rate of 4%, making their return comparable to government bonds, which yield 5.33%. Since housing bonds are subject to final taxation, they are neither subject to income tax nor to inheritance tax, making them an ideal investment for securing the financial future of children and grandchildren (Eerste Wohnbau Bank, 2007:6).

Today, bond purchasers are typically long term investors seeking a secure, low risk investment such as insurance companies, pension funds and municipalities (Amann and Mundt 2006; Czerny et al, 2007). It is also claimed that the presence of the HCCB facility has not only had a moderating effect on the general mortgage interest rate level (Deutsch, 2007 personal communication) but for every €1 of foregone tax revenue, €19 of commercial investment has been committed to affordable housing production (Housing Bank Austria, 2009).

HCCBs have been very successful in raising the level of investment in affordable housing, although the recent provision of a guarantee on savings deposits in response to the global financial crisis has diminished purchaser demand in the current economic climate (Housing Bank Austria, 2009; Amann, 2009). Housing banks have been able to assist the financing of new housing and refurbishment, generating approximately € 1.5 billion annually. Loans issued under bond issues cover approximately 45% of total construction costs, with the balance met by housing subsidies and provider contributions. Since 2000, Housing Banks have registered a sharp rise in demand for tax-free bonds. By the end of 2006, the total volume of bonds had reached approximately € 11 billion, of which € 9-10 billion had been directed toward the financing of the construction of more than 100,000 dwellings by 2006 (Czerny et al, 2007:28). Figure A.1 in the Appendix places this bonds model within the institutional context of the Austrian housing system. For more detail see Milligan et al, 2009, section 5.3 and Bauer, 2004). However, two factors have recently threatened the volume of investment raised via HCCB: during the crises the government extended its guarantee to savings and not to bonds, which siphoned away risk adverse investors from bonds and the international takeovers of national banks, less familiar with and committed to the unique rental housing market in Austria.

The guaranteed co-operative Swiss housing bond model

The Swiss government offers modest but strategic support to assist the social housing sector to access small loans and additional private funds (Lawson, 2009; FOH, 2006). Small low-interest loans are competitively allocated from a revolving fund (managed by the sector) that contributes around 5% of total project costs. The federal government secures all loans released by a Bond Issuing Cooperative for Non-Profit Builders (Hauri, 2004). Funds generated in this way contribute up to 70% of the cost of the total project. The remaining amount is financed by commercial loans and

owners' equity. Finally, the federal government can provide collateral security to specialised mortgage guarantee cooperatives that reduces second mortgage interest rates (although its impact is marginal).

The Swiss Bond Issuing Cooperative (BIC) (*Emissionzentrale für Gemeinnützige Wohnbauträger, EGW*) was established in 1990 to raise funds for non-profit housing entities that have formed a cooperative. It was founded during a time when interest on loans was high and there were risks associated with national adjustments to European financing costs. In 1991, the first bond of 85.1 million Swiss francs (CHF) was issued for a running period of 10 years. At that time, the market conditions for bonds were favourable compared with bank loans of the same maturity. Since that time, BIC has issued 3,048 million CHF in a series of 37 bonds (public issues or private placements). The BIC has played a leading role in financing small non-profit housing projects, when commercial rates where high. It has about 350 members and has helped to finance approximately 877 projects to supply 30,000 non-profit dwellings. Recent interest rates have made BIC financed loans less competitive. However, the bond vehicle remains on call for when these conditions reverse (Gurtner, 2009).

Key players in the establishment of BIC were the umbrella organisations in the sector and the Federal Office of Housing (FOH). Currently, the FOH issues 8-15 year bonds, which are covered by a state guarantee, with the funds raised able to provide loans to members with a fixed interest rate over a fixed term (Hauri, 2004). While some larger non-profit entities are financially strong, the BIC pool allows smaller non-profit builders to join together, improving their access to finance on more favourable terms.

Institutional investors, such as pension funds and insurance companies, are attracted to BIC bonds by the state guarantee and high credit rating (AAA). As recent requests show, the level of demand for the Swiss housing bonds is very high. In 2006 and 2007 the BIC raised 200 million CHF annually. A flow chart is provided in Figure A.2 in the Appendix. The following paragraphs describe the BIC application process (mimeo EGW, 2008; Hauri, 2004):

1. Requests can be submitted for a new project or to refinance a mortgage. Applicants must have a non-profit status, BIC membership and undertake appropriate activities according to the Charter and Federal Office of Housing standards. They must also be financially sustainable entities with a viable and suitable project (assessed against cost limits, quality requirements and location attributes) and be able to offer assurances with respect to lending limits and available mortgage deeds.

2. All requests are pooled by the BIC. When the pool is of sufficient size and market conditions advantageous, the BIC will issue a new bond. It then negotiates with a lead bank the conditions of issuance and applies for the State Guarantee to cover the entire extent of the bond.

3. The issuance can be as a public bond or a private placement. A private placement will be done for smaller pools (20-50 million CHF). In these cases, one investor, such as a pension fund or an insurance company, subscribes to the entire bond. Where the pool is more than 50 million CHF, the bond is divided into denominations of 5,000 and placed by a consortium of banks. A bond pool of 100 million CHF could serve around 40-60 non-profit organisations. All the bonds are listed on the stock exchange for trading.

4. After subscription, funds raised from the sales of bonds are allocated to non-profit housing entities according to their requests to be paid back in full at a fixed rate and defined term. On maturity, BIC organises conversion of the bond and seeks ongoing participation of investors (Hauri, 2004; FOH, 2006).

The advantages of the Swiss model are that it fits the local institutional and subsidy environment of limited profit housing provision in Switzerland – low government grants and loans, small associations, weak interest from institutional investors. The BIC is able to pool the borrowing demands of smaller associations reducing financing costs. The willingness of government to provide a guarantee further reduces the cost. However, there are disadvantages in terms of scale and affordability of provision. The level of grants and loans to association, whilst fulfilling expressed demand by numerous small associations, is not sufficient to address serious rental market scarcity endemic to major cities, such as Zurich and Geneva.

Overview

A number of key characteristics of these two successful approaches to institutionalising the raising of private investment to fund affordable housing can be singled out. The first is the establishment of financial intermediaries (such as the Housing Banks in Austria or the Bond Issuing Cooperative in Switzerland). The second is the development of a specific and standardised financial instrument (such as a bond) to raise funds. These bonds have been subsidised by the tax system and have additional credit enhancements (provided by preferential underwriting or guarantees) to increase their attractiveness to investors. A third is that bond holders are additionally protected by regulations requiring registration of housing providers. These delivery agents must comply with legislated requirements and regulatory codes. Finally, packaging (or pooling) of the various forms of assistance (such as direct public grants and in-kind support) is also facilitated.

These characteristics are consistent with the characteristics identified in studies of similarly successful attempts to raise private finance for social or affordable housing in other countries as being critical to the success of the approaches employed. Examples can be found in Berry et al. (2004, 2006), which draws conclusions from comparing the UK and Australian systems of affordable housing provision; in Oxley (2008), which draws conclusions from a range of European countries; and in Swack (2006) which drawn on US experience.

Progressing a bond financing scheme for Australia via a 'Housing Supply Bonds (HSB)' model

Before setting out a framework for a bond financing scheme for Australia, a number of additional essential conditions can be added to the key characteristics identified at the conclusion of the previous section. Those identified in previous research (Berry et al, 2006; Milligan, 2005) include:

1. Institutional and subsidy arrangements to attract private investment on a scale that is necessary to make a difference;

2. A resolute and consistent national framework for using the planning system to promote affordable housing, by capturing a share of development gain and redirecting it towards affordable housing, providing access to suitable sites for affordable housing development and promoting social inclusion, environmental sustainability, urban regeneration and affordable housing outcomes;

3. A regulatory framework for social housing organisations which gives high levels of confidence and assurance to all stakeholders, including institutional investors;

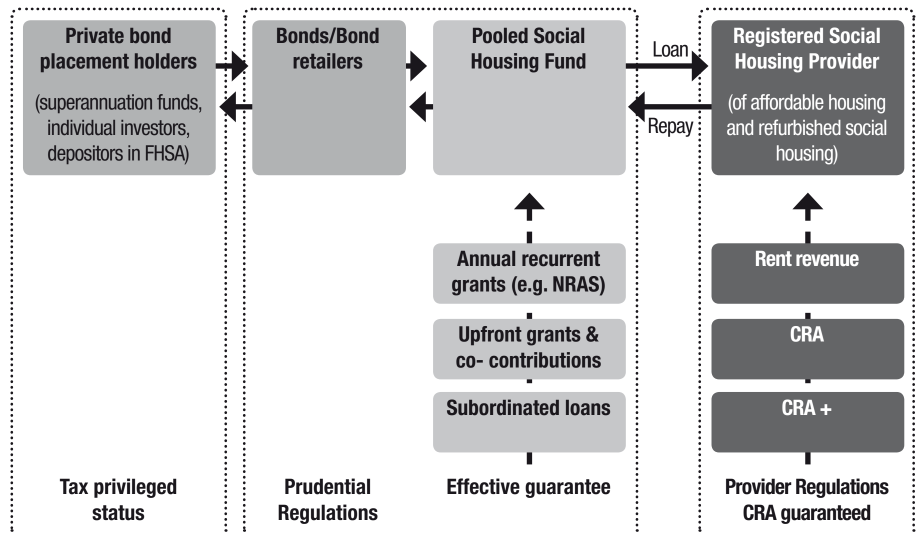
4. Rents that cover the cost of operating and financing decent housing, breaking the nexus between rents received on affordable housing and the incomes of resident households;

5. Adequate demand side subsidies to address the gap between incomes and the cost of decent housing; and

6. Management of assets by social housing providers in a manner that enhances their value and enables further leverage of private funding.

Any new proposal must also learn from the advantages and disadvantages associated with previous proposals for Australia. These suggest that, in terms of its financing aspects, it must recognise the constraints imposed by volatile housing markets; it needs to address the trade-offs between the extent of leverage and the amount of subsidy needed to fund housing affordable for specific household groups; and it needs to establish consistent and predictable privileged tax status (rather than having to rely on frequent rulings). In terms of its production and delivery aspects it must only involve housing providers that are well regulated through a nationally consistent regulatory framework and it must separate out financing and management roles so that investors are not required to be directly involved in housing management. To ensure sustainability and preservation of affordable housing over time, it must not require stock to be periodically sold to redeem debt. Finally, it must gain cross jurisdiction and interdepartmental support in each sphere of government, not endanger credit ratings of governments and not reduce the capacity of governments to loan funds for other purposes.

Figure 1: The Housing Supply Bonds model



The Austrian and Swiss models of housing construction bonds provide a large scale, well funded and a small scale, limited public loans illustration, respectively of how the sale of bonds can make a scaleable and cost effective contribution to the provision of affordable rental housing. The operation of the HCCB model demonstrates that private banks can deliver the bonds; that tax incentives can encourage investors to purchase bonds; and that these can be progressive to attract "granny" investors. Further, a public guarantee need not be provided where sufficient grant and loan programs comprise an adequate proportion of the financing package and are subordinate to the commercial loan, as in Austria. In Switzerland a guarantee is indeed required, due the low proportion of public loans (5%). However, the bonds do not have a tax privileged status. The regulations limiting the cost of commercial funds for affordable housing (less than 30 basis point above the Euribor rate) has moderated the cost of finance across the wider mortgage market. The BIC model demonstrates the value of co-operation between social housing providers and government offering a suitable guarantee.

This third section of the paper builds on these requirements and learning from the successful experience in Switzerland and Austria, to outline the basic elements of a bond financing scheme for Australian conditions. For expediency, this is called a "Housing Supply Bonds (HSB) model". This HSB model introduces financial intermediaries and standardised financial instruments (in the form of tax privileged bonds) into the existing NRAS model as a means of institutionalising the role of private investment and hence levering available public funds. By introducing what has been described as a missing link in the current model, it represents a logical development of the NRAS model.

The HSB model is based on a rent model to cover finance and operating costs, accessible to a wider range of households than social housing currently and accompanied by adequate demand side assistance coupled to social security payments, when and where this is required by different households. Options for retailing the bond instrument include a government financial intermediary, a co-operative buying group of social housing providers or one or more banking institutions with expertise in the sector. The bond obligations would be backed by well managed rent accounts and secured by grant funding, subordinate public loans and the like. In the Australian policy context, Commonwealth Rent Assistance will be an essential component of this funding arrangement and therefore needs to be guaranteed for the life of the loan for eligible participants. Interest on the bond would be tax privileged to attract superannuation savings and self funded retirees seeking low risk, low return socially responsible investments. Various forms of credit enhancement or additional subsidies could be applied to decrease costs further.

The bond instrument could make use of a special circuit of finance created by the First Home Savings Accounts as it develops, or special deposit accounts, as has been very successfully achieved in France with Livrét A tax free savings accounts and the role of the the Caisse de Depôt as described in Milligan et al (2009) and by Shaeffer (2003, 2008).

The above model offers a stepping stone to be further developed using detailed research to determine the precise terms and conditions for such a bond financing system that is appropriate to the Australian financial and policy environment. A number of key issues will need to be addressed. First and foremost, investment requires a financially (and politically) stable delivery system, which is capable of ensuring that subsidised affordable dwellings are retained in the affordable housing sector and which can produce and operate housing services accessible to a *broad range of tenants* including those who have high needs and/or low incomes.

Secondly, investors need to be reassured that rental returns will generate sufficient revenue to cover financing costs and maintain asset values. In Austria, for example, the viability of social housing providers is secured by long term (12 year) funding agreements between the national and nine regional governments, providing grants and loans for projects applying cost rents (covering financing and operating costs) to a range of household incomes. As indicated above, CRA is an essential component of this funding arrangement and needs to be guaranteed for the life of the loan for eligible participants. Supplementation by what has been called "CRA plus" (Burke 2006) will be needed in high cost areas where operating costs are likely to be higher and for high needs and low income households with lower capacity to pay.

Thirdly, investment should be long term and not speculative, seeking low risk, modest returns. The most likely source of investment is the Australian superannuation funds. With the introduction of compulsory contributions in 1992, there has been a growing pool of retirement savings that could be diverted to safe, secure and socially beneficial investments in Australia. Housing bonds could channel a small proportion

of these funds towards the social housing sector and offer a modest and low risk return.

Fourthly, affordable housing must be recognised as a *special form of investment* for an under-developed sector. Towards this end there is a need for governments at state and federal levels to re-prioritise affordable housing as a "case suitable for treatment". This could involve a special tax privileged funding instrument to channel funds towards approved, part publicly funded housing projects. This will require action through COAG, facilitation by the Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) and co-ordinated agreement by Treasury and the ATO.

Fifthly, given the small scale of community housing in Australia, as in Switzerland, *funding should be pooled* to improve economies of scale and provide greater liquidity. This is more likely to be achieved using a standardised instrument offered by a centralised financial intermediary, with specialist expertise in the sector. The national government should provide the right incentives to steer investment into affordable housing construction, in partnership with the financial sector. To do so, they will need to devise appropriate prudential norms for any financial intermediary, adequate tax incentives for bond purchasers relative to other investment products and permit the subordination of public loans or provision of public guarantees to primary bond financed loans. Careful work is required to accurately assess which incentives would be the most efficient and effective in Australia.

Another important factor concerns the *regulatory framework.* Both overseas examples involved social landlords that are regulated to safeguard stakeholder investment and ensure fulfilment of their social task. This arrangement improves the credit worthiness and importantly, the financial rating of the sector. Considerable efforts have been made in Australia towards such a framework drawing on best practice overseas (Milligan et al, 2009). Another barrier is that most non-profit providers currently lack balance sheets to secure private loans, have an insufficiently diverse client base and are too small to generate revenue surpluses to service much debt. Emerging efforts to strengthen balance sheets (for example by transferring government owned assets) and increase revenues (by capturing CRA) may be practical ways to address this issue in the Australian policy context.

Whilst it is not the focus on the paper, more effective and nationally consistent planning and land banking mechanisms also need to be engaged to ensure access to suitable development sites and to promote more equitable access to employment and community resources. Again, there are ample illustrations abroad to demonstrate how this can be done to achieve housing policy goals (see, for example, Gurran et al, 2008).

Conclusions

This paper has argued that sustainable and affordable finance is a crucial pillar to support the provision of affordable housing in the long term. It has revisited the case for housing bond financing in Australia. Whilst proposed bond schemes have not been implemented here, variations of bond financing have been introduced successfully in Austria and Switzerland. Their experience demonstrates the value of a well regulated sector of limited profit providers, sustained provision of public grants and loans and a long term, low risk tax privileged investment instrument to channel funds towards approved housing developments. Necessary steps towards an Australian model are outlined in this paper in order to attract additional funds to social housing provision and revive the housing choices of many Australians facing housing stress who deserve better outcomes from our housing system.

The paper explores the possibility of a Housing Supply Bonds model, developed as a logical extension of NRAS. It sees NRAS not as an end in itself but as a critical contributor to an integrated system of finance for affordable housing. Many of the components of the framework that underpin the proposed HSB model are already in place or are in the process of being developed. A delivery mechanism already exists and capacity is being expanded rapidly. Regulatory frameworks are in place in most states and adoption of a nationally consistent approach is being discussed. Recent initiatives have shown how both direct and indirect fiscal mechanisms (such as CRA and tax concessions) can be used to provide ongoing support that contributes to the viability of affordable rental housing provision. In addition to the need to have a mechanism to raise private finance, what is missing from the current approach to funding affordable housing is a mechanism for collecting, coordinating and distributing the totality of funds available in a cost-effective way. This would include pooling co-contributions from state and local governments, from non-profit organisations and from whatever philanthropic sources might be available.

The proposed HSB model represents a further move towards providing these missing links and to solving the problems that have emerged from the Australian system of affordable housing provision. It highlights the need for policy makers to continue to develop the financial institutions and delivery mechanisms required to supply an adequate level of socially inclusive, affordable and quality housing options for the next generation of Australian households.

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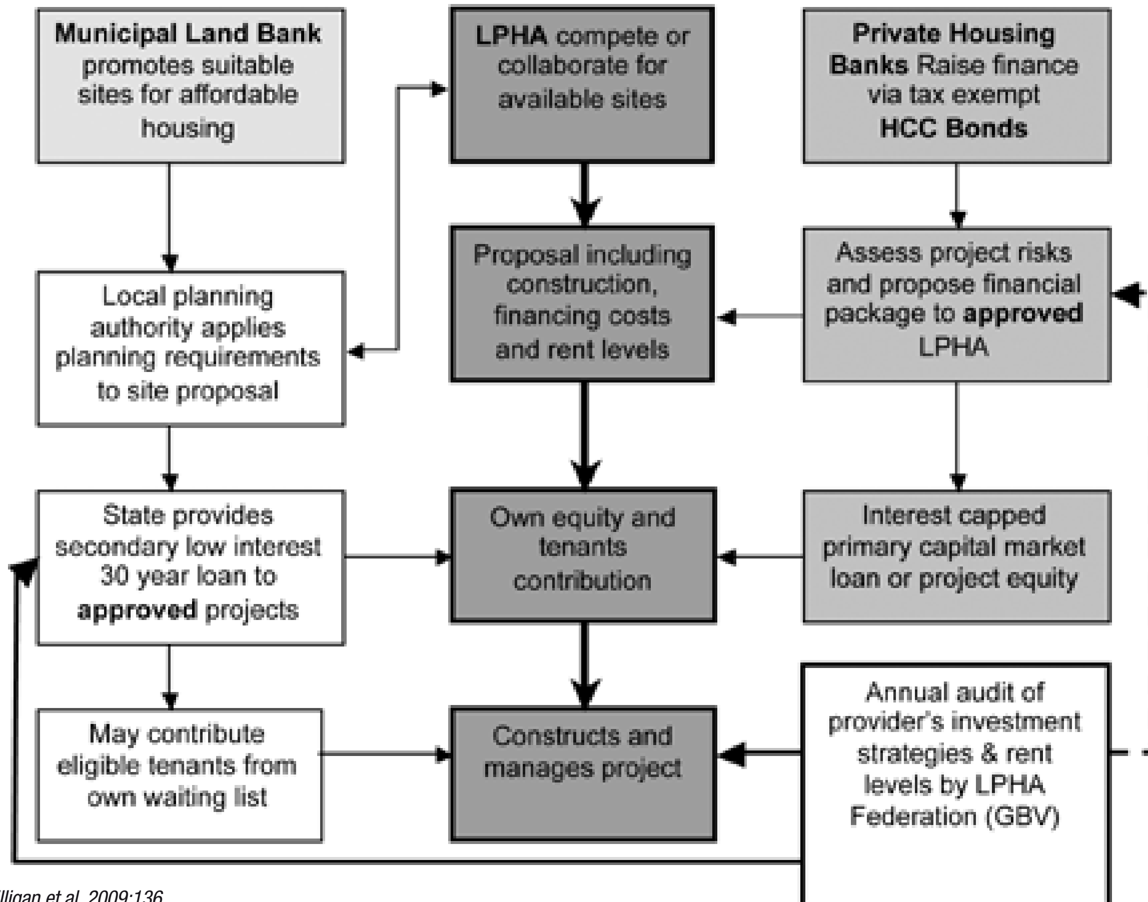
Appendix

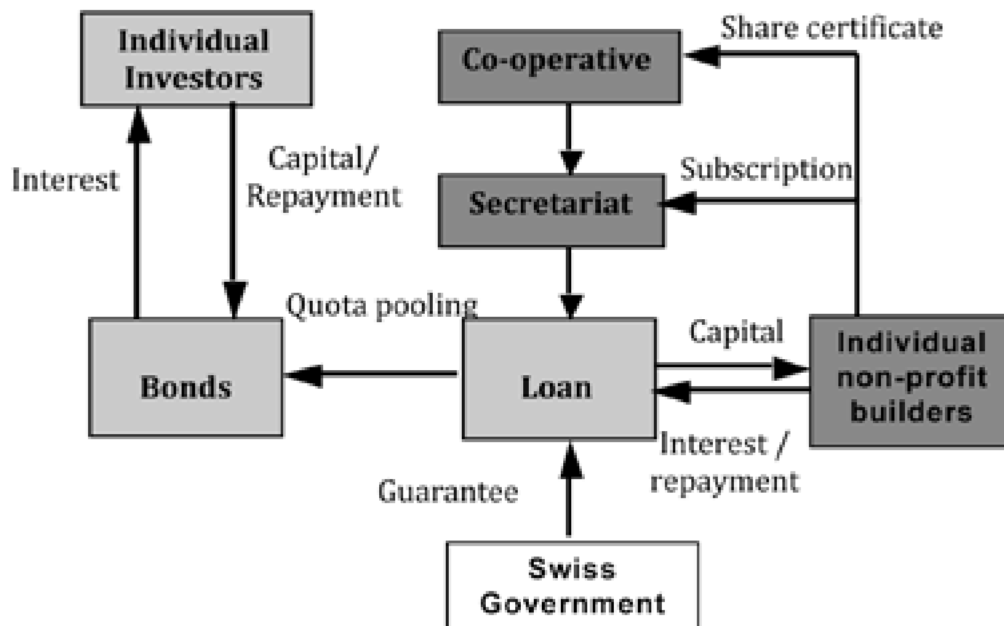
This Appendix provides a diagrammatic representation of the Austrian and Swiss schemes described in section 3 of the paper.

Figure A.1: Austrian bonds model in the context of related process supporting limited profit affordable housing



Source: Milligan et al, 2009:136

Figure A.2: Swiss Bond Issuing Cooperative



Source: Federal Offic

Mismatch between Homeownership and Residence in Korea[1]

By Jun-Hyung Kim, Mack Joong Choi and Jinsoo Ko[2]

1. Introduction

It is generally presumed that homeowners live in the house they own. However, strictly speaking, homeowners may reside in a rented house and lease their own home. That is, homeownership may not be matched to residence.

In particular, the unique Korean lease contract called "Chonsei" provides the leverage effect which may facilitate the mismatch between homeownership and residence. In a Chonsei lease contract, a tenant pays a landlord a stream of future rents discounted at present value in the form of an upfront lump-sum deposit roughly half of the sale price and obtains a right to live in the property a maximum of two years. After the contract period, a tenant can stay in the house with a renewed agreement (Suh, 1998; Ambrose and Kim, 2003).[3] Therefore, the Chonsei contract has functioned as an informal financing mechanism for homeowners: those homeowners who lease their houses with a sizable upfront lump-sum deposit can in turn utilise it for Chonsei deposit to rent another house, without disposing of ownership. Accordingly, it might be easier to find the discrepancy between homeownership and residence in Korea.

Nevertheless, studies of the mismatch are very rare. This paper aims to investigate how systematic the pattern of mismatch between homeownership and residence is and, if so, what factors contribute to the mismatch. The paper is organised as follows. In section 2 we present theoretical backgrounds regarding the causes of the mismatch. Section 3 explains data and methods for empirical analysis, and section 4 examines the characteristics of households whose residence is separated from homeownership. Major findings are summarised in section 5.

2. Theoretical Background

2.1. Definitions

In general, housing tenure is divided into two types: to own and to rent. Homeowners can be further subdivided into two categories. The most common type of homeowners are those who live in the house they own. We classify those as "matched households", because the home for ownership matches that for residence. However, it is also possible that homeowners do not live in the house they own. They can rent and live in a different house. For those households, the house they own is not identical to that they reside in, thus we categorise those as 'mismatched households' (Figure 1).

This mismatch can be realised in two ways. One is when the matched household moves to rental housing, not disposing of the previous house. We call this case as "non-selling mismatch". The other can be found when a renter purchases a new house but does not move to the house, staying in a rental housing. We describe this case as "non-moving mismatch".

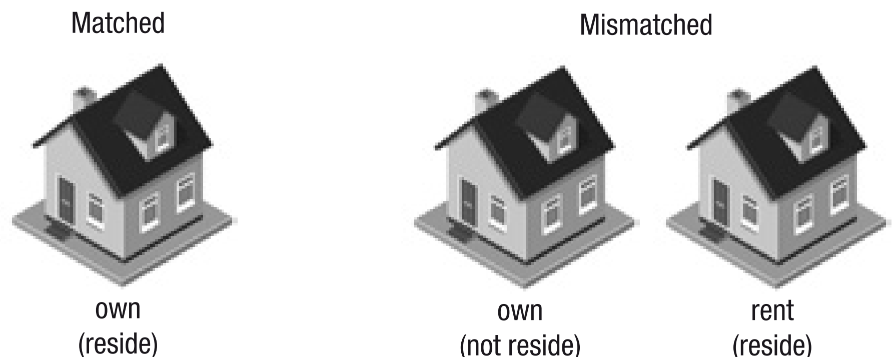
2.2. Causes of Mismatch

Why do households separate their ownership and residence? In the non-selling mismatch, it may be merely because they could not sell the previous housing due to a depressed housing market. Considering that these households can wait and sell their housing in a more favourable market, this kind of temporary mismatch cannot be regarded systematic.

However, the mismatch can be a systematic pattern of housing demand if households separate ownership and residence intentionally. Time-variant housing demand may be one of the reasons for intentional separation. For example, the house in which households want to live at the present time, perhaps for reasons of childcare, education, or journey-to-work, may differ from the house they prefer in the future. In this case, it might be better to rent the former and own the latter, resulting in the mismatch.

In this sense, we can expect that the more mobile a household is, the more likely the mismatch is. It is because, for highly mobile households, an attempt to match ownership to residence at the present time can result in higher costs in the future. Based on the empirical results showing

Figure 1: Diagram of the matched/mismatched household



[1] An earlier version of this paper was presented at the Asia Pacific Network of Housing Research (APNHR) conference held in Sydney, Australia on August 5-7th, 2009. The authors appreciate valuable comments by Professor Kyung-Min Kim of Seoul National University and the Editor.

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[3] According to 2005 Census, Chonsei comprises 54.1% of all housing lease contracts in Korea.

that younger households are more mobile than older (Rossi, 1980, p.224; Bourne, 1981, p.134; Long, 1992, p.145; Clark and Dieleman, 1996, p.49, 54; DiPasquale and Wheaton, 1996, p.224), we can predict that mismatched households are younger than matched ones.

This kind of housing consumption demand, however, does not explain all the cases of the mismatch. A representative example is when households purchase a house in which they do not intend to live not only at present but also in the future. This can be interpreted as another type of housing demand: investment demand.

It is well known that housing is a useful instrument for wealth accumulation.[4] Particularly in Korea, real estate comprises a significant portion of total wealth and has played a key role in accumulating wealth (Kim, 2009). In this regard, households may choose to rent, not to own, if the house is expected to contribute little to wealth accumulation. Instead they may convert the saved money to buying another house which is expected to produce a larger capital gain. As we mentioned, Korea's prevalent Chonsei lease contract can encourage this kind of investment demand since it guarantees a relatively stable tenant status for at least two years, while providing a flexibility to diversify investment.

The investment demand can be formulated with a simple user-cost approach. As stated above, there are two types of mismatch: the non-selling mismatch for previous owners and non-moving mismatch for previous renters. In the case of the previous owners, the profit of match (P1) they can expect when they own and move to a new house after disposing of the old one is specified as follows, assuming that property tax, depreciation and maintenance costs are negligible:

$$P_1 = V_a \cdot i - V_a \cdot g_a - V_b \cdot i + V_b \cdot g_b$$
$$= V_b (g_b - i) - V_a (g_a - i)$$

V_a is the house price of a previously owned home, and V_b is that of newly owned. The expected rate of price appreciation for each house is denoted by g_a and g_b respectively, and i is the interest rate common to both.

If the mismatch occurs, i.e. if the households who move and rent a new house still hold an old one, the expected profit of mismatch (P_2) is:

$$P_2 = V_a \cdot k_a \cdot i - V_b \cdot k_b \cdot i$$

where k_a and k_b represent the ratio of the Chonsei price to the sales price (Chonsei rate) for the old and new house respectively. There is no term for price appreciation because their ownership status does not change. When P_2 is larger than P_1, the households separate ownership and residence. We can write down this as:

$$V_a \cdot k_a \cdot i - V_b \cdot k_b \cdot i > V_b (g_b - i) - V_a (g_a - i)$$
$$V_a [g_a - i (1 - k_a)] > V_b [g_b - i (1 - k_b)] \quad (1)$$

The term i(1 - k) denotes the capital cost of their leverage under the Chonsei contract. Hence, the equation (1) implies that, if the expected capital gain minus the leverage cost of the previous house is larger than that of present housing, the household chooses separation.

For the non-moving mismatch, the renters compare the profits of the two alternatives in the same way. This time, the match for the renters means that they purchase the house they have lived in. The expected profit of match (P_1) can be stated as follows:

$$P_1 = V_b (g_b - i) + V_b \cdot k_b \cdot i = V_b [g_b - i (1 - k_b)]$$

In this equation, the previous house is denoted as 'b', because in both non-selling mismatch and non-moving mismatch, maintaining the ownership of house 'a' is the common cause of mismatch. The equation means that the profit of match is the expected capital gain minus the leverage cost of the house. If they become mismatched through buying but not moving to a new house, the expected profit of mismatch (P_2) can be calculated as follows:

$$P_2 = V_a (g_a - i) + V_a \cdot k_a \cdot i = V_a [g_a - i (1 - k_a)]$$

The equation has the same form of P_1 for house 'a'. The separation occurs when P_2 is larger than P_1. This can be specified as:

$$V_a [g_a - i (1 - k_a)] > V_b [g_b - i (1 - k_b)] \quad (2)$$

The equation (2) is the same with the case of non-selling mismatch, equation (1). This implies that, if households expect larger capital gains from other house they own in consideration of the Chonsei leverage, they may choose to separate. The expected rate of price appreciation (g) and Chonsei rate (k) are key parameters in determining investment demand.[5]

In this sense, we can predict that households with strong investment demand are ready to separate ownership and residence. According to Ioannides and Rosenthal (1994), the investment demand of housing is more affected by economic characteristics of households such as income or assets than by demographical attributes.

However, it is not easy to distinguish between consumption demand and investment demand since both are usually mixed in reality. For instance, as a household's income or assets increases, both consumption demand and investment demand for housing tend to increase simultaneously. In the same token, younger households may choose the separation not only because the house they own is fit for their long-run consumption purposes but also because the house price is expected to rise rapidly.

Furthermore, the mismatch may occur when the house does not correspond to both consumption and investment demand at the same time. In other words, the house that the mismatched household chooses to rent may reflect its consumption demand whereas the house to own investment demand.

In this regard, it is noteworthy that there is a regional variation in the degree of mismatch among geographical submarkets.[6] Manrique and Ojah (2003) found that households living in expensive housing submarkets tend to rent primary housing while owning secondary housing elsewhere. This implies that, the higher the regional price level of submarket is, the more likely the mismatch is. In interpreting this result, one thing relatively obvious is that the households choose to rent in expensive submarkets because the submarkets can provide what they want in terms of housing consumption demand such as high quality of childcare and education, infrastructure and accessibility, natural environment, and so on. But it is not clear why they choose to own a house elsewhere. This may be simply attributed to affordability in the expensive submarkets in the sense that house prices are too expensive and they cannot help seeking investment opportunities elsewhere. Otherwise they might expect that house prices in the expensive submarkets are too high to rise further or/and house prices elsewhere would increase more rapidly in the long run. In this sense, expensive house prices in Korea, especially in Seoul, may trigger the mismatch.[7]

The Korean housing market is also characterised by large differentials in housing prices

[4] It is easy to find the expressions which emphasise the virtue of housing as an investment tool: 'Many households have gained more from the housing market in a few years than would have been possible in a lifetime of saving from income'(Pahl, 1975 cited in Hamnett, 1992, p.307), 'buying and living in one's own home has proved to be one of the most profitable investments, at least since 1945'(Whitehead, 1979 cited in Hamnett, 1992, p.307), 'home purchase as the best investment for my money'(Grebler and Mittlebach, 1979, p.79), 'Housing has become a source as well as a store of wealth'(Hamnett, 1992, p.307), and so on.

[5] In relation to the investment demand, the tax system can also affect separation. The Korean government has imposed a heavy capital gain tax on the homeowners whose holding period is short. This may increase the likelihood of the non-selling mismatch to avoid a heavy tax burden.

[6] Choi and Ko (2006) also identify the housing submarkets in Korea by housing type (single-family and multi-family) based on the difference in asset liquidity.

[7] The Seoul's PIR (Price to Income Ratio) is 10.5 according to the recent survey by Kookmin Bank (2008). This is much higher than that of the U.S. (3.70), the U.K. (3.76), France (5.12), Germany (6.04), and Japan (5.30~5.90) (Kim, 2009, p.242).

among regional submarkets. Expensive submarkets are equipped especially with high quality education services as well as infrastructure and accessibility, which can draw a great deal of consumption demand. Therefore, Korean households may also show a divergence between consumption demand and investment demand of housing. That is, they may seek for high quality of housing services in expensive submarkets on the one hand, while searching for investment opportunities elsewhere on the other hand.

2.3. Literature Review

It is not easy to find literature shedding light on the concept and causes of the mismatch between ownership and residence. We can only detect some clues from Ioannides and Rosenthal (1994) and Manrique and Ojah (2003) who analyse the characteristics of housing tenure composition in the U.S. and Spain respectively. Based upon the numbers they reported, we can calculate that the proportion of the mismatched households is 2.9% in the U.S. and 1.6% in Spain.[8]

Ioannides and Rosenthal (1994) suggest that different types of tenure and ownership status result from the difference between consumption and investment demand of housing. For example, in the case of renters who do not own any other house, the consumption demand is much larger than the investment demand. On the contrary, as for owners who have other house(s), the investment demand is far stronger than the consumption demand.

Although their view provides a useful insight, it does not explain the mismatch *per se*. The mismatch may not be caused by either consumption demand or investment demand only. Rather we need to focus on divergence between consumption and investment demand, which results from the fact that the house the mismatched households rent or own does not satisfy both consumption and investment demand at the same time.

In summary, we do not yet have sufficient information to conclude whether or not the mismatch between ownership and residence is a systematic pattern of housing demand and, if so, what causes the separation. The following disaggregate empirical analysis can be a starting point for understanding the mismatch.

3. Research Design

3.1. Data

The data for empirical analysis is drawn primarily from KLIPS (Korean Labour and Income Panel Study). The KLIPS covers the longest time-span among Korean panel data and has surveyed around 5,000 households since 1998. It contains information on individual household's residence and tenure as well as whether they own a house elsewhere, which are critical factors in determining the mismatch along with other household profiles. Panel data is useful in understanding the characteristics of the mismatch since it has surveyed the same individual households every year.

Joining the information on tenure status of household's current residence and ownership of other houses, we can classify the households into four different types as in Ioannides and Rosenthal (1994) and Manrique and Ojah (2003): Those who live in a rented house without owning other houses (RN), those who live in a rented house and own other house(s) (RY), those who live in a house they own without owning other house (ON), and those who live in a house they own while owning other house(s) (OY) (Table 1). Among the four types, type RY are the mismatched households, i.e. the focus of our study, while type ON represents the matched households.[9] Hence, attention is given to comparing the household characteristics of type RY with those of type ON.

3.2. Procedure of Analysis

Three procedures are followed for the data analysis. First, we evaluate the relative importance and spatio-temporal features of mismatch in Korea based upon the frequency of matched and mismatched households. For this procedure, we use not only the KLIPS but also the Census data because the latter contains detailed information on household's residential location while the former is useful for time-series trajectory.

Next, we compare the characteristics of mismatched households with those of matched households based upon 2007 KLIPS data. In this procedure, differences in demographic, social and economic characteristics of individual households are verified using bivariate statistics.

Finally, we identify major factors which differentiate mismatched from matched households. For this purpose, the binary logistic analysis is carried out using 2007 KLIPS data.

4. Results and Interpretation

4.1. Proportion of Mismatched Households

Table 2 shows the percentage of each of the four household types as classified in Table 1. The figures on the left-hand side are derived from 2005 census data and those on the right-hand side from the KLIPS data.

Matched homeowners (ON) (50.5% and 55.0%) and renters (RN) (38.3% and 37.8%) together account for the majority of Korean households. Multiple-ownership (OY) (6.8% and 4.0%) follows them, while the percentage of mismatched owners (RY) is only 4.3% and 3.2% on average. Nevertheless, the proportion of mismatched households is still higher than that in the U.S. (2.9%) and Spain (1.6%). As explained in section 2, this result is presumably attributed to a certain degree to the unique Chonsei lease contract in Korea.

There is a significant regional variation in the proportion of mismatched household (RY). In particular, Seoul, the capital city, and the surrounding Gyeonggi province, which comprises the Seoul metropolitan area, show the highest percentages. Meanwhile, south western and south eastern provinces (Jeonbuk, Jeonnam and Gyeongbuk), which are distant from Seoul, have the lowest percentages. The percentage

Table 1: Household types classified by tenure for residence and other ownership

Other ownership Tenure for residence	No, we do not own other houses.	Yes, we own other house(s).
We live in a rented house.	Rented, No (RN) : Renters	Rented, Yes (RY) : Mismatched owners
We live in an owned house.	Owned, No (ON) : Matched owners	Owned, Yes (OY) : Multiple-ownership

[8] The data is based on the household survey, the 1983 Survey of Consumer Finances (SCF) in the U.S. and 1990-91 *Encuesta de Presupuestos Familiares* in Spain respectively.

[9] Type RY represents typical renters and type OY multiple-ownership.

Table 2: The percentages of household types

Census (2005)					KLIPS (1999~2007)				
Region	RN	RY	ON	OY	Year	RN	RY	ON	OY
Seoul	48.9	5.7	39.0	6.3	1999	39.2	3.7	53.1	4.1
Busan	38.7	3.3	50.3	7.7	2000	40.0	3.0	53.4	3.6
Daegu	41.1	3.5	48.4	6.9	2001	38.5	2.9	55.0	3.6
Incheon	33.8	4.0	54.7	7.5	2002	38.0	2.6	55.7	3.7
Gwangju	42.1	3.0	48.5	6.5	2003	37.4	2.6	57.0	3.0
Daejeon	41.6	5.0	45.8	7.6	2004	36.7	3.4	56.7	3.3
Ulsan	35.5	3.5	53.4	7.5	2005	36.6	3.5	55.3	4.6
Gyeonggi	39.7	5.6	47.3	7.4	2006	36.8	3.8	54.4	5.1
Gangwon	34.5	3.7	54.7	7.1	2007	37.1	3.7	54.1	5.2
Chungbuk	34.0	3.3	56.5	6.3	Average	37.8	3.2	55.0	4.0
Chungnam	29.9	3.6	60.8	5.7					
Jeonbuk	29.4	2.5	62.4	5.8					
Jeonnam	24.4	2.7	67.8	5.1					
Gyeongbuk	27.2	2.7	63.6	6.5					
Gyeongnam	31.7	3.5	57.8	7.0					
Jeju	36.4	3.0	52.8	7.8					
Total	**38.3**	**4.3**	**50.5**	**6.8**					
Urban (Dong)	42.4	4.7	45.9	7.0					
Semi-urban (Eup)	30.3	3.8	59.6	6.4					
Rural (Myeon)	14.6	2.0	77.5	5.8					

* unit: %

is also much higher in urban areas than rural areas on average. Therefore, it is clear that the separation between residence and ownership is more likely to occur in urban areas where housing prices are relatively high.

The proportion of type RY shows a temporal variation too. It decreased from 1999 until 2002-2003, although it has increased since then. Nevertheless, the temporal variation is not as large as regional variation.

4.2. Comparing Characteristics of Mismatched with Matched Households

Table 3 compares the characteristics of mismatched households (RY) with those of matched ones (ON) based upon 2007 KLIPS data. Households' characteristics are summarised in terms of households' age, numbers of household members and children, education level of the household, household income, wealth and residential location.

Mismatched households are younger than matched ones. The household's age is 45 for mismatched households as compared to 54 for matched ones on average. The difference is statistically significant both in t-test and chi-square test.[10] This result implies that high residential mobility of younger households is one of the reasons for the separation between ownership and residence: Younger households are able to relocate more easily than older households, which contributes to a greater difference between current and future residences.

Mismatched households have more household members that matched ones and the difference is statistically significant too. The mismatch is, therefore, more likely to occur for those who require larger space with increasing household members. Correspondingly, and more specifically, mismatched households have more children than matched ones with a statistical significance. This result suggests that, in addition to space requirement, the desire for high-quality childcare and education services may prompt the separation. Considering that the average household's age of mismatched households is 45, education services for children of school age appears to be an important factor. These requirements constitute the consumption demand in both quantitative and qualitative terms.

The education level of households is higher in mismatched households than matched ones, and the difference is statistically significant. On the one hand, the relatively high level of education may lead to an increase in consumption demand in pursuit of high-quality residential environment and amenities. Higher education of household may also extend to a high level of interest in better education of its offspring. On the other hand, investment demand increases by education level too (Ioannides and Rosenthal, 1994). Higher education may help households obtain wide information on investment values of various houses, which facilitates the investment demand. Hence, the mismatch appears to be related to a high level of both consumption and investment demand. Despite the younger age, mismatched households have a higher income than matched households with a statistical significance. On the one hand, as household

[10] T-test and Chi-square test is used to verify statistical significance of the difference between two groups' means and frequency distributions respectively.

Table 3: Characteristics of matched and mismatched households

		matched households		mismatched households		total		statistic
household's age	mean	53.8		45.0		53.3		11.19***
	under 35	218	(8.2)	19	(11.0)	237	(8.4)	**81.41*** **
	35~45	519	(19.6)	72	(41.9)	591	(21.0)	
	45~55	657	(24.8)	55	(32.0)	712	(25.3)	
	55~65	601	(22.7)	18	(10.5)	619	(22.0)	
	65 and above	651	(24.6)	8	(4.7)	659	(23.4)	
number of household members	mean	3.25		3.42		3.26		-2.28**
	2 or less	797	(30.1)	29	(16.8)	826	(29.3)	**19.1*** **
	3~4	1,525	(57.6)	128	(74.4)	1,653	(58.7)	
	5 or more	324	(12.2)	15	(8.7)	339	(12.0)	
number of children	mean	1.08		1.28		1.09		-2.78***
	0	902	(34.1)	39	(22.7)	941	(33.4)	**11.73*** **
	1	757	(28.6)	52	(30.2)	809	(28.7)	
	2	865	(32.7)	74	(43.0)	939	(33.3)	
	3 and above	122	(4.6)	7	(4.1)	129	(4.6)	
household's education level	high-school or less	1,832	(69.2)	73	(42.4)	1,905	(67.6)	**52.9*** **
	bachelor and above	814	(30.8)	99	(57.6)	913	(32.4)	
household income ($ US/year)	mean	30,742		40,825		31,358		-4.44***
	under 12,500	626	(23.7)	17	(9.9)	643	(22.8)	**40.59*** **
	12,500~25,000	676	(25.5)	34	(19.8)	710	(25.2)	
	25,000~40,000	684	(25.8)	48	(27.9)	732	(26.0)	
	40,000~55,000	367	(13.9)	32	(18.6)	399	(14.2)	
	55,000 and above	293	(11.1)	41	(23.8)	334	(11.8)	
household wealth ($ US)	mean	188,008		195,417		188,458		-0.29
	under 40,000	468	(17.7)	32	(18.6)	500	(17.7)	**4.42**
	40,000~80,000	573	(21.7)	37	(21.5)	610	(21.7)	
	80,000~150,000	643	(24.3)	39	(22.7)	682	(24.2)	
	150,000~300,000	545	(20.6)	28	(16.3)	573	(20.3)	
	300,000 and above	417	(15.7)	36	(20.9)	453	(16.1)	
residential location	Gangnam	46	(1.7)	16	(9.3)	62	(2.2)	**77.59*** **
	Seoul	435	(16.4)	48	(27.9)	483	(17.1)	
	Seoul metropolitan area	744	(28.1)	60	(34.9)	804	(28.5)	
	other regions	1,421	(53.7)	48	(27.9)	1,469	(52.1)	

The statistic is t-value in case of average and chi-square value in case of frequency.
***: p-value<0.01, **: p-value<0.05, *: p-value<0.1, 1 $ US = 1,200 Won

income increases, consumption demand for housing generally increases both in quantitative and qualitative terms. Accordingly, together with requirements for larger space and high-quality education services, the relatively high income of mismatched households indicates that their consumption demand is at a high level. On the other hand, the higher household income is, the more rapid is the increase in investment demand over consumption demand (Ioannides and Rosenthal, 1994). Therefore, statistics on education level and income indicate that the high level of both consumption and investment demand might give rise to the mismatch.

Regarding income, it is interesting to note that there is no significant difference in household wealth between the two groups.[11] This result suggests that, despite higher incomes, the mismatched households have not yet accumulated more wealth than the matched households, probably due to the younger age. Therefore,

[11] The wealth is calculated by summing up household's financial and real estate assets minus debt. Real estate asset (and debt) includes the appraised housing value and the Chonsei deposit.

compared to the matched households, the mismatched households may face a dilemma where they would like to have a high level of both consumption and investment demand, but do not have enough wealth to support it.

In this regard, it is noteworthy to mention that the residential location is significantly different between the two groups. In general, house prices inversely relate to the distance from Seoul in Korea, where Gangnam,[12] the southern part of Seoul, represents the most expensive housing submarket because of its reputation for highest-quality education services and good accessibility among others. Thus, house prices decrease in the order of Gangnam, Seoul (except Gangnam), the Seoul metropolitan area (except Seoul) and other regions.

It is clear that the more expensive the area's house prices are, the higher the percentage of mismatched households is. Hence the mismatched households are more likely to reside in a rented house located in expensive submarkets while owning a house elsewhere.[13] This result implies that, though the mismatched households may not have accumulated enough wealth to afford ownership in expensive submarkets, they still desire to satisfy at least their high level of consumption demand in the expensive submarkets which provide high-quality housing services. Instead they may own a house elsewhere in order to fulfil their high level of investment demand at the same time. In short, the mismatch between residence and ownership is likely to be caused by a location divergence between consumption and investment demand among submarkets. Expensive housing prices in Korea and Seoul may further encourage the divergence, while the leverage effect of Chonsei lease contracts functions as a medium to make the divergence easier in Korea.

4.3. Logistic Model

The previous bivariate analysis does not control the effects of other variables. To overcome this limitation, we employ the binary logistic regression model whose dependent variable is a match/mismatch dummy (mismatched = 1).

Independent variables are composed of the demographic and socioeconomic characteristics of individual households: household's gender, age, education level, employment status, changes in jobs for the last two years, number of household members,[14] household's income, wealth and residence location. In this case, the variables of employment status and recent change in job are added to the regression since they may contribute to the mismatch by affecting the journey-to-work. Residential location is classified into Gangnam, Seoul (except Gangnam), Seoul metropolitan area (except Seoul) and other regions as above, using dummy variables with other regions being the reference group. The estimation result of the logistic model is shown in Table 4.

Age, education and income are statistically significant. The probability of being the mismatched household increases as age, education level and income increases, *ceteris paribus*. These results are consistent with those of the bivariate analysis. All the location dummy variables are significant as well. The households who reside in the area of higher house prices, in the order of Gangnam, Seoul and the Seoul metropolitan area, are most likely to be mismatched, which is also consistent with the bivariate results. Furthermore, the standardised coefficients in Table 4 illustrate that the location variables in general, together with the age variables, have the greatest effect on the match/mismatch decision.

Household wealth, which is not significant in the bivariate analysis, is inversely and significantly related to the mismatch. Taking into consideration that mismatched households are more likely to live in expensive housing submarkets where more money is needed to own a house, this result implies that those who do not have sufficient wealth have no choice but to rent a house.

Meanwhile, gender, employment status, recent changes in jobs and number of household members do not affect the match/mismatch decision. It is noticeable that employment status, recent changes in jobs and number of household members, which were expected to contribute to the separation through changes in consumption demand, are not significant.[15]

5. Conclusion

We analysed the proportion of mismatch between homeownership and residence and factors affecting the mismatch. The main findings are summarised as follows.

Firstly, the proportion of the mismatched households is higher in Korea than the U.S. and Spain. We suggest that this result may be attributed to Korea's prevalent Chonsei lease contract, whose leverage effect enables households

Table 4: Logistic model

Variables		Unstandardized coefficient	Standardized coefficient	Wald χ^2	
constant		-1.8197	-	9.15	***
gender (male=1)		-0.0324	-0.0067	0.02	
age		-0.0386	-0.2917	20.75	***
education (bachelor and above=1)		0.5414	0.1397	8.24	***
employment status (in work=1)		0.2610	0.0642	0.95	
recent change in job (yes=1)		-0.0077	-0.0013	0.00	
number of household members		-0.0080	-0.0055	0.01	
household income ($ US/year)		0.0334	0.0650	3.90	**
household wealth ($ US)		-0.0075	-0.1366	4.22	**
location: Gangnam		2.3797	0.1937	42.79	***
location: Seoul		1.1950	0.2478	29.70	***
location: Seoul metropolitan area		0.7828	0.1948	14.36	***
Model Fit	LR	143.91***			
	Score	155.72***			
	Wald	125.89***			
Max-rescaled R2		0.136			

N = 2,781
***: p-value<0.01, **: p-value<0.05, *: p-value<0.1

[12] Gangnam indicate specifically three boroughs of Gangnam, Seocho, and Songpa in Seoul.

[13] The KLIPS data does not provide information about the location of houses mismatched households own.

[14] We cannot use the number of household members together with that of children due to multicollinearity.

[15] Especially, the number of household members, significant in the bivariate analysis, is no longer significant in the logistic model.

to rent a house without disposing of another house they may own elsewhere.

Secondly, as we explained from a theoretical perspective, the mismatch might be unavoidable, due to a given market situation, or intentional, if it is associated with households' housing demand. Empirical evidence confirms, however, that the mismatch is significantly related to many variables which influence consumption and investment demand for housing. Therefore, it is more appropriate to understand the mismatch as a systematic pattern of housing demand.

In the systematic pattern, the mismatch occurs more frequently for those households of higher education and income, who are generally expected to have higher level of both consumption demand and investment demand. Nevertheless, the mismatched households are younger and do not have enough wealth to realise their high level of consumption and investment demand in the same location and at the same moment in time.

These characteristics of the mismatched households may explain why they are inclined to reside in relatively expensive housing submarkets. On the one hand, the high level of consumption demand may lead them to choose to live in expensive submarkets which provide high-quality housing services. On the other hand, they may not have enough wealth to fulfil their high level of investment demand in that location at the same time. This might force them to rent a house in expensive submarkets for consumption purposes and to own a house elsewhere for investment purpose, taking advantage of the Chonsei lease contract. In other words, the mismatched households are likely to split the wealth into two in order to meet both their consumption and investment demands.

Therefore, we may conclude that the mismatch between ownership and residence is a systematic pattern of housing demand which results largely from a location divergence between consumption and investment demand. In this regard, we do not have to assume or argue that homeownership should always coincide with residence. Particularly in Korea, the systematic pattern of mismatch can be facilitated by expensive housing prices, especially in Seoul, and the Chonsei lease contract.

With regard to housing finance, the systematic pattern of mismatch may ultimately be attributed to the less-developed mortgage system in Korea (Kim, 2004, p.322). With limited access to housing finance, younger households are unable to afford expensive house prices, although they may have sufficient cash flows in the future. Hence, the proportion of the mismatched households may decrease to some extent through recent efforts of the Korean government to extend mortgage coverage by developing the second mortgage market. Nevertheless, the Korean government still needs to take advantage of the unique role of the Chonsei lease contract as an informal financing mechanism to complement the institutionalised financial market.

In terms of housing supply, the systematic pattern of mismatch may also be attributed ultimately to a shortage of housing stock in Seoul and the metropolitan area.[16] The core of the mismatch issue is that young, well-educated, and high-income households cannot afford houses they want, which are mainly located in those expensive submarkets. The Korean government needs to pay attention to increasing housing supply and thereby to provide various options which are affordable to those households, particularly in Seoul and the metropolitan area.

This paper has a number of limitations. A shortcoming of the KLIPS data employed in this study is that it does not contain specific information about the house the mismatched household owns, including its location and price. Thus we do not know exactly how the investment demand of the mismatched households is realised compared to the consumption demand in residence. Further analysis would also be required in order to illustrate how systematically consumption and investment demand are respectively related to various households' characteristics, such as age, education, number of household members, income, wealth, etc.

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[16] The ratios of housing to households are 91.8% in Seoul and 96.9% in the Seoul metropolitan area, which are far lower than the national average, 108.1% (MLTM, 2008, p.370).

Housing and the Financial Crisis: Causes, Consequences, Cures

↳ By Michael E. Stone[1]

Introduction

Sub-prime lending was but the last card in the house of cards that is the U.S. housing system and its senior partner – the global financial system. To those who say that no one could have predicted its collapse, I say "NONSENSE!" Not only was its collapse predictable; it was predicted. In 1975 – 34 years ago – I wrote the following:

Meanwhile the inability of working-class families to keep up existing mortgage payments has increased mortgage defaults and foreclosures on both owner-occupied housing and apartment buildings…. Unable to deal with the causes of mortgage defaults and foreclosure, which lie within the institutions of capitalism, the options available will only compound the problem in the long run. The proposals all basically involve … increasing debt…. Adding more claims to future income in these ways only adds to the increasing vulnerability of the entire financial system as well as the mortgage system in particular….

Since that time, I have chronicled the growth and instability of this house of cards (Stone, 1978; 1980a; 1980b; 1983, 1986; 1993; 2006b). Obviously, little heed was paid to my jeremiads.

This article sketches how the house of cards was constructed and collapsed, and will identify a few of the elements for building a different and solid house.

The house of cards

Just as there are four suits in a deck of playing cards, so there are four suits of cards out of which the housing house of cards has been built:

1. Wide and widening income inequality;
2. Persistent and pervasive racism in housing provision;
3. Treating housing increasingly as a speculative commodity at all levels; and
4. Over dependence on debt and the private capital markets to finance housing.

This deck of cards also includes wild cards and jokers in the form of public policies that exacerbated the growth and instability of the house.

Note that, with the exception of racism, which has a particular character and dynamic in the U.S. and connection to the crisis, all the other suits of cards are in no way unique to the U.S. and have highly relevant global linkages.

1. Wide and widening inequality: consequences for housing

For a generation after World War II in most of the developed capitalist world, there was modest reduction in inequality. However, during the 1960s the fabric began to unravel; the 70s were a transition time and by the 80s neo-liberal ideology and practice were well entrenched, leading to the drastic increase in inequality since then (Stone, 1993, pp. 103-140; Tilly, 2006).

The first consequence for housing, at least in the wealthier parts of the world, has been reduced affordability and rising house prices. On the one hand, since the mid-1970s most households in the U.S. have experienced little if any increase in their real incomes (Tilly, 2006, pp. 25-26). On the other hand, those at the top with more and more income have been driving up home prices, in both the owner-occupied and rental sectors, in existing housing and new (Stone, 2006a).

The second consequence has been decreased ability for most households to save. This, in turn, has had two major results: (a) Most households have had reduced capacity to make substantial down payment to buy, and hence there has been a push for lower down payments, i.e, higher loan-to-value ratios in the mortgage market, with associated increases in risk; (b) Furthermore, because middle-income households have not had money to put into savings (thrift) institutions, which traditionally were the self-sustaining source of most residential lending, housing finance has had to become more dependent on the capital markets.

The third major consequence for housing of widening inequality is that those at the top of the distribution have directly and indirectly also pursued high profits in the capital markets, contributing to the bubble of mortgage-backed securities.

2. Racism in all aspects of the provision of housing

There is a rather widespread view is that housing discrimination in the U.S. has largely ended, that segregation is an historical artifact that is gradually dissipating and that, to the extent it remains, reflects free choice in the market place. None of this is true.

Segregation has at best only modestly declined, and discrimination persists in the rental, sale, financing and insuring of housing. The burdens are greatest for Black households in most parts of the country, but there is evidence that the situation is worsening for Latinos and Asians (Denton, 2006).

The relevance of this to the current crisis is that the convergence of demography and geography – i.e., structural racism – created a largely untapped market, vulnerable to predatory practices in the sale, financing and refinancing of housing, as people of colour were swept into the grand illusions of mortgaged homeownership (Squires and Kubrin, 2006; Stone, 2006b, pp. 94-96).

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3. The speculative housing market

While treating housing as an object of speculation has a long and dishonourable history, it has become particularly pernicious in recent decades. Everyone came to believe that they are entitled to make a killing in residential real estate, up and down the food chain – not just distant investors, intermediate mortgage packagers, and nearby speculators and mortgage brokers – but including far too many homebuyers and homeowners.

This attitude has been coupled with the idealisation and over-promotion of speculative homeownership, based on a series of myths (that Kemeny, the author and a number of others identified decades ago; for critical examination of these myths, see, e.g.: Dean, 1945; Stone, 1975; Kemeny, 1981; Heskin, 1983; Edel, Sclar and Luria, 1984; and Stone, 1993, pp. 18-22; for an Australian critical examination of homeownership, see Badcock and Beers, 2000):

I. that you are always better off economically as a homeowner than a renter because you no longer have a landlord who can raise the rent;

II. that homeownership assures you of free housing in your old age;

III. that homeownership is a sound and effective way to build assets/accumulate wealth;

IV. that property values always go up, at least as long as you can keep undesirable activities and undesirable people out of your neighbourhood;

V. that homeowners are full citizens, but renters are not;

VI. that the degree of societal development is correlated with the homeownership rate; and

VII. the illusion of ownership through the reality of DEBT….

4. Over dependence on debt and the private capital markets to finance housing

Because housing is costly to produce and most producers are relatively small businesses, housing development is very dependent on borrowed money. More significantly, though, because housing is both a commodity and long-lasting, the transfer of houses is financed almost entirely by borrowed money, with the property as collateral. Furthermore, because housing is a speculative commodity, it is the prime source of collateral for borrowing even without transfer, i.e., refinancing and home equity borrowing.

Taking these three elements together, no sector of the economy has been as dependent on debt as housing. Over the entire period since World War II, housing-related debt has been the fastest growing component of the entire financial system. Over the past three decades, housing finance became fully integrated into global capital markets, with the full fruition of mortgage-backed securities (MBSs) and their derivatives. A major consequence has been that housing related debt has grown faster than the overall economy and hence faster than the ability to repay it.

From the late 80s to early 90s, there was a deep recession in the U.S., declining house values, high foreclosures, slow recovery. From the mid-90s to the mid-00s, the U.S. experienced the longest period of growth in over a century, but it was built on increasing inequality and debt. Combined with ever widening income inequality, and the more active and aggressive promotion of mortgage homeownership since the 1990s, the dependency of housing on debt has been turned into addiction, creating debt junkies at all levels of the system and pushers emerging at all levels because of enormous and growing opportunities for profit (Stone, 2006b).

Public Policies

The instability in these suits of cards was in turn stimulated and exacerbated by an array of public policies:

a. Housing and related Taxation Policies: Since the 1930s, the primary focus of housing policy in most of the predominantly white, English-speaking countries has been the promotion of mortgaged homeownership. This has consisted of institutions to support lending, ideological promotion and marketing, and subsidies through the tax system.

   The flattening of the progressive income tax and tax cuts in the U.S. since 1986 has contributed to widened income inequality, and provided more money at the top of the income distribution for speculation in housing and financial markets.

   With regard to tax benefits for homeownership, they are particularly regressive in the U.S., but by no means unique. The benefits rise with tax bracket, house value, mortgage amount, interest rate. Over half the benefits flow to the top 10% of the income distribution. No wonder it has been labelled the "mansion subsidy." Indeed, recently even conservative economists have been recognising that they distort the housing market, create perverse incentives to borrow and speculate, as well as depriving the Treasury of revenue (Glaeser and Shapiro, 2003; Carasso, Steuerle, and Bell, 2005).

b. Privatisation of the public institutions of housing finance (see Stone, 1993, Part II, and Stone, 2006b): The end of the post-war prosperity in the 1960s led to increased competition for credit, rising interest rates, and disintermediation from savings institutions. One major response was the expansion and privatisation of secondary mortgage markets. In 1968 Fannie Mae (FNMA) privatisation began; in 1970 Freddie Mac (FHLMC) was created. Fannie and Freddie are (were) quasi-public government sponsored enterprises (GSEs), with implicit government guarantees of their paper, but profit-motivated institutions with private shareholders. GSEs package mortgages into pools; they issue securities sold into capital markets backed by pools of mortgages. Initially these were plain vanilla pass-through securities bought mostly by institutional investors like pension funds, insurance companies and commercial banks.

c. Deregulation and lax regulation of private financial institutions and activities has been another, more publicised, major facet. A big push in the 1970s culminated in extensive deregulation of the financial system in the 1980s, which in turn was a direct cause of the drastic decline of the traditional model of housing finance, leading to the late 1980s S&L crisis in the U.S. (Stone, 2006b). In the late 1990s there was a second wave, pushed by some of President Obama's top economic advisors (Helmore, 2008). Add to deregulation, lax enforcement of remaining regulations and failure to regulate new, high-risk products and institutions over the past decade.

d. Monetary policy: Loose money/low interest rates by Greenspan's Fed encouraged borrowing and speculation, and leveraging of little capital with lots of debt to invest in high risk/high return real estate and capital market vehicles (see, e.g., Morris, 2008, pp. 62-65).

Implications for Households

Trends pointed to problems even before the sub-prime surge. First, there was a steady trend toward bigger, more costly houses. Second, in the U.S. homeownership peaked in 1980 and then declined until 1994. But in 1995 homeownership started to increase, with a focus on lower income households, especially households of colour. (This was the result of various factors, including the Community Reinvestment Act (CRA), easing of usury limits on interest rates resulting in more sub-prime lending, plus the Clinton administration's homeownership push; see Stone, 2006b; Immergluck, 2009.)

However, by the middle of the current decade, five vulnerabilities became apparent at the base:

I. <u>the spread of high-risk non-traditional loans:</u>

not just sub-primes, but a whole menagerie: alt-A, "ninja" (no interest, no job or assets), interest only, negative amortization, 100%+ loan-to-value, adjustable rate loans, option ARMs, etc.

II. rising housing occupancy costs: not only due to mortgage resets, but also increasing cashing out of equity, including refinancing of original primes into sub-primes; and debt costs, add rising property taxes, heating costs;

III. high leverage: meant lots of people with no equity cushion; so any decline in prices would mean negative equity in which default would be more likely;

IV. declining incomes: many people on the margin of being able to afford their housing (and other) debts, even with multiple jobs/incomes, facing risk of default if laid off, personal or family member illness, divorce, new child, etc.;

V. declining property values: fewer and fewer buyers able to sustain ever higher prices meant eventually and inevitably prices would turn down.

Implications and Consequences for the Financial System

Slicing and dicing of MBS into collateralised mortgage obligations (CMOs), originated by Freddie Mac in 1984, was so profitable for Freddie and Fannie, that in the 1990s Wall Street began private pooling and securitising of prime mortgages, outside of Fannie and Freddie, and then issued sliced and diced securities against these pools of plain vanilla MBS, derivatives of these securities, collateralised debt obligation (CDOs), etc. (Stone, 2006b; Immergluck, 2009).

But the mid-90s already gave hints of problems with securitisation and derivatives: computer models were inadequate because they did not account for the possibility of refinancing; thus, in the mid 90s there was an MBS crisis, with chaos in MBS markets (Stone, 2006b). Yet no constructive lessons were learned by the industry, regulators or policy-makers. Instead, new opportunities and new products were launched in the MBS markets.

In order to expand the volume of MBSs, it was necessary to promote vast increases in mortgage lending: on the one hand, since homeownership rates in the US were declining overall and were especially low for households of colour, there was both motive and opportunity for a whole new wave of over promotion of homeownership to underrepresented populations; on the other hand, among existing homeowners rising house prices created enormous increases in home equity, stimulating an orgy of refinancing, home equity loans, purchases of 2nd and 3rd homes and investment properties, etc.

Non-prime lending (sub-prime, Alt A, etc.) had long existed, but there had been no secondary market because such loans did not meet Fannie and Freddie standards. So, there were limited originations of such loans until the early 2000s, when Wall Street, looking for highly profitable outlets for vast pools of cash, started to buy and securitise non-prime mortgages. This led to a stampede into high-profit, non-prime MBSs and derivatives upon derivatives, with profits multiplied by fees and by high leveraging fostered by low interest, expansive monetary policies (Morris, 2008; Baker, 2009; Immergluck, 2009).

Instability in Fannie and Freddie was already apparent by early 2000s (Stone, 2006b). Nonetheless, with loss of market share to Wall Street, Fannie and Freddie lowered their standards to compete in non-prime secondary market and keep share prices up and stockholders happy, with heavy lobbying to prevent regulation.

This process generated almost limitless profit opportunities ostensibly for homebuyers, homeowners and speculators, but especially for the inventors and purveyors of exotic mortgage products.

Of course it also piled risks ever higher, as each and every level – not just homebuyers and homeowners – became leveraged to the hilt, borrowing far beyond any realistic potential of repayment – built on the myth that residential property values always and forever rise – a classic bubble.

Culmination and Collapse

Together these were a perfect storm that blew apart the house of cards. The vulnerabilities at the base resulted in surging defaults and foreclosures, and not just on sub-prime loans. While the foreclosure rate is of course much higher on sub-prime loans, most loans are not sub-prime and, indeed, about half of foreclosures have been on prime loans.

As all of the suits of cards had been built into an enormous yet precarious house, it was then inevitable that the collapse would spread up through the financial system to create the worst global economic crisis since the Great Depression, in which housing finance was also deeply implicated.

HOW TO BUILD A SOLID HOUSE

While it is apparent that a comprehensive program of reform is needed, my primary focus here will be on pieces of the ownership and financing agenda.

Ownership:

How can we address two major sources of both housing affordability and broader economic instability, viz, treating housing as a speculative commodity, and the over-dependence on debt to finance housing? We should greatly increase the amount of debt-free, non-speculative housing, which includes public housing, non-profit rental housing, and, my particular focus, an adaptation of the mutual housing alternative to mortgaged homeownership (Neighborhood Reinvestment Corporation, 1985; Stone, 1993, chapter 7; Stone, 2006c).

A mutual housing association (MHA) is a non-profit cooperative corporation, made up of residents, prospective residents and other community members. An MHA finances housing to the greatest extent possible through capital grants rather than mortgage debt. Residents make a modest "down payment," which is returned with interest upon moving out. In the conventional MHA model, capital grant financing is used to reduce residents' costs. In the modified MHA proposed here, residents would have monthly charges in lieu of mortgage payments, with the amount based on some affordability standard. This money, which would have gone for mortgage payments in conventional housing, would instead, like individual development accounts (IDAs), be put into safe investments such as term deposits at banks, money market accounts or similar vehicles; these investment funds could and should be managed by competent, respected, non-profit intermediaries, such TIAA-CREF.[2] Since wealth accumulation is separated from homeownership, residents may not sell their homes for a profit, thereby maintaining affordability for future generations.

What does the model offers residents?

- control over their homes comparable to conventional homeownership;
- greater security of tenure because there's no risk of mortgage foreclosure;
- asset development comparable in magnitude, on average, to conventional homeownership;
- but superior in terms of security (vulnerability), stability (volatility) and liquidity.

While especially beneficial for low and moderate income households, there is no reason for it to be limited. It is not second-class homeownership. It is a smart alternative that should be made widely available as a choice.

[16] The TIAA-CREF is a nearly $400 billion full-service financial services group of companies that has dedicated itself to helping those in the academic, medical, cultural, and research fields for over 90 years. For more information, please see www.tiaa-cref.org.

Financing:

Debt-free non-speculative housing of all types should be financed by capital grants from Housing Trust Funds. In the US there are several hundred state and local HTFs, and in the summer of 2008 a National Housing Trust Fund (NHTF) was finally enacted, after a very long grassroots campaign.

I have proposed that the NHTF be capitalised through a tax of about a few tenths of a percent on all capital market financial transactions, including stocks, bonds, mortgage-backed securities, derivatives, etc. Even such a tiny tax could generate several hundred billion dollars per year (Stone, 1993, pp. 266-268;Baker, 2000; 2008).

Such a dedicated revenue source would be

- progressively redistributive;
- not subject to the whims of the annual appropriation process; and
- not add to government budget deficits.

It could provide financing for upwards of a million units a year of debt-free non-speculative housing, though:

- new construction;
- acquisition of some private housing, such as foreclosed homes; and
- preservation of at-risk subsidised housing.

Macro-economic benefits:

A tax on financial transactions would reduce speculation in the capital markets. Also, under the MHA model the money that would have gone for mortgage payments into unproductive, speculative housing wealth would under the MHA model be available for investment in productive activities for a sustainable future.

Housing Finance Reform

In addition to the specific ownership and financing approach just described, I also propose a series of structural reforms to the existing housing finance system:

- Prohibit high-risk loans and restore plain vanilla mortgage loans: fixed-rate, fully-amortised, level-payment loans requiring non-negligible down payments (along with mortgage insurance and default insurance);
- Restore and strengthen local, mutually-owned & public lenders: credit unions, mutual savings banks, depositor owned s&ls, community loan funds and public lenders (HFAs);
- Promote the Ginnie Mae model for mortgage securitisation: now that Freddie and Fannie are fully in the public domain, they should remain there (without shareholders, without highly paid executives, without high-priced lobbyists), issuing government-backed, plain vanilla pass-through mortgage-backed securities on the plain vanilla mortgages; such securities should be prohibited from being sliced and diced and pyramided with derivatives; this would provide liquidity and access to the capital markets for responsible lending without the greed, speculation and risk that brought the system down;
- Strongly regulate financial markets, with transparency and accountability, including prohibition on pyramiding of securities, and including explicit criminal as well as civil liability for violations.

Comprehensive Program

These are a few of the building materials needed to construct a strong house on a solid foundation. For other elements of a comprehensive program to address not only the manifestations but underlying causes of the housing crisis, see the Appendix.

Conclusion

At this monumental moment, we have the opportunity to begin constructing a New Social Democracy for the 21st Century. I am not naively optimistic about the prospects politically, but am nonetheless certain that it is a goal worth pursuing.

We housing researchers have a particular responsibility in this effort - as intellectuals, as practitioners and as activists. Housing, as all of us surely know, lies at the core of the dilemmas and challenges facing our families, our communities, our nations and our planet. The resolution of these dilemmas is to be found not through the celebration of selfish individualism, but rather through the rediscovery of social responsibility and the transformation of our economic institutions. Let us join in this grand endeavour.

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Appendix

A COMPREHENSIVE PROGRAM TO SOLVE THE HOUSING, HOMELESSNESS AND INCOME CRISIS IN THE UNITED STATES

Expand social, non-profit, and non-speculative ownership and production of housing, to ensure long-term affordability, community viability, and responsible use of public resources. Social, non-profit and non-speculative housing can be expanded through:

- new housing production;
- preservation of subsidised rental housing (public and privately-owned) as permanently affordable to low-income households, with increasing resident and community control and ownership;
- financial assistance to low and moderate-income homeowners who are shelter poor or facing foreclosure, in return for their agreement to transfer to social ownership;
- buyout of absentee-owned, unsubsidised private rental housing through negotiated sale or eminent domain.

Finance the production and acquisition of social housing through direct public capital grants rather than debt, to reduce both the affordability burden of mortgage payments and the instability of the financial system.

Reform the financial system, in order to deflate the credit bubble, reduce speculative uses of credit and assure an adequate supply of credit -- to complement capital grants -- for productive investment in housing, as well as infrastructure and job-producing industry. All private capital market participants should be required to make below-market set-asides to finance non-speculative housing and community development. Credit allocation authority and incentives should be used to steer private savings to community loan funds, state housing finance agencies and mutually-owned thrift institutions.

Increase the capacity and scale of housing development by socially-oriented developers, and increase public and community control over land and housing production. Public and social resources for housing development should be directed increasingly to community development corporations, mutual housing developers, regional non-profit housing organisations, labour unions, and local housing authorities. Public financing of responsible private development for non-speculative ownership should not be precluded, particularly if under community control or in joint ventures with social developers.

Reform landlord-tenant law to facilitate tenant unionisation and institutionalise collective bargaining rights, just cause for eviction, habitability standards and enforcement, dispute resolution, and resources for technical and organising assistance.

Establish employer accountability and financial responsibility for contributing to meeting the housing needs of their workers and communities. Unions should negotiate for housing trust funds as part of their members' benefits. Private commercial and luxury developers should make linkage payments or meet inclusionary housing requirements. Other employers should establish voluntary housing programs or make payroll tax payments into housing trust funds.

[16] The TIAA-CREF is a nearly $400 billion full-service financial services group of companies that has dedicated itself to helping those in the academic, medical, cultural, and research fields for over 90 years. For more information, please see www.tiaa-cref.org.

Recognise in housing and income policies the disproportionate growth of affordability problems among larger households, and among households headed by women (both non-elderly single parents and older women without spouses). Since the housing crisis is one of the causes and manifestations of the crisis of U.S. families (with "family" broadly understood to include both non-traditional and traditional living arrangements), resources and support should be provided for appropriate and innovative housing schemes and designs, and supportive social and community services, as well as economic assistance.

Enforce anti-discrimination laws fully and aggressively, along with affirmative programs within communities of colour and the larger society to expand housing as well income opportunities for those who have always been disproportionately shelter poor because of racism.

Support community control and resident empowerment in the production and operation of housing, in balance with principles of social responsibility, non-discrimination, and inclusionary planning and development.

Assure adequate and secure incomes to all households. This should be through gainful employment at decent wages for all those able to participate in the paid labour force and through appropriate income supports for those who cannot obtain adequate incomes through employment. Income supports should consist of direct affordability assistance for those unable to afford social-sector housing costs, plus supplemental aid to the very lowest income households who would be unable to meet their non-shelter needs at a minimum level even with full housing assistance.

Provide adequate public resources and allocate them equitably for social housing, community development, services, and income supports. Resources should be generated through balanced economic growth, redirection of federal budget priorities away from the military, plus creation of a truly progressive income tax (including strong disincentives for speculation in housing, land and other assets, and phasing out of the increasingly regressive deductions for mortgage interest and property taxes).

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INTERNATIONAL UNION FOR HOUSING FINANCE

The International Union for Housing Finance (IUHF) is a multinational networking organisation that enables its members to keep up-to-date with the latest developments in housing finance from around the world, to learn from the experience of others and to anticipate trends in their own countries before they happen.

How does the Union do this? **By communicating!**

The Union does this in five different ways

- The Union runs a website - www.housingfinance.org. Please pay a visit!
- The Union publishes a quarterly journal, *Housing Finance International* (HFI)
- The Union organises a World Congress every two years
- The Union actively participates in events related to key housing finance issues around the world
- The Union facilitates the exchange of information and networking opportunities between its members

For more information, please see www.housingfinance.org
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