DECEMBER 2008

HOUSING FINANCE INTERNATIONAL

The Quarterly Journal of the International Union for Housing Finance

Housing Bubbles • Slum Upgrading • Social Housing • South Asia • Nigeria • Germany

HOUSING FINANCE INTERNATIONAL

Vol. XXIII No. 2 DECEMBER 2008

Housing Finance International is published four times a year by the International Union for Housing Finance

Subscriptions:
Regular annual rate £95. Three-year discounted subscription £195.
For further details on subscriptions please contact Keeley Baker.

International Union for Housing Finance
6th Floor, York House, 23 Kingsway, London, WC2B 6UJ,
United Kingdom
Tel: +44 (0)20 7440 2210 Fax: +44 (0)20 7836 4176
http://www.housingfinance.org

 ISSN: 1534-8784

Editor's Introduction

by Friedemann Roy

Two men look out a window. One sees mud; the other sees the stars. (Oscar Wilde)

One definition of perception is the "process of attaining awareness or understanding of sensory information. What one perceives is a result of interplays between past experiences, one's culture and the interpretation of the perceived. If the percept does not have support in any of these perceptual bases it is unlikely to rise above perceptual threshold."[1] This edition of the *Housing Finance International* is about perceptions. With the global credit crunch more deeply creeping into the individual economies, economists, regulators, government officials, etc deliver different views on its effects, lengths and repercussions.

Many in the emerging markets first believed in the decoupling theory ie these economies will weather the storm, irrespective of the turmoil in the developed countries. However, this perception turned out to be wrong: their currencies have toppled, investment has receded, and growth rates have gone down. As a result, most of the emerging economies plunged into recession as the developed countries are already experiencing it. At the beginning of the crisis, even some politicians in Europe (notably Germany) believed that their economies will be hurt less. Finally, they realised that they cannot escape this global credit crunch.

Our first article by Ballobh Kritayanavaj looks at Thailand's booms and bust cycles. First, Mr Kritayanavaj provides a definition of a housing bubble and its potential causes and factors. In addition, he recommends using a number of specific indicators to discover a bubble. The second part of his article deals with Thailand's various housing bubbles and government's intervention to overcome the busts.

The author of the second article is Geoffrey Payne. He deals with a thesis (or perception) by Hernando de Soto. By formalising title, the poor could turn their assets into working capital. Thus, homeownership could solve the problem of poverty. Mr Payne, however, does not follow this argument. His analysis shows that titles have not increased the likelihood of receiving credit from private sector banks or that banks are using property titles to secure loans in this context.

The next article, by Annika Nilsson, also refers to Hernando de Soto's statement. In her overview on financial systems for slum upgrading and housing she perceives the predominance of informal activities in a society as problematic in many respects. On the one hand, it deprives governments of the tax base, which is necessary to the provision of public goods necessary to sustain the growth process. On the other hand, people in the informal economy, ie the poor, live outside the sphere of law and order. In her article, she discusses two approaches to improve access to finance for this group: microfinance for housing and community funds.

The fourth article by Claude Taffin, delivers an overview on social rented housing in the member states of the European Union (EU). He explains the impact of EU Regulations on social housing policies in the individual member states. In this context, he specifies potential instruments aimed at financing and subsidising investments in social housing, thereby referring to the French system as an example.

The author of the fifth article is Zaigham Mahmood Rizvi. He analyses the housing markets in Bangladesh, India, Parkistan and Afghanistan from the perspective of price and affordability. After assessments of these four countries, he looks at the challenges and opportunities these markets contain for lenders and market stakeholders such as insurance companies, the construction material industry, and others.

The next article is by Olatoye Ojo and J I Ighalo. They assess the factors which affect the borrower's choice of a housing loan package in Nigeria. Their paper is based on a questionnaire distributed to 327 Nigerian households. The study shows that the three most significant factors are the interest rate (93.8%), the income of the borrower (90.5%) and the availability of a title document as collateral (83.7%).

Hartwig Hamm is the author of the last article. He deals with the housing finance model in Germany. He believes that the global credit crunch will not affect the home loan offers in Germany. He attributes his perception to two main factors ie risk aversion and stability. Risk aversion is propelled by conservative underwriting standards and deposits as the main refinancing instrument for home ownership acquisition loans (ie loans remain on the lenders' balance sheets). In addition, he points out that German consumers prefer fixed interest rates and high down-payments. He concludes that there are practically no potential clients with a poor credit rating as a result of stable financing terms and conditions. The problem is not scarcity of credit, but hesitant borrowers.

I hope you will enjoy reading these articles. Maybe the articles will inspire you to come up with your perceptions of the opinions and views expressed by the authors in their contributions. They are more than welcome!

[1] From Wikipedia, the free encyclopedia.

Housing and Real Estate Bubbles: Thailand's Boom and Bust Cycles

By Ballobh Kritayanavaj[1]

Real estate and housing bubbles were regular media topics during the decade from 1995 to 2006. The issues were regularly discussed in Thailand and largely centered around potential bubbles in China and US real estate.

During this period *The Economist* regularly published reports warning readers of the dangers of real estate bubbles. "The worldwide rise in housing prices is the biggest bubble in history. Prepare for the economic pain when it pops," it said (16 June, 2005).

The articles reiterated that real estate bubbles were a worldwide phenomenon with prices rising simultaneously in the US, England, Australia France Spain and China.

Although there were no obvious signs of a real estate bubble in Thailand, several publications were beginning to issue warnings of an impending problem. "A lot of real estate unsold, are we in for another bust?" (*Post Today*, July 19, 2006).

In this paper, we will first explore real estate bubbles and how we can protect ourselves by analyzing and studying all available data.

1. What is a bubble?

A "bubble" normally means a very thin film of soap that forms into a ball with air inside. Soap bubbles usually float for only few moments and then burst. Gurus and academics usually refer to phenomena as bubbles if they are unstable.

In most cases, economists use bubbles to describe companies or industries that have expanded too quickly and where prices have risen to very high levels. Bubbles burst when prices in these seemingly forever-rising but volatile environments suddenly stop increasing and begin plunging quickly.

A "bubble economy" occurs when many industries in an economy are experiencing fast-increasing prices at the same time. Thailand followed global markets in the 1990s with stock market and mild dot.com bubbles.

However, Thailand was severely affected by a real-estate property bubble-induced economic crisis in 1997. The bursting of this bubble severely affected the country's financial system and the overall economy.

Here, as in many countries, the real estate market is a very significant driver of the overall economy. GH Bank's Research Department[2] statistics indicate that the real estate market and related industries may constitute as much as 25 per cent of the country's GDP.

2. What is a housing bubble?

Housing bubbles occur when the market is experiencing unusually high volumes of buying and selling and prices are rising at extraordinarily high levels.

When the rising market suddenly comes to an end, buyers disappear and housing prices drop precipitously. This is the bursting of the housing bubble.

At the housing bubble's peak, basic housing prices are unaffordable for the general public and speculators and investors are the main market drivers. Nationally and globally, housing bubbles are usually a temporary phenomenon.

When a housing bubble bursts, many stakeholders usually suffer, including home-owners, developers, financial institutions and the overall economy.

The bursting of future housing bubbles may be even more severe than in the past if relevant parties do not realize their potential dangers to the overall economy and implement measures to mitigate their severity.

3. Housing bubbles and housing cycles

Housing bubbles do not happen quickly. They tend to gradually creep up on us. During periods of rising prices, almost everyone is initially very happy because of increasing wealth. Consumer spending is inevitably buoyed as people rush to spend some of their new-found wealth.

Real estate prices continue rising at much faster and faster rates. During this period few people dare to predict when an inevitable crash will occur.

Housing bubbles are part of any housing cycle. However, each cycle's length is usually quite different.

Boom and bust housing cycles are usually dependent on two basic factors, demand

[1] Senior Vice President, Government Housing Bank, Thailand

[2] GH Bank is Thailand's largest home mortgage provider. It was formed in 1953 and is 100 per cent owned by the Ministry of Finance.

and supply. When demand is much greater than supply, prices increase and a housing boom occurs.

When supply is greater than demand, prices turn downward and in severe situations, a housing bust occurs.

4. Causes and factors of housing bubbles - how does it happen?

Economists and real estate researchers have for a long time tried to explain how and why housing bubbles occur. However, no single universally accepted theory has been agreed upon.

Most real estate bubbles however, can be summarized with the following:

1) Housing Supply

During economic boom periods, housing demand is high and existing housing developers begin producing more homes to meet the demand. Speculators enter the market and drive prices even higher. New developers also enter the market to meet the demand until the market is oversupplied.

Prices begin falling. However, developers cannot immediately stop their projects because of the long lead-times it takes to develop and complete housing projects.

2) Housing Demand

During periods when the economy is slowing, demand for housing falls because consumers refrain from spending, especially on big-ticket items.

3) Housing finance

During periods of low-interest rates and high liquidity, the home buyer's purchasing power is increasing and homes become more affordable. Financial institutions in a highly-competitive environment fight to maintain market share by promoting housing loans.

Loan qualification standards are relaxed because everyone believes real estate prices will continue rising and mitigate most future risks.

When interest rates rise, financial system liquidity declines and financial institutions begin cutting back on real estate loans. At the same time, higher interest rates reduce home-buyer's purchasing power, housing demand begins falling and eventually prices fall.

4) Psychological factors

During any boom period, people tend to be over-optimistic. They become irrationally exuberant and tend to buy more than they can afford because they believe home prices will continue rising unabatedly.

In contrast, during economic downturns, people tend to be overly pessimistic. They become very sensitive and tend to act negatively to any rumors. Prices usually plunge precipitously.

These overly pessimistic psychological factors usually result in long and severe down cycles.

5) Other factors

Any severe downturn usually leads to a contagion affect that begins inundating other sectors of the economy. Bad consumer sentiment engulfs the whole economy.

In severe cases, stock markets crash or countries go into a financial crisis.

5. Housing bubble boom and bust indicators

Most countries, including large economies such as the USA, are still not clear on what types of indicators can be used to help prevent the recurrence of housing bubbles.

In Thailand, we think that the following indicators should be followed closely:

1) Sales volumes

We should monitor closely the number of new and second-hand home sales even though no official housing sales data is collected in Thailand.

Many developers monitor their own sales as well as those of their competitors.

2) Housing price index (HPI)

A Housing Price Index (HPI) is a most obvious housing bubble indicator. In Thailand, the Bank of Thailand began compiling an HPI since 2004 using the Government Housing Bank's collateral data base.

It indicates the change in housing prices nationwide and can be used to compute any changes in disposable income.

The HPI is used for asset appraisal purposes and more importantly is used by the government as a benchmark to develop and implement its housing development policies.

In Thailand the HPI only charts prices of middle and low income housing.

3) Vacant homes

This indicator is derived from calculating the number of vacant homes that have been completed for six months or more, categorized by location and type. The vacancy rates indicate demand and supply, production trends, future prices and economic loss on wasteful resource consumption

The Government Housing Bank conducted vacant home surveys for Bangkok and its surrounding areas in 1995 and 1999. It derived much of its data using electricity consumption information.

Housing vacancy information should be continuously updated.

4) Housing starts

Housing starts will predict the amount of construction equipment, labor and housing finance consumed during the ensuing one to three year period. It also is an indicator of

HOUSING AND REAL ESTATE BUBBLES:
THAILAND'S BOOM AND BUST CYCLES

future housing supply and perhaps more importantly is an indicator of the country's future economic expansion.

In the past, Thailand has not collected housing starts data even though the Government Housing Bank has recommended it for the past 15 years. The country's Housing Policy Sub-committee has passed a resolution recommending the collection of this data and has asked the Ministry of Interior to execute the plan but no action has been taken.

Currently, GH Bank's Real Estate Information Center is in the process of gathering such data. In the meantime, we are using land sub-division permits and building permits information to indicate current housing construction trends.

5) Housing completions

This indicator is derived from gathering data on the number of houses completed nationwide each month. It is an indicator for housing supply, sales volume, and housing finance demand.

It can also be used to predict future demand for furniture, home appliances, water and electricity consumption. GH Bank's Research Department has gathered such data for Bangkok and five surrounding provinces continuously for more than ten years.

6) Housing transactions (ownership transfers)

Housing ownership transfer information should be gathered from nationwide Land Departments categorized by province and housing type. This data will indicate real demand and supply, and housing finance volume.

Currently the Land Department publishes housing transfer data by province but not by housing type.

7) Number of new housing loans

Data on new housing loans for new and second-hand homes indicate home ownership expansion. During boom periods, we may need to analyze this data along with other factors such as interest rates, loan-to-value ratios, and bank promotional programs.

Bank of Thailand and GH Bank have collected national housing finance data for new and outstanding housing loans. This data would be more useful if the data for Bangkok and surrounding areas is separated from other provinces, and housing loans and other loan real estate loans are separated.

8) Housing affordability index

The housing affordability index shows the ratio between housing prices and income. The median market price of housing is used. A high-ratio indicates low affordability.

In the case of Thailand, the calculation is made as follows:

Median house price = Bt 500,000
Total family's income per year = Bt180,000
Ratio = 2.78 : 1

The National Association of Realtors in the US has developed a Housing Affordability Index, using median family income and median prices for homes to calculate the ratio.

If such an index were developed in Thailand, developers and financial institutions would have an additional indicator that would warn them when housing prices have become less affordable.

6. Proposals to mitigate housing bubble effects in Thailand

The following ideas should be considered:

1) Producing housing consistent with real demand and purchasing power

Developers should closely monitor the housing cycle and market environment for: demand, supply, interest rates, financial institution liquidity, population growth, legal changes, and the overall business environment. Their business plans should be flexible enough to quickly adjust for any real estate cycle changes.

2) Cautious/rigorous approval standards for mortgage applications

In the past, lax mortgage qualification standards contributed to housing bubbles. Banks and financial institutions should closely monitor housing cycles and establish appropriate loan policies for different environments (ie fixed or floating interest rates, credit limits, repayment calculations etc). For example, borrowers should have saving accounts equal to about 20 per cent of their loan amounts, and loan qualification repayment calculations should be based on an interest-rate that is above Bank's announced rate.

3) Money market and interest rate supervision

The Bank of Thailand's (BOT) interest rate policy affects housing loan interest rates, housing construction and real estate sales. Fast-rising interest rates affect borrower's purchasing power and mortgage payments. The BOT's overriding policy should be to maintain financial market stability and appropriate interest rates.

4) Housing information improvement and leading indicators

The Real Estate Information Center (REIC)[3] should be supported so that it can produce more timely relevant housing data. It should be funded so that it can produce the following additional data: housing for sale statistics, number of sales, and monthly

[3] The REIC was officially opened in 2004. It is an independent organization under the financial support from the Government Housing Bank. Its main role is collecting real estate data and providing information for the government's macro-economic plans. The REIC also provides information to real estate industry professionals, financial institutions and the general public.

housing starts etc. The REIC should be encouraged to develop leading indicator models.

5) Closely monitor Thailand housing industry

The Government, developers, financial institutions, real estate associations and other relevant organizations should monitor the housing industry closely; nationwide, Bangkok and surrounding areas and major provinces. Housing research and timely information, including from housing seminars or forums should be regularly disseminated.

6) Study other countries' housing bubble experiences

Thailand should study the causes and effects of housing bubbles in different countries worldwide and learn from their experiences. It will undoubtedly enhance our understanding of housing bubbles and help us mitigate any damage from future bubbles in Thailand.

7) Encourage housing bubble research

These institutions should be encouraged to research housing bubbles: Universities, REIC, GH Bank and the BOT. Research projects should be developed to create a housing bubble knowledge base that will allow us to recognize conditions that will lead to housing bubbles and develop measures to mitigate the effects of any future housing bubble. Risk prevention measures should also be developed.

8) Housing cycle and housing-bubble education

We should encourage the publication of research papers on housing bubbles. The GH Bank Research Department has published housing bubble articles in its GH Bank Journal for better education and understanding of the concerned parties. The training programs or education courses in the university level should also include the subject on housing cycle analysis.

7. Thailand's Housing Boom and Bust Cycles in the Past Forty Years

During the past 40 years, Thailand has experienced numerous boom-and-bust real estate cycles. We will analyze them and hope our findings will help Thailand avoid subsequent future boom and bust housing cycles.

Each housing boom and bust housing cycle in Thailand occurred over a five-to-ten year period. We will analyze what caused each of these crises and what precipitated each one's ultimate recovery. The two key factors of these boom and bust housing cycles were housing supply and demand. When demand was high, selling prices increased. Developers responded quickly by increasing supply and began creating a fast-surging housing boom. As an over-supplied market developed, selling prices began decreasing and when the market was massively oversupplied, a bust cycle began. Various factors affect the severity and length of Thailand's housing boom-and-bust cycles.

Previous Thailand's housing booms and busts can be divided into six cycles. In addition, further scrutiny will be given to the causes of the housing bust of 1996 (during the sixth boom and bust cycle).

7.1 First Land Division Development Boom and Bust Cycle (1957-1967)

The Thai housing market began about forty years ago in about 1957. Prior to this time people constructed their own homes. However rapid industrialization brought with it an environment that fostered the development of a viable housing industry. The Thai real estate market began with three main types of developments.

1) Row housing; this was a popular development technique because it could be used for both housing and commercial purposes.

2) Flats or apartments for rent; medium and high-rise buildings for middle-income people including foreigners.

3) Land sub-division development projects; These land sub-division projects didn't include a home but utilities such as electric, water and streets were provided. This type of project was an initial best-seller.

It is important to note that during the initial stages (1957-1967) banks and financial institutions offered few housing loans. Developers primarily used their own funds or co-invested with land owners for a share of the profits. Home buyers were required to use their savings to buy land and construct their homes. Purchasers usually occupied the houses and had no intention to sell them for speculative profits. The home-buyer's purchasing power was rather limited. The real estate and housing market was not deep and this environment precipitated a boom-and-bust cycle.

7.2 Second Boom and Bust Cycle (1968-1974)

In 1968, the housing market began improving and a new boom cycle developed between 1969 and 1972. However, the market again veered downward in 1973-1974.

Land developers began building and selling single homes on large scale housing development projects in 1968. Selling land with a home was a new innovative and effective marketing strategy to encourage home buyers. This strategy was aided by economic growth and increasing financial institution liquidity. The financial institutions began assuming a significant role by providing more housing loans to both developers and home buyers.

The rapidly growing housing market led to many abuses mainly because few laws and regulations were in place to control land developers. At the end of 1972, a Revolutionary Party Announcement was issued to protect home buyers. In addition, the National Housing Authority (NHA) was established to promote housing and to resolve a demand-deficiency problem. The NHA was established as a state enterprise responsible for developing low-and-middle income housing.

At the same time, the Government Housing Bank's land and housing development role was transferred to the NHA. Subsequently, the GH Bank's major role was to act as a specialized housing-finance institution. The GH Bank's changing role significantly benefited developers as well as home buyers who could now access a wider variety of housing loans.

The 1973 oil-shock-induced economic crisis turned the Thai housing market into another bust cycle. The oil-crisis that caused higher-price environment affected costs throughout the economy. Construction equipment, material costs and labor costs rose and disposable income eroded significantly. Consequently, fewer people could afford to buy homes.

In addition, the government implemented more restrictive land sub-division laws further discouraging land developers. These new laws required larger subdivision lots and more extensive sub-division infrastructure developments. Developers initially reacted by cutting back developments. Eventually, these conditions created a new housing-supply shortage.

7.3 Third Boom and Bust Cycle (1975-1982)

In 1975, the housing market began recovering and precipitated another boom period from 1976-1978. However, the boom was short-lived and crashed to a bust cycle again from 1980-1982.

Three factors encouraged a housing-market recovery and market expansion during 1975-1978;

1) Creating investor confidence: The NHA was commissioned by the Government to produce 120,000 units under a 5 year-scheme.

2) Funding for developers: Commercial banks and financial institutions had sufficient liquidity so interest rates decreased.

3) Funding for home buyers: The Government Housing Bank, the major housing-finance institution stimulated the market by speeding-up the delivery of lower-than market interest-rate loans to low and middle income home buyers.

During this period, developers began focusing on inner-city developments. Townhouses became popular because more of them could be built on smaller land areas and these homes could yield similar prices as single-family homes in the suburban areas.

The condominium era began in 1979 with the enactment of the Condominium Act. Because of high land costs, most initial developments were higher-priced units in prime areas. Townhouses were built in the inner-city and suburban areas for the lower-market segment.

In early 1980, after the second oil crisis, the Thai housing market began slowing down. The Bank of Thailand began implementing strict lending-ceiling regulations. Interest rates rose sharply to 18-19 per cent in 1982. Developers were adversely affected. Many developers abandoned projects, especially condominium projects because of high construction costs and the shortage of funds. They stopped constructing many of their mega-projects and chose instead to develop smaller phased-projects and custom made-to-order single-family homes. Developers began building new housing projects away from the city and into the suburbs where land prices were vastly lower.

7.4 Fourth Boom and Bust Cycle (1983-1986)

The Thai housing market experienced a brief short-term recovery in 1983 mainly due to liquid financial markets. Interest rates decreased but were still at a high 17-18%. The Thai housing market again dipped into a recession in 1984. Real estate prices decreased after the Government devalued the Baht and the Bank of Thailand began implementing housing-loan restrictions that limited housing loan growth to no more than 18% per year. Together with higher mortgage rates, the market was also adversely affected by major tax policy changes in March 1985 that adversely affected disposable incomes. Many developers faced a cash crunch. Construction costs remained high and overseas funding costs were high. Many condominium projects were stopped and the housing market continued dropping until 1986.

7.5 Fifth Boom and Bust Cycle (1987-1992)

The Thai housing market recovered in mid-1986 and a new boom period occurred from 1987-1990. This boom-market began slowing during 1991-1992.

When the housing market began slowing down in 1984 and 1985, the Government implemented new housing policies to accelerate housing development and drive economic recovery. The Government believed that a healthy housing market recovery would stimulate economic growth and create massive new employment opportunities. It implemented several key measures to promote home ownership.

The Government encouraged the GHB to widen its housing loan recipient base and encouraged commercial banks to provide construction loans to developers. The Government also provided several tax measures that promoted home ownership including allowing interest payments of Bt7,000 per month to be deducted from taxable income. Perhaps most importantly, it amended land sub-division regulations and streamlined project approval processes giving housing developers greater flexibility to develop lower-cost housing.

In mid-1986, the Government announced oil and electricity price reductions. Cement prices were also reduced and low interest rates prevailed. The Government began promoting policies that encouraged overseas investors to invest in the country. The Thai economy grew speedily at more than ten per cent per annum for three years from 1988 to 1990, with a high of 13.3 per cent in 1988.

As the Thai economy boomed, personal incomes also rose commensurately. The accompanying lower interest-rate environment also helped the Thai real estate market recover. The Thai housing market grew spectacularly between 1987 and 1990. This period is often considered the best-ever Thai real estate boom market. The boom was not limited to the housing market. Office buildings, agricultural land, golf courses, resort and mini-factories were all were selling quickly and prices soared continuously. Property was changing hands daily with rising prices, this was the theme of the day. The market became so overheated that speculators were crowding ordinary home purchasers out of the home market.

At the end of 1990, the Bank of Thailand tried to cool the booming real estate market and the "Bubble Economy" by restricting new real estate loans and implementing higher interest-rate policies. Then, the 1991 Persian Gulf War and the accompanying world economic downturn seriously affected the Thai housing market.

Speculators began abandoning their purchase deposits. Developers then followed by stopping half-completed housing and condominium projects. The Real Estate market began slowing in 1990 and 1991 and in 1992 another bust cycle commenced.

7.6 The Sixth Boom and Bust Cycle (1993-1997)

In 1993 the government promoted low-and-middle priced housing by reducing corporate income taxes for developers who constructed low-priced housing (not more than Bt600,000) for low and middle-income purchasers. The Government also increased civil service salaries and the Bank of Thailand liberalized regulations allowing commercial banks and other financial institutions to make more housing loans.

Thai financial institutions reduced interest rates to ten per cent in 1994, the lowest in recorded history. Land prices remained stable so developers expanded their land banks. Registered companies issued more than Bt10 billion in foreign bonds and invested the proceeds in land and launched many projects in new locations as they expected the economy to continue growing. In 1994, more than 250,000 housing units were for sale in Bangkok and surrounding areas. The housing market was fast becoming over-supplied.

In April 1995, the Government Housing Bank sent an ominous signal to the market when its Research Department conducted a survey of "empty or unoccupied completed-houses in developer-built housing projects" in Bangkok and surrounding areas from 1990-1995. It found that in 1994, 160,000 units were unoccupied and furthermore predicted that by the end of 1995, 300,000 units or 14% of the total housing stock would be unoccupied. In addition, the GHB found that during 1994-1996, developers were delivering about 170,000 housing units per year to the market while the demand for housing was between 100,000-120,000 units per year. Additional "empty houses" were therefore being added annually during this period.

Partly because of GH Bank's research, developers began cutting back on their projects. The Bank of Thailand also issued measures to restrict property sector lending. Interest rate increases in 1995 also forced many developers to curtail new project developments. New housing developments in 1996 fell 50 per cent when compared to 1995.

Lack of financial system liquidity, high mortgage rates and high construction costs were the main factors that precipitated the first to fourth cycle housing busts. However, the fifth and sixth cycle housing busts resulted from an oversupply of product.

8. Analysis of Boom and Bust Cycles

Boom and bust housing and real estate cycles are an inevitable economic phenomenon. Normally, boom and bust cycles can be divided into four distinct periods.

1) Recovery Period

As the economy recovers, employment and personal incomes increase, the investment environment returns and individuals and businesses begin purchasing land for commercial, industrial and residential developments. Prices then begin rising and developers introduce new projects to the market.

2) Boom Period

During stage two, housing and land prices increase at an accelerated pace because land developers and speculators increase their purchases. Housing prices increase quickly because housing demand is much greater than the available supply. The rising housing prices encourage developers to produce more units. During this period many purchasers are buying homes for investment rather than for primary residences and they are encouraged by financial institutions that begin competing fiercely for new loans. Lending risk is perceived as low during this period because collateral value is increasing continuously. Most developers are also realizing large profits in this environment.

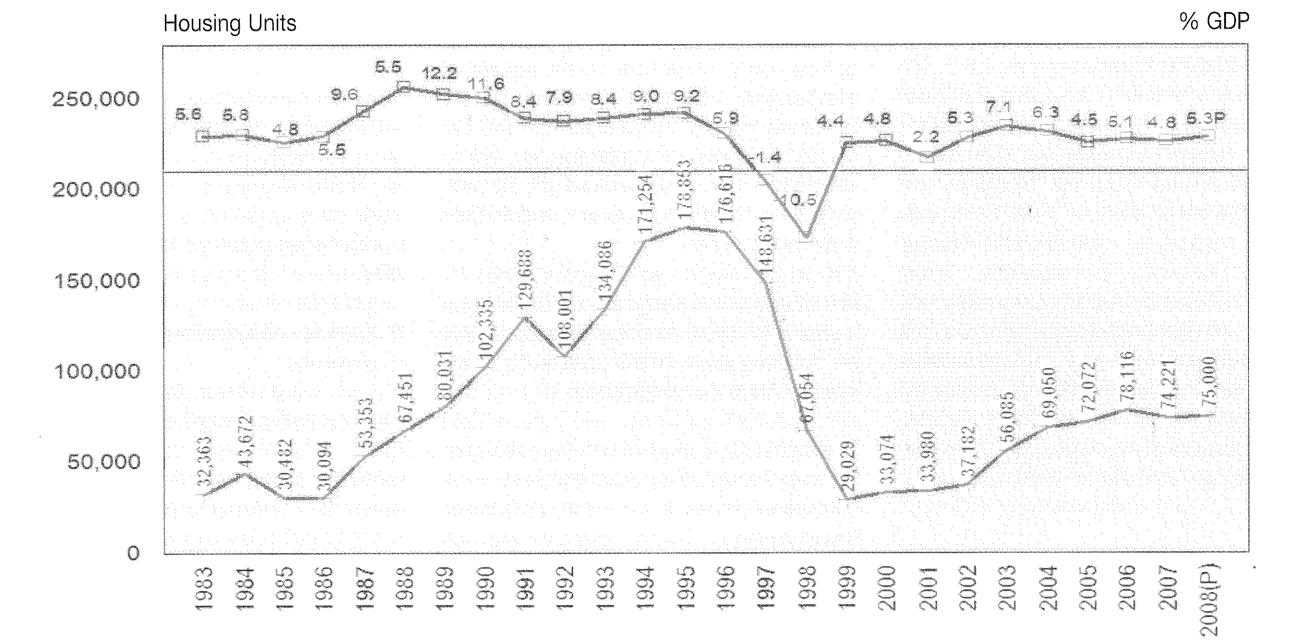
New developers also begin entering the housing construction during boom periods while many existing developers begin expanding their land banks for future development as they expect prices to continue increasing.

3) Recession Period

When the market reaches oversupply developers begin competing intensely for customers. They also stop investing in land banks because prices are beginning to slowly recede. Speculators also abandon the market during this period. Home purchasers are now buying for personal residences. However, during this period housing demand does not increase because housing prices are still too high for most potential purchaser's income levels.

Although developers realize that demand is falling, it is usually too late for them to take any action because projects are already under way. In addition, land for subsequent projects has already been purchased. Existing projects are continued even though

Housing Completions in Bangkok and Metropolitan Region 1983-2008



Source: GH Bank, REIC, NESDB
Compiled by: GH Bank Research & Information Services Department

they will realize fewer sales and decreased profits. New projects may be stopped or adjusted to reflect the new market conditions.

However, developers cannot stop projects and begin building lower-cost homes that are in demand because construction has already begun on higher-priced homes that were in demand during the boom period.

4) Bust Period

Although new projects are few, existing projects are still being completed and a huge oversupply of homes must be sold. Purchasing power during this bust period is also decreasing as the economy suffers a housing-bust related downturn. During this period, a housing crisis may arise if negative factors such as a protracted economic recession, a stock market collapse, a credit crunch, deflation or high interest rates and unemployment are allowed to fester. The market is vastly over-supplied and developers' profits are decreasing or even may be turning into losses as land and housing prices plummet. More developers and home owners begin defaulting on their loans. If the bust period is protracted, the financial performance of both developers and financial institutions are seriously affected.

Housing boom-and-bust cycles usually occur longer than normal economic cycles because of the housing industry's longer production-cycle requiring land procurement and construction before the finished product is transferred to end-buyers. The process usually takes two to four years. During this time, the economy itself may change while the developers are still completing their projects. Consequently, many developers often must inevitably complete projects during economic downturns.

Globalization and trade liberalization will lead to more housing boom and bust cycles. Housing market volatility or cyclical property fluctuations occur world-wide, not just in Thailand. During 1985 to 1994 in England, Australia, Singapore, Japan, US, Ireland, Denmark and Korea were impacted by boom and bust real estate cycles.

9. The Causes of the 1996 Housing Bust in Thailand

The Thai housing market was in a critical bust-cycle from 1996 to 1997. This bust cycle seemed much more severe than past cycles. Many experts predicted that if the bust cycle and its effects were not quickly resolved the country would experience a severe financial crisis and the stability of its banking system would be in doubt. Massive oversupply and decreased demand resulting from slower rising incomes exacerbated the situation.

However, a closer analysis reveals several other key factors:

1) Financial liberalization and financial deregulation

In the ten years prior to 1996, Thailand deregulated its financial infrastructure. Deregulation included permitting international capital inflows through Bangkok International Banking Facilities (BIBFs). Many housing developers funded and grew their operations by issuing overseas bonds and convertible bonds that carried much lower interest rates. As the Thai financial markets liberalized large amounts of low-cost international capital came into the market.

Prior Thai housing boom and bust cycles usually arose because of diminishing financial market liquidity. However, the 1996-1997 was different because it was largely caused by massive international capital inflows. In addition, many developers had borrowed low-interest rate short-term funds. When interest rates increased sharply during the crisis, many developers had great difficulty repaying or refinancing these loans. Their liquidity problems were compounded because they could not sell as many homes as projected.

2) BIS accords 50 per cent risk for housing loans

In 1993 the Bank of Thailand announced that commercial banks should follow BIS Capital Adequacy Ratios. The BIS gave housing loans a 50 per cent risk-ratio. In 1994, the BOT announced that finance companies must also follow BIS ratios. As a result Thai financial institutions competed aggressively for housing loans. Loan underwriting terms were relaxed allowing easy access to home loans.

3) Financial liquidity and speedier housing loans for developers

Because of high financial system liquidity, Thai financial institutions competed for 50% risk-weighted housing loans by offering low interest rates. They offered developers easy access to housing project development loans while home buyers also received easy access to housing loans. These two types of loans grew at a much faster rate than other loans.

4) Sloppy lending practices

During the 1987 – 1990 housing boom, commercial banks were the major lenders. At the end of 1990, the Bank of Thailand implemented measures to limit commercial bank real estate loans. At that time, commercial banks issued 68 per cent of all housing project loans. This percentage was reduced to 53.2 per cent in 1995 and 51.5 per cent in 1996. Thai finance companies quickly filled the void and their share of outstanding housing project loans increased rapidly from 29% in 1992 to 44.7% in 1995 and 46.4% in 1996. Thereafter, the BOT ordered all finance companies to follow the rules mandated for commercial banks.

Many finance company project loans were issued with sloppy lending practices. During the ensuing bust period, many of these loans became non-performing.

In addition to imprudent lending practices for project loans, these financial institutions were also careless in their lending practices for home loans. Shoddy practices such as improper property valuations and careless analyses of borrowers' creditworthiness resulted in increased non-performing loans.

5) Easy entry

During the real estate boom, everyone was interested in entering the real estate business. With few Government controls, thousands of new and inexperienced developers entered the business.

Thai law (Revolution Party Announcement No 286) permitted developers to sell homes without a license. More than 50 per cent of non-city projects were constructed by unlicensed developers with no land-subdivision permits. The Government could not monitor the vast number of housing projects being developed and did not know the exact number of homes being built. The Thai consumer ultimately paid the price because many developers failed to complete projects when the market plummeted into a deep recession.

6) Stock market listed housing developers

During the 1988-1989 housing market boom, only two real estate companies were listed on the Stock Exchange of Thailand (SET). This number of listed companies grew to eight in 1990-1991. Although only one company listed in 1992, the widely expected 1993 to 1995 housing boom attracted 12 more real estate companies to the SET.

However, listed companies are expected to generate continuous profits, forcing many of these newly-listed companies to compete by assembling land banks and building more housing projects. This environment led to an over-supply of housing in 1995 and 1996.

7) Increase and decline of speculative demand

Although most home purchases during 1987 to 1990 were for owner-occupied residential purposes, prices still rose rapidly. Speculative demand increased significantly in 1991-1992 because of fast-rising housing prices and high economic growth. The housing supply also skyrocketed. The Government Housing Bank's research indicated that 160,000 housing units were unoccupied during 1990-1995 (April). Eighty-seven per cent of these homes had already been sold.

The proliferation of new housing projects in 1994 increased the number of unoccupied houses on the market. At the same time, the public's purchasing power was decreasing while prices remained stable because of massive market over-supply. Speculators abandoned the housing market and it became a residential purchasers' market. The housing market began slowing in 1996 and this slowdown was expected to continue into 1997.

8) Thai stock market down

The SET peaked at 1,682 in 1994 and plummeted to 816 in 1996. During this period, the property index declined more than the overall index. It peaked at 2,266 in early 1994 and dipped to 519 at the end of 1996.

The SET downturn further eroded purchasing power and the declining property index caused many people to postpone their property purchases.

HOUSING AND REAL ESTATE BUBBLES:
THAILAND'S BOOM AND BUST CYCLES

9) Falling and rising interest rates

Lower loan-interest rates greatly increase an individual's ability to purchase a home. For instance, monthly payments may decrease by five to seven percent (15 to 20 year loans) if interest rates drop by one per cent. In 1994, Thai home buyers' purchasing power increased immensely as interest rates dropped to 10 per cent. Many new housing projects were launched and the market began recovering. However, this was a brief recovery as interest rates began rising again in 1995 and 1996.

10) Lack of statistical information on developers and housing indicators

Developers must closely monitor the market because each project requires a long-time to complete. The National Economic and Social Development Board (NESDB) recognized that housing information was important and produced an Annual Housing Report from 1987. The Government Housing Bank has also published a quarterly journal that provided housing articles and statistics since 1995. In addition, the National Housing Authority and many private companies provided other housing statistics.

However, these statistics did not provide adequate information for property developers and policy makers. They did not provide enough information for them to closely monitor the market and to derive the proper policy and investment decisions. No organization produced information in such key areas as housing starts, the overall number of and value of construction projects, project loans, monthly sale volumes, housing completions and financial information etc.

The lack of relevant market information was one of the key reasons why many Thai developers and financial institutions executed incorrect strategic decisions in 1996-1997.

10. Housing busts and resolution

The 1996-housing bust continued to seriously affect not only property-related industries such as land and housing developers (reduced sales, operational losses) and financial institutions (slow down in mortgage lending, increased NPLs and foreclosures) but also the overall Thai economy in subsequent years.

A consequence of any housing bust and concomitant economic downturn is mortgage-payment defaults. At the end of 1996, more than 150,000 accounts or ten per cent of mortgage loan accounts were delinquent. The housing market crisis severely affected bank and financial institution performance for several years.

Housing busts need speedy and appropriate government policy actions. The Thai Government and three housing developers' associations co-operated to develop solutions. Ten separate programs were used to help the Thai housing market recover. The most important program involved restructuring non-performing loans by extending terms and adjusting interest rates. The commercial banks and finance companies also jointly established a Resolution Property Trust Fund to restructure problem loans.

11. Summary: Lessons learned

Boom and bust cycles occur regularly in almost any free-market based property market. The 1996-1997 Thai property crisis provides many important lessons for developers, home buyers, financial institutions and other related companies as well as the government sector. These lessons include:

Boom and bust housing cycles recur. Some cycles are short and some are long. We must understand the volatility and envisage the uncertainty and changing environment. We must closely monitor the market and analyze key factors affecting supply and demand. To do this we must develop reliable information systems and learn from our past experiences and from other countries. We must foresee the problems that may occur and prepare to face them with prudence. We must recognize the key critical factors and develop reliable tools that will allow us to analyze and effectively deal with them.

Last but not least, we must also carefully analyze all government policies and measures that may affect the housing market and create new ideas and mechanisms that will prevent or avoid future severe housing cycles and support policies that will ensure a well-functioning stable long-term housing market.

Remarks: This article combines two articles originally published in the GH Bank Housing Journal (Thai version) in 1997 and 2006.

1) *Thailand Housing Boom and Bust Cycles*, published in the GH Bank Housing Journal, Volume 3, Number 8 (January – March 1997).

2) *Housing Bubble*, published in the GH Bank Housing Journal, Volume 12, Number 47 (October – December 2006).

These two articles were first translated into English and published in the GH Bank Housing Journal (English version), Volume 1 Number 1 in 2007.

The housing completion figures for Bangkok Metropolitan Region are updated.

Owning up: What Price Home Ownership?

By Geoffrey Payne[1]

A view from the West

As this paper is being written, the consequences of failings in the US housing sector are reverberating around the world in waves that seem to get stronger and wider by the hour. Only a diehard optimist would bet on things getting better in the near future. How did we get to this state and, more importantly, what lessons do we need to learn internationally for the future?

The conventional wisdom on the current crisis runs that the sub-prime loans scandal in the USA was the cause of our present difficulties. The promotion of home ownership to 'Ninjas' or those with no income, no jobs and no assets, was supported by both republican and democrat political parties, albeit for different reasons. Republicans were following the neo-liberal approach of individualized ownership of assets under a 'light touch' regulatory regime, whilst the democrats were keen to show that the benefits of ownership were also available to lower-income communities. To promote ownership, US banks created a secondary mortgage market to sell on mortgages using complex financial contracts that enabled them to securitize risks and even make profits through 'special purpose vehicles' and 'credit default swaps'.. This made it much easier to fund additional borrowing and proved extremely profitable for the banks, which earned a fee for each mortgage they sold on. Accordingly, mortgage brokers were encouraged to sell more and more of these mortgages. As demand for home ownership was artificially increased, so prices rose, further adding to demand. This in turn led to abuses as banks no longer had the incentive to check carefully the mortgages they issued.

By 2005, one in five US mortgages were to 'sub-prime' borrowers, ie those with poor credit histories, or limited evidence of income, usually because they were poor. Initial payments were fixed for two years, and then became variable and much higher. Consequently, a wave of repossessions started to sweep America as many of these mortgages were reset at higher interest rates. It is thought that as many as two million families may be evicted from their homes as their cases make their way through the courts. British banks, such as Northern Rock, sought to expand by financing heavily from the bond market, but as repossessions increased, banks stopped buying bonds, or trusting each other, triggering the current crisis. It remains to be seen whether this triggers a widespread economic collapse, or whether governments, operating within a newly emergent and enforceable international agreement, can save the day.

However, this conventional analysis is only part of the picture. As long ago as the 1950s, it was common in the UK to refer to the merits of a "property owning democracy" as though democracy could not exist without home ownership. Whilst private land ownership systems exist in most countries, their extent varies considerably from about 80% in Spain, 70% in the UK and USA to about 40% in Germany and 35% in Switzerland. The link between property ownership and democracy is therefore tenuous at best, even in 'mature' democracies. However, in the UK, property ownership was a precondition for being eligible to vote until as recently as 1918, and the 19th century building society movement was founded largely to enfranchise ordinary citizens by enabling them to buy their own dwelling. It was only ninety years ago, and immediately after the 'war to end all wars', that all men over 21 and women over 30 were given the right to vote without the condition of being property owners. Not until 1928 were women over 21 eligible to vote. Britain can therefore really only claim to have become a fully fledged democracy relatively recently and this helps to explain why home ownership became inextricably linked with the development of popular democracy.

In the 1980s, it was this theme that Margaret Thatcher's Conservative Party drew on in order to encourage tenants in publicly owned social housing to assert a 'right to buy' and become home owners. Her motive, however, was not to enfranchise the masses, but to give them a heavily discounted public asset so that they would vote for the political party which was most likely to protect it – the Conservatives. As demand increased, so did prices. The average price of a home in the UK increased a massive 47 times between 1970-2007 from £4,736 to £224,380, thereby reinforcing a positive association between property ownership and democracy as mutually reinforcing achievements of a capitalist model of social and economic development.

In this way, the electoral motivation driving property ownership was replaced by an economic imperative to hold an asset whose value would increase at least as rapidly as any other commodity. 'Getting on the property ladder' became a popular means of increasing wealth and personal security and increasing prices came to be regarded as highly desirable, at least for those already on the ladder. This tempted others to join on the bottom rung, pushing prices up for those higher up the ladder and stimulating an ever increasing, and self-sustaining, spiral of demand and price inflation. As a result, home ownership in the UK increased from 32% in 1953, to 43% in 1961; 51% in 1971 and 75% in 1981, reducing slightly to 70% in 2007. With house prices reflecting ever increasing demand, it was possible for one's income to increase more rapidly by lying in bed as one's home increased in value than it was by going out to work!

This approach to housing as a means of getting wealthy received its most articulate expression with the publication in 2000 of a book which claimed that property ownership was "why capitalism triumphs in the west and fails everywhere else" (de Soto, 2000). Released at a time when house prices were reaching astronomic levels, de Soto's analysis and prognosis received accolades from the likes of Margaret Thatcher, Milton Friedman and Bill Clinton, who saw it as an endorsement of their policy.

De Soto's thesis was simple: the major stumbling block that keeps the rest of the world from benefiting from capitalism is its inability to produce capital, and although the poor already possess the assets they need to make capitalism work for them, they hold these assets in defective forms. By this he means that they lack titles to their properties which they can use to invest in businesses, rendering their assets as 'dead' capital. He confidently estimates the total value of such 'dead' capital as at least US$9.3 trillion. By comparison, those who own their properties are able to use the collateral they embody to obtain formal credit, establish a business and lift themselves out of poverty into affluence. Thus, home ownership is the pillar on which capitalism has flourished in the West. This is his model for solving the problems of mass poverty in the South.

There are, however, two major flaws in de Soto's comparison between the experience of the USA and the Third World. First, and most importantly, while he provides fascinating material on the development of property rights and increasing affluence of the West, he fails to provide any empirical evidence in support of a causal relationship between this and the experience of developing countries. Second, he conveniently overlooks the significance of colonialism and slavery in building the economies of the West. The success of capitalism in the UK owes more to these factors than to home ownership, as can be testified by the fact that in 1914, when Britain was at the apex of its economic and political power, only 10 percent of its population were property owners. The remaining 90 percent were tenants and therefore not in a position to use the property they occupied as collateral in obtaining credit.

Nonetheless, the combination of these trends reinforced the link between democracy, capitalism and home ownership as a virtuous (if not holy) trinity in the popular imagination. This may help to explain why so many people in both the USA and UK associate property ownership with social, economic and political progress, despite evidence that other countries have realised these aims without recourse to this means. It also explains in part why more and more people in the West are beginning to question the ability of capitalism to meet social and economic needs.

A view from the South

For the one billion people, or 1 in 3 of the world's urban population, living in the slums and squatter settlements of cities in developing countries, the crisis dominating news media in the West must seem as relevant to their situation as a moon landing.

If de Soto had his way, they would have been given titles and been able, in theory, to lift themselves out of poverty by sharing in the housing price boom and using the collateral of their homes to obtain credit and set up a business. Certainly, it was not for want of trying. USAID and the World Bank pumped millions of dollars into land titling programmes in order to promote home ownership with this in mind. So what was the outcome? Did this ambitious plan to export the 'triumph' of capitalism in the West to the poor everywhere else succeed?

Before addressing this issue, it is pertinent to mention that whilst de Soto has been the most articulate advocate of property ownership, he was not the first. In fact, the World Bank was advocating land titling and ownership two decades ago. In 1989, I was invited by the World Bank to review a large number of reports, articles, books and papers on land tenure policies in developing countries as a potential contribution to the Bank's forthcoming housing policy paper. Not being a lawyer, surveyor, or economist, I explained that I had minimal knowledge of the subject, but was, of course happy to be paid to learn more.

During correspondence and the exchange of a first draft, it became increasingly clear that the Bank wanted my report to endorse a policy of promoting home ownership in developing countries. Other forms of tenure, such as customary, or rental tenure, were apparently of limited interest. As more and more reports and other publications were reviewed, the more these assumptions seemed politically driven rather than empirically based. There appeared to be no logical reason why home ownership was being so widely promoted. The reason given - that people could use the collateral of their titled homes to obtain credit, set up a business and thereby lift themselves out of poverty, was seductive, but made a rather basic assumption, namely that collateral is only relevant if you can afford to service the debt in the first place. For the majority of low-income households in developing countries, this was clearly not possible. Whilst tenure security is vital for everyone irrespective of their income level, home ownership, in other words, did not seem appropriate for everyone.

My draft report advocating caution and promoting tenure diversity was condemned internally as biased, though no substantive criticisms were made and I was told that they would permit publication

[1] Geoffrey Payne is a housing and urban development consultant with over three decades of experience in developing countries.

elsewhere. When the Bank finally released its report in 1993, it was under the revealing title of 'Housing: Enabling Markets to Work'. A cynic might claim that this was a clever high-jacking of the enabling strategy concept[2] being advocated by UN-Habitat and many progressive housing professionals working in developing countries. Certainly, the emphasis was on market-based solutions to improving access by the poor to housing and land and this was consistent with the macro-economic policies of structural adjustment which were being imposed by the Bank and the IMF on all developing countries which were not strong enough to resist them.

Assessing the documentary evidence

This brief summary of the 1993 World Bank and UK/US government housing policies suggests that home ownership in both the West and the South has been politically driven, initially as a 'bottom-up' movement to gain the vote and later as a 'top-down' agenda to broaden and deepen free-market capitalism. The fact that the policy has collapsed so spectacularly poses the question of how soundly based on hard evidence are the claims made for ownership?

These claims have generally been based on assumptions that ownership provides: 1) the highest level of tenure security; 2) access to formal credit; 3) incentives to invest in home improvements; 4) increased municipal revenues from property taxes and charges and 5) more efficient land and housing markets.

Recent research to assess the empirical foundation for these assumptions (Payne, Durand-Lasserve and Rakodi, 2007a, 2007b, 2008) found an extensive literature advocating titling and ownership (e.g. Panaritis 2007). In a review of USAID policy Stanfield and Bloch (2002:1-2) state that USAID "emphasized land markets, land titling, and real property registration. Policy options that relied on market forces were seen as more feasible politically than administratively determined land redistribution". In addition to USAID, several other organisations are promoting land titling, including the Inter-American Alliance for Real Property Rights, which was established to support the Summit of the Americas process in response to the commitments related to real property rights in the region made in the Declaration of Nuevo Leon; the Millennium Challenge Account (MCA); the Real Estate Advisory Group (REAG); and the Inter-Summit Property System Initiative (IPSI). Property rights and land titling are at the core of the aid and cooperation strategy being pursued by the US government under President George W. Bush.

According to Quan (2003:7), "the dominant thrust of the US based arguments to promote de Soto are basically about betting on the strong, on the assumption that opening up opportunities for enterprise by a few will benefit all, without explicitly building social protection into the equation".

In another review of land and housing policy, Daley and Hobley (2005:13) report that "the start of the Thailand Land Titling Program coincided neatly with a major international shift in development policies: during the 1980s the World Bank's structural adjustment programmes and liberalisation policies (and the IMF's stabilisation policies) linked beliefs about the importance to economic growth of privatising and individualising land rights with the broad pro-market tenets of 'neo-liberalism'. A similar review by the World Bank (2006:12) states that "during the 1970s and 1980s, there was a consensus on the need to formalize property rights by creating documentary evidence – title deeds". The Bank was an early supporter of urban land titling programmes and began funding the major programme in Peru in 1998. The consistency between the approach adopted at the time by the US government and the World Bank is remarkable and reinforces the impression that property ownership and land titling have been promoted as a neo-liberal programme to entrench capitalism at home and convert the masses in developing countries to the ways of the market.

Given this impression, recent changes in approach adopted by the World Bank are particularly significant. For example, a recent report (World Bank 2006:12) notes that "the earlier consensus on this issue has since changed and become more nuanced. For instance, most policy analysts now no longer simply assume that formalization in a given context necessarily increases tenure security, and leads to collateralized lending. The original assumptions have now become questions for empirical research". Buckley and Kalarickal (2006:23) also argue that "it would be dangerous to promote formal titling programs as the sole solution necessary to solve the problems of the urban poor as some have suggested. In many cases, formal titles are unquestionably valuable. Nevertheless, in most developing countries, where the capital markets are undeveloped and a spectrum of ownership structures exist, titling alone will not "unlock" capital. While such property rights may often be a necessary condition to develop a fully functional housing market, they are not a sufficient condition to unlock the trillions that are now locked up in dead assets."

This more nuanced approach reflects widespread academic criticism of de Soto's thesis and the emphasis on land titling programmes which it generated. For example, Quan (2003:7) noted that "formal property ownership may not be appropriate for all, indeed, until such time as property institutions become genuinely transparent, accessible and equitable in their operations, the costs of formal property ownership, as well as the debt burdens that are created when property is mortgaged, are not appropriate for the poor". Similar concerns regarding de Soto's analysis and the efficacy of land titling programmes in

[2] The enabling shelter strategy evolved during the 1980s. It focuses on managing the framework within which people are able to build or find their own accommodation, and on directing scarce government and private-sector resources to areas which the poor cannot finance for themselves. This movement was refined during the UN International Year of Shelter for the Homeless in 1987 and formalized in the Global Shelter Strategy one year later, to which 171 governments subscribed.

meeting their ambitious policy objectives have been expressed by other observers, including Angel (2002), Batt (2004), Bromley (2005), Calderón-Cockburn (2002), Durand-Lasserve and Selod (2006), Fernandes, (2002), Gilbert (2001), de Olarte (2001), Gravois (2005), Home and Lim (2004), Payne (2001) and Quan (2003).

Given the substantial investments on land titling programmes to date and the extensive reaction they have generated, perhaps the greatest surprise is the extremely modest empirical evidence to support or challenge the role of land titling in promoting social and economic development and reducing urban poverty. In fact, it has it is difficult to identify another developmental policy which has been so heavily promoted for so long on such a limited empirical foundation.

In an attempt to fill this gap in evidence, a two stage research project was undertaken between 2005 - 2007 of the social and economic impacts of land titling programmes in the urban and peri-urban areas of developing countries[3]. The review of literature in Stage 1 identified and reviewed 164 documents relating to land titling in urban and peri-urban areas. However, despite this wealth of material and the lavish claims made on behalf of titling by its advocates, very few examples were found which offered independent assessments of the social and economic impacts of titling programmes.

A second surprise revealed by the review of literature was that a key reason for the paucity of empirical assessments is simply that very few titling programmes have actually been undertaken so far in the urban and peri-urban areas of developing countries. Many proposed programmes, for example in the Philippines, Tanzania, Egypt and Ethiopia, have not so far been implemented or expanded from pilot projects into citywide programmes. In Africa, Senegal and South Africa are the only countries where, although at different scale and pace, property ownership has been promoted in order to secure tenure, ensure social inclusion and spatial integration of the urban poor and, in the South African case, redress historical inequalities.

Apart from these surprises, it was also evident from the literature that a key reason why property ownership has become so widely promoted is the need not only to provide security of tenure for residents but also to protect the investments of both local and international investors. As such, a common means is being advocated to meet different and possibly conflicting policy objectives.

Following the literature review, it was decided to undertake case study research in two developing countries where land titling programmes have been extensively undertaken in order to obtain independent empirical evidence of the social and economic outcomes. For reasons outlined above, Senegal and South Africa were selected and case studies undertaken by local teams. Programmes were assessed by comparing them with control settlements of similar social and environmental characteristics which were not titled.

Data on urban land and housing markets in developing countries is invariably limited, unavailable, outdated or inconsistent between cities and countries. Even where the data are available, they rarely deal with the key outcomes and impacts. For this reason, although the city case studies drew on secondary data where possible, primary data collection was essential in both cases. Attributing a range of social and economic outcomes to a specific change in legal status is, of course, problematic. Since time did not permit a before-and-after study of both beneficiaries of titling and a control group with similar socio-economic characteristics, comparative studies were undertaken of areas in which key factors could be held constant. Fieldwork involved a combination of quantitative and qualitative methods, as experience has shown that this provides the most effective way of gaining the necessary understanding of complex and dynamic policy outcomes.

So what were the key findings from the case studies? These can best be summarised under the following headings.

Titling and tenure security

Both the Senegal and South Africa case studies confirm that there whilst there are substantive differences between formal, informal and customary tenure categories, perceptions are important in determining tenure security. The surveys revealed that residents in most informal settlements in both case study countries already enjoy de facto tenure security. However, titling has had a very positive impact on increasing tenure security for women by specifying them on ownership records. The situation for tenants is less positive in that rents in the Senegal case increased sharply as newly regularised shack owners transferred onto them the costs of tenure regularisation and physical upgrading.

The Senegal case study found that many households entitled to regularisation have not yet completed the process of registering their rights. This suggests they consider the option of a title sufficient to realise an adequate level of tenure security and that finalising the process can be delayed indefinitely, especially if completion exposes them to additional unnecessary expenditure. Of course, this perpetuates the illegal, or semi-legal status of the settlements and inhibits formalisation of the urban land and housing markets.

Investment in housing

The superior tendency of land titling to stimulate investment in housing and property development has been advanced as a key factor in the promotion of titling. However, evidence of a link between titles and investment in house improvements is not always clear, either because titles are

[3] The project was undertaken by Geoffrey Payne, Alain Durand-Lasserve and Carole Rakodi. Case studies were undertaken in Senegal by Selle Ndiaye and in South Africa by Colin Marx and Margot Rubin. The project team gratefully acknowledge the support of Sida, the Global Land Tool Network at UN-Habitat and the Norwegian Ministry of Foreign Affairs, though the views expressed are those of the project team alone.

allocated as part of a general upgrading of a settlement, differences between titled and untitled settlements are unclear, or the location of a settlement influences behaviour.

The surveys in Dalifort, the first settlement in Dakar to be regularised, indicate that in 1987, before tenure regularisation, 90% of the dwelling units were shacks built in non-permanent materials. In 2007, after regularisation, 68% of the houses consisted of permanent building materials. Titles, or the anticipation of receiving them, have therefore clearly stimulated investment in housing, though high proportions of households in informal settlements have also invested in improvements when they considered themselves secure. When probed, most households in both titled and untitled settlements who had not invested in their homes claimed that the reason was a lack of finance rather than tenure status.

Access to formal credit

The ability to use property titles as collateral in accessing formal credit is widely considered a key reason for promoting land titling. However, no evidence was found in the published sources or the case studies that titles increase the likelihood of receiving credit from private sector banks or that banks are using property titles to secure loans. The proportion of households who have taken out loans to develop businesses is tiny, and none have used their houses as collateral. The main reason given was that households feared losing their prime asset, their property, whilst the banks usually ask for a bank guarantee provided by another person, or demand evidence that the borrower has a regular income before offering a loan. In this sense, the banks are operating in a far more responsible, if conservative, manner than those in the West.

Municipal government revenues

The integration of informal settlements into the formal urban land and housing market is widely held to increase the potential for local governments to raise revenue from property taxes as well as fees for land registration, transfer, capital gains and inheritance. This can then be used to finance public services and improve urban governance. However taxes and other charges may be collected by one agency or authority, while benefits, such as improved services, may be provided by others.

However, taxes and other charges place heavy demands on newly titled households, whose incomes may remain low and/or irregular. In South Africa, evidence was found of distress sales by beneficiary families unable to meet such costs. In Senegal, exposure to taxes and other charges was found to be a factor in the non-completion of the titling process by many households.

So far, revenues from taxation following tenure regularisation are so modest as to be insignificant. In South Africa, indigent households can make use of lower tariffs for a range of municipal services and the municipal council's tariff strategy has meant that it effectively writes off significant amounts each financial year, so that any increases in revenue are more than offset by the subsidies. As a result, the impact of the provision of real property rights on municipal government revenues was limited in both countries.

Impacts on urban land and housing markets

Land titling is often promoted as a means of stimulating land markets in which households use their properties to 'trade-up' as a means of increasing their asset base. However, the case study findings reinforce the literature in noting that residential mobility is very limited, and there is very little buying and selling of homes in consolidated communities, except in desirable areas that are subject to gentrification. This suggests that newly titled households regard their properties primarily as homes and the basis for family and community life, not commodities to be traded in the market.

When property transfers have occurred, they are not necessarily for the reasons predicted. In Cambodia, where property sales have increased following titling programmes, it was because titles have been provided in peri-urban locations to which residents have been relocated from informal inner-city settlements. Drastic increases in land prices in settlements declared for regularisation in Dakar and the commencement of delivery process of property rights (surface rights that could be converted into a freehold title) has increased market pressure in targeted settlements and accelerated gentrification. In South Africa, many sales were at prices lower than the cost of development by households unable even to meet the cost of service charges. Such sales were informal and, as a result, the formal land registration system had broken down.

Land titling programmes place heavy demands on land administration agencies, since they involve a number of administrative procedures. Many of these agencies are overstretched performing routine tasks, so their ability to adapt to new challenges within a dynamic policy and economic environment imposes further demands. The initial titling allocation process involves different teams and departments undertaking new tasks and operating within agreed, and possibly new, procedural guidelines. Such changes inevitably take time to operationalise and can cause serious delays which alone can prejudice programme outcomes.

Case studies of the tenure regularisation programme in Dakar show that the programme is having two opposite impacts: i) it has accelerated the formalisation of informal land markets and; ii) it has induced an "informalisation" of formal land transactions (to avoid taxation or temporary restrictions put on the transfer of real property rights). These two phenomena are closely interrelated and cannot be disentangled one from each other.

Conclusions

The literature review and the two case studies all indicate that the social and

OWNING UP: WHAT PRICE HOME OWNERSHIP?

economic objectives of land titling programmes have not been met and that any benefits realised have also been frequently met through other forms of land tenure.

In those countries where the threat of eviction is tangible, clearly the possession of a title is highly valued. Equally, where no threat exists, people feel sufficiently secure to invest what they have in housing improvements and in these cases titles are not regarded as important, and may even have negative connotations due to the increased commitments and visibility to the authorities that they entail. Ironically, titling programmes appear to be more widely implemented in countries where de facto security is already high and titles are relatively less needed than in countries where insecurity is widespread and titles would be most welcome.

A further policy consideration is that where titling programmes are undertaken on a small scale due to resource or other constraints, land market distortion is likely to be considerable, since well located settlements attract dramatically higher values and newly titled households become vulnerable to market-driven displacement. Where programmes are undertaken at a large enough scale to minimise market distortion, they place very heavy demands on land administrative agencies. In cases where land administration authorities are unable to maintain accurate and up-to-date records, or where those engaged in property transfers fail to formally register such transactions, land tenure regularisation has frequently encouraged the development of new forms of informal land delivery channels/markets. According to municipal sources in Dakar, most land sales in newly regularised settlements, especially in Dalifort, are not declared, because they have not been formally authorised. Paradoxically, formalisation of land tenure has therefore resulted in the informalisation of formal practices.

Policy implications

The research has been undertaken at a time when the excessive promotion of home ownership in the West, though questionable mortgage lending practices and inadequate regulation, has brought the entire Western financial system and possibly its economy, to the brink of collapse. The parallel promotion of land titling programmes in developing countries is unlikely to pose a similar threat as both potential borrowers and banking practices are more conservative and, arguably, more responsible. On balance, the costs of land titling and home ownership appear far greater than the benefits generated and governments would be well advised to reconsider any moves in that direction.

The research suggests that the social and economic policy objectives used to promote land titling programmes in developing countries can more easily be achieved through a range of tenure options other than formal ownership. The high proportion of low-income households also suggests that rental, communal or customary tenure options will remain appropriate for some time to come, as they offer flexibility and support without high entry costs. Given the enormous diversity and complexity of land tenure practices and the changing pressures under which urban land is used, it is preferable to build on local traditions and practices which are well known and which enjoy social legitimacy. An incremental approach, applied at a large scale and combined with other policy instruments, such as land use planning, transport policy and environmental management to reduce energy consumption, can provide a more sustainable basis for urban development in ways which benefit all sections of the population, not just an affluent minority.

The issue of equity is central and cannot be solved by continued economic growth. At some point in the near future, resource constraints, plus the impact of climate change, will impose limits and humanity will be forced to consider how to allocate what is available. Whilst more efficient use of resources and energy are vital, even this will not be sufficient to resolve the differences between and within nations.

Yet, as George (2008) has observed, there is no shortage of wealth. The problem is its allocation. She cites the UN World Institute for Development Economic Research, WIDER, which "estimates total world household assets at about $125 trillion. This is about three times world GDP and unsurprisingly, the top two percent of the world captures more than half of that wealth. The top 10 percent ... hold 85 percent, while the bottom half of humanity is obliged to stumble along with barely 1 percent". The problem is not confined to differences between rich and poor countries. For example, in a survey of 120 major cities, New York was found to be the ninth most unequal in the world and Atlanta, New Orleans, Washington, and Miami had similar inequality levels to those of Nairobi, Kenya Abidjan and Ivory Coast. Many were above an internationally recognised acceptable "alert" line used to warn governments (United Nations 2008). The UN report expresses concern that growing inequality in US cities could lead to widespread social unrest and increased mortality.

Whilst housing finance practices in one country have engendered an international financial crisis and this has brought into question the very survival of capitalism, it is worth asking if the present situation is not actually a blessing in disguise. Now that leading Western banks are effectively owned by governments, the era of unregulated, free-market capitalism has effectively ended. We now have a unique opportunity to redefine the public interest in economic development and create a form of social capitalism which can address both inequality and climate change. As George notes, "we can expect a new generation of 'smart regulation' in which private corporations will need to take into account the wider public interest when making their investments". Housing finance, land tenure and urban management policies have a major role to play in building a more sustainable and harmonious future.

References:

Angel, S. (2002) 'A Roundtable discussion of "the Mystery of Capital", in Interplan, Special Issue for Istanbul+5, No. 67, June 2001, pp.2-9.

Batt, W (2004) 'Review of The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else', http://www.cooperativeindividualism.org/batt_review-of-desoto.html GroundSwell, November-December.

Bromley, D. (2005), 'The Empty Promises of Formal Titles: Creating Potempkin Villages in the Tropics', University of Wisconsin-Madison, mimeo.

Buckley Robert M. and Kalarickal, J. (2006) ''Land Market Issues: The Mystery of Capital Revisited. Urban land policy – Is titling the answer?' Chapter 3 in Buckley and Kalarickal (Eds) 'Thirty years of World Bank Shelter Lending: Directions in Development Infrastructure' World Bank, Washington DC

Calder n Cockburn, J. (2002) 'The Mystery of Credit' Land Lines Vol14 No2 April

Daley, E. and M. Hobley (2005), 'Land: Changing Contexts, Changing Relationships, Changing Rights', Report to DFID.

de Olarte, E.G. (2001) 'Hernando de Soto's mysteries' SAIS review Vol XX1 No 1.

de Soto, H (2000) 'The Mystery of Capital: Why capitalism triumphs in the West and fails everywhere else' Basic Books, New York

Durand-Lasserve, A. and Selod, H. (2007) 'The formalisation of urban land tenure in developing countries'. A paper presented at the World Bank Urban Research Symposium on Urban Land Use and Land Markets, Washington DC, May 14-16.

Fernandes, E. (2002) 'The influence of do Soto's The Mystery of Capital' Land Lines, Newsletter of the Lincoln Institute of Land Policy Vol 14 No1, January pp5-8

George, S. (2008) 'Transforming the Global Economy: Solutions for a Sustainable World' The Schumacher lecture, 6 October 2008. www.tni.org/detail_page.phtml?act_id=18736

Gilbert, A. (2001), 'On the mystery of capital and the myths of Hernando de Soto: what difference does legal title make?', Paper presented at the European Science Foundation/Network-Association of European Researchers on Urbanization in the South (N-AERUS) International Workshop, Leuven, Belgium 23-26 May 2001. (www.naerus.org)

Gravois, J. (2005) 'The De Soto Delusion' http://www.slate.com/Default.aspx?id=2112792&

Home, R. (2004) 'Outside De Soto's bell jar: colonial post colonial land law and the exclusion of the peri-urban poor. In: Home, R. and Lim, H. 'Demystifying the Mystery of Capital: Land Tenure and Poverty in Africa & the Caribbean, Routledge Cavendish, 2004.

Panaritis, E (2007) 'Prosperity unbound: Building property markets with trust'. Palgrave Macmillan.

Payne, G., Durand-Lasserve, A., and Rakodi, C. (2008) 'Social and economic impacts of land titling programmes in urban and peri-urban areas of developing countries' Report to UN-Habitat, Sida and the Ministry of Foreign Affairs, Government of Norway, posted at www.gpa.org.uk

Payne, G., Durand-Lasserve, A., and Rakodi, C. (2007a) 'Social and economic impacts of land titling programmes in urban and peri-urban areas of developing countries: A review of the literature'. Paper presented at the World bank Urban Research Symposium, Washington DC, 2007 (www.worldbank.org/urban/symposium2007)

Payne, G., Durand-Lasserve, A., and Rakodi, C. (2007b) 'Urban land titling programmes' in Brøther and Solberg (eds) 'Legal empowerment – a way out of poverty, Norwegian Ministry of Foreign Affairs.

Payne. G (2001) 'The Mystery of Capital: Why capitalism triumphs in the West and fails everywhere else' Habitat Debate, Vol 7, No 3.

Quan, J. (2003), 'Reflections on the development policy environment for land and property rights, 1997-2003 (Draft)', Background Paper for International Workshop on Fundamental Rights in the Balance: New Ideas on the Rights to Land, Housing & Property, IDS, University of Sussex, 16-18 Oct 2003.

Stanfield, D. and P. Bloch (2002), 'USAID investments in land markets and property rights: Interim assessment based on secondary sources', Land Tenure Center, University of Wisconsin.

United Nations (2008) 'State of the World's Cities 2008/2009' UN-Habitat, Nairobi.

World Bank (2006) 'Afghanistan' Urban Policy Notes, Series 5.2, Washington DC

World Bank (1993) 'Housing: Enabling Markets to Work', Housing policy paper, The World Bank, Washington DC.

Overview of Financial Systems for Slum Upgrading and Housing

By Annika Nilsson[1]

Background

Developing countries are experiencing a rapid rate of urbanisation. African cities have some of the fastest rates of urbanisation in the world, followed by Asia (Groves, 2005). The most striking aspect of these urbanizing cities is that, contrary to the predictions of many economics, the informal economy continues to grow. It accounts today for one half to three quarters of non-agricultural employment in developing countries.

The predominance of informal activities in a society is problematic in many respects. On the one hand, it deprives governments of the tax base, which is necessary to the provision of public goods necessary to sustain the growth process. On the other hand, people in the informal economy, ie the poor, live outside the sphere of law and order. Unable to access and own formal land, 900 million people live in informal settlements, an estimated 1 billion do not have adequate access to water, and 2 billion do not have access to sanitation facilities (UN-habitat, 2005). Informal settlements are accompanied by problems of overcrowding, environmental degradation, crime, disease and family dysfunction that in turn are transferred to the larger city environment.

At the same time, the informal economy has been argued to be the sole way for entrepreneurial activities to develop in countries plagued by bad government practices, corruption and barriers to entry, and represents an important source of revenue and wealth. Thus, repressing the informal economy without offering alternatives may actually result in the deterioration of the quality of life of people operating in these sectors.

Hernando de Soto's vision for the informal economy to formalize is to develop proper legal frameworks, which recognize the assets of the informal economy and create a system of protecting and giving value to the property of the poor so they can access capital from formal financial institutions. Today informal rules govern property rights in these countries but they greatly limit the size of the market and raise transaction costs (de Soto, 2000). In de Soto's view, it is the formal judicial system that governs property and can transform it into capital that is the power engine of the economy.

Shelter finance sources for the low-income population

Securing finance for land, infrastructure and housing from commercial banks is particularly difficult for the bulk of informal residents. For example in Angola only 2 per cent of households' investment in housing comes from commercial banks. The low-income households, ie those in the informal economy, are excluded from formal sector mortgage finance for many reasons (see e.g. Ferguson, 1999; Smets 2006, Stein and Castillo 2005, Cain 2007):

- they cannot afford the debt service required to finance a small house.
- they have no capacity to make regular monthly payments over a long period of time.
- they do not have the full legal title to provide the secure collateral
- they are seen by formal financial institutions as both expensive to service and high risk.

Government programmes are in addition to this often out of sight, due to corruption, lack of commitment and scarce resources (Serageldin et al. 2000; UN-habitat 2005).

Therefore low-income households seeking to improve their living must use their own limited savings, and informal sources of capital such as loans from friends, remittances from abroad, and sale of their few assets (Ferguson 1999, Ferguson 2004). Although the informal financial sector has dynamism of its own, the structure and functioning of the formal financial sector largely determine the nature and extent of the informal sector.

Incremental building principles of the low-income population

As finance or enough savings are not available and because of the risk to be expulsed low income families build incrementally. The informal building process works in reverse to the formal one. People move into an informal subdivision. Gradually they improve the quality and add space to their homes over five to 15 years.

[1] Annika Nilsson is a first year Ph.D. Student at the Centre of Banking and Finance (CeFin) at the Royal Institute of Technology in Sweden, Stockholm. The main research is financial systems for land upgrading.

Urban services are informally or illegally installed, including electricity, water, etc. The provision of infrastructure and access to land and the titling of land remain insignificant compared to the need. An estimated 75-90 per cent of housing investment occurs through this type of progressive building (Smets, 2006, UN-habitat 2005, Jorgenson 2007). In African cities the informal land and housing market greatly exceeds the formal supply (Groves, 2005). However, the externalities of these unplanned communities are costly. Among these concerns are services in the informal economy that are often more expensive due to an informal land and housing market. (UN-habitat, 2005 and Jorgensen, 2007).

The rise of finance for low-income housing

As a response to the failure of formal finance to filter down to the growing informal population, and in particular to women, researchers and Non Governmental Organisations (NGOs) have argued that the provision of finance should be adapted to the traditional incremental building process of the poor (see for example Smets, 1999). There are two main approaches that suit the low-income population: (i) Microcredit for Housing and (ii) Community Funds. (UN-habitat, 2005).

1. Microfinance for Housing

Microfinance for Housing allows poor and low-income clients to finance their housing needs incrementally with methodologies adapted from the microfinance revolution considering a bottom up approach. Microfinance Institutions have experienced that a proportion as large as 30 per cent of micro enterprise finance could be diverted for housing. Housing provides a means of wealth accumulation and savings while at the same time meeting a social need. It is believed that with more proper housing and basic infrastructure, more time can be spent on income-generating activities, including home based business activities. Another potential income is by renting out rooms. This induced many microfinance institutions to include microfinance for housing in their portfolios (Seragelidin et al. 2000, Jorgensen 2006, Cain 2007).

The basic principles of Microfinance for housing include:

- **Size:** Small loan size based on capacity to repay. The loan could be smaller than for micro-entrepreneurs.
- **Incremental building:** Loans finance housing needs incrementally, such as a sturdier roof, walls, floors, a water, sewage or electrical connection, a latrine installation or an additional room, of an existing dwelling or a new core unit.
- **Previous savings:** Commitment and a capacity to save underlie the structure of housing micro-finance programs.
- **Term:** short repayment period.
- **Small or no subsidy:** Sometimes accompanied by housing subsidies.
- **Delivery method:** Almost always provided to individuals, rather than to groups. Collective guarantees are seldom used because the peer pressure created by programs in one neighborhood or village is largely absent. Also the larger loan amounts and longer terms of a housing loan impose greater risk on other members.
- **Technical assistance:** Most programs provide members with training and technical assistance in the development process, including housing design and construction and, when applicable, land ownership. Technical assistance helps to improve the quality of the house, lower the cost and finish a project/loan on time.
- **Formal title not required:** Some kind of assurance about right of occupancy is needed, for example tax receipts. Other forms of guarantees are sometimes also required as collateral, such as regular savings and other non-mortgage forms of guarantee.
- **Linked/unlinked:** Linked programmes rely on prior participation in micro enterprise or savings schemes, contrary to unlinked programmes that do not depend on such prior "participation".
- **Target clientele:** Low-income salaried workers and micro entrepreneurs primarily in urban areas.
- **Other services:** Sometimes accompanied by land acquisition and land registration.

Microfinance for Housing is provided by NGOs, "non-bank financial institutions" that are a cross between banks and NGOs, as well as other entities like for example cooperatives and private companies, which is illustrated below:

▪ **Jamii Bora Trust in Kenya:** Jamii Bora Trust started as a club of fifty beggars in 1999 and is now the fastest growing microfinance organization in Kenya. It is built on an innovative model, whereby for every shilling saved there is somebody willing to lend two shillings. A successful Micro business borrower, perfect repayment of at least three business loans, can borrow for housing on a monthly basis over a period of maximum ten years. In addition, Jamii Bora provides technical assistance. To achieve secure housing, Jamii Bora Trust has procured 293 acres of prime land in Kisaju, Kajiado District. Kaputiei Town has been built on sustainable principles and will provide new homes for 2,000 families, drawn from the slums. Half of the cost of infrastructure will be charged to the residential area and half to the commercial and industrial area. The members will receive loans from Jamii Bora with 8.5%-10% interest and 10-15 years repayment. Thus members will be able to live in a modern 3-room house at a cost of KES 2,500 (US$ 32) per month. The town will have a Town Management Board with representatives of all neighborhood associations and reporting to Jamii Bora Trust. Jamii Bora Trust covers its cost for maintenance through monthly fees and charges of KES 500 (US$ 6) from the homeowners (Williams, 2005)

▪ **KixiCasa in Angola:** KixiCasa is the first experience in housing microfinance in Angola. In 2005, a Development Workshop introduced a micro-housing product called "Kixi-Casa". The KixiCasa loan was administered initially under similar terms as the business loans but with larger amounts, from US$ 800, (sufficient to build a cement-block room or re-roof an existing house), up to US$ 2,500 and with a 10-month repayment period. Of the 51 clients involved in the first year 41 were women and a repayment rate of 97 per cent was maintained. KixiCasa does not only offer microloans to micro-entrepreneurs but also to salaried employees and poor clients without land titles. In addition to two guarantors for salaried employees, KixiCasa insists on an agreement with the client's employer to loan repayments. Clients without land titles get a loan as long as there is an indication that the land will be legally regularized or that it is not liable for expropriation within the time frame of the loan. Risks are kept to a minimum by keeping loans small, less than US$ 2,500, and with a short repayment period of 10 months to one year (Cain, 2007).

▪ **Swedish Co-operative Centre (SCC) in Central America:** Together with its local partners, SCC is promoting a co-operative model. Member participation in the building process brings down the building expenditure by 20-30 %. Before starting a project SCC inform thoroughly all interested in participating about the genuine collective commitment this model implies. Then some drop, usually the poorest stay. The social property model implies that the co-operative, as a legal entity, is the owner of the entire housing stock and the entity that negotiates credits and later on assumes the amortization of the credits. Since no individual default cases will occur (these are handled within the co-operative, that counts on a relief fund for individual members to borrow from) the legal security is high from the financer's point of view. As the idea is to avoid the need for direct subsidies, the payback has to be longterm and the interest rate, a preferential one. The lower-than-market interest rate can also be justified with the low transcations costs and high legal security for the fincing entity (Interview with Joakim Olsson at SCC).

▪ **CEMEX/ Patrimonio Hoy (PH) in Mexico:** CEMEX is a Mexican global building materials company. Patrimonio Hoy (PH) is a subsidiary of CEMEX. PH provides low-income families with micro-credits for building materials. With a previous saving of 20% of the value of the materials needed for the construction project, credit is granted without any requisites for the remaining 80%. The weekly charge per family is 151 or 180 Mexican pesos (approximately US$ 14 or 16.50) covering the cost of the materials, and the remaining MXP29 (ca. US$ 2.50) cover services such as access to technical consultants, fixed prices guaranteed for 70 weeks (typical duration of projects), one year of materials storage. Furthermore, PH hires community-based promoters: these are women who are the key factor for trust-building within the community. In launching PH in 2000 required CEMEX corporate funding for the first years, which clashed with the short-term business vision prevalent in many corporations. Management leadership and support to the program was crucial to overcome internal reluctance and resulted finally in 2004 in self-sustainability. By the end of September 2008, a total of 215,000 Mexican families in 45 cities had been benefited directly from PH and has enhanced the infrastructure of more than 518 public schools. Credits for US$ 100 million have been granted, with an on-time payment rate of more than 99%. About 80 per cent of the clients are women. The program has also been implemented in Colombia, Venezuela, Nicaragua and Costa Rica (Interview with Henning Alts at PH).

2. Community funds – group lending for housing

Many community-funds evolved from a community empowerment and advocacy agenda to emphasize access to land acquisition as the critical step toward obtaining shelter. The provision of infrastructure and housing is also high priority. Compared to microfinance for housing, community funds places more emphasis on collective capacity and tend to lend to poorer groups within a defined area and/or group. Collective loans are used both to build the capacity of the poor to act together and to access secure tenure and infrastructure. Their models are often not in accordance with local planning and regulations that do not work for them. Thus, relating to the state is a primary challenge for community funds in order to reduce development costs. The success of collective loans requires strong local organizations (UN-habitat, 2005, Smets, 2006, Mitlin 2008).

▪ **A community/NGO network Schack or Slum Dwellers International (SDI)** has expanded the last two decades and has affiliates in more than 12 countries ranging in size from a few hundred in Zambia to more than one and a half million in India. The foundations for these federations are thousands of savings groups formed and managed by urban poor groups. The network is made up of Federations of community organizations and other grassroots initiatives that are in the process of developing Federations. Federations support local grassroots organizations to develop initiatives for upgrading or new house development or improved services and learn from each other. They also help pressure the government to agree to regulatory reforms that reduce development costs (for instance, smaller plot sizes and less expensive infrastructure requirements) (D'Cruz and Satterthwaite, 2005).

▪ **The Society for the Promotion of Area Resource Centres (SPARC).** SPARC is an Indian NGO that supports two people's movements - the National Slum Dwellers Federation (NSDF) and Mahila Milan (MM). This alliance is part of the SDI. The Alliance of SPARC, NSDF and MM works with half a million households across some 70 cities in India and has built or is building housing for over 8,500 families. The strategy is to set precedents for housing solutions that can be scaled up across cities and states benefiting a large number of the poor without any slum dweller having to relocate. Another important component is building relationships with financial institutions so that they begin to work with the poor and seriously explore how to develop the low-income housing loan market. In 1998, a construction company was set up called SPARC Samudaya Nirman Sahayak, which means SPARC's assistance to community-led construction. At the local level, federation leaders train communities to build their own capacities well before negotiating with authorities. When land is scarce, communities look at multi-storey housing options. Since this type of

OVERVIEW OF FINANCIAL SYSTEMS FOR SLUM UPGRADING AND HOUSING

construction is more expensive, securing subsidies has shown to be essential (D'Cruz and Satterthwaite, 2005, UN-habitat, 2005).

- **uTshani Fund in South Africa:** Founded in 1995 uTshani Fund is a not-for-profit organization operating in Cape Town, Durban and Johannesburg. uTshani's community partners are grass root organizations practicing the principles of Shack Dwellers' International. In addition to providing low-cost housing finance directly to saving schemes uTshani Fund, as a revolving Fund, has pre-financed land purchase and infrastructure development. There is an agreement with the National Department of Housing which recognized uTshani as an accredited financial intermediary of the subsidy system and allowed them to access subsidies for community savers. Nevertheless, many Federation households who have taken loans have not been able to obtain the housing subsidy. This situation has led to reconsideration of the scheme that the Fund has followed (Baumann, 2001 and www.utshani.org.za).

Some experiences of microfinance housing programs

Good Performance: Providing finance for progressive construction projects fits with low-income households' existing method of construction. The repayment performance of ACCION's microfinance portfolio for housing is shown superior to their traditional micro-enterprise credits (Merrill and Mesarina, 2006). Experience with upgrading projects demonstrate that when neighborhood associations, NGOs and local MFIs manage projects providing microfinance for housing water, sanitation, roads and energy, costs can be not only reduced but also fully recovered and the quality of housing improved (Stein and Vance, 2008; D'Cruz and Satterthwaite 2005, Homeless International, 2008). Programs such as PRODEL in Nicaragua, Kuyasa Fund in South Africa and CLIFF in India rely on funding and active participation and commitment of multiple entities. This integrated approach to neighborhood upgrading has contributed to formalizing previously informal marginalized communities (UN-habitat, 2005; Stein and Castillo, 2005 and Homeless International 2008).

Demand far exceeds supply: The demand for housing just to accommodate the increase in the number of households over the next 25 years is estimated to be 877 million housing units (UN-habitat 2005).

Land: The supply of land is the greatest bottleneck to increase the supply of low-income housing. Due to legal and regulatory constraints the price of land accounts for almost half the cost of a house. A slow rate of housing consolidation may be the result of difficulties in assembling finance for land acquisition.

Subsidies: There are different perceptions about the need for housing subsidies. On the one hand, there is a belief that subsidies are necessary for low-income housing and because of the larger size of housing loans. On the other hand, it is often argued that subsidies are not important for their operations and that market terms would be a proper gauge of their activities.

Balancing the terms of liabilities (capital funds) and assets (loans): Access to medium- and long-term sources of capital is a major constraint for shelter finance organizations and community funds (see for example Serageldin et al, 2000). Financial institutions that are registered as banks rely on demand deposits. In many countries national banking regulations prohibit the bulk of unsupervised MFIs from accessing funds from the public through savings accounts (deposits) and other measures. Therefore many MFIs have become accustomed to get funding from donors (Ferguson in Daphnis and Ferguson (eds), 2004). The MFIs that cannot mobilize deposits seek to rely on savings accounts at commercial banks (Merrill and Mesarina, 2006). This deposit linkage between microfinance institutions and commercial banks is of potential importance, since it implies that microfinance institutions help commercial banks in their deposit mobilization. Mobilizing deposits from low-income households would mobilize a substantial source of funding and offer low-income households opportunities to be part of market.

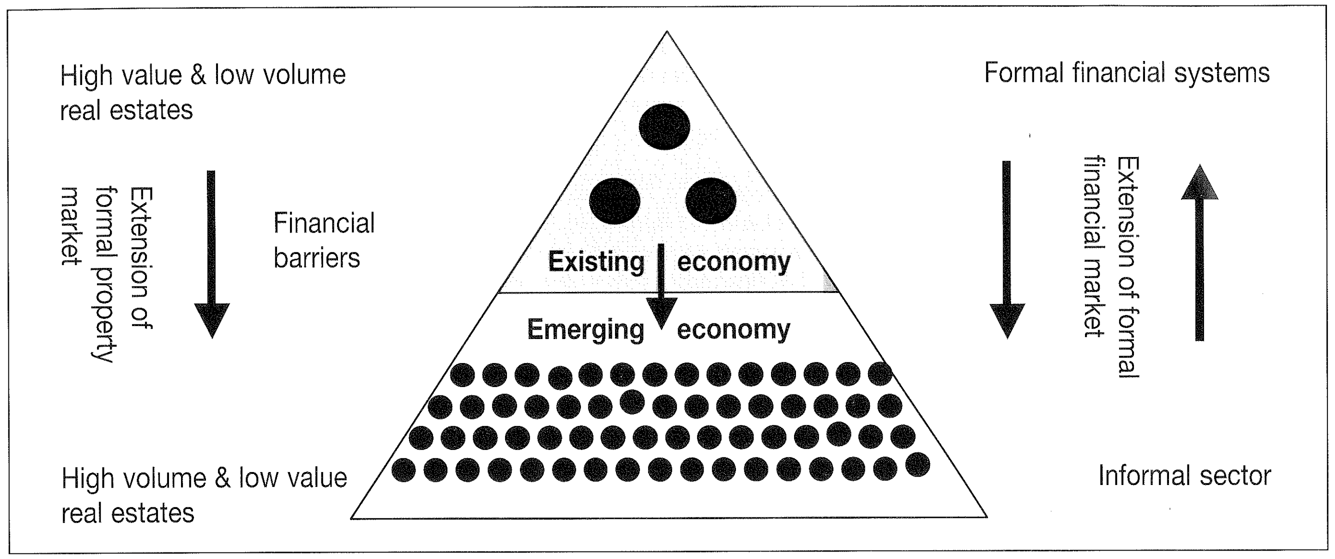
Balancing the affordability of clients versus cost of funds (profitability): A challenge is how to compensate lenders while maintaining affordability for the lowest-income households. Interest rates for micro finance initiatives have been much higher than for other market transactions in order to compensate lenders for the high fixed costs, relative to the small size of these loans, and the extra work that financing low/moderate-income households entails. Borrowers who would otherwise face astronomical rates from neighborhood moneylenders accept these high rates.

From an economic viewpoint, interest rates are likely to start out high; competition, increased scale and knowledge how to reach the clients can drive them down. Additionally, focus should be both on the cost of urban housing, including more appropriate standards, and the link between finance for income generation and improvements in housing.

Establishing an appropriate regulatory framework: The government has a major role to play in creating a macroeconomic environment that is conducive to financial institutions. Reaching the poor does not only requires macroeconomic stability, but also sound financial sector policies, as well as non-distortionary policies in other areas.

Linking the informal and formal financial systems

Commercial banks, being the key financial institutions in most developing countries, have a critical role to play in making available some of their resources for providing credit to the poor. On the other hand, microfinance institutions and community based NGOs generally have a comparative advantage over commercial banks in actually reaching the poor, reflecting factors such as proximity, trust, commitment, flexibility and responsiveness. The pyramid (page 23) illustrates the amount of real estates in relations to their values.



The top of the pyramid illustrates properties that can be used in formal financial systems: few houses with high value. The bottom of the pyramid contains the potential value of real estates for formal financial systems in currently informal financial systems: there are far more people than in formal systems, but where the values of their properties are comparatively low. The bottom of the pyramid, ie the poor, is hardly served at all. Note, however, the total value of the many small properties can exceed the total value of the properties currently contained within the formal systems.

Banking institutions are "downscaling"

Many banking institutions, driven by the competition in the sector, financial deregulation and the positive development of micro finance institutions, have started exploring new services, such as microfinance for housing. Adapting banking services to the poor is an opportunity to diversify into new property related markets and a way of cultivating public image as socially responsible institutions.

Examples of different models of commercial banks offering microfinance for housing:

- **G & T Continental Bank in Guatemala:** The Microfinance Unit as well as the microfinance programme for housing was established in 2006. Housing microfinance comprises 5% of the overall microfinance portfolio. The five year goal for the programme is 15%. The maximum loan size is US$21,000, repayable over a period of between one and fifteen years. The interest rate is between 16-18%, and a 1% banking fee. Payment is monthly. The Bank has established a Technical Unit for the Microfinance Housing Programme. The key to the initiative's success has been Board approval and commitment to growing the microfinance business of the Bank (Workshop Report, 2008).

- **HFC Bank and Boafo Microfinance Services Ltd in Ghana:** HFC Bank in Ghana lends for both microfinance purposes and for low income housing. The bank has injected equity into the associate microfinance company Boafo Microfinance Services Ltd. The loan portfolio is on the balance sheet of the bank. Boafo is managed by Co-operative Housing Foundation (CHF), and is owned jointly between CHF and the bank as majority shareholder. One advantage of Boafo is that it requires significantly less capitalization both upfront and over time than a financial subsidiary. Mandatory reserves and costs associated with regulation are also absorbed within the overall normal business of the bank. The low income housing loans have a maximum value of US$ 12,000 and an LTV of 70%. Requirements to get a microfinance loan for housing include a 50 percent deposit and a savings record of one year. Loans are expected to range up to US$ 2,000. This line of business is still small, perhaps 1% of the HFC portfolio (Martin et al 2008).

Microfinance organizations are up-grading/up-scaling

In order to achieve sustainable scale microfinance organizations have in recent years taken the initiative of transforming themselves into regulated financial institutions. Turning into a regulated institution gives the legal status to lend money from deposits, already used by customers as a way to earn interest on saved money.

- **KixiCasa in Angola:** The Angolan NGO "Development Workshop" has transformed its microfinance programme into an autonomous institution registered commercially under Angolan law as KixiCrédito. KixiCrédito, managed by an Angolan board of directors and drawing largely on Angolan commercial banks to feed its loan fund. (Cain, 2007).

- **The Kenyan Rural Enterprise Programme (K-REP):** K-REP, now urban focused, began as a NGO and transformed to a commercial community bank and an advisory service consulting firm. K-REP has now over 30,000 depositors. The bank offers housing microfinance loans to depositors who have taken out small loans with K-REP. The term of the loan is 2 years (Williams, 2005).

Guarantee funds and bridge loans

Guarantee funds and bridge loans are a way of help to bridge the gap between traditional institutions and low-income populations. They serve as a complement for legal and regulatory reforms by encouraging the use of business models that permit banks to profitably reach lower income populations at lower risk. Banks' willingness to enter this kind of partnership depends on a variety of factors, including general macroeconomic conditions, project cash flow, risk profiles, as well as the reputation of the borrowing organization.

Examples of the use of guarantees schemes include:

- **The Community-Led Infrastructure Finance Facility (CLIFF) in India, Kenya and the Philippines:** The CLIFF approach is to get banks and communities to do HMF-business. The first initiative is with the Society for the Promotion of Area Resource Centres (SPARC), the National Slum Dwellers Federation (NSDF) and Mahila Milan, which work in an alliance. Their collaboration started in 2002 when the Indian Alliance were in much need of bridge finance in order to complete housing and sanitation projects before full cost recovery could be achieved from projects. Government subsidies available for providing housing for the poor can only be claimed retrospectively in stages. To date, they have mobilized over US$ 7.8 million in finance and municipal guarantees from four separate banks in India and about US$ 1.47 million in guarantees from Homeless International, USAID. The CLIFF-supported project portfolio in India currently contains ten housing and five sanitation projects in six cities across three states. The Kenyan and Philippines Alliance of CLIFF have a much smaller portfolio of CLIFF-supported projects, compared to the Indian Alliance. The reason is that the political and economic environment limits the possibilities to scale up. (Homeless International 2008).

- **The global Slum Upgrading Facility (SUF) implemented by UN-HABITAT:** The Slum Upgrading Facility (SUF) established in 2005 is designed to assist low income groups to improve their living environment. The central objective of SUF is to assist developing countries to mobilize domestic capital for their own slum and urban upgrading activities. It facilitates links among these local actors, and packages the financial, technical and political elements of development projects to attract such investments. Four pilot countries for SUF are Ghana, Sri Lanka, Indonesia and Tanzania. Field projects are established in three other countries – Ghana, Indonesia and Sri Lanka. In Accra (Ghana), the city council has agreed to work with SUF and local bank to secure a loan that will enable the council to re-assess property rates throughout the city. In Sri Lanka, the Moratuwa Municipal Council (MCC) has agreed to partner with Women's Development Bank Federation (WDBF) Shack/Slum Dwellers International (SDI) and SUF to develop three slum locations in the city. In Indonesia, work has been agreed with the Ministry of Housing and the Ministry of Public works on the introduction of SUF to a variety of city-based projects (www.unhabitat.org).

- **USAID Guarantees provided for other financial instruments, such as bonds.** The US Agency for International Development (USAID) has developed the use of a new financing mechanism to stimulate lending from the private sector. The Development Credit Authority (DCA), offers credit guarantees to improve the availability of affordable housing.

A guarantee covers up to 50 percent of a lender's net loss on the guaranteed portion of the loan. Loans extended under DCA are provided to borrowers on commercial terms in local currency and/or US$. In India, for example, USAID/India obligated a 50% guarantee on a loan that ICICI Bank will issue to SPARC for the completion of a major slum redevelopment project in Mumbai known as Oshiwara II. 5.75 US$ million have been mobilized via USAID with a leverage ratio of 1:80. Thus for every US$ equivalent guaranteed, the bank will provide loans of 8 US$ to the low-income borrowers. (USAID's Development Credit Authority, 2008.)

Conclusions

Developing countries are experiencing a rapid rate of urbanisation, relatively low investment in housing, and a widespread poverty. This has created serious shelter problems, contributing to the proliferation of informal settlements, increased demands for infrastructure and services, and a declining quality of life particularly for low-income households.

The small and sequential loan products of microfinance for housing and community funds suit the traditional progressive building methods of the poor. The development of microfinance for housing follows the development of a growing microfinance sector. Community funds enable the poor to access shelter assets, especially land and infrastructure.

The fact that the majority of the people in the informal economy cannot access formal finance and the high rates charged by informal lenders are certainly one of the principal determinants of the high demand for microfinance for housing and community funds. The demand can also be contributed to the development for these programmes themselves. As large parts of the programs offer technical assistance as part of their savings and lending schemes, people are trained to think in terms of investment and assisted to build at lower cost and better quality than they would otherwise have done. The increase of the informal sector and liberalization of foreign trade may also have contributed to the higher demand.

A challenge is how to reach deeper and larger segments of the population. There are different opinions about the need for housing subsidies. A well-functioning legal

OVERVIEW OF FINANCIAL SYSTEMS FOR
SLUM UPGRADING AND HOUSING

and regulatory framework with a working enforcement system is crucial to the development of the housing sector. Increasingly the supply of land is one of the first challenges governments have to tackle.

Scaling up microfinance for housing and slum upgrading programmes requires an engagement with formal sector counterparts. Commercial banks have a critical role to play in making available some of their resources. A number of microfinance providers have taken the initiative of transforming themselves into formal banking institutions. This helps them to expand and improve their services, mobilize savings and to get integrated with the formal sector. At the same time, some formal banks have begun to test the waters, going down-market. This gives them an opportunity to diversify into new markets and raise profits while cultivating their public image as socially responsible institutions.

Although the microfinance housing programmes have shown a good performance and there is recognition that there are large reserves of dormant capital in the informal economies, the majority of commercial lenders are still hesitant to lend to informal activities with no formal proof of security. Guarantee schemes and bridge loans are good ways to address the gap between the informal and formal financial sectors. This partnership allows housing and slum upgrading programmes to be based on local participation while keeping the risk at manageable level.
Finance for low-income housing and slum upgrading flourish thanks to different strategies. Improving them require better data and further experimentation.

Bibliography

Cain, Allan. 2007. Housing microfinance in post-conflict Angola. Overcoming socioeconomic exclusion through land tenure and access to credit, Environment & Urbanization 2007 International Institute for Environment and Development (IIED). Vol 19(2): 361–390.

DeSoto, Hernando. 2000. *The Mystery of Capital*, Basic Books, New York.

Ferguson, Bruce. 1999. 'Micro-finance of housing: a key to housing to the low or moderate-income majority?', *Environment and Urbanization*, Vol. 11, No.1, April 1999

Smets, Peer. 2006. 'Small is beautiful, but big is often the practice: Housing microfinance in discussion', *Habitat International* 30, 2006

Smets, Peer. 1999. 'Housing Finance trapped in a dilemma of perceptions: Affordability criteria for the urban poor in India questioned. *Housing Studies*, 14 (6), 821-838

United Nations Human Settlement Programme (UN-Habitat). 2005. *Financing Urban Shelter: Global Report on human settlements*. UN-HABITAT, Earthscan

Jorgenson, N.O. 2007. 'Housing to the No-Income Group – The role of Housing Finance in Alleviating Urban Poverty', Housing Finance International, March 2007

Groves, R. 2005. 'Challenges Facing the provision of Affordable Housing in African Cities', *Housing Finance International*, Number 17 June 2005

Martin, Richard et. al. 2008. *Development of Appropriate Housing Finance Products to Support Upgrading Activities*, AUHF final Report

Stein, Alfredo and Vance, Irene. 2008. 'The role of housing finance in addressing the needs ot the urban poor: lessons from Central America', *Environment & Urbanization* 2008 International Institute for Environment and Development (IIED) Vol 20(1), Sagepublications

Daphnis, Franck and Ferguson, Bruce eds. 2004. *Housing Microfinance: A Guide to Practice*. Bloomfield, CT: Kumarian Press

HomelessInternational. 2008. *CLIFF India Monitoring Report for the CLIFF Advisory group to end of February 2008*, HomelessInternational

Mitlin, Diana. 2008. 'Finance for low-income housing and community development', Environment and Urbanization Brief – 19, IIED

Merrill, Sally and Mesarina, Nino. 2006. 'Expanding Microfinance for Housing', *Housing Finance International*, March 2006

d'Cruz, C. and D. Satterthwaite. 2004. *Building Homes, Changing Official Approaches*. International Institute for Environment and Development. Poverty Reduction Series, Working Paper 16.

Williams, Chris 2005. 'Setting the Context: Kenya', Housing Finance International – September 2005

Baumann, Ted. 2001. 'Out of the frying pan into the fire: the limits of loan finance in a capital subsidy context', *Environment and Urbanization*, Vol. 13, No. 2, 103-115 (2001)

Mitlin, Diana. 2008. 'Finance for low-income housing and community development', *Environment and Urbanization*, Brief – 16, IIED, Great Britain

USAID's Development Credit Authority. 2008. *Fact Sheet*, USAID's Development Credit Authority

Serageldin, M., et al. 2000. *Housing Micro-Finance Initiatives. Synthesis and Regional Summary: Asia, Latin America and Sub-Saharan Africa with selected case studies.* Harvard Center for Urban Development Studies, Harvard University

Fergusson, Bruce. 2004. 'Scaling up Housing Microfinance: a guide to practice', *Housing Finance International*, International Union for Housing Finance, Vol. 19, Issue 1, September, 2004.

Workshop Report: Growing Sustainable Housing Microfinance Options in Sub-Saharan Africa: Enhancing the relevance and scale of housing finance for the poor. 2008. Workshop in Tanzania , the FinMark Trust, Rooftops Canada and Habitat for Humanity International

Interviews:

Joakim Olsson, Programme Officer at SCC, Sweden

Henning Alts, Marketing Unit at Patrimonio Hoy, Mexico

Websites:

UN-habitat: www.unhabitat.org

uTshani Fund: www.utshani.org.za

Social Housing facing the EU Law

By Claude Taffin[1]

The 27 countries that now form the European Union (EU) have a share of 30 % in the world GDP and a total population of 500 million. These countries range from Germany (82 million inhabitants) to Luxemburg and Malta (400,000). They include the ultimate welfare states as well as traditionally liberal or recently converted ones.

The European Commission (EC) has to make work this heterogeneous entity as a single market. Although housing is not an EU competence, they had to take a number of measures concerning social housing because private developers complained that the privileges granted to social housing companies, in other words subsidies, they estimate disproportionate, were distorting competition in the free market. Unsurprisingly, most problems occurred in countries that still significantly invest in social housing.

After giving an overview on social rented housing (SRH) in EU, this paper will explain how SRH is impacted by EU regulations, using mainly the example of the French system of finance and subsidy.

Social Rented Housing in EU: an overview

To compare the SRH stocks in the EU countries, only national definitions can be used as there is no harmonized definition at the EU level.

In the fifteen older member states (graph 1) and in the twelve new as well (graph 2), there are huge variations that reflect differences in definitions, conception and quantity of the stock. The United Kingdom has a larger share than France because it used to be the largest in Western Europe, but only the underprivileged can now access it.

Among the first group, only Greece has no SRH at all; Luxemburg and Spain have very little, hardly 1% of the main residences, while the Netherlands have the largest share (34%). In Germany, the SRH stock never reached such a level and it has sharply decreased in the last 20 years due to regulatory changes (see below).

Except for the Czech Republic and Poland, the new member states have little SRH; some never had (Bulgaria, Cyprus and Malta) while the others massively privatized it.

Social history played an important role. The existence of powerful workers organizations explains why SRH is or was so much developed in France, Germany, UK, etc. The primary function of this stock was indeed to house these salaried workers with low but regular income needed by the local industries. The majority of the poorest were housed in the deteriorated private stock and taken care of by charities to find them a decent accommodation.

In most countries today, the trend is to target SRH on the most fragile parts of the population. This is the result of a double change: on the one hand, the most deteriorated segment of the private stock which was the actual social housing stock, has fortunately almost disappeared (slums, hard rent controlled old buildings, etc.); on the other hand, the initial target of SRH, salaried workers with moderate but regular income, has eroded and precariousness has increased (short-term, part-time employment, etc.).

Institutional framework

The organizations which build, own and manage SRH have various sizes and legal statuses: there is no European model in terms of SRH provider. There is however a common trend to return to the original private providers after decades of high public involvement in socialist economies and in West-European countries when they had to face huge and urgent housing needs in the post World War 2 years.

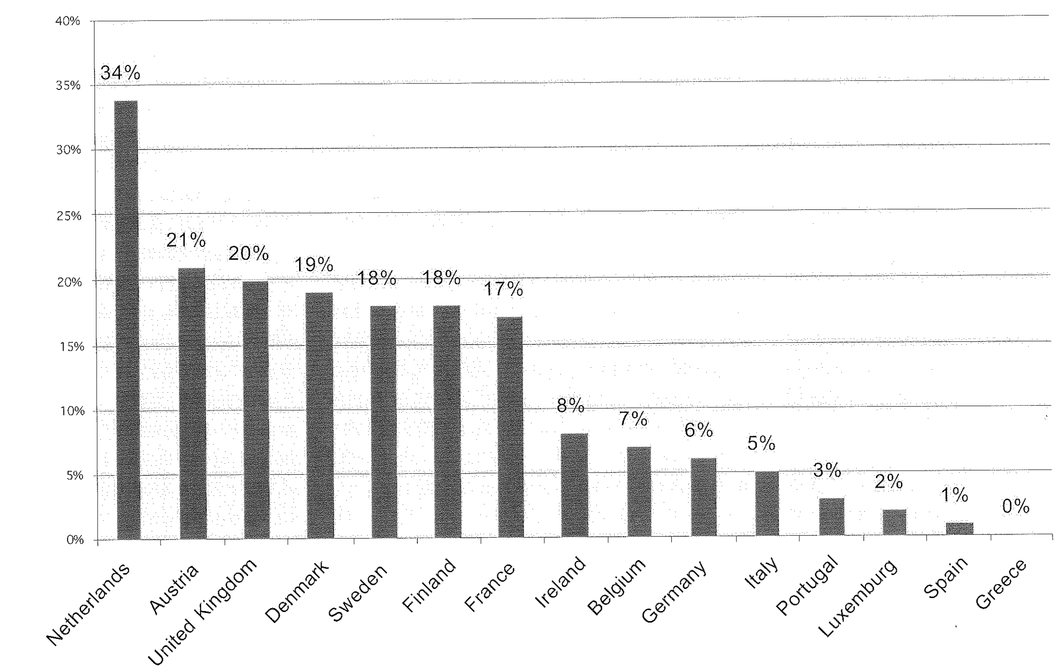
Therefore, while the most active investors are now often private, a large part of the stock still belongs to public entities, mostly local authorities or their subsidiaries. The UK provides a good example of these changes: the local authorities remain the main managers of SRH with 2 million units. They do not invest any more in new housing but those who perform well are allowed to create "Arm's-Length Management Organisations" (ALMOs) which manage their stock ("Council Housing") and renovate it with State subsidies, under the control of municipalities. The "Housing Associations", which are the majority of the "Registered Social Landlords" (RSLs) are on the contrary developing through investments in new programs and "Large Scale Voluntary Transfers" of "Council Housing".

In other countries also, the main two types of SRH providers, local authorities and non- or limited-profit private organizations or co-operatives co-exist (Austria, Czech Republic, Germany, France, Poland, Slovakia, Slovenia, etc.).

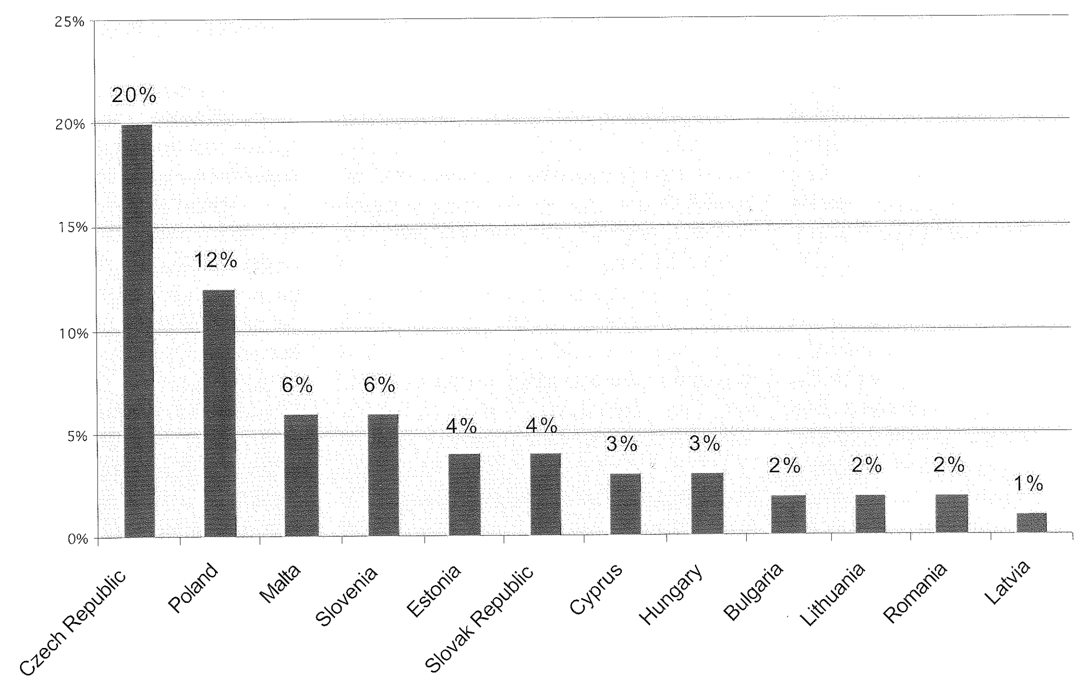
The recourse to standard legal or natural persons has developed in Germany since the termination of the privileged tax status of SRH providers. The commitment to house low-income tenants is now for less

[1] Senior Housing Finance Specialist, World Bank, Washington DC.

Graph 1: Social Rented Stock in EU15)[1]



Graph 2: Social Rented Stock in the EU (27-15)[1]



[1] *As a proportion (%) of the number of main residences in each country.*

Source: Cecodhas.

than 10 years instead of 35 in the previous system. Thanks to the abundance of private rental on markets with low demand, the recourse to existing units is increasing; it avoids the concentration of SRH in a single neighborhood or building. This form of management consisting in registering private entities of various statuses (associations, co-operatives, companies or individuals) also exists in the Czech Republic and in France.

Finance and subsidies

A variety of instruments can be used to finance and subsidize the investment in social housing and, again, different solutions are brought to similar problems.

Social housing landlords need a stable access to long-term finance with a low interest rate and necessary guarantees. As very few countries were able to provide market resources for loans to SRH investors when needs were at their highest, off-market finance instruments were created. The development and liberalization of the financial sector in the 1980s in Western Europe made it possible to use market-based funding. Macroeconomic stability, required for joining the Euro zone, and decreasing interest rates further encouraged social landlords to turn to market finance. However, specific intermediaries may be needed to help smaller investors to access capital markets and secure guaranteed loans (eg, in Finland, Netherlands, United Kingdom).

France (see below) and Luxemburg are the only countries in the Euro zone which still use a dedicated State Fund to finance the social rented sector. In Germany and Belgium, SRH is financed by regional public banks. Austria created six housing construction banks; these banks issue special convertible bonds at a below-market rate which is made competitive by tax benefits. In Finland, the Housing Fund (ARA) cumulates the benefits from the public sector (a good rating thanks to its backing by the Ministry of Finance) and the use of modern market financial techniques, including securitization.

In some transition economies, the State created public Funds to finance social housing construction and purchase. Some examples of such funds are the Housing Fund of Slovenia, the State Fund of Housing Development of the Slovak Republic, and the National Housing Fund in Poland. The European Investment Bank and the Council of Europe Development Bank are also participating in social housing finance, either directly (Estonia) or through these funds (Poland).

In a few countries, the tenants participate in the financing: in Denmark, a 2% deposit is required; it is paid back if the tenant moves. In Austria, tenants who contribute more than 50 Euros per m^2 have a right to buy after 10 years. Tenants' participation is also commonplace in Poland.

Subsidies to SRH providers can take various forms:

- Subsidized or guaranteed loans; as mentioned above, various ways are used to provide below-market interest rates; the interest rate can also be explicitly subsidized;
- Direct subsidies, as a proportion of the total (land + construction) cost; these budget grants can be provided by central, regional or local governments; they also can be financed by an earmarked tax, such as the "1% levy" in France (because it was originally 1% of the wages, it is now 0.45%);
- Tax subsidies, such as rebate or exemption of VAT on construction, of property tax, of income or corporate tax;
- Free or below-market priced provision of land by the state or local authorities; land can be given, sold or leased long-term.

The amount of these subsidies, more than their nature, depends on the gap to be filled between the market rent and the rent affordable by the target groups; it also depends on the existence and the scales of housing allowances. These subsidies are now available in most EU15 countries. They were recently introduced in Italy. Only Luxemburg, Belgium and Portugal, all three countries with little SRH, do not resort to them and, instead, set the level of the rent according to the income of their tenants. This technique entails management complications and the payment of "balancing subsidies". New member states are now also using housing benefits, with the only exceptions of Estonia and Malta. In Poland, about 5% of households benefit from a housing allowance scheme financed by municipalities. In Bulgaria and Latvia, they only cover energy expenses.

With the growth of housing allowances and the decrease of interest rates, most governments try to reduce their subsidies. As long-established landlords with a great proportion of amortized properties have accumulated own-funds, they are incited by the governments to invest more of these own-funds in new investments, should they have to sell a number of buildings to sitting tenants. Such a policy has been practiced on a large scale in the UK since the 80s while it is a more recent but controversial issue in France and the NL.

Impact of EU Regulations

The EU authorities are facing the following dilemma: how to conciliate normal market regulations and the specific features of social housing, like those of other 'services of general interest' (SGEI) such as education, health or public transportation, which can obviously not be treated like any economic activity? These regulations concern competition law, internal market law, indirect taxation and public contracts.

We will focus on competition law. The issue here is how to ensure that the subsidies received by social landlords in order to provide affordable housing do not exceed what is needed by this activity, so that a part of it may not be used to cross-subsidize other activities, distorting competition with private investors. The technical way to check if this condition is satisfied would be to notify the EU Commission the subsidy and finance planning of every new investment. Aware of the fact that the social housing companies need a secure legal environment and that systematic notification would put a heavy burden on both parties, the Commission has been looking for a better solution. However, a proposal to exempt all social housing providers from notifying was rejected by the European Parliament in 2005. Since then, an acceptable compromise has been sought.

The EU acknowledges the primacy of SGEI missions on Treaty rules (Art 86-2): 'Undertakings entrusted with the operation of SGEI... shall be subject ... to the rules on competition, **in so far as the application of such rules** does not obstruct the performance ... of the particular tasks assigned to them'.

If social housing is considered as a common economic activity, the general rule on state aids applies: '... any aid granted by a Member State ... which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market' (Article 87). 'The Commission shall ...**keep under constant review all systems of aid** .... It shall propose ...any appropriate measures required.... If ... the Commission finds that aid granted ...is not compatible with the common market having regard to Art. 87, or that such aid is being misused, it shall decide that the State concerned shall abolish or alter such aid' (Article 88).

Since November 2005, according to the 'Monti-Kroes Package' any SGEI compensation is a **compatible** state aid (which means that no notification is needed) in several cases, including social housing, along with hospitals, if the services performed are classified as SGEIs by the Member State and provided that these additional conditions are met:

- Entrustment: social housing enterprises must be entrusted of the responsibility for operating the SGEI by an official act carrying legal force; this act must mention the characteristics (nature, duration, territory, etc.) of the service and the parameters for calculating the compensation;
- Compensation: it must not exceed what is necessary to cover all the costs but may take into account a 'reasonable profit'; overcompensation must be controlled and paid back; an overcompensation of 20 % can be accepted and carried forward to the next period.

If these criteria are not met, social housing will be treated the same way as non-SGEI economic activities: compensations cannot benefit from the decision of compatibility and fall under Art. 87 on incompatible State Aids; they must be notified for a EU control (Art 88); if this control qualifies them as incompatible, the scheme must be abolished and redefined.

If the conditions of the 'Monti-Kroes Package' are met, the member state must prove that the state aids do not overcompensate (by more than 20 %) but they can do it on a general basis: it is the system of subsidies which has to be notified, not the individual aid of a given program. The member states are due to make a report to the EC on the implementation of this decision by the end of 2008 and the EC will evaluate it in the following year.

The concept of 'manifest error'

This is therefore a strong incentive for classifying any social housing as SGEI and this only depends on the member states. As there is no definition of SGEI in the EC Treaty, the 'principle of subsidiarity' applies: member states are free to establish or not SGEI according to their own criteria. The Commission can only control their proper entrustment and modalities and the 'manifest errors' or violations of the EC law.

This was the case with the Dutch SGEI of SRH. It was considered as a 'manifest error' as, according to the EU, social housing 'must have a direct link with disadvantaged households' while Housing Corporations in NL house ***in priority*** but not ***exclusively*** these populations. Although their subsidies have been abolished in the 90s, the Dutch social housing providers continue to offer low-rent housing without means-testing. A proposal to establish income ceilings for tenants has been rejected by the Parliament so that this case could end up at the European Court of Justice.

A similar case occurred in Sweden, with the big difference that Sweden does not consider that the rented units provided by the municipal companies are 'social' neither their activity as a SGEI. It is a public service, opened to all and aimed at regulating the housing sector. The preferred option, among those proposed by an ad-hoc commission, is to continue this same activity without any state aid.

The French case

As mentioned above, France still has an original off-market lending system, inherited from the period when long-term market finance was not available and kept alive according to the principle that 'one does not change a team that wins' and also it is sheltered from market volatility.

In short, loans that finance social rented housing in France are:

- Distributed only by a State subsidiary multifunctional financial institution 'Caisse des dépôts et consignations (CDC)' (actually under the control of Parliament),
- Very long term (up to 40 years for construction and 50 years for land acquisition),
- Funded by (short-term) deposits on 'Livret A',
- At a rate (now 4.60%) that only depends on the interest paid to 'Livret A' savers (4.00% + 0.60% margin), regardless of the characteristics either of the investor or of its investment; 3/4 of French people (there is no minimum age) own a 'Livret A'. Its rate used to be set by the Government. It is linked to market conditions through the following formula: 50% Consumer Price Index (Annual change) + 25% 3-month Euribor + 25% EONIA (Overnight rate), with a minimum of CPI + 0.25 which ensures a positive

real yield. It is revised every six months. Deposits on 'Livret A' are tax free (instead of 28% flat rate) and guaranteed by the State.

These loans have no credit risk, thanks to a double guarantee system: the repayment is fully guaranteed by local authorities (95% cases) which in return benefit from up to 20% of the units reserved for designated tenants. When the municipality is not able or willing to give its guarantee, it is replaced by a mutual fund ('Caisse de Garantie du Logement Locatif Social' - CGLLS) for a 2% fee. In practice, none of these guarantees is ever called on an individual (program) basis. CGLLS and all local authorities involved may be called on a general basis to rescue a landlord in financial distress.

These loans and their guarantees are only available to registered social landlords. These are either 'Hlm' (half of them are 'Offices Publics de l'Habitat', public entities linked to Local Authorities and half are Entreprises Sociales pour l'Habitat, non-profit private companies) or 'Sem' ('Sociétés d'Economie Mixte') as there are in many other sectors (transportation, energy, land equipment, etc.). Similar loans, with similar funding, but with higher rates and other guarantees are available to private investors in social housing.

The CDC loan accounts for 64 % in the finance of an average program. The remaining 36 % are obtained by piling up several subsidies and an increasing proportion of own-funds. As a program is due to be low-rent as long as it is not demolished nor sold to a tenant, it is easy to prove that these subsidies (even taking into account the subsidies embedded in the loan, its guarantee, and the underpriced land) are far from reaching the discounted value of the rent gap. The table below compares France and Scotland, which is its opposite, as the Scottish system is simple and mainly relies on a large budget grant.

Although some of them are competing in the small segment of loans to 'top of the range social housing' which are available to any investor, the lenders are not complaining of the monopoly of CDC but for that of their funding source as 'Livret A' is available in two networks only ('Caisses d'Epargne' and 'La Banque Postale'). These networks previously had a special status that limited the scope of their activities; they are now allowed to perform all retail banking operations (accounts, savings, lending). Following a joint complaint by several banks (French and the Dutch ING), the EC decided that these 'special rights' should be abolished because they are obstacles to the freedom of establishment in EU and are not justified by 'overriding reasons relating to the public interest'.

France first decided to go to Court against this decision but also named an expert (Mr Camdessus) to report on this issue and finally decided to open the distribution of 'Livret A' in January 2009 to any volunteer bank. Only the 'Livret A' distributed by 'La Banque Postale' will have specific characteristics designed to allow it to remain a privileged instrument of access to banking services for the underprivileged (transactions of a very low amount and transfers from social funds are authorized).

Concluding remarks

Although it is often felt by social housing landlords as uselessly inquisitive and backed by the lobbying of private groups, the way the EU institutions try to ensure compatibility between a well-functioning housing market and necessary State intervention to help house the most vulnerable is the complex result of successive compromises.

Maybe the European Union's greatest accomplishment so far has been to prompt national debates on the role of rented social housing (Netherlands, Sweden). It also invites to evaluate the efficiency of subsidies by taking into account all the parameters involved, including the hidden subsidies embedded in land or guarantee subsidies, but also the risk due to the lack of freedom in choosing the tenants.

In the French case, the reform which is due to take place in 2009 fueled a passionate debate. The future will tell if it should be seen as the needed ending of an out-of-time Gallic oddity or the first act of the dismantling of the most efficient of social rented housing finance system in Europe. Indeed, those who were favorable to the status quo emphasized that the commercial banks would strain to redirect the savings from 'Livret A' to more profitable financial products, thus drying the source of finance to SRH.

Table: How a social rented housing program is financed and subsidized

	SCOTLAND	FRANCE
Direct Subsidies	65% State	12% VAT 4% State 9% Local 3% Employers Fund
Loan	30% Market	64% Special
Own Funds	5%	8%
Other Subsidies	None	Property tax exemption (25 years) Corporate tax exemption
Other Features		
Targeting	System of points based on needs	Maximum income
Rent Setting	Must be "affordable"	Cost rent (under maximum)

References:

L. Ghekiere: Le développement du logement social dans l'Union Européenne (2007). Cecodhas, Dexia and l'Union Sociale pour l'Habitat, Dexia Editions

Housing Europe 2007: review of social, cooperative and public housing in the 27 EU member states. European Social Housing Observatory, Cecodhas.

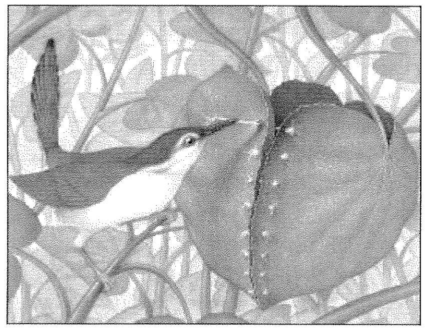
United Nations Economic Commission for Europe (2006) Guidelines on Social Housing: Principles and Examples. UNECE, New-York and Geneva.

Ministry of Infrastructure of the Italian Republic (2006). Housing statistics in the European Union (2006).

Housing and Housing Finance: A Social Challenge and Economic Opportunity

By Zaigham Mahmood Rizvi[1]

Food, clothing and shelter have always been considered a basic human need. It still is today and is likely to assume an even bigger and alarming size in the days to come. Philosophically, it is a basic necessity of all living things on the planet as all animals need food, clothing and shelter to survive. For the food the animals do not have to make any efforts to grow food, just struggle to search for it. It is either grown by nature or is an indirect result of human activities. Clothing is suitably provided by nature and they remain content with it all their lives. However, they are not blessed with shelter and each and every animal has to make efforts to make its own shelter. Interestingly enough, it appears that making a shelter of their own is a basic instinct and a part of their nature. Seeing a Tailorbird, one is amazed as to how much effort it makes in building its nest. Its design takes into consideration the availability of raw materials, the environmental, and the subtleties of interior design. It is quite strange that a Tailorbird would decide to make its own nest even though it may find a lot of empty nests. All the factors of production, especially the space, are "free goods" for them, with the exception of their own labor. As such, there is no issue of affordability. However, the bird decides to make the effort purely out of choice. (The Tailorbird of Southeast Asia sews leaves together to build a funnel shaped nest. Using their sharp bills like needles, these tiny birds pierce holes along the edges of large green leaves. They thread plant fibers through the holes and knot them so that stitches will not fall apart.)



The case is quite complex and challenging for us as human beings. We have to grow our own food, prepare clothing and, of course, build our own shelters. For building a shelter, all the factors of production are "economic goods" for humans, whereas the primary ingredient, land is getting more and more scarce and expensive. Thus, today the basic social need of shelter has become an issue of "Affordability" in case of humans.

Affordability

From the aspect of price and affordability, the housing sector may be segregated into market housing and social housing. Market housing is defined as that segment of the housing market where demand is commercially attractive and is being met by the market forces. Social housing is that segment of the market where the demand exists but the supply at affordable prices is not enough, since supply at such levels is neither commercially possible nor attractive.

From the aspect of income and affordability, the housing market could be divided into High, Middle, Lower Middle, Small and Micro Housing. Fig 1 presents the Housing Continuum from the aspects of Income and Affordability, using the case of Pakistan as an example.

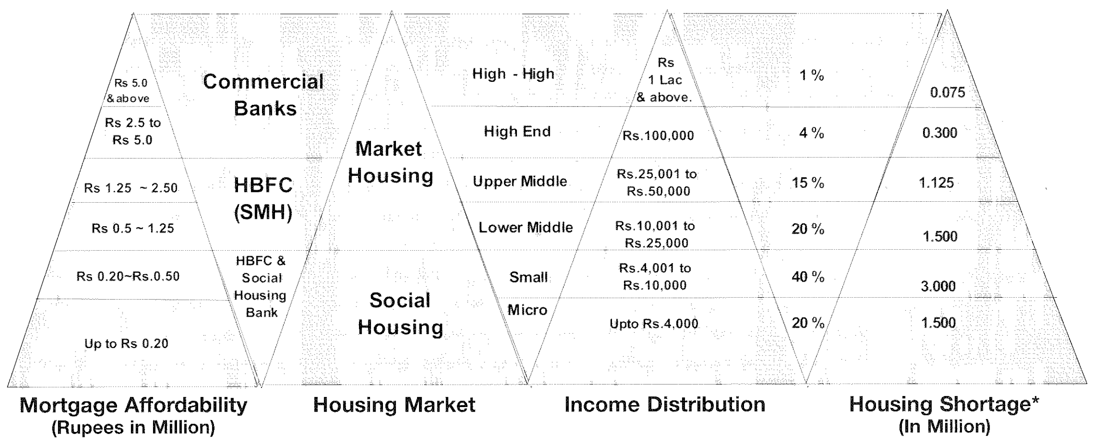
The candidates for Micro Housing and Housing Finance solutions are those falling near poverty levels. While the Housing Continuum presents the case of Pakistan, the situation would not be much different in most South Asian countries like Afghanistan, India, Bangladesh, Sri Lanka, etc. In Pakistan, nearly 20% of the population is a candidate for Micro Housing and Micro Housing Finance solutions. In the Market Housing segment, since the market forces are attracted by the existing commercially attractive options, no state intervention is needed to facilitate Market Housing supply. As we move down the ladder from middle to lower middle to low income groups, the housing shortage grows much bigger. The shortages start assuming alarming levels at the level of the very needy and the very poor segments of the population.

In the case of major metropolitans in South Asian regions such as Mumbai, Delhi, Dhaka, Karachi, Manila, etc., more than half of the urban habitats are illegal squatter settlements, slums, and shanty towns, and popularly known as Jhopar Patti, Basti, Jhuggi or Katchi Abadi in India, Bangladesh and Pakistan. The main contributing factor to these squatter settlements is massive urbanization. All this poor urban population, living at subsistence or below subsistence levels, may still manage to acquire some

[1] He is Adviser to the State Bank of Pakistan (the central bank) on Housing & Infrastructure. He is also working for the World Bank Group as Consultant on Housing and Housing Finance.

Fig. 1

Housing Continuum



Per Capita Income	Rs. 5,000 per month
Minimum Wage Rate	Rs. 6,000 per month

Total existing backlog is estimated at 7.5 Million units. The shortage in various income segments is assumed in the same proportion, as per income distribution pattern. However, actual shortage is much higher in low income segments as opposed to higher income segments.

food and clothing, but shelter/housing is way beyond their manageable and affordable limits. The recent massive urbanization results in population with a lack of shelter and manifests itself behind an ever increasing person per room density statistic, which is around 3.5 in India and Pakistan as compared to 1.1 in the EU and 0.5 in USA.

Furthermore, the cost of land in almost all countries is rising. The acquisition of land is the first stepping stone towards fulfilling the dream for a house. In any illegal squatter settlement, the people manage the cost of construction through "incremental or progressive" housing. However, it is impossible for the poor and needy to acquire land on a piecemeal basis. Their savings cannot catch the rising cost of land. The land mafia provides them land at a price these people cannot afford to pay. This means that many of these settlers use their lifelong savings for construction on a land which they acquire without any legal title. Such illegal developments are without any residential infrastructure and lead to the development of slums and shanty towns. Over the years the value of this land will rise and the illegal squatter settlements will be sitting on an enormous economic potential in terms of the cost of land. A State intervention may develop programs helping these poor to unlock the enormous equity potential for their own benefit and for the benefit of society at large. The market forces do not get attracted to this Social Housing segment without any policy intervention by the State.

Hernando De Soto in his book 'The mystery of capital – Why capitalism triumphs in the West and fails everywhere else' has discussed this issue at length. He mentions that the poor in these slums and squatter settlements are sitting on an enormous potential equity which could be "unlocked" for their benefit and for the benefit of society at large. Thus, the Social Housing segment has an enormous potential in terms of its business volumes and a State intervention is needed to make it commercially attractive through fiscal and regulatory policy interventions. Such state interventions may provide, wherever needed, the necessary fiscal support through direct and indirect subsidies.

Why the Financial Sector remained shy of the Social Housing segment

Considering the case of South Asia, Housing Finance has essentially remained the function of State-Owned Specialized Financial Institutions (SOE's). The entry of commercial banks in the area of Housing Finance is a relatively recent phenomenon. These SOEs have responded to the social agenda of the Government by providing housing finance to the low and middle income sections of the population and also by ensuring access to housing finance to the needy and poor through a wider geographical presence. However, being in the public sector, most of these institutions lack financial discipline. They solely relied on state funding to support their loaning operations. Yet, over time, due to economic compulsions, concessional funding from the State was no longer available, and the SOE's credit standing did not permit them to go for market- based funding. Therefore, over the years, these SOEs developed huge non-performing loan portfolios in their books and ended up losing their commercial viability and sustainability.

Case of Four Countries in South Asia

The phenomenon discussed above is illustrated by looking at some countries in South Asia, namely India, Bangladesh, Pakistan and Afghanistan. The basis of selecting these four countries from the South Asian Region is the following:

India and Pakistan represent a very sizeable population, a massive housing backlog, a fast growing urban population, a fairly developed housing finance market and yet they still show meager mortgage debt (MD) to GDP Ratios. In Bangladesh, a large portion of land is covered with rivers and lakes resulting in a much higher population density of 1,198 Persons/Sq. KM. These factors provide this country with its own challenges in the housing sector. Lastly, Afghanistan, a largely mountainous terrain has most of its people living in a tribal culture and has a financial infrastructure which has been virtually destroyed due to internal conflicts and wars. This country is faced with a massive challenge of new construction and reconstruction in the housing sector.

Some basic statistics of these countries is given in Table 1.

Bangladesh: Till recently, the State owned Bangladesh House Building Finance Corporation (BHBFC) had been the only player in the mortgage business. The commercial banks and two private sector specialized institutions (Delta-Brac and International Housing and Finance) are recent entries into housing finance. Bangladesh has an estimated backlog of about five million housing units. In the absence of the long term debt market, the relatively small private sector housing finance institutions lack of long term funding. The market needs a refinance window, the absence of which has restricted their loan operations. The business focus of the commercial banks and private sector institutions is the middle and high income population, and nearly 100% of their housing finance portfolio covers Dhaka (80%) and Chittagong (20%), the two main metropolitan cities of the country. However, these institutions serve the middle and high end of the population. This is evident from the average loan size per client which is nearly three times the average loan size of BHBFC. The BHBFC loan portfolio covers 18 cities of the country and shares 71% of the mortgage market in terms of number of loans and 30% in terms of outstanding portfolio value (as of June 30, 2007 Bangladesh Bank).

India: The mortgage industry in India is relatively developed but at the same time India faces a much bigger challenge in terms of its huge population and housing backlog.

The population of India is 1.1 billion as per 2007 estimates and is likely to touch 1.37 billion by the year 2023. The urbanization level is 26% and is likely to touch 33% by year 2023, which roughly translates to an increase of 225 million in the population of Urban India. This increase in urban population is likely to worsen the already alarming issue of urban slums, squatter settlements and shanty towns (Jhopar Patti) in urban India. The existing backlog of housing in India is assessed at 72.1 million housing units, out of which an estimated 24.7 million is in urban areas. While the new mortgage originations were around $25 billion during 2008 and are likely to reach $40 billion by the year 2012, the access to mortgage finance for low and middle income people still remains a challenge for the leading players in housing finance (HDFC, ICICI, State Bank etc), and the commercial banks. The National Housing Bank of India, having a unique role of being a regulator as well as a provider of long term funds to the housing finance institutions, is proactive in meeting the challenge of pro-poor and affordable housing.

Some model projects for providing affordable housing are being attempted under Public-Private Partnership. For affordable housing, the rising land prices in major metropolitans like Mumbai and Delhi is the main challenge which is depriving the low and middle income people from affordable housing. As in other countries of the region, the matter of long term funding is another major constraint resulting in issues of tenor and rate mismatches.

Pakistan: In Pakistan, until recently the state owned House Building Finance Corporation (HBFC) was the only player in the mortgage market. The entry of commercial banks into housing finance business is a recent phenomenon. Apart from HBFC there is no mentionable specialized housing finance institution in the country. Pakistan has an estimated shortage of about seven million housing units, of which nearly two-thirds is in low and middle income segment of the population. Until 2005, HBFC had a presence in 50 cities. Under its program for expanding its outreach to smaller cities and towns by setting up Service Centers and Representative Offices, HBFC has expanded its outreach to nearly 90 cities. With a wider "access to finance" and with a business focus on "Small and Medium Housing (SMH)" finance, HBFC's loan portfolio is now expanded to nearly 90 districts out of a total 131 Districts in the country. The target is to ensure access to finance at all Districts of the country. The commercial banks' mortgage loan portfolio is concentrated in the major 6-8 metropolitan cities of the country, and thus mostly serves the middle and high income market segments. Average loan size of the banking sector is nearly ten times the average loan size at HBFC. Another interesting aspect is that while 80 % of HBFC housing finance is for "new constructions", for commercial banks 70-80 % of the housing finance is for sale/purchase. Commercial banks are keener in funding housing purchase and avoid financing new construction since they consider it more risky investment, hence higher loan processing costs.

The present Government has announced a Pro-Poor Program for Housing aimed at building one million housing units per year. Most of it would be implemented under a Public-Private Partnership model. To support the program, the Government and the State Bank (the Central Bank) are creating a facilitating fiscal and regulatory environment. While the program appears too ambitious, at least it reflects the Government's intention to move forward to meet the housing backlog.

Afghanistan: The estimated housing backlog in Afghanistan is around 1.0-1.5 million units. Most cities in Afghanistan have an acute shortage of livable housing since the country has faced a war-like situation during the past two and a half decades. For this reason, most of the social and economic infrastructure in the country has been destroyed. According to the World Bank estimates, an investment of $ 2.5 billion in Kabul alone would be needed, excluding land, for rehabilitation and new construction. Informal settlements provide shelter for 80 % of the population and cover 69 % of the residential land in Kabul. As such, Kabul is facing a severe problem of informal settlements, mostly built on Government land (World Bank Report "Housing Finance in Afghanistan: Challenges and Opportunities" July 2008).

Afghanistan had a state owned housing finance bank, which for various reasons could not continue as a viable and sustainable entity and was closed down in 2003. The continuing conflict in Afghanistan for the last 25-30 years is primarily responsible for the decay and demise of the financial infrastructure. There are 16 commercial banks operating in the country and most of them are now keen to play some role in the housing finance area. The state owned Bank-e-Millie aims to take a lead role in this field. Most of the secondary market transactions in housing are usually on cash. The bank's lending ability is restricted to short tenors of 3-5 years for housing finance. While the Banks have excess liquidity, the tenor of their liability book does not permit creating long term assets. Due to the absence of a developed financial market, the availability of long term funds is the binding constraint on the banks to provide long term housing finance.

The Ministry of Urban Development and Da Afghanistan Bank (Afghanistan's Central Bank) are now playing a proactive role in the development of housing and housing finance in Afghanistan. Some NGOs are also keen in getting involved in the area of micro housing and micro housing finance. The Government has an ambitious project of creating 450,000 housing units for the country to partly meet the backlog in housing. The current Government initiative includes a project of 20,000 housing units and aims to make it affordable by providing infrastructure and land. While Afghanistan is working for the development of its financial sector as well capital markets, multilateral institutions like the World Bank and IFC are providing much needed technical and financial assistance. However, the Government has to play a much bigger role in promoting affordable housing and housing finance alongside developing a regulatory framework, title registration and mortgage laws.

Challenges and Opportunities

The housing scenario in the aforementioned South Asian countries brings to surface the following issues:

- These four countries represent a total population of 1.44 billion which translates into nearly one out of every four persons on the globe.
- Their combined total housing backlog is about 85 million housing units.
- A major portion of this backlog is in low and lower middle income segments of the population.
- The Mortgage Debt (MD) to GDP Ratio is very low, being the highest in India at 5%,

Table 1 SOCIO ECONOMIC STATISTICS

Countries	Population (mn)	Housing Backlog (mn units)	Population Growth Rate (%)	Urban Population (%age of total)	House Hold (mn)	MD* to GDP Ratio (%)	Occupancy/ House Hold	Population Density per sq km	GDP / Capita (PPP)
India	1,100	72	1.4	29	214	5	5.3	373	2,469
Pakistan	160	7	2.1	35	23	2	7.1	206	2,361
Bangladesh	156	5	1.8	26	26	2	6.1	1,198	1,155
Afghanistan	24	1.5	N/A	N/A	N/A	< 1	N/A	N/A	N/A

* MD = Mortgage Debt

"International Housing Finance Program 2008." Wharton - University of Pennsylvania. June-July 2008.

HOUSING AND HOUSING FINANCE: A SOCIAL CHALLENGE AND ECONOMIC OPPORTUNITY

which is still low compared to the other countries in the region like China (15%) and Malaysia (18%). This shows a substantial unrealized potential in the housing finance market.

- Urbanization is increasing at a fast pace. More than 50 % of the population in cities like Dhaka, Delhi, Mumbai and Karachi is living in slums and squatter settlements. In Kabul, the situation is even worse, with 80% of the population living in slums. This justifies the need for pro-poor programs for low and middle income housing, alongside programs for the improvement and rehabilitation of slums.
- Housing finance largely remained within the domain of the public sector financial institutions. The entry of commercial banks and private sector mortgage institutions has been only a recent phenomenon.
- There is a need to develop long-term debt markets to support the long-term funding needs of the housing sector.
- There is a need for the development of Capital Markets, introduction of Regulatory Reforms, and to promote liability products like Mortgage Backed Securities, Covered Bonds, and REITS.
- There is a need to develop innovative housing finance products to meet the needs of different market segments. Developing "Sharia" compatible products is essential for countries with a sizeable Muslim population.
- The creation of institutions for Mortgage Refinance, Mortgage Insurance, Title Insurance, Title Registry, Credit Bureaus etc will improve the situation greatly.
- There needs to be an acceleration of housing supply at a large scale. The role of large-scale developers and developer finance cannot be underestimated. Any program to develop large-scale housing under Public-Private Partnership would not succeed without the mechanism and regulations for developer finance being in place.
- It is the finance required for "new construction" and not for the "sale/purchase" of homes in the secondary market which will have a real impact on economic growth. New construction finance is relatively cost inefficient, involving more processing costs and thus is less appealing to profit driven commercial banks. It may appear riskier as well.
- The average size of loan, considering the financial intermediation cost, is another inhibiting factor for the private sector financial institutions to go for Small and Medium housing finance. On the contrary this segment, on social considerations, desires affordable finance at lower interest rates.
- In some countries there is a need to have specific prudential regulations for mortgage finance, separate from the Regulations for Consumer Finance.
- No government department or agency is responsible for the compilation of data on housing and related municipal infrastructure. This calls for the need to establish a Housing Observatory in these countries.

Socio-Economic Impact of Housing Sector

The large population base, the massive housing backlog, the fast expanding urban population, and mushrooming slums and squatter settlements are becoming a gigantic socio-economic challenge for most South Asian countries. Any program to meet this massive backlog has to take all the stakeholders on board, both on the housing supply and housing finance sides. The players on the housing finance side are:

1. Financial institutions and banks
2. Secondary market institutions
3. A vibrant capital market
4. An all service insurance industry
5. The construction material industry

If all these players are geared up to play their due role in the growth of the housing sector by stimulating housing finance, their socio-economic impact will be substantial and pervasive.

Opportunities for the Financial Sector

A proactive role of the financial sector in promoting housing and real estate in an economy will in return make an unimaginable contribution to the growth of the financial sector itself. A few such contributions might be:

Contribution to Banks and Financial Institutions (FI):

As mentioned earlier, the commercial banks' entry into housing finance in most South Asian countries has been a recent phenomenon. The banks have generally stayed away from mortgage debt. For commercial banks the retention of short term loans beyond one year needs a lot of efforts by the bank's marketing team.

The average life of a housing loan on a Financial Institution's (FI) Balance Sheet is around 12 years in Bangladesh as well as in Pakistan. With effective risk management and judicious credit appraisal by housing finance institutions in those countries, it is obviously cheaper to book and retain a mortgage debt on the balance sheet for 10-12 years. Depending upon the spreads available, the mortgage portfolio may recover its financial intermediation cost within 2-3 years, and the loan portfolio would yield profits to the institution for the remaining life of the loan. Furthermore, since the average retention life of mortgage debt is much higher, the size of earning assets and the balance sheet would gradually grow. This will create room for spinning-off of a part of the assets through securitization and refinance windows.

Contribution to the Capital Market:

In order to raise long-term funding through market based instruments, the financial institutions will need to come up with floatation of capital market instruments like securitization, covered bonds and REITS.

This will not only help the financial institution in expanding their liability book but will also provide the capital market with a regular source of long-term instruments of finance.

Since housing finance assets can easily be structured into "Sharia-compatible" assets, these instruments become attractive to Islamic Mutual Funds. Once these instruments are listed on the Stock Exchange, they can become a significant part of market capitalization. The Listed Property Trusts form about 10% of market capitalization of the Australian Stock Market. Listed REITS are worth $400-500 billion in the listed securities market of USA.

Contribution to the Insurance Industry:

The mortgage industry is probably the only industry needing involvement of insurance coverage in four different areas like:

- General insurance
- Life insurance
- Mortgage insurance, and
- Title insurance.

Looking at the size of mortgage debt in developed markets, its impact on the growth of insurance industry is quite obvious.

Contribution to the Construction Material Industry (CMI):

In USA and Europe it is said that nearly 270 CMIs are directly related to the growth of the construction industry. In Asian countries its potential is not recognised, and it is generally stated that between 40 and 50 CMIs have direct linkage to real estate development. The growth of the construction industry to support housing construction would expand the banks' market for project and working capital finance.

Contribution to Employment:

Once the countries start implementing large scale construction programs, the financial sector, the insurance sector, and the capital market will all witness a substantial growth and will in turn make a visible and sizeable contribution to income, employment and GDP.

While institutionalized housing finance has existed in most of these countries for a couple of years, it has remained a function of state owned enterprises to play the main and overwhelming role of the housing financier. Housing finance by commercial banks is generally a recent phenomenon. For commercial banks, mortgage loans are a possibility to diversify their assets within consumer financing. However, it is not the main business focus. The recent global financial crisis having their origin in sub-prime issues has somehow given a message to the commercial banks that housing finance is a very risky business. It is the need of the time to create awareness among the FI's and other stakeholders that housing finance is a good business with tremendous economic potential, particularly in the emerging economies. This is the activity which can make various contributions to the financial sector, insurance business, capital market, construction material industry and employments etc., thus ensuring more tangible GDP growth. This potential needs to be channelized and realized by promoting housing supply and the mortgage industry.

Factors Affecting Borrowers' Choice of Housing Loan Package in Southwestern Nigeria

By Olatoye Ojo[1] and J. I. Ighalo[2]

1.0 Introduction

There are various institutions which offer housing loans that prospective borrowers can access (Case & Clapp, 1978; Boykin, 1979; Floyd, 1980; Ojo, 1981; Ohibokun, 1985; Olufemi,1993). These include, inter alia, primary mortgage institutions (otherwise known as savings and loan associations in the US and building societies in the UK), banks, insurance companies or state housing corporations/ agencies. Because these lending institutions access their loanable funds through different sources and under varying terms and conditions, the terms and conditions under which they in turn grant housing loans to prospective borrowers also vary from one lending institution to another. This is why, for example, some institutions (like commercial banks) are active in short-term lending because of the nature of their deposit liabilities while some (like insurance companies) could afford to lend on a long term basis because they have a large, steady inflow of money and relatively small, predictable outflows (O'Mara, 1980). Also, the cost at which funds are sourced by these lending institutions will determine the rate of interest they would charge on their loans. This is why, for example, in Nigeria, housing loans granted by PMIs under the NHF scheme[3] bear interest rates of 6 % per annum while other housing loans granted by the same institutions bear interest rates of up to 21% per annum (Yaya, 2002). Furthermore, there are other lending conditions which also vary from one institution to another (Newcombe, 1985).

In effect, it can be reasoned that a prospective borrower is faced with the problem of choice in his attempt to access a housing loan. Which factors would affect his ultimate choice of a housing loan package from available financing sources or options? This paper aims to examine those factors that affect the borrower's choice of a housing loan package in Southwestern Nigeria. The paper also examines empirically how borrowers rank the various factors. The problem being investigated in this paper is within the context of a developing country (ie Nigeria). It is therefore envisaged that the findings from this research would be relevant to other developing countries as well.

2.0 Review of Literature

A review of the recent literature on the borrower's choice of a housing loan package shows the following results:

1. The prospective borrower's ultimate choice of a loan package will depend on the lender's requirements and his ability to meet them. Lender requirements are determined by their underlying funding structure. Often, poor, low and middle - income households (that are in the majority in developing countries) face difficulties to meet these requirements (UNCHS - Habitat, 2002). This also applies to Nigeria (Olufemi, 1993; Onibokun, 1985; Falegan, 1985). Borrowers cannot meet some lenders' requirements such as: collateral (title deed), building plan approval, amortization period, current tax clearance certificate, down payment, service charges (inspection and search fees), affordability criteria, repayment schedules, fire insurance policy and mortgage protection policy (Smith et al 1977; Olotu 1978; Boyki 1979; Renaud 1986; Eldred 1987; Olusola 1993; UNCHS 1994, 1995 and 1996; FMBN 1998; Yaya 2002; Ojo 2004).

2. Other factors have been documented in the literature as affecting the borrower's choice of a housing loan package. The factors (which are not presented here in any order of significance) include: (i) the interest rate, (ii) repayment period, (iii) monthly/annual repayment, (iv) title document, (v) project's viability with respect to debt service, (vi) tax structure of the project, (vii) reputation and experience of the lender, (viii) the age of borrower and (ix) income of the borrower (Smith et al, 1977; Boykin 1979; O'Mara 1980; Barlowe 1986; Bridges 1997 and Thomset 2002). These factors have been considered in separate contexts by the various scholars and without examining their relative degrees of significance. This paper however looks at all these factors within the Nigerian context as they affect the borrower's choice of a housing loan package. It also ranks them in order of significance.

[1] Senior Lecturer, Department of Estate Management, Obafemi Awolowo University, Ile-Ife, Nigeria.

[2] Professor of Estate Management, Federal University of Technology, Minna, Nigeria.

[3] The National Housing Fund (NHF) scheme is a mandatory savings scheme established by the Nigerian Government to provide a pool of cheap and long term funds for housing credit. Contributions to the Fund are deducted from employees in the private sector and self-employed persons.

FACTORS AFFECTING BORROWERS' CHOICE OF HOUSING
LOAN PACKAGE IN SOUTHWESTERN NIGERIA

3.0 The Study Area

Southwestern Nigeria, the study area for this work, is one of the six geopolitical zones of Nigeria. It covers the following states of the country: Lagos, Ogun, Oyo, Osun, Ekiti and Ondo. Although highly urbanized and cosmopolitan, the region is a monolithic ethnic geographical zone being the predominant home of the Yoruba tribe. The zone formerly housed the seat of the nation's capital (ie Lagos) until 1991. From this date, Abuja became the new capital. The 1991 census figures released by the National Population Commission (1992) put the population of the these five states of Southwestern Nigeria as follows: Lagos (5,685,781), Ogun (2,338,570), Oyo (3,488,789), Osun (2,203,016) and Ondo (3,884,485). Ekiti State was carved out of Ondo State after the 1991 census. Hence its population figure is subsumed in the 1991 figure for the Ondo State.

Lagos, in spite of the movement of the country's capital to Abuja remains the commercial, financial and business headquarters of Nigeria (Ojo, 2004). A 1985 Federal Office of Statistics survey indicates that the Lagos metropolitan area contains 38.12% of all the industrial establishments in Nigeria, while according to Oladimeji (1995), this area also accounts for 45.19% of total employment in the Nigerian industrial sector. Ibadan, which is another major metropolis within the zone, is the seat of many educational institutions (including the nation's premier University) and a big commercial centre in West Africa. The headquarters of 63.9% of the Primary Mortgage Institutions (PMIs), 89.89% of the banks and 83.05% of the insurance companies in the country are located in Southwestern Nigeria (Ojo, 2004). This is a clear, unambiguous and undisputable confirmation of the primacy of Southwestern Nigeria over and above other zones as the nation's financial, business and commercial hub. Because of the high business, commercial, industrial and employment opportunities in the zone, migration from other parts of the country is quite high.

4.0 Methodology

Borrowers are the subject of this study. They also constitute the respondent group for the purpose of the questionnaire administration within the study area. The sample comprised 327 individual borrowers randomly drawn from a sample frame of 467 borrowers, ie the total number of applicants who have succeeded in accessing a mortgage loan from the following financial institutions: PMIs[4] (50), Banks (89), Insurance Companies (98) and State Housing Corporations (6). The sample size adopted was 70% of the sample frame and this is quite manageable size wise. This is also in accordance with the assumption by Speigel (1961) that if 70% of a certain group falls within a particular class, then this class can be taken as being representative of the whole group. Based on the calculated sample size, a total of 327 questionnaires were distributed while 305 were duly completed and retrieved representing a 93.3% response rate which appeared impressive. The time frame of 1992 to 2000 adopted for data collection was chosen because the year 1992 marked the beginning of the major revolution in the mortgage sub-sector of the country's economy with the birth of the National Housing Fund - NHF.

From the review of literature, a number of factors were identified as affecting the borrower's choice of a housing loan package generally. With respect to the thrust of this paper, these possible factors were measured by asking the respondent borrowers to rank the factors in order of significance on a five point ordinal scale with 5 representing very significant and 1 not significant. The analysis involved reduction and selection of factors that are significant in view of the borrower's choice of a housing loan package. The analysis could be undertaken using any of the following techniques - proportion, relative importance index and principal component analysis - because they are all capable of ranking factors in order of significance. In this context, the study refers to two methods:

1. The Proportion Method is a statistical means of representing the significance of a variable relative to all other variables under consideration. The proportion value for every factor/variable is represented by the total score of the variable divided by the overall sum of scores of all variables being considered. It is usually expressed in percentage as follows:

$$\text{Proportion (P)} = \frac{\text{Total Score of Variable}}{\text{Overall Sum of Scores of all Variables}} \times \frac{100}{1}$$

The higher the proportion value, the more significant is the variable/factor. Relative Importance Index - RII rates factors against a scale in order to access the significance of each factor. The scale is then transformed into a relative importance index for each factor in order to determine the ranking of the different factors. RII is computed using the formula:

$$\text{RII} = \frac{\sum W}{A \times N}$$

where:

W = weighting given to each factor by the respondents and in this study, it ranges from 1 to 5 with 1 representing not significant and 5 very significant

[4] The first Primary Mortgage Institutions were established in 1989 as specialised institutions in mortgage lending. Their role is to collect retail deposits and to make mortgage loans, both on the open market and as the only institutions through which loans from the NHTF are distributed.

A = highest weighting (or ranking) which is 5 in this case

N = total number of respondents

2. The Principal Component Analysis – PCA is a technique of multivariate data analysis used as a tool for data reduction. It shows which parts of the data can be discarded with little loss of information. According to Guttman (1954), the technique assigns values called "Eigenvalues (= own values)" to each factor with an Eigenvalue below 1.0 are viewed as not significant. This technique was also used to rank the factors in order of significance based on their respective Eigenvalues.

5.0 Results and Discussion

The analysis of data has been undertaken at two levels. The first level, which is descriptive, using frequencies, relates to the general social-economic characteristics of the respondents in the study area. Results of this level of analysis are presented in Tables 1 to 6. The second level relates to an analysis of the factors which affect the borrower's choice of a housing loan package in the study area. The results are presented in Tables 7 and 8.

Table 1 shows the distribution of respondents by sex. 74.6 % are male while the remaining 25.4 % are female. It shows that more men take up a housing loan than women. As heads of the families, this is quite understandable. This is also in accordance with Ajayi's (1990) findings that men are apparently more inclined to acquire home ownership through mortgage loans than women. Table 2 shows the distribution of respondents by marital status. 86.9 % are married, 8.2 % single while the remaining 4.9 % are widows. This pattern may suggest that the concern of most married people is to have a house of their own. Table 3 documents the distribution of respondents by occupation as follows: professional (54.1 %), civil/public service (31.1 %), teaching (8.2 %), manufacturing (3.3 %) while trading and farming have 1.6% each. This pattern suggests that the professionals and civil/public servants are most likely to meet requirements set by lenders.

Table 1 – Distribution of respondents by sex

Sex	Frequency	%
Male	220	74.6
Female	75	25.4
Total	295*	100

* 10 Respondents did not indicate their sex

Source: Authors' Field Survey, 2004

Table 2 – Distribution of respondents by marital status

Marital Status	Frequency	%
Single	25	8.2
Married	265	86.9
Widow	15	4.9
Total	305	100.0

Source: Authors' Field Survey, 2004

Table 3 – Distribution of respondents by occupation

Occupation	Frequency	%
Professional	165	54.1
Trading	5	1.6
Civil/Public Service	95	31.1
Manufacturing	10	3.3
Farming	5	1.6
Teaching	25	8.2
Total	305	100.0

Source: Authors' Field Survey, 2004

Table 4 shows the distribution of the borrower's age. Borrowers within the age of 41-45 years constitute 34.4 % and those within the 46-50 bracket constitute 29.5 %. Those below 40 years make up 19.7% while those above 50 years constitute 16.4 %. It further shows that borrowers within the 41 and 50-years bracket constitute 63.9 % of the total group. This suggests that this is the age bracket in which most people aspire to have their own houses. Table 5 depicts the distribution of respondents by annual income. 72.1 % earn above N200,000 per annum while 18.1 % earn between N150,000 and N200,000 per annum with the remaining 9.8% earning less than N150,000 per annum. The distribution is greatly skewed in favor of an annual income of higher than N200,000. This is quite indicative of the significance of the borrowers' income as a factor in housing finance. Table 6 shows responses in view of their preferred source of finance for housing where 5 represents most preferred and 1 least preferred. 60.7 % ranked PMIs on a scale of 5 while 39.3 % rank State Housing Corporations also on a scale of 5.

FACTORS AFFECTING BORROWERS' CHOICE OF HOUSING LOAN PACKAGE IN SOUTHWESTERN NIGERIA

Table 4 – Distribution of respondents by age

Age	Frequency	%
Below 40	60	19.7
41-45	105	34.4
46-50	90	29.5
Above 50	50	16.4
Total	305	100.0

Source: Authors' Field Survey, 2004

Table 5 – Distribution of respondents by annual income (net)

Income[5]	Frequency	Percentage
< N150,000	30	9.8
N150,000-N200000	55	18.0
> N200,000	220	72.1
Total	305	100.0

Source: Authors' Field Survey, 2004

Table 6 – Sources of finance for housing preferred by borrowers (in order of preference)

	Ranking				
	1	2	3	4	5
Primary Mortgage Institutions	20(6.6)	25(8.2)	20(6.6)	55(18.0)	185(60.7)
Banks	55(20.0)	95(34.5)	95(34.5)	30(10.9)	-
Insurance Companies	45(16.7)	130(48.1)	95(35.2)	-	-
State Housing Corporations	20(7.1)	35(12.5)	35(12.5)	80(28.6)	110(39.3)

Note – The figures in brackets are percentages of responses

Source: Authors' Field Survey, 2004

No respondent ranks banks and insurance companies as most preferred, which indicates the borrower's low preference for these two sources. Potential borrowers prefer PMIs and state housing corporations to banks and insurance companies. This might be due to the perception that PMIs and state housing corporations are purposely set up to finance housing while housing financing is seen more as an ancillary role for banks and insurance companies.

Table 7 contains the results of the analysis of the factors that affect the borrower's choice of a housing loan package in Southwestern Nigeria by means of the Proportion Method. Results show that in rank order, the three most significant factors are the interest rate, the income of borrower and the title document (collateral).

The Proportion Values (which indicate the relative significance in order of magnitude) for the three factors are: 93.8 %, 90.5 % and 83.7 %. Results of the analysis also show that the tax structure of project has a Proportion Value of 46.9% and hence ranks as the least significant factor. Table 8 contains the results by means of the Relative Importance Index and the Principal Component Analysis (PCA). These two methods (which also rank factors/variables in order of significance) also rank equally the interest rate, the income of borrower and the title document as the three most significant factors. The PCA technique goes even further to reveal that there are indeed four significant factors (as revealed by their respective Eigenvalues which are all greater than 1.0), namely the interest rate (2,288), the income of the borrower (1,909), the title document (1,376) and the monthly/annual repayment (1,132).

Interestingly, the analysis using these three methods shows comparable results. The interest rate, the income of the borrower and the title document are the three most significant factors that affect the borrower's choice of a housing loan package in Southwestern Nigeria.

6.0 Conclusion

A major conclusion from this study is that the interest rate is the most significant factor that affects the borrower's choice of a housing loan package in Southwestern Nigeria. As a result, the interest rate charged must be seen as very crucial to policies aimed at promoting home ownership. Hence, housing finance and delivery which should be properly managed to promote availability and accessibility. The Federal Government decision to fix the interest rate on loans to NHF contributors at 6% is indicative of this factor. But the question is - even at this concessionary rate of 6% - how many people can benefit? There is no doubt that Nigeria is currently experiencing a regime of high interest rates. This issue appears complex because it is now being globally accepted that interest rates should be determined by market forces rather than fixed by the government. It is therefore recommended that the Federal Government should pursue fiscal and macro-economic

[5] One US Dollar is about Naira 117.

Table 7 – Analysis of factors that Affect the Borrower's choice of a loan package by means of the Proportion Method

Hypothesized Factors	Numbers	Sum	Proportion (%)	Ranking of factors
Cost of Loan (Interest Rate)	305	1430	93.8	1
Income of Borrower	295	1380	90.5	2
Title document/Collateral	305	1276	83.7	3
Monthly/Annual Repayment	301	1262	82.8	4
Project's Viability with respect to debt service	305	1255	82.3	5
Reputation & Experience of the lender	300	1230	80.7	6
Age of Borrower	300	1145	75.1	7
Other terms of loan	295	1115	73.1	8
Repayment Period (Tenor)	301	1065	69.8	9
Tax structure of project	300	715	46.9	10

Source: Authors' Field Survey, 2004

Table 8 – Analysis of factors affecting the borrower's choice of a loan package by means of 2 methods: Relative Importance Index (RII) and Principal Component Analysis, (PCA).

Hypothesized Factors	N	Sum	RII	Eigenvalues	Ranking of the factors by 2 Methods
Cost of Loan (Interest Rate)	305	1430	6.36	2.288	1
Income of Borrower	295	1380	6.13	1.909	2
Title document/Collateral	305	1276	5.67	1.376	3
Monthly/Annual Repayment	301	1262	5.61	1.132	4
Project's Viability with respect to debt service	305	1255	5.58	.815	5
Reputation & Experience of the lender	300	1230	5.47	.696	6
Age of Borrower	300	1145	5.09	.581	7
Other terms of loan	295	1115	4.96	.500	8
Repayment Period (Tenor)	301	1065	4.73	.414	9
Project Tax Structure	300	715	3.18	.287	10

Source: Authors' Field Survey, 2004

policies that would allow a reasonable degree of stability within an economy. The Government, while continuing to serve as a watchdog, should re-appraise the existing regulatory framework to promote an interest rate regime determined by market forces that would encourage long term borrowing.

Additionally, the Land Use Act should be reviewed to facilitate greater access to land. Specifically, the cost of procuring title to land under the Act should be brought down considerably in all the states of the federation. The time it takes to obtain a title and the Governor's consent to register a mortgage should be reduced considerably. For example, it should be possible to obtain a certificate of occupancy within three months. The Governor's consent should be given within two weeks. In addition, the Act should be removed from the constitution of the country to facilitate amendments.

References

Adibua, A. (1979); "Finance for Housing: A Problematic Issue." A paper presented at the 3rd Annual Conference of the Nigerian Institute of Town Planners held at Benin.

Ajayi, C.A. (1990); "An Analysis of Default Factors in Residential Mortgages of The Federal Mortgage Bank of Nigeria and Oyo State Property Development Corporation."

Unpublished PhD. Thesis of the Department of Estate Management, Obafemi Awolowo University, Ile – Ife.

Barlowe, R. (1986); "Land Resource Economics" Prentice-Hall, Englewood Cliffs New Jersey. 4th Edition.

Bridges, J. E. (1997): "Mortgage Loans" Better Way Book, Cincinnati, Ohio.

Case, F. E., & Clapp, J. M. (1978): "Real Estate Financing" Wiley/Hamitton Publication, New York.'

Eldred, G. W. (1987): "Real Estate Analysis and Strategy" Harper and Row Publishers, new York.

Falegan, S.B. (1985); "Housing Finance and Funding: The Nigerian Experience." In Onibokun P. (ed.) Housing in Nigeria (A Book of Readings), NISER, Ibadan. pp 179 – 197

Federal Government of Nigeria (1991); "The National Housing Policy, 1991" FGN, Lagos.

____ (1992); "National Housing Fund Decree No. 3 of 1992." FGN, Lagos.

____ (1996); "Terms and Conditions for Obtaining Loans from the National Housing Fund by Mortgage Institutions and Individual Contributors Regulations 1996". FGN, Abuja.

Floyd, C.F. (1980); "Real Estate Principles" Random House, New York.

FMBN, (1991); " Handbook for the Establishment of Mortgage Institutions." FMBN, Lagos.

____ (1998); "5-years of the National Housing Fund. 1992 – 1997. A Report on the Implementation of the Scheme over the Period since its Establishment". FMBN, Lagos.

Guttman, L. (1954): "Some Necessary Conditions for Common Factor Analysis" Pyschometrika, 19, 149-161.

Malpezzi, S. (1990); "Urban Housing and Financial Markets: Some International

Comparisons". Urban Studies, Vol. 27, No. 6 pp 971 – 1022.

Newcombe, V. Z. (1985): "Housing Policies in Ibadan" University of Wales

Institute of Science and Technology.

Ojo, O. (1981); "Real Estate Financing in Nigeria". Unpublished MSc. Thesis of the Department of Land Management, University of Reading, Berkshire, England.

Ojo, O. (2004); "Factors Affecting Residential Real Estate Financing in Southwestern Nigeria". Unpublished Ph.D. Thesis of the Department of Estate Management, Obafemi Awolowo University, Ile-Ife, Nigeria.

Olotu, O. (1978); "Financing Mortgage Operations in the Property Development

Corporation of Oyo State." Being a paper submitted to NIESV.

Olufemi, O.A. (1993); "Institutional Housing Finance in Nigeria: A case study of the Property Development Corporation of Oyo State." NISER, Ibadan. Monograph No. 6, 1993.

O'Mara (1980): Residential Development Handbook; The Urban Land Institute, Washington, D. C.

Onibokun, P. (1985); "Housing Finance in Nigeria: A Critical Survey of Private and Public Sources". In Onibokun P. (ed.) Housing in Nigeria (A Book of Readings) NISER, Ibadan. pp199 – 219.

Renaud, B. (1986); "Housing and Financial Institutions in Developing Countries. An Overview". The World Bank, Washington D.C. WPS No. 658.

Smith, H.C. et al (1977); "Real Estate and Urban Development". Richard D. Irwin Inc., Homewood.

Spiegel, M.R. (1961); "Schaum's Outline of Theory and Problems of Statistic."

Schaum's Outline Series.

Thomset, M. C. (2002): "Real estate Investing" John Wiley and Sons Inc. New York.

UNCHS (Habitat), (1991); "Housing Finance Manual for Developing Countries – A methodology for Designing Housing – Finance Institutions." UNCHS, Nairobi.

____ (1994); "Case Studies in Innovative Housing Finance Institutions". UNCHS, Nairobi.

____ (1994); "Improving The Performance of National Finance Institutions in

Shelter Delivery." UNCHS, Nairobi.

____ (1995); "Case Studies in Community-Based Credit Systems for Low-Income Housing". UNCHS, Nairobi.

____ (2002); "Financing Adequate Shelter for All – Addressing the Housing Finance Problem in Developing Countries". UNCHS, Nairobi.

Yaya, A. S. (2002): "Problems in the Implementation of the National Housing Fund: Contextual Issues and Sustainable Solutions". Unpublished M.Sc. Thesis of the Centre for Urban and Regional Planning, University of Ibadan, Ibadan.

Housing Finance in Germany: A Stable Funding Scheme Model

By Hartwig Hamm[1]

It is now clear that the financial crisis caused by risky forms of funding and financing homes in the USA has hardly left any country and any economic sector unscathed. For, sooner or later, the effects, emanating from the globalisation of markets, have made or will make themselves felt on the level of overall economic activity, world-wide. In some countries, the crisis adversely affects home loan markets directly; this is so mainly where financing models similar to that of the USA have been the general practice and/or where the funding of home loans strongly depends on the liquidity of international capital markets.

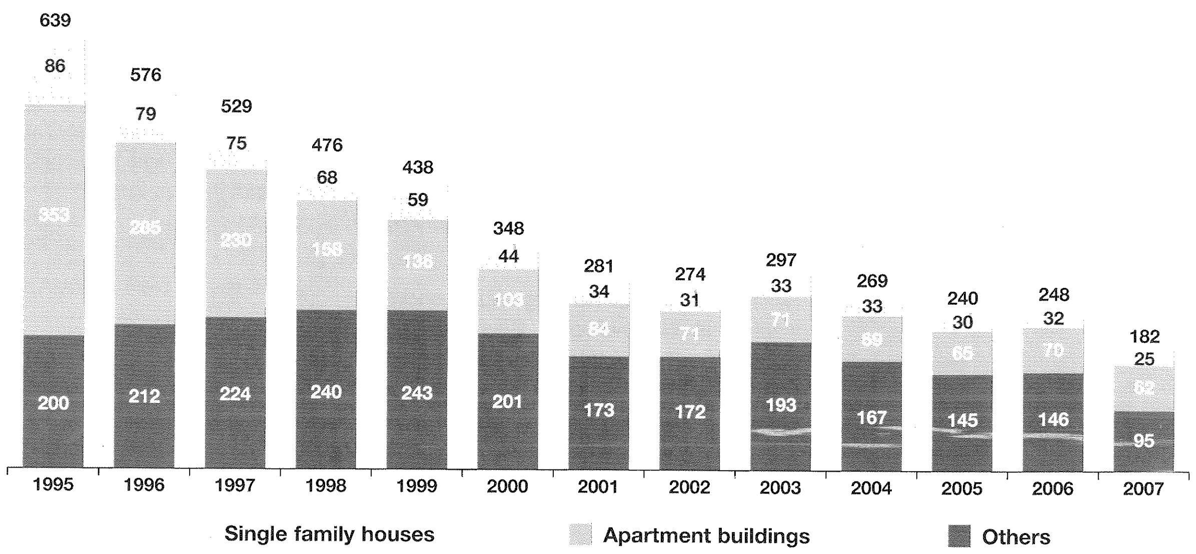
Europe's largest economy – Germany – is an obvious example to the contrary. Here, no inroad is threatening after a decade of stable demand and stable prices in the housing market. It would rather be fair to presume that this market will grow in the future. And it is clear at the same time that home loan products in Germany, traditionally characterised by risk aversion and stability, will not be affected by the banking crisis. Moreover, it is appreciated at the level of German politics that prospective home owners continue to be able to avail themselves of the same favourable credit offers of their choice for borrowing the capital amounts they require.

Visible weakening of home construction

Home construction in Germany now is at the end of a noticeable decline that began in the mid-1990s. This decline initially took place exclusively in the apartment block construction sector, partly as a reaction to the post-reunification boom in Germany. However, since the year 2000, owner-occupied housing construction has suffered from decline as well.

The number of 182,000 building permits granted in 2007 represents an all-time low. Building permits issued for owner-occupied homes halved in number between 2003 and 2007. A recovery is not yet in sight for 2008.

Figure 1 – Building permits in Germany – 1000 housing units

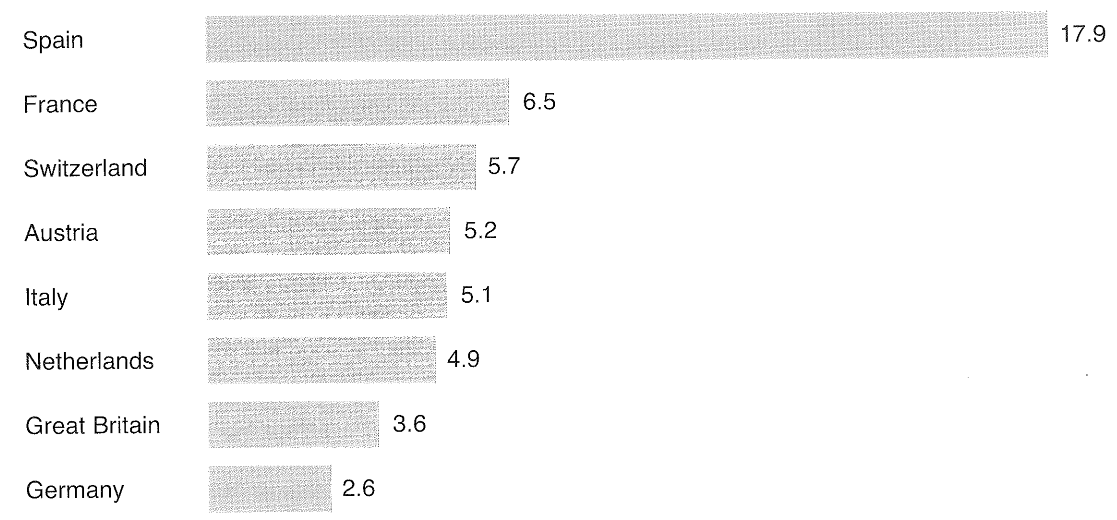


Source: Federal Statistical Office

[1] Managing Director, Association of Public German Bausparkassen.

HOUSING FINANCE IN GERMANY:
A STABLE FUNDING SCHEME MODEL

Figure 2 – Housing construction in Europe 2007 – Housing units completed per 1,000 inhabitants



Source: Euroconstruct

However, it is almost unanimously held by experts (like the Federal Office of Building and Regional Planning) that the demand for new housing construction is at least 50 percent up. This is to be explained by replacement needs, a growing number of households, and the population's further increasing demand for housing space. A comparison with other countries also shows how weak new housing construction activity has hitherto been. Measured by the size of its population, Germany has slipped from the second (1996) to the lowest rank in Europe.

In 2007, construction permits were issued for not more than 2.2 housing units per 1000 inhabitants. In most other countries, by contrast, the development of housing construction has been much more dynamic of late. Besides Spain, Ireland holds an especially prominent rank. In addition to these boom countries, Germany's direct neighbours to the north, the west and the south, all of which had seen similar developments in the past, now witness an intensity of home construction that is at least twice as strong as Germany's at index numbers between 4.9 (Netherlands) and 6.5 (France).

Stable house prices

Compared with Germany, the price rises recorded for single-family houses in most of the other countries were extraordinarily strong from the late 1990s to the year 2006, partly consisting of double-digit figures for several consecutive years.

In Germany, by contrast, home construction prices were stable by and large in the same period; as a consequence, they fell even short of the overall rates of inflation. For this reason, Germany – the "European champion" in the field of prices of owner-occupied housing right into the 1990s – meanwhile records clear price advantages compared with most of its neighbours. This applies also to countries like the Netherlands and France, where average prices used be not more than 60 percent of the German house price until 1995.

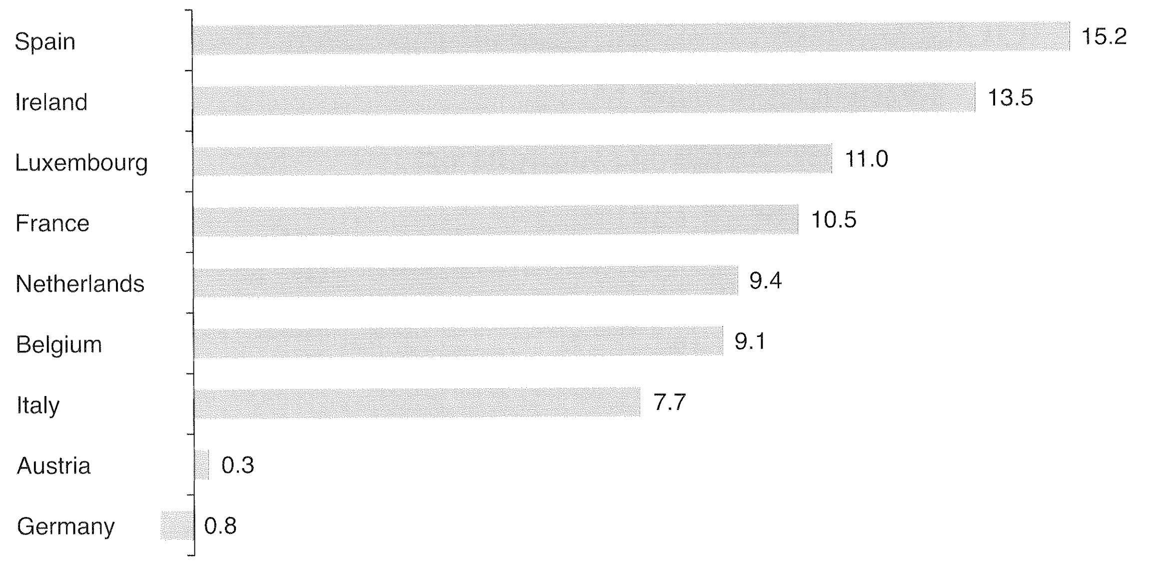
Whilst the advantages of declining capital market interest rates charged for the acquisition of homes have been more than compensated for by rising property prices in other countries, Germany saw clear improvements in the last ten years as regards the ability of households to foot the bill of home ownership acquisition costs. Besides a low level of mortgage interest rates, stable property prices and moderately rising incomes have resulted in a situation in which the net income shares families are required to initially spend for home ownership in typical cases halved from over 30 percent in 1996 to noticeably below 20 percent in 2006.

Two important reasons are responsible for the fact that the demand for home ownership has not risen in Germany in the wake of this development.

Cuts in subsidy as one main reason

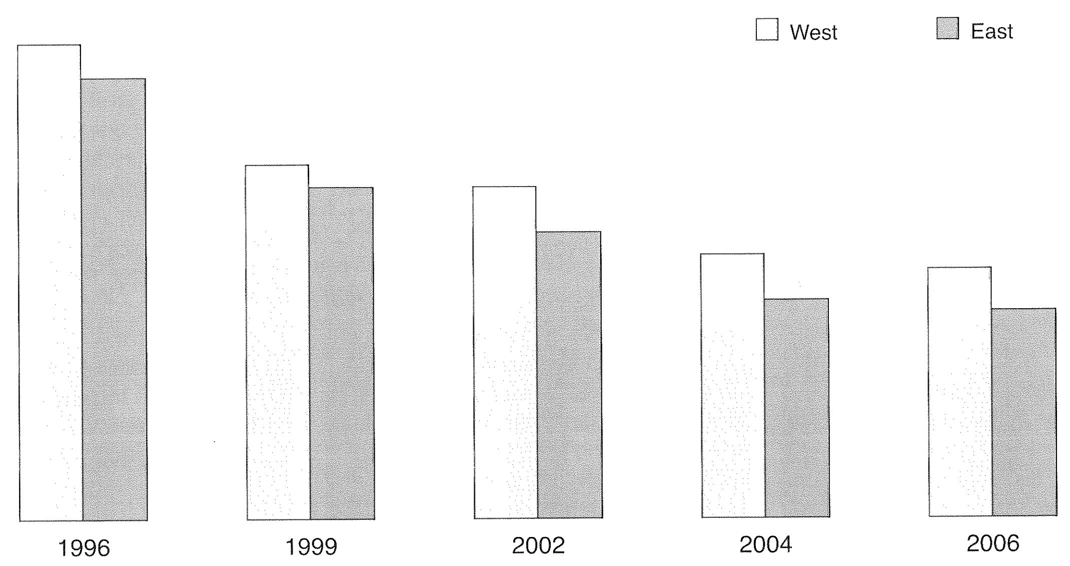
Promotion of home building activity has been massively reduced in Germany. This has affected apartment block construction on the one hand where tax concessions to

Figure 3 – House price developments in Europe – Annual percentage changes between 1999 and 2005



Source: European Central Bank

Figure 4 – Affordability of home ownership in Germany – Initial instalment as share of household income



Source: LBS Research

HOUSING FINANCE IN GERMANY:
A STABLE FUNDING SCHEME MODEL

private investors in particular had boosted investment volumes and prices in the whole market. This kind of promotion now is so much down that it really does not have any noticeable effect in the market any longer.

The cuts in aid to home owners have been even more substantial. In this field, debt interest deduction from tax liability never used to play any role in the past. There are thus no tax incentives prompting people to borrow on a scale extending beyond their absolute needs. And home owner-occupiers respond to changes in prices and interest rates with much greater sensitiveness in Germany for this reason.

Irrespective of individual financing arrangements, it used to be the practice for many years to give home owners the benefit of tax advantages for a period of eight years. Since 1995 this incentive consisted of even amounts of financial support regardless of the home owner's level of income. However, this form of support was reduced in 2000 and totally abandoned in 2006.

In most other – not only European – countries, by contrast, home owners have had the benefit of tax concessions boosting demand until recently. The most widely applied instrument in this regard is a facility permitting debt interest to be deducted from income tax when a new home is built or second-hand one is purchased.

Influence of an unstable economic development

While home ownership acquisition in Germany – as distinct from the systems practiced by most other countries – no longer depends on the terms and conditions of public support, it is largely the result of economic factors. But in the opinion of most individuals interested in home ownership acquisition, the main issues are not just the levels of current income and of financial burdens arising at the moment of transaction. The fact rather is that borrowers have ever since been used to making absolutely sure that they can afford to pay for the resultant costs over decades. This explains the paralysing effects that have emanated from poor economic and labour-market perspectives for a number of years, especially job-loss fears.

Unlimited diversity of products available for home financing

It follows from the above that the practice of financing home loans rather reflects a marked interest of potential owner-occupiers in stable financing terms and conditions. Important in this context is the demand side, not so much the behaviour of credit suppliers. For, the German credit industry's offer comprises an unlimited diversity of financing schemes, as a matter of principle. For example, financing proposals covering up to 100 percent (and over) of the property purchasing price are known to have been made ever since. However, such non-standard products are only made to customers with a top credit rating, giving rise to the legitimate expectation that they can afford to meet their financing obligations on a lasting basis also without using capital of their own. The often-quoted loan-to-value ratio of 60 percent is not the result of any regulatory measure putting a lid on bank lending activities, but represents the limit up to which loans may be refinanced by the German Pfandbrief. The German Bausparkassen are even prepared to finance as much as 80 percent of the value of the property without charging an interest agio. Moreover, on principle, variable interest-rate loans are obtainable in Germany as well.

The German financing market is thus not only a diverse and an open one. Moreover, competition in the German credit industry is so intensive that spreads are the lowest in Europe. The most recent analysis prepared by Mercer Oliver Wyman for the European Mortgage Federation ("European mortgage markets – 2006 adjusted price analysis") shows that mortgage interest rates in Germany are just 0.35 percentage points higher than the yield of respective bonds (this result is called the adjusted mortgage price). In the United Kingdom, by contrast, this difference is almost twice as big.

Key elements of the German financing culture

In spite of the fact that all kinds of financing products are available in Germany, the current practice of financing home construction differs substantially from that of many another countries, especially from that of the USA. Reflecting the mentality of large groups of customers – the focus of home financing schemes has, by tradition, not been on visibly low initial financial burdens. It has rather been on stable financing terms and conditions so as to permit uninterrupted debt repayment in full. This can be perfectly demonstrated by the following facts:

1. Fixed-interest credit still is the main form of home financing in Germany. 85 percent of new loans fall into this category, and 75 percent is provided for a fixed-interest period of ten years and over. For Bausparkassen loans, fixed low interest is guaranteed from the beginning of the savings contract until the end of the credit period. As a result, borrowers are largely safe against rising interest. Members of the small and medium-income brackets especially reject variable-interest loans as too risky for home ownership acquisition. Interest rates tied to money market rates (which is customary in Spain, for instance) would not be acceptable to both clients and consumer organisations because of the risk of leapfrogging financial burdens. Even less acceptable would be "teaser-rates" with an inbuilt upward movement mechanism.

2. German home owners are used to financing the construction or purchase of real property by capital of their own up to at least 30 percent; but, on average, this share is 40 percent or even higher. This is not so because credit institutions believe in restrictive lending practices. The reason rather is that especially small and medium-income bracket households are simply not able to bear on a lasting basis the financing burdens that are associated with large amounts of credit. Expert analyses made for Germany show that these households

simply have no demand for new financing offers of the kind that has caused the subprime crisis; their interest rather is in successful strategies for accumulating saving capital before borrowing bank money. This explains the great attractiveness of building-saving contracts as a financing instrument for most parts of the population.

3. As a rule, Germans are eager to meet their obligations under loan contracts for the acquisition of home ownership in full before reaching the age limit for pensioning in order to reap the benefit of rental-free and debt-free home ownership with a view to making a sparing use of their monthly incomes. Considering the current interest rate level, the agreed debt repayment rate is generally in excess of one percent per annum, initially. Deliberations to suspend or stretch repayment obligations are held only in cases of income problems that may arise at a later stage. And when the repayment period draws to an end, special redemption instalments are often made with a view to advancing the end of the credit period. Even elderly home owners in particular rarely finance modernization measures by credit. Finally, it is not customary in Germany to use an existing mortgage to finance consumer spending.

4. Moreover, the aversion of German home owners to risky financing schemes can also be seen from yet another fact: As distinct from Austria, for example, low-interest loans denominated in Swiss francs or Japanese yen do practically not play any role at all in Germany because of the exchange-rate risk borrowers deem to be too difficult to control.

Against this background, information on the ability of customers to meet their long-term debt service obligations under home loan contracts (ie credit rating) and a reliably established loan-to-value ratio represent just additional quality elements. In Germany, there is simply no "risk-mindedness" that must be brought under control within the help of credit contract. In all, the German culture of home ownership financing is characterized by a pronounced risk-aversion and, thus, by an extremely low rate of defaulted credit arrangements. This is even more so if one considers that there is no noticeable risk of a negative property price trend eroding the value of encumbrances on real property.

Box 1

Main features of home financing in Germany

- Relatively high share of own capital (average: 40 percent)
- Mainly fixed-interest loans (85 percent)
- No "teaser-rates", no foreign currency loans
- Deposit based banks as main lenders: savings banks, Bausparkassen, cooperative banks

Deposit based financing ensures independence from capital market volatilities

Furthermore, the structure of the German credit industry, too, enhances stable financing of housing construction, which is particularly welcome at present. For, most lending arrangements are made not by credit intermediaries, but by banks. In the first place, these are institutions permanently represented in the local market, which makes sure that – in these institutions' own best interest – lending decisions are taken with a great sense of responsibility. After all, such institutions would be reminded of possible mistakes even after several years so that they would have to face the risk of damage to their image, which might substantially impair their branded products and, thus, their market opportunities.

Another asset precisely at the present moment is the fact that home ownership acquisition is not refinanced in the capital market for the most part. The majority of the banks operating in this market refinance themselves on the basis of their clients' savings deposits. This applies to Germany's three largest groups of credit institutions in this business in particular, ie the savings banks, the co-operative banks and the Bausparkassen. They are crucially influencing market terms and conditions simply because they are represented area-wide. Mortgage banks, by contrast, have played an only marginal role in this market for a number of years.

With fairly minor fluctuations, the demand for credit to finance home ownership acquisition has remained stable as well of late. However, similar considerations apply also to the terms and conditions of financing offers. A long-term comparison shows that interest rates have remained low also in the course of recent months [this manuscript was completed in November 2008]; they have fluctuated around 5 percent for ten-year-fixed-interest loans.

And finally there have not been any indications to the effect that credit is on short supply in this market. The term "credit crunch" is still unknown to clients interested in home ownership acquisition in Germany also during the current financial market crisis. This is actually no wonder, because the demand still focuses on healthy standard-type financing terms and conditions. There are practically no potential clients with a poor credit rating. The problem rather is not scarcity of credit, but hesitant borrowers.

Political support of Bausparen as a stability element

The latest crisis has shown how much the German home financing culture actually is

appreciated. It is unanimously held at the levels of politics and the credit industry that the market for housing construction credit in Germany guarantees not only open-mindedness to innovation, product diversity and favourable credit terms and conditions. The widely practiced financing system based on adequate own capital and strong interest rate stability rather meets the legitimate interest of the population in security. These quality elements of home credit are owed to the practice of lending at fixed rates and to the widely preferred Bauspar contracts. In the opinion of the German Government, especially this type of contractual savings – often ridiculed by other countries in the past – must be generally recognized as a factor of stabilization, which experience has taught of late.

For this reason, it has only been logical on the one hand to put up political resistance to proposals such as the ones submitted to the EU Commission by the consultant firm of London Economics ("The Costs and Benefits of Integration of EU Mortgage Markets"), one-sidedly propagating positive growth effects of a greater product availability for "non-conforming borrowers": ie not only low equity loans (LTV more than 90 percent), but also loans to so-called self-certified income or credit impaired borrowers. In other words, it was the establishment of a subprime market that was proposed as a model for the future of the whole of Europe still at the end of 2005, referring to assumed growth impulses generated by a more generous, but risky lending practice. In view of the positive experience gained with the low-cost stable offer of housing credit in Germany it is simply logical precisely in the present situation to believe in proven products and to prevent such products from being put in question in the course of financial, economic and consumer policy discussions at the EU level.

On the other hand, soundly financed home ownership (with the help of contractual savings schemes as an instrument ensuring own capital formation at an early stage as well as stable low interest-rates overall) has again been deemed worthy of government support of late. In spite of the German Government's continued efforts for a stringent budget consolidation course accompanied by a consistent policy of cutting subsidies, it was officially confirmed a few months ago that, from the age of sixteen, building-savers would even in the future be able to claim support in amounts graded by income levels. Furthermore, saving for the purpose of home ownership acquisition as well as financing, is now part of the system of public support to private individuals in making provision for old age. In this context, Bauspar contracts have been expressly referred to both as a saving instrument and as a financing product. This represents not only a good basis for strengthening the existing contractual savings model in the coming years. It also proves that Germany will continue on the road ensuring that stability-oriented home credit is available.