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The Quarterly Journal of the International Union for Housing Finance

- Federal structures and public housing
- Funding affordable housing: a rapid and concise review
- Exploring institutional investment in social rented housing in the United Kingdom, the Netherlands and France
- Housing microfinance; does it make sense?
- Stimulus measures driving confidence and growth in the Thai real estate sector in 2016

International Union for Housing Finance

Housing Finance International

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"Life is what happens to you when you're busy making other plans"

The late John Lennon was not thinking of housing finance when he coined the line above. However, in the pre-referendum frenzy that currently afflicts the UK it has a strong resonance.

As referendum day (23rd June) approaches politicians and pundits are bringing the furore of claim and counter claim to an unholy climax. At times the debate takes on the air of farce; remain campaigners seriously suggesting that the UK could find itself short of professional footballers if we leave the EU and BREXIT campaigners arguing that the EU is an evil empire belatedly putting Hitler's geo-political aspirations into practice.

In spite of these sometimes bizarre (if entertaining) ideological by-ways, the meat of the campaign has focussed on the economy and migration. Any members of the public who are still listening, are having to work their way through a bewildering maze of statements which are made by one side and promptly denounced in vehement terms by the other. In the absence of any source of hard data accepted by all sides it has become almost impossible for the average citizen to distinguish truth from fiction and hard fact from speculation. Will leaving the EU put a "time bomb" under the economy, or will the saving in net financial contributions to the EU solve the problems of funding the National Health Service? Will leaving the EU really enable politicians to slash the level of inward migration? Who really knows?

Anyone with a serious interest in housing finance will be feeling very short-changed by the campaign. True, the "remain" side have claimed that house prices could fall sharply if the British people choose BREXIT. Independent commentators (such as the present writer) have claimed that there could a range of impacts if the UK leaves the EU including more expensive mortgages, costlier borrowing to fund affordable housing and falling government investment, but in general housing finance has received comparatively little attention.

It is therefore perhaps not surprising that in housing terms "Life is what happens to you when you're busy making other plans." While overseeing the referendum campaign the Government has simultaneously shepherded the *Housing and Planning Act 2016* through Parliament, achieving Royal Assent on 12th May. The Act aims to address a shortfall of almost 100,000 new homes completed per year. It is an explicit Government objective to reverse the progressive fall in home-ownership since 2003. To achieve these ends, the Government intends to build 200,000 "Starter Homes" to be sold at 20% discount to first-time buyers under 40. 135,000 new shared ownership units are to be built by 2020. In contrast, there will be no more grant for new social rented housing, housing associations have been manoeuvred into a "voluntary" agreement to sell social rented homes under an extended Right to Buy policy and local authorities are being forced to sell off their high-value social rented stock. In many ways the Act and its associated policies represent a revolution in the provision of affordable housing.

All this has taken place without any significant reference to the EU referendum debate. Yet the vote on 23rd June could have profound implications for the feasibility or even the desirability of these policies. Whether the UK leaves the EU and net inward migration falls from c. 300,000 to less than 100,00 per annum must have an impact on the number of new homes needed. If interest rates rise and the economy falters, will building 200,00 Starter Homes be realistic? Will selling off social rented housing look such a good idea if unemployment rises and governments cannot afford to build new affordable housing? John Lennon was right; we may be making other plans but life goes on and will ultimately impact upon those plans.

Affordable and public housing is an important topic in this issue of HFI. In our first article *Federal structures and public housing*, Julie Lawson addresses some key structural issues in relation to the implementation of affordable housing strategy. She traces a trend toward devolving the provision of public housing investment to lower tiers of government within the US, Canada, Germany and Austria and examines the implications for funding and the maintenance of standards and social focus. She offers some key findings for making devolved administration work.

As the UK Housing and Planning Act referred to above illustrates, policies relating to affordable housing, and indeed the definition of affordable housing, are matters that are complex, subject to change over time and differ widely across different national markets. In a timely and controversial article, *Funding affordable housing; a rapid and concise review*, Peter Williams and Michael Oxley offer an analysis of the shifting affordable housing landscape and raise important issues such as what makes housing "affordable" and the relationship between affordability and depth of subsidy.

In the UK, institutional investment in the affordable housing sector has grown rapidly in the wake of the Global Financial Crisis and its aftermath. In 2013-14 institutional investment amounted to 52% of all new investment within the sector. Such investment has proved to be a viable and important alternative to the traditional secured bank finance. The picture for institutional investment has not been so positive in other countries however. In their article *Exploring institutional investment in social rented housing in the United Kingdom, the Netherlands and France*, Marietta Haffner and colleagues look at the reasons why investors will participate in particular markets and at the role of Government in developing appropriate policies to foster such investment.

Making housing affordable is, of course, as much about providing appropriate finance for those wishing to access housing as it is about providing the housing itself. In a fascinating article *Housing microfinance; does it make sense?* Victor Mints asks why, over 50 years since its introduction across much of the developing world, microfinance still needs to be promoted and why in many markets it cannot survive without special subsidy. Mints examines the interactions between microfinance and its customers and with other products in the market in order to analyse how microfinance can be used more effectively and proposes some significant changes.

There is evidence that housing markets and underlying economies are slowing in many parts of the World, leading to speculation about future outlooks. In his article *Stimulus measures driving confidence and growth in the Thai real estate sector in 2016*, K.I. Woo examines how in Thailand the Government has intervened to stabilise the market and housing production and analyses how successful those interventions have been.

At a time of significant uncertainty across the Globe, we commend this issue of HFI as an important contribution to ongoing debate about the role of housing finance in different markets and housing sectors.

Contributors' biographies

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Professor Michael Oxley is Director of the University of Cambridge Centre for Housing Planning Research. He was previously Professor of Housing at De Montfort University and a visiting Research Fellow at Delft University of Technology. He has published widely in the field of social rental housing and housing finance. This has included work on investment in social housing in the UK and internationally.

Alex J. Pollock is a distinguished senior fellow at the R Street Institute in Washington DC. He was president and CEO of the Federal Home Loan Bank of Chicago 1991-2004, and president of the International Union for Housing Finance 1999-2001.

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Connie Tang (PhD) worked as a Research Associate at the Cambridge Centre of Housing and Planning Research, University of Cambridge from March 2008 to June 2015. She holds a Ph.D. in urban and regional studies from the University of Birmingham. In April 2015, she moved to the Department of Public Health and Primary Care as a Data Scientist, specialising in informatics, statistical programming and data management.

Mark Weinrich holds graduate degrees in political science and economics from the University of Freiburg, Germany. He is the Secretary General of the International Union for Housing Finance and the manager for international public affairs at the Association of Private German Bausparkassen.

Peter Williams is Executive Director of the Intermediary Mortgage Lenders Association and a Departmental Fellow, Department of Land Economy, University of Cambridge. He was previously Director of the Cambridge Centre for Housing and Planning Research, Deputy Director General of the Council of Mortgage Lenders and Professor of Housing at the University of Wales, Cardiff. He is currently on the board of The National Housing Federation.

K. I. Woo has been a business advisor to financial institutions and large corporations throughout Asia for more than two decades. He is also a business journalist who regularly publishes globally. Mr. Woo is also a Senior Advisor and Director of Pathfinder Asia Ltd and Human Capital Alliance Ltd with offices in Bangkok and Hong Kong.

Asia Pacific Union for Housing Finance: news update May 2016

By Zaigham M. Rizvi

Pakistan

During the current quarter, the overall housing finance portfolio stood at Rs. 60.80 billion as of December 31, 2015; an increase of 4.77% over the quarter. The House Building Finance Company [HBFC] remained the largest provider, in terms of gross outstanding assets, with a share of 24%. HBFC is the only specialized housing finance institution in the country, operating in the public sector. However, based on category, Islamic Banks remained the largest players with a 35% share of gross outstanding assets. Fresh disbursement for the quarter accounted for Rs. 5.67 billion with 1,369 borrowers. Furthermore, non-performing loans decreased to the level of Rs 13.28 billion compared to previous quarter's Rs 14.12 billion; a marked decrease of 6% during the quarter. HBFC, being the largest player in the housing finance market, accounted for 59.88% of new borrowers and contributed 24.17% of the new disbursements; equivalent to Rs. 1.37 billion. Islamic banks disbursed Rs. 2.98 billion. The major portion of the total outstanding lending remained directed towards the "Outright Purchase" category as 63.10% of gross outstanding was used to finance these housing loans. It was followed by "Construction" and "Renovation" products with 25.20 and 11.71% respectively.

During the quarter ending December 31, 2015, Islamic banks and HBFC remained active in extending housing finance. This rise in disbursements is a reflection of efforts to create an enabling environment for housing finance in Pakistan. This will be instrumental in increasing economic growth through positive changes in 40 industries allied to the housing sector. Keeping in view overall trends, it shows that housing finance in Pakistan is gradually growing and NPLs are declining.

Pakistan to benefit from Turkish experience in the housing sector

The Minister for Housing, Urban Development & Public Health of the Government of Punjab, Tanveer Aslam Malik, leading a high-level delegation of officials and private sector executives, met with the President of Housing Development Administration of Turkey [TOKI] Mehmet Ergun Turan. The meeting was attended by senior officials of TOKI as well as Pakistan's Ambassador to Turkey Sohail Mahmood.

Mr. Tanveer Islam Malik, in his remarks after detailed presentations by TOKI, described Turkey as a good example to emulate in terms of provision of low-cost housing in Pakistan. *(http://nation.com.pk/lahore/29-Jan-2016/pakistan-to-benefit-from-turkish-experience-in-housing-sector)*

New loan recovery law

Parliament has passed the Financial Institutions (Recovery of Finances) (Amendment) Bill, 2015 in a bid to facilitate recovery of bank loans and to minimize the growing trend of loans to be written off in the country, especially in foreclosure cases. The State Bank of Pakistan [SBP] initiated the process of consultation among the relevant stakeholders to frame the amendments in the Financial Institutions (Recovery of Finances) Ordinance [FIRO], 2001 in the light of the Apex court judgment and requirements of the financial institutions. The proposed amendments are meant to facilitate the recovery process of bank loans so that loan defaults and written off loans can be minimized.

Meeting between Banking Courts, senior bankers and SBP

In December 2015, SBP took the initiative to organize a joint session among major housing finance stakeholders in Pakistan; financial institutions, Banking Court judges and the State Bank of Pakistan itself. The initiative was unique because this was the first interaction between Bankers and Banking Court Judges outside courtrooms.

Various issues were discussed including delays in mortgage finance foreclosure cases. The program also involved training sessions from renowned legal professionals and seasoned housing finance practitioners from Pakistan.

Malaysia[1]

Government of Malaysia's initiatives for affordable housing

The trend in the Malaysian property market currently is largely defined by imbalances of demand and supply in different segments of the market. Shortage is particularly evident in the supply of affordable housing as opposed to high-end housing particularly in the cities where the houses for sale are predominantly around the mid to higher tier price points. The Federal and State Governments in Malaysia have embarked on several initiatives to address the shortages in the affordable housing segment. Nevertheless, the efforts by government agencies such as Syarikat Perumahan Negara Berhad [SPNB] (National Housing Corporation Limited) and Perumahan Rakyat 1Malaysia [PR1MA-1Malaysia Citizen Housing] are met with headwinds; the current level of house-building in the affordable housing segment has not been sufficient to meet the demand.

Tenth Malaysia Plan: affordable housing initiatives

The initiatives undertaken to address affordable housing issues during the Tenth Malaysia Plan [2011-2015] seek to provide sufficient

[1] SOURCE: Bank Negara Malaysia; Economic Planning Unit.

and affordable housing for the poor as well as for the low and middle income households. These initiatives include:

Program **Bantuan Rumah [PBR]** [HOUSING ASSISTANCE PROGRAMME]	▪ Implemented to provide a comfortable home in the rural areas particularly for hardcore poor households headed by elderly, single parent and disabled as well as households with a larger number of dependents including Orang Asli [aborigines] in Peninsular Malaysia, and poor households in the rural and remote areas in Sabah and Sarawak. As of March 2015, 15,322 houses were built and another 41,346 houses were repaired.
Program Perumahan Rakyat [PPR] [CITIZEN HOUSING PROGRAMME]	▪ Implemented to address the increasing demand for affordable housing among low income households, particularly in urban areas. The PPR was developed to provide comfortable houses with adequate infrastructure and basic amenities in suitable locations. As of March 2015, 23 projects with 12,025 houses were built and 63 projects with 27,087 houses were under various stages of development. The end-financing is provided under the Ministry of Urban Wellbeing, Housing and Local Government.
Rumah Mesra Rakyat 1Malaysia [RMR1M] [1MALAYSIA FRIENDLY CITIZEN HOUSING]	▪ Implemented by SPNB to provide subsidies between RM15,000 and RM20,000 for the low income households to build houses priced between RM45,000 to RM65,000 per unit on the land owned by the recipients. The end-financing is provided via SPNB.
Perumahan Rakyat 1Malaysia [PR1MA] [1MALAYSIA CITIZEN HOUSING]	▪ Launched in 2011 to provide affordable homes to middle-income household in urban areas with a monthly household income between RM2,500-RM10,000. As of March 2015, Perbadanan PR1MA Malaysia approved 119,933 homes for development nationwide, and 18,400 units were under construction. In addition, Rent-to-Own and 110% financing schemes were introduced in 2014 to assist PR1MA house buyers. Land provided at minimal cost by federal or state government. Panel of banks were invited to facilitate end-financing.
1Malaysia Civil Servants Housing [PPA1M]	▪ Launched in April 2013, the aim of PPA1M is to assist civil servants to own a house, particularly in major cities. As of March 2015, 13,539 units of PPA1M houses were being constructed. Land provided at minimal cost by federal or state government.
Rumah Wilayah Persekutuan [RUMAWIP] [FEDERAL TERRITORY HOUSING]	▪ Comprising low and medium cost housing priced between RM42,000-RM300,000 with the objective of providing housing to the residents of the Federal Territories (launched in April 2013). As of March 2015, 9,309 units were under construction.
Skim Perumahan Mampu Milik Swasta [MyHome]	▪ Launched in April 2014 to help the low-income households to own a house at affordable prices. The Government provides a subsidy of up to RM30,000 per unit to private developers to enable first-time buyers with a monthly household income of RM3,000 to own a house.

Issues and challenges

The issues and challenges relating to the provision of housing include the following:

- **Mismatch between demand and supply for affordable housing**

  The demand and supply gap in relation to affordable housing was caused by rapid socio-economic changes, urbanization and evolving population structures. An inadequate supply of affordable housing exists particularly in the low and lower middle income households segment. In 2014, there were 63,662 households living in squatter areas involving 273,381 inhabitants, where the majority was in Sabah, Sarawak, Johor and Penang.

- **Escalating house prices in major cities**

  The housing affordability index shows that house prices in most major cities in Malaysia are more than three times the annual median income of households. Since the fourth quarter of 2011, residential property prices have recorded a quarterly price increase of above 10%. The increase in house prices has attracted high end property development at the expense of affordable housing. This has resulted in the shortage of affordable housing, driving up prices of existing houses in the low and middle price segments.

- **Lack of integrated planning and implementation**

  There are multiple authorities involved in developing affordable housing for different target groups. The key agencies are the Ministry of Housing and Local Government, Ministry of Rural and Regional Development, Ministry of Agriculture and Agro-based Industry, Perbadanan PR1MA Malaysia and SPNB. Improved coordination among these agencies is required to encourage provision of affordable housing. In addition, the lack of an integrated database on housing supply and demand has hampered planning and implementation of affordable housing programmes.

- **Poor maintenance of public housing**

  The Housing Maintenance Programme is subject to financial constraints faced by the state governments and agencies in undertaking major repairs to their public low-cost housing.

The collection of maintenance funds from the residents is insufficient due to low the rental rate plus unpaid or uncollected rents. As a result, local authorities have been burdened with the maintenance of public housing. Acts of vandalism and irresponsible behavior have also affected the quality of housing facilities and increased their maintenance costs.

- **Insufficient amenities**

  Several public housing projects in the suburbs were insufficiently equipped with basic amenities such as schools, clinics, and public transportation. The Household Income, Expenditure and Basic Amenities Survey [HIES] 2014 indicated that about 10.3% of Malaysian households lack access to health services. Further, about 6.6% of the urban households do not have access to garbage collection services which can pose health hazards to the citizens.

- **Improving the quality and condition of the low and medium cost housing**

  Under the Government's National Blue Ocean strategy, the My Beautiful Malaysia programme was initiated to improve the quality and condition of low and medium cost housing. The programmes' main objectives are maintenance of houses through the Program Penyenggaraan Perumahan [PPP – Housing Maintenance Programme], Tabung Perumahan 1Malaysia [TP1M – 1Malaysia Housing Fund] and maintenance of Government quarters. The scope of these programmes includes major repairs and maintenance works such as repainting, replacement of lifts, water tanks and sanitary system for public low cost housing, private low and medium cost housing and Government quarters. During the implementation of the Tenth Malaysia Plan, approximately RM750 million has been allocated to fund various public and private housing maintenance programmes under PPP and TP1M.

Other Government of Malaysia initiatives: promoting home ownership

Several home ownership and financing schemes such as the "My First Home Scheme", "Youth Housing Scheme", "MyHome" and "MyDeposit" were introduced to provide opportunities to the low and middle income households to own their first home.

The "My First Home Scheme" was introduced in 2011 to assist youth earning RM5,000 per month or less, to obtain 100% financing from participating banks to purchase their first home. The assistance in financing is bolstered by the provision of mortgage guarantee through Cagamas SRP Berhad which provides a guarantee to banks for financing above 90% of the cost of the house. This enables the eligible applicants to purchase houses costing between RM100,000 to RM500,000 without having to pay the 10% down payment. The scheme is supported by 22 participating banks.

The "MyDeposit" scheme was also introduced in April 2016 to help Malaysians pay their initial deposit. RM200 million has been provided for this specialized program for middle income earners to own their first house.

In 2015, the "Youth Housing Scheme" was introduced for married youths with a household income not exceeding RM10,000, to own a house. The scheme offers funding for the purchase of a first home costing less than RM500,000 by Bank Simpanan Nasional [National Savings Bank]. Cagamas SRP provides the guarantee facility whereby the guarantee fee is paid by the Government and at the same time enables the bank to provide 100% financing.

Encouraging home ownership through specialized government linked corporations such as Cagamas will also be intensified through innovative financing facilities to the primary home lenders. Cagamas will continue to leverage on its successful business model to provide affordability and accessibility to financing via schemes initiated by the Government for low to middle income citizens.

The way forward

The issues of affordable housing will be addressed through the provision of financing facilities, ensuring availability of suitable land and provision of environment friendly facilities and infrastructure. The role of the National Housing Department [NHD] will be strengthened to improve the coordination in the planning and implementation of affordable housing development. The private sector will also be encouraged to develop public housing through public private partnerships.

The Eleventh Ma laysia Plan (2016-2020) will give priority to the provision of adequate and quality affordable housing for Malaysians. Approximately 650,000 public houses are targeted to be built during the 5-year period under various government agencies. The provision of quality affordable housing will be centered on three main strategies as follows:

1. Increasing access to affordable housing for targeted groups
2. Strengthening planning and implementation for better management of public housing
3. Encouraging environment-friendly facilities for enhanced livability

Affordable housing programs for the low and middle income groups in urban areas and suburbs such as PPR, RMR1M, PR1MA and PPA1M will continue to be implemented based on need. In addition, state governments will be encouraged to provide affordable housing to increase supply.

Better management of the delivery of affordable housing is to be achieved by strengthening planning and implementation. Three measures will be implemented, namely, establishment of a land bank, improvement in the management and delivery system and identification of potential waqf (donated asset) land. The role of NHD will be strengthened in planning, coordinating and monitoring affordable housing programs across ministries, agencies and the private sector.

Additionally, housing units for specific target groups with appropriate facilities will be provided to create a livable housing environment for the citizens. Special target groups such as persons with disabilities, the elderly and single mothers will have the ability to own a house to ensure improvement in their quality of life. Public housing will be better managed and maintained to create a conducive environment for livable housing.

The Government will continue to promote home ownership with new initiatives and enhance existing schemes to enable low and middle income households to purchase affordable houses. Cagamas will continue to support the Government of Malaysia's initiatives with innovative solutions.

Thailand

The Thai housing market experienced strong growth in Q1 2016 because of strong government incentives. The Thai Government reduced transfer and mortgage registration fees and introduced "Baan Pracha Rath" financing packages for home purchases of up to Bt1.5 million ($US42,857).

Lersuk Chuladesa, the Chief Operating Officer of Pruksa Real Estate Plc, told The Nation that his company's presales in the first quarter rose 4% in Q1 to Bt9.36 billion ($US267 million), up 4% from an earlier estimate of Bt9 billion ($US245 million) because transfer and mortgage fees were reduced to 0.1% and new "Baan Pracha Rath" program sales. "We believe this campaign will drive our first-half sales strongly," he said.

LPN Development Plc sold Bt4 billion ($US114 million) of new homes to customers in the first quarter, more than double the Bt1.9 billion ($US54 million achieved in the same period last year. The company also has an inventory of condominiums (Bt5 billion ($US142 million)) that will benefit from the Government's "Baan Pracha Rath" campaign.

Golden Land Residence – a subsidiary of Golden Land Property Development Plc had presales worth Bt3.1 billion ($US88 million) in the first two months of the year. Managing Director, Saenphin Sukhee, told "The Nation", "We believe presales will grow beyond our estimates thanks to strong residential demand among home-buyers, and especially among those speeding up their decision to purchase before the measure to cut transfer and mortgage fees to 0.1% per cent expires on April 28".

Supalai, another major developer had sales of Bt3.13 billion ($US894 million in the first two months of the year, 27% higher than in the same period last year. "Sales started to recover during the final quarter of last year, when the Government's measure to cut the mortgage and transfer fees came into effect. This increased demand was for detached housing and townhouses in the final quarter of 2015 and the first quarter of this year," said Tritecha Tangmathithum, Supalai's Managing Director.

A recent Government Housing Bank's Real Estate Information Center survey indicated that more than 36,100 residential units priced up to Bt1.5 million ($US52,857) were available nationwide; 20,300 units are located in Bangkok and its suburbs. "The 'Baan Pracha Rath' campaign will help property firms reduce their inventory. It drove strong growth in the first quarter, and will continue in the second," said Director-General Samma Kitsin.

Lower incomes raise home-loan rejection rates

Home loan rejection rates for low-income wage earners are expected to rise to 25-30% this year from 20% last year largely because of the economic slowdown and the group's unstable income, the National Housing Authority [NHA] told Bangkok Post.

To help low-income earners, the NHA is offering hire-purchase services. This short-term low-cost scheme helps potential homebuyers attain financial discipline. After two years, those taking part in the scheme can apply for home loans at banks.

According to the Bangkok Post, since 2003 about 30,000 purchasers under the NHA's Baan Eua- athorn low-cost housing buyers used the hire-purchase scheme. The NHA expects that the Government's current Baan Pracha Rath low-cost housing program will help low-income earners acquire housing more easily.

Ubonwan said NHA will also be promoting seniors' housing this year because this demographic is growing quickly. Since 2012 the NHA has renovated more than 100 homes for seniors in seven provinces at a cost of Bt100,000 baht ($28,571) per unit. Currently a waiting list exists for these unit types.

GH Bank supports 2016 Taekwondo national team

Laiwan Pongsangium, GH Bank's Senior Executive Vice President and Acting President presented Bt7.5 million ($US 214,286) as its initial 2016 support funds to Dr. Somkid Pinthong, Vice Chairman of the Taekwondo Association of Thailand. Under the Government's "One Sports Association, One State Enterprise" policy, the Bank will help develop Thailand's Taekwondo athletes for the 31st Rio 2016 Summer Olympic Games in Brazil.

GH Bank offers low-interest-rate "Baan Pracha Rath" housing loans

Laiwan Pongsangium, Senior Executive Vice President and Acting G H Bank President announced that after the Cabinet's recent "Baan Pracha Rath" project approval, the Bank will allocate Bt30,000 million ($US857 million) to provide homes for low-to-middle income citizens under the following loan programs:

Purchases from housing developers

The Bank has allocated Bt10,000 million ($US285 million) to "Baan Pracha Rath" home purchases from housing developers. Interest rates will be fixed at 4% per annum [p.a.] for years one and two: from the 3rd year until the end of the loan- term the interest rate will be not lower than MLR – 1% p.a. (the Bank's MRR currently is 6.65% per annum).

Retail customers

The Bank has allocated Bt20,000 million ($US571 million) under this program for general retail customers. Loans can be for the following purposes; Loans for purchasing and constructing houses not exceeding Bt700,000 ($US20,000) and for home renovation loans not exceeding Bt500,000 ($US14,286). The Bank will charge 0% interest for the first year, 2% for the 2nd-3rd year, 5% p.a. for the 4th-6th year, MRR-0.75% p.a. for the 7th year until the loan term ends (the Bank's MRR currently is 6.75% p.a.)

Loans for purchasing and constructing houses exceeding Bt700,000 ($US20,000) but not exceeding Bt1.5 million ($US47,857), the Bank will charge 3% p.ae for the 1st-3rd year, 5% p.a. for the 4th-6th year, MRR-1% p.a. (welfare customers) and MRR-0.75 % p.a. (general retail customers) for the 7th year until the loan term ends.

Borrowers under this program (except loans for renovations) must not have owned homes previously. The total value of renovated land and houses must not exceed Bt1.5 million ($US47,857).

Debt Service Ratios [DSR] for these loans will be increased to not more than 50% of total net income per month for retail customers and 80% for welfare (corporate benefits) borrowers that agree to have their monthly payments automatically deducted from their payroll accounts.

India

NHB to launch over 80 new housing finance companies

Sriram Kalyanaraman took over as Managing Director and Chief Executive Officer of the National Housing Bank [NHB] in July 2015. Prior to this regulatory role, Sriram Kalyanaraman worked for Standard Chartered Bank and Deutsche Bank. He also helped set up a credit bureau, Equifax, based in Mumbai.

In an interview with Manju AB, he says housing finance companies [HFCs] have no regulatory arbitrage and have to lend competitively even if they do not have a base rate like banks. "In fact", he says, "they have a tougher environment to work in without having access to low-cost deposits like banks".

NHB is a wholly-owned subsidiary of the Reserve Bank of India [RBI]. NHB's task is to regulate, develop and refinance HFCs. Sriram Kalyanraman says that NHB will work with RBI to address issues like loan retention and capital requirements.

In line with the Centre's ambitious plan to provide housing for all by 2022, the Delhi-based

NHB is gearing up to spawn 80 new HFCs. The focus will be on financing affordable houses.

At present, there are 66 active HFCs in the market. According to rating agency ICRA, HFCs' loan portfolios grew 22% to Rs 5,23,800 crore in March 2015, from Rs 4,29,800 crore in March 2014. (10 Lacs is one million, and 10 million is one Crore)

If the goal of housing for all by 2022 is to be reached, the number of HFCs in the region should be 150, up from the current 66," said Kalyanaraman.

HFCs need hand-holding

HFCs need differential treatment. Most HFCs can't compete with banks on loans in the Rs 30-40 lakh space. HFCs offer financing to a segment where the emphasis is on understanding the socio-economic status of customers.

NHB would work with RBI to help HFC's meet its capital requirements. Kalyanaraman intends to push for some comfort for HFCs on retaining loans for a certain period, say 12-18 months. He said, "They [HFCs] need some sort of protection at least for the initial period from balance transfers (takeover loans)".

The purpose is to give finance for housing and not just look at growing outstanding loan books.

HFCs go and acquire those customers, that others are not willing to underwrite. For HFCs, the upfront cost to acquire a customer is Rs 2,000.

Affordable housing finance

Affordable housing finance is a rapidly growing niche segment. NHB is giving a fresh look at ways of taking an equity stake in HFCs and creating some form of new instruments to help them.

According to rating agency ICRA, the overall market size is Rs 67,800 crore. The portfolio of new players in the affordable housing sector stood at Rs 6,500 crore as on March 31, 2015. This sector could continue to grow at a compound annual growth rate of 50% over the next three-to-five years.

There will be challenges emerging from promoting new entities. The regulator would have to figure out ways to keep an eye on their governance and ensure HFCs stick to the ground rules for servicing the lower-end customers.

Rejuvenating a body

While NHB improves regulation under the wings of RBI, the real work is in the area of development, refinance and capacity building.

NHB's goal is to become a knowledgeable regulator for the housing finance sector and provide more refinance for those serving the low-end segment.

This calls for a break from the present ways of working at NHB. While conceding there are challenges ahead, Kalyanaraman does not see them as hurdles. "Neither the current structure nor bandwidth will be a constraint. The moment people see that you are implementing things, support will come your way for increasing peoples' capacity or make changes in the structure."

Europe: A shifting regulatory landscape – the Mortgage Credit Directive

By Mark Weinrich

The Mortgage Credit Directive [MCD] is a piece of European legislation designed to provide for a more integrated internal European mortgage market with minimum standards and provisions for the protection of consumers. As it is a European directive, the European Member States have to transpose it into national law. The deadline for implementation was March 21 2016. However, end of June only 12 out of 28 Member States had communicated their National Implementing Measures. The Mortgage Credit Directive requires minimum harmonization in the Member States which means that all have to meet a certain minimum level but can also implement stricter rules. There are two major exceptions from the minimum harmonisation rule which have to be taken over exactly as the European legislator determined:

1. Borrowers have to receive pre-contractual information through a European Standardised Information Sheet [ESIS]

2. The information has to include the effective interest rate, which is called the "annual percentage rate of charge", as it includes also all fees and charges. It has to be calculated according to an EU standard.

The MCD applies to loans provided to borrowers which are secured on residential immovable property or are provided for the purposes of acquiring or retaining rights in land or in an existing or projected building. Member States have the discretion not to apply these rules on "buy-to-let loans" and public loans.

The rules of the Directive can be divided in four sections:

- Rules concerning pre-contractual obligations
- Rules concerning contractual obligations in relation to the credit agreement
- Supervisory rules
- Professional rules for credit intermediaries

The division in these four sections is somewhat arbitrary but it offers a better structure than the Directive itself.

The most important **rules for the pre-contractual phase** include standards for credit advertisements, pre-contractual information and tying practices.

Lenders who want to indicate an interest rate or any figures relating to the cost of the credit in advertisements have to refer to a representative offer. Furthermore, standard information defined by the Directive has to be included in the advertisement. These are among others the identity of the creditor or credit intermediary, the borrowing rate, indicating whether it is fixed or variable, the total amount of credit, the annual percentage rate of charge and several other items if applicable. These rules complicate specific advertisement for loans so that lenders might increasingly shift to purely promoting their image in advertisements.

The Directive states also that consumer must be given general and personalised information by way of the European Standard Information Sheet.

In addition, the European Directive also restricts tying practices. In general, tying is not allowed unless the financial service or product offered together with the credit agreement is a fully integrated part of the credit. However, Member States can allow tying practices if the creditor can demonstrate that it is to the clear benefit of consumers. Exceptions to the prohibition exist for example for savings accounts if the purpose of such an account is to accumulate capital to repay the credit or to service the credit. The lender can also ask the borrower to hold an insurance policy as long as the borrower can freely choose the supplier of this policy. To conclude, although tying practices are not allowed in general, this part of the directive really is not that restrictive due to the exceptions that are allowed.

The most important **contractual obligations** that the Directive regulates are the reflection or withdrawal period, the right to early repayment, rules regarding foreign currency and variable rate loans, rules for the conduct of business, rules for assessing the credit worthiness of the consumer and property valuation.

The reflection period guarantees that every consumer has sufficient time for consideration (at least seven days). This time for consideration can be either a pre-contractual period of reflection or a period during which the consumer can withdraw or a combination of both. It is Important to know that the offer by the creditor is binding and may be accepted by the consumer at any time during the reflection period. However, Member States can decide that consumers cannot accept the offer for a period not exceeding the first 10 days of the reflection period – this is what France decided – and they can allow the borrowing rate to vary from that stated in the offer in accordance with the value of an underlying bond or other long-term funding instrument. Member States in fact used the range of options that the Directive offers them: While the UK goes with the minimum standards – 7 days' reflection period, but the consumer can accept the offer at any time – France decided for a reflection period of 10 days without giving the consumer the choice to shorten this period, Germany has a 14 day right of withdrawal and the Czech Republic a combination of both.

The issue of early repayment was debated at length. There were fears that an indiscriminate right could damage well-established long-term financing practices. In general, the Directive determines that consumers have a right to early repayment, but in order to assuage the above-mentioned fears Member States may provide that the creditor is entitled to fair and objective compensation if the early repayment falls within a period for which the borrowing rate is fixed.

Foreign currency loans and variable rate loans – which have created severe problems in some countries – are also regulated in the Directive. Basically, consumers have to be informed about the implications of this kind of loan. Furthermore, the index for variable rate loans has to be objective and transparent.

For foreign currency loans there is a further rule: that consumers have the right to convert the credit agreement into an alternative currency under specified conditions. It has to be specified by the Member State whether this is the currency in which the consumer receives his/her income or whether it is the currency of the Member State in which the consumer is resident. As a minimum, the bank has to inform their borrowers if there is fluctuation of 20% or more in the exchange rate. Conversion is carried out at the market exchange rate. It is important to note that according to the definition in the Directive a foreign currency loan is not only a loan denominated in a currency other than that of the Member State in which the consumer is resident but also if the consumer receives his/her income in another currency other than that in which the credit is to be repaid. This is not a trivial issue: A Hungarian working in Austria might find it difficult to buy a house in Hungary as lenders might refuse to give this customer a loan – as it would be a foreign currency loan. It is understandable if banks refuse loans to such customers as they might end up with costly foreign exchange positions in their balance sheet although they originally only lent in the local currency.

The most important **supervisory rules** of the Directive focus on rules for the conduct of business, the creditworthiness assessment and the property valuation

The Directive also provides clear rules for the conduct of business. For instance, the payment structure for commissions to the agent should not prejudice his ability to act in the consumer's best interest and should not be – and this is most important – contingent on sales targets. This rule has quite an impact on business practices. Although lenders are still permitted to pay a bonus to a sales person that is linked to the total credit volume achieved, it is no longer permitted to pay a bonus that is linked to the sales volume achieved for a single loan product only. Member States may even decide to ban commissions paid by the creditor to the credit intermediary all together.

The Directive has also precise rules about assessing the creditworthiness of consumers. Lenders are obliged to make an assessment of the consumer's creditworthiness, which – and this is most important – shall not rely predominantly on the value of the residential property. This means that it is the ability to repay that counts. Thus, only consumers who are likely to meet their obligations should get a loan.

There are also rules regarding property valuation. In the beginning it was proposed that property valuation should be done externally. This proposal has been weakened. Now the rule is that only reliable valuation standards must be in place and appraisers have to be professionals and independent of the credit underwriting process. Although internal appraisers are allowed, these new rules might make it more efficient for many lenders to use external appraisers.

The Mortgage Credit Directive also regulates **professional rules for credit intermediaries**. Real estate professionals who provide services relating to mortgages beyond a mere introduction or referral of a consumer to a creditor need to comply with the requirements of the Directive. Credit intermediaries have to have professional indemnity insurance, be of good repute and have an appropriate level of knowledge. But what is an "appropriate level of knowledge"? France decided to include a minimum duration for the training in its law: 60 hours. Germany did not include a certain number in its law but the duration of the recognized training is around 220 hours. Again other countries have very relaxed rules regarding the necessary training. This might turn out to be an issue as credit intermediaries admitted in one Member State are allowed to carry out business in all other EU Member States (the so called "passport regime") – although it is doubtful that a credit intermediary trained in French rules will be competent in a German legal environment – as the rules in each county still differ quite a lot.

This leads me to my concluding remarks. The basic question is: What is the Mortgage Credit Directive good for? Does it improve consumer protection? Yes, certainly it does although it might unnecessarily complicate access to credit. However, the legal basis for the Directive is the advancement of the EU internal market. But due to its minimum harmonization approach the Mortgage Credit Directive fails to establish the basis for a truly internal market as the national rules are still too different to facilitate cross-border lending.

Why can't the U.S. reform its housing finance sector?

By Alex J. Pollock

It is sobering to us Americans that U.S. housing finance collapsed twice in three decades: in the 1980s and again in the 2000s. This is certainly an embarrassing record.

The giant American housing finance sector, with $10 trillion in mortgage loans, is as important politically as it is financially. Many interest groups want to receive government subsidies through the housing finance system. This makes it very hard to reform.

From the 1980s to today, U.S. housing finance has been unique in the world for its overreliance on the so-called "government-sponsored enterprises," Fannie Mae and Freddie Mac. Fannie and Freddie get government guarantees for free, which are said to be only "implicit," but are entirely real. According to Fannie and Freddie in their former days of power and glory, this made American housing finance "the envy of the world." In fact, the rest of the world did not feel such envy. But Fannie and Freddie did attract investment from the rest of the world, which correctly saw them as U.S. government credit with a higher yield: in the 2000s this channeled the savings of thrifty Chinese and others into helping inflate American house prices into their amazing bubble. Fannie and Freddie became a key point of concentrated systemic vulnerability.

In 2008, Fannie and Freddie went broke. What schadenfreude my German housing finance colleagues enjoyed after years of being lectured on the superiority of the American system! Official bodies in the rest of the world pressured the U.S. Treasury to protect their investments in the obligations of the insolvent Fannie and Freddie, which the Treasury did and continues to do. The Federal Reserve in the meantime has become the world's biggest investor in Fannie and Freddie securities.

Almost eight years after their financial collapse, America is still unique in the world for centering its housing finance sector on Fannie and Freddie, even though they have equity capital that rounds to zero. They are primarily government-owned and entirely government-controlled housing finance operations, completely dependent on the taxpayers. Nobody likes this situation, but it has outlasted numerous reform efforts.

Is there a way out of this statist scheme – can we move American housing finance toward something more like a market? Is there a way to reduce the distortions caused by Fannie and Freddie, to control the hyper-leverage that inflates house prices and the excessive credit that sets up both borrowers and lenders for failure? Can we reduce of the chance of repeating the mistakes of 1980 to 2007? Here are some ideas.

Restructure Fannie and Freddie

The original 2008 government bailout of Fannie and Freddie created a senior preferred stock with a 10% dividend which the U.S. Treasury bought on behalf of the taxpayers. This was later amended to make the dividend be all their net profit. That meant there would never be any reduction of the principal, and they would be permanent wards of the state.

It is easy, however, to calculate the cash-on-cash internal rate of return [IRR] to the Treasury on its $189.5 billion investment in senior preferred stock, given the dividend payments so far of $245 billion. This represents a return of about 7% – positive, but short of the required 10%. As Fannie and Freddie keep sending cash to the Treasury, the IRR will rise, and will reach a point when total cash paid is equivalent to a 10% compound return plus repayment of the entire principal. That is what I call the "10% Moment." It provides a uniquely logical point for reform, and it is not far off, perhaps in early 2018.

At the 10% Moment, whenever it arrives, Congress should declare the senior preferred stock fully repaid and retired, as in financial substance it will have been. Simultaneously, Congress should formally designate Fannie and Freddie as Systemically Important Financial Institutions [SIFIs]. They are in fact unquestionably SIFIs, indeed Global SIFIs, which are able to put not only the entire financial system but also the finances of the U.S. government at risk. This is beyond the slightest doubt.

As soon as Fannie and Freddie are designated officially, as well as in economic fact, SIFIs, they will get the same minimum equity capital requirement as bank SIFIs: 5% of total assets. At their current size, this would require about $250 billion in equity. They must of course be regulated as undercapitalized until they aren't. Among other things, this means no dividends on any class of stock until the capital requirement is met.

As SIFIs, Fannie and Freddie will and should get the Federal Reserve as their systemic risk regulator, in addition to their housing finance regulator.

It is impossible to take away Fannie and Freddie's too-big-to-fail status, no matter what any government official may say. Therefore, they should pay the government for its ongoing credit guaranty, on the same basis as banks have to pay for deposit insurance. I recommend a fee of 0.15% of total liabilities per year.

Then Fannie and Freddie will be able to compete in mortgage finance on a level basis with other SIFIs, and swim or sink according to their competence.

Promote skin in the game for mortgage originators

A universally recognized lesson from the American housing bubble was the need for more "skin in the game" of credit risk by those involved in mortgage securitization. But lost in the discussion is the optimal point at which to apply credit risk skin in the game. This optimal point is the originator of the mortgage loan, which should have a junior credit risk position for the life of the loan. The entity making the original mortgage is in the best position to know the most about the borrower and the credit risk of the borrower. It is the most important point at which to align incentives for creating sound credits.

The Mortgage Partnership Finance [MPF] program of the Federal Home Loan Banks was and is based on this principle. (I had the pleasure of leading the creation of this program.) It finances interest rate risk in the bond market but keeps the junior credit risk with the original lender. The result is excellent credit performance of the MPF mortgage loans, including through the 2000s crisis.

I believe this credit risk principle is obvious to most of the world. Why not to the United States?

Create countercyclical LTVs

As the famous investor, Benjamin Graham, pointed out long ago, price and value are not the same: "Price is what you pay, and value is what you get." Likewise, in mortgage finance, the price of the house being financed is not the same as its value: in bubbles, prices greatly exceed the sustainable value of the house. Whenever house prices are in a boom, the ratio of the loan to the sound lendable value becomes something much bigger than the ratio of the loan to the inflated current price.

As the price of any asset, including houses, goes rapidly higher and further over its trend line, the riskiness of the future price behavior becomes greater – the probability that the price will fall continues to increase. Just when lenders and borrowers are feeling most confident because of high collateral "values" (really prices), their danger is in fact growing. Just when they are most tempted to lend and borrow more against the price of the asset, they should be lending and borrowing less.

A countercyclical LTV (loan-to-value ratio) regime reduces the maximum loan size relative to current prices, in order to keep the maximum ratio of loan size to underlying lendable value more stable. The boom would thus induce smaller LTVs, and greater down payments, in bubbly markets – thus providing an automatic dampening of the house price inflation and a financial stabilizer.

Countercyclical capital requirements for financial institutions reduce the leverage of those lending against riskier prices. The same logic applies to reducing the leverage of those who are borrowing against risky prices. We should do both.

Canada provides an interesting example of where countercyclical LTVs have actually been used; Germany uses sustainable lendable value as the same basic idea. The U.S. needs to import this approach.

Liquidate the Fed's mortgage portfolio

What is the Federal Reserve doing holding $1.7 trillion of mortgage-backed securities [MBS]? The authors of the Federal Reserve Act and generations of Fed chairmen since would have found that impossible even to imagine. This massive MBS portfolio means the Fed allocates credit to housing through its own balance sheet. Its goal was to push up house prices, as part of its general scheme to create "wealth effects." It succeeded – house prices have not only risen rapidly, but are back over their trend line on a national average basis. This means by definition that the Fed has also made houses less affordable for new buyers.

Why in 2016 is the Fed still holding all these mortgages? For one thing, it doesn't want to recognize losses if selling its vastly outsized position would drive the market against it. Some economists argue that losses of many times your capital do not matter if you are a fiat currency central bank. Perhaps or perhaps not, but they would be embarrassing and cut off the profits the Fed sends the Treasury to reduce the deficit.

Whatever justification there might have been in the wake of the collapsed housing bubble, the Fed should now get out of the business of manipulating the mortgage securities market. If it is unwilling to sell, it can simply let its mortgage portfolio run off to zero over time through maturities and prepayments. It should do so, and cease acting as the world's biggest savings and loan institution.

In sum, the collapses of the 1980s and 2000s should have taught the American government a lesson about the effects of subsidized, over-leveraged mortgage markets. They didn't. The reform of the Fannie and Freddie-centric U.S. housing finance sector has not arrived, nor is there any sign of its approach. But we need to keep working on it.

Housing finance in Latin America 2016 (first quarter)

By Ronald A. Sánchez Castro

This article offers a brief description of the most relevant facts related to housing finance in some of the countries of Latin America and the Caribbean.

In Argentina, according to information from the Institute of Statistics and Record of the Construction Industry of Argentina, unemployment increased by 6.5% during the first quarter of 2016. In addition, the Central Bank of Argentina announced a kind of mortgage credit that will have initial deposits less than those of conventional credit and which will allow families with low incomes to have access to finance for housing.

In Bolivia, the State Housing Agency reported that the Government will build 6,093 social housing units and will improve 19,200, with an investment of 934 million bolivianos, it also reported that within the Social and Economic Development Plan, the State Housing Agency has a goal to build and improve a total of 115,000 houses by 2020, of these 60% will be improved and 40% will be new housing.

In Brazil, the Brazilian Association of Real Estate Loans and Savings Companies reported that in the first quarter of the year 2016, loans for the acquisition and construction of immovable property totaled R$ 10.9 billion, 54.6% lower than the same period last year. In addition, the Caixa Economica Federal estimated a fall of 3% in new mortgage originations in the present year, a total of around R$ 87 billion, against the R$ 90 billion originated in 2015.

In Chile, the Chilean Chamber of Construction reported a 41.4% drop in the sale of houses in Greater Santiago during the first quarter of 2016, due to the number of advanced purchases that occurred in the same period of the previous year. This result translates into sales of 3,585 apartments and 1,430 houses in the first three months of the year, which compares negatively to the 6,457 apartments (-44,5%) and 2,104 houses (-32%) sold during the first quarter of 2015.

In Colombia, the Colombian Chamber of Construction reported that in January and February of this year 28,218 homes were sold. This represents an increase compared to the same period of 2015, the sales that were registered translate into an investment of 5.2 trillion Colombian pesos. In addition, it reported that sales in February were the highest in recent years.

In Ecuador, the National Finance Corporation [FNC] delivered a credit of 8 million dollars for the construction of more than 360 high priority homes in Guayaquil. The resources are part of the 220 million dollars made available to the FNC for the promotion of high priority housing; this is a type of financing by this public bank which represents real and effective measures to generate employment. On the other hand, the International Monetary Fund offered a credit for 400 million dollars without conditions to Ecuador to deal with the emergency caused by an earthquake of 7.8 degrees on the Richter scale, which happened in April 2016.

In Guatemala, the Ministry of Communications, Infrastructure and Housing announced the reactivation of the program for the construction of social housing following the announcement of an annual deficit of more than 1 million units. The budget to promote the construction of homes amounts to approximately 222 million quetzales (27.8 million dollars) invested this year by the Ministry of Communications, Infrastructure and Housing; in addition, this Ministry has committed 700 million quetzales (88 million dollars) in programs for the financing and construction of housing.

In Mexico, the President of the National Chamber of Industry Development and Promotion of Housing, Valley of Mexico stated that 70,000 homes should be built in Mexico City each year, but only 10,000 per year have been achieved, all as a result of the suspension of the standard 26 for the construction of housing in the Federal District. In addition, the Mexican Chamber of the Construction Industry estimated that this sector in the year 2016 will have growth of 2% and generate 200,000 direct jobs in the country. These private sector projects will help offset to a large extent the planned cuts in public works by Federal, State and municipal authorities this year.

In Nicaragua, the Government will earmark US$ 81.3 million for social housing, by means of the Program of Construction and Improvements of Social Housing that has national coverage and will benefit 8,692 families, producing a total of 25,000 housings. The finance will be earmarked for families with incomes between 1 to 4 minimum salaries. The construction sector of the country expects this year an injection of private investment of between US$ 300 and $500 million for the construction of shopping malls, convention centers, hotels, office buildings and housing, as reported by the President of the Nicaraguan Chamber of Construction. They also expect US$ 714 million from the public sector, mainly for the construction of roads and hospitals.

In Panama, according to the Ministry of Economy and Finance, the construction sector could achieve growth of 10.5% this year and 14% the next. In addition, the Comptroller General of the Republic reported that investment in construction for the month of January increased to 143,738,241 dollars. On the other hand, with an investment exceeding 53.8 million balboas the Government initiated the construction of aqueducts, a supply of potable water and homes in West Panama, works that will improve the quality of life for more than 250,000 people in this part of the country.

In Peru, the Ministry of Housing, Construction and Sanitation reported that the government was delivering from August, 2011 to March, 2016 more than 210,000 units of social housing nationally. This is close to the target of 240,000 set by the current government. On the other hand, the Fondo Mivivienda reported that this year that more than 100,000 bonds will be delivered so that Peruvian families can access housing. In addition, according to estimates by the Peruvian Chamber of Construction, the deficit in the supply of housing relative to the increasing demand will continue stimulating prices to rise. House prices will rise nearly 5%.

In the Dominican Republic, the Superintendence of Banks reported that during 2015 the credits granted for the purchase and renovation of houses in total amounted to RD$35,569.37 million, while the credit portfolio for this category experienced a growth of 14.19%, confirming the trend of sustained growth of mortgage credit in recent years. The National Office of Statistics and the Association of Builders and Promoters of Housing reported that in January of the year 2016, the Index of Direct Costs of Housing Construction increased by 3.10%, mainly due to the fact that every two years the National Wage Committee adjusts the salaries of most construction workers, which rose by 7.88%.

In Venezuela, the social program Great Mission Housing Venezuela completed 5 years of existence. The Government reported that up until April 26 1,016,952 dwellings were delivered, of which 60% were built by the efforts of people in their communities. It was also estimated that 3 million homes will be delivered by 2019.

Federal structures and public housing

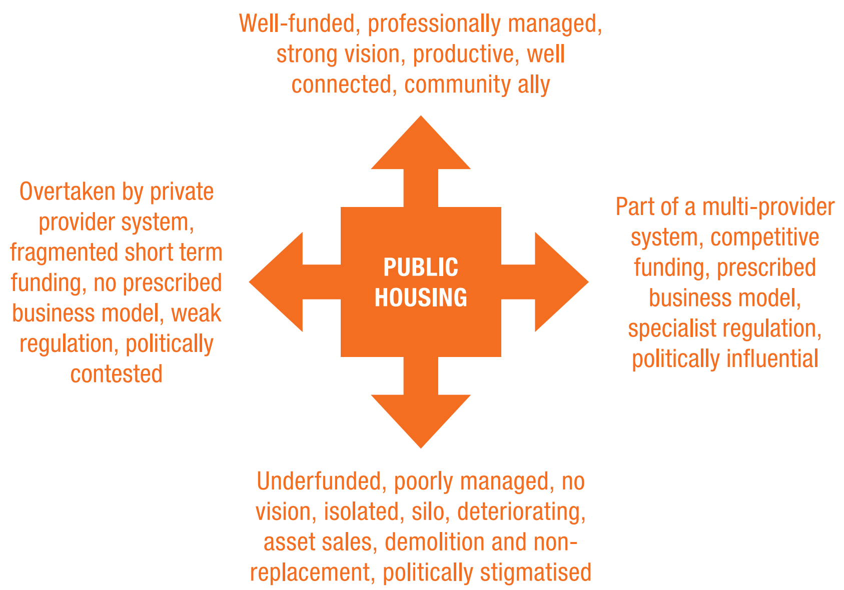
By Julie Lawson

1. Introduction

The Australian Government is reshaping federal-state relations that govern many areas of social infrastructure funding and delivery, including public housing in the name of choice, localism and competition. Public housing is typically funded nationally, engaging more local players in delivery, so devolution is likely to have a profound impact on the sector's capacity. This article examines the experience of four federal states: The United States, Canada, Germany and Austria where changes in federal arrangements transformed their public housing systems. It argues that outcomes will be greatly determined by how core competencies in public housing policy, program funding, service delivery and regulation are developed and fostered across government jurisdictions and a more diverse affordable housing industry.

2. Different pathways

There are alternative visions for systems of public housing provision and each carries profoundly different outcomes for both landlords and their tenants (Figure 1).



Source: Lawson et al, 2016

Many players are involved in public housing provision, which is increasingly part of a multi-provider social and affordable housing sector. Given the cross jurisdictional governance of publicly provided social housing, before any reform can begin, key questions need to be asked such as:

- What is the most appropriate and sustainable mechanism for transferring and tying resources to ensure that social housing systems are comprehensive, responsive, efficient and innovative?
- How can the benefits of local innovation, competition and experimentation be shared to build and strengthen more productive social housing systems across the nation?
- Under what conditions can stock transformation most effectively drive sector development and achieve social housing policy objectives?

3. International experience

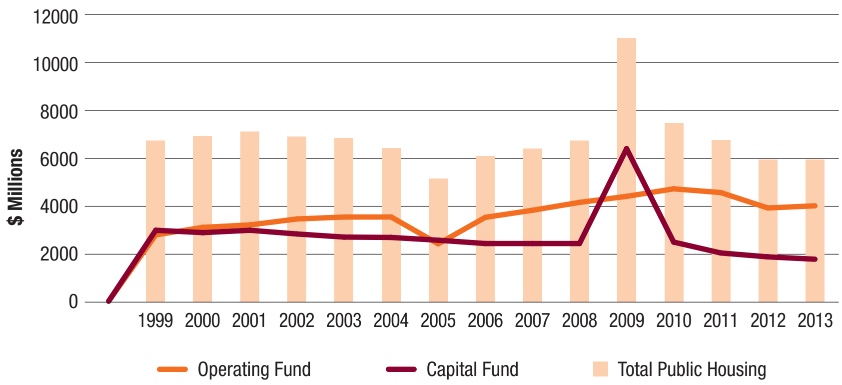
With the aim of informing Australia's own federal strategy, over the past twelve months our research team examined the pathways taken by other federal states and their impact on housing supply and allocation. With the help of national experts[1] in each country we undertook an extensive literature and policy review and in depth interviews with practitioners, examining just how this process of public housing transformation occurred in Canada, the United States, Austria and German at the national and local level. This work contributed to an ongoing study led by Professor Hal Pawson (UNSW), examining Australia's own capacity for public housing transformation.

Our international research strongly suggests that the allocation of national level resources and the guiding institutions and instruments it establishes such as dedicated funds, legislated models of provision and rent setting rules and their enforcement, play a very influential role in steering the development of the social housing sector and building the capacity of public housing systems within the broader housing market.

In the US, prescriptive regulations govern the use of public housing assets funded by Department of Housing and Urban Development [HUD] programs that are managed by almost 4,000 local housing authorities. Many public housing units were demolished in the 1990s under mixed tenure redevelopments. Recently, HUD has loosened funding requirements, enabling authorities to utilize Housing Vouchers payments as a revenue stream to attract investment and renovate housing stock. However, once out of the permanent public housing system, they are dependent on ongoing temporary Voucher agreements to remain part of the social sector.

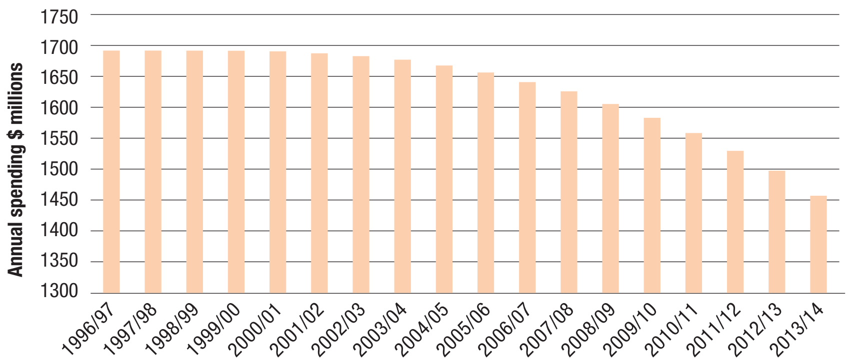
[1] Rachel Garshick-Kleit, Ohio State University, US, Greg Suttor, University of Toronto, Canada, Thomas Knorr-Siedow, Brandenburg University of Technology, Germany, Wolfgang Amann and Alexis Mundt, IIBW, Austria.

Figure 1 US Federal public housing funds – operating and capital expenditure 1999-2013



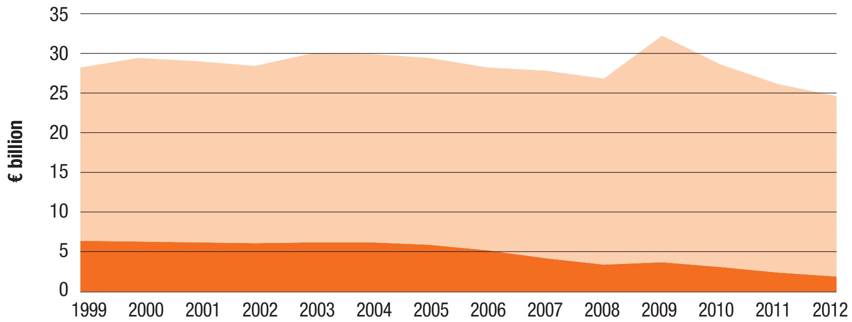
Source: McCarty, 2014 in Lawson et al, 2016

Figure 2 Annual housing expenditure Canadian government (unadjusted for inflation) 1996 to 2013



Source: Pomeroy[2], 2015

Figure 3 Share of public funding for housing and total funding in Germany from 1999-2012



Source: Figures based on figures from Public funding of the Federal Government in form of subsidies and tax incentives acc. to the 18th to 23rd public funding report of the Federal Government in Lieberknecht, 2012 German housing markets – facts, figures and structures for the CECODHAS Housing Europe Conference, 26th April 2012, Brussels, Committee of the regions.

In Canada, agreements between federal and provincial governments have transferred housing assets to lower levels of government, winding back future operating subsidies by 2040, leaving a fragmented and uneven social housing industry behind. Without a dedicated funding model covering operating costs in this rent geared to income sector, the future of public housing is uncertain. Innovation is being fostered in some states, but a stable long term funding model is still lacking.

In Germany, guided by the goal of subsidiarity, the federal government has increasingly withdrawn from the housing arena, devolving the task of supply to state and municipal governments, with variable results. A heavy burden has fallen on lower tiers of government, forcing privatizations (100% of stock in Dresden, See Box 1) and increased reliance on market rent mechanisms. In cities such as Berlin, tenant protests are large and frequent. In the absence of federal leadership, cities such as Hamburg are now forming housing alliances.

BOX 1. Results of an inquiry into business models of investors in municipal housing

Germany – the privatisation of municipal housing

The government of North Rhine-Westphalia conducted a commission of inquiry into the business models of new financial investors that acquired large public housing portfolios in this region over the last 15 years (NRW, 2012).

The study examined the impact of privatisation of municipal stock involving international financial investors in six areas in Dortmund (Stad Raum Konzept and University of Wuppertal, 2012). It found that while investors were strongly orientated towards a high rate of return, corporate strategies depended on the profitability of the portfolio. Stock was often in a poor condition upon purchase, of a standard design and many of subject to de-jure tenancies, drawing low rents. Dwellings were occupied by households with a low-income and/or reliant on welfare payments. The study found that in the six case study areas, the housing situation in areas acquired by new financial investors deteriorated over time.

For investors, low income occupancy was perceived negatively, while the tenants

[2] Data compiled by Steve Pomeroy, Focus Consulting Inc. in Pomeroy (2015) sourcing Schedule "E" to Provincial-Territorial Social Housing Agreements (as provided under an FOI request to CMHC); and CMHC Canadian Housing Statistics 1998, Table 57 (Public Funds Authorized under the National Housing Act).

viewed the new service regime as worse than the previous local or regionally based companies. While there remained caretaker (often on a much smaller scale) and/or tenant contact local offices, there were complaints from tenants about poor accessibility (call-centres, unclear responsibilities etc.), as well as delayed or temporary repairs. The municipalities considered that the reduced presence of the landlord and the absence of binding commitments for action with financial investors undermined their commitment to improve stock and co-operate with key stakeholders at a neighbourhood level. This varied by the size of their housing stock and the development history of the area.

In neighbourhoods with marked socio-economic and urban development disadvantages, such problems were exacerbated. While stable areas had greater resilience in dealing with changes, some came to be perceived at problem areas through changed investment and occupancy policies and high levels of tenant dissatisfaction.

According to the study (ibid, 2012) local strategies for dealing with the financial investors are very diverse, but of limited effectiveness. They included: institutionalized dialogue with key players, incentives and legal coercive measures to invest in the stock.

The study called for greater support via strategic municipal action at the neighbourhood level, equipped with an adequate information base to support public awareness and facilitated by a constructive exchange between the various actors, including the housing industry, and political support. It also recommended that provincial (sub regional government in NRW) and federal information and advisory services should be provided to the affected communities and that municipalities be supported to acquire housing for social purposes in tight markets. This could be complemented by planning gain instruments with real 'teeth' to help generate funds and suitable sites.

Example: The privatisation experience of Dresden

By 2006 Dresden had sold 100% of its 168,000 public housing units to a single investor: Fortress. Soon after purchase, evidence emerged of Fortresses' non-compliant management of social contracts. The municipality sued the new owners for their failure to maintain the social charter governing the allocation and rent setting of the dwellings. The city tried to reclaim €1 billion from Fortress on the basis of misconduct including illegal rent-rises. Their claim was settled in an out of court settlement in 2012. However, the German parliament has since raised the spectre of social charters breaching EU common market regulations (Droste and Knorr-Siedow, 2014:407-408).

Dresden's negative and costly experience in selling social housing to a single foreign investor and the broader difficulty experienced by municipalities in enforcing social contracts and their potential conflict with European competition law has fuelled media criticism and a public backlash.

Successful local referendums have stalled further sales of public housing in Freibourg and promoted a general shift in policy away from privatisations across Germany.

Centralist Austria has also undergone a long term process of devolution to regional governments, untying long dedicated funds for housing programs for particular tenures and income groups, but still strongly steering efforts to improve quality, ensure supply and promote environmental sustainability. Under national legislation and regulation, the limited profit sector has now overtaken public housing as the main provider of affordable (rather than social) housing.

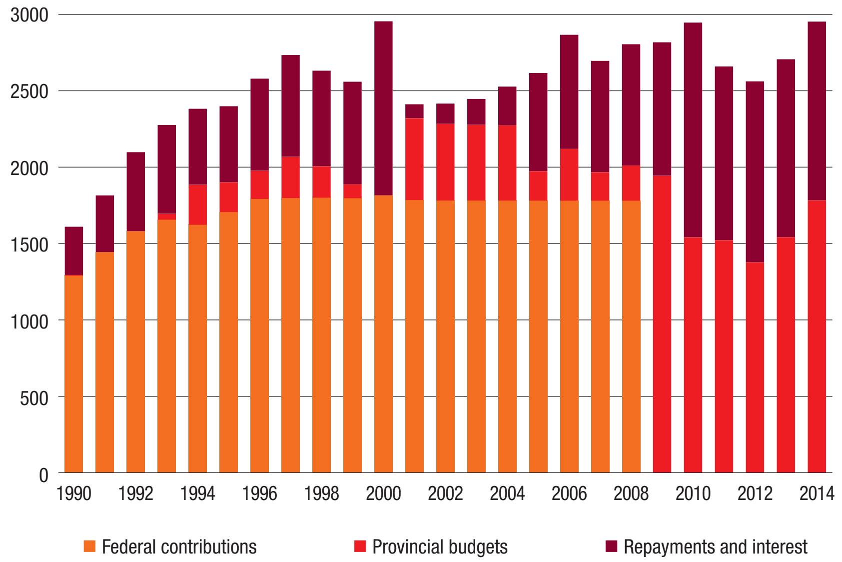
4. Local illustrations

Within each federal state there were local variations, national experts from each country guided the selection of organisational case studies which were investigated via a review of literature and key stakeholder interviews.

4.1. US – San Diego and Portland

In the United States, we examined the experience of San Diego Housing Commission [SDHC] in California and Homeforward in Portland, Oregon. For both Public Housing Authorities [PHAs], the operating and capital subsidies provided by HUD were insufficient to maintain and invest in good quality public housing. New flexibility in HUD rules had enabled them to utilize Voucher payments as a project based revenue stream to underpin private investment and renovate housing stock. This has implied a transfer of public housing units to limited liability companies for which the PHA is majority shareholder. The units are offered to households with a wider housing income range at higher maximum rents for a duration limited to the terms of the Housing Voucher contract. In 2009, the SDHC transferred 1,366 HUD regulated PH units for $1 to a limited liability company operating under the Housing Voucher private rental sector model. In doing so they exchanged PH property based operating subsidies for ongoing Housing Vouchers and used the equity and revenue stream to access private finance by issuing bonds (A+ SP rating). The inclusionary planning regime of the City of

Figure 4 Austrian public funding of housing subsidy schemes (€ millions) 1990-2014



Source: IIBW, 2015

San Diego has also delivered vital sites and equity, enabling the construction of 810 new affordable dwellings. As an entity, SDHC transformed its leadership team and re-orientated asset management strategies to be more efficient, knowledgeable and customer orientated as well as media savvy.

Portland's PHA (1941) renamed Homeforward manages an older stock of 1,345 units, including a number of high rise buildings. Traditionally it has implemented HUD programs, including public housing, HOPE VI, Housing Vouchers and LIHTC. In recent years it has also invested in critical research and innovative program development of its own and has established a reputation as trusted industry reformer. It undertook a detailed review of the impact of HUD public housing regulations on investment, rent and allocation conditions and piloted a more flexible approach to the use of these subsidies. Homeforward has inspired the development of national programs, such as the Rent Assistance Demonstration program. Homeforward's organisation has become less bureaucratic in order to move beyond program implementation and attract much needed capital investment. It created specific market rent standards for 9 districts and now comprises six LLC companies to manage LIHTC and HV funded properties. However, more would have been possible with the aid of inclusionary zoning, which after a decade of deliberation was finally approved by the City of Portland in October 2015.

4.2. Canada – Toronto and Vancouver

Turning northwards to Canada, we see public housing providers in Toronto and Vancouver being driven by bilateral devolution agreements transferring responsibility to provinces (and municipalities in Ontario). Under patchy provincial leadership and investment, the affordable housing industry has developed in a fragmented, sporadic and uneven fashion and in some provinces faces an uncertain future.

In British Columbia, BC Housing has 51,600 units but most of these are managed by one of 800 different non-profit organisations. BC is one of few provinces where housing policy has held a consistently high profile and is well integrated with other portfolios. It also invests in new rent-geared-to-income housing, constructing around 1,500 units per year. The province operates a wholesale financing scheme to raise lowest cost finance for new social housing and in 2014 launched a Non Profit Asset Transfer Scheme for organisations providing fair market rent housing under operating agreements with a range of tenant income, transforming land leases into ownership in order to facilitate investment. Over the years, the City of Vancouver has employed inclusionary zoning, contributing sites and fees towards affordable rental housing. BC Housing drives a strong environmental agenda, funding improvements through retrofitting to reduce greenhouse gasses [GHGs]. The province has moved from a directive role to more collaborative partnerships with NPOs, supporting a variety of entrepreneurial practices which help to make up for the shortfall in federal funding. However, no comprehensive 'model' has emerged. Given the limits on provincial spending BC continues to campaign for a greater federal role in housing programs.

Ontario has taken a very different approach, devolving responsibility for managing housing to the large Toronto Community Housing Corporation [TCHC] (2002) with 59,700 units in fair to poor condition. TCHC operates under a prescriptive provincial framework with 90% rent-geared-to-income housing allocated to low income households. It is financed by Canada Housing Mortgage Corporation loans, some of which are very high and fixed interest long term loans (11%). TCHC has institutionalised building condition reports and shifted resources from administration to asset management and has made efforts to improve the energy efficiency of its buildings. Fund raising on the basis of this revenue model and municipal tax base is constrained hence mixed tenure redevelopment of high land value estates such as Regent Park has been pursued. Unlike BC, Ontario does not provide wholesale financing for new social dwellings. It has co-funded an initiative which injected 30-50% capital replacement costs for 3,500 units, but this is insufficient and short term. Toronto has also joined BC in calling for a return of national governments to housing. In 2015 a Mayor's Task Force on Toronto's Community Housing Task Force was established to examine how to fund necessary capital repairs, in the absence of adequate federal and provincial funding.

4.3. Germany – Berlin and Munich

Devolution in Germany has led to the central government retaining a role in demand assistance and rent setting policy, but largely withdrawing from supply policy. Expiring conditional subsidies and cessation of federally co-funded regional programs has led to a 'melting away' of social housing stock. Like Canada, a very uneven regional response has emerged with many closing down their housing supply programs, some continuing and a few active cities taking heroic measures. Demand assistance is co-funded (Fed/State) but delivered locally and a very heavy burden has fallen on municipalities at the coal face providing support services. In the 2000s, municipalities and public savings banks experiencing financial problems undertook mass privatisations of their housing assets. New investors, being global financial institutions and domestic real estate consortia, have streamlined their portfolios, raising rents, selling marketable properties but also neglecting low rent units on social contracts. This has generated legal disputes with municipalities and broad tenant protests concerning the landlord's breach of social contract. The wave of privatisations has now passed and some buybacks by municipalities have taken place. A few larger cities such as Berlin and Munich are actively returning to a more direct role in housing to address rising housing shortages and increased housing costs.

Berlin has a very large municipal housing stock, but almost 200,000 units were sold to global investors, such as Cerberus and Goldmann Sachs, many under social contract over the two past decades. Rents in these apartments have been maximised and selected apartments sold as condominiums; yet there were few sales to sitting tenants. Initial proceeds from the sale of public dwellings (for as little as €30,000 per unit) had a minimal impact on overall public deficits. However, a very active speculative apartment market has arisen. With rapid resales, the municipality is struggling to enforce existing social contracts and replace those that are expiring. There has been no new social housing built since 2001. The City planned to return to direct supply in 2014 and has bought back some of the stock it sold, albeit at much higher prices. There is discussion of a potential return of corporatized public companies to direct government administration. However, the City's efforts have been hampered by a sluggish economy and ongoing austerity measures.

Munich, in contrast, has a strong local economy and their share of corporate tax is paid directly into the City's treasury, thus it is also less dependent on federal transfers to finance its own initiatives. With a high pressure housing and land market, the need for affordable rental housing has strong cross party political support. Munich owns 100% of its municipal housing, being 8 per cent of the city's housing stock, and did not did not pursue a privatisation agenda. Conversely, it tried to purchase the provincial social housing provider but was outbid by the large real estate fund Patrizia. Subsequently rents have risen considerably in these 8,000 flats. Patrizia offered many for sale which the City Munich purchased, but at considerable cost.

Munich also co-funds a five-year housing subsidy program. It has tailored its land use policies to support affordable housing development, for middle income housing and social housing usage (tied for 40yrs, at 75-80% below market rents). This delivers 7,000 dwellings per year, half with tied social contracts for varying income groups.

4.4. Austria – Vienna and Lower Austria

Finally, the two illustrations in Austria demonstrate how transformation under the nationally legislated limited profit cost rent model can occur. For almost six decades transferred federal housing funds were tied to regional housing programs. These funds were capped in 2008 then untied and have become submerged in the general transfer of tax revenue to the regions. Decentralisation has allowed for more variation in regional housing subsidy programs but also for a real a decline in funds for housing programs. The gap between the rising cost of constructing dwellings and the subsidies has been met by gap revolving loan repayments returning to program funds, tax privileged private investment (housing bonds) and tenant equity. There has been a marked shift in social housing construction from municipal to cost rent affordable rent (to buy) housing. Further, Limited Profit Housing Associations [LPHA] increasingly manage small municipal housing portfolios as their professional and market presence strengthens.

Wiener Wohnen [WW] however is an exception. It is the largest landlord in Europe with 216,000 dwellings and is owned by the City State of Vienna. This gives WW a strong role in Vienna's rental market, with the direct management of rental dwellings and in recent years it has focused on their renovation and energy efficiency. While construction of new dwellings has diversified via the LPHA sector, WW recently revived its ambitions to build new innovative dwellings for young starters in the housing market and supported the development of 7,275 new units in 2014. WW is nestled within a very comprehensive government approach with supportive land, planning, funding, management and social integration policies as well as responding to the needs of people who are homeless and new migrants.

Nearby Vienna, in the province of Lower Austria, is the top ranking building company Wien Süd (1910), a limited profit building co-operative with 16,000 units. With declining provincial subsidies, it is increasingly reliant on its own equity, land bank and private finance, which is partly provided via the Housing Bank with the proceeds of Housing Construction Convertible Bonds. The co-operative has institutionalised building-based tenant evaluation and like WW focused on energy efficient building techniques and management practices. The cooperative has had to adapt to changing subsidy levels and directions and now delivers the non-profit construction of neighbourhood-related social infrastructure. It is also internationally active in Germany and Eastern Europe, promoting not for profit approaches to building housing. Closer to home it has been contracted to manage smaller municipal housing companies, yet there are often hidden challenges in this task. Overall, the LPHA sector has strong cross party support but opposition is rising from far right populist parties who fear 'migrant friendly' organisations.

5. Implications

Like Australia, federal governments such as Germany, Canada and Austria are undergoing a process of devolution; decentralising responsibilities for public housing to lower tiers of government. Their experience strongly suggests that the budgetary transfers, designed to cover the shortfall in operational and capital costs of a narrowly targeted and aging portfolio, are often poorly defined early on and quickly prove inadequate. Consequently, lower levels of government are either forced to rely on their narrow local tax base or withdraw from direct provision, stalling investment and in the case of Germany generating mass privatisations. This transformation has given rise to several unintended consequences, including the rapid rent increases (Hamburg and Berlin), a boom in speculative rental investment in sold dwellings (Berlin) and even the buy-back of once public dwellings in wealthier cities such as Munich.

At the regional level, some governments have used their own resources and recycled future loan repayments to support demand-driven supply programs as in Austria, where grants and long term loans are available to providers in order to maintain stable construction markets, improve quality and grow affordable rental housing in line with demand. However, when long established tied transfers are loosened, the majority of regions (outside Vienna) diverted once dedicated housing resources to more politically expedient ones (such as flood mitigation and road upgrading), a similar experience was found in Canada and Germany.

To make up for shortfalls in public investment, some governments have designed better structures to package and lever their housing assets, forming limited liability and joint stock companies to raise funds and protect public accounts (US and Austria). Social policy outcomes (allocations and rents) can be sustained where social contracts governing transferred stock are robust and ideally long term, as in the US and Austria, but this is resource intensive and fallible, as found in Germany.

However, it is at the national level that the big drivers of private investment are ultimately sustained and promoted most comprehensively. In the US and Austria, special purpose financial instruments such as Housing Construction Convertible Bonds and Low Income Housing Tax Credits successfully channel private finance towards *affordable* rental housing, including most recently to US *public* housing when differently structured with deep demand assistance payments.

Public funding shortfalls have not only necessitated greater reliance on private investment but also shifted rents upwards from social to affordable. Indeed, Austria has shifted most production towards limited profit affordable rental and shared ownership housing. This well-regulated and professional sector is now so successful that municipalities outsource their housing management to them. In the US, the over-subscribed Rent Assistance Demonstration program has the potential to shift more public units out of the sector faster than any previous program. Germany's harsh experience of municipal housing privatisation underscores the importance of sustainable social contracts involving third sector players and re-asserted the value of municipal housing companies in direct public ownership and management.

Findings from Austria demonstrate the importance of ongoing but competitive capital loans and grants and a sophisticated legislative and regulatory framework underpinning a sustainable social business model. Notable is breadth of tenant base, cost rent basis of rent setting and generous provision (made by tenants) for refurbishment and equity (which in turn provides for later purchase). Affordability and supply is ensured by the use of deep but conditional subsidies, promoting contemporary energy and carbon emission goals. With rising construction costs, there has also been a growth in demand side assistance (covering both rent and equity payments), which is now provided by most but not all, provincial governments in Austria.

6. Capacity to deliver in a federal system

In the broadest sense, the capacity to deliver public housing involves much more than funding and resources and includes organisational, specialist knowledge and skills, as well as networking and political capacity (Glickman and Servon,1998). Using this comprehensive definition as a guide, selected international efforts addressing these capacity needs were summarised as follows:

DIMENSIONS OF CAPACITY BUILDING AND WHAT THEY COVER	GOVERNMENT STRATEGIES INFLUENCING INDUSTRY CAPACITY
Resource capacity: fairer and appropriate budget transfers, long term funding agreements, reasonable borrowing limits, positive lending environment.	■ Evaluation of the capital and operating resources required to deliver social housing within an agreed rent and allocation regime (Austria, legislated for in US, though not fully adhered to) ■ Medium to long term resource sharing agreements covering operating and capital costs (Canada, though poorly). ■ Ability of providers to access subsidies, build up equity and surpluses, which in turn can be used to harness private investment (Austria, US) ■ Facilitates a competitive long term lending market to attract lowest cost longest term private investment (Austria, US).
Organisational capacity: commitment to a clear vision, well defined roles, effective leadership, client driven, professional.	■ Clear definition of market role and business model of affordable housing providers (Austria, US) ■ Legislation defining conditional use of housing subsidies, incentivised by tax regime governing housing providers (Austria) ■ Modernisation of traditional public management to become more client focused and build appropriate links with partners (US, Austria, Canada) ■ Competitive dynamic promoting professionalization, productivity and social mission (subsidy competitions Vienna, Austria).
Programmatic capacity: ability to plan long term and steer strategic actions to achieve desired housing outcomes	■ Mechanisms to drive new production and ensure quality improvements (reinvestment requirements, Austria) ■ Specific programs to address long term agendas (Energy efficiency and carbon emission goals, Austria, movement to opportunity and rent assistance demonstration, US) ■ Planning mechanisms to improve access to building sites and generate local funds (Germany, some cities in US, Austria)
Networking capacity: integrating not isolating, effective inter-governmental relationships, working with partner providers, community ally not an island	■ Recognition that social housing is not an island, breaking down silos and forming appropriate partnerships (US, Canada) ■ Strong professional body (government requires membership) which audits members, shares technical innovations (Austria). ■ Requires sector to compete for available subsidies and for larger developments collaborate with multiple partners (Austria) ■ Expectation that large providers integrate space, social services and facilities in their developments, but not necessary provide them (Austria)
Political capacity: framing of the problem, linking more influential agendas, forming constructive alliances, sophisticated relations with private sector, able to influence public discussion via appropriate communication channels.	■ Link social housing to broader economic and environmental agendas beyond welfare (Austria, Germany) ■ Institutionalise multi-stakeholder evaluation, client focused (Vienna) ■ Establish housing alliances, involving all stakeholders in more collaborative forms of governance (Germany alliances, US local charters) ■ Establish feasible and enforceable social charters governing privatised housing stock (Germany) ■ Educate the media and take a more proactive role in defending affordable housing (US)

7. Key findings

In conclusion, the allocation of federal resources and the institutions national governments establish to drive housing system reform, such as conditional programs, legislation and regulation, have a vital impact on the orientation and capacity of social housing systems operating within the broader housing market. Our research on the experience of four federal states in transforming their public housing has the following findings:

1. The allocation of national level resources and the associated establishment of institutions, including dedicated funds, legislated models of provision and their regulation, play a very influential role steering the scale and nature of social housing development. Their long term stability is also crucial in attracting private investment on a scale that is required to address needs.

2. Deteriorating quality and supply of public housing assets has been a long term trend in the US, Canadian and German cases, and is clearly an outcome of declining public investment from federal transfers, short term operating agreements and increased targeting to very low income and high needs households.

3. Federal governments such as Germany and Canada are undergoing a process of devolution, decentralising responsibilities for social housing to lower tiers of government without making dedicated transfers for their operational and capital needs and this is having negative and unintended consequences on supply and affordability outcomes.

4. Despite the rhetoric of localism and subsidiarity, comprehensiveness of public housing provision has been severely challenged by devolution. When long established tied federal transfers are loosened, the majority of regions divert resources away from housing programs (Canada, Germany and Austria).

5. Much progress has been made in the US and Austria towards channeling private investment and tax credits towards the not-for-profit and private sector, but this has tended to bypass public housing organisations and access often requires their privatisation.

6. Active asset management requires both fine grained attentiveness to building occupancy and the application of cost standards across the stock. Sustainable asset management requires adequate build up and expenditure of

funds maintaining, refurbishing and eventually replacing public housing, to ensure that assets remain appropriate and in good quality for the long term (Austria, US).

7. To make up for shortfalls in public investment, some providers have designed better structures to package and lever their housing assets and revenue streams and raise private investment in order to reduce reliance on public funds, but this tends to result in less affordable rents (US, Austria, Canada).

8. A national level legislative framework outlining the business model for not for profit housing provision, establishing cost rent setting rules and delineating conditions for the use of direct and indirect subsidies consolidates good business practices, ensures contestability and transparency in the allocation and use of subsidies, promotes efficiency and facilitates private investment to grow supply (Austria).

These findings and much more can been found in the peer reviewed Final Report available online from AHURI.

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Funding affordable housing; a rapid and concise review

↳ By Peter Williams and Michael Oxley

1. Introduction

It is very evident that the ways different countries seek to address the need for affordable housing are hugely varied around the world ranging from largely non-existent, through safety net type approaches to major interventions aimed at balancing out market provision. In part, this spectrum turns on the balance in different societies between the role of the state and the market in housing provision and the approach to patterns of inequality. Some countries focus their housing interventions via economic subsidies through the tax system while others offer direct provision supported by specific housing subsidies. Many countries offer combinations of the two. In this article Peter Williams and Michael Oxley discuss the general issue of affordable housing provision before then briefly focussing on the current picture in England where provision is undergoing radical change. This is also true in other countries where the effects of the global financial crisis and its aftermath are still being felt in terms of budget cuts and where it is often the case that it is housing expenditure that has borne the brunt of the retrenchment (CECODHAS, 2009&2013). This article draws on a presentation and discussion at the Housing Finance Corporation's Cambridge symposium held in mid-2015[1] and in the context of other presentations on France, Germany, the Netherlands and the USA.

2. What's in a name; affordable housing

The use of the term affordable housing has become a confusing shorthand for an array of activity which typically involves some kind of state subsidy aimed at ensuring it is affordable to those who cannot pay full market costs (see Li, 2014 for a useful review). In England it is now the government's preferred term for describing what might have previously been called 'council housing' or more recently 'social housing'. The term is now used to refer both to homes for rent and for ownership and the term affordable has been given a specific meaning because it has been adopted by the government to refer to a reduced subsidy stream to fund homes to let at 80% of market rents in contrast to the deeper social housing subsidy at 40% of market rents. Of course this prompts the inevitable question – affordable to whom? However, simply applying the label is often enough to divert media attention away from the underlying reality.

In many European countries (especially Germany and France) the boundary between social/affordable housing and market sector housing is becoming increasingly blurred (Haffner et al 2009). Private landlords in many countries, for example France, have been incentivised to provide housing for lower income households through the use of tax breaks that are conditional on rent limits and income thresholds for tenants (Oxley et al 2011). This means that internationally the definition and ownership of affordable housing as well as the financing is far from straightforward.

What is evident in the UK and elsewhere is the failure to maintain 'cost renting' as a viable tenure (Kemeny, 1981; Murie and Williams, 2015). As the name suggests cost renting was seen a method of building up a stock of rental housing which over time would become self-supporting. Rents would rise in line with costs but as historic debt was paid down so the provider had a pool of assets which could be borrowed against to support upgrading and more building. Cost renting was established in the UK, Scandinavia, Australia and elsewhere but by and large it has been overtaken by events. Governments have required sales, drawn down on surpluses and insisted on higher rents. Of course there were many unresolved issues around cost renting, for example, who was eligible for the homes and the large subsidy being enjoyed by long established residents who may no longer be in need of subsidised housing. It was almost inevitable that cost renting would become more politically exposed as time went on (ibid) and in essence it is now largely forgotten.

Another debate that has shifted over the years is the question of property versus people subsidy, i.e. the mechanism through which homes are rendered affordable (however defined). Some countries have favoured subsidies into the property (Australia and historically the UK) while others have focussed on subsidies being attached to the individual household (USA) and many combine both (as in the UK at present). Questions arise as to the financial efficiency and effectiveness of each route.

What is quite clear is that there has been no final resolution of these issues. Affordable housing has become a policy battleground as many countries seek to respond to the very evident housing pressures that exist post the GFC. As this article will show the debates and policies continue to evolve.

3. Overview

A number of recent reviews have been undertaken on the funding of affordable housing (Williams et al, 2012; LGA, 2013; Priemus and Whitehead, 2014; UNECE, 2015, European Parliament, 2013; Eurocities, 2013; Lawson et al, 2010; Northern Ireland Assembly, 2010; see also Whitehead, 2003 in this journal). In 2013 the Joseph Rowntree Foundation published its report on Innovative financing for affordable housing, looked at developments in a number of countries (Gibb et al, 2013) and made the following observations as to the underlying trends in this market segment;

- There had been a shift upmarket to shallower subsidy and to affordable rather than social

[1] The Cambridge Housing Finance Symposium, 20–22 July 2015, Downing College, Cambridge sponsored by the Housing Finance Corporation.

housing – higher rents and more limited security of tenure were part of that.

- There was more use of state-backed guarantees, and competition among providers had intensified, requiring the sweating of existing housing assets and the encouragement of finding alternative sources of provider income.

- Policy was about creating opportunities to 'blend' different subsidies creatively and encourage co-operation among providers.

Longer term, it was evident fundamental market failures such as in the land and credit markets still needed addressing, and funding programmes for social housing needed prioritising if rising housing need was to be met.

Overall there was still a need for affordable housing to be part of a clear, overarching policy vision identifying the overall mix of policies, including how they are to be delivered and by whom.

Looking specifically at the UK we have seen funding models evolve from the 'traditional' grant based approaches through to cross subsidy structures, sales and leaseback arrangements, tax increment financing, prudential borrowing by local authorities for on lending, local asset backed vehicles alongside full market debt and bond finance, albeit underpinned by regulation and implicit government guarantees. Most recently the government has provided equity in the form of land and other support and widespread use of guarantees which can bring the cost of funds down sharply.

Most of these different structures will resonate in other countries. Indeed, looking elsewhere, we have a huge array of models with for example China and Hong Kong also using public land sales as a way of raising finance. In Spain some affordable housing is provided through what is called **officially protected housing [VPO]** built almost entirely for owner-occupation with a small proportion offered for rent. There are a mix of subsidies via cheap land, tax deductions and controls on use for 20 years. Germany too has a subsidised time-limited affordable housing structure. In France we have the Livret A savings scheme through which short term savings are transformed into long term loans for social housing while in Singapore the compulsory employee's social security system includes a housing savings fund through which households can build up the capacity to buy homes. Switzerland has a cooperative housing bond alongside discounted land and a federal mortgage guarantee. Loan guarantees are also in use in the Netherlands (see Lawson et al, 2014 for a useful review) while Austria has housing construction convertible bonds – a protected housing finance circuit with tax-incentivised bonds specifically for affordable housing. The US low income tax credit regime has attracted attention in the UK and Australia but only the latter has adopted it (see O'Brien, 2014, Oxley, 2015) via the National Rental Affordability scheme (NRAS) though that has now been reduced (Milligan et al, 2015).

It is not appropriate here to track through the details of each of these schemes. Some countries rely fully on public funds and support even though this might not be grant, whereas others rely on the market with government creating incentives for particular activities or investment. The pattern is impacted by the maturity of the social housing/affordable housing sector in that country (and thus its reliance on public funds or the ability to raise finance against existing assets), the government's own stance on issues around equality and social justice and on conditions in the mortgage market which ease or hinder the raising of commercial finance. Within all of this the issue of rents and rent determination looms large as does the existence of demand side welfare support to individual households. The level of the rent, how it increases over time and how rent paying capacity is supported is key to the question of the capacity of such a stock of homes to support borrowing from the finance market.

Similarly, while the stance of national governments varies enormously, so too does the position of municipalities which may often have considerable housing powers and financial capacity (although of course typically underwritten by central government). Some offer direct funding and others use their control over land as a key intervention in the creation of affordable housing.

What is evident in this rapid review is that there is no single model for the creation and operation of affordable housing or indeed a single successful model which all might try and emulate. The wider social and economic contexts and the historical evolution of housing and the housing market all play a central role in what is provided and how. Most countries do focus on supply side assistance but it is evident there are a number where housing allowances supporting the rental stream also play a key role.

4. And the outcome; who is housed and by whom?

Much turns on the overall policy ambition – is this a universal right to affordable housing or a targeted intervention, a safety net, for those who fall out of the mainstream market? Typically, there are income ceilings in place defining who can/can't get affordable housing though this still leaves open the question of changes in income post take up of the tenancy. In some countries, notably Austria, France and Germany, the ceiling is set quite high in order to encourage an income mix whereas in others, e.g., Italy it is set quite low. In the EU competition law also places limits on what can be achieved (Konig, 2015). Other criteria come in around housing conditions, homelessness and overcrowding. In terms of who provides the homes the spectrum is wide ranging from local authorities, public companies, non-profit/limited profit organisations whether in the public or private sectors, cooperatives and in some cases for-profit providers. Over time we can see a general loosening and decentralisation of responsibilities with public stakeholders stepping further back and central government passing responsibility to regional and local bodies (See article by Julie Lawson in this issue of HFI). Private and not for profit organisations are now much more commonly involved, backed by government subsidies, public sector regulation and programming. As this suggests it is now much more common for there to be multiple stakeholders with local authorities working with the private sector and mixing roles with respect to existing and new stock.

5. Some initial conclusions

It is quite clear from this rapid review that there is no given relationship between society and social /affordable housing. There are a complex set of interactions around this and there is no single outcome. There is evidence of a major shift over time since the immediate post-war reconstruction phase to where we are now with much more complex models in place and a more active investor appetite to support this type of housing. The mobilisation of private sector capacity and a better understanding of how governments can most effectively intervene has helped shift the basis of intervention around affordable housing –from grants to loans to guarantees – although whether these prove to be sustainable in the long term we must wait to see. It is clear that the historic debate about the efficacy of provision via property or people-based subsidy has not gone away, not least because of the post GFC erosion of the favoured people-based subsidy capacity.

This suggests that as society and economies evolve so does the provision and scale of social and affordable housing. As a generality in many countries we have seen the sustained rise in the number of households owning or buying their own homes. This is partly about rising affluence but it is also about the easing of access to mortgage credit. Equally as other asset classes have weakened there has been some renewed interest in investing in residential real estate both by individuals and companies. Social and affordable housing has in some sense been squeezed by these two trends along with the general tightening of public expenditure on which it relies in some countries. The upshot has been a general weakening in the provision of social and affordable housing, raising the question: how big should such a sector be?

Clearly there is no given figure – how much and what is needed will depend on a number of factors, e.g. trends in income and housing costs, public expenditure priorities and political control and these will vary over time. As indicated earlier some countries have an ideological commitment to social and affordable housing and work to maintain a high level of provision not least so that the sector is not 'residualised', occupied only by the very poorest. Much turns on how active government is in maintaining overall housing supply and managing the housing market (and finance market) to ensure a sensible balance between supply and demand and with an eye on housing costs and affordability. Governments do not find this very easy as is evident by the price and rent volatility that is a feature of so many markets.

6. Illustrating the tensions; affordable housing in England

In 1976 over 30% of the homes in England were owned by local authorities or housing associations (4.985 million and 281,000 respectively). In 2014, that percentage stood at 17.1% (1.669 million and 2.343 million respectively) a remarkable change in the space of 38 years. Local authorities in 1975 were building over 100,000 homes a year. In 2014 it was just 2,630 while in 1975 housing associations were starting 18,768 and in 2014 it was higher at 22,900 but still a long way short of what is required. Home ownership peaked in 2002 at 70% and in 2014 it was 63% while private renting declined to 9% in 1991 but reached 20% in 2014. These dramatic shifts in the role of individual tenures and providers gives some sense of how the landscape has changed in England and indeed is continuing to change.

Since the election of the Conservative Government in 2015 the government has refocussed housing policy around two key objectives – increasing supply and increasing home ownership. Almost all of the support being directed at affordable housing is now focussed upon a range of home ownership initiatives – 200,000 new build 'starter homes' (20% discount from the market price), 135,000 new shared ownership homes (part rent, part buy), £12 billion of support for equity loans (20% outside of London, 40% in London, an extension of the Right to Buy to 1.3 million housing association tenants. There are now 15 different schemes on the government's **Own Your Home** website. The obverse of this are moves by the government to reduce the role of social housing through local authorities and housing associations via a number of mechanisms including the extension of the right to buy to housing association tenants, requiring local authorities to sell high value council housing, introducing 'pay to stay' to force 'higher income tenants to pay market rents for their council housing, removing the security of tenure for all local authority (council) tenants and removing the requirement for new housing developments to include a proportion of social or affordable rent dwellings. If this in itself was not enough, social landlords have to reduce their rents by 1% per annum for the next 4 years.

Much of the detail of this new programme is still being debated and finalised but this work will be completed shortly and although government has made some concessions the basic thrust of this continues (see Wilcox, 2016). What we are witnessing is a total reworking of the social housing sector, indeed Wilcox argues 'it will push the social rented sector into a more clearly residual and marginal role' a very different position to what it was in 1976! Though the focus is on reducing, or even removing, the role of local authorities in the direct provision of rented homes it is also clear that the government is now bearing down on housing associations who have been the preferred provider from the 1980s onwards. Somewhat bizarrely this sector got caught up in a definitional issue around what is counted as public expenditure by the Office of National Statistics [ONS], an independent body that oversees the national accounts. This resulted in housing associations being reclassified as public sector bodies and their borrowing counting as public expenditure. The government moved immediately to have them reclassified as private by undertaking a number of deregulatory measures removing legislation that had led to the reclassification. The upshot of this is that housing associations into the future will operate with greater freedoms and that in turn will impact upon business plans and mission.

As housing associations adapt to a world of lower direct public support, some are using their freedom to develop housing for the market (for rental or purchase) to effectively "cross-subsidise" provision of affordable housing. This transfer of surpluses from commercial to sub-market activities is typically facilitated by arrangements which allow for a separation of these activities within an overarching group structure.

As this discussion suggests the 'affordable housing sector in England is undergoing further transformation with moves that might end local authority rented housing and a reprioritisation in the housing association sector towards more home ownership, less social renting and more market renting and on the back of much reduced grant, greater imperatives to cross subsidy and possibly higher priced borrowing as funders are less protected by government regulation. Taken together with welfare cuts which are eroding the capacity of tenants to pay rents –whether social, affordable or market, it is possible to foresee a much reduced and residualised social rented sector, an expanded 'affordable' rented sector and a growing market rent sector (despite government efforts to impede its expansion) alongside at best a static albeit still dominant home ownership sector (although renting in total might edge towards 50%).

The England case study highlights the reality that even embedded forms of provision can change dramatically over the space of 30 or 40 years and that this change is not simply a product of limited resources or the consequences of the global financial crisis. It is also about ideologically driven choices and the right opportunity to deliver long preferred outcomes. There is no absolute certainty this will be the outcome as governments come and go. However, there is a sense that old certainties will no longer be as well supported as they were in the past and that all governments of whatever persuasion will need to march more loudly to the drum of home ownership in the future, even if only to help this tenure to hold its current position albeit underwritten by substantial state finance.

7. Overall conclusions

This article has sought to explore the funding of affordable housing, howsoever defined. It is evident from around the world that affordable housing, though so often a key watchword for any government, means very different things in different places. Moreover, the models used to fund such housing are hugely varied as are the outcomes achieved.

In general, and despite the widespread moves to diminish social and affordable housing, the scale of need for this type of provision has increased. However, we have seen reduced funding for affordable housing and subsequent contractions in public spending as countries seek to manage out the consequences of the GFC. Certainly in the short term this type of provision was boosted in the GFC as a means of rapidly generating economic activity. However, in the aftermath contraction seems to be more the order of the day and along with that a new focus on cost efficiency, the use of guarantees as distinct from grant and a predisposition to bring in new sources of finance from the private sector – mainly in the form of pension funds.

In their valuable review of the situation in the European Union, Pittini and colleagues (2015) discussed how different housing finance systems for social housing coped with the downturn. They concluded that in countries such as Ireland, Italy, Spain and Portugal where funding was via a combination of banking finance and state aid the outcome was the least favourable. Banks withdrew from funding and state support was cut. By contrast models based on long term, regulated financing mechanisms such as dedicated savings accounts or real estate bonds and with diversified state aid, as found in countries such as Denmark, Austria and France, coped rather better. They highlighted the countercyclical role that investment in social and affordable housing played – a factor that was recognised in many countries around the world but rather rapidly put aside in subsequent years.

There is clearly no given role for social and affordable housing and no given funding model. Moreover, we have seen that most of the models in use have their own strengths and weaknesses. England provides a good example of what might be seen to have been an embedded form of provision through local authorities and central government support that has been consciously eroded and its future is now under question. There is a sense that what we are seeing is a withdrawal by the state from direct provision and an erosion of public sector provision. If there is any emerging model it would seem to be more about institutional investment in affordable housing, perhaps supported and assisted by focussed state support whether in the form of loans or guarantees plus of course via taxation. How far such a model will stand the test of time and economic cycles is less clear. The boundaries between publicly supported markets and the private market have been shifting. This reflects the ways finance markets have developed over time and of course well publicised challenges under State Aid rules. What it suggests is that the state takes on an enabling role by still providing funding but that affordable housing is delivered via the private market rather than as a counter to it.

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Exploring institutional investment in social rental housing in the United Kingdom, the Netherlands and France

↳ By Marietta Haffner, Joris Hoekstra, Connie Tang and Michael Oxley[1]

1. Introduction

Prior to the 2008 Global Financial Crisis [GFC], the 'traditional' source of private finance for social landlords in the United Kingdom [UK] was bank loans to supplement decreasing government grants (Williams & Whitehead, 2015). Subsequently, banks in the UK, and elsewhere, were less able to lend cheaply or for long periods particularly after the new Basel III regulation forced them to hold extra capital for long-term debts (Milligan et al., 2013). As a result, social landlords have sought alternative sources of private finance. On the other hand, UK institutional investors have started to take an interest in social rented housing, finding the investment profile of potentially long-term, index-linked income an attractive proposition to match against their annuity/pension liabilities. The value of institutional investment in social rental housing has been expanded in the UK but not so much in other European countries. To understand why, this paper aims to uncover a) the reasons why social landlords need institutional investment; b) the reasons for institutional investors to invest in social housing; and c) the policies and barriers associated with institutional investment in social housing. It first examines the situation in the UK, then in the Netherlands and France. The paper also considers whether governments in the three countries have explicit policies or intentions aimed at achieving a bigger involvement of institutional investors in the social rental market.

2. What is social rental housing and who are the social housing providers and institutional investors?

Social rental housing and social landlords have different meanings in different European countries. In general, a social landlord is a public body or a non-profit organisation which is obliged to perform a public task: to provide social housing (Oxley, 1995; Haffner et al., 2009, 2010). However, in Germany and the UK, for example, private landlords are also involved in the provision of social housing (see also, Oxley et al., 2010); therefore, a broader definition of social renting would be helpful, such as the one used by Harloe (1988). He introduces affordable rents, administrative allocation according to a socially desired level and a political (governance) framework. The primary purpose of social renting is therefore to meet housing needs (see also Maclennan & More 1997). Haffner et al. (2009, 2010) argue that in theory, there is only one defining characteristic of social housing: allocation according to needs rather than according to market conditions (demand and supply). In this view, certain dwellings are set apart and are allocated according to administratively defined needs. This treatment is not only reserved for rental dwellings for low-income households. An official definition states that "Affordable housing is social rented, affordable rented and intermediate housing, provided to eligible households whose needs are not met by the market. Eligibility is determined with regard to local incomes and local house prices" (UK Government, 2016).

In the UK, social housing is principally low-rent housing for people on low incomes. There are approximately four million social housing units in the UK, which equates to about 18% of total housing stock. These are split between 2.4 million units with registered providers (housing associations (HAs) or private developers using government grants: 10% of total housing stock) and 1.7 million units that are retained by local authorities (8% of total stock). Almost half (46%) of HAs' units were once in local authority ownership. Social rental housing includes so called "affordable rental housing" which may have rents of up to 80% of market levels but is still allocated according to social allocation criteria (see for example Housing Solutions, 2016). Much of the rent in the social rented sector, 62%, is paid by the state in the form of housing benefit (British Property Federation, 2013).

In France, dwellings with a rent level well below market rent are owned by non-profit social housing providers called *Habitations à Loyer Modéré* [HLMs]. However, these dwellings are generally not a candidate for institutional investment, since HLMs have a long-term commitment to build and manage social rental housing under specific rules in which there is hardly any place for such investment. First of all, sales of HLM-dwellings to institutional investors are not allowed. Second, French social rental landlords are financially supported through a specific system in which tax free household savings (accumulated in any bank) are used to provide loans to landlords which build social rental housing. This system is coordinated by a financial institution devoted to the public interest called *Caisse des Dépôts*. Recent information (July 2014) shows that the European Investment Bank (EIB) has signed a partnership agreement with the *Caisse des Dépôts*. Since institutional investors may buy securities from the EIB, this partnership agreement may lead to some form of (very) indirect institutional investment in the French social rental sector. However, until now, the importance of this still seems to be very marginal. Therefore, the focus here is on the so-called intermediate rental sector which offers rents that are 'in-between' social rents and market rents and which are subsidised. Suppliers

[1] The research entitled Prospects for Institutional Investment in Social Housing (2015) was commissioned by the Investment Property Forum (IPF) Research Programme 2011-2015. The full study examined the institutional investors' appetite for investment in social housing as well as social housing providers' appetite for new sources of finance. More information about the study findings can be found in the main report on which this article draws (Oxley et al., 2015). The research team gratefully acknowledges the generous assistance and valuable information provided by persons who were interviewed or who participated in the round table discussion.

can be the HLMs, but also institutional investors or individual households. The selection criterion applied therefore is administrative allocation, as income limits are relevant, although these limits are higher than in the social sector.

For the Netherlands, the allocation criterion also targets the social housing providers which we will call social landlords. They are non-profit organisations with a public role. They own about 30% of the housing stock (Haffner et al., 2009). Most of this stock has a rent that is regulated by the government. This stock is considered here as social rental stock.

In contrast to the definition of social renting, there is a general agreement across countries about who are institutional investors. They are often large organisations (such as finance companies, insurance companies, labour union funds, mutual funds or unit trusts, and pension funds) which have considerable cash reserves that need to be invested. These organisations may operate in groups or in an umbrella type of organisation to use scale advantages. Institutional investment may take two main forms: equity investment (e.g. joint ventures, sale and leaseback agreements) and debt finance (loan or bond finance) (Pawson & Milligan, 2013). The latter involves no sharing or transfer of ownership, while the former may be seen as similar to direct property investment, even though the actual ownership may be in hands of intermediaries.

3. Our study

It is important to notice that our study was based on a series of semi-structured telephone interviews conducted between July and September 2014. In the UK, the Finance Director/Head of Corporate Finance of nine housing associations (HAs) and 11 institutional investors were interviewed. With the housing associations we talked about their funding needs and explored what they thought about attracting institutional investment. With the institutional investors, we talked about their experience with, and interest in, investing in the social rental sector. The HA interviewees represented a range by both scale of stock and location across the UK. The investor interviewees included consultants that facilitated investments for clients and fund managers from life insurance and pension funds in both the public and private sectors. Respondents were selected to obtain a breadth of views amongst "equity type" property investors and those with a bond only focus. These interviews aimed to identify the key characteristics of the existing financial models that are used as well as barriers to investment in the sector.

Similarly, in France four social housing and institutional investment professionals or experts were contacted. In the Netherlands, six experts were interviewed, three of which were employed by private sector institutional investors, and three others represented social housing sector institutions. The aim was to identify the main factors (e.g. government policies, specific financial models) that help to attract institutional investment into social housing.

4. Institutional investment in the UK

4.1. Policy and crisis context

Prior to the 2008 GFC, the 'traditional' source of funding for HAs was a mixture of government grants from the Homes and Communities Agency [HCA] and bank debt to allow the sustainability of low-cost housing construction. Since 2008/2009, the HCA grant has been significantly reduced. The proportion of HCA grants in HA gross investment expenditure was around 40% throughout the period from 2008/2009 to 2011/2012 (Pawson & Wilcox, 2013; Williams & Whitehead, 2015). The October 2010 Spending Review announced that between 2011 and 2015, the HCA invested £4.5 billion in affordable housing through the Affordable Homes Programme (down from £8.4 billion over the period of the previous Spending Review; HCA, 2011 and Wilson & Bate, 2015). Despite that, the amount of public funding available for the construction of new social homes was been cut by 60% as a result of the Coalition Government's austerity agenda (see also Allen, 2014). With regard to bank debt, HAs have traditionally been able to borrow long term at very low margins from banks. As of March 2014, 78% of the HA sector's debt was attributable to bank loans, reflecting the historical significance of bank finance to the sector (Moody's, 2014). However, since the GFC, banks have no longer been able to lend cheaply or for long periods, now typically set at five years (rather than the traditionally offered 20 years). Because of the reduced bank lending, HAs have begun to shift towards capital market bond financing. For example, capital market funding, including private placements, contributed 30% of all new lending between July and September 2015 (HCA, 2015).

4.2. Institutional investment

Multiple attempts have been made by successive governments to stimulate investment from institutional investors (insurance companies and pension funds) in the residential sector. Notable government measures include the 1988 Business Expansion Scheme, the Housing Investment Trust Scheme (Crook et al., 1998; Crook and Kemp, 2002), Real Estate Investment Trusts and more recently the Build to Rent Fund (Alakeson et al., 2013). Despite these efforts, the scale of institutional investment in the residential market is very small. The 2014 Investment Property Forum's (IPF, 2014) survey of institutional investors' attitudes regarding residential real estate investment in the UK showed that only 4.2 per cent (£200 billion out of £4.8 trillion) was invested in real estate, of which only £12.8 billion was in residential property. Of this £12.8 billion, £4.4 billion was in private renting (market rent/assured shorthold tenancies) with only £0.4 billion in social housing.

Institutional investment in HA housing includes HA bonds, development partnerships/joint ventures and sale and leaseback agreements. Of these, HA bonds have been the main mechanism by which institutions have invested in the social housing sector. HAs have issued bonds since 1996 but it is only after the GFC that bond issuance has accelerated. Today, HAs can raise funds with retail and wholesale bonds with 'own name' issues or bonds issued by an aggregator, such as The Housing Finance Corporation (THFC). For example, from 2011–12 to 2013–14, £7.9 billion was raised from the bond market, equivalent to 63% of total external finance raised over the period (Moody's, 2014, Exhibit 1). In 2012–13 alone, HAs raised £3.6 billion debt in which £3.2 billion was from the bond market, representing over two thirds of all new debt facilities arranged (HCA, 2013). The main bond investors are insurance corporations and pension funds such as Aviva, Legal and General, M&G Investments (Prudential) and Standard Life.

To encourage more institutional investment in social housing, the UK Government in September 2012 launched the Affordable Housing Guarantee scheme whereby the Department for Communities and Local Government [DCLG] provides a guarantee to support debt raised by borrowers (HAs and other private registered social landlords) to develop additional new affordable homes. The guarantee scheme (£3.5 billion initially, with £3.0 billion held in reserve) was complemented in England by grant funding, although the guarantees themselves are UK wide (DCLG, 2013b). On 20 June 2013, DCLG appointed the THFC through a newly formed subsidiary, Affordable Housing Finance, as the delivery partner for the Affordable Housing Guarantee scheme. In May 2014, under the Affordable Housing Guarantee scheme, 13 HAs secured £208.4 million of funding through AAA-rated 28-year bonds, which was believed to be the HA sector's cheapest ever bond finance. It is estimated the guaranteed-bond will support the delivery of 5,800 additional homes, with over 4,100 homes to be delivered outside London (see also Cross, 2014). However, the government has decided to end this scheme at the end of March 2016. While the deadline is March 2016, in practice, both bond and EIB transactions will complete later in 2016 and 2017 under the terms of the licence (*Social Housing*, 30 November 2015).

In our study, eight of the nine HAs interviewed had used institutional investment to fund their new developments in the last five years (2009-2014). The interviews were conducted before the government announced that there would be a one per cent a year reduction in social sector rents for four years from April 2016. The adverse consequences of this for investment are considered in section seven below. Within the group interviewed, bond issuance was the main form of institutional investment. Bonds were typically structured with fixed coupon rates for 20 to 40 years. Most often, there was no amortisation prior to final maturity date. Larger HAs, defined as those owning more than 20,000 units or were credit rated, issued 'own name' bonds through public issuance. The most common financial covenant was asset cover, in which at least 105% of the value of the bonds is secured on property. The amount of capital raised through private placement could be quite small. One HA raised as little as £10 million through an overseas investor within the last five years. For smaller HAs (i.e. those owning fewer than 10,000 units) and some medium-sized HAs, bond issuance was usually via an aggregator, such as THFC or GB Social Housing. One HA obtained institutional investment through the subsidiary of THFC, Affordable Housing Finance, under the government's Affordable Housing Guarantee Scheme. Aggregated bonds were usually required to meet both asset cover and interest cover covenants (i.e. ratio of net rental income/interest). The minimum property security value had to be 115% of the loan. Most often, the bonds issued were senior debt.

While bond issuance and development partnership/joint venture have been used to fund new development, sale and leaseback arrangements were solely for the acquisition of existing stock. Amongst the HA interviewees, development partnerships/joint ventures had rarely been used for the development of social rented units. Only one HA interviewed had entered into a sale and leaseback arrangement with an institutional investor in the last five years. The HA used the proceeds to acquire existing stock from another HA. Lease payments were based on the Retail Price Index [RPI], but the HA will seek to change to Consumer Price Index [CPI] when the annual rate of rent increase changes after 2015/16 to CPI plus 1%. The length of the lease was 50 years, but in effect, 45 years as, for the last five years, rental payments will be notional. At the end of the term, the HA will pay £1 and the ownership of the leased stock will transfer back to the HA.

Overall, the interviews revealed that there was no barrier to institutional investment in social housing, particularly in the case of bond issuances. In the past, medium- and smaller-sized HAs used to think that institutional investors would not invest in their HAs because of their small size and, hence, smaller amounts of capital required. Today, HAs believe they can access the bond market through many routes, and transaction size is no longer seen as an issue, although some medium- and smaller-sized HAs found that substantial conditions were required to be met in order to issue bonds via an aggregator (for example, the EIB and THFC). Even though they had no problem in issuing bonds, many medium- and smaller-sized HAs still thought that institutional investors needed to understand their distinctness from larger HAs. However, there were barriers for HAs to accept index-linked finance (i.e., sale and leaseback). A number of HAs expressed concerns at potential cash flow problems if rental income failed to keep pace with inflation, either due to policy changes or a growth in arrears or vacancy rates. One HA that had entered into a sale and leaseback stated that it had to cap the extent of such index-linked arrangements at not more than 25% of the HA's whole loan portfolio.

Four institutional investors had successfully invested in either traditional social housing or shared ownership, while a further three had deals in the pipeline. Notably, there was little evidence of investor participation in equity-type investment in traditional social housing beyond sale and leasebacks. Investor interviewees indicated that HAs played a key role in mitigating reputational risk to manage social rental housing. Other investors interviewed were either looking at the sector or have tried and failed to invest. Reasons given for not investing included: internal priorities and resources, the lack of attractive investment opportunities, pricing and generally being unready to invest. In relation to this lack of readiness, a number of respondents mentioned that the sector is a new one for them and the route of entry would need to be a simple investment as a first step, such as a straightforward refinancing of existing stock. This highlights that new investors have a hurdle to overcome, before taking more risk and participating further in the sector – successful transactions were required before the sector becomes recognised as a natural area of investment for a number of prospective investors.

Institutional investor respondents listed a number of motivations for investing, relating to specific characteristics of social housing. These reasons can be categorised into three groups: (1) cash flow and return prospects; (2) ethical and moral preferences of HAs; and (3) regulatory environment (the role of HCA) and macroeconomic conditions (the slow economic growth and the very low interest rates). Social housing and infrastructure were seen as growth opportunities, driven by underlying demographics and the need for housing. In general, it was believed that there were diversification benefits from exposure to social housing relative to other commercial real estate sectors, given the stability of its cash flow from the rental incomes. The current low interest rate environment has also driven down expectations, making social housing more palatable.

4.3. Expected development

When asked what will be the main funding source for new development, all HA interviewees stated that bonds would increasingly become the main (or only) source of funding. While there was an increasing appetite for bond finance, HAs continued to have very limited or no interest in using equity finance (joint venture and sale and leaseback arrangements).

Institutional investors, on the other hand, were keen to expand their equity investment in social housing. The reasons offered for the dominance of bond finance, as given by both surveyed HAs and institutional investors, stemmed from inertia amongst HAs and how they considered advice and the stance and approval process of the HCA, as well as the attitude of treasury advisors consulted by HAs. In practice, the HCA has urged HAs to exercise caution when entering into sale and leaseback deals because linking debt to the RPI over 30 years or longer can cause problems when the rent regime, which was also RPI-linked, and which at the time of the research was expected to change after 2015/2016 to CPI plus 1% each year for the following 10 years (Wilson, 2014). Also, there are possibilities (as subsequent policy developments have confirmed) that there will be further changes to rent regimes over the next 15, 25 or 30 years. It is evident that the ability to raise debt cheaply has a significant impact on HA choices. While interest rates remain low, the greater interest in fixed-rate debt is likely to continue.

5. Institutional investment in the Netherlands

5.1. Policy and crisis context

The Dutch economy has been relatively hard hit in the aftermath of the GFC by moving into and out of three recessions since the start of the crisis resulting in a drop in house prices of approximately one fifth. The interviewees believed that house prices would be bottoming out, offering new opportunities for investment in the private rental market (Eichholtz et al., 2014). Moreover, the new policies for homeownership (annually decreasing tax advantages because of new regulation as of 2013 and 2014) are expected to improve the relative attractiveness of renting.

The interviewees expected these generally 'good' investment conditions for 'market' investments only, and not for the social rental sector, given policy changes since 2010 (Donner, 2011; Haffner, 2014). For example, in response to the budget problems following the GFC, a landlord levy was introduced in 2013. Landlords who own more than ten dwellings with a regulated rent (all social rental dwellings) are obliged to pay this levy.

5.2. Institutional investment

Traditionally social landlords finance their investments in the regulated stock with private sector borrowing, e.g. loans from the special-purpose banks, the BNG Bank and the NWB Bank. The shares of both banks are in the hands of different government and/or statutory bodies. Their aim is to provide financing for the public sector and/or for socially beneficial purposes.

Social landlords in search of the 'cheapest' loan offered for the finance of social rental dwellings increasingly seem to be serviced by other organisations than the sector banks. The share of sector banks in the amount of newly-guaranteed loans has slowly been decreasing from 90% in 2009 to 88.5% in 2013, while the share in the annual new loan volume from institutional investors has increased from 1.2% to 7.9%. Loan volume in 2013 amounted to 5.5 billion Euros (*Waarborgfonds Sociale Woningbouw*, 2014). The increased interest from institutional investors can roughly be explained by two factors according to one of the interviewees. First, with the low interest in especially Dutch and German government bonds, the search for yield causes institutional investors to consider alternative attractive investments. In particular, insurance companies, including some from Germany, were said to discover the finance of social rental housing with a regulated rent as a way of asset-liability matching in the longer term. Second, *Waarborgfonds Sociale Woningbouw* [WSW], the guarantee fund for loans for social rental dwellings with a regulated rent to social landlords with government backing, has actively stimulated the HAs to search for new funding sources. This guarantee fund, makes the sector a relatively attractive investment opportunity for financiers as risks of non-payment are taken away.

5.3. Future prospects

Social landlords have traditionally relied on loans from the sector banks (guaranteed by government in the last instance) to provide rental stock with a regulated rent. Since 2009, the share of loans from institutional investors has increased, because the guarantee fund and the social landlords have actively diversified their supply of finance. Insurance companies have been discovering that investment in social rental housing can be a source of acceptable alternative returns. However, the future of investment in the regulated segment of the social rental market looks relatively gloomy considering the changed regulation, such as the landlord levy. This measure mirrors the government's emphasis on 'more' investment in the rental sector with deregulated (or market) rents. The study considered whether, as a result of these changes in policy, the sale of dwellings by social landlords to institutional investors might take place. Such sales of regulated rental stock from social landlords to institutional investors would only take place, it was concluded, if rates of return were acceptable to the buyers, taking into account all the costs, including the landlord levy. The interviewees indicated that the levy would lower the profits substantially.

6. Institutional investment in France

6.1. Context: policy and crisis

Institutional investment in the French social rental sector is basically investment in the French intermediate rental sector. In many respects, the intermediate rental sector occupies a middle position between the social rental sector and the market rental sector. The rent levels in this sector are higher than in the social rental sector, but lower than in the market rental sector in which the rent setting is un-regulated. Just as in the social rental sector, tenants who want to live in the intermediate rental sector generally have to meet certain income criteria. However, the income limits that apply are higher than those in the social rental sector (Haffner et al., 2009).

The idea behind the intermediate rental sector is that it fills the gap between the social rental sector and the market rental sector, by offering a good alternative to tenants from both of these sectors. Intermediate rental dwellings are especially needed in regions with a relatively tight housing market, in which there are large price differences between relatively 'cheap' social rental dwellings and relatively expensive market rental dwellings (Hoekstra & Cornette, 2014). These price differences have remained large in recent years despite the influence of the GFC.

Intermediate rental dwellings are mainly provided by individual private rental landlords. Many of these landlords make use of the various tax incentives that are provided by the government. These incentives assure that in exchange for the financial support of the government, landlords have to meet certain criteria for the rent level and the income of the tenants (see Hoekstra, 2013, for a detailed description of these tax incentives). The financial arrangements between government and individual private rental landlords apply to a rather long (typically more than seven years) but fixed period of time. When this time period has passed, the dwellings concerned will be part of the free rental market.

6.2. Institutional investment in the intermediate rental sector

The French government has been trying to stimulate investment in the intermediate rental sector for several decades because of a continuing shortage of affordable rental dwellings for middle-income groups, especially in areas with a strong population growth such as the Paris region and cities like Bordeaux and Toulouse. Investors in the intermediate rental sector can be HLM organisations, market parties (including institutional investors) and individual households. For HLM organisations and market parties, special loans are available: The *Prêt Locatif Social* [PLS] and the *Prêt Locatif Intermédiaire* [PLI]. However, institutional investors are generally not interested in taking up PLS and PLI loans as they are accompanied by strict conditions for rent setting, the income of tenants and the duration of the arrangement. Consequently, almost all PLI and PLS loans are taken out by social rental landlords. In terms of financed dwellings, most of the investment in the French intermediate rental sector takes place by individual private rental landlords, stimulated by the fiscal incentives that the French central government provides (see Hoekstra, 2013).

Recently, however, two important new developments have taken place in the intermediate rental sector that aim to further enhance investments in this sector by social rental landlords and institutional investors. First, a new legal and taxation framework that gives the intermediate sector a more formal position has been introduced. This legal framework gives HLM-organisations the opportunity, albeit under strict conditions, to set up a branch organisation that provides intermediate rental housing. Furthermore, the new framework provides some tax advantages to institutional investors that choose to invest in the intermediate rental sector; these investors pay a lower VAT rate (10%) and are exempt from paying local property taxes for a period of 20 years. Finally, a new initiative has been developed that aims to attract institutional investors to the intermediate rental sector: The *Fonds Logement Intermédiaire* [FLI].

The FLI has been introduced by the *Caisse de Dépôts*[2] and its branch *Société Nationale Immobilière* [SNI]. SNI is one of the largest landlords in France and manages more than 185,000 social rental and almost 90,000 intermediate rental dwellings. The FLI was officially launched in July 2014. Apart from SNI, the fund consists of seven institutional investors, mainly active in the field of insurance and pensions. These investors already have affinity with investment in residential property. At this moment (2016), the fund has an investment capacity of 1.2 billion Euros[3], which is sufficient to build 7,000 new intermediary rental dwellings. Half of this amount of money comes from own equity of the fund participants, whereas special bank loans are available for the financing of the remaining half. The fund expects to have a yearly net rental yield of 3.5% per year, and a total yield (including the future sale of the dwellings) of 7% (IRR). The fund will run for a period of 20 years after which the dwellings will have been sold.

In 2015, the FLI is attempting to attract additional investors, including institutional investors from abroad. For this purpose, they scheduled meetings with two big Dutch pension funds, as well as with some German institutional investors. FLI does not construct the new intermediate rental dwellings itself but buys them from construction companies and project developers. Interested property developers can submit their plans to FLI, which will make the selection via a tender procedure.

6.3. Future prospects

The prospects for institutional investment in intermediate rental are expected to be good, although it is still too early to draw a firm conclusion. The yields for institutional investment can be attractive, particularly in areas with a tight housing market. However, there are a number of factors that might deter many institutional investors from investment in intermediate rental housing. First of all, strong tenant protection, and the broad societal support for this, plays a role. Institutional investors are afraid of non-paying tenants. Not only because it is difficult to evict them, but also because evicting non-paying tenants can lead to ‘bad advertising’ and give the institutional investors an image of a ‘bad guy’. This is something that they want to prevent at all costs. Second, French housing policies and regulations (rent regulation, tenant protection and particularly the availability of fiscal advantages) are not very stable and often change once a new government has been installed. This leads to insecurity about the yield that institutional investors can expect in the medium and longer term. Finally, there has been a lack of investment products for investors do not want to manage the residential property in which they invest themselves. Obviously, the newly created FLI attempts to fill this gap.

7. Policies and perceived barriers

In the UK and France, large scale direct institutional investment in social housing is a relatively new development. A significant barrier is thus the lack of understanding and experience with this form of investment on the part of both social housing providers and investors. In the Netherlands, there has been a long term tradition of indirect institutional investment in regulated-rented dwellings. Drivers of the expansion of institutional investment in these three countries have included, in varying degrees, a reduction in direct support for social housing from government and constraints on the cost and availability of “traditional” lending from banks as a consequence of the GFC and tighter regulatory requirements in the financial sector.

The form that institutional investment takes is driven by the circumstances of individual countries, the variations in the forms of social housing provision and the stance of governments with respect to regulation and financial incentives to promote institutional investment.

The net costs to providers of alternative forms of new funding are of great importance. In the UK, for example, whereas pension funds and insurance companies have shown some interest in equity investment in social housing organisations, many HAs are content with what they see as the lower costs of funds raised through the issuance of bonds.

In the UK, various government initiatives have boosted institutional involvement. In the social housing sector, HA bonds have been the main form of investment despite an appetite for more equity investment on the part of the institutions. Bond finance is expected to grow as both other sources of finance become more difficult and familiarity with bonds increases. Since the completion of the research, there have been policy changes in the UK which may have the unintended consequence of reducing the attractiveness, from institutions’ perspectives, of investment in HAs. These are the government’s proposal to extend the right to buy, with significant discounts, to HA tenants (HM Government, 2015a) and the decision to limit increases in social rents to constrain the housing benefit budget (HM Government, 2015b). An extended right to buy will constrain the asset base of HAs, and lead to revised business plans which make HAs less attractive to investors. The one per cent a year reductions in social sector rents for four years from April 2016 will directly reduce social landlords’ rental income. The Office for Budget Responsibility [OBR] has stated that they expect that this will reduce HAs “ability and willingness to invest in housing, so we have lowered our forecast for residential investment, proportionate to the expected reduction in rental income” and they expect fewer affordable homes to be built as a consequence (OBR, 2015, p 41). The impact expected by OBR is likely to be reinforced by a reduction in investors’ confidence in the attractiveness of the sector. The government policies that extend the right to buy and lower social rents are likely to be viewed negatively by financial institutions who have previously seen housing association investment as providing secure long term returns supported by positive political attitudes to the sector.

In the Netherlands, there were concerns about political risks, as policies and policy proposals generally are moving in the direction of constraining the social rental sector

[2] *Caisse de Dépôts* is a public investment fund. Among other things, the *Caisse de Dépôts* provides low-interest loans to social rental landlords. A substantial part of the money that *Caisse de Dépôts* invests comes from tax-free saving accounts for French households (the so-called *Livret A* scheme).

[3] Part of this investment capacity will also be used to build social rental dwellings and home-ownership dwellings.

and reducing the favourable tax treatment of owner-occupiers; thus, improving the relative position of the private rental sector. Therefore, in the Dutch situation the attractiveness, from an investor's perspective, of the regulated part of the rental market seems to be declining as regulated tenancies have been made less attractive by the imposition of a new tax on the landlords. However, the volume of loans that are guaranteed to social housing providers has been shifting in favour of institutional investors and away from the sector banks as insurance companies, in particular, have been taking advantage of secure long term yields backed by a guarantee fund.

In France, government has been trying to expand the intermediate rental sector to meet a growing need from households who are not poor enough for social housing but cannot afford market rents or home ownership. However, initially most of the government incentives focused on individual investors rather than on institutional investors. In an attempt to change this, special tax incentives and a new funding vehicle have recently been established to specifically promote institutional investment. As in other countries, reputational risk for French investors is an issue. They do not want to be associated, for example, with the eviction of tenants in rent arrears. They are also concerned about the impact of rent regulations and tenant protection. A further lesson from the French experience is that fluctuations in government policy and changes in the fiscal advantages of involvement can be problematic for institutional investors looking for long term secure yields.

8. Conclusions

Institutional investment in housing takes different forms in different countries which not surprisingly reflects the context in the social rental market. In the UK, bond finance has become popular, while in the Netherlands, social landlords finance their social rental investment mainly with loans, increasingly also from institutional investors. This paper has shown that institutional investment takes the form promoted by the structure and the governance of the rental market.

Reticence associated with a lack of experience by both social housing providers and institutional investors may well decline as more deals are struck and learning increases. However, the French experience, in particular, suggests that governments have a crucial role in developing fiscal incentives and institutional arrangements that promote institutional investment in social housing or, more precisely, in the French case, intermediate housing. A dedicated fund was established in 2014 with the aim of funding the development of several thousand new intermediate dwellings with support from seven institutional investors who are mainly active in insurance and pensions. Governments can, in several ways, increase the rate of return and decrease the risks of institutional investment in social housing. The French case provided the clearest example of tax reductions which increase rates of return. The Dutch provide a clear example of how a government backed guarantee ensures the financial security of social housing providers. It can reduce the risk associated with residential investment, as is the aim of the UK Affordable Housing Guarantee scheme.

At the time the study was taking place (2014), social housing investment was seen as a potential growth opportunity by some UK investors given the underlying housing shortage and the perceived diversification benefits from social housing. Low interest rates have had an important impact on expectations increasing the advantages of this alternative form of investment. This type of reasoning has also been applied in the Netherlands to insurance companies' finance for social landlords.

Institutional investment in social housing is ultimately a function of the costs and availability of alternative forms of finance from the social housing providers' perspective and the relative returns and risks from the investors' perspective. Governments can exercise a good deal of influence on the extent and specific form of institutional investment. If governments want more of such investment, as they appear to, they can excise this influence mainly through fiscal and regulatory changes. To be successful, government initiatives have to be seen as long term and contributing positively to investors' risks and returns.

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Housing Microfinance; does it make any sense?

By Victor Mints

1. Introduction

Housing Microfinance [HMF] has a very strange history for a financial product. This product was first presented to the market more than 55 years[1] ago. Through all these years, strong efforts have been made to turn HMF into a widespread and a well-developed lending instrument. Numerous presentations have been presented and publications (one of them is in front of you) published. Donors, NGOs, Governments and International Developmental Organizations [IDOs] have financed initiation of this product in a large number of financial institutions [FIs] all over the world. It is very strange that in spite of all this, HMF is still an innovation that needs to be actively promoted.

One of the recent examples of the efforts to promote this "middle-aged" innovation is the Microbuild fund that since 2012 has been spending $50 million "to convince … microfinance institutions that they should … offer housing loans"[2]. In terms of "convincing" the fund provides FIs with liquidity at concessional terms and free technical assistance.

The question is what is wrong with the HMF lending product that after 55 years of its existence, financial institutions (FIs) still need to be "convinced" to use it? Why does the product still need free TA and cheap funding to be implemented?

Does it make any sense for donors, governments and IDOs to continue supporting HMF product development or will this support never bring long-term results because the product is not sustainable and FIs lose the interest in implementing it as soon as the support is discontinued?

This paper argues that the HMF product, if properly implemented, is the subject of strong demand from borrowers willing to improve their housing conditions and is very efficient for financial institutions. The reason why most of the efforts to convince FIs in this have not been successful yet, is grounded in the set of omissions in the most widely used approach to the HMF product design. The paper presents an opinion about the nature of these omissions and suggests what should be done to make financial institutions interested in offering HMF loans.

2. What is HMF and why does an FI become interested in implementing it?

HMF is a lending product for low-income households who live in their own (often informal and inadequate) houses. These households suffer badly from leaking roofs, wet and muddy earth floors, cracked walls, terrible congestion in rooms where 3-4 generations are jammed together, etc. The necessity to improve their living conditions is one of their burning needs. Being unable to take a mortgage loan to buy or build a new house, they do their best to improve the existing ones. They mend roofs, repair walls, cover mud floors with concrete, add new rooms and conduct other improvements. Sometimes they incrementally build[3] a new house in addition to, or instead of an old one. To simplify the further text, we will name all these types of activities "home improvements".

These home improvements, though comparatively small in scale, have very high impact. A study of an effect that such a small home improvement as installation of a cement floor (average cost – $150 per house) has on poor households was conducted in Mexico. It was proved that as a result of cementation of floors in their homes, children demonstrated 78% reduction in parasitic infestations, 81% reduction in anemia and a 36 to 96% improvement in cognitive development (ability to reason and understand) while their parents self-reported 69% increase in quality of life satisfaction[4].

Needing money to carry out even such small home improvements, low-income people often look for an opportunity to borrow. HMF is a specialized lending product that brings to them this opportunity. It is a product under which loans are provided to low-income people for home improvements, home extensions or incremental housing construction[5].

It is presumed, that FIs are interested in offering HMF loans because this attracts to them clients with home improvement needs. If it is so evident, why there is a need to convince FIs to start HMF lending? The need exists because FIs suspect that potential borrowers may not be attracted by a HMF product since they can fund their home improvement needs using other lending products as well. FIs understand that HMF will be demanded by clients only if this product serves home improvement needs better than other products. To verify if this is really the case, the suitability of a wide spectrum of products to serve home improvement needs is to be compared with the suitability of HMF.

Most of the authors writing about HMF, compare it with two types of lending products that can also be used to finance home improvements of low-income households. These are micro-entrepreneurial loans[6] and micro-mortgage loans[7]. According to these authors, HMF is much more convenient for borrowers and hence can attract new clients to the lender that introduces a HMF product.

Specifically, it is considered, that HMF loans are better for borrowers financing home

[1] The first HMF product was launched in 1961 see at HOFINET http://www.hofinet.org/themes/theme.aspx?id=56

[2] See Habitat for Humanity website. http://www.habitat.org/lc/hw/inside_habitat/MicroBuild_Fund.aspx

[3] Here this term means progressive building by low-income households who invest into new construction whenever the funding is available so that the new building is completed only after several years.

[4] Matias D. Cattaneo et al. Housing, Health and Happiness https://openknowledge.worldbank.org/bitstream/handle/10986/7295/wps421401update.pdf?sequence=1

[5] There is a big variety of lending products that can be named HMF. FIs often name them not HMF loans but "housing loans", "residential loans", "home improvement loans", "home maintenance loans", etc.

[6] Strictly speaking, micro-entrepreneurial loans should not be used for home improvements, because their target use is micro-business, but since the money is fungible they very often are

[7] See for example Merrill Sally. Microfinance for housing: Assisting the "Bottom Billion" and the "Missing Middle". IDG working paper, 2009. Pages 2-3.

improvements than micro-entrepreneurial loans, because HMF loans tend to be (a) individual rather than group loans, (b) are bigger in size and (c) have comparatively a longer term than micro-entrepreneurial loans. These characteristics enable HMF to serve home improvement lending needs better than micro-entrepreneurial loans do, because home improvements tend to be costlier and more specific for each household than typical micro-entrepreneurial investments.

If compared with micro-mortgage loans, HMF loans are more convenient for low-income borrowers because these loans are: (a) not collateralized by mortgages, (b) use informal clients' assessment and (c) are comparatively small. For low-income clients, whose repayment capacity is not enough to qualify for a mortgage loan and whose houses are informal and can't be mortgaged, these are great advantages.

It seems to be proved that HMF loans are more attractive to meet the home improvement needs of low-income households than mortgage and micro-entrepreneurial loans, but these two are not the only types of loans available to low-income people to finance home improvements. Low-income people can take personal loans as well (also known as multi-purpose, general purpose, signature or consumer loans).

According to the most widely used definitions of personal loans, these are the loans where the funds are used at the borrower's discretion. Home improvements are often mentioned as the key target use of personal loans[8]. This is especially the case for personal loans of FIs dealing with low income borrowers. For example, analysis of the personal loan portfolio of Access Bank in Azerbaijan in 2011 showed that 43% of the portfolio was used for home improvement needs. Hence, personal loans are also an option for borrowers to finance home improvements and should also be compared with HMF loans.

The advantages of HMF loans vis-a-vis personal loans are not evident. These two types of loan seem to be very similar to each other. Like HMF loans, personal loans for low-income borrowers are in most cases individual (rather than group) loans, are not collateralized and use an informal client assessment. The term for both of these types of loans is limited only by the terms of lender's liabilities (in case of an entrepreneur loan it is limited by the production cycle). The size of a personal loan as well as of a HMF loan is limited by the client's repayment capacity (for mortgage or micro-entrepreneurial loans the limit is the price of the property or the size of the investment in the micro business project)[9].

The key difference between personal loans and HMF loans is that for the former, home improvement is one of their potential uses, while for the latter it is the only allowed use. From here is follows that these types of loans are competing. If both types of loans are available on the market, a borrower can use for a home improvement either a personal loan or an HMF loan. It is the borrower, who has an option to choose between these two competing types of loans. Of course the borrower would prefer a HMF loan to a personal loan only if he sees that for home improvement finance a HMF loan has some advantages against a personal loan (more convenient, has better terms, better conditions, etc.). A FI in its turn will be convinced to offer HMF loans only if the borrowers see the HMF advantages and demand for home improvements HMF loans rather than personal loans.

The question "can it be demonstrated to a borrower that a HMF loan has competitive advantages against a personal loan" is actually the question "can HMF be a successful product". If personal loans are available to potential borrowers and it is not clear for them that for home improvements it is better to use HMF loans, than there is no sense for the FI to introduce a HMF product. This will not attract new clients and hence will not give any benefits to the FI.

It can be summarized that it will be impossible to convince the FI to offer HMF loans unless the advantages of these loans in comparison to personal loans are evident to their borrowers.

Let us discuss what the competitive advantages of HMF loans are vis-a-vis personal loans that can make borrowers choose HMF loans.

3. Reduced interest rates as a competitive advantage of HMF lending

It is clear that HMF loans would be advantageous for borrowers if home improvements financed under HMF loans turned out to be less costly than home improvements financed under personal loans. There are several options to make this happen. The most obvious one is to make interest rates on HMF loans lower than on personal loans.

There is a view that a FI can make the interest rate for HMF loans lower than for personal loans because the credit risk for HMF loans is lower than that for personal loans. The lower the credit risk, the lower the probability of default and hence the lower the loss that a FI can encounter. If the loss is lower, the FI can add a smaller margin to the interest rate to compensate for the potential loss. Hence, for products with lower credit risk (such as HMF), a FI can make the interest rate lower than for products with higher risk (such as personal loans).

Why is the credit risk of HMF loans lower than that of personal loans? Because the HMF lender can better manage the key risk of home improvement lending – a risk of mismatch between the home improvement cost and the size of the loan.

The mismatch risk is the risk that the cost of the home improvement may turn out to be higher than the loan size. If this happens, the client needing to complete his/her home improvement will have no choice but to borrow more from other sources. The total debt will exceed borrower's repayment capacity and he/she will become unable to repay the loan.

For a HMF loan, this risk is lower than for a personal loan. A personal loan lender defines the maximum size of the loan mainly on the ground of borrower's repayment capacity[10]. Unlike a personal loan lender, a HMF lender requests each borrower to present a description of the home improvement and a cost estimate. This cost estimate (in addition to the borrower's repayment capacity) is the basis for defining the size of the HMF loan. If the credit officer sees, that the home improvement cost is higher than the repayment capacity of the borrower, he/she rejects the loan application. This reduces the credit risk on the HMF loans and provides a reason to reduce the interest rate.

It seems evident that HMF lenders have a reason to reduce the interest rate. However, in reality, the situation is not as simple as it seems to be. To what extend the risk is reduced, depends on the reliability of the information about the home improvement cost (the cost estimate) that the HMF lender obtains from the borrower. If the cost estimate is not reliable, there is no risk reduction, because the loan size can still turn out to be smaller than the home improvement costs.

The problem that HMF lenders encounter in practice, is that most low-income borrowers

[8] See for example a definition of personal loans at http://www.businessdictionary.com/definition/personal-loan.html; or at http://credit.about.com/od/avoidingdebt/a/basics-of-personal-loans.htm

[9] Size of the home improvement is also a limit for a HMF loan, but since the demand for home improvements of an average low-income household is normally much bigger than its repayment capacity, the latter is in fact the real limit.

[10] This criterion is the key one though the credit history, public conduct, assets, etc. are also taken into account.

prepare cost estimates in the form of "my neighbor did the same home improvement and said that this loan amount would be enough". To get a more reliable cost estimate, a staff member of a lender would have to spend a lot of time and effort. Actually, they would need to prepare a cost estimate for the borrower. Since lender's staff typically do not have the expertise necessary to do it, costly services of professional engineers would be required.

If services of professional engineers are used to verify/prepare cost estimates, overhead expenses under HMF lending become much higher than under personal lending[11]. It is not clear whether the FI's benefit as a result of the reduced risk, offsets its losses caused by the increase in overhead expenses. Most of the FIs involved in HMF lending do not consider that the balance is in favor of risk reduction and that therefore the HMF interest rates decrease cannot be financially justified.

There are cases, however, when FIs provide HMF loans at reduced interest rate. They do it either because they have concessional (subsidized) funding earmarked for HMF lending or because they consider HMF a socially important product that is worth being subsidized by themselves though it reduces their profit.

4. Subsidizing of HMF interest rate

If the HMF interest rate is subsidized, HMF terms become better than the terms of non-subsidized personal loans and hence become more attractive to borrowers. There are many programs subsidizing HMF through the provision of FIs with liquidity earmarked for HMF at below market interest rates and/or through accompanying HMF loans with cash subsidies.

In some cases, subsidized liquidity is provided by donors or NGOs. For example, while I am writing these words, four FIs in Tajikistan offer HMF loans subsidized by KfW at 28% interest rate, while the average rate on personal loans offered by the same institutions is about 40%.

Very often liquidity at concessional rates is provided by states. One of the examples can be found in South Africa where liquidity for HMF is provided via the state-owned Rural Housing Loan Fund and National Housing Finance Corporation[12]. Another example is Tanzania where a state owned liquidity facility – the Tanzania Housing Microfinance Fund, makes liquidity available for HMF lending.

Very often liquidity support for HMF is combined with provision of subsidies. A good example is the ABC system (Ahorro– Savings, Bono– subsidy, Credito– Loan). The program was first implemented in Chile (that served as a model for other countries) and was later exported to Costa Rica and Ecuador[13]. Under the program, the borrower receives from a FI both a loan funded by a state-owned liquidity facility and a subsidy financed from the state budget.

A similar program has been launched by SHF (Sociedad Hipotecaria Federal) – a housing liquidity provider in Mexico – that starting from 2005 has become a liquidity window for HMF lenders and later started offering a subsidy that can be joined with a housing microfinance loan[14].

An important group of HMF loans supported by cash subsidies and/or subsidized liquidity is represented by the Residential Energy Efficiency lending programs. These are HMF loans that can be used only for a specific set of home improvements – the ones that increase the energy efficiency of houses. An example is the KYRSEFF program in Kyrgyzstan[15] that provides to each borrower funding at concessional rates and a subsidy equal to up to 35% of home improvement costs via four commercial banks. The support is mostly provided for such home improvements as installation of windows and heat insulation of walls.

There are three issues that negatively influence the efficiency of subsidizing HMF lending. One of them is the low sustainability of the created HMF programs, another is the market distortion that is caused by such subsidizing, and the other is the high risk of a misuse of funds.

The issue with sustainability is that under this scheme, HMF lending is more attractive to borrowers than personal lending only while donors, IDOs or states provide concessional funding and/or subsidies. FIs are easily convinced to offer HMF loans under subsidy programs because there is a great demand for subsidized HMF loans from borrowers. However, this demand disappears as soon as the subsidy program is withdrawn, and FIs start using the same funding sources for HMF lending as they use for personal loans. When this happens, the demand for HMF loans plummets, which causes FIs to discontinue the product.

Market distortion is caused by the sharp reduction in the demand for personal loans (often used for home improvements) for those FIs that are not supported under HMF (or Residential EE) programs. These unlucky FIs lose their position in the market and in some cases even become bankrupt. It takes a lot of time and effort to restore the personal lending market when the subsidy and low cost funding programs are over.

Another issue is that the higher the subsidy for HMF loans, the more borrowers are inclined to use at least part of HMF loans funds for their personal needs. Most of these needs are very different from housing. As a result, the subsidized HMF loans in fact often turn out to be subsidized personal loans.

To manage the risk of the misuse of funds allocated for HMF loans, the subsidy provider should, in addition to spending money on an interest rate or a cash subsidy, allocate funding for the control over the target use of this money. For example, SEWA bank arranged such control in 2002 when it became evident that the funds from some of its HMF loans (Paki Bhit) were not being used for home improvements. This happened because the interest rate on Paki Bhit was 14.5% while for other loans it was 17%. This encouraged borrowers to pretend that they were intended to finance a home improvement whenever they needed to borrow for any purpose. SEWA was compelled to carefully verify the actual use of all Paki Bhit loans and increase the interest rate in cases where misuse was identified[16].

This type of control is extremely costly and requires special engineering knowledge. Because very often only a part of a HMF loan is misused, to identify this part, a controller should be able to assess the actual cost of the conducted improvement and compare it with the loan size. To do this the controller should know the state of the house before and after the improvement, and be able to assess the volume of materials and labor spent to transform the house from the original state to the current one. In fact, it may require at least two visits by the controller – a professional engineer – to a borrower (before the lending and after the works are done). Besides it is important to arrange at least random independent "control of the controller" inspections also conducted by professional engineers.

There are cases, where control over the target use of subsidized HMF loans is conducted

[11] This does not happen during the period when the services of engineers are covered by donors such as under the MicroBuild program, but these lucky days for HMF lenders can't last forever.

[12] Mikhael Kihato. State of Housing Microfinance in Africa. Working paper CAHF in Africa. 2013. P 11.

[13] C. Klaufus. The two ABCs of aided self-help housing in Ecuador. Habitat International 34. 2010. 351-358.

[14] Bruce Ferguson, Peer Smets. Finance for incremental housing: current status and prospects for expansion. Habitat International, 2009 (1-11), p. 5.

[15] http://www.kyrseff.kg/en/home-main

[16] Cities Alliance. *SEWA Bank's housing microfinance program in India.* P.3. www.citiesalliance.org

very formally. For example, many HMF (and REE) programs disburse money directly to construction materials' retailers, or require borrowers to provide retailers' receipts, considering that this guarantees the target use of funds. In practice, it does not, because borrowers often make an agreement with the retailers, and instead of the materials, receive cash from them (minus retailer's fees). In this case, the subsidy (including the rate difference between HMF loans and personal loans) is shared between the borrower and the retailer, while the loan proceeds are used for purposes different from housing. (Of cause, faked receipts from the construction materials retailers are provided).

Another example of formal control, is when an engineer visits only some of the borrowers and only after completion of the improvement. In this case, he/she cannot even verify whether the improvement took place before the loan was received or after[17].

Of course, formal engineering control is better than the complete lack of it. However, there are many cases when HMF lenders and providers of subsidized liquidity (donors, IDOs, states) do not conduct even minimal engineering control over the target use of funds and ignore the fact that part of the HMF loans are used for purposes different from housing. Managers of Banko ADEMI in the Dominican Republic have even "publicly stated that [control over target use of HMF loans] is contrary their operating philosophy; clients, they believe, must decide for themselves how best to use their own money"[18]. Under such an approach the HMF product remains "housing" in name only and in fact becomes a personal loan product.

Demand for HMF loans, that are supported by liquidity at concessional rates and/or cash subsidy, and can de-facto be used at the discretion of a borrower is always great. A significant proportion of most of HMF loans in this case, is used for purposes very different to meeting housing needs. When the liquidity and subsidy support is over, these "housing" programs are normally discontinued.

It can be concluded, that promotion of HMF lending through the reduction of interest rates and cash subsidies does not make a lot of sense. This approach (a) does not create a sustainable product, (b) requires substantial and costly control over the target use of funds, (c) very often turns out to be a promotion of personal lending rather than of HMF lending and (d) heavily distorts the personal lending market.

5. Support for non-financial services under HMF

The cost of funds is not the only element of home improvement costs that can be influenced to make HMF loans more efficient for financing home improvements than personal loans. Engineering costs[19] as well as labor costs can also be reduced to increase the attractiveness of the HMF product for borrowers. To achieve this reduction, a lender should accompany a HMF loan with the provision of non-financial services that would enable a HMF borrower to save on these costs. The resulting reduction in the total cost of a home improvement will make a HMF loan more attractive for the borrower than a personal loan even if the interest rates for these two loans are the same. If this happens, the HMF product will be in high demand and FIs will become interested in launching the product.

Traditionally non-financial services for HMF lending are called Construction Technical Assistance [CTA] or Technical Construction Services [TCS]. The CTA that helps to save on engineering costs is called a Pre-loan CTA and the CTA that helps to save on labor costs is called a Post-loan CTA[20].

To help clients save on engineering costs, FIs (under the Pre-loan CTA) advise them on how to prepare basic drawings, chose the most appropriate construction technology, develop list of necessary materials, and make a cost estimate. To help them save on labor costs, FLs (under the Post-loan CTA) provide advice that enables borrowers to undertake a substantial portion of works themselves and not pay for professional labor.

CTA also enables borrowers to save on another important element of costs, which is the maintenance cost. CTA helps to increase the quality of home improvement and makes houses more disaster resilient. This was demonstrated during the flood of 1988 in Bangladesh. The households who lived in houses built under the CTA supported HMF lending program of Grameen Bank spent much less than their neighbors on repairing their homes after the flood[21].

Maintenance costs are also decreasing in the cases when CTA enables borrowers to improve the energy efficiency [EE] of their homes thus enabling them to save on heating, collecting of water, etc. For example, CTA of IFC HMF program in Kyrgyzstan helped the installation of PVC windows in the way necessary to eliminate cracks in joints between the windows and walls, thus radically reducing the consumption of coal in winter.

CTA is professional advice and is provided by engineers. Under some HMF programs these engineers are staff members of FIs. For example, in "most of CHF International HMF programs there is one technical person for every two loan officers"[22]. Many HMF lenders instead of hiring engineers, outsource provision of CTA to engineering companies.

The issue is that whether these engineers are outsourced or in-house, someone is supposed to pay for their services. Donors, NGOs, IDOs and states finance CTA under many of HMF programs. The MicroBuild program is an example of donor financing for CTA.

There are programs under which CTA for HMF lending is financed by producers of construction materials. They do it under the condition that HMF borrowers will be obliged to purchase construction materials from these producers. The cost of CTA is recouped through the increase in sale volumes. Most known examples of such HMF products are the ones initiated and promoted by cement producers such as Cemex and La Farge – Holcim. The most widely known HMF product of such a type is Patrimonio Hoy in Mexico[23].

Both sources of funds for CTA have their shortcomings. Programs under which CTA is financed by construction materials' producers are not convenient for final borrowers who often prefer to purchase materials from other sources and complain that they are forced to choose a particular supplier. HMF programs under which CTA is financed by donors, IDOs, NGOs or states are not sustainable. They are in most cases temporary

[17] If a borrower shows to a controller a newly painted wall, the controller does not know whether the borrower built the wall and then painted it, or just painted an old wall that was built long before the HMF loan was received.

[18] Daphnis Frank, Bruce Ferguson. Housing Microfinance: A Guide to Practice. Kumerian Press, 2004, P 11.

[19] Preparing a design, a cost estimate, bills of quantities, etc.

[20] Daphnis Frank, Bruce Ferguson. Housing Microfinance: A Guide to Practice. Kumerian Press, 2004, P.118

[21] John Norton, "Grameen Bank Housing Project, 1989 Technical Review Summary", P.12. http://archnet.org/sites/715/publications/906

[22] Daphnis Frank, Bruce Ferguson. Housing Microfinance: A Guide to Practice. Kumerian Press, 2004, P.121

[23] Segel, A, Chu, M, Patrimonio Hoy: A financial prospective.

solutions that exist only for the period during which FIs are "convinced" to offer HMF loans.

A FI that wants to conduct HMF lending with CTA independently and in a sustainable way has no choice but to charge final borrowers for CTA. In most cases, FIs that charge borrowers for CTA do not introduce CTA fees, but rather add payment for CTA to the interest rate. Hence, the interest rate for HMF loans becomes higher than the interest rate for personal loans.

A borrower making a decision about what type of loan to use for a home improvement, choses between a costlier HMF loan with CTA and a less costly personal loan without CTA. In what case will he/she choose a HMF loan? The rational borrower will prefer a HMF loan if the value that the CTA brings to him/her is higher than the difference between the interest rates for the HMF loan and for the personal loan.

In practice, borrowers very rarely conclude that the value of CTA is higher than the cost difference. This is because (a) some borrowers consider that they do not need any CTA although they can't avoid paying for it with an HMF loan, (b) borrowers who need CTA prefer to take a personal loan and purchase CTA on the market.

The CTA that can be purchased on the market is often better, more user friendly and cheaper, than the one that is supplied by FIs. This happens because the engineers, who provide CTA under HMF, do not compete for clients. The clients are submitted to them by HMF lenders, and can't change the CTA provider, even if they are not happy with their services. Such lack of competition normally results in the reduction of quality, so a borrower, who pays extra for a HMF loan to get CTA packaged in it, pays more than a borrower who takes a less costly personal loan and pays for the engineering services in the market.

It looks as if for borrowers there is no sense in choosing a HMF product with CTA if the payment for CTA is included in the interest rate. In most cases, it would be more efficient for a borrower to use a personal loan and to procure CTA services on the market. Hence, making HMF more advantageous to borrowers than personal loans, through the provision of non-subsidized CTA does not make a lot of sense for a FI either. The value that borrowers get is not high enough to justify the relevant increase of lending costs and hence to create a demand for the HMF lending product. Hence, it can't make FIs interested in initiating HMF lending.

6. How to make CTA sustainable

The experience of CTA provision demonstrated that, (a) most low-income people (in every particular region of the world) live in houses which are very similar to each other (one story, rectangular, mud brick walls, mud floor, etc.), and (b) most of the home improvements these people conduct are the same (mend roof, cement floor, add a room, etc.). Due to the above, engineers providing CTA, very often repeat the same advice many times.

Since CTA consists of repetitive advice, it can be standardized and presented to borrowers in the form of ready-made CTA tools. Construction advice to borrowers in the form of ready-made CTA tools is called Pre-developed CTA. To establish a HMF product based on pre-developed CTA, FIs (or donors, IDOs, NGOs, states) must invest in preparing standardized CTA tools. FIs will be able to distribute these tools later to final borrowers without (or with minimum) involvement of engineers. Predevelopment of CTA tools requires up-front costs, but, due to the economy of scale, the CTA based on pre-developed tools, costs practically nothing to each HMF client.

Pre-developed CTA tools cover both pre-loan and post-loan CTA. They can be in the form of electronic calculators and tables to prepare budgets of home improvements, standardized drawings, pamphlets and brochures outlining basic construction procedures, educational videos, etc.

The most well-known HMF product based on pre-developed CTA was initiated in 1984 by Grameen Bank in Bangladesh. For HMF lending, Grameen predeveloped CTA materials necessary to incrementally build a rather primitive small house. The house was very small in size (20 square meters) had bamboo mat walls and a corrugated steel roof[24]. The average size of a loan necessary to finance the building of that house was TK 8 058 (US 115).

Borrowers were provided with basic construction elements necessary to build the house (including concrete rings for columns, sheets of corrugated steel for roof, materials for roof frame) and schemes and drawings necessary to self-help build the house[25].

The program enabled borrowers to save on engineering costs (the design, list of materials and cost estimate were predeveloped) on labor cost (there were instructions on self-help building) and even on material costs (materials were purchased wholesale by Grameen and brought to borrowers). The program also enabled them to save on maintenance costs due to the better quality of the house and to substantially increase the resilience of houses against natural disasters.

The key issue with the Grameen CTA was that it covered only a very limited number of home improvements. Borrowers could benefit from this CTA only if they were willing to build a particular "standardized" type of a house. If a borrower wanted to build a slightly different house, or to extend the existing one, or to improve it (change the roof, mend the wall, etc.) he had no choice but to take a personal loan with no CTA.

A more universal approach towards pre-developed CTA was implemented under the Kyrgyz HMF project of IFC[26]. The project first conducted a survey to find out what types of houses low-income Kyrgyz households live in and what home improvements they conduct most often. The survey demonstrated that most of the houses were very similar to each other. They were 6 by 8 meters, were made of mud bricks, had an asbestos roof, one glass window, etc. Most of the borrowers who were questioned wanted to install energy efficient windows (47%), to heat insulate walls (30%), to extend a house or build a new one (20%), etc.

For each of the 10 most popular home improvements IFC pre-developed CTA tools. The tools were in the forms of (a) a calculator preparing a list of materials and a cost estimate for the improvement, (b) leaflets explaining the basics of the suggested technology, (c) detailed educational videos distributed on DVDs.

The calculator gives a credit officer (not a professional engineer) an opportunity to provide engineering advice to a borrower under the pre-loan CTA. To do this the credit officer enters the key dimensions of the house and of the planned improvement (length, height, thickness of walls, etc.) into the system. The calculator prepares bill of quantities and construction cost estimate.

Leaflets and educational videos were prepared to play the role of post-loan CTA. They help borrowers to save on labor costs, and facilitate better quality home improvements, for the increase in disaster resilience (earthquake protection) and for the increase in energy efficiency (energy savings) of the houses. These

[24] http://archnet.org/system/publications/contents/904/original/FLS0914.pdf?1384749010

[25] http://www.akdn.org/architecture/pdf/1066_Ban.pdf

[26] The project was financed by SECO – Swiss State Secretariat for Economic Affairs. http://www.ifc.org/wps/wcm/connect/region__ext_content/regions/europe+middle+east+and+north+africa/ifc+in+europe+and+central+asia/countries/improving+housing+microfinance

CTA tools gave borrowers detailed step-by-step instructions on how to conduct each piece of work on a self-help basis, choose the necessary materials, ensure safety on the construction site and the quality of work.

It is important that, unlike interest rate and cash subsidies, pre-developed CTA tools can bring value only to poor households. This happens because the tools are valuable only to those, whose houses meet the standardized description of a typical house and who are ready to save on labor costs by doing hard work themselves. Better-off households typically do not value pre-developed CTA because they live in different types of houses than the ones CTA is based on, conduct more complex and costly improvements and prefer to hire labor.

The project also provided for saving on construction materials but it was done differently than in the case of Grameen. FIs providing HMF lending entered into agreements with construction material suppliers. Under such agreements, the FI guarantees that all HMF borrowers would be advised (but not required) to purchase materials from the supplier, while the supplier (in exchange for that recommendation) guarantees that the HMF borrowers will enjoy discounts.

The project was piloted with micro-credit company Baylik Finance (BF) in 2013. IFC provided the company with developed CTA tools and trained credit officers to use them. Liquidity was not provided. BF was using its own funding sources for HMF lending so the interest rate on the HMF loans was the same as on other loans of BF. Borrowers had the choice to finance their home improvements either with HMF loans of BF or with personal loans of BF or its competitors. The only advantage for the borrowers taking HMF loans was the ability to benefit from the pre-developed CTA.

The high demand from low-income households demonstrated that the pre-developed CTA brings substantial value for them. In two years the number of HMF loans grew from zero to 22% of the BF portfolio. The product is sustainable, because it does not require any support. It has never relied on liquidity provided at concessional rates or on external financing of CTA. BF has all that it needs to continue providing value to their clients: pre-developed CTA tools.

It is important that only poor households demanded HMF loan. This is confirmed by the very small average size of the HMF loans of BF, which is only $700.

The success of BF stimulated 4 other Kyrgyz Microfinance companies to follow suit and launch HMF products based on the same CTA tools.

7. Conclusion

Finance for home improvement is needed by low-income people all over the world. HMF is not the only product that can help them to finance improvements to their homes. They can use for that purpose a personal (consumer) loan, and also micro-entrepreneurial and micro-mortgage loans. However, HMF is the only product that can help them (a) save on the costs of implementation of the home improvement, (b) make the quality of the improvement better, (c) make their houses more disaster resilient, (d) improve the energy efficiency of their homes.

As demonstrated above, among several mechanisms that have been used to create a HMF product, the most efficient and sustainable one is the mechanism based on the pre-developed CTA. The key advantage of the mechanism is that once launched, it does not require any additional financial support, neither in the form of interest rate or cash subsidies, nor in the form of payment for CTA provided to each client. FIs make a HMF product an efficient and popular lending instrument through the use of the CTA tools that they have in their possession. Once the CTA tools are available, the FIs do not require any external support.

When compared to the classical approach to HMF promotion, under which FIs are provided with low-cost liquidity and/or free CTA to make them interested in offering HMF loans, it can be stated that the classical approach brings "fish" to FIs, while the approach based on the pre-developed tools brings them a "fishing net".

At the same time, this form of HMF has its own shortcomings. The key shortcoming is that it can be used only for a limited number of home improvements. If a borrower needs to conduct a home improvement that has not been identified as the most popular one, or if he/she wants or needs to use slightly different technology than the one that the CTA tool has been based on, he/she will lose the opportunity to benefit from the pre-developed CTA. For low-income people this shortcoming is not as important because most of them do the same (mostly basic) improvements and use the same technologies. However, this shortcoming becomes important for a HMF lender that wants to go up-market where the variety of home improvements and technologies are greater.

Another important shortcoming of this model is that creation of the product requires highly sophisticated work. The quality of the survey to identify the most popular home improvements as well as the quality of the CTA tools development, should be very high. If the most popular improvements are not correctly identified, HMF loans will lose their advantages. The same will happen if final borrowers consider that CTA tools are not clear enough to advise them on doing works on a self-help basis or do not relate to the technology they prefer to implement.

A lot of attention should be given to the training and coaching of credit officers. They need to get basic engineering knowledge, learn how to operate CTA tools and (what turns out to be the most complex in practice) how to explain the benefits of the HMF product to poor and often illiterate borrowers.

The creation of a HMF program based on pre-developed tools requires a highly qualified team of experts with deep understanding of a wide variety of topics such as engineering, development of education materials, training, active sales technique, microfinance lending procedures, software development, marketing, surveying.

Of course, it is much easier to launch a HMF program through the provision of "fish" – low cost liquidity to HMF lenders or external financing to engineers that provide CTA as personal advice to each borrower. Over the last 55 years, such support to HMF programs has been provided many times and proved to be unsustainable. At the completion of each of these programs, as soon as the support was over, it became clear that created HMF programs can't compete by themselves with personal lending and hence can't attract borrowers to FIs. The FIs had no choice but to discontinue the HMF programs or to convert them into personal lending.

The situation would be different if the support were used to pre-develop CTA – a "fishing net" – that could be used by FIs to provide benefits for future HMF borrowers after the support is over. It looks like it is time for donors, NGOs, IDOs and governments to quit supporting HMF lending products again and again with low-cost funding and free TA. It is time to start using a more complex but much more sustainable approach based on supporting the pre-development of CTA tools.

Stimulus measures driving confidence and growth in the Thai real estate sector in 2016

By K I Woo

1. Introduction

Buoyed by massive government incentives in the fourth quarter of 2015, Thailand's housing industry is strongly driving the slow-growth economy's 2016 recovery.

A weak 2015 Thai economy and a still-recovering global economic environment also seriously affected the housing industry's growth.

Record six-year-low export-volumes and lower agricultural prices impeded Thai economic growth despite higher government expenditures, capital investment and record tourism revenues.

Luckily, in 2015, more than 30 million tourists contributed to an industry that generated about 10% of Thailand's GDP. Almost eight million Chinese visitors constituted about 25% of Thailand's tourists. Nevertheless, the National Economics and Social Development Board [NESDB] statistics indicated that the Thai economy grew by only 2.9% in 2015, much slower than its neighbors.

For much of the year, the real estate and finance sectors were also seriously affected by a still uncertain political environment.

2. Housing market environment

The Thai housing market was relatively inactive in the first half of 2015, because the environment did not support market growth.

Housing finance institutions pared-down housing-finance marketing campaigns because of rising fears of non-performing loans, which forced many of them to impose more stringent loan approval requirements.

Even when the Monetary Policy Committee lowered interest rates 50 basis point from 2.0% to 1.50% through two first-quarter adjustments, the housing market didn't improve significantly even though financial institutions lowered interest rates.

However, during the year, the economy slowly began recovering and late in the year industry was buoyed by government housing stimulus programs.

3. Initial government stimulus measures

As the housing market began slowly recovering in the second half of 2015, the Thai Government began formulating stimulus measures that were ultimately enacted in the fourth quarter.

The initial stimulus packages included:

1. Reducing home transfer and mortgage fees and
2. Income tax reductions for purchasing homes priced at less than Bt 3 million ($US85,700).

Transfer fees were reduced from 2% to 1% and mortgage fees to .01%.

These programs were designed as a short term impetus to spur real estate sales. They began on October 29, 2015 and expired on April 28, 2016 and benefited all real estate transactions.

These two programs greatly contributed to the Thai housing market recovery.

4. Effects of measures

According to the Real Estate Information Centre [REIC], the number of new housing unit title transfers in Greater Bangkok rose 21% during the period November-December 2015, immediately after the measures were imposed and were expected to contribute to a 2016 first half industry recovery.

REIC Secretary General Samma Kitsin said at a property market seminar that these government measures ensured a soft real estate industry landing from its then current doldrums. "The market will slow-down for a month or two after the incentives end but will quickly return to normal as in the past."

He said the tax incentives encouraged many middle-to-high-price home purchasers. To enhance the development of lower-income housing and to further stimulate the economy, the government also instituted several housing programs targeted at lower income people in early 2016.

5. Overall housing market structure

Despite rising land, labor and construction materials costs, Thailand's developers are still able to provide affordable housing to its middle-income home buyers.

A key infrastructural element, prohibiting foreigners from owning land has helped maintain housing prices at affordable levels. Foreigners can only lease land to build homes.

At the same time, condominium projects are also subject to foreign ownership restrictions. In general, foreigners are only permitted to own less than 50% of the units in any condominium project. Mortgage financing from local financial institutions is also difficult for foreign buyers.

Consequently, house prices in Thailand as a whole are significantly lower than in Bangkok or other major regional cities such as Singapore and Hong Kong.

In Bangkok and its metropolitan region [BMR] home buyers have a wide range of home choices in different price ranges. A recent Government Housing Bank [GH Bank] study showed that 53% of new homes offered in the Bangkok metropolitan area were offered for sale at Bt2 million ($US66,667) and below.

About 81% of the Government Housing Bank's new loans were priced at less than Bt2 million ($US66,667). In fact, more than 52% of GH Bank loans were for homes priced at less than Bt1 million ($US33,333).

5.1. JICA study

A recent Japan International Cooperation Agency [JICA] and National Housing Authority [NHA] study indicated that increasing urbanization, rising personal incomes and changing demographics will continue to influence the Thai housing market's structural development.

The study said that although housing supply has been increasing steadily for the past decade, a significant imbalance exists between high and low income groups.

In terms of affordability, the study shows a shortage of affordable housing supply for lower income groups, while developers are building more homes than currently needed for high-income groups.

5.2. Increasing urbanization

Along with economic growth, Thailand is also experiencing tremendous urbanization that will expand further in the next several decades to about 61% in 2030. Increasing urbanization has already changed Thailand's housing structure with high-rise condominiums fast becoming the new homes of choice for middle-income city-dwellers.

Many condominium developments are now built near or adjacent to mass-transit lines throughout Bangkok and its metropolitan areas.

5.3. Second-hand home market rising

In the past most Thai housing experts said that Thai people aren't interested in buying used homes. The JICA study indicates these preferences are fast-changing.

Increasing land and construction costs and higher urban densities are now finally making purchasing second-hand homes viable options especially in major urban areas.

The JICA study shows that current second-hand home sales may be slightly higher than new home sales (new homes sales are about 80,000 to 90,000 per year; second hand home sales 60,000 to 100,000 homes annually.

5.4. Low-end real estate

Thailand's National Housing Authority works with private sector developers to build low-priced housing for families with low-incomes. Its Baan Eur-athorn program provides subsidized home ownership through innovative housing finance programs with the Government Housing Bank and the Government Savings Bank. At the program's inception these homes were priced at Bt390,000 ($13,000).

5.5. High-end real estate

Surprisingly, very-high-end houses priced at more than Bt5 million ($166,667) and extremely high-end houses priced at more than Bt10 million $(333,333) that are most often seen in newspaper and television advertisements only constitute about 12% of homes offered for sale by Thai real estate developers. In Bangkok, many high-end single family homes are priced at more than Bt40 million ($US 1.1 million) but this sector still constitutes a very low percentage of the Thai housing market.

6. Government plays major role

Throughout the past several decades, various Thai governments have led major economic recovery initiatives by implementing housing stimulus programs that initially revived moribund real estate markets and ultimately spurred economic recovery.

After the 1997 financial crisis, special housing loans programs were developed and primarily targeted at state enterprise and government civil-servants who had previously waited until retirement to acquire new homes.

These special programs not only spurred economic recovery but also helped more than 100,000 credit-worthy families acquire their own homes.

After the 2008, US sub-prime led global financial crisis, the Thai government asked the Government Housing Bank to develop and execute housing stimulus policies that became key factors in the country's economic recovery and prosperity.

7. Affordable housing

Thailand has successfully provided affordable housing for decades.

Numerous governments have tapped government-owned financial institutions such as the Government Housing Bank to help develop viable housing and housing finance policy-frameworks that always focused on providing affordable housing especially for low-and-middle income households.

Thailand's home ownership of about 80% is among the highest globally. The country has no serious housing shortfall and in-fact faced oversupply problems during the period 1995 to 1997 before the 1997 economic crisis.

Over the past six decades, Thailand has successfully minimized slums and squatter settlements. The Government Housing Bank, Government Savings Bank, National Housing Authority and the Community Organizations Development Institute [COD]) have all played significant roles.

8. Market housing

Market housing in Thailand is provided primarily by private developers and is readily available for sale in most market segments. Similar to other markets, the Thai housing market has experienced periodic cyclical fluctuations.

New housing development in Bangkok during the five-year boom period from 1993 to 1997 totaled about 800,000 units, an average of about 160,000 per year, a clear indication that developers could produce homes in large numbers. Current, new housing completions are still only about 100,000 to 110,000 per year.

9. Subsidized social housing

Government intervention has always been used to provide adequate housing for low-income population segments. The two main government organizations that provided affordable housing to lower-income groups are the National Housing Authority [NHA] and the Community Organizations Development Institute [CODI].

The NHA is a state enterprise, under the Ministry of Social Development and Human Security that promotes affordable home ownership. Until 2003, the NHA had only developed a total of 430,000 low-income housing units nationwide.

9.1. Baan Eur-athorn programs

In 2003, the NHA began developing 600,000 subsidized-low-cost housing project via its Baan Eur-athorn (BEA) programs. The homes were priced at Bt390,000 ($US11,142) with a Bt80,000 ($US2,286) subsidies. The majority of Baan Eur Athorn units are 33 sqm. condominium units in Bangkok. Others are semi-detached or detached homes throughout the country.

9.2. CODI's Ban Mankong program

CODI was established in 2000 as a public organization also under the Ministry of Social Development and Human Security. Its mission was to support and empower community organizations through financial assistance, career development, housing developments and environment improvements.

In 2003, the Thai government through CODI initiated the Baan Mankong housing program as part of its efforts to address the housing problems of the country's poorest urban citizens who live in slum communities. The programs receive infrastructure subsidies and housing loans from the Government.

The Baan Mankong concept is not to tackle each individual slum's problems but to look at collective community problems on a city-wide scale. Each slum community collectively plans and carries out housing improvements by their own efforts within allocated budgets.

Once city-wide plans are finalized and upgrading projects are selected, CODI channels infrastructure subsidies and housing loans directly to the communities through legally established cooperatives or savings groups. Since its inception, the Baan Mankong housing program has been carried out in more than 1,000 communities and has benefited more than 100,000 families.

10. The housing market in 2015

In Bangkok and surrounding provinces, housing completions in the first eleven months of 2015 (Jan-Nov, 2015) decreased by 6.9% to 111,636 units, when compared to the same period the previous year.

With land costs rising, condominiums constituted about 52.9% of sales and single-family homes, duplexes and townhouses constituted the balance.

10.1. Number of newly-launched units

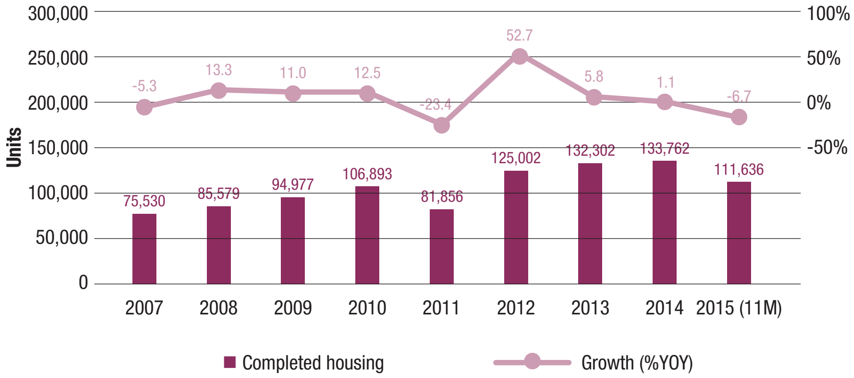
The number of newly-launched housing units (i.e. housing starts) in Bangkok and surrounding provinces in the first eleven months of 2015 increased 1%.

Of these units, condominiums constituted the highest volume (63.5%) while low-rise housing dropped to 36.5%.

10.2. Housing transfers

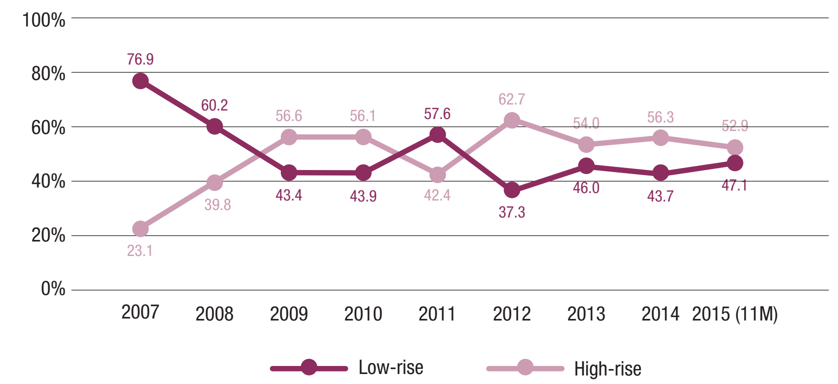
Housing transfers (registered property sales) in Bangkok and surrounding provinces in the first eleven months of 2015 (Jan-Nov, 2015) were 166,157 units, increasing 6.8% compared to the same period of the previous year.

Chart 1 Completed housing units – Bangkok and surrounding provinces



Source: REIC *Created by: GH Bank's Analysis and Strategy Planning Department*

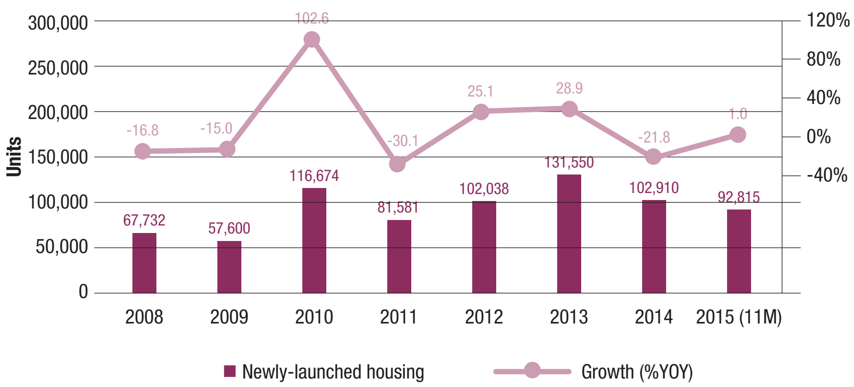
Chart 2 Completed Housing Units – by type



Low-rise (Units)	58,098	51,530	41,252	46,974	47,122	46,611	60,862	58,453	52,553
High-rise (Units)	17,432	34,049	53,725	59,919	34,734	78,391	71,440	75,309	59,083

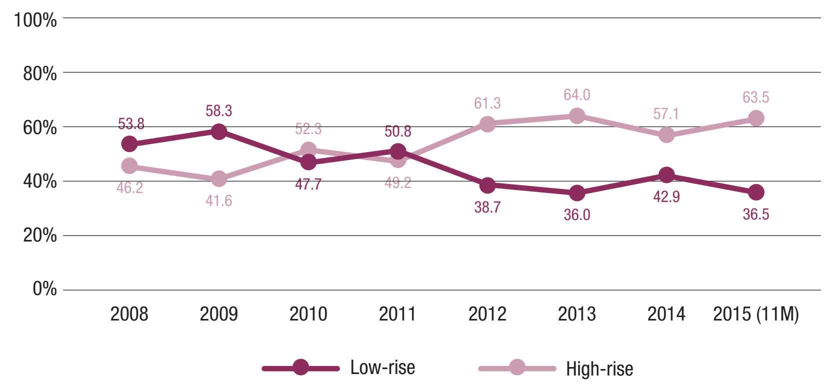
Source: REIC *Created by: GH Bank's Analysis and Strategy Planning Department*

Chart 3 Newly-launched housing units in Bangkok and surrounding provinces



Source: BOT *Created by: GH Bank's Analysis and Strategy Planning Department*

Chart 4 Newly-launched housing – by type



Low-rise (Units)	36,410	33,607	55,702	41,447	39,490	47,300	44,178	33,894
High-rise (Units)	31,322	23,933	60,972	40,134	62,548	84,250	58,732	58,921

Source: BOT *Created by: GH Bank's Analysis and Strategy Planning Department*

Estimated total transfers in 2015 were 173,812 units. Low-rise housing increased to 62.9% while condominiums constituted 37.1%.

11. The housing market in 2016

The aforementioned government real estate stimulus programs that reduced transfer and mortgage fees and provided income tax deductions for home purchases of less than Bt3 million ($US 85,700) have helped the housing market recover in early 2016 and have reduced the current excess housing inventory.

These stimulus programs reduced overall home purchase costs, provided additional funding for housing appliances and brought additional funds into the economy. Tax payers hoping to benefit from tax deductions also increased the rate of house purchases.

12. Rising costs, but increased revenues and profits

Even with numerous government stimulus programs, Thailand's housing developers are still finding it difficult to hold prices stable.

On May 13, 2016 the country's largest housing developer, Pruksa PCL announced that it was raising its home prices by 5% this year because of the higher land costs. Piya Prayong, the company's Value Business President told The Nation that it had raised its 2016 projected revenue targets from Bt52 billion ($US1.49 billion) to Bt 53 billion ($US1.51 billion) because of the government's temporary stimulus measures. Land prices, he said had risen 20 to 30% from the previous year but these costs were mitigated somewhat by stable construction-material costs. Even with the current low-growth Thai economy, Pruksa believed that Bangkok's housing demand will grow by eight per cent this year. He said that most of the demand is for homes priced at less than Bt7 million ($US200,000).

13. Baan Pracha Rath stimulus program

After successfully reviving the housing industry's growth, the government began contemplating replacing the initial short-term housing stimulus program that were to expire on April 28, 2016,

A new Baan Pracha Rath program was announced late in the first quarter of 2016. The new program targeted development of homes priced below Bt1.5 million ($US 42,857) for low-income families and is expected to increase industry sales by 10% or Bt400 billion in 2016.

Prasert Taedullayasatit, President of the Thai Condominium Association told The Nation that the Baan Pracha Rath program would drive the industry's second quarter growth and help meet the low-income sector's huge housing demand,

13.1. Three state banks

Three state banks, Government Housing Bank, Government Savings Bank and Krungthai Bank will fund the projects.

Laiwan Pongsangium, GH Bank's acting President said the Bank has allocated Bt30 billion ($US857 million) for the Baan Pracha Rath project, of which Bt10 billion ($285 million) will be allocated to National Housing Authority and private housing developer low-income housing projects.

Interest rates for these loans will be fixed at 4% per annum for years one and two: from the 3rd year until the end of the loan- term there will be floating interest rates.

The remaining Bt20,000 million ($US571 million) will be for loans to low-income Baan Pracha Rath home buyers, who have previously not owned homes. These loans are for buying or building homes at prices not exceeding Bt700,000 ($US20,000) or home renovations not exceeding Bt500,000 ($US14,285).

Subsidized interest rates of 0% interest will be charged in the first year, 2 % for the 2nd to 3rd year, 5 % per annum for the 4th – 6th year and floating interesting rates for the remaining term. Families purchasing homes priced at Bt700,000 to Bt1.5 million ($US20,000 to $US42,857) will be charged slightly higher subsidized interest rates.

To further assist low income buyers, debt service ratios [DSR] for these loans will be increased to not more than 50% of total net income per month for retail customers and 80% for corporate benefits borrowers that agree to have their monthly payments automatically deducted from their payroll accounts.

13.2. Homes on leased government land

To further enhance the Baan Pracha Rath program, the Government has also offered six pieces of government land for the project. Leasehold homes (30 year leases) priced at no more than Bt1 million ($28,571).

Two pieces of land are in Bangkok: one is on the former site of the Royal Mint on Pradiphat Road and the other in the Phaya Thai district. Four additional sites will be in Chiang Mai, Chiang Rai and Phetchaburi's Cha-am district.

Condominium units must be a minimum of 24 sqm and houses no less than 48 sqm.

So far, the project has had huge demand. The Government Savings Bank reported that almost 30,000 potential borrowers have sought loans worth more than Bt20 billion baht ($US571 million), while GH Bank had 15,400 applicants seeking mortgages of Bt 13.1 billion ($US374 million).

14. Higher end developer strategies

Thailand's middle income and high-income housing developers have begun announcing new promotional strategies. Riding on the euphoria of increased sales in the fourth quarter of 2015 and especially during the first quarter of 2016, numerous developers have announced new incentive deals.

Shopping center owners, Gaysorn Property Co introduced its latest luxury condominium, the Tela Thonglor, (Bt4.1 billion ($US117 million). Its Managing Director, Fafuen Temboonkiat told the Bangkok Post that the company was confident the demand for luxury condominiums, especially in Bangkok's Toney Thonglor area was still growing.

High-end housing builder, Sansiri PLC launched its Bt3.1 billion ($US88 million) detached-housing estate, Setthasiri Pattanakarn. Metha Angwatanapanich, a Sansiri senior executive vice president for business and low-rise project development told the Bangkok Post that the company would monitor sales at low-rise housing projects after the government's tax incentive expired." He also said, "We aim to have sales of Bt1 billion ($US285 million) per month from May to September from detached-housing and townhouse projects,".

During the first four months of 2016, Sansiri sold Bt4 billion ($114 million) of detached-housing and townhouse projects, aided by the government incentives.

Another company, Kanda Property Co offered to pay transfer and mortgage fees for an additional month after government incentives expired. "Some customers couldn't transfer units in time because they were waiting for Bank mortgage approvals," Managing Director Issara Boonyoung told the Bangkok Post.

15. Huge coat-tails

The Thai government's successful real estate stimulus measures first launched in late 2015 have provided new confidence to its many housing developers.

In late May, The Nation reported that developers are planning to launch new projects of about Bt200 billion ($US5.71 billion) in greater Bangkok alone during the balance of 2016. Many delayed projects have been relaunched.

"We launched only eight projects in the first four months of the year because we speeded up sales from our inventory to match the government measure to reduce transfer and mortgage fees to 0.01%, which expired on April 28," Prasert Taedullayasatit, Pruksa Real Estate's president for premium business, said.

The company plans to launch another 63 projects worth up to Bt50 billion ($US1.42 billion) during the rest of the year, so that it could reach full-year 2016 sales targets.

At the same time, Sansiri said it will launch seven projects valued at Bt13.2 billion ($US377 million) in the first half of 2016, and 10 additional projects valued at Bt20 billion ($US571 million) during the second half of the year. In the first quarter of 2016, it only launched four projects and recorded pre-sales of Bt5 billion ($US143 million). The company's president Srettha Thavisin told The Nation, he was confident that residential demand would grow during the remainder of the year, even though the government stimulus measure for property business expired. "We are maintaining our transfer-value target of Bt36 billion for the year," he added.